CONJUNCTURE FLASH

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MONTHLY PUBLICATION ON THE STATE OF THE LUXEMBOURG ECONOMY

A tense recovery

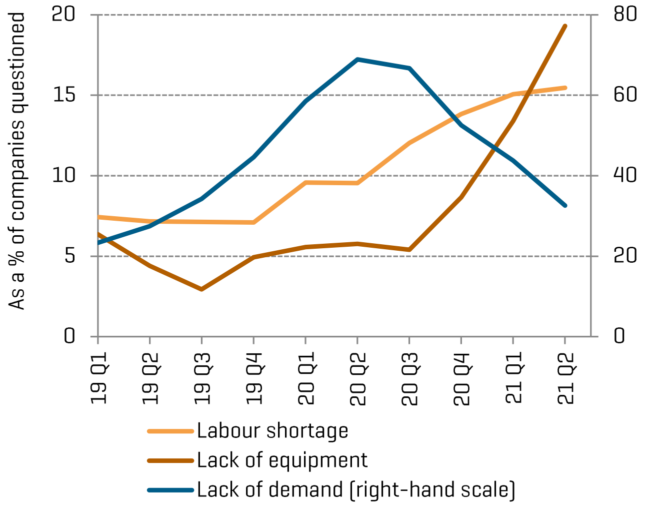
The recovery of the world economy is marked by difficulties in adjusting supply to demand, a phenomenon which also affects Luxembourg. Pressure on producer and consumer prices is also reinforced by increasing energy prices.

The recovery in global activity is accompanied by pressures on the production chains. Supply is struggling to keep up with demand in the production of goods in particular, due to supply difficulties for various materials and raw materials. This is causing bottlenecks in production chains as well as a sharp rise in input prices (which has repercussions on "ex-factory" prices). Supply difficulties are due to both shortages of materials and saturation problems in the logistics chain. Global sea freight is under particular pressure (with the "race for containers", which is causing sharp price increases in this area)[1] and many ports in advanced economies are finding themselves clogged with ships due to overcrowded warehouses that hauliers are struggling to empty.

In Europe, these supply difficulties are affecting Germany in particular, primarily its automotive industry (due to the lack of electronic chips). But more broadly, most areas of industry are paying the price, to varying degrees. In Luxembourg, industrial output rebounded strongly in Q3 2020, but has been stabilising since then and has even been trending downward since the summer of 2021. However, industrial confidence continued to improve over this period, in particular owing to favourable trends in order books.

It is therefore not demand that seems to be the problem, but rather the means to satisfy it. Like elsewhere in Europe, Luxembourg manufacturers are this year reporting a growing lack of equipment and extremely low stock levels,[2] but also increased recruitment difficulties and rising selling prices.[3] The construction sector is also largely affected by these supply problems, with upward pressure on prices of inputs and services,[4] and recruitment difficulties (which are even more marked than in manufacturing). According to a specific Chamber of Trades survey,[5] the shortage in equipment and goods is mainly affecting construction (60% of entrepreneurs surveyed) and engineering (50%), and is reflected above all in extended delivery times and increased selling prices.

FACTORS WEIGHING ON INDUSTRIAL ACTIVITY IN LUXEMBOURG



Source: STATEC (economic surveys – data smoothed over three quarters)

Increased pressure on energy

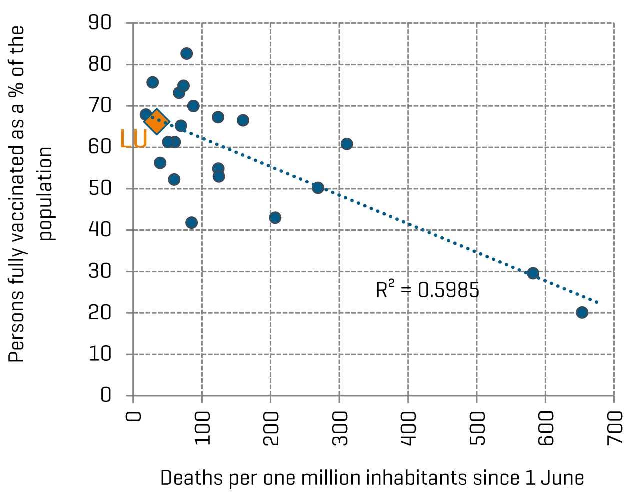
The current recovery is also accompanied by increased demand for energy resources, which is not in itself surprising. But here again, for various reasons (including declining oil output in the United States, China's shift to oil and gas over coal, falling Russian gas supplies to Europe) supply is struggling to keep up with demand and this is having a considerable effect on prices. Oil and natural gas prices have risen sharply in recent months and there is no indication that this trend has come to an end. In addition to this mismatch of supply and demand, there are upward effects linked to policies to "decarbonise" the economy. However, such policies account for only a relatively small proportion of current price increases for fuel, heating oil, gas and electricity.

