Creditreform Sovereign Rating

Creditreform Rating
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Rating Object	Rating Information	
REPUBLIC OF LITHUANIA	Assigned Ratings/Outlook: **A /positive**	Type: Monitoring, unsolicited
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:	25-11-2016 23-11-2018 "Sovereign Ratings"

Rating Action

Neuss, 23 November 2018

Creditreform Rating has revised its outlook on the Republic of Lithuania to positive from stable and affirmed the unsolicited long-term sovereign rating of "A". Creditreform Rating has also affirmed Lithuania's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "A".

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Key Rating Drivers

1. Although set to moderate in view of softening external demand, growth likely to remain solid, fueled by strong investment activity and robust consumption, backed by strong labor demand and enacted tax and pensions system reforms
2. Income convergence with EU levels resumed, but concerns related to medium-term challenges persist, as demographics are likely to drag down potential output further out; perils of wage growth unmatched by productivity gains
3. Generally high quality of institutional framework; so far, economic and fiscal policy-making has not been adversely affected by political constellation after governing coalition lost majority in Seimas
4. Revenue-rich growth and fiscal prudence have resulted in favorable development of fiscal metrics; expansionary measures related to tax and pension system reform as well as rising public wages should not put a halt on gradually declining government debt in the medium term
5. As a small and open economy, Lithuania remains highly exposed to external risks and macro-financial volatility; still large and negative NIIP has continued to improve and risks are mitigated by large FDI-share in external liabilities

Reasons for the Rating Decision

Creditreform Rating has revised its outlook on the Republic of Lithuania to positive from stable. The positive outlook is underpinned by our expectation that (i) the sovereign will retain its strong fiscal position, with general government debt and interest outlays continuing on their downward trend; (ii) the adopted tax and social security reforms are not likely to thwart fiscal consolidation, but should foster inclusive growth; and (iii) robust growth should result in continued income convergence over the next years.

Our assessment of the Republic of Lithuania's creditworthiness continues to reflect its generally solid macroeconomic performance profile, balancing relatively high levels of wealth, strong economic growth, and a business-friendly environment against a high degree of macroeconomic volatility and structural impediments to medium- to long-term economic growth.

To begin with, Lithuania's macroeconomic profile continues to be somewhat constrained by its small and open economy, which makes it more prone to external shocks and entails a high degree of macro-financial volatility. Although having grown significantly over the last years and standing above its Baltic peers, Lithuania's economy is among the smallest in the EU-28, with a nominal GDP of roughly EUR 42bn (2017). Moreover, trade accounted for 159% of GDP in 2017, one of the highest readings in the EU and among Central and Eastern European (CEE) peers.

Economic growth bounced back in 2017 on the heels of a rather dismal performance in 2015/16, when total output rose by 2.0 and 2.4% respectively, which was partly due to a slow transition to the new European Structural and Investment (ESI) funding cycle and sluggish export growth. Thus, real GDP grew by 4.1% last year, the fastest growth since 2011 (6.0%) and well above the annual average in 2011-16 (3.0%). Faster output expansion came mainly on the back of recovering investment activity and soaring exports. Buttressed by favorable financial conditions and capacity constraints, which entailed the need to engage in expansion investment, investment growth leapt to 6.8% as compared to an increase of 0.3% in 2016. It has to be highlighted that investment in intellectual property products and in ICT equipment exhibited particularly vivid growth, surpassing the previous year's level by 13.0 and 20.4% respectively. Strong investment activity was accompanied by brisk external demand from the EU and Russia, resulting in a significant surge in exports, which skyrocketed by 13.6%, the highest reading in the EU-28 last year. According to Statistics Lithuania, exports of goods to the EU-28 and Russia jolted by 14.3 and 29.3% respectively. As exports were met by equally vigorous import growth (12.0%), the contribution of net external trade amounted to only 1.1 p.p. which was still notably higher than in 2016 (0.1 p.p.). At the same time, private household spending growth shifted into a somewhat lower gear, falling back from 5.0 to 3.3% in 2016-17, as surging HICP inflation (2017: 3.7%, 2016: 0.7%) dragged on real wages and employment fell by 0.5% in an otherwise favorable labor market environment (see below). Yet, private consumption remained the main growth engine, making a marked growth contribution of 2.2 p.p.

