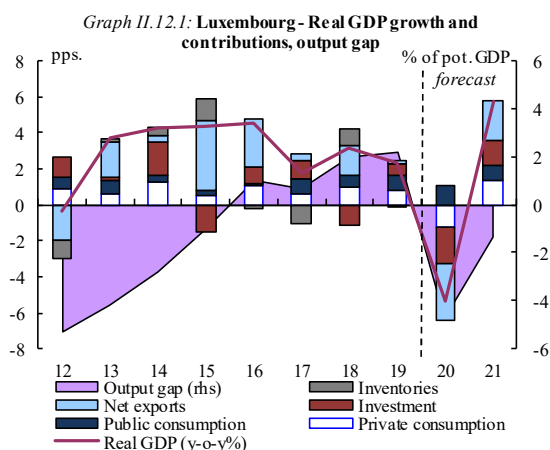


12. LUXEMBOURG

Restrictions put in place to control the COVID-19 pandemic are expected to impact domestic demand and net trade leading to a large decline in real GDP in 2020. Strong fiscal measures are projected to mitigate the decline and pave the way for real GDP growth to rebound in 2021. Consequently, the general government balance will revert into a deficit, while government debt, although increasing, remains at a low level. Inflation is forecast to decline significantly following the drop in energy prices in 2020.

A broad-based fall in activity in 2020

The COVID-19 crisis will push Luxembourg into recession in 2020. Real GDP is forecast to decline by -5½% in 2020. Compared to 2.3% GDP growth estimated for 2019, which was already lower than in previous years. Assuming normalisation over the course of 2020, Luxembourg is projected to show a strong recovery in 2021 when GDP is forecast to grow by 5¾%.



In 2020, private consumption is expected to decline as a result of the lock down and travel ban that were implemented since mid-March. In recent years, private consumption had been a solid driver of GDP growth in Luxembourg. The high level of uncertainty and the squeeze on liquidity due to falling revenues, especially for corporations, will result in a sharp contraction in gross fixed capital formation by 12% in 2020. The government measures to buffer the liquidity contraction and increased government consumption (+6¼%) will only partly mitigate the economic impact of the crisis. The sharp drop in international trade in goods and services and lower cross border consumption are expected to be a drag on economic growth as well. In addition, the heightened stock market volatility and the decline in economic activity are expected to negatively

impact the financial sector which represents a large share of GDP in Luxembourg.⁽¹²⁰⁾

Rebound after normalisation

Private consumption, the main driver of domestic demand growth, is expected to rebound in 2021 once restrictions are completely lifted and the economy goes back to normal again, while the expected wage indexation in the third quarter of 2021 should support purchasing power. As uncertainty dissipates, investment should recover, while the normalisation of international trade should also provide a strong positive contribution to GDP growth in 2021. As a small open economy with strong trade and financial links with international markets, Luxembourg is highly exposed to external risks. Uncertainty related to the end of the COVID-19 crisis and any financial turmoil that may ensue, could result in a less benign outcome for its economy.

Higher unemployment and lower inflation

The labour market peaked in 2019 as employment growth fell back from the high levels of previous years and the decline in unemployment stopped. The COVID-19 crisis is expected to lead to higher unemployment in 2020. Disposable income will be supported by the indexation of wages in January 2020, the short-time unemployment scheme and other crisis-related measures implemented by the government. Specific measures are addressed to cross border workers such as teleworking arrangements and travel permits. Headline inflation is forecast to fall to 0.7% in 2020, mainly due to the sharp decline in oil prices, falling demand and the introduction of free public transport. A rebound to 1.6% is foreseen for 2021, on the back of some positive base effects related mainly to energy prices.

⁽¹²⁰⁾ Luxembourg's national accounts are subject to sometimes substantial revisions, amongst others due to methodological difficulties related to the important role of multinational firms and financial services in external trade.

The general government balance falls into deficit for the first time since 2010

The general government surplus declined from 3.1% of GDP in 2018 to 2.2% of GDP in 2019, as revenues declined by 0.6 pps. of GDP and expenditure increased by 0.3 pps.

