S&P Global
Ratings

RatingsDirect®

Research Update:

Liechtenstein 'AAA/A-1+' Ratings Affirmed; Outlook Stable

May 27, 2022

PRIMARY CREDIT ANALYST

Michelle Keferstein
Frankfurt
(49) 69-33-999-104
michelle.keferstein
@spglobal.com

SECONDARY CONTACT

Thomas F Fischinger
Frankfurt
+ 49 693 399 9243
thomas.fischinger
@spglobal.com

RESEARCH CONTRIBUTOR

Meghna Ashtekar
CRISIL Global Analytical Center, an S&P affiliate, Mumbai

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Overview

- The Russia-Ukraine conflict will affect Liechtenstein's small open economy mainly indirectly via trade, the supply chain, and commodity price channels.
- We have therefore lowered our real GDP growth forecast for 2022 to 0.4% from about 1.5% previously.
- Liechtenstein's wealthy and diversified economy, and the government's large asset position and social security funds, provide ample leeway to react to any pressures arising on the external or budgetary side.
- We therefore affirmed our 'AAA/A-1+' long- and short-term sovereign credit ratings on Liechtenstein and maintained the stable outlook.

Rating Action

On May 27, 2022, S&P Global Ratings affirmed its 'AAA/A-1+' long- and short-term sovereign credit ratings on Liechtenstein. The outlook is stable.

Outlook

The stable outlook indicates that we expect Liechtenstein to weather the short-term negative economic fallout from the Russia-Ukraine war over the next two years without an adverse impact on its credit metrics. This is supported by Liechtenstein's strong budgetary position, ample financial buffers, high policy effectiveness, and prudent regulatory framework.

Downside scenario

We could lower the rating if we observed a significant weakening of the principality's finances. We could also lower the rating if we observed increased international tax or financial regulatory pressure on financial centers, including Liechtenstein. In such a scenario, this could severely constrain the government's revenue, as well as its political strategy and effectiveness over a prolonged period.

Rationale

The Russia-Ukraine conflict will affect Liechtenstein's economy mainly indirectly because its direct exposure is relatively low. We have therefore lowered our real GDP growth projection for 2022 significantly by 1.1 percentage points to 0.4%. This reflects intensifying supply chain disruptions, higher energy and food prices, and weaker business and consumer confidence. We also revised up our inflation projection significantly to 3.1% for 2022 from 0.7% and expect it to moderate to 1.3% in 2023.

The principality's small open economy is used to economic volatility, which allows its market participants to adapt quickly. In addition, the strong general government net asset position provides a large buffer to cushion negative economic effects, thereby protecting the country's exceptionally high economic wealth. Liechtenstein's high liquid asset position supports this, as does its high government policy effectiveness and prudent regulatory flexibility.

At the same time, we consider Liechtenstein's monetary flexibility to be limited because it is in a contract-based currency union with Switzerland, forming a common currency area.

Institutional and economic profile: The Russia-Ukraine war will weigh on growth in 2022, but the impact is manageable due to predictable policymaking and exceptionally high wealth levels

- We currently forecast Liechtenstein's real GDP growth will be 0.4% in 2022, down from our previous forecast of 1.5%.
- Negative economic effects of the war come from the intensification of supply side bottlenecks and rising energy prices, amplifying already high inflation.
- The government has ample fiscal room and reserves will help cover additional costs arising from external or fiscal shocks.

Liechtenstein's export-oriented economy will be indirectly affected by the Russia-Ukraine conflict through further deterioration in global trade conditions and higher inflation. Direct trade links with Russia and Ukraine are relatively small, combined accounting for about 2% of Liechtenstein's goods exports; however, exposure for many of its key trading partners (e.g., Germany, Austria, and Italy) is high. The current COVID-19-related lockdown in China will further amplify supply chain bottlenecks, in our view. As in some other countries, Liechtenstein's economy already cooled in the fourth quarter of 2021, according to estimates, and economic sentiment has clouded. In the first quarter of 2022 and already prior to the onset of the war in Ukraine, pressures from labor shortages arose along with uncertainties related to the evolution of the pandemic in China and its effects on the global supply chain. We expect the current commodity price shock to weigh on this year's economic growth. As a result, we lowered our real GDP growth forecast for Liechtenstein to 0.4% in 2022, with expected recovery by 2.0% in 2023, as supply chain disruptions fade. We note that the full extent of the war's effects is still uncertain.

