

# conjoncture flash

September 2007

## Turbulence on the financial markets

There has been a good deal of turbulence on the financial markets since mid-July. Stock market indices from the major financial centres fell by at least 10% in the space of a month, in the wake of the subprime mortgage crisis. This crisis may lead to a slowdown in the European and Luxembourg economy but the extent of the slowdown remains very difficult to assess at present.

### A property crisis combined with a crisis in confidence

This situation has been caused by subprime mortgages on the American market. These were granted to people with minimal resources at interest rates that became unreasonable within a relatively short period. The number of properties repossessed following payment defaults on these mortgages has pushed up the number of vacant properties and is putting downward pressure on the property market. Institutions that had granted these mortgages were able to reduce their share of risk by securitizing doubtful loans in the form of high-yield financial products. Other, more traditional, financial products also incorporated some of these risky securities. The risks linked to subprime mortgages were thus spread throughout the financial system. The main problem stemmed from the lack of information on how this spread arose: some banking establishments, averse to this type of publicity, obviously took on more risk than others and may not be able to meet their commitments towards other banks. This lack of information led to a general crisis of confidence that could, at worst, degenerate into a systemic crisis.

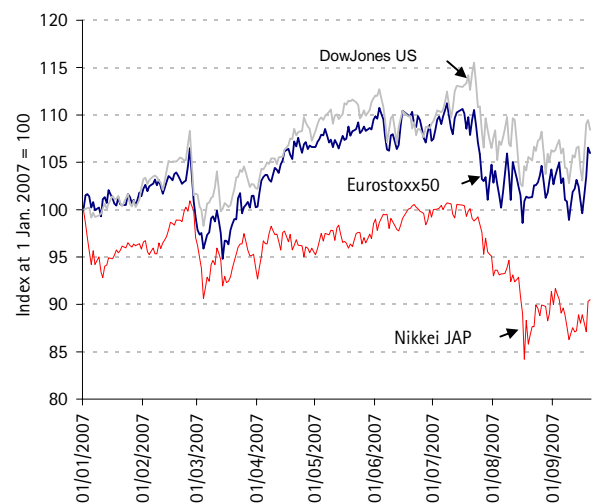
### Impact on Europe and Luxembourg

The slowdown in American growth, linked to the property price slump, had already been partly taken on board in forecasts for European economies. On the other hand, the prospects of a collapse, or at the very least a steep decline in the international financial markets was confirmed in the last few weeks, as regards growth risks in Europe and, as a corollary, in Luxembourg, which is highly dependent on the performance of its financial sector.

The European Commission<sup>1</sup> revised its growth forecasts slightly downwards for the eurozone in 2007 (from 2.6% to 2.5%), citing increased risk. It is in fact very difficult to estimate the impact that this risk will have on European growth, firstly because solid data is not yet available to assess the extent of this risk, and secondly because a crisis in confidence is technically extremely difficult to formalize.

## Monthly publication of the state of the Luxembourg economy

Recent performance of principal stock-market indices



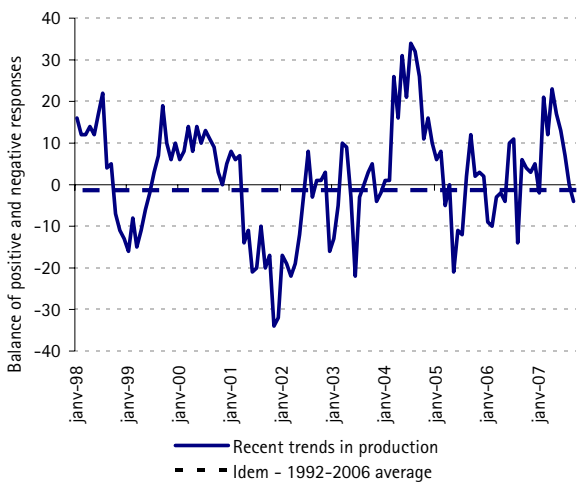
Source: EUROSTAT

However, despite this apparent vagueness, there is a degree of certainty in some areas. First of all, the fall in stock market indices (which occurred between mid-July and mid-August, prices having risen slightly since then) is, for the time being, directly comparable to the fall in May and June 2006, which was subsequently qualified as a simple "correction" or at worst a "little turbulence". In fact, the drop was more significant only in the United States (-10% compared to -8% during the drop in 2006), undoubtedly feeding the extensive media coverage of the phenomenon. Secondly, there is little risk of the American property crisis leading to a European property crisis, as the property markets operate in significantly different ways (specifically, the criteria for granting mortgages are tighter in Europe). Finally, if there is any impact, this should materialize in Europe mostly in 2008. STATEC has chosen not to modify its growth forecasts for 2007 and will continue to carefully monitor the financial markets and modify its forecasting for 2008 if necessary.

