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Country Report Cyprus 2015

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EXECUTIVE SUMMARY

Although the external environment is unfavourable, Cyprus' macroeconomic outlook shows signs of stabilisation. The recession is gradually losing momentum, and real GDP has contracted by 2.4%, i.e. significantly milder than the 5.4% contraction in 2013. While the resilience in private consumption continued in 2014, investment, particularly in construction, continued its downward adjustment. Despite the fall in activity, the unemployment rate has stabilised and has registered 16.1% of the labour force during the first part of 2014. In 2015 and 2016, growth is forecast to resume only gradually as private domestic demand slowly picks up, supported by lower energy prices. External demand is expected to be negatively affected by the deterioration of the economic situation in Russia. Negative risks remain however, notably due to a potentially more extended period of tight credit supply and a worse-than-expected deterioration of the economic situation in Russia.

Fiscal consolidation remains necessary. Building on the strong fiscal performance to date, the authorities would need to maintain prudent budget execution. As agreed at the start of the programme, an additional adjustment will be necessary towards the end of the programme to attain the long-term objective of a sustained 4% of GDP primary surplus, which is needed to place public debt on a sustainable downward path. The 2014 primary balance could be significantly better than the end-year primary target (of -1.2% of GDP). However, the statistical accounting of the cooperative banking sector recapitalisation in early 2014 could have a one-off negative impact amounting to several percentage points of GDP.

Although there has been progress on various fronts, compliance with programme conditionality in some fiscal structural and structural reforms is lagging behind schedule. Progress has been made, notably with the adoption of the welfare reform, the adoption of the medium-term debt management strategy and risk assessment of government guarantees, and on international tax cooperation, which could reverse the negative rating by the Global Forum. Measures to facilitate employment and to mitigate the negative social effects of unemployment have been partially implemented, albeit at a slow pace. However, some delays have accumulated since September 2014, particularly on healthcare reform,

privatisation, revenue administration, and public administration reform.

The banking sector has gradually stabilised. The outcome of the Comprehensive Assessment by the European Central Bank was positive with only one bank requiring additional capital that could be met with private capital. As a result, deposit outflows continue, but they have stabilised. Capital controls on domestic transactions have been abolished and the controls on external transactions are now being gradually phased out.

The most pressing challenge going forward is to reduce the excessively high level of non-performing loans in the banking sector, which will be key in restoring bank intermediation functions and thereby supporting investment growth. Non-performing loans are still on the rise, reaching 48.5% of outstanding loans in September and 49.7% in November 2014. Bank restructuring of these loans remains very slow. Two key measures in this regard are the proper implementation of the foreclosure law (which allows a bank to seize real estate collateral) and a modern insolvency framework for individuals and companies. These two legal frameworks are needed to create incentives for both debtors and creditors to agree on debt restructuring. The foreclosure law has been adopted, albeit with delay, thereby postponing the conclusion of the fifth review, as it was one of the prior actions for concluding the review. However, the House of Representatives has further postponed the implementation of the Law. Concerning the insolvency framework, most draft laws have been sent to Parliament, but work on the new personal insolvency framework process is not as advanced.

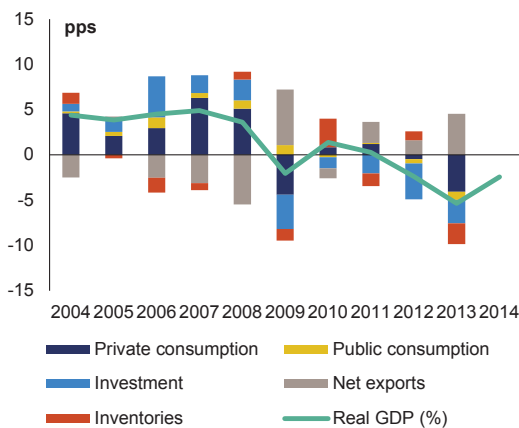
There is an urgent need to step up the momentum of structural reforms, notably in the areas of public administration, privatisation, healthcare, liberalisation of regulated professions, and energy, if substantial progress is to be achieved by the end of the programme in March 2016. This would also help a revival of productive investment, one of the key priorities of the new Commission.

1. SCENE SETTER: ECONOMIC SITUATION AND OUTLOOK

The recession moderated in 2014, with real GDP down by -2.4%, which is significantly less than the -5.4% contraction in 2013. While the resilience in private consumption continued in 2014, exports weakened, particularly to Russia. Imports, however, increased, following their weak level in 2013 while also reflecting one-off purchases, and leading to a deterioration of the current account balance.

Gross fixed capital formation declined further in 2014, although at a slower pace than in 2013. Investment in construction was particularly weak, dragging down investment to 12% of GDP. Equipment and other investments also fell, partly reflecting the low use of production capacity and lack of credit.

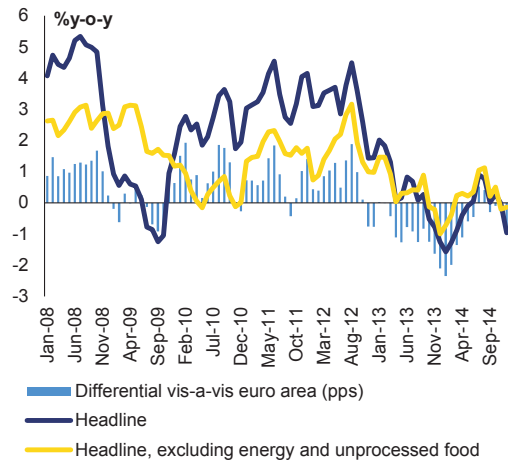
Graph 1.1: Real GDP growth and contributions



Source: European Commission

Low domestic cost pressure and declining energy prices weighed on the Harmonised Index of Consumer Prices inflation, which turned negative in 2014 (-0.3%). Harmonised Index of Consumer Prices inflation has been supported by prices on goods consumed by tourists, while prices of goods consumed mostly by residents have continued to fall.

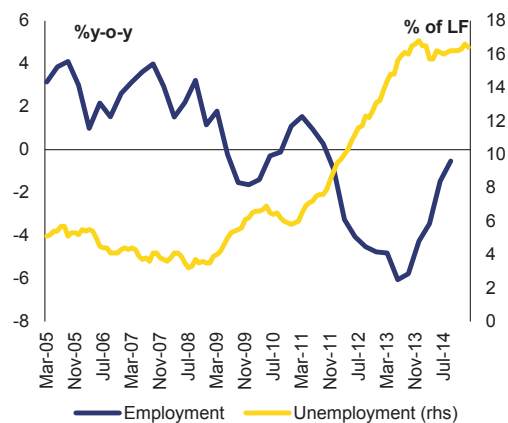
Graph 1.2: Harmonised Index of Consumer Prices



Source: European Commission

Signs of a stabilising labour market emerged in the course of 2014, with the unemployment rate registering 16.1%. Employment continued to contract, albeit at a slower pace. Youth unemployment reached 40% towards the end of 2013, but has since then declined, while long term unemployment continued its upward trend.

Graph 1.3: Employment and Unemployment



Source: European Commission

The housing market continued its adjustment in the course of 2014, bringing the cumulative fall in prices since mid-2008 to around 30%. The

fundamentals for housing demand remain weak. Labour income is still falling, credit for house purchases remains limited, and lending rates remain high.

In 2015 and 2016, growth is forecast to resume only gradually as private consumption slowly picks up, supported by lower energy prices. This should be accompanied by gradual deleveraging of both households and corporates and a reduction of the non-performing loan ratio down to more sustainable levels. Investment is forecast to start recovering modestly in 2015 and 2016, supported by ongoing work on rebuilding a sound banking system. The economic recession in Russia is forecast to weigh on export growth and to more than offset the positive impact on demand from lower energy prices. Import growth is forecast to gradually pick up and, as a result, the current account deficit is foreseen to hover around 4-5% of GDP in 2015 and 2016. ⁽¹⁾ The moderate pick-up in domestic demand is expected to be reflected into improved labour market conditions, with unemployment starting to ease gradually. Harmonised Index of Consumer Price inflation is also expected to remain low, weighed down by recent declines in oil prices.

Risks to the recovery are tilted to the downside.

On the domestic front, a failure to reduce the high non-performing loan ratio could lead to a more prolonged period of tight credit supply conditions, stalling the economic recovery. On the external side, a further deterioration of the economic situation in Russia would weight on GDP growth via its impact on tourism and professional services.

Fiscal consolidation continued over the course of 2014. Preliminary data for 2014 suggests that the general government primary balance has performed better than expected in the context of the Commission's Winter Forecast 2015 (presented in the table below) and shall exceed the programme targets set in July 2014. However, depending on the Eurostat decision on the statistical treatment of the cooperative banking sector recapitalisation, which is likely increase the headline deficit by some percentage points of

⁽¹⁾ The recent revisions of the balance of payments, in accordance with the Balance of Payments Manual 6 (BPM6) have led to a 1.3pps. downward revision of the current account balance.

