

A disappointing 2nd quarter for the euro zone

The 2nd quarter of 2014 was marked by lower than expected GDP growth in the eurozone. This stagnated, due notably to the counter-performance of its three leading economies. Over 2014 as a whole, growth is not expected to exceed 1%, below the trajectory anticipated last spring.

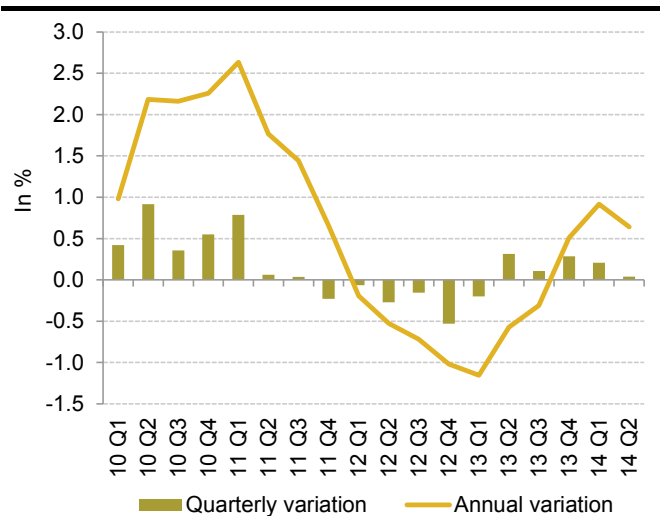
Disappointing results for larger euro-zone countries

According to Eurostat's preliminary estimates, GDP in the eurozone stagnated during the 2nd quarter of 2014, a disappointing result to say the least given what had been suggested by various economic surveys. As output statistics for the manufacturing and construction sectors were published throughout the spring – with figures generally lower than expectations – the impression that activity was running out of steam gradually set in.

GDP growth in the major euro-zone economies was particularly disappointing: down 0.2% in Germany and Italy and stagnating in France (for the 2nd quarter in a row). Some negative catch-up effects were to be expected, particularly in Germany, after a first quarter with weather conditions that were particularly favourable to the construction sector. Other technical factors may be at play here, such as the fact that there were more bank holidays than usual in May this year. But these effects are not enough to explain the scale of the correction in growth.

There is little doubt that the international context, with growing geopolitical tensions in Eastern Europe (Ukraine/Russia) and the Middle East, has also disrupted the economic climate. These external factors have not necessarily been passed on to euro-zone exports. In Germany for example, exports to Russia fell some 15% over one year over the first 5 months of the year (a trend which could intensify with the embargo on European foodstuffs imposed by Russia in early August), but these account for only about 3% of total German exports. However, investment may be more affected by these events and by the uncertainty they cause. Furthermore, German investor sentiment has fallen continuously since February 2014 (as revealed by a ZEW survey), dropping below its long-term average in July.

Euro zone – GDP in vol.



Source: EUROSTAT

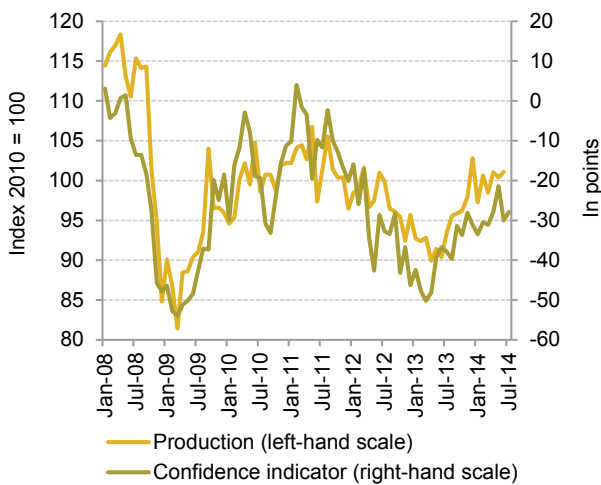
Other member states have posted surprisingly positive results, particularly Spain (up 0.6% over one quarter), Portugal (up 0.6%) and the Netherlands (up 0.5%), even though a certain technical rebound was expected for the latter two countries.

