



# Under gloomy economic conditions, Luxembourg is not able to remain dry

**The year 2023 is marked by a slowdown in activity in the eurozone, with some countries, including Luxembourg, unable to avoid a recession. Given the convalescent international context, the expected recovery in 2024 will be modest.**

## Minimum service in terms of growth in the euro area

Global growth experienced a slowdown in 2023 and is expected to reach around 3% this year, a level that is likely to remain the norm in 2024. The slowdown observed in 2023 essentially affected developed economies - with the notable exception of the United States - and more specifically Europe, where the effects of the energy crisis have been more widely felt by economic stakeholders.

While the euro area has avoided recession for the time being, it has not escaped stagnation, with growth fading to close to zero in recent quarters. On the back of worsening economic indicators, we could see the economy slip into recession in the fourth quarter.

Despite a slowdown in inflation, growth in the euro area is set to recover only slightly in 2024 (+0.8%, after +0.5% in 2023, according to the hypotheses used by STATEC). However, the rise in interest rates had a greater impact than expected on demand and could thus lead to stagnation.

## A particularly difficult economic climate in Luxembourg

Economic activity in Luxembourg has tended to stagnate since the start of 2023, and is down on last year. The financial sector's poor results in volume terms (the performance is better in value terms) partly explain this loss of momentum, but non-financial services as a whole also seem to be experiencing a worsening economic situation.

At the same time, the construction industry has seen its activity (and headcount) decline under the significant effect of rising interest rates on the real estate market. In most non-financial market activities, business confidence deteriorated this year, due in particular to the fall in demand and financing difficulties. There are some signs of recovery in industry and non-financial services, but these are very recent and remain very modest.

STATEC therefore expects a slight recession in activity (real GDP -1%) for 2023, while the euro area is expected to continue to expand at a sluggish pace (+0.5%). Private household consumption and public spending (consumption and investment) will have helped to keep domestic demand intact. Exports are likely to have fallen across sectors in 2023, but should pick up again in 2024, against a backdrop of stabilising factors, such as the slight upturn in

growth in the euro area (+0.8%) and the probable fall in interest rates. However, with a meagre +2% forecast for real GDP in 2024, and taking into consideration the lack of economic momentum already seen in 2022 (+1.4%), the three years 2022-2024 should be considered as an episode of economic under-performance for Luxembourg.

## Inflation slows, wages should follow in 2024

Inflation is receding across Europe, following the easing of energy and food prices. At present, it is still mainly services that are preventing a sharper slowdown, following sustained wage growth. In the euro area, wage growth has been less pronounced than consumer price inflation in recent years, while in Luxembourg, compensation per employee in real terms has risen significantly since 2019.

The inflation forecasts for the euro area are 5.6% in 2023 and 2.0% in 2024. STATEC expects inflation in Luxembourg to be 3.8% this year and 2.6% in 2024, resulting in a single index bracket next year.

Average compensation per employee should rise by 6.3% in 2023, then slow to +3.1% in 2024, due to a smaller contribution from indexation and compensation to employers for the cost of the September 2023 indexation bracket next year.

## Luxembourg's labour market clearly affected by the downturn in activity

In similar fashion to business activity, the labour market in Luxembourg is experiencing a harder landing than in Europe. After holding up relatively well last year, employment has slowed considerably since the start of the year, and was virtually flat in the third quarter. Business services - usually among the main growth drivers - and construction are the main contributors to this slowdown.

At the same time, the rise in unemployment has increased in Luxembourg. While these changes have helped to alleviate some of the labour shortage, which hit a historical high in 2022, recruitment problems persist.

Despite a slight upturn in activity in 2024, employment is expected to slow further (+1.3% in 2024, after +2.1% forecast for 2023) and unemployment to continue rising to 5.9% of the labour force (back to its average of the last 15 years). On the other hand, for the euro area as a whole, the unemployment rate is likely to remain relatively stable over the forecast horizon.

