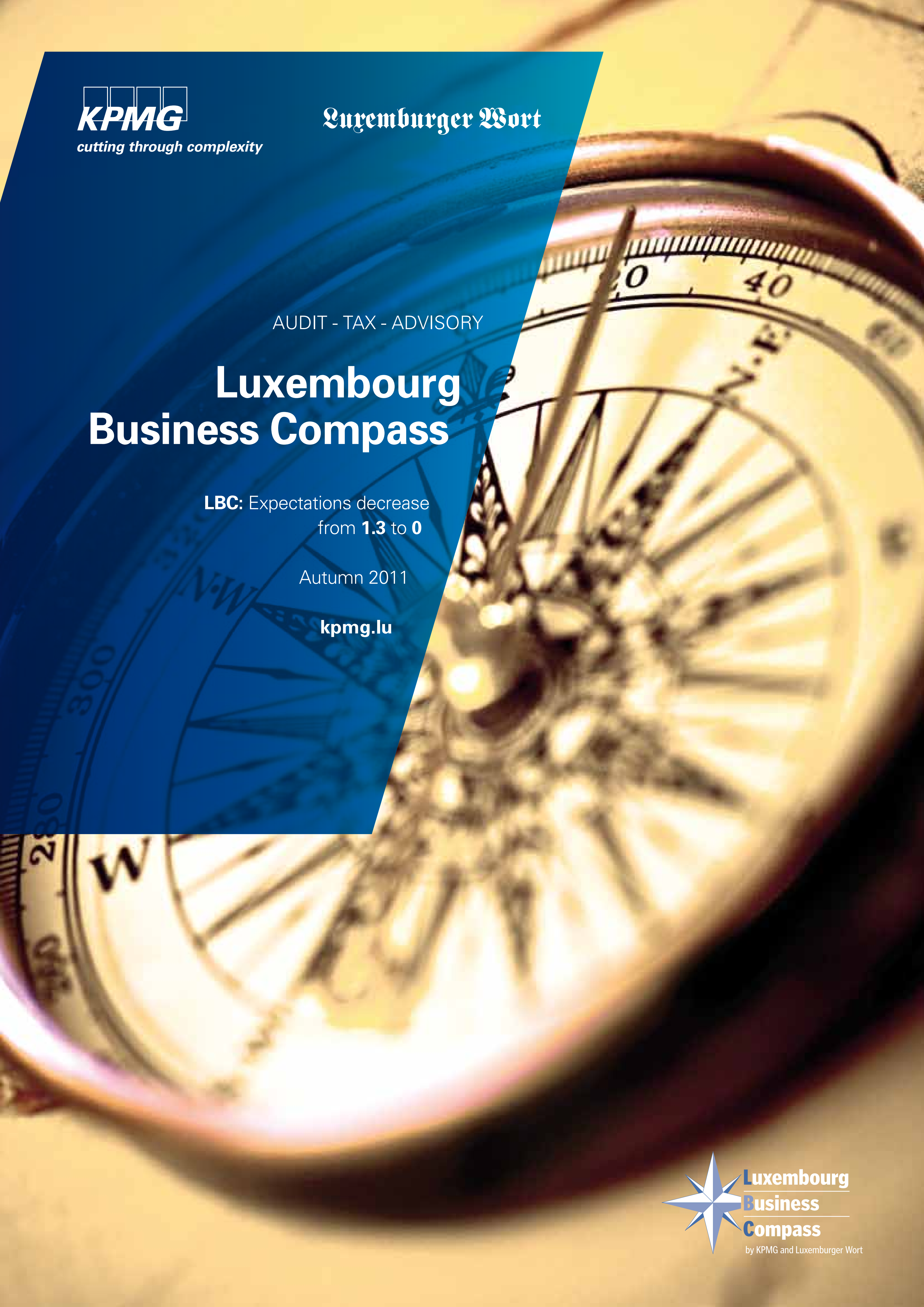

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Luxembourg Business Compass

LBC: Expectations decrease from **1.3** to **0**

Autumn 2011

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Luxembourg Business Compass
by KPMG and Luxemburger Wort

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Contents

Introduction

It is my pleasure to introduce you to the Autumn 2011 edition of the Luxembourg Business Compass.

When launching the LBC in early 2009 together with Luxemburger Wort and with the support of the Luxembourg Chamber of Commerce, we said that the perennial success of this economic indicator would depend on the enthusiasm of the Luxembourg entrepreneurs. Now, three years later, I'm pleased to see that the interest for the LBC has been steadily increasing, making of this survey a reliable and only in its kind tool in Luxembourg. Therefore, I would like to take the opportunity to thank you for your continuous support.

