Creditreform Sovereign Rating

Creditreform Rating

Rating Object	Rating Information	
REPUBLIC OF LITHUANIA	Assigned Ratings/Outlook: **A+ /negative**	Type: Monitoring, unsolicited, with participation
Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Initial Rating Publication Date: Rating Renewal: Rating Methodologies:	26-11-2016 20-11-2020 "Sovereign Ratings" "Rating Criteria and Definitions"

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Rating action

Neuss, 20 November 2020

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of "A+" for the Republic of Lithuania. Creditreform Rating has also affirmed Lithuania's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "A+". The outlook is negative.

Key Rating Drivers

1. After years of solid economic growth, the economic situation has deteriorated sharply in the face of Covid-19; this year's real GDP will decline, but contraction should be relatively moderate as the economic collapse in H1-20 was less severe than expected; while our baseline scenario still predicates a rebound in 2021, already high uncertainty has intensified following renewed infection waves in Europe

2. Income convergence has progressed markedly and should continue after a transitory Covid-19 related setback, given strong underlying determinants of growth, national and EU-funded investment plans, and maintained competitiveness; demographic and labor market pressures remain medium-to-long-term risks

3. Generally strong institutional set-up buttressed by extensive benefits from EU/EMU membership; geopolitical risks pertaining to Russia and Belarus and high, though declining, energy dependence on Russia; despite relatively frequent changes in the composition of the governing coalition and a fragmented parliament, we expect policy continuity, with the new government following along the key policy items

4. Sharply declining economic activity and the strong fiscal Covid-19 response will see the deficit soar, translating into a significant erosion of fiscal space; while the negative outlook mirrors our belief that the sovereign's public finances could weaken further if its economy does not recover, the - from a European angle - moderate debt levels and increasingly affordable debt, underpinned by historically low interest rates, ECB support, and sizable EU funding are key factors informing the affirmation of its credit ratings

5. Although we deem Lithuania's economy as vulnerable to external shocks, risks on the external front seem mitigated by a persistently improving NIIP which is largely driven by broadly stable net foreign direct investment

Reasons for the Rating Decision and Latest Developments

Macroeconomic Performance

The Republic of Lithuania's credit ratings continue to be underpinned by a track record of robust real GDP growth shown over a multi-year period, which translated into considerable progress in terms of income convergence. While GDP per capita growth should be temporarily paused by the outbreak of Covid-19, we believe that convergence towards EU levels will resume in our base case, as Lithuania should be able to outpace the euro area average going forward, also thanks to ramped up investment, increasing productivity, and a benign business environment. While we deem the private sector's risk-bearing capacities as ample, the historical backdrop of pronounced macro-financial volatility, maintaining cost competitiveness, and demographics remain the main challenges to Lithuania's economy.

Being a small open economy, with trade-to-GDP coming in at a high 149.7% and boasting nominal GDP of roughly EUR 49bn (2019 data), Lithuania is ultimately susceptible to larger swings in its macro-financial variables. Despite the sizable fluctuations engendered by the corona crisis, which has been a common theme among euro area members, we stick to our belief for now that macro-financial volatility should recede over the medium to long term amid continued sound policy-making and EU/EMU membership.

Lithuania has displayed a favorable run of economic growth over the last decade. According to latest revised national accounts data, the Lithuanian economy was able to expand by 4.3% last year, and averaged at 4.2% in 2017-19, well above the 1.3% (2017-19 average 1.9%) seen in the euro area as a whole. Healthy growth contributed to significant convergence towards the EU average. As highlighted by recently updated IMF data, GDP per capita in PPP terms totaled around USD 38,587 in 2019, broadly on par with Estonia and well above Latvia. With that, Lithuania's per capita income stood at roughly 83% of the weighted EU average, up from 80% a year before, and comparing favorably against other Central and Eastern European (CEE) economies, only lagging the Czech Republic (91%) and Slovenia (87%). What is more, we note that other CEE peers followed a much milder convergence pattern than Lithuania, which gained 8 p.p. in 2015-19 on that count.

