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Recommendation for a

COUNCIL RECOMMENDATION

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

{SWD(2026) 213 final}

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

THE COUNCIL OF THE EUROPEAN UNION,

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

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

Whereas:

- (1) Regulation (EU) 2024/1263 specifies the objectives of the economic governance framework, which aims at promoting sound and sustainable public finances, sustainable and inclusive growth and resilience through reforms and investments, as well as preventing excessive government deficits. The Regulation stipulates that the Council and the Commission conduct multilateral surveillance in the context of the European Semester in accordance with the objectives and requirements set out in the Treaty on the Functioning of the European Union (TFEU). The European Semester includes, in particular, the formulation and the surveillance of the implementation of country-specific recommendations.
- (2) On 16 July 2025, the Commission adopted its proposal for a regulation establishing the European Fund for economic, social and territorial cohesion, agriculture and rural, fisheries and maritime, prosperity and security for the period 2028-2034 and amending Regulation (EU) 2023/955 and Regulation (EU, Euratom) 2024/2509 ⁽²⁾. The proposal aims to increase the effectiveness of Union funding by reducing the fragmentation of the financial architecture and to support Member States in the coordination of their economic policy in line with Article 175 TFEU.
- (3) On 25 November 2025, the Commission adopted an opinion on the 2026 draft budgetary plan of Cyprus. On the same date, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the 2026 Alert Mechanism Report, in which it did not identify Cyprus as one of the Member States for which an in-depth review would be needed. The Commission also adopted a recommendation for a Council

¹ Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on the effective coordination of economic policies and on multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97 (OJ L, 2024/1263, 30.4.2024, ELI: <http://data.europa.eu/eli/reg/2024/1263/oj>)

² Proposal for a Regulation of the European Parliament and of the Council establishing the European Fund for economic, social and territorial cohesion, agriculture and rural, fisheries and maritime, prosperity and security for the period 2028-2034 and amending Regulation (EU) 2023/955 and Regulation (EU, Euratom) 2024/2509 - COM(2025) 565 final. The proposed Regulation is currently the subject of negotiations with the co-legislators.

recommendation on the economic policy of the euro area ⁽³⁾, a recommendation for a Council recommendation on human capital in the European Union, and a proposal for the 2026 Joint Employment Report, which analyses the implementation of the Employment Guidelines and the principles of the European Pillar of Social Rights. The Council adopted the Recommendation on the economic policy of the euro area on 21 April 2026 and the Joint Employment Report and the Recommendation on human capital on 9 March 2026.

- (4) On 29 January 2025, the Commission published the Competitiveness Compass, a strategic framework that aims to boost the Union's global competitiveness over the next five years. It identifies the three transformational imperatives of innovation, decarbonisation and competitiveness, and security as critical pillars for sustainable economic growth. The European Semester is aligned with the Competitiveness Compass, ensuring that Member States' economic policies are consistent with the Commission's strategic objectives, creating a unified approach to economic governance that fosters sustainable growth, innovation and resilience across the Union.
- (5) In 2026, the European Semester for economic policy coordination continues to develop alongside the final stage of the Recovery and Resilience Facility (RRF) implementation ⁽⁴⁾. Recovery and resilience plans (RRPs), along with cohesion policy funding, have been essential for delivering on the policy priorities under the European Semester, as the plans were required to effectively address all or a significant subset of challenges identified in the relevant country-specific recommendations issued in recent cycles, and programmes funded by the European cohesion policy were required to take country-specific recommendations into account. As the RRF approaches the end of its lifetime, it remains essential to sustain the reforms and investments supported and implemented under the RRF, in particular those that contribute to addressing challenges identified in the country-specific recommendations.
- (6) On 3 June 2026, the Commission published the 2026 country report for Cyprus. It assessed Cyprus's progress in addressing the relevant country-specific recommendations and took stock of Cyprus's implementation of the RRP. On the basis of that analysis, the country report identified the most pressing challenges Cyprus is facing. It also assessed Cyprus's progress in implementing the European Pillar of Social Rights and in achieving the Union headline targets on employment, skills and poverty reduction, as well as progress in achieving the United Nations Sustainable Development Goals.
- (7) On 21 January 2025, the Council, upon the assessment and recommendation of the Commission, adopted a Recommendation endorsing the national medium-term fiscal-structural plan of Cyprus ⁽⁵⁾. The plan covers the period from 2025 until 2028 and presents a fiscal adjustment spread over four years. The Council recommended the following maximum growth rates of net expenditure: 6.0% in 2025, 5.0% in 2026, 5.4% in 2027 and 4.3% in 2028, which correspond to the maximum cumulative growth rates calculated by reference to the base year of 2023 of 8.9% in 2025, 14.3% in 2026, 20.5% in 2027 and 25.7% in 2028.

