CONJONCTURE FLASH

Économie et prix

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

SLOWDOWN IN THE UNITED STATES, ONSET OF RECOVERY IN THE EUROZONE

In 2023, the United States experienced a much stronger upturn in economic activity than the eurozone. This tendency will certainly continue throughout 2024. However, at the start of the year, the US economy seemed to have run out of steam while signs of a recovery emerged in the eurozone.

Since mid-2022, the US economy has expanded strongly, in stark contrast to the near-stagnation in the eurozone. Over 2023 as a whole, the United States witnessed GDP growth of 2.5%, compared to only 0.5% for the countries of the European Monetary Union. Nevertheless, both areas encountered high inflation in 2022 and 2023[1] and, in response, a significant tightening of monetary policy[2].

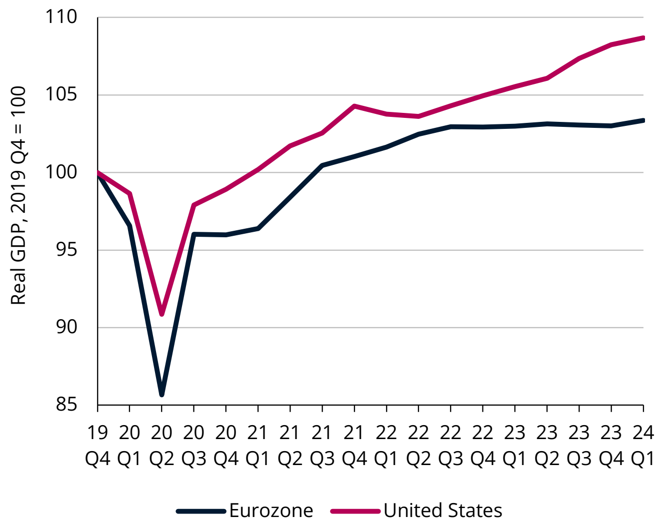
A number of factors have contributed to the resilience of business activity in the United States over the past year. Household consumption remained buoyant (+2.2%, compared with just +0.6% in the eurozone), supported in particular by the fact that American households drew more heavily on their savings. Public consumption and investment expenditure also rose substantially (+4.1%). The contribution of foreign trade was also higher, driven specifically by the rise in exports (+2.6%, compared with -1.0% in the eurozone). Alongside the increase in public spending, US fiscal policy has also orchestrated a reduction in taxes for households and businesses, ultimately propelling the budget deficit to an extremely high level, equivalent to -8.4% of GDP in 2023[3], after -4.0% in 2022.

Changing dynamics at the start of 2024

According to most of the forecasts published recently, US growth should still be hovering around 2.5% this year, which is again much higher than in the eurozone (where it is likely to be around 0.8%). However, this difference is largely due to the respective profiles of GDP in 2023 - rising throughout the year in the United States, while flat in the eurozone - resulting in a much more favourable carry-over[4] in the United States (by around 1.5 percentage points).

In a climate where core inflation (excluding energy and food) remains relatively elevated in the US (in contrast, it has fallen sharply in the eurozone over the past few months) the prospect of a forthcoming interest rate cut has receded in the US. In the eurozone, the first interest rate cut is expected at the end of the second quarter of this year. Nevertheless, signs of a cooling in activity could tip the balance in the other direction. The US economy slowed significantly in Q1 2024, with GDP increasing by merely 0.4% over a quarter (compared with +0.8% on average per quarter in 2023).

GDP - EUROZONE VS. UNITED STATES



Source: Eurostat

This slowdown is in line with the decrease in public spending, a slower rise in inventories and a deterioration in the external balance. Private consumption has also reduced slightly but remains buoyant. Business surveys are sending out mixed signals: on the one hand, the ISM manufacturing and services indices fell back into contraction territory in April, while on the other hand, the PMI indices remain in expansion territory (with a particularly sharp rise in services in May). Job creation, meanwhile, fell sharply in April (to its lowest level in six months).