The Covid-19 pandemic has shaken the Lithuanian economy, but the impact observed in the first half of the year was not as devastating as expected during our last review. With the lockdown from mid-March to mid-April, real GDP stagnated in the first quarter of this year (0.0% q-o-q) and slumped by 5.9% q-o-q in Q2. Repercussions of the pandemic were particularly felt in external trade. Exports contracted by 0.6% and 10.9% q-o-q in Q1 and Q2 respectively, with exports of services declining markedly by 6.2% and 17.4% – also under the influence of the new EU mobility regulation which is being gradually phased in (see below). Gross fixed capital formation also contracted significantly in Q2 (-8.0%), with investment in machinery and equipment as well as transport investment bearing the brunt, whereas ICT and intellectual property investment cushioned the impact (11.3% and 5.7%). Household spending dropped by a relatively moderate 5.5% in the second quarter.

To be sure, economic activity declined in lockstep with that of other European economies, yet the contraction in real GDP growth was considerably less harsh than in other parts of Europe. As compared to the last quarter of 2019, total output in the EA-19 and EU-27 had declined by 15.1% and 14.3% by the end of Q2. By contrast, Lithuanian real GDP had fallen by 5.9% over

that period, which meant that Lithuania was among the least-affected economies. The relatively small reduction in domestic demand appears to be explained by the relatively short phase of stringent confinement measures, as well as by timely and comprehensive support to households and enterprises. Also, activities in manufacturing were not as heavily restricted as in other European economies, and tourism does not play a key role in Lithuania's economic model.

The government had reacted swiftly by introducing stringent confinement measures at a relatively early stage of the Covid-19 pandemic, with a nation-wide lockdown commencing on 16 March. Owing to a comparatively moderate course of the pandemic in Lithuania, the cumulative 14-day infection rate peaked at a mere 25.1 on 4 April during the first infection wave in spring. Authorities began to unwind confinement measures as early as mid-April and ended the lockdown phase in June. The gradual easing of containment measures prompted a rapid recovery in the Lithuanian economy over the following months, entailing extremely strong economic growth in the third quarter which came in at 3.7% q-o-q, according to preliminary Statistics Lithuania data.

Overall, we now expect real GDP to decline by 1.9% in the current year, followed by a rebound of 2.8% in 2021. Public consumption expenditure should limit the impact of the significant decline in other expenditure components this year and also contribute to next year's rebound. Under the confluence of containment measures, contracting employment growth, and very high uncertainty, household spending will decline this year before likely bouncing back in 2021. Still solid wage growth, mainly due to public sector wages and a minimum wage hike from EUR 555 to EUR 607 in 2019-20, and subdued HICP inflation should buttress private consumption in the near term. Monthly deflated sales in the retail sector seem to have lost momentum more recently, after already exceeding their pre-crisis levels in June. This points to a rather bumpy recovery in consumption going forward, depending on the stringency and duration of the respective containment measures. While the slump in industrial production was compensated for in July, prospects for business investment are clouded by extreme uncertainty, restrained demand, and weaker financing conditions. At this stage, we expect that investment will also underpin next year's growth, largely driven by public investment which will be bolstered by continued flows of EU funding and domestic spending plans. Export and imports should see large contractions this year, with the fall in imports assumed to be somewhat more pronounced. Judging by goods export volumes, the recovery of exports is underway (Aug-20: -1.1% y-o-y; Apr-20: -21.3%, Statistics Lithuania). Exports should evolve in line with the recovery of its main trading partners, prospectively being conducive to next year's growth. We note that the EU Mobility Package represents a downside risk to both investment activity and services exports (see below).

Leading indicators such as new orders and export expectations in the industrial sector, as well as sentiment data as of Oct-20, continue to send positive signals. However, risks to our projections are heavily skewed to the downside, and already high uncertainty has increased further, reflecting the recent sharp rise in infection figures. As illustrated by ECDC data, the cumulative 14-day infection rate had remained below the 50-mark until early October, but has risen at a rapid clip since then. The infection rate climbed to 577.1 on 12 November (30-Oct: 226.5), while the positivity rate jumped to 11.4 in week 45 (week 43: 4.2).

We thus expect to see a tepid recovery of Lithuania's economy, since a rapid deterioration of the epidemiologic situation in the country has led authorities to re-introduce restrictive

measures to break a second infection wave, casting shadows on economic development in Q4 and the first half of 2021. A renewed national quarantine, which will be in effect from 7-29 November, has been introduced by the Lithuanian government. At this stage, we believe that the impact on the economy will be less severe compared to the most acute phase in the spring, as the government is better prepared and can resort to more targeted, effective, and tested measures than during the first wave. Most of the recently seized confinement measures take the form of "targeted lockdowns", or "recreational lockdowns", as restrictions are mainly geared towards consumer-facing services and the leisure sector. However, new lockdowns resembling those witnessed in spring can no longer be excluded. In any case, uncertainty surrounding our projections will remain unusually high unless tested medical treatments are broadly available.