³ OJ C, C/2026/2434, 28.4.2026, ELI: <http://data.europa.eu/eli/C/2026/2434/oj>

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

⁵ Council Recommendation of 21 January 2025 endorsing the national medium-term fiscal-structural plan of Cyprus (OJ C, C/2025/639, 10.02.2025, ELI: <http://data.europa.eu/eli/C/2025/639/oj>).

- (8) Russia's war of aggression against Ukraine and its repercussions constitute an existential challenge for the European Union. The Commission invited Member States to request the activation of the national escape clause of the Stability and Growth Pact in a coordinated manner to support the EU efforts to achieve a rapid and significant increase in defence spending ⁽⁶⁾ and this proposal was welcomed by the European Council of 6 March 2025. Member States may still request the activation of the national escape clause at any time until 2028, if they fulfil the criteria set in Article 26 of Regulation (EU) 2024/1263.
- (9) On 30 April 2026, Cyprus submitted its 2026 Annual Progress Report ⁽⁷⁾ on adherence to the recommended maximum growth rates of net expenditure, and the implementation of reforms and investments responding to the main challenges identified in the European Semester country-specific recommendations.
- (10) Real GDP growth in 2025 was 3.8% and HICP inflation stood at 0.8%. The Commission Spring 2026 Forecast projects real GDP to grow by 2.3% in 2026 and 2.7% in 2027, and HICP inflation to stand at 3.6% in 2026 and 2.2% in 2027.
- (11) Based on data provided by Eurostat ⁽⁸⁾, Cyprus's general government surplus decreased from 4.1% of GDP in 2024 to 3.4% of GDP in 2025. Based on policy measures known by the cut-off date of the forecast, the Commission Spring 2026 Forecast projects a surplus of 2.1% of GDP in 2026 and 2.5% of GDP in 2027. The decrease in the surplus in 2026 mainly reflects the implementation of the general tax reform at the beginning of the year. The increase in the surplus in 2027 mainly reflects higher tax revenue due to the ending of VAT reductions on electricity and basic goods, as well as the overall better growth outlook.
- (12) Based on the Commission's estimates, the fiscal stance ⁽⁹⁾, which includes both nationally and EU financed expenditure, was expansionary, by 1.8% of GDP, in 2025. It is projected to be expansionary, by 0.4% of GDP, in 2026, and contractionary, by 1.2% of GDP, in 2027.
- (13) Based on data provided by Eurostat ⁽¹⁰⁾, Cyprus's general government debt decreased from 62.7% of GDP at the end of 2024 to 55.0% of GDP at the end of 2025. The decrease in the debt ratio in 2025 mainly reflects a primary surplus of 4.5% of GDP along with nominal GDP growing more than twice as fast as interest payments. Based on policy measures known at the cut-off date of the forecast, the Commission Spring 2026 Forecast projects the debt-to-GDP ratio to decrease to 50.4% by the end of 2026 and to further decrease to 45.5% by the end of 2027. The decrease in the debt ratio in 2026 and 2027 mainly reflects a primary surplus of 3.3% of GDP in 2026 and 3.7% of

⁶ Communication from the Commission, 'Accommodating increased defence expenditure within the Stability and Growth Pact', Brussels, 19.03.2025, C(2025) 2000 final.