Reinvigorated real GDP growth translated into significantly higher per capita income in 2017. In PPP terms, the Lithuanian per capita income is estimated to have risen from USD 30,131 in 2016 to 32,379 last year (IMF data). Therefore, Lithuania not only moved closer to the median per capita income of our A-rated universe (USD 33,775), income convergence with EU-levels also progressed notably, as the Lithuanian GDP per capita now accounts for 78% of the EU average, up from 76% a year before. We note that Lithuania continues to lie ahead of its Baltic peers Estonia and Latvia, which recorded a comparable pace of income convergence with respective per capita incomes of USD 31,649 and 27,702 (77 and 67% of EU average).

Looking forward, income convergence is set to continue, facilitated by solid growth this and next year. Net external trade's growth contribution is likely to turn negative again, as import growth should outpace export growth. While we expect exports to decelerate, reflecting weaker growth and slackening external demand from main markets in Europe as well as base effects, import-intensive investment and household spending will presumably provide a strong boost to imports.

Thus, robust domestic demand is set to spur economic growth. In particular, we expect that investment will continue to thrive, buoyed by healthy loan growth backed by low funding costs, and high capacity utilization, but also due to a faster drawdown on ESI funds. Capacity utilization in the Lithuanian industry sector has been high and upward trending for several years; in Q4-18 it stood at 77.4%, unchanged from last year's fourth quarter, but steadily above the long-term average (2000-18) of 69.6%. Moreover, we expect that ESI fund absorption will gain further traction and the project pipeline will be extended going forward. Experience with the programming periods 2007-13 and 2014-20 shows that the flow of funds typically starts late and can be expected to be significantly scaled up as early as two to three years after the start of the funding cycle, while EU member states are permitted to draw on funds up to three years after the end of the period. According to latest EU Cohesion data, financial funds allocated to selected projects increased from around EUR 5.03bn at the end of 2017 to EUR 6.12bn by 15-Nov-18, and the amount of funds spent climbed to roughly EUR 2.51bn – corresponding to 61.5 and 25.1% of planned investment respectively.

Private consumption is also set to remain strong, underpinned by the well-performing labor market and concurrent wage growth. In addition, we expect that real disposable income will be aided by declining inflationary pressures (2018e: 2.6%) and the positive effects of the tax and social security reforms (see below). Upbeat economic sentiment signals that domestic demand is likely to continue on its upward trajectory. Throughout 2018 the EU Commission's Economic Sentiment Indicator saw a further rise to its highest level since the end of 2007, with industrial and consumer confidence high and rising.

The Lithuanian labor market continued to tighten. Reflecting the benign economic development and a declining working-age population, the quarterly average of the harmonized unemployment rate (s.a.) edged down from 6.8% in Q3-17 to 6.2% in this year's third quarter, representing the lowest level since Q2-08 and below the EU-28 average of 6.8%. What is more, Lithuania's employment and participation rates climbed to new record highs, posting at 72.0 and 76.7% in Q2-18 respectively (Eurostat LFS, 15-64y, s.a.). We also note that employment growth rebounded in Q2, having turned positive for the first time since the last quarter of 2016.

Going into 2018, quarterly national accounts data illustrate that domestic demand has indeed been able to sustain its growth momentum. Investment and private consumption both continued to rally, lifting quarterly real GDP growth to 3.7 and 3.8% y-o-y in the first half of 2018. According to Statistic Lithuania's first estimate, real GDP took a hit in the third quarter, with the yearly rate being dented to 2.7% (Q3-17: 3.8%), partly mirroring the slower pace of growth in the euro area. We believe that this was only a transitory setback and that

the Lithuanian economy will follow its solid underlying trend, expecting total output to grow by 3.3% in 2018, before easing to 2.8% next year.

