CONJONCTURE FLASH

Economy and prices

MONTHLY PUBLICATION ON THE STATE OF LUXEMBOURG'S ECONOMY – **FEBRUARY 2024**

TWO CHALLENGING YEARS FOR THE EUROZONE

The stagnation in activity continued at the end of 2023 in the eurozone, although results varied extensively between the different Member States. Growth in 2024 is likely to remain weak, particularly given the lack of dynamism expected in the first half of the year.

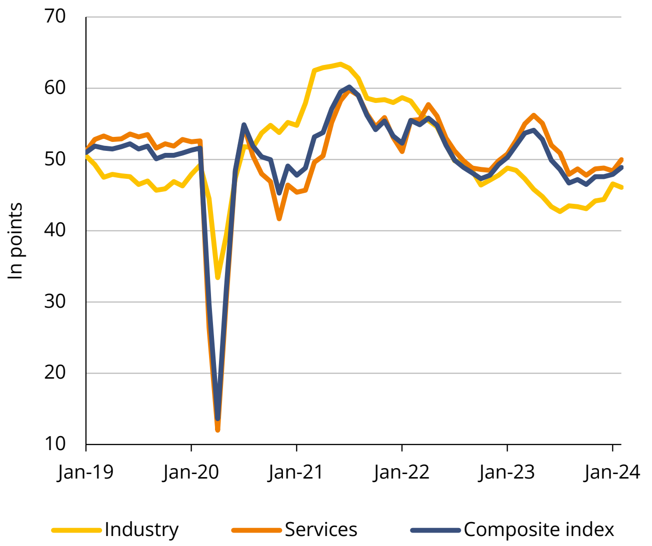
GDP in the eurozone continued to stagnate in the fourth quarter of 2023 (+0.0% over one quarter), in line with the trend witnessed over the previous four quarters. Over 2023 as a whole, the eurozone recorded growth of 0.5% compared to 2022 (a year which still benefited from the catching-up effects of the first three quarters). This weak growth (the historical average is close to +1.5% per year) is mainly due to high inflation and monetary tightening, which have considerably dampened the components of domestic demand (household consumption, public consumption and investment spending).

Significant differences persist between the main Member States. In the fourth quarter, Germany (the largest economy in the eurozone and Luxembourg's main trading partner) saw its GDP fall by 0.3% over the quarter, confirming its poor position on the European economic stage. In 2023, industry was the sector most affected by the economic downturn in the eurozone, and it has a particularly high weighting in the German economy[1]. While French industry held up better in 2023 (see January's Conjoncture Flash), overall activity in France has been treading water since the third quarter, negatively affected in particular by services (especially trade, transport and accommodation and food service activities) and construction. Spain posted the best results, with growth of 0.6% over one quarter in Q4, close to the figure recorded over the previous three quarters. The Spanish economy stands out for its private and public consumption spending, which remained buoyant in 2023 (the positive performance of the labour market has supported real wage growth).

A modest rise in activity in the euro area in 2024

In its latest forecasts (published in mid-February), the European Commission has revised downwards the growth forecast for the eurozone in 2024 to 0.8%[2] (compared with +1.2% in its forecasts of last November), partly as a result of a less favourable results than expected at the end of the year (the Commission had previously expected a growth rate of 0.2% in the fourth quarter). The latest results of the PMI survey (22 February) show that the composite activity index for the eurozone continues to rise, but at 48.9 points, the highest for eight months, it still indicates a slight contraction in activity (for services, the index has just reached the 50-point threshold, which corresponds to stabilisation).

