EXECUTIVE BOARD MEETING

SM/22/94
Correction 1

May 23, 2022

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Cyprus—Staff Report for the 2022 Article IV Consultation**

Board Action:	The attached corrections to SM/22/94 (5/11/22) have been provided by the staff:
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Pages 6, 7, 8, 16, 26, 29, 31, 32, 33, 38, 45, 51, 52, 66**
Typographical Errors	**Page 2**
Questions:	Mr. Maliszewski, EUR (ext. 34855) Ms. Liu, APD (ext. 36618) Mr. Zhang, EUR (ext. 35955) Ms. Cheng, MCM (ext. 37034)

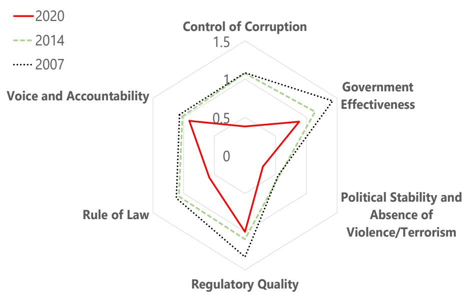
Approved By
Philip Gerson (EUR) and Bjoern Rother (SPR)

Virtual discussions were held during March 11–28, 2022. The mission team comprised Mr. Wojciech Maliszewski (head), Ms. Estelle Xue Liu and Mr. Ruifeng Zhang (all EUR), Mmes. Zihan Cheng (MCM), and Chanda DeLong (LEG). Mr. Boyang Sun and Ms. Erika Paola Espinoza (EUR) supported the mission from headquarters. Messrs. Luc Dresse and Michalis Ghalanos (office of the Executive Director) joined some of the meetings.

CONTENTS

Governance has deteriorated sharply since 2014.

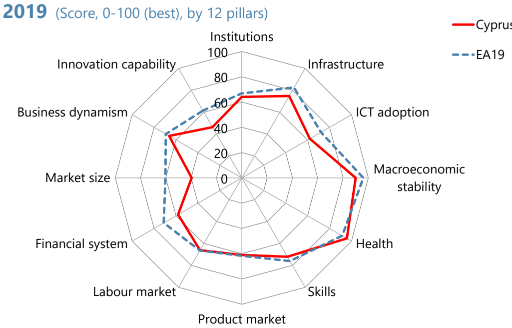
World Governance Indicator: Cyprus
(Estimates)



Sources: World Bank, and IMF staff.

Cyprus lags behind in infrastructure and ICT adoption, and skills.

World Economic Forum: Global Competitiveness Index, 2019 (Score, 0-100 (best), by 12 pillars)

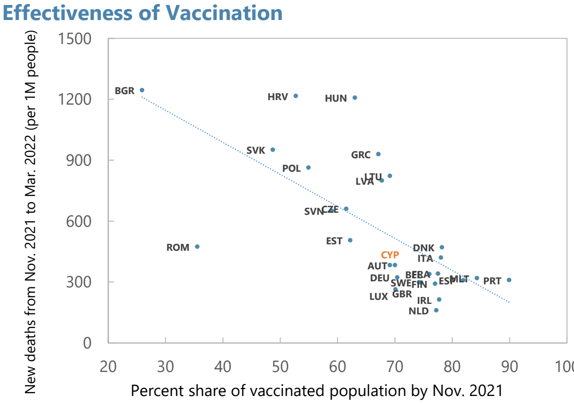


Sources: World Economic Forum; and IMF staff calculations.

RECENT DEVELOPMENTS: RECOVERY FROM COVID

6. Cyprus has managed the new Covid waves well. The infection rate surged during the Omicron outbreak. But the high vaccination rate—around 70 percent of the population has been fully vaccinated and around 40 percent has received a booster—has contributed to low hospitalization and mortality rates. The authorities further eased Covid restrictions in March, including shortening quarantines and eliminating testing requirements on arrival for vaccinated tourists.

Effectiveness of Vaccination



Source: Our World in Data.

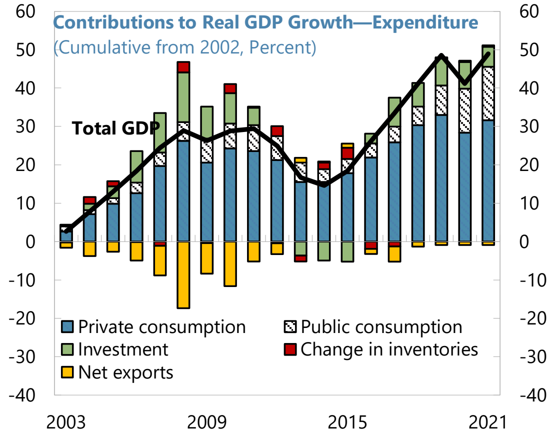
7. Still sizeable Covid-related support in 2021 has by now largely been withdrawn (Annex II). COVID-related fiscal support measures were equivalent to around 3 percent of GDP in 2021, but most expired in December, except for interest subsidy schemes and a new loan guarantee scheme. Most financial support (including debt payment moratoria, where the take up, especially by tourism-related businesses, was high) has also expired.

8. Limited mobility disruption and strong policy support have engendered a rapid recovery (Figure 1). Output returned to its pre-crisis level after GDP grew by an estimated 5½ percent last year. Public consumption ~~was the main~~ remained a large contributor, while ~~net~~ exports rebounded with the partial recovery of international tourism. Private consumption also started to recover, supported by the markedly stronger labor market. The unemployment rate declined sharply, to 6.3 percent by 2021Q4, which is around the pre-pandemic level. The labor force participation rate and employment reached all-time highs (even though this may partly reflect a transition of workers from informal to formal employment to benefit from Covid-related support schemes).

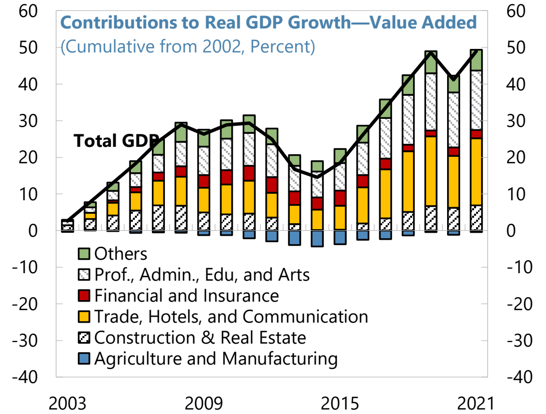
9. But slack remains as the recovery has lagged in tourism-related sectors. Value added, employment and hours worked in services dependent on international tourism are still below pre-pandemic levels. The underutilization of labor (lower hours worked) in tourism-related sectors contributed to the slack in the labor market and the output gap in 2021 is still negative at -½ percent.