In our view, Liechtenstein's real GDP strongly rebounded by about 13% in 2021 on the heels of the recovery in global external demand. Economic growth performance in the small and open economy tends to be more volatile than in other European countries. Compared with previous crises, the pandemic had little impact on Liechtenstein's machinery and financial service sectors, which account for about 43% and 22% of GDP, respectively. The manufacturing base contributes a large share to the gross value added, which differentiates the country from other small sovereigns with large financial centers. The high share of small and midsize enterprises, some of which are world leaders in niche markets, also supports the country's economic diversification. We expect the overall picture of the principality as a very wealthy country with low unemployment to remain unchanged.

Liechtenstein continues to benefit from its customs and currency union with Switzerland alongside full access to the European Economic Area. Total refugee inflows from Ukraine to Liechtenstein will likely remain lower than to neighboring countries based on Liechtenstein's small size, but will nevertheless present a greater burden on the budget. We expect Liechtenstein's labor market will remain strong and labor shortages will persist. The unemployment rate dropped to 1.3% in March 2022 from 1.6% at year-end 2021, and we expect very low unemployment levels over the next few years. The number of available jobs in the country remains higher than the total population, so a significant part of the workforce is filled by commuters, especially from Switzerland and Austria.

Liechtenstein's political system is based on a constitutional hereditary monarchy and has a strong track record of predictable and effective policymaking, reflecting strong checks and balances and a mature institutional framework. This is underpinned by the two ruling coalition parties that have been in power for decades and continuously form a coalition, including after the parliamentary elections in early 2021.

Future challenges to the country's economy might stem from international developments like the implementation of a global minimum tax rate on corporate profits starting in 2023. Liechtenstein's reputation as a small financial center remains exposed to changes in international norms for financial regulation and cooperation. We continue to expect that the government will extend its track record of proactive and swift adoption of international standards and international cooperation. The government is actively working to implement a global minimum tax rate on corporate profits of 15% from its currently flax tax of 12.5% starting in 2023. All else being equal, this would likely lead to higher corporate tax revenue, although the impact on the tax base is not fully clear yet. We do not expect any significant adverse effect on the government's budgetary position, however. This is based on our assumption of usually conservative government budgeting and the low probability of sudden outward migration of businesses due to taxation changes, as well as on the government's large asset position.

Flexibility and performance profile: Budget balance will remain in positive territory over the forecast horizon, despite the lower economic growth outlook

- Rising energy and food prices will drive inflation to about 3.1% this year.
- Prudent government policymaking and economic diversification will result in a general government surplus of about 3.8% of GDP over 2022-2025.
- The government's large asset position and social security funds, totaling an estimated Swiss franc (CHF) 7.8 billion or 117% of 2022 GDP, according to our estimates, provide ample leeway for unexpected budgetary costs or external shocks.

We believe Liechtenstein's strong economic recovery resulted in better-than-expected fiscal performance in 2021. This was thanks to strong tax revenue growth across most items. We estimate Liechtenstein's general government surplus will narrow but remain high at 5.0% in 2022, owing to higher inflation boosting government revenue and the elimination of temporary pandemic-related budgetary support measures. In our view, the budgetary framework includes sufficient buffers to accommodate potential pressures stemming from a slowdown in economic activity or inflow of refugees from Ukraine. The current government has prolonged the targeted COVID-19 support measures until the end of June 2022, but usage remains low and no additional support measures are planned for now. No further economic or budgetary support measures are currently planned but we understand the government is willing to deploy them if needed.

In our view, the principality will run a general government surplus of about 3.8% of GDP on average during 2022-2025. Overall, the central government has no debt outstanding and the general government, including 11 municipalities and the social security system, has very little debt at below 1% of GDP, which relates to short-term loans contracted by some municipalities. Expected budget surpluses during our forecast horizon will lead to an accumulation of government assets over the next few years, further strengthening Liechtenstein's ample fiscal buffers.

We expect the general government's liquid financial assets, including social security and pension funds, will stay above 100% of GDP over our forecast horizon through 2025. Most of these government assets are either denominated in Swiss francs or hedged against exchange rate risk. Total government assets depend not only on the performance of the central government's budget, but also on returns achieved on assets in financial markets. As witnessed in the past, some valuation risks remain, due notably to financial market volatility.

