

# Countryreport

## Balticstates

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### Summary

Prime-minister Ansip prolonged his term in last year's parliamentary elections in **Estonia**, which implies that little change in the policy direction is expected. With real economic growth projected to slow down to 4% this year (from 7% last year, and 11% in 2006), the economy has allegedly overheated. Inflation is forecast to run up to 8.2% in 2008, and a procyclical fiscal stance has not helped to lower it. EMU-entry will most likely be deferred to 2012. Rapid credit growth has pushed the current account into a large deficit, which appears increasingly difficult to finance. Although the liquidity position is still sufficient, this puts Estonia's external solvency under pressure.

### Thingstowatch:

- Inflation
- External solvency

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### Summary

The centre-right coalition in Latvia secured another term in office in 2006, but with the addition of a fourth party, it may prove difficult to sail smoothly to the wind, especially now that the Latvian economy is in turbulent waters. Early last year, rumours of a devaluation of the lat caused jitters on financial markets that led to soaring interest rates on interbank lending. Double-digit growth and inflation rates, and a current account deficit of 24% of GDP, have triggered doubts about the sustainability of Latvia's external finances. A more orderly slowdown can still relieve external imbalances, but as financing conditions are tightening worldwide, the recent build-up in foreign debt is to be watched closely.

### Thingstowatch:

- Inflation
- External solvency



### Summary

Elections are due in **Lithuania** in October of this year. The policy direction of the next government could become more populist if Viktor Uspaskich or Rolandas Paksas would return to power, but so far, their chances are slim. It is more likely that the stance of mainstream parties is continued. The overheating of the Lithuanian economy is not as pronounced as in the other Baltic States, but at 6.4% this year, inflation will still be far beyond the Maastricht benchmark. Euro adoption, therefore, is not expected before 2013. Since Lithuania has to contract more debt to finance its current account deficit, its external solvency is under pressure.

### Things to watch:

- Elections in October 2008
- Inflation
- External solvency

**Economicstructureandgrowth**

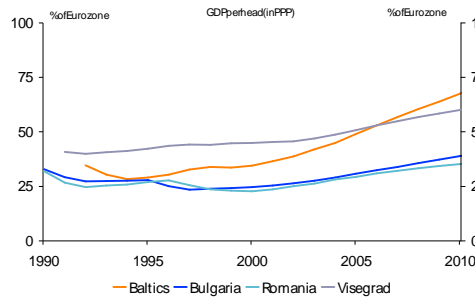
Since their independence from the Soviet Union in 1991, the Baltic States have experienced a dramatic transition. At the start of the transition process, the tiny economies of Estonia, Latvia and Lithuania had a highly vulnerable economic structure because they used to produce only a few goods for the entire Soviet Union, a market that had collapsed. Fifteen years, and a truckload of reforms later, the Baltic economies share a growth story that appears too fast, too furious. The Baltic economies have, on average, grown by 8.5% over the last five years, and each of them has clocked a double-digit growth rate within this timespan (see Chart 1) and are comfortably embedded in the EU. In recent years, however, the Baltic economies have, on average, grown by 8.5% over the last five years, and each of them has clocked a double-digit growth rate within this timespan (see Chart 2).

Unfortunately, this rate of expansion is proving unsustainable, and a slowdown is forthcoming. Estonia is already experiencing a serious dent with its economic growth rate dropping from 11.2% in 2006 to 7% last year. This year, it is projected to drop further to 4%. Latvia's economic growth rate touched 12% in 2006, but it is also slipping. The 2007 estimate is put at 10.7%, and for 2008, a decrease to 7.5% is expected. The real growth rate of the largest Baltic economy will decelerate to about 7.4% this year, down from 9.2% in 2007.

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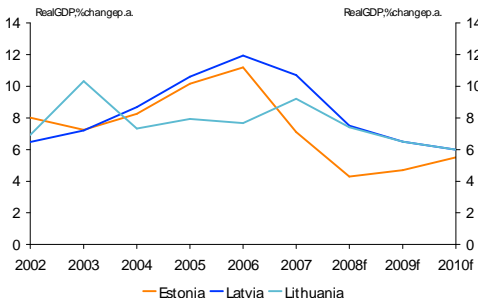
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**Chart 1: Baltics are catching up rapidly**



Visegrad 4: Czech Rep., Hungary, Poland and Slovakia.  
Source: EIU

**Chart 2: But a cooling is in the offing**



Source: EIU

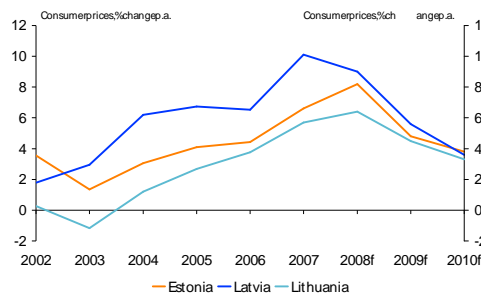
The clearest sign that the Baltic economies are overheating is given by Chart 3. In recent years, inflation has been running high. In Estonia and Lithuania, respectively, increases in consumer prices are forecast to peak at 8.2% and 6.4% this year. Latvia's inflation rate is projected to come down from 10.1% to 9%, but this is still alarmingly high. Because the Baltic currencies follow rigid exchange rate regimes anchored on the euro (the Latvian latis is pegged to the euro, and Estonia and Lithuania operate currency boards), monetary policy cannot be used to combat inflation. For the slowdown to be gentle, therefore, credit growth has to moderate through other channels. Chart 4 indicates that total domestic credit growth reached its peak at 40% in 2006 for Estonia, and even a whopping 60% in 2005 for Latvia and Lithuania. Especially private banks, which hold virtually all banking assets in Latvia (55%), have the power to curb private credit growth. Even though term loans from parent companies are generally more secure than market debt, it offers no guarantee that the foreign owners will stand by their subsidiaries. The Nordic professional risk management capabilities, but since holders, it poses both concentration and contagion risks to the banking sectors of the Baltic States.

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The projected slowdowns for the Baltic economies are substantial, but not yet catastrophic. They can still be seen as a natural, albeit strong, correction to severe external imbalances. This analysis is based on a typical overheating scenario of a small, open economy in which domestic supply fails to keep track of burgeoning domestic demand. In such a scenario, rising incomes and rapid credit growth boost investment and consumption, which cannot be satisfied by the narrow structure of domestic supply. Since foreign supply meets the soaring demand for imports, the current account balance moves into deficit. In case of the Baltic States, the drive for liberalisation and reform that came with European integration sped up this process. If the buoyant economy cannot attract sufficient (productive) foreign investment, it will have to fall back on debt-creating capital flows. An orderly slowdown of domestic demand and growth may deflate the external imbalances, but policymakers in the Baltic States will have to be careful not to push the cart over the hill.

