

E C O N O M I C O U T L O O K

January 2025

Summary

Real GDP growth in Cyprus is estimated to have accelerated from 2.6% in 2023 to 3.7% in 2024. Growth is projected to moderate to 3.3% in 2025 and to 3.0% in 2026. The growth outlook is supported by the recent strong economic momentum and disinflation in Cyprus, as well as by robust labour markets and monetary policy easing in the euro area. Compared to the October issue, the 2024 growth forecast has been revised up by 0.2 percentage points, because of higher-than-expected growth in the third quarter and further improvements in domestic activity and the job market, reflected in data for the last months of 2024. The growth forecast for 2025 has remained unchanged.

Inflation (based on the Consumer Price Index) decelerated to 1.8% in 2024 and is expected to remain at similar levels in 2025 and 2026. Inflation is projected at 1.7% in 2025, down by 0.4 percentage points compared to the October issue, as inflation surprised on the downside in the fourth quarter of 2024. In 2026, inflation is forecast at 1.6%. The inflation outlook is influenced by the recent declines in international oil prices, the deceleration of inflation in the second half of 2024, the still restrictive financing conditions in Cyprus, and easing selling price expectations, particularly in services.

Risks to the growth outlook are tilted to the downside, while risks to the inflation outlook are skewed to the upside, especially as uncertainties about international trade policies have increased and geopolitical risks have persisted.

Ιανουάριος 2025

Περίληψη

Ο ρυθμός μεγέθυνσης του πραγματικού ΑΕΠ στην Κύπρο εκτιμάται ότι έχει επιταχυνθεί από 2,6% το 2023 σε 3,7% το 2024. Ο ρυθμός μεγέθυνσης προβλέπεται να μετριαστεί στο 3,3% το 2025 και στο 3,0% το 2026. Οι οικονομικές προοπτικές υποστηρίζονται από την πρόσφατη δυναμική της μεγέθυνσης και τη σημαντική μείωση του πληθωρισμού στην Κύπρο, καθώς και από τις ευνοϊκές συνθήκες στην αγορά εργασίας και τη νομισματική χαλάρωση στην ευρωζώνη. Σε σύγκριση με το τεύχος Οκτωβρίου, η πρόβλεψη για το 2024 έχει αναθεωρηθεί προς τα πάνω κατά 0,2 ποσοστιαίες μονάδες, λόγω του υψηλότερου ρυθμού μεγέθυνσης από τον αναμενόμενο κατά το τρίτο τρίμηνο του 2024, αλλά και λόγω περαιτέρω βελτιώσεων στην εγχώρια δραστηριότητα και στην αγορά εργασίας, σύμφωνα με στοιχεία των τελευταίων μηνών του 2024. Η πρόβλεψη για το 2025 έχει παραμείνει αμετάβλητη σε σχέση με το τεύχος Οκτωβρίου.

Ο πληθωρισμός (με βάση τον Δείκτη Τιμών Καταναλωτή) επιβραδύνθηκε στο 1,8% το 2024 και αναμένεται να κυμανθεί σε παρόμοια επίπεδα το 2025 και το 2026. Το 2025, ο πληθωρισμός προβλέπεται στο 1,7%, χαμηλότερος κατά 0,4 ποσοστιαίες μονάδες σε σχέση με το τεύχος Οκτωβρίου, λόγω ηπιότερου ρυθμού πληθωρισμού από τον αναμενόμενο κατά το τελευταίο τρίμηνο του 2024. Ο πληθωρισμός για το 2026 προβλέπεται στο 1,6%. Οι προοπτικές για τον πληθωρισμό επηρεάζονται από τις πρόσφατες μειώσεις των διεθνών τιμών του πετρελαίου, την επιβράδυνση του πληθωρισμού, το σχετικά υψηλό (ακόμη) κόστος δανεισμού στην Κύπρο, καθώς και από την υποχώρηση των επιχειρηματικών προσδοκιών για τις τιμές πώλησης, ιδίως στις υπηρεσίες.

