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# In-Depth Review 2025

## Cyprus

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European Commission
Directorate-General for Economic and Financial Affairs

# In-Depth Review 2025

## Cyprus

EUROPEAN ECONOMY Institutional Paper 311

This in-depth review presents the main findings of the Commission's staff assessment of macroeconomic vulnerabilities for Cyprus for the purposes of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances. It provides technical input to the Commission for the Communication "European Semester – 2025 Spring Package" that will set out the Commission's assessment as to the existence of imbalances or excessive imbalances in Cyprus. That Communication will be published in June 2025.

European
Commission

# Cyprus

## In-Depth Review 2025

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# 1. INTRODUCTION

**This in-depth review (IDR) analyses the evolution of Cyprus's vulnerabilities related to high private, government and external debt.** This year's IDR, which follows the 2025 Alert Mechanism Report (AMR) published in December 2024, assesses the persistence or unwinding of the vulnerabilities identified last year, potential emerging risks, and relevant policy progress and policy options that could be considered for the future[(1)].

**Vulnerabilities in Cyprus are assessed against the backdrop of dynamic economic growth, mainly driven by domestic demand.** Real GDP growth is projected at 3.6% in 2024, from 2.6% in 2023, driven primarily by strong private consumption and an ongoing surge in investment, partly due to projects funded by the Recovery and Resilience Facility (RRF) and other EU funds. The momentum is expected to be largely maintained, with a projected growth close to 3% in 2025 and 2026[(2)]. Domestic demand is expected to remain the main growth driver, with net exports expected to contribute positively as well. On the supply side, growth is driven by long-established sectors such as tourism and financial services. At the same time, the diversification of the economy's business model is becoming more visible as reflected by a booming ICT sector. Inflation continues to abate, and came at 2.3% in 2024, despite service price growth exhibiting some stickiness [(3)].Inflation is set to decline further; inflation excluding energy, food, alcohol and tobacco came in at 2.6% in 2024, marginally below the euro area average, and is expected to recede marginally this year and next. The inflow of foreign workers has more than made up for the recent decrease in the local workforce, resulting in a solid employment outlook. The ongoing geopolitical tensions have led to companies and individuals to relocating their investments to Cyprus, attracted by the strategic location and access to the EU's single market. However, these tensions also warrant vigilance .

(1) European Commission (2024), Alert Mechanism Report 2025, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, COM(2024) 702 final; and European Commission (2024), Alert Mechanism Report 2025, Staff Working Document, SWD(2024) 700 final.

(2) All forecast data used in the IDR come from the Commission Autumn 2024 Forecast (European Economy, Institutional Paper 296), unless stated otherwise, in order to ensure the coherence of the various figures and calculations. The cut-off date for the data for the preparation of this IDR was 20 February 2025. Actual outturn data that have become available after the Autumn Forecast, and before the cut-off date for the IDR, are mentioned.

(3) Input-output analysis indicates that over 2019-2024, foreign demand contributed 1.2 pps. to Cyprus' cumulated GDP growth of 23%; conversely, due to its limited size, the Cypriot domestic demand had little impact on the EU growth. Over the same period, imported value-added inflation accounted for 2.1 pps. of the 16.1% cumulated inflation. See European Commission Institutional Paper 2025 (forthcoming) – "Economic spillovers and financial linkages in the EU".

# 2. ASSESSMENT OF MACROECONOMIC IMBALANCES

**In recent years, Cyprus has been experiencing a large current account deficit as well as high but receding levels of private, government and external debt.** The current account deficits reflect a large negative income account balance and have been recorded against a backdrop of high domestic demand. The corporate and household debt-to-GDP ratios continue declining. At the same time, the government has recorded significant headline surpluses which are expected to continue, supporting further marked reductions in government debt.

## 2.1. EXTERNAL SECTOR

*Assessment of gravity, evolution and prospects of vulnerabilities.*

**The current account deficit declined in 2024.** After increasing to close to double-digit figures in 2023, external accounts have been improving throughout 2024 and by end-September the current account deficit stood at 4.3% of GDP. It is not expected to deteriorate in the coming quarters [8][9]. This is closer to the current account norm [10] of around 3% of GDP and below the benchmark for a net international investment position (NIIP)-stabilising deficit [11] of around 5% of GDP. The current account deficit of Cyprus is historically explained by a negative trade in goods balance due to strong domestic demand and low domestic production and more recently by a large negative net primary income balance, reflecting mainly the repatriation of profits of foreign owned companies.

**The trade surplus has been increasing mainly thanks to services**. The surplus improved substantially by the end of the third quarter of 2024, reaching 7% of GDP, reflecting a declining trade-in-goods deficit and a rising surplus in services. The trade-in-goods deficit stood at around 18.4% of GDP by September 2024, down from 23% at end-2023. This improvement is mainly attributed to a lower deficit of capital goods, particularly due to ship registrations, which were exceptionally large in 2023. The surplus in services reached 25.4% of GDP in the third quarter of 2024, a more than 1.2 pps. increase compared to end-2023, underpinned by a strong ICT sector

(8) Hereunder, any reference concerning the first three quarters of the year is based on a four-quarter-sum calculation.

(9) The current account figures reflect the recent revision, which was implemented as part of the scheduled benchmark revision and took into account, among others, new information sources, and improved methodologies for the compilation of external sector data. As a result, the current account deficit as a share of GDP decreased by 2.1 and 2.0 pps. in 2023 and 2024 respectively. The latest European Commission forecast of Autumn 2024 does not take into account the revised data, therefore it is not presented in this section.

(10) Current accounts in line with fundamentals (current account norms) are derived from reduced-form regressions capturing the main determinants of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See L. Coutinho et al. (2018), "Methodologies for the assessment of current account benchmarks", European Economy, Discussion Paper 86/2018, for the description of the methodology for the computation of the fundamentals-based current account used in this AMR; the methodology is akin to S. Phillips et al. (2013), "The External Balance Assessment (EBA) Methodology", IMF Working Paper, 13/272.

(11) The net international investment position (NIIP) is a statistical statement that shows the value of financial assets of residents of an economy that are claims on non-residents minus liabilities of residents of an economy to non-residents. I provides an aggregate view of the net financial position of a country vis-à-vis the rest of the world.

mostly owned by foreign companies. The service balance was also supported by traditionally strong exports of tourism, shipping and financial services.

**The distribution of profits by foreign-owned companies continues to drive the large and growing primary income deficit [12].** Although foreign-owned companies significantly boost service exports in Cyprus, the persistent repatriation of their profits is a key driver behind the growing primary income deficits. By end-September 2024, the primary income balance reached a deficit of 10.4% of GDP, from 9.6% by the end of 2023. Direct investment income remained the largest negative flow (deficit of 5.6% GDP) in the incomes account, reflecting the repatriation of profits from both exporting and non-exporting corporations including banks and credit acquiring companies.

**Household investment and consumption decisions have contributed to external deficits**. Net household borrowing stood at -2.2% of GDP in 2023, as compared to 3.1% in the euro area on average. The gross savings rate of households stands at 11% of gross disposable income, considerably higher than its pre-pandemic level, but still below the euro area average of around 13% and below households' gross investment rate of around 15%, which is among the highest in the EU (Graph 2.1.d). Households mainly invest in real estate, suggesting that purchase of dwellings is considered as an alternative to deposits [13]. This trend recently showed signs of abating in view of high borrowing costs [14]. At the same time, household consumption was bolstered by increased inward migration of highly skilled and highly paid individuals. The recent surge in foreign labour force inflows has added around 3% to the working-age population.

