

Less favourable outlook for second half of the year

Activity in the euro area remained strong in the second quarter. However, in Luxembourg, the trends are more mixed. The situation is positive for non-financial services but less favourable for the financial sector. The economic outlook in Europe has darkened considerably, suggesting a more challenging second half of the year.

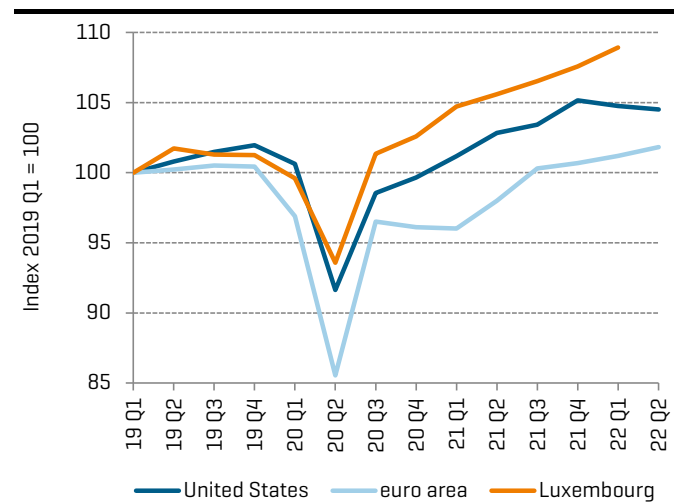
Euro-area GDP continued to grow in Q2 2022, up +0.6% over a quarter (after +0.5% in Q1). This is a pleasant surprise, coming after the results of business surveys showed a deterioration in business confidence in spring [see Conjoncture Flash for July]. Nevertheless, performance was very contrasted between Member States. Of the large euro-area economies, Spain (+1.1%) and Italy (+1.0%) stood out favourably, no doubt helped by a clear recovery in tourist numbers. Germany, by contrast, stagnated, with manufacturing hit hard by its heavy reliance on Russian gas, the disruptions in global production chains and its high export exposure to emerging countries, notably China¹.

Luxembourg GDP figures for the second quarter are not yet available (they will be published in September). The financial sector is likely to decline further as a result of the deteriorating stock market environment over this period. And given the slightly negative output trend last spring, industry and construction are not expected to make a positive contribution to value added this quarter either. For non-financial services, on the other hand, despite the drop in confidence recorded since May, trends remain favourable for turnover in volume terms in the second quarter, particularly for business services, transport, hospitality and wholesale trade. The situation is more difficult for other trade components. The volume of retail sales fell for three consecutive months from April to June, echoing the decline in consumer confidence (consumers are particularly concerned about their financial situation in the current high-inflation environment). Passenger car sales remain constrained by limited supply from manufacturers².

Activity set to decline?

The data observed and the outlook for household consumption have deteriorated significantly in both Luxembourg and the euro area over the last few months, as rising inflation eroded their purchasing power (which is more or less affected depending on the various relief measures implemented).

GDP IN VOLUME



Sources: Eurostat, STATEC

Business confidence in non-financial services held up relatively well in the first part of the year, but fell back sharply as summer approached (May in Luxembourg, July across the euro area). Companies feel that their situation has deteriorated and that both recent and anticipated demand have weakened. In the July PMI survey for the euro area, the composite activity index continued to fall and is now just under 50 points, which corresponds to a slight contraction in activity. The war in Ukraine shows no sign of ending in the short term, which will keep up the pressure on household and business energy bills³. The risk of a downturn in activity is growing in the euro area, and the August and September business surveys will provide more information for assessing this situation.

The United States, where the post-COVID recovery and the rise in inflation came earlier than in Europe, was in a technical recession (two consecutive quarters of negative GDP growth) at the end of the second quarter, although it is difficult to see it as being in a crisis situation given the continuing strength of US employment.

