



Interim Report 2026

of the Fiscal Council of Cyprus (FCC)

- SUMMARY -

Sound fiscal indicators, long-standing challenges

- the major test for the Cyprus economy -



SUMMARY

Key message

The Cyprus economy continues to record satisfactory macroeconomic and fiscal performance, with one of the highest growth rates in the European Union (EU) during 2023-2025, fiscal surpluses and a rapid decline in public debt, despite the adverse geopolitical and energy environment.

These favourable conditions should not lead to complacency. They must be, instead, used as an opportunity for targeted interventions and structural reforms, so that long-standing weaknesses in the economy do not translate into permanent fiscal costs.

1. Introduction

This Interim Report assesses the macroeconomic and fiscal developments in the Cyprus economy during 2025 and the outlook for 2026-2027.

More specifically, the Report examines the developments and forecasts of the main macroeconomic aggregates, as well as fiscal developments based on the State Budget and General Government data. It also assesses the compliance of public finances with the established ceilings for the fiscal deficit and public debt, as well as the consistency of the fiscal trajectory with the applicable European and national fiscal frameworks.

In parallel, the Report assesses the main fiscal policy measures and their implications for medium- and long-term fiscal sustainability, as well as their contribution to economic growth, social cohesion, addressing the effects of climate change, and the quality of public goods. Taking the above into account, it sets out proposals and recommendations, aimed at sustaining the satisfactory macroeconomic performance of the Cypriot economy, while addressing long-standing structural challenges.

The Executive Summary in the following section provides a brief analysis of the key findings and recommendations and is intended for the public.

In the Greek version of the Interim Report 2026, the Summary is followed by chapters that present the analysis, key findings, and recommendations in greater detail and are intended for readers with specialized knowledge and interest in public finances. To assist the reader, each chapter begins with a boxed summary of its findings.

It is envisaged that the analytical chapters will provide a platform for a constructive dialogue and future interventions by members of the Fiscal Council of Cyprus (FCC), officials of the competent authorities across the broader public sector and interested economists.

2. Executive Summary

Summary of Macroeconomic Developments

The Cyprus economy maintained its growth momentum in 2025, with real GDP growth at 3.8%, compared with 3.9% in 2024, remaining among the highest rates in the EU. Growth was driven mainly by private consumption and exports of services, particularly information and communication services and tourism.

In the first quarter of 2026, the Cypriot economy recorded growth of 3% compared with the corresponding quarter of 2025¹. For the year, growth is expected to remain at around 3%². Geopolitical instability in the Middle East continues to pose a significant downside risk to Cyprus's macroeconomic outlook. Heavy dependence on imported energy and the economy's openness, increase its exposure to any renewed escalation through higher energy and transport prices and weaker external demand, creating downside risks to growth and upside risks to inflation. In addition, the upward trend in US government bond yields is exerting upward pressure on sovereign bond yields more broadly and constituting an additional challenge.

Over the medium term, growth is expected to remain at around 3%, provided there is no escalation in geopolitical tensions in the Middle East and no further deterioration in the external environment.

The satisfactory growth performance in 2025 was accompanied by employment growth of approximately 3.5% while unemployment remained at a historically low level of 4.4%. During 2026, unemployment declined further to 3.6% in the second quarter³, while the annual rate is projected at 4.2%. The coexistence of low unemployment and a high number of vacancies confirms mismatches between available skills and business needs. At the same time, annual employment growth is expected to slow markedly, to 1.3%. These developments indicate that further long-term growth cannot rely primarily on the continued expansion of employment. Higher productivity, skills upgrading, greater specialization of the workforce, increased productive investment, and the broader adoption of new technologies are required.

Inflation declined to 0.8% in 2025, mainly owing to lower international energy and goods prices.

However, upward pressures re-emerged in early 2026, with the annual rate of change in the Harmonized Index of Consumer Prices (HICP) reaching 5.2% in August compared with August 2025, amid significant

¹ Statistical Service of Cyprus, Quarterly National Accounts: Q1 2026.

² For consistency of presentation, the Executive Summary uses as its baseline the latest available forecasts of the European Commission, as presented in the Spring 2026 Economic Forecast and the AMECO database, together with the latest International Monetary Fund forecasts (Cyprus: 2026 Article IV Consultation, IMF Country Report No. 26/145). By way of exception, the 2026 growth estimate has been updated by the FCC on the basis of the latest available data from the Statistical Service of Cyprus, which differ from the European Commission forecast.

