Growth sustained by domestic demand

The Luxembourg economy is expected to experience GDP growth of close to 4% in 2016 and 2017, a rate of expansion comparable to that observed in 2013. This growth is based more on domestic demand, particularly consumption and investment, and should allow unemployment to continue to decline.

Stable global economic prospects, but growing political risks

The international economic environment is becoming more uncertain, with political risks, particularly in Europe. Regarding foreign demand prospects, STATEC expects GDP growth in the eurozone of 1.7% in 2016, followed by a slight slowdown to 1.5% in 2017. After a sharp fall in 2016, stock markets are expected to see a more favourable trend in 2017, in line with a broadly stabilised economic situation. This improvement will be modest, however, due to the aforementioned uncertainties.

Luxembourg: towards GDP growth of almost 4% in 2016 and 2017

After falling in the 1st quarter, Luxembourg GDP recovered well over the spring. Underlying activity trends remain unchanged, showing a relatively high rate of growth since 2013, but also a decline in the financial sector since 2015. The indicators available for the 3rd and 4th quarters generally point to an economic climate that remains buoyant. These factors suggest real growth in Luxembourg’s GDP of 3.7% this year. For 2017, STATEC expects a slight acceleration, mainly due to the rebound in financial markets that positively impact domestic economic activity (+4.2% for real GDP).

Private consumption, somewhat sluggish in recent years, is expected to accelerate in 2017 due to the impact of the tax reform. Investment will be boosted by acquisitions of machinery and equipment, but housing and public sector spending will be somewhat slower. In terms of foreign trade, 2016 had been marked by a surge in exports of non-financial services, while in 2017, exports of financial services should take over.

Strengthening inflation and wage pressures

The impact of previous drops in oil prices continued to weigh on energy prices in Luxembourg in 2016, but its gradual dissipation pushed up the rate of inflation in the second half of the year. On the other hand, the rise in other prices remained moderate, reflecting the low level of domestic pressure on prices.

Labour market: unemployment should follow a moderate downward trend

The labour market showed resilience, even momentum, in early 2016. Despite less favourable signals at the end of the year, job creation is accelerating compared to 2015, and should continue as such in 2017. Unemployment will continue to decline, on a progressively softened slope, approaching 6.4% of the working population in 2016, then 6.2% in 2017.

Significant deterioration of the public budget surplus in 2017

The public balance, across all sectors, should be a surplus of just EUR 1 billion in 2016, an increase of about EUR 100 million compared with 2015. This improvement should come from a stronger acceleration of revenue compared to expenditure. In 2017, the more sustained increase in expenditure, mainly due to income adjustments, and the slowdown in revenues (linked notably to tax reform) should lead to a sharp decline in the surplus to around EUR 200 million or 0.4% of GDP according to the STATEC forecast.
Employment fares better but not output

According to initial estimates, Luxembourg industrial output fell approximately 2.2% over one month in October. In terms of trend, it remained relatively stable (and even fell slightly compared to late 2015). These results are quite disappointing as they do not replicate the renewed confidence expressed by manufacturers since last spring. In contrast, employment in this sector continues to grow: after bottoming out in 2014, it has rebounded significantly, posting a rise of 0.3% over one quarter in the 3rd quarter of 2016 (+1.4% over one year, which corresponds to about 500 additional jobs).

In the euro zone, industrial output has regained momentum since the 3rd quarter. It is reassuring to note that southern euro-zone countries – where manufacturing activity has suffered greatly in recent years – have now started expanding again (especially Portugal and Spain, more tentatively for Italy and Greece).

Positive figures

Confidence among construction companies had slumped somewhat over the summer but recovered in October and November 2016. It has remained high overall since 2015, due to satisfactory results for many indicators linked to the sector, particularly turnover figures. Turnover is often marked by short-term variations, generally due to exceptional weather conditions but also sometimes due to discretionary measures (such as the VAT hike in 2015, which boosted receipts in late 2014). Apart from this volatility, the background trend in turnover volumes (i.e. deflated by the construction price index) was relatively satisfactory at the end of the 3rd quarter of 2016.

