CONJONCTURE FLASH

July 2019

MONTHLY PUBLICATION ON THE STATE OF THE LUXEMBOURG ECONOMY

Uncertainty persists in the eurozone

The mood among eurozone businesses has been flagging since 2018 and continues to show subdued growth in activity coming up to the summer. Services are holding up well, with some recent signs of recovery, but pessimism remains widespread among manufacturers.

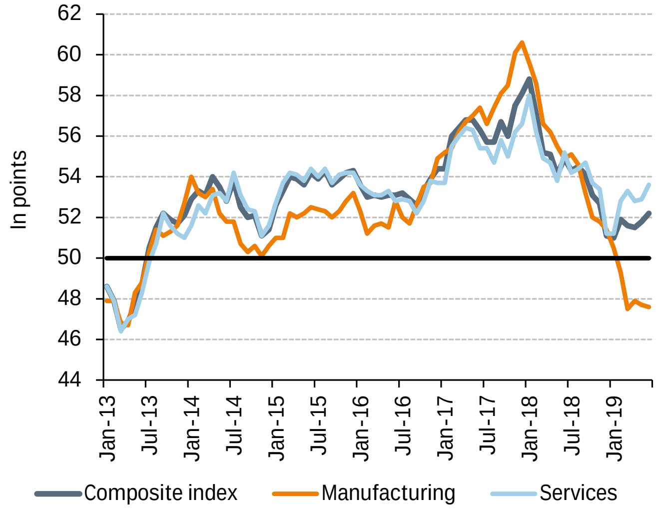
Increased international trade tensions and the volatile European political climate, particularly in the United Kingdom and Italy, are weighing on short-term economic prospects. The climate of uncertainty which the eurozone is currently facing is evident in business opinion surveys. These show that activity has been slowing since mid-2018 and, as summer 2019 begins, they do not point to any great rally in the coming months. There are significant differences within this general observation, depending on the sector and country.

Manufacturing is by far the sector most affected by the downturn. According to the European Commission's indicator, confidence among manufacturers in the eurozone was still trending downward up to June 2019. The PMI[1] manufacturing index bottomed out in March (corresponding to a contraction in activity) and does not seem to have deteriorated further. But opinions on new orders,[2] one of the indicators determining future output trends, have shown no signs of recovery.

Things are better in services: business opinion surveys vary from rally (PMI indices since early 2019) to stabilisation (European Commission), both of which are compatible with ongoing, albeit subdued, activity growth. Confidence in the construction sector is relatively robust, having barely declined since 2018 and remaining very high (higher than previous historic peaks in 1990, 2000 and 2007).

Germany is one of the eurozone countries where business confidence has fallen the most since 2018. This is not very surprising given the German economy is highly industrialised (25% of value added, against about 20% for Italy and 15% for France). In recent years, German manufacturing exports have also been increasingly focused on emerging economies, which are currently extremely exposed to the consequences of international trade tensions. This was not the case in France, where manufacturing output recovered over the 1st half of 2019 (albeit from a low base in the aftermath of the yellow vest protests in late 2018).

BUSINESS OPINION SURVEYS – PMI INDICES FOR THE EUROZONE



Source: IHS Markit

Luxembourg manufacturers also affected

The mood among Luxembourg manufacturers has also been on the decline since 2018. Due mainly to the deterioration in opinions regarding the order books, this decline accelerated over the first four months of 2019. Manufacturing output has been more or less stagnant since 2018 (after 4 years of growth). In early 2019, it fell back in the areas of consumer goods and iron and steel but remains healthy for capital goods. Jobs created in manufacturing have fallen significantly since mid-2018.

