

Slowdown in the euro zone

Parallel with declining business and household confidence, economic growth in the euro zone has significantly slowed since the start of the year. This slowdown, linked mainly to sluggish exports, is expected to continue into next year. Its extent will be relatively limited but the risks of a downward adjustment have increased, mostly due to international trade tensions.

Slowdown confirmed...

GDP growth in the euro zone was just 0.2% in the 3rd quarter of 2018, down from +0.4% in the 1st and 2nd quarters, and some distance from the 0.7% per quarter recorded over 2017 as a whole.

The summer period was particularly disappointing for Germany, where GDP fell 0.2%, and Italy, which recorded zero growth. It is difficult as yet to discern the reasons for the downturn in Germany, but it appears that the new anti-pollution standards may have destabilised output for several car makers and exports. In Italy, under-performance in the industrial sector seems to have driven results down, a bad sign for the government of Prime Minister Giuseppe Conte, who had planned to implement a largely expansive budgetary policy.¹

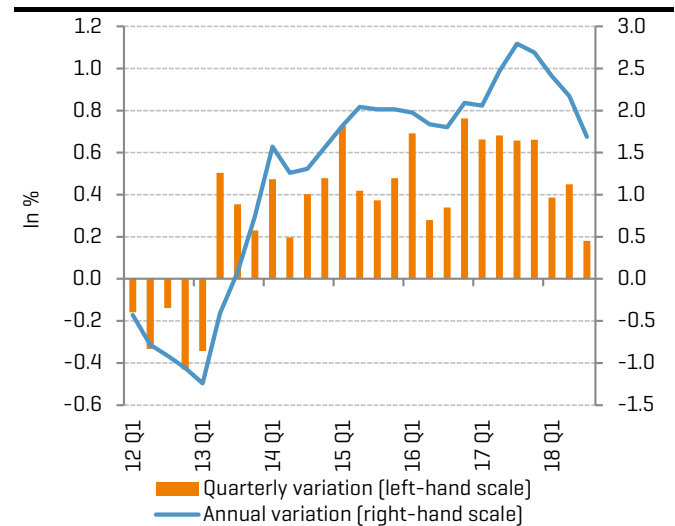
In contrast, Q3 results were better in France, with GDP up 0.4% over one quarter, against just +0.2% over each of the two previous quarters. However, performance was below expectations,² because the 1st half was hampered by temporary phenomena – strikes and a negative effect linked to the tax reform schedule – suggesting that activity will bounce back more strongly.

Generally speaking, the temporary elements that could be invoked – over the first part of the year for France and the 3rd quarter for Germany – are not enough on their own to explain the slowdown observed in the euro zone this year. The slowdown has been accompanied by a decline in the confidence indicators for businesses and households, which seems to point to concerns with deeper roots. This drop in confidence in the euro zone continued into the 4th quarter, with the purchasing managers index (PMI composite index) falling again in October and November and the Economic Sentiment Indicator slumping in October, and there are no indications of a significant rally in late 2018.

¹ Italy presented a draft budget for 2019 providing for a deficit of 2.4% of GDP, against just -0.8% forecast in July by the previous majority. The European Commission rejected this proposal – a first in European Union history – and asked for it to be revised, with the threat of financial sanctions under the excessive deficit procedure.

² Banque de France had predicted GDP to recover by 0.5%.

GDP IN VOLUME IN THE EURO ZONE



Source: Eurostat

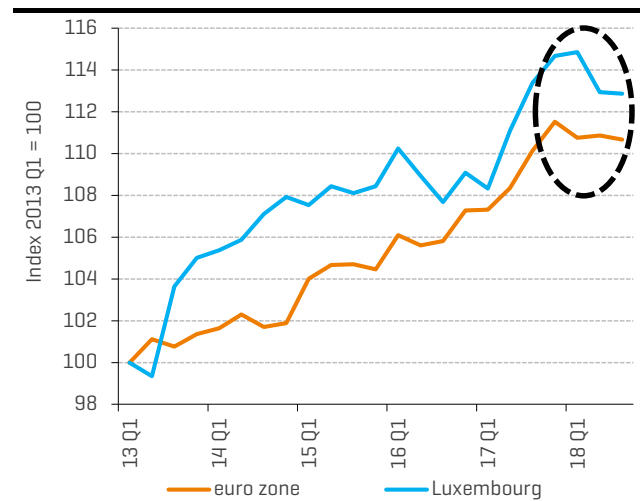
... and forecasts revised slightly upwards