One swallow does not make a Summer. A few positive figures from 2009 to 2011 cannot hide the negative trend indicated in this autumn edition, a tendency that has also been confirmed by the official statistics published over the last few weeks.

Being used to the benefits of the long standing success story that Luxembourg is, it was tempting to believe that we would get away from the last crisis without tackling the structural problems. It was also tempting to listen to the few that announced the end of the crisis rather than to those who sounded a nok of caution and a long term view. Nevertheless, the latter have been proved to be correct.

Indeed the crisis as a catalyst of the structural weaknesses seems to make things worse. Therefore, more than ever, there is a need for action.

However, given the past experience and the well established positions of the different stakeholders to the tripartite, wouldn't it be a legitimate question to ask ourselves whether we still believe if Luxembourg is capable of being reformed to adapt itself in the best possible way to the new global economic playing field?

Although we do not question the will of the different stakeholders' representatives to come to a positive result, it would be desirable that they try to sort things out, for the best of our country, without tabou, without doctrine.

In this context, we hope that the LBC is a helpful tool to encourage the politicians as well as the society in general to overcome old fashioned and overdue positions and to bring all of us to consider and accept the steps of change necessary for a fruitful future.

Georges Bock
Partner
KPMG in Luxembourg

The recovery has stopped

The Luxembourg economy has hardly digested the blow of the recent economic crisis, when dark clouds start to loom again on the horizon. Because of the growing uncertainties, it is not surprising that Luxembourg economic decision makers look with some apprehension at the next month to come. Their reaction reflects the negative downturn which many polling institutes in the neighbouring countries also notice. What surprises in the results of this sixth edition of the "Luxembourg Business Compass" is the speed and the brutality of the drop in entrepreneur confidence.

Since the start of this trend indicator in April 2009, the outlook has continuously become more optimistic. Now, for the first time, there is a sharp decline in short-term expectations. In itself, that finding might be unsettling, but is still in line with the overall uninspiring perspectives of the eurozone, due to slower demand and decreasing exports, as governments struggle to stabilize borrowing.

More alarming than the sharp decline in confidence is the downturn which competitiveness has taken. Two thirds of the entrepreneurs consider Luxembourgs' competitiveness as a business location "poor" to "average". In the previous survey led in April, more than half of the decision makers believed that the Grand-Duchy was a "good", if not a "very good" place to run a business.

Almost all the factors which contribute to the attractiveness of an economic environment – cost of workforce, legal frame, lowering of bureaucratic hurdles, and surprisingly even social stability - have declined in the opinion of the Luxembourg decision makers. The availability of a qualified workforce – a major factor for the success of the Luxembourg economy – has suffered the most. This might indicate, that the Grand-Duchy is loosing its lustre as a pool of attraction in the Greater region.

Only the promotion of foreign trade has significantly improved, which in itself is good, but for the overall picture not enough.

These unsettling findings might be due in part to the spreading pessimism due to sovereign debt worries and the fragile financial system. They certainly reflect a growing dissatisfaction of the luxembourgish entrepreneurs, which the political class should take seriously. Without a healthy economy, political action becomes ineffective.

Pierre Leyers
Financial Editor
Luxemburger Wort

Message by Mr Pierre Gramegna

The new global economic downturn: full acknowledgment by the business leaders and ongoing lack of concern by national policy-makers

In the spring edition of the 2011 Luxembourg Business compass (LBC), I had the opportunity to point out the significant challenges that were looming on the Luxembourg, European and worldwide economic horizon: *"the road to a sustainable economic recovery (...) is winding and bumpy, and challenges are local, European and global in their scope. A number of key domestic economic sectors are still directly struggling with the effects of the crisis, and Luxembourg's export-oriented economic model remains truly incompatible with the slow, continuous and unsustainable degradation of the cost- and price related competitiveness. The 2010 economic recovery had been supported by negative baseline effects and by industrial restocking. Now that this process has touched to an end, Luxembourg's economic foundations have to be solidified in order to ensure the competitiveness of its goods and services on the global marketplace".*

Now, less than half a year later, the least that can be said is that the economic skies have darkened even further. Even if the worst case scenario - a breakdown of the Euro area for instance - could thus far be avoided, the sovereign debt crisis has significantly worsened and a number of Member States face tremendous challenges as to their mere budgetary sovereignty. In addition, Europe is not only facing tough challenges related to public finance. Indeed, a whole new worldwide momentum of crisis is currently building up. Both the lack of consumer and investor confidence and the reduction of the public deficits trigger a tremendous slowing down of economic recovery in developed economies. This cocktail of negative economic effects is further fuelled by the recapitalisation and the down-leveraging of financial institutions. Unfortunately, less credit further squeezes investment and consumption.