Inflation has increased in recent months, and we estimate it stood at 2.5% year-on-year in April, mainly due to higher energy prices. It is significantly below eurozone inflation, which we estimate reached 7.5% in the same month. We expect inflation to average about 3.1% for 2022, before moderating in the coming years.

The economy's financial industry consists of banks, asset managers, insurance companies, and trust and company service providers. We believe the sector poses a moderate contingent liability for the government. For example, banks' assets represent more than 11x local GDP. We understand the banking sector exposure to Russian clients remains relatively small and manageable. Sanctions in Liechtenstein are the same as those applied in the EU, the U.S., and the U.K. They include, among other things, measures targeting Russian clients on the sanctions list. In our view, most banks are well capitalized, and follow a comparably low-risk model as asset managers. Under our Banking Industry Country Risk Assessment, we assess Liechtenstein at '2' (where '1' is the lowest risk and '10' the highest; see "Banking Industry Country Risk Assessment Update: April 2022," published April 26, 2022, on RatingsDirect).

Liechtenstein is in a contract-based monetary union with Switzerland, and its economy is closely synchronized with its larger neighbor. This enables the sovereign to use the Swiss franc as legal tender and provides direct access to the Swiss National Bank's (SNB's) liquidity facilities against eligible collateral, on par with any Swiss financial institution. However, Liechtenstein has no vote on the SNB's monetary policy council and receives no benefits from seigniorage (profit made by a government by issuing currency). This set-up reduces Liechtenstein's monetary flexibility.

In our rating, we continue to consider the lack of comprehensive data on Liechtenstein's external accounts, since there are no data available for external trade and balance of payments. However, there is more visibility on certain aspects of the country's international investment position through financial institutions' aggregated external accounts. This has also improved transparency vis-à-vis Swiss counterparties, indicating the sector's high external creditor position. However, data on the external accounts of the public sector and nonfinancial private sector remain unavailable. We therefore base our assessment of Liechtenstein's external position on that of Switzerland, factoring in the absence of comprehensive external data.

Key Statistics

Table 1

Liechtenstein--Selected Indicators

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Economic indicators (%)										
Nominal GDP (bil. CHF)	6	6	7	6	6	7	7	7	7	7
Nominal GDP (bil. $)	6	6	7	6	6	7	7	7	7	7
GDP per capita (000s $)	165.0	169.9	174.4	165.9	156.5	183.1	176.7	175.7	180.2	182.7
Real GDP growth	2.5	4.1	1.9	(2.3)	(9.7)	13.0	0.4	2.0	1.6	1.2
Real GDP per capita growth	2.0	3.3	1.2	(3.3)	(10.4)	12.3	(1.1)	1.2	1.1	0.6
Real investment growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Investment/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Exports/GDP	54.6	52.9	55.9	57.9	49.5	53.1	52.7	51.2	50.0	48.9
Real exports growth	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Unemployment rate	2.3	1.9	1.7	1.5	1.9	1.6	1.6	1.5	1.5	1.5
External indicators (%)										
Current account balance/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Current account balance/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
CARs/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trade balance/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net FDI/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net portfolio equity inflow/GDP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Gross external financing needs/CARs plus usable reserves	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Narrow net external debt/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Narrow net external debt/CAPs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net external liabilities/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Net external liabilities/CAPs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Short-term external debt by remaining maturity/CARs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Usable reserves/CAPs (months)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Table 1