Growth heading below 1% for 2014 as a whole

Based on these results, the euro zone had growth acquisition of just 0.6% for 2014 at the end of the 1st half of the year. The 1.2% growth forecast for 2014 issued by the European Commission last spring appears unachievable in these conditions. For this, there would need to be at least 0.8% growth per quarter over the next two quarters, a target that is unrealistic in present conditions. In fact, while economic surveys available up to July indicate no marked slump in confidence but rather a certain stabilisation – among both businesses and households and right across the euro zone – they do not point to the possibility of any significant pick-up in growth. The European financial markets have also been heavily hit since the summer (down about 10% on the Eurostoxx50 index between early July and August) – never an encouraging signal. Given the above, GDP growth in the eurozone is set to fall below 1% this year.

Manufacturing

Output and confidence in the manufacturing sector



Source: STATEC (seasonally adjusted figures)

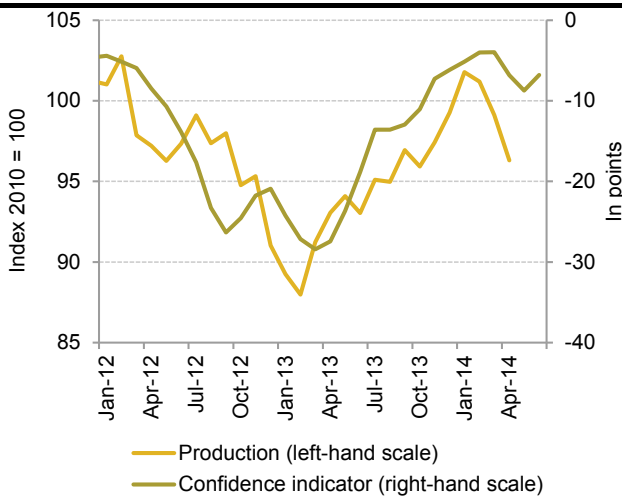
Trend remains favourable in the 2nd quarter

Industrial output in Luxembourg remained buoyant in the 2nd quarter of 2014. This trend compares favourably with that of the euro zone, where output has fallen back somewhat on foot of disappointing results in Germany and France in particular.

Confidence among Luxembourg manufacturers fell appreciably in June, but the July results (as well as the figures available for August) do not point to any major downturn. Generally speaking and despite the visibly improving trend in output (which should allow the industry to again contribute positively to economic growth in the 2nd quarter), activity levels remain relatively weak and the economic climate for manufacturing is far from good. There are also very few tensions in industrial prices at present.

Construction

Output and confidence



Source: STATEC (seasonally adjusted, smoothed over 3 months)

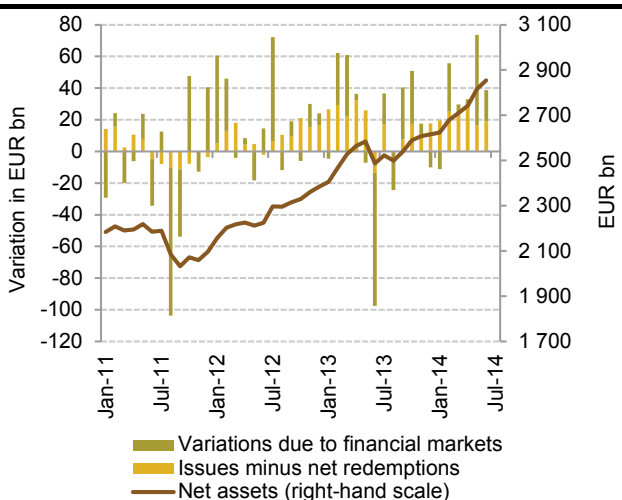
A purely technical pull back?

