Principality of Liechtenstein: Staff Concluding Statement for the 2025 Article IV Mission

FOR IMMEDIATE RELEASE

Washington, DC – January 20, 2025: *An International Monetary Fund (IMF) mission, led by Kazuko Shirono, conducted discussions for the 2025 Article IV Consultation during January 7-20 with the Principality of Liechtenstein. At the end of the visit, the mission issued the following statement:*

Context

1. **The Principality of Liechtenstein, the IMF's newest member from October 2024, is participating in its first Article IV consultation.** Liechtenstein has a high per capita income and a fiscal framework that has ensured no deficits since 2013, virtually no public debt, and accumulation of large fiscal buffers. Activity is underpinned by specialized and export-oriented manufacturing and private banking and wealth management oriented financial services. Liechtenstein is globally integrated, with close economic ties with Switzerland and the EU.

Recent economic developments and outlook

2. **In recent years, economic activity has been volatile and affected by consecutive shocks.** Output contracted in 2020 with COVID-19 but strongly rebounded in 2021. The economy contracted again in 2022-23, reflecting disruptions in exports and spillovers from Russia's war in Ukraine. Unemployment has been lower than the EU average. The labor market remains tight reflecting skills shortages and labor hoarding.

3. **The economy is recovering moderately.** The economy likely recorded growth of around 0.5 percent in 2024 and is expected to continue to expand moderately in 2025, supported by a recovery in external demand and growth in the financial sector. The labor

market will remain tight, supporting activity, and unemployment will slightly decline. In the medium-term, the economy is projected to reach potential growth of 2 percent—slightly below pre-pandemic average growth. Inflation is expected to remain low and in line with Switzerland.

4. Risks are tilted to the downside. As an open economy, a potential global slowdown or accelerated geo-fragmentation would adversely affect exports and impede recovery. Other risks are heightened uncertainty in major economies, sharp appreciation of the franc, and/or negative interest rates in Switzerland. The financial center faces some risks from dependency on a foreign client base. Elevated household indebtedness presents vulnerabilities to large shocks. On the other hand, large fiscal buffers provide room to address shocks. Businesses' tendency to retain skilled workers during downturns helps stabilize employment and maintain tax revenue streams.

Fiscal policy

5. Fiscal policy is expected to remain conservative with continued surpluses and accumulation of buffers. The 2025 budget envisages higher spending on investment, including a national hospital and a reserve allocation to the occupational pension scheme for state employees, offset by higher tax revenues (CIT and VAT). A surplus of 3 percent of GDP is expected—just below the 3.2 percent in 2024.

6. Fiscal policy should broaden its scope beyond building buffers. The fiscal framework aims at maintaining at least a balance in the central government's income statement, independent of the cycle. This has supported consolidation for the past decade, establishing credibility and building large buffers, justified in part by Liechtenstein's vulnerability to shocks. However, this approach abstracts from fiscal policy's role as the sole lever to mitigate the impact of the cycle in the absence of monetary policy. While the effect of fiscal policy is more limited than for larger economies due to Liechtenstein's small size and openness, the Principality is well equipped with the necessary tools to dampen the impact of shocks—automatic stabilizers, notably progressive personal income taxes and unemployment benefits that are automatically triggered during downturns. In navigating the uncertain global environment and with substantial buffers now in place, the authorities should focus on the stabilization role of fiscal policy going forward.

7. Liechtenstein faces medium-term spending needs arising from aging, climate, and public investments. In the medium-term, surpluses of over 3 percent of GDP are expected. No major tax reforms are envisaged, and investment in health and education will be accommodated within budget rules. However, future budgets will need to address looming medium-term spending pressures, whose full extent is yet to be assessed:

- *Demographics:* The population 65 years and above is expected to reach 28.6 percent by 2050, adding to pensions and health outlays. Pillar I pension projections indicate that assets will fall from 9.8 to 3.1 years of annual expenditures by 2043, well below the statutory 5-year minimum. If reserves fall below the minimum threshold, the law suspends the inflation adjustment of the old-age, survivors' and disability insurance benefits.

- *Climate:* Liechtenstein is exposed to extreme weather events, including drought, flooding, and landslides; transitional risks towards a greener economy are also present. Reaching ambitious climate targets will necessitate more spending on renewable energy.

- *Growth-enhancing investment*: Data point to declining growth over time. Sustaining Liechtenstein's growth model depends on a continued supply of foreign, skilled workers and therefore more productivity-supporting investments, including for infrastructure and public services.

8. Despite long-term spending needs, costing has been limited. Against the background of large fiscal buffers, planning for necessary long-term investments is key. While budget rules have some flexibility, they require upfront identification of financing. All large investment projects should be systematically identified, costed and prioritized, with funding sources and implementation modalities set at a later stage.

