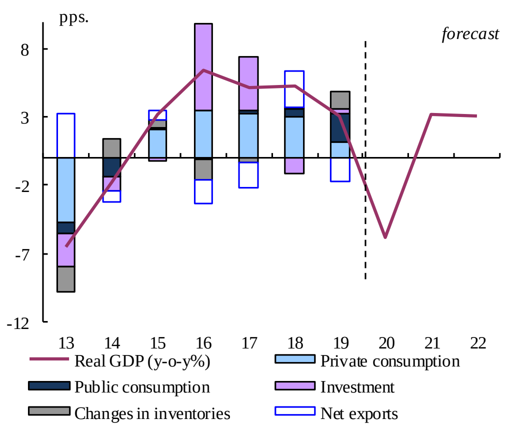
2.9. CYPRUS

Real GDP rebounded strongly in the third quarter of 2020 (+9.4% compared to the second quarter). This rebound was driven by domestic demand, which was mainly underpinned by fiscal stimulus, while exports of goods and services decreased. The recovery lost some steam towards the end of the year as lockdown measures were reintroduced to combat a resurgence in COVID-19 infections. Economic sentiment and consumer confidence worsened in the last two months of the year and again in January 2021. Real GDP is estimated to have contracted by 5.8% in 2020.

In 2021, a partial recovery is forecast, with real GDP growth expected to reach 3.2%. Containment measures have become stricter since the start of the year but they affect a smaller share of economic activity than in spring 2020. As restrictions are expected to continue until vaccinations pick up and cases drop, the recovery is expected to take place mainly in the second half of 2021. Domestic demand is again expected to be the main contributor to growth. Policy measures adopted to mitigate the impact of the crisis have been extended into 2021, and some of them, such as the loan repayment moratorium, are planned to remain in place at least until June 2021. These measures should continue to support employment, household incomes and help businesses to maintain their capacity. Furthermore, construction activity has so far escaped disruption from the lockdown measures.

Tourism, a key sector for Cyprus, has borne the brunt of the COVID-19 pandemic. Receipts from tourism have significantly declined by around 85% in 2020. This trend is expected to be only partially reversed in 2021. On the supply side, interruptions to airline capacity and, on the demand side, varying progress with vaccinations in Cyprus's main tourist markets and lower confidence in air travel are expected to weigh on the sector's recovery. In 2022, real GDP is forecast to grow by 3.1% and return to its 2019 level. This will be mainly on the back of domestic demand, as well as a small positive contribution from net exports. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

Graph 2.9: **Cyprus - Real GDP growth and contributions**



Headline inflation fell to -1.1% in 2020, dragged down by lower prices for energy and processed foods. In addition, the VAT rate reduction in the hospitality industry led to a fall in the prices of services. Inflation is forecast to turn positive again in 2021 and 2022, at 0.7% and 1.1%, respectively, underpinned by higher energy and services prices.