

Luxembourg, 30th of May 2017

Note de Conjoncture 1-2017 A more balanced growth

Over the last months, national and international business activity gained momentum. Benefiting from this environment, the Luxembourgish economy is expected to grow by up to 5 percent in 2017 and 2018. This expansion will profit from a well balanced growth, consisting of interior and exterior demand as well as financial and non-financial growth.

Continued growth in the euro zone

After having slowed down in 2015 and 2016, global growth should strengthen this year and next, bolstering developed and emerging markets. At present, the euro zone is experiencing a relatively moderate and yet consistent cycle of expansion. Very positive data published in economic surveys over recent months point towards the possibility of a further strengthening of activity across the euro zone this year.

Based on these developments and the forecasts of the main international organisations, STATEC expects growth in the euro zone to be close to 2% in 2017 and 2018. Domestic demand, which up until now has been mainly driven by household consumption, is expected to reap the rewards of an increase in private investment in 2017. This trend should accelerate further in 2018, meaning that the recovery in the euro zone is likely to become more and more self-sustaining.

Luxembourg economic growth heading towards 5% for this year and 2018

Luxembourg GDP growth went above the 4% mark in 2016 and momentum for previous years has been revised upward. Economic expansion continued at the end of the year, with a better balance between external and domestic demand. The financial sector should benefit from a more favourable climate underpinned, in particular, by the recovery in stock markets and the continuation of an encouraging trend of loans granted to households and businesses. With regard to other sectors, trends in output indicators (industry and construction) and turnover (non-financial services) were a little disappointing in the first months of 2017. However, corporate and household confidence is at historically high levels and, coupled with the strengthening of European economic momentum, should stimulate activity. In various quarters, there is a groundswell of support for strengthening private consumption and investment, two factors that have only had a modest impact on growth in recent years.

For the current year as a whole, STATEC forecasts a rise of close to 5% in GDP in volume, a pace that should be easily maintained in 2018. The economy is thus heading towards a peak with a distinctly positive output gap and a rapidly expanding labour market. This is being played out against the backdrop of a lack of significant tensions with regard to prices and wages.

Consumer prices and wages go up, but cyclical pressures remain moderate

In Luxembourg and across the euro zone, the inflation rate has recovered considerably, reaching levels last witnessed in 2013. At the beginning of the year, it was sustained by rising oil prices as well as food prices and additionally, in Luxembourg, by the effects of the wage indexation which came into force in January. Apart from these factors, the underlying pressures are weak.

STATEC expects the inflation rate in Luxembourg to be 1.8% in 2017 and 1.7% in 2018. This marked recovery would not only result from the upturn in oil prices but also from the projected increase in underlying inflation. This figure will rise to 1.4% in 2017 and 1.8% in 2018.

In 2017, average wage costs in Luxembourg are expected to increase significantly, mainly due to the indexation which took place at the start of the year, as well as the wage agreement in the public service and, to a lesser extent, the readjustment of the minimum social wage on January 1st. The forecasted drop in unemployment for this year and the following year should also increase the economic pressures on wages. In real terms, i.e. excluding the impact of indexation, wage trends will remain relatively moderate until 2018.

Upward momentum in employment; unemployment steadily declining

Domestic paid employment picked up in late 2016, reaching +3.3% over one year in the 4th quarter. All sectors are playing their part in this recovery and job vacancies remain at historically high levels. This trend has been reflected in unemployment, which has continued to fall, dropping to 6.0% of the working population in April 2017; whereas at the turn of the year it stood at 6.2%. However, it is still too high to generate any significant tension on prices and wages. These developments, alongside the expected strengthening of economic growth in 2017 and 2018, should lead to a sustained and sharp increase in job creations as well as to a drop in the unemployment rate this year and next.

Public finances: slight surplus forecast for 2017 and 2018

Luxembourg's public finances are in very good shape and fully compliant with all European criteria. Moreover, for the sixth consecutive year, they are in surplus. The latter, at EUR 850 million or 1.6% of GDP in 2016 should decrease in 2017. The reasons for this are the tax incentives relating to the tax reform as well as the new losses in terms of VAT on e-commerce.

The impact of indexation which came into force at the start of 2017 should be two-fold: it should stimulate receipts as well as expenditure, with a slight increase in the latter, which will affect the overall balance. This should however remain positive and then improve substantially in 2018, provided that the recovery continues and that there are no new structural upheavals. In contrast, discounting the effects of economic momentum, the structural balance could become negative in 2017 according to STATEC forecasts, but should remain in line with the European target of a deficit below 0.5% of GDP.

Macroeconomic forecasts

	1995-2016	2016	2017	2018	2016	2017
					Revisions (points of % or otherwise specified) ¹	
		Growth rate in % (or otherwise specified)				
GDP in volume	3.6	4.2	4.8	4.8	0.5	0.6
Total domestic employment	3.2	3.0	3.3	3.4	0.2	0.3
Unemployment rate (ADEM, % of labour force)	4.3	6.4	5.9	5.6	-	-0.3
Inflation (National prices index)	1.8	0.3	1.8	1.7	-	0.4
Average wage costs	2.7	0.5	3.5	2.4	0.3	0.3
Balance of public finances (% of GDP) ²	1.9	1.6	0.5	0.7	-0.1	0.1

Source: STATEC (1995-2016: observed data; 2017-18: forecasts)

¹ With regards to the NDC 2-16, published on 30 Nov. 2016

² STATEC forecasts 2017-2018

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