

Luxembourg, 11 May 2016

Note de Conjoncture n°1-2016

Under pressure from the markets

While 2015 ended with GDP up almost 5%, growth is set to slow this year, due to the less favourable external economic environment, particularly for financial activities. STATEC thus anticipates GDP growth of 3.1% in 2016, followed by a further +4.6% in 2017.

Global growth lower than expected

The international climate is sluggish, with systemic consequences: weak growth in both emerging and developed countries, particularly in the euro zone, is weighing on global demand. This phenomenon is leading to low investment, inflation (including in commodities) and international trade. Falling commodity prices are weighing on demand in producer countries and pushing down income from international trade in developed countries, reducing growth and employment prospects in both emerging and developed countries. The financial markets are also extremely volatile at the moment.

While the main international organisations (European Commission, OECD, IMF) have all downgraded their forecasts in recent months, they placed much emphasis on the emergence of new downside risks in many world regions, particularly the euro zone.

Positive results over 2015 as a whole, but flagging momentum in financial services in early 2016

In Luxembourg, economic activity continued to perform well at the end of the year, bringing economic growth to almost 5% for 2015 as a whole (as compared to a little over 4% per annum over the two previous years). The turn of the year was marked by a less buoyant international financial environment and this is likely to keep weighing on the Luxembourg financial sector this year – a sector already marked by a slump in the 2nd half of 2015. In the other sectors of activity, the indicators available for early 2016 – the most recent of which relate to opinion surveys – are in general sending out very positive signals for manufacturing, construction and non-financial services. The current year should see domestic demand strengthen thanks to investment and private consumption, while foreign trade is set to be adversely affected by the sluggishness in financial activities.

While economic growth was relatively strong last year, it did not generate any significant pressure on consumer prices and this trend is likely to continue in 2016. This lack of inflationary tension is due to low commodity prices worldwide (particularly oil), the passing of the impact of the 2015 VAT hike, and also to a more widespread slowdown in consumer prices. This low inflation, more marked than expected, is also restricting wage inflation because of automatic index-linking and, by extension, is also contributing to slowing public expenditure and receipts.

Growth forecasts: +3.1% in 2016, +4.6% in 2017

The relative weakness in global demand is not affecting Luxembourg directly but indirectly due to the slowdown of its trading partners. Macroeconomic trends in Luxembourg will consequently be characterised by a slowdown in activity in 2016, with real growth rates at about 3% compared to almost 5% in 2015.

The labour market is doing well, with the downward trend in unemployment confirmed in early 2016 and job offers significantly up. Driven mainly by cross-border workers, domestic employment is set to rise some 2.9% in 2016, mostly in reaction – with some delay – to the sharp rise in activity in 2015.

The ongoing volatility in the financial markets and their downward trend at the turn of the year has led STATEC to downgrade its forecasts in this regard (especially for 2016). Despite this correction, expected growth in 2016 (up 3.1%) has only been marginally revised compared to the previous Note de Conjoncture (up 3.4%). It must be said that in the meantime, growth acquisition in late 2015 was substantially revised upwards, as economic activity was stronger than expected at the end of last year.

Assuming an improvement in euro-zone growth and on the financial markets, economic activity should bounce back in 2017 with growth at 4.6%. Inflation (NCPI) is set to increase to 1.3% after practically stagnating in 2016.

Market fluctuations always have a delayed impact on the labour market. Thus, in 2017, the labour market should weaken following the slower growth in 2016. Unemployment is set to fall from 6.8% to 6.4% in 2016, and then stagnate in 2017.

Public finances display a less favourable pattern

STATEC expects that 2016 and 2017 will see a slight deterioration in the nominal public balance, from 1.2% of GDP in 2015 to 0.3% in 2017. This decline will be due more to low receipts than excessive hikes in expenditure.

With 3.6% growth in 2016, the increase in public spending will be one of the lowest ever recorded. Low inflation, which is pushing back index-linked adjustments, and the slowdown in public investments – which remain at a high level – are the main reasons for this. Consequently, the share of total expenditure in GDP will be just 40.5% in 2017 compared to almost 45% five years ago.

Public receipts are set to rise only slightly, as in the two previous years. STATEC expects growth of about 3% per annum in 2016 and 2017 (among the lowest recorded since 2000). There are many reasons for this moderation. Firstly, it is due to a mixed climate in 2016. Low inflation, weak real GDP growth and the downward trend in the financial markets are all negatively affecting revenue sources. Secondly, it is down to partially exogenous policy measures: the loss of VAT on e-commerce, which is expected to bring GDP down by almost 2 points in 2017, and the household tax reform (down 0.7 points of GDP).

Macro-economic forecasts

	1990-2015	2015	2016	2017	2015	2016
	Growth rate in % (or otherwise specified)				Revisions (points of % or otherwise specified) ¹	
GDP in volume	3.7	4.8	3.1	4.6	1.6	-0.3
Total domestic employment	3.1	2.5	2.9	2.6	-	0.4
Unemployment rate (ADEM, % of labour force)	.	6.8	6.4	6.4	-0.2	-0.5
Inflation (National prices index)	2.1	0.5	0.1	1.3	-	-1.2
Average wage costs	3.2	0.8	0.5	2.4	-0.3	-1.2
Balance of public finances (% of GDP) ²	1.9	1.2	1.0	0.3	0.5	0.2

Source: STATEC (1990-2015: observed data; 2016-17: forecasts)

¹ With regard to the NDC 2-15, published on 25 November 2015

² STATEC forecasts 2016-2017 (average 1995-2015 instead of 1990-2015)

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