This economic sluggishness is reflected in the forecasts drawn up in autumn 2018 by various international organisations. After rising 2.4% in 2017, GDP growth in the euro zone is set to slow to about 2% this year and next.³ This slowdown is due to almost zero contribution from foreign trade – which significantly boosted activity in 2017 – but domestic demand is favourable for both consumption and investment. Compared to the forecasts last spring, the downward revisions were most significant for the 2018 outlook (they were relatively limited for 2019). The downside risks weighing on these forecasts have also increased, particularly those relating to escalating trade tensions and a deterioration in the international financial environment.

³ The OECD is predicting euro-zone GDP to rise 1.9% in 2018 and 1.8% in 2019, compared to 2.1% and 1.9% for the European Commission and 2.0% and 1.9% for the International Monetary Fund. The OECD and the European Commission have also drafted a forecast for 2020, which indicates that the slowdown is set to continue, with rises of just 1.6% and 1.7% respectively.

Manufacturing

INDUSTRIAL OUTPUT



Sources: Eurostat, STATEC (seasonally adjusted figures)

Downturn

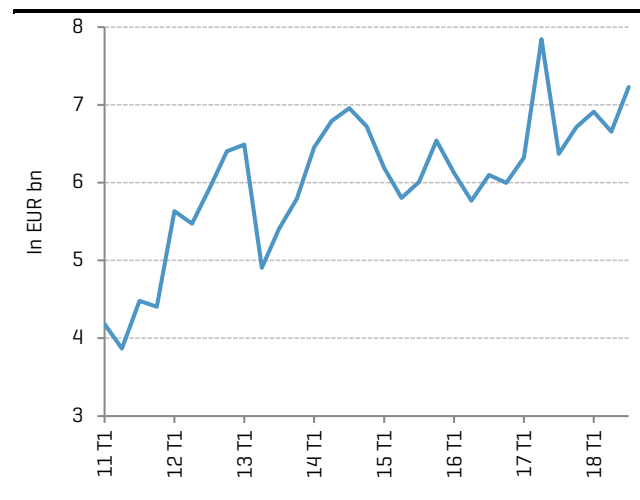
Luxembourg manufacturing output rose 2.8% over one year over the first eight months of 2018. This is slightly higher than that recorded for the euro zone as a whole [+2.2% over the same period].

As in other European countries, confidence among Luxembourg manufacturers peaked in late 2017 and has progressively fallen back since then. At the same time, manufacturing is the sector where opinions among European business owners declined the most this year.

European industrial output has clearly undergone a trend reversal, heading toward stabilisation (and even a slight fall) since early 2018. In Luxembourg, it declined significantly between the 1st and 2nd quarters (it more or less stagnated in the 3rd), mainly in textiles, electronic products and glass. This trend is far from being widespread among all industrial sectors: iron and steel and machinery and equipment have stood up well, for example.

Financial sector 1/2

INSURANCE PREMIUM INCOME



Sources: CAA, STATEC (seasonally adjusted figures)

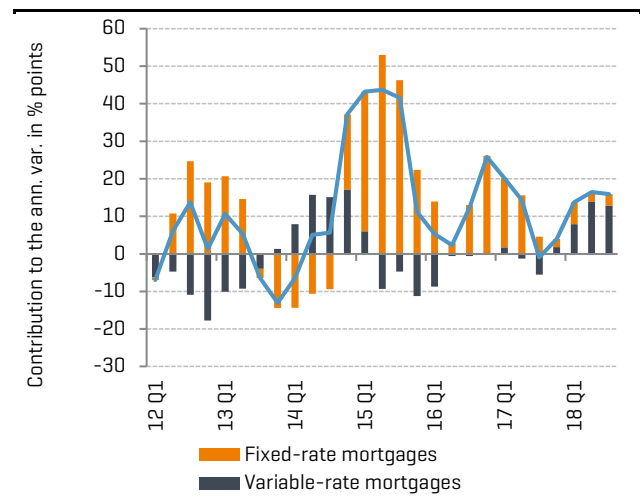
Guaranteed-return life insurance bounces back

In the 3rd quarter, premiums collected by insurance companies rose 17.6% over one year, boosted by the renewed attractiveness of guaranteed-return life insurance, where premiums have more than doubled [+115%]. In contrast, increased risks and volatility on the stock markets have rendered life insurance products invested in equities less attractive [-9.8% over one year against +28% over 2017 as a whole. Their weighting among overall premiums has fallen 60% between 2015 and 2017 and 53% in 2018.

