

## Forecasts adjusted downwards

Since spring, international organisations have downgraded their growth forecasts for the euro zone to 0.8% for 2014 and 1% for 2015. With growth acquisition at about 3% by the end of second quarter, STATEC's forecast of a GDP in volume increase of **2.9% in 2014** for Luxembourg may seem too low. However, a number of factors give grounds for caution:

- opinions in domestic economic surveys have been falling since the 2<sup>nd</sup> quarter;
- inflation has slowed considerably, partly reflecting low demand worldwide.

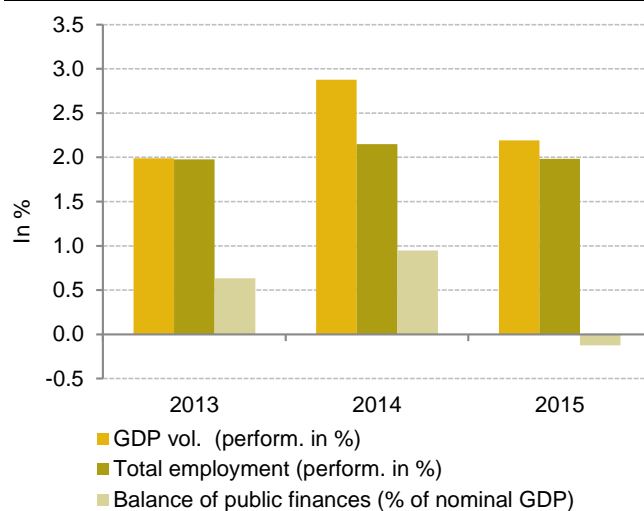
Thus, even though international organisations anticipate a (slight) pick-up at European level in **2015**, activity in Luxembourg is set to slow and GDP growth is unlikely to exceed **2%**. Factors impeding growth are:

- the partial loss of VAT from e-commerce, which is set to have a slight but palpable impact on growth, in 2015 (all other things being equal);
- the VAT hike (minimum impact of -0.1% on GDP in volume);
- savings measures and tax hikes in the draft budget for 2015. These are not yet included in STATEC's main scenario but the best estimate of their potential impact is currently a drop of 0.3 pts on GDP in volume.

The signals from the labour market are not worrying for the moment. Domestic employment is expected to rise 2.1% in 2014, stabilising at 2.0% in 2015, a slight revision on last spring's forecast. Unemployment is set to continue to rise in 2015, despite some easing off recently. Net jobs created, although high compared to the rest of Europe, are still not enough to absorb labour supply or eliminate structural deficiencies in the labour market. The estimated unemployment rate for 2014 as a whole is 7.2% and it is expected to rise to 7.4% in 2015.

Inflation has slowed continually and although this is due to falling oil prices, more and more products are seeing their prices drop. Compared to the last forecast, the inflation rate (NCPI) for 2014 has been revised downward by 0.3 percentage points to 0.7% and by 0.8 pts to 1.4% for 2015. This revision is due firstly to trends in the price per barrel of Brent (down USD 20 for 2014 compared to the spring) and secondly by a downward adjustment in assumptions about the future pace of underlying inflation.

## Macro-economic forecasts



Source: STATEC (NDC forecasts 2/-2014)

