

**Note de Conjoncture No 2-2011****The recovery is confirmed but signs of a slowdown suggest  
that growth will moderate**

*The Luxembourg economy is set to grow 4.0% in 2011. The economic situation was particularly dynamic in late 2010 and early 2011 but there are now signs of a slowdown, both in the international economic environment and in terms of national indicators. GDP growth is set to slow slightly in 2012, to about 3.8%.*

These are the main facts highlighted in Note de Conjoncture No. 2-2011, which STATEC has just published. Macro-economic forecasts, the international economic situation, recent developments in the main sectors of activity, inflation, wages, external economic relations, the labour market and public finances are dealt with in detail in this issue. This Note also features a number of specific sections providing methodological analyses on topics including an economic survey of services, the impact of the adjustment in the automatic wage indexation system, the macro-economic impact of a fall in the stock markets, the discrepancy in inflation between Luxembourg and its neighbours, the effect of oil prices on consumer prices and the inflation rate by household category.

**International environment: the prospects of a slowdown become clearer**

The international economic environment was relatively buoyant up to early 2011. In the eurozone, 1<sup>st</sup> quarter GDP was surprisingly vigorous, whereas the trend in the previous quarters had been pointing to an earlier slowdown. European growth in early 2011 was due in part to the effects of a catch-up in the construction sector but also to Germany's very good performance in terms of industrial output and exports, which contributed substantially to overall growth. However, momentum in the eurozone remains very unevenly spread and large economies like Italy and Spain did not follow the general recovery.

Despite this positive start to the year in the eurozone, there have been a number of strong signs of a slowdown in recent months, such as the fall in leading European economic indicators in manufacturing and services, the flat trend in the financial markets and lower development perspectives for global trade.

Furthermore, like the sword of Damocles, the sovereign debt crisis remains an ongoing threat, the potential consequences of which are difficult to ascertain: the uncertainties surrounding this issue are undermining investor, business and consumer confidence and are hampering expansion prospects.

## **External demand contributes more to growth**

Despite almost zero quarterly growth in early 2011 (up 0.1%), the growth in Luxembourg GDP continues apace, with the 1<sup>st</sup> quarter results disappointing mainly in comparison to the very high growth in the 4<sup>th</sup> quarter of 2010 (up 2.7% over one quarter). Year-on-year, GDP growth reached almost 5% over the first two quarters, higher than the historical average of 4%.

A number of sectors stand out in the current recovery in terms of their contribution to GDP growth, particularly trade, hotel & catering, transport and communications, where total added value since the start of 2010 has exceeded that of the financial sector. Business services have also been trending favourably over the same period, as has manufacturing. However, the results for manufacturing must be treated with caution as statistical sources vary: activity and economic surveys in particular point to a less dynamic environment since mid-2010.

The economic indicators for the construction sector were, on the whole, relatively strong in early 2011. Trends for output, employment, business prospects and prices indicate that Luxembourg construction was less penalised by the 2008-2009 crisis than most other European countries and that a recovery is well underway.

The least favourable trend concerns the financial sector, which has not really displayed any signs of recovery in terms of volume indicators. However, trends in this sector remain highly varied, with banks bringing the overall result down while other segments such as UCIs and insurance appear much more positive.

Finally, the economic survey of non-financial services shows that this sector has been slowing down since early 2011.

The external momentum in expenditure is benefitting from the recovery in trade sectors focused on exports of goods and services, offsetting the weakness in private consumption in the recent period. Public consumption, which rose significantly during the crisis (in 2009), gradually stabilised thereafter and fell in early 2011. In terms of private consumption, the figures for the last quarters indicate a certain stabilisation. Finally, the recovery trend is also confirmed for investments, although the level of total investment remains almost 15% below pre-crisis levels.

## **Inflation rises again, followed by wages**

Partly due to the recovery, consumer prices, industrial output prices and property prices have all climbed higher since 2010 – as have added value prices in the overall economy.

Regarding consumer prices, the Luxembourg inflation rate rose from 2.0% in early 2010 to a little over 3.5% in the 2<sup>nd</sup> quarter of 2011. Luxembourg is following the global trend for rising inflation due to the increase in commodity prices since mid-2009. This globalised phenomenon is primarily affecting energy and food prices – thus impacting more on poorer households – and is spreading to all other expenditure items that contain these components. Furthermore, inflation is also contributing more to administered prices, particularly in relation to changes in water rates and health services.