PMI INDICES FOR THE EURO ZONE



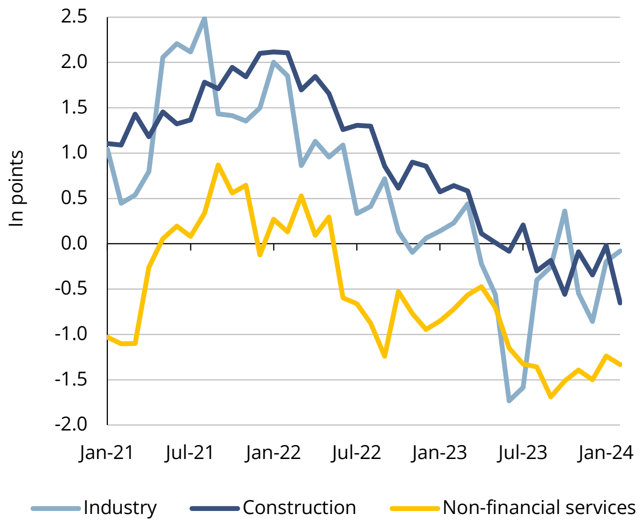
Sources: HCOB, S&P Global (latest data: Feb. 2024)

The Commission, like most forecasters, does not expect a significant economic recovery in the first half of this year, particularly given the burden of high interest rates on the financing capacity of households and businesses. The significant fall in inflation in the eurozone - back below 3% since October[3] - is an encouraging sign in this respect, as it supports the idea of an easing of monetary policy in the future. The question remains as to when (a priori around mid-2024) and at what pace. It also implies a catching-up of real wages which would support domestic demand (which will also influence the setting of monetary policy decisions). However, downside risks to business remain particularly (among the most imminent) the end of energy support measures, as well as persistent geopolitical tensions and the possible escalation of conflict in the Middle East. These factors are currently hampering maritime freight in the Red Sea (with longer delivery times and higher transport costs[4]).

[1] Industry accounts for around 25% of total value added in Germany, compared with just under 20% in the eurozone as a whole (data for 2022).
[2] STATEC also assumed growth of 0.8% for the eurozone in 2024 in its autumn 2023 forecasts (using the assumption provided by Oxford Economics, which has since been revised downwards to 0.6%).
[3] It reaches 2.8% in January 2024.
[4] The European Commission indicates that, according to several studies, the rise in these costs could lead to an inflation surplus of around 0.2 to 0.3 percentage points for the EU.

Activity

BUSINESS CONFIDENCE INDICATORS IN LUXEMBOURG



Source: STATEC calculations (seasonally adjusted data, standardised, latest data Feb. 2024)

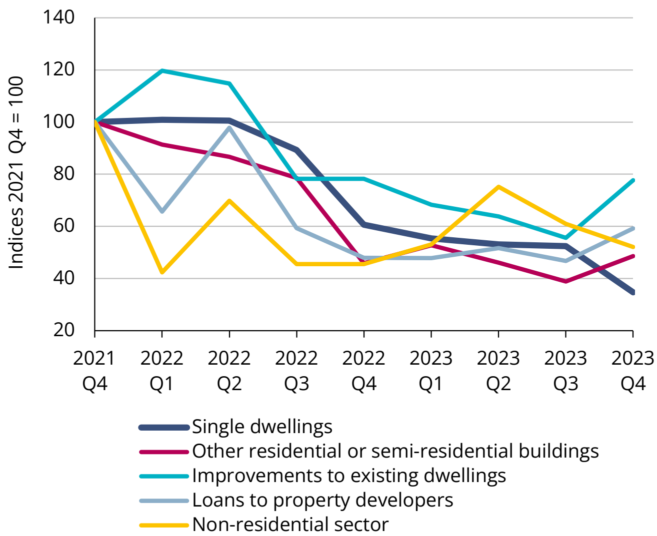
Has the decline in confidence come to an end?

Business confidence in Luxembourg has deteriorated sharply since the spring of 2022 (and the start of the war in Ukraine) and this trend has continued throughout the first half of 2023. In industry, as in the eurozone as a whole, business sentiment has been trending upwards since last summer, benefiting from more favourable opinions on the outlook for production and the state of order books (particularly in the metalworking sector). The employment outlook for manufacturers seems at least to have stopped deteriorating as we enter 2024, and could be heading towards a recovery. Confidence in non-financial services also seems to have reached a low point last September, and has since recovered slightly (including in transport services, information services and legal and accounting activities). However, it is still well below its long-term average (which corresponds to the zero-point threshold on the adjacent graph).