As one of the world's most open economies, Luxembourg is obliviously severely hit by all these challenging trends. First of all, as prospects of a new recession are materialising in a threatening way, one has to point out that the Grand-Duchy has never actually recovered from the previous crisis. Indeed, GDP in real terms had still been, by the end of 2010, 2% below the level it reached by the end of 2007. In the meantime, though, overall wages paid have increased by 15% in nominal terms whereas margins only went up by 2%. Therefore, companies have never, in fact, recovered from the last crisis. It is therefore not surprising that 75% of respondents to this edition of the LBC highlight that "the cost of labour and the competitiveness of wages" have "gotten worse". Because of the automatic wage indexation, enterprises are forced to distribute more wages than their productivity gains. A truly unsustainable development! The financial, as well as the manufacturing sectors, are among the key economic areas that were not only hit hardest by the 2008-2009 slump, but are, at the same time, the sectors for which future prospects are the direst.

In its draft budget law for 2012, presented on the 5th of October, the Government put GDP growth prospects for 2011 at 3.2% and for 2012 at 2.1%. However, in 2011, growth has settled at a mere 2.9% in the 1st and at 1.9% in the 2nd quarter, i.e. at 2.4% on average. However, as the first semester can definitely be considered as 2011's highlight in terms of economic growth, how can the economy still grow at 3.2% for the whole year? In addition, the 2.1% growth rate for 2012 is clearly not realistic anymore.

This rather depressing economic outlook makes structural reforms unavoidable. As far as Luxembourg is concerned, one has – alas – been disappointed so far. Cost and price competitiveness of the Luxembourg economy are still deteriorating, wage evolution is still disconnected from productivity growth, and the State budget is still significantly in deficit, whereas the time bomb related to the long term sustainability of the welfare model is ticking continuously. While countries around Luxembourg are trying to take their fate in their own hands, by carrying out structural reforms and by trying to restore competitiveness, Luxembourg is still profoundly in a hibernation state and at best reacting to events: reforms are put off, issues related to competitiveness are played down and the unsustainable evolution of public finances is not taken care of wholeheartedly.

As far as the business community is concerned, the call for reform is loud and clear: Luxembourg's competitiveness as a business location is considered to be "good" only by a third of respondents, whereas 53% of business leaders expressed a favourable opinion in this sense only one year ago.
81% of economic decision-makers consider that the European debt crisis has a "somewhat" or "very negative" effect on their companies.
Albeit the difficult context, 84% of respondents consider it "somewhat" or even "very difficult" to find qualified staff at the moment. Business leaders are also aware of the necessity to consolidate public finances: indeed, only a short majority (57%) advocate the Government's plan to abolish the crisis tax on the 1st January, 2012. Knowing that normally business never likes tax increases this result is quite remarkable. As far as the wage indexation mechanism is concerned, 90% consider it "somewhat" or even "very" burdensome if wages were to be adapted - yet again - in spring 2012, after having increased by 2,5% only in October 2011. These few highlights of this edition of the LBC, alongside many others, draw a clear roadmap for economic and structural reforms which must be taken seriously by policy-makers and implemented via resolute actions. If not now, then when? :
"Since August 2007, we have experienced a crisis of a new kind. A global phenomenon that has no equivalent since World War II, in its nature and dimension. (...). People may accept change when they are faced with necessity, and only recognise necessity when a crisis is upon them[1]."

Since 2009, the Chamber of Commerce has fully supported the KPMG / Luxemburger Wort initiative of the LBC, whose first goal is to gather opinions, challenges, priorities and concerns of Luxembourg's economic decisions makers. The LBC survey is a very useful complement to the benchmark studies and the surveys already carried out by the Chamber of Commerce and others. In this context, it is worth pointing out that all these studies – be it Eurochambers' annual economic survey, the "Global Competitiveness Report" published by the World Economic Forum or the Institute for Management Development's "World Competitiveness Yearbook" – are confirming the main messages of the LBC: the recovery is fragile at best and a number of key challenges must be met in order to achieve a sustainable economic growth for Luxembourg.

Let me take the opportunity to express once again my gratitude to all the respondents to the LBC – survey and to congratulate once again its initiators – KPMG and the Luxemburger Wort – for this excellent new tool of economic intelligence.

Pierre Gramegna
Director General of the Luxembourg Chamber of Commerce

[1] Speech by Jean-Claude Trichet, President of the ECB, Frankfurt am Main, 19 October 2011.