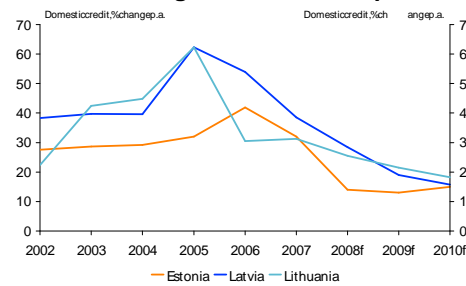
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Chart3: Inflation still to be curbed



Source: EIU

Chart4: Credit growth reached its peak



Source: EIU

**Political and social situation**

In **Estonia**, the Reform Party of prime-minister Andrus Ansip won the parliamentary elections in March 2007. Although this enabled him to prolong his premiership, a novelty in post-independence Estonia, he formed another coalition, at loggerheads over tax policy and relations with Russia. In spite of a broad consensus for fiscal consolidation, this change makes a decrease in the 23% flat tax rate more likely. A similar story holds for **Latvia**. Prime-minister Aigars Kalvitis was also the first to prolong his term in office winning the country's parliamentary elections in October 2006. He continued with his centre-right coalition with the addition of another junior partner. This implies that the coalition counts four parties, which is proving too many for effective decision-making. Corruption charges against Latvian oligarchs will also continue to distract politics. Despite the controversy surrounding his candidacy, however, Valdis Zatlers became the new president in July 2007. The ruling coalition in **Lithuania** does not have much room for manoeuvre either. In 2006, the government collapsed and a minority coalition continued with only 60 out of 141 parliamentary seats. The minority government is expected to hold out until the elections of October 2008, however, since neither the Social Democrats of prime-minister Gediminas Kirkilas, nor the conservative Homeland Union, the main opposition party, will do well in a snap poll. However, a possible return of Viktor Uspaskich or Rolandas Paksas might rock the boat during the upcoming elections. The former is the founder of the Labour party who had left for Russia after corruption charges. Last September, he came back feeling mistreated and regained leadership of the party. Since Rolandas Paksas was impeached and elected president in 2004, he cannot run for elective office at present, but his party won control of Vilnius in the municipal elections of

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February 2007 and he yearns for a comeback. He already declared the 2004 impeachment unconstitutional. Both as they campaign on a populist platform of flowertax-bewronged by the political establishment. Even though unwilling to engage with them, a landslide victory in policy direction could become more populist with full economy and prospect of euro adoption.

ady appealed to the European Court to may have good chances in the elections, xes-higher pensions, and they can claim to ough the mainstream parties are recurrently could put them in the driver's seat. If so, the rther risks for Lithuania's public finances,

Foreign affairs in all of the Baltic States continue to be dominated by relations with Russia. Both Estonia and Latvia have large groups of Russian minorities, a quarter and a third of their respective populations. The treatment of ethnic Russians is often a point of dispute with the Kremlin. **Estonia**, for instance, ran into a diplomatic row when it tried to move a Russian war shrine out of central Tallinn, and **Latvia** infuriated Moscow by conditions on citizenship: half of Latvia's ethnic Russians have passed up the opportunity of a Latvian passport. **Lithuania** managed to avoid this social exclusion by offering its Russian minorities (only 6% of the population) unconditional citizenship. Like many other states in Eastern Europe, it has to engage in tough negotiations with Russia's energy giants, which seek better remuneration for their oil and gas supplies. However, this strengthens relations among the Baltic States, but also with neighbouring Poland and other like-minded countries. Russia, from its part, has discovered energy diplomacy as a powerful tool to make governments move all around Europe. A renegotiation of contracts is not necessarily a bad thing, as long as the Kremlin respects the national sovereignty of other Baltic States. Russia still has to come to terms with the Baltic States being members of both NATO and the EU. The Duma's slinging over the ratification of border treaties strikes a false note in this.

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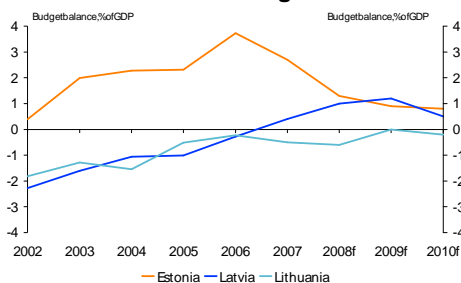
### Economic policy

The strength of public finances in the Baltic States is undisputed. **Estonia** consistently records a fiscal surplus, and even pleasantly surprises budget surplus targets on the upside from time to time. In 2006, bumper revenues and lower expenditures saw the budget balance churn out a surplus of 3.7% of GDP, although delayed investment played an important role. The Estonian government has used these surpluses to reduce its public debt (2.3% of GDP) and build a stabilisation reserve (2.9% of GDP) to cushion external shocks, such as the Russian ruble crisis in 1998. Without prejudice to the excellent state of Estonia's public finances, its current fiscal stance is not helpful in cooling down the economy. Plan to lower the flat tax and increase spending will erode the budget surplus over the forecast period. This may lead to an undesirable procyclical effect called inflation, which is already high. The public accounts of **Latvia** have also seen significant improvements in recent years. The budget deficit has been turned into a surplus that may reach 1% of GDP this year. The government was planning to gradually lower the flat tax from 25% to 15% in 2009, but has wisely postponed this proposal because of inflation worries. In setting public sector wages, some more restraint could still be exercised. Even though the outflow of migrant workers is rightened labour markets, the 40% wage increase awarded to civil servants does not serve as a good example for private sector negotiations. Latvia's public debt-to-GDP ratio has come down from 13% to 9%. This marks a significant improvement, even though the old level was no cause for alarm either. In addition, Latvia has also created a rainy-day fund carrying reserves worth 1% of GDP. The government budget of **Lithuania** shows trends similar to the Latvian budget, but since 2006, the consolidation appears to have slipped somewhat. At -0.6% of GDP this year, the balance will remain in deficit. This is still comfortably within the Maastricht target of -3%, but in comparison

