

October 2008

conjoncture flash

The scale of the financial crisis is weighing on growth prospects

The financial turbulence which has persisted since summer 2007 has taken a definite turn for the worse as from mid-September 2008, leading to a systematic crisis affecting the entire international banking sector. States have had to intervene to shore up several ailing establishments (via recapitalisation operations) and guarantee interbank lending. In Luxembourg, the Government supported Dexia and Fortis – banks which are firmly imbedded in the country's economic fabric, especially in terms of employment. Recent developments related to the financial crisis have increased the threat of an abrupt halt to economic growth in Luxembourg and the eurozone.

Downturn in growth in the 1st half of 2008

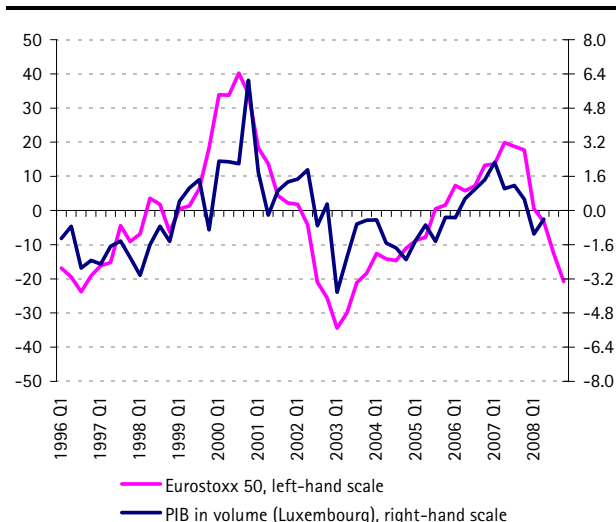
STATEC has just published (on 13 October) the national accounts for the second quarter of 2008 and the revised data relating to the previous years. In general, over the period 2005–2007, growth was revised upwards. The average GDP growth in volume for these years was recorded at 0.4 points per year. For the last two quarters of 2007, the average revision, again on GDP growth in volume, amounted to around 0.7 points (year-on-year). For early 2008, however, growth was revised downwards: GDP growth reached a low in the first quarter of 2008, with an increase of 1.2% year-on-year. In the second quarter, it recovered slightly at an annual rate of 2.8%, with a substantial contribution from the financial sector. Generally, it could be said that despite the difficult context, the Luxembourg financial sector got through the first half of 2008 relatively unscathed, both in terms of results and employment.

Worsening economic prospects

The outlook for the second half-year, on the other hand, is not bright. Not many statistics are available on the 3rd quarter¹ at national level, especially relating to the financial sector, but certain elements are already incompatible with a recovery in the short term. The strong correlation observed between the stock market indices and Luxembourg GDP (on the graph opposite, the two series are represented separately in relation to their respective trends) and the pronounced downturn on the stock markets since September point to an additional slowdown in Luxembourg economic growth.

Monthly publication of the state of the Luxembourg economy

Luxembourg GDP and stock market indices (trend deviations)



Sources: Eurostat, STATEC

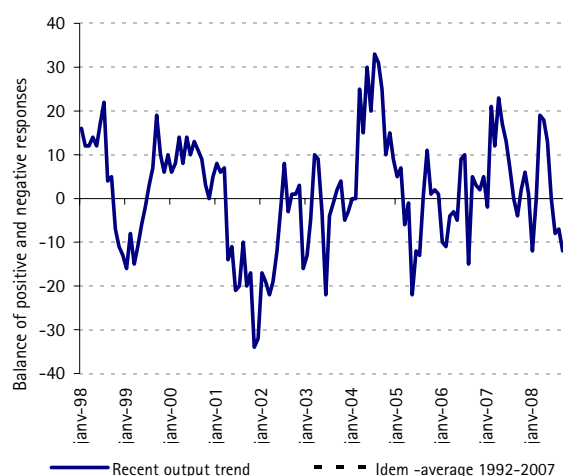
Furthermore, economic surveys carried out among business owners and consumers reveal results marked by pessimism (this is not only true for Luxembourg, but also the eurozone as a whole). With regard to STATEC's previous official forecast for 2008, released in June and predicting an increase in GDP in volume of 3%, it would be preferable to deduct at least half a point; this is the direction adopted recently by the IMF, which predicts an increase of just 2.3%. For 2009, the IMF predicts a further slowdown in GDP growth to 1.8%. STATEC will publish its new forecast in NDC 2-08 on 3 December.

¹ The next quarterly accounts, including an initial estimate for the 3rd quarter of 2008, will be published in mid-January 2009.

