DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

The contents of this document are preliminary and subject to change.

GRAY/10/1919

May 27, 2010

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

We thank staff for an insightful report, and Mr. Prader and Mr. Mevis for their comprehensive Buff statement.

We welcome the economic recovery underway in Luxembourg following two years of contraction due to the global recession and financial crisis. Business and financial indicators are strengthening, as external economic conditions, notably in the neighboring countries, are improving. We note the recent pick up in inflation as a result of higher oil prices and utility tariffs, and the stabilization in the labor market.

Looking ahead, Luxembourg' economic outlook is positive as external conditions are expected to improve further, although economic growth in 2010-11 is expected to remain below its pre-crisis pace. Given the uncertainty surrounding future developments in the global economy and financial markets, and the sensitivity thereto of Luxembourg's economy, we agree that the policies going forward should be geared towards addressing the vulnerabilities exposed by the crisis, with a view to strengthening macroeconomic and financial stability.

In the **fiscal sector**, we agree that the supportive policy stance has been successful in mitigating the impact of the crisis on the economy, although this will translate in a greater fiscal deficit in 2010 at 4 percent of GDP, above the Maastricht limit of 3 percent. We agree that, as economic activity is rebounding, fiscal support should be gradually withdrawn, in order to bring public finances back on a sustainable path. In this regard, we welcome the adoption of a fiscal consolidation package for 2011-12 aimed at rationalizing current expenditures and ultimately achieving a balanced budget by 2014. We commend the authorities for securing a social consensus on the elements of this package. Going forward, an agreement between all parties concerned on a comprehensive reform of the pension system and a reform of the compensation policy in the public service will be key to ensure long term fiscal sustainability. We look forward to the progress on these two issues in the next staff report.

In the **financial sector**, we welcome the improvement in the financial indicators and note that the sector would remain resilient to severe shocks according to the stress-tests. Nevertheless, the financial crisis unveiled significant weaknesses in the financial sector framework and actions taken to address them have been timely and appropriate. In particular, we support ongoing efforts to strengthen the prudential and regulatory framework in order to reduce risks from interbank exposures, integrate various recommendations from international financial bodies, and improve bank reporting. Likewise, steps taken to enhance collaboration between domestic supervisory institutions, strengthen the deposit insurance scheme and improve home-host cooperation go in the right direction. That said, we note that the finalization of several regulatory initiatives by the authorities is pending the issuance of directives by the European Commission. We would like staff to elaborate on the progress on this issue.

With these remarks, we wish the Luxembourgish authorities every success in their endeavors.