

AUDIT - TAX - ADVISORY

# Luxembourg Business Compass

**LBC:** expectations rise  
from **-0.4** to **+1.0**

Edition II/2010

[kpmg.lu](http://kpmg.lu)

KPMG in Luxembourg

With the support of the Luxembourg Chamber of Commerce

# Executive Summary

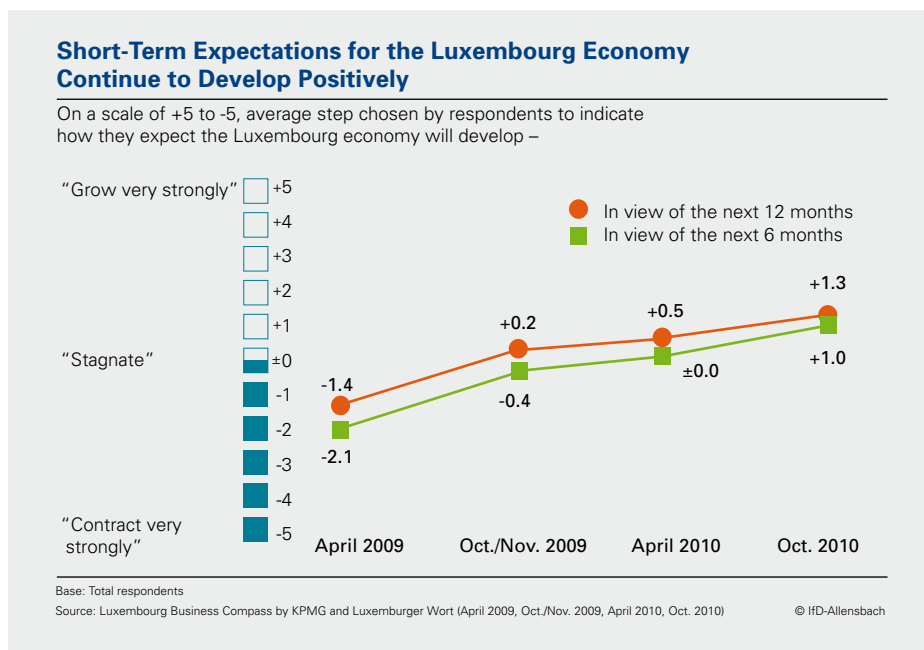
## 1. Things are (or soon will be) looking up:

Expectations for the Luxembourg economy are clearly becoming more positive

**LBC in view of the next 6 months = +1.0**

**LBC in view of the next 12 months = +1.3**

By and large, Luxembourg entrepreneurs already expect to see moderate economic growth over the course of the next six months, which is the first time that short term expectations have been positive since the initial survey was conducted in April 2009. Similarly, expectations for the next 12 months have also continued to improve.



## 2. Optimism on the rise within Luxembourg companies:

Increase in the number of employees expected over the next 6 months within Luxembourg companies.

## 3. Widespread skepticism when it comes to Luxembourg's development in terms of competitiveness:

2/3 of the entrepreneurs consider that competitiveness is worse than 2 years ago.

## 4. Tendency towards expansion

With increased budgets being allocated for development of new products/services, a geographic extension, as well as related marketing/promotion and training.

## 5. Tripartite as a balancing instrument and its various stakeholders lost in credibility

## 6. Skeptical assessments of the Government's new tax measures

## 7. To reduce the health funds' deficit,

entrepreneurs favor increasing co-payments, encouraging the use of generic drugs and reducing the sickness allowance.

# Interview with Mr. Pierre Leyers



## **Things are looking up, but not for all**

The recently released results of the 4<sup>th</sup> edition of the “Luxembourg Business Compass” clearly demonstrate that Luxembourg’s economy has recovered from the crisis.

Decision makers at the helm of the economy view future development with increased optimism. Nonetheless, the economic wounds caused by the crisis (also) in Luxembourg are not yet fully healed, and excessive optimism would be misplaced: “one swallow does not a summer make.” The upswing is distinguishable, but there are sectoral differences.

In the industrial sector, demand has improved since January 2010. In the financial sector, the carthorse of the Luxembourg economy, the outlook is however much more hazy. The balance sheet total of banks is depressed and the number of employees is decreasing. Tax revenue generated from the financial and service sector forms an integral part of national revenue and budgetary latitude of authorities should not increase in the foreseeable future. In turn this will lead to a slowdown of activities in the construction sector. Statistically, growth has not yet reached pre-crisis level.

To a certain extent, the speed of Luxembourg’s return to growth will be dictated by the general international climate. Although the forecast is tentatively positive as yet, dark clouds over Ireland, Portugal and Spain threaten to create stormy conditions across the rest of Europe. In the coming weeks it will be clearer whether we have really overcome the crisis.

