# CONJONCTURE FLASH

Economy and prices

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

# HIGH INTEREST RATES WEIGH ON BUSINESSES

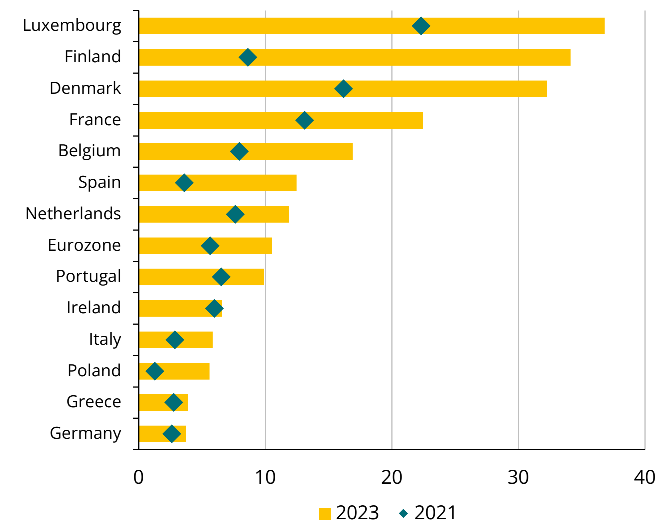
**High interest rates weigh heavily on the expenses of non-financial companies, the availability of credit and investment. Demand for credit and outlook for investment remain weak at the start of 2024. Investment should pick up again in 2025 due to a fall in key rates and a recovery in demand.**

Financing conditions have become particularly tight since the summer of 2022, and despite the modest reduction in key rates in June (-0.25 percentage points), monetary policy remains restrictive. The average interest rate on outstanding loans of enterprises stabilised in the first four months of 2024 at 4.4% in Luxembourg (compared with 4.0% in the eurozone). These high rates affect businesses in two ways : interest charges on outstanding loans have risen and the supply of credit has been restricted, weighing doubly on investment projects.

Luxembourg companies paid almost EUR 2 billion in additional interest charges between 2021 and 2023 (+62%). This interest paid by companies accounted for more than a third of their gross operating surplus in 2023 (+15% points compared with 2021), which is much higher than in the other countries of the European Union[1]. This sharp rise in the proportion of interest paid in Luxembourg is largely explained by the fall in gross operating surplus (-2% between 2021 and 2023 in Luxembourg, compared with +15% in the eurozone), while interest charges have risen sharply in all eurozone countries (+115% overall). The sectors that would have paid the most interest include real estate, administrative and support services and construction[2]. In the construction sector, half of all businesses regularly turn to banks for funding, and consider financing conditions as a major challenge, according to the latest Barometers of the Economy from the Chamber of Commerce.

According to the bank lending survey in Luxembourg (and in line with the trend in the eurozone), banks have seen a fall in demand for loans since the first rate rise in July 2022. This fall is mainly attributed to the high level of interest rates and a reduction in investment projects. The outlook for loan applications remains gloomy in Q2 2024, both in Luxembourg and in other European countries. Lending conditions for business loans have been tightened considerably as interest rates have risen. Banks in Luxembourg and other eurozone countries have demanded more collateral, raised fees and margins, and rejected more financing requests. This fall in the supply and demand for bank loans is reflected in the new loans granted to businesses, the amounts of which have collapsed (-12% over one year in 2022, -40% in 2023, -45% in Q1 2024).

**INTEREST PAID BY COMPANIES (AS A % OF GROSS OPERATING SURPLUS)**




Sources: Eurostat, STATEC

## Fall in investment

Real investment by non-financial companies in Luxembourg fell by 2.5% in 2022 and by 6.0% in 2023. Luxembourg's investment rate has been among the lowest in the eurozone since 2015, mainly due to the small share of industry (which is more capital-intensive) in the country's activity[3]. In 2023, the investment rate was 14% in Luxembourg (compared with 23% in the eurozone), well below its level before the pandemic (19%, compared with 25% in the eurozone). Real investment in non-residential construction fell by 14% year-on-year in Q1 2024 (after -2.4% year-on-year in 2023), compared with -0.4% in the eurozone. Investment in machinery and equipment fell more sharply in Q1 2024 (-26% year-on-year in Luxembourg, -1.4% in the eurozone).