Figure 1. Cyprus: Recent Developments

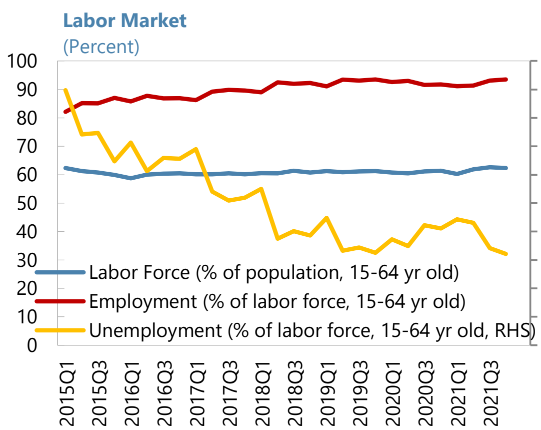
The strong growth in 2021 was mainly driven by ~~net~~ exports and ~~public~~ consumption.



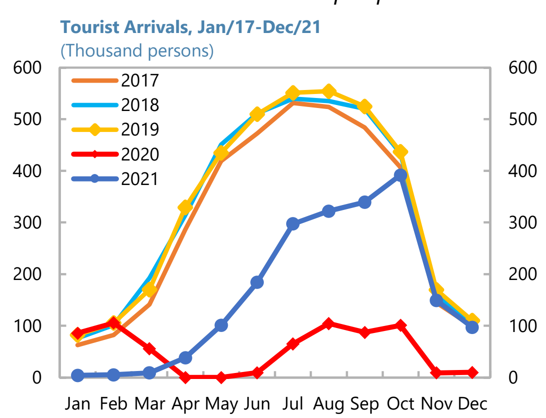
Service sectors such as retail trade and hotels rebounded strongly.



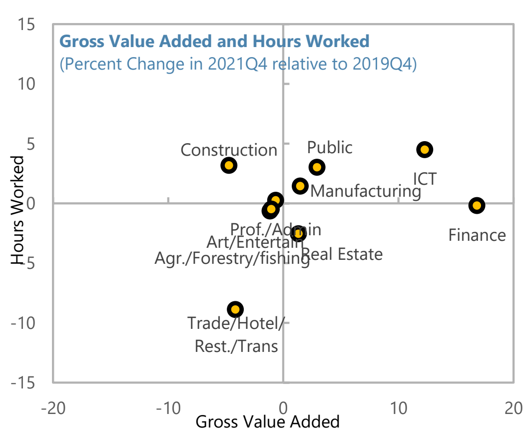
Labor market has improved markedly.



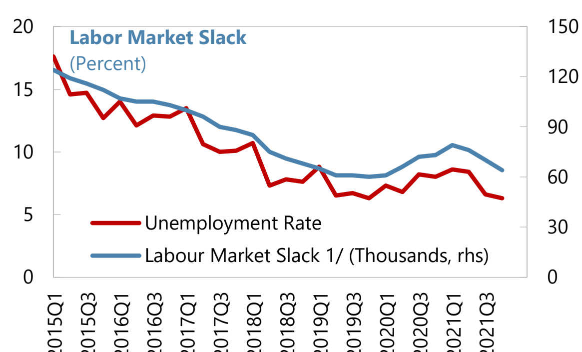
Tourist arrivals were still below pre-pandemic level...



...and there is still significant underutilization of labor in tourism-related sectors...



... contributing to the slack in the labor market.



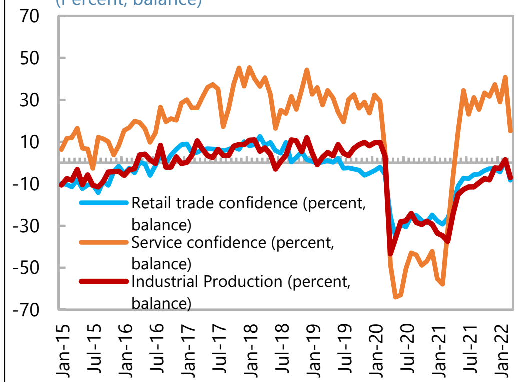
1/ Labor Market Slack includes unemployment, underemployed part-time workers, jobless persons seeking a job but not immediately available for work, and jobless persons available for work but not seeking.

Sources: Cystat; ECB; Eurostat; and IMF staff calculations.

10. Confidence weakened in the aftermath of the war in Ukraine. High-frequency consumer and business confidence indicators had been improving, but there has been a marked deterioration in the aftermath of the war in Ukraine (even though business confidence in the services sector was still in positive territory in March, pointing to an expansion).

Cyprus: Confidence Indicators, Jan.15 - Mar.22

(Percent, balance)



Source: European Commission.

11. Higher inflation—largely driven by energy prices—prompted a revision in expectations (Figure 2). Headline and core inflation edged up sharply, to 5.8 and ~~2.5~~2.8 percent (yoy) in February. Increases in utility and transportation prices reflected a pass through from imported energy prices, and households and businesses expect higher inflation. Wages started recovering (not fully in tourism-related services; but have continued increasing in public services).

12. Private balance sheets strengthened on the back of support measures (Figure 3). Support measures combined with subdued consumption and lower investments contributed to the strengthening of households' and NFCs' balance sheets. Households increased assets (mainly deposits) and NFCs reduced debt liabilities.

13. Banks have stayed resilient (Figure 3, Table 6). Liquidity has remained high and capital ratios broadly stable (the Tier1 capital ratio stands at 19.0 percent overall). The effects of the pandemic on NPLs have been minimal so far and banks have been actively restructuring problem loans. But stage 2 loans—performing exposures with significantly deteriorated credit quality—still accounted for 15 percent of total loans as of December 2021 (the EU average is 9 percent). The high take up of the debt repayment moratoria indicate these loans are concentrated in tourism-related sectors, which have not fully recovered from the pandemic and will likely be most affected by the war-related shocks. Moreover, margin pressures and high costs continue weighing on banks' profitability. Still, the European Banking Authority (EBA) stress test published in July 2021 (before the war) indicated that systemically important banks in Cyprus remain resilient.

14. Banks have also made significant progress in offloading NPLs (Table 6)**.** The two largest banks have progressed with large NPLs sales, reducing the NPL ratio in the banking sector to around 10 percent in December 2021 (from 17.7 percent a year earlier). The CACs and KEDIPES already held 74 percent of the total NPLs in the economy before these transactions.

projects. The staff's baseline scenario assumes that the use of funds for new projects is paced gradually but concentrated over 2022–24. Absorption could be challenging, in part due to the wide range of ministries involved, but the paced spending could help. In this context, the authorities should continue to strengthen public investment management, including the investment planning through SOEs.

