Research Update:

Ratings On The Principality of Liechtenstein Affirmed At 'AAA/A-1+'; Outlook Stable

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Overview

- Liechtenstein's very wealthy economy will likely see healthy growth rates supported by the government's proactive policy-making.
- We expect to see fiscal surpluses and the government remaining in a strong net asset position over the coming years.
- We are therefore affirming our 'AAA/A-1+' long- and short-term sovereign credit ratings on Liechtenstein.
- The stable outlook reflects our expectation that policymakers will readily adapt Liechtenstein's institutional and legal framework to a changing international environment for taxation and financial services.

Rating Action

On July 28, 2017, S&P Global Ratings affirmed its 'AAA/A-1+' long- and short-term sovereign credit ratings on the Principality of Liechtenstein. The outlook is stable.

Outlook

The stable outlook is based on our expectation that policymakers will readily adapt Liechtenstein's institutional and legal framework to a changing international environment for taxation and financial services. We also believe that Liechtenstein will be able to maintain its strong public finances over the next two years, based on robust tax revenues.

The ratings could come under pressure if our assumptions about Liechtenstein's economic vitality no longer hold, for example if its financial services sector loses significant market share. In addition, if international tax or financial regulations became especially hostile to financial centers, many jurisdictions would come under ratings pressure and Liechtenstein would be among them. However, we do not expect such a destabilizing occurrence within the next two years.

Rationale

Liechtenstein benefits from its very strong and stable institutions, which enable the government to implement reforms if necessary to address challenges to the principality's economic model. In addition, the ratings are supported by the country's very wealthy local economy. Its outstandingly high GDP per capita supports the ratings and its healthy public accounts are virtually debt-free. The ratings also take into consideration Liechtenstein's external position, about which we note some limitations on the availability of external data. The principality's monetary flexibility is somewhat limited due to the use of another country's currency (the Swiss franc).

Institutional and Economic Profile: Efficient and quick decision making underpins a wealthy economy

- Liechtenstein is an established monarchy with efficient and predictable decision making.
- As a small country in the heart of Europe and member of the European Economic Area, it benefits from access to European markets.
- Industrial niche players and financial service providers are key economic drivers.

Liechtenstein is a hereditary monarchy under a constitution with sovereign powers jointly exercised by the prince and the people. Although the prince has extensive powers under the constitution, that same constitution contains checks and balances between the prince and parliament. One of the most effective checks is provided by the extensive use of direct democracy (referenda) in the principality. The latest elections in early 2017 confirmed the two ruling coalition parties, which have been in power for decades.

Liechtenstein's policymakers have a track record of proactively addressing regulatory changes and adopting international standards swiftly, for example regarding the automatic exchange of tax information with other jurisdictions, as well as passing legislation to comply with Organization for Economic Cooperation and Development initiatives against tax evasion of multinational corporations ("BEPS"). A key government policy focus is to avoid being blacklisted, for example appearing on the upcoming EU list of countries that facilitate tax-evasion. Liechtenstein is therefore having ongoing dialogues with various institutions like the EU on business taxation and other matters.

Given the size of Liechtenstein's financial system and its international orientation, we think that the principality's reputation remains exposed to changes in international norms for financial regulation and fiscal cross-border cooperation. That said, we do not expect that Liechtenstein will be subject to sanctions given that it has expanded its double-taxation agreements and signed a considerable number of new tax-information-exchange agreements with other countries, including a multilateral agreement on adminstrative assistance in tax matters.

Liechtenstein has a prosperous, open, and highly specialized economy benefiting from its custom and currency union with Switzerland and access to European markets via its membership of the European Economic Area. We view Liechtenstein's economic growth as balanced: its two pillars are its very competitive machinery industry (machine, engine, and tool building) and financial services.

Economic diversification is underpinned by the high share of small and midsize enterprises, some being world leaders in their niches. The manufacturing sector's share of gross value added is nearly twice the contribution from the financial sector. The strong manufacturing base differentiates Liechtenstein from other small financial centers. Its labor market remains very strong, with additional employment filled by commuters from neighboring Switzerland and Austria. Even when adjusted for commuters, local GDP is one of the highest worldwide.

