DOMESTIC ECONOMY

After a contraction phase beginning in mid-2021 and a temporary upswing around the turn of the year 2022 / 2023, the business cycle outlook for Liechtenstein's economy has recently worsened again. Liechtenstein's economy benefited from the international economic recovery from the COVID-19 recession of the first half of 2020 and profited from catch-up effects, especially in exports of investment and intermediate goods, which are highly important for the domestic economy. Liechtenstein's estimated quarterly real GDP (seasonally / calendar adjusted, Figure 6) reached the pre-crisis level very early in international comparison, already in the first quarter of 2021. However, these catch-up effects gradually receded, as the international economy normalised its pace.

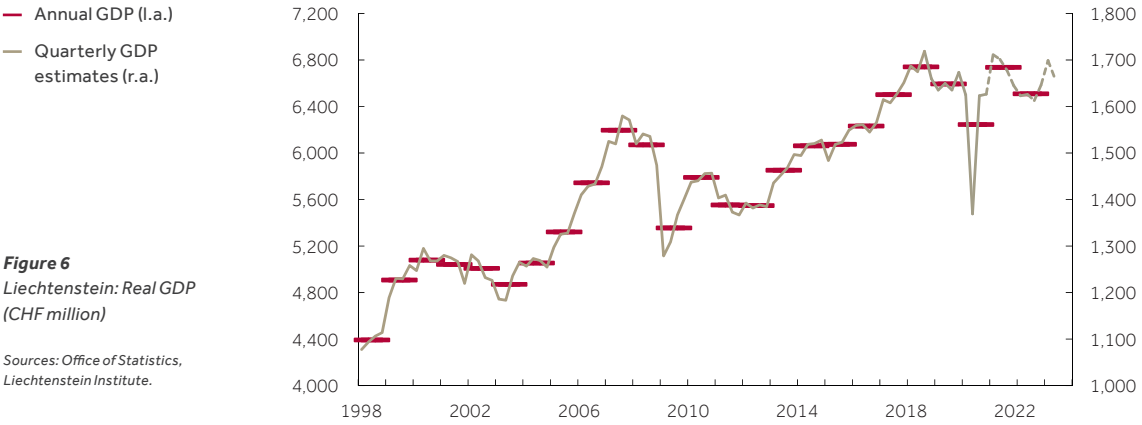


Figure 6
Liechtenstein: Real GDP (CHF million)

Sources: Office of Statistics, Liechtenstein Institute.

Liechtenstein's strong recovery after the COVID-19 recession was supported by targeted policy measures, although the fiscal response remained small by international standards. In international comparison, the Liechtenstein government spent relatively little on support measures for the economy, with total uptakes of policy measures being limited to around 2.2% of GDP throughout the entire pandemic (see Box 2). The main pillar of the economic crisis response in Liechtenstein was the short-time work program. These measures were primarily aimed at preserving production capacity during shut-down periods, and effectively stabilised employment and prevented bankruptcies.

Towards the turn of the year 2021 / 2022, ongoing supply chain issues exacerbated the global slowdown. The start of the Russian war against Ukraine in February 2022 represented a further obstacle for the world economy and thus also for Liechtenstein's export industry and its economy as a whole. These factors led to a gradual decline of Liechtenstein's GDP until the third quarter of 2022. The international economic sentiment gradually decoupled from the Russian invasion over the course of 2022. At the same time, however, global monetary tightening has gained traction. The recent economic slowdown of the world economy, especially in Liechtenstein's important export destinations (such as Germany or China),



Figure 7
Cyclical indicator "KonSens" (index)

Source: Liechtenstein Institute.

interrupted the swift but short real GDP upswing. The strong GDP growth in the fourth quarter of 2022 and the first quarter of 2023 was followed by a renewed decrease in the second quarter of 2023.