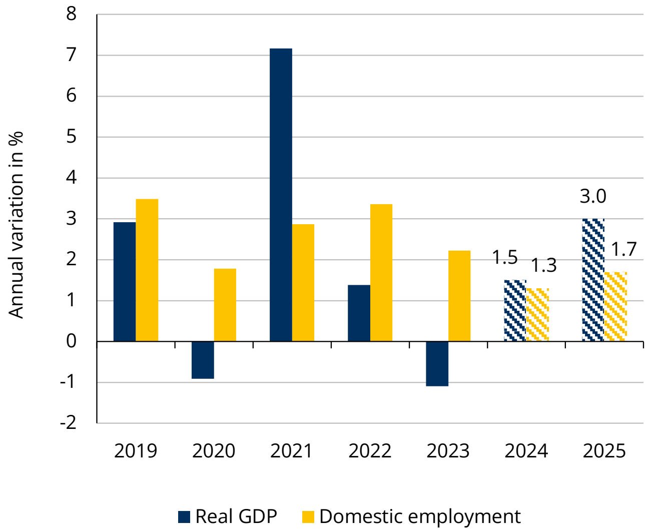
The European Commission's business survey[4] highlights a fall in investment intentions in 2024 among service and industrial companies in Luxembourg and the eurozone. STATEC forecasts a recovery in investment in 2025 thanks to lower key interest rates. Corporate interest charges in Luxembourg should fall by around EUR 600 million between 2023 and 2025 (-12%, compared with -10% in the eurozone).

[1] National accounts estimates of gross operating surplus are provisional and subject to revision. Furthermore, the historically higher proportion of interest charges to gross operating surplus in Luxembourg than in the eurozone can be explained by the large proportion of multinational companies that are financed in Luxembourg but contribute relatively less to activity, and by intra-group debts.
[2] See study 7.2 in the Note de conjoncture 1-2024.
[3] Industry accounts for around 5% of total GVA in Luxembourg (versus 20% in the eurozone).
[4] See European Economic Forecast, Spring 2024 (pp.45-46).

STATEC

## Activity 1/2

GDP AND EMPLOYMENT IN LUXEMBOURG




Source: STATEC (2024-2025 forecasts)

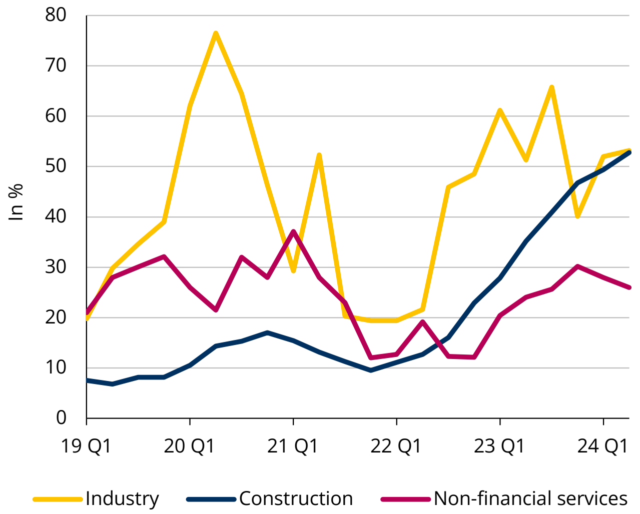
## Slight expansion in 2024

According to the latest STATEC forecasts (published on 19 June in the Note de conjoncture 1-24), Luxembourg's real GDP is set to rise by 1.5% this year, before strengthening to +3.0% in 2025. After a slight recession in 2023, the recovery in activity is likely to be moderate in 2024, against a backdrop of investment weakened by persistently high interest rates and sluggish exports. The expected easing of monetary policy (the first cut in key rates took place at the beginning of June) should further stimulate domestic and foreign demand next year. However, it will be determined by inflationary trends over the coming months.

Employment, which always lags GDP to some extent, should continue to slow in 2024. It is forecast to increase by just 1.3% over the year as a whole, a historically low rate for Luxembourg. In 2025, employment is forecast to rise by 1.7%. However, this increase in the workforce would not be enough to bring the unemployment rate down (it would reach 5.9% in 2025, after 5.2% in 2023 and 5.8% in 2024).