Although we believe that long-term credentials for continued income convergence will mostly remain in place, the Covid-19 pandemic will result in a sharp economic slump in 2020, likely leaving scars on the economy in the near to medium term, in particular on the labor market. The government's wide-ranging support measures have dampened the shock on the Lithuanian labor market. Nevertheless, employment (national accounts domestic concept) fell significantly (Q2-20: -1.7% y-o-y) amidst surging unemployment. On a monthly basis, LFS-adjusted unemployment has increased rapidly since the outbreak of Covid-19, leaping by 3.5 p.p. between February and September, a larger increase than in any other EU member state; at 9.8% unemployment in Lithuania stands well above the euro area average of 8.3% (Feb-20: 7.3%). We note that returning emigrants also played a role in this regard.

Furthermore, demographic pressures should persist, feeding into a declining working-age population and prospectively dragging on the economy's underlying growth. As suggested by latest projections (EUROPOP 2019, Apr-20), the share of the Lithuanian population at the age of 15-64y will decline by 4.5% in 2019-30, one of the largest declines in the EU. We are aware of some tentative success in reversing migration flows, which could mitigate demographic challenges if sustained. After recording positive net migration for the first time since independence in 2019, immigration accelerated further in the first nine months of 2020, facilitated by returning Lithuanians (i.e. Brexit, Covid-19) as well as non-residents, translating into a net migration of +12,215 persons (Jan-Sep 2019: +7,243).

We expect to see further productivity gains, while an erosion of the country's cost competitiveness should be avoided, as suggested by a still comparatively moderate level of average hourly labor costs. While real compensation per employee has outpaced real labor productivity growth over recent years, we expect wage growth to stabilize over the medium term. Additionally, with a view to non-cost factors, Lithuania's welcoming business environment, as documented by an excellent 11th rank out of 190 economies in the latest Doing Business ranking, the highest among euro area members, provides fertile ground for increases in productivity.

Concurrently, investment will receive a large boost going forward. In June, the government adopted the Plan for the DNA for the Future Economy, which is aimed at enhancing human capital, digitization, innovation and infrastructure, and greening the economy. Against this backdrop, long-term investment is envisaged to be ramped up by EUR 2.2bn, so that the total amount to be implemented by the end of 2021 will come to EUR 6.3bn (EUR 5.8bn in 2021) or 12.9% of 2019 GDP. In addition, we think that capital accumulation will be decisively supported by the new Multiannual Financial Framework (MFF) 2021-27 and Next Generation EU (NGEU). On the whole, Lithuania will receive EUR 6,54bn in terms of cohesion policy allocations under

MFF 21-27 as compared to roughly EUR 4.9bn (ESF, ERDF, CF) in the previous MFF. On top of this, Lithuania will gain sizable support from the Recovery and Resilience Facility (9.0% of 2019 GDP).

The EU Mobility Package remains a key downside risk to Lithuania's economic development. The package, which is to be implemented in stages in 2020-25, foresees significant requirements that may hamper SME transport businesses and constrain the transport sector's flexibility. While it is difficult to disentangle the Mobility Package's impact from the repercussions of Covid-19, its implementation had visible effects on national accounts data, as investment in transport equipment plunged in the first half of 2020 (-26.7% q-o-q in Q1 and -44.5% in Q2). All else being equal, we would also expect negative ramifications for Lithuania's' global export market share as well as its current account, which have been largely driven by brisk services exports in recent years, with transport services accounting for roughly 59% of the total services exports (2019, BPM6 Eurostat data). Finally, we also see implications for immigration, as the transport sector is among the largest employers for migrant workers. We gather that Lithuania contests the Mobility Package in the European Court of Justice, accompanied by several other EU member states.

Institutional Structure

Our assessment continues to reflect Lithuania's generally strong institutional set-up and far-reaching political and economic benefits pertaining to the sovereign's integration in multi- and supranational structures such as EU/EMU as well as NATO. As a small, open economy, Lithuania benefits from the Single Market and the euro's reserve currency status, as well as from multilateral support via the ECB and the EU's budget. These strengths have to be set against geopolitical risks related to Russia and Belarus, as well as the risks associated with cyber-attacks and energy security.

