CONJUNCTURE **FLASH**

June 2023

MONTHLY PUBLICATION ON THE STATE OF THE LUXEMBOURG ECONOMY

Contrasting trends in transport services

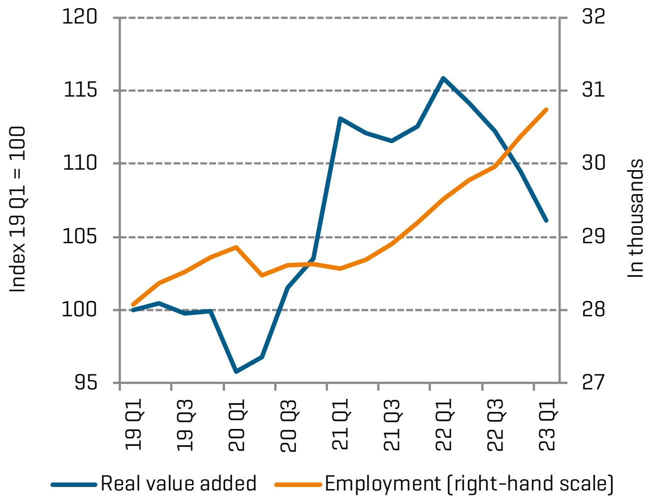
Value added in the transport and storage sector held up surprisingly well during the health crisis, thanks in particular to good results in air freight. However, it has been on a downward trend since mid-2022. Nevertheless, employment in the sector continues to trend favourably, supported in particular by the increase in the number of people employed in road passenger transport.

The transport and storage sector in Luxembourg performed remarkably well during the pandemic. Value added in volume terms fell just 3% in 2020 (against almost 20% in the euro area), before rebounding 14% in 2021 (+10% in the euro area). This resilience owes much to the strength of air transport results over the period, particularly in the freight sector (thanks in particular to the transport of medical equipment and the temporary recovery in freight for airlines specialising in passenger flights).

These factors are reflected in the freight volume figures for Findel airport (+6% in 2020, +20% in 2021) but the phenomenon did not continue in 2022 (-11%) and the trend was still downwards in early 2023 (-20% year-on-year in the first five months of the year against relatively high figures in early 2022). Overall, air freight volumes at the start of the year were back to the levels seen before the outbreak of the pandemic. In the air passenger transport sector, the airport figures show that passenger numbers shrank 70% in 2020 compared to 2019, mainly due to the halt in passenger traffic between the end of March and the end of May, before gradually recovering as restrictions were eased (+40% in 2021, +100% in 2022, results very close to those observed in other European countries over the same period). In early 2023, the number of passengers who checked in at Luxembourg airport was back to pre-crisis levels. Tourist numbers have also more or less returned to normal. Luxembourg accommodation establishments reported arrival numbers at close to 2019 numbers in the first five months of the year (although the recovery is less marked in Luxembourg than in the euro area as a whole, where results in the southern countries are particularly good).

The freight and passenger data for rail transport stop in 2022. Over the past year, freight fell 7% in Luxembourg on 2021, weaker than France and Germany (-3.2% and +0.4% respectively). Passenger numbers rose 33% in Luxembourg, placing it between France (+26%) and Germany (+44%). Over the first half of 2022, however, Luxembourg outperformed its neighbours in road freight (+4.2% year on year, compared with a 1.4% rise in Germany and a 1% fall in both France and Belgium).

TRANSPORT AND STORAGE: VALUE ADDED AND EMPLOYMENT IN LUXEMBOURG



Source: STATEC (National accounts – seasonally adjusted data)

Lastly, for inland waterway transport, 2022 was marked by declining transport volumes in Luxembourg and neighbouring countries, due in particular to a very poor third quarter when drought-induced low water levels considerably hampered activity.

