CONJONCTURE **FLASH**

February 2019

MONTHLY PUBLICATION ON THE STATE OF THE LUXEMBOURG ECONOMY

# Negative signals for manufacturing

**Luxembourg industrial output was more dynamic than that of the euro zone in late 2018, but not over the year as a whole. As Luxembourg and European industrial business cycles are relatively well synchronised, the trend reversal seen in the euro zone since 2018 is a negative signal for Luxembourg industry over the short term. Industrial job creations also seem to have entered a slowing phase since the 2nd half of 2018.**

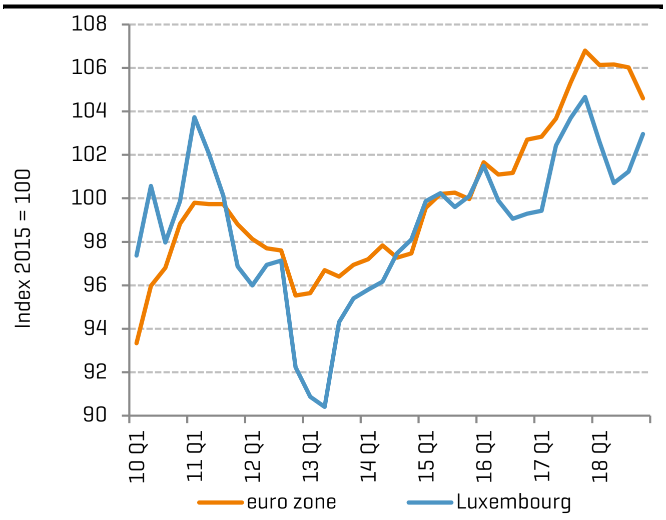
## An ominous European downturn

According to initial estimates[1], Luxembourg industrial output rose approximately 1.7% over one quarter in the 4th quarter of 2018. This rise was mostly due to increases in the textile industry, the manufacture of metal products (excluding machinery and equipment) and rubber products. It contrasts favourably with the collapse observed in the euro zone in late 2018 (-1.4% over one quarter), particularly among the heavyweights in European manufacturing, starting with Germany[2] (-1.4%), as well as Italy (-1.1%) and France (-0.5%).

By contrast, over 2018 as a whole, Luxembourg manufacturing underperformed the euro zone, with output down 0.7% on 2017 (+1.0%). The reason for this was the sharp fall in output at the start of the year in metal products, machinery and equipment (a very volatile component in Luxembourg), the food industry and plastic products.

Even though they can differ over the very short term, Luxembourg trends rarely diverge from European industrial cycle for long. This is why the reversal observed in the euro zone is worrying. It is accompanied by a decline in manufacturers' opinions since the start of 2018 – a phenomenon also observed in Luxembourg (see January 2019 issue of Conjoncture Flash) – which worsened further in early 2019.[3] Some factors behind the drop in euro-zone output are temporary, such as low water levels on the Rhine – which impeded supplies to many manufacturers (particularly in Germany) – and new emission standards, which have disrupted the automotive sector. While new car registrations have started to recover since the slump last September, there is still some way to go: in January, they were still down on last year (-5.6% for the euro zone as a whole, -3.4% in Luxembourg). Economic surveys also point to a continuing decline in manufacturers' opinions regarding orders, in both their domestic and export markets.[4]

INDUSTRIAL OUTPUT




Source: Eurostat

## Loss of momentum in employment

In Luxembourg, industrial employment rose 1.5% over one year over the first three quarters of 2018, in line with 2017. Over the same period, euro zone manufacturing rose 1.7% (a slight increase on the +1.4% recorded in 2017). However, not all Member States benefited from this momentum, with France in particular reporting disappointing data (+0.1%).

In Luxembourg, paper and cardboard manufacture and the manufacture of non-metallic mineral products saw the highest numbers of jobs created in 2018 (while there was a sharp downturn in the food industry). Finally, it is important to note that employment growth seems to have entered a period of slowdown since the 3rd quarter of 2018 (a trend visible since the 2nd quarter of 2018 across the euro zone).

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[1] The December result is an estimate generated from a reduced sample of companies.