Financial Sector Policies

9. The financial center strategy following the global financial crisis has been anchored by compliance with international standards and regulations. Key measures have included reform of the laws governing the fiduciary sector, adherence to automatic exchange of information in tax matters and the OECD's Base Erosion and Profit Shifting (BEPS) initiatives, and implementation of comprehensive AML/CFT measures. Financial supervision is fully integrated with the European System of Financial Supervision framework, with the Financial Markets Authority (FMA) as the independent national supervisory authority. EU regulations are promptly transposed into Liechtenstein law.

10. The banking sector is liquid and well-capitalized although risks remain. The sector is focused on private banking and wealth management and dominated by three banks. Balance sheets and assets under management (AUM) are large relative to the size of the GDP. The sector's capital and liquidity buffers are well above regulatory requirements. Non-performing loans are low. However, profitability is under pressure, reflecting the high cost of the private banking model, compliance, and digitalization investments. AUM activities are off-balance sheet and do not present direct financial risks; however, the international client base warrants continued close monitoring, including for ML/TF risks and adherence to sanction regimes.

11. Macroprudential policies should continue to be calibrated in line with the evolution of financial stability risks. Household indebtedness, primarily mortgages, remains high at 115 percent of GDP. The authorities employ a comprehensive macroprudential toolkit, with capital-, lender-, and borrower-based measures, including an amortization requirement for mortgages based on affordability standards. The FMA has improved data collection to better monitor mortgage-related risks, and additional data on market prices would further support macroprudential oversight. The authorities plan to implement CRR-III rules in 2025, including for mortgage exposures.

12. While the comprehensive AML/CFT framework has been further strengthened in recent years, continued vigilance is warranted. The financial center model presents ML/TF risks, and adherence to sanctions regimes is fundamental. Even small breaches carry risks that could, for example, jeopardize correspondent banking relationships, with a negative impact for the sector. The FMA initiated risk-based AML/CFT supervision in 2018, and an update of the national ML/TF risk analysis (NRA) is scheduled for February 2025. In response to recommendations in the 2022 MONEYVAL review, the authorities have notably increased onsite inspections, including for the fiduciary sector. The planned revision of the Professional Trustees Act, which would provide the FMA more insight and power to intervene, is an important step to further mitigate prudential risks in the sector.

Structural Reforms

13. Continued reforms are needed to address skills shortages. Demand for skilled workers is expected to persist and exceed resident labor supply. Reflecting skills shortages, the share of cross-border commuters has increased to 57 percent of employment from 25 percent in the 1980s. Infrastructure constraints, including in transport, could limit growth in commuters and should be addressed. In addition, residents should increasingly attain required skills. Government efforts appropriately prioritize job training and reintegration, expanded educational programs, and skills development through targeted incentives.

14. Additional efforts are needed to increase labor supply, including women and older workers. While the female labor market participation has increased, it remains below men. A sizeable gender wage gap exists, higher than in Switzerland or the EU average. Offering flexible work options, extending parental leave for men, and subsidizing childcare should continue. As labor shortages are exacerbated by demographics, measures to enhance labor supply of older workers should be explored, including flexibility in retirement age and work schedules.

15. The pension system has substantial buffers, but actions are needed to close future financing gaps. Pillar I assets account for 60 percent of GDP, laying a foundation for retirement incomes with a replacement ratio of 35 percent. Occupational pension schemes complement Pillar I with 120 percent of GDP of assets, along with private savings (Pillar III). Yet aging will pressure the system going forward, calling for measures to ensure sustainability, including raising the retirement age and/or contributions.

16. Climate reforms are progressing. Liechtenstein successfully met its Kyoto target, achieving a 20 percent reduction in GHG emissions. Recently, Parliament adopted a long-term climate strategy aiming for climate neutrality by 2050 and an interim target to reduce greenhouse gas emissions by 55 percent by 2030 relative to 1990; the authorities intend to amend the Emission Trading Act in line with the EU’s directive. Estimating climate related expenditures in the forthcoming update of the climate adaptation strategy is important to advance the green transition.

17. Policies to address cybersecurity risks have been implemented and continued oversight is needed. The National Cyber Security Unit was created in 2022 to monitor threats, protect critical infrastructure, and coordinate information sharing within the country and with neighboring authorities. This has been supplemented with a new unit within the FMA tasked with supervising and auditing cybersecurity at financial institutions. The unit will oversee implementation of the EU Digital Operational Resilience Act (DORA), which became effective in January 2025. Going forward, intra-institutional coordination remains key due to the evolving cybersecurity risks.

Closing data gaps

18. Liechtenstein has significant gaps in macroeconomic statistics that the authorities have pledged to address. The gaps reflect the small size of the administration and limited resources allocated. The authorities agree that improving the timeliness of national accounts (currently available 23 months after the reference year) and then establishing balance of payment (BOP) statistics are priorities. Additional resources allocated to the Office of Statistics is a step in the right direction, and leveraging intra-institutional collaboration, including with the Office of Statistics, the FMA, the Fiscal Authority, and the Liechtenstein-Institute, will further facilitate data collection, compilation, and dissemination.

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