³ Unemployment rate based on the Labour Force Survey of the Statistical Service of Cyprus, press release of 27 August 2026, not seasonally adjusted (<https://www.cystat.gov.cy/el/PressRelease?id=73312>)

increases in energy and services prices⁴. For 2026, inflation is projected at 3.6%, before declining to around 2.2% in 2027. Core inflation is expected to rise to 2.3% in 2026, reflecting mainly persistent services price pressures and indirect effects from higher energy costs, before edging down to 2.2% in 2027⁵. At the same time, housing affordability pressures are intensifying, particularly for younger and lower-income households, warranting closer monitoring of housing market developments.

In the external sector, exports of services continue to expand rapidly and remain the principal driver of economic activity.

Nevertheless, the current account deficit is projected to widen from 6.4% of GDP in 2025 to 7.2% in 2026. The persistently negative primary income balance is a key explanatory factor, while the projected deterioration in 2026 is also linked to higher energy import costs and weaker tourism activity.

It should be noted, however, that a significant share of primary income outflows relates to so-called reinvested earnings, namely profits generated by Cypriot companies with foreign shareholders. These outflows arise from their statistical treatment in the balance of payments and are offset by corresponding direct investment inflows recorded in the financial account. This limits the immediate financing risk; however, it does not alter the fact that a significant share of income generated domestically accrues to non-residents.

At the same time, foreign capital inflows, including investment in real estate, contribute to financing the current account deficit, without making a commensurate contribution to productivity or the economy. Priority should therefore be given to attracting and channeling investment into activities that expand productive capacity, strengthen energy autonomy and increase national income.

Summary of Fiscal Developments

The FCC's assessment is not confined to describing fiscal developments. It focuses on the sustainability and composition of fiscal policy, the identification of any deviations from agreed fiscal targets, and policy priorities in the context of the 2027 Budget and the medium-term framework for 2027-2029.

Cyprus's fiscal position remains favourable. The General Government surplus stood at 3.4% of gross domestic product (GDP) in 2025, while the primary surplus stood at 4.6%⁶.

The positive fiscal picture should, however, also be considered in light of the persistently low implementation rate of the development budget. In the first half of 2026, implementation stood at 25% (€412.4 million against a total budget of €1.62 billion), the same rate as in the corresponding period of 2025 and close to the 22% average of the past decade.

⁴ Eurostat, Euro area annual inflation up to 3.3% - flash estimate, August 2026, 1 September 2026. The 5.2% rate for Cyprus is a preliminary estimate (<https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-01092026-ap>).

⁵ Central Bank of Cyprus, Macroeconomic Forecasts for the Cypriot Economy, June 2026.

⁶ A primary surplus is the positive difference between total General Government revenue and total expenditure, excluding interest payments on public debt. It is a key fiscal indicator because interest expenditure stems from past borrowing decisions and market conditions and is not controlled by current fiscal policy; the primary balance therefore isolates the part of the balance shaped by current policy choices.

Revenue growth remained positive but slowed owing to lower inflation, the normalization of activity in construction and real estate, and relief measures under the tax reform. According to the 2026 Annual Progress Report⁷, the tax reform is estimated to result in a net reduction in public revenue of approximately €284 million in 2026, equivalent to around 0.7% of GDP. At the same time, the social and redistributive dimension of the tax reform appears limited, as a significant share of tax relief is not targeted at lower-income groups but also extends to middle- and higher-income households.

Public expenditure increased, mainly owing to faster implementation of EU-funded investments and higher spending on wages and social transfers. The projected decline in the fiscal surplus in 2026 does not reverse the overall positive fiscal position. Over the medium term after 2026, there is scope for a gradual and carefully calibrated reduction in surpluses, provided that available fiscal space is channeled towards productive public investment and better-targeted social interventions, rather than wage expenditure and across-the-board and permanent benefits that increase expenditure rigidities.

Public debt declined from its peak of more than 114% of GDP in 2020 to 55% in 2025, below the 60% reference value, and is expected to continue on a downward path. The decline in debt reflects sustained primary surpluses, satisfactory nominal growth⁸, and favourable financing conditions. Although debt sustainability risks are low, available fiscal space is not unlimited. Maintaining fiscal discipline is particularly important during periods of heightened electoral pressure.