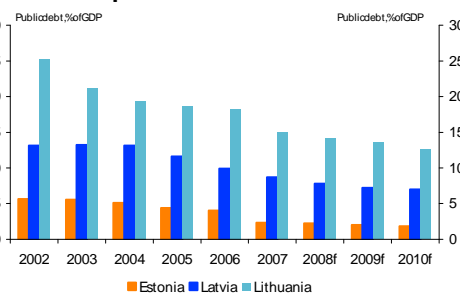
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to its peers, it is rather low. Both Estonia and Latvia operate a currency board, even records a surplus in 2006. To prevent procyclicality, however, Lithuania has implemented the start of this year. It caps the maximum speed of revenue growth over the last five years. Together with productivity increases, this budget rule should work moderate inflationary pressures. Although seemingly debt ratios of the other Baltic States, the solvency record of the Lithuanian public sector is more than adequate. The public debt-to-GDP ratio dropped from 25% to 15% in recent years and in addition, the government has a Privatisation Fund and expenditures, such as pension reform and restitution savings.

Latvia scores better, and Bulgaria, which also has a next excess of 3% of GDP. To prevent a commendable Fiscal Discipline Law from 2007, expenditure growth is half the average of the effort to keep wage growth in line with that of the government's strategy to be more vulnerable than the government's record of the Lithuanian public sector is more than adequate. The public debt-to-GDP ratio dropped from 25% to 15% in recent years and in addition, the government has a Privatisation Fund and expenditures, such as pension reform and restitution savings.

**Chart 5: Prudent fiscal budgets**


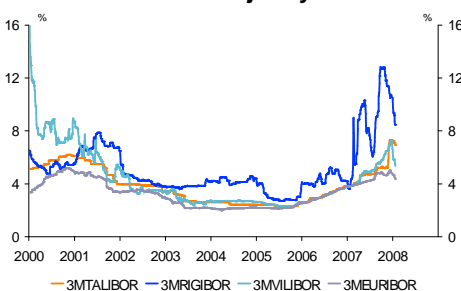
Source: EIU

**Chart 6: Limited public indebtedness**


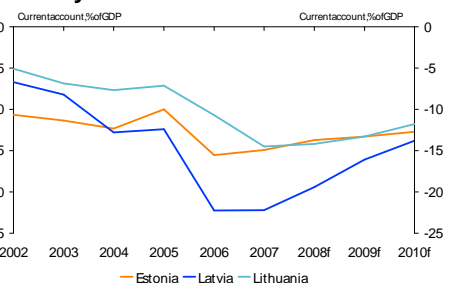
Source: EIU

As mentioned before, monetary policy in the Baltic States is firmly anchored on fixed exchange rate regimes. This implies, however, that the monetary authorities cannot hike the interest rate to halt inflation. Instead, they are dependent on the policy stance of the ECB. Chart 5 demonstrates that maintaining confidence in the currency pegs is essential. Early last year, rumours of a devaluation of the Latvian lats shocked local markets. The three months interbank rate, RIGIBOR, skyrocketed from 4% to almost 10%, and with the international credit crisis adding to uncertainties, it still seems to have lost its orbit. The recent increases of interbank rates of Estonia and Lithuania (TALIBOR and VILIBOR), and especially the growing gap with three months EURIBOR, indicate that risk premiums have also increased for these markets. Investors have clearly come to wonder whether they will be financed as easily in the future as they were in the past.

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**Chart 7: Interbank rates jittery**


Source: EIU

**Chart 8: Hefty current account deficits**


Source: EIU

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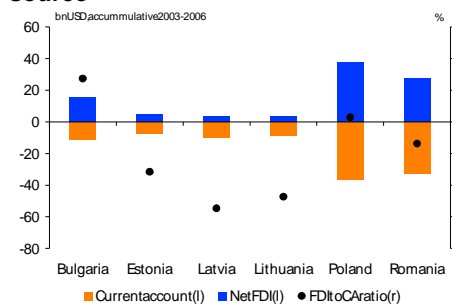
Baltic States have been deferred. **Estonia** is expected to enter EMU in 2012, whereas **Latvia** and **Lithuania** are projected to join a year later. All will depend, however, on the success in combating inflation and sustaining external solvency.

**Balance of payments**

Chart 8 reveals that the Baltic States have massive current account deficits. Over the last two years, the current account deficit of **Estonia** rose from 10% to 15% of GDP. The deficits on the current account balances of **Latvia** and **Lithuania** doubled from 7% to 15%, and from 12% to 24% of GDP, respectively. Faltering competitiveness, however, is not the issue. Within annual increase of more than 20% on average, the value of exported goods and services is showing healthy growth. Albeit negligible, the share of Baltic imports in the basket of Eurozone imports is also rising. The reason for the external deficits is buoyant domestic demand and considerable increase in the import prices of goods within the EU demand, food, petrol and basic materials for the construction boom. The deficits on the trade balance are roughly similar to the current account deficits because the other balances are leveling each other out. In **Estonia**, the surplus on the services balance outweighs the deficit on the income balance at (-)6% of GDP. This would imply that the country spends about as much on paying net dividend to foreign investors and other commercial services. The transfer balance record is only a negligible plus, which means that Estonia does not benefit significantly from an net inflow of worker remittances or foreign aid. This is different for **Latvia** and **Lithuania**. Both receive a net inflow in the order of 1.5%-2% of GDP. Since their deficits on the income balance are somewhat higher than the surpluses on their services accounts, however, the trade and current account deficits do not differ much for these countries either.

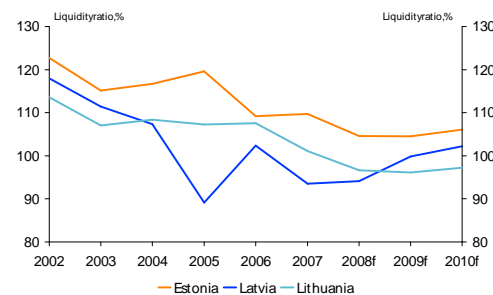
More interesting than the exact composition of the current account deficits, however, are the capital flows completing the balance of payments. Arguably, the most benign way to finance a current account deficit is to attract foreign direct investment (FDI). Chart 9 demonstrates that the Baltic States have been able to finance about a third of their current account deficits out of inward direct investment in recent years. This is less than Hungary, Turkey and Slovenia shows similar ratios. The other half of the current account deficit, therefore, has to be financed out of debt inflows or foreign exchange reserves. Another fairly benign source of financing is short-term debt, which is often consisted of trade credits that can easily be renewed. Last year, all of the Baltic States attracted new short-term debt. The share is slightly higher for Latvia, which has a much lower share of commercial bank loans because fewer of its banks are in foreign hands.