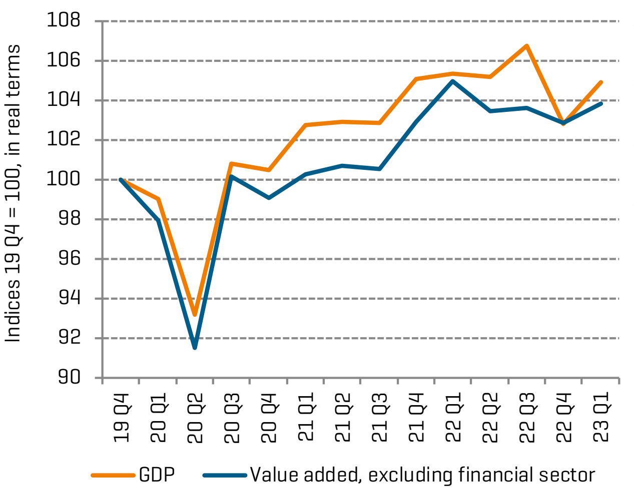
Employment remains dynamic in early 2023

The trend in the number of employees in transport and storage services remained favourable in the first few months of the year. Employment in this sector rose 4.2% year on year in Q1 2023, higher than employment in the economy as a whole (+2.9%) and, unlike the broader economy, is showing no signs of slowing down.

The momentum observed owes much to the creation of jobs in companies specialising in collective road passenger transport. In this respect, it is worth noting that after two consecutive years of decline in 2020 and 2021, new bus and coach registrations rose sharply in 2022 and even reached an all-time high (by some 300 vehicles).

Activity

REAL GDP AND VALUE ADDED IN LUXEMBOURG



Sources: STATEC (seasonally adjusted data)

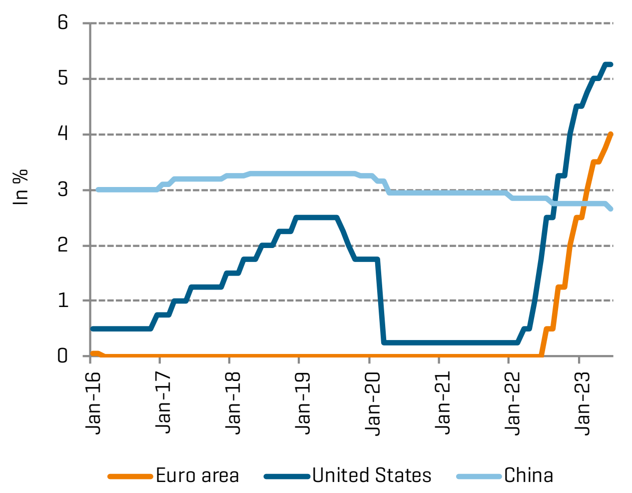
GDP rebounds in Q1

Luxembourg GDP posted a small increase in Q1 2023, up 2.0% over one quarter (-0.4% over one year). This rebound comes after a sharp fall in Q4 2022, largely due to falling value added in the financial sector. This sector recovered well in early 2023 but other sectors, particularly business services, also made a positive contribution to growth. The construction sector has rebounded slightly, but this may only be temporary, given the downturn in a number of economic indicators for this sector (opinions in business surveys in particular continued to deteriorate up to May).

The overall trend in all other commercial sectors is towards a slight contraction, in line with the trend observed for overall activity in the euro area in late 2022 and early 2023 (i.e. a slight recession, with GDP down 0.1% over two consecutive quarters).

Financial environment

KEY INTEREST RATES



Source: Macrobond

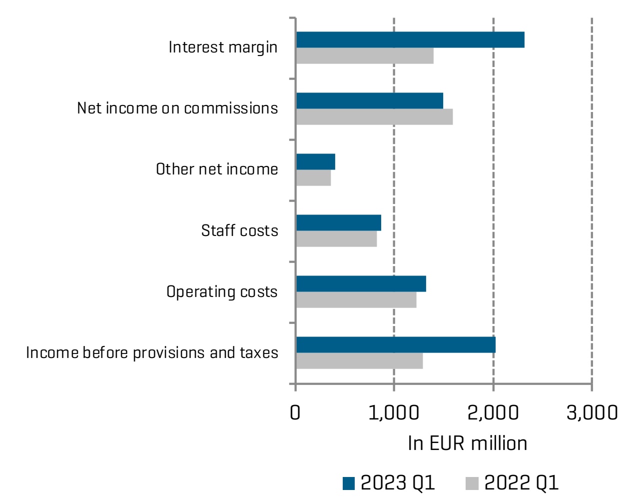
Monetary policies diverge

Meetings of central bank governors in June led to diverging decisions on the direction of monetary policy in the euro area, the United States and China. The European Central Bank raised its key rates by a further 25 basis points, its eighth hike in eleven months, in the face of underlying euro-area inflation (excluding energy and food), which remained extremely high at 6.9% in May. With indicators of underlying price pressures remaining robust, even if some are showing signs of flagging, the central bank has upgraded its inflation forecasts for 2023 (5.4%) and 2024 (3.0%). It is expected to raise rates again in July and is unlikely to cut them before 2025.