Cyprus: Fiscal Targets: 2019–27

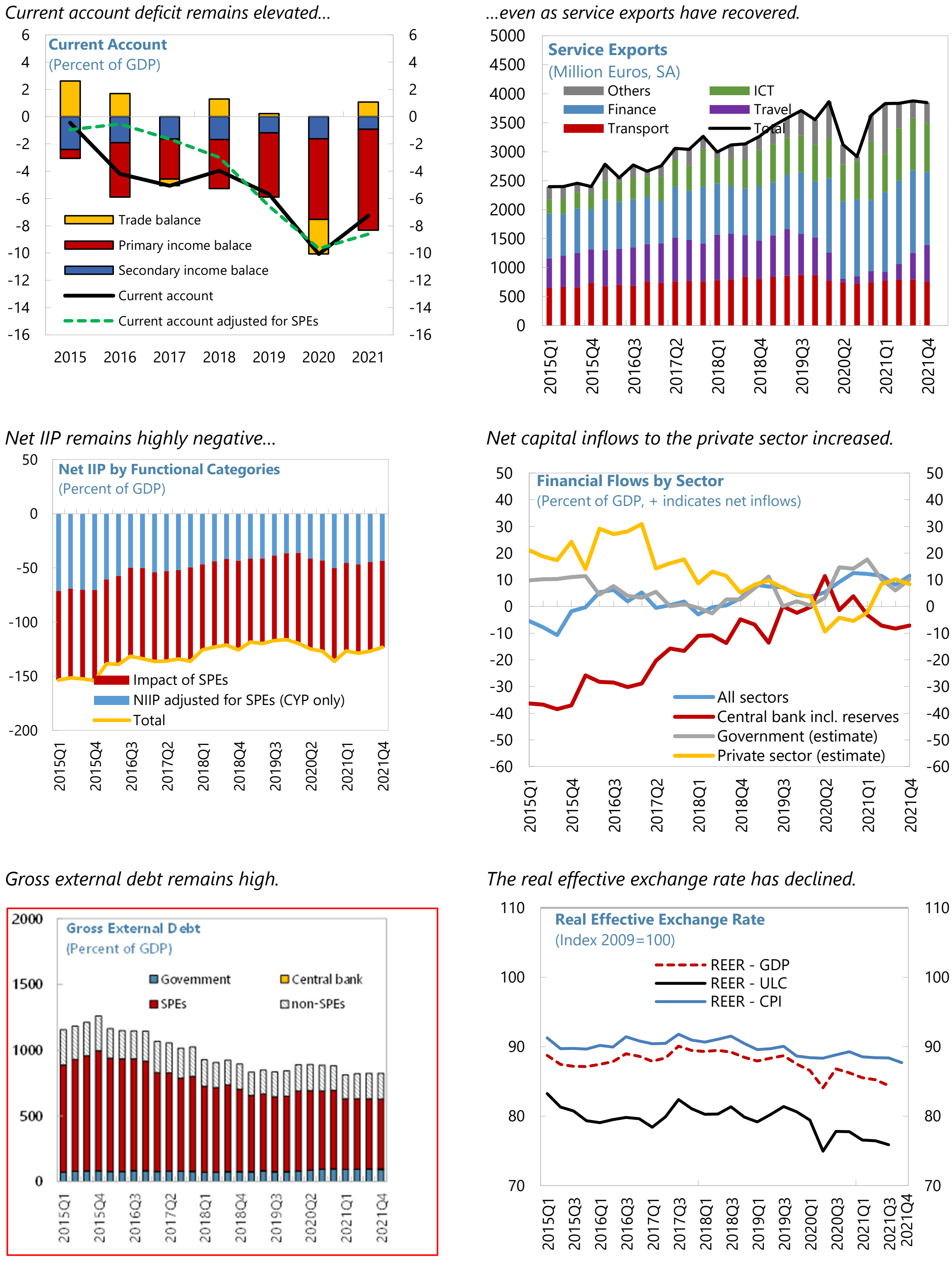
	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Act.	Act.	Act.			Proj.			
	(Percent of GDP, unless otherwise noted)								
Stability Program 2022-2025									
Total revenue	39.7	39.3	42.1	41.7	41.3	41.3	40.6	...	...
Total expenditure	38.4	45.0	44.2	41.7	40.9	39.9	38.9	...	...
Overall balance	1.3	-5.7	-2.1	0.0	0.4	1.5	1.7	...	...
Primary balance	3.5	-3.6	-0.3	1.6	1.6	2.6	2.9	...	...
Gross public debt	91.1	115.0	103.9	93.9	88.2	81.0	76.7	...	...
Staff Projections									
Total revenue	39.7	39.3	42.1	41.0	41.2	41.1	40.8	40.1	39.8
Total expenditure	38.4	45.0	44.2	42.3	41.3	40.5	39.5	38.6	38.2
Overall balance	1.3	-5.7	-2.1	-1.3	-0.1	0.6	1.2	1.5	1.6
Primary balance	3.5	-3.6	-0.3	0.5	1.4	1.9	2.5	2.4	2.5
Gross public debt	91.1	115.0	103.9	97.7	94.1	87.8	84.5	78.2	73.6
	(Percent of potential GDP, unless otherwise noted)								
Primary balance	3.6	-3.5	-0.3	0.5	1.4	1.9	2.5	2.4	2.5
Cyclically-adjusted revenue	39.8	39.2	42.1	40.9	41.2	41.1	40.8	40.1	39.8
Primary expenditure	37.1	42.3	42.3	40.2	39.7	39.2	38.3	37.7	37.2
Structural primary balance	2.7	-3.3	-0.4	0.7	1.5	2.0	2.5	2.4	2.5
Structural primary balance excluding Covid-related measures 1/	2.7	0.2	1.9	0.8	1.5	2.1	2.5	2.4	2.5
Output gap	2.5	-1.3	-0.2	-0.6	-0.2	0.0	0.1	0.1	0.0

1/ For 2021, also excluding the EU grants that the government received in October and November 2021.

Authorities' Views

27. The authorities are committed to maintaining fiscal discipline and rebuilding fiscal buffers. They currently do not envisage the need for new schemes to support the economy, which would, at the current juncture, only increase inflationary pressures. If developments warrant additional support, they agreed that the measures should be temporary, targeted and promote rather than hinder labor reallocation (and such support is considered in their contingency plans). Regarding support to the tourism sector, they prefer a scheme providing hotel discounts for local tourists to avoid disincentives for restructuring which could arise if measures are also extended to loss-making parts of affected industries. The authorities shared the concerns about the financial sustainability of the NHS but emphasized that progress has been made to address the irregularities of the system. While recognizing the benefit of new revenue sources, they indicated that a re-introduction of an immovable property tax should only be considered in the context of a broader tax reform and considering the impact on the real estate sector.

Figure 5. Cyprus: External Developments



Sources: Eurostat, Cystat; IMF IFS; Haver Analytics; and IMF staff calculations.