This increase in energy prices is putting further pressure on producer prices (particularly in manufacturing) and consumer prices. The rise in inflation, only a few months ago considered more of a transitory phenomenon (by the European Central Bank in particular), thus seems to more lasting in nature and is likely to weigh on economic growth prospects.

[1] The Baltic Dry Index, the benchmark for the cost of sea freight transport, peaked in early October (it has fallen slightly since).
[2] In September (latest survey available) however, manufacturers reported a significant rise in stock levels. It remains to be seen whether this trend will be confirmed in October.
[3] Industrial output prices were up 5.2% over one year over the first eight months of 2021 (compared to -2% in 2020).
[4] See Conjoncture Flash for July 2021.
[5] "Trades in Q2 2021: will the shortage of equipment weigh on the recovery of construction and engineering?", Chamber of Trades, July 2021 (in French).

International

RELATIONSHIP BETWEEN COVID-19 VACCINATIONS AND DEATHS



Source: ourworldindata.org
Data as of 16/10/2021, countries included: AUT, BEL, BGR, HRV, CZE, DNK, EST, FIN, FRA, DEU, GRC, IRL, ITA, LVA, LUX, MLT, NOR, POL, ROU, SVK, SVN, CHE, GBR.

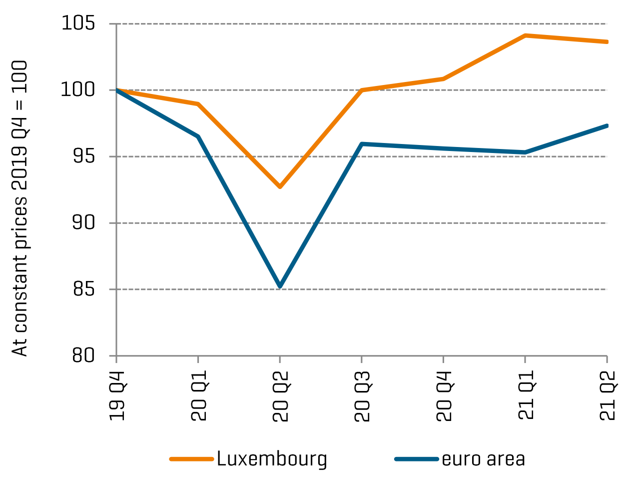
Covid-19 pandemic enters its second autumn

While infections, hospitalisations and deaths from Covid-19 have been on the rise again since the end of September, so have vaccination rates. So far, countries with high immunisation rates do not have high numbers of deaths or hospitalisations. In Germany, around 8 out of 10 patients in intensive care due to Covid-19 are not vaccinated. This figure is all the more striking as more than 65% of the population has already been vaccinated (the figure is even higher if only the adult population is taken into account).

In fact, there is a strongly negative correlation between the proportion of the population that is fully vaccinated and the number of deaths due to Covid-19 since 1 June, in 23 European countries. The countries that have recorded the highest death rate since 1 June are Bulgaria and Romania, both of which have very low vaccination rates. However, the rate of new vaccinations in Romania has sky-rocketed since the end of September, followed by Bulgaria a few weeks later.