⁷ The 2026 Annual Progress Reports are available on: https://economy-finance.ec.europa.eu/economic-and-fiscal-governance/stability-and-growth-pact/preventive-arm/annual-progress-reports_en

⁸ Eurostat-Euro Indicators, 22 April 2026.

⁹ The fiscal stance is defined as a measure of the annual change in the underlying budgetary position of the general government. It aims to assess the economic impulse stemming from fiscal policies, both those that are nationally financed and those that are financed by the EU budget. The fiscal stance is measured as the difference between (i) the medium-term potential growth and (ii) the change in primary expenditure net of discretionary revenue measures and including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds.

¹⁰ Eurostat-Euro Indicators, 22 April 2026.

GDP in 2027. In both years, nominal GDP is also expected to continue growing around twice as fast as interest payments.

- (14) Based on the Commission Spring 2026 Forecast, total general government defence expenditure in Cyprus amounted to 1.8% of GDP in 2025 and it is projected at the same level in 2026.
- (15) The Union continues to face risks of energy supply disruptions and elevated price volatility, exacerbated by geopolitical tensions which affect global oil and gas markets. Experience from the 2022–2023 energy crisis has shown that broad and untargeted measures entail large fiscal costs and are socially and economically inefficient. Since the outbreak of the war in the Middle East in February 2026, Cyprus adopted fiscal policy measures to mitigate the impact of high energy prices on households and firms ⁽¹¹⁾. These include untargeted reductions in VAT on electricity (until March 2027) and in excise duties on fuels (April to June 2026), as well as targeted subsidies to farmers (April and May 2026), airlines (June to September 2026) and the tourism industry (April 2026). According to the Commission Spring 2026 Forecast, the fiscal cost of these measures is projected to amount to approximately 0.1% of GDP in 2026. According to Commission estimates, if these measures were to remain in force until end-2026, their fiscal cost would amount to 0.3% of GDP in 2026.
- (16) Based on the Commission’s calculations, net expenditure in Cyprus grew by 9.6% in 2025 and 11.8% cumulatively over 2024 and 2025. The net expenditure growth in 2025 is above the recommended maximum growth rate, corresponding to a deviation of 1.3% of GDP in annual terms. When considering 2024 and 2025 together, the cumulative growth rate of net expenditure is also above the recommended maximum growth rate, corresponding to a deviation of 1.0% of GDP in cumulative terms. At the same time, as noted, the budgetary position for 2025 was in surplus, and general government debt was below 60% of GDP.
- (17) Based on the Commission’s calculations, net expenditure in Cyprus is projected to grow by 7.4% in 2026, and 20.1% cumulatively over 2024, 2025 and 2026. The projected net expenditure growth in 2026 is above the recommended maximum growth rate, corresponding to a deviation of 0.9% of GDP in annual terms. When considering 2024, 2025 and 2026 together, the projected cumulative growth rate of net expenditure is also above the recommended maximum growth rate, corresponding to a deviation of 1.8% of GDP in cumulative terms. At the same time, as noted, the budgetary position for 2026 is projected to be in surplus, and general government debt is below 60% of GDP and projected to decrease further.
- (18) The systematic, meaningful and timely involvement of local and regional authorities, social partners, civil society and other relevant stakeholders remains essential in order to ensure broad ownership for the successful implementation of the Union’s funding instruments, as well as in the context of the European Semester.
- (19) The implementation of cohesion policy programmes, which encompass support from the European Regional Development Fund (ERDF), the Just Transition Fund (JTF), the European Social Fund Plus (ESF+) and the Cohesion Fund (CF) in Cyprus, is above the average pace at EU level, both in terms of project selection and payments. It is important to keep current momentum, while maximising the impact of investments

¹¹ This reflects the situation at the cut-off date of the Commission Spring 2026 Forecast (4 May 2026).

on the ground. Cyprus is already taking action under its cohesion policy programmes to boost competitiveness and growth. Nevertheless, some areas may require further strengthening in implementation, including those relating to waste management and public urban transport. It is essential to ensure that the new investments identified by Cyprus in its mid-term review of the cohesion policy funds, notably those linked to the five priorities identified in the Mid-Term Review Regulation ⁽¹²⁾, are deployed rapidly and effectively.