Although uncertainty is mounting as to the extent of the global recovery, commodity prices have been stabilising in recent months (and, in some cases, have fallen), somewhat easing the threat of lasting inflationary pressure.

Average wage costs rose 4.1% over one year in the 1<sup>st</sup> quarter of 2011, above the average rate of about 3% observed over the last decade. Apart from potential pressures linked to recovering employment, wage trends – which have been relatively low in recent years – were affected in early 2011 by a number of exceptional trends, in particular the increase in the number of hours worked in the manufacturing and construction sectors. Apart from these short-term trends, there is a general trend for rising wage costs across the spectrum.

## **The recovery in employment spreads to the competitive sector**

Domestic employment rose 2.5% over one year in the 1<sup>st</sup> quarter of 2011. During the crisis, net job losses (jobs created minus jobs lost) were limited in terms of the economy as a whole by an almost continuous rise in employment in the protected services sector (administration, education, health and social welfare). As the recovery took hold, recruitment in the traded services sector gradually took over, firstly with increased recourse to temporary work (where momentum fell significantly in early 2011) and later in a more generalised fashion.

The higher percentage of cross-border workers in the competitive sector made them more exposed to the consequences of the crisis. With the recovery, they were the main beneficiaries of the rise in temporary employment (where they account for about 80% of the labour force). In 2011, employment growth among cross-border workers outstripped that among residents, but the difference is not as marked as it was before the crisis: at the start of the year, they held less than half of the newly created jobs, compared to two thirds before the crisis.

The unemployment rate in Luxembourg (based on ADEM figures) has been falling recently, but this fall is very slight compared to the rise in 2009 and 2010, which pushed the number of job seekers to a record 6% of the working population. Employment growth, at less than 3% year-on-year, is still not enough to have any substantial impact on unemployment. Whereas in 2010, unemployment growth was contained by the development of job schemes, the fall in early 2011 seems more linked to a real improvement in the economic climate, with the overall unemployment rate (i.e. including people in job schemes) also falling.

## **GDP growth forecasts: 4.0% in 2011 and 3.8% in 2012**

Economic growth forecasts have been revised slightly upwards compared to the forecasts published in the Note de conjoncture of May 2011: GDP growth in volume is now expected to be 4.0% in 2011 (instead of 3.2% as previously forecast) and 3.8% in 2012 (instead of 3.5%).

This upward revision is linked to a revision of the assumptions included in the forecasting model, which are mainly variables linked to the international economic environment. Foreign demand for Luxembourg goods and services has been revised upwards, especially with regard to goods. Services are not expected to grow as strongly in 2011, mainly due to the deteriorating outlook for the stock market environment (dampening exports of financial services) but are set to improve in 2012.

The increase in growth will have a positive impact on employment and a negative impact on unemployment: the latter is expected to fall very slightly over 2011 as a whole (to 5.9%) and to 5.7% in 2012.

Consumption and investment have also been revised upwards, particularly for 2011. The adjustment of assumptions on oil prices and exchange rates also means that inflation prospects have been revised slightly downwards.

Assumptions relating to public finances have also been adjusted, with in particular the dynamic rise in receipts confirmed in early 2011.

The public deficit is set to amount to 0.8% of GDP in 2011 (against the 1.0% previously forecast) and 1.1% of GDP in 2012 (instead of 1.5%).

## Main macroeconomic variables

	1985-2010	2010	2011	2012
	Growth rate in % (or otherwise specified)			
GDP in volume	4.8	3.5	4.0	3.8
Total domestic employment <sup>2</sup>	3.2	1.5	2.3	2.2
Unemployment rate <sup>1</sup>	2.8	6.0	5.9	5.7
Inflation (National prices index)	2.1	2.3	3.3	2.1
Average wage costs <sup>2</sup>	3.6	1.6	2.7	4.3
Balance of public finances (% of GDP) <sup>3</sup>	1.7	-1.7	-0.8	-1.1

Source: STATEC (1985-2010: National accounts statistics; 2011-2012: forecasts July 2011)

<sup>1</sup> Registered concept (ADEM), in % of working population.

<sup>2</sup> Drawn up using the national accounting methodology

<sup>3</sup> STATEC forecasts for years 2011-2012, average 1990-2010 instead of 1985-2010

A complete electronic version of Note de Conjoncture No. 2-2010 is available free of charge on the STATEC website <http://www.statistiques.public.lu/fr/publications/conjoncture/noteConjoncture/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](mailto:info@statec.etat.lu), at the price of EUR 5.00 (postage not included).

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