We have to emphasize that Lithuania has improved considerably on all Worldwide Governance Indicators (WGIs) we assess, according to the latest update provided by World Bank, being broadly in line with the respective averages (median) of our A-rated universe. Regarding the WGI government effectiveness, which gauges the quality of policy formulation and implementation, the sovereign is now placed at rank 40 out of 209 economies, ticking up from last year's relative rank 41, and further closing the gap towards the EA-19 median (rank 35). Regarding democratic participation and freedom of speech, Lithuania jumped from rank 46 to rank 38/209 (EA: rank 26), while advancing to rank 40/209 with a view to the perceived quality of property rights, contract enforcement, and courts. By the same token, we observe substantial improvements concerning the perception of corruption. Here, the sovereign climbed a remarkable 12 ranks to 54/209 on the WGI control of corruption, now on par with the EU-27 median (rank 54), while still lagging the euro area average (rank 42).

In our opinion, these outcomes reflect responsive policy-making and the significant number of reforms of the Lithuanian judicial system and checks and balances more generally. Reform action has thus ameliorated the efficiency and quality of the justice system, e.g. via new provisions on appointing judges, on the structure of the Supreme Court, and the judicial map. In the same vein, the combat of corruption as well as the framework for media pluralism and independence have been strengthened in recent years, although the implementation of the anti-corruption action plan 2015-25 seems to be facing some delays, according to an assessment by the European Commission. Headway in improving the rule of law is also reflected by the latest edition of the EU's Justice Scoreboard. Thus, the estimated time needed to resolve

litigious cases and the backlog of pending cases, being already among the lowest in the EU, edged down further.

The recent Seimas election held in October has brought a change to Lithuania's government, as the opposition party Homeland Union (TS-LKD) has become the strongest political force. The conservative TS-LKD won 50 of the 141 seats in Parliament, receiving 25.7% of the public vote after 22.6% back in 2016. The Farmers and Greens Union came in second, suffering heavy losses, falling from 22.5% to 18.1%. Its previous coalition partners also lost significantly. TS-LKD will form a center-right coalition, together with the Liberal Movement (LRLS, 13 seats) and the newly founded Freedom Party (LP, 11 seats), with the coalition agreement having been signed on 9 November and details of the coalition program yet to be fleshed out. Next to managing the corona crisis, priorities would also include education, a Lithuanian green deal, and facilitating a more inclusive society.

The tripartite coalition will command a narrow majority in parliament (74 of 141 seats), where the Social Democrats and the Labor Party have taken 13 and 10 seats respectively. Moreover, several smaller parties and independent candidates also managed to get into the Seimas. Despite frequent changes in the composition of the governing coalition and the slim majority of the incoming governing coalition amid a fragmented parliament, we expect policy continuity, as we view broad consensus on key policy items such as fostering income convergence, ensuring fiscal sustainability, and increasing energy security as given.

Fiscal Sustainability

While we still see Lithuania's' fiscal performance as a factor supportive of its credit rating, fiscal space will be significantly eroded in the wake of the corona crisis. Risks posed by the unfavorable debt trajectory are currently balanced by debt levels which appear rather moderate from a European perspective, and increasingly affordable debt that is buttressed by low interest costs, ECB support, and sizable EU funding. At this stage, we believe that debt servicing should remain manageable, but the sovereign's public finances could weaken further if its economy fails to recover.

Thanks to significant progress in fiscal consolidation over the last decade, Lithuania's healthy public finances put the sovereign in a favorable starting position to cope with the Covid-19 impact with regard to economic activity and public health. According to the slightly revised government finance statistics from October, general government debt amounted to a low 35.9% of GDP in 2019, below the 2019 median of our A-rated universe (47.1% of GDP) and below the respective euro area average by a sizeable margin (84.0% of GDP).

However, fiscal space will be significantly eroded in 2020/21 as a large headline deficit opens up, mainly driven by operating automatic stabilizers and the costly, though imperative, fiscal response to the pandemic. We estimate the total scope of the direct fiscal impact of Covid-19 measures to be roughly EUR 3.2bn or 6.6% of GDP in 2020. While the recently published draft budgetary plan for 2021 lists a raft of discretionary measures, the largest items will presumably be wage subsidies (approx. 0.4% of GDP), funding to support the take-up of vocational trainings (~0.6% of GDP), and one-off social benefit payments (~0.4% of GDP). Authorities also enacted a business support fund with a targeted volume of EUR 1bn, for which around EUR 345mn is budgeted for 2020. In addition, the Covid-19 envelope includes credit guarantees at a cost of around 1.0% and 0.8% in 2020/21 respectively, although these have no immediate budgetary impact. Budget execution data hint at the marked revenue shortfall for this year,

largely driven by tax deferrals. In the first nine months of the year, consolidated income and profit taxes as well as VAT fell short of the execution target by 12.1% and 18.3%. Also, the government envisaged to expand public investment, which is to increase from 3.1% of GDP last year to 4.4% and 3.8% of GDP in 2020 and 2021. In this respect, the DNA plan will play a crucial role (see above), the targets of which will apparently overlap with the implementation of NGEU.