Table 1. Cyprus: Selected Economic Indicators, 2019–27

	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Projections					
Real Economy									
Real GDP	5.3	-5.0	5.5	2.0	3.5	3.0	2.7	2.8	2.9
Domestic demand	6.0	-2.9	2.7	2.6	3.0	3.0	2.8	3.1	3.4
Consumption	4.9	-0.7	4.9	2.0	2.6	2.6	2.7	3.0	3.2
Private consumption	3.0	-5.0	3.7	2.3	2.5	3.0	3.3	3.3	3.5
Public consumption	12.7	15.0	8.4	1.0	2.8	1.4	0.8	2.0	2.3
Gross capital formation 1/	10.6	-11.5	-6.6	5.8	5.1	5.0	3.5	3.7	4.4
Foreign balance 2/	-0.7	-1.9	2.7	-0.4	0.5	-0.1	-0.2	-0.3	-0.5
Exports of goods and services	7.5	-5.1	13.4	5.1	4.5	3.8	3.4	3.6	3.6
Imports of goods and services 1/	8.3	-2.5	9.5	5.5	3.9	3.9	3.6	3.9	4.2
Potential GDP growth	4.6	-1.3	4.3	2.5	3.1	2.8	2.5	2.9	3.0
Output gap (percent of potential GDP)	2.5	-1.3	-0.2	-0.6	-0.2	0.0	0.1	0.1	0.0
HICP (period average)	0.5	-1.1	2.3	5.3	2.3	2.0	1.8	1.8	1.9
HICP (end of period)	0.7	-0.8	4.8	3.0	2.5	2.0	1.8	1.8	2.0
GDP deflator	1.1	-1.1	2.4	3.8	3.3	3.0	2.6	2.6	2.7
Unemployment rate (percent, period average)	7.1	7.6	7.5	7.9	7.5	7.0	6.5	6.0	5.5
Employment growth (percent, period average)	3.9	0.2	3.4	0.0	1.5	1.5	1.4	1.4	1.3
Labor force	2.4	0.8	3.3	0.5	1.0	1.0	0.9	0.8	0.8
Public Finance									
General government balance	1.3	-5.7	-2.1	-1.3	-0.1	0.6	1.2	1.5	1.6
Revenue	39.7	39.3	42.1	41.0	41.2	41.1	40.8	40.1	39.8
Expenditure	38.4	45.0	44.2	42.3	41.3	40.5	39.5	38.6	38.2
Primary Fiscal Balance	3.5	-3.6	-0.3	0.5	1.4	1.9	2.5	2.4	2.5
General government debt	91.1	115.0	103.9	97.7	94.1	87.8	84.5	78.2	73.6
Balance of Payments									
Current account balance	-5.7	-10.1	-7.3	-8.2	-6.8	-5.7	-5.5	-5.2	-5.0
Trade Balance (goods and services)	0.2	-2.5	1.1	-1.1	0.3	1.2	1.8	2.1	2.3
Exports of goods and services	75.6	75.8	81.3	86.4	86.1	85.6	85.2	84.7	84.3
Imports of goods and services	75.4	78.3	80.2	87.6	85.8	84.4	83.4	82.6	82.0
Goods balance	-20.1	-19.2	-18.4	-20.4	-19.8	-19.2	-18.9	-18.7	-18.7
Services balance	20.3	16.7	19.5	19.3	20.1	20.4	20.6	20.8	21.1
Primary income, net	-4.7	-5.9	-7.4	-6.6	-6.6	-6.6	-6.4	-6.2	-6.1
Secondary income, net	-1.2	-1.6	-0.9	-0.5	-0.5	-0.3	-0.9	-1.1	-1.2
Capital account, net	0.1	0.1	0.8	0.2	0.4	0.3	0.3	0.3	0.1
Financial account, net	-4.4	-12.5	-4.8	-8.0	-6.4	-5.4	-5.2	-4.9	-4.9
Direct investment	0.4	-17.9	-9.5	-14.4	-13.7	-13.2	-12.8	-12.6	-12.4
Portfolio investment	7.6	-19.3	-2.8	-2.5	0.0	0.0	-1.9	2.2	1.9
Other investment and financial derivatives	-12.3	24.5	6.0	8.9	7.2	7.7	9.5	5.5	5.6
Reserves (+ accumulation)	0.0	0.2	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Program financing 3/	0.0	-3.3	0.0	0.0	0.0	0.0	-1.2	-3.2	-3.0
Errors and omissions	1.2	-2.5	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Saving-Investment Balance									
National saving	13.1	9.9	10.6	10.1	11.7	12.9	13.2	13.5	13.8
Government	5.6	-2.2	1.2	2.1	3.4	4.3	4.8	4.8	4.6
Non-government	7.5	12.1	9.4	8.0	8.3	8.6	8.3	8.8	9.2
Gross capital formation	18.8	19.9	17.9	18.4	18.5	18.6	18.6	18.7	18.8
Government	4.3	3.5	3.4	3.4	3.5	3.7	3.6	3.3	3.0
Private	14.5	16.5	14.5	14.9	14.9	14.9	15.1	15.4	15.8
Foreign saving	-5.7	-10.1	-7.3	-8.2	-6.8	-5.7	-5.5	-5.2	-5.0
Memorandum Item:									
Nominal GDP (billions of euros)	23.0	21.6	23.4	24.7	26.4	28.0	29.5	31.2	32.9
Structural primary balance	2.7	-3.3	-0.4	0.7	1.5	2.0	2.5	2.4	2.6
External debt	843.3	880.9	825.2	762.4	719.7	684.3	656.1	626.7	599.0
Net IIP	-116.1	-136.2	-123.3	-124.3	-122.8	-121.1	-120.2	-118.8	-117.3

Sources: Statistical Service of the Republic of Cyprus, Eurostat, Central Bank of Cyprus, and IMF staff estimates.

1/ Estimated negative growth of gross capital formation in 2018 reflect the base effect of volatile special purpose entities (SPEs) activity.

2/ Contribution to real GDP growth.

3/ Program financing (+ purchases, - repurchases) is included under the Financial Account, with consistent sign conversion.