Construction output fell significantly from March to May, replicated in the rest of the euro zone. While a downturn was expected in the form of a correction after much more favourable weather conditions than usual at the start of the year, the decline may also be partly due to cyclical factors.

Indeed business owners' opinions fell in parallel up to June. Confidence rallied somewhat in July and the partial figures available for August confirm this trend. Throughout the euro zone, the confidence indicator in the sector bounced back in July, but not in Germany or France (where the deterioration has been almost continuous since early 2014).

Financial sector (1/2)

Undertakings for Collective Investment



Source: CSSF

Positive signals for the 2nd quarter

The financial sector indicators were relatively favourable in the 2nd quarter of 2014, at least in the non-banking sector.

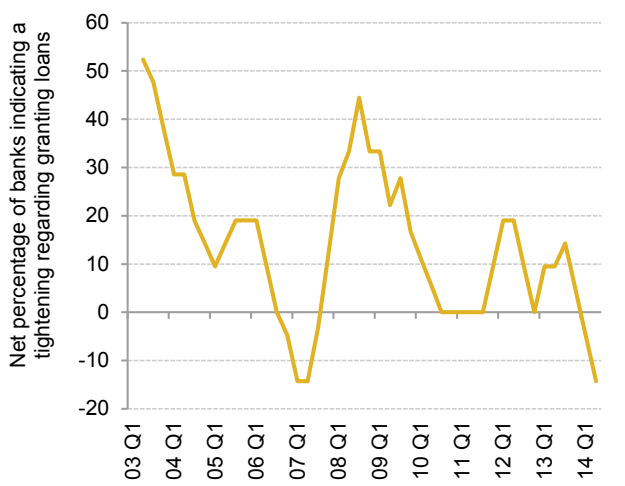
Provisional figures for banks' profit and loss accounts seem to indicate that the interest margin is stabilising, but income from commissions remained down.

Investment funds continued to grow at a relatively high rate, due mainly to the robust financial markets (this factor is set to have the opposite effect in the 3rd quarter) and net investment on a scale comparable to that in the 1st quarter.

Finally, in the insurance sector, income from premiums in the 2nd quarter have also continued to recover (as has been the case since mid-2013, based on seasonally adjusted figures), mainly due to conventional life products (i.e. those with guaranteed returns).

Financial sector (2/2)

Conditions for granting business loans



Source: ECB, STATEC (data smoothed over 3 quarters)

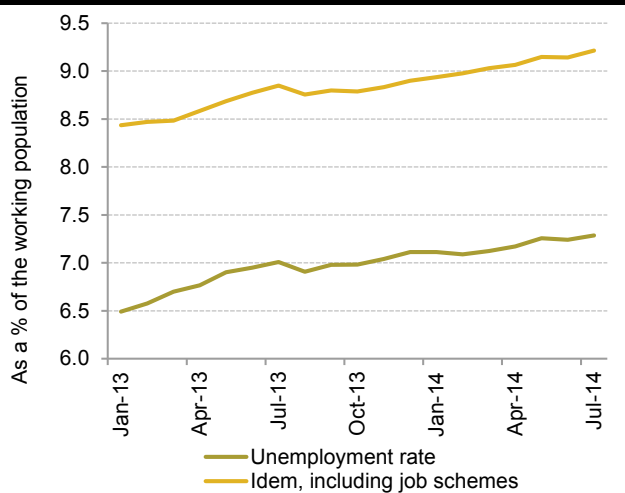
More flexibility in business lending

According to the latest survey on the distribution of bank lending (July 2014), Luxembourg banks seem more inclined to ease pressure on the conditions for granting loans to businesses. On closer reading, this easing seems to be based mostly on improved activity prospects and on the more favourable liquidity position of banks and should result in a reduction in the margin applied and an increase in the size of the loans granted. However, the banks surveyed identified ongoing low demand for lending from businesses up to the 2nd quarter, but they seem much more optimistic in their expectations regarding the 3rd quarter.

