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Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Cyprus

{SWD(2025) 213 final}

EN EN

Recommendation for a

COUNCIL RECOMMENDATION

on the economic, social, employment, structural and budgetary policies of Cyprus

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 121(2) and Article 148(4) thereof,

Having regard to Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97[1], and in particular Article 3(3) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

General considerations

(1) Regulation (EU) 2024/1263, which entered into force on 30 April 2024, specifies the objectives of the economic governance framework, which aims at promoting sound and sustainable public finances and sustainable and inclusive growth and resilience through reforms and investments, and preventing excessive government deficits. The Regulation stipulates that the Council and the Commission conduct multilateral surveillance in the context of the European Semester in accordance with the objectives and requirements set out in the TFEU. The European Semester includes, in particular,

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1 OJ L, 2024/1263, 30.4.2024, ELI: http://data.europa.eu/eli/reg/2024/1263/oj.
2 OJ L 306, 23.11.2011, p. 25, ELI: http://data.europa.eu/eli/reg/2011/1176/oj.

the formulation, and the surveillance of the implementation of country-specific recommendations. The Regulation also promotes national ownership of fiscal policy and emphasises its medium-term focus, combined with more effective and coherent enforcement. Each Member State must submit to the Council and the Commission a national medium-term fiscal-structural plan, containing its fiscal, reform and investment commitments, over 4 or 5 years, depending on the length of the national legislative term. The net expenditure[3] path in these plans has to comply with the Regulation's requirements, including the requirements to put or keep general government debt on a plausibly downward path by the end of the adjustment period, or for it to remain at prudent levels below 60% of gross domestic product (GDP), and to bring and/or maintain the general government deficit below the 3%-of-GDP Treaty reference value over the medium term. Where a Member State commits to a relevant set of reforms and investments in accordance with the criteria set out in the Regulation, the adjustment period may be extended by up to three years.

(2) Regulation (EU) 2021/241 of the European Parliament and of the Council[4], which established the Recovery and Resilience Facility (the 'RRF'), entered into force on 19 February 2021. The RRF provides financial support to Member States for implementing reforms and investments, delivering a fiscal impulse financed by the Union. In line with the priorities of the European Semester for economic policy coordination, the RRF fosters economic and social recovery while driving sustainable reforms and investments, in particular promoting the green and digital transitions and making Member States' economies more resilient. It also helps strengthen public finances and boost growth and job creation in the medium and long term, improve territorial cohesion within the Union and support the continued implementation of the European Pillar of Social Rights.

(3) Regulation (EU) 2023/435 of the European Parliament and of the Council[5] (the 'REPowerEU Regulation'), which was adopted on 27 February 2023, aims to phase out the Union's dependence on Russian fossil-fuel imports. This helps achieve energy security and diversify the Union's energy supply, while increasing the uptake of renewables, energy storage capacities and energy efficiency. Cyprus added a new REPowerEU chapter to its national recovery and resilience plan in order to finance key reforms and investments that will help achieve the REPowerEU objectives.

(4) On 17 May 2021, Cyprus submitted its national recovery and resilience plan to the Commission, in accordance with Article 18(1) of Regulation (EU) 2021/241. Pursuant to Article 19 of that Regulation, the Commission assessed the relevance, effectiveness, efficiency and coherence of the recovery and resilience plan, in accordance with the

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3 Net expenditure as defined in Article 2, point (2), of Regulation (EU) 2024/1263: 'net expenditure' means government expenditure net of (i) interest expenditure; (ii) discretionary revenue measures; (iii) expenditure on programmes of the Union fully matched by revenue from Union funds; (iv) national expenditure on co-financing of programmes funded by the Union; (v) cyclical elements of unemployment benefit expenditure; and (vi) one-offs and other temporary measures.

4 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility (OJ L 57, 18.2.2021, p. 17, ELI: http://data.europa.eu/eli/reg/2021/241/oj).