The next edition of the Luxembourg Business Compass that will be published in April/May 2011 is already highly anticipated.

*Pierre Leyers*

# Interview with Mr. Carlo Thelen



## **The expectations of Luxembourgish entrepreneurs have developed in a very positive way. Is the crisis over?**

An upward trend can be seen, however, sectorial differences remain. For example, the demand in the industrial sector has strongly increased since early 2010. The banking sector, on the other hand, remains below pre-crisis levels of development: total assets have decreased by 1.7% in September compared to August. The retail sector is increasing slightly, while the construction sector and services sector have developed in a dynamic way. The answers collected from our LBC-questionnaire have therefore to be interpreted with caution as the first edition of the survey was realized in April 2009, right in the middle of the crisis. It is easy to understand that the economic expectations are more positive compared to the lowest point attained during the crisis. Statistically, the growth level reached before the crisis has not yet been recovered. At the same time, many other different risk factors increase in the global economy, on which Luxembourg has no influence. The uncertainty prevails, and many of our businesses continue to struggle with the consequences of the crisis.

## **The development of the competitiveness of Luxembourg is being widely viewed with pessimism. If this trend continues, is there cause for concern?**

Export-orientated companies in particular are suffering greatly from the increasingly weaker competitiveness of our economy. Unit labor costs have increased by 34% in Luxembourg between 2000 and 2009, in the Euro Zone by 21 % and in Germany by only 8%. But these are our main trading partners! With increasing competition and declining competitiveness, it is more difficult for the Luxembourg based firms to sell their products and services abroad. This has serious consequences on our open and export-driven economy: rising unemployment, lower investment, higher budget deficits of the government and social security. Such a trend is highly dangerous and not sustainable for a small country like Luxembourg. Even more astonishing is the fact that the current slight economic recovery serves to some observers as a pretext to postpone or abolish the required structural reforms.

## **The fiscal measures proposed by the government are met with a skeptical view of entrepreneurs. Do you share their standpoint?**

Absolutely! With regards to nominal corporate tax, Luxembourg is at best average in international comparison. The original intention of the government to decrease the rate of taxation from 29 to 25.5 % is probably not enforceable in the medium term. That our budget deficit leads to tax increases for businesses, is a wrong signal to foreign investors.

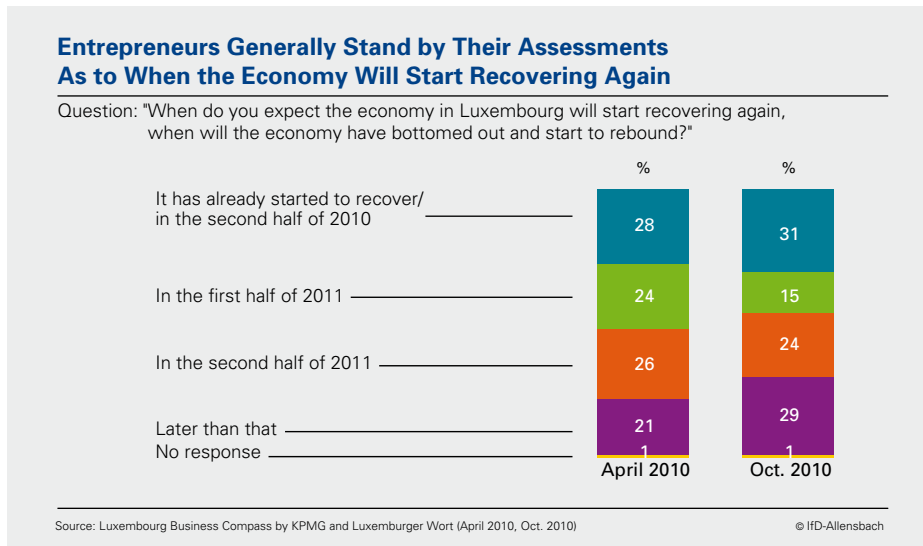
Of course, the budget deficit must be brought back into balance, but this should be done on the basis of more efficient spending due to a reduction of the current government costs. Furthermore, there should quickly be a long term hedging/ protection of our social security system (pensions, health care), so that the lowest social contributions can be secured – one of the few competitive advantages that Luxembourg managed to maintain so far. In a global economy, higher taxes and charges on companies lead in the medium term to less growth and less tax revenue.

