

# Country report

## LUXEMBOURG

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### Summary:

Luxembourg's solid economic performance and creditworthiness (i.e. ample financial cushion) shall remain underpinned by a strong public sector balance sheet and exceptionally high levels of prosperity (per capita income was USD 90,000 in 2010). That said, the concentration of economic activity in the financial sector can pose risks in times of global economic and financial market turbulence.

### Things to watch:

Pension system reform  
Level of stress in the global financial markets

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Luxembourg			
<b>National facts</b>		<b>Social and governance indicators</b> rank / total	
Type of government	Constitutional Monarchy	Human Development Index (rank)	24 / 169
Capital	Luxembourg	Ease of doing business (rank)	45 / 183
Surface area (thousand sq km)	3	Economic freedom index (rank)	13 / 179
Population (millions)	0.5	Corruption perceptions index (rank)	11 / 178
Main languages	Luxembourgish	Press freedom index (rank)	14 / 178
Main religions	German/French (admin.)	Gini index (income distribution)	30.8
	Roman Catholic (87%) Other (13%)	Population below \$1.25 per day (PPP)	N/A
Head of State (president)	Grand Duke Henri	<b>Foreign trade</b> 2007	
Head of Government (prime-minister)	Jean-Claude Juncker	<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
Monetary unit	Euro (EUR)	Germany 29	Belgium 34
		France 23	Germany 29
		Belgium 14	China 21
		UK 10	France 12
<b>Economy</b> 2010		<i>Main export products (%)</i>	
<i>Economic size</i>	<i>bn USD</i> % world total		
Nominal GDP	54 0.09	Machinery and transport equipment	62
Nominal GDP at PPP	41 0.06	Food, drinks and tobacco	6
Export value of goods and services	82 0.44	Chemicals and related products, n.e.s.	7
IMF quatum (in mln SDR)	279 0.13	Raw materials	2
<i>Economic structure</i>	2010 5-year av.	<i>Main import products (%)</i>	
Real GDP growth	3.4 3.0	Machinery and transport equipment	55
Agriculture (% of GDP)	0.4 N/A	Mineral fuels, lubricants, and related materi:	13
Industry (% of GDP)	13.6 N/A	Food, drinks and tobacco	10
Services (% of GDP)	86 N/A	Chemicals and related products, n.e.s.	10
<i>Standards of living</i>	USD % world av.	<i>Openness of the economy</i>	
Nominal GDP per head	113915 1159	Export value of G&S (% of GDP)	163
Nominal GDP per head at PPP	87606 750	Import value of G&S (% of GDP)	119
Real GDP per head	90160 1126	Inward FDI (% of GDP)	281

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

## Economy

The economic recovery is underway, led by private domestic demand. Both private consumption and investment have expanded at high rates, reflecting improvements in confidence and low interest rates. The recovery is anticipated to continue over the coming quarters with GDP growth above the euro area average, although Luxembourg's growth performance is unlikely to return to the lofty levels witnessed earlier this decade. Stronger exports of financial and business services compared to the crisis years (2008-2009), linked to improved financial conditions, will be an important driver of the expansion. Of course, we must note that exports of financial services will not reach pre-crisis levels in the short-term. Domestic demand will maintain momentum from consumption as labour demand strengthens, and investment will continue to recover as spare capacity diminishes. However, fiscal consolidation measures will modestly dampen activity.

Although the general government balance has deteriorated sharply from a surplus of 2.6% of GDP in 2008 to a deficit of 3.8% in 2010, Luxembourg's public finances are no cause for concern (unlike in many other advanced economies). Gross government debt is still very low in Luxembourg when compared to neighbouring countries. The IMF expects public debt-to-GDP to rise to 23% in 2015. Even better, the government's large gross financial asset position (61.5% of GDP) means public debt has further room to increase before markets start worrying about the country's debt sustainability. That said, the combination of an ageing population and one of the most generous pension systems in the world weakens Luxembourg's ability to sustain deficits in the long term.