In the euro zone, output in the construction sector seems to be recovering little by little. It has been boosted notably by improved results in France, where a number of indicators – planning permission, new construction projects and property prices – appear to indicate a sustainable upswing.

Yields on sovereign bonds up

In November, yields on 10-year government bonds rallied significantly, returning to the same levels as at the start of the year. With financial operators anticipating a progressive rise in leading rates in the United States and a possible return to inflation under the policies of President-elect Donald Trump, yields on 10-year US Treasury bonds grew 0.5 percentage points, rising from 1.83% to 2.36% in November.

In the euro zone, yields on sovereign bonds also bounced back after reaching historical lows this summer. Rates grew more moderately than in the United States, but yield spreads between countries, particularly with the German benchmark rate, have reduced. France, Portugal and Italy saw the spread between their bonds and German bunds grow the most (from 20 to 50 basis points between July and November), due in particular to the uncertain outcome of the Italian referendum in early December and the upcoming French elections.
Stock markets bounce back

Alongside the rise in interest rates on sovereign borrowings, the financial environment was marked by a rally in the equity markets at the end of the year. The Eurostoxx 50, the euro-zone benchmark index, recovered from the turbulence caused by the Brexit vote, returning to the same level as at the start of the year. The LuxX index, which held up more favourably than the average of European indices this year, also continued to soar in recent weeks, reaching a year high on the Luxembourg stock exchange on 8th December (gaining 23% since early 2016).

This turnaround reflects the sharp rebound in banking stocks, which had a particularly rough ride this year up to the summer, but which have bounced back in the last four months. The banking sector seems to be benefiting from the rising interest rates on the bond market, a trend that is likely to reduce pressure on bank margins.

Unemployment still falling in early 2016

In recent months, paid employment continued to grow at about 3% over one year. The pace of growth is relatively high, particularly in comparison with other European countries, but the accelerating trend that dominated since 2014 seemed to mostly peter out in 2016. According to the latest forecasts from STATEC, the pace of 3% should last into next year.

Alongside this steady employment growth, unemployment continues to fall. The unemployment rate tended to stabilise over the summer but it has since fallen back significantly. It dropped to 6.2% in November 2016, against 6.3% in October and 6.4% in August.

Over recent months, this drop in unemployment has mostly benefited Luxembourg nationals with lower level qualifications. There are also fewer women signing on than men.

Commodity prices recover

After bottoming out in January 2016, commodity prices grew strongly in 2016. In November, they were about 30% higher than at the start of the year. This growth is quite widespread and is affecting foodstuff, metals and energy. Oil products were the main driver over the year as a whole and were recently boosted by agreements between producer countries to limit output in order to maintain prices. Between late November and mid-December, the Brent price (in USD) rose more than 10%. The price of coal was also boosted by reduced extraction in China.

The jump in metal prices in late November (+12% compared to October) was mainly due to metals required for steel production (iron ore +25%, zinc +11%, nickel +8%) and copper (+25%). Speculation on these metals was sustained in particular by more favourable indicators in China for the property sector and other infrastructure works. Furthermore, the election of Donald Trump seems to have had a positive impact on investment expectations. However, there was a partial downward price correction in December.
No autumn depression

The opinions of business leaders in non-financial services slumped in August and September, but recovered somewhat over the following two months. This improvement is mostly due to more optimistic opinions as regards recent demand trends. Luxembourg business owners have also been more positive about recent employment trends in their companies. These developments suggest that non-financial services may have an even greater impact on economic activity in late 2016.

In the euro zone, the confidence indicator for non-financial services also slipped somewhat over the summer. As in Luxembourg, this recovered in autumn, propelled by improving sentiment as regards demand for their services. This rally was noted in most Member States, particularly so in Greece, Malta, Spain and Austria.