In the United States, the Federal Reserve has put a halt to raising interest rates and seems unsure about which direction to take in the coming months. Underlying inflation is high but has been slowing since October 2022 and remains lower than in the euro area (at 5.3% in May). On the other side of the Pacific, China is in a different position. It is experiencing slow recovery in activity post-Covid and low inflation (+0.2% in May, down from +2.0% in 2022) and has therefore cut its key rate by 10 basis points to stimulate demand and investment.

Financial sector

PROFIT AND LOSS ACCOUNTS FOR BANKS IN LUXEMBOURG



Source: BCL

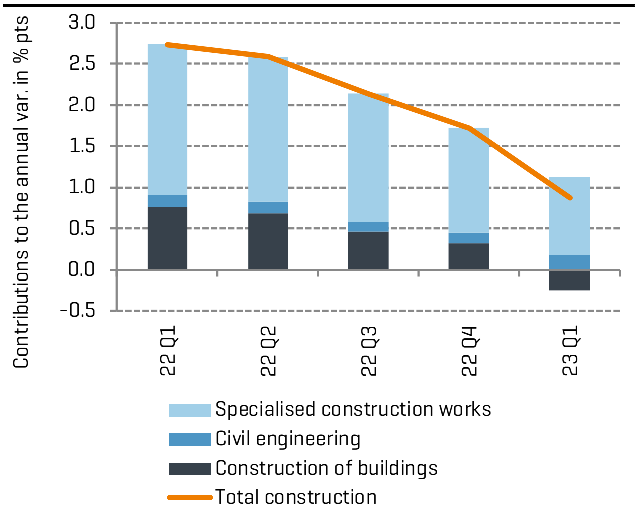
Rising interest rates further boost bank earnings

In Q1 2023, bank earnings were further boosted by the effects of the rate hike on interest income. Interest margins rose for 80% of banks, up 66% year on year. On the other hand, net commission income was down 5.9% year on year. This drop affected private banks and custodian banks for investment funds particularly badly, with valuations of assets under management for investment funds falling sharply since 2022 (they have not yet returned to late-2021 levels) and net issuance remained low in early 2023. Operating and staff costs continued to rise for 72% of banks (+7.2% over one year).

The sustained rise in interest rates led to a significant increase in banking sector profits (before provisions and tax) and value added (+57% and +16% year on year respectively in Q1). In real terms, value added for banks rose 7% year on year – compared with -11% for insurance companies and +2.5% for ancillary activities – bringing growth in the financial sector to +3.2% year on year (+5.5% quarter on quarter).

Labour market 1/2

PAYROLL EMPLOYMENT IN THE CONSTRUCTION SECTOR



Source: IGSS

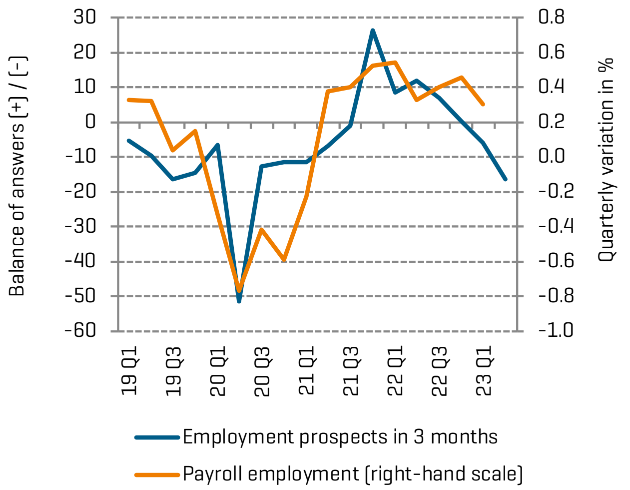
Construction employment slows sharply

Payroll employment in the construction sector continued to slow in Q1 2023, rising 0.9% year on year. Compared with Q4 2022, it even recorded a slight fall of -0.1%, the first since 2013. Payroll employment in the euro area in this sector is also slowing in many countries, although the results are very mixed.