GDP, the headline deficit may still exceed the EDP benchmark of 3% of GDP.

The fiscal performance for 2014 was equally driven by revenue and expenditure developments. Revenue increased compared to 2013, driven by consolidation measures, high dividends from the Central Bank of Cyprus, and more resilient private consumption than initially anticipated. Total expenditure remained on a clear declining path, despite the adverse impact of called government guarantees. This largely reflects tight expenditure control, as a measure under Cyprus' economic adjustment programme, aiming at reducing the public sector wage bill and moderating early retirements in the public sector, as the cost of lump-sum pension payments has been reduced.

Further gradual fiscal adjustment is expected in 2015 and 2016, reflecting the impact of enacted consolidation measures and gradually improving economic conditions. The debt-to-GDP ratio is expected to peak in 2016 and to gradually reduce to below 100% by 2020.

Box 1. Programme surveillance

As for all Member States benefiting from a financial assistance programme, progress in implementing the accompanying policy programme in Cyprus is monitored in a regular and specific manner, in line with the provisions of the Memorandum of Understanding. This Country Report, which is part of the 2015 European Semester procedure, provides a synthesis of recent progress in implementing the programme. More details can be found in the reports on the state of implementation, which the European Commission publishes following each programme review mission.⁽²⁾ Given the extensive reporting requirements under financial assistance programmes, as well as their strict monitoring and enforcement, programme countries are exempt from the obligation to submit national reform programmes and stability or convergence programmes (Regulation (EU) No 472/2013, Article 10(1)). However, countries with a financial

⁽²⁾ These reports, along with other information related to the financial assistance programme, can be found on: http://ec.europa.eu/economy_finance/assistance_eu_ms/cyprus/index_en.htm

assistance programme have been asked to present the standard fiscal tables and report on the Europe 2020 targets.

Following the request made by Cyprus on 25 June 2012, the European Commission, the European Central Bank, and the International Monetary Fund negotiated an Economic Adjustment Programme with the Cypriot authorities. It was approved by the European Stability Mechanism on 24 April 2013 and by the International Monetary Fund board on 15 May 2013. The programme covers the period of 2013-2016. Its financial package covers up to EUR 9 billion provided by the European Stability Mechanism and EUR 1 billion by the International Monetary Fund. So far, a total of EUR 6.1 billion has been disbursed (EUR 5.7 billion from the European Stability Mechanism and EUR 428 million from the International Monetary Fund).

The main objectives of the programme build on three fundamental pillars: (i) policies to restore the soundness of the financial sector and rebuild depositors' and market confidence by thoroughly restructuring and downsizing financial institutions and strengthening supervision; (ii) continued fiscal consolidation in order to correct the excessive general government deficit by 2016 and put the gross public debt-to-GDP ratio on a clear downward path in the medium-term; and (iii) structural reforms to support competitiveness, to enable the economy to return to sustainable growth, and to unwind the macroeconomic imbalances.

Table 1.1: Key economic, financial and social indicators

	2008	2009	2010	2011	2012	2013	Forecast		
							2014	2015	2016
Real GDP (y-o-y)	3.6	-2.0	1.4	0.3	-2.4	-5.4	-2.8	0.4	1.6
Private consumption (y-o-y)	8.0	-6.6	1.3	1.8	-0.7	-6.0	-1.2	-0.5	1.1
Public consumption (y-o-y)	5.7	6.4	-1.4	0.7	-2.7	-4.9	-4.7	-0.9	-2.5
Gross fixed capital formation (y-o-y)	9.0	-13.9	-5.1	-9.4	-20.7	-17.1	-11.1	-1.6	4.5
Exports of goods and services (y-o-y)	-1.7	-7.3	2.6	4.2	-1.7	-5.0	0.3	2.0	2.6
Imports of goods and services (y-o-y)	7.7	-16.0	4.5	-0.6	-4.6	-13.6	-0.5	-0.1	1.3
Output gap	5.1	1.0	0.9	0.3	-1.3	-5.0	-6.0	-4.3	-1.7
Contribution to GDP growth:									
Domestic demand (y-o-y)	8.3	-7.1	-0.6	-0.7	-4.9	-7.6	-3.1	-0.7	0.9
Inventories (y-o-y)	0.8	-1.3	3.1	-1.4	1.0	-2.3	0.0	0.0	0.0
Net exports (y-o-y)	-5.5	6.1	-1.1	2.3	1.6	4.5	0.4	1.1	0.8
Current account balance (% of GDP), balance of payments	-15.61*	-10.73*	-9.83*	-3.36*	-6.86*	-3.0	.	.	.
Trade balance (% of GDP), balance of payments	-11.39*	-5.51*	-6.22*	-4.27*	-3.08*	0.1	.	.	.
Terms of trade of goods and services (y-o-y)	-1.7	0.4	-0.1	-0.4	-0.2	-0.7	-0.9	-0.3	0.0
Net international investment position (% of GDP)	-15.1*	-30.4*	-35.6*	-71.7*	-147.3	-156.8	.	.	.
Net external debt (% of GDP)	-4.0*	1.3*	8.0*	38.2*	36.6*	41.6*	.	.	.
Gross external debt (% of GDP)	447.4*	544.1*	491.9*	468.2*	508.8	436.3	.	.	.
Export performance vs advanced countries (% change over 5 years)	-3.7*	-0.6*	-12.0*	-8.9*	-19.1*	-22.0*	.	.	.
Export market share, goods and services (%)	0.1*	0.1*	0.1*	0.0*	0.0*	0.1	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	-0.9	4.6	5.5	3.5	-4.6	-16.0	.	.	.
Private credit flow, consolidated, (% of GDP)	37.4	12.8	22.2	22.2	-0.6	-11.2	.	.	.
Private sector debt, consolidated (% of GDP)	285.2	303.2	315.2	330.8	331.5	344.8	.	.	.
Deflated house price index (y-o-y)	1.2	-7.2	-7.7	-9.6	-1.6	-5.4	.	.	.
Residential investment (% of GDP)	12.2	9.8	7.9	6.1	4.9	3.9	.	.	.
Total financial sector liabilities, non-consolidated (y-o-y)	24.1	16.7	-5.7	-3.7	21.5	-19.5	.	.	.
Tier 1 ratio ¹	.	.	.	.	.	.	.	.	.
Overall solvency ratio ²	.	.	.	.	.	.	.	.	.
Gross total doubtful and non-performing loans (% of total debt instruments and total loans and advances) ²	.	.	.	.	.	.	.	.	.
Change in employment (number of people, y-o-y)	2.0	-0.4	-0.2	0.4	-4.2	-5.3	-1.8	0.2	1.3
Unemployment rate	3.7	5.4	6.3	7.9	11.9	15.9	16.2	15.8	14.8
Long-term unemployment rate (% of active population)	0.5	0.6	1.3	1.6	3.6	6.1	.	.	.
Youth unemployment rate (% of active population in the same age group)	9.0	13.8	16.6	22.4	27.7	38.9	35.5	.	.
Activity rate (15-64 year-olds)	73.6	73.0	73.6	73.5	73.5	73.6	.	.	.
Young people not in employment, education or training (%)	9.7	9.9	11.7	14.6	16.0	18.7	.	.	.
People at risk of poverty or social exclusion (% of total population)	23.3	23.5	24.6	24.6	27.1	27.8	.	.	.
At-risk-of-poverty rate (% of total population)	15.9	15.8	15.6	14.8	14.7	15.3	.	.	.
Severe material deprivation rate (% of total population)	9.1	9.5	11.2	11.7	15.0	16.1	.	.	.
Number of people living in households with very low work-intensity (% of total population aged below 60)	4.5	4.0	4.9	4.9	6.5	7.9	.	.	.
GDP deflator (y-o-y)	4.5	0.2	2.1	2.0	2.0	-1.4	-1.7	0.8	1.3
Harmonised index of consumer prices (HICP) (y-o-y)	4.4	0.2	2.6	3.5	3.1	0.4	-0.3	0.7	1.2
Nominal compensation per employee (y-o-y)	3.4	2.6	2.6	2.5	-0.8	-6.0	-4.6	0.2	1.2
Labour productivity (real, person employed, y-o-y)	1.6	-1.6	1.6	-0.2	1.8	-0.1	.	.	.
Unit labour costs (ULC) (whole economy, y-o-y)	1.8	4.3	1.0	2.7	-2.6	-5.9	-3.7	0.0	0.9
Real unit labour costs (y-o-y)	-2.6	4.1	-1.1	0.7	-4.6	-4.6	-2.0	-0.8	-0.5
REER ³⁾ (ULC, y-o-y)	0.4	1.5	-1.5	2.4	-5.6	-3.1	-4.0	-2.6	-0.3
REER ³⁾ (HICP, y-o-y)	-1.7	1.0	-3.0	-0.3	-1.6	-0.1	1.6	4.4	-1.3
General government balance (% of GDP)	0.9	-5.6	-4.8	-5.8	-5.8	-4.9	-3.0	-3.0	-1.4
Structural budget balance (% of GDP)	.	.	-5.2	-5.7	-5.5	-2.1	-0.9	-1.4	-1.1
General government gross debt (% of GDP)	45.3	54.1	56.5	66.0	79.5	102.2	107.5	115.2	111.6

(1) Domestic banking groups and stand-alone banks.