Activity

REAL GDP IN LUXEMBOURG COMPARED TO THE EURO AREA



Sources: Eurostat, STATEC

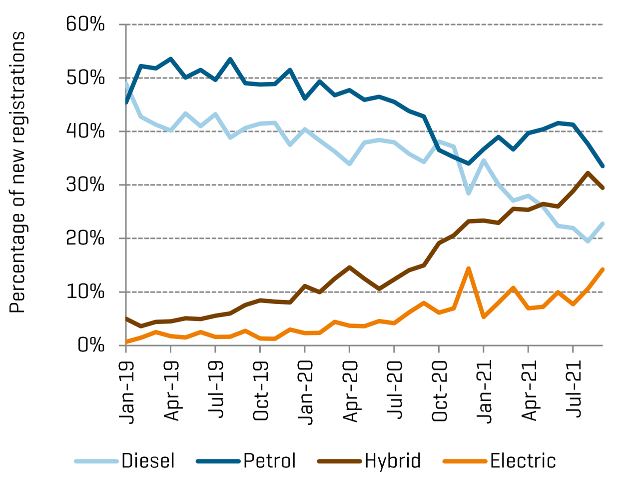
Activity dips slightly in Q2

In Q2 2021, GDP posted a decline of 0.5% over one quarter, in contrast to the strong recovery observed throughout the euro area (+2.1% over one quarter). Transport services are the main contributor to this trend. Performance in financial services and information and communication services was much less positive than in previous quarters.

It is important to note that activity in financial and non-financial services was very strong in Luxembourg in Q4 2020 and Q1 2021, leading to quarterly GDP growth of +0.8 and +3.2% respectively, while the euro area as a whole was in recession. From this point of view, the 0.5% drop in Q2 looks more like a correction than a genuine downturn. At the end of this quarter, Luxembourg's GDP was 3.5% above its pre-crisis level (Q4 2019), while that of the euro area remains 3% lower.

Consumption

NEW REGISTRATIONS OF PRIVATE CARS



Sources: SNCA, STATEC

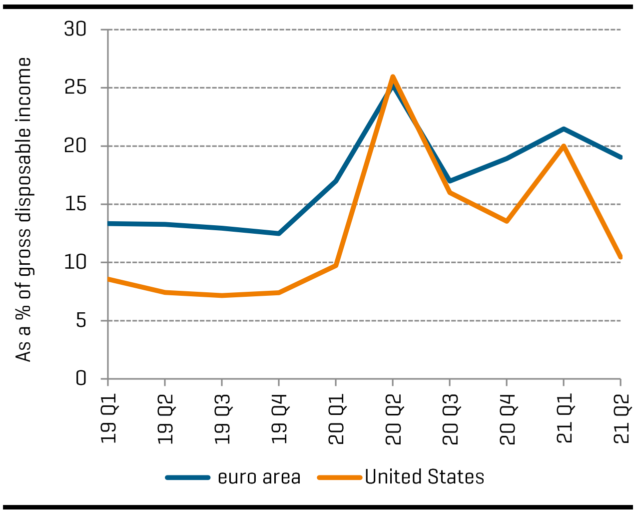
Electricity gains ground despite the supply crisis

The proportion of electric and hybrid cars in new vehicle registrations in Luxembourg reached 14% and 30% respectively in September. Electric and hybrid cars now account for around 2% and 5% of the total number of vehicles in Luxembourg. In the first half of 2021, 8% of new Luxembourg registrations were for electric cars, compared to almost 7% in the EU as a whole.

While demand for electric cars is increasing in the EU, overall registration numbers are slowing. During the summer of 2021, registrations in Luxembourg and the EU were down 25% year on year. Just as the auto industry was recovering from the health crisis, supply bottlenecks for semiconductors (the heart of microchips) emerged, crippling large parts of the auto industry and causing significant delivery delays, affecting registration levels for internal combustion vehicles in particular. Thus, while registrations of electric and hybrid cars rose over the summer (+30% and +60% over one year), those of diesel and petrol cars dropped significantly (-55% and -35%).

Savings

GROSS HOUSEHOLD SAVINGS RATE



Sources: Bureau of Economic Analysis, Eurostat

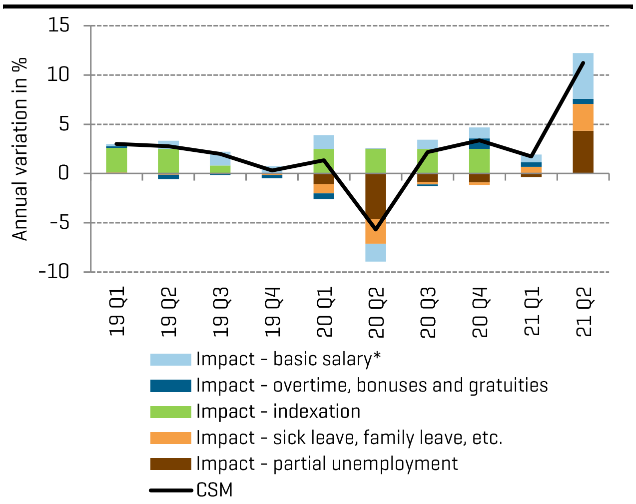
Savings remain high in the euro area

The household savings rate in the euro area fell slightly between Q1 and Q2 2021 (from 21% to 19% of disposable income), as health restrictions were eased and consumption resumed (+4% over one quarter). However, it remains high compared to pre-crisis levels (13% in 2019). Germany, the Netherlands and France are still reporting high savings rates (24%, 23% and 21% respectively), unlike Spain and Portugal (9%). In Luxembourg, savings accumulated in current accounts grew a further 2% between Q1 and Q2 (+8% over one year, inflating the savings glut to EUR 1.8 billion in June).

