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Research Update:

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

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Overview

- The principality closed its 2017 fiscal accounts with very high surpluses, driven by strong financial returns on its public assets, significantly increasing its strong net asset position.
- We believe the government will continue to pursue proactive policymaking in cooperation with international partners, and focus on avoiding damaging Liechtenstein's reputation as a financial center.
- We are therefore affirming our 'AAA/A-1+' long- and short-term sovereign credit ratings on Liechtenstein.
- The outlook is stable.

Rating Action

On June 1, 2018, 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 is based on our expectation that Liechtenstein will maintain its very strong economic and fiscal position. Its strong economy and the government's financial reserves provide the principality with leeway to adapt to potential future challenges to the country's tax and economic model.

The ratings could come under pressure if external shocks significantly weakened fiscal or external balances and stocks, leading to structural deterioration in economic growth and Liechtenstein's fiscal position. However, Liechtenstein's public sector has substantial financial and policy flexibility, which provide strong buffers to such potential shocks. In addition, we could lower the ratings if we observed increased international tax or financial regulatory pressure on financial centers, including Liechtenstein. This could severely constrain the government's political strategy and effectiveness over a prolonged period. We currently consider this scenario unlikely over the next two years.

Rationale

The ratings on Liechtenstein benefit from its very strong and well-established institutions, which enable the government to implement reforms, if necessary, to address challenges to the principality's fiscal and economic policies. In addition, the ratings are supported by outstandingly high GDP per capita, healthy public accounts, and the public sector's strong net creditor position. The principality's monetary flexibility is limited as it uses the Swiss franc.

Institutional and Economic Profile: Proactive policy-making will ensure compliance with international financial regulatory standards

- As a small country in the heart of Europe, Liechtenstein benefits from unlimited access to main European markets through its simultaneous membership in the European Economic Area and its customs union with Switzerland.
- Liechtenstein remains one of the wealthiest countries in the world on a per capita basis, due to its strong manufacturing sector, with several industrial niche players, and numerous financial service providers.
- The political system has a strong track record of efficient and predictable decision-making, particularly with respect to addressing international regulatory changes.

As a small financial center, the principality's reputation remains exposed to changes in international norms for financial regulation and fiscal cross-border cooperation. We do not expect Liechtenstein will be subject to international sanctions any time soon given that it has implemented various transparency initiatives and base-erosion and profit-shifting standards, as well as having signed tax cooperation agreements with multiple jurisdictions. Liechtenstein also expanded its double-taxation agreements and put in force a considerable number of new tax-information-exchange agreements with other countries, including a multilateral agreement on administrative assistance in tax matters. The EU has blacklisted nine countries--not including Liechtenstein--for not cooperating with EU anti-tax-evasion efforts. Liechtenstein remains on the watch list, together with 65 other countries, but we don't expect any political consequences at this stage as Liechtenstein committed to cooperate with the EU and intends to tackle the inquired tax issues.

The country's policymakers have a track record of proactively and swiftly adopting international standards. One example related to the automatic exchange of tax information with more than 80 jurisdictions, including Switzerland. The agreement with Switzerland will become effective in 2019.

The principality's political system comprises a constitutional hereditary monarchy, 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 the parliament. One of the most effective checks is the extensive use of direct democracy (referenda). The latest elections, in early 2017, confirmed the two ruling coalition parties, which have been in power for decades.

The country has a prosperous, open, and highly specialized economy benefiting from its customs and currency union with Switzerland. At the same time, Liechtenstein has unlimited access to the European Economic Area, which is unlikely to change. We currently view the economic development of the country as very balanced. Its two pillars are its globally competitive machinery industry (machinery, engines, and tool-building) and financial services.

The strong manufacturing base also differentiates Liechtenstein from other small financial centers. The manufacturing sector's share of gross value added is nearly twice the contribution from the financial sector. Economic diversification is further underpinned by the high share of small and midsize enterprises, including some that are world leaders in their niches. The financial sector is currently performing very well, posting high profits and significant asset inflows (see "Rating Actions Taken On Liechtenstein-Based LGT Bank And VP Bank On Stronger Business Positions," published May 17, 2018). Liechtenstein's labor market remains very strong, with additional employment filled by commuters from neighboring Switzerland and Austria. Even adjusted for these commuters, domestic GDP per capita remains one of the highest globally.

We have revised our expectations for real GDP growth upward to 2.3% in 2018, based on growth trends in the principality's main trading partners, Switzerland, the U.S., and the EU, with a slightly decreasing growth trend over the next few years. That said, Liechtenstein's nominal GDP has previously shown some volatility; it posted negative growth in 2015. This is inherent in an open economy with a population of just 38,000, and it reflects the comparably large effect that individual contributors can have on the economy's output.

Flexibility and Performance Profile: Strong budgetary performance increases government net assets

- The principality outperformed its budget for the third consecutive year in 2017, also benefiting from the very strong financial performance of its public assets.
- The general government net assets position has continued to strengthen over the past year.
- The currency union with Switzerland limits monetary flexibility and availability of comprehensive external data.

Liechtenstein's fiscal accounts are in a structural surplus and the principality again outperformed its budget in 2017. Primarily benefiting from a very strong performance of its financial assets, but also based on a primary budget surplus, the government has significantly increased its net asset position over the past year. The central government is free of debt and the

general government has negligible debt relating to very low short-term loans of municipalities. We expect the net change in debt to remain negative as assets accumulate over the next year, albeit at slower pace than 2017. Despite a reduction in value-added tax rates and some other potential revenue-reducing measures, we expect the public sector will run an average surplus of 1.4% of GDP in 2018-2021.

