

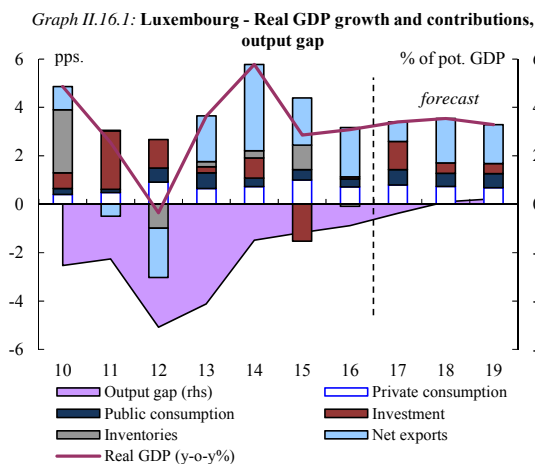
16. LUXEMBOURG

Sustained, broad-based growth

Economic growth is projected to accelerate further in 2017 and 2018, albeit tapering off before slightly decelerating by the end of the forecast horizon. Employment growth is set to remain solid, while unemployment is expected to decrease further. Inflation is projected to be driven mainly by underlying price pressures, as the influence of energy prices fades. In spite of the implementation of a tax reform that decrease the overall tax burden, public finances are projected to remain sound.

Scope for further growth in 2017

Following a significant revision in its National Accounts, Luxembourg's economic growth is projected at 3.4% in 2017. In the first half of the year economic activity grew below expectations. Nevertheless, conditions remain favourable and the latest indicators point to an increasing momentum in the second half of the year.



Private consumption is expected to recover after a weak performance in the first half of 2017, mainly on the back of stronger employment creation among residents, while the impact of income gains from the tax reforms and the wage indexation measures implemented in January was lowered by the surge in consumer prices. High households' indebtedness and increasing debt burdens, could be also affecting consumption growth. In 2017, private investment will be mainly driven by the satellite and aircraft industry, while growth of construction investment is forecast to remain robust throughout the forecast horizon.

The contribution to growth from the financial sector, traditionally Luxembourg's main growth engine, strengthened in the first half of 2017, underpinned by the euro area's recovery. The fund investment industry set new records, while the profitability of the banking sector was maintained,

in spite of the high costs that new regulatory standards have entailed. The latest indicators suggest a continuation of these trends in the second half of the year.

Stable and balanced growth ahead

In 2018, sustained employment creation, the implementation of the next wage indexation (projected for mid-2018) and lower inflation are expected to continue to support private consumption and domestic demand growth. The external sector is expected to remain solid, supported by an improved external environment, especially in the euro area. Overall, GDP is forecast to grow by 3.5% in 2018, with a more balanced, and broad-based composition.

In 2019, consumption growth is projected to ease further, with income gains fading away and inflation progressively taking effect. The external sector, which is dominated by financial services exports, is expected to remain robust, even if receding, in line with financial markets prospects.

Sustained employment creation

In 2017, employment growth is expected to rise to 3.1% from 3.0% in 2016. Strong economic momentum should support stable employment creation throughout the forecast period. Resident employment (excluding frontier workers, who do not count as part of Luxembourg's active working population) rose markedly, helping to curb the unemployment rate, which was 6.3% in 2016. The unemployment rate is forecast to stabilise at around 6.0% by the end of the forecast horizon.

A change of inflation drivers

Headline HICP inflation is forecast to reach 2.1% in 2017 from zero in 2016, mainly as a result of oil price movements. As these effects dissipate, underlying price pressures, including from wage increases, should drive the headline inflation rate to 1.9% in 2019, after 1.7% in 2018.

Rising revenues offset expenditure growth

In 2017, the general government surplus is projected to decline to 0.5% of GDP from 1.6% of GDP in 2016. The drop is mostly explained by the impact of the tax reform enacted by the government at the start of the year to increase households' purchasing power and the country's competitiveness. The reforms are expected to shave revenues from households and corporates by about 0.8% of GDP. Finally, additional revenues, equivalent to 0.3% of GDP, will be lost, due to a cut from 30% to 15% in the share of VAT revenues that Luxembourg earns from e-commerce related transactions.