- (20) Cyprus's research and innovation ecosystem remains characterised by low investment in research and development, weak knowledge valorisation, and limited links between research and business. On the positive side, targeted funding initiatives via the RRF and cohesion policy have been adopted, and the spin-off legislation has been recently adopted. Nevertheless, key bottlenecks persist, including the absence of a comprehensive research and innovation long-term strategy, which constrain the effective commercialisation of research results. The rapid expansion of the Information Communication Technology (ICT) sector presents an opportunity for spillovers to the wider economy, through stronger linkages with domestic firms and research institutions.
- (21) Access to non-bank financing in Cyprus is limited, constraining business expansion, diversification, and productivity growth. Bank lending continues to dominate corporate financing, while capital markets are underdeveloped, with one of the lowest levels of market-based funding in the Union. Although some initiatives under the RRF such as the Cyprus Equity Fund have been launched to support alternative financing, the scale of funding mobilised is still limited. As a result, many firms, in particular young and innovative ones, face difficulties in accessing adequate financing. Financial literacy levels are still low compared to the EU average, constraining households' ability and motivation to engage in diversified investment strategies. At the same time, the second pillar of the pension system remains underdeveloped and highly fragmented, limiting its role in both retirement provision and the supply of long-term capital. Strengthening occupational pensions and improving households' participation in capital markets could support the availability of long-term financing and contribute to more efficient allocation of savings.
- (22) Cyprus faces several challenges related to the regulatory and administrative framework. Some steps have been initiated, but obstacles to investment persist. Infrastructure projects continue to face delays due to lengthy land acquisition and procurement procedures, limited administrative capacity and coordination challenges. While measures to reduce administrative burden and improve investor services have been adopted, further efforts are needed to enhance efficiency, streamline procedures and reduce regulatory fragmentation.
- (23) Cyprus has scope to improve the governance of state-owned enterprises (SOEs). These enterprises play a central role in key sectors of the economy, particularly in industries characterised by natural monopolies (e.g. electricity, telecommunications, water, wastewater management and infrastructure). However, their governance remains below international standards, with persistent weaknesses in accountability, transparency, board appointment procedures and the absence of a clear ownership

¹² Regulation (EU) 2025/1914 of the European Parliament and of the Council of 18 September 2025 amending Regulations (EU) 2021/1058 and (EU) 2021/1056 as regards specific measures to address strategic challenges in the context of the mid-term review.

policy. The effective implementation of the recently adopted action plan on SOEs' governance could help to address those challenges and improve SOEs' performance, support their modernisation and enhance their contribution to strategic policy objectives including the green and digital transition.

