Summary for non-specialists
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Macroeconomic Imbalances

Luxembourg 2014

On 13 November 2013, the European Commission presented its third Alert Mechanism Report (AMR) in accordance with the Regulation (EU) No. 1176/2011 on the prevention and correction of macroeconomic imbalances. The AMR serves as an initial screening device to identify Member States that warrant further in depth analysis into whether imbalances exist or risk emerging. According to Article 5 of Regulation No. 1176/2011, these country-specific "in-depth reviews" should examine the nature, origin and severity of macroeconomic developments in the Member State concerned, which constitute, or could lead to, imbalances. On the basis of this analysis, presented on 5 March 2014, the Commission will conclude whether it considers that an imbalance exists or not, and if so whether it is excessive or not, and what type of follow-up it will recommend to the Council to address to the Member State.

The 2014 in-depth reviews (for Belgium, Bulgaria, Germany, Denmark, Ireland, Spain, France, Croatia, Italy, Luxembourg, Hungary, Malta, Netherlands, Slovenia, Sweden, Finland and the United Kingdom) were published on 5 March 2014 together with a Commission communication summarising the results. On the basis of the analysis in the In-depth review the Commission concluded that:

The macroeconomic challenges of **Luxembourg** *have not been identified as imbalances in the sense of the MIP*. They stem from a growth model based on an efficient financial sector, which has weathered the crisis well. Still, losses in the manufacturing competitiveness, the evolution of the housing market and the high level of indebtedness of the private sector deserve continued monitoring.

More specifically, the analysis of the current account surplus shows that it does not stem from an anaemic domestic demand, but is rather the result of the particular growth model of the country strongly based on financial services. Still, it masks a large and steadily increasing deficit in merchandise trade, which broadly comes from disappointing exports. Losses of export market shares are largely associated with unit labour costs rising much faster than in trading partner countries, driven to a certain extent by the wage setting mechanism. In such regard, finding a structural solution to the temporary modulation of the automatic wage indexation constitutes a challenge. Risks to the domestic financial stability stemming from the presence of a large financial sector exist, but they are relatively contained as the sector is diversified and specialised at the same time. Furthermore, domestic banks post sound capital and liquidity ratios. The high level of indebtedness of the private sector and in particular of the non-financial corporations mainly reflects the presence of a large number of multinational firms that use their branches or subsidiaries in Luxembourg for intra-group financing operations. The dynamism of house prices represents an increasing source of concern. Finally, the current favourable position of public finances is highly dependent on the sustainability of the growth model based on a buoyant financial sector and presents a high sustainability risk in the long term. In this vein, the recently implemented pension reform is insufficient to cope with the challenge. However the structural balance is above the medium-term objective.