**Similar to households, corporate savings remain low and the sector continues to be a net borrower, while the government sector remains in surplus.** The corporate sector is projected to record a net borrowing rate of above 10% of GDP in 2024, up from 9.4% in 2023, according to the autumn 2024 forecast. This evolution is partially attributed to new investment in real estate, as well as large infrastructure projects and other investments financed by domestic but also foreign capital. In 2023, corporate gross savings went negative from a historically positive position. This dissaving seems to also be associated with the large dividend payments from foreign-owned domestic banks. It should also be noted that the size of corporations' gross disposable income is impacted by the size of corporate taxation paid domestically from foreign enterprises which have chosen Cyprus as tax residence. Corporate income tax paid in Cyprus is close to 8% of GDP (against an EU total of around 4% of GDP). The general government maintains a large net saving position, projected at 3.5% of GDP in 2024.

**Net foreign direct investment (FDI) is the main financing source of the current account deficit.** Net FDI stood at 11.8% of GDP by end-September 2024, 7 pps. down from a year ago but remains the main financing source of the current account. The net FDI is comprised predominantly of equity excluding reinvested earnings (59% of total), followed by reinvested earnings (36.4% of total), and debt instruments (4.5% of total). Inward FDI transactions are mostly related to real estate activities (around 7.5% of GDP) for both commercial and residential purposes, as well as ICT (around 1.8% of GDP) in 2023.

(12) See thematic chapter in the 'In-depth review of Cyprus' 2024 – Institutional Paper 273, March 2024, Brussels.

(13) The limited domestic financial investment options available domestically shape household investment decisions in Cyprus. As a result, households invest heavily in real estate instead of in financial assets. This is reflected in the strong correlation between gross savings and investment in dwellings (see Graphs 2.1.c, d and private debt section below).

(14) Data from the Central Bank of Cyprus indicate that real estate demand from domestic households is higher than the corresponding one from foreigners in all districts except Paphos (around 65% of total sales contracts in the 5 largest cities are awarded to domestic households).

**The net international investment position (NIIP) continued improving in 2024, despite the current account deficit**. As of the end of the third quarter of 2024, the NIIP stood at -84.6% of GDP, 10 pps. above its level of a year before due to nominal GDP growth and positive valuation changes, despite the large current account deficits. When excluding SPEs,[15] the NIIP reflects a less negative stock of -30.3% of GDP [16]. A considerable share of liabilities in the NIIP arises from the outright transfers of non-performing loans (NPLs) to foreign-owned credit acquiring companies (CACs) between 2018 and 2021. The portfolios managed by these CACs currently amount to approximately 33% of GDP, contributing to the net liabilities in other investment. Looking ahead, medium-term projections are for a deterioration in the NIIP, driven by continued large current account deficits, in particular the primary income deficit (see Box 2.1).

*Assessment of MIP relevant policies.*

**Improvements in the current account reflect recent initiatives to support the diversification of the economy**. These included for example, attracting foreign investment through headquartering policies, and incentivising foreign talents to relocate in Cyprus. No other major corresponding policies were adopted in the last year, but the Cyprus government has started exploring ways to strengthen foreign investment controls [17] to mitigate risks for the domestic economy, especially in critical sectors or essential infrastructure, also linked to potential outflows of profits. In the area of taxation, Cyprus is currently preparing an amended legislation to address aggressive tax planning through withholding taxes on dividends, interest and royalties paid to zero and low-tax jurisdictions, which could also reduce the dividend outflow and thus primary income deficits. Several reforms and investments under Cyprus's Recovery and Resilience Plan (RRP) aim to further diversify domestic production by boosting trade openness, increase resilience of the economy to external shocks in particular on energy and making it more attractive to productive foreign investment.

## 2.2. PRIVATE SECTOR INDEBTEDNESS

*Assessment of gravity, evolution and prospects of vulnerabilities.*

**Private sector debt as a share of GDP remains high but has been on a steep downward trajectory.** Total private debt, encompassing both households and non-financial corporations (NFCs), reached 183% of GDP by Q3 2024. This reflects a marked reduction since 2023 of more than 10 pps. (Graph 2.2.a), primarily driven by an increase in the country's nominal GDP and negative net credit flows. A significant portion of the debt is held by foreign companies established as special purpose entities (SPEs) whose lenders are located outside of Cyprus, thereby mitigating risks to the domestic financial system. Excluding SPEs, private debt stood at 139% of GDP as of Q3 2024, closer to but still above the euro area average of about 110%.

**Household debt continues its gradual downward trend and the financial position of households has shown overall improvement.** In Q3 2024 household debt reached 60% of GDP, down from 64.3% of GDP at the end of 2023, as the mildly negative household credit growth and

(15) Special purpose Entities (SPEs), mostly ship-owning, contribute significantly to the negative headline NIIP. The risks of SPEs for the real domestic economy notably the banking system are reportedly limited, as ship-owning SPEs are mostly funded by foreign financial institutions or other related non-resident entities and own assets located outside Cyprus. Furthermore, the impact of SPEs on the current account balance is limited.

(16) By instrument category, the main contributor to the negative NIIP balance is other investment, standing at –153% of GDP.

(17) The purpose of the bill is to align with European regulations established in 2020, which provide a framework for Member States to control foreign investments that could threaten security or public order and protect from concentration risk.

strong nominal GDP growth supported continued household deleveraging (Graph 2.2.c and d). The debt ratio still stands above the prudential threshold but is considerably below the fundamentals-based benchmark (see Table 2.1). At 20% of gross disposable income, the median debt service to income ratio for debtors is relatively high, and it is even more so for households in the two bottom deciles of the income distribution. However, rising household disposable income and improved savings through strong deposits are improving the debt repayment capacity of households and reducing the risk of new household loan defaults. Despite the recent strong rise in borrowing costs and the high incidence of flexible mortgage rates, no increases have been observed in non-performing or stage 2 loans to households[18], and data from the latest Household Finance and Consumption Survey suggest that debt service to income ratios are improving over time for households across the income distribution due to borrower-based measures that have been introduced in the aftermath of the financial crisis. Projections suggest the decline in household debt is set to continue under a broad set of scenarios, backed by low net credit flows, real GDP growth and inflation (See Box 2.0.1).

**Debt levels of the non-financial corporates (NFCs) remain high but have been decreasing over the past years.** In 2024, the debt of the NFC sector declined to 123% of GDP, down from 130% in 2023, largely driven by nominal GDP growth, as well as negative credit growth. The debt ratio remains above the prudential threshold but is relatively in line with the fundamentals-based benchmark (Table 2.1). NFC debt excluding SPEs stood at 79% of GDP. Elevated lending rates, especially on variable interest-rate loans linked to the Euribor or ECB base rate, have affected the balance sheets of domestic NFCs (51% of NFC loans are linked to the Euribor rate) and increased their interest burden. This did not affect the overall credit quality of the NFC sector though, as reflected in improved liquidity buffers and decreasing stage 2 loans (Graph 2.2.f). Recent reductions in the ECB's key interest rates, as well as a positive outlook for economic growth and employment are expected to further strengthen NFCs debt repayment capacity in the future. NFC debt-to-GDP is projected to decline further over the next 10 years according to the baseline scenario of the NFC debt projections (see Box 2.1).

**The banking sector remains resilient.** It benefits from strong capital buffers, high liquidity, sustained strong profitability and improved asset quality which are adequate to absorb unexpected losses. Profitability is expected to normalise from recent highs as interest rates return to normal levels. Despite the recent high-interest rate environment, lending growth has accelerated, and both corporate and household borrowers demonstrate solid debt service capacity.

