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**Statement by Mr. Alazzaz on Luxembourg
(Preliminary)
Executive Board Meeting 10/54
May 28, 2010**

I thank staff for a clear and concise report and Messrs. Prader and Mr. Mevis for their helpful Buff statement. Luxembourg's economy was severely affected by the global economic and financial crisis, given its highly open nature and internationally-integrated financial sector. Despite countercyclical fiscal policies to support the economy and a prompt policy response to safeguard the financial sector and mitigate adverse economic effects, the economy contracted by 3.4 percent in 2009. The main challenge in the immediate term is to support the ongoing recovery and safeguard financial stability. In the medium and long term, the focus of policies should be on ensuring fiscal sustainability and pursuing reforms aimed at fostering long-run growth of the economy.

In the financial sector area, the authorities deserve credit for the forceful actions, in close cooperation with neighboring countries, to tackle troubled banks. These actions helped quell potential spillover effects and maintained financial stability. Furthermore, a five-fold increase in the deposit guarantee, in line with an EU-wide initiative, helped safeguard banking sector confidence. Furthermore, the authorities took several measures over the past year to strengthen the supervisory framework, as detailed in the Buff statement. Staff has also made a number of useful suggestions to tighten the prudential regulatory environment, including the need to tackle risks originating from the sizable interbank exposures, achieving a better alignment of capital buffers with tail risks in the context of ongoing international initiatives, and the development of a new set of indicators to facilitate the assessment of liquidity risks in individual banks as well as system-wide exploiting forward-looking information. The upcoming FSAP update should provide an important opportunity to examine further issues related to the strengthening of the prudential framework.

Regarding fiscal policy, Luxembourg's strong pre-crisis fiscal position enabled the provision of substantial stimulus to support the economy. The budget balance turned from a surplus in 2008 to a deficit of 0.7 percent of GDP in 2009, and the deficit is expected to widen further to

about 4 percent in 2010. Looking ahead, there is agreement between the authorities and staff about the need to pursue fiscal consolidation so as to place the public finances on a sustainable basis. In this connection, I welcome the announcement by the authorities in early May of a fiscal consolidation package for 2011 and 2012 of revenue increases and expenditure cuts equivalent to 1.7 percent of GDP in each of the two years. I also welcome the commitment by the authorities to review the budgetary situation in 2012 and take measures, if necessary, to achieve the medium-term goal of a balanced budget for 2014. Fiscal adjustment would also be enhanced if the medium-term fiscal framework is strengthened, and staff offer several useful suggestions in this regard. Here, it is encouraging to note that the authorities are reviewing the options for a systematic expenditure framework that should be oriented on the medium-term.

With these remarks, I wish the authorities continued success.