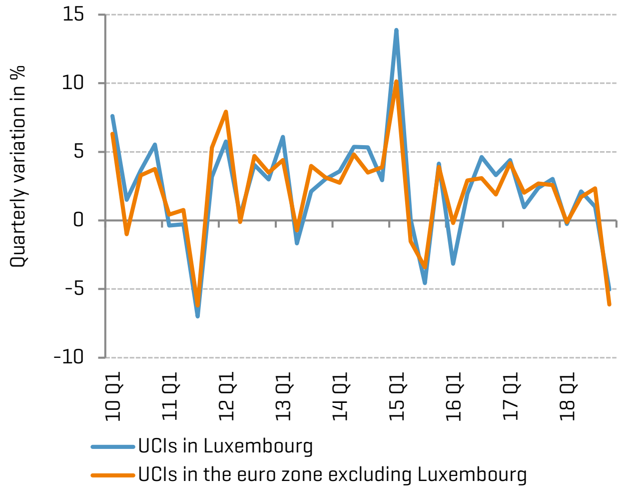
[2] In 2017, Germany accounted for almost 40% of total added value in the manufacturing sector across the euro zone (with Italy and France each accounting for 15%).

[3] The confidence indicator for manufacturers in the euro zone published by the European Commission and the euro-zone manufacturing PMI index both fell sharply in December 2018 and January 2019.

[4] The euro-zone PMI index for the manufacturing sector fell again in February. It slipped to 49.2 points, below the 50-point threshold that marks the boundary between contraction and expansion, its lowest level in 69 months. In contrast, the composite index (i.e. covering all branches of the economy) recovered slightly thanks to improved opinions in the services sector.

## Financial sector 1/2

NET ASSETS OF UNDERTAKINGS FOR COLLECTIVE INVESTMENT




Sources: ECB, CSSF

## A difficult end to the year for investment funds

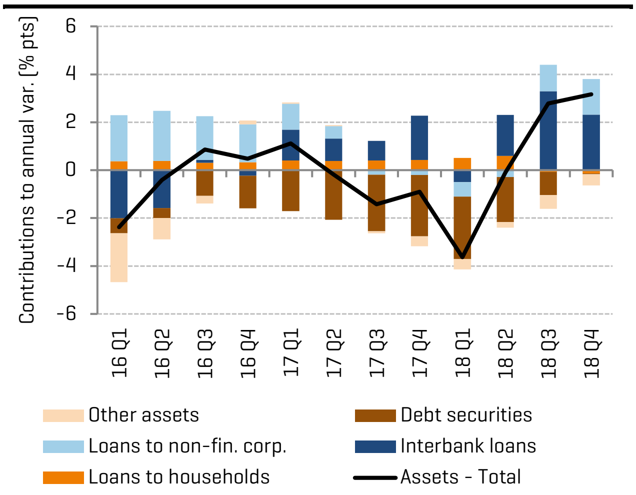
In the final quarter of 2018, sluggishness on the stock markets severely affected investment funds in the euro zone. The slump in asset prices (which accounts for 92% of the decline) was accompanied by investors' concerns over market volatility, which also restricted transactions and asset issues. Assets in undertakings for collective investment in Luxembourg and more generally in the euro zone fell 5 and 6% respectively over one quarter.

Fears about the slowdown in the global economy and the US raising its key interest rate for the fourth time led to a depreciation in almost all asset categories in December. Only European and American bonds – which are fixed-income assets and thus less subject to market volatility – achieved a slightly positive performance.

The results should improve this quarter, buoyed by renewed optimism on the stock markets since the start of 2019 (+9% for the Euro Stoxx 50 and +11% for the Dow Jones at the end of February).

## Financial sector 2/2

BANK ASSETS IN LUXEMBOURG




Source: BCL

## Banks boost their balance sheets

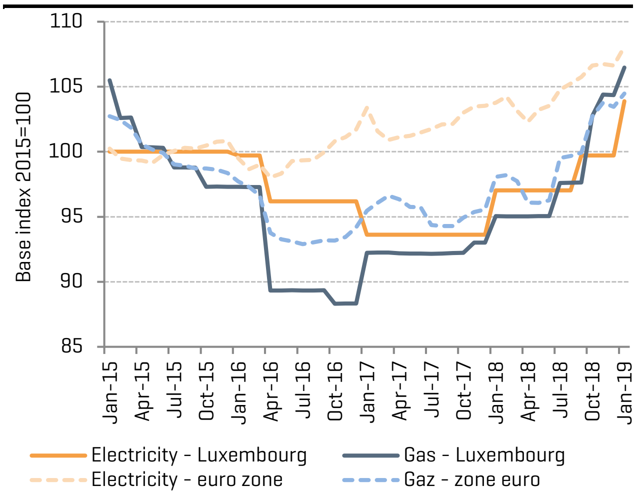
Contrary to undertakings for collective investment dependent on the stock markets, Luxembourg bank assets started to rise again in mid-2018 (+3.2% over one year in the 4th quarter). This rally was driven by loans granted to foreign non-financial companies (making a contribution of +1.1 percentage points) and foreign banks (+1.3 percentage points).