Expenditure growth is also projected to rise as for effect of the automatic wage indexation, which took place at the start of the year. Public investment is expected to further expand while the wage bill should grow faster given the impact of the implementation of the recent wage agreement in the public sector.

In 2018, the general government surplus is expected to marginally decline further to 0.3% of GDP. Buoyant revenue growth underpinned by strong underlying economic growth will be

outpaced by growth in government expenditure, especially still high spending for infrastructure investment.

Based on a no-policy-change assumption, the surplus of the general government balance is projected to slightly improve in 2019. This projection includes the purchase of a military plane for a cost estimated at around 0.3% of GDP.

Mirroring the evolution of the headline balance, a substantial drop in the structural balance from 2.0% to around ½% of GDP is projected in 2017. In the light of the closing of the output gap towards the end of the forecast period, the general government's structural surplus is expected to further diminish in 2018, although it should remain in positive territory. In 2019, the structural surplus is expected to stabilise as the slight improvement in the headline position is offset by the more positive output gap.

After declining to 20.8% in 2016, Luxembourg's debt-to-GDP ratio is set to increase to 22.9% by 2019, as the government must issue debt to cover its deficit, since the surplus of the social security sector cannot be used for this purpose.

Table II.16.1:

Main features of country forecast - LUXEMBOURG

	2016			Annual percentage change						
	mio EUR	Curr. prices	% GDP	98-13	2014	2015	2016	2017	2018	2019
GDP		53004.8	100.0	3.5	5.8	2.9	3.1	3.4	3.5	3.3
Private Consumption		16036.7	30.3	2.4	2.3	3.3	2.4	2.6	2.5	2.3
Public Consumption		8849.1	16.7	3.5	2.0	2.6	2.0	3.8	3.2	3.4
Gross fixed capital formation		9112.4	17.2	4.6	4.3	-8.0	0.5	6.8	2.4	2.4
of which: equipment		3168.1	6.0	6.8	5.3	-16.5	-7.0	12.1	1.0	1.5
Exports (goods and services)		117282.5	221.3	6.4	14.0	6.9	2.7	5.0	4.8	4.0
Imports (goods and services)		98675.5	186.2	6.8	14.6	7.1	2.1	5.5	4.7	4.0
GNI (GDP deflator)		36074.6	68.1	1.5	2.5	5.4	5.8	2.6	3.6	3.1
Contribution to GDP growth:	Domestic demand			2.4	1.9	-0.1	1.1	2.6	1.7	1.7
	Inventories			0.0	0.3	1.0	-0.1	0.0	0.0	0.0
	Net exports			1.1	3.6	1.9	2.0	0.8	1.8	1.6
Employment				3.3	2.6	2.6	3.0	3.1	3.0	2.9
Unemployment rate (a)				4.0	6.0	6.5	6.3	6.1	5.9	6.0
Compensation of employees / head				3.0	2.2	3.0	0.7	2.9	2.5	2.0
Unit labour costs whole economy				2.9	-0.9	2.8	0.7	2.6	1.9	1.6
Real unit labour cost				0.1	-2.5	1.4	2.0	0.3	-0.4	-0.2
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				2.8	1.6	1.3	-1.3	2.3	2.3	1.9
Harmonised index of consumer prices				2.5	0.7	0.1	0.0	2.1	1.7	1.9
Terms of trade of goods				0.3	0.8	-2.2	0.3	-1.0	0.4	0.2
Trade balance (goods) (c)				-6.4	1.6	-0.5	-1.4	-2.6	-2.2	-2.1
Current-account balance (c)				8.4	5.2	5.1	4.8	4.6	4.8	4.7
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				8.0	3.8	4.6	4.4	4.3	4.4	4.4
General government balance (c)				1.9	1.3	1.4	1.6	0.5	0.3	0.4
Cyclically-adjusted budget balance (d)				1.9	2.0	1.9	2.0	0.6	0.3	0.3
Structural budget balance (d)				-	2.0	1.7	2.0	0.6	0.3	0.3
General government gross debt (c)				11.7	22.7	22.0	20.8	23.7	23.0	22.9

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.