*Carlo Thelen*

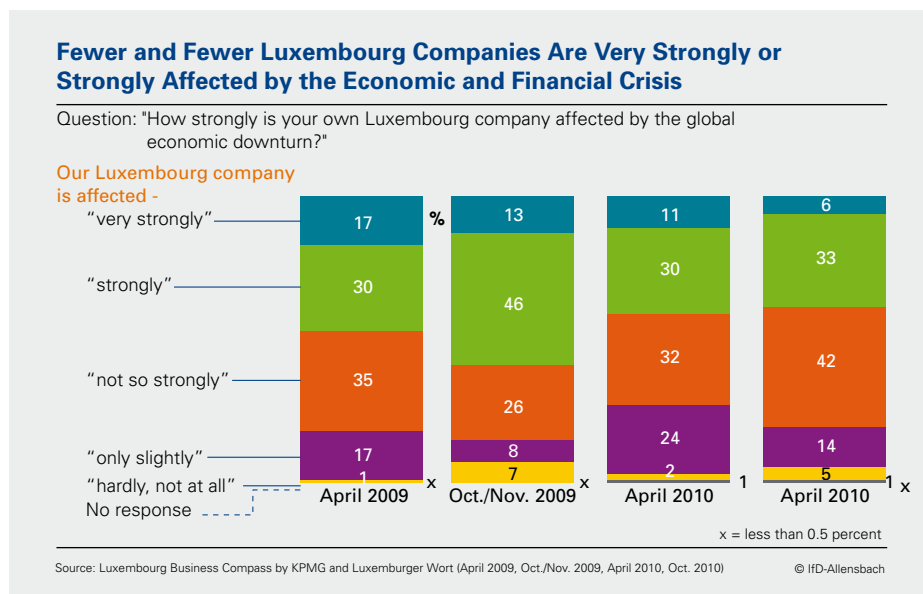
# Findings

## Optimism on the rise within Luxembourg companies

In contrast to the last survey, Luxembourg entrepreneurs have hardly revised their expectations as to when the economy will start recovering, that is, they generally have not adjusted their forecasts downwards.



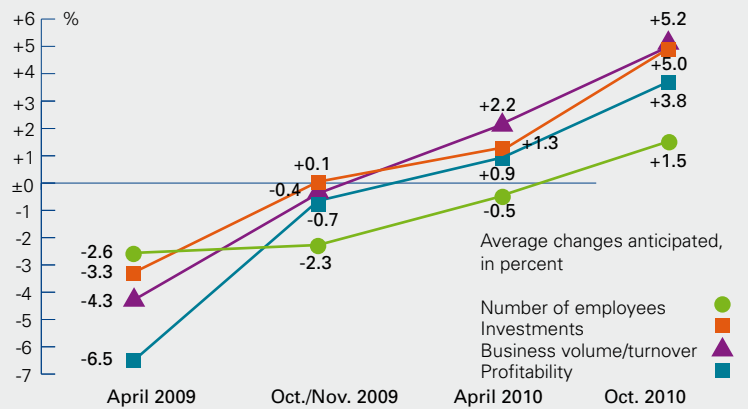
Just as entrepreneurs' assessments of the general economic trend in Luxembourg are becoming increasingly optimistic, the share of business leaders who say that their companies are affected "very strongly" (6 percent) or "strongly" (33 percent) by the global economic downturn is also declining.



The business leaders interviewed are also becoming significantly more optimistic when it comes to several key economic indicators at their own companies. Over the next 6 months, entrepreneurs expect, on average, to see substantial increases in business volume (+5.2 percent), investments (+5.0 percent) and profits (+3.8 percent). Only a year ago, a negative trend was expected with regard to both business volume and profits. When it comes to the number of employees, expectations are still relatively cautious. For the first time in the past one and a half years, however, entrepreneurs anticipate an increase in the number of employees at their own companies (+1.5 percent on average) - so here too, it would seem that the worst point has already been reached and the situation is now beginning to improve.

### Expectations for Entrepreneurs' Own Companies: Clear Increases in Turnover, Investments and Profitability, Along with a First-Time Increase in the Number of Employees

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

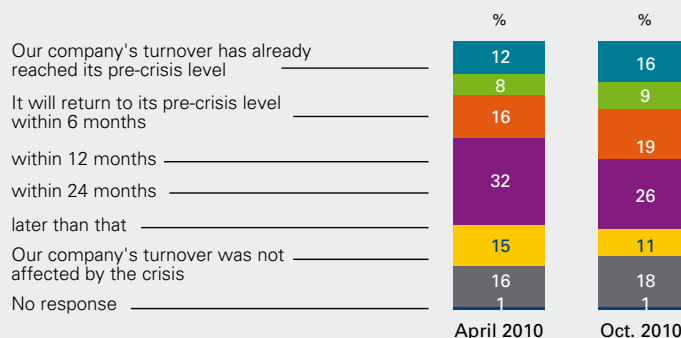


Base: Total respondents  
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2009, Oct./Nov. 2009, April 2010, Oct. 2010) © IfD-Allensbach

Nevertheless, more than one out of three Luxembourg business leaders expect it will take two years (26 percent) or more (11 percent) before their company's turnover returns to pre-crisis levels. At the same time, however, an almost equally large share of entrepreneurs report that their company's turnover was not affected by the crisis at all (18 percent) or, respectively, that their turnover has already reached its pre-crisis level (16 percent).