Οι προβλέψεις συνοδεύονται από κινδύνους για χαμηλότερους από τους προβλεπόμενους ρυθμούς μεγέθυνσης και υψηλότερο από τον προβλεπόμενο πληθωρισμό, ειδικά καθώς η αβεβαιότητα σχετικά με πολιτικές του διεθνούς εμπορίου έχει αυξηθεί και οι γεωπολιτικοί κίνδυνοι συνεχίζουν να υφίστανται.

1. Recent developments

In the second half of 2024, economic momentum in Cyprus has remained strong and inflationary pressures have eased substantially. The year-on-year (y-o-y) growth rate of real GDP rose from 3.5% in the second quarter of 2024 to 3.8% in the third quarter.

Real gross value added expanded (y-o-y) at robust rates across most sectors in the third quarter of 2024. Compared to the second quarter, growth (y-o-y) strengthened markedly in the sectors of trade and tourism, financial activities, and entertainment; growth moderated in the primary and secondary sectors, as well as in information and communication services.

Real consumption expenditure continued to rise robustly in the third quarter of 2024, on the back of strong growth in government consumption; household consumption growth decelerated to around its long-term average. Gross fixed capital formation contracted in the third quarter, owing to lower investment in transport equipment. Construction investment increased (y-o-y) again in the third quarter, but at a slower pace compared to the first half of 2024. The contribution of net exports to growth remained positive in the third quarter, as exports increased (y-o-y) faster than imports; the positive contribution resulted from strong growth in services exports and a contraction in goods imports.

Monthly indicators (e.g. card purchases, registrations of new companies, registrations of motor vehicles, retail trade volume, tourist arrivals) suggest that economic activity in Cyprus sustained its growth momentum in the final quarter of 2024. The number of registered unemployed continued to decline (y-o-y) rapidly during the fourth quarter of 2024, and the unemployment rate (Eurostat) decreased further in November, recording its lowest value since March 2009.

Upward pressures on energy prices subsided significantly in the second half of 2024, contributing to disinflation. In the final quarter of 2024, inflation (based on the Consumer Price Index – CPI) stood at 1.5%, compared to 1.4% in the third quarter. Nevertheless, food inflation accelerated in the fourth quarter, especially in December, driven by large increases in the prices of local agricultural goods. Food inflation, as well as inflation in some services

(e.g. restaurants, repairs and home maintenance) persisted at high levels in the last quarter, adding to the overall inflation rate.

The Economic Sentiment Indicator (ESI) improved further in the fourth quarter of 2024, because of stronger business confidence in services and, to a lesser extent, higher consumer confidence. The changes in business confidence in the remaining sectors between the third and fourth quarters were very small. Economic uncertainty in Cyprus decreased in the final quarter of 2024, as firms in services and construction were less uncertain about their future business situation. However, firms' employment expectations declined to just above their long-term average during the fourth quarter, signalling a moderation in employment growth in the short run. During the fourth quarter, selling price expectations eased considerably in services and construction, while they edged up in industry but remained at relatively low levels. Price expectations in retail trade and among consumers have proved stickier than those in the other sectors.

Cyprus's fiscal position remained strong over the period January – November 2024, as government revenue rose (y-o-y) faster than expenditure, and the budget balance continued to register a sizeable surplus. The ratio of public debt to GDP has stayed on a downward path, and the long-term interest rate for Cyprus has declined to just below 3%.

In November 2024, domestic lending interest rates for most categories were below their peaks reached earlier in 2024. A downward trend can be discerned in interest rates for some loan categories, such as outstanding corporate and housing loans, following a series of policy rate cuts between June and October 2024. New lending between January and November 2024 registered robust growth, with new loans to businesses rising faster than new household credit. The stock of loans has been rising steadily since February, driven by increases in the stock of non-resident loans. Deposits have been increasing throughout the period January – November, owing to strengthening growth in domestic deposits. The ratio of non-performing loans (NPLs) to total loans continued to trend downwards, declining from 6.9% in June to 6.5% in September.