## Activity 2/2

PERCENTAGE OF COMPANIES REPORTING INSUFFICIENT DEMAND




Source: STATEC (economic surveys)

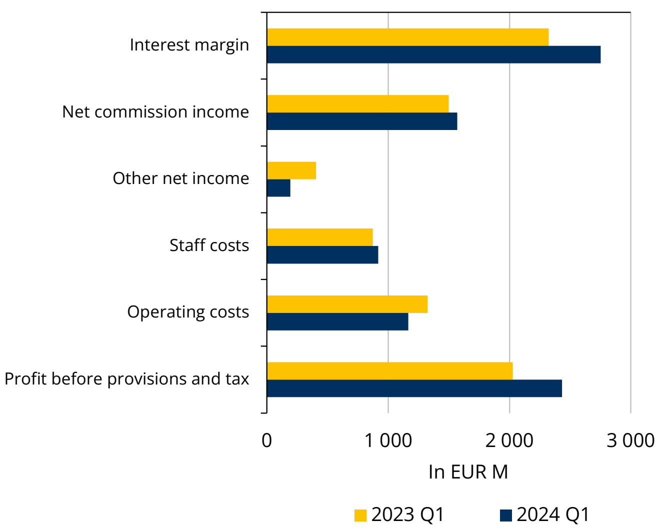
## Lack of demand

Demand remains a major problem for companies. In industry and construction, half of the companies surveyed in Q2 indicate that the lack of demand is weighing on their business. This proportion has fallen slightly in industry (compared to the start of 2023), but continues to rise in construction. In (non-financial) services, around 25% of respondents are still experiencing insufficient demand in Q2 (after peaking at 30% at the end of 2023). These results reflect the business confidence indicators, which have been improving in recent months in industry and services, but which continue to deteriorate in construction.

In recent quarters, fewer companies have reported recruitment difficulties (which were particularly high in mid-2022). But it would be wrong to interpret this data as a purely positive phenomenon, since hiring intentions have also fallen sharply (as reflected by the marked slowdown in employment).

## Financial sector

PROFIT AND LOSS ACCOUNTS FOR BANKS IN LUXEMBOURG




Source: CSSF

## Sustained growth in bank earnings

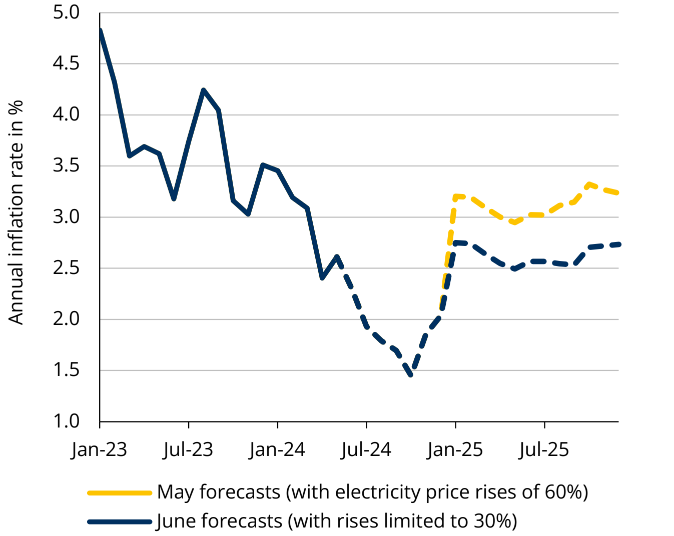
In Q1 2024, earnings in Luxembourg's banking sector rose by 20% year-on-year, driven by continued strong growth in interest margins (+19%), as well as an increase in net commissions (+5%) and a reduction in costs (-5% overall, -12% excluding staff costs). According to the CSSF, the fall in costs is mainly due to the banks' contributions to the Single Resolution Fund.

At current prices, value added in the banking sector is up by 11% year-on-year, according to initial estimates from the national accounts. Excluding price effects linked to high interest rates and asset valuation effects, real value added stabilised between the last quarter of 2023 and the first quarter 2024. Banking assets linked to households and non-financial businesses are also stabilising, after declining throughout 2023.