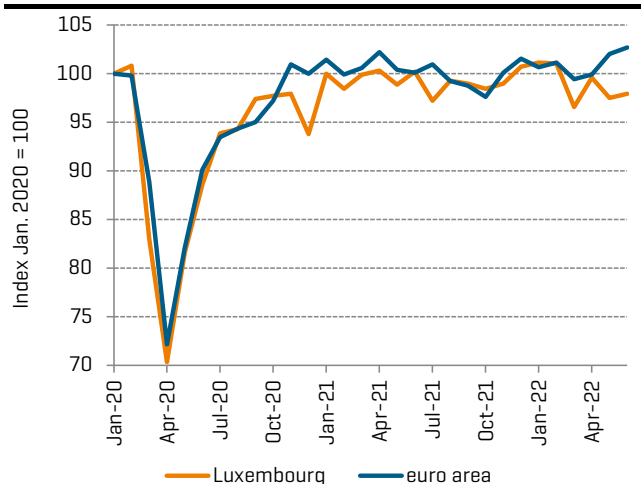
¹ China's GDP contracted sharply in the second quarter [-2.6% quarter-on-quarter] due to the drastic lockdown measures implemented across many cities.

² New registrations of passenger cars fell by 13% year-on-year in the first seven months of 2022 in Luxembourg [-14% for the euro area over the same period].

³ Although the price of oil has fallen since mid-June (when it was around USD 120 per barrel for Brent, compared with just under USD 100 in mid-August), the price of gas (which ultimately determines the price of electricity) has risen to new records over the same period.

Manufacturing

MANUFACTURING OUTPUT PER WORKING DAY



Sources: Eurostat, STATEC

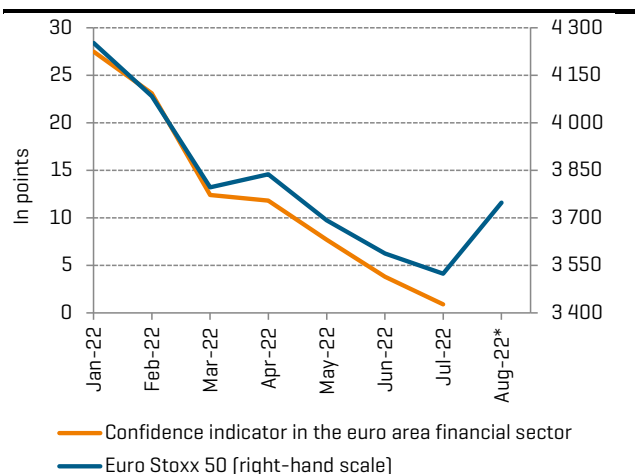
Output remains sluggish

Manufacturing output has remained sluggish this year. Over the first six months of 2022 (June data are partial estimates), it was down 0.7% over one year in Luxembourg (but up +0.2% for the euro area as a whole). Performances are very different over this period depending on production sector, with marked downward contributions in plastic, rubber, glass and ceramic products and textiles, but improved results for machinery and equipment, energy production and distribution, metal products and construction materials.

The outlook for the third quarter is not very promising, as industrial confidence – which has been declining in both the euro area and Luxembourg since the start of the war in Ukraine – continued to fall in the July business surveys. In Luxembourg, this new decline in morale – reflected in deteriorating order books and rising stock levels – is particularly pronounced for players in the metalworking, IT and electronic products, and textile sectors.

Financial sector 1/2

ECONOMIC SURVEY – EURO AREA FINANCIAL SECTOR



Sources: DG ECFIN, Macrobond

* Data up to 19/08/2022

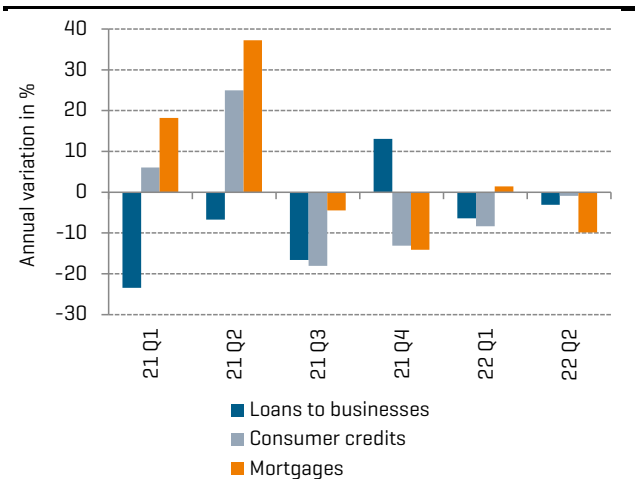
Markets a little more optimistic in August

Financial companies confidence in the euro area declined further in July, in line with surveys and stock markets in previous months. Banks and insurance companies are slightly more pessimistic about their recent and future activity, but opinions on demand trends, results and employment in Q2 remain positive overall. Major European banks increased their earnings in the second quarter, mainly due to strong investment and market activities with their clients, while investment funds suffered from stock market asset write-downs and fund outflows.