5 Regulation (EU) 2023/435 of the European Parliament and of the Council of 27 February 2023 amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulations (EU) No 1303/2013, (EU) 2021/1060 and (EU) 2021/1755, and Directive 2003/87/EC (OJ L 63, 28.2.2023, p. 1, ELI: http://data.europa. eu/eli/reg/2023/435/oj).

assessment guidelines set out in Annex V. On 20 July 2021, the Council adopted its Implementing Decision approving the assessment of the recovery and resilience plan for Cyprus[6], which was amended under Article 18(2) on 8 December 2023 to update the maximum financial contribution for non-repayable financial support, as well as to include the REPowerEU chapter[7]. The release of instalments is conditional on the adoption of a decision by the Commission, in accordance with Article 24(5), stating that Cyprus has satisfactorily achieved the relevant milestones and targets set out in the Council Implementing Decision. Satisfactory achievement requires that the achievement of preceding milestones and targets for the same reform or investment has not been reversed.

(5) On 21 January 2025, the Council, upon the recommendation of the Commission, adopted a recommendation endorsing the national medium-term fiscal-structural plan of Cyprus[8]. The plan was submitted in accordance with Article 11 and Article 36(1), point (a), of Regulation (EU) 2024/1263, covers the period from 2025 until 2028 and presents a fiscal adjustment spread over four years.

(6) On 26 November 2024, the Commission adopted an opinion on the 2025 draft budgetary plan of Cyprus. On the same date, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the 2025 Alert Mechanism Report, in which it identified Cyprus as one of the Member States for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area and a proposal for the 2025 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area[9] on 13 May 2025 and the Joint Employment Report on 10 March 2025.

(7) On 29 January 2025, the Commission published the Competitiveness Compass, a strategic framework that aims to boost the EU's global competitiveness over the next five years. It identifies the three transformative imperatives of sustainable economic growth: (i) innovation; (ii) decarbonisation and competitiveness; and (iii) security. To close the innovation gap, the EU aims to foster industrial innovation, support the growth of start-ups through initiatives like the EU Start-up and Scale-up Strategy, and promote the adoption of advanced technologies like artificial intelligence and quantum computing. In pursuit of a greener economy, the Commission has outlined a comprehensive Affordable Energy Action Plan and a Clean Industrial Deal, ensuring that the shift to clean energy remains cost-effective, competitiveness-friendly, particularly for energy-intensive sectors, and is a driver for growth. To reduce excessive dependencies and increase security, the Union is committed to strengthening global trade partnerships, diversifying supply chains and securing access to critical raw materials and clean energy sources. These priorities are underpinned by horizontal enablers, namely regulatory simplification, deepening of the single market, financing

[6] Council Implementing Decision of 20 July 2021 on the approval of the assessment of the recovery and resilience plan for Cyprus (10686/2021).

[7] Council Implementing Decision of 8 December 2023 amending the Implementing Decision of 20 July 2021 on the approval of the assessment of the recovery and resilience plan for Cyprus (15571/2024).

[8] Council Recommendation of 21 January 2025 endorsing the medium-term fiscal-structural plan of Cyprus, OJ C/2025/10/2.

[9] Council Recommendation of 13 May 2025 on the economic policy of the euro area (OJ C, C/2025/2782, 13.05.2025, ELI: http:// data.europa.eu/eli/C/2025/2782/oj).)

competitiveness and a Savings and Investments Union, promotion of skills and quality jobs, and better coordination of EU policies. The Competitiveness Compass is aligned with the European Semester, ensuring that Member States' economic policies are consistent with the Commission's strategic objectives, creating a unified approach to economic governance that fosters sustainable growth, innovation and resilience across the Union.

(8) In 2025, the European Semester for economic policy coordination continues to develop alongside the implementation of the RRF. The full implementation of the recovery and resilience plans remains essential for delivering on the policy priorities under the European Semester, as the plans help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent years. The country-specific recommendations remain equally relevant for the assessment of amended recovery and resilience plans in accordance with Article 21 of Regulation (EU) 2021/241.

(9) The 2025 country-specific recommendations cover the key economic policy challenges that are not sufficiently addressed by measures included in the recovery and resilience plans, taking into account the relevant challenges identified in the 2019-2024 country-specific recommendations.

(10) On 4 June 2025, the Commission published the 2025 country report for Cyprus. It assessed Cyprus's progress in addressing the relevant country-specific recommendations and took stock of Cyprus's implementation of the recovery and resilience plan. Based on this analysis, the country report identified the most pressing challenges Cyprus is facing. It also assessed Cyprus's progress in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.