(2) Domestic banking groups and stand-alone banks, foreign-controlled (EU and non-EU) subsidiaries and branches.

(3) Real effective exchange rate

(*) Indicates BPM5 and/or ESA95

Source: European Commission 2015 winter forecast; Commission calculations.

Table 1.2: The MIP scoreboard

		Thresholds	2008	2009	2010	2011	2012	2013	
External imbalances and competitiveness	Current Account Balance (% of GDP)	3 year average	-4%/6%	-11.5	-12.7	-12.1	-8.0	-6.7	-4.0
		p.m.: level year	-	-15.6	-10.7	-9.8	-3.4	-6.9	-3.1
	Net international investment position (% of GDP)		-35%	-15.1	-30.4	-35.6	-71.7	-147.3	-156.8
	Real effective exchange rate (REER) (42 industrial countries - HICP deflator)	% change (3 years)	±5% & ±11%	2.2	3.5	0.0	-3.0	-5.9	-0.8
		p.m.: % y-o-y change	-	3.2	1.0	-4.1	0.1	-2.0	1.1
	Export Market shares	% change (5 years)	-6%	-14.9	-9.0	-19.4	-16.8	-26.8	-27.2
		p.m.: % y-o-y change	-	-3.4	4.4	-15.4	-5.4	-9.3	-3.9
	Nominal unit labour costs (ULC)	% change (3 years)	9% & 12%	3.7	7.6	7.2	8.1	0.9	-5.9p
		p.m.: % y-o-y change	-	1.8	4.3	1.0	2.7	-2.6	-5.9p
	Deflated House Prices (% y-o-y change)		6%	0.8	-6.9	-8.0	-9.3	-2.0	-5.5
Private Sector Credit Flow as % of GDP, consolidated		14%	37.4	12.7	22.2	22.3	-0.6	-11.2p	
Private Sector Debt as % of GDP, consolidated		133%	285.2	303.3	315.3	330.7	331.4	344.8p	
Internal imbalances	General Government Sector Debt as % of GDP		60%	44.7	53.5	56.5	66.0	79.5	102.2
	Unemployment Rate	3-year average	10%	4.1	4.3	5.1	6.5	8.7	11.9
		p.m.: level year	-	3.7	5.4	6.3	7.9	11.9	15.9
	Total Financial Sector Liabilities (% y-o-y change)		16.5%	16.6	23.0	-2.6	-0.9	8.8	-19.5

Flags: e: estimated, p: provisional.

Figures highlighted are the ones falling outside the threshold established by EC Alert Mechanism Report. For REER and ULC, the first threshold concerns Euro Area Member States.

(1) Figures in italic are according to the old standards (ESA95/BPM5).

(2) Export market shares data: the total world export is based on the 5th edition of the Balance of Payments Manual (BPM5).

(3) Unemployment rate: i=Eurostat backcalculation to include Population Census 2011 results

(4) International investment position data have been revised downwards following the incorporation of ship-owning Special Purpose Entities

(5) House Price indicator: e = Eurostat estimates.

Source: European Commission

2. STRUCTURAL ISSUES

2.1. FISCAL POLICY AND TAXATION

The fiscal performance in 2014, which was above the targets set in the programme, is due to developments on the revenue and expenditure side. Generally, on the revenue side, the better-than-projected macroeconomic outcome has mainly resulted in higher receipts of indirect taxes and government fees. On the expenditure side, the main drivers were lower-than-expected lump-sum retirement payments and intermediate consumption (reflecting tight budget control), as well as lower-than-expected calls of government guarantees.

Progress has been made in public finance management. The Fiscal Council has started working and has recently published its autumn 2014 report. However, the institution is not strong enough. That is why the Memorandum of Understanding foresees measures aimed to strengthen it in terms of working processes, technical expertise and resources to ensure its full operability. In addition, Cyprus has for the first time undertaken a systematic risk assessment of government guarantees to be called in 2014 and beyond. The government also adopted a comprehensive medium-term debt management strategy in late December 2014. It is expected to issue the appropriate guidelines for public investment projects in line with the Fiscal Responsibility and Budget System Law provisions.

The new Cyprus Tax Department (merging the Inland Revenue Department and the VAT Services) has been created, but there has been no significant progress in the reform of the revenue administration. The appointments of a Tax Commissioner and of an Assistant Tax Commissioner have not resulted in the anticipated acceleration of reforms. The new integrated Large Taxpayer Office formally opened its doors in early January 2015, but is not yet fully operational, which could create a substantial risk for tax collection. In general, despite extensive technical assistance received and significant reform steps achieved, the pace of the reform is lagging behind, mostly due to insufficient business process ownership and unclear responsibilities. In particular, the enhanced collection powers (garnishing bank accounts and seizing movable assets) have not been tested in practice; no strategy to fight tax fraud including by criminal prosecution has been drafted; and new approaches on improving taxpayer compliance have not yet been

applied in practice. Finally, management appointments are lagging behind schedule. The end-January technical programme mission has however produced some encouraging progress and overall the reform is going forward, albeit slower than expected.

The main policy decisions on the design of immovable property taxation, which are expected to be implemented in 2015, and which aim at improving the fairness of the tax burden and at increasing the efficiency of the tax administration, have not yet been communicated. It remains unknown how the Cypriot authorities intend to design the immovable property taxation system, consolidate its administration and its related transaction fees.

2.2. FINANCIAL SECTOR

Overall, bank restructuring has been successful.

The Bank of Cyprus has broadly finalised the operational implementation of its restructuring plan, as all planned branches and international business units have been closed and the migration of all Information Technology operations has been completed. The cooperative sector has also achieved a number of milestones, namely in terms of recruitment and cost cutting.

However, serious challenges remain in terms of reducing non-performing loans.

The level of non-performing loans continues to increase in banks and reached 63%, 56.7% and 56% in Bank of Cyprus, Coops and Hellenic, respectively, in late 2014. Arrears management units have been created to deal with the largest non-performing loans. However, progress towards restructuring non-performing loans remains relatively slow. In that regard, once effectively implemented, the amended foreclosure law is expected to give banks better ways to deal with borrowers in default. In addition, developing a market for non-performing loans and removing impediments for the banks to obtain financial information on non-performing borrowers should further contribute to the banks' restructuring efforts.

Despite the volatile deposit outflows, bank liquidity buffers have improved continuously since early 2015.

In the fourth quarter of 2014, and in particular after the announcement of the results of the European Central Bank's comprehensive assessment, deposit outflows started to stabilise. As a result, and combined with loan repayments, recapitalisation and asset divestiture that brought in fresh cash, the liquidity buffers increased by about EUR 1.25 billion in commercial banks and in the coops during 2014.

Capital controls on domestic transactions have been abolished and controls on external transactions are now being gradually phased out.

As of 8 December 2014, the restrictive measures were changed and the government issued a Communication⁽³⁾, complementing the Roadmap on the liberalisation of external controls. In the Communication, the authorities committed

⁽³⁾

[http://www.mof.gov.cy/mof/mof.nsf/All/2ABF791E C1C658B1C2257DA5004AE3F9/\\$file/Policy%20for%20gradual%20relaxation%20of%20remaining%20restrictive%20measures%20CLEAR%204%20Dec%202014.pdf](http://www.mof.gov.cy/mof/mof.nsf/All/2ABF791E C1C658B1C2257DA5004AE3F9/$file/Policy%20for%20gradual%20relaxation%20of%20remaining%20restrictive%20measures%20CLEAR%204%20Dec%202014.pdf)

that the relaxation of controls will take place in a gradual and prudent manner and will be assessed at regular intervals. The restrictive measures on external transactions were relaxed twice, first on 8 December 2014 and then on 12 January 2015.⁽⁴⁾

Despite significant progress, reform of the insolvency framework, which is a major legislative measure for the economic adjustment programme, has not yet been finalised.