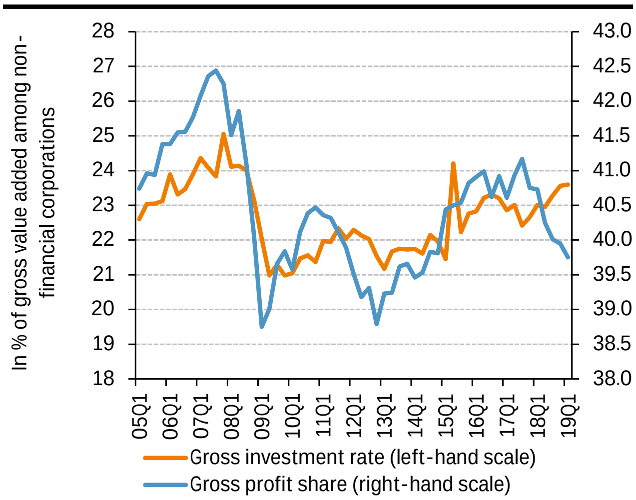
Confidence among Luxembourg companies remains high in the construction and non-financial services sectors. For the latter, the results for Q2 2019 also indicate a favourable economic climate, particularly in business services, IT and trade.

[1] Purchasing Managers' Index (the threshold of 50 points indicates the boundary between activity contraction and expansion).
[2] Also from the PMI survey.

STATEC

International 1/2

INVESTMENT AND PROFITS AMONG EUROZONE BUSINESSES



Source: Eurostat

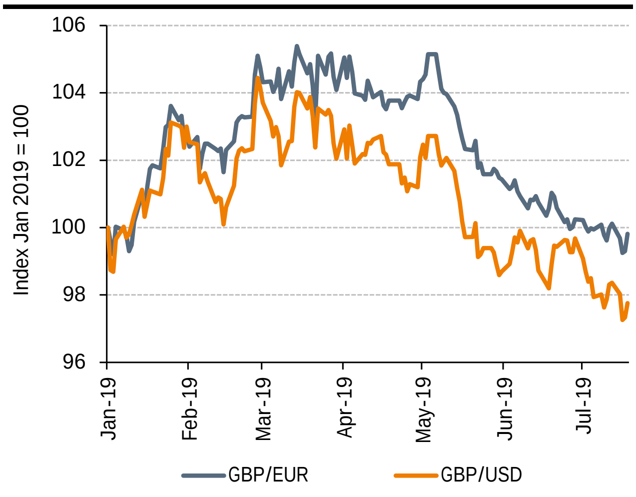
Businesses in the eurozone investing less

While the eurozone is currently under pressure from its worsening external economic environment, internal demand remains robust. The resilience of the labour market and upward pressures on wages encourage household consumption. Although consumer sentiment has worsened somewhat since early 2018, it is still significantly higher than its long-term average as summer gets underway.

Furthermore, investment expenditure in the eurozone picked up pace in early 2019 (see June 2019 issue of Conjoncture Flash), a trend encompassing both households – which are mostly making property investments – and businesses. However, investment momentum in businesses is expected to be less favourable in the short term. Profitability has dipped sharply since 2018, which will negatively impact on growth in productive capital.

International 2/2

STERLING EXCHANGE RATE



Source: Macrobond (BoE)

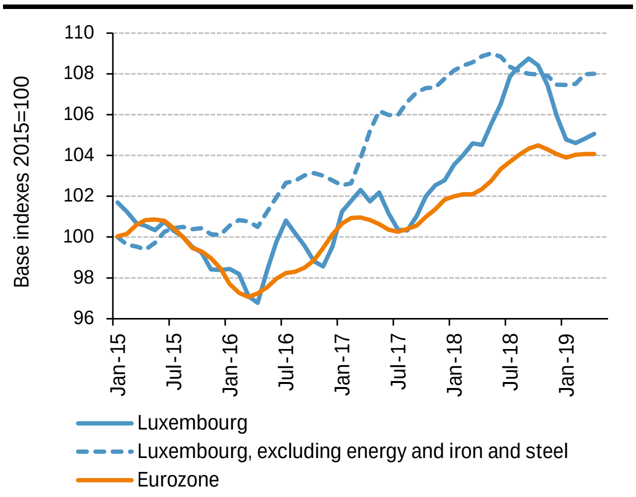
Pound hit by failure to reach agreement on Brexit

The postponement of Brexit, which was initially scheduled on 29 March, and the prime ministerial leadership contest have weighed on sterling over the last four months. Although the currency rose in early 2019, inconclusive parliamentary debates and the last-minute postponement have spooked investors (since March the pound has slid -6% against the dollar, -4% against the euro). The same can be said of exports and imports of goods between Britain and the EU, which had been picking up until March before falling back (-7% and -16%, respectively, from March to May). Growth is expected to slow in the second quarter.