The COVID-19 outbreak is expected to bring a sharp deterioration in public finances in 2020. The general government balance is projected to shift to a deficit of 4¾% of GDP. Revenues will be heavily affected; although increasing as a share of GDP to 45½% in 2020, a decline in their absolute value is expected. Taxes on income and wealth are expected to decline by the lower profitability of the financial sector, which is the main contributor. The sharp decline in the stock market will bring a drop in the taxes collected on assets managed by the fund industry. The travel ban is expected to lead to drop in excises collected on the sales of fuels, tobacco and alcohol.

In line with the sizeable measures adopted by the government to combat the pandemic and its impact, expenditure is expected to shoot up to

50¼% of GDP. In particular, the existing short-time working scheme has been extended to all companies affected by the current crisis, a new aid scheme to support SMEs in temporary financial difficulty has been introduced, and procedures for requesting special leave for family reasons due to school closure has been simplified. Additional expenditures in the context of health and crisis management are expected to boost government investment. Measures such as tax and social contribution deferrals, refundable loans and credit guarantees aimed at providing liquidity support to companies are not assumed to have a budgetary impact in 2020. Finally, the purchase of a military plane will have an impact on public investment (EUR 0.2 billion).

At unchanged policies and assuming that the measures adopted to fight the pandemic will have only a temporary effect in 2020 and that economic activity should recover in 2021, the government balance is forecast to improve close to a small surplus in 2021. Public debt is expected to increase from 22.1% of GDP in 2019 to 26½% in 2020 and fall slightly to 25¾% in 2021.

Table II.12.1:

Main features of country forecast - LUXEMBOURG

	2018			Annual percentage change						
	mio EUR	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	60053.1		100.0	3.1	4.6	1.8	3.1	2.3	-5.4	5.7
Private Consumption	17874.0		29.8	2.3	3.4	2.2	3.3	2.8	-4.1	4.6
Public Consumption	10004.5		16.7	3.1	1.0	4.7	4.1	4.8	6.3	4.1
Gross fixed capital formation	10096.4		16.8	2.9	4.6	5.6	-5.9	3.9	-12.0	8.5
of which: equipment	3164.0		5.3	3.9	-1.0	16.3	-22.2	12.5	-14.4	9.4
Exports (goods and services)	127047.7		211.6	6.1	2.6	0.7	0.5	0.8	-11.5	8.4
Imports (goods and services)	105419.8		175.5	6.5	1.6	0.6	-0.3	0.9	-12.0	8.8
GNI (GDP deflator)	38255.6		63.7	1.4	2.2	3.1	1.9	9.9	-2.1	4.8
Contribution to GDP growth:		Domestic demand		1.9	2.0	2.4	0.5	2.3	-2.2	3.5
		Inventories		0.1	-0.2	-1.1	0.9	-0.2	0.0	0.0
		Net exports		1.2	2.7	0.4	1.6	0.2	-3.2	2.2
Employment				3.1	3.0	3.4	3.7	3.6	0.9	3.1
Unemployment rate (a)				4.6	6.3	5.5	5.6	5.6	6.4	6.1
Compensation of employees / head				3.0	0.8	3.0	3.3	1.7	1.8	2.4
Unit labour costs whole economy				3.0	-0.7	4.6	3.9	3.0	8.5	-0.2
Real unit labour cost				0.2	-1.5	2.8	1.3	-0.4	8.1	-2.9
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				2.7	0.8	1.7	2.5	3.4	0.4	2.8
Harmonised index of consumer prices				2.5	0.0	2.1	2.0	1.6	0.7	1.6
Terms of trade of goods				0.4	2.0	-1.4	0.4	-1.0	0.2	0.0
Trade balance (goods) (c)				-4.8	-1.1	-2.0	-2.0	-3.1	-2.6	-2.7
Current-account balance (c)				3.7	0.2	-0.9	0.0	4.5	4.5	4.5
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				3.1	-0.4	-1.5	-0.7	4.0	4.1	4.1
General government balance (c)				1.6	1.8	1.3	3.1	2.2	-4.8	0.1
Cyclically-adjusted budget balance (d)				1.9	1.4	1.0	2.2	1.2	-2.6	0.7
Structural budget balance (d)				-	1.4	1.0	2.2	1.2	-2.6	0.7
General government gross debt (c)				14.0	20.1	22.3	21.0	22.1	26.4	25.7

(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.