The aim of this reform is to develop the elements necessary for a comprehensive reform of both the personal and corporate insolvency regimes. This will be crucial to create incentives for debtors and creditors to agree on debt restructuring, thereby helping reduce banks' non-performing loans. The drafting process for most bills has been concluded and texts have been submitted to the House of Representatives. However, the legislation on the personal insolvency process is still at the drafting stage. The difficult issues include the treatment of guarantors and the conditions for obliging banks to participate in a debt restructuring proposal (compulsory restructuring).

The Cypriot authorities have continued to implement the anti-money laundering action plan,

focusing on measures to strengthen effective supervision of financial institutions, lawyers, accountants and administrative service providers.

⁽⁴⁾ On 8 December 2014, the limits for external transfers were doubled as follows: (1) the ceiling for payments exempted from the approval of the Payment Committee would be raised to EUR 2,000,000; (2) the ceiling for transfers of deposits/funds outside the Republic per person for each credit institution and or payment institution regardless of the purpose would be raised to EUR 10,000 per month; (3) the ceiling for the export of euro notes and/or foreign currency notes per natural person per journey abroad would be raised to EUR 6,000.

On 12 January 2015, the restrictive measures were relaxed in the following way: (1) the ceiling for payments exempted from the approval of the Payment Committee was abolished, but the Committee might request information on payments or transfers from the banks; (2) the ceiling for transfers of deposits/funds outside the Republic per person for each credit institution and/or payment institution regardless of the purpose were raised to EUR 20,000 per month; (3) the ceiling for the export of euro notes and/or foreign currency notes per natural person per journey abroad was raised to EUR 10,000.

2.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

The Cypriot labour market has been affected by the economic crisis, with unemployment and poverty having increased. For 2014, the employment rate of those aged 20-64 years old stood at 67.3%, decreasing by 8 pps compared to the employment rate in 2009. The unemployment rate was 16.1% in 2014 (from 11.9% in 2012 and 15.9% in 2013). The number of people at risk of poverty or social exclusion increased in the last years, reaching 27.8% of the total population in 2013, above the EU average (24.5%) Youth unemployment (people under 25) reached 35.5% in 2014, an increase of 8 pps compared with 2012. Measures to boost employment and to mitigate the negative social effects of unemployment have been introduced and are currently being implemented. These include reinforcing the public employment services, activation measures for the unemployed, the National Youth Action Plan, and the Guaranteed Minimum Income. As the outlook of Cyprus's labour market remains challenging, more margin for rapid, continuous and effective responses is expected.

The authorities are advancing in the reform of the system of activation policies, but the capacity of the public employment services to address its new tasks remains insufficient, both in terms of the number of staff and of organisation and procedures. A budget of EUR 5.7 million has been allocated to boost the administrative capacity of public employment services through the 2014-2020 Operational Programme of the European Social Fund, out of which about EUR 2 million are expected to be immediately committed. However, an action plan reflecting how the increase in staff is matched by other measures could be a tool ensuring a more effective and efficient service delivery.

A system for the continuous monitoring and evaluation of active labour market policies is expected to be operational in 2015. Cyprus is currently implementing a comprehensive reform of its active labour market policies improving the design, administration, and monitoring of the different measures. Regarding implementation of these schemes, a uniform monitoring and evaluation framework is under preparation, with the aim of applying the framework in 2015 to all active labour market policies. A common database is being set up so as to improve coordination and the automatic exchange of information between the

different implementing bodies. The challenge will be to follow up on the results of these evaluations, in order to significantly improve the impact of the active labour market policies.

Cyprus is making substantial efforts to implement the Youth Guarantee, but policy responses are not comprehensive enough to ensure that all the youth not-in-employment-education-or-training (NEET) are covered by a Youth Guarantee. In 2013 only 36% of unemployed youth were registered with the public employment services. A fully-fledged outreach strategy for young people not-in-employment-education-or-training is lacking and the pace of implementation of ongoing reforms seems to be too slow to have an impact on the employability of young people even in the medium term. The biggest challenges for the delivery of a Youth Guarantee in Cyprus remain the capacity of the public employment services to provide Youth Guarantee-related services to all young people not in employment, education or training, the provision of good quality offers under the Youth Guarantee, and the creation of a partnership approach for the delivery of the Youth Guarantee.

There has been a tripartite agreement for the suspension of wage indexation (Cost of Living Adjustment, CoLA) in the private sector until end-2016, but there is still no consensus on the application thereafter of the reformed system adopted for the public sector. With regards to the adoption of a reformed system after the end of the suspension, social partners have so far accepted the application of a lower (annual) frequency of adjustments and the automatic suspension of indexation during recessions, but no agreement has been reached on partial indexation at 50% of inflation.

The system in place to fight undeclared labour suffers from a number of structural shortcomings. A review of the system of labour inspections has been initiated in order to improve its effectiveness and efficiency. A technical assistance project provided through the Support Group for Cyprus is currently on-going, with the aim of identifying the key components necessary to efficiently fight undeclared work.

The new guaranteed minimum income is being implemented, albeit at a slow pace, while the

implementation of the other parts of the welfare reform is progressing less rapidly. The Cypriot authorities started implementing the new guaranteed minimum income as of mid-July 2014, but the processing of applications has been slow so far. Out of some 70,000 applications received, only about 10,000 had been processed by December 2014. The authorities indicate the lack of staff, complex eligibility verification, adjusting to new processes and Information Technology issues as key causes. In addition, progress on building a national registry of social transfer beneficiaries is much slower than initially anticipated. The purpose of the registry is to limit abuse of the system and collect important information, with a view to a possible streamlining of benefits by building a database with profiles and eligibility information covering beneficiaries of all types of social transfers. On the basis of the registry, the authorities are to provide an assessment report of the welfare reform, including recommendations for refinements. Work has not yet started on some elements of the July 2013 welfare reform plan, notably concerning need-driven benefits outside the scope of the guaranteed minimum income. According to the plan, some of the benefits would be streamlined and better targeted, and some would also be consolidated (e.g. child and disability benefits and housing benefits for the displaced).

Early school leaving has declined steadily, but this masks a lack of efficiency of public spending and low quality of educational outcomes. The country also features the lowest participation rate in vocational education and training in the EU ⁽⁵⁾, although recent reforms in this area include a gradually expanding offer of vocational education and training. While the tertiary attainment rate is one of the highest in the EU, Cyprus is faced with the lowest employability rate of recent graduates in the EU and with low levels of young adults' basic skills.

Overall progress regarding healthcare reform has been very limited. The reform of the National Health System is expected to be fully implemented by mid-2016. However, very limited progress has been made on adopting the amended National Health System bill and automating hospital bills, on finalising tendering of the Information

Technology infrastructure for the National Health System, on defining pharmaceutical policies under the National Health System, or on adopting contingency measures under the National Health System.

⁽⁵⁾ 12.7% in 2012 (EU average being 50.3%).

2.4. STRUCTURAL MEASURES PROMOTING SUSTAINABLE GROWTH AND COMPETITIVENESS

Programme conditionality also includes the implementation of structural reforms to support competitiveness and sustainable growth. These reforms tackle specific areas such as the privatisation of state-owned enterprises, the implementation of reforms in the goods and services markets (including the liberalisation of regulated professions, the revamping of the tourism strategy, the issuance and transfer of title deeds, the elimination of court backlogs), and development of the energy sector. An overhauling approach provided by a national growth strategy is aimed at complementing these reforms.

Some progress has been made on privatisation, which should help improve competitiveness and economic efficiency. The Privatisation Unit in charge of implementing the agreed privatisation plan and law (adopted in December 2013 and March 2014, respectively), was formally established in June 2014 but is still striving to get fully staffed. The appointment of independent advisers is gradually taking place, although with delays. As the main source of privatisation proceeds, Cyprus's Telecoms Authority's rapid conversion into a Limited Liability Company remains a number one priority.⁽⁶⁾ The Energy Authority of Cyprus's unbundling study has also incurred delays, as the tender for selecting its adviser has been very recent. The concession agreement of Limassol Port's commercial activities, which is under the direct umbrella of the Ministry of Communication and Works, also needs speeding up. The law on state-owned enterprises' corporate governance, which introduces better coordination, control and supervision of state-owned enterprises, and a more rigorous approval procedure for the creation of new state-owned enterprises, is facing delays for its adoption.

