

Country note, June 2017

## Key messages:

- GDP growth is expected to accelerate to 4.4% in 2017 and to 5.2% in 2018 due to strong GDP growth projections in the euro area and the projected performance of the Eurostoxx50 index
- Fiscal surplus in 2017 may near +0.2% of GDP, well below balances recorded in previous years
- Meeting the medium-term fiscal objective (MTO) from 2017 to 2019 (structural deficit of 0.5% of GDP) is realistic but the government's leeway in the event of an adverse shock has decreased considerably
- Gross debt is expected to remain under 25% up to 2021
- The MTO should be fixed at a more ambitious threshold for the period 2020-2022

## Macroeconomic outlook

In the short term, the economy is expected to accelerate to 4.4% in 2017 and to 5.2% in 2018 followed by a marked slowdown at the end of the period (+1.9% in 2021). The government explains the slowdown by the assumption that real growth is oscillating around potential growth over the 2017-2021 period, which is estimated at 3.6%. Compared to forecasts of the European Commission and the IMF, the medium-term macroeconomic forecasts in the SGP are relatively pessimistic.

## Short-term fiscal outlook

With +0.2% of GDP in 2017 and +0.3% of GDP in 2018, the expected general government surplus remains well below the more positive balances recorded in previous years (+1.4% of GDP in 2015 and +1.6% of GDP in 2016). In fact, in 2017, revenues would only increase by 3.1% due to the tax reform and the losses from VAT on e-commerce, and expenditures would increase by 6.4%, mainly due to the acceleration of gross fixed capital formation (Chart 1).

## Medium-term fiscal outlook

In the medium term, the nominal balance is estimated to improve gradually towards +1.2% of GDP in 2021. However, the CNFP notes that the medium-term budgetary forecasts should be assessed with caution.

The government declares meeting the medium-term objective (MTO) (structural deficit of 0.5% of GDP). However, the government's leeway in the event of an adverse shock has decreased considerably (Chart 2).

Gross debt is expected to continue on an upward trajectory in the medium term (+€3 billion over the 2018-2021 period). However, because of favourable economic developments, gross debt should stabilize at around 22.5% of GDP.

## Fiscal framework and national fiscal rules

Regarding the structural balance and its compliance with the MTO, the CNFP reminds that there are several methods for determining potential GDP and hence the output gap. The results obtained through the various calculation methods analysed by the CNFP can give rise to divergent interpretations of Luxembourg's positioning in the economic cycle and hence of the budgetary performance related to the MTO (Chart 2).

Furthermore, the CNFP recommends setting a more ambitious MTO for the years 2020 to 2022 in order to ensure that there is room to cope with unexpected developments.

Chart 1: Revenue and Expenditure growth rates

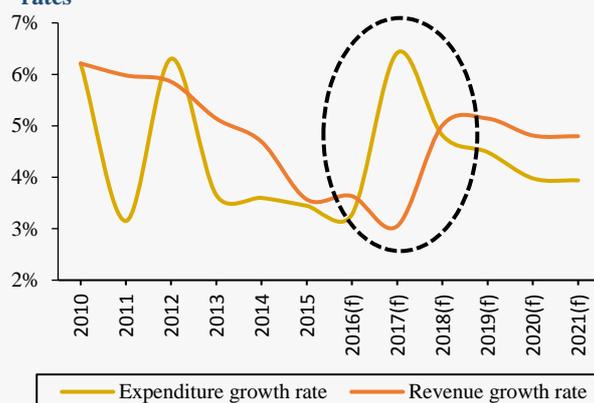
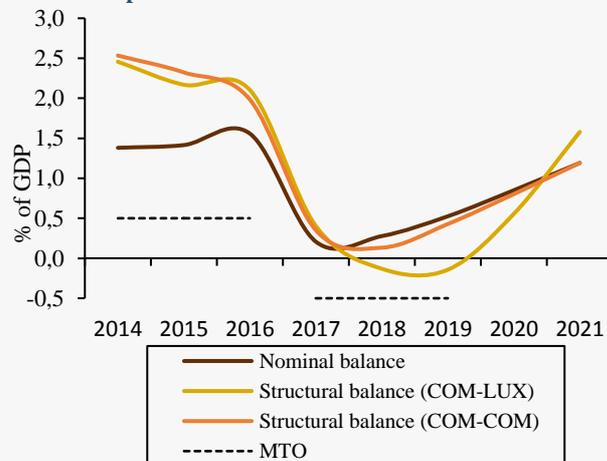


Chart 2: Evolution of the structural balance and compliance with the MTO



COM-LUX – SGP MoF est.  
COM-COM – European Commission est.

## Key indicator forecast

		2015	2016 f	2017 f	2018 f	2019 f	2020 f	2021 f
Real GDP growth rate – MoF est.	[% y-to-y]	4.0	4.2	4.4	5.2	4.4	2.0	1.9
Output Gap – MoF est.	[% of GDP potential]	-1.7	-1.2	-0.4	0.9	1.5	0.7	-0.9
GG balance – MoF est.	[% of GDP]	1.4	1.6	0.2	0.3	0.5	0.9	1.2
GG debt – MoF est.	[% of GDP]	21.6	20.0	22.2	22.4	22.6	22.8	22.6
GG structural balance – MoF est.	[% of GDP]	2.2	2.1	0.4	-0.1	-0.1	0.6	1.6
Adjusted real GG expenditure growth – CNFP est.	[% y-to-y]	0.1	3.8	5.8				
Discretionary revenue measures – CNFP est.	[% of GDP]	0.4	0.2	-0.6	0.0	0.0	0.0	0.0

Sources:

Stability and Growth Programme of Luxembourg for the 2017-2021 period (SGP), 28.04.2017;

CNFP: Assessment of the SGP, 02.06.2017

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