Overall, we expect the headline balance to post at 9.1% of GDP this year, before narrowing to 4.6% of GDP in 2021 as support measures phase out gradually and economic activity picks up. This forecast incorporates EUR 744mn (approx. 1.5% of GDP) for investments which are assumed to be financed via NGEU funds in 2021, with investment projects geared towards green transformation, innovation and science, and education accounting for the bulk of it (DBP21 data). The main downside risk informing our negative outlook is that public finances could weaken further if the Lithuanian economy fails to recover and/or if the contagion risks require further extensive fiscal measures – both of which cannot be ruled out at the current juncture. Sharply declining economic activity and the strong fiscal Covid-19 response will push the public debt ratio to historically high levels, which we would expect to come in at approx. 48% of GDP in 2020 and edge up somewhat further next year before broadly stabilizing at around 50% of GDP over the medium term. By the end of this year's second quarter, government debt had already risen by 14.9% (in nominal terms) since Q4-19, standing at 41.4% of GDP.

We have some confidence that the debt trajectory will prospectively flatten, given the track record of sound fiscal policy-making over recent years. As a case in point, the sovereign achieved modest headline surpluses for four consecutive years, despite the comprehensive six-reform package adopted in 2018 that included labor taxation, pensions, education and healthcare. We assume that the incoming governing coalition will remain committed to a sustainable fiscal policy. Prudent debt management is further evidenced by the sovereign's debt profile. The average weighted maturity stood at a relatively high 9.2y as of September 2020 (Dec-2019: 7.1y, ECB data), while debt denominated in foreign currency is on a declining path. According to the Quarterly Public Sector Debt database, the respective share declined from 20.2% in Q1-19 to 12.0% of general government debt in Q1-20. Foreign exchange risks should be eliminated by 2022, as the outstanding amount of roughly EUR 2.57bn (5.3% of 2019 GDP) in USD-denominated bonds will be repaid by February 2022.

What is more, we take note of the government's progress in strengthening its fiscal framework. We understand that authorities are currently preparing a management methodology setting out details with a view to the provisions of the Law on Strategic Management. Additionally, preparations are underway for the implementation of the budgetary system reform, with pilot strategic action plans for the new structure of ministries for 2022-24 being launched.

So far, negligible public guarantees (2019: 0.9% of GDP) will prospectively rise to still moderate levels of 2.0% and 2.7% of GDP in 2020 and 2021 respectively, according to Ministry of Finance projections. Contingent liability risks stemming from the banking sector are rather limited, as financial stability metrics are sound and it is largely controlled by foreign parent corporations (~91% of total assets). Dynamic residential property prices have grown unabatedly through the first half of the year (Q2-20: 7.0% y-o-y), coupled with brisk mortgage lending. Whilst a housing market correction may trigger losses in the banks' portfolios, households and NFCs

should increasingly face difficulties in meeting financial obligations going forward, as insolvencies will inevitably rise at some point in time; however, risks entailed by a deteriorating bank loan portfolio are limited in view of a very low NPL ratio (Q2-20: 1.4%).

Fiscal risks are mitigated by increasing debt affordability, which should be buttressed by low and stable funding costs going forward. Interest outlays totaled a moderate 2.49% of general government revenues at the end of 2019 (2018: 2.55%) and stood at 2.38% at the end of Q2-20 (4-quarter sum). Long-term government bond yields remain at historically low levels, hitting an all-time low at 0.06% on 09-11-20 (weekly quote).

