

Public finance assessment of the Stability and Growth Programme 2022-2026

In its "Public Finance Assessment" of Luxembourg's Stability and Growth Programme for the period 2022 to 2026 ("2022 SGP"), the National Council of Public Finance ("CNFP") takes note of the Government's use of the "exceptional circumstances" clause **for the years 2020 to 2022. The Government is therefore not obliged to respect the medium-term budgetary objective ("MTO") set at +0.50% of GDP over this period.** However, according to the 2022 SGP forecasts and from 2021 onwards, either the MTO would be respected or the structural balance would not show a significant deviation from the MTO (this is not the case for the other euro area countries).

At the time of the preparation and submission of the 2022 SGP, the European Commission ("EC") and the European Council had not yet decided about a suspension of the budgetary rules for the year 2023 (a decision which was subsequently taken on 23 May 2023) and hence, **the Government referred to the current legal framework. It set the MTO at 0.00% of GDP over the period 2023 to 2025** (thereby aligning itself with the new minimum MTO calculated by the EC in April 2022), **which would be respected according to the 2022 SGP forecasts.** In this context, however, it needs to be mentioned that the EC has announced to provide guidance on possible changes to the budgetary rules before the end of the current year, which would apply as from the end of the above-mentioned suspension of the current rules. Thus, it is currently unknown which precise fiscal governance rules will apply from 2024 onwards.

On the macroeconomic side, high inflation and an economic climate currently marked by high uncertainty weigh heavily on Luxembourg's economic development, with growth estimated at 1.4% in 2022, after a strong economic recovery in 2021 (6.9%). Luxembourg's economy therefore now seems to be more affected than the economy of euro area (3.0% growth in 2022 according to the SGP 2022), particularly in view of the fact that the financial markets, which play a particularly important role in the Luxembourg economy, have reacted significantly to the current uncertainties. These contingencies are linked in particular to the outcome of the war in Ukraine, the outlook for inflation development, future monetary policy decisions and the behavior of individual economic actors. Despite these challenges, Luxembourg's economic activity is expected to rebound by 2.9% in 2023 before hovering around 2.7% in the medium term (2024-2026) and would thus be close to the forecasts established in the 2021-2025 Multiannual Budgetary Programming Law ("LPPF") (drawn up before the outbreak of the war in Ukraine) and to the historical rate.

As regards budgetary forecasts, the general government nominal balance falls from +0.9% of GDP in 2021 (EUR 650 million) to -0.7% of GDP in 2022 (EUR -544 million) and to -0.4% of GDP in 2023, thus presenting itself less favorably than the forecasts established by the EC in May (-0.1% of GDP in 2022 and +0.1% of GDP in 2023). In the medium term (2024-2026), revenue growth (+4.6%) is expected to exceed expenditure growth (+4.3%), compared with historical trends (1996-2020) of +5.9% and +6.5% respectively. The nominal balance would thus slowly improve towards +0.00% of GDP in 2026. While there is a slight improvement in the central government balance (which would still show a deficit of 551 million euros in 2026), the CNFP notes a sharp deterioration in the social security balance, which is particularly worrying in the context of the long-term sustainability of public finances. Indeed, social security would present a surplus of only 242 million euros in 2026 compared to 1.2 billion in 2019.

Compared to previous budget estimates (i.e. the 2021-2025 LPPF voted in December 2021), the CNFP notes only a slight deterioration in the nominal balance (by about 50 million euros on average over the 2021-2025 period), whereas these estimates did not yet take into account the invasion of Ukraine by Russia. This is explained in particular by a correction of the nominal balance for 2021 of around 1 billion euros in the 2022 SGP (due in particular to an improvement in revenue of 795 million euros), which would therefore be of almost the same order of magnitude as the deterioration in the nominal balance

estimated following the invasion of Ukraine by Russia (and which originates both from the economic slowdown and from the aid programmes for households and businesses decided on in particular within the framework of the Tripartite of 31 March 2022). Compared with the 2019-2023 LPFP (drawn up before the COVID-19 pandemic), the CNFP also notes an improvement in revenue (by almost 390 million euros on average over the 2022-2023 period) which is, however, more than offset by an increase in expenditure (by around 2.2 billion euros on average over the same period). The resulting deterioration in the balance (EUR 1.8 billion) is explained, on the one hand, by the new measures taken in the context of the war in Ukraine and, on the other hand, by the higher assumptions regarding the index number ("NI") retained in the 2022 SGP, but also (for around 1 billion euros) by a much more moderate estimate of expenditure, particularly current expenditure, when the 2019-2023 LPFP was submitted.

Although the government's objective of keeping the public debt below 30% of GDP seems to be respected over the entire period, the CNFP notes that the public debt is estimated to increase by about 8 percentage points of GDP (about 7.5 billion euros) compared with the debt trajectory forecast in the 2019-2023 LPFP.