MONTHLY PUBLICATION ON THE STATE OF THE LUXEMBOURG ECONOMY

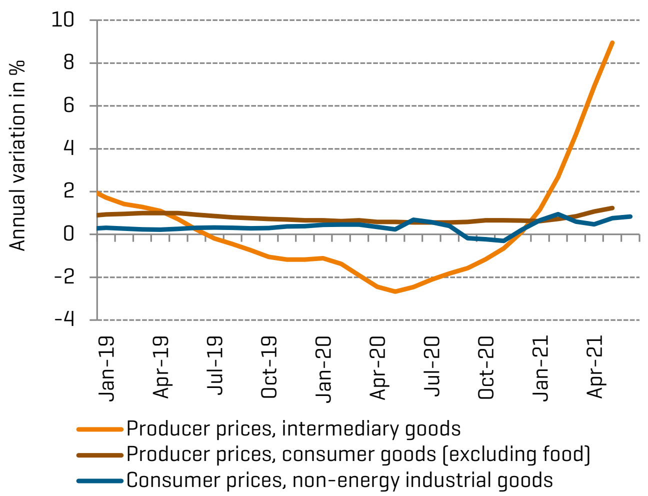
Input prices under pressure

Commodity prices, which have been rising since spring 2020, are pushing up output prices. Apart from oil products, the upward pressure has not yet been reflected in consumer prices in Luxembourg.

After collapsing in spring 2020, commodity prices bounced back significantly after the global economic recovery. They were over 20% higher in early August than in late 2019 (according to the S&P GSCI composite index). This rise on pre-crisis levels is mostly due to constraints experienced during the pandemic, which have disrupted the recovery in supply at a time of robust demand.

However, in recent months, the upward trend in base prices has shown signs of flagging. The announcement in May by the Chinese authorities of measures to combat rising industrial input costs (including anti-speculation measures) brought an end to the strong upswing in metal prices without leading to a substantial fall. Oil prices have lost some momentum recently, standing at about USD 70 per barrel in mid-August compared to USD 75 in late July. Food prices are also down slightly (-4% between May and July, still +22% up on December 2019), but the extreme weather conditions in some world regions could stimulate prices. The strong pressure on wood prices appears to be abating, as is reflected in timber prices (based on the Lumber index), which are close to levels seen in early 2020.

TRENDS IN THE PRICES OF GOODS IN THE EURO AREA



Sources: Eurostat, European Central Bank (moving average over three months)

Partial and delayed repercussions

Households generally do not buy commodities directly but rather manufactured goods containing varying levels of raw materials. In general, commodity price fluctuations are somewhat absorbed throughout the supply chain and the repercussions on consumer prices usually take more than one year.[1] Rising input prices can be partly counterbalanced by lower pressure on other inputs (such as wages) or by reducing margins. In addition, contracts between stakeholders setting longer-term prices also slow the passing on of price changes. In the euro area, the past appreciation of the euro absorbed some of the upward pressures on imported input prices. In contrast, transport costs, which have soared since the start of the recovery, could increase tensions.

Price rises are therefore more marked further back along supply chains. In June, output prices on intermediate goods in the (domestic) euro area market rose almost 11% over one year, the highest rise ever observed (since records began in 1991).

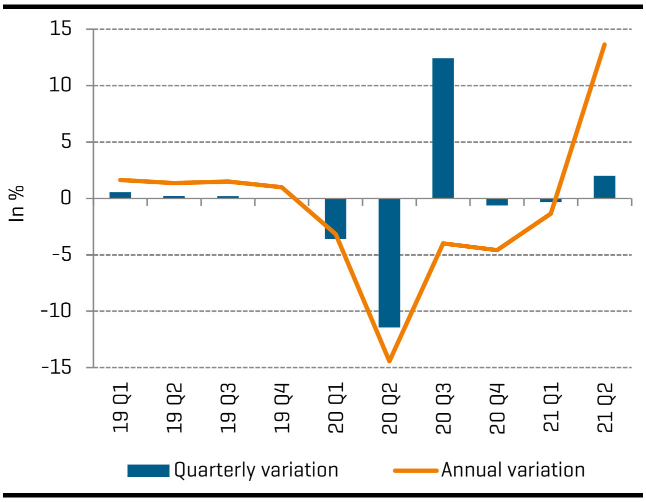
Further down the chain, ex-works prices for consumer goods have picked up 1.4% over one year – their highest level since late 2011. Growth in consumer prices (for manufactured goods excluding energy) in the euro area seems to have strengthened in recent months (0.8% over one year between May and July compared to a long-term average of 0.6%). However, several base effects (relating to delayed sales and the VAT rate cut in Germany in the second half of 2020) make it more complicated to interpret this rise.