(11) The Commission carried out an in-depth review under Article 5 of Regulation (EU) No 1176/2011 for Cyprus. The main findings of the Commission's assessment of macroeconomic vulnerabilities for Cyprus for the purposes of that Regulation were published on 13 May 2025[10]. On 4 June 2025, the Commission concluded that Cyprus is no longer experiencing macroeconomic imbalances. In particular, vulnerabilities relating to external and private debt are receding, in part on account of strong economic growth, and government debt reduction is further supported by continued budgetary surpluses; the current account deficit remains sizeable. Cyprus has made important progress in implementing measures that address its vulnerabilities. Household and non-financial corporate debt have been falling as a share of GDP, predominantly thanks to strong denominator effects on account of high nominal GDP growth. A large share of corporate debt is owed by special purpose entities, whose lenders are located outside of Cyprus, and which pose limited risks to the economy. Additionally, non-performing loans held by banks has been declining significantly due to sales, write offs and repayments. Non-performing loans held by credit-acquiring companies are also decreasing leading to further deleveraging. The government debt is decreasing at a fast pace and Cyprus is forecast to sustain budgetary surpluses. Despite declining in 2024, the current account deficit remains elevated and is expected to improve only marginally; the negative net international investment position remains

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10 SWD(2025) 68 final.

sizeable but is significantly inflated due to the presence of special purpose entities without significant direct links to the domestic economy. Cyprus is making policy progress to address its vulnerabilities. In particular, the foreclosure framework became fully operational in 2024, and legislation aiming to facilitate the non-performing loans resolution is expected to ease household indebtedness and boost their savings.

Assessment of the Annual Progress Report

(12) On 21 January 2025 the Council recommended the following maximum growth rates of net expenditure for Cyprus: 6.0% in 2025, 5.0% in 2026, 5.4% in 2027, and 4.3% in 2028, which correspond to the maximum cumulative growth rates calculated by reference to 2023 of 8.9% in 2025, 14.3% in 2026, 20.5% in 2027, and 25.7% in 2028. On 30 April 2025 Cyprus submitted its Annual Progress Report[11], on adherence to the recommended maximum growth rates of net expenditure and the implementation of reforms and investments responding to the main challenges identified in the European Semester country-specific recommendations. The Annual Progress Report also reflects Cyprus's biannual reporting on the progress made in achieving its recovery and resilience plan in accordance with Article 27 of Regulation (EU) 2021/241.

(13) Russia's war of aggression against Ukraine and its repercussions constitute an existential challenge for the European Union. The Commission recommended to activate the national escape clause of the Stability and Growth Pact in a coordinated manner to support the EU efforts to achieve a rapid and significant increase in defence spending and this proposal was welcomed by the European Council of 6 March 2025.

(14) Based on data validated by Eurostat [12], Cyprus's general government surplus increased from 1.7% of GDP in 2023 to 4.3% in 2024, while the general government debt fell from 73.6% of GDP at the end of 2023 to 65.0% at the end of 2024. According to the Commission's calculations, these developments correspond to a net expenditure growth rate of 2.9% in 2024. In the Annual Progress Report, Cyprus estimates the net expenditure growth in 2024 at 3.2%. The Commission estimates that the net expenditure growth was lower than in the Annual Progress Report. The difference between the Commission's calculations and the estimates of national authorities is due to lower total expenditure and higher deductions for the national co-financing of EU programmes, reflecting more recent available data[13]. Based on the Commission's estimates, the fiscal stance[14], which includes both nationally and EU financed expenditure, was contractionary, by 1.9% of GDP, in 2024.

(15) According to the Annual Progress Report, the macroeconomic scenario underpinning the budgetary projections by Cyprus expects real GDP growth at 3.1% in both 2025

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[11] The 2025 Annual Progress Reports are available on: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/annual-progress-reports_en

[12] Eurostat-Euro Indicators, 22.4.2025.

[13] The Commission figures for 2024 are based on outturn data in line with the April 2025 fiscal notification, while national authorities rely on earlier data.

[14] The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

and 2026, while HICP inflation is projected at 1.9% in 2025 and 2.1% in 2026. The Commission Spring 2025 Forecast projects real GDP to grow by 3.0% in 2025 and 2.5% in 2026, and HICP inflation to stand at 2.0% in both 2025 and 2026.