In contrast, GDP rose by 0.3% over a quarter in the eurozone, the strongest growth since six quarters, echoing the more positive findings from the business surveys (see April's Conjoncture Flash). Few details are yet available on the composition of this recovery, but it appears to be a quite generalised trend across all Member States (benefiting in particular the four leading countries of the eurozone).

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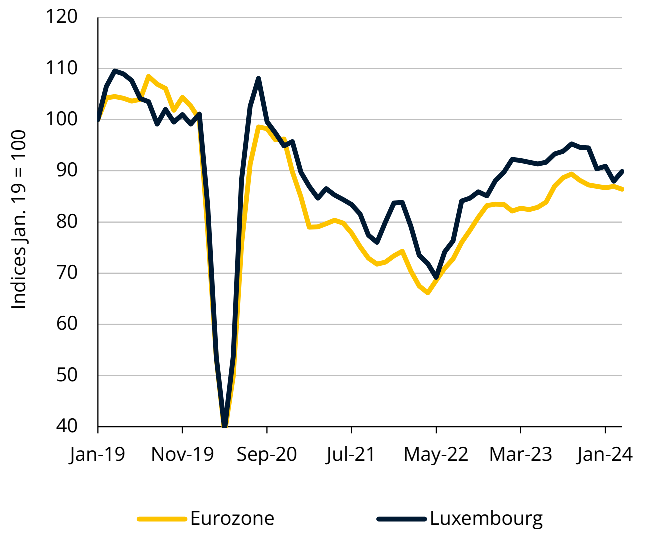
[1] Consumer prices rose by 8.0% in 2022 and 4.1% in 2023 in the United States, increases similar to those in the eurozone (+8.4% in 2022 and +5.4% in 2023).
[2] The main key interest rates have been raised by 525 basis points in the United States (between March 2022 and July 2023) and by 450 basis points in the eurozone (between July 2022 and September 2023).
[3] In the eurozone, the budget deficit will be -3.6% in 2023.
[4] The carry-over corresponds to the change in GDP for the current year, assuming that it stabilises at its last observed level over the remaining quarters of the year.

Consumption

NEW REGISTRATIONS OF PRIVATE CARS



Sources: ACEA, SNCA, STATEC (seasonally adjusted series, smoothed over three months)

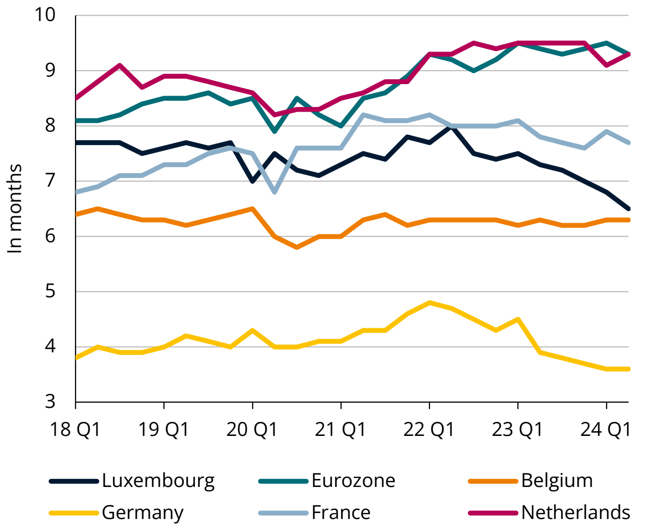
Car sales running out of gas

New car registrations rose sharply in 2023 (+16.8% in Luxembourg, +14.5% in the eurozone), driven by a recovery in supply, which had been hampered in 2021 and 2022 by supply chain issues for certain materials and components. However, registrations have been on a downward trend since the end of last year, which continues in the first few months of 2024 (with a relatively sharper fall in Luxembourg). The European Automobile Manufacturers' Association partly attributes this decline to the reduction in subsidies for electric vehicles, particularly in Germany and France (in Luxembourg, the subsidies currently in force will remain in place until the end of June). Dealers are also reporting that consumers are taking a wait-and-see attitude towards switching to electric vehicles.