For the financial sector as a whole, real value added recovered slightly in Q1 (+1.3% over one quarter, after -1.6% in the final quarter of 2023). There has been a recovery in net commissions and fund management assets, as well as a rebound in life insurance premiums.

## Inflation

**INFLATION FORECASTS**




Source: STATEC (forecast from early June 2024)

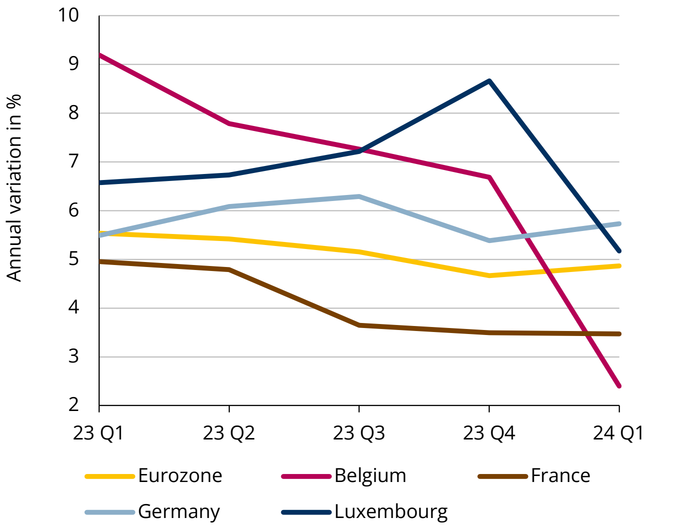
### Less inflation than expected in 2025, thanks to the extension of the tariff shield

According to the latest STATEC forecasts, inflation in Luxembourg should average 2.3% this year, before rising to 2.6% in 2025. This represents a downward revision of 0.5 percentage points for next year compared with the May 2024 forecast. The latter still assumed that tariff shields would be completely removed from January 2025 onwards. Following the government's announcements, current forecasts include a limit on the rise in electricity prices of +30% in 2025, compared with +60% previously. Gas prices are set to rise by 17%, as a result of the end of the reimbursement of network costs and the increase in the $CO_2$ tax. The next index bracket would take place in Q4 of this year, then in Q4 of next year (one quarter later than in the previous forecast).

For the eurozone, most forecasts predict inflation of just over 2% in 2024 and 2025. For 2024, they fall within a narrow range of 2.3% (Oxford Economics) to 2.5% (European Commission and ECB). For 2025, inflation forecasts range between 1.4% (Oxford Economics) and 2.2% (OECD and ECB).

## Wages

**COMPENSATION PER EMPLOYEE**




Sources: Eurostat, STATEC

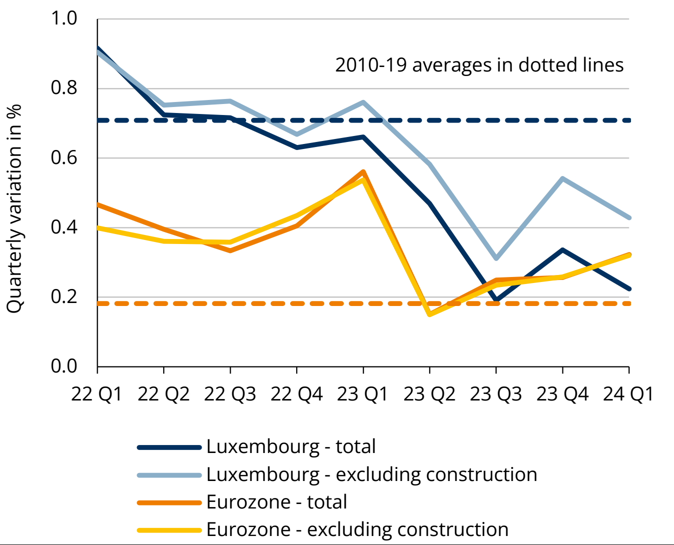
### Labour costs starting to slow in Luxembourg

In Luxembourg, compensation per employee (CPE) slowed considerably in Q1 2024 (+5.2% year-on-year), after rising throughout 2023 (+8.7% in Q4). On the one hand, employer contributions have been reduced in 2024 to compensate for payments linked to the last index bracket, which has a negative impact of close to 1 percentage point on CPE growth. On the other hand, the impact of indexation is only 5.9 percentage points in Q1 2024, after 7.7 percentage points at the end of 2023. This trend should continue in Q2, with the indexation having an impact of just 2.5 points (as only the September 2023 index bracket will still affect annual CPE growth).