**Chart 9: FDI falls short as financing source**



Source: EIU

**Chart 10: External liquidity decreases**



Source: EIU

## External position

As a result of a growing current account deficit with non-debt creating capital inflows, the external position should be noted, however, that this mainly holds for the private sector, which in each of the Baltic States holds some more than half of external obligations. In 2007, the share of public debt consisted of short-term debt, most of it also private. The deteriorating external position related to higher sovereign risk. If it would come to a severe balance of payments crisis, the countries' public finances are not immediately endangered. Since some private or semi-public players may have to be bailed out, however, the possibility of such an event poses a contingent liability on the sovereign. Even if such an event would occur, however, public finances in the Baltic States are deemed strong enough to recapitalise the essential players in strategic sectors (e.g. a bank or refinery). It would lead to a painful shake-out in the private sector, whose indebtedness is growing rapidly.

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In five years, **Estonia's** foreign debt obligations have tripled to more than USD 25 bn in 2007. As a ratio to GDP, it increased from 71% to 108%, a jump from 95% to 132%. Over the same period, total debt service obligations also tripled and the debt service ratio soared from 38% to 51%. The interest service ratio also noted a remarkable increase. It went from 3.8% to 5.9% and is projected to exceed 7% over the forecast period. Clearly, Estonia's external solvency record is under pressure. There is no immediate risk, however, since the liquidity ratio stands at 110%. The external position of **Latvia** shows a similar trend. Between 2003 and 2007, total foreign debt more than tripled to USD 30 bn. As a % of GDP, it rose from 78% to 109%, and as a ratio to current account revenues, it soared from 148% to 212%. The debt service ratio increased from 85% to 104%, but the pressure on Latvia's external solvency is best shown by its interest service ratio, which rose from 3.1% in 2003 to a whopping 11.4% last year. This suggests that external creditors price in a higher risk of non-repayment on Latvian holdings. The country's external position has also become less liquid, as the liquidity ratio dipped below 100%, and official foreign exchange reserves cover just over a third of total debt service. Also in **Lithuania**, foreign debt obligations tripled. Relative to its size, however, Lithuania is not as indebted as the other Baltic States. The ratios to GDP and current account revenues have surely increased markedly, but at 57% and 91% in 2001, respectively, they are still substantially lower. This also holds for the debt- and interest service ratios.

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At 49%, the debt-service ratio is still rather high by international standards, but at 4%, the interest service ratio shows that external creditors are not yet perceiving a substantially higher risk of repayment. Lithuania's external liquidity is not luxurious, but with a liquidity ratio hovering around 100% and two-thirds of debt service obligations covered by foreign exchange reserves, there is no immediate cause for concern.

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See pages 10-12 for factsheets and data tables of the

of the Baltic States.

| Estonia                              |  |   |
|--------------------------------------|--|---|
| <b>National facts</b>                |  |   |
| Type of government                   | Republic   |   |
| Capital                              | Tallinn  |   |
| Surface area (thousands qkm)         | 45   |   |
| Population (millions)                | 1.3  |   |
| Main languages                       | Estonian (67%)<br>Russian (23%)                        |   |
| Main religions                       | Lutheran (16%)<br>Orthodox (13%)<br>Unaffiliated (68%) |   |
| Head of State (president)            | Toomas Ilves   |   |
| Head of Government (prime-minister)  | Andrus Ansip   |   |
| Monetary unit                        | Estonian kroon (EEK)                                   |   |
| <b>Economy (2006)</b>                |  |   |
| <b>Economic size</b>                 |  | <b>Social and governance indicators</b> |
| Nominal GDP                          | 17 bnUSD   | rank/total                              |
| Nominal GDP at PPP                   | 26   | Human Development Index (rank)          |
| Export value of goods and services   | 13   | Ease of doing business (rank)           |
| IMR quotient (mIn SDR)               | 65   | Economic freedom index (rank)           |
| <b>Economic structure</b>            |  | Corruption perceptions index (rank)     |
| Real GDP growth                      | 11.2   | Press freedom index (rank)              |
| Agriculture (% of GDP)               | 3  | Gini index (income distribution)        |
| Industry (% of GDP)                  | 28   | Population below \$1 per day (PPP)      |
| Services (% of GDP)                  | 69   |   |
| <b>Standards of living</b>           |  |   |
| Nominal GDP per head                 | 12361 USD  |   |
| Nominal GDP per head at PPP          | 19386  |   |
| Real GDP per head                    | 11540  |   |
| <b>Foreign trade (2006)</b>          |  |   |
| <b>Main export partners (%)</b>      |  | <b>Main import partners (%)</b>         |
| Finland                              | 18   | Finland                                 |
| Sweden                               | 12   | Russia                                  |
| Latvia                               | 9  | Germany                                 |
| Germany                              | 5  | Sweden                                  |
| <b>Main export products (%)</b>      |  | <b>Main import products (%)</b>         |
| Machinery & equipment                | 24   | Machinery & equipment                   |
| Mineral products                     | 16   | Mineral products                        |
| Timber products                      | 11   | Transport equipment                     |
| Non-precious metals & metal products | 9  | Chemicals                               |
| <b>Openness to the economy</b>       |  |   |
| Export value of G&S (% of GDP)       | 79   |   |
| Import value of G&S (% of GDP)       | 91   |   |
| Inward FDI (% of GDP)                | 10.1   |   |