Non-life insurance premiums continue to rise, buoyed in part by foreign companies relocating in the run-up to Brexit [+11.7%]. According to KPMG, 10 insurance companies have announced that they are to move to Luxembourg to prepare for the probable loss of their European passports (IMD and Solvency II) following Brexit.

Financial sector 2/2

NEW MORTGAGES GRANTED TO HOUSEHOLDS



Source: BCL

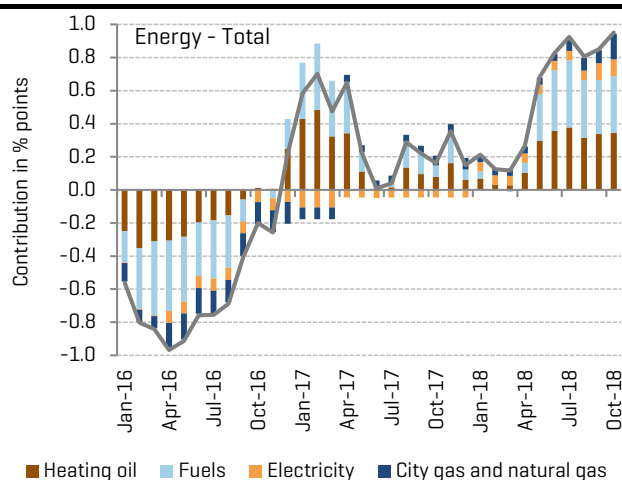
Variable rates popular again

After being overlooked for 2 years, variable-rate mortgages are again demanded by households this year. In the 3rd quarter, these rose 32% over one year against just 5% for fixed-rate mortgages. This change is mostly due to the rise in interest rates applied to fixed-rate mortgages since early 2017 [+0.3 percentage point], making them less attractive compared to variable-rate mortgages [-0.1 percentage point].

Note that the gradual drop in the key interest rates since the crisis drove banks to significantly reduce the interest rates applied to mortgages, thus reducing the difference between fixed-rate mortgages (which are generally higher) and variable-rate mortgages, eliminating the difference entirely at the end of 2016. According to the European Commission, the key rates could start to be raised during the summer 2019.