### When Will Turnover Return to Pre-Crisis Levels? Entrepreneurs Have Mixed Expectations

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

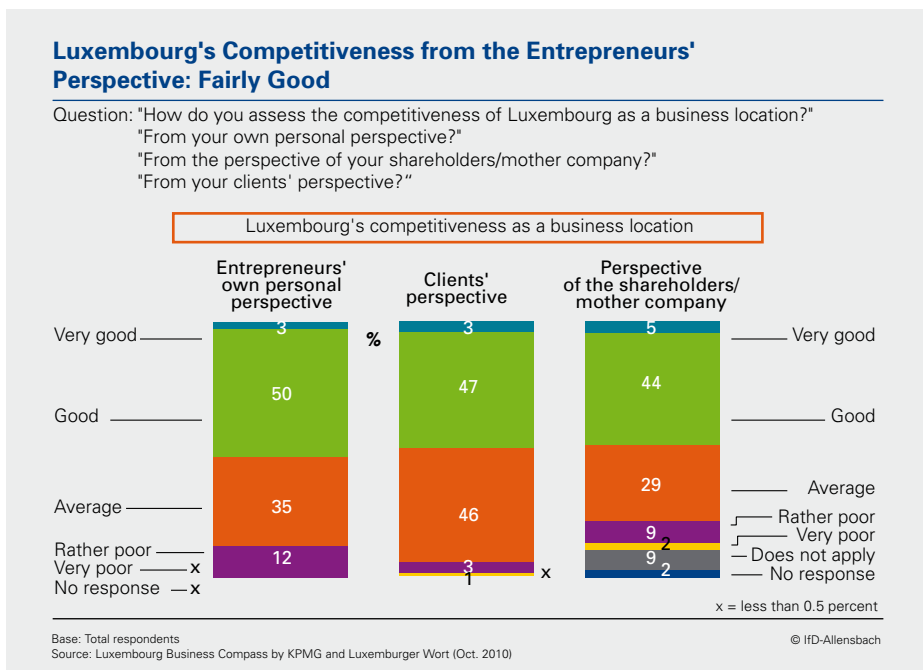


Base: Total respondents  
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (April 2010, Oct. 2010) © IfD-Allensbach

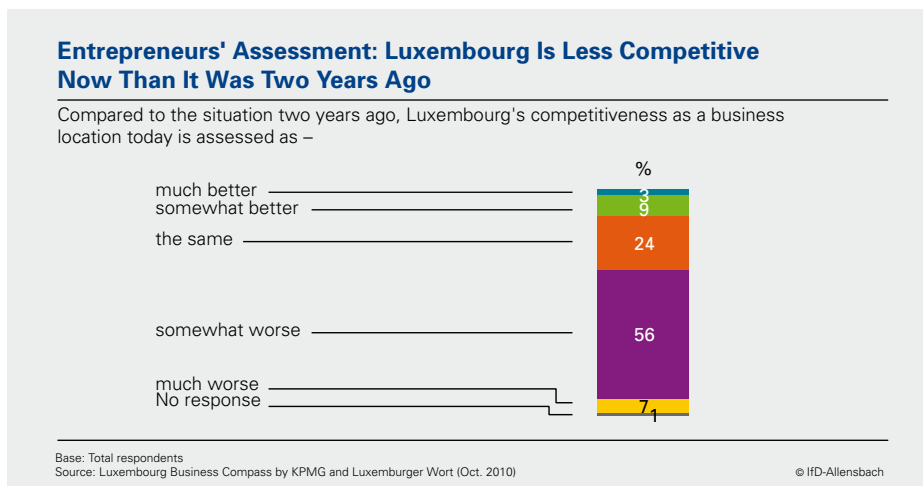
**Widespread skepticism when it comes to Luxembourg’s development in terms of competitiveness**

On the whole, the business leaders interviewed assess Luxembourg’s competitiveness as a business location “only” as fairly good that is 50 percent say it is “good” and an additional 35 percent choose “average.” In comparison to assessments of Luxembourg’s image as a business location in the prior survey, entrepreneurs are clearly more cautious when assessing Luxembourg in terms of competitiveness.

When asked to assess Luxembourg’s competitiveness from the presumed perspective of clients, along with that of their parent companies or, respectively, shareholders, entrepreneurs’ responses are quite similar: in each case, the majority assess Luxembourg’s competitiveness as “good” or “average.”