Stock markets have been on the rise since the end of July, mainly driven by energy stocks but also by hopes of a tightening less strong in monetary policy in the coming months. If this bullish phase in the stock markets continues, it should support the financial sector's Q3 results.

Financial sector 2/2

NEW LOANS GRANTED BY LUXEMBOURG BANKS



Source: BCL

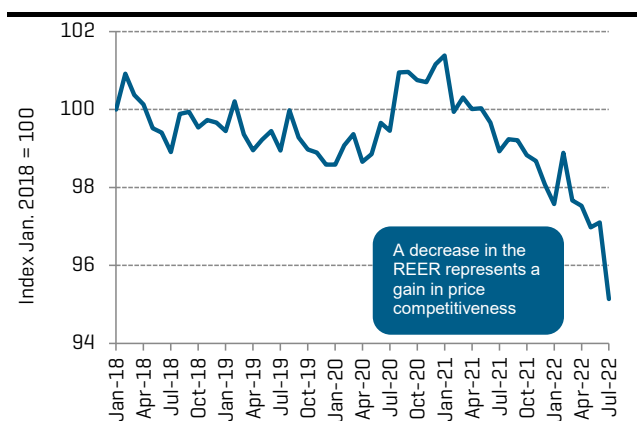
Decline in loan applications

In the second quarter, new fixed-rate mortgages issued by Luxembourg banks fell 18% over the year, while variable-rate mortgages rose by 5.4%. The gap between long-term fixed rates and short-term variable rates is widening, with the former averaging 2.3% in June (+0.9 percentage points over one year) – and as high as 3.5% on 30-year mortgages according to AtHome – compared with just 1.3% for variable rates (+0.1 percentage points). Rates on business loans remain low at 1.1% (+0.1 percentage points over one year), but new loans issued have decreased by 3.1% over one year.

According to the bank lending survey conducted in July, demand for home loans is declining in Luxembourg and the euro area due to a drop in consumer confidence, a less favourable outlook for the housing market and tighter lending criteria and conditions. Business loan demand declined in Luxembourg but continued to rise in the euro area, driven by working capital needs.

External relations

REAL EFFECTIVE EXCHANGE RATE IN LUXEMBOURG



Sources: STATEC, Eurostat, ECB, Fed St Louis, ONS, BFS, STATEC calculations.

Note: Based on Luxembourg's trade in goods and services between 2018 and 2020. Countries and weighting are as follows: Germany (18%), Belgium (7%), Spain (3%), United States (9%), France (10%), Ireland (3%), Italy (7%), Netherlands (3%), the United Kingdom (13%) and Switzerland (5%).

Price competitiveness gains in Luxembourg

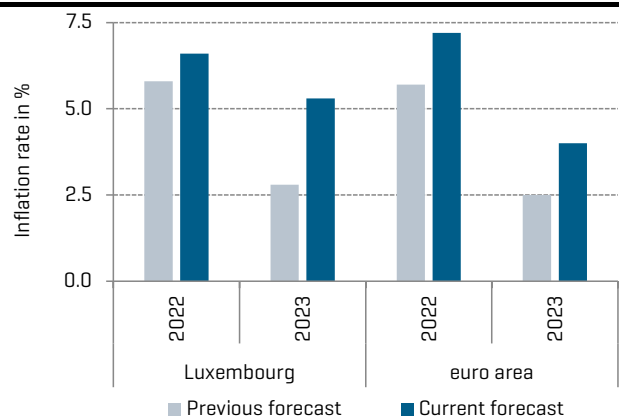
The real effective exchange rate (REER) is a measure of the exchange rate which takes into account consumer price trends in a country relative to its trading partners. For economists, it is thus an indicator of a country's price competitiveness in international trade.

