

Country note, November 2017

Key messages:

- With 2.7% in 2017 and 3.7% in 2018, the economy is expected to grow less quickly compared to the forecasts of 4.4% in 2017 and 5.2% from April 2017
- Fiscal surplus in 2017 should be close to +0.6% 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 has decreased. For the 2020-2022 period, the MTO should be fixed at a more ambitious threshold
- Gross debt is expected to remain under 25% of GDP up to 2021

Macroeconomic outlook

With 2.7% in 2017 and 3.7% in 2018, the economy is expected to grow less quickly compared to the forecasts of 4.4% in 2017 and 5.2% in 2018 included in the Stability and Growth Programme (SGP) of Luxembourg, which was published in April 2017. The government explains the slowdown with a major revision of GDP growth over the 2013-2016 period. Furthermore, the CNFP notes that the multi-year macroeconomic forecasts are based on a combination of two different scenarios: the growth rates for the years 2017 and 2018 have been updated for this exercise, while those for the years 2019 to 2021 come from the 2017 SGP (4.4% in 2019; 2.8% in 2020 and 1.9% in 2021). In order to avoid inconsistencies in the data, the CNFP recommends advancing the draft multiannual financial programming law (LFPF) to the spring of each year.

Short-term fiscal outlook

With +0.6% of GDP in 2017 and 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 4.6% due to the tax reform and the losses from VAT on e-commerce, while expenditures would increase by 7.1%, mainly due to the acceleration of public investment expenditures (Chart 1).

The CNFP notes that it is difficult to grasp the impact of the significant downward revision of real growth on the evolution of public revenue. In fact, the CNFP does not identify a downward revision of the public revenue estimates in the 2017-2021 LFPF as compared to the 2017 SGP. The CNFP recommends that the government quantify this impact in the future.

Medium-term fiscal outlook

In the medium term, the nominal balance is estimated to improve gradually towards +1.7% of GDP in 2021. On the one side, the 2017-2021 LFPF assumes a gradual recovery of government revenues (5.2%). On the other hand, public spending is expected to increase less quickly (4.4% against a historical average of 6.1%) (Chart 1). The CNFP notes that the document does not provide any details to understand the significant increase in government revenues and the slowdown in public spending growth over the medium term. The medium-term budgetary forecasts should therefore be assessed with caution: direct investment in particular is likely to be underestimated with an average growth rate of +2.9%.

Fiscal framework and national fiscal rules

Regarding the structural balance and its compliance with the MTO, there are several methods for determining potential GDP and hence the output gap. The CNFP notes that estimates of the output gap of the three calculations methods analysed were made at different points in time and are therefore based on different macroeconomic scenarios. The results obtained give rise to different interpretations of Luxembourg's positioning in the economic cycle and hence of the budgetary performance related to the MTO (Chart 2). In any event, regardless of the method used, Luxembourg should comply with the national budgetary rule over the entire period. The CNFP continues to recommend the pursuit of sufficiently ambitious budgetary targets not to approach the -0.5% threshold on the structural balance. If the aim is to keep public debt below 30% of GDP, a minimum structural balance of +0.25% would be required. If, in addition, one takes into account the new Eurostat population projections, the structural balance should even be + 0.75% of GDP.

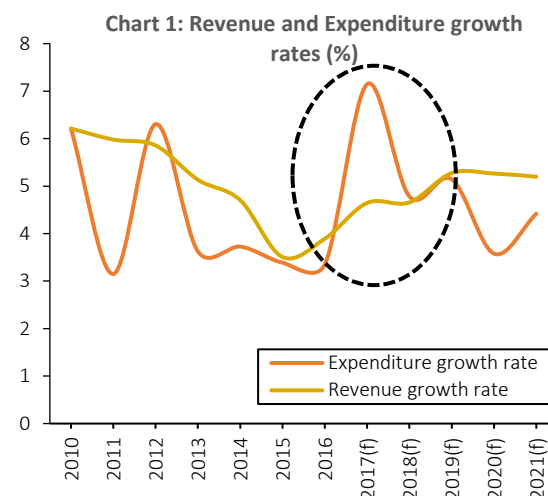
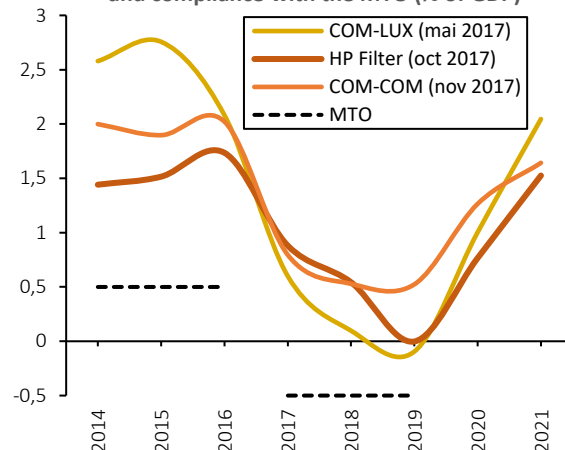


Chart 2: Evolution of the structural balance and compliance with the MTO (% of GDP)



COM-LUX – DB MoF est.
COM-COM – European Commission est.
HP filter – CNFP est.

Sources:

Draft budget for 2018 (2018 DB),
October 2017

Draft multiannual financial
programming law for the period
2017-2021 (2017-2021 LFPF),
October 2017

CNFP: Assessment of the 2018 DB
and 2017-2021 LFPF, 20.11.2017

f – forecast
MoF – Ministry of Finance

Key indicator forecast		2016	2017 f	2018 f	2019 f	2020 f	2021 f
Real GDP growth rate – MoF est.	[% y-to-y]	3.1	2.7	3.7	4.4	2.8	1.9
Output Gap – MoF est.	[% of GDP potential]	-1.0	0.1	1.1	1.6	0.7	-0.8
GG balance – MoF est.	[% of GDP]	1.6	0.6	0.6	0.6	1.3	1.7
GG debt – MoF est.	[% of GDP]	20.8	23.5	22.7	22.5	22.3	21.6
GG structural balance – MoF est.	[% of GDP]	2.1	0.6	0.1	-0.1	1.0	2.0