

Key messages:

- In reaction to the Covid-19 pandemic, the general escape clause of the Stability and Growth Pact triggered on March 20, 2020, will remain activated in 2021. Henceforth, the government is not required to respect the medium-term budgetary objective and the correction mechanism, referred to in article 6 (1) of the amended law of 12 July 2014, will not be triggered over the period 2020-2021.
- The general government's nominal balance has deteriorated abruptly due to the surge in government expenditure and sharp decline in government revenue due to the COVID-19 crisis. In the medium term, it is estimated to improve gradually to reach -0.9% of GDP by 2024.
- In case of non-prolongation of the exceptional circumstances clause, the adjustment path towards the medium-term objective should be established to ensure medium-term fiscal sustainability.

Fiscal framework and national fiscal rules

In accordance with the Annual Sustainable Growth Strategy 2021 (ASGS) by the Commission, "member States should continue to provide targeted and temporary fiscal support in 2021 in a context where the general escape clause is activated, while safeguarding fiscal sustainability in the medium term." The Luxembourg government follows these guidelines by endorsing the activation of the clause in 2021. Consequently, the government is not required to respect the medium-term budgetary objective (MTO) and the correction mechanism, referred to in article 6 (1) of the amended law of 12 July 2014, will not be triggered over the period 2020-2021.

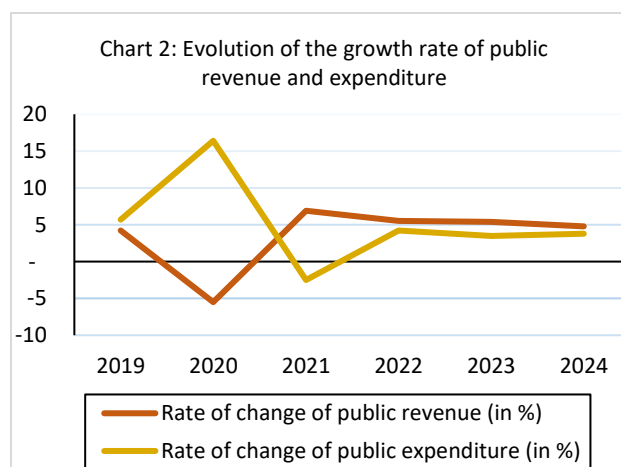
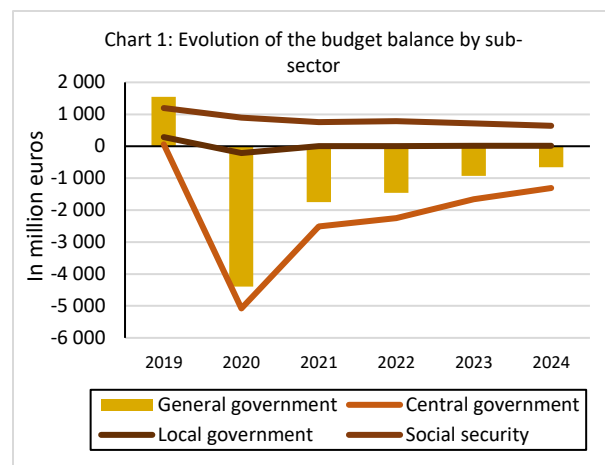
Given the macroeconomic uncertainty surrounding all aspects of the pandemic, the structural balance may deviate substantially from the MTO. In case of non-prolongation of the general escape clause, an adjustment path towards the MTO should be established over the period 2022-2024 to ensure medium-term fiscal sustainability. The schedule on the adjustment path towards the MTO at EU level should be proposed in the next update of the Stability and Growth Program, to be published in April 2021.

Macroeconomic outlook

The swift and massive shock of the pandemic and ensuing containment measures have plunged the national economy into a severe contraction. The real GDP growth rate is anticipated to shrink at -6.0% in 2020, followed by a sluggish recovery of 7.0% in 2021. The 2020-2024 PLPFP also presents an alternative scenario labelled as unfavorable, which is characterized by the emergence of a second wave of COVID-19 infections and new restrictive measures. In this case, both national real and nominal GDP continue to decline in 2021, with the economic recovery postponed to 2022.

Short-term fiscal outlook

The abrupt deterioration in the general government's nominal balance is driven by the surge in government expenditure and sharp decline in revenue. The expenditure peaks at 16.4% whereas the revenue reaches an all-time low of -5.5% in 2020, followed by the bounce-back and slow recovery from 2021 to 2024 (see chart 2). The public deficit is estimated at around 7.4% of GDP in 2020 and is expected to improve gradually in 2021 to reach 2.7% of GDP. In the medium term, the nominal balance is estimated to improve gradually to reach -0.9% of GDP by 2024. The economic stabilization program and the package of measures, known as "Neistart Lëtzebuerg" has been presented with an overall estimate of 11.2 billion euros (19.0% of GDP) to help Luxembourg's economy during the COVID-19 crisis.



Sources:

Draft budget for 2021 (2021 DB), October 2020;

Draft multiannual financial programming law for the period 2020-2024 (2020-2024 LPFP), October 2020;

CNFP, Assessment of the 2021 DB and 2020-2024 LPFP, November 2020.

f – forecast MoF – Ministry of Finance

Key indicator forecast		2019 f	2020 f	2021 f	2022 f	2023 f	2024 f
Real GDP growth rate – MoF est.	[% y-to-y]	2.3	-6.0	7.0	4.1	3.5	2.7
GG balance – MoF est.	[% of GDP]	2.4	-7.4	-2.7	-2.2	-1.3	-0.9
GG debt – MoF est.	[% of GDP]	22.1	27.4	29.4	31.3	32.4	32.9