

Note de Conjoncture No. 3-2012**Minimal growth**

The European institutional environment changed considerably over the 3rd quarter of 2012. Substantial changes were adopted to create tools to deal with the problem of public debt in the eurozone. As regards the economic indicators, the situation has deteriorated and recession has taken hold in the eurozone, with household and business confidence at an all-time low. While growth in the Luxembourg economy in early 2012 was a little better than expected, there were worrying signs in a number of sectors. The prospects for 2013 have deteriorated significantly, due in particular to the worsening situation in the eurozone. Expected growth for Luxembourg GDP is 0.5% in 2012 and it has been revised downwards to just 1.0% for 2013. This low growth will not be enough to stem the rise in unemployment.

These are the main facts highlighted in Note de Conjoncture No. 3-2012, which STATEC has just published. Macro-economic forecasts, the international economic situation, recent developments in the main sectors of activity, inflation, wages, the labour market and public finances are dealt with in detail in this issue.

Eurozone: moving towards debt pooling

The vicious circle of sovereign risk and banking risk has given rise to growing tensions between eurozone Member States since end-2011 and has highlighted, to a certain extent, an institutional deadlock. An important step was reached in the summer of 2012, with the announcement of a European banking union and the launch of a sovereign bond-buying programme by the European Central Bank. These decisions, which tie monetary policy to fiscal policy and involve the transfer of national sovereignty, are indications of closer economic integration within the eurozone.

While the financial markets seem to have responded relatively positively to these developments, as shown by the recovery in European equity markets in the 3rd quarter and the substantial decline in government bond rates for the countries in greatest difficulty, real economy indicators have significantly deteriorated. Confidence indicators for both households and businesses in particular, have in the main returned to crisis levels. The eurozone is therefore back in recession, penalised in particular by fiscal consolidation measures that are dampening demand.

First half of 2012 better than expected for Luxembourg but an unfavourable trend in a number of sectors

GDP grew 0.4% in the 2nd quarter of 2012 (up 0.8% over one year). This result, together with the revised figures for the previous quarters, significantly improves the assessment of the economic situation in the first half of 2012. The financial sector in particular, which had fallen back alarmingly in the 1st quarter in the previous version of the national accounts, now appears to be less affected by the recent economic slowdown.

Other sectors, however, show worrying trends. These include manufacturing and construction where output levels, after trending downward throughout 2011, stagnated at a low level in the 1st half and the partial indicators

available for the 3rd quarter hold out no promise of a rally. Indicators of activity in the trade and transport sectors for their part have been on a downward trend since the 1st quarter of 2012. Finally, business services, which had significantly contributed to the rise in GDP and employment in 2010 and 2011, saw their added value grow only marginally in the 2nd quarter of 2012.

Domestic demand is also showing signs of weakness, with investment falling for two consecutive quarters and a drop in household consumption in the 2nd quarter of 2012.

Persistent inflationary tension and low wage growth

Although inflation dropped considerably in the 1st half of 2012, consumer prices have again been coming under pressure since the 3rd quarter. Much of this is due to energy prices, linked to the rise in oil prices over the summer, but also to the recent rise in administered prices and higher inflation affecting some foodstuffs (this latter is more of a technical than a cyclical phenomenon). The inflation rate thus grew from some 2.5% in mid-2012 to almost 3% in September and October.

As average nominal wage costs are rising at a historically low rate, below 2% year-on-year, the purchasing power of wages has deteriorated. The sectors most affected by the slowdown in pay rises include the manufacturing and transport sectors. Pay rates in the financial sector fell sharply in the 3rd quarter (compared to the 3rd quarter of 2011), related to the downward revision in bonuses.

Labour market stalls

The pace of domestic employment growth has been slowing since mid-2011. While this sluggishness in employment is particularly marked in the manufacturing sector, the trend is also affecting most other sectors, most of which have experienced slower employment growth than last year. The impact of the cyclical slowdown is affecting cross-border workers more than resident workers, particularly in temporary employment, which fell sharply in 2012. The less buoyant climate is also leading to fewer working hours. The drop in average working hours involves a reduction in overtime and increased recourse to part-time employment (which itself is mainly linked to partial unemployment measures).