Despite the solid growth momentum, Lithuania's medium-term challenges persist. Most prominently, demographics are likely to weigh on potential output further out, as ageing and emigration should result in a shrinking working-age population, aggravating skill shortages and curbing labor input. According to the EU's Ageing Report 2018, the Lithuanian old-age dependency ratio is forecast to increase sharply from 29.0% in 2016 to 46.4% by 2030, not only significantly higher than in the EU-28 (39.5%) but also one of the highest readings among the EU-28 members.

Negative net migration is adding to the decline in its working-age population, more so as emigration mainly affects prime-age and high skilled workers. On a positive note, immigration has significantly increased more recently. Drawing on monthly migration data from Statistics Lithuania, the number of immigrants up to October 2018 totaled 31,871 people, resulting in a net migration of -4,259 people – as compared to a net migration of -30,171 and -27,557 in 2016 and 2017 respectively. Certainly, it is too early to speak of a trend reversal, but policy changes related to restrictions on permissible professions for workers from third countries as well as periodic updates of a list of high skilled occupations the economy is currently lacking appear to bear fruit. Still, Lithuania's working-age population is projected to decline by 8.2 p.p. to 57.9% of total pop in 2016-30, the largest decrease in the EU.

Furthermore, Lithuania's trend growth has been dragged down by relatively weak labor productivity growth, which averaged at 2.4% p.a. in the period between 2009 and 2017 – significantly below the pre-crisis average of 6.0% (2000-08). To be sure, surging investment lifted the growth rate of real labor productivity per hour worked to 7.0% in 2017, corresponding to a six-year high. However, real labor productivity thus stood only 5.2% above the level of 2014, recording an annual average growth rate of 1.8% over the last three years, one of the weakest performances among the CEE economies. Consequently, nominal labor productivity per hour worked has been virtually stagnant as a percentage of the EU total, standing at 66.8% in 2017, almost unchanged as opposed to 2014 (66.4%).

This underscores the importance of sustained investment growth to the Lithuanian economy. Unfortunately, the recovery of investment activity has been tepid so far, mirrored by an investment-to-GDP post-crisis average of 18.3%. In the run-up to the crisis, total investment equaled 23.4% of GDP. What is more, at currently 19.3% of GDP, investment stands well below the levels observed in Estonia or Latvia, where investment accounts for 24.6 and 21.3% of GDP respectively (EU average 20.3%). As elaborated above, investment has picked up recently and should accelerate on the back of capacity constraints, investment-enhancing reforms, and a larger take-up of EU funds. Nevertheless, it has to be pointed out that available EU funds can be expected to be lower in the next multi-annual EU budget framework. According to Bank of Lithuania calculations, cohesion policy and agricultural policy funds may equal 2.7% of nominal GDP p.a. in the funding cycle 2021-27 as compared to 3.9% for 2014-20.

Meanwhile, unabated rapid wage growth continues to harbor significant risks in terms of endangering the economy's cost competitiveness given rather sluggish labor productivity gains. Against the backdrop of the increasingly tight labor market, wages have been persistently rising over the last couple of years. In this year's second quarter, average monthly earnings were up by 10.7% y-o-y (Q2-17: 9.0%). We assess that public sector earnings have also shot up more recently, while private sector wage growth has hovered at around 10% since mid-2016. Rapidly rising minimum wages have played a pivotal role in this regard. In early 2019, there will be another increase in minimum wages, then standing at EUR 430, almost 50% above the level seen in 2014.

Although further developments should be monitored carefully, we observe no detrimental effects on Lithuania's cost competitiveness at the current juncture. Its share in global export markets has been moving sideways since 2013. Also, we assess that real unit labor costs fell for the first time since 2012, edging down by 0.5% in 2017, as strong investment helped to raise labor productivity growth to heights not seen in years. Thus, real ULC in Lithuania were on par with the euro area (-0.3%) and compared well to the development in Latvia and Estonia.