Theresa May's successor, Boris Johnson, has sharpened his tone, asserting that he would see to it that the United Kingdom leaves the EU on 31 October, the new exit date, even if there is no agreement in place; this would see the UK lose access to the EU market and could lead to economic recession. The British parliament also has a say, however, and will have to agree on the desired outcome.

Manufacturing

PRODUCTION PRICE TRENDS: LUXEMBOURG AND EUROZONE



Sources: STATEC, Eurostat (rolling 3-month averages)

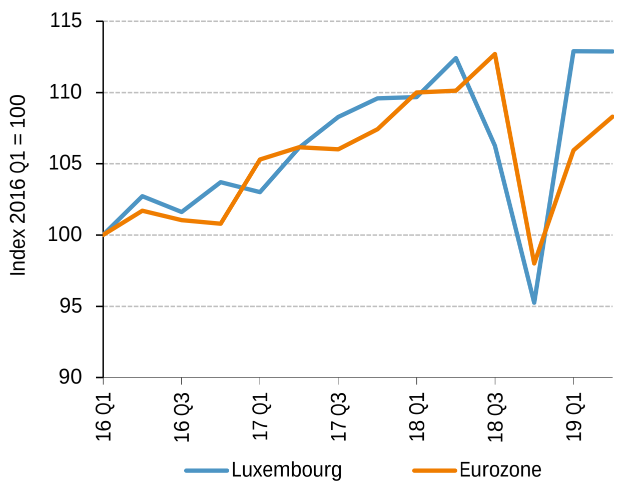
Production prices mark time

The upswing in ex-works prices dating back to early 2016 appears to be over. Prices in the eurozone have stagnated since the second half of 2018, when the downturn in the global economic outlook led to a decline in commodity prices, particularly oil. This lesser pressure from input costs and the slowdown in global trade are taking the steam out of production prices. By contrast, prices are being bolstered by accelerating wage growth in the eurozone and the resulting stronger internal demand.

The background trend for production prices in Luxembourg was broadly in line with that in the eurozone. Nevertheless, the importance of iron and steel makes Luxembourg's price index more volatile. A short-lived jump in corresponding prices over the 2nd half of 2018 temporarily nudged it away from European trends. Ex-works prices for energy, machinery and equipment rose in early 2019, while a downturn was observed in textiles and iron and steel.

Consumption

NEW REGISTRATIONS OF PRIVATE CARS



Sources: ACEA, STATEC (seasonally adjusted figures)

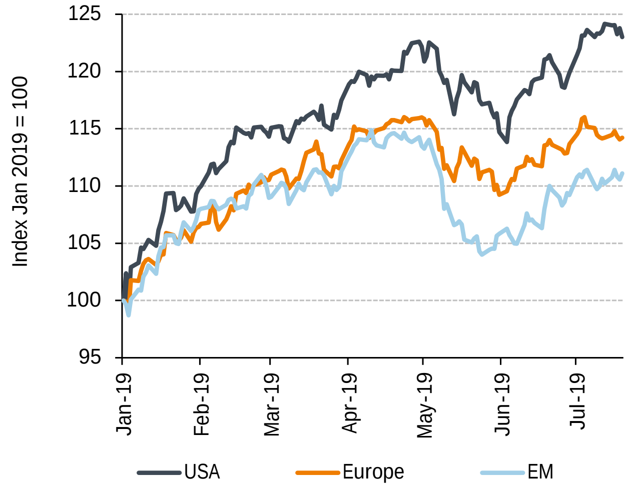
Car industry revs up

New car registrations in Europe fell sharply in late 2018, after the entry into force of new approval standards. They have recovered since, but are still well below levels seen in early 2018. This phenomenon is affecting most eurozone countries (especially France, Spain and Belgium), but not Luxembourg, where sales were relatively high over the entire 1st half of 2019.