- (24) Cyprus experiences challenges related to the efficiency of its justice system, with long case resolution times, low levels of digitalisation and delays in the enforcement of judgments. Implementation of a recently adopted reform aiming to accelerate the resolution of certain cases through the establishment of the Admiralty and Commercial courts is lagging, and neither of the courts is operational yet. Progress in digitalising judicial processes including a comprehensive case system and digital audio recording technologies remains limited, and enforcement bottlenecks persist, weighing on legal certainty and investment conditions.
- (25) While Cyprus has made progress in advancing its energy transition, significant challenges persist. Cyprus remains heavily reliant on fossil fuels, with oil and petroleum products accounting for 85.2% of its gross energy consumption in 2024. Furthermore, Cyprus has one of the largest energy import dependencies in the EU (87.7% of gross available energy in 2024). Efforts to diversify the energy supply by including natural gas in the energy mix are hindered by persistent administrative delays in the construction of a liquified natural gas (LNG) terminal in Vasilikos. Similarly, efforts to develop energy interconnections with neighbouring countries have stalled. Notably, the Great Sea Interconnector project aimed at ending Cyprus's energy isolation is still beset by delays. High external dependencies make renewable energy sources crucial not only to decarbonise Cyprus's economy, but also to improve energy security and resilience in the face of external energy shocks.
- (26) Cyprus increased its renewable energy production, although further efforts are needed to expand grid capacity and energy storage facilities in order to facilitate broader renewable energy uptake. The installed capacity for solar and wind energy grew considerably in 2025, pushing the share of renewables in the electricity mix to 27.4%. While measures to ease and digitalise permitting procedures were introduced, significant delays still affect the connection of new renewable energy plants to the grid. Cyprus has no operational fossil-free electricity storage systems. While some projects are being planned under the transmission system development plan, implementation remains at an early stage. The roll-out of energy efficiency renovation schemes for buildings, supported by the RRF and cohesion policy, has continued to advance, complemented by regulatory measures aimed at leveraging private financing for energy efficiency. Sustainable transport remains a pressing challenge, compounded by full reliance on road freight. Further efforts are needed to develop public transport, expand charging infrastructure, and provide financial incentives for sustainable mobility.
- (27) Cyprus faces significant and persistent environmental challenges. Water scarcity has reached a critical level, with freshwater exploitation and water productivity indicators placing Cyprus among the worst performers in the EU. Despite efforts under the RRF and cohesion policy, investments in water infrastructure have so far not been sufficient to address systemic vulnerabilities related to drinking water and wastewater treatment. Similarly, waste management performance lags behind EU targets; for example, Cyprus's per capita municipal waste generation is among the highest in the EU. Several measures adopted under the 2021 Circular Economy Action Plan and under cohesion policy target waste reduction, improved waste sorting and increased recycling, though their full potential is yet to be realised. Improving the administrative

capacity of local and district authorities is also critical to support investment planning and coordination in water and waste management across Cyprus.

- (28) Cyprus remains vulnerable to various climate risks (for example, wildfires, floods, droughts and coastal erosion), which threaten to harm the country's biodiversity, societal resilience, and economy. The updated national adaptation strategy 2025-2050 was finalised in 2025 but its ministerial adoption remains pending, delaying critical actions. Moreover, an improved governance system included under the national strategy could bring coherence and effectiveness in the institutional framework governing climate adaptation and resilience, but its establishment also faces delays. Further actions, including some supported by cohesion policy, focus on developing anti-flood infrastructure and fire and disaster risk management. However, Cyprus's investment for climate adaptation falls short of actual needs.
- (29) In light of the crucial role of human capital in enhancing the Union's competitiveness and strategic autonomy, in 2026 the Council recommended that Member States take action to urgently address human capital-related structural challenges in the areas of skills and education, which hamper competitiveness. The 2026 country-specific recommendations addressed to Cyprus can contribute to the implementation of the Council Recommendation on human capital in the Union.
- (30) Cyprus faces several challenges related to the labour market integration of women and persons with disabilities, as well as in addressing skills mismatches and labour shortages. Although the labour market in Cyprus remains strong, supported by robust economic growth, with the employment rate surpassing the national 2030 target and unemployment declining further, targeted activation measures and active labour market policies remain limited in coverage and effectiveness, particularly for women and vulnerable groups. Moreover, the Public Employment Service's capacity remains limited and would benefit from stronger monitoring, evaluation, and proactive outreach, supported by upgraded IT systems.
- (31) Cyprus could further strengthen quality employment. Despite low unemployment and a dynamic labour market, working conditions, notably long working hours and a relatively high share of low-paid jobs compared to the EU average, remain a concern, disproportionately affecting women. The impact of parenthood on women's employment outcomes, combined with limited access to affordable and quality care services, constrains career progression and contributes to gender pay and pension gaps. While recent policy initiatives, including hiring incentives and measures promoting flexible working arrangements, are steps in the right direction, their effective implementation, alongside supporting transitions into higher-quality jobs, improved access to training in high-demand sectors and expanded care services, can help to enhance women's labour market participation and job quality.
- (32) Cyprus faces challenges related to the strengthening of vocational education and training, the low participation in STEM fields and the weak performance in the provision of basic skills. This contributes to persistent skills mismatches and labour shortages, including in sectors key to the green and digital transitions. Early childhood education and care participation has increased under RRF measures, yet it remains below the EU target, constraining both early skills development and labour market participation, while inclusive education continues to face significant challenges, with young learners with disabilities and special educational needs, still facing barriers to effective participation in mainstream education.

