

Increased inflationary pressure lingers

Inflation has accelerated considerably in the euro area over the last few months and is now comparable to that of the US. To counter the risks of price hikes, monetary policies are tightening and creating a less favourable financial environment.

Global inflation is currently at its highest level in forty years. This is true for the euro area countries, including Luxembourg and the United States. The rise in consumer prices began in 2021, driven by the recovery in consumption following the acute phase of the pandemic crisis. This recovery in consumption started earlier in the US, due to a fiscal policy that was particularly favourable to households¹ and quickly drove US inflation higher (mainly due to supply-side bottlenecks). The inflation gap between the US and the euro area reached more than 3 percentage points in mid-2021, but has since narrowed significantly. This is due in particular to the consequences of the war in Ukraine, which is having a more direct impact on European economies. In May 2022, the inflation rate exceeded 8% in both the United States and the euro area.

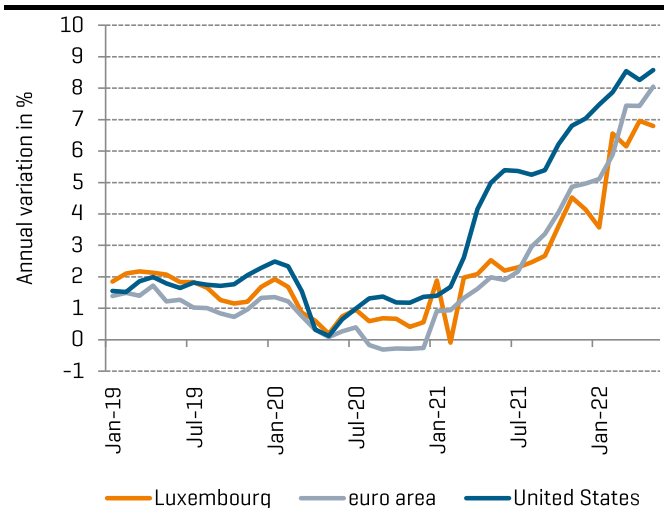
Within the euro area, the differences between countries are pronounced. The Baltic States (Estonia, Latvia and Lithuania) have the highest inflation rate, currently close to 20%. It must be said that these countries were the most dependent on Russian gas and oil and wanted to move away from this supplier quickly. They have shifted to new, much more expensive sources of supply, resulting in large increases in household energy bills. Countries such as Belgium, Greece, the Netherlands and Slovakia are also experiencing above average inflation, at around 10%. With a rate of 6.8% in May, Luxembourg is among the five Member States least affected by price rises, but still far from Malta (5.6%) or France (5.8%, where the “energy shield” significantly reduces pressure on gas and electricity prices, albeit at a high cost to public finances).

According to the latest STATEC forecasts, published in the Note de conjoncture at the beginning of June², inflation in Luxembourg should reach 5.8% over the whole of 2022, then slow to 2.8% in 2023. This is provided, however, that the war in Ukraine does not drag on into next year (and that Russian gas supplies are not cut off) and that disruptions in global production chains are significantly reduced. On the other hand, inflation should exceed 6% this year and be around 4% next year.

Tightening of monetary policies

This rise in global inflation, initially seen as a transitory phenomenon but which has taken on a more sustained character, is making monetary policy makers nervous.

CONSUMER PRICES



Sources: Eurostat, STATEC (NCPI for Luxembourg)

Especially in the US, where wage pressures are higher than in Europe (and therefore also the risk of a runaway wage-price loop). The US Federal Reserve has already started to raise its key interest rates since March. On 15 June, it raised its benchmark rate by a further 75 basis points – the highest since 1994 – partly as a result of a higher than expected inflation rate in May (8.6%, compared to the consensus forecast of 8.3%).

On the European Central Bank side, the first increase in key rates (close to or equal to 0% since 2015) is expected to take place in July and a further increase has already been announced for September. The European Monetary Authority is also concerned about the rise in government bond rates in some southern euro area countries and the risk of “fragmentation” among euro area Member States (which was at the heart of the sovereign debt crisis in the early 2010s).