Executive Summary

1. Expectations for the Luxembourg economy are clearly more pessimistic

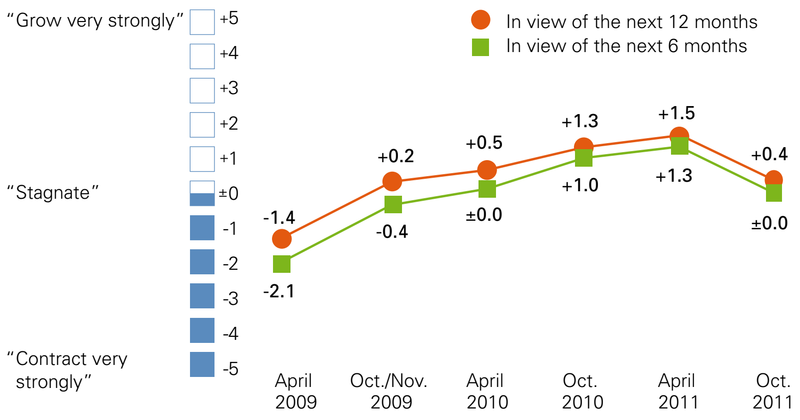
In the past five survey waves, Luxembourg business leaders' expectations regarding the economic development improved steadily. However, the findings of the current survey wave indicate - for the first time since April 2009 - a negative trend.

Over the course of the next 6 months, Luxembourg entrepreneurs generally expect the Luxembourg economy to stagnate. Whereas on the longer run, i.e. the next 12 months, expectations are somewhat more optimistic, as a majority of entrepreneurs anticipate a slight economic growth.

This turnaround reveals a considerably more gloomy outlook in conjunction with the ongoing euro crisis and European debt crisis.

Short-Term Expectations for the Luxembourg Economy Decline Sharply

On a scale of +5 to -5, average step chosen by respondents to indicate how they expect the Luxembourg economy will develop -



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, April 2010, Oct. 2010, April 2011, Oct. 2011)

2. **Luxembourg's competitiveness as a business location has been harmed**

3. **Luxembourg companies have also been adversely affected by the euro crisis and the European debt crisis**

4. **Despite widespread cost-cutting measures, companies are still planning to increase expenditures in most areas of operations, although the increases will be more modest than in the recent past**

5. **Current issues relating to economic policy:**
   - **Only 57% of entrepreneurs think that the crisis tax should be abolished at the start of next year as planned.**
   - **In order to strike a fair balance between employees' and employers' interest, entrepreneurs think the next wage indexation should not take place before 2013.**
   - **A financial transaction tax would only be supported by a majority of entrepreneurs if it were introduced globally.**

Findings

Expectations for the Luxembourg economy are clearly more pessimistic

Trends expected for the next 6 months

- Entrepreneur's expectations of Luxembourg's economic growth have regressed to the level of economic stagnation.
- The expectations of this survey match the expectations revealed during the LBC Spring 2010 edition in terms of economic growth over the next 6 months.
- A year ago, 72% of the entrepreneurs interviewed anticipated a positive economic trend over the next six months, as compared to only 40% today.

Index of Expectations for the Luxembourg Economy in View of the Next 6 Months

On a scale of +5 to -5, step chosen by respondents to indicate how they expect the Luxembourg economy will develop -

		April 2009		Oct./Nov. 2009		Oct. 2010		Oct. 2011	
"Grow very strongly"	+5	x		x		x		x	
	+4	x		x		x		x	
	+3	x	**5**	x	**30**	4	**72**	x	**40**
	+2	x		6		29		12	
	+1	5		24		39		28	
"Stagnate"	±0	10		30		20		32	
	-1	15		13		6		12	
	-2	27		20		2		12	
	-3	30	**84**	7	**40**	x	**8**	4	**28**
	-4	9		x		x		x	
"Contract very strongly"	-5	3		x		x		x	
No response		1		x		x		x	
		100		100		100		100	
On average		-2.1		-0.4		+1.0		±0.0	

x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, Oct. 2010, Oct. 2011)

32%

of the entrepreneurs interviewed now expect that the Luxembourg economy will stagnate over the next six months.

28%

of the entrepreneurs interviewed anticipate (slightly) recessionary trend.

Forecasts for the next 12 months

- Expectations for the next 12 months are somewhat more optimistic compared to the expectations over the next 6 months.

57%

of entrepreneurs anticipate that Luxembourg economy will grow over the course of the year.

20%

of entrepreneurs anticipate that Luxembourg economy will contract over the course of the year.