The reduction in the savings rate is much more marked in the United States, where it amounted to just 10% in Q2, close to its pre-crisis level. The rebound observed in Q1 was due to the payment of welfare benefits under the American Rescue Plan Act in March 2021. US household consumption has held steady since Q3 2020, while the health restrictions in the euro area last winter led to a reduction in consumer spending by European households.

Wages

AVERAGE WAGE COSTS IN LUXEMBOURG



* Including the likely non-payment of the wage contribution exceeding the State partial unemployment subsidy (80% of wages, capped at 2.5 times the social minimum wage).
Sources: STATEC (national accounts), IGSS

Backlash on labour costs

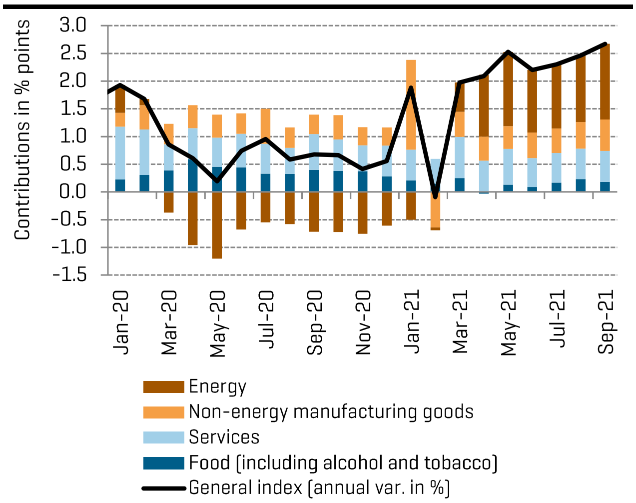
Average wage costs rose 11% over one year in Luxembourg in Q2 2021. This sharp rise was in reaction to the drop observed a year earlier, when a large part of the wage bill was replaced by welfare benefits (partial unemployment, leave for extraordinary family reasons).

Compared to pre-crisis levels (Q4 2019), average wage costs rose 4.3% in Q2 2021. The largest hike was in transport and warehousing services (due to an isolated increase in bonuses and gratuities), followed by real estate activities, information and communication services and business services. However, hospitality, where 12% of the workforce was still on short-time work in mid-2021, saw a sharp drop (-15%).

The wage indexation adjustment on 1 October 2021, combined with the lack of manpower and the growing mismatch between supply and demand on the labour market, is set to put further pressure on wages in the short term.

Inflation

CONTRIBUTORS TO INFLATION IN LUXEMBOURG



Source: STATEC

Inflation "full of energy"

In Luxembourg, inflation stood at 2.7% over one year in September, of which 1.4 percentage points is attributable to rising energy prices – or more accurately oil prices (electricity prices have again fallen slightly over one year). Fossil fuels (nearly +30% over one year in September) and heating oil (+74%) each contributed 0.6 percentage points to inflation, while the increase in gas prices (+18%) added 0.2 percentage points. While the recovery in base prices for oil and natural gas is the main reason for this, 0.3 percentage points are due to the carbon tax introduced on 1 January 2021. The impact of energy prices on the inflation rate could remain high over the coming quarters if there are significant increases in gas and electricity prices (as can be currently seen on the wholesale markets).

Inflation excluding energy still remains relatively contained and accelerated only slightly – to 1.4% in September. From October, however, prices of services are set to rise due to the new wage indexation adjustment. In addition, rising producer prices could have repercussions on consumer prices for manufactured goods.