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Manufacturing

Economic survey on manufacturing



Source: STATEC

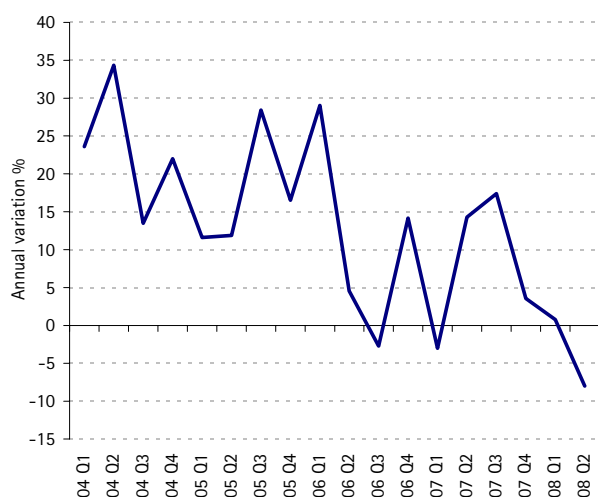
Deteriorating prospects

Industrial activity has lacked dynamism in 2008. Over the first 7 months of the year, production virtually stagnated (-0.3%) compared to the previous year's performance. Manufacturers' rather pessimistic views of recent and future activity and of order books until September unfortunately make it impossible to envisage a turnaround this year.

Production rose slightly in August throughout the eurozone, but the basic trend remains downward. Economic surveys also indicate a drastic slowdown in European industrial activity over the coming months.

Construction

Mortgages granted (property in Luxembourg)



Source: BCL (mortgages recently granted, residential sector)

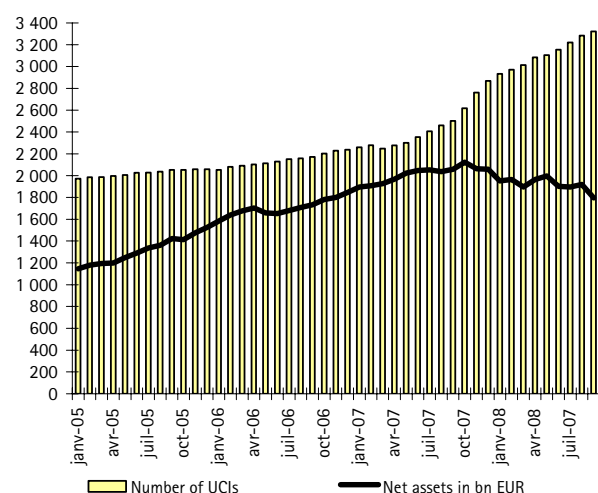
Drop in mortgages

The number of new mortgages granted in Luxembourg during the first half of 2008 remained historically high, but headed quite clearly towards a downward trend, with a drop of around 4% in comparison with the first half of 2007.

In the eurozone as a whole, mortgage lending for households rose in July and August 2008 at an annual rate of around 4%, two times lower than the previous year (source: ECB). The impact of a reversal on the European housing market coupled with the consequences of the financial crisis forced banks to toughen up their criteria for granting loans and households to postpone their purchasing decisions. The rising interest rate until July 2008 also increased credit charges.

Financial sector

Number of UCIs and net assets



Source: CSSF

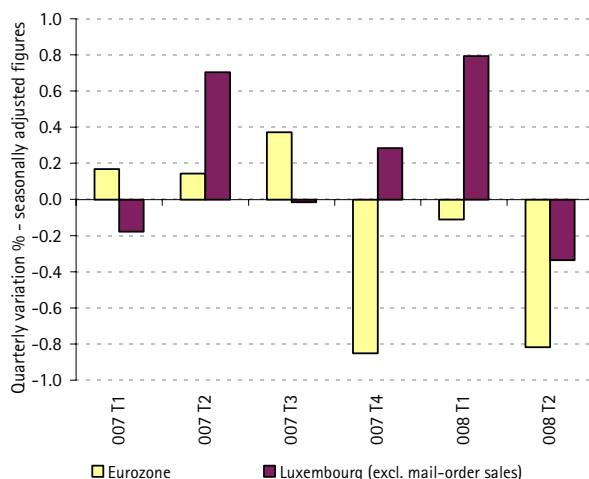
Autumn turbulence for UCIs

The net assets of Luxembourg UCIs fell significantly in September, losing 6.3% compared to the previous month. The direct impact of the financial markets accounted for around 3/4 of this drop. It must be noted that the main stock markets had a particularly rough ride in September, recording a loss of around 10%. The worst, however, was yet to come in this sector, as the main US and European indices fell even more sharply in October (down around 20% as at 23 October).

Net capital investment bore the brunt, falling by EUR 28 billion in September. Over the first 9 months of 2008, this net investment grew on average by just EUR 1 billion per month, versus EUR 15 billion per month in 2007.