Index of Expectations for the Luxembourg Economy in View of the Next 12 Months

On a scale of +5 to -5, step chosen by respondents to indicate how they expect the Luxembourg economy will develop -

		April 2009		Oct./Nov. 2009		Oct. 2010		Oct. 2011	
"Grow very strongly"	+5	x		x		x		x	
	+4	x		x		x		x	
	+3	x	11	2	48	10	82	5	57
	+2	4		22		42		16	
	+1	7		24		30		36	
"Stagnate"	±0	17		22		10		23	
	-1	24		13		4		4	
	-2	23		11		3		9	
	-3	15	72	6	30	1	8	7	20
	-4	6		x		x		x	
"Contract very strongly"	-5	4		x		x		x	
		100		100		100		100	
On average		-1.4		+0.2		+1.3		+0.4	

x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, Oct. 2010, Oct. 2011)

Luxembourg’s competitiveness as a business location has been harmed

24%

of the entrepreneurs interviewed rate Luxembourg’s competitiveness as “rather poor”.

43%

of the entrepreneurs interviewed feel that Luxembourg’s competitiveness in comparison to the situation two years ago is “somewhat worse”.

84%

of the entrepreneurs interviewed report having difficulties when it comes to finding qualified staff.

In comparison to the last two survey waves, the assessment by the entrepreneurs of Luxembourg’s competitiveness is significantly worse.

When It Comes to Many Location Factors, Entrepreneurs Tend to Perceive a Negative Trend in Luxembourg

Question: "Thinking of Luxembourg's competitiveness as a business location: which of these areas have improved over the past two years, in which areas has the situation gotten worse, and in which ones has the situation basically stayed the same?"

	Improved %	Stayed the same	Gotten worse	No response
The cost of labor, how competitive wages are in Luxembourg	x	24	75	1
The socially stable environment in Luxembourg	1	72	26	1
Abolishment of bureaucratic hurdles	1	64	32	3
Availability of work permits	4	78	17	1
Access to political decision-makers	5	84	10	1
The tax environment	7	65	27	1
The stable and coherent political environment	9	82	8	1
Availability of a skilled, high quality workforce	11	53	35	1
The transportation system, infrastructure	11	63	25	1
The regulatory environment	13	37	47	3
Government policies that adequately consider business interests	15	65	16	4
Cost management by Luxembourg companies	19	48	32	1
The Luxembourg economy's innovative power when it comes to introducing new products and services and developing new markets	19	71	9	1
Promotion of Luxembourg as a business location	36	52	11	1

x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2011)

Negative impact of the euro crisis and the European debt crisis on the majority of Luxembourg's largest companies.

81%

of the entrepreneurs interviewed say the crises have had a "somewhat negative" (60%) or "very negative "(21%) effect on their own company.

27%

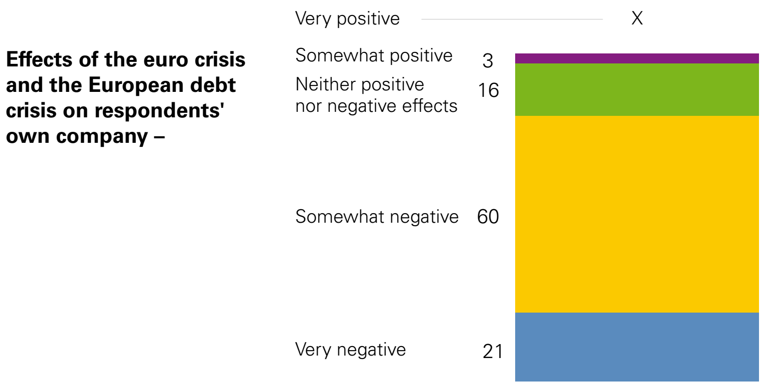
of the Luxembourg companies report that getting a bank loan has become more difficult compared to one year ago.

68%

of the Luxembourg companies report that the bank loan conditions have not changed compared to one year ago.

Negative Effect of the Euro Crisis and the European Debt Crisis on Respondents' Own Companies

Question: "What effects have the euro crisis and the European debt crisis had on your company?"



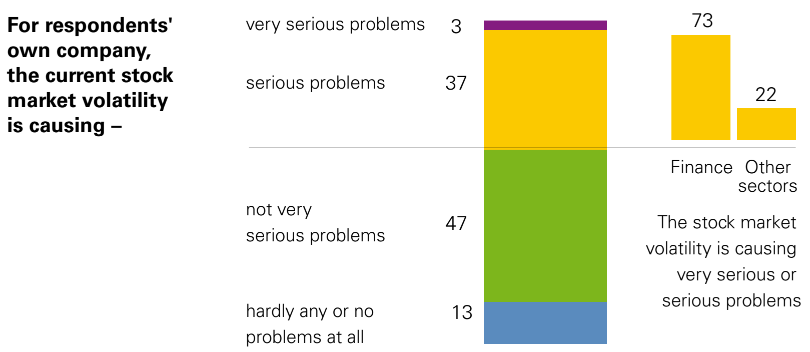
Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2011)

40%

of Luxembourg companies are seriously or very seriously affected by the high volatility on the stock market, among which 73% are active in the financial sector.