| Estonia   |       |        |        |        |       |       |       |
|---|-------|--------|--------|--------|-------|-------|-------|
| Selection of economic indicators  | 2003  | 2004   | 2005   | 2006   | 2007  | 2008f | 2009f |
| <b>Key country risk indicators</b>  |       |        |        |        |       |       |       |
| GDP (% real change pa)  | 7.2   | 8.3    | 10.2   | 11.2   | 7.1   | 4.3   | 4.7   |
| Consumer prices (average % change pa)   | 1.3   | 3.0    | 4.1    | 4.4    | 6.6   | 8.2   | 4.8   |
| Current account balance (% of GDP)  | -11.4 | -12.3  | -10.0  | -1.55  | -14.9 | -13.7 | -13.3 |
| Total foreign exchange reserves (mIn USD)   | 1373  | 1788   | 1943   | 2786   | 3600  | 3900  | 4100  |
| <b>Economic growth</b>  |       |        |        |        |       |       |       |
| GDP (% real change pa)  | 7.2   | 8.3    | 10.2   | 11.2   | 7.1   | 4.3   | 4.7   |
| Gross fixed investment (% real change pa)   | 19.2  | 4.4    | 9.9    | 22.4   | 7.0   | 3.0   | 5.0   |
| Private consumption (% real change pa)  | 9.7   | 6.7    | 10.7   | 14.9   | 9.4   | 6.0   | 4.5   |
| Government consumption (% real change pa)   | 0.3   | 3.0    | 1.6    | 2.6    | 4.3   | 2.5   | 2.5   |
| Exports of G&S (% real change pa)   | 8.0   | 16.6   | 20.5   | 8.3    | 3.0   | 6.0   | 6.7   |
| Imports of G&S (% real change pa)   | 10.4  | 15.5   | 16.3   | 17.1   | 4.0   | 5.7   | 5.9   |
| <b>Economic policy</b>  |       |        |        |        |       |       |       |
| Budget balance (% of GDP)   | 2.0   | 2.3    | 2.3    | 3.7    | 2.7   | 1.3   | 0.9   |
| Public debt (% of GDP)  | 5.6   | 5.1    | 4.4    | 4.0    | 2.3   | 2.2   | 2.0   |
| Money market interest rate (%)  | 2.9   | 2.5    | 2.4    | 3.2    | 4.4   | 4.3   | 4.1   |
| M2 growth (% change pa)   | 10.9  | 15.8   | 41.9   | 28.2   | 18.0  | 13.0  | 12.0  |
| Consumer prices (average % change pa)   | 1.3   | 3.0    | 4.1    | 4.4    | 6.6   | 8.2   | 4.8   |
| Exchange rate ECU to USD (average)  | 13.85 | 12.59  | 12.58  | 12.47  | 11.43 | 10.72 | 11.79 |
| Recorded unemployment (%)   | 10.0  | 9.7    | 7.9    | 5.9    | 4.7   | 4.8   | 4.9   |
| <b>Balance of payments (mIn USD)</b>  |       |        |        |        |       |       |       |
| Current account balance   | -1116 | -1467  | -1392  | -2581  | -3110 | -3340 | -3260 |
| Trade balance   | -1557 | -2020  | -1904  | -2958  | -3097 | -3280 | -3190 |
| Export value of goods and services  | 4596  | 5983   | 7771   | 9654   | 10938 | 11940 | 12930 |
| Import value of goods and services  | 6153  | 8003   | 9675   | 12613  | 14035 | 15220 | 16120 |
| Services balance  | 831   | 1073   | 1027   | 1024   | 1280  | 1310  | 1370  |
| Income balance  | -526  | -635   | -579   | -758   | -1373 | -1460 | -1540 |
| Transfer balance  | 136   | 115    | 63     | 110    | 80    | 90    | 100   |
| Net direct investment flows   | 763   | 703    | 2252   | 569    | 600   | 670   | 600   |
| Net portfolio investment flows  | 94    | -130   | -2245  | -1309  | -620  | -670  | -670  |
| Net debt flows  | 2028  | 2979   | 1399   | 4291   | 5056  | 3820  | 3150  |
| Other capital flows (negative is outflow)   | -1394 | -1670  | 141    | -125   | -1113 | -170  | 380   |
| Change in international reserves  | 374   | 415    | 156    | 844    | 813   | 300   | 200   |
| <b>External position (mIn USD)</b>  |       |        |        |        |       |       |       |
| Total foreign debt  | 6972  | 10008  | 11255  | 16359  | 22570 | 25580 | 27620 |
| Short-term debt   | 2442  | 2999   | 3999   | 6000   | 7777  | 8630  | 9140  |
| Total debt service due incl. short-term debt                                      | 2810  | 3893   | 4590   | 6084   | 8663  | 10850 | 12010 |
| Total foreign exchange reserves   | 1373  | 1788   | 1943   | 2786   | 3600  | 3900  | 4100  |
| International investment position   | -7241 | -11316 | -12654 | -16470 | #N/B  | #N/B  | #N/B  |
| Total assets  | 6138  | 8784   | 10710  | 15247  | #N/B  | #N/B  | #N/B  |
| Total liabilities   | 13379 | 20100  | 23364  | 31717  | #N/B  | #N/B  | #N/B  |
| <b>Key ratios of balance of payments external solvency and external liquidity</b> |       |        |        |        |       |       |       |
| Trade balance (% of GDP)  | -15.9 | -17.0  | -13.7  | -17.8  | -14.8 | -13.4 | -12.9 |
| Current account balance (% of GDP)  | -11.4 | -12.3  | -10.0  | -1.55  | -14.9 | -13.7 | -13.3 |
| Inward FDI (% of GDP)   | 9.4   | 8.2    | 20.7   | 10.1   | 12.0  | 8.1   | 6.5   |
| Foreign debt (% of GDP)   | 71.0  | 84.1   | 80.7   | 98.5   | 107.9 | 104.6 | 112.3 |
| Foreign debt (% of XGSI)  | 95.2  | 103.5  | 93.1   | 110.4  | 131.5 | 139.0 | 141.1 |
| International investment position (% of GDP)                                      | -73.8 | -9.51  | -90.8  | -99.2  | #N/B  | #N/B  | #N/B  |
| Debt service ratio (% of XGSI)  | 38.4  | 40.3   | 37.9   | 41.1   | 50.5  | 59.0  | 61.3  |
| Interest service ratio incl. arrears (% of XGSI)                                  | 3.8   | 3.5    | 3.2    | 4.4    | 5.9   | 7.3   | 7.6   |
| FX-reserves import cover (months)   | 3     | 3      | 2      | 3      | 3     | 3     | 3     |
| FX-reserves debt service cover (%)  | 49    | 46     | 42     | 46     | 42    | 36    | 34    |
| Liquidity ratio   | 115   | 117    | 120    | 109    | 110   | 105   | 105   |