**The banking sector showed continued improvement in asset quality, with a continued decrease in Non-Performing Loans (NPLs).** The total stock of NPLs decreased, despite high interest rates, lowering the NPL ratio in the banking sector to 3.3% in Q3 2024, down from 3.7% in Q3 2023, yet remaining above the EU average. Exposure to loans at risk of becoming non-performing (stage 2 loans [19]) fell to 7.6%, which is below the EU average. Data shows an overall improvement in the quality of loans lowering risks of new NPL inflows (Graph 2.2.e and f). However, challenges remain for less significant institutions, which continue to carry a higher share of NPLs. A significant portion of legacy NPLs is also held on the balance sheets of Credit Acquiring Companies (CACs), outside of the banking sector (see Annex on NPLs). These loans have been paid to the banking sector, are not securitised by the State and banks have no exposure to CACs. Since 2022 CACs have started to record profits from loan workouts, mostly loan repayments. The new

(18) Stage 1 assets are financial instruments that either have not deteriorated significantly in credit quality since initial recognition or have low credit risk; Stage 2 assets are financial instruments that have deteriorated significantly in credit quality since initial recognition but offer no objective evidence of a credit-loss event; Stage 3 loans are considered to be credit-impaired (i.e. a credit loss has occurred). Credit-impaired is usually a wider definition than '90 days past due'.

(19) See footnote (14) for a definition of stage 2 loans.

foreclosure framework should facilitate repayment of collateralised loans that remain on banking and CACs balance sheets.

*Assessment of MIP relevant policies.*

**In 2024, Cyprus implemented key reforms to accelerate NPL resolution and support private debt deleveraging.** The foreclosure framework became fully operational, though it is premature to quantify its impact at this stage. The pace of foreclosure initiations for non-cooperative borrowers was slow, but according to Cyprus's authorities debtors have increased their NPL repayments or sought settlements in higher numbers. Meanwhile, the Mortgage-to-Rent scheme, exceeding participation expectations, is helping to settle mortgage debt of vulnerable households with overdue loans secured against the primary residence. The longstanding issue of property title deeds saw major progress, with the Cypriot authorities resolving 16,606 pending title deed cases by either issuing or rejecting them. Unresolved title deeds cases thus dropped from nearly 20,000 in 2021 to just 3,524 in 2024 removing a key obstacle to legacy NPL resolution. Additionally, Cyprus is introducing a strengthened crisis management framework for its credit institutions, including new laws on liquidation of insolvent banks and procedures for government intervention, aimed at ensuring more effective responses to financial distress in the banking sector.

## 2.3. GOVERNMENT SECTOR

*Assessment of gravity, evolution and prospects of vulnerabilities.*

**Government debt has continued decreasing at a fast pace.** At the end of 2024, the debt-to-GDP is estimated at 66.4% of GDP, recording a cumulative decline of more than 50 pps. since its peak in 2020. Cyprus's general government debt ratio is forecast to continue declining and be below 60% of GDP in 2026. The main drivers of the debt reduction are the strong fiscal position with sustained budgetary surpluses, and high nominal GDP growth. The government budget is expected to continue recording surpluses, underpinning further reductions of government debt in the coming years. In 2025 and 2026, the total gross financing needs are expected to remain low at about 6% of GDP per year. Moreover, Cyprus retains a strong cash position of approximately 11% of GDP and a relatively favourable maturity profile (of 7 years), limiting short-term re-financing risks for government finances. Credit-rating upgrades continued throughout 2024 with positive outlook and a few notched within the investment grade by all major credit-rating agencies.

**The heightened interest rates somewhat increased the cost of issuing new debt, but interest payments are decreasing overall.** The higher borrowing costs on the primary markets have so far only slightly increased the weighted average cost of debt. At the beginning of 2025, the yield of the Cyprus 10-year government bond stood at around 3% and the spread with respect to the 10-year German Bund stood at around 0.6 pps, following a decreasing trend since 2022. Interest payments are projected to decrease as the debt stock reduces in nominal terms. The interest expenditure to GDP is projected at 1% of GDP in 2026 (from 1.3% in 2023 and 2% in 2020).

*Assessment of MIP relevant policies.*

**In its medium-term fiscal-structural plan, Cyprus commits to a net expenditure growth [20] that does not exceed 25.7% in cumulative terms by 2028.** In particular, Cyprus

[20] Net expenditure as defined in Article 2 of Regulation (EU) 2024/1263, namely government expenditure net of (i) interest expenditure, (ii) discretionary revenue measures, (iii) expenditure on Union programmes fully matched by revenue from

commits to a net expenditure growth that does not exceed 6% in 2025, 5% in 2026, 5.4% in 2027 and 4.3% in 2028[21]. According to the plan, general government debt would gradually decrease from 68.9% of GDP in 2024 to 47.4% of GDP at the end of the adjustment period (2028). The plan considers the impact of adopted revenue and expenditure measures such as public sector wage increases, adopted in 2024, measures to support housing needs of vulnerable households, the phasing out of tax rate reductions and the non-indexation of the personal income tax brackets.

**Cyprus's fiscal policy remains robust with continued surpluses and no additional measures seem to be required to achieve the budgetary targets.** In particular, the medium-term fiscal-structural plan does not envisage additional revenue from the backlog of tax cases and highlights that the set targets will be achieved without requiring additional budgetary measures.

Table A: **Main policies increasing or reducing risks of imbalances considered in this IDR**

| Vulnerability | Policies | Implementation status |
|---|---|---|
| **External sector** | *Headquartering policies.*<br><br>A set of tax incentives aimed at attracting foreign companies with strong export orientation to relocate in Cyprus.<br><br>This set of measures complements the introduction of the Digital Nomad Visa and the right of their family members to re-unite and work in Cyprus. | *Implemented in May 2022.*<br><br>In 2023 alone, almost 30 thousand foreign workers moved to Cyprus, a figure that represents a significant increase in working-age population.<br><br>Moreover, the measure has attracted significant FDI in residential and commercial real estate activities. |
| | *Implementation of the Recovery and Resilience Plan.*<br><br>Actions aspire to diversify the economy by boosting green and digital sectors. Reforms in taxation, modernisation of public administration, and importantly the justice system, aspire to enhance the business environment. | *Ongoing implementation.*<br><br>As of Q1-2025, Cyprus has submitted four payment requests (five instalments) and 377.7 million have been disbursed for the grant and loan components combined.<br><br>A REPowerEU chapter was included in Cyprus's RRP, which is currently in progress. |
| **Household debt and saving** | Mortgage-to-Rent scheme.<br><br>The Mortgage-to-Rent scheme is designed to assist low-income households with overdue loans secured against the primary residence. | *Implemented in December 2023.*<br><br>The scheme has received great interest. Around 3.5 thousand applications were submitted and are currently reviewed for compliance. |
| | *Foreclosure framework.*<br><br>The new foreclosure reform aims to strike a balance between protecting genuinely vulnerable borrowers and preventing system abuse by strategic defaulters. | *Implemented in 2024.*<br><br>In the first nine months of 2024, the pace of foreclosure initiations for non-cooperative borrowers was slow, but according to the authorities, debtors have increased their NPL repayments or sought settlements in higher numbers before auctions are initiated. |
| | *Resolving the issue of title deeds by examining the backlog of pending cases.* | *Ongoing implementation.*<br><br>Around 16.5 thousand pending cases |

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.