In the construction sector, business sentiment seemed to have stabilised somewhat since last autumn, but February's results show a downturn (with a fall in order books and employment prospects).

Real estate

NEW MORTGAGES IN LUXEMBOURG



Source: BCL (seasonally adjusted data)

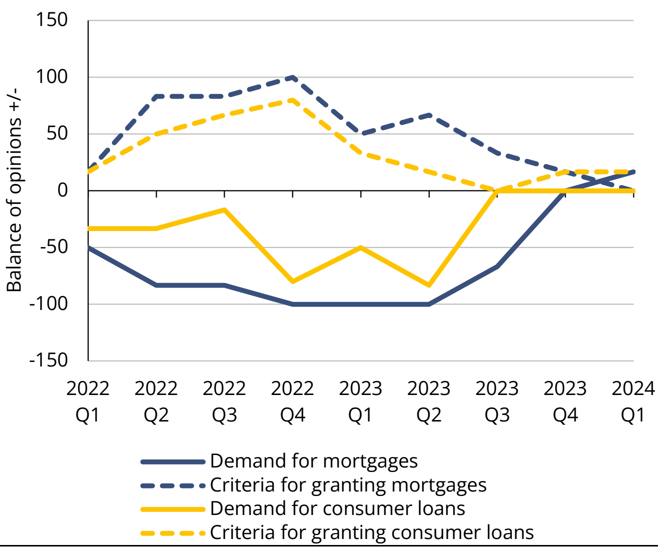
Mortgages continue to fall

New mortgages granted in Luxembourg fell again in the fourth quarter of 2023 (-14% year-on-year, -17% quarter-on-quarter on a seasonally adjusted basis). However, trends differ according to the type of property financed. Loans for single-family homes (houses or flats), which account for the majority of new mortgages, fell for the sixth consecutive quarter. This fall could be partly linked to an additional decline in sales prices (these are not yet known) and demand (the number of new loans fell by 37% year-on-year in the fourth quarter). The amount of new lending for single-family homes has thus reached its lowest level since 2013, while house prices are still much higher than they were at that time, despite their recent decline.

On the other hand, loans for residential property and improvements to existing homes rose again in Q4 (+25% and +40% quarter-on-quarter respectively), returning to their level of a year ago. Loans to property developers were also up (+27% over the quarter, +24% over the year). Lending to the non-residential sector, which recovered in the first half of 2023, has since fallen back.

Financial sector

BANK LENDING SURVEY IN LUXEMBOURG



Source: ECB (2024 Q1: expectations)

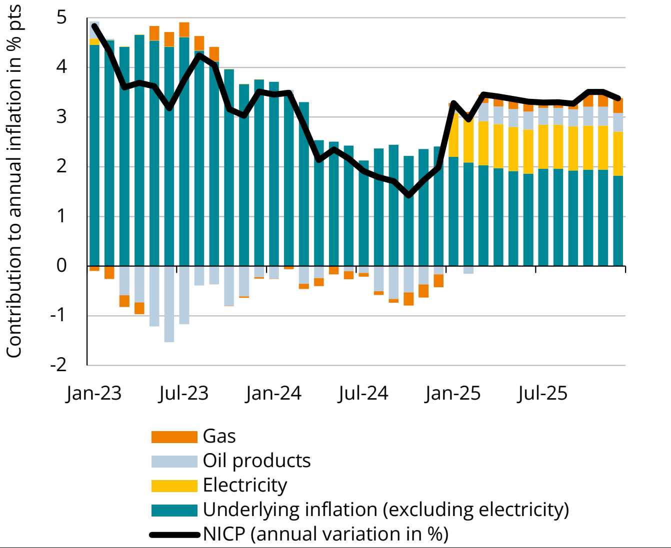
Better outlook for household loans in 2024?

