

Robust in terms of growth and business environment

General Information



GDP	USD60.131bn (World ranking 75, World Bank 2014)
Population	0.56mn (World ranking 168, World Bank 2014)
Form of state	Constitutional Monarchy
Head of government	Xavier BETTEL (Democratic Party, Coalition)
Next elections	2017, legislative



Strengths

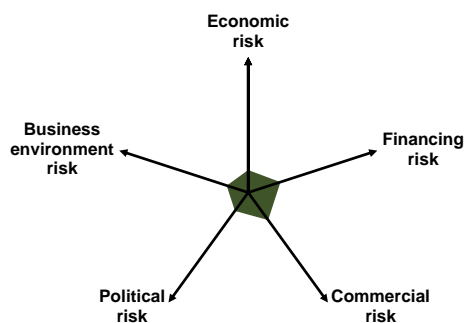
- Strong reputation as a sophisticated financial regulator state
- Solid banking system and the second largest investment fund industry in the world
- Business-friendly environment with responsive authorities and modern infrastructures
- Ability to embrace capital account openness
- Very low public debt and fiscal deficit
- Net service exports as the main growth's driver

Weaknesses

- Backdrop of lower potential growth
- High dependency on the banking sector
- High dependency on cross border workers

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Germany	24% 1	29% Belgium
Belgium	16% 2	25% Germany
France	13% 3	11% France
Netherlands	6% 4	8% United States
Italy	5% 5	4% Netherlands

By product (% of total)

Exports	Rank	Imports
Iron Steel	18% 1	10% Refined Petroleum Products
Plastic Articles	9% 2	9% Cars And Cycles
Rubber Articles (Incl. Tyres)	5% 3	4% Iron Steel
Non Ferrous Metals	4% 4	4% Plastic Articles
Yarns Fabrics	4% 5	4% Aeronautics

Source: Chelem (2013)



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Economic Overview

2015 marks the end of two consecutive years of above 4% GDP growth

Luxembourg found its success in economic and financial openness and a business-friendly and low tax environment. In 2015, real GDP growth is expected to reach 3%, mainly driven by net services exports. Private consumption has been hit by the VAT rate hikes at the start of 2015: +2pps in all VAT rates (with the main rate at 17%) except for the reduced 3% rate on basic goods (food, pharma, public transport etc). In 2016 and 2017, the economic activity is expected to continue to expand at a strong pace (GDP growth above 3%) supported by the execution of large public infrastructure projects, a pick-up in private consumption and dynamic exports. While goods exports will suffer from continued slow growth in advanced economies and emerging markets, services exports, mainly financial, will remain the main engine of growth. Although the traditional banking sector has been overall impacted by the low interest rate environment, the investment fund industry gained momentum and globally the contribution of the financial sector to the overall economy strengthened in 2015.

Low inflation, healthy public finances but high dependency on the financial sector

Headline inflation has trended downward since start of 2012 given increasing deflationary pressures in the Eurozone and the fall in oil prices since mid-2014. An uptick is expected for 2015 (+0.9%) following the VAT increases and the domestic economic recovery in addition to the lower euro is expected to support a further rise in inflation (+1.7% in 2016).

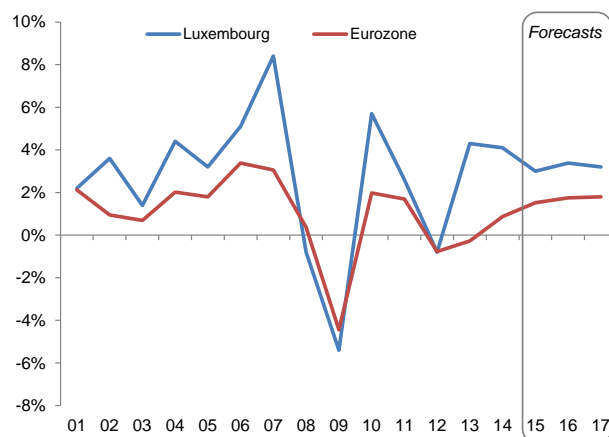
In addition to the VAT increases the government introduced a temporary personal income tax set at 0.5% of income. Further, a spending review – *Zukunftspack* – has been launched, amounting to 1.7% of GDP over the next five years. These measures are expected to fight the loss of VAT revenues following the entry into force of the new taxation regime on e-commerce. Hence, the fiscal balance will be almost neutral in 2015 (+0.1%), following a +0.6% of GDP in 2014. The debt-to-GDP ratio will hover around 23% in the short-medium term (2015-17), well below the 60% level of the Maastricht criteria. It is worth noting Luxembourg's high dependency on the financial sector, including (i) a banking system with assets of roughly 16 times GDP and (ii) the second largest investment fund industry in the world. However, the international central securities depository is settled in Luxembourg – *Clearstream Banking S.A.* – and the overall banking system is sound.

Figure 1: Key economic forecasts

	2014	2015f	2016f	2017f
GDP growth (% change)	4.1	3.0	3.4	3.2
Inflation (% average)	0.6	0.9	1.7	1.9
Fiscal balance (% of GDP)	1.4	0.1	0.5	0.5
Public debt (% of GDP)	23.0	22.1	23.5	23.2
Current account (% of GDP)	5.5	4.3	4.0	3.7

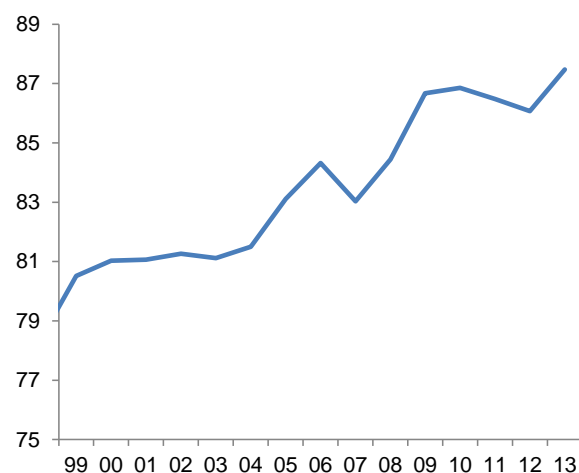
Sources: National sources, IHS, European Commission, Euler Hermes

Figure 2: GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Figure 3: Gross value added for services, % of GDP



Sources: OECD, IHS, Euler Hermes

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