Recent cyclical indicators feature heterogeneous business cycle signals with strong employment data, robust business sentiment, but a decrease in goods exports and imports. The KonSens (Figure 7), a quarterly index that summarises 16 data series, which are indicative for domestic business cycle developments, has remained negative in the second quarter of 2023, indicating economic growth below historical average. Yet, Liechtenstein's economy has remained relatively resilient in light of the global challenges. While employment figures showed a strong development and the business sentiment survey data turned out robust in the second quarter, goods exports and imports featured significant decreases compared with the first quarter after the short recovery period throughout 2022 and early 2023.

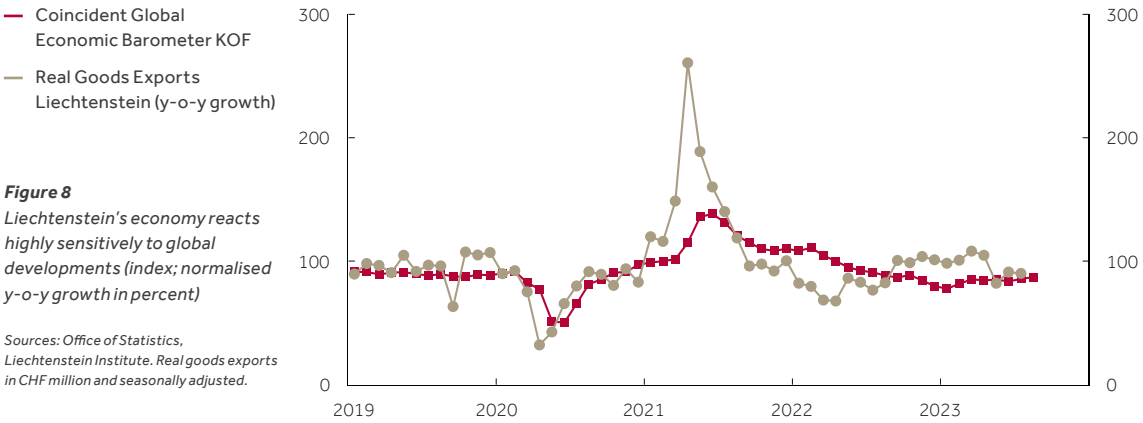


Figure 8
Liechtenstein's economy reacts highly sensitively to global developments (index; normalised y-o-y growth in percent)

Sources: Office of Statistics, Liechtenstein Institute. Real goods exports in CHF million and seasonally adjusted.

Liechtenstein generally exhibits a very sensitive and early response to the global business cycle. For Liechtenstein, goods exports are the most important indicator for GDP development, while business activity in financial services is also relevant. Against this background, Liechtenstein's economy is very dependent on global economic developments, because domestic demand can only provide a small buffer against international economic shocks in comparison to larger economies. Figure 8 shows Liechtenstein's real goods exports as normalised growth rates against the same month of the previous year. The export figures are thus directly comparable with the metric of the Coincident Global Economic Barometer (KOF), an index of global economic sentiment consisting of over 1,000 data series. When comparing the two data series, the volatility of the Liechtenstein economy becomes evident. Liechtenstein's goods exports and hence Liechtenstein's GDP react very sensitively to changes in global economic sentiment. In addition, it appears that Liechtenstein's exports are highly responsive to global developments, as can be seen from the earlier turning points in spring 2020, spring 2021 or early summer 2022.