In Luxembourg, the trend in the workforce is most unfavourable in building construction (-0.8% year on year in Q1 2023). Employment in specialised construction work is still growing (+1.6%) but is clearly slowing, in contrast to civil engineering, where job creation remains dynamic. This configuration reflects the deterioration in real estate indicators over the last few quarters, which is likely to have repercussions initially on building construction and then subsequently on specialised work (technical installations and finishing), where renovation projects should help business to hold up better. With business sentiment in relation to the order books and job prospects continuing to deteriorate until May, the economic surveys do not point to any improvement in the short term.

Labour market 2/2

EMPLOYMENT IN INDUSTRY



Sources: STATEC (economic surveys and national accounts)

Employment in industry holds up

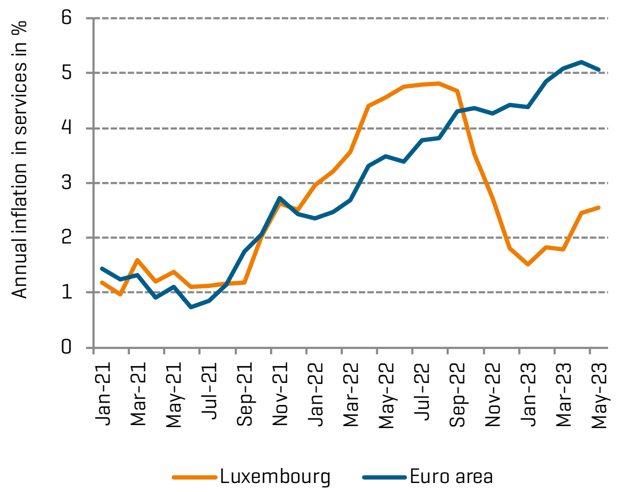
Despite falling industrial output in Q1 (see Flash 5-23), a worsening employment outlook according to economic surveys and a rise in partial unemployment applications since autumn 2022, employment in industry held up well in Q1 2023.

Employment in industry in Luxembourg slowed slightly in early 2023, falling from +0.5% over one quarter in Q4 2022 to +0.3% in Q1 2023 (with very similar results in the euro area). However, the pace remains relatively high, compared with an average of +0.2% per quarter over the last 10 years. While partial unemployment applications related to roughly 7,500 manufacturing employees in the first half of the year (i.e. almost 1 in 5 workers), only 1.5% of employees in this sector actually took up this state aid. This seems to indicate that many applications were made as a precautionary measure, in particular because of fears of gas rationing (which failed to materialise).

Sub-sectors of the food industry (+0.8% over one quarter), the chemical industry (+2.3%) and energy production and distribution (+2.8%) contributed the highest level of growth in Q1.

Inflation

CONSUMER PRICES FOR SERVICES



Sources: STATEC, Eurostat

Services inflation remain relatively low in Luxembourg

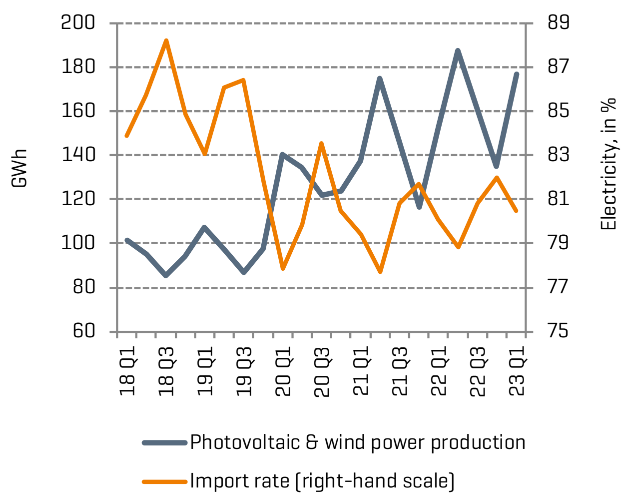
Annual inflation in services remains moderate in Luxembourg (+2.5% in May compared with 5.1% in the euro area). Rising inflation in services in the euro area can be explained by rising energy costs, coupled with higher labour costs at a time of historically low unemployment.