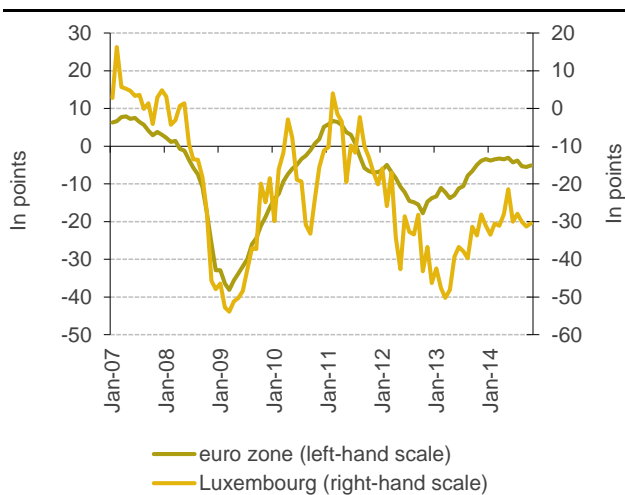
The next wage indexation adjustment has therefore been pushed back to the second quarter of 2015, generating an annual average rise of 1.2% in the trigger level, down 0.9 pts compared to the spring. It should be noted that the VAT hike, which is expected to impact the NCPI by +0.7 pts, would bring forward the timing of the wage adjustment by about 6 months. Thus, consumers will be compensated, belatedly, for the loss of their purchasing power due to the VAT hike.

STATEC estimates that the headline government balance will improve in 2014, moving towards a surplus of about 1 point of GDP, after rising 0.6% in 2013. This improvement is underpinned in particular by the monthly statistics on spending and (above all) public receipts (increase in the aforementioned of 5.2% year-on-year over the first 9 months).

In 2015, the balance is set to deteriorate, mainly due to the loss of VAT linked to e-commerce (down 1.5 points). The VAT hike will offset this by only about half (0.7 percentage points). The cyclical downturn will also play a part, meaning that the government balance will be almost nil (-0.1%). It should be noted that at this stage, the measures are not included in the estimates (apart from VAT, which is included in STATEC's main scenario). Their impact should be about +0.6% on an ex-ante basis, i.e. without economic closure.

## Manufacturing

Confidence indicator among manufacturing companies



Source: Eurostat

## Prolonged stagnation

Over the first nine months of 2014, industrial output rose satisfactorily compared to the previous year (over 7%), which is explained by the exceptionally low level of output in the 1<sup>st</sup> half of 2013. Since early 2014, the underlying trend has been for a stabilisation in output, in line with the stagnation observed in the euro zone as a whole and the levelling off in confidence indicators drawn up on the basis of economic surveys. These surveys, both for Luxembourg and the euro zone, do not hold out much hope of any recovery before the end of the year; quite the opposite in fact.

Falling energy prices and the depreciation of the euro observed in recent months may, however, generate positive effects over time for manufacturers.

## Construction

Construction prices - observations and expectations



Source: STATEC

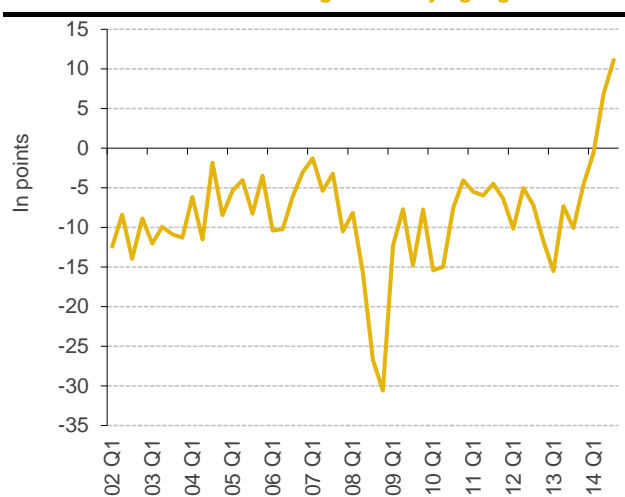
## A more favourable third quarter

Output in the construction sector fluctuated considerably in 2014. The weather conditions were extremely favourable in the 1<sup>st</sup> quarter, but there was a counter-movement in the spring months, with a concomitant downturn in opinion surveys. Morale improved thereafter among construction companies, rising on a continuous and sustained basis from July to September (a very slight drop followed in October). This renewed confidence was not reflected in output figures until August and those for September are expected to be equally positive.

This nascent improvement in activity is likely to generate more pressure on construction prices. Prices for various services collated by STATEC indicate that there was something of a turnaround in early 2014, and this is likely to become more pronounced if the opinion surveys in this sector are to be believed.

