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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Delegations will find attached document C(2020) 8502 final.

EUROPEAN
COMMISSION

Brussels, 18.11.2020
C(2020) 8502 final

COMMISSION OPINION

of 18.11.2020

on the Draft Budgetary Plan of Cyprus

{SWD(2020) 852 final}

(Only the Greek text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan by 15 October, presenting the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

3. On 20 March 2020, the Commission adopted a Communication[1] on the activation of the general escape clause[2] of the Stability and Growth Pact. In its Communication, the Commission set out its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the conditions to activate the general escape clause were met. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission[3]. As indicated in the Annual Sustainable Growth Strategy 2021[4] and as communicated in the letter of 19 September 2020 from the Commission to the EU Ministers of Finance[5], Member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term.

4. On 27 May 2020, the European Commission put forward its proposal for the creation of a new recovery instrument Next Generation EU, alongside the proposal for the reinforced long-term budget of the EU[6] for 2021-2027[7]. This proposal includes the establishment of a Recovery and Resilience Facility offering large-scale financial

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[1] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

[2] The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn.

[3] https://www.consilium.europa.eu/en/press/press-releases/2020/03/23/statement-of-eu-ministers-of-finance-on-the-stability-and-growth-pact-in-light-of-the-covid-19-crisis/

[4] Communication from the Commission on Annual Sustainable Growth Strategy 2021, Brussels, 17.9.2020, COM(2020) 575 final.

[5] https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries/draft-budgetary-plans-2021_en

[6] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - Europe's moment: Repair and Prepare for the Next Generation, Brussels, 27.5.2020, COM(2020) 456 final.

[7] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - The EU budget powering the recovery plan for Europe, Brussels, 27.5.2020, COM(2020) 442 final.

support for both public investments and reforms. By contributing to the economic recovery and by providing financial support to strengthen the economy's long-term growth, the Recovery and Resilience Facility will help public finances to return to more favourable positions in the near term and will contribute to strengthening their sustainability in the medium and long term.

CONSIDERATIONS CONCERNING CYPRUS

5. On 23 October 2020, Cyprus submitted its Draft Budgetary Plan for 2021. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

6. On 20 July 2020, the Council recommended Cyprus[8] to take all necessary measures, in line with the general escape clause, to effectively address the pandemic, sustain the economy and support the ensuing recovery. It also recommended Cyprus to pursue, when economic conditions allow, fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while enhancing investment.

   On 20 May 2020, the Commission issued a report under Article 126(3) TFEU, as Cyprus' general government deficit in 2020 was planned to exceed the 3% of GDP Treaty reference value and Cyprus did not comply with the debt reduction benchmark in 2019. The report concluded that, after the assessment of all relevant factors, the deficit criterion was not fulfilled, while the debt criterion was complied with. In light of the exceptional uncertainty created by the outbreak of COVID-19 and its extraordinary macroeconomic and fiscal impact, including for designing a credible path for fiscal policy, which will have to remain supportive in 2021, the Commission considered that a decision on whether to place Member States under the Excessive Deficit Procedure should not be taken.

7. According to the Commission 2020 autumn forecast, Cypriot real GDP is expected to contract by 6.2% in 2020 and to grow by 3.7% in 2021. According to the Draft Budgetary Plan, the Cypriot economy is expected to contract by 5.5% in 2020 before rebounding by 4.5% in 2021, driven by the fall and subsequent recovery of domestic demand, notably private consumption helped by the fiscal stimulus package adopted. However, the macroeconomic scenario underlying Draft Budgetary Plan expect weaker recovery of domestic demand, which explains the difference in the growth projection. The effects of the pandemic crisis on the Cypriot tourism sector were particularly negative. According to the Plan, the unemployment rate is expected to increase to 8% in 2020, before falling back to its 2019 level of 7% in 2021.

   Cyprus complies with the requirement of Regulation EU No 473/2013 as the draft budget is based on independently-endorsed macroeconomic forecasts. In its endorsement of the forecasts, Cypriot Fiscal Council concluded that the projections for macroeconomic variables were "within acceptable limits".

8. For 2020, the Draft Budgetary Plan expects the general government balance to turn into a deficit of 4.5% of GDP, compared to a surplus of 1.5% of GDP in 2019. This marked deterioration results from both the operation of automatic stabilisers, which led to a contraction in revenue and an increase of cyclical expenditure, and from discretionary COVID-19-related measures. According to the Draft Budgetary Plan, the deficit ratio is expected to narrow to 0.7% of GDP in 2021, helped by the

[8] Council Recommendation of 20 July 2020 on the national Reform Programme of Cyprus and delivering a Council opinion on the 2020 Stability Programme of Cyprus, OJ C 282, 26.8.2020, p 82.