## Towards a sharper slowdown in revenue than in government spending, leading to a widening of the deficit

In 2023, tax receipts were supported by the effects of a buoyant total payroll on household taxes and social security contributions, as well as by large corporate income tax balances relating to previous tax years. On the other hand, low growth in subscription tax and VAT, as well as a sharp fall in registration fees on property transactions, have weighed on revenues. The latter should slow significantly again in 2024, as a result of the slowdown in employment, inflation and the reduction in contribution rates to compensate for the third index bracket in 2023.

Government spending was boosted in 2023 by the rise in the total payroll and by specific transfers. They should also slow in 2024, given the smaller contribution from wage indexation and the expiry of the energy tax credit.

However, growth in expenditure is expected to remain higher than growth in revenue in 2023 and 2024, pushing up the government deficit to -1.7% of GDP in 2023 and -2.7% in 2024. This deterioration in the balance goes hand-in-hand with the worsening economic outlook and the succession of anti-crisis measures. The measures announced in the coalition agreement have not been included in these forecasts.

# Energy consumption impacted by price rises

With gas stocks full ahead of the peak heating season, Europe is well prepared for the winter ahead. The continent benefited from moderate consumption throughout the year and the growing use of liquefied natural gas (LNG) to compensate for the reduction in Russian deliveries.








Despite a fall in energy market prices in 2023 compared with the previous year, household energy bills have not yet eased, and those of businesses have even risen sharply. Nevertheless, according to STATEC forecasts households could benefit from gas prices below the ceiling set by the government in 2024.

Energy consumption fell sharply in 2022 and early 2023. In the first ten months of 2023, fuel sales, electricity consumption and gas consumption fell by 2%, 7% and 10% respectively compared with the same period in 2022. However, this downturn in consumption has tended to fade in recent months. According to STATEC estimates, the reduction in fossil fuel consumption would lead to a 1.9% fall in emissions in 2023 and a further 1.3% reduction in 2024.

## Thematic studies in this Note

- Recent changes in the mark-up rate in Luxembourg
- The concept of instantaneous inflation, an additional tool for determining recent trends in consumer prices

## MACROECONOMIC FORECASTS

MACROECONOMIC FORECASTS						Tighter credit conditions <sup>1</sup>		Excess savings run <sup>2</sup>	
		1995-2022	2022	2023	2024	2023	2024	2023	2024
Growth rate in % unless otherwise specified									
	Real GDP	3.2	1.4	-1.0	2.0	-1.1	0.7	-0.9	3.2
	Total domestic employment	3.2	3.4	2.1	1.3	2.0	0.8	2.1	1.7
	Unemployment rate (% of labour force)	4.6	4.8	5.2	5.9	5.2	6.2	5.2	5.7
	Inflation (NICP)	1.9	6.3	3.8	2.6	3.8	2.5	3.8	2.6
	Compensation per employee	2.6	5.8	6.3	3.1	6.3	2.9	6.3	3.3
	Government budget balance (% of GDP)	1.5	-0.3	-1.7	-2.7	-1.7	-3.4	-1.6	-2.2
	Greenhouse gas emission <sup>3</sup>	-2.2	-12.0	-1.9	-1.3	-1.9	-2.2	-1.9	0.0

Source: STATEC (2023-2024: previsions)

1. In this unfavourable scenario, economic activity falters as past policy rate rises feed through more powerfully than expected. Renewed strains in the global banking system result, exacerbating the credit conditions tightening, particularly in the US and UK. While stock market falls exacerbate the hit to demand in the near term, asset prices ultimately stabilise. Euro area GDP lies 0.8 % points below baseline in 2024.
2. In this favourable scenario, consumers across advanced economies follow the recent example of the US in running down a significant proportion of the savings accumulated during the pandemic. Overall, the global economy recovers strongly and financial markets strengthen, particularly in Europe. The consumer-led recovery feeds inflation and has implications for monetary policy in advanced economies. Euro area GDP rises 1.1 % points above baseline in 2024.
3. Evolution 2005-2022.

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