Pension reforms are therefore of paramount importance to ensure long-term fiscal sustainability. Ageing-related expenditure in Luxembourg, according to the OECD, will rise by 5.5%-points of GDP in the period 2010-2025– the highest amongst the advanced countries.

### **Banking Sector:**

In our view, the financial sector (contributing around 30% to annual GDP growth and employing roughly 20% of the population) —is unlikely to regain the same dynamism of the past, given the changed global environment for the sector as well as further possible regulatory tightening. The 148 banking institutions currently operating in Luxembourg, although well-capitalised, have registered a decline in their total balance sheet of 16% from their peak at the end of 2008 to October 2010. But the fact that the overwhelming proportion of domestic credit is granted by banks that are subsidiaries of foreign institutions, the sector only poses a moderate risk as a contingent liability to the state. It should be noted, however, that the direct involvement of the state in the Belgian-led bailout of Fortis Bank in 2008 (costing it USD 2.5bn or 7% of GDP) implies that the country is not always insulated.

<b>Luxembourg</b>							
Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
<i>Key country risk indicators</i>							
GDP (% real change pa)	5.0	6.6	1.4	-3.7	3.4	3.0	3.1
Consumer prices (average % change pa)	2.7	2.3	3.4	0.4	2.3	2.6	2.6
Current account balance (% of GDP)	10.3	10.2	5.4	6.6	8.2	9.2	9.1
<i>Economic growth</i>							
GDP (% real change pa)	5.0	6.6	1.4	-3.7	3.4	3.0	3.1
Gross fixed investment (% real change pa)	4.7	12.6	-0.1	-14.5	0.0	2.0	2.0
Private consumption (real % change pa)	3.2	3.3	4.7	0.2	1.8	1.7	1.8
Government consumption (% real change pa)	1.7	2.8	2.7	4.7	1.5	2.0	2.0
Exports of G&S (% real change pa)	13.0	9.1	6.6	-8.2	7.1	4.5	4.1
Imports of G&S (% real change pa)	12.8	9.3	8.5	-10.3	6.7	4.2	3.8
<i>Economic policy</i>							
Budget balance (% of GDP)	0.1	3.9	3.7	-0.7	-1.9	-1.2	-1.0
Public debt (% of GDP)	7	4	8	14	15	16	17
M2 growth (% change pa)	10	8	-2	-16	19	1	2
Consumer prices (average % change pa)	2.7	2.3	3.4	0.4	2.3	2.6	2.6
Exchange rate LCU to USD (average)	0.8	0.7	0.7	0.7	0.8	0.8	0.8
Recorded unemployment (%)	4.4	4.4	4.4	5.7	5.8	5.8	5.1
<i>Balance of payments (mln USD)</i>							
Current account balance	4396	5215	3147	3495	4400	4900	4900
Trade balance	-4307	-4801	-6340	-4323	-5800	-6200	-6500
Export value of goods	16497	18406	21417	15527	18200	18300	18300
Import value of goods	20805	23206	27755	19850	23950	24550	24720
Services balance	20838	27312	29401	24869	26000	26100	25800
Income balance	-10984	-15282	-17266	-15809	-14600	-13800	-13200
Transfer balance	-1151	-2014	-2649	-1242	-1300	-1200	-1300
Net direct investment flows	14319	-75466	-27730	-29050	2383	19330	-6950
<i>External position (mln USD)</i>							
Total foreign exchange reserves	218	144	335	700	N/A	N/A	N/A
International investment position	58760	52730	43310	45060	N/A	N/A	N/A
Total assets	4907640	6199270	5624670	6444540	N/A	N/A	N/A
Total liabilities	4848880	6146540	5581360	6399480	N/A	N/A	N/A
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	-10.1	-9.4	-10.9	-8.2	-10.8	-11.6	-12.1
Current account balance (% of GDP)	10.3	10.2	5.4	6.6	8.2	9.2	9.1
Inward FDI (% of GDP)	304.9	377.6	171.1	367.6	188.5	219.6	200.9
International investment position (% of GDP)	138.0	102.8	74.3	85.0	N/A	N/A	N/A

Source: EIU

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