## CountryreportBalticstates

| Latvia                              |  |  |                                |
|-------------------------------------|--|--|--------------------------------|
| <b>National facts</b>               |  | <b>Social and governance indicators</b> rank/total |                                |
| Type of government                  | Republic                               | Human Development Index (rank)                     | 45/177                         |
| Capital                             | Riga                                   | Ease of doing business (rank)                      | 22/178                         |
| Surface area (thousands sq km)      | 65                                     | Economic freedom index (rank)                      | 41/157                         |
| Population (millions)               | 2.3                                    | Corruption perceptions index (rank)                | 51/180                         |
| Main languages                      | Latvian (58%)<br>Russian (38%)         | Press freedom index (rank)                         | 12/169                         |
| Main religions                      | Lutheran<br>Roman Catholic<br>Orthodox | Gini index (income distribution)                   | 37.7                           |
| Head of State (president)           | Valdis Zatlers                         | Population below \$1 per day (PPP)                 | <2%                            |
| Head of Government (prime-minister) | Aigars Kalvitis                        | <b>Foreign trade (2006)</b>                        |                                |
| Monetary unit                       | Latvian lat (LVL)                      | <b>Main export partners (%)</b>                    |                                |
| <b>Economy (2006)</b>               |  | <b>Main import partners (%)</b>                    |                                |
| <b>Economic size</b>                | <i>bn USD</i>                          | <i>% world total</i>                               | <b>Main export product</b> %   |
| Nominal GDP                         | 20                                     | 0.04   | Timber products                |
| Nominal GDP at PPP                  | 35                                     | 0.05   | Metals                         |
| Export value of goods and services  | 9                                      | 0.06   | Machinery & equipment          |
| IMR quotient (in mln SDR)           | 127                                    | 0.06   | Textiles & clothing            |
| <b>Economic structure</b>           |  | <b>Main import product</b> %                       |                                |
| Real GDP growth                     | 2006                                   | 5-year av.   | Machinery & equipment          |
| Agriculture (% of GDP)              | 11.9                                   | 8.2  | Transport equipment            |
| Industry (% of GDP)                 | 4                                      | 4  | Mineral products               |
| Services (% of GDP)                 | 21                                     | 24   | Metals                         |
| <b>Standards of living</b>          |  | <b>Openness of the economy</b>                     |                                |
| Nominal GDP per head                | USD                                    | % world av.  | Export value of G&S (% of GDP) |
| Nominal GDP per head at PPP         | 8770                                   | 110  | Import value of G&S (% of GDP) |
| Real GDP per head                   | 15078                                  | 138  | Inward FDI (% of GDP)          |
|                                     | 7824                                   | 117  |                                |

| Latvia  |       |       |       |        |       |       |       |  |
|---|-------|-------|-------|--------|-------|-------|-------|--|
| Selection of economic indicators  | 2003  | 2004  | 2005  | 2006   | 2007  | 2008f | 2009f |  |
| <b>Key country risk indicators</b>  |       |       |       |        |       |       |       |  |
| GDP (% real change p.a.)  | 7.2   | 8.7   | 10.6  | 11.9   | 10.7  | 7.5   | 6.5   |  |
| Consumer prices (average % change p.a.)   | 2.9   | 6.2   | 6.7   | 6.5    | 10.1  | 9.0   | 5.6   |  |
| Current account balance (% of GDP)  | -8.2  | -12.8 | -12.4 | -22.5  | -22.2 | -19.4 | -16.1 |  |
| Total foreign exchange reserves (mln USD)   | 1432  | 1912  | 2232  | 4353   | 5000  | 5500  | 5700  |  |
| <b>Economic growth</b>  |       |       |       |        |       |       |       |  |
| GDP (% real change p.a.)  | 7.2   | 8.7   | 10.6  | 11.9   | 10.7  | 7.5   | 6.5   |  |
| Gross fixed investment (% real change p.a.)                                       | 12.3  | 23.8  | 23.6  | 18.3   | 14.5  | 9.5   | 8.0   |  |
| Private consumption (% real change p.a.)  | 8.2   | 9.5   | 11.5  | 19.8   | 18.3  | 9.0   | 6.6   |  |
| Government consumption (% real change p.a.)                                       | 1.9   | 2.1   | 2.7   | 4.0    | 5.5   | 2.0   | 1.0   |  |
| Exports of G&S (% real change p.a.)   | 5.2   | 9.4   | 20.3  | 5.3    | 10.8  | 9.4   | 7.8   |  |
| Imports of G&S (% real change p.a.)   | 13.1  | 16.6  | 14.8  | 17.5   | 20.8  | 10.3  | 7.3   |  |
| <b>Economic policy</b>  |       |       |       |        |       |       |       |  |
| Budget balance (% of GDP)   | -1.6  | -1.1  | -1.0  | -0.3   | 0.4   | 1.0   | 1.2   |  |
| Public debt (% of GDP)  | 13.2  | 13.1  | 11.6  | 9.9    | 8.7   | 7.8   | 7.2   |  |
| Money market interest rate (%)  | 2.9   | 3.3   | 2.5   | 3.2    | 5.6   | 5.0   | 3.9   |  |
| M2 growth (% change p.a.)   | 22.1  | 26.7  | 38.3  | 38.7   | 30.0  | 21.8  | 17.8  |  |
| Consumer prices (average % change p.a.)   | 2.9   | 6.2   | 6.7   | 6.5    | 10.1  | 9.0   | 5.6   |  |
| Exchange rate (LVL to USD) (average)  | 0.57  | 0.54  | 0.56  | 0.56   | 0.51  | 0.48  | 0.53  |  |
| Recorded unemployment (%)   | 8.7   | 8.8   | 8.0   | 7.0    | 5.9   | 5.0   | 4.5   |  |
| <b>Balance of payments (mln USD)</b>  |       |       |       |        |       |       |       |  |
| Current account balance   | -920  | -1761 | -1991 | -4518  | -5936 | -6470 | -5490 |  |
| Trade balance   | -2002 | -2781 | -3018 | -5131  | -6240 | -6500 | -5640 |  |
| Export value of goods and services  | 3171  | 4221  | 5361  | 6140   | 7647  | 8870  | 10530 |  |
| Import value of goods and services  | 5173  | 7002  | 8379  | 11271  | 13887 | 15370 | 16170 |  |
| Services balance  | 577   | 601   | 606   | 662    | 708   | 720   | 750   |  |
| Income balance  | -25   | -275  | -176  | -532   | -904  | -1300 | -1350 |  |
| Transfer balance  | 530   | 694   | 597   | 483    | 500   | 610   | 750   |  |
| Net direct investment flows   | 254   | 527   | 586   | 1491   | 1840  | 1020  | 890   |  |
| Net portfolio investment flows  | -216  | -269  | -264  | -452   | -450  | -350  | -300  |  |
| Net debt flows  | 1617  | 3392  | 2243  | 8784   | 4998  | 4060  | 4120  |  |
| Other capital flows (negative is outflow)   | -527  | -1401 | -236  | -3155  | 199   | 2240  | 980   |  |
| Change in international reserves  | 208   | 487   | 338   | 2149   | 651   | 500   | 200   |  |
| <b>External position (mln USD)</b>  |       |       |       |        |       |       |       |  |
| Total foreign debt  | 8803  | 12654 | 14284 | 22943  | 29082 | 33440 | 35100 |  |
| Short-term debt   | 5632  | 7653  | 7493  | 11500  | 12250 | 12800 | 13250 |  |
| Total debt service due incl. short-term debt                                      | 5097  | 7003  | 10756 | 9728   | 14324 | 15500 | 16240 |  |
| Total foreign exchange reserves   | 1432  | 1912  | 2232  | 4353   | 5000  | 5500  | 5700  |  |
| International investment position   | -5162 | -7520 | -9051 | -14519 | #N/B  | #N/B  | #N/B  |  |
| Total assets  | 6674  | 9380  | 10045 | 15174  | #N/B  | #N/B  | #N/B  |  |
| Total liabilities   | 11836 | 16900 | 19096 | 29693  | #N/B  | #N/B  | #N/B  |  |
| <b>Key ratios of balance of payments external solvency and external liquidity</b> |       |       |       |        |       |       |       |  |
| Trade balance (% of GDP)  | -17.9 | -20.2 | -18.8 | -25.5  | -23.4 | -19.5 | -16.5 |  |
| Current account balance (% of GDP)  | -8.2  | -12.8 | -12.4 | -22.5  | -22.2 | -19.4 | -16.1 |  |
| Inward FDI (% of GDP)   | 2.7   | 4.6   | 4.5   | 8.3    | 7.5   | 3.6   | 3.2   |  |
| Foreign debt (% of GDP)   | 78.7  | 91.9  | 89.0  | 114.0  | 109.0 | 100.1 | 92.7  |  |
| Foreign debt (% of XGSI)  | 147.5 | 162.5 | 147.7 | 197.0  | 211.8 | 166.3 | 198.4 |  |
| International investment position (% of GDP)                                      | -46.1 | -5.4  | -56.4 | -72.1  | #N/B  | #N/B  | #N/B  |  |
| Debt service ratio (% of XGSI)  | 85.4  | 89.9  | 111.2 | 83.5   | 104.3 | 100.2 | 91.8  |  |
| Interest service ratio incl. arrears (% of XGSI)                                  | 3.1   | 4.1   | 5.6   | 8.7    | 11.4  | 11.4  | 12.5  |  |
| FX-reserves import cover (months)   | 3     | 3     | 3     | 5      | 4     | 4     | 4     |  |
| FX-reserves debt service cover (%)  | 28    | 27    | 21    | 45     | 35    | 35    | 35    |  |
| Liquidity ratio   | 111   | 107   | 89    | 102    | 94    | 94    | 100   |  |