We expect real GDP growth to reach 1.7% in 2017, based on growth trends in the principality's main trading partners Switzerland, the U.S., and the EU, and stay at about this level over the next few years. That said, Liechtenstein's nominal gross domestic product can exhibit some volatility, inherent in an open economy with a population of 37,000, and reflective of the comparably large effect that few contributors can have on the economy's output.

Flexibility and Performance Profile: Debt-free public households are here to stay

- Fiscal surpluses are likely to continue over the next few years.
- The general government is in a very strong net asset position.
- Currency union with Switzerland limits monetary flexibility and availability of external data.

The ratings on Liechtenstein are supported by the country's prudent fiscal policies and high level of liquid government assets. Liechtenstein's fiscal accounts are in a structural surplus. The central government is free of debt and the general government has negligible debt as municipalities contract short-term loans. After some consolidation measures, Liechtenstein's general government achieved a very strong fiscal surplus of 3.6% of GDP in 2016, which is likely to moderate to an average surplus of 1.6% in 2017-2020. In recent years, the government has implemented sizable expenditure consolidation measures and reformed its retirement scheme. It has also benefited from sound tax revenues and the returns on investments of its large fiscal assets.

We expect the general government's liquid financial assets, including social security, to reduce to about 80% of GDP at year-end, and remain that way until 2020. We note that a large majority of these public-sector fiscal assets are either denominated in Swiss francs or hedged. The level of assets also equals the government's net asset position--given that there is almost no general government debt. Total government assets depends not only on the performance of the central government's budget, but also on returns achieved on assets in the financial markets. Hence, some downside valuation risks remain, due notably to currency and equity market movements.

Liechtenstein uses the Swiss franc as currency, which we view as actively traded. Liechtenstein is in a monetary union with Switzerland, although the principality has no vote on the Swiss National Bank's (SNB) monetary policy council and receives no benefits from seigniorage. Being the junior member in this monetary union reduces Liechtenstein's monetary flexibility. The monetary union is based on a 1980 currency treaty, which establishes the Swiss franc as legal tender for the principality. The treaty also provides Liechtenstein's banks access to SNB liquidity facilities against eligible collateral on par with any Swiss financial institution.

That said, we do not expect that the SNB would act as a lender of last resort to Liechtenstein's banks. In our opinion, the 1980 currency treaty anchors Liechtenstein's economy and strengthens its economic links with Switzerland. We do not think the monetary union, and in particular the Swiss franc's exchange rate trends, will disproportionately affect Liechtenstein's economic development vis-à-vis that of Switzerland given the two countries' similar economic structures.

Our ratings also take into consideration the lack of data for external accounts. There is limited data available for external trade, balance of payments, and the international investment position. In line with our criteria, we therefore base our assessment of Liechtenstein's external position on that of the Swiss Confederation. That is, we define Switzerland as the "host country" and use Switzerland's external position as a starting point. We then adjust the initial assessment downward for the lack of external data because these data gaps reduce the visibility of external risks. That said, Liechtenstein's large net asset position and its local banks' predominant business model as asset managers indicate a strong external position.

Although we do not view the financial industry as monolithic--it consists of regional banks, asset managers, insurance companies, Trusts and Company service providers--we consider the sector poses a moderate contingent liability for the government. For example, domestic credit to GDP reached about 270% in 2016. However, the banks are well capitalized and well funded. We rank Liechtenstein in group '2' under our Banking Industry Country Risk Assessment (BICRA; scores range from '1' to '10', with the lowest-risk banking systems in group '1' and the highest-risk in group '10').