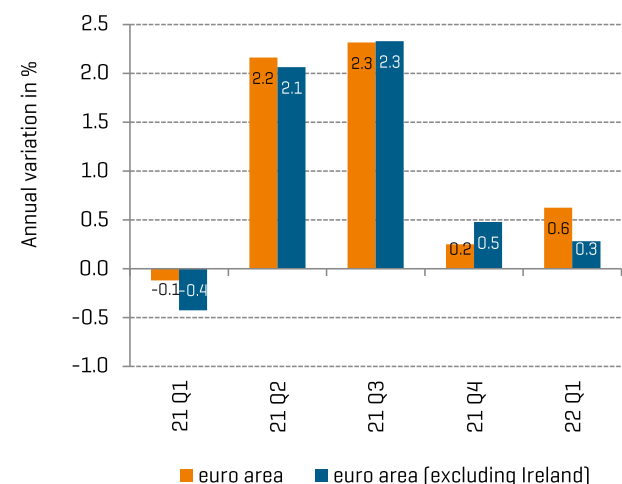
The acceleration of monetary policy tightening is also weighing on the outlook for equity markets. The main stock market indices in the US and Europe resumed a downward trend in the first half of June, which from Luxembourg’s point of view is still a negative signal for the performance of its financial sector.

¹ Stimulus package of USD 900 bn voted at the end of the Trump presidency (December 2020) and then a new Biden administration stimulus package in March 2021 of USD 1,900 bn, for a total fiscal stimulus equivalent to about 13% of GDP.

² <https://statistiques.public.lu/dam-assets/catalogue-publications/note-conjoncture/2022/ndc-01-22.pdf>

International

EVOLUTION OF GDP IN EURO AREA



Source: Eurostat [STATEC calculations]

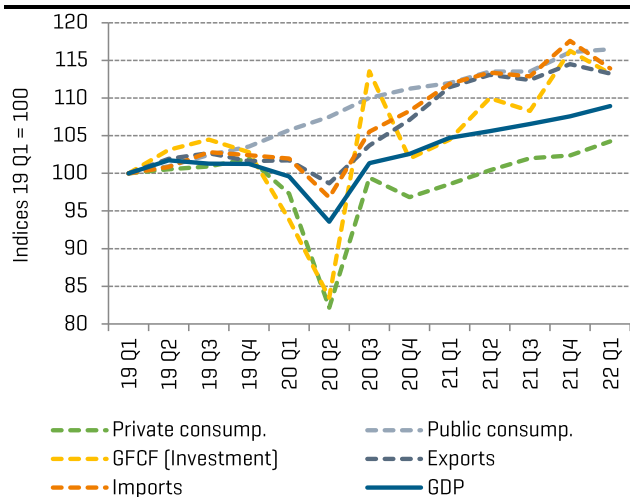
Deceptive growth for the euro area

Euro area GDP grew 0.6% over one quarter in Q1, according to figures released on 8 June. This is a significant upward revision from the 0.3% predicted in the flash estimate of 17 May. The major difference between the two versions comes from the inclusion of data from Ireland, where GDP grew by almost 11% in a single quarter! It should be noted that Irish GDP is very volatile, as it is heavily influenced by certain accounting transactions of foreign multinationals, and therefore difficult to interpret as an indicator of real economic activity.

Leaving aside the Irish data, the euro area does show a slowing trend between late 2021 and early 2022. On the business side, this decreased dynamism is particularly evident in the branches of industry, information and communication services and business services. This is likely to be the case for trade as well (detailed data is not yet available), as household consumption fell by 0.7% over the quarter (with declines in particular in Germany, France, Italy and Spain). Germany's net exports also fell sharply.

Activity

EVOLUTION OF GDP IN LUXEMBOURG



Source: STATEC (National accounts – seasonally adjusted data)

