2.12. LUXEMBOURG

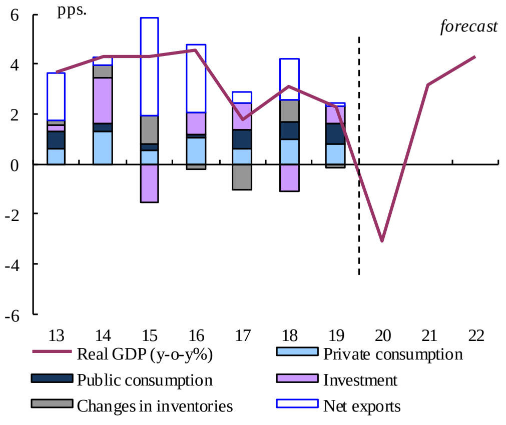
The COVID-19 pandemic resulted in a recession that is projected to have lowered GDP in 2020 by 3.1%. ([1]) Although better than average compared to the rest of the EU, this is the sharpest decline since the financial crisis in 2009 for the Luxembourg economy. Lockdown measures, especially in the first half of 2020 but also in the fourth quarter, have had a very significant impact on private consumption, private investment, and on Luxembourg's international trade in goods and non-financial services. Net exports are expected to have weighed on GDP growth. The impact on economic growth has been mitigated by two economic support programmes launched by the government in 2020. GDP was also supported by the relatively strong performance of the country's international trade in financial services, which actually grew during the first three quarters of 2020. The financial sector has demonstrated resilience during the crisis, including the banking and fund management sectors.

GDP is expected to recover in 2021 when it is forecast to grow at a rate of 3.2%. As containment measures are assumed to continue into the first half of 2021, the rebound is set to take place mainly in the second half of the year. The recovery is expected to be driven by a rebound in private consumption and investment from their low 2020 levels. Private consumption is projected to be supported in 2021 by the labour market, which held up relatively well during the crisis, and by household savings accumulated in 2020. The extension of government support measures into the first half of 2021 should also support domestic demand during this period. Following the removal of the majority of the restrictions, a strong recovery is expected with GDP growth of 4.3% in 2022, mainly driven by domestic demand but also supported by net exports.

The main risks to the forecast for Luxembourg are related to potential vulnerability in the valuation of equity markets, which could spill over into the financial and the external sector, and to the impact the EU-UK trade agreement could potentially have on trade in financial services. Future spending related to the Recovery and Resilience Facility is not included in this forecast and constitutes an upside risk.

In 2020, annual HICP inflation declined to 0.0%, mainly reflecting the large drop in oil prices and the introduction of free public transport in March 2020. In 2021, the expected increase to 1.7% is supported by higher oil prices and the introduction of a carbon tax. Service inflation is projected to increase over the forecast period but remain below the 2019 rate due to lower expected wage growth in 2021. In 2022, inflation is expected to normalise to 1.9%, fuelled by wage indexations expected in the first half of the year.

Graph 2.12: **Luxembourg - Real GDP growth and contributions**



([1]) Luxembourg's national accounts can be subject to significant revisions, among others due to methodological difficulties stemming from the role of multinational firms and financial services in the external sector.