While Liechtenstein exhibits a high amplitude of business cycle volatility, employment and business activity remained remarkably resilient over the past decades. Thanks to a highly competitive economy, total employment (42,514 employees at end-2022) exceeds the number of inhabitants (39,677) in Liechtenstein. More than half of the employees are inward-commuters, mostly living in Switzerland or Austria. Liechtenstein's labour market is highly resilient, with unemployment rates and employment growth hardly related to the business cycle. This general observation was again confirmed in the COVID-19-related recession in 2020. Furthermore, other structural characteristics of Liechtenstein render the real economy resilient vis-à-vis macroeconomic shocks. First, Liechtenstein's industrial sector is remarkably innovative, also in light of extremely high private spending on research and development, and comprises highly successful niche players in global markets. Against the background of the small domestic market, companies are used to compete against global market leaders. The corporate sector has to remain flexible to adjust to new structural circumstances and navigate Swiss franc appreciations. Second, high equity ratios among non-financial corporations (NFC), partly due to respective tax incentives, as well as zero debt (and high financial reserves) in the public sector contribute to a high level of resilience of the economy. Third, the highly specialised economy benefits from its strong international integration, including full access to the European Single Market through Liechtenstein's membership in the European Economic Area (EEA), as well as to Switzerland, via a customs union, established in 1923. The currency treaty with Switzerland and the associated membership in the Swiss franc currency area also contributes significantly to the stability of both the financial sector and the economy as a whole. Finally, private wealth and income are very high, with Liechtenstein's Gross National Income (GNI) per capita being among the highest in the world. High income and wealth increase the resilience of private households and the economy, as temporary shocks can be better cushioned. Strong capital and liquidity indicators in the banking sector also support the economy's stability, as unexpected adverse developments can be absorbed by the financial sector without large negative implications for credit supply or financial stability.

While adverse financial market developments in 2022 led to the first budget deficit in a decade, public finances in Liechtenstein remain remarkably sound. Liechtenstein's public finances are characterised by virtually zero debt and large financial reserves. Sound public finances and the preservation of high financial reserves, to cushion for unforeseen shocks to the economy and to stay independent from international debt markets, are uncontroversial among

all political parties in parliament. Following an ambitious structural reform package after the global financial crisis, Liechtenstein has reported budget surpluses since 2014, with budget balances remaining significantly positive in the pandemic-related years of 2020 and 2021. In contrast, due to the adverse investment performance in light of financial market corrections in 2022, the budget balance turned negative in 2022. While numbers for the general government level are not yet available for 2022, the central government reported a budget deficit of CHF 203 million (i.e. about 3% of GDP). The primary balance – i.e. in the case of Liechtenstein without the losses on financial investments and interest income from reserves – has remained significantly positive, reporting a surplus of CHF 112 million (i.e. about 1.7% of GDP). Notwithstanding the negative performance in 2022, financial reserves of the public sector remain high. Net assets of the public sector amounted to CHF 9.8 billion (i.e. about 149% of GDP) at the end of 2021, of which CHF 3.6 billion were held at the state level, CHF 4.1 billion by social insurances and the remaining CHF 2.1 billion at the community level. Against this background, public finances remain well-equipped for future challenges.

BOX 2

Economic policy response to the COVID-19 pandemic

The pandemic caused a particularly severe, swift, and globally synchronised recession that heavily affected the Liechtenstein economy through various channels. Widespread lockdowns and disruptions in supply chains gave rise to shortfalls in production (Bonadio et al., 2021). At the same time, lockdowns resulted in income shortfalls and limited consumption opportunities, dampening aggregate demand (Eichenbaum, Rebelo, and Trabandt, 2021). Moreover, due to its unprecedented nature, the pandemic increased uncertainty, which potentially induced consumers and firms to postpone spending and investment (Breitenlechner et al., 2023).

Driven by the dramatic economic downturn caused by the COVID-19 pandemic, the Liechtenstein government set up a range of measures to preserve the production capacity of the domestic economy. Within one week after implementing regulatory shutdown measures, the Liechtenstein government launched support measures comparable to other German speaking countries. These measures comprised short-time work compensation and other direct grants to support firms to cover fixed costs, public guarantees for targeted bank loans, and tax deferrals. While other countries extended the set of economic measures to stimulate demand during the course of the pandemic, the Liechtenstein government limited the policy response to supply side-oriented measures.

The main pillar of the economic crisis response in Liechtenstein was the short-time work program. Figure B2.1 shows granted volumes of support measures for which firms were eligible to apply for until the second quarter of 2022. The stacked bars refer to the uptake per measure and quarter, while the black line represents the cumulated sum of the total uptake. In line with the chronology of the pandemic, the bulk of the uptake took place in the second quarter of 2020. Amounting to almost 72 million CHF, a large share of the total economic response measures (CHF 156 million) was spent in the form of short-time work compensation. Beginning with the fourth quarter of 2020, the Liechtenstein government extended the set of measures to support for economic hardship cases in sectors that were persistently affected by the pandemic (food service industry, catering, travel and tourism, cultural sector), making up the majority of the uptake in the later phase of the pandemic.