The impact of rising wages appears to be tempered by companies' recourse to profits. On average, the net profit margin of Lithuanian enterprises fell from 2.2 to 2.1% in 2015-17, while net profit to equity has been broadly stable over the last few years. Moreover, we view Lithuania as well-situated in terms of non-cost competitiveness. According to the latest Doing Business report 2019, the World Bank attests Lithuania to stand out as the most business-friendly country in the euro area, ranking the country at 14 out of 190 economies, up from rank 16 last year, and ahead of its Baltic peers as well as economies such as Finland (17), Germany (24), and Ireland (23).

In our opinion, such positive results also testify to the generally high quality of Lithuania's institutional setup, which we continue to view as a credit support. It has to be mentioned that the sovereign has ample room to improve as compared to the euro area average, as reflected by the most recent edition of the World Bank's Worldwide Governance Indicators (WGIs), which represent our preferred measure of good governance and the institutional framework. Thus, Lithuania is ranked at 42 out of 209 economies as regards the quality of policy formulation and implementation, while it stands at rank 41 when it comes to the perception of freedom of expression and free media (euro area median ranks 33 and 45 respectively). Furthermore, we assess a considerable gap with regard to the WGI Control of Corruption, concerning which the sovereign performs well below the euro area average (rank 63 vs. 41). Yet, Lithuania's WGIs are essentially in line with the median of our A-rated universe and compare well with the respective CEE peer median values.

Additionally, we are observing a marked long-term improvement in all WGIs we consider, which has also been facilitated by Lithuania's accession to EU and EMU. The sovereign benefits from EU/EMU membership, involving significant trade integration, financial support via EU funds, and the adoption of common standards and rules. By contrast, we view the country as exposed to geopolitical risks, i.e. large shocks arising from tensions with Russia or a deterioration of the relationship between Russia and the EU more generally. Against this background, we assess that Lithuania is among the most energy dependent EU-28

members, importing 77.4% of its total energy consumption (2016 Eurostat data). At the same time, Russia accounts for 74.8% of its solid fuel imports and 75.2% of total petroleum product imports, although this share has decreased over the last decade (2007: 87.6 and 88.4% respectively).

Authorities are forging ahead with structural reforms in a bid to tackle long-standing structural weaknesses pertaining to the overarching goals of increasing labor productivity, mitigating the adverse impact of demographic developments, and reducing pervasive inequality and poverty. Regarding the latter, Lithuania is still among the EU members with the highest share of people at risk of poverty or social exclusion (2017: 29.6%) and displays one of the highest levels of inequality (Gini coefficient 41.3%, second to Bulgaria). In September 2018, the parliament endorsed an encompassing roadmap for the years up to 2030, namely the Strategy for the Demographic, Migration, and Integration Policy.

To promote productivity growth and raise public investment efficiency, the government envisaged, among others, reducing the regulatory burden by amending the Law on Public Administration, setting up a new public investment management procedure, streamlining the innovation system and the respective legal requirements by means of the Law on Technologies and Innovations, and implementing government support programs to incentivize innovation and improve cooperation between science and business in the field of R&D. A so-called National Productivity Board was established in late 2017, responsible for drawing up concrete proposals for reform actions – with the first annual productivity report awaited towards the end of this year.

While the government continues its efforts for the improvement of the health system performance by consolidating the network of healthcare institutions, policy-makers are also striving for an enhancement of the quality and efficiency of education, e.g. by modernizing content and equipment of education, and of the network of VET institutions. Earlier this year, the Law on Education was put in place, promoting higher quality in preparatory and primary education.

Last year's government reformation involved a split of the Social Democrats, and led to the Farmers and Greens Union (54/141 seats in Seimas), together with the newly formed Social Democratic Labor Political Group (11 seats), finding themselves in a minority government. Policy-making and the adoption of reform actions may have become somewhat more cumbersome and time-consuming. In view of a broad consensus across parties on key policy objectives, policy continuity should be given and authorities will move forward in implementing their action plan.