Liechtenstein--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Usable reserves (mil. $)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Fiscal indicators (general government; %)										
Balance/GDP	3.2	3.0	3.1	3.8	7.8	5.2	5.0	2.6	4.2	3.4
Change in net debt/GDP	(2.7)	(6.5)	1.3	(10.1)	(11.7)	(8.1)	(5.6)	(5.7)	(5.9)	(6.1)
Primary balance/GDP	3.2	3.0	3.1	3.8	7.8	5.2	5.0	2.6	4.2	3.4
Revenue/GDP	27.5	26.8	26.8	28.4	40.6	30.2	32.0	31.5	32.0	32.2
Expenditures/GDP	24.3	23.9	23.7	24.6	32.8	25.0	27.0	28.9	27.8	28.8
Interest/revenues	0	0	0.1	0.1	0	0	0	0	0	0
Debt/GDP	0.5	0.6	0.5	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Debt/revenues	1.9	2.2	2.0	2.2	1.5	1.8	1.7	1.7	1.6	1.5
Net debt/GDP	(90.3)	(93.5)	(89.8)	(102.2)	(125.4)	(117.5)	(122.2)	(124.6)	(127.6)	(130.9)
Liquid assets/GDP	90.8	94.1	90.4	102.8	126.1	118.1	122.7	125.1	128.1	131.4
Monetary indicators (%)										
CPI growth	(0.4)	0.5	0.9	0.4	(0.7)	0.6	3.1	1.3	1.0	1.3
GDP deflator growth	(0.6)	(0.4)	0.7	(0.1)	(0.5)	1.4	0.4	0.8	0.8	1.0
Exchange rate, year-end (CHF/$)	1.02	0.98	0.98	0.97	0.88	0.91	0.97	0.96	0.96	0.97
Banks' claims on resident non-gov't sector growth	(3.0)	(44.0)	7.7	1.0	2.1	3.0	5.0	3.5	3.0	3.0
Banks' claims on resident non-gov't sector/GDP	368.0	198.6	208.4	215.7	245.0	220.2	229.3	230.9	232.2	233.9
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(2.8)	(1.3)	(5.1)	0.8	2.2	0.4	N/A	N/A	N/A	N/A

Sources: Office of Statistics (Economic /Monetary/ Fiscal/Debt/External Indicators); International Monetary Fund (Monetary Indicators).

Adjustments: None.

Definitions: 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 claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. CHF--Swiss franc. 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

Liechtenstein--Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	1	Proactive policymaking and a strong track record in managing past economic and financial crises and delivering economic growth. Ability and willingness to implement reforms to ensure sustainable public finances and economic growth over the long term. Extensive checks and balances between institutions; Unbiased enforcement of contracts and respect for rule of law.
Economic assessment	1	Based on GDP per capita ($) as per the Selected Indicators table above.
External assessment	3	Given the customs and currency union between Switzerland and Liechtenstein, there is limited availability of comprehensive information on Liechtenstein's trade and external statistics. We base Liechtenstein’s external score on that of Switzerland and define Switzerland as the "host country". We believe this leads to an underestimation of external risks on the basis of available statistics.
Fiscal assessment: flexibility and performance	1	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1. Based on liquid assets to GDP as per Selected Indicators in Table 1. The general government (central and local government, and the social security system) hold large liquid financial assets above 100% of GDP.
Fiscal assessment: debt burden	2	Based on net general government debt (% of GDP) as per Selected Indicators in Table 1. Banks' contingent liabilities are assessed as moderate because banks' aggregated balance sheets account for more than 11x of local GDP. In addition, reputational risk for Liechtenstein remains, which can impact banks' profitability.
Monetary assessment	3	Liechtenstein uses the Swiss franc, which we treat as an actively traded currency. The Swiss National Bank (SNB) has a track record in monetary authority independence with market-based monetary instruments and has the ability to act as a lender of last resort for the financial system. The consumer price index is low and in line with that of its trading partners. Liechtenstein-based banks' access to SNB facilities is on par with that of Switzerland-based banks. Liechtenstein is a member of the Swiss franc area through a customs and monetary union with Switzerland, restricting individual monetary flexibility.
Indicative rating	aaa	As per Table 1 of "Sovereign Rating Methodology".
Notches of supplemental adjustments and flexibility	0	
Sovereign credit rating		
Foreign currency	AAA	
Notches of uplift	0	Default risks do not apply differently to foreign-and local-currency debt.
Local currency	AAA	

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). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings Score Snapshot, May 9, 2022
- Sovereign Ratings List, May 6, 2022
- Sovereign Ratings History, May 6, 2022
- Default, Transition, and Recovery: 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022
- Banking Industry Country Risk Assessment Update: April 2022, April 26, 2022
- Global Sovereign Rating Trends: First-Quarter 2022, April 13, 2022
- Sovereign Risk Indicators, April 11, 2022; a free interactive version is available at http://www.spratings.com/sri
- Sovereign Debt 2022: Borrowing Will Stay High On Pandemic And Geopolitical Tensions, April 5, 2022
- Sovereign Debt 2022: Ukraine Conflict Could Push Developed EMEA's Commercial Borrowing Higher Than $1.6 Trillion, April 5, 2022
- Next Generation EU Will Shift European Growth Into A Higher Gear, April 27, 2021

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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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

Ratings Affirmed	
Liechtenstein	
Sovereign Credit Rating	AAA/Stable/A-1+
Transfer & Convertibility Assessment	AAA