The unemployment rate in Luxembourg has stabilised in recent months. This trend is mainly due to the fact that employment among resident workers is relatively dynamic in some sectors, particularly those unaffected by cyclical phenomena. Employment among resident workers is also bolstered by the increasing development of assisted jobs (job schemes). Despite this recent stabilisation – which is not expected to last given the sluggishness of economic activity – unemployment is at an all-time high (over 6% of the working population since the 2nd quarter of 2012).

Growth forecasts: 0.5% in 2012 and 1.0% in 2013

Recession has taken hold of the eurozone and to a large extent throughout the worldwide economy. STATEC has therefore significantly downgraded its 2013 growth assumptions for the eurozone published in NDC 2-2012 (up 0.2% instead of 1%).

From a fiscal perspective, 2013 will be marked by a reining in of public expenditure in Luxembourg, in contrast with 2012, characterised by a highly positive fiscal stimulus. In all, public spending is set to rise by 2.8% in 2013, about 1/3 of the average historic rate, which amounts to virtual stagnation in real terms. In early November 2012, the Government unveiled fiscal consolidation measures of almost 2 points of GDP, which have been integrated into STATEC's main forecasting scenario.

Notwithstanding these negative developments, economic activity as measured by GDP in volume is set to return to pre-crisis levels in 2012, due to a rise currently estimated at 0.5% (for 2012 as a whole). In 2013, a very slight acceleration is expected (up 1.0% for GDP in volume), based on a stabilisation of the situation in the financial sector, where a repeat of the extremely negative performance seen in recent years is not expected. However, because of the deterioration across the eurozone and against a backdrop of fiscal consolidation, growth is now expected to reach just 1.0%, compared to the 1.7% predicted in July.

In the labour market, the slowdown in growth in activity is affecting net job creation with some delay and points to another (downward) adjustment in working hours. Thus, for 2012, STATEC still expects employment to rise by 2.2%, but this rate is expected to fall to 1.3% in 2013, driven by rising unemployment (6.5% in 2013, as an annual average). Household confidence, already close to the extremely low levels observed during the financial turbulence 4 years ago, is set to suffer as a result for many long months to come.

On the inflation side, the effects of the depressed economic climate, marked by a highly negative output gap, have taken some time to trickle down. This is due in large part to commodity prices, which have remained high for various reasons. Inflation (NCPI), however, is set to slow in 2013, settling at slightly below 2% on average, based on oil prices that are set to (automatically) remain at the latest levels observed. Persistent inflation and wage restraint, due particularly to falling bonuses and gratuities, mean that real wages will continue to stagnate.

Due mainly to consolidation efforts, the fiscal situation is set to be better in 2013 (expected balance: down 1.4%) than in 2012 (estimated balance: down 2.0%), assuming that the draft budget is implemented as planned. On the revenue side, STATEC predicts a slight reduction (compared to the draft budget), which leads to a difference of 0.6 percentage points on the balance, due in part to the STATEC's less favourable assumption as regards economic growth, and in part to the consolidation efforts, which will marginally erode the tax base.

In short, the current economic situation is starting to weigh on the public finances and the labour market and is now starting to affect sectors that up until now had been relatively spared (construction, retail trade and personal services). This spread of the crisis and its consequences to other sectors is highly likely to extend beyond 2013.

Macro-economic forecasts

	1985-2011	2009	2010	2011	2012	2013
	Growth rate in % (or otherwise specified)					
GDP in volume	4.6	-4.1	3.0	1.7	0.5	1.0
Total domestic employment ¹	3.2	0.9	1.9	2.9	2.2	1.3
Unemployment rate (ADEM)	3.3	5.4	5.8	5.6	6.1	6.5
Inflation (National prices index)	2.2	0.4	2.3	3.4	2.7	1.9
Average wage costs ¹	3.6	1.8	2.6	2.0	2.2	2.2
Balance of public finances (% of GDP) ²	1.9	-0.8	-0.9	-0.3	-2.0	-1.4

Source: STATEC (1985-2011: National accounts statistics; 2012-13: forecasts October 2012)

¹ Drawn up using the national accounting methodology

² average 1990-2011 instead of 1985-2011

A complete electronic version of Note de Conjoncture No. 3-2012 is available free of charge on the STATEC website <http://www.statistiques.public.lu/fr/publications/series/note-conjoncture/index.html>. The printed version will be available shortly from STATEC, B.P. 304, L-2013 Luxembourg, tel.: 247-84219 / fax: 26201902, E-mail: info@statec.etat.lu, at the price of EUR 8.00 (postage not included).

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Published by **STATEC**

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