Continued dynamism in Q1 2022

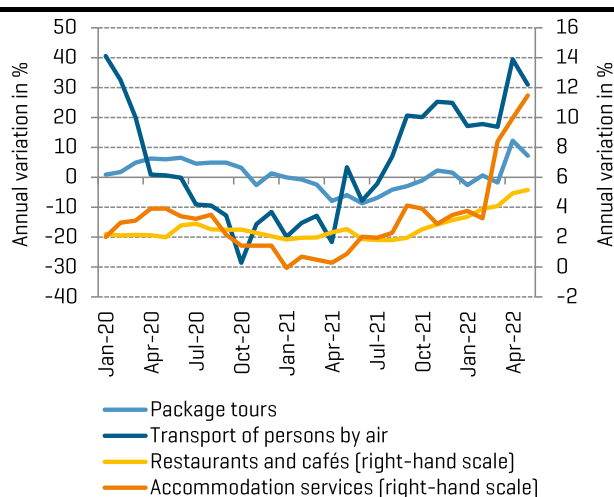
Activity in Luxembourg remained dynamic at the beginning of 2022. In Q1, GDP grew by 1.2% over the quarter, supported in particular by the solid performance of trade, transport services, business services and construction. In contrast to the trend in the euro area, household consumption continued to grow in Luxembourg. Investment, on the other hand, declined, but recovered strongly in Q4 due to the acquisition of a satellite. The trend remains well oriented and benefited in Q1 from increased spending on non-residential construction.

Net exports (exports minus imports) of financial services decreased, as did the value added of the financial sector (see hereafter). This decline was, however, more than offset by strong net exports of other services activities.

On the basis of these results (still partly based on estimates and therefore to be considered provisional), the growth overhang for 2022 amounts to 2.7% at the end of Q1.

Recreational activities

EVOLUTION OF PRICES OF CERTAIN SERVICES IN LUXEMBOURG



Source: STATEC (consumer prices)

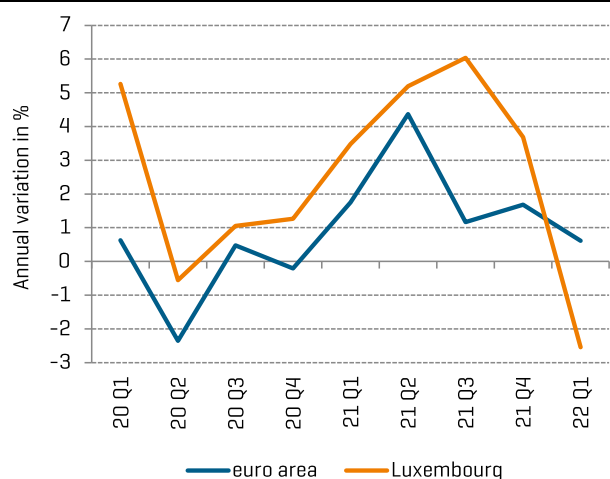
Rising demand and prices

The improvement of the health situation is boosting demand for certain recreational activities and thereby boosting their prices. Tourism demand continues to recover and is expected to be close to 2019 levels this year. However, it may suffer from a lack of investment in recent years and difficulties in recruiting staff. This imbalance is driving up the price of the services concerned, in addition to various cost pressures on providers.

Increases in fuel prices should also accelerate the rise in fares for passenger air transport (+31% over one year in May in Luxembourg) and package tours (+7%). Wage increases (following the two indexations paid over the last few quarters) and soaring food prices should play a certain role in boosting prices in the hotel and catering sector (+11% for accommodation, +5% for restaurants and cafés). Very similar inflationary trends are being observed in the euro area. With 0.4 percentage points in May, the contribution of these services to inflation in Luxembourg still appears relatively limited.

Financial sector 1/2

VALUE ADDED IN THE FINANCIAL SECTOR IN VOL.



Sources: Eurostat, STATEC (National accounts)

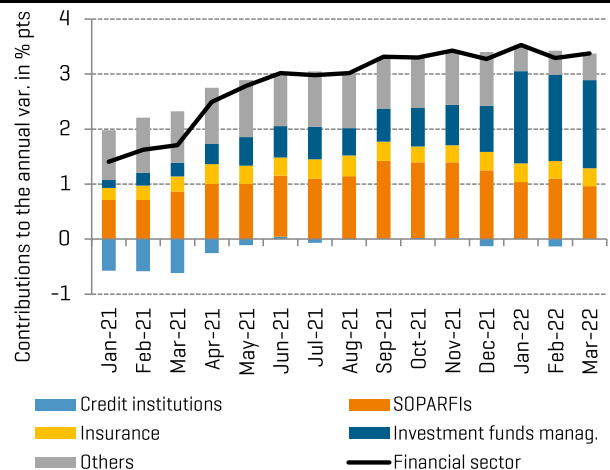
Financial sector suffers as stock markets deteriorate

