## 15. LUXEMBOURG
This time, not spared by the general hardship

Activity is contracting sharply …

The recession is taking its toll on the Luxembourgish economy and primarily on its manufacturing industry, which exports almost its whole production: in the fourth quarter of 2008, industrial production dropped like a stone. Even if the manufacturing industry now only represents less than 9% of total value added but its collapse had a sizeable impact on growth: industrial production fell by 15.8% (s.a.) from Q3 to Q4, the biggest drop in the whole EU-27 [3]. The Luxembourgish industry is heavily concentrated on steel products, car suppliers and glass, which makes it very dependent on the automotive industry and on construction. Services have been hit also, first of all services to enterprises but also the financial sector, which, due to its structure of ownership (nearly all Luxembourgish financial institutions belong to foreign groups) and to the international character of its activity, is extremely sensitive to developments abroad. As a result, according to a preliminary estimate, real GDP dropped by 4.5% quarter-on-quarter (s.a.) in the fourth quarter of 2008 and by 0.9% in yearly average.

With exports markets projected to contract by almost 10%, exports of goods are expected to record a historic fall in 2009. Exports of services - both financial and non-financial (Luxembourg has a very large air freight transport sector [4]) - will drop too, though probably less than exports of goods. Even if this fall in exports will be partially offset by a parallel drop in imports, the contribution of external trade to GDP growth is projected to be substantially negative this year.

Graph 2.15.1: **Luxembourg - Real GDP and domestic employment**
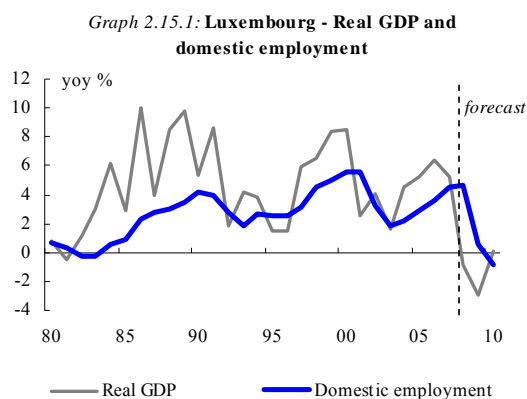
Private investment is also projected to plummet, but this fall will be partially offset by a more than 10% surge in public investment decided within the country's economic recovery plan. Government consumption, too, will remain dynamic and it is possible that private consumption will do so also, (though to a lesser extent), fuelled by the large cuts in income tax operated at the beginning of 2008 and 2009 and by the recent decline in interest rates (most mortgage loans in Luxembourg are at a variable rate). However, since last summer, consumer confidence, though remaining higher than in most other Member States, has declined as much as the EU average. In total, GDP is forecast to contract by about 3% in real terms in 2009.

The Luxembourgish economy might begin to recuperate around the end of 2009 following the expected timid recovery in the world economy. However, with the exception of public expenditure, which is projected to remain extremely dynamic, most demand components will only post very modest positive growth rates (or even in some cases still negative ones due to the carry-over from this year) and real GDP is likely to grow only marginally in yearly average in 2010.

…and job creation is decelerating strongly

Employment remained buoyant for the larger part of 2008, rising by 4¾% over the whole year. However, the big drop in activity since the autumn has led to a standstill in job creation and to a substantial increase in unemployment, which had been rising since the beginning of 2008 and strongly accelerated in recent months, surging from 4.4% of the active population during the summer to 5.2% in February. The recession also resulted in an explosion in part-time unemployment, from virtually zero last summer to more than 3% of the total amount of wage-earners in the latest weeks. In order to limit the increase in unemployment and to support global demand, the authorities have recently decided to reimburse the employer's share of the partial unemployment allowance, to extend its duration and to increase it from 80% of the wage to 90% for wage-earners who accept to follow vocational training during their unemployment period.

Employment is projected to contract throughout 2009, the still positive growth rate forecast for this

year being exclusively due to the large carry-over from 2008. Conversely, the negative carry-over at the end of 2009 will result in a decline in employment in annual terms in 2010. However, the ensuing increase in residents' unemployment, though substantial, will probably be limited by the fact that a large part of the workers who will lose their job (or be unable to find one) in Luxembourg will be non-residents.