(16) In the Annual Progress Report, the general government surplus is expected to decrease to 3.5% of GDP in 2025, while the general government debt-to-GDP ratio is set to decrease to 57.4% by the end of 2025. These developments correspond to net expenditure growth of 6.8% in 2025. The Commission Spring 2025 Forecast projects a government surplus of 3.5% of GDP in 2025. According to the Commission's calculations, these developments correspond to net expenditure growth of 7.3% in 2025. These higher projections of net expenditure growth than in the Annual Progress Report are due to the Commission expecting a slightly stronger increase of net expenditure growth in 2025, although starting from a lower base. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be expansionary, by 1.1% of GDP, in 2025. The general government debt-to-GDP ratio is set to decrease to 58.0% by the end of 2025. The decrease of the debt-to-GDP ratio in 2025 mainly reflects the high government surplus together with solid economic growth.

(17) General government expenditure amounting to 1.1% of GDP is expected to be financed by non-repayable support ("grants") from the Recovery and Resilience Facility in 2025, compared to 0.4% of GDP in 2024, according to the Commission Spring 2025 Forecast. Expenditure financed by Recovery and Resilience Facility non-repayable support enables high-quality investment and productivity-enhancing reforms without a direct impact on the general government balance and debt of Cyprus.

(18) General government defence expenditure in Cyprus amounted to 1.7% of GDP in 2021, 1.5% of GDP in 2022 and 1.9% of GDP in 2023 [15]. According to the Commission Spring 2025 Forecast, expenditure on defence is projected at 1.4% of GDP in both 2024 and 2025. This corresponds to a decrease of 0.3 percentage points of GDP compared to 2021.

(19) According to the Commission Spring 2025 Forecast, net expenditure in Cyprus is projected to grow by 7.3% in 2025 and 10.4% cumulatively in 2024 and 2025. Based on the Commission Spring 2025 Forecast, the net expenditure growth of Cyprus in 2025 is projected to be above the recommended maximum growth rate, corresponding to a deviation[16] of 0.5% of GDP in annual terms. When considering 2024 and 2025 together, the cumulative growth rate of net expenditure is also projected to be above the recommended maximum growth rate, corresponding to a deviation of 0.5% of GDP. The projected deviation exceeds the 0.3% of GDP threshold for the annual deviation but does not exceed the 0.6% of GDP threshold for the cumulative deviation. Overall, this means there is a risk of deviation from the recommended maximum net expenditure growth, when outturn data for 2025 will be available next spring.

(20) In the Annual Progress Report, the general government surplus is projected to increase to 3.7% of GDP in 2026, while the general government debt-to-GDP ratio is projected to decrease to 52.6% by the end of 2026. After 2026, in the Annual Progress Report,

15 Eurostat, government expenditure by classification of functions of government (COFOG).

16 From 2026 these figures will appear in the control account that is established in Article 22 of the Regulation (EU) 2024/1263.

the general government surplus is projected to remain at 3.7% of GDP in 2027 and 2028. In turn, after 2026, the general government debt-to-GDP ratio is projected to decrease to 48.4% in 2027, and to 43.3% in 2028. Based on policy measures known at the cut-off date of the forecast, the Commission Spring 2025 Forecast projects a general government surplus of 3.4% of GDP in 2026. These developments correspond to net expenditure growth of 5.4% in 2026. Based on the Commission's estimates, the fiscal stance, which includes both nationally and EU financed expenditure, is projected to be contractionary, by 0.6% of GDP, in 2026. The general government debt-to-GDP ratio is projected by the Commission to decrease to 51.9% by the end of 2026. The decrease of the debt-to-GDP ratio in 2026 mainly reflects the high government surplus together with solid economic growth.

Key policy challenges

(21) In accordance with Article 19(3), point (b), of Regulation (EU) 2021/241 and criterion 2.2 of Annex V to that Regulation, the recovery and resilience plan includes an extensive set of mutually reinforcing reforms and investments to be implemented by 2026. These are expected to help effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations. Within this tight timeframe, finalising the effective implementation of the recovery and resilience plan including the REPowerEU chapter, is essential to boost Cyprus's long-term competitiveness through the green and digital transitions, while ensuring social fairness. To deliver on the commitments of the recovery and resilience plan by August 2026, it is essential for Cyprus to accelerate the implementation of reforms and investments by addressing relevant challenges. Cyprus should increase its administrative capacity to effectively oversee the implementation of the recovery and resilience plan, expedite investment execution, and sustain progress in implementing key reforms. The systematic involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful implementation of the recovery and resilience plan.