In Luxembourg, manufactured goods excluding energy account for 30% of the NCPI basket, while services – where price rises remain moderate – account for almost half. Allied with the delayed and partial passing on of prices mentioned above, this explains the relative sluggishness of underlying inflation in Luxembourg and in the euro area (at about 1% over one year), despite the significant increase in commodity. Apart from oil prices (where price changes are passed on very quickly) and construction prices (see July 2021 issue of Conjoncture Flash), Luxembourg households have not yet had to face marked price increases. This recovery in oil prices has brought inflation rates back up over 2%, albeit temporarily. In its forecasts published on 4 August, STATEC predicted a gradual strengthening in underlying inflation in Luxembourg, by 1.4% this year and 1.7% in 2022 (while the overall inflation rate is set to fall from 2.2% to 1.7%).

[1] According to a study by the European Central Bank, see "Recent developments in pipeline pressures for non-energy industrial goods inflation in the euro area", Economic Bulletin Issue 5, 2021.

International

GDP IN VOLUME IN THE EURO AREA



Source: Eurostat (seasonally adjusted data)

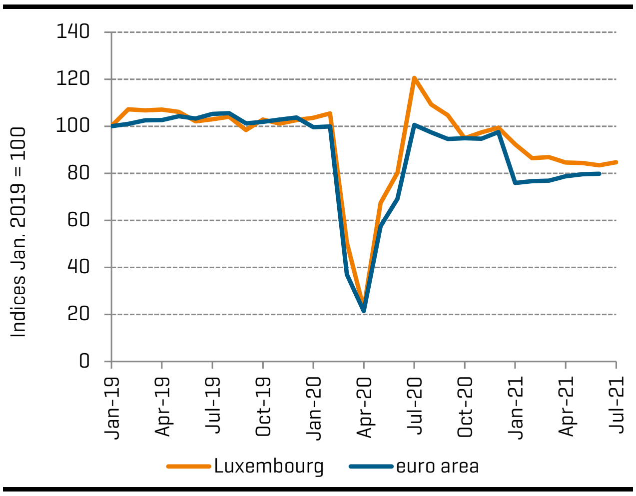
Euro area returns to growth

GDP in the euro area bounced back strongly in Q2 (+2.0% over one quarter). After falling for two quarters in a row, this return to growth was largely expected as restrictions were eased and the vaccination campaign was ramped up. This outcome was, however, better than expected – the consensus of economists had predicted +1.5% – except for Germany (+1.5%, against the +2.0% predicted by the same consensus). The recovery was most marked in Portugal (+4.9%), Austria (+4.3%), Spain (+2.8%) and Italy (+2.7%).

The outlook is more mixed for the rest of the year, due to rising infection numbers in most euro-area countries since July (although numbers have been falling in Luxembourg) and the potential re-introduction of restrictive measures. Any such measures are likely to be less restrictive than before as the progress made in vaccinations reduces the risk of congestion in hospital settings. Business confidence continued to grow in July but consumer confidence fell back slightly (in the euro area and Luxembourg alike).

Consumption

NEW REGISTRATIONS OF PRIVATE CARS



Sources: SNCT, ACEA, STATEC (seasonally adjusted data)

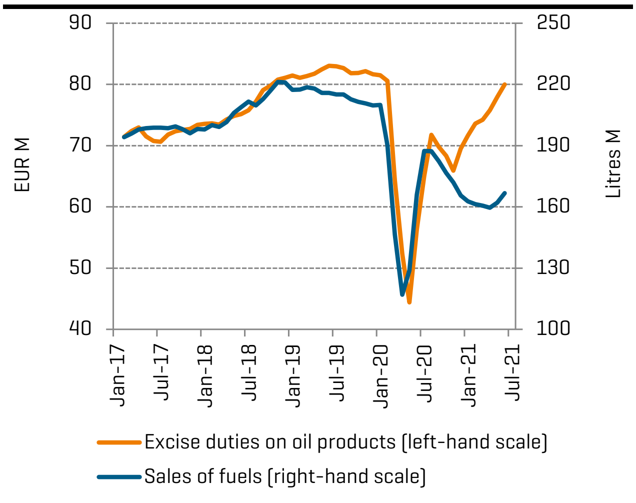
Supply issues in the automotive industry