<sup>1</sup>Interim forecast, September 2007.

## Manufacturing

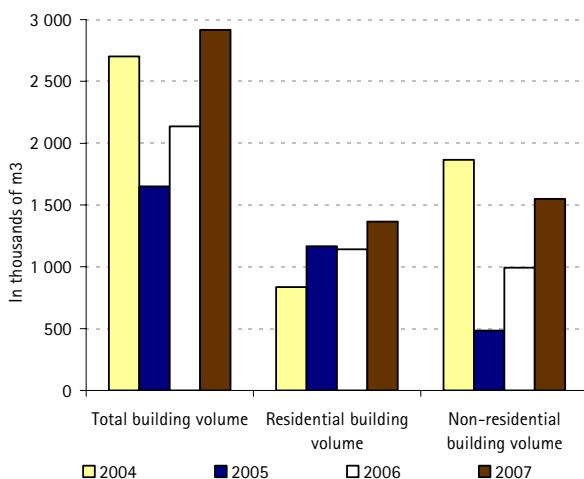
Economic survey on manufacturing industry



Source: STATEC

## Construction

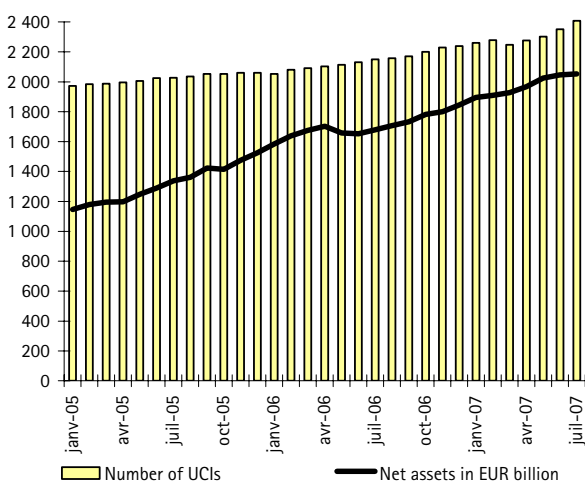
Construction permits granted at the end of 2nd quarter



Source: STATEC

## Financial sector

Total UCIs and net assets



Source: CSSF

## Euphoria returns to earth

Manufacturers' confidence levels fell significantly during the 3<sup>rd</sup> quarter of 2007, both as regards recent output trends and order books.

However, it is difficult to estimate how this will affect business statistics for the 2<sup>nd</sup> half of 2007 because there are other elements that should have the opposite effect: in particular, energy output (particularly low in early 2007) is expected to rise and the underlying negative effect due to closure rates for some companies during the 1<sup>st</sup> half of 2006 should dissipate.

At European level, output is better than expected, based solely on economic surveys. In July, output rose by 0.6% over the month, compared to the expected 0.2%.

## Net rise in construction permits

The relative volume of projects that were granted construction permits during the 1<sup>st</sup> half of 2007 rose sharply, by +36%, compared to the same period last year.

This rise is mostly due to non-residential construction projects (+56%), with May being a relatively exceptional month with several large construction projects given the green light in Bissen, Esch-sur-Alzette and Luxembourg City.

Results for housing construction were also good, after a disappointing 2006, when a drop of about 4% in terms of volumes granted was registered. Indeed, the number of residential construction permits granted has risen some 20% compared to the 1<sup>st</sup> half of 2006, mostly linked to apartment building projects.

## UCIs: limited increase in July

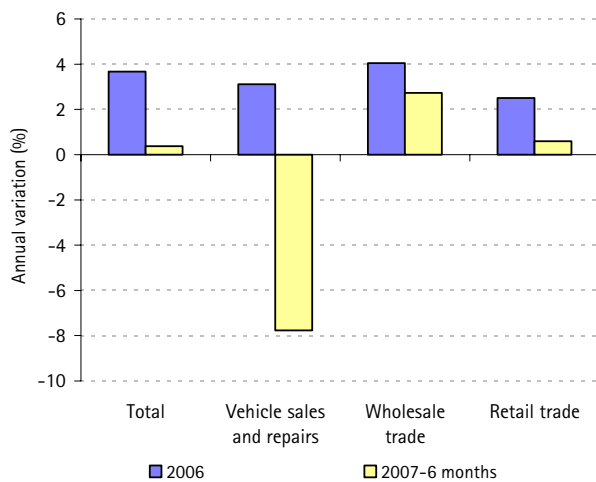
According to results published by the CSSF in late July 2007, overall net assets for undertakings for collective investment and specialized investment funds grew by 0.3% over one month (+22.2% over one year), reaching EUR 2,053 billion.

This rise is mainly due to new inflows of capital, higher in July than over the 4 previous months, while financial markets made a negative contribution. As regards the financial markets, the CSSF states that "initial uncertainty was experienced in the mortgage market during July".