[21] These are also the growth rates that the Council recommended. The cumulative growth rates are calculated by reference to the base year of 2023. Council Recommendation of 21 January 2025 endorsing the national medium-term fiscal-structural plan of Cyprus, Official Journal of the European Union C/2025/639, 10 February 2025.

| | | |
|---|---|---|
| | The authorities are making efforts to resolve the issue of title deeds by examining the backlog of pending cases. In the past, many purchases of immovable properties were not accompanied by a transfer of the rights of the property (title deeds), creating disincentives for buyers to continue servicing their loans. | have been resolved by either issuance or rejection. In total this marks a reduction in the total number of unresolved cases from 20 thousand in 2021 to just 3.5 thousand in 2024. |

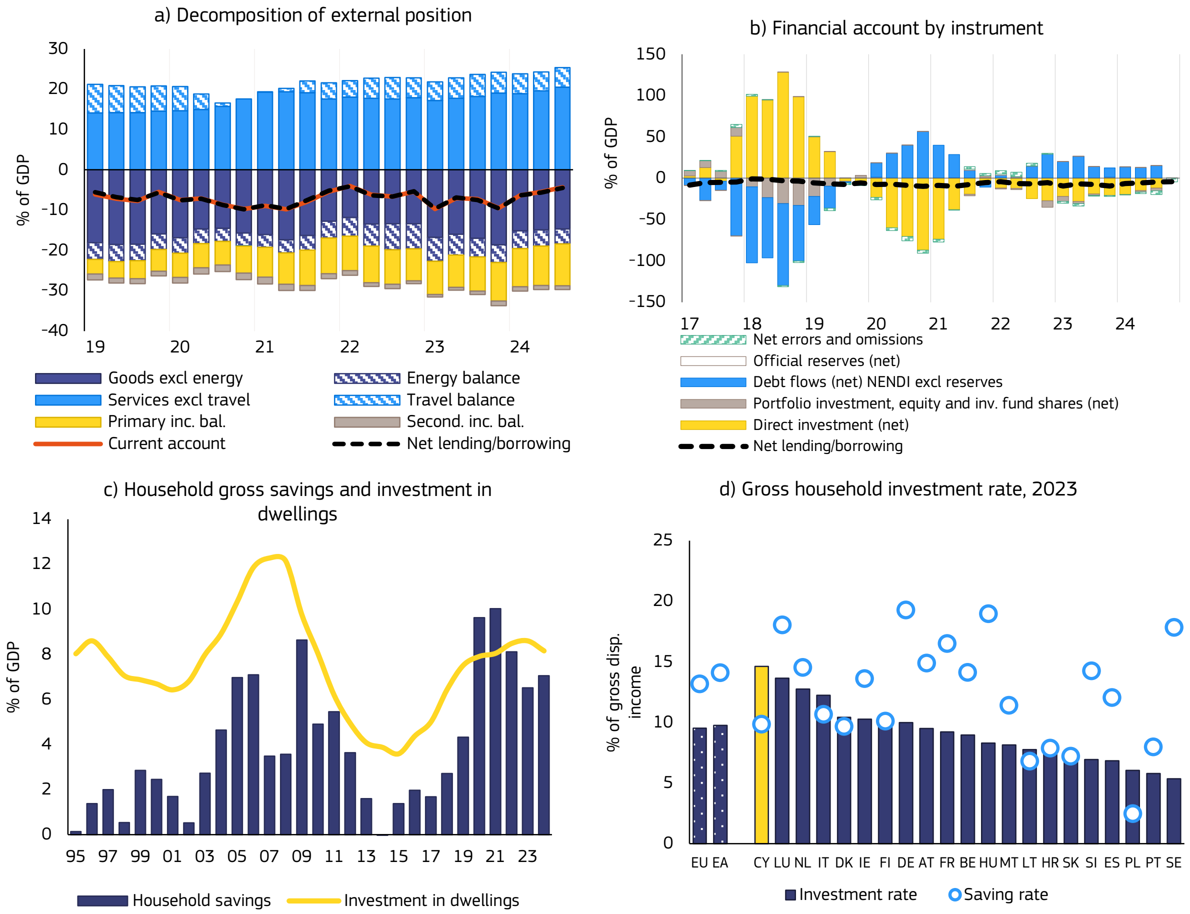
***Note***: This table lists the main measures that may increase or reduce the risks of macroeconomic imbalances. The measures are described more at length and reviewed in the text of this IDR.

## CONCLUSIONS

**Vulnerabilities relating to external and private debt remain but continue to recede, thanks to evolving dynamics in the economy, while government debt is projected to fall below 60% of GDP in 2026.** By end-September 2024, the current account deficit had improved notably reflecting stronger, export-oriented growth amidst a still high domestic demand. Household and non-financial corporate debt as a share of GDP continue to abate, predominantly thanks to the strong denominator effect. A large share of corporate debt is owed by SPEs, which pose limited risks to the economy. Additionally, the stock of NPLs held by banks has been declining significantly due to sales, write-offs and repayments. NPLs stock held by credit-acquiring companies is also decreasing since 2022 leading to further deleveraging. The government debt is decreasing at a fast pace and Cyprus is forecast to sustain budgetary surpluses in the medium-term supported by moderate expenditure growth.

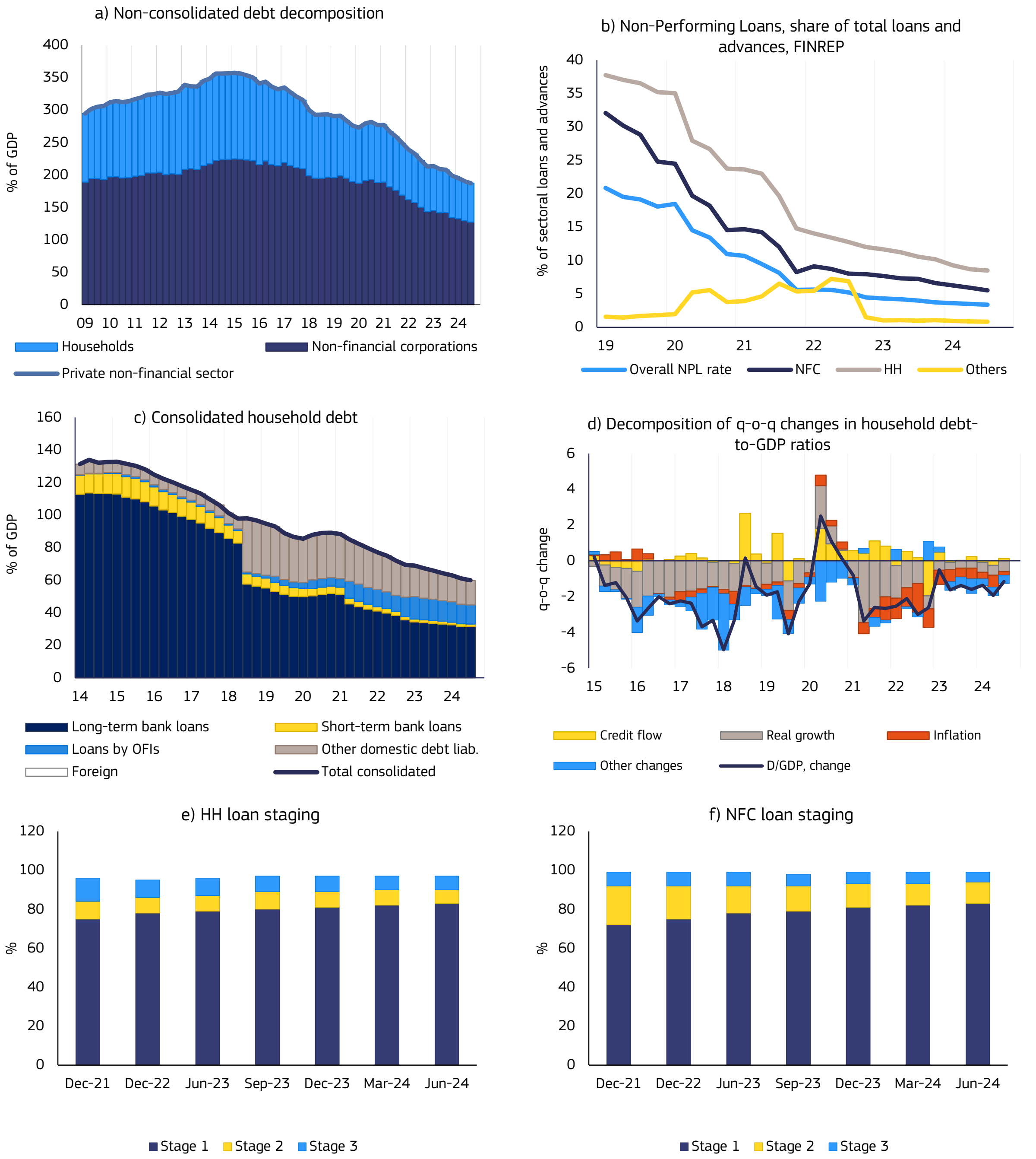
**Cyprus is making some progress on the policy side to address vulnerabilities.** Cyprus has implemented measures to support the export orientation of the economy and to increase foreign investment inflows. At the same time, the foreclosure framework became fully operational in 2024, and legislation aiming to facilitate the NPLs resolution is expected to ease household indebtedness and boost their savings. Fiscal policy remains robust and targeted at sustained surpluses. On the other hand, little progress has been made in diversifying household investment, as a significant share of its gross disposable income continues to flow into real estate, given limited alternative investment options.