In Q1 2022, the value added of the financial sector decreased by 3.2% in Luxembourg compared to the last quarter of 2021 [-2.5% over one year], whereas it remained rather stable in the euro area [+0.2% over one quarter, +0.6% over one year]. Luxembourg financial companies weathered the health crisis relatively well in 2020 [+1.7% growth compared to -0.4% in the euro area] and increased their activity strongly in 2021 [+4.6% compared to +2.2% in the euro area]. As the largest investment fund centre in Europe (with a 27% market share), Luxembourg has benefited more from the buoyancy of the stock markets in 2021 but has been more strongly affected by the deterioration of the latter since the beginning of 2022 (especially financial auxiliaries, which account for 40% of the GVA of the financial sector in Luxembourg, compared with less than 20% in the euro area).

In contrast, employment in financial companies remained on the rise in Q1 2022 in Luxembourg [+0.8% over one quarter, +3.6% over one year], whereas it fell slightly in the euro area [-0.7% over one quarter, -0.4% over one year].

Financial sector 2/2

EMPLOYMENT IN THE FINANCIAL SECTOR



Source: IGSS

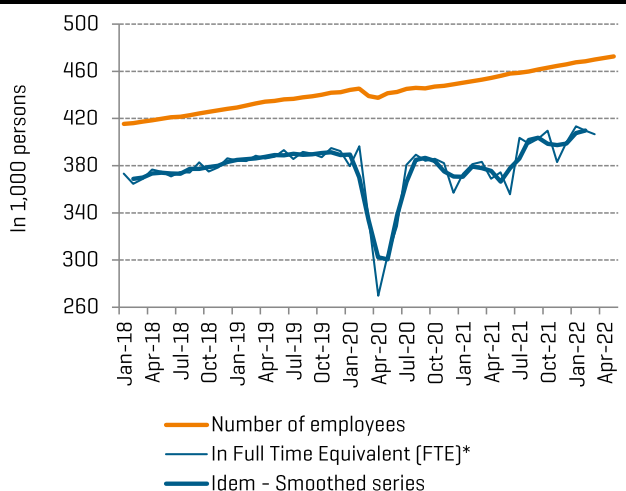
Strong growth in fund management employment

Employment in investment fund and pension management companies again rose strongly, with more than 250 jobs created in Q1 2022 [+2.5% over one quarter and +9% over one year]. Financial holding companies and insurance companies also continued to hire [+1.0% and +1.3% over the quarter respectively]. In contrast, employment in credit institutions is stable [-0.1% over one quarter, -0.1% over one year]. However, the latter have been losing staff since the beginning of the health crisis (260 fewer positions since the end of 2019).

Companies that relocated part of their activity to Luxembourg following the Brexit referendum in 2016 also continue to create jobs. They had contributed to about 1/4 of the annual employment growth in the financial sector by the beginning of 2022.

Labour market

DOMESTIC PAID EMPLOYMENT



Sources: IGSS, STATEC (seasonally adjusted data)

*Hours worked/hours to be reported for a full-time employee

A lot of overtime to compensate for absences

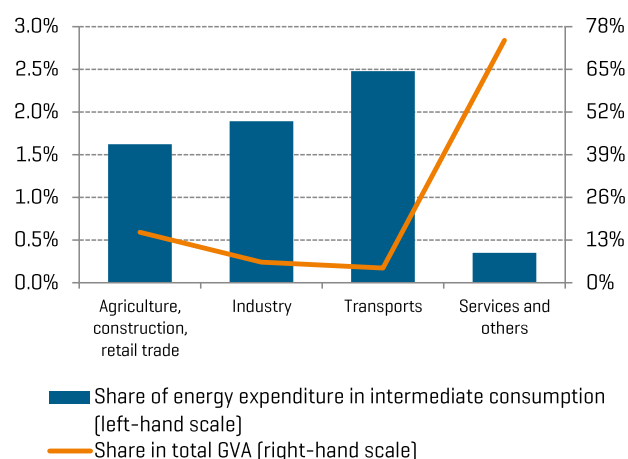
In Q1 2022, hours worked increased by 8% year-on-year, despite the surge in positive cases of Covid-19 and associated quarantines and isolations in early 2022. The shortage of labour was partly compensated by a high level of overtime [+16% over one year].