Over the first half of the year, they were up 1.5% year-on-year, whereas they fell some 3% in the eurozone as a whole. Assuming that the sales trend observed in the first half continues for the rest of the year, Luxembourg can hope for an approximately 6% rise over 2019 as a whole (compared with stagnation in the eurozone) and new car registrations could exceed the 55,000 mark for the first).

Financial environment

MSCI STOCK MARKET INDICES



Source: Macrobond (figures in EUR)

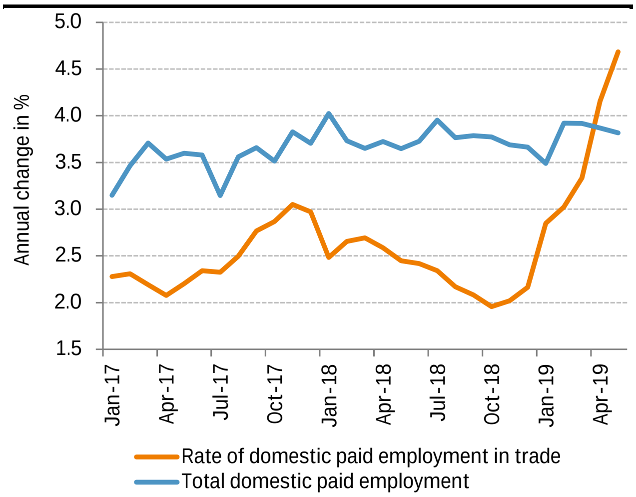
Equity rally boosted by central bank decisions

Although stock market valuations had been on the up since the start of the year, the renewed trade war between the US and China in early May and the resulting new tariff hikes weighed heavily on equities worldwide (-6% for emerging markets and the United States in May, -5% in Europe).

Since then, expectations of more accommodating monetary policies to bolster the European, American and Chinese economies drove indices up again (see the Conjoncture Flash of June 2019). Quantitative easing measures are generally welcomed by investors because they allow businesses and households to refinance at lower cost. Reduced key rates also decrease yields on fixed-yield financial products, which tends to make equities more attractive.

Labour market

TRENDS IN EMPLOYMENT IN TRADE



Source: STATEC – National Accounts

Employment in trade picks up strongly

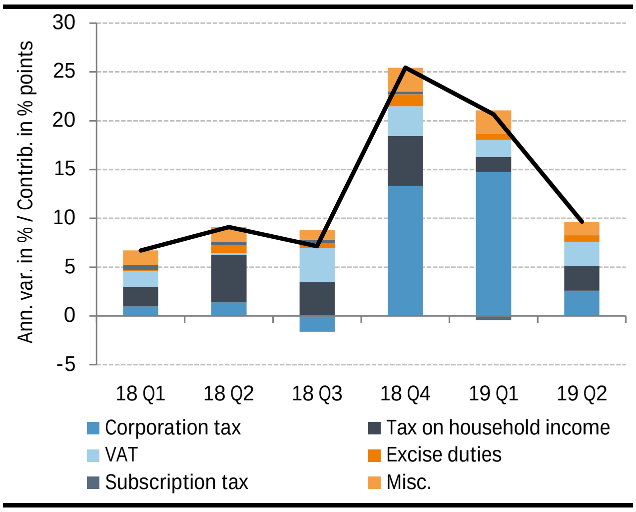
Employment in trade has picked up strongly in recent months, rising from a year-on-year growth rate of +2.0% in October 2018 to +4.7% in May 2019.

Along with human healthcare and social welfare, trade is one of the only sectors where employment continued to accelerate in early 2019. The sector is very important for employment in the Grand Duchy, accounting for 12% of domestic paid employment (the same as the financial sector). This momentum saw overall employment stabilising at +3.7-3.8% year-on-year in recent quarters, even though most sectors were hit by a slowdown.

This trend, driven mainly by in-store retail trade and vehicle maintenance and repairs, goes hand in hand with extremely dynamic private consumption (boosted by rising purchasing power in recent years, low unemployment rates and very low interest rates) and the concomitant expansion in the retail offering (with several sales outlets recently opening).