Over the last two years, the European Central Bank's ten interest rate hikes have led banks to tighten their lending criteria and conditions. Over this period, interest rates have tripled for new home loans and doubled for consumer loans in Luxembourg and the eurozone. Since the last increase in key rates (September 2023), interest rates for households have stabilised at historically high levels.

Nevertheless, the outlook seems to be improving. According to the bank lending survey in Luxembourg, the seven major banks questioned indicated that, on average, they had refused fewer loans and would not be tightening their criteria for granting home loans any further in the coming months. They anticipate an upturn in demand for mortgages from the first quarter of 2024, while demand for consumer loans is likely to remain unchanged. Rates should remain more or less stable over the first half of the year and then start to fall with the expected reduction in key rates.

Inflation 1/2

INFLATION FORECASTS



Source: STATEC (forecast of 6 February 2024)

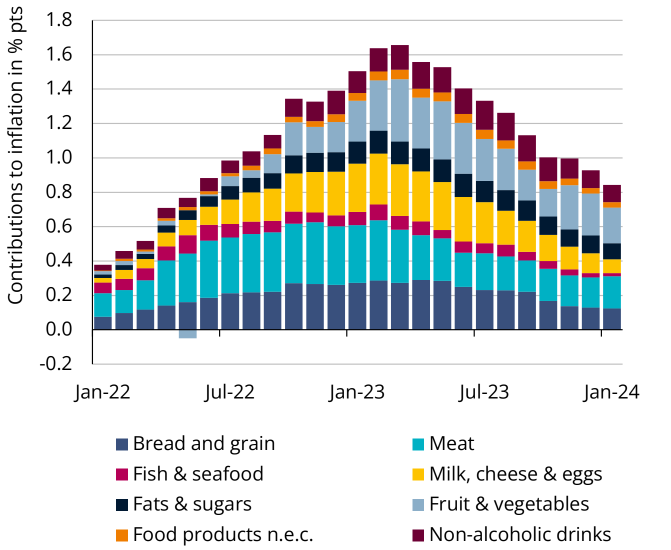
Inflation close to 2% in 2024

As in the eurozone, the slowdown in inflation in Luxembourg was stronger than expected at the end of 2023. STATEC has lowered its inflation forecast for this year to 2.2% (from 2.5% previously) and is expecting the next index bracket in the final quarter of 2024. In Luxembourg, government measures on energy prices introduced in 2022 and 2023 have kept inflation at a lower level than in the eurozone. In 2024, as in 2023, the price of gas paid by households will increase by no more than 15% compared with its value in September 2022, the price of electricity will not rise and the price of heating oil will be reduced by 15 euro cents per litre.

After the lifting of the tariff shields, scheduled for 1 January 2025, and in the absence of new measures, inflation should rebound and remain above 3% throughout next year (3.3% in 2025). This is mainly due to positive contributions from electricity and gas prices (+17% and +60% respectively). This forecast is a direct result of price trends on derivative markets and the supply strategies of energy suppliers in Luxembourg. It goes without saying that market price expectations are volatile, so the resulting forecasts for 2025 should be treated with caution. A new indexation would be triggered for the third quarter of 2025.