Loans granted to households, businesses and banks domiciled in the Grand Duchy – which continued to grow in 2017 – also remained quite dynamic (+7.1%, +12.6% and +6.5% respectively over one year).

In the euro zone, loans granted to non-financial companies are up since the start of 2016 and rose again in the final quarter of 2018 (+2.1% over one year). Loans to households were also up (+1.7%), as were interbank loans (+3.2%), in an environment where interest rates remained close to 0.

## Inflation 1/2

TRENDS IN GAS AND ELECTRICITY PRICES




Sources: STATEC, Eurostat

## Gas and electricity soar

In recent quarters, there were a number of electricity and gas price hikes. The increases observed in January (+4.2% over one month for electricity and +2.0% for gas) brought annual adjustments to 7% and 12% respectively. While electricity prices are close to the record high of 2009, gas prices are still 13% below their peak in early 2013. Even though other factors are also affecting these prices, trends identified in recent years – falling prices followed by a recovery from 2017 on – reflect the trajectory of oil prices with some delay. While there is no longer any direct link, prices for different energy sources correlate over time.

The recent sharp rise in gas prices is a phenomenon seen across the euro zone. In electricity, grid charges and other expenses have a significant impact on the end prices paid by consumers. Thus, the rise observed last month was due to an increase in the contribution to the offsetting mechanism.

## Inflation 2/2

INFLATION FORECASTS FOR LUXEMBOURG – MAIN SCENARIO

| | | Forecast | |
|---|---|---|---|
| | 2018 | 2019 | 2020 |
| Inflation (IPCN) | 1.5 | 1.7 | 1.7 |
| Underlying inflation | 1.1 | 1.9 | 1.8 |
| Oil products | 9.6 | -2.1 | 0.1 |
| Index | 1.0 | 1.7 | 2.3 |
| Index (1.1.1948=100) | 802.8 | 816.1 | 834.8 |
| Indexation of salaries | 2018 Q3 | 2019 Q4 | - |
| Price of Brent (USD/barrel) | 70.9 | 62.6 | 65.6 |
| Exchange rate EUR/USD | 1.18 | 1.17 | 1.23 |

Source: STATEC (forecasts dated 13/02/2019)

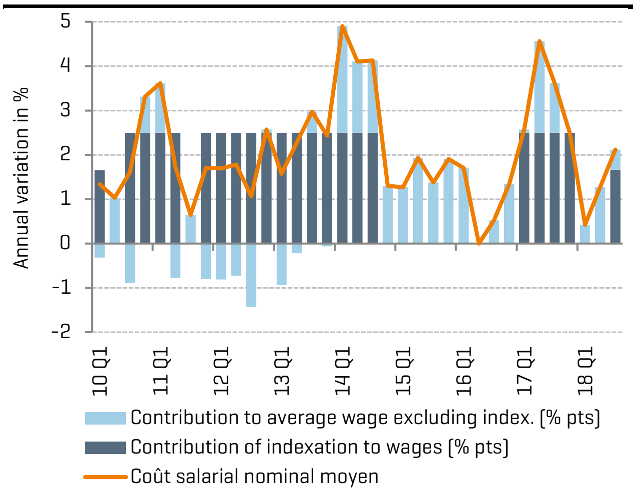
## Underlying pressures increase

In its forecasts published in early February, the European Commission expects euro-zone inflation to slow to 1.4% this year, down from 1.7% in 2018. In autumn, it was still forecasting a pick-up. Although it finds the recent inertia in underlying inflation surprising (given the momentum in wages in particular), the downward revision is mostly due to an adjustment to oil price assumptions based on the downturn observed in recent months.

In February, STATEC also adjusted is 2019 oil price forecast, reducing its price by EUR 10 as compared to its November forecast. Despite the downward adjustment and its implication on inflation in Luxembourg (-0.2 percentage points for 2019), inflation should nevertheless accelerate from 1.5% in 2018 to 1.7% in 2019 (and 2020). This strengthening will come from the rally in underlying inflation. In January, it was already at 1.8% over one year in Luxembourg, compared to just 1.2% in the euro zone. The next wage indexation adjustment, scheduled for the 4th quarter of 2019, would bolster it even further, just before the introduction of free public transport (on 1 March 2020) brings it back down.