Financing conditions are aided by the ECB's very accommodative monetary policy. The ECB's Pandemic Emergency Purchase Program (PEPP) totals EUR 1,350bn and runs at least until the end of June 2021, with reinvestments of maturing principal payments from securities purchased under PEPP conducted until at least the end of 2022. An additional envelope of EUR 120bn to its APP until the end of 2020 remains in place, as do a number of measures to ensure liquidity to the banking sector, a comprehensive set of collateral measures to mitigate the tightening of financial conditions, and measures to temporarily allay the effects of rating downgrades on counterparties' collateral availability. In our opinion, the ECB at its October meeting delivered a strong signal that more stimulus could be brought on its way in December. Even with the Covid-19 situation worsening and more fiscal stimulus to come, this leaves room for interest rates to fall further, or at least remain at current low levels.

We view NGEU as a further building block mitigating fiscal sustainability risks over the medium term. Lithuania will gain sizable support from the Recovery and Resilience Facility, totaling EUR 4.38bn or 9.0% of 2019 GDP, of which approx. EUR 2.4bn will be provided in the form of grants, following the political agreement on the new MFF and NGEU reached between the European Council and the European Parliament on 10 November. Further financial support to Lithuania will come via SURE, from which the sovereign is set to receive EUR 602mn (approx. 1.2% of 2019 GDP).

Foreign Exposure

We see Lithuania's economy as vulnerable to external shocks. However, risks on the external front have been gradually waning, as mirrored by a persistently improving net international investment position (NIIP) which is characterized by a sizable and broadly stable net FDI share. Downside risks arise in the context of the abovementioned EU Mobility Package.

The Lithuanian NIIP is on a firm upward trajectory, standing at -20.2% of GDP in this year's second quarter, coming from -24.1% of GDP in Q4-19 and -28.9% of GDP a year earlier. Hence, external balances have improved significantly over a medium-term perspective. Furthermore, we have to reiterate that external risks appear mitigated by the large share of net FDI. In the same vein, its NENDI (Q2-20: 8.6% of GDP) has continued to improve since entering positive territory in the third quarter of 2019.

As mentioned before, sizable transfers from EU funds alongside sustained current account surpluses have backed the external deleveraging. Vibrant services exports (essentially transport services) which translated into a higher services surplus (10.0% of GDP) and a narrowing goods deficit, boosted the current account surplus to 3.3% of GDP in 2019 (2018: 0.3% of GDP). The current account surplus almost doubled to 6.2% of GDP by the end of Q2, largely

driven by net goods exports which improved on the back of significantly weakening imports, while the services surplus remained stable at 10.2% of GDP.

Looking ahead, we expect the current account to remain in surplus, as the services balance will likely display a sizable surplus and exports should contract less than imports, while Lithuania's primary income deficit should narrow somewhat. That said, Covid-19 related risks could hamper transport activity, a major driver of the services balance. As a corollary, weaker transport services may curb the services surplus and, concurrently, the current account surplus. Challenges related to the EU Mobility Package (see above) would add to this.

Rating Outlook and Sensitivity

Our rating outlook on the Lithuanian long-term sovereign ratings is negative, as public finances could weaken further if the Lithuanian economy fails to recover, and/or the contagion risks require further extensive fiscal measures – both of which cannot be ruled out at the current juncture. Having said this, the assessment of Lithuania's economic development is fraught with extreme uncertainty and is therefore significantly more difficult than usual, as is the case for other metrics, mainly due to the very dynamic development of the Covid-19 pandemic.

We could thus reinstate the stable outlook on Lithuania's credit ratings if its economy evolves broadly in line with our forecast over the medium term, or recovers even faster than expected, or if the sovereign's debt trend reverses, implying a sustainable decline in the debt-to-GDP ratio, thus helping to rebuild depleted fiscal space. A rating uplift would critically depend on accelerated, deep-seated reforms targeted towards ensuring the economy's competitiveness and increasing potential growth, and on receding geopolitical tensions.

We could consider a downgrade if our expectations of a sustained, albeit sluggish, recovery are disappointed, i.e. if we see a significant deterioration in medium-term growth beyond 2020 or, even worse, a severe scarring of the Lithuanian economy leading to curtailed potential growth. In such a scenario, fiscal metrics would likely fail to improve and the public debt ratio could remain on a more entrenched upward trajectory. As we regard a rapid implementation of the ambitious recovery and resilience plans as vital to economic development, as well as to medium-term fiscal sustainability, we view a delay as a rating downside.