Although automotive industrial production in the eurozone also rose last year (+11%), it has tended to decline in recent months. In the first quarter of 2024, it fell by 3.6% over one quarter (-8.3% over one year), and business surveys reveal growing pessimism among automotive manufacturers.

Construction

DURATION OF ASSURED ACTIVITY IN CONSTRUCTION



Source: European Commission

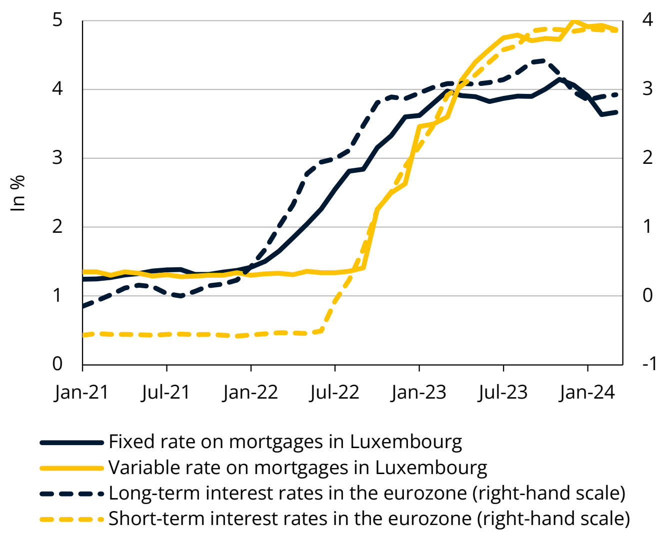
Reduced visibility on activity

The duration of assured activity, reflecting the time taken by ongoing and already contracted work, is indicated by construction companies in business surveys. In Luxembourg, this duration has fallen sharply, by around 1.5 months since mid-2022. Germany has witnessed a similar decline, while France experienced a more limited decrease. The stabilisation in the eurozone is due in particular to positive trends in Spain and Italy (where generous subsidies have stimulated housing renovation), which have offset the falls seen in Germany and France.

The decline in the duration of assured activity indicates that there are fewer and fewer new projects replacing those that are coming to an end. Meanwhile, after stabilising somewhat at the turn of the year, opinions with regard to order books fell sharply again in April. In the same month, more than 50% of construction companies in Luxembourg reported insufficient demand, far more than in neighbouring countries and the eurozone. This has repercussions on the sector's employment prospects, which continue to deteriorate in Luxembourg (while they appear to have bottomed out in the eurozone).

Financial environment

RATES ON NEW MORTGAGES AND MARKET RATES



Sources: BCL, BCE (seasonally adjusted data)

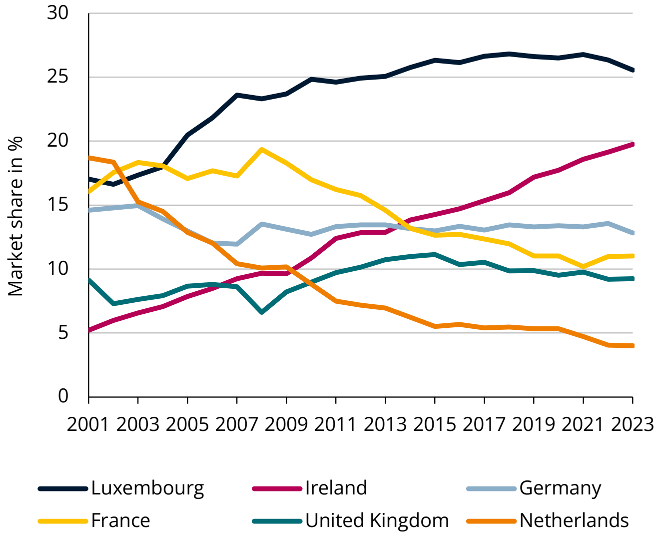
Fixed rates ease, variable rates stabilise