## Labour market 1/2

AVERAGE WAGE BILL AND INDEXATION




Source: STATEC, national accounts

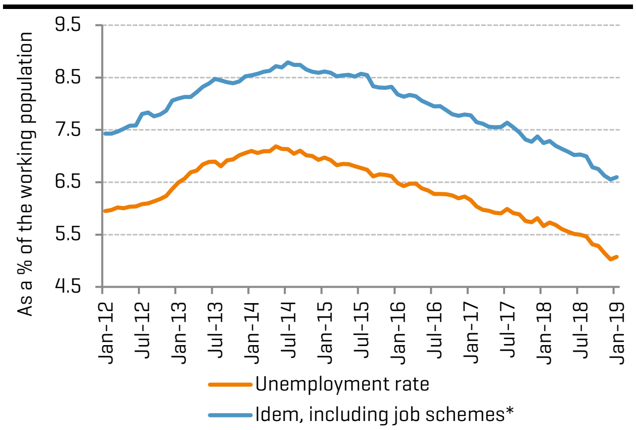
## Wages continue to grow

In the 3rd quarter of 2018, the average wage bill rose 2.1% over one year in Luxembourg, compared to a rise of +0.4% in Q1 and +1.2% in Q2. The clear acceleration in Q3 was mainly due to automatic indexation of wages, with a new adjustment in August. However, as in the rest of the euro zone, wage growth is strengthening in Luxembourg as well, with stronger cyclical pressures related mainly to falling unemployment and worsening recruitment difficulties in certain sectors.

The pick-up in wages in Q3 was particularly significant in public administration, education and healthcare (due to the impact of collective agreements in these sectors) and in business services (the sector with the highest vacancy rates). In contrast, wages slowed in the financial sector, mostly due to a large drop in bonuses in SOPARFIs (holding companies).

## Labour market 2/2

UNEMPLOYMENT RATE AND JOB SCHEMES




* Excluding the professional integration activities (AIP) organised by the SNAS, now monitored exclusively by the National Office for Social Inclusion (ONIS) and no longer by the ADEM.

Sources: ADEM, STATEC (seasonally adjusted figures)

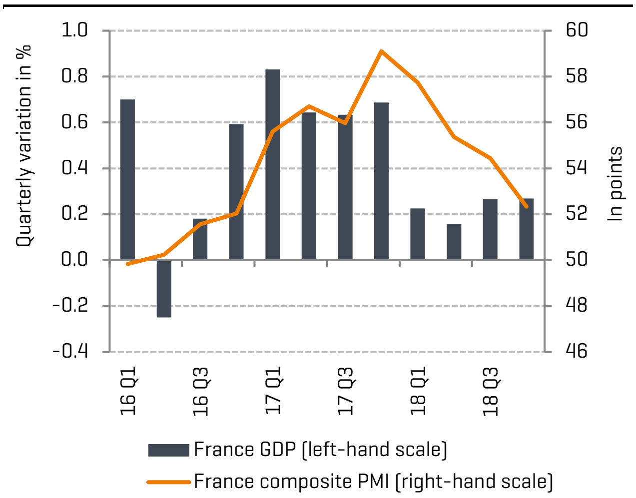
## Subsidised jobs continue to fall

In 2018, 22% of people registered with ADEM were on job schemes – a total of 4,250 job seekers. The numbers on these schemes fell last year, a trend discernible since 2016 that is also in line with falling unemployment. They accounted for 1% of national employment in 2018 (down from 1.2% in 2015). Thus, the drop in subsidised jobs cut employment growth by 0.1 percentage points in 2018. Unemployment stood at 5.1% of the working population in January 2019, a figure that rises to 6.6% when those on job schemes are taken into account (and with a downward trend that is very similar between the two).

Special schemes where job seekers ineligible for benefits are taken on by non-profit organisations account for most of the beneficiaries (42% in 2018) and continues to trend upward. These schemes witnessed the most expansion, followed in 2018 by internships, a new scheme introduced in 2016. Schemes aimed at job seekers in receipt of payments (specific temporary occupations) and young job seekers (job insertion placements) fell by contrast.

