

COUNTRY PROFILE:**GRAND DUCHY OF LUXEMBOURG****DATED:****MAY 2009****CREDIT GUARANTEE:**

IES/02: ATTACHMENT A

Recent Political Highlights

- The Grand Duchy of Luxembourg is a hereditary constitutional monarchy ruled by the Grand Duke Henri. Legislative power is exercised by the unicarmel Chamber of Deputies with 60 members elected for five-year terms. The June 2004 elections resulted in the formation of a new Christian Democrat/ Socialist government and the next elections will be held in June 2009. Recent polls indicate a high level of approval for the work of the current government with the global financial crisis having no tangible impact on public perceptions so far.

Recent Economic Highlights

- Luxembourg's population is estimated at 491,775 with annual growth rate of 1.2%.
- The economy of Luxembourg is largely dependent on the banking, steel and industrial sectors. Banking is the largest sector in the economy. Steel accounts for 29% of all exports, 1.8% of GDP and 3.9% of the work force. Although Luxembourg has weathered the global economic crisis better than expected, its manufacturing industry which exports almost its whole production is experiencing a downturn. The contraction in European demand is weighing heavily on the economy's traditional export sectors.
- The ongoing financial turmoil poses daunting challenges to Luxembourg's small open economy. As at the end of March 2009, the financial sector hosted 152, mostly foreign-owned subsidiary banks with over 27,000 employees. Luxembourg is the second-largest mutual fund market after the US with about 3403 registered funds holding €1.53 trillion in assets thus it's fully exposed to the financial global crisis. The continued flow of liquidity from Luxembourg's financial sector is important to financial stability in the euro area; any instability in money market funds will represent a systematic risk to the euro area. The IMF has advised Luxembourg to safeguard the country's reputation as a well run financial centre.
- GDP growth fell from 5.2% in 2007 to 1% in 2008, with the economy expected to contract by 0.9% in 2009 before stabilising in 2010. The IMF forecasts growth to fall by 3.8% this year. The EIU estimates that inflation averaged 3.4% in 2008 and will fall to 0.5% in 2009 and rise to 1.2% in 2010. The unemployment rate is expected to remain between 5% and 6% until 2010.
- The Luxembourg government has been working on a package of economic and social measures to combat the global financial crisis, with infrastructure projects scheduled for 2011-2012 brought forward. The package is valued at over 3% of GDP and would result in a 25% increase in public spending. The measures will see Luxembourg record a record budget deficit of around 1% of GDP for 2009.
- Bernard Madoff's global fraud is not expected to have a long term effect on Luxembourg's fund industry, the head of the country's financial regulator CSSF (Commission de Surveillance du Finaceir) has said. The CSSF was forced to seek the liquidation of three funds that invested with Madoff. Another 14 sub-funds ceased redemptions to customers. Investors from across Europe have swamped Luxembourg courts with lawsuits suing Luxembourg-based banks, auditors and the CSSF, seeking compensation. There may be huge losses for single investors but potential losses in Luxembourg funds through Madoff could be as much as €1.7bn, about 0.15% of the assets managed by Luxembourg funds. The regulator is proceeding with investigations into the way custodian banks including Luxembourg units UBS AG and HSBC Holdings, handled money for local investment funds affected by Madoff. After Madoff's arrest, the CSSF created a team of 12 specialists to work on Madoff-related cases. Luxembourg's strict laws on banking secrecy mean the system can be exploited for the purposes of tax evasion and fraud.

Latest Trade Developments

- Major exports: machinery and equipment, steel products, chemicals, rubber products, glass.
- Main imports: minerals, metals, foodstuffs and quality consumer goods.
- Main trading partners: Germany, France, Belgium, Italy, UK, Netherlands, Spain and China.
- South African exports to Luxembourg totaled R90.5m in 2007, R916m in 2008 and R85.6m in the year-to February 2009.
- Luxembourg's Minister of the Treasury has signed a taxation treaty with Finance Minister of Bahrain to avoid double taxation and fiscal fraud in terms of income and capital taxation in the Grand Duchy of Luxembourg and the Kingdom of Bahrain.