

A steady strong performer

General Information



GDP	USD57.793bn (World ranking 74, World Bank 2015)
Population	0.57mn (World ranking 168, World Bank 2015)
Form of state	Constitutional Monarchy
Head of government	Xavier BETTEL (Democratic Party, Coalition)
Next elections	October 2018, legislative



Strengths

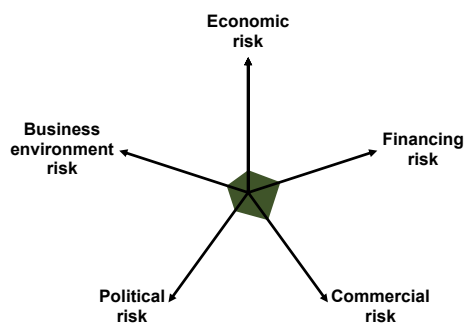
- Strong growth prospects
- Complex financial hub, with a solid banking system and the second largest investment fund industry in the world
- Business-friendly environment with responsive authorities and modern infrastructure
- Strong reputation as a sophisticated financial regulator state
- Very low public debt and fiscal balance in surplus

Weaknesses

- Potential vulnerabilities considering the structure of the financial system and the high dependency of the economy on the banking sector
- Intense dependence on cross-border workers
- Weak long-term viability of the pension system

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Germany	24% 1	27% Belgium
Belgium	14% 2	26% Germany
France	13% 3	11% France
Netherlands	5% 4	7% United States
Italy	5% 5	4% Netherlands

By product (% of total)

Exports	Rank	Imports
Iron Steel	16% 1	9% Cars And Cycles
Plastic Articles	9% 2	6% Refined Petroleum Products
Yarns Fabrics	4% 3	5% Plastic Articles
Non Ferrous Metals	4% 4	4% Iron Steel
Miscellaneous Hardware	4% 5	3% Aeronautics

Source: Chelem (2015)



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Economic Overview

A strong economy...

Economic activity remained strong in 2016. GDP rose by +3.2%. Although growth is expected to ease to +2.5% in 2017 and +2.3% in 2018 (see Figure 2), performance should stay well above the eurozone average. The growth engines are - as usual - domestic demand and net exports of services, with the financial sector leading the pack. In particular, incomes benefit from the tax-cutting reform while the investment fund industry has gained momentum. As for national targets under the Europe 2020 Strategy, Luxembourg performs well in job creation and education. Yet more effort is needed in R&D, environment, and poverty reduction.

Downside risks arise from the high openness of the economy at a time when global policy uncertainties remain high. The size and interconnectedness of the financial system call for rigorous monitoring of risks, as well as enhanced regulation and supervision in the framework of EU rules. Inflated real estate valuations since the global financial crisis have been addressed with a rise in tax credits allocated to house purchases.

... supported by timely tax reforms

In 2016, the fiscal balance is forecast to reach +1.6% of GDP. Yet a cut in the corporate income tax rate from 21% to 19%, implemented as part of a recent reform scheme, should make life easier for SMEs. This surplus will shrink to +0.2% of GDP perhaps already in 2017. A plan for large public infrastructure projects could add to the pressure on the government's budget.

Brexit remains a risk in the short to medium run. European firms face some export losses given the UK's reduced purchasing power. Yet in the long-term Luxembourg is well positioned to win some of the assets that will relocate from the UK to the EU.

Euler Hermes' assessment of several European countries' tax environment compared to that of the UK, identifies potential competitors in a post-Brexit European Union. By plotting corporate tax rates against withholding tax rates, we find a proxy for business attractiveness (see Figure 3).

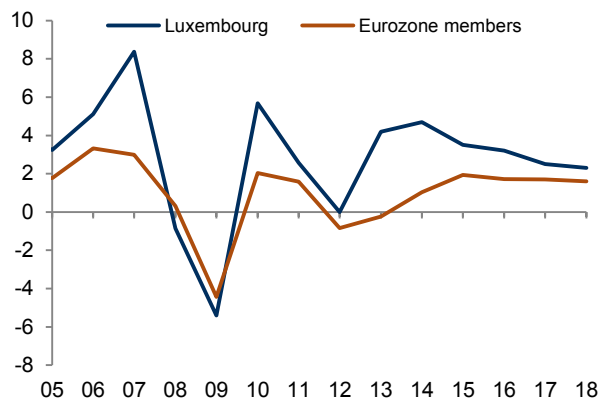
Luxembourg is well-positioned to be top of the list. Its low tax rates (corporate tax, withholding dividends tax, employer social contributions) combined with a comfortable location at the heart of Western Europe could attract many businesses on the hunt for a new home. Moreover, the 2017 tax reform signals Luxembourg's will to enhance its competitiveness.

Figure 1: Key economic forecasts

	2015	2016f	2017f	2018f
GDP growth (% change)	3.5	3.2	2.5	2.3
Inflation (% , average)	0.8	1.7	1.9	2.2
Fiscal balance (% of GDP)	1.6	1.6	0.2	0.3
Public debt (% of GDP)	22.1	21.0	23.1	23.5
Current account (% of GDP)	4.4	4.7	5.0	5.2

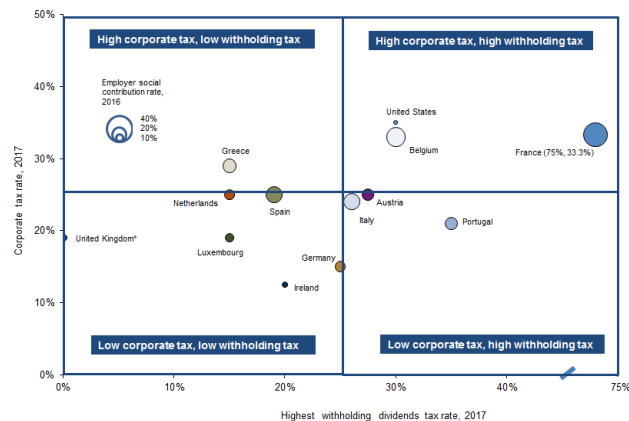
Sources: National sources, IHS, Euler Hermes

Figure 2: GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Figure 3: Tax rates mapping in the EU



Sources: Deloitte, KPMG, Euler Hermes

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