Inflation 1/2

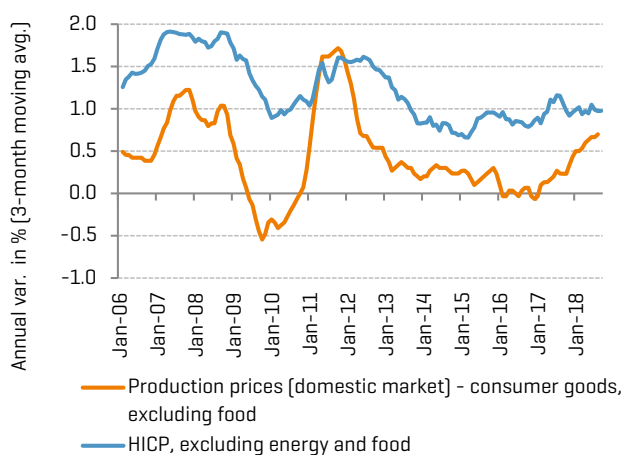
CONTRIBUTION OF ENERGY PRICES TO ANNUAL INFLATION



Source: STATEC, seasonally adjusted

Inflation 2/2

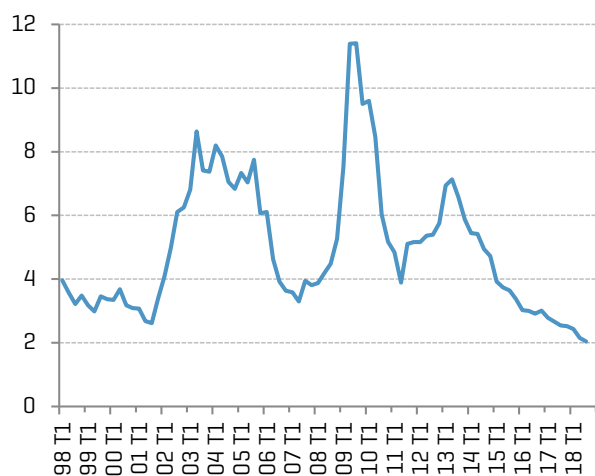
PRODUCTION AND CONSUMER PRICES IN THE EURO ZONE



Sources: Eurostat, ECB Statistical Warehouse

Labour market

NUMBER OF JOB SEEKERS PER VACANCY



Sources: ADEM, STATEC (seasonally adjusted figures)

The contribution of energy prices should decline

In October, energy prices were 14% higher than last year, accounting for almost 1 percentage point of general inflation. Since its latest peak at 85 USD per barrel in the beginning of October, the oil price declined considerably (to 60 USD in the end of November). This recent drop in oil prices should pass on quickly to fuel and heating oil prices. Unless Brent prices rebound, the next wage indexation adjustment will be postponed to after 2019.

The recent drop in oil prices should stem from the downward revision in growth prospects worldwide and American sanctions against Iran that were less draconian than anticipated. In the run-up to the OPEC meeting on 6 December, a record output in Saudi Arabia and the construction of new pipelines in the United States (expected for end-2019) currently fuel speculations on excess supply.

Signals of a strengthening of underlying inflation in the euro area

Global inflation has risen significantly in the euro zone and Luxembourg alike, pushed up by energy prices (see above) and is currently close to 2.0% over one year. While in Luxembourg, underlying inflation (excluding energy and food) also made a contribution, it remains surprising low in the euro zone, stable at about 1.0% over one year since early 2017.

However, both the uptick in commodity prices since early 2016 and the pick-up in wages since the end of last year have increased production costs. The resilience of domestic demand should also mean that these rises will have an impact on end prices. Prices ex-works in the euro zone (see graph) are thus rising at their highest rate since 2012. In contrast, following the strong appreciation of the US dollar between late 2016 and early 2018, prices of imported goods (-2.0% over one year in the 1st half of the year) have put a brake on underlying inflation. Recent figures indicate however a gradual dissipation of this exchange-rate effect.

Two job seekers for every vacancy

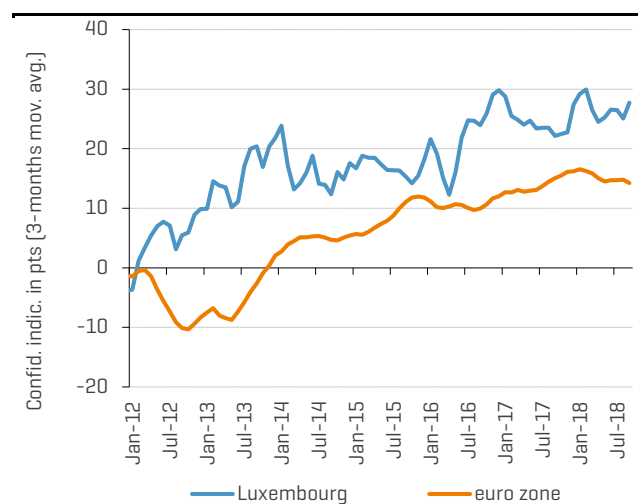
Unfilled job vacancies remain numerous despite a slight drop in the 3rd quarter. The number of job seekers per vacancy continues to fall: there were two job seekers per vacancy in the 3rd quarter of 2018, compared to seven in early 2013.

Most vacancies are in business services and the financial sector, accounting for 50% of the 7 600 job vacancies notified to ADEM in the 3rd quarter. Information and communication services, health services and hotel & catering are also seeing strong demand for staff.

The job vacancy rate remains at its highest level since records began, both in Luxembourg (1.8% in the 2nd and 3rd quarters of 2018) and for the euro zone as a whole (2.1% over the first 3 quarters in 2018).