In March, the average rate applied to new variable-rate mortgages was 4.9% (+1.2 percentage points over one year), while the rate for fixed-rate mortgages was just 3.7% (-0.3 percentage points). These divergent trends can be explained by the fact that variable and fixed rates are determined by different market rates. Variable rates depend on short-term rates (one to three months) which are affected by key rates. Fixed rates depend on long-term government bond rates, which are influenced by supply and demand for these securities.

Long-term rates have risen since the beginning of 2022, due to the growing risks associated with the energy crisis and investors' expectations of a rise in key rates. Since the end of 2023, the improved outlook for activity in the eurozone and expectations of monetary easing have led to a fall in long rates and fixed rates on new mortgages. Variable and short-term rates began to rise in July 2022 when the ECB raised its key rates. They have stabilised since autumn 2023 and should fall from June 2024 given the expected key rate cuts. In March 2024, fixed-rate loans accounted for 65% of new loans granted in Luxembourg.

Financial sector

NET ASSETS OF INVESTMENT FUNDS DOMICILED IN EUROPE



Source: EFAMA (end-of-year data)

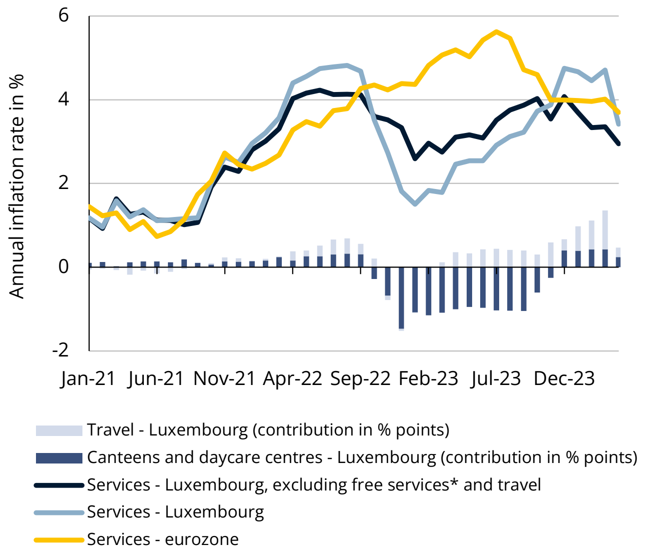
Smaller market share for funds from Luxembourg

The assets of Luxembourg-domiciled investment funds grew slightly in 2023 (+5% year-on-year) after falling by 14% in 2022. Average growth in Luxembourg over the last 20 years has been 10% a year. The last two years have been characterised by negative net asset issuance, meaning that redemptions exceeded issuance. The other European fund industries almost all displayed much stronger growth in 2023, with the exception of Germany, Denmark, Norway and Malta. Although Luxembourg continues to account for the majority of investment fund assets under management in Europe, its market share has slightly declined since 2021 (-1% point).

As of 2015, Ireland has established itself as the second largest domicile for funds in Europe and has firmly positioned itself as the largest domicile for index funds (ETF). These contributed 60% of the growth in net issuance in Europe in 2023. Ireland has increased its market share the most (+1.2 % points since 2021), followed by France (+0.8 % points), Switzerland, Italy, Turkey and Spain (+0.2 % points) and Liechtenstein (+0.3 % points). On the other hand, the Netherlands lost 0.7 % points of market share, Germany and the UK 0.5 % points and Denmark 0.3 % points.

Inflation

SERVICES INFLATION



Sources: STATEC, Eurostat. *Partially free services for Luxembourg: public transport, school canteens and daycare centres.