Consumption

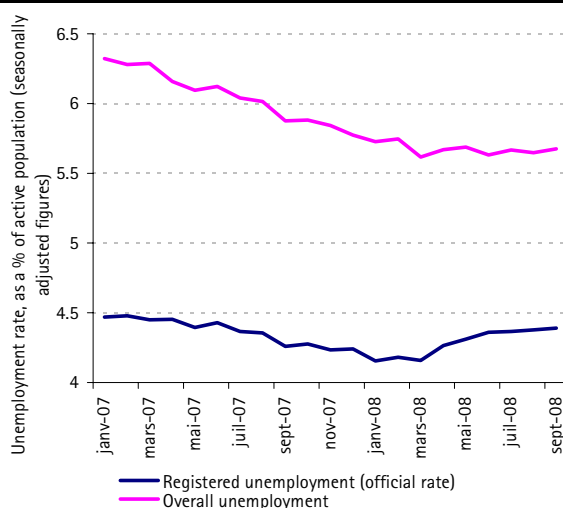
Trends in volume of retail sales



Sources: Eurostat, STATEC

Labour market

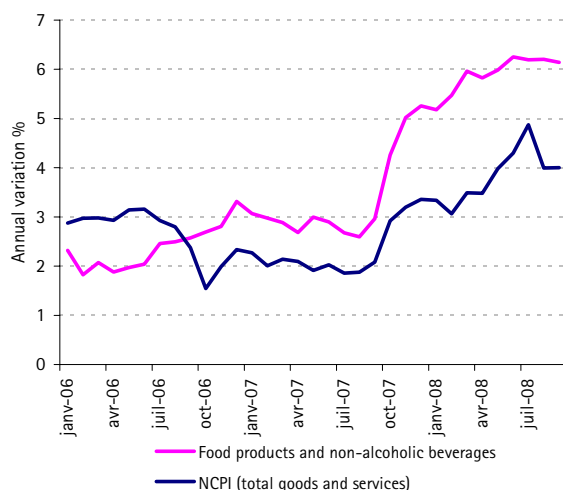
Recent trends in unemployment



Source: ADEM, IGSS, STATEC

Inflation - wages

Trends in food prices



Source: STATEC

Relatively good performance

Retail trade in Luxembourg performed relatively well during the first half-year of 2008, with turnover in volume (i.e. deflated by prices) excluding mail-order sales up 1.2% over one year. Sales were best in the 1st quarter of the year – up 1.9% over one year compared to 0.6% over the following quarter – which explains the decline of the seasonally adjusted data during the 2nd quarter (see graph).

The results compare favourably to the other eurozone countries, which have seen their retail sales fall by 0.9% on average over the first half of 2008, especially Spain (-4.2%), Italy (-3.8%) and Germany (-0.9%), where trends were the least favourable over this period. The dynamism of sales experienced by some countries in 2007 diminished substantially, as was the case in Ireland (+0.4% in the 1st half of 2008 compared to 6.4% in 2007) or France (+0.8% versus +3.1% in 2007).

Unemployment stable in September at 4.4%

The seasonally adjusted unemployment rate stood at 4.4% of the working population in September, remaining stable for the 4th consecutive month. Overall unemployment (which includes people involved in job schemes) rose slightly to 5.7%, showing little progression since March 2008.

The number of workers registered on job schemes fell markedly in 2008, with 650 fewer people than the previous year on average (i.e. a drop of 17%). Certain schemes were scrapped (CAT, SIE) and new ones were introduced (CAE, CIE), but struggled to take over in terms of participants. This appears to explain, in part, why the registered unemployment rate rose in early 2008; nevertheless the economic trend remains the same regardless of the definition: unemployment stopped falling at the beginning of the year and the expected slowdown in employment will increase the rate of unemployment in the coming months.

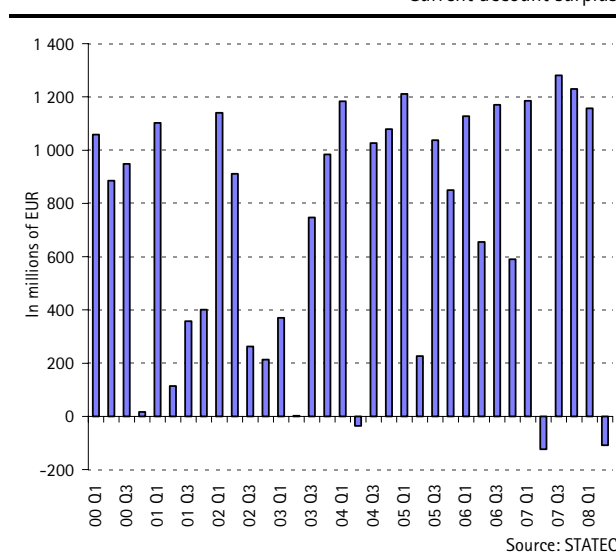
Food inflation set to slow down

Food prices soared as from the 4th quarter of 2007 due to the rise in prices of primary agricultural products. At the end of the 3rd quarter of 2008, their growth was still above that of the general index, at over 6% as an annual variation. For certain products, however, inflation has been more modest in recent months. This is true for dairy products (down since July), fish (stable prices since January), fresh (but not processed) vegetables, sugar and potatoes, with the prices of the latter being around 8% lower than those of 2007). Inflation remains high, however, on cereal products (+15% over one year in September) pasta products (+28%), fruit (+10%) and chocolate (+10%).

