

LUXEMBOURG

Economic growth is projected to remain robust, due to ongoing supportive monetary conditions, dynamic domestic demand and a rebound in financial sector activity, which will foster exports. Inflation is projected to rise as slack diminishes and wages are pushed up by the next round of indexation, due at the beginning of 2017.

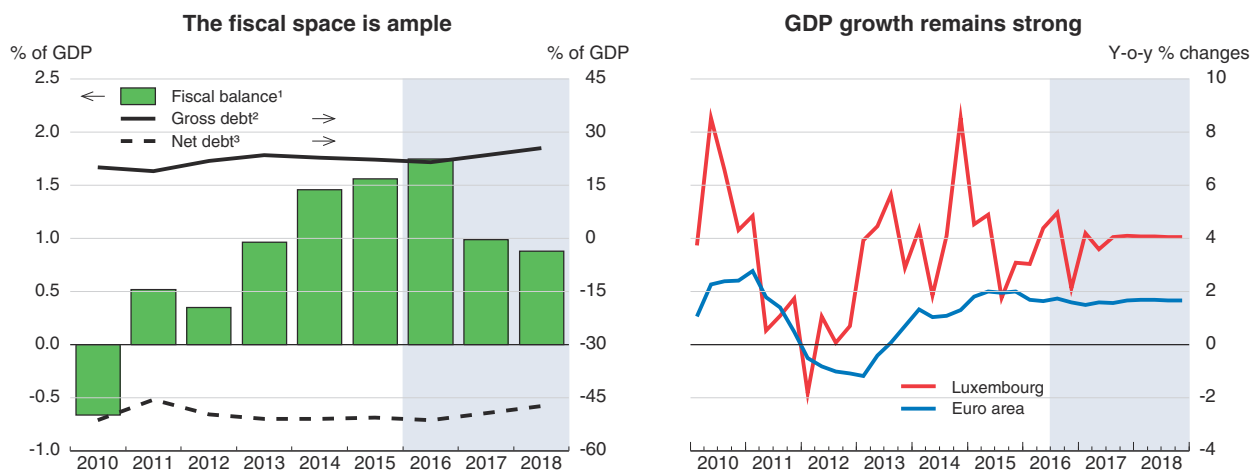
Structural reforms, such as strengthening incentives to accept job offers and stricter job search obligations for recipients of unemployment benefits, would improve the use of existing skills and reduce structural unemployment. Reforms that reduce barriers to labour mobility, such as changes in housing-market and life-long learning policies, should be complemented by the provision of adequate infrastructure and public services to accommodate the needs of new residents.

The government has shifted towards an expansionary fiscal policy stance. This shift is welcome given the ample fiscal space afforded by low levels of debt and low interest rates. The new fiscal target will make room for a growth-enhancing tax reform, combining a reduction in corporate and income tax rates with higher tax credits for investors and low-income taxpayers. This will make the tax system more growth and equity-friendly. In addition, fiscal space could be used for growth-enhancing spending on R&D and infrastructure.

Economic growth has been driven by the non-financial sectors

Indicators of economic activity in 2016 point to robust growth of non-financial services. However, the financial sector is suffering from low interest rates and associated weak profits. Luxembourg's external position remains strong, characterised by persistent current account surpluses and a positive net international asset position. The general government budget is in surplus, the general government gross debt is low, at 21% of GDP, and net debt is negative.

Luxembourg



1. General government net lending.
2. General government gross debt, Maastricht definition.
3. General government net financial liabilities.

Source: OECD Economic Outlook 100 database.

StatLink  <http://dx.doi.org/10.1787/888933437819>

Luxembourg: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	46.3	4.7	3.5	3.6	4.0	4.0
Private consumption	15.1	2.7	1.8	1.4	3.0	3.1
Government consumption	8.2	0.0	2.3	3.6	2.0	2.9
Gross fixed capital formation	9.0	5.4	1.4	2.1	6.4	3.6
Final domestic demand	32.3	2.7	1.8	2.2	3.7	3.2
Stockbuilding ¹	- 0.2	0.7	0.4	0.9	0.1	0.0
Total domestic demand	32.1	6.6	2.7	3.4	3.9	3.2
Exports of goods and services	88.9	12.1	12.8	4.5	4.7	4.5
Imports of goods and services	74.7	13.0	14.1	4.4	4.7	4.3
Net exports ¹	14.2	2.2	2.0	1.8	1.5	1.9
<i>Memorandum items</i>						
GDP deflator	—	1.5	0.4	-1.5	2.1	2.1
Harmonised index of consumer prices	—	0.7	0.1	-0.1	1.4	1.5
Private consumption deflator	—	0.3	-0.7	-0.1	1.3	1.5
Unemployment rate	—	7.1	6.8	6.4	6.3	6.2
General government financial balance ²	—	1.5	1.6	1.7	1.0	0.9
General government gross debt ²	—	32.0	31.4	30.7	32.7	34.7
General government debt, Maastricht definition ²	—	22.8	22.1	21.4	23.4	25.4
Current account balance ²	—	5.1	5.2	4.5	4.7	4.8

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of GDP.

Source: OECD Economic Outlook 100 database.

StatLink  <http://dx.doi.org/10.1787/888933439114>

The government plans to start reducing corporate and income tax rates in 2017 in a multi-year tax reform that is projected to make the tax system more progressive and offset, at least partly, the tax base broadening resulting from European and international tax transparency initiatives. As a result, the fiscal surplus of the general government is projected to decline in 2017 and remain broadly stable in 2018.

Structural reforms will improve labour market outcomes

The proposed personal income tax reform will bring welcome changes, such as more progressive taxation and additional tax credits for low-income earners. Although affordable, the tax cuts could be partly compensated by increasing currently low taxation on housing. The possibility of individual taxation of family income could lead to lower marginal tax rates for second earners, mostly women, hence improving their incentive to work full-time and make better use of their skills. Higher tax credits for childcare and the recent extension of the childcare voucher scheme to cross-border workers will reduce barriers to work by making it easier to manage a job and a family. Active labour market policies offering individualised support and focusing on training, rather than on temporary job creation, are crucial to reduce long-term unemployment and boost inclusive growth.

However, the incentives introduced by the reforms need to be coupled by additional changes in structural policies. Including childcare providers outside Luxembourg in the childcare voucher scheme could prevent structural imbalances between demand and

supply. Rising house prices in Luxembourg may reflect supply bottlenecks that should be addressed by reformed zoning regulations, simplifying procedures for granting building permits and improved provision of social housing.

Growth is projected to remain strong

Growth is projected to be 4% in both 2017 and 2018. Private consumption and investment will be boosted by the reduction in private and corporate income tax rates from 2017. Activity will also be supported by accommodative monetary conditions and gradually improving services exports. A round of wage indexation is projected to take place at the beginning of 2017 and will likely lift inflation above the euro area average.

Given Luxembourg's trade and financial linkages, much depends on the pace of the euro area recovery and the continuation of accommodative monetary policies. High cross-border financial linkages between domestic banks, their groups' foreign banks and investment funds could transmit external shocks into the domestic economy. Creating a more level playing field in corporate taxation at a global level could benefit Luxembourg by emphasising its competitive advantages, including political stability and a highly qualified labour force.