Reforms in the goods and services markets are slowly being implemented. The Cypriot authorities submitted four draft laws on the access to and exercise of regulated professions (ergo-therapists, agriculturists, veterinarians, psychologists) to the House of Representatives in September 2014. In December 2014, the laws on ergo-therapists and psychologists were adopted,

whilst the laws for agriculturists and veterinarians are expected to be adopted by February. As far as the engineers professions are concerned, Cyprus has so far failed to address concerns over shareholding requirements applicable to engineering companies. Discussions revamping the tourism strategy are also taking a new direction, considering their recent relevance in the growth strategy. Amendments to the legislation on the mergers and antitrust laws have been agreed, and while some positive steps have been taken to improve the staffing of the Cyprus Commission for the Protection of Competition, it remains to be seen whether this is sufficient to ensure effective competition enforcement. In relation to the ongoing infringement procedure for incorrect implementation and enforcement of EU rules on unfair commercial practices and unfair contract terms concerning property sales in Cyprus, progress on addressing the problem has been made, but has been limited compared to the attention that it would deserve. The substantial backlog of property rights (title deeds) pending for issuance and/or transfer to the final property buyer poses risks from legal disputes and slows the pace of judicial procedures. Although progress has been made on the pace of issuance and transfer of the title deeds, additional streamlining and facilitation of these processes can help addressing the significant risks entailed with the buyers not being the legal owners. The Cypriot authorities committed to improving the pace of court handling to eliminate court backlogs which are particularly high. Since part of the backlogs is due to immovable property cases, specific judges were assigned in each District Court, with instructions to give priority to these cases.

For the energy sector, the Cypriot government is developing a comprehensive strategy for exploiting its potentially large off-shore gas reservoir and transforming its domestic energy sector (including expanding renewable energy sources). This includes a roll-out plan for the gas infrastructure; setting up a Sovereign Wealth Fund well anchored in the Fiscal Responsibility and Budget System Law, with clear inflow and outflow rules; and an outline of the market organisation and regulatory regime for the domestic energy sector and gas exports. A successful strategy will contribute to establishing a stable public revenue flow and to lower electricity prices.

⁽⁶⁾ Cyprus is at the vanguard of the EU when it comes to the availability of fixed broadband networks, including high-speed, but is lagging behind in the deployment of high-speed mobile networks.

The Cypriot authorities have made progress in developing a comprehensive and coherent growth strategy. This builds on the ongoing public administration reform, public financial management reform, tourism strategy, business environment, and on other commitments in Cyprus's economic adjustment programme and relevant EU initiatives. It also takes into account the Partnership Agreement for implementing the European Structural and Investment Funds, as well as the smart specialisation strategy, which identifies the comparative advantages of the country and the sectors with high added-value, in view to boosting competitiveness and creating sustainable jobs. Whilst the action plan for the growth strategy exists, implementation and streamlining are yet to take place.

2.5. MODERNISING PUBLIC ADMINISTRATION

The Cypriot authorities are committed to undergo a comprehensive public administration reform. The public administration review has been seriously delayed since last summer 2014 and it is essential to set clear priorities for a meaningful horizontal public administration reform. The World Bank and experts from the United Kingdom produced a report identifying the main shortcomings in the public administration, notably the high wage bill, the lack of a link between performance and pay, as well as between performance and promotion, the inefficient personnel selection and management, and the practically inexistent mobility between and within government entities. On the basis of this report, the authorities are preparing a reform plan, with detailed features and deadlines of the envisaged reforms, including the government's main priorities, while ensuring an appropriate digitalisation of the Public Administration. ⁽⁷⁾

Progress has been made on the ministries covered by the first batch of reviews (health, education and agriculture); however, a delay of more than six months has been accumulated for the review of local governments, which still lacks a specific reform plan. Preparatory steps on the second batch of ministries/institutions (remaining ministries, state-owned enterprises) are ongoing.

⁽⁷⁾ Currently, Cyprus only ranks 21st out of 28 Member States in eGovernment users (27.7% comparing to an EU average of 32.8%).

ANNEX A

Overview Table

Europe 2020 (national targets and progress)	
2011 Commitments	Summary assessment
<p><i>Employment rate:</i> 75% - 77% of the population aged 20–64 should be employed by 2020.</p>	<p>The employment rate has fallen ever since 2009 and continued to do so in 2013. For 2014, the employment rate of those aged 20-64 years old was 67.3%, 8 pps. below the rate in 2009, and below the EU average of 69.2%. Women continue to face low employment rates (62.2% in 2013 against 63.4% in 2014) compared to men (72.6% in 2013 against 71.6% in 2014), although the overall unemployment rate was slightly higher for men than for women in 2014. Employment rates for men are below the EU average, while for women they remain the same.</p> <p>From 11.9% in 2012 and 15.9% in 2013, the unemployment rate reached 16.1% in 2014 on the back of a shrinking labour force and a milder GDP contraction, with fewer job losses and slightly improved job-finding rates.</p> <p>After peaking at 38.9% in 2013, youth unemployment declined to 35.5% in 2014. Long-term unemployment has also increased considerably in recent years and it has reached 7.7% in 2014 (up from 6.1% in 2013 and 3.6% in 2012).</p> <p>Cyprus has a not-in-education-employment-and-training rate of 18.7% in 2013 for people aged 15-24 years old up from 16% in 2012, (13% for EU in 2013), while for people up to 29 years old, the Not-in-education-employment-and-training rate reached 20.4% up from 17.3% in 2012 (15.9% for EU in 2013).</p> <p>Given the continuing contraction of the economy, reducing unemployment – including the long-term unemployment – remains a major challenge. Reaching the national employment target of 75-77% over the medium-term would remain extremely difficult.</p>
<p><i>Research and development target:</i> Increase research and development expenditure to 0.5% of GDP by</p>	<p>The Cypriot authorities decided to maintain the modest national Europe 2020 target for research and development at 0.50% of GDP</p>

<p>2020.</p>	<p>(set in the context of the 2013 national reform programme). Investment in research and development as a percentage of GDP amounted to 0.45% in 2010, 0.46% in 2011, 0.43% in 2012 and 0.48% (provisional) in 2013, as the crisis had already started to kick-in with severe budgetary cuts affecting also the research and development sector.</p> <p>The share of private sector spending is one of the lowest in EU and is decreasing. On the policy side, there is now awareness that the participation of business in research and development activities might also have been hampered by institutional factors, complex and lengthy procedures in the system of incentives, as well as policies that favour academia, rather than the need of enterprises to improve their competitiveness. A National Committee on Research, Innovation and Technological Development was set up in September 2013, with the aim of reviewing the national research and innovation system and giving relevant recommendations. While the work of the committee was completed in March 2014, it is still unclear how governance of research and development system will be overhauled. However, significant funding opportunities from EU's Horizon 2020 Research & Innovation Programme continue to exist, providing support to Research beneficiaries and SMEs from Cyprus.</p> <p>Further monitoring is encouraged on the developments of the smart specialisation strategy in the context of what is currently being defined as Cyprus's national growth strategy.</p>
<p><i>Renewable energy target:</i> 13% of gross final energy consumption from renewable sources.</p>	<p>The main challenges in the energy and climate field for Cyprus are twofold: (1) the high dependence on imported fuels, which strains public finances and poses concerns from the energy security perspective; (2) the higher than EU average greenhouse gas and energy intensity of the economy (0.52Gg tonnes per million EUR GDP compared to 0.35 for the EU). On (1), some progress has been made with initiatives in the field of renewable energies (large photovoltaic parks, 'Solar energy for all' initiative, net metering)</p>

	<p>and with the exploration of the off-shore gas resources. For instance, Cyprus has made progress developing energy from renewable sources: according to the most recent Eurostat data, Cyprus has achieved a share of renewable energy of 7.4% in 2013 respectively and has thus met the first interim target of 4.8%. For the time being, Cyprus can be considered to be on track towards this Europe 2020 target. However, since the trajectory is not linear, the final target will be achieved by means of a stronger annual average growth of the renewable energy share, in line with Cyprus's high potential in this area. On (2), preliminary initiatives for the transposition of the EU <i>acquis</i> in the field of energy efficiency have been undertaken, but progress is limited. Cyprus is benefiting from the Support Group for Cyprus's technical assistance, encompassing both areas.</p>
<p><i>Greenhouse gas emission target:</i> Reduce greenhouse gas emissions to 5.5 Mt CO₂ equivalent in 2020.</p>	<p>According to national projections submitted in 2013 and taking existing measures into account, the greenhouse gas emissions in the sectors out of the EU Emission Trading System (non-ETS) are projected to be 2.8 Mt CO₂ equivalent in 2020, therefore, the target is expected to be reached (with a margin of 46 percentage points). However, challenges remain in respect to greenhouse gas emissions, such as reliance on oil imports, energy intensity of the transport sector, and non-differentiated energy mix and low energy efficiency.</p> <p>As an island, Cyprus depends heavily on transport to guarantee accessibility of citizens to the EU and trade within the internal market and to overseas. Along with the priorities of developing the ports and airports, as well as their connections to the production and distribution areas of freight and to cities for passengers, logistic information systems and traffic management services have not yet been fully developed. The use of cleaner fuels in transport has not yet been considered either. The efficient use of the available EU funding instruments, such as the European Structural and Investment Funds, the Connecting Europe Facility and the new European Fund for Strategic Investment</p>

would help improving all transport-related areas. In particular, priority could be given to Trans-European Transport Networks core network projects on the Orient/East-Med Corridor and on Motorways of the Sea projects. As transport represents more than half of total CO₂ emissions from non-ETS activities in Cyprus, reversing the trend in CO₂ emissions from transport could enable Cyprus to meet its Europe 2020 target.