Key Statistics

Table 1

Principality of Liechtenstein Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	5.1	5.1	5.9	6.1	6.0	6.2	6.4	6.6	6.8	7.0
Nominal GDP (bil. $)	5.7	5.5	6.4	6.7	6.2	6.3	6.3	6.7	6.8	7.0
GDP per capita (000s $)	157.4	148.1	172.1	178.3	165.4	165.3	166.8	174.2	176.9	180.4
Real GDP growth	(3.5)	0.9	12.1	3.7	1.2	1.5	1.7	1.7	1.6	1.6
Real GDP per capita growth	(4.3)	(0.1)	11.3	3.1	0.5	1.0	1.2	1.2	1.0	1.1
Exports/GDP	65.3	65.8	56.7	56.6	53.7	54.5	52.8	51.1	49.5	47.9
Unemployment rate	2.3	2.4	2.5	2.4	2.4	2.3	2.1	2.1	2.1	2.1
FISCAL INDICATORS (%, General government)										
Balance/GDP	2.4	(2.4)	(1.0)	2.3	3.8	3.6	1.4	1.6	1.7	1.7
Change in debt/GDP	0.4	0.2	(0.1)	0.2	(0.1)	0.0	0.0	0.0	0.0	0.0
Primary balance/GDP	2.4	(2.4)	(1.0)	2.3	3.8	3.6	1.4	1.6	1.7	1.7
Revenue/GDP	33.8	34.4	26.0	26.8	28.3	27.8	27.8	27.8	27.8	27.8
Expenditures/GDP	31.4	36.8	27.0	24.4	24.5	24.2	26.4	26.2	26.1	26.1
Interest /revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt/GDP	0.4	0.6	0.5	0.6	0.5	0.5	0.5	0.5	0.5	0.4
Debt/Revenue	1.3	1.8	1.8	2.3	1.9	1.8	1.8	1.7	1.7	1.6

Table 1

Principality of Liechtenstein Selected Indicators (cont.)										
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Net debt/GDP	(92.9)	(99.2)	(91.8)	(86.0)	(89.9)	(90.8)	(88.0)	(85.1)	(82.5)	(79.8)
Liquid assets/GDP	93.4	99.9	92.3	86.6	90.5	91.3	88.5	85.6	82.9	80.3
MONETARY INDICATORS (%)										
CPI growth	0.2	(0.7)	(0.2)	(0.0)	(1.1)	(0.4)	0.3	0.6	1.0	1.1
GDP deflator growth	(0.4)	(0.5)	3.3	(0.6)	(3.1)	1.3	1.4	1.7	1.6	1.7
Exchange rate, year-end (LC/$)	0.94	0.92	0.89	0.99	0.99	1.02	0.99	0.99	1.01	1.00
Banks' claims on resident non-gov't sector growth	2.5	(7.7)	1.6	8.0	4.6	18.3	1.1	1.5	1.5	1.5
Banks' claims on resident non-gov't sector/GDP	261.6	240.7	211.2	221.3	235.9	271.3	265.9	260.9	256.7	252.1
Real effective exchange rate growth	10.7	(0.7)	(1.2)	1.3	10.8	(2.9)	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Principality of Liechtenstein Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Strength
Economic assessment	Strength
External assessment	Neutral
Fiscal assessment: flexibility and performance	Strength
Fiscal assessment: debt burden	Strength
Monetary assessment	Neutral

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23, 2014
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18, 2009

Related Research

- Calendar Of 2017 EMEA Sovereign, Regional, And Local Government Rating Publication Dates: Midyear Update, July 10, 2017
- Global Sovereign Rating Trends Midyear 2017, Jul. 17, 2017
- Sovereign Risk Indicators, July 6, 2017. An interactive version is also available at http://www.spratings.com/sri.
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion - February 23, 2017
- Sovereign Ratings History - July 12, 2017
- Credit Trends: 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions - April 18, 2017
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017
- Banking Industry Country Risk Assessment: Liechtenstein, Dec. 6, 2016
- Banking Industry Country Risk Assessment Update: July 2017, July 5, 2017
- Bulletin: Switzerland Ratings And BICRA Unaffected By Swiss National Bank's Change In Exchange Rate Policy, Jan. 15, 2015

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

	Rating	
	To	From
Liechtenstein (Principality of)		
Sovereign Credit Rating		
Foreign and Local Currency	AAA/Stable/A-1+	AAA/Stable/A-1+
Transfer & Convertibility Assessment	AAA	AAA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.