Graph 2.1: **Selected graphs on external sector and household finances, Cyprus**




***Source:*** ECB, Eurostat and European Commission calculations.

Graph 2.2: **Selected graphs on private debt, Cyprus**




***Source:*** ECB, Eurostat and European Commission calculations.

*Box 2.1:* **Medium-term external, private, and government debt projections**

This Box summarises external and internal debt to GDP projections for Cyprus over the next decade, based on scenario analysis. It covers scenarios to take into account different underlying assumptions for external, corporate and household debt stocks, as well as the outcomes of the latest government debt sustainability analysis (DSA) conducted by the Commission.

**Cyprus' net international investment position is projected to continue declining under a wide range of scenarios.** Under the baseline assumptions that take the 2024 forecasts as a starting point, the NIIP is estimated to worsen to around -120% of GDP in 2034 (Graph 1 a). The deeply negative balance of primary income is a key factor behind this deterioration, as the trade and capital account balances are comparatively negligible. In an adverse scenario of a lower trade balance and if the annual inflation is assumed to be on average 1.5 pp below the baseline (assuming an annual average inflation rate of 0.5%), the NIIP would still deteriorate to -122% of GDP by 2034. Excluding the impact of SPEs, the NIIP deteriorates in the baseline scenario as well as the two alternative scenarios.

**The corporate debt-to-GDP ratio is projected to continue to decline over the next decade under the baseline scenario.** The baseline scenario takes the 2024 nowcast as a starting point and foresees an average real GDP growth of 1.9% per year, average annual inflation rate of 2.1%, and annual corporate credit flows of 3.1% of GDP (below the debt-stabilising[1] NFC credit-to-GDP of 4.9%). In the baseline scenario, the NFC debt-to-GDP ratio is projected to decrease by around 14 pps from 120% in 2024 to 106% in 2034 (Graph 1 b). Under an adverse scenario of high corporate credit flows over the entire projection horizon, this ratio would increase by about 16 pps to above 136% of GDP. If in addition to high credit flows, annual inflation is assumed to be on average 1.5 pps below the baseline (assuming an annual average inflation rate of 0.5%), the NFC debt-to-GDP ratio would increase to about 155% by 2034.

**The household debt-to-GDP ratio is projected to continue decreasing over the next decade under a broad range of scenarios.** The baseline scenario takes the 2024 nowcast as a starting point and foresees an average real GDP growth rate of 1.9%, an average inflation rate of 2.1% and credit flows of 0.5% of GDP (solidly below the debt-stabilising credit-to-GDP ratio of 2.4%) for years 2025 until year 2034. As a result, the household debt-to-GDP ratio would drop by about 15 pps by 2034, to 41% (Graph 1 c). Under an adverse scenario of credit flows being higher for the entire period under consideration, the household debt-to-GDP ratio would decrease by almost 10 pps by 2034. If in addition to high credit flows, annual inflation is on average 1.6 pps below the baseline, the debt ratio would only decline by 2 pps by 2034.

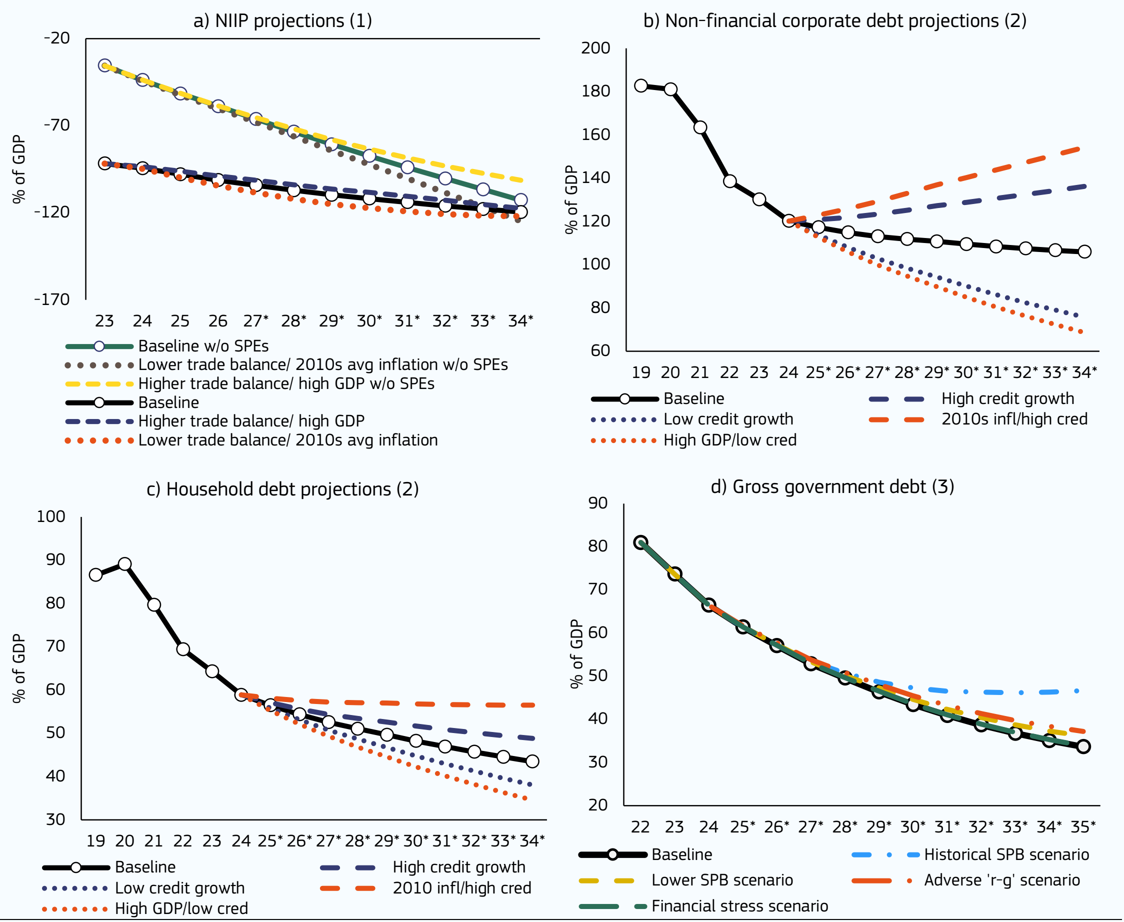
**Medium-term risks to fiscal sustainability are overall medium, whereas they are overall low in the short term and in the long term.** The debt sustainability analysis carried out by the Commission indicates that, under the baseline scenario, the government debt-to-GDP ratio is projected to decrease to around 46% in 2029 and to around 35% in 2034 (Graph 1 panel d)°[2]. This Commission's assessment of fiscal sustainability risks does not take into account Member States' commitments as outlined in the medium-term fiscal-structural plans. In line with standard practice, it only incorporates fiscal measures that have been legislated or agreed for 2025 and assumes unchanged policy afterwards.