(22) The implementation of the cohesion policy programme, which encompasses support from the European Regional Development Fund (ERDF), the Just Transition Fund (JTF), the European Social Fund Plus (ESF+) and the Cohesion Fund (CF), has accelerated in Cyprus. It is important to continue efforts to ensure the swift implementation of this programme, while maximising its impact on the ground. Cyprus is already taking action under its cohesion policy programme to boost competitiveness and growth. At the same time, Cyprus continues to face challenges, including rising temperatures and drought risks, which are placing increased strain on water supply and critical infrastructure, as well as labour shortages and skills mismatches. In accordance with Article 18 of Regulation (EU) 2021/1060, Cyprus is required – as part of the mid-term review of the cohesion policy funds – to review its programme taking into account, among other things, the challenges identified in the 2024 CSRs. The Commission proposals adopted on 1 April 2025[17] extend the deadline for submitting an assessment of the outcome of the mid-term review beyond 31 March 2025. It also provides flexibilities to help speed up programme implementation and

[17] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulations (EU) 2021/1058 and (EU) 2021/1056 as regards specific measures to address strategic challenges in the context of the mid-term review – COM (2025) 123 final.

incentives for Member States to allocate cohesion policy resources to five strategic priority areas of the Union, namely competitiveness in strategic technologies, defence, housing, water resilience and energy transition.

(23) The Strategic Technologies for Europe Platform (STEP) provides the opportunity to invest in a key EU strategic priority by strengthening the EU's competitiveness. STEP is channelled through 11 existing EU funds. Member States can also contribute to the InvestEU programme supporting investments in priority areas. Cyprus could use these initiatives to support the development or manufacturing of critical technologies, including clean and resource-efficient technologies.

(24) Beyond the economic and social challenges addressed by the recovery and resilience plan and other EU funds, Cyprus faces several additional challenges related to research and innovation, access to finance, business environment, energy transition, climate change adaptation, skills mismatches and labour shortages.

(25) Public and private R&D investment in Cyprus remains among the lowest in the EU, with public R&D intensity stagnating at 0.29% of GDP in 2023 (EU average: 0.72%) and business R&D dropping to 0.28% – five times below the EU average. This stems from structural factors such as a service-based economy, a limited number of large businesses, an underdeveloped private equity market and a small budget for incentives. Despite low funding, Cyprus has strong scientific output, but commercialisation is weak, with only 0.7 patent applications per EUR 1 billion of GDP in 2022 (EU average: 3.2). The innovation ecosystem is fragmented, with poor linkages between universities, start-ups, government, and the financial sector. The number of science, technology, engineering and mathematics (STEM) graduates is declining, and researcher density remains low. The current research and innovation strategy lacks targets and indicators, a monitoring and evaluation mechanism, impact assessments, and long-term funding, and there is a need to improve the legal framework for commercialisation and high-risk venture capital.

(26) A well-functioning and diversified financial system is essential to boost investment, innovation, and economic resilience. In Cyprus, access to alternative saving and investment instruments remains limited, and capital markets are insufficiently developed. The banking sector is robust, but non-bank financing remains underutilised, and households' reliance on traditional bank deposits persists, hindering the flow of capital into more productive investments. Financial literacy levels are still low compared to the EU average, constraining households' ability and motivation to engage in diversified investment strategies. Furthermore, the limited presence of institutional investors and venture capital hampers the funding opportunities available to innovative firms and start-ups.

(27) As set in the Competitiveness Compass, all the EU, national, and local institutions must make a major effort to produce simpler rules and to accelerate the speed of administrative procedures. The Commission has set ambitious goals for reducing administrative burden: by at least 25% and by at least 35% for SMEs; and has created new tools to achieve these goals, including systematic stress test of the stock of EU legislation and enhanced stakeholders' dialogue. To match this ambition, Cyprus also needs to take action. 68% of businesses consider the complexity of administrative procedures to be a problem for their company when doing business in Cyprus[18]. A

[18] 'Businesses' attitudes towards corruption in the EU' Flash Report, Eurobarometer Report (April 2024).

business-friendly regulatory environment is essential to boost investment, innovation and entrepreneurship. Cyprus has made progress in improving its business environment, including reforms to simplify business registration and a reduction in late payments in business-to-business and government-to-business transactions. At the same time, regulatory and administrative barriers remain significant. Complex licensing and permitting procedures, high tax compliance costs for small to medium-sized enterprises, and barriers to competition in retail and professional services continue to weigh on business dynamism.