Over the first half of 2021, new car registrations rose more than 20% over one year in both the euro area and Luxembourg. This was due to an extremely low basis for comparison last year, when sales collapsed during the first lockdown (particularly in early spring 2020). Things improved somewhat in the second half of 2020, driven notably by new incentives to buy (particularly in Germany and Spain, where many automakers are located). Sales have fallen off significantly since then, with some incentive schemes coming to an end, but also due to supply chain difficulties, with automakers particularly affected by the shortage of microchips.

And these difficulties are set to last. Since May, euro-area automakers have been pointing up a deterioration in output trends in economic surveys, despite the improved order books (and with stocks at all-time lows).

Public finances

TRENDS IN EXCISE DUTIES ON OIL PRODUCTS



Sources: Ministry of Energy, ADA, STATEC (seasonally adjusted., moving average over 3 months)

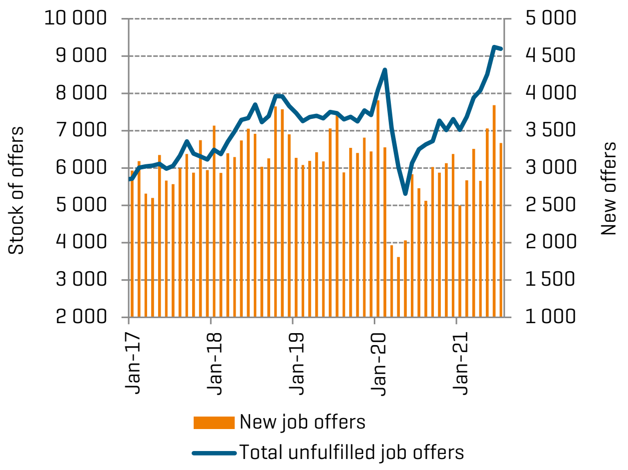
Lower fuel sales, same amount of excise duties

Excise duties on oil products collected since late 2020 have recovered significantly, coming close to pre-crisis levels recently. The pandemic crisis drove both fuel sales and excise duties down in spring 2020, reflecting the shutdown in the economy, travel restrictions and remote working arrangements. Fuel sales recovered somewhat from summer 2020 on, before falling back again when health restrictions were re-imposed in late 2020 and above all after the carbon tax was introduced on 1 January 2021.

This new excise duty has pushed pump prices up by 5 to 6 cents per litre and is thus dampening demand, particularly among non-residents. Fuel sales had already slowed somewhat following the hike in excise duties from by 1 and 2 cents per litre in May 2019, while related excise duties stabilised. This decorrelation was reinforced by the introduction of the carbon tax, due to its higher impact on fuels but also because of the sharp increase in the duty on heating oil and gas, which previously brought in very little revenue.

Labour market

JOB VACANCIES



Sources: ADEM, STATEC (seasonally adjusted data)

Some sectors struggling to recruit

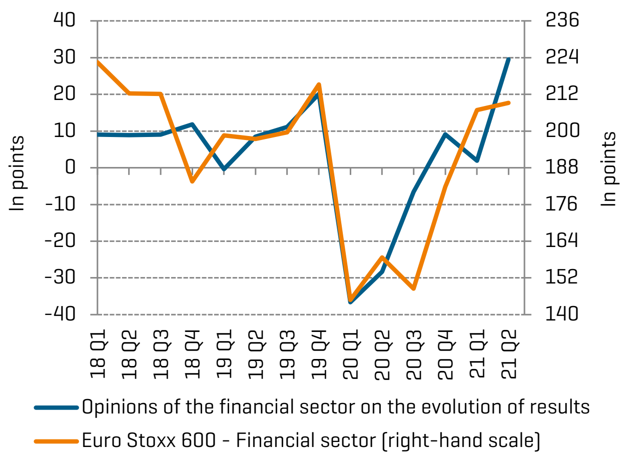
Job vacancies declared at the Public Employment Agency (ADEM) reached record highs in mid-2021: 9 724 are to be filled in June. The ratio of vacancies to all positions occupied or to be filled rose to 2% in June, up from 1.5% in 2020 (which is also the average over the last five years).