| Lithuania                           |   |  |        |
|-------------------------------------|---|--|--------|
| <b>National facts</b>               |   | <b>Social and governance indicators</b> rank/total |        |
| Type of government                  | Republic  | Human Development Index (rank)                     | 43/177 |
| Capital                             | Vilnius   | Ease of doing business (rank)                      | 26/178 |
| Surface area (thousands sq km)      | 65  | Economic freedom index (rank)                      | 22/157 |
| Population (millions)               | 3.4   | Corruption perceptions index (rank)                | 51/180 |
| Main languages                      | Lithuanian (82%)<br>Russian (8%)<br>Polish (6%) | Press freedom index (rank)                         | 23/169 |
| Main religions                      | Roman Catholic (79%)<br>Orthodox (4%)           | Gini index (income distribution)                   | 36     |
| Head of State (president)           | Valdas Adamkus                                  | Population below \$1 per day (PPP)                 | <2%    |
| Head of Government (prime-minister) | Cediminas Skirvilas                             | <b>Foreign trade (2006)</b>                        |        |
| Monetary unit                       | Lithuanian litas (LTL)                          | <b>Main export partners (%)</b>                    |        |
|                                     |   | Russia   | 13     |
|                                     |   | Latvia   | 11     |
|                                     |   | Germany  | 9      |
|                                     |   | Estonia  | 6      |
|                                     |   | <b>Main import partners (%)</b>                    |        |
|                                     |   | Russia   | 24     |
|                                     |   | Germany  | 15     |
|                                     |   | Poland   | 10     |
|                                     |   | Latvia   | 5      |
| <b>Economy (2006)</b>               |   | <b>Main export products (%)</b>                    |        |
| <b>Economic size</b>                |   | Mineral products                                   |        |
| Nominal GDP                         | 30 bn USD                                       | Machinery & equipment                              |        |
| Nominal GDP at PPP                  | 55  | Transport equipment                                |        |
| Export value of goods and services  | 18  | Textiles   |        |
| IMR quotient (in mln SDR)           | 144   |  |        |
| <b>Economic structure</b>           |   | <b>Main import products (%)</b>                    |        |
| Real GDP growth                     | 2006  | Mineral products                                   |        |
| Agriculture (% of GDP)              | 5   | Machinery & equipment                              |        |
| Industry (% of GDP)                 | 34  | Transport equipment                                |        |
| Services (% of GDP)                 | 61  | Chemicals  |        |
| <b>Standards of living</b>          |   | <b>Openness to the economy</b>                     |        |
| Nominal GDP per head                | 8753 USD  | Export value of G&S (% of GDP)                     |        |
| Nominal GDP per head at PPP         | 16193   | Import value of G&S (% of GDP)                     |        |
| Real GDP per head                   | 8148  | Inward FDI (% of GDP)                              |        |
|                                     |   | 6.2  |        |