Table 3. Cyprus: General Government Financing Requirements and Sources, 2019–27
(Millions of Euros, unless otherwise indicated)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Projections					
Gross borrowing needs	3,034	3,677	2,919	2,782	1,727	2,491	1,702	2,479	2,359
Overall deficit	-287	1,270	543	321	37	-168	-366	-461	-517
Primary surplus	-809	774	62	-129	-362	-546	-731	-759	-829
Interest payments	523	496	480	450	399	379	365	298	312
Amortization	3,288	2,407	2,377	2,461	1,690	2,659	2,068	2,940	2,876
Medium- and long-term	3,288	1,403	901	2,161	1,390	2,359	1,418	1,640	1,576
Foreign	2,158	541	90	1,095	1,097	1,947	1,247	1,093	1,329
Eurobonds	199	458	0	1,000	1,000	1,850	1,000	1,000	1,250
Russia	1,875	0	0	0	0	0	0	0	0
Other	84	83	90	95	97	97	247	93	79
Domestic	1,131	862	811	1,066	293	412	172	547	247
Short-term	0	300	1,475	300	300	300	300	300	300
EU and IMF	0	705	0	0	0	0	350	1,000	1,000
Stock-flow adjustment 1/	33	0	0	0	0	0	0	0	0
Gross financing sources	2,466	4,057	2,657	2,782	1,727	2,491	1,702	2,482	2,364
Privatization receipts	0	0	0	0	0	0	0	1	2
Market access	2,900	6,725	1,803	2,374	2,395	2,400	2,396	2,353	2,750
Medium- and long-term	2,600	5,250	1,503	2,074	2,095	2,100	2,096	2,053	2,450
Foreign	2,600	4,850	1,503	1,974	1,995	2,000	1,996	1,953	2,350
Domestic	0	400	0	100	100	100	100	100	100
Short-term	300	1,475	300	300	300	300	300	300	300
EU and IMF	0	0	0	0	0	0	0	0	0
Use of deposits 2/	-434	-2,669	854	408	-668	91	-694	129	-386
Net placement	-388	4,318	-574	-87	705	-259	328	-587	-126
Medium and Long Term Debt	-688	3,847	602	-87	705	-259	678	413	874
Domestic Securities	-1,131	-462	-811	-966	-193	-312	-72	-197	-147
Eurobonds	2,401	4,042	1,000	700	800	-50	800	800	950
Domestic Loans	0	0	0	0	0	0	0	-250	0
Foreign Loans	-1,959	267	413	179	98	103	-51	60	71
Short term (Net increase)	300	1,175	-1,175	0	0	0	0	0	0
EU and IMF	0	-705	0	0	0	0	-350	-1,000	-1,000
Memorandum item:									
Cash holding (eop)	947	3,616	2,762	2,354	3,022	2,931	3,625	3,496	3,882
General government debt (eop)	20,958	24,852	24,271	24,184	24,889	24,630	24,958	24,371	24,245
General government debt (eop, percent of GDP)	91.1	115.0	103.9	97.7	94.1	87.8	84.5	78.2	73.6
General government net debt (eop, percent of GDP) 3/	87.0	98.2	92.1	88.2	82.7	77.4	72.2	66.9	61.8

1/ Adjustments for consistency between estimated cash basis fiscal balance and debt data.

2/ Minus (-) sign represents accumulation of deposits.

3/ General government debt minus cash holding.

Table 4: Cyprus: Balance of Payments, 2019–27
(Percent of GDP)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Projections					
Current Account Balance	-5.7	-10.1	-7.3	-8.2	-6.8	-5.7	-5.5	-5.2	-5.0
Trade Balance (Goods and Services)	0.2	-2.5	1.1	-1.1	0.3	1.2	1.8	2.1	2.3
Goods Balance	-20.1	-19.2	-18.4	-20.4	-19.8	-19.2	-18.9	-18.7	-18.7
Exports	13.4	13.7	15.4	18.5	17.9	17.4	16.9	16.4	15.9
Imports	33.5	32.9	33.7	38.9	37.7	36.6	35.8	35.1	34.6
Services Balance	20.3	16.7	19.5	19.3	20.1	20.4	20.6	20.8	21.1
Exports	62.2	62.1	65.9	68.0	68.2	68.3	68.2	68.3	68.4
Imports	41.9	45.4	46.5	48.7	48.2	47.8	47.6	47.5	47.4
Primary Income	-4.71	-5.93	-7.42	-6.6	-6.6	-6.6	-6.4	-6.2	-6.1
Secondary Income	-1.19	-1.62	-0.91	-0.5	-0.5	-0.3	-0.9	-1.1	-1.2
Capital Account	0.1	0.1	0.8	0.2	0.4	0.3	0.3	0.3	0.1
Financial Account (- financing)	-4.4	-12.5	-4.8	-8.0	-6.4	-5.4	-5.2	-4.9	-4.9
Direct Investment	0.4	-17.9	-9.5	-14.4	-13.7	-13.2	-12.8	-12.6	-12.4
Portfolio Investment	7.6	-19.3	-2.8	-2.5	0.0	0.0	0.0	0.0	1.9
Financial Derivatives	0.1	-1.6	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Other Investment	-12.4	26.1	5.7	8.7	7.0	7.5	9.3	5.3	5.4
Reserves (+ accumulation)	0.0	0.2	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omission	1.2	-2.5	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Current Account Balance, adjusted for SPEs 1/	-5.8	-9.7	-8.6	...	...	...	...	...	...
Program Financing 2/	0.0	-3.3	0.0	0.0	0.0	0.0	-1.2	-3.2	-3.0
Private Net Capital Flows 3/	-4.7	5.4	...	...	...	...	...	...	...
o/w Portfolio Investment	19.5	0.8	...	...	...	...	...	...	...
o/w Other Investment	-24.6	24.1	...	...	...	...	...	...	...
o/w MFIs	9.9	4.1	...	...	...	...	...	...	...
o/w Non-MFIs	-34.5	20.0	...	...	...	...	...	...	...
Gross External Debt	843.3	880.9	825.2	762.4	719.7	684.3	656.1	626.7	599.0
o/w Short-term Debt	187.4	177.2	170.1	157.7	143.5	133.5	125.1	117.2	109.8

Sources: Central Bank of Cyprus; Eurostat; and IMF staff estimates.

1/ Treating Special Purpose Entities (SPEs) as non-residents.

2/ Program financing (+ purchases, - repurchases) is included under the Financial Account, with consistent sign conversion.

3/ Private net capital flows (- inflows, + outflows) are defined to exclude the public-sector flows (the central-bank flows and part of the general-government flows). It is not possible to exclude all general government-related flows from "other investment" in the published data because of secondary confidentiality issues (i.e., these data are suppressed to preserve the confidentiality of data pertaining to other sectors that could otherwise be indirectly deduced).

Table 5. Cyprus: External Financing Requirements and Sources, 2019–27

(Millions of Euros)