Much of this increased demand for labour is coming from sectors severely hit by the health crisis, namely hospitality, temporary employment and transport. Unfilled job vacancies in these sectors, which offer sometimes difficult working conditions, have doubled if not tripled (in the case of hospitality) since last summer. Like in the past, it is business services, hospitality and ICT which are experiencing the most hiring difficulties.

Employment and employment prospects for contractors were still healthy in mid-2021 and unemployment continued to fall (to 5.6% of the working population in July, close to the figure of 5.4% recorded before the crisis).

Financial sector 1/2

FINANCIAL SECTOR INDICATORS IN THE EURO AREA



Sources: DG ECFIN (euro-area economic survey), Macrobond

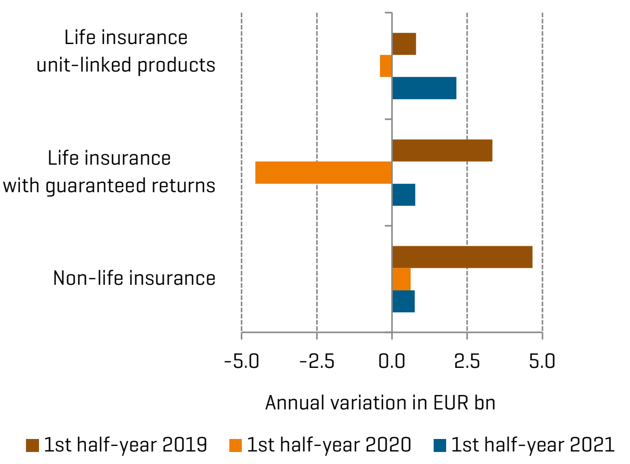
European financial companies confident

According to the economic survey conducted in July, opinions on income and earnings in Q2 have never been so good for euro-area banks. This is confirmed by the results published by the major European banks. They were boosted by a sharp reduction in provisions set aside last year to cover credit default risks, a solid recovery in retail and investment banking activities and rising income from commissions, stimulated by dynamic stock markets. The increase in stock market valuations also benefited life insurance investments (see below for more details relating to Luxembourg) and investment funds, where assets rose 11% in the euro area over the first half of 2021.

The outlook for European financial companies as regards trends in demand, revenue and employment remain positive for Q3, but operating costs are also set to rise and low rates will continue to weigh on interest margins.

Financial sector 2/2

PREMIUMS COLLECTED BY INSURANCE COMPANIES IN LUXEMBOURG



Sources: CAA, STATEC

Life insurance recovers in the first half-year

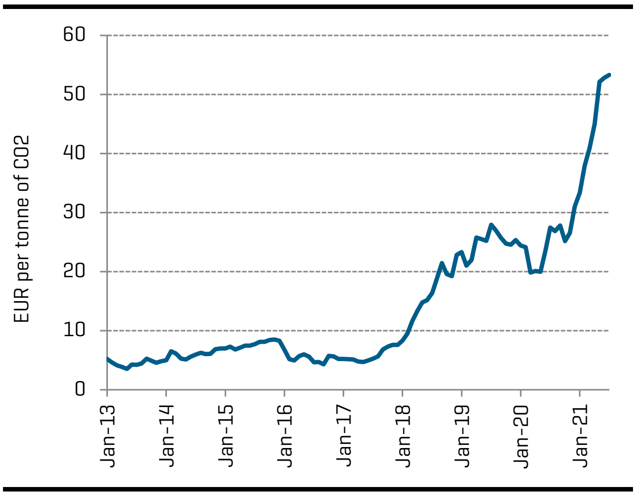
Premiums collected by insurance companies in Luxembourg bounced back well in the first half of 2021 (+21% over one year), buoyed by healthy growth in the stock markets, which bolstered the rise in premiums collected on life insurance products. These products were particularly badly hit by savers' concerns regarding the health crisis and by high volatility on the stock markets (-34% over one year on the 1st half of 2020).

According to a survey conducted in late 2020 by the Luxembourg insurance regulator, Commissariat aux Assurances, all the main life insurance companies have seen a significant impact of the crisis in terms of collection, while most non-life insurance companies saw little or no impact.

