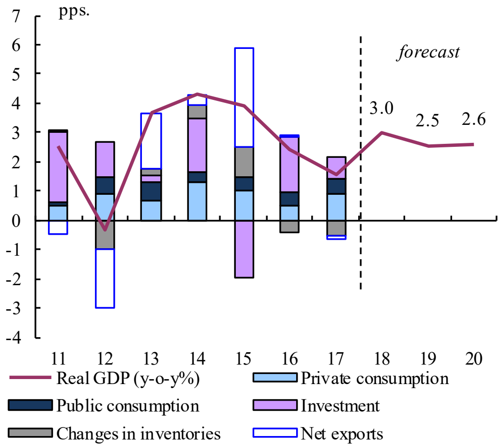
2.16. LUXEMBOURG

After slowing to 1.5% in 2017, GDP growth in Luxembourg regained momentum, and is estimated to have reached 3.0% in 2018. Notably, the international services balance showed a sizeable expansion, largely related to renewed dynamism in the financial services sector, which had been exceptionally weak in 2017. However, historical figures need to be taken with caution given the frequent and substantial revisions to Luxembourg's national accounts data. Private consumption growth also strengthened in 2018, benefitting from the improvement in the labour market, including stronger resident employment creation, while disposable income received a boost from tax reforms and increases in wages, salaries and pensions due to a wage indexation applied from August.

The recent softening growth momentum in world trade, as well as in euro area GDP growth, has contributed to higher volatility in financial markets. A broad set of indicators suggesting that these trends may continue in 2019 has weakened growth prospects for the financial services sector and the economy as a whole. Therefore, external trade is expected to weaken markedly. As a small open economy with strong trading and financial links in international markets, Luxembourg remains especially exposed to external risks surrounding the euro area outlook. At the current juncture, uncertainty has increased and risks remain tilted to the downside.

Graph 2.16: **Luxembourg - Real GDP growth and contributions**



Domestic demand is forecast to be the main growth driver going forward. However, private consumption growth is projected to lose some momentum as employment growth slows. Private investment, by contrast, should recover after a drop in 2018 mainly driven by past effects; specifically, from bulk investments in 2017 by the aircraft and satellites industry (which were also fully debited from the external balance of goods). Overall, despite supportive domestic demand, GDP growth is forecast to ease to 2.5% in 2019 before perking up again slightly to 2.6% in 2020. While the underlying conditions for private consumption and investment remain favourable, further weakness due to waning consumer confidence, could raise precautionary savings and result in lower domestic demand growth.

Headline inflation eased slightly to 2.0% in 2018 from 2.1% in 2017, mainly due to oil price movements. Oil prices are assumed to ease significantly in 2019, which should drive down headline inflation to 1.6%, although this effect will gradually dissipate in 2020. At the same time, domestic price pressures, including from past wage increases, are set to reassert their influence and headline inflation should increase from 1.6% in 2019 to 1.8% in 2020.