Given the stock market trends in August (see page 1 herein), this phenomenon is expected to be repeated in upcoming UCI statistics.

## Wholesale and retail trade

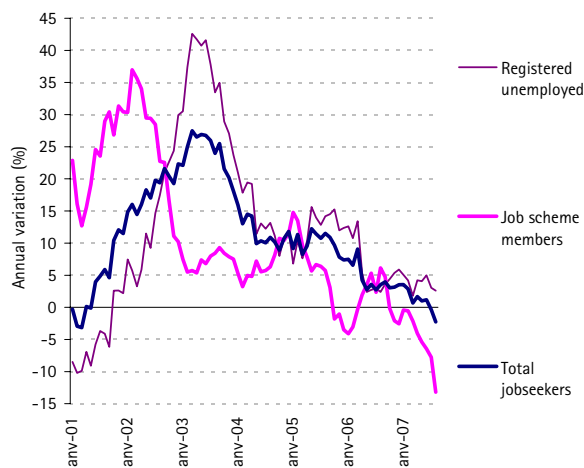
Changes in turnover volume



Source: STATEC

## Labour market

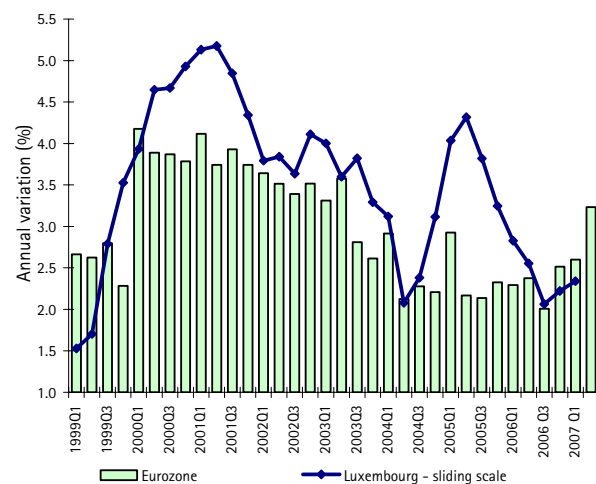
Changes in unemployment figures



Source: ADEM

## Inflation – wages

Changes in salaries in Luxembourg and Europe



Sources: STATEC (Luxembourg), Eurostat

## A difficult start to the year

Provisional results for turnover volumes for the Luxembourg trade sector show a very slight increase over the first part of 2007, which is difficult to explain, given the relatively favourable economic climate and perceptible improvements in the labour market.

In broad terms, although there is marked volatility in the most recent data available, it is possible to identify some trends underlying this apparent slowdown in commercial activity. Firstly, falling car sales (in line with the fall in new car registrations) and fuel sales seem particularly marked. In addition, non-specialist superstores had a relatively timid start to the year and specialized retailers (apart from food, pharmacy and perfume) had to content themselves with stagnant results compared to the 1<sup>st</sup> half of 2006.

## Falling numbers of job seekers

After the significant rise in the number of job seekers in the period between 2001 and 2003, the pace of growth has increasingly slowed down over recent years. Since July 2007, the total number of job seekers (including people in job schemes) has even fallen on an annual basis.

The overall unemployment rate, which also takes account of people involved in job schemes, has fallen since the start of 2007, standing at 6.1% in August 2007 as against 6.3% in January.

There is still a rise when only registered job seekers (excluding people in job schemes) are taken into account. This rise, however, is increasingly insignificant (about 4% over recent months). The registered unemployment rate fell slightly, standing at 4.4% in August as against 4.5% at the start of the year.

## Wages continue to rise

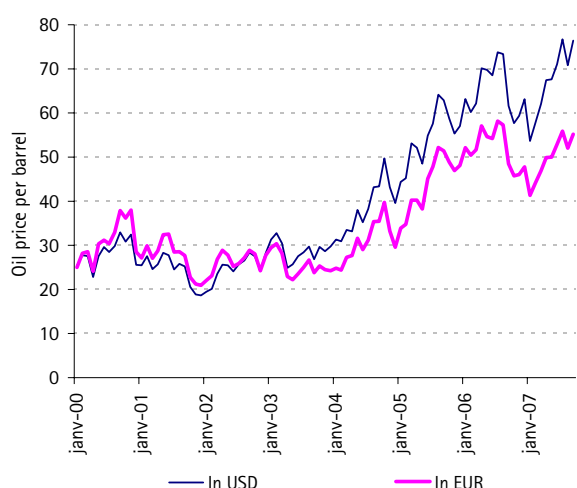
In the first six months of 2007, wages in Luxembourg grew by 3.0% annually according to the labour cost index. This growth was more sustained than in 2006 (+2.2%), even when the basic effect linked to delayed effect of wage indexation adjustments is taken into account (+2.7% in 2006 excluding the basic effect).