Public finances

TAX RECEIPTS (CASH BASIS) AND SOCIAL SECURITY CONTRIBUTIONS

	2021 - 9 months	Change 21/20	Change 21/19
	En Mio EUR		*En %*
Household tax	5 256	18.8	22.6
VAT	3 446	24.8	16.5
Corporate tax	2 414	10.0	-18.0
Excise duties	1 226	17.0	4.3
Subscription tax	942	21.4	22.7
Others	1 412	18.4	9.9
Total tax receipts	**14 696**	**18.6**	**9.6**
Social contributions*	**8 116**	**3.5**	**7.8**

*Data for the 1st half of the year, produced according to the ESA2010 system of national accounts.

Sources: Tax authorities, IGSS, STATEC

Tax receipts remain high

In Q3 2021, taxes collected by the State stabilised at a level close to the first two quarters (seasonally adjusted data). By the end of the first three quarters, tax receipts had increased by nearly 20% over one year – partly due to the dramatic decline in activity in Q2 2020 – but still by 10% compared to 2019.

Most but not all tax categories are performing well. Although up from 2020, corporate taxes continued to fall in Q3 and after nine months posted a decline of 18% compared to inflows in 2019 – which were admittedly very high. All in all, the end of the year is expected to bring a sharp increase in tax revenue (growth acquisition of 16% if there is a stabilisation in Q3). The October 2021 wage indexation adjustment should also boost household taxes and social security contributions. The latter (+5.2% in 2020) increased by only 3.6% over one year in the first half of 2021, which will weigh on the growth in total government revenues for 2021, given their high weight.

Trend chart

	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21	Jul-21	Aug-21	Sep-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	-0.1	-3.1	17.6	40.8	20.2	11.3	1.8	...	...	6.0	-10.5
Construction output per working day, in volume	-10.8	-5.3	53.9	99.1	0.7	3.7	-5.5	...	...	-0.5	-0.9
Turnover by volume of total retail trade	-2.0	10.6	26.5	56.9	15.1	4.6	0.8	...	...	3.2	8.0
Prices, wages											
Consumer price index (NCPI)	1.9	-0.1	2.0	2.1	2.5	2.2	2.3	2.5	2.7	2.5	0.7
Underlying inflation	2.5	-0.1	1.5	1.0	1.2	1.1	1.2	1.3	1.4	1.3	1.6
Oil product index	-8.4	0.4	13.0	28.9	35.5	28.6	28.3	29.9	34.6	30.9	-14.9
Industrial producer price index	-1.4	1.4	3.6	3.0	2.7	4.5	11.0	16.8	...	10.7	-0.1
Construction price index[1]	4.1	4.1	4.1	5.2	5.2	5.2	...	...	...	5.2	3.2
Average wage bill, per person (National accounts)	1.7	1.7	1.7	11.2	11.2	11.2	...	...	...	23.3	-5.7
Foreign trade											
Exports of goods (volume)	-6.6	-3.1	19.1	41.4	19.8	12.4	...	...	...	23.3	-21.6
Imports of goods (volume)	-5.7	-0.3	21.1	52.7	31.1	14.4	...	...	...	30.8	-23.8
Employment, unemployment											
Domestic number of employees	1.5	1.5	3.2	4.1	3.4	3.5	3.1	3.0	3.2	3.1	1.7
National employment	0.9	1.0	2.1	2.8	2.4	2.7	2.3	2.2	2.3	2.2	1.4
Unemployment rate (% of working population, seas. adj.)	6.4	6.2	6.1	6.1	5.9	5.7	5.6	5.6	5.5	5.6	6.5

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)	-3.5	-11.7	12.6	-0.4	-0.3	2.2
Luxembourg - Growth in volume of GDP (STATEC)	-1.0	-6.3	7.9	0.8	3.2	-0.5
	Annual variation in %					
	2017	2018	2019	2020	Forecast 2021	Forecast 2022
Luxembourg - Growth in volume of GDP (STATEC)	1.3	2.0	3.3	-1.8	6.0	3.5

GDP at current prices 2020: EUR 64 221 million

Minimum monthly salary (since 01/10/2021): EUR 2 256.95

Current account balance (2021 Q2): EUR 636 million

Resident population (01/01/2021): 634 730

Consumer price index (09/2021) - base January 1st 1948: 902.29

Half-yearly average of the index linked to base as at January 1st 1948 (09/2021) : 896.23

Estimated deadline for next salary indexation: 2023

STATEC
info@statec.etat.lu
(+352) 247-84219
www.statistiques.lu

For further information:
Bastien Larue
Bastien.Larue@statec.etat.lu
(+352) 247-84339

Cathy Schmit
Cathy.Schmit@statec.etat.lu
(+352) 247-88459