After a slowdown in 2023, labour costs in the eurozone accelerated slightly in Q1 2024. This movement is mainly due to non-market sectors, where wages had tended to slow in previous quarters. In most other sectors, however, CPE continues to slow down. Over the year as a whole, CPE in the eurozone should rise by 4.2% according to the European Commission, which is more than the 2.6% forecast by STATEC for Luxembourg.

## Labour market

**INFLATION TRENDS IN LUXEMBOURG AND THE EUROZONE**




Sources: Eurostat, STATEC (seasonally adjusted data)

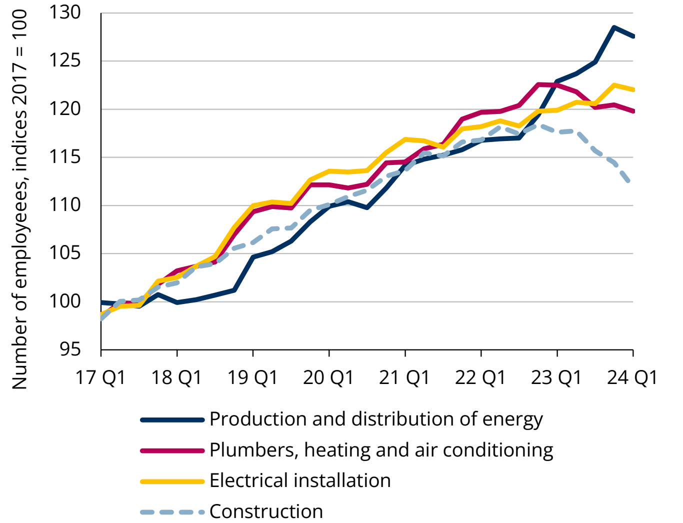
### Construction takes a heavy toll on employment in Luxembourg

During the second half-year of 2023 and Q1 2024, employment growth in Luxembourg was similar to the one of the eurozone, whereas over the last decade, the differential in favour of Luxembourg was around 0.5 percentage points per quarter. Poor results in the construction contribute greatly to this. While employment in construction slowed in the eurozone last year (+1.5% in 2023, after +3.2% in 2022), Luxembourg is one of the three Member States where employment in this sector fell in 2023 (-0.9% in Luxembourg, -0.1% in Austria and -7.1% in Finland).

In Q1 2024, employment growth weakened further in Luxembourg, while it strengthened in the majority of eurozone countries. The recovery in the European average is constrained by the sluggishness of employment in the heavyweights - Germany and France - where growth remained anchored at around +0.1% over one quarter (+0.2% for Luxembourg, +0.3% for the eurozone on average). Employment growth in Luxembourg fell to 0.8% year-on-year in May (preliminary monthly data), the lowest level since the 2009/2010 crisis (excluding COVID).

## Energy

**EMPLOYMENT IN SECTORS LINKED TO THE ENERGY TRANSITION**




Sources: IGSS, STATEC (seasonally adjusted figures)

### Employment remains buoyant in sectors linked to the energy transition

Despite the pronounced slowdown in employment, the workforce in sectors linked to the energy transition remained buoyant. With an increase of 8%, employment in the energy production and distribution sector accelerated sharply. This positive trend is undoubtedly associated with the expansion of electricity production in Luxembourg and the corresponding development of the grid. However, this positive trend was interrupted at the beginning of 2024.

While employment in construction fell sharply in 2023, certain sub-sectors related to energy transition performed better. In particular, employment among electrical contractors grew favourably in 2023. After a sharp fall at the start of 2023, plumbers and heating engineers have managed to stabilise their workforce at the turn of 2024.