On environment, Cyprus is second only to Denmark in the list of municipal waste generation and faces significant problems with the treatment of its waste. In order to reach the 2020 recycling target of the Waste Framework Directive (50%) and the goals set in the 7th Environment Action Programme, Cyprus has requested technical assistance in the field of waste management, so as to, among others, further develop separate collection, combined with the required facilities ensuring a high level of recycling/composting.

Water management may also be regarded as one of Cyprus's environmental priorities, considering its increasingly challenging scarcity in the island; and more is needed on eco-innovation, e.g. dealing with water and energy shortages, excess of waste and air pollution. According to the 2013 Eco-Innovation Scoreboard, Cyprus is ranked as the 3rd worst performer in the EU.

Cyprus is particularly vulnerable to the adverse impacts of climate change⁽⁸⁾ and is likely to suffer multiple stresses due to, in particular, increasing heat waves and droughts exacerbated also by the competition for water. The Cypriot economy could be seriously affected, in particular in such areas as forestry, agriculture, water and biodiversity⁽⁹⁾. Cyprus has started to develop a National Adaptation Strategy which has not yet been adopted, despite the strong encouragements made in the EU's Adaptation Strategy. It is unclear where this process

⁽⁸⁾ EU Strategy on adaptation to climate change COM(2013) 216 final:
<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013DC0216&from=EN>

⁽⁹⁾ Sixth National Communication under the United Nations Framework Convention on Climate Change.

	currently stands.
<i>Energy efficiency target:</i> absolute level of primary consumption of 2.8 Mtoe	Primary consumption of energy in Cyprus amounted to 2.7 Mtoe in 2010, 2.6 Mtoe in 2011, 2.5 Mtoe in 2012, and 2.2 Mtoe in 2013. This means that gross inland primary consumption has been reduced significantly in the last few years and therefore the absolute objective has been overachieved. Nonetheless, two additional factors may have had a significant impact: first, the economic recession since 2012 indirectly drew the energy consumption downwards; second, over 90% of the inland's energy consumption is covered by imported oil and oil products, which in the last few years have become increasingly expensive, thus constraining consumption. Should these two factors eventually change direction, energy consumption could then again swiftly rise.
<i>Early school leaving target:</i> Reduce the rate of early school leavers to 10% by 2020.	Cyprus has witnessed a steady drop in early school leaving rates from 14.9% in 2006 to 9.1% in 2013 (compared to 11.9% in the EU) and has thereby exceeded its national target of 10%. Young men are three times more likely to leave school early (14.8%) than young women (4.2%). Children with a migrant background are at a significantly higher risk of dropping out from education. As regards basic skills in mathematics, reading, and science, the country showed poor performance in the 2012 OECD Programme for International Student Assessment (PISA) in all three areas. Cyprus had the weakest EU results for sciences (38% low achievers), the second worst for mathematics (42% low achievers), and the third worst EU score for reading (32.8% low achievers). Underperformance concerns mainly boys with a migrant background. Finally, Cyprus had a not-in-employment-education-or-training rate of 18.3% in 2013 in the 15-24 age cohort.
<i>Tertiary education target:</i> Increase participation in higher education to 46%.	Cyprus has one of the highest tertiary attainment rates in the EU, with 47.8% in 2013 compared to the European average of 36.9%, and has therefore outperformed its national quantitative target of 46%. However, as regards basic skills, the performance of tertiary graduates is not significantly better

	<p>than that of upper secondary school graduates.⁽¹⁰⁾ In 2012, Cyprus had the second lowest number of tertiary graduates in science and technology per 1,000 inhabitants aged 20-29 in the EU (9 compared to approximately 17 at EU level).⁽¹¹⁾ Finally, the employment rate of recent tertiary education graduates in Cyprus is the lowest in the EU (64.9% vs. EU average 80.7%).⁽¹²⁾</p>
<p><i>Target for reducing the population at risk of poverty or social exclusion in number of persons:</i> Reduce the number of people at risk of poverty or social inclusion by 27,000 persons or decrease to 19.3% of the population.</p>	<p>Data until 2013 show that the social situation in Cyprus has been deteriorating. Almost all indicators are showing negative trends in 2013. The proportion of people-at-risk-of-poverty-or-social-exclusion sharply rose in recent years, reaching 27.8% of the total population in 2013, well above the EU average (24.5%) and the poverty target set by Cyprus (19.3%). As a consequence, the number of people-at-risk-of-poverty-or-social-inclusion increased to 240,000 people, from 234,000 in 2012 and 207,000 in 2011.</p> <p>The increase of the people-at-risk-of-poverty-or-social-exclusion is reflected in all 3 sub-indicators: the at-risk-of poverty rate (i.e. monetary poverty) increased from 14.7% in 2012 to 15.3% in 2013; the severe material deprivation increased from 15% in 2012 to 16.1% in 2013 (severe material deprivation sharply increased in the period 2009-2013 by 6.6 pps, well above the EU average of 9.6%); and the share of people living in very low work intensity households (quasi-jobless households) increased by 1.4% in 2013 (2013: 7.9%, 2012: 6.5%). Despite the general increase of the people-at-risk-of-poverty-or-social-exclusion, not all age groups are affected in the same way. While the rate for elderly people has decreased considerably (from 33.4% in 2012 to 26.1% in 2013), the rate for youth and working-age people has increased (from 27.5% and 25.8% in 2012 to 27.7% and 28.2% in 2013).</p> <p>The recently introduced guaranteed minimum income, which inter alia established a guaranteed minimum income for the long-term unemployed and the working poor, is</p>

⁽¹⁰⁾ OECD International Report on the Survey of Adult Skills (2012) <http://www.oecd.org/site/piaac/>.

⁽¹¹⁾ Eurostat, Science and technology graduates by sex (tps00188)

⁽¹²⁾ See additional contextual indicators at: <http://ec.europa.eu/education/monitor>

	expected to reduce the people-at-risk-of-poverty-or-social-exclusion.
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ANNEX B

Standard Tables

Table B.1: **Macroeconomic indicators**

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015	2016
Core indicators									
GDP growth rate	3.9	3.6	2.5	0.3	-2.4	-5.4	-2.8	0.4	1.6
Output gap ¹	n.a.	1.1	2.9	0.3	-1.3	-5.0	-6.0	-4.3	-1.7
HICP (annual % change)	n.a.	2.5	2.3	3.5	3.1	0.4	-0.3	0.7	1.2
Domestic demand (annual % change) ²	3.2	4.3	3.7	-2.0	-3.8	-9.7	-3.2	-0.8	0.9
Unemployment rate (% of labour force) ³	3.6	4.3	4.8	7.9	11.9	15.9	16.2	15.8	14.8
Gross fixed capital formation (% of GDP)	21.9	20.5	24.7	19.1	15.2	13.4	12.3	12.2	12.6
Gross national saving (% of GDP)	20.2	17.9	14.1	16.0	10.9	10.8	9.9	10.4	11.5
General government (% of GDP)									
Net lending (+) or net borrowing (-)	-3.6	-3.6	-1.5	-5.8	-5.8	-4.9	-3.0	-3.0	-1.4
Gross debt	53.5	61.7	53.8	66.0	79.5	102.2	107.5	115.2	111.6
Net financial assets	-33.5	-35.2	-30.9	-39.1	-49.9	n.a.	n.a.	n.a.	n.a.
Total revenue	30.3	34.6	38.7	37.0	36.3	36.5	39.1	38.5	38.4
Total expenditure	33.8	38.3	40.1	42.8	42.1	41.4	42.1	41.5	39.9
<i>of which: Interest</i>	2.7	3.1	2.6	2.2	2.9	3.1	3.1	3.2	3.1
Corporations (% of GDP)									
Net lending (+) or net borrowing (-)	0.3	-3.2	-10.4	-3.2	-5.5	6.7	1.9	3.8	2.5
Net financial assets; non-financial corporations	-81.3	-103.4	-114.0	-168.3	-187.1	n.a.	n.a.	n.a.	n.a.
Net financial assets; financial corporations	-50.4	5.9	9.7	31.4	51.2	n.a.	n.a.	n.a.	n.a.
Gross capital formation	7.5	6.6	7.3	6.4	6.6	6.2	5.4	5.3	5.8
Gross operating surplus	25.0	21.5	19.5	20.4	21.6	33.5	29.5	29.7	29.8
Households and NPISH (% of GDP)									
Net lending (+) or net borrowing (-)	0.3	1.8	0.5	3.5	1.2	-1.0	-1.3	-2.2	-2.0
Net financial assets	103.8	130.4	128.6	107.7	102.0	n.a.	n.a.	n.a.	n.a.
Gross wages and salaries	36.6	36.0	35.1	35.0	33.4	31.6	30.6	30.3	30.1
Net property income	6.5	5.0	5.8	7.6	4.6	2.2	2.4	1.8	2.3
Current transfers received	16.6	19.7	22.0	24.6	25.8	25.3	27.0	26.8	26.4
Gross saving	7.1	8.7	8.7	8.6	5.2	2.6	2.1	1.3	1.6
Rest of the world (% of GDP)									
Net lending (+) or net borrowing (-)	-2.5	-3.0	-10.0	-2.8	-5.4	0.0	-2.1	-1.2	-0.6
Net financial assets	62.8	3.5	8.5	71.9	87.5	n.a.	n.a.	n.a.	n.a.
Net exports of goods and services	1.2	1.3	-5.7	-3.4	-1.9	2.5	2.5	3.5	4.2
Net primary income from the rest of the world	-4.3	-5.5	-4.6	1.3	-2.8	-3.1	-2.7	-3.1	-3.2
Net capital transactions	0.0	0.4	0.1	0.2	0.1	1.3	-0.9	-0.6	-0.6
Tradable sector	47.1	43.4	37.7	37.4	37.6	38.8	n.a.	n.a.	n.a.
Non-tradable sector	46.0	47.9	52.4	54.3	53.9	53.3	n.a.	n.a.	n.a.
<i>of which: Building and construction sector</i>	8.2	8.3	9.3	6.1	4.9	3.4	n.a.	n.a.	n.a.