	2019	2020	2021	2022	2023	2024	2025	2026	2027
				Projections					
GROSS FINANCING REQUIREMENTS	**48,415**	**54,319**	**46,847**	**53,480**	**51,984**	**51,516**	**50,619**	**50,575**	**50,387**
Current account deficit ("-" = CA surplus)	1,308	2,177	1,696	2,035	1,792	1,602	1,624	1,611	1,661
Medium- and long-term debt amortization	12,392	8,319	6,834	11,239	11,179	11,969	11,220	11,008	11,186
Public sector	2,158	541	90	1,095	1,097	1,947	1,247	1,093	1,329
Banks	424	341	233	279	278	277	278	279	279
Other private	9,810	7,437	6,511	9,865	9,805	9,745	9,696	9,636	9,577
Short-term debt amortization	34,714	43,118	38,317	40,206	39,013	37,945	37,424	36,956	36,541
Public sector	398	399	78	683	683	683	683	683	683
Central Bank	381	399	69	683	683	683	683	683	683
General government and SOEs	16	0	9	0	0	0	0	0	0
Banks	13,407	10,641	9,567	10,582	10,404	10,315	10,739	11,183	11,648
Other private	20,910	32,078	28,672	28,941	27,926	26,947	26,002	25,090	24,210
EU and IMF	0	705	0	0	0	0	350	1,000	1,000
SOURCES OF FINANCING	**48,415**	**54,319**	**46,847**	**53,480**	**51,984**	**51,516**	**50,619**	**50,575**	**50,387**
Capital account (net)	24	17	176	46	96	96	81	85	46
Foreign direct investment (net)	-82	3,864	2,226	3,574	3,621	3,690	3,791	3,920	4,094
Cypriot investment abroad	37,438	-3,996	-2,596	6,972	7,425	7,827	8,204	8,613	9,055
Foreign investment in Cyprus	37,357	-132	-191	10,546	11,047	11,517	11,996	12,533	13,149
New borrowing and debt rollover	49,074	50,559	48,530	50,828	49,732	49,242	48,638	48,540	48,882
Medium and long-term borrowing	5,956	12,242	8,324	11,815	11,787	11,818	11,682	11,584	11,925
General government	2,600	4,850	1,503	1,974	1,995	2,000	1,996	1,953	2,350
Banks	346	-72	551	271	272	283	283	284	285
Other private	3,010	7,464	6,270	9,570	9,519	9,535	9,403	9,346	9,290
Short-term borrowing	43,118	38,317	40,206	39,013	37,945	37,424	36,956	36,956	36,956
Public sector	399	78	683	683	683	683	683	683	683
Central Bank	399	69	683	683	683	683	683	683	683
General government and SOEs	0	9	0	0	0	0	0	0	0
Banks	10,641	9,567	10,582	10,404	10,315	10,739	11,183	11,183	11,183
Other private	32,078	28,672	28,941	27,926	26,947	26,002	25,090	25,090	25,090
Other	-602	-122	-4,085	-968	-1,465	-1,512	-1,892	-1,970	-2,634
Of which: Net errors and omissions	279	-546	404	0	0	0	0	0	0
FINANCING GAP	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
ESM	0	0	0	0	0	0	0	0	0
IMF	0	0	0	0	0	0	0	0	0
ROLLOVER RATES									
General government	120%	899%	1523%	180%	182%	103%	160%	179%	177%
Central bank	105%	17%	989%	100%	100%	100%	100%	100%	100%
Private	103%	90%	103%	97%	97%	98%	98%	99%	100%
Banks	79%	86%	114%	98%	99%	104%	104%	100%	96%
Non-financial corporates	114%	91%	100%	97%	97%	97%	97%	99%	102%

Sources: Eurostat; Central Bank of Cyprus; and IMF staff estimates.

Annex III. External Sector Assessment

Overall Assessment: On a preliminary basis adjusted for the impact of Covid-related factors (tourism and remittances), the external position of Cyprus in 2021 was moderately weaker than the level implied by fundamentals and desirable policies. The current account (CA) deficit improved in 2021 due to recovery of services exports, which was partially offset by deteriorating terms of trade and continued decline in primary income. Over the medium term, the current account deficit is set to continue recovering and gradually narrow while the NIIP is projected to gradually decline over the medium term.

Potential Policy Responses: Gradual fiscal adjustment and continued efforts to deleverage would be essential for external rebalancing by raising the current account and lowering net IIP liabilities. Structural reforms to raise productivity and enhance competitiveness will help to improve the external position. The Recovery and Resilience Plan both at the national and EU-levels will support these efforts.

Foreign Assets and Liabilities: Position and Trajectory

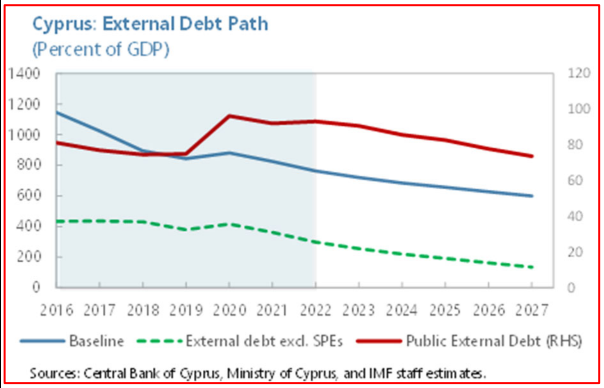
Background. The net international investment position (NIIP), which averaged about –146 percent during 2014–17, improved to –116 percent of GDP in 2019, before deteriorating to -136 percent in 2020. In 2021, the NIIP increased to –123 percent of GDP, largely due to the increases in direct investment and financial derivatives, offset by the improvements in portfolio and other investment. Excluding the contribution of SPEs' foreign financial positions, the underlying NIIP improved from -78 percent of GDP in 2014 to ~~-44~~ -37 percent of GDP in 2019, decreased to -50.1 percent in 2020Q4 and improved slightly to -43.5 percent in 2021Q4. The NIIP is dominated by the private sector, which stood at -113 ½ percent of GDP (-41 excluding SPEs) in 2019 and -115 percent of GDP (-35 excluding SPEs) in 2021Q4. Gross liabilities declined to 2371 percent of GDP in 2019, with around one third in the form of external debt. Under the IMF staff's baseline scenario, the NIIP is projected to gradually decline through the medium term, on the back of improved CA balances.

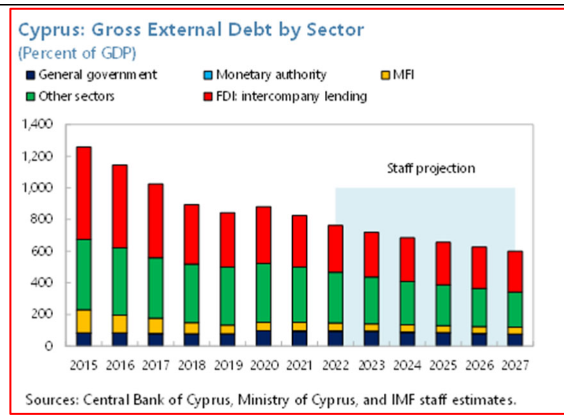
Assessment. External vulnerabilities increased with a deterioration in the NIIP since before the pandemic in 2020. The significant size of NIIP reflects Cyprus's role as a financial center and the effects of SPEs, and the NIIP remains broadly sustainable when excluding SPEs. Projected improvements in CA deficits suggest that the NIIP-to-GDP ratio will improve at a moderate pace in the medium term.

Current Account

Background. The overall current account deficit widened substantially in 2020 mainly due to collapsed services exports in the wake of the pandemic and larger deficit in primary income. The overall current account deficit improved in 2021, with a higher services balance offset by the negative terms of trade shock and a further decline in primary income.