| Lithuania   |       |       |        |        |       |       |       |
|---|-------|-------|--------|--------|-------|-------|-------|
| Selection of economic indicators  | 2003  | 2004  | 2005   | 2006   | 2007  | 2008f | 2009f |
| <b>Key country risk indicators</b>  |       |       |        |        |       |       |       |
| GDP (% real change pa)  | 10.3  | 7.3   | 7.9    | 7.7    | 9.2   | 7.4   | 6.5   |
| Consumer prices (average % change pa)   | -1.2  | 1.2   | 2.7    | 3.8    | 5.7   | 6.4   | 4.5   |
| Current account balance (% of GDP)  | -6.9  | -7.7  | -7.1   | -10.8  | -14.5 | -14.2 | -13.3 |
| Total foreign exchange reserves (mln USD)   | 3372  | 3513  | 3720   | 5654   | 8298  | 9830  | 10830 |
| <b>Economic growth</b>  |       |       |        |        |       |       |       |
| GDP (% real change pa)  | 10.3  | 7.3   | 7.9    | 7.7    | 9.2   | 7.4   | 6.5   |
| Gross fixed investment (% real change pa)   | 14.1  | 15.5  | 10.9   | 17.4   | 16.6  | 9.5   | 9.0   |
| Private consumption (% real change pa)  | 10.2  | 12.2  | 11.9   | 11.9   | 11.0  | 8.9   | 7.1   |
| Government consumption (% real change pa)   | 3.8   | 7.7   | 3.6    | 5.5    | 5.0   | 5.0   | 3.0   |
| Exports of G&S (% real change pa)   | 6.9   | 4.4   | 17.7   | 12.2   | 9.4   | 1.2   | 10.3  |
| Imports of G&S (% real change pa)   | 10.4  | 14.9  | 17.2   | 13.8   | 12.9  | 11.5  | 10.0  |
| <b>Economic policy</b>  |       |       |        |        |       |       |       |
| Budget balance (% of GDP)   | -1.3  | -1.5  | -0.5   | -0.2   | -0.5  | -0.6  | 0.0   |
| Public debt (% of GDP)  | 21.1  | 19.4  | 18.6   | 18.2   | 15.0  | 14.2  | 13.6  |
| Money market interest rate (%)  | 1.8   | 1.5   | 2.0    | 2.8    | 4.2   | 4.0   | 3.6   |
| M2 growth (% change pa)   | 19.4  | 21.4  | 31.9   | 21.5   | 22.7  | 19.5  | 16.8  |
| Consumer prices (average % change pa)   | -1.2  | 1.2   | 2.7    | 3.8    | 5.7   | 6.4   | 4.5   |
| Exchange rate (LTL to USD) (average)  | 3.05  | 2.78  | 2.77   | 2.75   | 2.52  | 2.36  | 2.60  |
| Recorded unemployment (%)   | 10.3  | 6.8   | 4.8    | 3.4    | 3.2   | 3.1   | 3.0   |
| <b>Balance of payments (mln USD)</b>  |       |       |        |        |       |       |       |
| Current account balance   | -1278 | -1725 | -1831  | -3218  | -5453 | -6510 | -6130 |
| Trade balance   | -1704 | -2383 | -2916  | -4209  | -5690 | -6480 | -5890 |
| Export value of goods and services  | 7658  | 9306  | 11774  | 14151  | 17300 | 20390 | 22860 |
| Import value of goods and services  | 9362  | 11689 | 14690  | 18360  | 22990 | 26850 | 28750 |
| Services balance  | 614   | 812   | 1050   | 1083   | 940   | 960   | 990   |
| Income balance  | -482  | -612  | -627   | -817   | -1403 | -1730 | -1960 |
| Transfer balance  | 294   | 458   | 662    | 725    | 700   | 720   | 730   |
| Net direct investment flows   | 142   | 511   | 689    | 1551   | 1270  | 1080  | 1130  |
| Net portfolio investment flows  | 0     | 228   | -934   | -602   | -750  | -650  | -650  |
| Net debt flows  | 747   | 1635  | 1313   | 5067   | 5236  | 4790  | 2750  |
| Other capital flows (negative is outflow)   | 1426  | -505  | 986    | -841   | 2323  | 2820  | 3890  |
| Change in international reserves  | 1037  | 144   | 222    | 1957   | 2626  | 1530  | 1000  |
| <b>External position (mln USD)</b>  |       |       |        |        |       |       |       |
| Total foreign debt  | 7465  | 9482  | 11201  | 16199  | 21435 | 26230 | 28980 |
| Short-term debt   | 3277  | 3766  | 5325   | 6500   | 7900  | 8700  | 9000  |
| Total debt service due incl. short-term debt                                      | 4328  | 5038  | 6348   | 8379   | 11560 | 14710 | 17450 |
| Total foreign exchange reserves   | 3372  | 3513  | 3720   | 5654   | 8298  | 9830  | 10830 |
| International investment position   | -6859 | -8544 | -10588 | -15474 | #N/B  | #N/B  | #N/B  |
| Total assets  | 5717  | 7413  | 9129   | 13457  | #N/B  | #N/B  | #N/B  |
| Total liabilities   | 12576 | 15957 | 19717  | 28932  | #N/B  | #N/B  | #N/B  |
| <b>Key ratios of balance of payments external solvency and external liquidity</b> |       |       |        |        |       |       |       |
| Trade balance (% of GDP)  | -9.2  | -10.6 | -11.3  | -14.1  | -15.2 | -14.1 | -12.7 |
| Current account balance (% of GDP)  | -6.9  | -7.7  | -7.1   | -10.8  | -14.5 | -14.2 | -13.3 |
| Inward FDI (% of GDP)   | 1.0   | 3.4   | 4.0    | 6.2    | 4.3   | 3.2   | 3.2   |
| Foreign debt (% of GDP)   | 40.1  | 42.1  | 43.5   | 54.4   | 57.2  | 57.4  | 62.7  |
| Foreign debt (% of XGSST)   | 74.1  | 74.6  | 68.8   | 81.9   | 91.6  | 96.7  | 95.9  |
| International investment position (% of GDP)                                      | -36.9 | -37.9 | -41.1  | -52.0  | #N/B  | #N/B  | #N/B  |
| Debt service ratio (% of XGSST)   | 43.0  | 39.6  | 39.0   | 42.3   | 49.4  | 54.3  | 57.7  |
| Interest service ratio incl. arrears (% of XGSST)                                 | 3.7   | 2.7   | 2.1    | 3.2    | 4.4   | 4.3   | 4.8   |
| FX-reserves import cover (months)   | 4     | 4     | 3      | 4      | 4     | 4     | 5     |
| FX-reserves debt service cover (%)  | 78    | 70    | 59     | 67     | 72    | 67    | 62    |
| Liquidity ratio   | 107   | 108   | 107    | 108    | 101   | 97    | 96    |

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