In Luxembourg, the REER has been on a downward trend since 2021. This is mainly due to the real appreciation of both the dollar and the pound sterling against the euro and, more recently, by an acceleration of inflation in Germany compared to Luxembourg.

This real depreciation in the exchange rate against the currencies of trading partners (goods and services) represents a gain in price competitiveness for Luxembourg. This should help the Grand Duchy's trade balance as exports become cheaper than imports.

Inflation

INFLATION FORECASTS FOR LUXEMBOURG AND THE EURO AREA



Sources: STATEC, IMF, OECD, European Commission and ECB

Note: for Luxembourg, the current forecast is the STATEC forecast published on 3 August 2022 (STATNEWS 36) and the previous forecast is the one published on 4 May 2022 (STATNEWS 20). For the euro area, the current and previous forecasts are an average of forecasts published by the OECD, the IMF, the European Commission and the ECB in June-July 2022 and April-May 2022.

Inflation forecasts revised significantly upwards

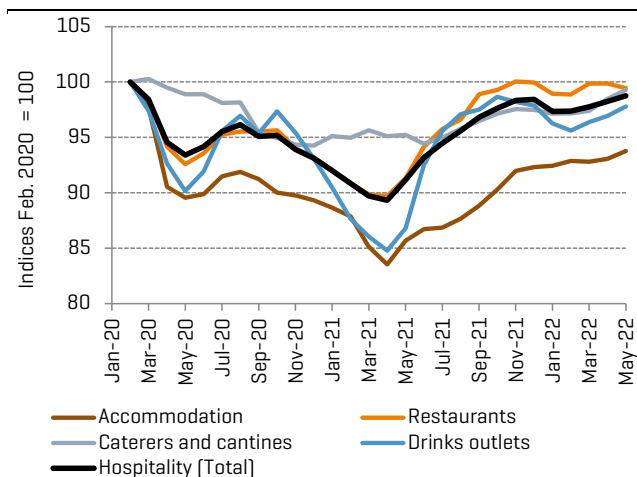
The most recent forecasts by international institutions point to euro-area inflation of 7.2% in 2022 and 4.0% in 2023. In Luxembourg, STATEC expects 6.6% this year and 5.3% next year. According to these forecasts the next wage indexation adjustment will come in Q4 2022.

Forecast assumptions have been adjusted to the economic situation. The price of Brent crude has been revised upwards, while the euro-dollar rate has been devalued. As a result of the recent surge in energy markets, the price of gas in Luxembourg is expected to go up by almost 90% by the end of winter and the price of electricity by at least 35% by January 2023.

Nevertheless, there remain uncertainties that could impact inflation. A further depreciation of the euro against the dollar and a further reduction in Russian gas supplies would further fuel inflation. On the downside, an easing of the zero COVID strategy in China or further monetary policy tightening in Europe could have a dampening effect on consumer prices.

Labour market

PAID EMPLOYMENT IN THE HOSPITALITY SECTOR



Source: IGSS (seasonally adjusted data)

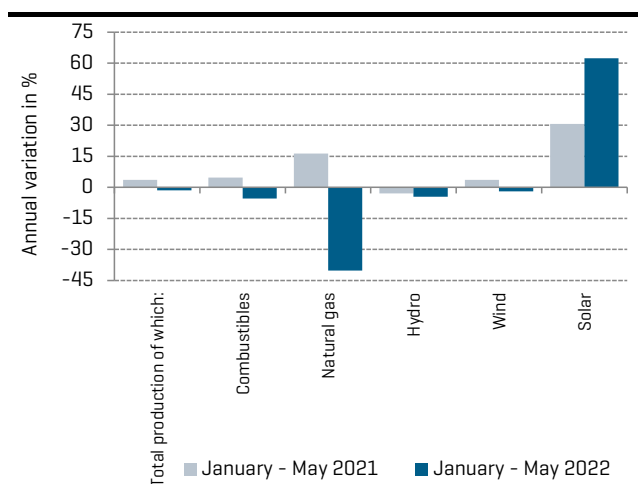
Hospitality: employment close to pre-COVID levels

The hospitality industry is one of the sectors that suffered most from the health crisis, but the lifting of restrictions saw employment in this sector make a remarkable recovery in early 2022 (+8% year-on-year in the first six months of the year). At the same time, the number of jobseekers registered with ADEM in this sector continues to decline, to about 1,300 in June 2022 on a seasonally adjusted basis, after peaking at almost 2,300 in October 2020. The job vacancy rate rose to 3.7% for this sector in the second quarter of 2022, compared to 2.2% before the crisis in the first quarter of 2020.