(1) The output gap constitutes the gap between the actual and potential gross domestic product at 2010 market prices.

(2) The indicator of domestic demand includes stocks.

(3) Unemployed persons are all those who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source: European Commission 2015 winter forecast; Commission calculations

Table B.2: **Financial market indicators**

	2009	2010	2011	2012	2013	2014
Total assets of the banking sector (% of GDP) ¹⁾	827.0	775.4	736.3	723.1	547.1	570.7
Share of assets of the five largest banks (% of total assets)	64.9	64.2	60.8	62.5	62.6	n.a.
Foreign ownership of banking system (% of total assets)	37.0	30.6	35.5	34.6	29.3	n.a.
Financial soundness indicators:						
- non-performing loans (% of total loans) ²⁾	4.5	5.6	9.6	18.6	33.7	41.3
- capital adequacy ratio (%) ²⁾	12.1	12.5	12.4	6.6	14.3	15.3
- return on equity (%) ²⁾	14.1	11.0	-68.7	-75.8	-13.0	1.9
Bank loans to the private sector (year-on-year % change) ¹⁾	10.6	5.9	6.9	4.2	-9.4	-4.1
Lending for house purchase (year-on-year % change) ¹⁾	11.5	13.4	4.8	0.3	-6.8	-2.8
Loan to deposit ratio ¹⁾	113.8	103.9	112.6	119.3	152.3	151.4
Central Bank liquidity as % of liabilities ³⁾	6.0	4.6	4.9	8.9	15.4	12.8
Private debt (% of GDP)	303.2	315.2	330.8	331.5	344.8	n.a.
Gross external debt (% of GDP) ⁴⁾						
- public						
- private						
Long-term interest rate spread versus Bund (basis points)*	137.8	185.7	317.9	550.5	493.0	483.7
Credit default swap spreads for sovereign securities (5-year)*	110.6	149.7	638.0	1196.2	943.9	423.1

(1) Latest data November 2014.

(2) Latest data Q2 2014.

(3) Latest data September 2014.

(4) Latest data June 2014. Monetary authorities, monetary and financial institutions are not included.

* Measured in basis points.

Source: IMF (financial soundness indicators); European Commission (long-term interest rates); World Bank (gross external debt); ECB (all other indicators).

Table B.3: Taxation indicators

	2002	2006	2008	2010	2011	2012
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	30.9	35.8	38.6	35.6	35.3	35.3
Breakdown by economic function (% of GDP) ¹						
Consumption	11.9	14.7	15.2	13.4	12.8	13.0
of which:						
- VAT	6.6	9.7	10.6	9.2	8.5	8.9
- excise duties on tobacco and alcohol	0.9	1.4	1.3	1.3	1.3	1.4
- energy	1.0	1.8	1.6	1.8	2.0	1.9
- other (residual)	3.4	1.7	1.8	1.1	1.0	0.8
Labour employed	9.9	11.0	11.0	12.5	12.5	13.0
Labour non-employed	0.1	0.1	0.1	0.1	0.1	0.1
Capital and business income	7.4	7.7	9.7	7.6	8.2	7.4
Stocks of capital/wealth	1.6	2.3	2.6	1.9	1.7	1.8
<i>p.m.</i> Environmental taxes ²	3.0	3.3	3.2	2.9	2.9	2.7
VAT efficiency ³						
Actual VAT revenues as % of theoretical revenues at standard rate	66.9	87.8	91.4	79.2	71.3	66.2

(1) Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.

(2) This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.

(3) VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative scale of cross-border shopping (including trade in financial services) compared to domestic consumption also influences the value of the ratio, notably for smaller economies. For a more detailed discussion, see European Commission (2012), Tax Reforms in EU Member States, and OECD (2014), Consumption tax trends.

Source: European Commission

Table B.4: Labour market and social indicators

	2008	2009	2010	2011	2012	2013	2014
Employment rate (% of population aged 20-64)	76.5	75.3	75.0	73.4	70.2	67.2	67.3
Employment growth (% change from previous year)	2.0	-0.4	-0.2	0.5	-4.2	-5.2	-1.8
Employment rate of women (% of female population aged 20-64)	68.2	68.3	68.8	67.7	64.8	62.2	63.4
Employment rate of men (% of male population aged 20-64)	85.2	82.8	81.7	79.6	76.1	72.6	71.6
Employment rate of older workers (% of population aged 55-64)	54.8	55.7	56.3	54.8	50.7	49.6	46.6
Part-time employment (% of total employment, age 15 years and over)	7.8	8.6	9.5	10.2	10.7	12.7	14.2
Part-time employment of women (% of women employment, age 15 years and over)	11.4	12.4	12.7	12.9	13.7	16.1	17.4
Part-time employment of men (% of men employment, age 15 years and over)	4.8	5.3	6.8	7.7	8.0	9.5	11.2
Fixed term employment (% of employees with a fixed term contract, age 15 years and over)	13.9	13.7	14.0	14.1	15.0	17.4	19.2
Transitions from temporary to permanent employment	29.2	26.7	22.1	22.7	24.3	n.a.	n.a.
Unemployment rate ¹ (% of labour force, age group 15-74)	3.7	5.4	6.3	7.9	11.9	15.9	16.1
Long-term unemployment rate ² (% of labour force)	0.5	0.6	1.3	1.6	3.6	6.1	7.7
Youth unemployment rate (% of youth labour force aged 15-24)	9.0	13.8	16.6	22.4	27.7	38.9	35.5
Youth NEET rate (% of population aged 15-24)	9.7	9.9	11.7	14.6	16.0	18.7	n.a.
Early leavers from education and training (% of pop. aged 18-24 with at most lower sec. educ. and not in further education or training)	13.7	11.7	12.7	11.3	11.4	9.1	n.a.
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	47.1	45.0	45.3	46.2	49.9	47.8	n.a.
Formal childcare (from 1 to 29 hours; % over the population aged less than 3 years)	8.0	8.0	11.0	7.0	7.0	n.a.	n.a.
Formal childcare (30 hours or over; % over the population aged less than 3 years)	18.0	14.0	13.0	16.0	19.0	n.a.	n.a.
Labour productivity per person employed (annual % change)	1.6	-1.6	1.6	-0.2	1.8	-0.1	-0.9
Hours worked per person employed (annual % change)	-0.3	-0.5	0.4	0.1	0.7	-0.7	0.0
Labour productivity per hour worked (annual % change; constant prices)	1.9	-1.1	1.2	-0.3	1.2	0.5	-0.9
Compensation per employee (annual % change; constant prices)	-1.1	2.4	0.5	0.5	-2.8	-4.7	-2.9
Nominal unit labour cost growth (annual % change)	1.8	4.1	1.0	2.5	-2.7	-5.8	n.a.
Real unit labour cost growth (annual % change)	-2.7	4.0	-0.9	0.2	-4.2	-4.3	n.a.