## Consumption

Consumers now thinking about buying big-ticket items



Source: BCL (consumer survey)

## From thinking to buying is just one step

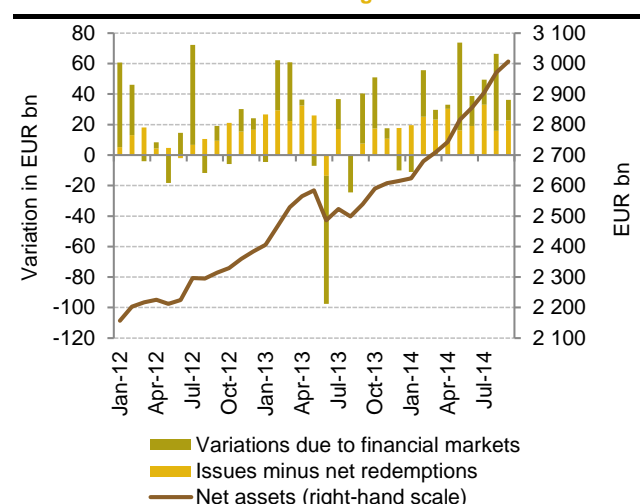
Over the course of recent quarters, more and more Luxembourg consumers believe that now is a good time to buy big-ticket items.

This trend seems linked with the VAT hike to come in January, as inflation expectations are also on the rise (in contrast, they are falling in the euro zone as a whole). On the other hand, consumer plans to buy capital goods, cars or housing showed no significant rise until October, as attested by this survey.

Retail sales were relatively disappointing up to August; only car sales saw an upturn, although the level of new car registrations in the 3<sup>rd</sup> quarter was not particularly high in view of historical data.

## Financial sector

## Undertakings for Collective Investment



Source: CSSF

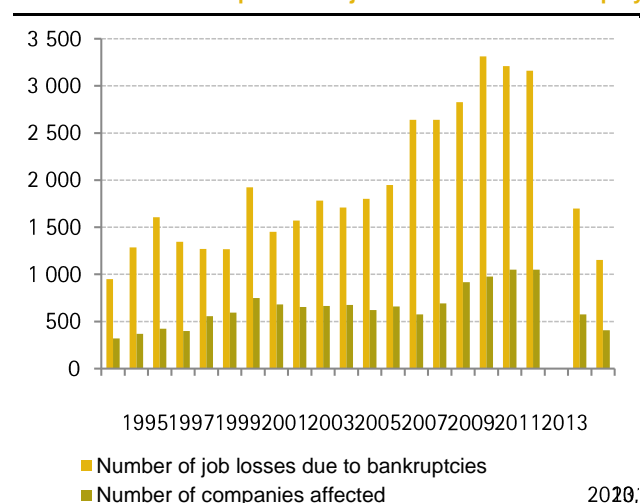
## Funds continue to perform well

At the end of the 3<sup>rd</sup> quarter of 2014, net assets of undertakings for collective investment and specialised investment funds reached record highs, exceeding the EUR 3,000 billion mark. Growth in 2014 was at a sustained rate, with both net issues and valuation effects linked to financial market trends rising for eight months in a row.

Despite the dramatic movements in equity markets in the 3<sup>rd</sup> quarter, a number of phenomena contributed to the positive influence of market effects. UCIs not invested in European equities (i.e. in American, Japanese and Asian equities) benefitted from the drop in the euro compared to their respective reference currencies. Furthermore, the troubled geopolitical climate (in Europe and the Middle East) favoured purchases of bond UCIs. Currency effects also boosted UCIs invested in non-European bonds.