International empirical literature does not support the proposition that pre-election fiscal relaxation increases the likelihood of electoral success. On the contrary, in advanced and established democracies, a deterioration in the fiscal balance has been associated with a lower probability of re-election⁹.

Future pressures arising from population ageing and climate adaptation make it necessary to maintain adequate buffers and avoid new permanent current expenditure.

Regarding pension reform, the FCC takes a broadly positive view of its main directions, particularly maintaining the statutory retirement age at 65 and strengthening support for low-income pensioners and the basic pension. It nevertheless considers a full and transparent presentation of the cost and financing sources to be essential. The FCC also considers it critical to link the statutory retirement age to life expectancy, as provided for by law, and to implement the planned contribution increases in 2029, 2034 and 2039. Moreover, the gradual extension of the second pension pillar, namely occupational provident funds, to achieve universal labour-force coverage is crucial for pension adequacy.

Developments in major energy projects constitute an additional source of fiscal uncertainty, particularly the completion of the liquefied natural gas (LNG) import terminal at Vasilikos and the Great Sea Interconnector (GSI). Delays, uncertainty regarding final costs and implementation schedules, and any additional financing needs require close monitoring of potential fiscal exposure. Any decision on additional public financing or other State support should be based on an updated technical and

⁷ Ministry of Finance, Cyprus Annual Progress Report 2026, April 2026.

⁸ Nominal growth is the annual percentage change in GDP at current prices and incorporates both the change in the real volume of output and the change in prices. GDP at current prices increased from €34,770.2 million in 2024 to €36,483.5 million in 2025.

⁹ Brender, A. and Drazen, A. (2008), "How Do Budget Deficits and Economic Growth Affect Reelection Prospects? Evidence from a Large Panel of Countries", *American Economic Review*, 98(5), 2203-2220. The study covers 74 countries over 1960-2003, including Cyprus, and finds no evidence that creating fiscal deficits increases the likelihood of re-election. In advanced countries and established democracies, fiscal deterioration is instead associated with a lower probability of re-election.

economic feasibility study demonstrating the project's viability and clearly identifying the amount and form of public support required to ensure that viability.

At the same time, timely project completion is important for helping to address Cyprus's water-related challenges, diversifying energy supply and increasing the use of renewable energy sources.

High energy costs remain a significant constraint on economic competitiveness and households' disposable income, while increasing inflation's sensitivity to external energy shocks.

Regarding climate risks, recent indicative estimates at constant 2023 prices place the annual economic cost of key physical climate risks at approximately €50 million in 2026 and between €0.70 billion and €1.26 billion in 2050. Although these amounts do not correspond in full to public expenditure, they highlight the need to incorporate climate risks into long-term fiscal planning at an early stage and to assess the State's potential financing needs through 2050¹⁰.

Main structural weaknesses and risks

Despite the overall positive picture, significant long-standing structural weaknesses remain:

- low labour productivity growth across the economy and mismatches between available skills and labour-market needs;
- delays in implementing major development projects and a failure to complete Recovery and Resilience Plan projects on time;
- limited redistributive effectiveness of social expenditure;
- delays in the administration of justice;
- a high stock of non-performing loans outside the banking system;
- limited credit intermediation, particularly for innovative activities;
- high energy dependence, resulting in high energy costs; and
- underperformance in research, innovation, and technology adoption.

Prolonged delays in the administration of justice are of particular importance, as they impede the effective functioning of public administration while also burdening the private sector and the business environment. Accelerating the administration of justice is therefore an important prerequisite for strengthening institutional effectiveness and economic competitiveness.

Additional risks arise from protracted geopolitical instability and the consequent slowdown in the growth of key trading partners.

Against this background, maintaining fiscal stability must go hand in hand with improving the quality of public expenditure and investment, enhancing the effectiveness of social protection, and accelerating reforms that strengthen the economy's productivity and resilience.

¹⁰ The Cyprus Institute, Climate physical costs for Cyprus (2026). Note: Annual estimates in millions of euro, at constant 2023 prices. The two tourism estimates are alternative scenarios and should not be added together.



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September 2026 edition