MOODY'S
RATINGS

Rating Action: Moody's Ratings affirms Luxembourg's Aaa ratings, maintains stable outlook

07 Feb 2025

Paris, February 07, 2025 -- Moody's Ratings (Moody's) has today affirmed the Aaa senior unsecured and long-term issuer ratings of the Government of Luxembourg. The outlook remains stable.

The affirmation of the Aaa ratings is driven by our expectation that Luxembourg's debt burden will remain very low and broadly stable, while its debt affordability metrics will remain significantly stronger than peers, despite a gradual weakening. It also reflects the robust growth prospects and exceptionally high wealth levels of the Luxembourgish economy, as well as a level of institutions and governance strength that remains among the highest of our rated sovereigns.

The stable outlook reflects our view that Luxembourg's credit profile will remain resilient to the economic growth challenges that many European countries are facing. Given the economy's small size and high reliance on financial services, the strength of the government's balance sheet is of particular importance to the sovereign credit profile. In this context we expect the strength of Luxembourg's institutions, in particular in terms of fiscal policy effectiveness and financial sector supervision, to ensure that risks to the public finances or financial stability will continue to be effectively managed.

Luxembourg's local- and foreign currency country ceilings remain unchanged at Aaa. For euro-area countries, a six-notch gap between the local-currency ceiling and the local currency rating (in Luxembourg's case, a zero-notch gap applies, which brings the ceiling to the maximum level of Aaa) as well as a zero-notch gap between the local-currency ceiling and foreign-currency ceiling is typical, reflecting benefits from the euro area's strong common institutional, legal and regulatory framework, as well as liquidity support and other crisis management mechanisms. It is also in line with our view of de minimis exit risk from the euro area.

RATINGS RATIONALE

RATIONALE FOR THE AFFIRMATION OF THE Aaa RATINGS

A LOW AND STABLE DEBT BURDEN COUPLED WITH DEBT AFFORDABILITY METRICS THAT WILL REMAIN VERY STRONG DESPITE A GRADUAL WEAKENING

Luxembourg's government debt burden will remain among the lowest of Aaa-rated sovereigns. We estimate that debt stood at 25.9% of GDP at the end of 2024 (only a marginal increase relative to 2023), and we expect the debt burden to remain broadly stable also in 2025 and 2026. This reflects our estimate that the general government recorded a small fiscal surplus in 2024, and our expectation that this will remain the case in 2025 and 2026.

These projections for the government financial balance and debt burden are materially stronger than our previous forecasts, as strong revenue growth across the board outpaced substantial growth in expenditures. Some of the support measures introduced to help households and businesses weather the economic downturn and rise in the cost of living in recent years were phased out already in 2024, while we expect additional energy price support measures will be phased out by the end of 2025.

We expect Luxembourg's debt affordability metrics to weaken somewhat in coming years as the sharp shift in the global interest rate environment in the recent past forces the government to refinance its maturing debt at significantly higher rates. While we project Luxembourg's interest payments-to-revenue ratio will increase from 0.7% in 2024 to just below 1% in 2026, it will remain significantly below the median of Aaa-rated peers.

LUXEMBOURG'S ROBUST GROWTH PROSPECTS AND EXCEPTIONALLY HIGH WEALTH LEVELS

We expect Luxembourg will record real GDP growth of 2.4% in 2025 and 2026, making it one of the fastest growing economies among Aaa peers. We estimate that Luxembourg returned to solid growth of 1.7% already in 2024, following a 1.1% contraction in 2023, driven by weak external demand and investment in that year.

While the economy's rebound in 2024 and 2025 is partly driven by base effects following the contraction in 2023, we expect the economy to continue growing at robust rates in coming years, supported by a broader economic rebound in the euro area as well as still robust domestic consumption and a gradual pick up in investment as interest rates fall and the country's construction industry gradually recovers from its contraction in recent years.

The strength and resilience of Luxembourg's credit profile is also underpinned by the country's extraordinarily high wealth levels. At over US$ 150,000 on a purchasing power parity (PPP) basis in 2024, GDP per-capita was much higher than the median for Aaa-rated countries and among the highest of all Moody's rated sovereigns.

The large financial services sector, which accounts for just over one fifth of Luxembourg's GDP remains a key engine of growth and stands out by its relative size in comparison to other European countries. The financial services sector is well diversified in areas such as investment funds, wealth management and insurance but other sectors such as information and communications technology (ICT), logistics and satellites also help diversify the country's economic base.

LUXEMBOURG'S EXCEPTIONALLY HIGH LEVEL OF INSTITUTIONS AND GOVERNANCE STRENGTH

Despite its small size, we consider Luxembourg as having one of the highest levels of institutions and governance strength of all rated sovereigns. This has been demonstrated in recent years by the authorities' ability to counter shocks and mitigate an increase in potential risks for the economy, public finances and the financial services sector.

The government effectively intervened to support households' purchasing power and the ailing construction sector, to counter the impact of the rise in inflation and interest rates since 2022. This has contributed to the economy weathering the contraction of 2023 without significant lasting damage, with the public finances also brought back to balance much sooner than expected from a moderate deficit of 0.7% of GDP in 2023. We also believe that the strong cross-party consensus to maintain the government debt burden below 30% of GDP remains intact.