In terms of household lending, the criteria for consumer lending remain tough but seem to be easing somewhat for mortgage lending (they were relatively onerous from mid-2012 to mid-2013).

Labour market

Unemployment rate



Sources: ADEM, IGSS, STATEC

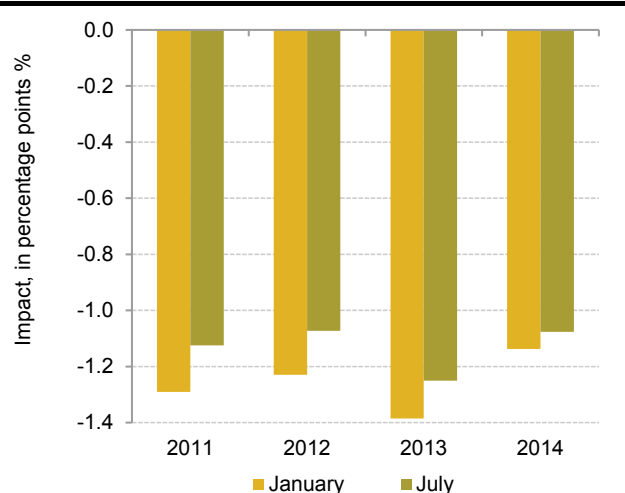
Unemployment continues to rise

In contrast to most other European countries, unemployment continued to rise in the Grand Duchy of Luxembourg in mid-2014. In July 2014, the unemployment rate stood at 7.3%, up from 7.1% in January (seasonally adjusted figures). The increase in July was mainly among men, those aged over 50, those not in receipt of benefits and those with lower levels of education. There is therefore still a mismatch between supply and demand, as the number of job offers again rose in July 2014, especially in services.

In parallel to this rise in the number of job seekers, the number of subsidised jobs has also continued to rise. If we take into account job seekers and those on job schemes, the rate stood at 9.2% of the working population in July 2014, compared to 8.9% in January (seasonally adjusted figures). Most of the rise in the numbers on job schemes is among those in training and those in a retraining placement scheme.

Inflation

Impact of sales on consumer prices



Source: STATEC

A less significant "sales" effect in 2014

The downward trend in inflation noted since the start of the year came to an end with the annual rate rising from 0.9% in June to 1.0% in July.

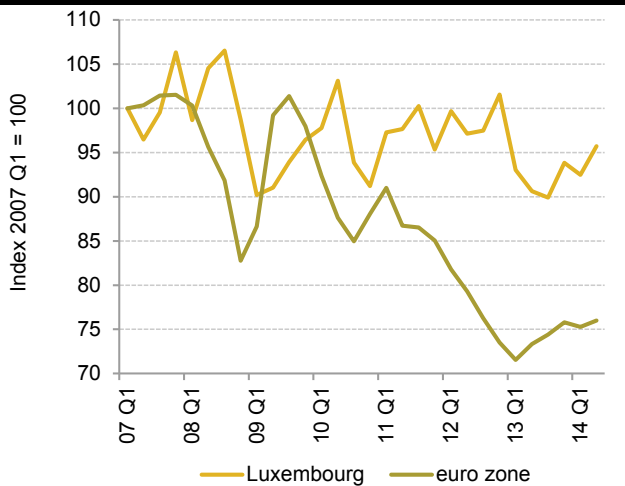
Nevertheless, this rise is closely linked to a short-lived effect. It seems that there were fewer price reductions on many products this year in sales, including clothes and furniture. The "sales" effect thus accounted for 0.12 fewer percentage points this year in July, corresponding exactly to the rise in the inflation rate between June and July.

The general trend for consumer prices remains disinflationary, as seen in underlying inflation excluding sales, which stood at just 1.2% over one year in July, reaching its lowest point in four years. Inflation is notably weakening in foodstuffs, with fruit and vegetables falling continuously over recent months. This is due to over-supply which is likely to rise even further in the short term (due to the Russian embargo on some European foodstuffs).