## Labour market

## Number of bankruptcies and job losses due to bankruptcy



Source: STATEC

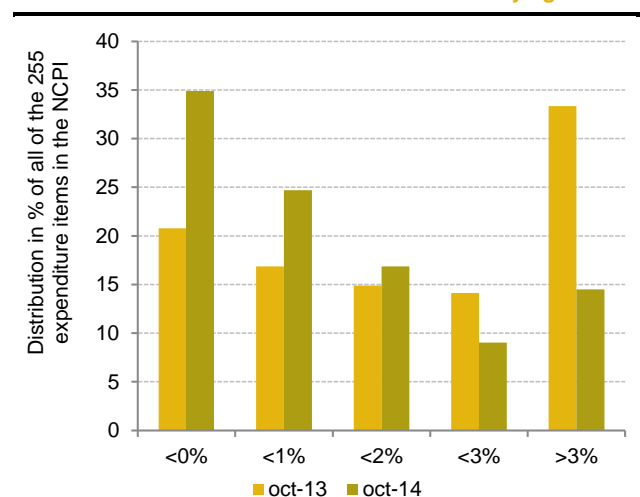
## Fewer bankruptcies in 2014

In the first 6 months of 2014, 406 companies were declared bankrupt in the Grand Duchy of Luxembourg, 168 fewer than in the first 6 months of 2013 (574 companies). The number of people who lost their jobs due to these bankruptcies also fell compared to the same period in 2013 (from 1,700 in the first 6 months of 2013 to 1,150 in the first 6 months of 2014).

Hotel & catering was the sector most affected by bankruptcies in terms of jobs in early 2014. In this sector, 190 people lost their jobs due to bankruptcy in the first 6 months of the year, 1.1% of the total workforce in this sector (the proportion was even higher last year, at 1.7%). It was the same in construction, where job losses due to bankruptcy fell from 1.9% of the workforce in this sector in early 2013 to 1.0% in 2014 (first 6 months). In contrast, job losses rose slightly in administrative and support service activities, ICT, manufacturing and trade. As in 2013, there were very few job losses due to bankruptcy in financial and insurance activities (around a dozen).

## Inflation

## Distribution of underlying inflation



Source: STATEC

## Widespread disinflation

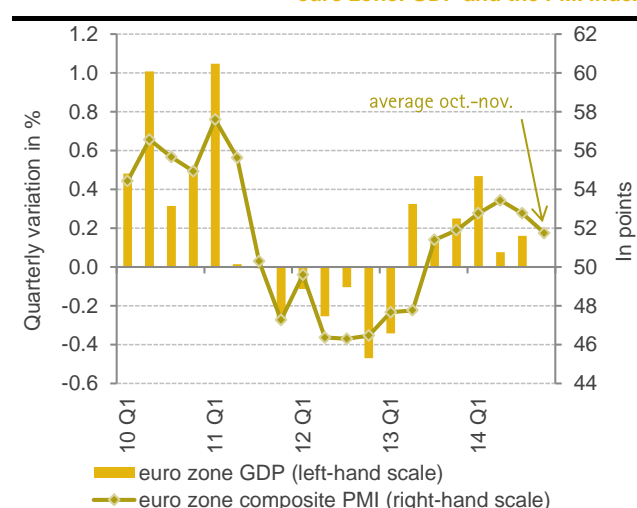
Falling energy prices, food prices and lower rises in some administered prices or taxes are the main reasons for low inflation in 2014, both across the euro zone and in Luxembourg. The inflation rate was just 0.3% over one year in October in Luxembourg (and 0.4% in the euro zone).

Beyond these isolated factors, a more widespread disinflationary trend is also taking shape. This phenomenon is distinctly due to trends in how consumption items are distributed according to their degree of inflation. For example, in October 2014, annual inflation was below 1% for almost 60% of the 255 expenditure items in the National Consumer Price Index, whereas this proportion was just 35% a year previously.

