

Country note, July 2018

Key messages:

- GDP growth is expected to accelerate to 4.6% in 2018 and 2019
- Fiscal surplus in 2018 should be close to +1.1% of GDP, slightly below balances recorded in previous years
- The nominal budget balances of the general government were significantly underestimated over the last 10 years
- Meeting the medium-term fiscal objective (MTO) in 2018 and 2019 (structural deficit of 0.5% of GDP) is realistic
- Gross debt is expected to remain under 25% over the period, even passing under 20% in 2022
- The MTO needs to be fixed at a more ambitious threshold for the period 2020-2022

Macroeconomic outlook

At a rate of 2.3% in 2017, the economy is expected to grow less quickly compared to the forecasts of 4.4% included in the Stability and Growth Programme (SGP) of Luxembourg, which was published in April 2017. In the short term, the economy is expected to accelerate to 4.6% in 2018 and 2019. Compared to forecasts of the EC and the IMF, the short term forecasts in the SGP are relatively optimistic. The CNFP notes a marked slowdown of the economy at the end of the period (+2.9% in 2022). The government explains the slowdown by the assumption that real growth is oscillating around potential growth over the 2018-2022 period.

In a separate report, the CNFP has assessed the accuracy of macroeconomic forecasts realized by STATEC over the 1996 to 2016 period. The assessment is positive overall. However, the statistical tests suggest a significant underestimation of the employment growth rate.

Short-term fiscal outlook

With +1.1% of GDP in 2018 and +1.4% of GDP in 2019, the expected general government surplus will remain slightly below the more positive balances recorded in previous years (+1.6% of GDP in 2016 and +1.5% of GDP in 2017).

However, the CNFP notes that the nominal budget balances of the general government were significantly underestimated in the past. In fact, in its assessment of the accuracy of forecasts of budgetary data, CNFP shows that the nominal budget balances observed over the last 10 years are significantly higher than previously estimated (Chart 1).

Medium-term fiscal outlook

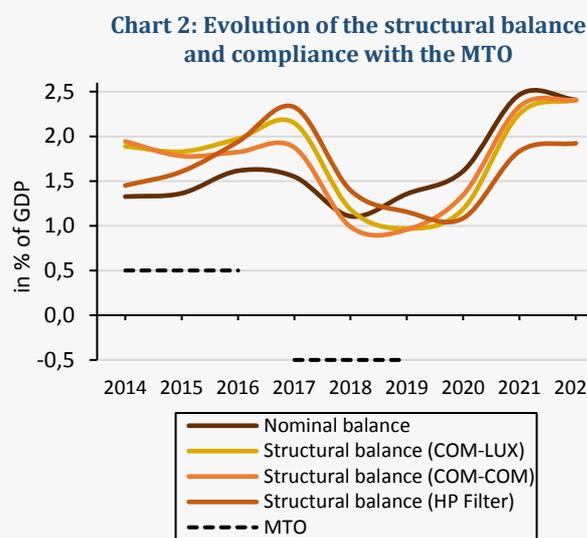
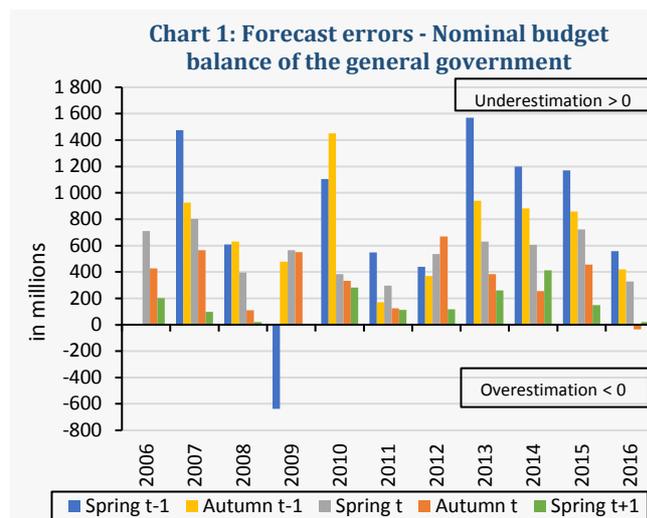
In the medium term, the nominal balance is expected to improve gradually towards +2.4% of GDP in 2022. Gross debt should pass under 20% of GDP in 2022 because of the favourable economic developments. However, the CNFP notes that the medium-term budgetary forecasts should be assessed with caution.

Fiscal framework and national fiscal rules

Regarding the structural balance and its compliance with the MTO, the CNFP points out 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).

The government declares meeting the medium-term objective (MTO) (structural deficit of 0.5% of GDP) over the 2017 to 2019 period.

For the years 2020 to 2022, the minimum MTO applicable at European level will be calculated by the EC based on the new demographic, macroeconomic and budgetary projections that have recently been adopted by the "Ageing Working Group" of the EC. According to a preliminary estimate of the CNFP, this could result in a minimum MTO of +0.25% of GDP over the 2020 to 2022 period. The CNFP therefore recommends that appropriate measures be implemented in the short and medium term.



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

Sources:

Stability and Growth Programme of Luxembourg for the 2018-2022 period (SGP), 27.04.2018;

Assessment of the SGP, 15.06.2018

Assessment of the accuracy of forecast, 15.06.2018

f – forecast
MoF – Ministry of Finance
GG – general government

Key indicator forecast

		2016	2017 f	2018 f	2019 f	2020 f	2021 f	2022 f
Real GDP growth rate – MoF est.	[% y-to-y]	3.1	2.3	4.6	4.6	4.2	3.6	2.9
Output Gap – MoF est.	[% of GDP potential]	-0.8	-1.4	-0.2	0.9	1.0	0.5	0.0
GG balance – MoF est.	[% of GDP]	1.6	1.5	1.1	1.4	1.6	2.5	2.4
GG debt – MoF est.	[% of GDP]	20.8	23.0	22.7	22.1	21.3	20.0	18.8
GG structural balance – MoF est.	[% of GDP]	2.0	2.1	1.2	1.0	1.2	2.3	2.4