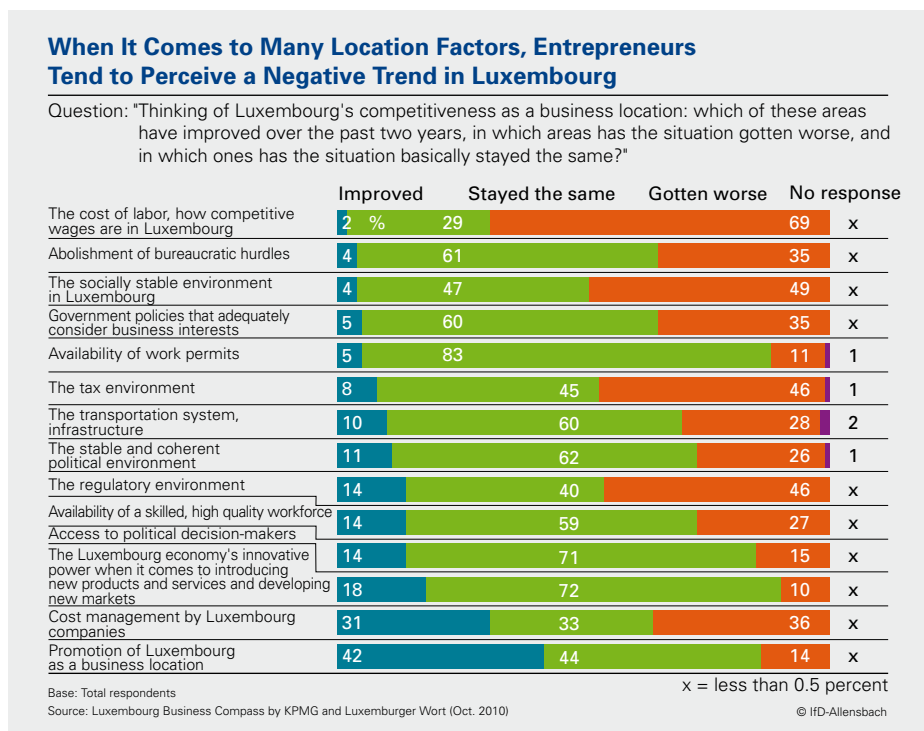


In comparison to the situation two years ago, entrepreneurs now tend to view Luxembourg as weaker in terms of competitiveness: about two thirds say Luxembourg’s competitiveness is “somewhat worse” now than it was two years ago (56 percent) or even “much worse” (7 percent).



When it comes to location factors, entrepreneurs tend to perceive that the situation has become worse for the following factors:

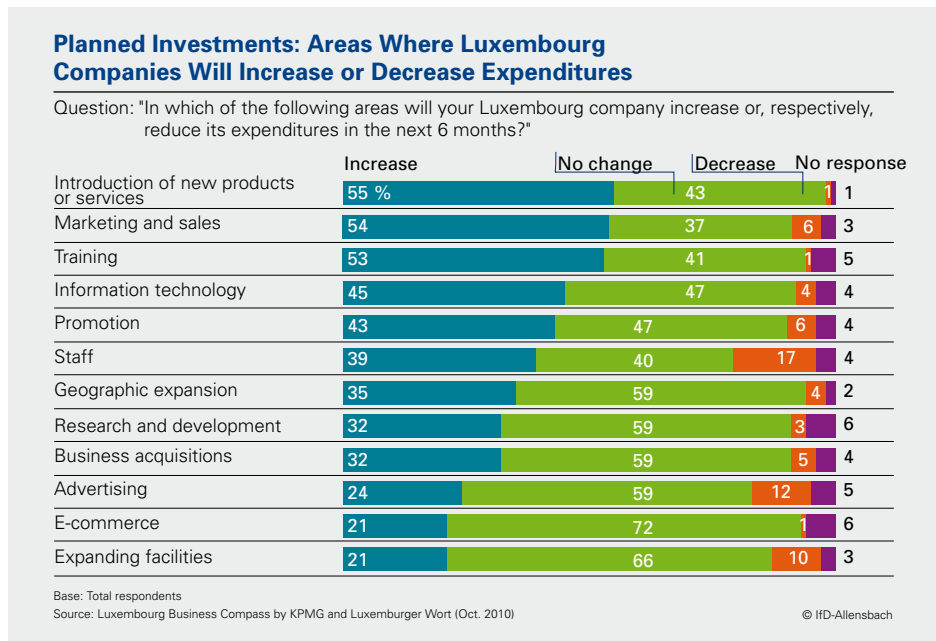
- Cost of labor, how competitive wages are in Luxembourg (69% of responses)
- Socially stable environment in Luxembourg (49% of responses)
- Tax environment (46% of responses)
- Regulatory environment (46% of responses)



**Investment plans: Tendency towards increased budgets in all areas of operations**, with more money being allocated especially for the introduction of new products and services, for marketing and for training.