However, employment in the hospitality industry (around 5% of total paid employment) was still slightly below pre-crisis levels in mid-2022. Accommodation in particular is struggling to recover, with employment still 6% below February 2020 levels. Confidence and employment prospects in the hotel and catering industry deteriorated in the July business survey, but remain relatively high.

Energy

NATIONAL ELECTRICITY PRODUCTION



Sources: STATEC, EUROSTAT

Decline in gas-fired electricity generation

National electricity production, which represents around 20% of total electricity consumption in Luxembourg, fell slightly by around 2% year-on-year in the first five months of 2022. This movement can be explained by a simultaneous drop in hydroelectric [-4% over one year], wind [-2%] and combustibles excluding natural gas production [-5%], and above all in power generation from natural gas [-40%]. The decrease in hydro and wind generation is attributable to unfavourable weather conditions (notably the drought in recent months and low wind speeds). The decline in gas-fired generation is probably due to soaring input prices following the surge in spot gas markets.

However, photovoltaics continue to grow and were up by more than 60% year-on-year over the same period. This increase is explained on the one hand by an increase in photovoltaic production capacity [+50% year-on-year in 2021] and on the other hand by an increase in sunshine hours [+20% compared to 2021]. Photovoltaics now account for 15% of total electricity production in Luxembourg.

Trend chart

	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-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	1.0	8.1	1.3	2.9	-3.2	-0.4	-1.8	...	...	-1.8	26.0
Construction output per working day, in volume	-0.1	-8.1	5.8	5.7	-1.9	-4.0	2.7	...	...	-1.2	42.0
Turnover by volume of total retail trade	0.5	4.9	6.5	-6.2	0.4	-5.9	-4.0	-9.9	...	-6.6	22.5
Prices, wages											
Consumer price index (NCPI)	4.5	4.1	3.6	6.6	6.1	7.0	6.8	7.4	6.8	7.0	2.3
Underlying inflation	2.2	2.3	1.4	4.2	3.5	4.2	4.5	4.8	4.7	4.7	1.2
Oil product index	60.0	46.9	48.7	51.7	56.9	59.2	49.7	56.3	43.6	49.8	30.7
Industrial producer price index	25.3	26.3	25.7	24.5	24.8	29.8	33.0	30.0	...	30.9	3.4
Construction price index ¹	9.3	9.3	11.6	11.6	11.6	13.9	13.9	13.9	...	13.9	5.2
Average wage bill, per person (National accounts)	5.2	5.2	7.0	7.0	7.0	...	...	...	...	7.0	1.6
Foreign trade											
Exports of goods (volume)	0.6	1.7	1.5	2.0	-0.9	-4.4	4.9	...	...	-0.3	24.3
Imports of goods (volume)	0.5	1.9	5.5	5.4	7.1	6.8	4.0	...	...	6.0	34.0
Employment, unemployment											
Domestic number of employees	3.8	3.8	3.8	3.6	3.7	3.6	3.6	3.5	3.6	3.5	3.3
National employment	2.9	2.9	2.8	2.7	2.6	2.4	2.4	2.2	2.6	2.4	2.4
Unemployment rate [% of working population, seas. adj.]	5.2	5.1	4.9	4.9	4.7	4.7	4.7	4.7	4.7	4.7	5.7

Source: STATEC

¹ Estimations based on half-yearly data

Indicators

	Quarterly variation in %					
	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2
Eurozone - real GDP growth (European Commission)	-0.1	2.1	2.3	0.4	0.5	0.6
Luxembourg - real GDP growth (STATEC)	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 [07/2022] - base January 1 st 1948: 951.88					
Current account balance [2022 Q1]: EUR 440 million	Half-yearly average of the index linked to base as at January 1 st 1948 [07/2022] : 950.31					
Resident population (01/01/2022): 645 397	Estimated deadline for next salary indexation: April 2023					

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