Consumption

Registrations start to recover

New registrations of private cars



After a very average start to the year, sales of new cars in Luxembourg seem to be taking a more favourable turn. The 2nd quarter saw registrations grow more than 5% over one year (against 0.0% over one year in the 1st quarter). The figures already available for July (with a sharp hike of almost 15% over one year) suggest that this improvement could last throughout the 3rd quarter.

Over the first 7 months of 2014 as a whole, the number of new registrations in Luxembourg rose some 4% compared to last year, similar to levels seen elsewhere in the euro zone (over the first 6 months). Spain and Portugal saw the most favourable trends in the euro zone (more than a third of the rise was in Spain and 10% was in Portugal).

Sources: SNCT, STATEC (seasonally adjusted figures)

Trend chart

	Nov-14	Dec-14	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Average over the last three months	Same period previous year
Annual variations in %, except where otherwise indicated											
Activity											
Industrial output per working day, in volume	6.0	9.0	4.8	9.5	8.3	9.1	9.5	...	...	9.0	-7.4
Construction output per working day, in volume	3.2	4.5	26.2	20.9	5.2	1.9	2.1	...	...	3.1	-4.1
Turnover by volume of total retail trade	0.9	-0.6	1.1	1.5	-0.5	-0.1	-0.5	...	...	-0.4	-0.7
Prices, wages											
Consumer price index (NCPI)	1.2	1.5	1.5	0.9	0.8	0.8	1.0	0.9	1.0	1.0	1.9
Underlying inflation	1.9	2.0	2.1	1.6	1.5	1.4	1.3	1.2	1.4	1.3	2.2
Oil product index	-6.2	-3.6	-4.7	-6.8	-6.4	-6.1	-2.3	-2.7	-3.2	-2.7	-2.1
Industrial producer price index	-2.8	-2.6	-3.1	-4.2	-4.6	-4.0	-3.6	...	...	-4.1	-3.2
Construction price index ¹	1.9	1.9	2.0	2.0	2.0	2.1	2.1	2.1	...	2.1	2.2
Average wage bill, per person (National accounts)	3.7	3.7	2.9	2.9	2.9	...	...	...	...	2.9	2.6
Foreign trade											
Exports of goods (volume)	4.8	12.4	12.3	11.0	16.1	6.2	10.0	10.7	...	9.0	2.4
Imports of goods (volume)	-2.0	-2.2	-4.6	-6.1	-5.1	-3.1	-3.7	-2.8	...	-3.2	0.4
Employment, unemployment											
Domestic number of employees	2.0	1.7	2.2	2.4	2.4	2.4	2.3	2.2	2.6	2.3	1.7
National employment	1.6	1.5	1.9	2.0	2.0	2.0	2.1	2.0	2.2	2.1	1.7
Unemployment rate (% of working population, seas. adj.)	7.0	7.1	7.1	7.1	7.1	7.2	7.3	7.2	7.3	7.3	7.0

Source: STATEC

Data yellow coloured are estimates

¹ Estimations based on half-yearly data

Indicators

	Variation on previous quarter in %					
	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2
Eurozone- Growth in volume of GDP (European Commission)	-0.2	0.3	0.1	0.3	0.2	0.0
Luxembourg - Growth in volume of GDP (STATEC)	0.0	1.5	0.5	1.0	0.8	...
	Annual variation in %					
	2009	2010	2011	2012	2013	Forecast 2014
Luxembourg - Growth in volume of GDP (STATEC)	-5.6	3.1	1.9	-0.2	2.1	2.9
GDP at current prices 2013: EUR 45 478 million						
Minimum monthly salary (since 01/10/2013): EUR 1 921.03	Consumer price index (July) - base January 1 st 1948: 819.46					
Current account balance (2013 Q4): EUR 431 million	Half-yearly average of the index linked to base as at January 1 st 1948: 825.34					
Resident population (01/01/2014): 549 680	Estimated deadline for next salary indexation: 1 st quarter 2015					

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