Assessment. The EBA model estimates a CA norm at -4.0 percent of GDP, against a CA of -4.3 percent of GDP adjusted for cyclical contributions, SPE effects, and additional temporary factors to account for the impact of the pandemic on tourism and remittances. Policy gaps—reflecting deviations of current policy settings in Cyprus and the rest of the world (ROW) from their desired settings—contribute 5.6 percentage points. Based on the CA model, IMF staff crisis. The high external debt level reflects its role as a financial center and the presence of SPEs. In 2021, the government external debt was generally stable at 92 percent of GDP in 2021, and net debt is estimated to decline to 253 percent of GDP for the economy and -15 after excluding SPEs. In 2022, gross external debt is projected to decline to 762 percent of GDP, mainly reflecting declining rollover needs as the economy improves, then gradually declines to 599 percent of GDP by 2027. Government external debt is projected to gradually decline over the medium-term to around 74 percent of GDP, supported by GDP growth and fiscal consolidation efforts.





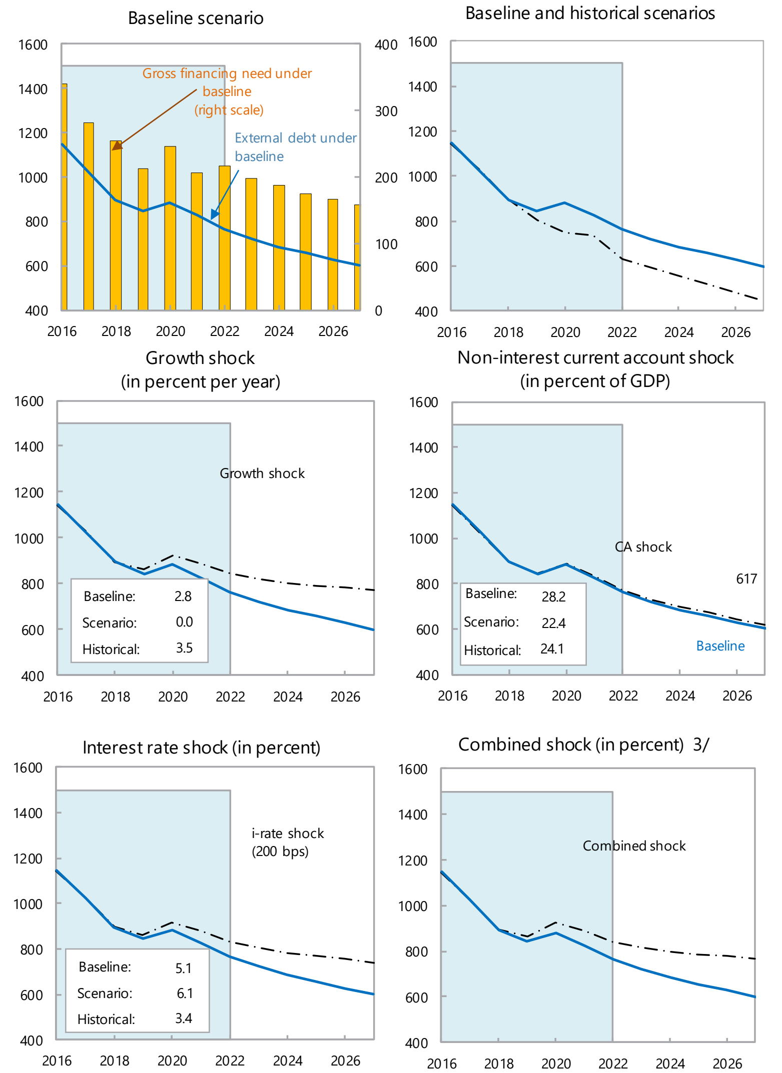
14. Despite the projected decline, the high level of external debt leaves Cyprus vulnerable to a variety of risks. Standardized shocks to interest rates and economic growth would significantly impede debt reduction, as the large size of external debt would markedly increase debt services costs in the case of higher interest rates and reduce the denominator effect on the debt-to-GDP ratio. Standardized current account deficit shocks would have a more limited impact on the debt ratio.

15. The Cypriot economy remains exposed to liquidity and other risks as a result of continued large gross financing needs. Gross external financing needs are projected start to decline in 2021 but remain elevated (over 150 percent of GDP) through the projection period, reflecting sizable stock of short-term debt of the private sector. Sound financial sector policies and structural reforms targeting a more diversified economy would help to ensure balanced and sustainable growth and limit risks of a new boom-bust cycle. Maintaining prudent fiscal policy post-pandemic that avoids procyclicality would help safeguard the downward path of external public debt and create space to absorb possible contingent fiscal shocks. It also will remain important to closely align the maturity of external assets and liabilities.

16. In conclusion, Cyprus's public debt and external debt remain at high levels although debt sustainability risks have receded over the past year, reflecting strong growth recovery and a better medium-term outlook. Ensuring continued fiscal adjustment, reducing risks to financial stability, and strengthening structural reforms to enhance the resilience of the economy are needed to reduce risks to debt sustainability. The debt reduction path could be affected by the growth shock, geopolitical tensions, global financial tightening, and the realization of contingent liabilities. As recommended in the main text of the staff report, maintaining strict fiscal discipline is important to ensuring fiscal sustainability. Sound financial sector policies and structural reforms

Figure 6. Cyprus: External Debt Sustainability—Bound Tests[1,2]

(Percent of GDP)



Sources: Ministry of Finance; Central Bank of Cyprus; and Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Five-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the five-year period, and the information is used to project debt dynamics five years ahead. Unlike the default settings, the path of non-debt creating flow is set to be the same as the baseline, because its historical average is influenced by exceptional flows during the crisis period and seems too optimistic.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

Table 1. Cyprus: External Debt Sustainability Framework, 2016–27

(Percent of GDP, unless otherwise indicated)