Inflation 2/2

CONTRIBUTION OF FOOD PRICES TO DOMESTIC INFLATION



Source: STATEC

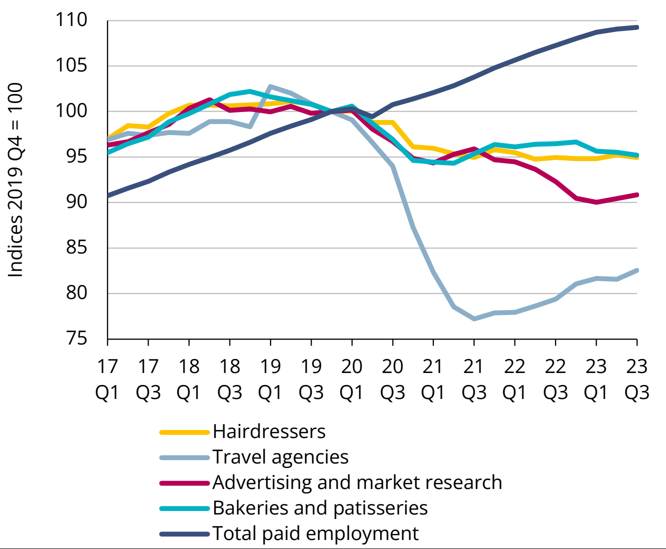
Food prices still nourish inflation

Food inflation is slowing. Food prices (excluding alcohol and tobacco) rose by 6.4% year-on-year in January, compared with 11.8% a year earlier. However, they still accounted for a quarter of inflation in January. This dynamic is fuelled mainly by fruit and vegetables, meat and grains. In the Grand Duchy, food products which have experienced the highest increases over the last two years (between Jan. 22 and Jan. 24) were: olive oil (+37%), butter (+32%), potatoes (+29%) and prepared sauces, vinegar and other condiments (+27%).

In its winter forecast, the European Commission shows that the surge in food prices in the eurozone was the result of higher energy prices and higher labour costs weighing on producer prices, while the contribution of agricultural import prices was relatively small. Most agricultural commodity prices, which had soared in the wake of climate disasters and various geopolitical crises, had more or less subsided by the turn of 2023/2024. Only world cocoa prices remain firmly on the rise (+70% year-on-year in January 2024), with Ghana and the Ivory Coast (60% of world cocoa production) having been affected by particularly unfavourable weather.

Labour market

TRENDS IN PAID EMPLOYMENT



Sources: IGSS, STATEC (seasonally adjusted data)

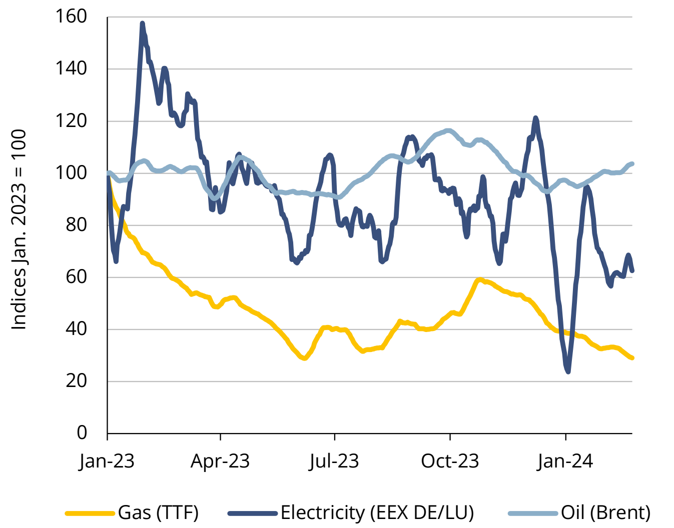
Certain businesses lastingly affected by crises

The Covid-19 pandemic led to a fall in employment in Luxembourg in the second quarter of 2020, but the workforce then began to grow again at a similar rate to before the crisis. However, developments in certain activities contrast negatively with this general observation: Covid-19 and the energy crisis caused by the war in Ukraine have led to a fracture of a much more lasting nature.

This is particularly true of hairdressing salons, bakeries and patisseries, where the crises seem to have altered consumer habits. In addition to the demand for their services, the shortage of labour could constitute a second constraint on employment in these professions (around -5% compared to the end of 2019). The advertising workforce is highly sensitive to the vagaries of the economic climate, as shown by the double dip observed since 2020 (almost -10% compared with the end of 2019). Travel agencies have suffered even more, with the workforce falling by more than 20% by mid-2022, although a mild recovery has occurred in the interim period. For all these activities, the workforce was on a clear upward trajectory over the five years preceding the pandemic.