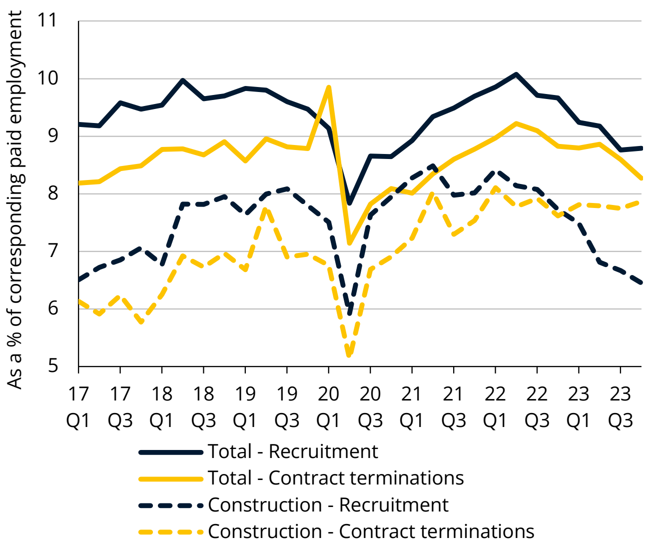
Services inflation slows down

Annual service inflation reached 3.4% in April (compared to 4.7% in March). This sharp slowdown reflects the reduced impact of the indexations from 2023. In fact, only the index bracket from September 2023 still has an impact on annual inflation in April.

In recent quarters, however, other factors have had an impact on the price of services in Luxembourg, notably the fact that certain public services are free. For example, school canteens and daycare centres have been (partially) free since the start of the 2022 school year, pulling service inflation down sharply in 2023 (by around 1 percentage point in annual variation), an impact that faded by the end of 2023. Free public transport, which has been in place since March 2020, no longer has a direct impact on the price of services in 2023, but as transport prices have risen substantially in the eurozone because of the energy crisis, the service inflation in Luxembourg is lower than in the eurozone. At the turn of the year 2023 to 2024, it was above all air travel that boosted service prices. Without these two elements, the slowdown in services inflation would be much more evident. In the eurozone, inflation in services also fell sharply, reaching 3.7% in April (compared with 5.2% a year earlier).

Labour market

RECRUITMENT AND CONTRACT TERMINATIONS



Sources: IGSS, STATEC (seasonally adjusted data)

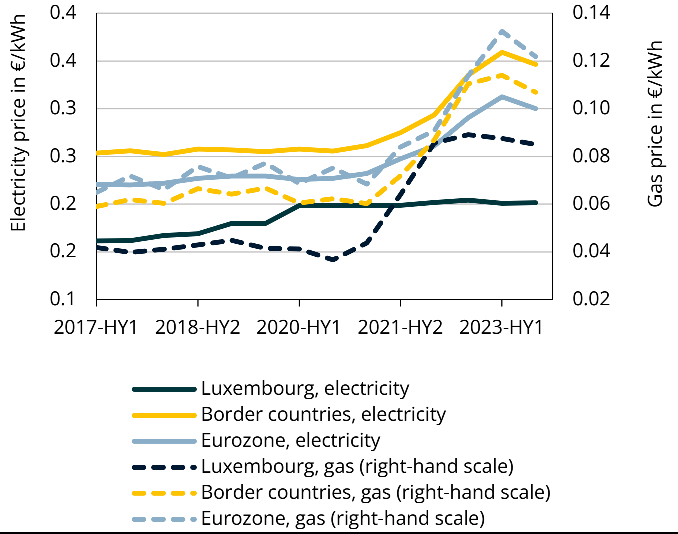
Less activity on the labour market

The economic slowdown which has been ongoing since 2022 has been accompanied by a sharp drop in recruitment (-6.7% in 2023). On the other hand, contract terminations, which are historically strongly correlated with recruitment, only fell by 2.2% last year. This smaller gap between new hires and contract terminations implies a fall in net job creation. As a result, paid employment has slowed from +3.4% in 2022 to +2.1% in 2023. The turnover rate - the ratio between the average (new hires, contract terminations) and total paid employment - has fallen to its lowest level since 2015 (excluding 2020, the first year of the COVID pandemic), which penalises new workers entering the labour market (+18% of unemployed people under 30 in 2023).

