Luxembourg

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MACROECONOMIC OVERVIEW

In 2016, GDP in Luxembourg continued to increase by a healthy 4.2%, an acceleration of 0.2 pps with respect to the previous year. The drivers of this growth over the last decade have been overall private and public consumption and net export, especially in relation to financial services. The financial sector remains the main economic engine of the country accounting for 26% of its economic activity in terms of gross value added. The fund industry achieved a record high with EUR 3.6 tn assets worth managed by Luxembourgish funds, the highest level to date and twice the amount recorded at the trough of the financial crisis. At the same time, the private sector benefitted from buoyant credit from banks which supported solid investment, notably in the real estate and non-residential construction sectors. Also public investment in relation to significant infrastructure projects rebounded sharply in recent years after a subdued period.

Demographic expansion and dynamic wages have sustained the purchasing power of households, supported by subdued inflation of 0%. This figure is expected to change due to the bottoming out of the long-lasting fall in oil prices, which dragged inflation down in previous years.

After showing strong resilience throughout the crisis, the pace of job creation accelerated in 2016 to 3.0% from 2.6% in 2015. All sectors have posted positive growth rates since 2015; however, cross-border workers benefited the most from this development as employment across non-resident workers increased by 3.5% in 2016 compared to 2.6% for nationals. Moreover, the unemployment rate, though relatively low, stagnated around 6.3%. Despite an overall positive picture of the labour market, the employment rate remains persistently low especially among the younger and older workers, both below the EU average.

Overall, public finances remain sound. The general government surplus reached 1.6% of GDP in 2016 from 1.4% in 2015. This positive development is due to low inflation combined with the incremental impact of fiscal consolidation and expenditure savings adopted in 2015 in order to counter the loss of VAT revenues following the change in e-commerce regulation.

HOUSING AND MORTGAGE MARKETS

The mortgage market in Luxembourg continues to grow at a sustained, though slightly decelerating pace, with outstanding and gross mortgage loans increasing by 6.5% and 12.4% respectively, thus reaching all-time highs in both cases. Besides sound underlying fundamentals, this increase can be also explained by the easing of lending criteria of Luxembourg banks, in line with the same trend observed across the Euro area. These eased conditions, principally due to the fierce competition among the few active banks in mortgage lending in the Grand Duchy, will continue to contribute to the high demand in the Luxembourg real estate market. Mortgage interest rates have continued to fall (in line with the general trend) for the sixth consecutive year, reaching 1.68% p.a. in 2016 and remaining among the lowest in Europe. This development has resulted in an increase in per capita indebtedness to more than EUR 60,000 for every resident older than 18 years, the highest in the EU. Potential risks in relation to vulnerabilities of the housing market have been counterbalanced by the introduction of macro-prudential measures, such as more demanding capital requirements for mortgages with an LTV higher than 80%, by the adequate capitalisation of Luxembourgish banks and by the low proportion of NPLs. Despite these developments, in September 2016 the ESRB issued a warning to Luxemburg on medium-term vulnerabilities in the residential real estate sector of Luxembourg as a source of systemic risk to financial stability which may have consequences also for the real economy.

As the Luxembourg market for mortgage loans is dominated by variable-rate loans – though the share of fixed rate mortgages is increasing – borrowers are very sensitive to interest rate changes. For this reason, cuts in reference interest rates have a significant impact on borrowing volumes, and ultimately on house prices, which increased in Luxembourg in line with the other euro area neighbouring countries. In 2016 alone the HPI of the Grand Duchy increased by 6.0% y-o-y. This dynamism is driven by both demand and supply factors. Excessive demand has contributed to this steep price development, which is exacerbated by migration-induced demographic pressures, the relatively strong purchasing power of resident households as well as bottlenecks on the supply side. A significant role is also played by socio-demographic factors such as the reduction of the size of households and the average size of dwellings. High house prices in Luxembourg City have also fostered urban sprawl to less densely inhabited areas in the country.

On the supply side, the principal factors are related to land availability and to the constraints of permit issuances due to administrative burdens. Notwithstanding the increased demand, the number of housing permits reached 4,846 in 2016, increasing by 6.3% with respect 2015, but still far away from the estimated 6,300 new dwellings needed to keep up with the growing demand. The Doing Business Survey highlights scope for improvement particularly in the time required to complete the administrative procedure, which sees Luxembourg performing 50th out of 184 countries. Another slowing factor is the relative lack of land availability. Recent estimates show that municipalities and the state only own around 8% constructible land, while the rest is in the hands of private citizens or corporations, who do not have incentives to sell as the land generates good rent and increases in value, which is particularly attractive in the current low interest environment. To overcome this bottleneck, in 2008 the government introduced a piece of legislation known as the Housing Pact, which granted financial incentives for municipalities to encourage housing development and introduced some new housing policy tools to compensate for the limited amount of land owned by the municipalities. This plan showed mediocre effects in a survey of 2014, and the government is currently planning to reform the Pact, paying particular attention to the actual allocation and continuous monitoring of the funds. To this end, in 2016 a working group of representatives of the states and municipalities was set up to explore proposals for a new Housing Pact.

MORTGAGE FUNDING

Mortgages in Luxembourg are principally funded through deposits.

	LUXEMBOURG 2015	LUXEMBOURG 2015	EU 28 2016
Real GDP growth (%) (1)	4.0	4.2	1.9
Unemployment Rate (LSF), annual average (%) (1)	6.5	6.3	8.5
HICP inflation (%) (1)	0.1	0	0.3
Outstanding Residential Loans (mn EUR) (2)	26,599	28,314	6,981,540
Outstanding Residential Loans per capita over 18 (EUR) (2)	59,127	61,324	16,838
Outstanding Residential Loans to disposable income ratio (%) (2)	n/a	n/a	n/a
Gross residential lending, annual growth (%) (2)	11.5	12.4	3.2
Typical mortgage rate, annual average (%) (2)	1.9	1.7	2.6
Owner occupation rate (%) (1)	72.5	73.2	n/a**
Nominal house price growth (%) (2)	5.4	6.0	4.6

* Please note that this value is the simple average of the typical interest rate of the EU 28 countries
** Please note that for the EU this data has a one year lag. For the latest available data please refer to statistical table 10.

Sources:
(1) Eurostat
(2) European Mortgage Federation - Hypostat 2017, Statistical Tables.

LUXEMBOURG FACT TABLE

Entities which can issue mortgage loans:	Banks and bank' branches from German Bausparkassen and the "Caisse Nationale d'Assurance Pension", which lends only to private sector employees who contribute to the pension fund.
The market share of the mortgage issuances:	100%
Proportion of outstanding mortgage loans of the mortgage issuances:	Not available
Typical LTV ratio on residential mortgage loans:	The usual maximal LTV ratio amounts to 85%.
Any distinction made between residential and non-residential loans:	Not available
Most common mortgage product(s):	The most common mortgage contract is at a variable rate.
Typical maturity of a mortgage:	The standard maturity for mortgage loans is 20 to 25 years, while some banks grant credits for up to 40 years.
Most common way to fund mortgage lending:	Mostly deposits
Level of costs associated with a house purchase:	Roundtrip transaction cost (registration tax, notary fees, real estate agent's fee, transcript tax) are between 12% – 16.5%.
The level (if any) of government subsidies for house purchases:	In the case of affordable housing for sale, public support – 50% of study and infrastructure costs – is available under the condition that at least 60% of the homebuyers are people who qualify to obtain a construction subsidy from the state based on the household income.