The High Volatility on the Stock Market Is Problematic for Many Companies, Particularly in the Financial Sector

Question: "To what extent is the current stock market volatility causing problems for your company? Would you say it is causing..."



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2011)
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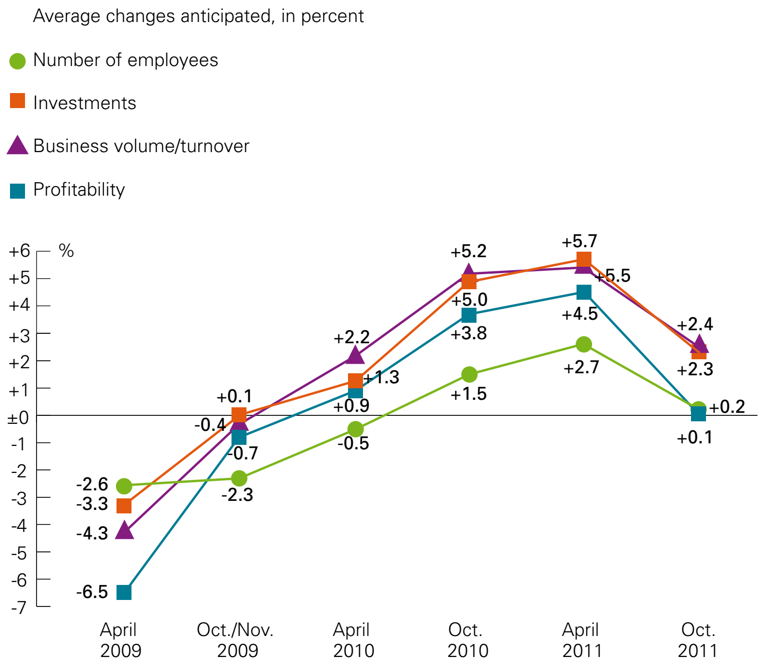
Steep decline in optimism among Luxembourg business leaders in comparison to recent survey waves. Nevertheless all indicators remain slightly positive or positive.

Trends observed over the next 6 months

- 32% of the entrepreneurs interviewed expect a decline in profitability over the next 10 months, including 9% who even predict a decline of 10% or more.
- 27% of the entrepreneurs interviewed anticipate a drop in the number of employees.
- The greatest disparity is found with regard to investments. While about 34% of all entrepreneurs expect no change in this area, 11% anticipate an increase of 10% or more. At the same time, an equally large share of entrepreneurs interviewed expect that investments at their companies will decline by 5% or more.

Expectations for Entrepreneurs' Own Companies: Considerable Decreases in Turnover, Investments, the Number of Employees and Profitability in Particular

Question: "How do you expect the following areas or indicators will develop at your Luxembourg company over the next 6 months?"



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, April 2010, Oct. 2010, April 2011, Oct. 2011)

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42%

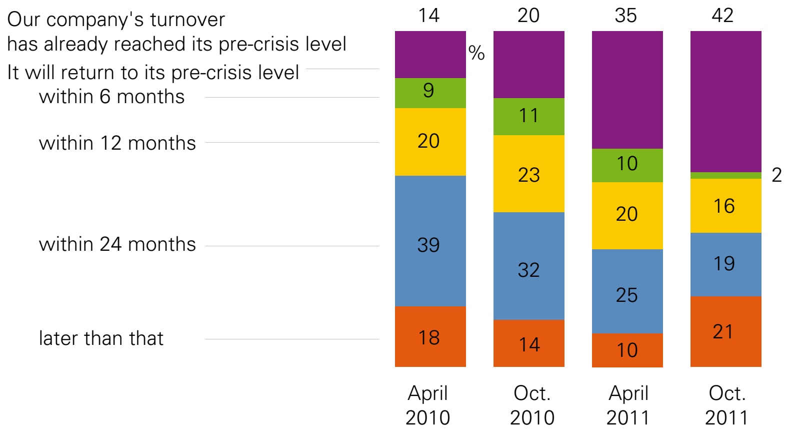
of the entrepreneurs say that their company's turnover has already reached its pre-crisis level

21%

of the entrepreneurs say that their company's turnover will not reach its pre-crisis level within 24 months.

When Will Turnover Return to Pre-Crisis Levels?
Some Companies Have Suffered a Setback

Question: "When do you expect your company's turnover will return to its pre-crisis level?"