(1) The debt stabilising credit-to-GDP ratio refers to the credit ratio between 2025 and 2034 that would stabilise the debt-to-GDP ratio at its 2024 level.
(2) Post-Programme Surveillance Report - Cyprus, Autumn 2024, European Economy, Institutional Paper 298. See also European Commission (2025), Debt Sustainability Monitor 2024, European Economy Institutional Paper 306.

(Continued on the next page)

*Box (continued)*

Graph 1: **External, private, and government debt projections, based on scenario analysis for Cyprus**




(1) The baseline NIIP projections are based on the Commission's medium-term forecasts for GDP and interest rates. Additionally, assumptions are made about the drawdown of NGEU and MFF funds, and the median value of the last 3 years is used for non-investment income. The 'higher trade balance/ high GDP' scenario assumes higher trade balance in 2025 and beyond, with the difference to the baseline calculated as half the interquartile range of the annual 10-year-average trade balance to GDP ratios over 2013-2023 and additionally reflects a permanent 1 pp increase in GDP growth relative to the baseline scenario. The 'lower trade balance/ 2010s avg inflation' scenario assumes the same as the first scenario but with an opposite sign in the trade balance and also reflects an inflation rate that is set to the country-specific average inflation rate observed over the 2010s. The baseline scenario for the NIIP projection including SPEs described above assumes the trade balance to stay constant beyond the forecast horizon of 2026, which results in mild dynamics for the current account balance that consequently averages around -6% of GDP over 2027-34. In contrast, the baseline scenario for the NIIP projection excluding SPEs from 2027 to 2034 cannot rely on the trade balance, because there is no forecast and no direct attribution of SPE items to the various subcomponents of the current account. That baseline scenario therefore keeps the current account balance constant, close to its latest observed value at around -10 % of GDP. The scenarios excluding SPEs, therefore, assume the current account balance to stay more negative than the scenario including SPEs. As a result, the strong current account deficit in the baseline scenario excluding SPEs results in a strong decline of the NIIP until 2034. Further variants have been assessed for sensitivity analysis, also with varying assumptions, yet the baseline scenario excluding SPEs would see the NIIP drop to beyond -100% of GDP in either case. In addition, due major data revisions, the results presented here differ from the ones displayed in the in-depth review 2024.
(2) Both for the NFC and HH debt projections, the baseline refers to the country-specific median annual credit flow to GDP ratio over 2015-24. The high/low credit scenario assumes a higher/lower credit flow to GDP ratio, with the difference to the baseline calculated as half the intertercile range of the annual credit flow to GDP ratios over 2015-24. The high GDP growth scenario reflects a permanent 1 pp increase in GDP growth relative to the baseline scenario. The low inflation scenario reflects an inflation rate that is set to the country-specific average inflation rate observed over the 2010s.
(3) The baseline projection for government debt is stress-tested against four alternative deterministic scenarios to assess the impact of changes in key assumptions: 'historical structural primary balance (SPB)' scenario, in which the SPB returns to its historical 15-year average of 1% of GDP; 'lower SPB' scenario: the SPB in 2025 deteriorates by 50% more than in the forecast; 'adverse interest-growth rate differential' scenario: the interest-growth rate differential is 1 pp. higher compared with the baseline; 'financial stress' scenario: interest rates temporarily increase by 1 pp. compared with the baseline.
***Source:*** Eurostat, Post-Programme Surveillance Report - Cyprus, Autumn 2024 - Institutional Paper 298, and European Commission forecasts and calculations.