(28) The governance of state-owned enterprises (SOEs) continues to fall short of international standards, with shortcomings in areas such as ownership policies and financial transparency. Cyprus has recently set up an Advisory Council for the nomination of SOEs board members and has adopted measures to improve financial oversight. Nevertheless, the absence of mandatory reporting obligations and a comprehensive inventory of public entities hinders effective monitoring. This also leads to concerns related to governance, accountability and the quality and pricing of services in sectors predominantly controlled by SOEs, such as the electricity sector. To address these challenges, it is essential to create a regularly updated inventory of public entities and adopt a coordinated reform approach involving all stakeholders. This should include the development of a clear SOE ownership policy that defines the roles, responsibilities and accountability of institutions overseeing SOEs.

(29) Cyprus has continued to advance its energy transition, in particular by increasing its renewable energy production. However, oil and petroleum products still account for a major part of energy consumption and the country needs to further accelerate the phase-out of fossil fuels across all sectors. This continued fossil fuel use poses a significant challenge to reducing overall GHG emissions and to meeting Cyprus's 2030 target under the Effort Sharing Regulation. Energy isolation persists and needs to be overcome by expediting the Great Sea Interconnector project, which has been beset by delays. It is necessary to expand and upgrade Cyprus's electricity system and grid and particularly energy storage systems for renewable energy. Developing renewable energy storage systems is vital for increasing renewable energy capacity in the transmission network and for reducing energy curtailment. Sustainable and affordable transport remains a priority, as Cyprus's transport sector faces rising energy use, full reliance on road freight, and limited incentives and infrastructure for fleet electrification. The country's high dependence on energy imports exacerbates external sector vulnerabilities. A deeper integration of renewables into the energy mix would strengthen the economy's resilience to external energy shocks and make the country more attractive for productive foreign investment. Cyprus needs to scale up its efforts in leveraging private financing for energy efficiency improvements and renovations, especially of worst-performing buildings exposing vulnerable consumers to energy poverty, among others, by encouraging its financial institutions to participate in the European Energy Efficiency Financing Coalition.

(30) Energy poverty and affordable electricity is a pressing issue in Cyprus even though targeted support measures have been implemented. Cyprus is among the countries with the highest household electricity prices in the EU, placing in particular vulnerable consumers under considerable financial pressure. Both arrears on utility bills and structural problems like leaks and damp are still widespread. High cooling costs also place a significant burden on households.

(31) Cyprus is confronted with significant environmental challenges, particularly concerning water scarcity and waste management. In 2022, water exploitation reached

a critical level, reflecting severe overuse of renewable water resources. Agriculture, consuming 88% of the nation's water, worsens the issue with outdated irrigation and limited use of water-saving technologies. Cyprus faces a significant shortfall in water infrastructure investment, with major needs in drinking water and waste water treatment. Despite efforts through the 2021-2027 Circular Economy Action Plan and the recovery and resilience plan, the circular material use rate and resource productivity are still below the EU average. In 2022, Cyprus recycled just 15% of municipal and 70% of packaging waste, while generating the most food waste per person in the EU and above-average volumes of municipal waste. A landfill charge under the recovery and resilience plan could improve waste management if properly enforced.

(32) Cyprus is increasingly vulnerable to climate risks, including wildfires, irregular rainfall, droughts and storms. Despite planned investments, Cyprus's resources for climate adaptation fall short compared to EU averages. The national adaptation strategy aims to increase resilience, focusing on sustainable water management and coastal protection, but the approach remains largely non-binding. Strengthening governance and boosting cooperation among ministries and local authorities are critical steps to effectively implement climate adaptation measures and for Cyprus to improve its climate resilience and align more closely with EU standards.