A case in point was the adoption of a landmark package of tax and social security reforms in June 2018, which is aimed at mitigating poverty and inequality by making the tax and pension system more inclusive. As a consequence of multiple amendments to the Personal Income Tax Law, the Law on State Social Insurance and the Law on the Accumulation of Pensions, new PIT rates and PIT reliefs will be introduced, and the threshold and scope for non-taxable income (NTA) will be gradually extended. Moreover, employee's social security contributions are about to be consolidated and an upper bound (i.e. ceiling) will be applied. The pension system will also undergo several changes, with the amendments

geared towards moving the basic pension to the state budget and better linking benefits with social contributions, while strengthening the second pillar. The number of contributors to the system is foreseen to be increased and resident involvement in the pensions system fostered. Also, social assistance pensions will be ramped up and pension bonuses for disadvantaged groups are to be established.

The increase in NTA and the reduction of social security contribution rates are likely to contribute to stronger social protection and a lower tax wedge for low-income earners. Meanwhile, further measures geared towards curbing inequality and poverty are planned, as policy-makers intend to increase child benefits and advance a social housing fund as well as a new support program for young families.

Despite costly structural reforms, Lithuania's public finances are likely to remain healthy and fiscal metrics should improve. In this vein, our sovereign assessment continues to be underpinned by the sovereign's sustainable fiscal policy, which features moderate and gradually declining government debt accompanied by decreasing interest costs as measured by general government revenue.

Fiscal consolidation efforts are ongoing and the government was able to record a headline surplus for the second year in a row. After having made huge strides in reducing the general government deficit from 8.9% to 0.3% of GDP in 2011-15, 2017 saw a surplus of 0.5% of GDP, slightly up from 0.3% of GDP in 2016. The improvement was mainly due to expenditure constraint. Final consumption expenditure and the public wage bill grew significantly less dynamic than nominal GDP, falling by 0.6 and 0.3 p.p. to 16.4 and 9.5% of GDP. Concurrently, economic activity and strong wage growth led to a briskly rising intake of income taxes and strong VAT collection, posting y-o-y increases of 3.7 and 9.4% respectively. Net social security contributions also contributed notably to revenue generation, edging up by 9.4% on the year.

Accordingly, general government debt came in a touch lower, dropping from a moderate 39.9% of GDP in 2016 to 39.4% last year. It has to be highlighted that Lithuania already exhibits one of the lowest debt levels among the EU-28 members and the third lowest in the euro area, only undercut by Luxembourg and Estonia. Going forward, we assume that government debt will follow a gradually declining downward path in the medium-term. That being said, debt can be expected to spike next year, as authorities envisage pre-financing the redemption of Eurobonds in early 2020.

Equally important is that Lithuania's gross debt has become increasingly affordable over the past years, and we expect interest outlays to fall further as measured by revenue as well as GDP. Last year, interest expenditure fell to its lowest level since 2008 (1.9%), accounting for 3.3% of general government revenue, down from 3.9% in 2016.

We note that the sovereign has a track record of consistently outperforming its fiscal targets since 2014. For now, we believe that policy-makers are in a promising position to manage the demanding balancing act of addressing its reform priorities of raising labor productivity and mitigating demographic pressures, while avoiding significant fiscal slippages. Looking forward, fiscal prudence should be further promoted by the budget framework reform, which

aims to ameliorate medium-term budget planning by better linking multi-year budgets with strategic planning. The new framework is planned to be applied from 2021 onwards.

With a view to public finances in 2018 and 2019, moderate headline surpluses of 0.6 and 0.4% of GDP should be achieved, implying that the government is likely to comply with its fiscal targets. Above all, the aforementioned structural reforms entail a host of measures on the revenue and expenditure side. The biggest items should be budget neutral, i.e. increase of PIT rates and reduction of social security rates on the one hand and transferring pensions to the state budget on the other. Furthermore, the budget foresees additional costs associated with granting financial support to young families, scaling up child benefits, and increasing wages in the public sector (education, health care, budgetary institutions). These shall essentially be counter-financed by enhancing the efficiency of the state's tax administration. Thus, authorities plan with an additional intake of CIT, PIT, VAT, excise duties, and social security contributions of approx. 0.4 and 0.5% of GDP in 2018 and 2019 respectively. We note that VAT collection has improved over the years, but Lithuania still has one of the highest VAT gaps in the EU-28 (24.5% of VTTL vs. an EU-average of 12.3%). The budget also includes measures to reduce Lithuania's pervasive shadow economy (estimated at 18.2% of GDP in 2017).