Base: Companies whose turnover declined during the financial and economic crisis
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort
(April 2010, Oct. 2010, April 2011, Oct. 2011)

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Modest increase in company expenditures compared to the past

Investment plans:

- More funds will be allocated to the introduction of new products and services, training, IT along with marketing and sales.
- Despite the general more pessimistic outlook, advertising is the only area where the balance of expected expenditures is actually negative.

Planned Investments: Areas Where Luxembourg Companies Will Increase or Decrease Expenditures

Question: "In which of the following areas will your Luxembourg company increase or, respectively, reduce its expenditures in the next 6 months?"

	Increase	No change	Decrease	No reponse
Introduction of new products or services	60%	31	9	x
Training	44	43	8	5
Information technology	41	51	8	x
Marketing and sales	41	48	11	x
Staff	35	41	21	3
Geographic expansion	32	61	7	x
E-commerce	26	64	7	3
Research and development	24	64	8	4
Promotion	23	61	13	3
Advertising	19	60	21	x
Business acquisitions	18	72	9	1
Expanding facilities	17	70	13	x

x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2011)

52%

of the largest Luxembourg companies have already implemented special cost-reduction measures.

only

28%

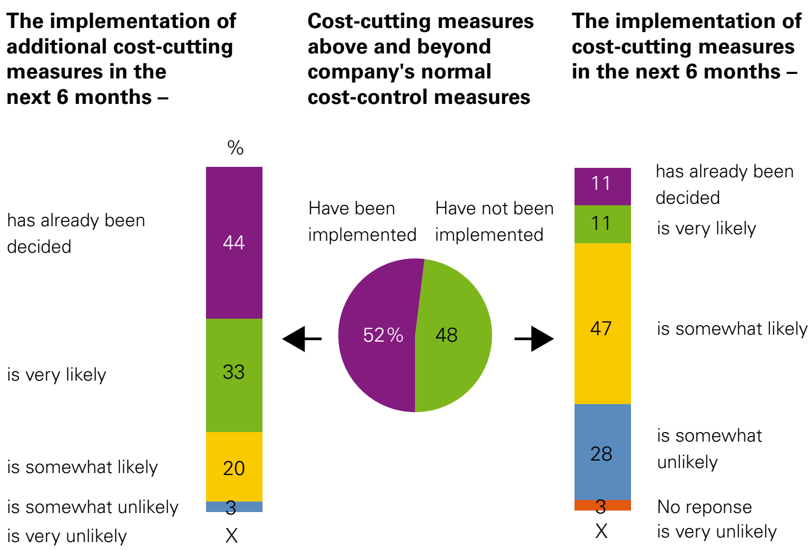
of the companies not having implemented special cost-reduction measures say that such cost cutting measures are "somewhat unlikely", while no one rules out their implementation completely.

Cost-cutting measures are currently an issue for most Luxembourg companies.

The Majority of Companies Have Already Implemented Cost-Cutting Measures or Will Start Implementing Such Measures in the Upcoming Months

Question: "Are there currently any cost-cutting measures that have been implemented at your company above and beyond its normal cost control measures?"

Question: "What do you think: In the next 6 months, how likely is it that your company will implement (additional) cost-cutting measures above and beyond its normal cost control measures?"



x = less than 0.5 percent

Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2011)

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Current issues relating to economic policy

90%

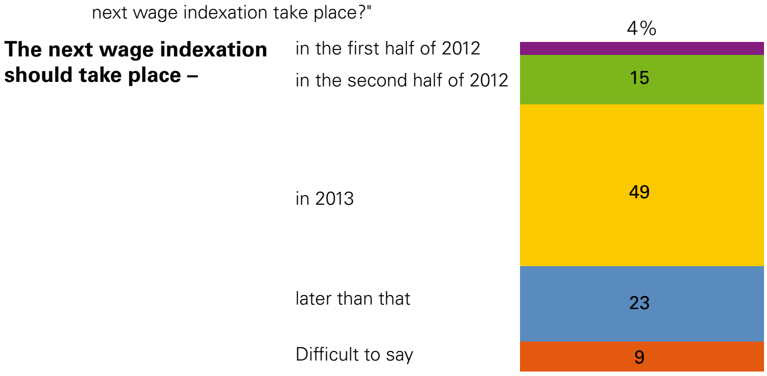
of the entrepreneurs interviewed feel that a wage indexation taking place in spring 2012 would be “very burdensome” (44%) or “somewhat burdensome” (46%).

43%

of the entrepreneurs feel that the crisis tax should be kept.