Energy

SPOT PRICES FOR GAS, ELECTRICITY AND OIL



Sources: Macrobond (moving averages over 14 days)

Different trajectories for energy prices

After the energy crisis of 2022, Europe's energy markets experienced a disparate trajectory in 2023. Gas prices continued to fall, despite a temporary rebound in the autumn on fears that the Middle East conflict would spread. The easing of gas prices is largely attributable to a fall in consumption (-8% in the EU in 2023 after -14% in 2022) and the diversification of supply sources. However, the price of electricity has undergone a certain degree of decoupling from the price of gas, showing that during certain periods gas was no longer the means of electricity production with the highest marginal costs (but coal instead).

On the other hand, the price of oil has generally remained in the range of $70-90 per barrel. Despite the recent unrest in the Red Sea, the price of black gold has been held down by record production in the United States, which exceeded 20 million barrels per day, and by slower-than-expected global growth. In response, the OPEC+ countries cut their production several times.

Dashboard

	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	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	-7.1	-6.4	-6.6	-5.3	-10.1	-3.8	-5.0	...	...	-6.3	-1.0
Construction output per working day, in volume	-2.6	-0.5	-1.2	6.7	-2.9	-1.9	-5.8	...	...	-3.5	-0.2
Turnover by volume of total retail trade	-3.0	3.1	-1.6	-2.5	-4.2	-0.2	-0.6	...	...	-1.7	-0.2
Prices, wages											
Consumer price index (NCPI)	3.6	3.2	3.7	4.2	4.0	3.2	3.0	3.5	3.4	3.3	5.4
Underlying inflation	4.8	4.7	4.9	4.5	4.3	4.2	3.9	4.0	4.0	4.0	4.8
Oil product index	-13.9	-17.4	-12.8	-1.3	-0.6	-10.8	-9.2	-4.4	-4.4	-6.1	13.3
Industrial producer price index	-1.4	-3.8	1.8	1.5	1.5	-2.5	-1.9	-1.4	...	-2.0	20.8
Construction price index[1]	12.3	12.3	9.3	9.3	9.3	6.4	6.4	6.4	...	6.4	15.9
Average wage bill, per person (National accounts)	6.8	6.8	7.0	7.0	7.0	...	...	...	...	7.0	6.0
Foreign trade											
Exports of goods (volume)	-5.4	-0.2	4.8	-3.3	-1.3	2.6	-0.3	-5.3	...	-0.9	-5.2
Imports of goods (volume)	1.0	2.4	-1.4	2.3	-2.6	-1.2	-3.1	-5.7	...	-3.3	-15.2
Employment, unemployment											
Domestic number of employees	2.4	2.2	1.9	1.9	1.7	1.7	1.5	1.4	1.4	1.4	3.1
National employment	2.1	1.9	1.7	1.5	1.5	1.5	1.4	1.3	1.2	1.3	2.3
Unemployment rate (% of working population, seas. adj.)	5.1	5.2	5.2	5.3	5.5	5.5	5.7	5.5	5.5	5.6	4.9

Source: STATEC
seasonally adjusted, quarterly national accounts
[1] Estimates based on half-yearly data

Indicators

	2022 Q3	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4
	% change on previous quarter					
Eurozone - Real GDP growth (European Commission)	0.5	-0.1	0.1	0.1	-0.1	0.0
Luxembourg - Real GDP growth (STATEC)	0.2	-2.3	0.9	-0.2	-0.1	-

	2019	2020	2021	2022	Forcecast 2023	Forecast 2024
	Annual variation in %					
Luxembourg - Real GDP growth (STATEC)	2.9	-0.9	7.2	1.4	-1.0	2.0

GDP at current prices (2022)

EUR **77 529** million

Minimum monthly wage (01/09/2023)

EUR **2 570.93**

Next scheduled wage indexation:
Q4 2024

Consumer price index (01/2024)

991.89

Index half-yearly average:
998.80

Current account balance (Q3 2023)

EUR **2 687** million

Resident population (01/01/2023)

660 809

STATEC

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