

COUNCIL OPINION**of 10 February 2004****on the updated stability programme of Luxembourg, 2002-2006**

(2004/C 43/05)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ⁽¹⁾, and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission, after consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 10 February 2004 the Council examined the 2003 update of the stability programme of Luxembourg, which covers the period 2002 to 2006. The updated programme complies with the data requirements of the revised 'code of conduct' on the content and format of stability and convergence programmes.

The budgetary strategy underlying the update is based on maintaining balanced public finances in the medium term. While the government intends not to cut public spending drastically in the present period of weak economic growth, measures have been taken to limit the growth rate of public expenditure.

The update projects real GDP growth at 1,2 % in 2003, from 1,3 % in 2002. In 2004 growth is estimated to pick up to 2 %, increasing to 3,8 % in 2006. Employment growth is expected to decelerate to around 1 % in 2004 and to increase to slightly above 2 % by 2006. HICP inflation is forecast to decrease gradually to around 1,3 % in 2006. On the basis of currently available information, the macroeconomic scenario underlying the programme seems plausible for 2004 and 2005. However, the growth projection for 2006 may be on the high side.

The update targets a general government deficit of 1,5 % of GDP in 2004, a marked deterioration from the 0,6 % of GDP deficit foreseen for 2003. This deterioration to a large extent seems to reflect the lagged impact of the economic slowdown

on public finances. In cyclically adjusted terms, based on Commission calculations according to the commonly agreed methodology, there would be a stable surplus. In 2005, the deficit would rise further to 2,3 % of GDP, and it would decrease again to 1,5 % of GDP in 2006. In cyclically-adjusted terms, a surplus would be maintained. The debt ratio is forecast to decline somewhat over the time horizon covered by the update, 5,2 % of GDP in 2004 to 4,4 % of GDP in 2006.

The balance of risks to the budgetary projections seems skewed to the downside. This regards in particular the strength of the expected cyclical upturn, and the feasibility of the planned slowdown in expenditure in the baseline projection of the update. Under adverse economic circumstances, the 3 % of GDP threshold may be breached, particularly in 2005. On the other hand, the changes in the cyclically adjusted balance indicate that the maintenance of a budgetary position close to balance seems sufficiently established by the programme.

However, the estimate of the output gap and hence the cyclically-adjusted balance present unusual margins of uncertainty due to the special features of the economy of Luxembourg. In particular, current estimates of the rate of potential growth in the medium term may be on the high end of plausible outcomes. Although the starting position of public finances is very sound, some expenditure restraint may be called for in order to ensure that public expenditure remains in line with the revenue base in the medium term. Further, it has to be noted that the ratio of public investment to GDP would decline somewhat over the time horizon covered, but would remain well above the EU average at more than 4 % of GDP.

Luxembourg presents no risks of unsustainable public finances in the long term. The debt to GDP ratio will remain very low over the projection period, and the total net asset position is even more favourable in view of the substantial financial assets accumulated over past years with fiscal surpluses.

The economic policies as reflected in the updated programme are broadly consistent with the recommendations in the Broad Economic Policy Guidelines, specifically those with budgetary implications.

⁽¹⁾ OJ L 209, 2.8.1997.