## International

## Euro zone: minimal growth

euro zone: GDP and the PMI index



Sources: Eurostat, Market Economics

Third-quarter GDP trends in the euro zone were a little better than expected, posting a rise of 0.2% compared to the 2<sup>nd</sup> quarter. Activity grew in Germany (0.1%, while the 2<sup>nd</sup> quarter was revised upwards to just -0.1% against -0.2% previously) and France surprised everyone by announcing a rise of 0.3%. Italy shrank again (-0.1%), but to a lesser extent than in the 2<sup>nd</sup> quarter (-0.2%).

Although third-quarter growth was a little higher than expected, it nevertheless confirms the sluggishness in euro-zone activity. Demand is still remarkably low and growth in earnings is limited by production overcapacity in terms of capital and labour. The prospects for the end of the year are not much better. The composite PMI for the euro zone dropped again in November and the trend emerging at the moment from these figures points to no more than minimal GDP growth in the 4<sup>th</sup> quarter.

## Trend chart

	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	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	9.6	8.3	9.1	8.9	7.9	6.8	6.8	...	...	7.2	-6.4
Construction output per working day, in volume	20.8	5.3	1.8	1.5	-5.6	-2.0	1.6	...	...	-2.6	-4.4
Turnover by volume of total retail trade	0.4	-1.5	-0.1	2.2	-1.6	-2.2	-2.2	...	...	-2.0	0.9
<b>Prices, wages</b>											
Consumer price index (NCPI)	0.9	0.8	0.8	1.0	0.9	1.0	0.6	0.3	0.3	0.4	1.5
Underlying inflation	1.6	1.5	1.4	1.3	1.2	1.4	1.1	1.0	0.8	1.0	2.1
Oil product index	-6.8	-6.4	-6.1	-2.3	-2.7	-3.2	-4.8	-6.8	-4.8	-5.5	-5.5
Industrial producer price index	-4.2	-4.6	-4.0	-3.6	-3.2	-3.4	-2.3	-2.5	...	-2.7	-3.4
Construction price index <sup>1</sup>	2.0	2.0	2.1	2.1	2.1	...	...	...	...	2.1	2.2
Average wage bill, per person (National accounts)	3.1	3.1	2.2	2.2	2.2	...	...	...	...	2.2	3.5
<b>Foreign trade</b>											
Exports of goods (volume)	11.2	16.9	7.2	11.9	11.2	15.0	0.2	...	...	9.1	-2.9
Imports of goods (volume)	-6.6	-5.1	-3.4	-2.9	-2.5	-3.2	-2.8	...	...	-2.9	-4.4
<b>Employment, unemployment</b>											
Domestic number of employees	2.4	2.4	2.4	2.3	2.3	2.5	2.3	2.6	2.5	2.5	2.0
National employment	2.1	2.1	2.1	2.1	2.1	2.2	2.1	2.2	2.2	2.1	1.9
Unemployment rate (% of working population, seas. adj.)	7.1	7.1	7.1	7.2	7.2	7.2	7.2	7.2	7.1	7.1	7.0

Source: STATEC

Data yellow coloured are estimates

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

## Indicators

	Variation on previous quarter in %					
	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Eurozone - Growth in volume of GDP (European Commission)	0.3	0.1	0.2	0.5	0.1	0.2
Luxembourg - Growth in volume of GDP (STATEC)	1.4	0.6	0.2	1.7	0.7	...
	Annual variation in %					
	2010	2011	2012	2013	Forecast 2014	Forecast 2015
Luxembourg - Growth in volume of GDP (STATEC)	5.1	2.6	-0.2	2.0	2.9	2.2
GDP at current prices 2013: EUR 45 288 million						
Minimum monthly salary (since 01/10/2013): EUR 1 921.03						
Current account balance (2014 Q2): EUR 533 million						
Resident population (01/01/2014): 549 680						
Consumer price index (October) - base January 1 <sup>st</sup> 1948: 825.51						
Half-yearly average of the index linked to base as at January 1 <sup>st</sup> 1948: 825.76						
Estimated deadline for next salary indexation: 2 <sup>nd</sup> quarter 2015						

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