In the next 6 months, the largest Luxembourg companies are primarily planning to increase expenditures for the introduction of new products or services, for marketing and sales, as well as for employee training.

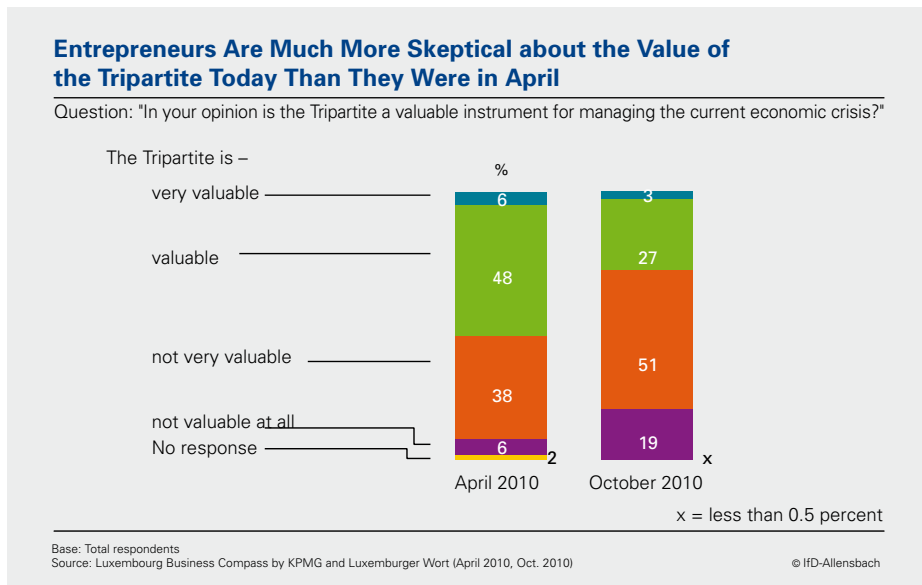
Compared to the investment plans reported in the prior three surveys, Luxembourg companies' willingness to invest in the introduction of new products or services, marketing and sales, and promotion has continued to grow.



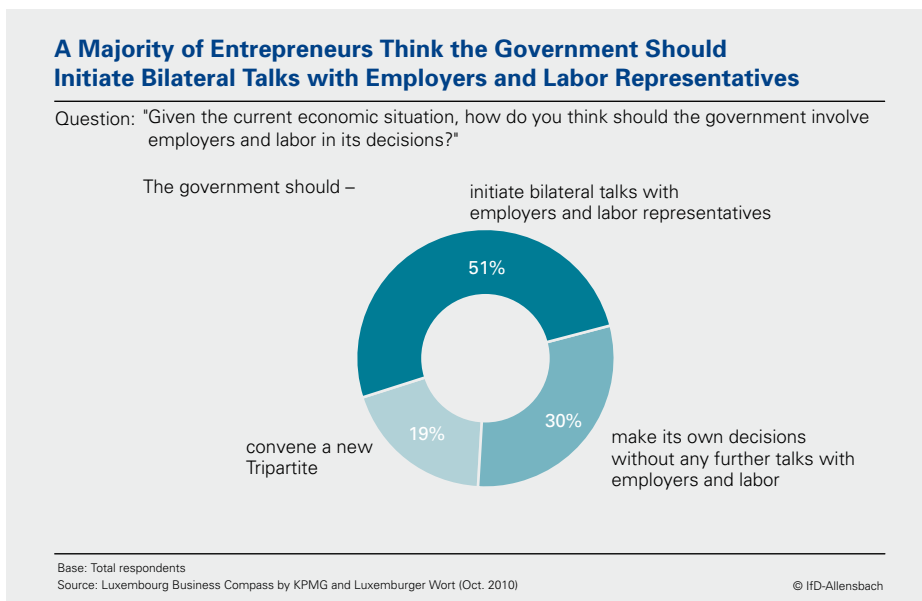
**Assessments of measures relating to economic policy:**

The unsuccessful conclusion of the Tripartite this past spring has obviously strongly shaken entrepreneurs' confidence that this is an effective way to involve employers and labor representatives in economic policy-making aimed at addressing the economic crisis.

The vast majority of entrepreneurs currently consider the Tripartite to be "not very valuable" (51 percent) or even "not valuable at all" (19 percent).



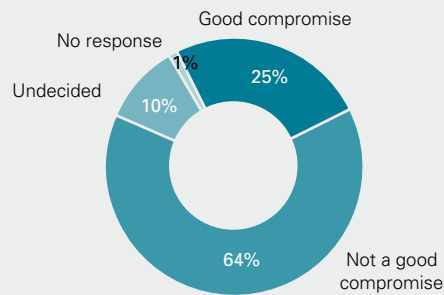
Instead, a majority of the most important Luxembourg entrepreneurs advocate bilateral talks between the government and employers or, respectively, labor representatives (51 percent). A large share of entrepreneurs (30 percent) even think the government should make its own decisions without conferring with employers and labor, rather than convening a new round of Tripartite talks (19 percent)



Nevertheless, a large share of entrepreneurs are critical of the compromise that was negotiated by the government and labor unions in late September during the course of such bilateral talks.