Since mid-2018, non-life insurance has benefited from relocations of operations linked to Brexit, which drove up premiums coming from abroad (70% of non-life premiums were linked to these activities in 2020). International activities account for 86% of non-life insurance premiums collected in the first half of 2021.

Energy/Environment

EUROPEAN EMISSIONS PRICES (EUA)



Source: Macrobond

Market price of emissions soars

The EU Emissions Trading System (EU-ETS) is the world's largest emissions trading market. It covers about 45% of EU emissions (but only 15% of Luxembourg's) and mainly concerns energy production and manufacturing. In July 2021, carbon permits reached a new high, trading at EUR 53 on the market. This means that carbon prices have witnessed a nine-fold increase since 2017 and almost doubled in one year.

These increases in market prices are due to the reductions, both effective and anticipated, in emissions quotas made available. To achieve its 55% reduction target by 2030, the European Commission has proposed reducing ETS emissions by 61% in comparison to 2005 levels, gradually phasing out the quotas allocated for free to the internal European aviation industry and including emissions from shipping. Since the ETS was set up in 2005, the emissions covered by the system have been reduced by 42%. The measures would result to an annual decrease of 4.2% between 2024 and 2030.

Trend chart

	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	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	-1.0	-2.6	-0.1	-3.1	17.6	40.8	21.3	...	...	25.7	-24.4
Construction output per working day, in volume	-0.4	-0.4	-10.8	-5.4	53.9	99.0	1.4	...	...	42.2	-29.7
Turnover by volume of total retail trade	5.5	1.3	-2.1	10.4	26.3	56.4	15.5	2.5	...	21.1	-7.8
Prices, wages											
Consumer price index (NCPI)	0.4	0.6	1.9	-0.1	2.0	2.1	2.5	2.2	2.3	2.3	0.6
Underlying inflation	1.4	1.4	2.5	-0.1	1.5	1.0	1.2	1.1	1.2	1.2	1.7
Oil product index	-17.6	-14.8	-8.4	0.4	13.0	28.9	35.5	28.6	28.3	30.7	-18.4
Industrial producer price index	-5.1	-5.0	-1.4	1.4	3.6	2.5	2.1	3.9	...	2.8	1.9
Construction price index[1]	2.9	2.9	4.1	4.1	4.1	5.2	5.2	5.2	...	5.2	3.2
Average wage bill, per person (National accounts)	2.4	2.4	1.6	1.6	1.6	...	...	...	...	3.1	0.4
Foreign trade											
Exports of goods (volume)	1.1	8.5	-6.3	-3.1	19.3	42.0	16.8	...	...	25.1	-23.3
Imports of goods (volume)	-3.8	-2.1	-6.1	0.0	19.2	53.7	30.0	...	...	32.5	-25.3
Employment, unemployment											
Domestic number of employees	1.3	1.6	1.5	1.5	3.2	4.1	3.4	3.5	3.3	3.4	1.6
National employment	0.9	1.0	0.9	1.0	2.1	2.8	2.4	2.7	2.4	2.5	1.5
Unemployment rate (% of working population, seas. adj.)	6.3	6.4	6.4	6.2	6.1	6.1	5.9	5.7	5.6	5.7	6.9

Source: STATEC
[1] Estimations based on half-yearly data

Indicators

	Variation on previous quarter in %					
	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2
Eurozone- Growth in volume of GDP (European Commission)	-3.6	-11.4	12.4	-0.6	-0.3	2.0
Luxembourg - Growth in volume of GDP (STATEC)	-1.6	-7.1	9.2	1.9	1.4	-
	Annual variation in %					
	2017	2018	2019	2020	Forecast 2021	Forecast 2022
Luxembourg - Growth in volume of GDP (STATEC)	1.8	3.1	2.3	-1.3	6.0	3.5

GDP at current prices 2020: EUR 64 143 million
Minimum monthly salary (since 01/01/2021): EUR 2 201.93
Current account balance (2021 Q1): EUR 352 million
Resident population (01/01/2021): 634 730

Consumer price index (07/2021) - base January 1st 1948: 892.31
Half-yearly average of the index linked to base as at January 1st 1948 (07/2021) : 890.73
Estimated deadline for next salary indexation: Q4 2021

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