In Order to Strike a Fair Balance between Employees' and Employers' Interests, Entrepreneurs Think the Next Wage Indexation Should Not Take Place before 2013

Question: "Aside from the wage indexation this October: in your opinion, when should in the spirit of striking a fair balance between the interests of employees and employers the next wage indexation take place?"



Base: Total respondents
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2011)

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A local application of the financial transaction tax does not seem to be supported by most of Luxembourg's entrepreneurs.

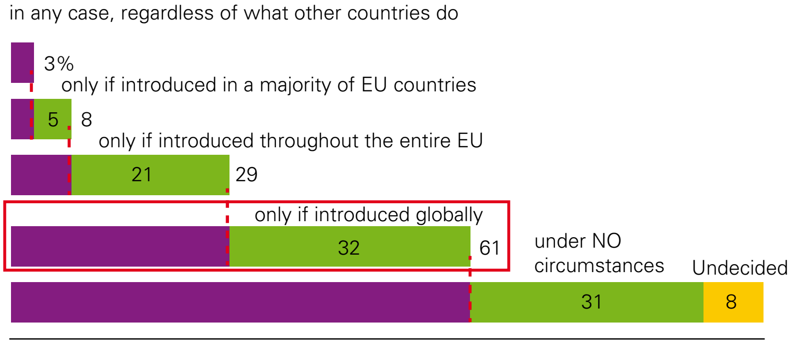
31%

of the entrepreneurs interviewed are opposed to introducing a financial transaction tax under any circumstances.

A Financial Transaction Tax Would Only Be Supported by a Majority of Entrepreneurs If It Were Introduced Globally

Question: "In your opinion, should a financial transaction tax be introduced in Luxembourg?"

A financial transaction tax should be introduced in Luxembourg –



Base: Total respondents
Source: Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2011)

About the survey

In April 2009, top decision-makers at the largest companies in Luxembourg, as defined by the number of employees, were interviewed for the first time within the framework of the "Luxembourg Business Compass." Using this instrument, the aim was to establish an economic indicator - for the first time ever - that could be employed to ascertain Luxembourg business leaders' expectations regarding the future economic trend in Luxembourg at regular intervals. The survey focuses particularly on how business leaders expect the Luxembourg economy will develop in the next six or, respectively, 12 months, along with their expectations and plans for their own companies' future development. These core questions are supplemented by varying questions pertaining to business or politics.

In April 2011, the survey for the "Luxembourg Business Compass" was repeated for the fifth time. As with the prior survey waves, the INSTITUT FÜR DEMOSKOPIE ALLENSBACH was commissioned by KPMG S.A.R.L. to design the survey methodologically, develop the questionnaire in cooperation with the client,confidentially process the anonymous data collected and compile a report on the findings. After being notified about the survey in writing or by telephone, a total of 80 top decision-makers were interviewed using an online questionnaire in English in the time from April 1 to 20, 2011. As in the previous survey waves, it was also possible to draw a top-notch sample for the present survey. In 15 percent of the cases, the interview was completed by the company owner him- or herself, while more than two thirds of the respondents hold the position of CEO/CFO or COO at their companies (69 percent), and an additional 15 percent hold other executive positions.[1]

The companies were selected based on the STATEC directory, "Les principaux employeurs au Luxembourg d'après l'effectif classés par branche d'activité économique de la NACE Rév.2, Situation au 1er janvier 2009 (édition juin 2009)."

[1] *One respondent did not indicate his/her position at the company.*

In drawing the sample, companies were selected from the different business sectors in line with these sectors' share of the gross domestic product in Luxembourg. Within the different economic sectors, the largest companies - as determined by the number of employees - were included in the investigation.

At the time when the first survey wave was conducted, the Luxembourg economy was still firmly in the grip of the global economic and financial crisis. The current findings show that the Luxembourg economy is clearly on the path towards recovery, with Luxembourg business leaders assessing both the general state of the economy and the situation at their own companies more optimistically than in any of the previous four survey waves.
The core questions on the economic trend are augmented in the present survey by differentiated trend questions on Luxembourg's competitiveness and on the various developments entrepreneurs anticipate in their own line of business or economic sector. In addition, several questions pertaining to current political issues or economic policies are included: specifically, questions on introducing quotas for women in executive positions, on the evaluation and remuneration of public sector employees, and on the proposed reform of the retirement pension system in Luxembourg.

The present report summarizes the most important findings of the study and presents them in graphic form. The report is supplemented by a basic volume of tables showing the responses to all questions in tabular form.

Allensbach on Lake Constance, INSTITUT FÜR DEMOSKOPIE ALLENSBACH
May 12, 2011

For the entire report and additional information,

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