Public finances

CONTRIBUTIONS TO INCREASE IN TAX RECEIPTS



Sources: Tax authorities, STATEC

Growth in tax receipts heads towards stabilisation

Over the 1st half of the year, the State collected 15% more in taxes year-on-year (+EUR 1.2 billion). This strong growth was mainly due to higher corporation tax receipts. These surged in late 2018 and Q1 2019, partly due to the launch of mandatory electronic tax returns from 2018 (automatic taxation means revenue is collected more quickly). While they slowed considerably in Q2, their year-on-year growth in the 1st half of 2019 was still +50%.

Taxes levied on household income rose significantly last year (+11.5%). After a rather disappointing Q1 2019, annual growth again came close to its long-term average in Q2 (year-on-year growth in the 1st half was 5.7%). Over the 1st half of 2019, VAT receipts and excise duties continued apace with last year, growing +9 and +7%, respectively, year-on-year. The drop in subscription tax revenue at the start of the year mirrors the slump in the stock market indices coming into 2019.

Trend chart

	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-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	2.4	-4.3	-4.7	-2.2	-1.2	-1.0	2.3	...	...	0.0	-1.6
Construction output per working day, in volume	4.0	2.2	6.0	-12.2	17.0	1.9	0.8	...	...	5.8	-0.6
Turnover by volume of total retail trade	6.6	5.4	4.2	2.2	2.3	-1.1	5.3	4.4	...	2.8	3.0
Prices, wages											
Consumer price index (NCPI)	2.0	2.3	1.9	1.8	2.1	2.2	2.1	2.1	1.8	2.0	1.3
Underlying inflation	1.2	1.7	1.7	1.8	1.9	1.8	2.0	2.0	2.0	2.0	0.8
Oil product index	16.6	11.7	5.5	0.8	5.6	9.1	5.5	4.1	-2.0	2.5	10.3
Industrial producer price index	6.4	5.0	2.9	1.3	-0.6	1.0	0.2	0.4	...	0.5	2.7
Construction price index[1]	2.6	2.6	2.6	2.9	2.9	2.9	3.3	3.3	3.3	3.3	1.3
Average wage bill, per person (National accounts)	4.1	4.1	4.1	2.5	2.5	2.5	...	...	...	2.5	1.0
Foreign trade											
Exports of goods (volume)	6.7	2.1	1.2	3.7	2.1	-1.9	11.7	...	...	3.8	3.6
Imports of goods (volume)	7.7	0.1	-4.8	-3.2	5.2	-1.2	5.1	...	...	2.8	-1.2
Employment, unemployment											
Domestic number of employees	3.8	3.7	3.7	3.5	3.9	3.9	3.9	3.8	3.8	3.8	3.7
National employment	2.7	2.6	2.7	2.4	2.6	2.6	2.8	2.7	2.6	2.7	2.7
Unemployment rate (% of working population, seas. adj.)	5.3	5.2	5.1	5.2	5.3	5.4	5.4	5.5	5.5	5.5	5.5

Source: STATEC
Data coloured are estimates
[1] Estimations based on half-yearly data

Indicators

	Variation on previous quarter in %					
	2017 Q4	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1
Eurozone- Growth in volume of GDP (European Commission)	0.7	0.4	0.4	0.1	0.2	0.4
Luxembourg - Growth in volume of GDP (STATEC)	1.4	0.5	0.2	0.4	0.6	0.3
	Annual variation in %					
	2015	2016	2017	Forecast 2018	Forecast 2019	Forecast 2020
Luxembourg - Growth in volume of GDP (STATEC)	3.9	2.4	1.5	2.6	2.7	3.3

GDP at current prices 2018: EUR 58 869 million

Minimum monthly salary (since 01/01/2019, July version): EUR 2 089.75

Current account balance (2019 Q1): EUR 725 million

Resident population (01/01/2019): 613 894

Consumer price index (June 2019) - base January 1st 1948: 872.74

Half-yearly average of the index linked to base as at January 1st 1948: 868.48

Estimated deadline for next salary indexation: 4th quarter 2019

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