## Dashboard

| | Sep-23 | Oct-23 | Nov-23 | Dec-23 | Jan-24 | Feb-24 | Mar-24 | Apr-24 | May-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 | -9.9 | -3.7 | -5.5 | -1.6 | -4.2 | -7.8 | -0.9 | ... | ... | -4.2 | -4.5 |
| Construction output per working day, in volume | -3.6 | -1.7 | -6.0 | 5.1 | -6.2 | -7.8 | -4.3 | ... | ... | -6.1 | -4.6 |
| Turnover by volume of total retail trade | -1.2 | 1.1 | -0.4 | -0.5 | -2.7 | 2.4 | 1.3 | 3.1 | ... | 2.3 | -3.5 |
| **Prices, wages** | | | | | | | | | | | |
| Consumer price index (NCPI) | 4.0 | 3.2 | 3.0 | 3.5 | 3.5 | 3.2 | 3.1 | 2.4 | 2.6 | 2.7 | 3.6 |
| Underlying inflation | 4.3 | 4.2 | 3.9 | 4.0 | 4.0 | 3.4 | 3.2 | 2.4 | 2.5 | 2.7 | 4.8 |
| Oil product index | -0.6 | -10.8 | -9.2 | -4.4 | -4.4 | 1.1 | 1.0 | 3.5 | 4.2 | 2.9 | -12.9 |
| Industrial producer price index | 1.5 | -2.4 | -1.4 | -1.6 | -2.6 | -1.0 | -0.7 | 0.4 | ... | -0.4 | 8.3 |
| Construction price index[1] | 9.3 | 6.4 | 6.4 | 6.4 | 3.9 | 3.9 | 3.9 | ... | ... | 3.9 | 14.1 |
| Average wage bill, per person (National accounts) | 7.2 | 8.7 | 8.7 | 8.7 | 5.2 | 5.2 | 5.2 | ... | ... | 5.2 | 6.6 |
| **Foreign trade** | | | | | | | | | | | |
| Exports of goods (volume) | -0.7 | 5.1 | -0.4 | -7.9 | -0.3 | 1.3 | -8.4 | ... | ... | -2.8 | 1.0 |
| Imports of goods (volume) | -2.1 | 4.8 | 2.6 | -0.1 | 8.8 | 6.5 | -13.5 | ... | ... | -0.8 | -0.8 |
| **Employment, unemployment** | | | | | | | | | | | |
| Domestic number of employees | 1.7 | 1.6 | 1.5 | 1.5 | 1.3 | 1.1 | 1.0 | 0.9 | 0.7 | 0.9 | 2.6 |
| National employment | 1.5 | 1.5 | 1.4 | 1.3 | 1.1 | 0.9 | 0.9 | 0.8 | 0.7 | 0.8 | 2.2 |
| Unemployment rate (% of working population, seas. adj.) | 5.5 | 5.5 | 5.7 | 5.5 | 5.6 | 5.6 | 5.6 | 5.6 | 5.7 | 5.7 | 5.0 |

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

## Indicators

| | % change on previous quarter | | | | | |
|---|---|---|---|---|---|---|
| | **2022 Q4** | **2023 Q1** | **2023 Q2** | **2023 Q3** | **2023 Q4** | **2024 Q1** |
| Eurozone - Real GDP growth (European Commission) | 0.0 | 0.0 | 0.1 | -0.1 | -0.1 | 0.3 |
| Luxembourg - Real GDP growth (STATEC) | -1.3 | 0.3 | 0.3 | -1.3 | 0.0 | 0.5 |
| | Annual variation in % | | | | | |
| | **2020** | **2021** | **2022** | **2023** | **Forecast 2024** | **Forecast 2025** |
| Luxembourg - Real GDP growth (STATEC) | -0.9 | 7.2 | 1.4 | -1.1 | 1.5 | 3.0 |

GDP at current prices (2023)

EUR **79 310** million

Minimum monthly wage (01/09/2023)

EUR **2 570.93**

Next scheduled wage indexation:
**Q4 2024**

Consumer price index (05/2024)

**1012.86**

Index half-yearly average:
**1004.46**

Current account balance (Q1 2024)

EUR **1 717** million

Resident population (01/01/2024)

**672 050**

STATEC

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