*(Continued on the next page)*

Table 2.1: **Key economic and financial indicators, Cyprus**

| | average 2017-2019 | average 2020-2022 | 2023 | 2024 + | forecast 2025 | 2026 |
|---|---|---|---|---|---|---|
| **Output and Prices** | | | | | | |
| Real GDP (1 year % change) | 6.0 | 5.0 | 2.6 | 3.6 | 2.8 | 2.5 |
| Real GDP per capita (1 year % change) | 4.7 | 3.8 | 1.0 | 2.2 | 1.8 | 1.5 |
| GDP deflator (1 year % change) | 1.1 | 2.8 | 3.8 | 3.5 | 2.3 | 2.2 |
| Harmonised index of consumer prices (1 year % change) | 0.7 | 3.0 | 3.9 | 2.3 | 2.1 | 2.0 |
| Core inflation (HICP excluding energy, food, alcohol and tobacco) (1 year % change) | 0.5 | 1.8 | 3.8 | 2.6 | 2.5 | 2.4 |
| **External position** | | | | | | |
| **Current account balance, balance of payments (% GDP, 3y average)** | **-4.1** | **-6.7** | **-6.7** | **-8.0** | **-9.0** | **-8.6** |
| Current account balance, balance of payments (% of GDP) | -4.8 | -6.8 | -9.5 | -9.2 | -8.4 | -8.2 |
| of which: trade balance (% GDP) | 0.7 | 2.2 | 1.3 | | | |
| of which: income balance (% GDP) | -5.5 | -9.0 | -10.7 | | | |
| Current account norm (% of GDP) (1) | -2.4 | -2.5 | -2.6 | -2.6 | -2.4 | -2.3 |
| Current account req. to reach fund. NIIP (% of GDP) (2) | -1.1 | -1.1 | -0.1 | 0.1 | | |
| **Net international investment position (% of GDP)** | **-124.9** | **-108.2** | **-92.7** | **-84.4** | **-84.0** | **-83.6** |
| NENDI - NIIP excluding non-defaultable instruments (% of GDP) | -319.6 | -213.2 | -133.8 | | | |
| Net lending-borrowing (% of GDP) | -4.5 | -6.7 | -9.6 | | | |
| **Competitiveness** | | | | | | |
| **Nominal unit labour cost index per hour worked (3y % change)** | **0.3** | **5.4** | **3.7** | **11.5** | **9.0** | **6.5** |
| Nominal unit labour cost index per hour worked (1 year % change) | 2.2 | 1.2 | 3.8 | 3.4 | 1.5 | 1.5 |
| **Real effective exchange rate - 42 trad. part., HICP defl. (3y % ch.)** | **-1.5** | **-1.9** | **0.3** | **1.0** | **-2.1** | **-0.5** |
| Real effective exchange rate - 42 trading partners, HICP deflator (1 year % change) | -0.1 | -1.0 | 3.7 | 0.4 | -0.2 | 0.0 |
| **Export performance against advanced economies (3y % change)** | **14.3** | **28.5** | **17.4** | **12.3** | **9.8** | **9.9** |
| Export performance against advanced economies (1 year % change) | 4.5 | 9.1 | 2.9 | 155.1 | 37.3 | 4.1 |
| Core inflation differential vis-à-vis the euro area (pps.) | -0.6 | -0.2 | -1.1 | -0.2 | 0.0 | 0.3 |
| **Corporations** | | | | | | |
| **Non-financial corporate (NFCs) debt, consolidated (% of GDP) (3)** | **191.3** | **161.0** | **130.2*** | **120.2*** | | |
| NFCs debt fundamental benchmark (% of GDP) (4) | 141.6 | 138.3 | 128.6 | 124.8 | | |
| NFC (excl. FDI) credit flow, cons. (% debt stock t-1, excl. FDI) | 3.2 | 0.1 | 0.2 | -1.9 | | |
| **Households and housing market** | | | | | | |
| **Household debt, consolidated (% of GDP) (3)** | **96.4** | **79.4** | **64.3*** | **58.9*** | | |
| Household debt fundamental benchmark (% of GDP) (4) | 90.8 | 93.7 | 90.3 | 89.1 | | |
| Household debt, consolidated (% of Households' GDI) | 128.7 | 99.6 | 83.7 | 76.7 | | |
| **Household credit flow, consolidated (% debt stock t-1)** | **1.3** | **1.7** | **1.0** | **0.3** | | |
| Household gross saving rate (&) | 4.3 | 13.6 | 9.9 | | | |
| **House price index, nominal (1 year % change)** | **2.6** | **-0.3** | **2.9** | | | |
| House prices over/undervaluation gap (5) | -4.6 | -10.9 | -13.0 | | | |
| Standardized price-to-income ratio | 93.6 | 79.1 | 71.1 | | | |
| Building permits (m2 per 1000 inh) | 1764.2 | 2092.8 | 2103.3 | | | |
| **Government** | | | | | | |
| **General government gross debt (% of GDP)** | **94.4** | **97.0** | **73.6** | **66.4** | **61.4** | **56.7** |
| General government balance (% of GDP) | -0.1 | -1.5 | 2.0 | 3.5 | 2.7 | 2.7 |
| **Banking sector** | | | | | | |
| Return on equity of banks (%) | -0.4 | 0.8 | 21.8 | | | |
| Tier-1 capital ratio banking sector (% risk-weighted assets) | 16.8 | 19.4 | 23.4 | | | |
| Gross non-performing loans, domestic and foreign entities (% gross loans) | 23.0 | 7.0 | 3.7 | 3.3 | | |
| Cost of borrowing for households for house purchase (%) | 2.4 | 2.3 | 4.2 | 4.5 | | |
| Cost of borrowing for NFCs (%) | 3.6 | 3.2 | 5.5 | 5.4 | | |
| **Labour market** | | | | | | |
| **Unemployment rate (% labour force Y15-74)** | **8.9** | **7.0** | **5.8** | **4.9** | **4.7** | **4.5** |
| **Labour force participation rate - % pop. aged 15-64 (3y change in pp)** | **1.5** | **2.6** | **3.1** | **2.1** | **0.6** | **-0.2** |

+ If actual data were unavailable at the cut-off date, forecast or nowcast data are presented instead; * Denotes values above prudential thresholds;

(1) Current accounts in line with fundamentals (current account norms): derived from reduced form regressions capturing the main determinant of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.

(2) Current account required to reach the prudential level of the NIIP over 10 years: calculations make use of Commission's T+10 projections. See Coutinho, Turrini and Zeugner (2018), "Methodologies for the Assessment of Current Account Benchmarks", European Economy, Discussion Paper 86, DG ECFIN, European Commission.

(3) Prudential threshold for non-financial corporate and household debt-to-GDP ratio: corresponds to the level above which banking crises become more likely. It is derived from regressions minimising the probability of missed crises and that of false alerts. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.

(4) Fundamentals-based benchmarks for non-financial corporate and household debt-to-GDP ratios: assesses private debt from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. See Bricongne et al. (2020), "Is Private Debt Excessive?", Open Economies Review, 31:471-512.

(5) House prices over/undervaluation gap: is the simple average of the price-to-income, price-to-rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. Based on Philiponnet, N., Turrini, A. (2017), "Assessing House Price Developments in the EU", European Economy - Discussion Papers 2015 - 048, DG ECFIN, European Commission.

***Source:*** Eurostat and ECB; European Commission for forecast figures (Autumn Forecast 2024).

**The financial health of Cypriot banks began to show clear signs of strain, mainly as a result of non-performing loans (NPLs), as early as 2010 leading to the banking crisis of 2012 - 2013.** The rapid rise in NPLs eroded bank solvency as asset quality continued to decline. Provisioning for these impaired loans was insufficient, covering only about one-third of their value. As a result, bank profitability turned negative, resulting in an erosion of capital. The recessionary economic environment, falling real estate prices, defaults by over-indebted borrowers and the ineffective foreclosure and insolvency frameworks drove NPLs to very high levels, exceeding 50% of total loans in 2015. In response, as part of the economic adjustment programme, credit standards and supervisory guidelines were tightened, resulting in a relatively low default rate of loans issued after the financial crisis and higher resilience of the banks in Cyprus. Despite recent economic shocks, Cypriot banks maintained asset quality and contained new NPL inflows. Loans at risk of becoming non-performing (stage 2 loans) [18] have been steadily decreasing over the years representing less than 8% of total loans in 2024 and standing below the EU average of 9%. The majority of NPLs present in the Cypriot economy today are legacy loans originating during the financial crisis (Graph 2.2.b).

**Over the past several years, Cyprus has made substantial progress in reducing these legacy NPLs by moving them away from the banking sector.** In 2018, KEDIPES was set up as a state-owned credit acquiring company (CAC), with a view to manage and monetise NPLs and real estate assets which were transferred from the liquidated Cyprus Cooperative Bank (CCB). KEDIPES purchased the NPL portfolio at a discount, where the government financed the difference between the nominal value and the discounted price. This transaction was paid and recorded in the 2018 general government debt level. This implies that, despite the state guarantee for KEDIPES, the fiscal risks for the government are very limited. By mid-2024, KEDIPES resolved 26% of its NPL portfolio and a full resolution of its remaining EUR 5 billion NPL portfolio is expected by 2030 (Graph A.1.b).

**In the meantime, other CACs emerged in the market which bought up large portions of NPLs from banks.** The Central Bank of Cyprus issued licenses for 10 CACs [19], and 4 credit servicers, which are for the major part owned by international investment funds. The foreign ownership of these CACs (excluding KEDIPES), whose NPL portfolios account to 44% of GDP (EUR 14.87 billion), helps diversify the risks away from the Cypriot financial sector and has implications for the current account balance [20].

**In total, 92% of Cyprus's total NPL stock (€19.66 billion or 58% of GDP) is held by CACs.** Approximately 85% of this NPL stock is collateralised by real estate (35% primary residences) with 50.6% of the stock representing household loans. High real-estate collateralisation of these NPLs may have some effect on the supply and price of both commercial and residential real estate, however there are no indications of overvaluation in the market, despite rising housing prices.