We expect the general government's liquid financial assets, including social security and pension funds, will reach around 94% of GDP and roughly remain so over our forecast horizon to 2021. We note that the 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 depend not only on the performance of the central government's budget, but also on returns achieved on assets in the financial markets. Consequently, some downside valuation risks remain, due notably to currency and equity market movements.

Although we do not view the financial industry as monolithic--it consists of banks, asset managers, insurance companies, and trust and company service providers--we consider the sector poses a moderate contingent liability for the government. For example, we estimate private sector credit at about 139% of GDP in 2017. However, Liechtenstein's banks are well-capitalized. Under our Banking Industry Country Risk Assessment we assess Liechtenstein at '2' (where '1' is the lowest risk and '10' is the highest; see "Banking Industry Country Risk Assessment: Liechtenstein," published Feb. 8, 2018).

Liechtenstein is in a monetary union with Switzerland, and its economy is closely synchronized with its larger neighbor. The principality has no vote on the Swiss National Bank's (SNB's) monetary policy council and receives no benefits from seigniorage. Being the junior member in the 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.

Our ratings also take into consideration the lack of data for external accounts. There is virtually no data available for external trade, balance of payments, and the international investment position within the Swiss franc area. We therefore base our assessment of Liechtenstein's external position on that of Switzerland, factoring in the absence of external data. That said, Liechtenstein's large net asset position and its local banks' predominant business model as asset managers indicate a strong external position.

Key Statistics

Table 1

Liechtenstein Selected Indicators										
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	5.1	5.9	6.1	6.1	6.1	6.3	6.4	6.6	6.8	7.0
Nominal GDP (bil. \$)	5.5	6.4	6.7	6.3	6.2	6.4	6.8	7.3	7.4	7.4
GDP per capita (000s \$)	148.1	172.1	178.2	167.2	164.8	166.8	177.7	188.5	189.1	188.8
Real GDP growth	0.9	12.1*	3.6	(0.4)	1.7	1.6	2.3	1.8	1.6	1.5
Real GDP per capita growth	(0.1)	11.3	3.0	(1.1)	1.2	0.8	1.6	1.1	0.8	0.8
Exports/GDP	65.8	56.7	56.6	53.1	54.7	53.6	52.1	50.6	49.4	48.1
Unemployment rate	2.4	2.5	2.4	2.4	2.3	1.9	1.7	1.7	1.7	1.7
FISCAL INDICATORS (% , General government)										
Balance/GDP	(2.4)	(1.0)	2.3	3.8	3.2	4.0	1.6	1.5	1.3	1.3
Change in net debt/GDP	(6.7)	(6.1)	3.1	(2.2)	(2.7)	(5.8)	(2.6)	(3.4)	(3.4)	(2.7)
Primary balance/GDP	(2.4)	(1.0)	2.3	3.8	3.2	4.0	1.6	1.5	1.3	1.3
Revenue/GDP	34.4	26.0	26.8	28.0	27.5	28.1	26.6	26.1	25.8	25.5
Expenditures/GDP	36.8	27.0	24.5	24.2	24.3	24.1	25.0	24.7	24.5	24.3
Interest /revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt/GDP	0.6	0.4	0.6	0.6	0.5	0.4	0.4	0.4	0.4	0.4
Debt/Revenue	1.7	1.7	2.2	2.0	1.9	1.6	1.6	1.6	1.6	1.5
Net debt/GDP	(99.3)	(91.8)	(86.1)	(89.0)	(90.4)	(94.5)	(94.4)	(95.1)	(96.1)	(96.4)
Liquid assets/GDP	99.9	92.3	86.7	89.5	90.9	94.9	94.9	95.5	96.5	96.8
MONETARY INDICATORS (%)										
CPI growth	(0.7)	(0.2)	(0.0)	(1.1)	(0.4)	0.5	0.7	0.9	1.3	1.3
GDP deflator growth	(0.5)	3.3	(0.6)	(0.3)	(0.3)	0.3	0.5	1.1	1.0	1.1
Exchange rate, year-end (LC/\$)	0.92	0.89	0.99	0.99	1.02	0.98	0.91	0.91	0.94	0.94
Banks' claims on resident non-gov't sector growth	(7.7)	1.6	8.0	4.6	18.3	3.8	3.8	3.5	3.5	3.5
Banks' claims on resident non-gov't sector/GDP	240.7	211.2	221.5	233.3	272.2	277.0	279.6	281.2	283.7	286.3
Real effective exchange rate growth	(0.7)	(1.3)	1.3	9.9	(2.3)	(0.2)	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. *Statistical effect due to alignment to ESGV 2010.

Ratings Score Snapshot

Table 2

Liechtenstein Ratings Score Snapshot	
Key rating factors	
Institutional assessment	1
Economic assessment	1
External assessment	3
Fiscal assessment: flexibility and performance	1
Fiscal assessment: debt burden	2
Monetary assessment	3

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

- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Global Sovereign Rating Trends: First-Quarter 2018 - April 11, 2018
- Sovereign Ratings History - May 7, 2018
- Sovereign Ratings List, May 7, 2018
- Banking Industry Country Risk Assessment: Liechtenstein - February 8, 2018
- Sovereign Debt 2018: Global Borrowing To Remain Steady At US\$7.4 Trillion - February 22, 2018
- Default, Transition, and Recovery: 2017 Annual Sovereign Default Study And Rating Transitions - May 8, 2018
- Credit FAQ: What's New In S&P Global Ratings' Updated Sovereign Rating Methodology? - December 18, 2017
- Calendar Of 2018 EMEA Sovereign, Regional, And Local Government Rating Publication Dates - December 15, 2017
- Sovereign Risk Indicators - April 10, 2018. An interactive version is

also available at <http://www.spratings.com/sri>

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

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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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at

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