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Ratings*

Long-term sovereign rating	A+ /negative
Foreign currency senior unsecured long-term debt	A+ /negative
Local currency senior unsecured long-term debt	A+ /negative

*) Unsolicited

Economic Data

[in %, otherwise noted]	2015	2016	2017	2018	2019	2020e	2021e
Real GDP growth	2.0	2.5	4.3	3.9	4.3	-1.9	2.8
GDP per capita (PPP, USD)	28,824	30,925	33,821	36,239	38,587	38,605	41,288
HICP inflation rate, y-o-y change	-0.7	0.7	3.7	2.5	2.2	1.1	1.4
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	74.6	74.9	75.8	76.0	n.a.	n.a.	n.a.
Fiscal balance/GDP	-0.3	0.2	0.5	0.6	0.3	-9.1	-4.6
Current account balance/GDP	-2.4	-1.1	0.5	0.3	3.3	n.a.	n.a.
External debt/GDP	76.7	86.2	82.6	78.1	67.7	n.a.	n.a.

Source: International Monetary Fund, Eurostat, own estimates

ESG Factors

While there is no universal and commonly agreed typology or definition of environment, social, and governance (ESG) criteria, Creditreform Rating views ESG factors as an essential yardstick for assessing the sustainability of a state. Creditreform Rating thus takes account of ESG factors in its decision-making process before arriving at a sovereign credit rating. In what follows, we explain how and to which degree any of the key drivers behind the credit rating or the related outlook is associated with what we understand to be an ESG factor and outline why these ESG factors were material to the credit rating or rating outlook.

For further information on the conceptual approach pertaining to ESG factors in public finance and the relevance of ESG factors to sovereign credit ratings and Creditreform Rating credit ratings more generally, we refer to the basic documentation, which lays down key principles of the impact of ESG factors on credit ratings.

The governance dimension plays a pivotal role in forming our opinion on the creditworthiness of the sovereign. As the World Bank's Worldwide Governance Indicators Rule of Law, Government Effectiveness, Voice and Accountability, and Control of corruption have a material impact on Creditreform Rating's assessment of the sovereign's institutional set-up, which we regard as a key rating driver, we consider the ESG factors 'Judicial System and Property Rights', 'Quality of Public Services and Policies', 'Civil Liberties and Political Participation', and 'Integrity of Public Officials' as highly significant to the credit rating.

Since indicators relating to the competitive stance of the sovereign such as the World Bank's Ease of Doing Business index and the World Economic Forum's Global Competitiveness Indicator add further input to our rating or adjustments thereof, we judge the ESG factor 'Business Environment' as significant.

The social dimension plays an important role in forming our opinion on the creditworthiness of the sovereign. Indicators or projections providing insight into likely demographic developments and related cost represent a social component affecting our rating or adjustments thereof. We regard the ESG factor 'Demographics' as significant since it has a bearing on the economy's potential growth.

While Covid-19 may have significant adverse effects on several components in our ESG factor framework in the medium to long term, it has not been visible in the relevant metrics we consider in the context of ESG factors – though it has a significant bearing concerning economic prospects and public finances. To be sure, we will follow ESG dynamics closely in this regard.

ESG Factor Box

Environmental Quality	Ecological Risks	Ressource Management	Education	Health	**Demographics**
Labor	Equality	Technology & Infrastructure	Safety & Security	**Judicial System**	**Quality of Public Services**
Integrity of Public Officials	Quality and Efficacy of Regulations	**Civil Liberties/ Political Participation**	Market Access	**Business Environment**	Data Transparency

Environment	Social	Governance	Highly significant	Significant	Less significant	Hardly significant

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	26.11.2016	A /stable
Monitoring	24.11.2017	A /stable
Monitoring	23.11.2018	A /positive
Monitoring	22.11.2019	A+ /stable
Monitoring	22.05.2020	A+ /negative
Monitoring	20.11.2020	A+ /negative

Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions

of the CRA-Regulation. The rating was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

This sovereign rating is an unsolicited credit rating. The Lithuanian Ministry of Finance participated in the credit rating process, as it provided additional information and reviewed the draft version of the rating report. Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	YES
With Access to Internal Documents	NO
With Access to Management	NO

The rating was conducted on the basis of CRAG's "Sovereign Ratings" methodology (v1.2, July 2016) in conjunction with its basic document "Rating Criteria and Definitions" (v1.3, January 2018). CRAG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on our website.

To prepare this credit rating, CRAG has used following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, Blavatnik School of Government, European Centre for Disease Prevention and Control (ECDC), Central Bank of Lithuania, Ministry of Finance Lithuania, Official Statistics Portal Lithuania.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on

the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available on the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

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