(1) Unemployed persons are all those who were not employed, but had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. Data on the unemployment rate of 2014 includes the last release by Eurostat in early February 2015.

(2) Long-term unemployed are persons who have been unemployed for at least 12 months.

Source: European Commission (EU Labour Force Survey and European National Accounts)

Table B.5: Expenditure on social protection benefits

	2007	2008	2009	2010	2011	2012
Sickness/healthcare	4.5	4.5	5.1	5.0	5.1	4.9
Invalidity	0.7	0.7	0.8	0.7	0.8	0.8
Old age and survivors	8.3	8.4	9.3	10.2	10.8	11.8
Family/children	1.9	2.1	2.2	2.1	2.0	1.6
Unemployment	0.9	1.0	1.0	1.1	1.2	1.5
Housing and social exclusion n.e.c.	0.6	0.8	1.1	1.1	1.0	0.6
Total	17.8	18.6	20.8	21.8	22.4	22.6
of which: means-tested benefits	1.8	2.2	2.8	3.0	2.9	3.2
Social inclusion indicators	2008	2009	2010	2011	2012	2013
People at risk of poverty or social exclusion ¹ (% of total population)	23.3	23.5	24.6	24.6	27.1	27.8
Children at risk of poverty or social exclusion (% of people aged 0-17)	21.5	20.2	21.8	23.4	27.5	27.7
Elderly at risk of poverty or social exclusion (% of people aged 65+)	49.3	48.6	42.6	39.8	33.4	26.1
At-risk-of-poverty rate ² (% of total population)	15.9	15.8	15.6	14.8	14.7	15.3
Severe material deprivation rate ³ (% of total population)	9.1	9.5	11.2	11.7	15.0	16.1
Proportion of people living in low work intensity households ⁴ (% of people aged 0-59)	4.5	4.0	4.9	4.9	6.5	7.9
In-work at-risk-of-poverty rate (% of persons employed)	6.3	6.8	7.3	7.3	7.9	8.9
Impact of social transfers (excluding pensions) on reducing poverty	30.6	33.1	33.6	37.0	37.4	37.0
Poverty thresholds, expressed in national currency at constant prices ⁵	9410.6	9257.2	9088.5	9304.9	8957.6	8147.8
Gross disposable income (households)	12555.0	12555.0	13316.0	13871.0	12960.0	n.a.
Relative median poverty risk gap (60% of median equivalised income, age: total)	15.3	17.2	18.0	19.0	19.0	17.7
Inequality of income distribution (S80/S20 income quintile share ratio)	4.3	4.4	4.5	4.3	4.7	4.9

(1) People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).

(2) At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60% of the national equivalised median income.

(3) Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.

(4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20% of their total work-time potential in the previous 12 months.

(5) For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices (HICP) = 100 in 2006 (2007 survey refers to 2006 incomes)

(6) 2014 data refer to the average of the first three quarters.

Source: For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table B.6: Product market performance and policy indicators

	2004-08	2009	2010	2011	2012	2013	2014
Labour productivity ¹ in total economy (annual growth in %)	1.3	-1.7	1.7	-0.1	1.9	0.1	n.a.
Labour productivity ¹ in manufacturing (annual growth in %)	-1.2	-3.8	1.4	-1.6	0.2	-2.8	n.a.
Labour productivity ¹ in electricity, gas (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity ¹ in the construction sector (annual growth in %)	1.0	-14.6	-2.5	-5.2	-5.2	-17.0	n.a.
Labour productivity ¹ in the wholesale and retail sector (annual growth in %)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labour productivity ¹ in the information and communication sector (annual growth in %)	4.3	-5.1	4.1	0.8	5.2	3.5	n.a.
Patent intensity in manufacturing ² (EPO patent applications divided by gross value added of the sector)	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.
Policy indicators	2004-08	2009	2010	2011	2012	2013	2014
Enforcing contracts ³ (days)	735	735	735	735	735	735	735
Time to start a business ³ (days)	8.0	8	8	8	8	8	8
R&D expenditure (% of GDP)	0.4	0.5	0.5	0.5	0.4	0.5	n.a.
Total public expenditure on education (% of GDP)	7.0	8.0	7.9	7.9	n.a.	n.a.	n.a.
(Index: 0=not regulated; 6=most regulated)	2008	2009	2010	2011	2012	2013	2014
Product market regulation ⁴ , overall	n.a.	n.a.	n.a.	n.a.	n.a.	1.65	n.a.
Product market regulation ⁴ , retail	n.a.	n.a.	n.a.	n.a.	n.a.	1.67	n.a.
Product market regulation ⁴ , professional services	n.a.	n.a.	n.a.	n.a.	n.a.	3.11	n.a.
Product market regulation ⁴ , network industries ⁵	n.a.	n.a.	n.a.	n.a.	n.a.	2.64	n.a.

(1) Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

(2) Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.

(3) The methodologies, including the assumptions, for this indicator are presented in detail here: <http://www.doingbusiness.org/methodology>.

(4) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are presented in detail here: <http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm>

(5) Aggregate OECD indicators of regulation in energy, transport and communications (ETCR).

Source: European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators)

Table B.7: **Green growth**

Green growth performance		2003-2007	2008	2009	2010	2011	2012
Macroeconomic							
Energy intensity	kgoe / €	0.19	0.19	0.19	0.18	0.17	0.17
Carbon intensity	kg / €	0.73	0.68	0.68	0.65	0.63	0.62
Resource intensity (reciprocal of resource productivity)	kg / €	1.36	1.75	1.45	1.34	1.18	n.a.
Waste intensity	kg / €	n.a.	0.12	n.a.	0.15	n.a.	0.14
Energy balance of trade	% GDP	-4.3	-7.1	-5.1	-6.6	-7.5	-8.3
Energy weight in HICP	%	9.6	11.5	12.0	10.6	8.7	9.4
Difference between energy price change and inflation	%	7.5	12.5	-16.5	18.9	14.0	17.9
Ratio of environmental taxes to labour taxes	ratio	33.0%	28.5%	23.7%	23.1%	22.9%	20.4%
Ratio of environmental taxes to total taxes	ratio	10.3%	8.2%	8.2%	8.2%	8.2%	7.6%
Sectoral							
Industry energy intensity	kgoe / €	0.26	0.21	0.19	0.17	0.16	0.14
Share of energy-intensive industries in the economy	% GDP	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.16	0.13	0.16	0.19	0.23
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public R&D for energy	% GDP	n.a.	0.00	0.00	0.00	0.00	0.00
Public R&D for the environment	% GDP	n.a.	0.01	0.01	0.00	0.00	0.00
Recycling rate of municipal waste	ratio	3.9%	7.3%	8.3%	15.1%	20.7%	21.2%
Share of GHG emissions covered by ETS*	%	n.a.	52.8	52.1	50.6	47.5	47.3
Transport energy intensity	kgoe / €	1.79	1.54	1.56	1.65	1.79	1.74
Transport carbon intensity	kg / €	3.75	3.31	3.41	3.62	3.79	3.70
Security of energy supply							
Energy import dependency	%	98.0	97.5	96.2	100.9	92.5	97.0
Diversification of oil import sources	HHI	0.17	0.13	0.14	0.14	0.17	0.16
Diversification of energy mix	HHI	n.a.	n.a.	n.a.	n.a.	n.a.	0.90
Renewable energy share of energy mix	%	2.2	3.3	3.6	3.8	4.5	5.1

(1) Country-specific notes:

2013 is not included in the table due to lack of data.

General explanation of the table items:

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: Greenhouse gas emissions (in kg CO₂ equivalents) divided by GDP (in EUR)

Resource intensity: Domestic material consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Energy weight in HICP: the proportion of "energy" items in the consumption basket used for the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)

Environmental taxes over labour or total taxes: from DG TAXUD's database 'Taxation trends in the European Union'

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices for medium-sized industrial users: consumption band 500–2000MWh and 10000–100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of recycled municipal waste to total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Proportion of GHG emissions covered by ETS: based on greenhouse gas emissions (excl LULUCF) as reported by Member States to the European Environment Agency.

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2005 EUR)

Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Renewable energy share of energy mix: %-share of gross inland energy consumption, expressed in tonne oil equivalents

* European Commission and European Environment Agency

** For 2007 average of S1 & S2 for DE, HR, LU, NL, FI, SE & UK. Other countries only have S2.

*** For 2007 average of S1 & S2 for HR, IT, NL, FI, SE & UK. Other countries only have S2.

Source: European Commission unless indicated otherwise; European Commission calculations