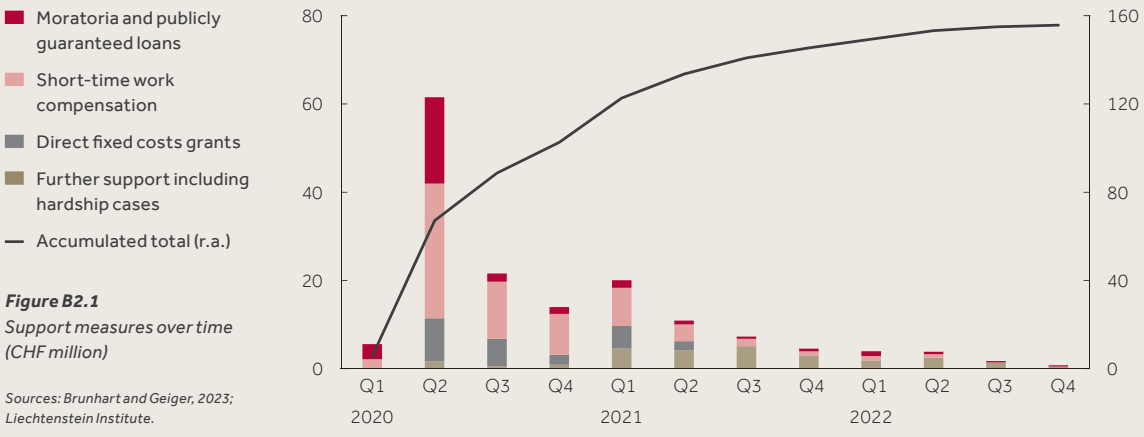


Figure B2.1
Support measures over time (CHF million)

Sources: Brunhart and Geiger, 2023; Liechtenstein Institute.

BOX 2

The uptake of the measures is tightly linked to Liechtenstein's business cycle dynamics in the course of the COVID-19 recession. Figure B2.2 shows an estimate of quarterly GDP (real, seasonally adjusted) indexed to 2019Q4 together with employment and the support uptake. While the Liechtenstein economy experienced a massive contraction during the first two quarters of 2020, a swift recovery beginning in the third quarter can be observed. Liechtenstein's real GDP reached pre-crisis levels already in the first quarter of 2021, which is very early in international comparison. Employment remained very stable throughout the recession, which is remarkable given the extent of the downturn even when considering the fact that the business cycle sensitivity of employment is traditionally low or even absent in Liechtenstein (Brunhart and Lehmann, 2021). Stable employment and absent firm closures suggest that the production capacity of the Liechtenstein economy was preserved in the recession so that the recovery could unfold at full pace.