### About Two Thirds of the Entrepreneurs Criticize the Compromise Reached between the Government and Labor Unions in Late September

Question: "On September 29, 2010, the government and the major union leaders negotiated a compromise in which the union leaders agreed to suspend all wage increases based on the wage indexation mechanism until October 1, 2011 and, in return, the government agreed not to cut the tax deduction for commuting expenses in half, as planned. What do you think: Is that a good compromise or is it not a good compromise?"



Base: Total respondents

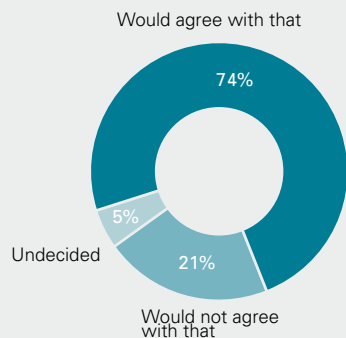
Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2010)

© IFD-Allensbach

In this connection, about three quarters of Luxembourg business leaders criticize the compromise as a wasted opportunity to fundamentally reform the wage indexation mechanism in Luxembourg.

### About Three Fourths of the Entrepreneurs View the Compromise between the Government and Labor Unions as a Wasted Opportunity to Fundamentally Reform the Indexation Mechanism

"By making this compromise, the government wasted an opportunity to change the indexation mechanism altogether"



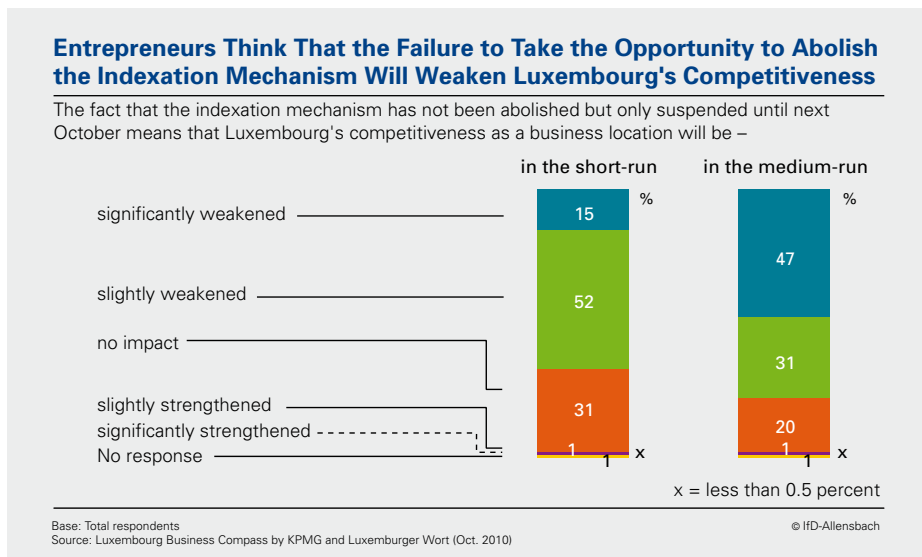
Base: Total respondents

Source: Luxembourg Business Compass by KPMG and Luxemburger Wort (Oct. 2010)

© IFD-Allensbach

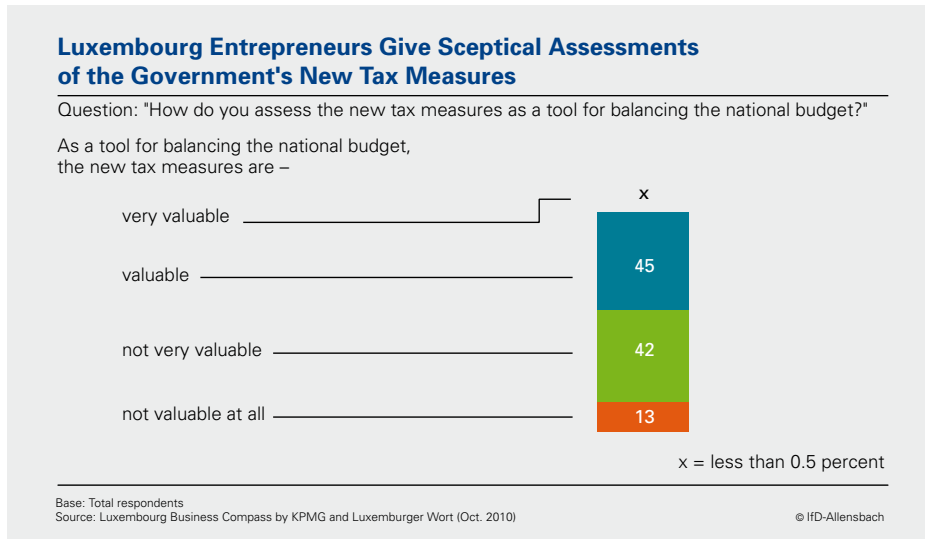
In the eyes of the majority of entrepreneurs interviewed, simply suspending wage increases until October of next year will have a negative impact on Luxembourg's competitiveness as a business location in both the short run and, even more so, in the medium term.