	Actual														Debt-stabilizing non-interest current account 5/
	2016	2017	2018	2019	2020	2021			2022	2023	2024	2025	2026	2027	
Baseline: External debt	1144	1024	894	843	881	825			**762**	**720**	**684**	**656**	**627**	**599**	**0.3**
Change in external debt	-114.4	-120.4	-129.7	-51.0	37.6	-55.6			-62.8	-42.7	-35.4	-28.2	-29.4	-27.7	
Identified external debt-creating flows (4+9+14)	-112.7	-102.4	-136.8	-21.7	41.4	-64.8			-39.2	-42.3	-35.1	-27.9	-29.1	-27.6	
Current account deficit, excluding interest payments	-32.8	-29.3	-26.8	-23.9	-20.4	-20.2			-21.9	-29.3	-30.6	-29.9	-29.4	-28.4	
Deficit in balance of goods and services	-1.7	0.5	-1.3	-0.2	2.5	-1.1			1.1	-0.3	-1.2	-1.8	-2.1	-2.3	
Exports	70.5	73.9	75.1	75.6	75.8	81.3			86.4	86.1	85.6	85.2	84.7	84.3	
Imports	68.8	74.4	73.8	75.4	78.3	80.2			87.6	85.8	84.4	83.4	82.6	82.0	
Interest receipts (negative)	-14.7	-12.4	-12.9	-12.4	-14.3	-13.0			-14.6	-19.8	-20.4	-20.3	-20.1	-19.6	
Net non-debt creating capital inflows (negative)	-49.0	-22.7	-55.5	4.5	-14.8	7.4			-24.3	-0.1	0.2	1.4	0.2	0.9	
Net foreign direct investment, equity	-39.8	-19.9	-46.4	-3.9	-19.0	-12.2			-28.4	-5.6	-5.2	-5.0	-4.8	-4.7	
Net portfolio investment, equity	3.6	16.4	-15.5	2.1	0.7	1.6			0.3	2.8	0.1	0.7	4.3	4.3	
Net sales of assets under other investment	-13.6	-20.3	4.5	5.3	4.4	14.8			3.2	2.0	4.5	4.8	0.1	0.6	
Financial derivatives, net	1.7	1.4	3.2	0.1	-1.4	0.2			0.2	0.2	0.2	0.2	0.2	0.2	
Automatic debt dynamics 1/	-31.0	-50.4	-54.5	-2.2	76.5	-52.1			6.9	-12.9	-4.6	0.5	0.1	-0.2	
Contribution from nominal interest rate	37.0	34.4	30.7	29.6	30.4	27.4			30.1	36.1	36.3	35.4	34.6	33.4	
Contribution from real GDP growth	-77.0	-61.4	-52.2	-46.8	43.9	-43.3			-17.0	-25.0	-20.1	-17.2	-17.6	-17.3	
Contribution from price and exchange rate changes 2/	9.0	-23.4	-33.1	15.0	2.2	-36.1			-6.2	-24.1	-20.9	-17.6	-16.9	-16.2	
Residual (2-3 or 19+20+21+22)	-1.6	-18.0	7.1	-29.4	-3.8	9.2			-23.6	-0.4	-0.3	-0.3	-0.3	-0.1	
Net accumulation of official reserve assets	-0.1	0.0	0.2	0.0	0.1	1.3			0.0	0.0	0.0	0.0	0.0	0.0	
Captial account flows, net (negative)	-0.1	-0.4	-0.5	-0.1	-0.1	-0.6			-0.2	-0.3	-0.3	-0.2	-0.2	-0.1	
Errors and omissions, net (negative)	-2.0	-2.5	-0.3	-1.1	2.2	-1.5			0.0	0.0	0.0	0.0	0.0	0.0	
Changes in debt stock without flow transactions, incl. valuation changes, write-offs, and reclassifications	-15.5	-22.2	-10.7	-5.0	-12.8	-3.3			-0.2	0.0	0.0	0.0	0.0	0.0	
External debt-to-exports ratio (in percent)	1622	1385	1191	1116	1162	1015			882	836	799	770	740	710	
Gross external financing need (in billions of euros) 3/	71	64	65	55	61	57			60	58	58	58	58	58	
in percent of GDP	340	282	254	213	246	205			216	197	187	175	167	158	
Scenario with key variables at their historical averages 4/							5-Year Historical Average	5-Year Standard Deviation	**630**	**591**	**553**	**517**	**481**	**446**	Projected Average
Key Macroeconomic Assumptions Underlying Baseline															
Nominal GDP (in billions of euros)	20.9	22.9	25.5	25.8	24.7	27.6			27.6	29.5	31.3	32.9	34.8	36.7	
Real GDP growth (in percent)	6.5	5.9	5.7	5.3	-5.0	5.5	3.5	4.7	2.0	3.5	3.0	2.7	2.8	2.9	2.8
GDP deflator in euros (change in percent)	-0.8	3.1	5.7	-4.2	0.8	6.2	2.3	4.2	-2.2	3.3	3.0	2.6	2.6	2.7	2.0
Nominal external interest rate (in percent)	3.1	3.3	3.4	3.3	3.5	3.5	3.4	0.1	3.6	5.1	5.3	5.4	5.6	5.6	5.1
Growth of exports (euro terms, in percent)	6.2	14.4	13.4	1.6	-4.0	20.2	9.1	10.0	6.1	6.5	5.4	4.8	5.0	5.1	5.5
Growth of imports (euro terms, in percent)	7.7	18.0	10.7	3.1	-0.5	14.8	9.2	7.8	8.9	4.7	4.3	4.2	4.5	4.9	5.2
Current account balance, excluding interest payments	32.8	29.3	26.8	23.9	20.4	20.2	24.1	4.0	21.9	29.3	30.6	29.9	29.4	28.4	28.2
Net non-debt creating capital inflows	49.0	22.7	55.5	-4.5	14.8	-7.4	16.2	25.4	24.3	0.1	-0.2	-1.4	-0.2	-0.9	3.6

Source: IMF staff estimates.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in euro terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and non-interest current account in percent of GDP.

5/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Cyprus: Selected Economic Indicators, 2019–23

	2019	2020	2021	Projections 2022	2023
Output/Demand					
Real GDP	5.3	-5.0	5.5	2.0	3.5
Domestic demand	6.0	-2.9	2.7	2.6	3.0
Consumption	4.9	-0.7	4.9	2.0	2.6
Private consumption	3.0	-5.0	3.7	2.3	2.5
Public consumption	12.7	15.0	8.4	1.0	2.8
Gross capital formation	10.6	-11.5	-6.6	5.8	5.1
Foreign balance 1/	-0.7	-1.9	2.7	-0.4	0.5
Exports of goods and services	7.5	-5.1	13.4	5.1	4.5
Imports of goods and services	8.3	-2.5	9.5	5.5	3.9
Potential GDP growth	4.6	-1.3	4.3	2.5	3.1
Output gap (percent of potential GDP)	2.5	-1.3	-0.2	-0.6	-0.2
Prices					
HICP (period average, percent)	0.5	-1.1	2.3	5.3	2.3
HICP (end of period, percent)	0.7	-0.8	4.8	3.0	2.5
Employment					
Unemployment rate (EU standard, percent)	7.1	7.6	7.5	7.9	7.5
Employment growth (percent)	3.9	0.2	3.4	0.0	1.5
Public Finance					
General government balance	1.3	-5.7	-2.1	-1.3	-0.1
Revenue	39.7	39.3	42.1	41.0	41.2
Expenditure	38.4	45.0	44.2	42.3	41.3
Primary Fiscal Balance	3.5	-3.6	-0.3	0.5	1.4
General government debt	91.1	115.0	103.9	97.7	94.1
Balance of Payments					
Current account balance	-5.7	-10.1	-7.3	-8.2	-6.8
Trade Balance (goods and services)	0.2	-2.5	1.1	-1.1	0.3
Nominal GDP (billions of euros)	23.0	21.6	23.4	24.7	26.4

Sources: Statistical Service of the Republic of Cyprus, Central Bank of Cyprus, and IMF staff estimates.

1/ Contribution to growth (percentage points).