International Monetary Fund

IMF Executive Board Concludes 2012 Article IV Consultation with Luxembourg

Public Information Notice (PIN) No. 12/67
July 3, 2012

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2012 Article IV Consultation with Luxembourg is also available.

On June 27, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Luxembourg.[1]

Background

Economic growth has slowed in 2011 amid the euro area sovereign debt crisis. Private consumption held up in the first half of the year. But as the crisis and uncertainty lingered, consumer and manufacturing business confidence fell and slowed domestic demand. Reflecting the waning impact of global fuel price increases and postponements in automatic wage indexation, inflation has eased. In recent months, employment growth has remained stable but the unemployment rate has risen, particularly long-run joblessness that accounts for about 45 percent of overall unemployment.

The fiscal deficit fell in 2011, reflecting an over performance in revenues and continued expenditure restraint. Staff estimates that the structural deficit, at ½ percent of GDP, was roughly unchanged from 2010. Public debt has nonetheless almost tripled to about 20 percent of GDP since the outset of the global financial crisis and is poised to continue increasing in the face of medium-term fiscal pressures.

The financial sector has endured the crisis and remained stable. The investment fund industry experienced some valuation losses in 2011 mainly due to euro area related market turbulence, but has largely recovered, with assets under management surpassing €2 trillion in early 2012. Though bank assets have been slower to recover, Luxembourg-based banks have generally remained well capitalized, profitable, and liquid. Their exposures to distressed sovereigns in the European periphery are generally contained, but cross-border exposures remain high. Cross-border, mainly intragroup, exposures still account for about ¾ of bank loans.

Reflecting sluggish external demand, economic activity is expected to further weaken, with growth projected to decline to ½ percent in 2012. Volatile financial markets and unclear economic prospects will likely continue to weigh on domestic demand. These factors will also likely reduce price pressures and reinforce inflation’s declining trend. Risks are tilted to the downside given ongoing uncertainties in the euro area.

Executive Board Assessment

Executive Directors welcomed the continued stability of Luxembourg’s economy despite the turbulence in the euro area, but noted that slowing activity and an uncertain economic outlook call for further steps to limit financial sector risks, safeguard fiscal sustainability, and boost medium-term growth.

Directors commended the authorities on measures taken to strengthen the financial sector and implement recommendations from the Financial Stability Assessment Program update. They supported further participation in EU supervisory colleges and the development of similar arrangements to promote cross-border cooperation among supervisors of non-EU banking groups and investment funds. Directors also advised the authorities to continue pursuing ahead of EU-level initiatives, if appropriate, regulatory enhancements not requiring legislation, and to continue encouraging banks to prepare for tighter liquidity standards under Basel III. More broadly, Directors saw scope for revisiting institutional arrangements for regulation and supervision, to better align these with evolving international standards. Regarding the AML/CFT framework, Directors noted the authorities’ commitment to undertake the needed measures to comply with revised FATF standards.

Directors welcomed the support to the economy provided by the 2012 budget. They urged the authorities to adhere to the budget’s expenditure allocations but cautioned that reliance on public investment caps could hurt growth in the long run. Directors generally agreed that automatic stabilizers should be allowed to operate if downside risks materialized. A few Directors, however, were not convinced that this would be effective, given low fiscal multipliers and the need to preserve hard-won credibility.

In light of the expected deterioration in public finances in coming years, Directors encouraged high-quality consolidation measures supported by a medium-term fiscal framework. In particular, while welcoming the proposed pension reforms, they urged the authorities to undertake a more comprehensive reform of the pension and healthcare systems to ensure fiscal sustainability.

Directors commended the authorities' efforts to lay the foundation for higher medium-term growth through a comprehensive reform agenda. They encouraged nonetheless further steps to improve active labor market policies and the social safety net with a view to minimizing work disincentives and addressing market rigidities. Directors also welcomed measures to limit the adverse competitiveness effects of the wage indexation system, and suggested revising or eliminating this system in the medium term. Product market regulations should also be reviewed to foster competition, productivity growth, and economic diversification.

Luxembourg: Selected Economic Indicators

	2009	2010	2011	2012 /1
Real economy	(Change in percent, unless otherwise indicated)			
Real GDP	-5.3	2.7	1.6	0.5
Gross investment	-21.9	16.2	10.7	2.0
Unemployment (as percent of the labor force)	5.8	6.2	5.7	6.2
Resident employment (thousands)	216.0	219.1	225.3	227.6
Total employment (thousands)	352.2	357.8	368.4	375.3
CPI (harmonized), p.a.	0.0	2.8	3.7	2.3
Public finances	(Percent of GDP)			
General government revenues	42.2	41.6	41.4	42.1
General government expenditures	43.0	42.4	42.0	44.0
General government balance	-0.8	-0.9	-0.6	-1.9
General government gross debt	14.8	19.1	18.2	21.4
Balance of payments				
Current account balance	6.5	7.7	7.1	7.2
Balance of trade in goods and services	39.3	46.1	41.3	39.5
Factor income balance	-30.1	-36.8	-31.5	-30.6
Transfer balance	-2.8	-1.7	-2.8	-1.7
Exchange rates	Member of the euro area			

U.S. dollar per euro	1.4	1.3	1.4	...
Nominal effective rate (2005=100)	104.9	102.1	102.6	...

Sources: Data provided by the authorities; IMF, WEO database; and IMF staff calculations.

1/ IMF Staff projections.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

IMF EXTERNAL RELATIONS DEPARTMENT

Public Affairs	Media Relations
E-mail: publicaffairs@imf.org	E-mail: media@imf.org
Fax: 202-623-6278	Phone: 202-623-7100