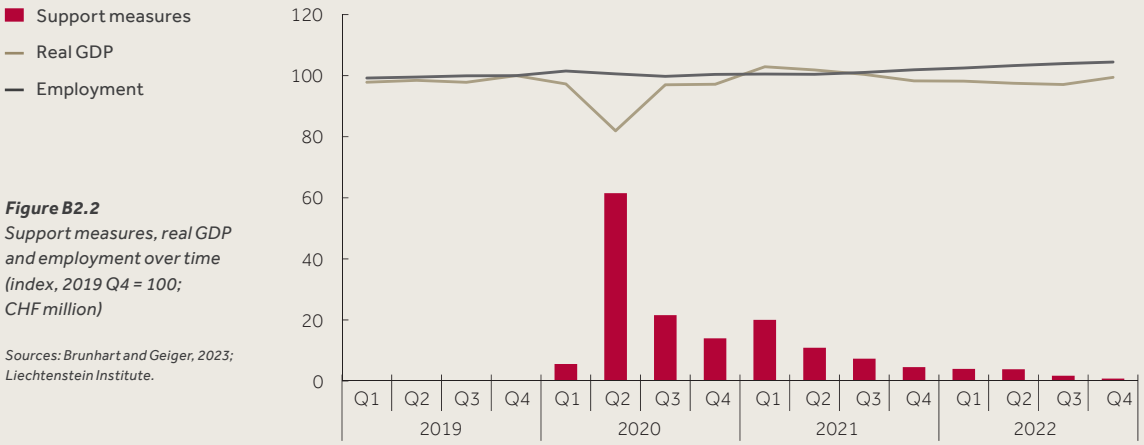


Figure B2.2
Support measures, real GDP and employment over time (index, 2019 Q4 = 100; CHF million)

Sources: Brunhart and Geiger, 2023; Liechtenstein Institute.

Real GDP contracted by –5.3 % in 2020 and thus to a substantially lower extent compared to the global financial crisis (–0.6 % in 2008 and –11.4 % in 2009). Against the background of the typically high business cycle volatility in Liechtenstein, the economic decline during the COVID-19 recession turned out to be moderate. In particular, this can be explained by the sectoral composition of Liechtenstein's economy, which heavily depends on the industrial and financial services sectors. Both sectors remained relatively stable in the recent crisis. By contrast, sectors that primarily serve domestic demand – i.e. sectors that are less important in a small state like Liechtenstein – were directly and more persistently affected by the pandemic (Brunhart, Geiger and Ritter, 2022). However, the supporting measures that were tightly linked to the business cycle dynamics contributed to preserving the production capacity and to the swift recovery.

BOX 2

	Support Measures (in % of GDP)				
	Moratoria and tax deferrals	Public loans and guarantees	Direct grants	Tax reliefs	Sum of uptake
Estonia	0.0 %	2.0 %	1.9 %	0.1 %	3.9 %
Iceland	0.4 %	1.0 %	2.2 %	1.0 %	4.5 %
Liechtenstein	0.1 %	0.4 %	1.8 %	0.0 %	2.2 %
Luxembourg	0.8 %	0.6 %	1.8 %	0.0 %	3.1 %
Latvia	0.8 %	0.7 %	3.9 %	0.0 %	5.4 %
Malta	1.0 %	3.4 %	0.0 %	0.0 %	4.4 %
Slovakia	0.6 %	1.1 %	3.1 %	0.0 %	4.7 %

Table B2.1
Uptake of economic support measures in small European economies (CHF million)

Explanations: The data for economic aid was provided by the European Systemic Risk Board (ESRB) upon request. Some (minor) economic aid measures were not included in the ESRB database and the time coverage is up to the second quarter of 2022. For the calculation of the percentages / ratios, the respective national nominal GDP of the year 2019 is used in the denominator (UN database).

Source: Brunhart and Geiger, 2023; Liechtenstein Institute.

By international comparison, the Liechtenstein government spent relatively little on support measures for the economy. Larger countries such as Germany and Austria spent substantially higher amounts – calculated as a ratio of GDP – on support measures. This outcome is unsurprising, considering the sectoral exposure, substantial share of the domestic economy, and the implementation of demand-side measures. However, also relative to other very small open economies, the volume of the fiscal response was limited in Liechtenstein, as shown in Table B2.1.

Support measures in Liechtenstein were overall timely, targeted, and temporary. Given the sequence and depth of the recession, it appears that the support measures were proportional and warranted. Moreover, as these measures were primarily geared towards preserving the production capacity throughout shut-down periods, the scope of the measures was limited while effective in stabilising employment and preventing the closure of firms. Furthermore, the prompt disbursement of payouts and loans under the various measures reflects a high level of efficiency (Brunhart and Geiger, 2020; 2023). The rather low quantitative value of the (supply side) support measures in Liechtenstein can also be justified by the low GDP share of domestic demand. At the same time, demand side measures abroad and the swift international recovery served as important stimulus for Liechtenstein's export-oriented economy.

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