Alongside business services (including temporary work), construction is the biggest contributor to this fall in turnover. Contract terminations in construction have stabilised since 2022 at a relatively high level (compared to the pre-crisis COVID period), while recruitment has fallen by 16% in 2023. Since the start of 2023, the latter have been lower than contract terminations (and the gap continues to widen), resulting in a 1% fall in the construction workforce in 2023.

Energy

GAS AND ELECTRICITY CONSUMER PRICES FOR HOUSEHOLDS



Source: Eurostat

Luxembourg households less affected by the energy crisis

Compared with other European countries, Luxembourgish households have been relatively well protected from the energy crisis. Electricity prices, which were lower than in most European countries even before the crisis, have remained relatively stable since 2020. This is mainly because the majority of Luxembourg's providers obtain their supplies on the long-term energy markets (which limited price increases in 2021 and 2022), but also due to the price cap negotiated by the tripartite at the end of 2022. In the eurozone, on the other hand, electricity prices have risen by around 30% since 2020.

By contrast, gas prices in Luxembourg have almost doubled since the end of 2020, despite starting from a relatively low level. Thanks to the tripartite measures, prices have stabilised since 2022, unlike in other European countries where they have continued to rise. As a result, the consumer price of gas in Luxembourg remains significantly lower than in the majority of countries in the eurozone, including neighbouring countries.

Dashboard

	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-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	-5.7	-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	7.1	-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	-0.5	-1.1	1.1	-0.9	-2.2	-1.7	3.3	1.3	...	0.9	-2.0
Prices, wages											
Consumer price index (NCPI)	4.2	4.0	3.2	3.0	3.5	3.5	3.2	3.1	2.4	2.9	3.9
Underlying inflation	4.5	4.3	4.2	3.9	4.0	4.0	3.4	3.2	2.4	3.0	4.8
Oil product index	-1.3	-0.6	-10.8	-9.2	-4.4	-4.4	1.1	1.0	3.5	1.9	-9.6
Industrial producer price index	1.6	1.5	-2.4	-1.4	-1.6	-2.6	-1.0	-0.8	...	-1.4	13.4
Construction price index[1]	9.3	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)	7.3	7.3	8.6	8.6	8.6	...	...	...	...	8.6	2.9
Foreign trade											
Exports of goods (volume)	0.6	-0.7	5.1	-0.4	-7.9	-0.3	1.3	-8.4	...	-2.8	1.0
Imports of goods (volume)	4.0	-2.1	4.8	2.6	-0.1	8.8	6.5	-13.5	...	-0.8	-0.8
Employment, unemployment											
Domestic number of employees	1.9	1.7	1.6	1.5	1.5	1.3	1.1	1.0	0.9	1.0	2.7
National employment	1.6	1.5	1.5	1.3	1.3	1.1	0.9	0.9	0.8	0.9	2.2
Unemployment rate (% of working population, seas. adj.)	5.3	5.5	5.5	5.7	5.5	5.6	5.6	5.6	5.6	5.6	4.9

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)	-1.5	0.6	0.2	-1.4	0.0	-
	Annual variation in %					
	2019	2020	2021	2022	2023	Forecast 2024
Luxembourg - Real GDP growth (STATEC)	2.9	-0.9	7.2	1.4	-1.1	2.0

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 (04/2024)

1010.47

Index half-yearly average:
1002.11

Current account balance (Q4 2023)

EUR **1 465** million

Resident population (01/01/2024)

672 050

STATEC

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