Practically none of the entrepreneurs interviewed thinks the compromise will have a positive impact, regardless of whether in the short or medium run.



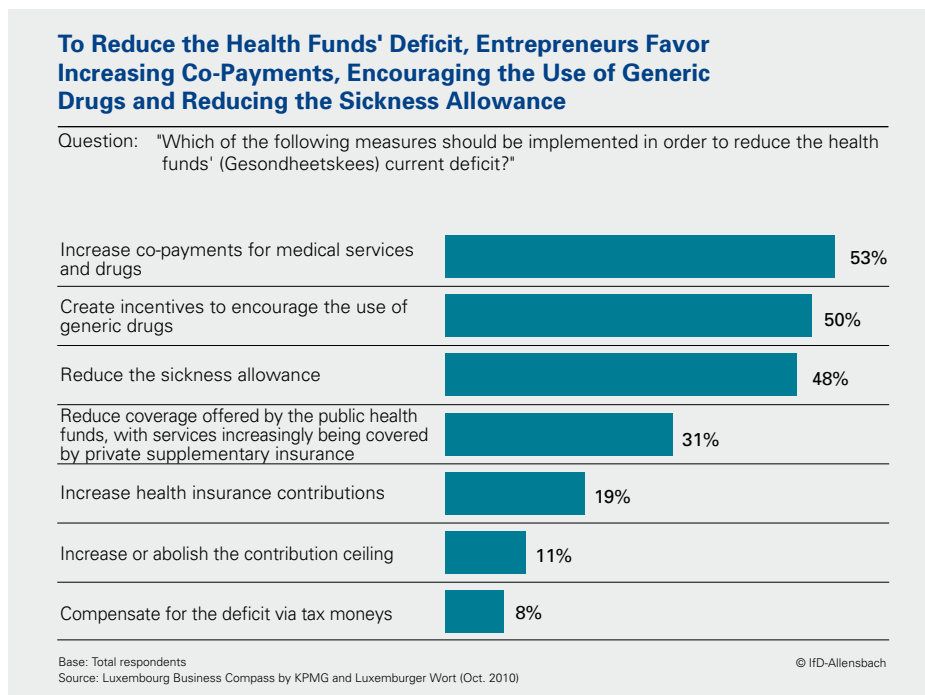
### Skeptical assessments of the Government's new tax measures

When it comes to the new tax measures the government is planning to implement in order to reduce the budget deficit, opinions are split among entrepreneurs, although they do generally tend to be somewhat skeptical.



**To reduce the health funds' deficit, entrepreneurs favor increasing co-payments**, encouraging the use of generic drugs and reducing the sickness allowance.

When asked what measures should be implemented in order to reduce the health funds' deficit, Luxembourg entrepreneurs primarily favor increasing patients' co-payments for medical services and drugs (53 percent), creating incentives to encourage the use of generic drugs (50 percent), along with reducing the sickness allowance in the event of illness (48 percent).





## Your contacts at KPMG

### **Karin Riehl**

**Managing Partner**

**T:** +352 22 51 51 6210

**E:** karin.riehl@kpmg.lu

### **John Li**

**Partner, Chairman  
of Supervisory Board**

**T:** +352 22 51 51 6200

**E:** john.li@kpmg.lu

### **Georges Bock**

**Partner**

**Head of Tax**

**T:** +352 22 51 51 5522

**E:** georges.bock@kpmg.lu

### **Alain Picquet**

**Partner**

**Head of Advisory**

**T:** +352 22 51 51 7910

**E:** alain.picquet@kpmg.lu

### **Patrick Wies**

**Partner**

**T:** +352 22 51 51 6305

**E:** patrick.wies@kpmg.lu

## **KPMG**

**9, Allée Scheffer**

**L-2520 Luxembourg**

**T: +352 22 51 51 1**

**F: +352 22 51 51 71**

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2010 KPMG S.à r.l., a Luxembourg private limited company, is a subsidiary of KPMG Europe LLP and a member of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name, logo and "cutting through complexity" are registered trademarks or trademarks of KPMG International. Printed in Luxembourg.