2. Forecasts

Projections for GDP growth and CPI inflation are constructed using a dataset with numerous domestic and foreign indicators, as well as a large number of dynamic econometric models. Quarterly series available up to the third quarter of 2024 were used, along with monthly data containing information about developments over the last months of 2024. The cut-off date for the data used in the analysis was 17 January 2025.

Table 1 presents the forecasts for the growth rate of real GDP for 2024, 2025 and 2026. Growth is estimated to have accelerated from 2.6% in 2023 to 3.7% in 2024. In 2025 and 2026, growth is expected to gradually slow, but to remain robust. Growth is projected at 3.3% in 2025 and at 3.0% in 2026. The recent strong economic momentum and disinflation in Cyprus, as well as robust labour markets and monetary policy easing in the euro area, are expected to contribute to growth in the coming quarters.

Compared to the October issue, the growth forecast for 2024 has been revised up by 0.2 percentage points, while the forecast for 2025 has remained unchanged. The upward revision to the 2024 growth forecast resulted mainly from higher-than-expected growth in the third quarter, as well as from additional improvements in domestic activity and the job market, reflected in both hard and soft data for the final months of 2024.

Table 1 also shows the forecasts obtained from the different components (groups of models) and the weights assigned to these forecasts in shaping the final forecasts. The real economy component is based on factors estimated from real activity and labour market indicators; the component relating to economic aspects other than the real economy is based on hard and soft data.¹ The component that combines information on both the real economy and other economic aspects plays a key role in forming the final forecasts.²

Table 1: GDP growth forecasts and components

YEAR	2024		2025		2026	
FORECAST	3.7		3.3		3.0	
	WEIGHT	FORECAST BY COMPONENT	WEIGHT	FORECAST BY COMPONENT	WEIGHT	FORECAST BY COMPONENT
COMPONENTS						
I. Real economy	0.44	3.7	0.52	3.1	0.41	2.8
II. Other economic aspects	0.55	3.7	0.57	3.3	0.51	3.1
III. Real economy & other aspects	99.01	3.7	98.91	3.3	99.08	3.0
Fiscal	5.42	3.7	5.77	3.1	5.46	2.9
Prices	13.26	3.7	12.66	3.3	13.25	2.8
Exchange rates	3.31	3.7	3.31	3.1	3.28	2.9
Interest rates, spreads	17.76	3.7	18.39	3.3	19.30	3.0
Stock markets	13.69	3.7	12.73	3.4	12.85	3.0
Economic sentiment, uncertainty	36.18	3.7	36.03	3.2	36.13	2.9
Loans, deposits	9.39	3.7	10.01	3.4	8.81	3.0

¹ Factors refer to a small number of principal components extracted from a large dataset of series relating to real domestic and foreign activity, and the labour market. The component concerning aspects other than the real economy is based on indicators such as interest rates, stock market returns, economic sentiment indicators, exchange rates, domestic and foreign price indices, international commodity prices, fiscal indicators, loans and deposits. Monthly information within the forecast horizon (monthly leads) is included in the models if available.

² Economic sentiment indicators refer to data obtained through the Joint Harmonised EU Programme of Business and Consumer Surveys conducted by the Directorate General for Economic and Financial Affairs. The Economics Research Centre acknowledges funding from the European Union, the Ministry of Finance, and the University of Cyprus for carrying out the project “Business and Consumer Surveys” in Cyprus.

ECONOMIC OUTLOOK

January 2025

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Table 2: CPI inflation forecasts

YEAR	2025	2026
FORECAST	1.7	1.6

Positive developments during the second half of 2024, mainly associated with economic performance in Cyprus, outweigh uncertainties relating to economic prospects in Cyprus's trading partners, resulting in strong growth ahead. The key factors that shape the outlook are discussed below.