The prices of food commodities on the global markets have dropped around 13% since June, which should have a positive impact on consumer prices during the next few months.

Foreign trade

Current account surplus



Services still sound in 1st half of 2008

The current account balance of the 1st half of 2008 resulted in a surplus of EUR 1.05 billion, on an equivalent scale to that of the 1st half of 2008. The new record surplus of the balance of services (EUR 10.0 billion versus EUR 9.7 billion in 2007) and the improvement of the net owing to investment income practically offset the downturn in the other partial balances. Due to the rise in imports of oil products, the deficit caused by goods transactions worsened in the 1st half of 2008, rising to EUR 1.7 billion as opposed to 1.5 billion in 2007. The performance recorded for services was mainly due to non-financial services, in particular exports of transport services, which witnessed an increase of almost 8% over one year. Furthermore, the growing surpluses generated by communication services (+33%) and other business services (48%) were mainly linked to players operating in electronic services from Luxembourg. Financial services were able to hold their course, despite an increase in financial service imports (4.2%) above that of exports (2.7%).

Statistics table

	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	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	-4.1	-0.3	-1.4	1.9	3.5	-3.4	1.1	...	...	0.4	1.2
Construction output per working day, in volume	-5.4	-3.1	0.2	0.3	2.1	-1.4	-2.3	...	...	-0.5	-0.5
Turnover by volume of total trade	15.0	29.2	12.5	14.3	20.1	69.8	68.7	...	...	52.2	-7.1
Turnover by volume of total retail trade	1.2	7.9	-2.4	-0.9	3.8	-1.0	...	...	...	0.6	0.5
Prices, wages											
Consumer price index (IPCN)	3.3	3.1	3.5	3.5	4.0	4.3	4.9	4.0	4.0	4.3	1.9
Underlying inflation	2.3	2.1	2.4	2.4	2.5	2.6	3.0	2.7	2.7	2.8	2.2
Oil prices	19.8	20.4	21.0	21.1	25.4	29.6	31.9	23.3	23.3	26.1	-2.0
Industrial producer price index	7.0	6.0	5.0	5.0	7.5	9.7	14.5	13.9	...	12.7	8.3
Construction price index ¹										3.0	2.4
Average wage bill, per month, per person	2.5	2.4	4.4	4.6	1.2	...	...	...	...	4.4	5.3
Foreign trade											
Exports of goods	-0.7	2.0	-10.4	2.9	-2.8	-5.5	-0.2	-6.2	...	-3.9	-2.9
Imports of goods	-0.1	-6.6	-11.2	2.3	-13.7	-11.2	-13.1	-21.4	...	-15.1	-0.6
Employment, unemployment											
Domestic number of employees	5.4	5.4	5.5	5.4	4.9	5.2	5.1	4.7	5.0	4.9	4.7
National employment	3.0	3.2	3.2	3.2	3.1	3.3	3.2	2.8	3.0	3.0	2.4
Unemployment rate (% of working population, seasonally adjusted)	4.2	4.2	4.2	4.3	4.3	4.4	4.4	4.4	4.4	4.4	4.3

Sources: STATEC

Data in italic font are estimates

¹Estimations based on half-yearly data

Indicators

	Variation on previous quarter in %					
	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2
Eurozone- Growth in volume of GDP (European Commission)	0.7	0.3	0.7	0.4	0.7	-0.2
Luxembourg - Growth in volume of GDP (STATEC)	2.4	-0.4	0.6	0.9	0.1	1.2
	Annual variation in %					
	2006	2007	Forecast 2008		Forecast 2009	
Luxembourg - Growth in volume of GDP (STATEC)	6.4	5.2	3.0		4.0	
GDP at current prices for 2006: EUR 36 297 million	Minimum monthly salary (since 01/03/2007: EUR 1 609.53)					
Consumer price index (September 2008) - base January 1 st 1948: 747.45	Half-yearly average of the index linked to base as at January 1 st 1948: 744.77					
Current account balance (2008 - 2nd quarter): EUR -108 million	Resident population (01/01/2008): 484 000 (estimation)					

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