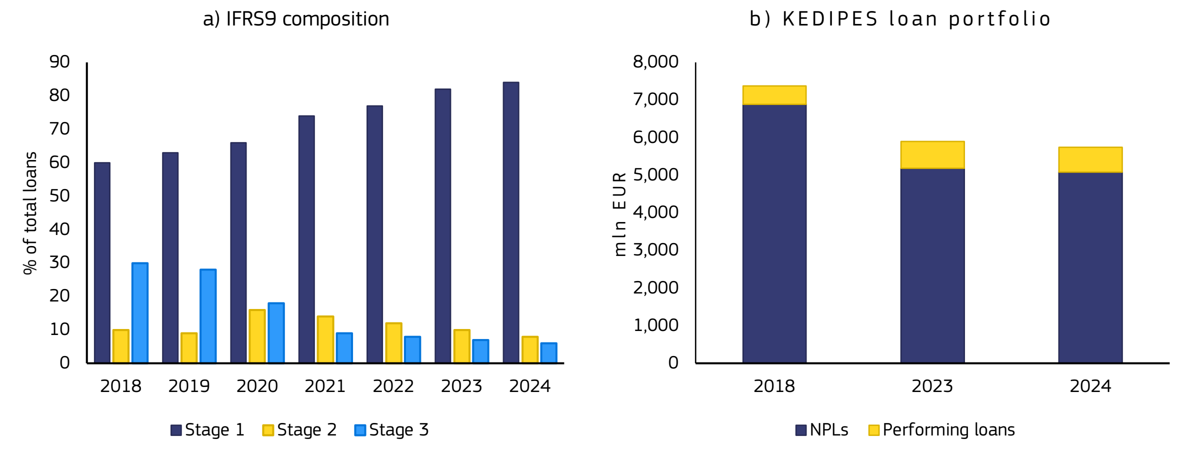
[18] Stage 1 assets are financial instruments that either have not deteriorated significantly in credit quality since initial recognition or have low credit risk; Stage 2 assets are financial instruments that have deteriorated significantly in credit quality since initial recognition but offer no objective evidence of a credit-loss event; Stage 3 loans are considered to be credit-impaired (i.e. a credit loss has occurred). Credit-impaired is usually a wider definition than '90 days past due'.

[19] According to EU directive 2021/2167 and amending directives on credit servicers and credit purchasers, regulation introduced new rules addressing situations where NPL stocks become too high on credit institutions' portfolios. According to this directive, where NPLs become a significant and broad-based problem, Member States would be able to set up national asset management companies or other alternative measures within the framework of current state aid and bank resolution rules. This Directive enables credit institutions to either: (i) outsource the servicing of those loans to a specialised credit servicer (thereunder: "credit servicers") or (ii) to transfer the credit agreement to a credit purchaser that has the necessary risk appetite and expertise to manage it (thereunder: "credit acquiring companies" or "CACs").

[20] A more detailed analysis can be found in the NIIP paragraph in section 2.1 above.

These NPLs are no longer part of the banking system, thereby alleviating risks to financial stability, as they have been transferred to CACs, where they are owned, serviced, and accounted for on their balance sheets. By purchasing NPLs at a discount, CACs make a profit even if they recover only part of the original loan amounts, limiting financial risks. CACs have accelerated their loan workout activities since 2022, achieving around €3.5 billion in recoveries from 2021 to Q1 2024). Loan workouts are mostly driven by loan repayments (62%), debt-to-asset swaps (28%) and the foreclosure process (10%).

Graph A.1: **Loan classification in in banks and loan resolution in CACs**

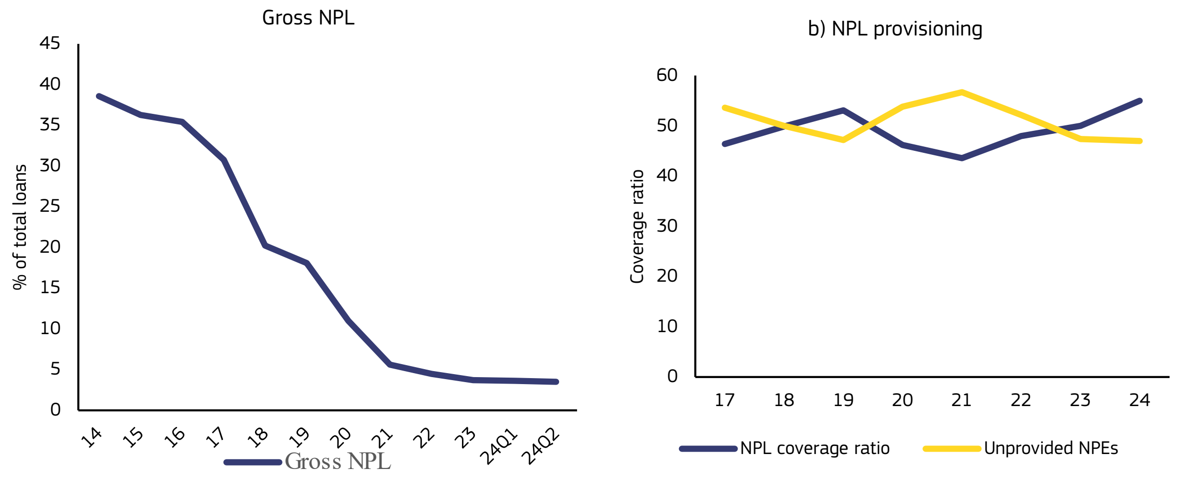



***Source:*** Central Bank of Cyprus and KEDIPES.

**Besides the sale of NPL portfolios to CACs, banks at the same time managed to further decrease NPLs through write-offs and loan repayments.** Over time, the NPL portfolio in the banking sector decreased to 8% of the economy's total legacy NPLs (€1.637 billion or 4% of GDP). The NPL ratio as defined by the European Banking Authority (including loans and advances to central banks and credit institutions) [21] also reached a historic low of 3.3% in 2024 (Graph A.2.a). The primary driver behind the reduction of legacy NPLs in the banking sector have been systemic institutions (SIs), which have over the period 2020-2024 achieved an average annual 36% deleveraging rate (calculated as the year-on-year reduction in NPLs), reducing their NPL ratio to a historic low of 2.4%, exactly aligned with the EU average. Less significant institutions (LSIs), however, holding 29% of the banking sector's legacy NPLs (approximately 1% of GDP), have made slower progress in their NPL reductions. This is mostly linked to the smaller size of their individual portfolios, limiting their liquidity. Positively, LSIs have achieved some progress in the deleveraging of their NPL stock, especially over the last few years (20% annually). Improved deleveraging, high provisioning of NPLs (around 50%), strong capital positions, high profitability, and low amounts of stage 2 loans (the majority of them concentrated only in one LSI) skew the risks to the LSIs deriving from their almost 21% NPL ratio (including loans to central bank) to the downside. Cypriot banks have substantially strengthened their NPL provisioning, with the NPL coverage ratio standing well above the EU average at 55% in 2024 and unprovided NPLs falling to their lowest level ever observed at €800 million in mid-2024 (Graph A.2.b), minimising the risks of legacy NPLs to the banking sector.

[21] The EBA definition allows for a better comparison in NPL ratios across EU countries. The definition differs from the NPL ratio used in the Post-Programme Surveillance Cyprus Report, which is a more prudent definition as it excludes loans and advances to central banks and credit institutions that present no arrears and are highly sensitive to fluctuations. This is the definition used by the Central Bank of Cyprus. The NPL ratio under this definition was 6.1% in Q2 2024.

Graph A.2: **Cyprus Banking Sector: NPL Levels and Provisioning Trends**




***Source:*** Central Bank of Cyprus and ECB.

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