Non-financial services

CONFIDENCE IN NON-FINANCIAL SERVICES



Sources: Eurostat, STATEC

Morale holding up well

While confidence in non-financial services has been slightly down in the euro zone since the start of the year, it is holding up well in Luxembourg.

However, results vary depending on sector. In transport services, added value this year has been stabilising compared to results at end-2017. This trend is notably apparent in air transport indicators, with freight and passenger volumes breaking in recent quarters with the strong rises in previous years. Less buoyant global trade is certainly a factor in this, as are the fewer arrivals for new airlines operating via Findel Airport.

The results are more trending more favourably for business services and hotel and catering, which are major job providers. For business services, turnover in volume was up 2.6% over one year over the first 8 months of 2018, after slipping somewhat last year (-1.3%). In hotel and catering, turnover was up 3.7% in volume over the same period, mainly due to results in the hotel industry and mass catering.

Trend chart

	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	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	5.6	3.5	2.1	3.2	0.0	-0.1	4.2	...	...	1.3	3.4
Construction output per working day, in volume	-8.1	2.7	4.7	-0.5	6.1	0.4	7.7	...	...	4.3	3.4
Turnover by volume of total retail trade	0.4	7.4	-0.7	0.4	3.8	6.5	6.9	-0.2	...	4.3	2.7
Prices, wages											
Consumer price index (NCPI)	1.0	1.1	1.1	1.3	1.4	1.5	1.6	2.0	2.0	1.9	1.9
Underlying inflation	1.0	1.1	0.9	0.7	0.8	0.7	1.0	1.3	1.2	1.2	1.7
Oil product index	1.4	1.2	4.1	12.2	15.0	16.9	14.7	14.6	16.6	15.3	5.6
Industrial producer price index	1.2	4.2	1.4	2.6	3.2	4.5	6.3	...	...	4.7	-0.4
Construction price index ¹	1.7	1.7	1.3	1.3	1.3	...	...	...	...	1.3	1.9
Average wage bill, per person (National accounts)	0.4	0.4	1.2	1.2	1.2	...	...	...	...	1.2	4.6
Foreign trade											
Exports of goods (volume)	4.5	2.9	8.3	2.1	8.4	3.4	3.7	0.0	...	2.3	3.7
Imports of goods (volume)	-6.7	-3.8	8.8	-6.8	-1.1	6.1	2.6	2.4	...	3.7	-0.2
Employment, unemployment											
Domestic number of employees	3.8	3.7	3.9	3.9	4.0	4.0	3.8	3.6	3.7	3.7	3.6
National employment	2.8	2.8	2.9	2.8	2.9	2.9	2.7	2.6	2.5	2.6	2.7
Unemployment rate [% of working population, seas. adj.]	5.7	5.7	5.6	5.6	5.5	5.5	5.5	5.4	5.3	5.4	5.9

Source: STATEC

Data coloured are estimates

¹ Estimations based on half-yearly data

Indicators

	Variation on previous quarter in %					
	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2	2018 Q3
Eurozone - Growth in volume of GDP (European Commission)	0.7	0.7	0.7	0.4	0.4	0.2
Luxembourg - Growth in volume of GDP (STATEC)	0.7	0.5	1.5	1.1	-0.6	...
	Annual variation in %					
	2014	2015	2016	2017	Forecast 2018	Forecast 2019
Luxembourg - Growth in volume of GDP (STATEC)	4.3	3.9	2.4	1.5	3.9	4.0
GDP at current prices 2017: EUR 55 301 million						
Minimum monthly salary (since 01/08/2018): EUR 2 048.54						
Current account balance (2018 Q1): EUR 607 million						
Resident population (01/01/2018): 602 005						
Consumer price index (October) - base January 1 st 1948: 866.04						
Half-yearly average of the index linked to base as at January 1 st 1948: 859.92						
Estimated deadline for next salary indexation: 4 th quarter 2019						

STATEC

info@statec.etat.lu
[+352] 247-84219
www.statistiques.lu

For further information:

Bastien Larue
Bastien.Larue@statec.etat.lu
[+352] 247-84339

Pauline Perray
Pauline.Perray@statec.etat.lu
[+352] 247-74236