After a deceleration in recent quarters, the labour cost index for the eurozone also registered more sustained growth during the second quarter of 2007 (2.5% after 2.3% during the first quarter).

Of the neighbouring countries, France again registered the strongest growth, with +3.5% during the 2<sup>nd</sup> quarter of 2007, even though this marks a slight deceleration compared to the previous quarter (+3.8%). Despite strong acceleration, Belgium (+2.7% after 2.1% in Q1 2007) and particularly Germany (+1.2% after +0.2% in Q1 2007) continued to register the slowest wage growth in the eurozone during the 2<sup>nd</sup> quarter of 2007.

## Oil prices

Oil price per barrel (Brent) in EUR and USD



Source: STATEC

## Oil prices at an all-time high but no shock in sight

The price of a barrel of oil reached new heights during the last fortnight of September, at times breaking the record of USD 80 (for North Sea Brent crude). Despite this historically high price, it is difficult to posit an oil shock for the current year, in part because of the appreciation of the euro.

Indeed, while the price per barrel should remain at this level of USD 80 until the end of 2007, this should manifest itself by a rise of only 7.7% for 2007 as a whole, far from the 19.7% rise seen in 2006 and even further from the 42.4% rise in 2005. This observation is even more striking when calculating in euro: at USD 80 per barrel until the end of 2007 with the exchange rate stabilizing at current levels (USD 1.40 for EUR 1) the price per barrel in euro for 2007 as a whole should drop slightly (-0.6%), after an increase of 2007 in 18.2% and 42.9% in 2006.

## Statistics table

	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-08	Average over the last three months	Same period previous year
Annual variations in %, except where otherwise indicated										
<b>Activity</b>										
Industrial output per working day, in volume	-1.4	3.9	2.0	3.7	-0.5	4.7	...	...	2.2	1.1
Construction output per working day, in volume	9.3	14.1	9.3	3.9	-3.4	0.8	...	...	0.4	0.6
Turnover by volume of total trade	1.8	-2.0	1.9	1.3	-1.4	-1.2	...	...	-0.4	2.9
Turnover by volume of total retail trade	2.3	-0.5	4.5	0.7	-4.0	3.8	...	...	0.1	4.1
<b>Prices, wages</b>										
Consumer price index (IPCN)	2.3	2.0	2.1	2.1	1.9	2.0	1.9	1.9	1.9	3.0
Underlying inflation	2.4	2.3	2.3	2.3	2.4	2.2	2.1	2.2	2.2	2.2
Oil prices	0.4	-4.1	0.0	-2.2	-4.9	-1.0	-2.3	-3.0	-2.1	14.8
Industrial producer price index	12.5	12.2	11.3	13.2	9.9	10.3	6.1	...	8.8	9.0
Construction price index <sup>1</sup>	2.8	2.8	2.8	3.3	3.3	3.3	...	...	3.3	2.9
Average wage bill, per month, per person	4.2	5.1	5.8	4.0	6.2	...	...	...	4.4	3.8
<b>Foreign trade</b>										
Exports of goods	13.6	7.6	9.1	8.8	2.7	6.5	...	...	5.9	10.5
Imports of goods	9.1	6.2	7.0	-6.0	9.3	6.4	...	...	3.1	17.5
<b>Employment, unemployment</b>										
Domestic number of employees	4.4	4.4	4.1	4.5	4.4	4.3	4.7	4.7	4.5	4.3
National employment	2.0	2.0	1.7	1.9	1.8	1.9	1.9	1.9	1.9	2.2
Unemployment rate (% of working population, seasonally adjusted)	4.5	4.5	4.4	4.5	4.4	4.5	4.4	4.4	4.4	4.4

Sources: STATEC

Data in italic font are estimates

<sup>1</sup>Estimations based on half-yearly data

## Indicators

	Variation on previous quarter in %			
	2007 Q1	2007 Q2	Forecast 2007 Q3	Forecast 2007 Q4
			Min	Max
Eurozone- Growth in volume of GDP (European Commission)	0.7	0.3	0.3	0.8
	Annual variation in %			
	2005	2006	Forecast 2007	Forecast 2008
Luxembourg - Growth in volume of GDP (STATEC)	4.0	6.2	6.0	5.0
GDP at current prices for 2006: EUR 33 055 million				
Consumer price index (August 2007) - base January 1 <sup>st</sup> 1948: 718.40				
Current account balance (2007 - 1st quarter): EUR 1 111 million				
	Minimum monthly salary (since 01/01/2007: EUR 1 570.28)			
	Half-yearly average of the index linked to base as at January 1 <sup>st</sup> 1948: 714.88			
	Resident population (01/01/2007): 476 200 (estimation)			

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