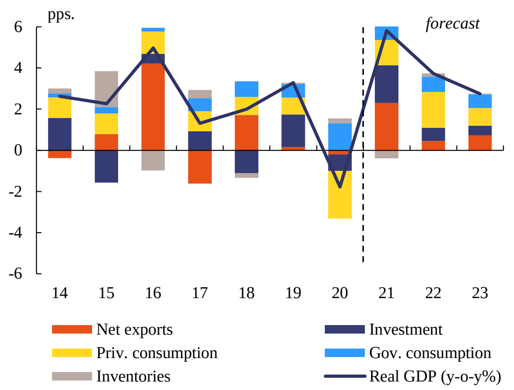
12. LUXEMBOURG

Economic growth in Luxembourg is set to rebound strongly in 2021. The easing of restrictions after a successful vaccination campaign is expected to allow GDP to grow strongly this year, supported by private consumption and investment, as well as by the strong performance of the external sector. The economy is projected to continue a steady growth path in 2022 and 2023, leading to a decrease in unemployment. The general government balance is forecast to improve gradually.

A strong recovery in 2021 following a limited contraction in 2020

Real GDP growth is expected to increase strongly in 2021, after only a limited drop of 1.8% in 2020 caused by the COVID-19 crisis. The relative resilience of the Luxembourg economy in 2020 was due to several factors: government support measures to businesses and households, a strong performance in the information and communication and transport sectors, and the country's large financial sector, which was less affected by the crisis than contact-based services. As such, real GDP already returned to its pre-crisis level before the end of 2020.

Graph II.12.1: **Luxembourg - Real GDP growth and contributions**



Social-distancing measures still in place in the first half of this year curbed private consumption, particularly for service sectors whose activities relied on close contacts with clients, like restaurants and leisure activities. A successful vaccination campaign kept under control the number of hospital cases and allowed the gradual lifting of restrictions over the course of 2021. Support measures have protected household incomes from economic distress and have even allowed a strong increase in the saving rate. Consumer sentiment, meanwhile, showed a strong recovery. This is in line with an observed increase in employment, mirrored by a drop in unemployment during 2021. With improved confidence level of consumers, the easing of restrictions is expected to increase private consumption.

Furthermore, with good financing conditions and improved business sentiment, investments are set to rebound strongly in 2021 after the decline in 2020. Public consumption is also forecast to increase in 2021. Improvements in the economic outlook for Luxembourg's commercial partners bode well for export growth. Furthermore, due to Luxembourg's reliance on the financial sector, the positive performance of stock market indexes in the first half of the year is positive for growth. Real GDP growth is forecast to reach 5.8% in 2021. In the following years, economic activity is expected to return gradually to historic trends with 3.7% of real GDP growth in 2022 and 2.7% in 2023. However, the introduction of new international taxation rules may pose a risk to the outlook for Luxembourg's economy.

Lower unemployment ahead

The government's short-term work scheme has supported employment levels and unemployment decreased so far in 2021. With strong real GDP growth in 2022 and 2023, unemployment is expected to continue its decline from 6.1% in 2021, to 5.8% and 5.7% in 2022 and 2023, respectively. Bankruptcy and unemployment levels are not projected to be affected by the gradual withdrawal of support measures, but this still represents a downside risk to the outlook.

Inflation on the rise

Headline inflation is set to rebound from 0% in 2020 to 3.2% in 2021, due to higher energy prices and the implementation of a carbon tax. It is subsequently expected to moderate to 2.2% in 2022 and 1.8% in 2023, as some energy price base effects fade out. Core inflation is projected to increase from 1.4% in 2021 and to get closer to headline inflation in 2022 and 2023.

Strong revenues pave the way to an improved government balance

In 2021, the general government balance is expected to improve to a deficit of 0.2% of GDP from a deficit of 3.5% in 2020. In line with the recovery of the economy, revenues are expected to sharply expand, in nominal terms, to situate around 9% above their 2019 level. Strong personal income taxes are expected to post a large increase, also due to the lack of automatic adjustment of tax brackets to inflation. Corporate taxes are also expected to grow after the large drop recorded in 2020, but still to remain below their 2019 level. Excise duties are expected to increase compared to the previous year, however due to the introduction of a carbon tax at beginning of 2021, which has reduced the price differential for fuel with the neighbouring countries, they will remain below their 2019 level.