(33) Cyprus's employment performance has been strong, but labour and skills shortages increasingly constrain economic development. Key sectors such as construction, energy, healthcare, agriculture and hospitality face acute shortages, which are further exacerbated by skills mismatches and an underutilised workforce. Additionally, the share of young people not in employment, education or training (12.9%) is still higher than the EU average, especially for young women. Cyprus is also facing a significant decline in basic skills attainment among young people – marked by the largest rise in underachievement in the EU since 2018 – due to factors such as limited participation in early childhood education, incomplete policy implementation, and low school autonomy. This poses a major barrier to reskilling efforts. Participation in secondary vocational education and training (VET) remains limited, while work-based learning opportunities and alignment with labour market needs are insufficient. The share of students enrolled in STEM fields is the lowest in the EU, contributing to persistent shortages in critical areas for the green and digital transitions. Furthermore, digital skills among the working-age population are still low, particularly among vulnerable groups, and adult participation in learning has significantly declined. Reforms supported by the Recovery and Resilience Facility and the European Social Fund Plus are under way – such as the implementation of individual learning accounts, e-skills programmes, and curriculum updates – but their full impact has yet to materialise.

(34) Access to long-term care services for older people remains limited and public spending is among the lowest in the EU. The proportion of people aged 65 and over who require long-term care due to severe difficulties with personal care or household activities, is one of the highest in the EU, at 34.3%. The increasing share of the population aged 65 and over will result in even higher demand for long-term care in the years to come. Access challenges are compounded by shortages of workers, driven by low wages and low coverage of collective bargaining. To improve the availability, access to, and quality of services, Cyprus could introduce an integrated long-term care model, incorporating a robust quality assurance mechanism for all forms of long-term care.

(35) In view of the close interlinkages between the economies of euro-area Member States and their collective contribution to the functioning of the economic and monetary union, in 2025, the Council recommended that the euro-area Member States take action, including through their recovery and resilience plans, to implement the 2025 Recommendation on the economic policy of the euro area. For Cyprus, recommendations (2), (3) and (5) help implement the first euro-area recommendation on competitiveness, while the recommendations (4) and (5) help implement the second euro-area recommendation on resilience, and the recommendation (1) helps implement the third euro-area recommendation on macro-economic and financial stability set out in the 2025 Recommendation.

HEREBY RECOMMENDS that Cyprus take action in 2025 and 2026 to:

1. Reinforce overall defence spending and readiness in line with the European Council conclusions of 6 March 2025. Ensure that net expenditure respects the path recommended by the Council on 21 January 2025.

2. In view of the applicable deadlines for the timely completion of reforms and investments under Regulation (EU) 2021/241, accelerate the implementation of the recovery and resilience plan, including the REPowerEU chapter. Accelerate the implementation of the cohesion policy programme (ERDF, JTF, ESF+, CF), building, where appropriate, on the opportunities offered by the mid-term review. Make optimal use of EU instruments, including the opportunities provided by the InvestEU and the Strategic Technologies for Europe Platform, to improve competitiveness.

3. Strengthen research and innovation and the commercialisation of research results by fostering public and private R&D investment, enhancing research-business synergies, and adopting a continuous long-term research and innovation strategy with input-output indicators and multiannual funding. Facilitate the diversification of the economy and further productive investment by enabling alternative saving and investment instruments, increasing financial literacy, facilitating the participation in capital markets and improving access to non-bank financing opportunities for businesses. Simplify regulation, improve regulatory tools and reduce administrative burden, especially focusing on improving licensing and permitting procedures for investment and setting up new businesses. Improve the governance of state-owned enterprises by aligning it with international best practices, including merit-based nomination of boards, ownership policy and performance-based management.

4. Reduce overall reliance on fossil fuels and further diversify energy supply, notably by developing energy interconnections with neighbouring countries, scaling-up funding for energy efficiency, promoting sustainable transport and upgrading the electricity grid and energy storage facilities, to accommodate an increasing share of renewables. Address energy poverty. Step up investments in water, waste water, and waste management infrastructure, promote sustainable water use practices, and strengthen efforts to prevent waste and improve the separate collection of municipal and packaging waste. Improve the implementation of climate adaptation measures, by focusing on improving the institutional framework governing climate adaptation.

5. Address labour shortages and skills mismatches by strengthening labour market participation of young people, further increasing the capacity and attractiveness of vocational education and training as well as promoting adult learning. Step up policy efforts to strengthen green and digital skills. Further increase participation in early childhood education and care, improve basic skills, and increase students'

participation in science, technology, engineering and mathematics (STEM) fields. Improve the availability of and access to long-term care services by introducing a modern, adequately funded, integrated long-term care model.

Done at Brussels,

For the Council
The President