rebound in activity. The Commission 2020 autumn forecast projects the general government deficit at 6.1% of GDP in 2020 and at 2.3% of GDP in 2021. The differences between the budgetary projections in the Plan and the Commission 2020 autumn forecast, result from the fact that the latter is based on a slightly more conservative macroeconomic scenario[9], it uses higher tax revenue elasticities leading to a higher expected decrease in revenues and projects higher public investments in both years. In 2021, the difference in the projections of the headline deficit is mainly due to a base effect stemming from 2020. The Draft Budgetary Plan does not include any revenue from or expenditure to be financed under the Recovery and Resilience Facility. For the time being, since the submission of the Recovery and Resilience Plans and their subsequent approval are expected to take place in 2021, the Commission forecast assumes in the budgetary projections for 2021 the 10% pre-financing of Recovery and Resilience Facility grants and treats it as a financial transaction with no impact on the budget balance, but with a public debt-reducing impact. In the case of Cyprus, the 10% pre-financing of Recovery and Resilience Facility grants is equivalent to EUR 104 million in 2021.[10]

On the expenditure side, in line with its no-policy change assumption, the Commission forecast includes no expenditure related to the Recovery and Resilience Facility, as the corresponding measures were not sufficiently specified at the cut-off date of the forecast.[11] The evolution of the deficit in 2021 could hence turn out more favourable as a result of the higher growth from the implementation of measures financed by the Recovery and Resilience Facility.

The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will rise to 114.8% at the end of 2020 before declining to 111.0% in 2021, similar to the Commission's projection of 112.6% and 108.2%, respectively.

9. The Draft Budgetary Plan reports discretionary fiscal measures in response to the COVID-19 outbreak and its related economic effects with a direct budgetary impact in 2020 of about 4.0% of GDP. The main measures presented in the Draft Budgetary Plan are on the expenditure side and include the extension of the wage subsidy scheme until the end of October 2020. The extended scheme targets specifically hotels and tourist accommodation providers, and businesses pursuing special predefined activities, for an estimated to cost 0.6% of GDP. In addition, other support measures provide subsidies for small enterprises and the self-employed, for an amount of 0.5% of GDP, and provide subsidies to specific sectors affected by the crisis in the order of 0.1% of GDP. On the revenue side, the measures presented in the Plan include a temporary reduction of the VAT special rates from 1 July until the

[9] Additionally, it should be noted that the Draft Budgetary Plan does not use the more recent and better-than-expected data for nominal GDP, which contributes to differences in the revenue and expenditure ratio and related subcategories.

[10] Indicative number based on the Council Presidency compromise proposal for the RRF Regulation (11538/20) of 7 October 2020, on which the Council Presidency obtained a mandate for conducting the negotiations with the European Parliament.

[11] The treatment of the Recovery and Resilience Facility (RRF) in the Commission's 2020 autumn forecast is explained in detail in Box I.4.3 of the European Commission's Economic Forecast Autumn 2020 (https://ec.europa.eu/info/sites/info/files/economy-finance/ip136_en.pdf). In line with the customary no policy-change assumption, the forecast only incorporates those measures that are credibly announced and sufficiently detailed in the Draft Budgetary Plans, irrespective of whether they are planned to be part of Recovery and Resilience Plans. No financing from the RRF has been included on the revenue side of the budgetary projections. Only the pre-financing of RRF grants is included in the forecast for 2021. The assumptions on expenditure measures linked to the RRF in the Commission forecast are without prejudice to the assessment of the Recovery and Resilience Plans.

end of 2020 amounting to 0.1% of GDP, and revenue losses of 0.1% of GDP caused by the extension of specific wage subsidy schemes. None of the support measures with a fiscal cost in 2020 are expected to have a budgetary impact in 2021. These measures are presented in sufficient detail in the Draft Budgetary Plan and thus have been included in the Commission forecast, with no difference concerning the size of their expected budgetary impact. Overall, the measures taken by Cyprus in 2020 were in line with the guidelines of the Commission Communication of 13 March 2020 on a coordinated economic response to the COVID-19 outbreak.

10. In 2021, the overall budgetary impact of new measures amounts to 0.3% of GDP. The Draft Budgetary Plan presents two new expenditure measures aimed at supporting the recovery. The measures consist of interest subsidy schemes, respectively for new business loans (expected budgetary impact of 0.28% of GDP in 2021) and for housing loans (expected budgetary impact of 0.05% of GDP in 2021) during a five year-period (2021-2025), which is why they are considered to be of a non-temporary nature.

11. The Commission is of the opinion that the Draft Budgetary Plan of Cyprus is overall in line with the recommendation adopted by the Council on 20 July 2020. Most of the measures set out in the Draft Budgetary Plan of Cyprus are supporting economic activity against the background of considerable uncertainty. Cyprus is invited to regularly review the use, effectiveness and adequacy of the support measures and stand ready to adapt them as necessary to changing circumstances.

    It is anticipated that Cyprus will submit its Recovery and Resilience Plan in 2021. The Regulation establishing a Recovery and Resilience Facility will set out how the Commission is to assess that the reforms and investments included in the Recovery and Resilience Plan are coherent with the policy priorities of the Union and the challenges identified in the context of the European Semester. This assessment by the Commission will inform the approval of the Plan by the Council and the information to the European Parliament.

Done at Brussels, 18.11.2020

For the Commission
Paolo GENTILONI
Member of the Commission