Expenditure is projected to show a moderate increase in 2021, in spite of being inflated by the cost associated with the different measures to combat the pandemic and to relaunch the economy. As in the previous year, a strong increase in the number of public employees is pushing up the government wage bill. Public investment is projected to remain high on the back of sizeable transport infrastructure projects and of support for the green and digital transition. Nevertheless, public investment will decline compared to the previous year, when it included additional expenditures related to health and crisis management and the purchase of a military plane.

In 2022, the general government balance is expected to turn to a surplus of 0.2% of GDP. Revenues should continue to expand even if at a more moderate pace. The complete phase out of crisis-related measures should contain expenditure growth in spite of the upward pressure from the triggering of the automatic indexation mechanism, to which around half of government expenditure is linked. The government balance is then forecast to further improve to a surplus of 0.3% of GDP in 2023. This forecast includes the impact of Recovery and Resilience Facility-financed expenditure.

Public debt is expected to increase from 24.8% of GDP in 2020 to 25.9% in 2021 and to decrease to 25.6% and to 25.4% in 2022 and 2023 respectively.

Table II.12.1:

Main features of country forecast - LUXEMBOURG

	2020				Annual percentage change				
mio EUR	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP	64221.1	100.0	2.7	2.0	3.3	-1.8	**5.8**	**3.7**	**2.7**
Private Consumption	19705.9	30.7	2.5	2.7	2.5	-6.9	**4.0**	**5.8**	**2.8**
Public Consumption	11771.4	18.3	2.7	4.7	3.9	7.7	**4.6**	**4.1**	**3.7**
Gross fixed capital formation	10788.6	16.8	2.6	-6.2	9.8	-4.6	**10.9**	**3.6**	**2.7**
of which: equipment	3295.6	5.1	3.8	-22.5	15.1	-5.1	**10.9**	**3.6**	**2.7**
Exports (goods and services)	131454.7	204.7	4.1	3.6	5.8	1.3	**10.4**	**3.9**	**3.0**
Imports (goods and services)	110206.2	171.6	4.4	3.2	6.9	1.6	**11.0**	**4.4**	**3.2**
GNI (GDP deflator)	45354.7	70.6	1.3	0.9	-3.4	4.8	**7.9**	**4.3**	**2.9**
Contribution to GDP growth:	Domestic demand		1.8	0.5	3.1	-1.8	**3.9**	**3.1**	**2.0**
	Inventories		0.1	-0.2	0.1	0.2	**-0.4**	**0.2**	**0.0**
	Net exports		0.8	1.7	0.2	-0.2	**2.3**	**0.4**	**0.7**
Employment			2.8	3.6	3.5	1.9	**2.9**	**3.4**	**3.2**
Unemployment rate (a)			5.0	5.6	5.6	6.8	**6.1**	**5.8**	**5.7**
Compensation of employees / head			2.7	2.8	1.9	0.4	**1.4**	**2.6**	**1.9**
Unit labour costs whole economy			2.7	4.5	2.1	4.1	**-1.4**	**2.2**	**2.4**
Real unit labour cost			-0.2	2.7	1.5	-0.2	**-3.6**	**0.0**	**0.2**
Saving rate of households (b)			:	:	:	:	**:**	**:**	**:**
GDP deflator			2.9	1.7	0.6	4.3	**2.3**	**2.2**	**2.2**
Harmonised index of consumer prices			2.2	2.0	1.6	0.0	**3.2**	**2.2**	**1.8**
Terms of trade goods			0.8	-0.7	-0.2	3.6	**-0.7**	**0.2**	**0.0**
Trade balance (goods) (c)			-1.1	3.5	3.3	4.1	**4.4**	**3.7**	**3.5**
Current-account balance (c)			4.7	3.0	-2.4	3.7	**5.5**	**5.2**	**5.2**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			3.7	1.8	-3.3	2.8	**4.7**	**4.4**	**4.5**
General government balance (c)			1.1	3.0	2.3	-3.5	**-0.2**	**0.2**	**0.3**
Cyclically-adjusted budget balance (d)			1.3	3.3	2.4	-1.5	**0.6**	**0.5**	**0.7**
Structural budget balance (d)			1.8	3.3	2.4	-1.5	**0.6**	**0.5**	**0.7**
General government gross debt (c)			15.1	20.8	22.3	24.8	**25.9**	**25.6**	**25.4**

(a) Eurostat definition. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.