In the Grand Duchy, tripartite measures such as postponing the second wage indexation adjustment from 2022 to April 2023 and aid for businesses affected by rising energy prices have helped curb inflation in services. Since September 2022, free canteens (down 36% year on year in May) and daycare centres (down 18%) have also contributed to the -0.5 percentage point fall in the price of services in the Grand Duchy.

However, over the next few months, services are likely to become more expensive (there has already been a slight rebound since April), fuelled by the two wage indexation adjustments paid out in February and April 2023.

Energy

ELECTRICITY PRODUCTION AND IMPORTS



Sources: STATEC, Eurostat

Electricity: increased production, fewer imports

Luxembourg is heavily dependent on imported electricity, which accounts for around 80% of its current consumption. However, this dependence has recently fallen slightly, with electricity imports down 8% in the first quarter compared with the same period in 2022. This fall in imports is largely attributable to the energy crisis, which led to a 9% fall in electricity consumption in the first quarter compared with the previous year.

Moreover, thanks to the boom in renewable energies, particularly wind and photovoltaic production (+16% year-on-year in Q1), this dependence is set to further decrease in the future due to planned capacity increases (threefold by 2030). Electricity consumption is however set to rebound as the Luxembourg economy becomes increasingly electrified (+30% until 2030). For the time being, renewable energies seem to be mainly replacing what is known as "dispatchable" generation (combustion plants), which fell 40% year-on-year in the first quarter.

Trend chart

	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	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	1.2	-2.0	-1.6	-6.3	-8.1	-2.9	-1.6	...	...	-4.1	0.1
Construction output per working day, in volume	0.5	-1.7	1.2	15.9	-11.9	0.7	-2.1	...	...	-4.1	2.0
Turnover by volume of total retail trade	5.1	-2.9	-1.8	-1.3	-1.1	-1.2	-2.1	-0.7	...	-1.3	-3.6
Prices, wages											
Consumer price index (NCPI)	6.9	6.9	5.9	5.4	4.8	4.3	3.6	3.7	3.6	3.6	6.6
Underlying inflation	5.2	5.1	4.9	4.6	4.8	4.8	4.7	4.9	4.8	4.8	4.1
Oil product index	37.4	35.2	20.9	15.8	3.9	-3.5	-11.4	-13.5	-13.9	-12.9	55.2
Industrial producer price index	22.5	23.0	20.3	19.0	18.0	13.6	10.1	2.9	...	8.7	26.5
Construction price index[1]	14.9	15.9	15.9	15.9	...	...	...	...	...	15.9	9.3
Average wage bill, per person (National accounts)	5.4	2.2	2.2	2.2	6.5	6.5	6.5	...	...	6.5	6.8
Foreign trade											
Exports of goods (volume)	-2.3	0.4	-2.1	-9.1	1.3	-1.2	-4.7	2.4	...	-1.5	-1.0
Imports of goods (volume)	1.1	-9.0	0.2	-3.7	2.2	0.6	-1.2	-10.9	...	-3.9	5.5
Employment, unemployment											
Domestic number of employees	3.4	3.3	3.2	3.4	2.8	3.0	2.8	2.7	2.7	2.7	3.5
National employment	2.6	2.6	2.6	2.7	2.2	2.3	2.2	2.2	2.2	2.2	2.6
Unemployment rate (% of working population, seas. adj.)	4.8	4.9	4.9	4.9	4.9	4.9	4.9	4.9	5.0	4.9	4.7

Source: STATEC

[1] Estimations based on half-yearly data

Indicators

	Quarterly variation in %					
	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1
Eurozone - real GDP growth (European Commission)	0.5	0.7	0.8	0.4	-0.1	-0.1
Luxembourg - real GDP growth (STATEC)	2.2	0.2	-0.1	1.5	-3.7	2.0
	Annual variation in %					
	2019	2020	2021	2022	Forecast 2023	Forecast 2024
Luxembourg - real GDP growth (STATEC)	2.3	-0.8	5.1	1.5	1.5	2.5

GDP at current prices 2022: EUR 78 130 million

Minimum monthly salary (since 01/04/2023): EUR 2 508.24

Current account balance (2022 Q4): EUR -1 058 million

Resident population (01/01/2023): 660 809

Consumer price index (05/2023) - base January 1st 1948: 988.26

Half-yearly average of the index linked to base as at January 1st 1948 (05/2023) : 975.66

Estimated deadline for next salary indexation: Q3 2023

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STATEC