Inflation, which had substantially increased since the fourth quarter of 2007 as a result of the surge in oil and food prices dramatically declined in the fourth quarter of 2008 for symmetric reasons. It should remain very weak in 2009 and even turn negative in the course of the year (at least when measured by the HICP, where the weight of oil products is much larger than in most other Member States due to the large purchases of car fuel by non-residents).

The government surplus will turn this year into a deficit, which will increase in 2010

Thanks to still buoyant tax receipts and employment, the government surplus only declined from 3.6% of GDP in 2007 to 2.6% in 2008. This surplus will turn into a deficit this year, due not only to the impact of the crisis on government

revenues and on unemployment outlays but also to the tax cuts decided in the 2009 budget before the aggravation of the crisis and implemented since the beginning of this year; moreover, expenditure is forecast to rise substantially, reflecting in particular the sharp increase in government investment which constitutes the bulk of the government's economic recovery plan. The deficit could reach 1½% of GDP this year and widen to about 2¾% of GDP in 2010, as a result of the delayed effects of the recession on tax revenues and social transfers.

The public debt doubled in 2008, due to the financing of the support to the financial sector but at about 14% of GDP, it still remains one of the lowest in the EU.

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[3] On average, the quarter-on-quarter decline in industrial production amounted to 5.4% in the EU-15 and to 6.6% in the EU-27.

[4] Luxembourg-Findel is the 5th airport in the EU for freight before e.g. Brussels, Madrid or Munich.

Table 2.15.1:

Main features of country forecast - LUXEMBOURG

	2007			Annual percentage change						
	mio Euro Curr. prices	% GDP	92-04	2005	2006	2007	2008	2009	2010	
GDP at constant prices	36411.1	100.0	4.2	5.2	6.4	5.2	-0.9	-3.0	0.1	
Private consumption	11728.0	32.2	2.5	1.9	2.9	2.0	1.8	1.2	1.5	
Public consumption	5572.5	15.3	4.4	3.4	2.7	2.6	1.3	5.0	2.4	
Gross fixed capital formation	7110.7	19.5	4.5	3.4	1.0	11.8	1.7	-8.9	-2.3	
of which : equipment	2374.0	6.5	2.7	4.6	2.5	22.2	0.0	-15.0	-4.0	
Exports (goods and services)	65515.8	179.9	7.3	6.0	14.6	4.4	0.3	-6.3	-1.0	
Imports (goods and services)	53709.6	147.5	7.1	6.0	13.4	3.5	1.8	-6.3	-0.9	
GNI at constant prices (GDP deflator)	29370.7	80.7	3.5	3.3	-5.7	15.5	-3.0	-3.6	0.5	
Contribution to GDP growth : Domestic demand			2.8	2.0	1.7	3.3	1.2	-0.9	0.5	
Stockbuilding			-0.1	1.7	-0.5	-0.7	-0.1	-0.5	0.0	
Foreign balance			1.5	1.5	5.3	2.7	-2.2	-1.6	-0.3	
Employment			3.3	2.9	3.6	4.5	4.7	0.5	-0.8	
Unemployment rate (a)			2.8	4.6	4.6	4.2	4.9	5.9	7.0	
Compensation of employees/head			3.3	3.7	3.1	4.3	1.5	1.7	1.5	
Unit labour costs whole economy			2.5	1.4	0.4	3.6	7.2	5.4	0.6	
Real unit labour costs			-0.1	-2.9	-4.8	1.5	5.5	3.4	-1.0	
Savings rate of households (b)			-	-	-	-	-	-	-	
GDP deflator			2.6	4.5	5.4	2.0	1.6	1.9	1.6	
Harmonised index of consumer prices			-	3.8	3.0	2.7	4.1	-0.6	2.0	
Terms of trade of goods			-0.6	-0.4	1.7	3.4	-0.6	4.8	-0.5	
Trade balance (c)			-11.2	-11.3	-9.6	-8.1	-10.1	-7.5	-7.8	
Current account balance (c)			11.1	11.0	10.4	9.8	6.4	6.1	5.6	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-	-	-	-	-	-	-	
General government balance (c)			2.5	0.0	1.4	3.6	2.6	-1.5	-2.8	
Cyclically-adjusted budget balance (c)			-	-0.4	-0.6	0.9	2.0	0.6	0.1	
Structural budget balance (c)			-	-0.4	-0.6	0.9	2.0	0.6	0.1	
General government gross debt (c)			6.6	6.1	6.7	6.9	14.7	16.0	16.4	

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.