The hospitality industry in particular was forced to adjust its workload via hours in Q1 (working hours: +118%, overtime: +207%), and this situation could continue as the vacancy rate in this sector remains very high.

Despite employment still being very dynamic at the beginning of the year (around +3.7% year-on-year for the first five months), unemployment fell slightly less rapidly in April and May than at the very beginning of the year.

Energy

ENERGY EXPENDITURE OF COMPANIES



Source: STATEC

Service activities hardly impacted by the surge in energy prices

High energy prices are affecting businesses through large increases in input prices. It is mainly industry, an energy intensive sector, that is affected by the price hikes. While industry usually pays about one third of the price of gas and electricity in comparison with an average business consumer, it now pays more (industry prices having doubled for electricity and tripled for gas).

STATEC estimates that in 2022, energy price increases would increase energy expenditure in all branches of the total economy by around EUR 620 million compared to 2019, half of which would be spent by industry and one third by services. This would amount to a 100% increase for the industry and an average of about 40% for other sectors. In 2019, energy expenditure accounted for 2% of intermediate consumption in industry and 2.5% in transport, while it represented only 0.4% in services. The structure of the Luxembourg economy, which is dominated by (relatively energy-efficient) service activities should limit the direct impact of the price hike on activity.

Trend chart

	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	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	1.6	0.7	0.9	7.9	1.3	2.8	-3.1	...	...	0.2	5.1
Construction output per working day, in volume	-0.2	-0.9	-0.1	-8.1	5.7	5.4	-2.9	...	...	2.3	8.4
Turnover by volume of total retail trade	0.6	1.7	0.2	4.7	6.6	-5.8	-4.3	-7.0	...	-5.7	30.4
Prices, wages											
Consumer price index (NCPI)	2.7	3.6	4.5	4.1	3.6	6.6	6.1	7.0	6.8	6.6	2.2
Underlying inflation	1.4	1.8	2.2	2.3	1.4	4.2	3.5	4.2	4.5	4.1	1.3
Oil product index	34.6	48.5	60.0	46.9	48.7	51.7	56.9	59.2	49.7	55.2	25.1
Industrial producer price index	21.7	22.7	25.3	26.3	25.7	24.5	24.2	28.2	...	25.6	2.7
Construction price index ¹	7.2	9.3	9.3	9.3	...	...	...	...	...	9.3	2.9
Average wage bill, per person (National accounts)	2.9	5.2	5.2	5.2	7.0	7.0	7.0	...	...	7.0	1.6
Foreign trade											
Exports of goods (volume)	-1.1	-5.6	0.7	2.0	1.7	2.8	-1.2	...	...	1.0	2.6
Imports of goods (volume)	4.7	15.5	1.7	1.5	5.9	2.1	4.6	...	...	4.2	4.3
Employment, unemployment											
Domestic number of employees	3.6	3.6	3.8	3.8	3.8	3.7	3.8	3.7	3.7	3.7	3.5
National employment	2.9	2.9	2.9	2.9	2.9	2.9	2.7	2.5	2.5	2.6	2.4
Unemployment rate [% of working population, seas. adj.]	5.5	5.3	5.2	5.1	4.9	4.8	4.7	4.7	4.6	4.7	6.0

Source: STATEC

¹ Estimations based on half-yearly data

Indicators

	Quarterly variation in %					
	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1
Eurozone - real GDP growth (European Commission)	-0.4	-0.1	2.2	2.3	0.2	0.6
Luxembourg - real GDP growth (STATEC)	1.2	2.1	0.8	0.9	1.0	1.2
	Annual variation in %					
	2018	2019	2020	2021	Forecast 2022	Forecast 2023
Luxembourg - real GDP growth (STATEC)	2.0	3.3	-1.8	6.9	2.0	4.0
GDP at current prices 2021: EUR 73 313 million						
Minimum monthly salary (since 01/04/2022): EUR 2 313.38	Consumer price index [05/2022] - base January 1 st 1948: 954.27					
Current account balance (2021 Q4): EUR -1 345 million	Half-yearly average of the index linked to base as at January 1 st 1948 [05/2022] : 936.68					
Resident population (01/01/2022): 645 397	Estimated deadline for next salary indexation: April 2023					

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