The effective supervision of the financial services sector is particularly important, given its large size and importance to the overall economy. Our assessment of Luxembourg's institutions and governance strength thus receives support from the prudent supervision and rigorous control of credit institutions and other financial entities. This reflects both its monitoring of risks during the recent period of turbulence in the real estate market as well as through reforms that have been implemented in recent years to strengthen the resilience of the financial system, not least through the introduction of borrower-based macroprudential measures.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

Luxembourg's exposure to environmental risks is low across most categories. That said, Luxembourg is exposed to elevated flood risk. Though Luxembourg is small, it has 1800km of waterways, including many small rivers that can be vulnerable to flooding when large amounts of rain fall in a short time. Effective monitoring and preparation for potential flooding helps mitigate risks. The large number of cross-border workers employed in Luxembourg also poses some environmental challenges. For example, this may make large emissions reductions more challenging to achieve, even though the government has implemented measures such as free public transportation and an enhanced electrical vehicle charging network. A high degree of urbanization, which is related to this issue, also increases pressures on biodiversity. However, these risks are quite manageable for the sovereign and its overall E issuer profile score is therefore (E-2).

Luxembourg shows very low or low exposure to most sources of social risks, with particularly strong scorings in health and safety and access to basic services. Quality and access to education pose limited risks. Domestic political discussion focuses on income distribution and housing issues, but overall social risks from them are neutral to low. Like other advanced economies, Luxembourg faces long-term economic and fiscal pressures from population ageing, but these are mitigated by the sizable buffers in the social security funds, posing moderately negative risks. That said, the age at which the workers leave the labor force is among the lowest in Europe at just under 61 years. Overall, we assess Luxembourg's S issuer profile score as (S-2).

Luxembourg's very high institutions and governance strength is reflected in a G issuer profile score (G-1). This is underpinned by the government's high credibility, transparency and consensus on key fiscal policy goals and macroeconomic policies. Despite its very small size, Luxembourg has a professional and well-staffed public administration. Coupled with the government's very strong balance sheet this supports a very high degree of resilience.

Luxembourg's ESG Credit Impact Score is (CIS-1), reflecting low exposure to environmental and social risks, and like many other advanced economies, very strong governance and capacity to respond to shocks.

GDP per capita (PPP basis, US$): 148,694 (2023) (also known as Per Capita Income)

Real GDP growth (% change): -1.1% (2023) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 3.2% (2023)

Gen. Gov. Financial Balance/GDP: -0.7% (2023) (also known as Fiscal Balance)

Current Account Balance/GDP: 6.8% (2023) (also known as External Balance)

External debt/GDP: 4548.3% (2023)

Economic resiliency: aa2

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 04 February 2025, a rating committee was called to discuss the rating of the Luxembourg, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutions and governance strength, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. Other views raised included: The issuer's susceptibility to event risks has not materially changed.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects our view that Luxembourg's credit profile will remain resilient to the economic growth challenges that many European countries face. High levels of immigration help counter the effects of population ageing on the labour force, while Luxembourg's focus on high-value added services limits its exposure to the challenges facing the manufacturing industry in many European countries, including its largest export partner Germany (Aaa stable).

Given the economy's small size and high reliance on financial services, the strength of the government's balance sheet is of particular importance to the sovereign credit profile. We expect the strength of Luxembourg's institutions, in particular in terms of fiscal policy effectiveness and financial sector supervision, to ensure that risks to the public finances or financial stability will continue to be effectively managed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade of Luxembourg's ratings is not possible as its Aaa ratings are at the highest level on our ratings scale.

Downward pressure on the stable outlook, and ultimately Luxembourg's Aaa rating would arise if we were to anticipate a large, permanent increase in the government's debt burden and associated significant deterioration in debt-affordability metrics. Luxembourg's debt levels are low relative to peers but the country's small size somewhat limits its ability to take on significant quantities of debt compared to larger, more diversified economies.

A significant weakening of the growth potential of the Luxembourgish economy, coupled with evidence of weakening institutional strength or a surge in financial sector risks with potential negative implications for the economy and the government balance sheet could also put negative pressure on the ratings.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at https://ratings.moodys.com/rmc-documents/395819 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

Luxemburg's "a1" economic strength is set above the initial score of "a3" to reflect Luxembourg's exceptionally high level of income per-capita, which we believe offsets the constraints related to the country's small size. This leads to a final scorecard-indicated outcome of Aaa-Aa2, compared to an initial scorecard-indicated outcome of

Aa1-Aa3. The assigned rating is within the final scorecard-indicated outcome.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions .

For any affected securities or rated entities receiving direct credit support/credit substitution from another entity or entities subject to a credit rating action (the supporting entity), and whose ratings may change as a result of a credit rating action as to the supporting entity, the associated regulatory disclosures will relate to the supporting entity. Exceptions to this approach may be applicable in certain jurisdictions.

For ratings issued on a program, series, category/class of debt or security, certain regulatory disclosures applicable to each rating of a subsequently issued bond or note of the same series, category/class of debt, or security, or pursuant to a program for which the ratings are derived exclusively from existing ratings, in accordance with Moody's rating practices, can be found in the most recent Credit Rating Announcement related to the same class of Credit Rating.

For provisional ratings, the Credit Rating Announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating.

Moody's does not always publish a separate Credit Rating Announcement for each Credit Rating assigned in the Anticipated Ratings Process or Subsequent Ratings Process.

These ratings are solicited. Please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website https://ratings.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/rmc-documents/435880.

The Global Scale Credit Rating(s) discussed in this Credit Rating Announcement was(were) issued by one of Moody's affiliates outside the UK and is(are) endorsed for use in the UK in accordance with the UK CRA Regulation.

Please see https://ratings.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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