## International

FRANCE: GDP AND PMI INDEX




Sources: Eurostat, Markit Economics

## Slowdown in French economy

There was a general slowdown in the French economy in 2018, even though unemployment reached its lowest point since the 2009 crisis (8.8%). GDP growth in France fell from 2.3% in 2017 to 1.5% last year and the European Commission has predicted it will slow even further in 2019, with just 1.3% growth expected. In Q4 2018, household consumption stagnated compared to the previous quarter and business investment slowed dramatically. The less buoyant economic environment of preceding quarters was exacerbated by the "yellow vests" movement.

Surveys conducted among purchasing managers (PMI indices) point to concerns in the services sector, where the related index fell sharply towards the end of 2018. There was a similar trend in consumer confidence. Industrial output in France continued to fall in late 2018. However, the PMI index for the manufacturing industry recovered in January and February, rising slightly above 50 points.

## Trend chart

| | May-18 | Jun-18 | Jul-18 | Aug-18 | Sep-18 | Oct-18 | Nov-18 | Dec-18 | Jan-19 | 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 | 0.0 | -1.8 | -1.0 | -2.4 | -3.8 | 2.6 | -5.7 | -5.2 | ... | -2.8 | 5.8 |
| Construction output per working day, in volume | -0.5 | 6.1 | 0.4 | 8.1 | -2.1 | 5.8 | 2.0 | 9.6 | ... | 5.4 | 0.2 |
| Turnover by volume of total retail trade | 0.4 | 3.7 | 6.2 | 6.7 | -0.6 | 5.2 | 2.3 | 1.3 | ... | 2.8 | 3.3 |
| **Prices, wages** | | | | | | | | | | | |
| Consumer price index (NCPI) | 1.3 | 1.4 | 1.5 | 1.6 | 2.0 | 2.0 | 2.3 | 1.9 | 1.8 | 2.0 | 1.3 |
| Underlying inflation | 0.7 | 0.8 | 0.7 | 1.0 | 1.3 | 1.2 | 1.7 | 1.7 | 1.8 | 1.7 | 1.1 |
| Oil product index | 12.2 | 15.0 | 16.9 | 14.7 | 14.6 | 16.6 | 11.7 | 5.5 | 0.8 | 6.0 | 5.2 |
| Industrial producer price index | 2.6 | 5.9 | 7.5 | 9.2 | 7.9 | 6.7 | 5.1 | 3.0 | ... | 4.9 | 4.0 |
| Construction price index[1] | 1.3 | 1.3 | 1.9 | 1.9 | 1.9 | 2.6 | 2.6 | 2.6 | ... | 2.6 | 2.0 |
| Average wage bill, per person (National accounts) | 1.3 | 1.3 | 2.1 | 2.1 | 2.1 | ... | ... | ... | ... | 2.1 | 3.6 |
| **Foreign trade** | | | | | | | | | | | |
| Exports of goods (volume) | 0.9 | 6.3 | 1.8 | 1.2 | -1.2 | 7.2 | 2.4 | 1.6 | ... | 3.9 | 5.0 |
| Imports of goods (volume) | -7.0 | -1.3 | 5.4 | 0.8 | 2.9 | 6.6 | -2.5 | 1.0 | ... | 1.7 | -0.7 |
| **Employment, unemployment** | | | | | | | | | | | |
| Domestic number of employees | 3.9 | 4.0 | 4.0 | 3.8 | 3.8 | 3.8 | 3.7 | 3.7 | 3.4 | 3.6 | 3.9 |
| National employment | 2.8 | 2.9 | 2.9 | 2.7 | 2.8 | 2.7 | 2.6 | 2.7 | 2.5 | 2.6 | 3.0 |
| Unemployment rate (% of working population, seas. adj.) | 5.6 | 5.5 | 5.5 | 5.5 | 5.3 | 5.3 | 5.2 | 5.0 | 5.1 | 5.1 | 5.7 |

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 | 0.4 | 0.4 | 0.2 | 0.2 |
| Luxembourg - Growth in volume of GDP (STATEC) | 0.7 | 1.4 | 1.0 | 0.1 | 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 | 3.0 | 3.0 |

GDP at current prices 2017: EUR 55 299 million

Minimum monthly salary (since 01/01/2019): EUR 2 071.10

Current account balance (2018 Q3): EUR 2 790 million

Resident population (01/01/2018): 602 005

Consumer price index (January) - base January 1st 1948: 855.37

Half-yearly average of the index linked to base as at January 1st 1948: 863.07

Estimated deadline for next salary indexation: 4th quarter 2019

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