- *Activity and the labour market.* In the third quarter of 2024, activity growth strengthened, and the labour market registered further improvements, as employment and job vacancies continued to rise, and unemployment approached its historical low. Monthly indicators over the period October – December 2024 suggest that domestic activity continued to expand at a healthy pace and the number of registered unemployed continued to fall. The favourable economic conditions in Cyprus, described above, are found to support growth in the coming quarters. Also, the domestic outlook is expected to benefit from developments in trading partner economies (e.g. EU, euro area, UK), namely the low levels of unemployment and a further pickup in growth during the third quarter of 2024. Nevertheless, growth in trading partner economies remained muted in the third quarter, while manufacturing production in the EU and the UK continued to decrease (y-o-y) in October and November, dampening the outlook for Cyprus.
- *Financial conditions.* Monetary policy in the euro area has been loosening, after inflation in the bloc moderated markedly in the first half of 2024. The European Central Bank cut its policy rates four times between June and December 2024. Monetary easing in the euro area is expected to fuel activity in Cyprus by pushing down domestic interest rates and boosting demand in trading partner economies. The declines in interest rates registered in Cyprus in the autumn of 2024, as well as the pickup of credit growth during the second half of 2024, are found to generate strong positive effects on the outlook. Ample liquidity in the domestic banking sector, backed by robust growth in deposits and the downward trend in NPLs, is also expected to contribute to the strong outlook for Cyprus. Lastly, the favourable performance of stock markets in 2024, reflected in positive returns (y-o-y) and relatively low volatility, is estimated to support growth in the short run.
- *Economic sentiment and uncertainty.* Economic confidence in Cyprus continued to pick up in the fourth quarter of 2024, reaching levels well above its long-term-average. The recent improvement in economic sentiment, most notably confidence gains in the services sector, are found to significantly boost the outlook. Additionally, the relatively low levels of business uncertainty in Cyprus, reflected in survey measures, are expected to facilitate activity prospects. Yet, firms' employment expectations deteriorated in the final quarter of 2024, weighing on growth in the short run. Furthermore, recent survey data for trading partner economies suggest slower economic momentum over the forecast horizon compared to signals from other indicators. Key developments in survey indicators during the fourth quarter of 2024 include weakening economic sentiment and employment expectations in the euro area; declines in business confidence within the UK manufacturing sector; and sliding consumer confidence in both the euro area and the UK. Finally, a sharp increase in global policy uncertainty in the last months of 2024 reveals economic challenges ahead.
- *Prices.* Inflation in both Cyprus and its trading partner economies moderated substantially during 2024, most notably in the second half of the year. With inflation rates close to target, pressures on real incomes are expected to ease further, raising consumer confidence and supporting demand. The declines (y-o-y) in international oil prices observed in the second half of 2024 contributed significantly to low inflation and the sustained economic momentum in Cyprus. However, the outlook is somewhat dampened by the recent acceleration of food inflation and the depreciation of the euro against the US dollar in the last months of 2024, which triggered some upward pressure on energy prices.
- *Public finances.* Cyprus's fiscal position remained strong between January and November 2024, with

government revenue rising at a robust pace, surpassing expenditure growth. The budget surplus remained sizeable, while the ratio of public debt to GDP continued to decline in the period January – November 2024. The strong fiscal performance for the third consecutive year is expected to safeguard growth momentum by increasing Cyprus’s economic resilience to shocks and by reinforcing investor confidence.

The risks to the growth outlook, particularly for 2025, are tilted to the downside, especially as uncertainties about international trade policies have increased and geopolitical risks have persisted.

Downside risks to the growth outlook for Cyprus could result from weaker-than-expected growth in trading partner economies, particularly in large euro area countries. Trade tensions and protectionist policies could impact on international trade flows and could weigh on global demand and, most importantly, activity in the EU, adversely affecting growth prospects in Cyprus.

Ongoing geopolitical conflicts may renew upward pressures on prices, particularly energy prices, limiting domestic demand, and may dampen external demand for goods and services in Cyprus. Extreme weather events continue to pose downside risks to growth, especially through elevated food inflation.

Significant lags in the transmission of monetary policy easing to domestic financing conditions could weigh on economic sentiment and activity. Furthermore, delays in launching and successfully concluding reforms, as well as setbacks in completing infrastructure projects could dent economic confidence and competitiveness, limiting growth prospects.