- (33) Cyprus has scope for improvement of several its social protection system. While strong economic growth has helped to reduce poverty overall, poverty risks for older people remain well above the EU average due to inadequate pension income, in particular for those on low incomes during their working lives. At the same time, the absence of a comprehensive, adequately funded and integrated long-term care system, coupled with staff shortages and limited home- and community-based services, constrains access and hampers deinstitutionalisation. Energy poverty is still a concern despite some targeted measures, reflecting limited coverage and the lack of systematic monitoring. In addition, a shortage of social housing, combined with high rates of housing-related arrears, continues to weigh on vulnerable households, notwithstanding recent support schemes and planned increases in housing supply.
- (34) In view of the close interlinkages between the economies of euro-area Member States and their collective contribution to the functioning of the economic and monetary union, in 2026 the Council recommended that the euro-area Member States take action, including through their RRP, to implement the 2026 Recommendation on the economic policy of the euro area. For Cyprus, recommendation (1) helps implement the first, the second and the third recommendation on the euro area, recommendation (2) helps implement the fourth recommendation on the euro area, recommendation (3) helps implement the seventh, ninth and eleventh recommendations on the euro area, recommendation (4) helps implement the seventh recommendation on the euro area and the recommendation (5) helps implement the fifth recommendation on the euro area.

HEREBY RECOMMENDS that Cyprus take action in 2026 and 2027 to:

1. While recognising a general government surplus in Cyprus, in view of the material deviation recorded by 2025 and projected for 2026 by the Commission vis-à-vis the recommended net expenditure ceiling, ensure that net expenditure respects the maximum growth rates recommended by the Council on 21 January 2025. Reinforce defence spending and readiness while ensuring spending efficiency and gradually adapting the budget to sustain structurally higher defence spending. Ensure that any measures taken to mitigate the impact of the hike in energy prices are temporary, targeted at protecting vulnerable households or at addressing the needs of energy-intensive firms, preserve incentives for energy savings while ensuring that their fiscal cost is compatible with the commitments under the EU fiscal framework.
2. Ensure continuity of reforms and investments implemented under the Recovery and Resilience Facility. Sustain implementation momentum under cohesion policy programmes, building, where appropriate, on the reallocation to strategic priorities and flexibilities in the mid-term review of the cohesion policy framework.
3. Strengthen research and innovation by fostering public and private R&D investment, enhancing research-business synergies, and adopting a long-term research and innovation strategy with indicators and multiannual funding. Facilitate the diversification of the economy by improving access to alternative saving products and capital market instruments, strengthening the supplementary pension system and increasing financial literacy. Simplify regulation and reduce administrative burden. Improve the governance of state-owned enterprises through merit-based nomination of boards, ownership policy and performance-based management. Enhance the efficiency of the justice system including by further digitalising judicial workflows.

4. Reduce overall reliance on fossil fuels and further diversify energy supply, notably by developing energy interconnections with neighbouring countries, scaling-up funding for energy efficiency, upgrading the electricity grid and energy storage facilities, and expand sustainable mobility and public transport. Improve water, waste water and waste management by stepping up investments in infrastructure, increasing administrative capacity of local authorities, promoting sustainable water use practices, and expanding the separate collection of municipal and packaging waste. Improve the institutional framework governing climate adaptation.
5. Address labour shortages and promote job quality by strengthening labour market participation of vulnerable groups, further increasing the capacity and attractiveness of vocational education and training, promoting adult learning, enhancing the capacity of the Public Employment Service and strengthening active labour market policies. Further increase participation in early childhood education and care, improve basic skills, and increase students' participation in science, technology, engineering and mathematics (STEM) fields. Expand the availability and coverage of long-term care services, broaden eligibility, and reduce high out-of-pocket payments. Improve social protection for vulnerable groups by providing targeted support to energy-poor households, ensuring adequate minimum pensions and increasing the availability of affordable and social housing.

Done at Brussels,

*For the Council
The President*