

Public Finance Assessment of the draft budget for 2024 (“2024 DB”) and the draft multiannual financial programming law for the years 2023-2027 (“2023-2027 PLPFP”)

The macroeconomic and budgetary figures presented in the 2023-2027 PLPFP can be summarized as follows:

- The Luxembourg economy was unable to avoid a recession in 2023. However, economic activity in Luxembourg is expected to recover in 2024 and 2025 (with expected growth of 2.0% and 3.0% respectively). Regarding the labour market, employment is expected to grow at a historically low rate in 2024 (1.3%) and unemployment is expected to stabilize at a high rate in 2024-2025 (5.9%). Inflation should continue to ease in 2024 (to 2.2%). Nevertheless, a temporary rebound in inflation is expected in 2025 (3.3%) following the removal of the energy price cap and without any new measures.
- Regarding budgetary forecasts, the nominal balance of general government (i.e. the difference between budgetary revenues and expenditures) is expected to reach -0.7% of GDP (€566 million) in 2023 and -1.2% of GDP (€987 million) in 2024. In the medium term (2025-2027), the nominal balance would improve only slowly towards -0.9% of GDP or -921 million euros in 2027. In addition to the fact that the deficit of the central government will remain in 2027 (€-1,293 million), the surplus of the social security is set to fall continuously from €1,055 million in 2023 to €261 million in 2027. Public debt should continue to rise in absolute terms over the medium term, reaching €26,579 million or 27.3% of GDP in 2027.

The CNFP made some observations (which are explained in detail in the respective sections of the assessment) concerning the budgetary forecasts:

- In the medium term (2025-2027), the average growth rate of central government revenues (5%) could *a priori* be described as prudent, whereas the low average growth rate of expenditures (4%) implies that measures will be taken to curb the downward rigidity of current expenditure.
- Article 5 of the 2023-2027 PLPFP defines, for the first time, the maximum amounts of expenditures for the central government (provided for by the law of 12 July 2014), which correspond exactly to the expenditure forecasts. Hence, it appears that the Government is committed to reducing current expenditures. This new provision will enable the CNFP to assess compliance with future maximum amounts declared in PLPFP and eventual overspending need to be explained by the Government.
- The CNFP notes an improvement in the nominal balance of the central government of €375 million on average per year over the period 2023 to 2027 despite a downward revision of the average economic forecasts (2.1% compared to 3.0% over the 2023-2027 period) and a slightly lower inflation forecast (2.5% compared to 2.6%) in the 2023-2027 PLPFP compared to the 2023 SCP (Stability and convergence programme), as well as additional measures taken by the new Government in the period after the 2023 SCP. This confirms the result of the *Assessment of the accuracy of forecast of macroeconomic and budgetary data* published by the CNFP in May 2023, which revealed a significant underestimation of the forecasts of the nominal balance of the central government.

As per the figures presented in the 2023-2027 PLPFP, it appears that the nominal balance of the general government will remain negative over the entire period. Despite the fact that public finances continue to comply with the Maastricht criteria (deficit below 3% of GDP, public debt below 60% of GDP), the question that arises is whether the Government has the capacity to increase its revenues in the event of future economic shocks, taking into account the downward rigidity of numerous

expenditures, the maintenance of negative nominal balances and the rise in public debt and its financing cost.

Regarding the budgetary governance rule, the medium-term budgetary objective (MTO) of 0.00% of GDP is expected to be respected in 2024. According to the forecasts in the 2023-2027 PLPFP, the structural balance (i.e. the cyclically adjusted nominal balance corrected for one-off and temporary measures) is expected to reach 0.00% of GDP in 2024. In 2025, the structural balance would no longer respect the MTO, but it would not show a significant deviation. It should be noted, however, that the Council of EU Finance Ministers and the European Parliament reached agreement on 10 February 2024 on the proposed reform of the EU's economic governance framework. In the preventive arm (Regulation (EC) No 1466/97), the MTO criterion would be abrogated and replaced with a single operational indicator based on the sustainability of public debt, through a reference multiannual adjustment path in terms of net primary public expenditure.

The CNFP notes that Luxembourg will not be impacted by a significant portion of the preventive arm if it continues to comply with the Maastricht criteria. To ensure sound and prudent budgetary governance at the national level, it would however be appropriate to put in place a national budgetary framework with a medium and long-term view, adapted to the state of Luxembourg's public finances and to the country's current and future challenges. The CNFP could usefully help to set up a new national budgetary framework. It has taken due note of the Finance Minister's declaration to maintain the MTO criterion at the national level.

Unlike the new criteria proposed at the European level, the MTO considers a third of the future costs linked to the ageing of the population (these costs would rise from 17.2% of GDP in 2022 to 27.9% of GDP in 2070 in Luxembourg according to the 2023-2027 PLPFP) and thus considers the long-term sustainability of public finances. Since the MTO is no longer imposed by the EC, Luxembourg would be able to adapt the calculation methodology to specific national circumstances, i.e., by adopting a more nuanced approach for certain categories of expenditure, such as investment. Other ways to strengthen the national budgetary framework could of course also be developed.