Upside risks to the growth outlook could arise from a stronger reform momentum and new investments in Cyprus. Stronger-than-expected external demand, particularly if policy and geopolitical uncertainties gradually subside, could lead to higher-than-projected growth rates.

CPI inflation decelerated to 1.8% in 2024 and is expected to remain at similar levels over the forecast horizon. CPI inflation is projected at 1.7% in 2025 and at 1.6% in 2026 (Table 2).³ Compared to the

October issue, the 2025 inflation forecast has been revised down by 0.4 percentage points, as inflation in the final quarter of 2024 surprised on the downside. The declines (y-o-y) in international oil prices and the significant deceleration of inflation in Cyprus during the second half of 2024 are the key drivers of the subdued inflation outlook. Financing conditions in Cyprus have remained rather restrictive, despite some declines in borrowing costs, and are expected to continue curbing inflationary pressures in the following quarters. Additionally, selling price expectations in services and construction eased considerably in the last quarter of 2024, contributing to low inflation ahead. The above developments, which have a moderating influence on the inflation forecasts, outweigh the effects of recent upward pressures on food prices.

The risks to the inflation outlook are mostly tilted to the upside. A faster depreciation of the euro against the US dollar, rapid wage growth in Cyprus due to a robust labour market and stronger-than-expected demand could lead to higher-than-projected inflation. Geopolitical tensions continue to present upside risks to the inflation outlook through their impact on international commodity prices, especially energy prices. Extreme weather events could further intensify upward pressures on food prices. The green transition could also push inflation up, albeit temporarily. Finally, trade tensions culminating in retaliatory protectionism could raise inflation expectations and create upside risks to inflation.

Downside risks to the inflation outlook could arise from a slowdown in employment growth, as firms’ employment expectations have been sliding. Additional downside risks could result from weaker-than-expected external demand, as growth in trading partner economies could be weighed down by elevated policy uncertainty and weakening economic sentiment.

3. Concluding remarks

Quarterly and monthly series released up until 17 January 2025 were used in dynamic econometric models to construct forecasts for GDP growth and CPI inflation.

³ CPI inflation forecasts are constructed using a methodology similar to that described for GDP growth forecasts.

Real GDP growth in Cyprus is estimated to have gained momentum in 2024, strengthening to 3.7%. Growth is expected to moderate but to remain robust in 2025 and 2026. Real GDP growth is forecast at 3.3% in 2025 and at 3.0% in 2026. The outlook is supported by the recent strong economic momentum and disinflation in Cyprus, as well as by robust labour markets and monetary policy easing in the euro area. Relative to the October issue, the growth forecast for 2024 has been revised up by 0.2 percentage points, as growth in the third quarter of 2024 was stronger than expected and domestic monthly indicators continued to reflect positive developments in the fourth quarter.

Forecasts by other organisations also suggest that growth in 2025 and 2026 is expected to moderate, following a strong economic momentum in 2024. Real GDP growth in Cyprus for 2024 is estimated at 3.7% and 3.6% by the Central Bank and the European Commission, respectively. In 2025, growth is projected to decelerate to 3.0% and 2.8% according to the Central Bank and the European Commission, respectively. For 2026, the Central Bank's growth forecast points to a slight pickup (3.1%), while the Commission's forecast indicates a further slowdown (2.5%).^{[1] - [2]}

CPI inflation is forecast at 1.7% in 2025, down by 0.4 percentage points compared to the October issue, as inflation surprised on the downside in the fourth quarter of 2024. In 2026, inflation is projected at 1.6%. The inflation outlook is influenced by the recent declines in international oil prices, the deceleration of inflation in the second half of 2024, the still restrictive financing conditions in Cyprus, and easing selling price expectations, particularly in services.

Risks to the growth outlook are tilted to the downside, while risks to the inflation outlook are skewed to the upside, especially as uncertainties about international trade policies have increased and geopolitical risks have persisted.

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