In any event, economic activity and strong wage growth should provide for robust revenue generation. Budget execution data up to Q3 indicates that 2018 is going to be another year of vividly growing tax revenues, with income and profit taxes standing 10.2% above the previous year's level, and VAT and excise duty collection having risen by 3.5 and 8.3% respectively. Fiscal risks thus appear manageable, although the yield of measures geared towards improving tax collection may turn out to be lower than projected, and the final budgetary impact of the tax and pension reform is shrouded by a certain degree of uncertainty, in view of the plethora of revenue and expenditure measures. The Ministry of Finance reckons that public guarantees will total 0.9% of GDP in 2018 and inch up to 1.1% of GDP next year. Even if we include the capital subscribed to the European Stability Mechanism, approx. 6.8% of 2017 GDP, contingent liability risks appear rather limited.

Meanwhile, we view housing market risks to banking sector stability as largely contained, and we do not observe imbalances on the housing market at this stage. House prices are continuing on their upward trajectory, as the 3-year-growth rate has risen by 13% or more since Q3-15 (OECD data). Still, in this year's second quarter, real house prices stood roughly 25% below their peak in Q1-08, and well-anchored affordability metrics do not signal serious imbalances regarding the housing market, with the price-to-income and price-to-rent ratios standing 19.3 and 17.5% below their respective long-term averages (2006-18). The household sector displays one of the healthiest balance sheets in the EU, with debt accounting for 26.2% of GDP in 2017, the lowest level since 2006 (Eurostat consolidated financial accounts data). In view of dynamic mortgage lending and housing market activity, the Bank of Lithuania raised the countercyclical buffer requirement again, to 1% effective from June 2019, after it had been lifted to 0.5% at the end of 2017.

Moreover, the small-sized and highly concentrated banking sector, with assets-to-GDP amounting to 61.5% of GDP, is almost entirely controlled by foreign branches and subsidiaries (55.8% of GDP) and in good shape. According to EBA data, the CET 1 ratio equated

to 19.3% in Q2-18, well above the EU average of 14.5%. With a NPL ratio of 2.7% (EU-28: 3.6%), asset quality is high, and considering that the loans-to-deposit ratio has hovered at around 100% since the last quarter of 2014, banking sector liquidity appears to be sufficient.

Turning to the external sector, Lithuania remains highly exposed to external risks, while the still large and negative net international investment position (NIIP) has continued to improve, and we view risks as mitigated by the large FDI-share in external liabilities. The NIIP has dwindled to its lowest level since the beginning of 2004, climbing to -34.5% of GDP in the second quarter of 2018, up from -40.8% of GDP in Q2-17. Short- to medium-term risks are tempered by the fact that the highly negative NIIP is mainly due to foreign direct investment, which reduces the risk of a large and sudden capital outflow. In 2017 net FDI totaled -28.1% of GDP and thus accounted for almost 80% of Lithuania’s NIIP. Although Lithuania remains in a net debtor position, net external debt is steadily declining, amounting to 19.2% of GDP (Q2-18) after 23.8% a year before. While the general government sector accounts for the largest share of net external debt, its long-term improvement was largely driven by deleveraging in the banking sector. The deposit-taking institutions’ share in net external debt totaled approx. 21% in Q2-18 as compared to 74% ten years ago. In terms of competitiveness, we note that Lithuania does not appear to be the prime destination for FDI among CEE economies, as the FDI inflow is comparatively low, with inward FDI amounting to only 41% of GDP in 2017 as compared to 96 and 59% of GDP in Estonia and Latvia respectively.

The NIIP improvement was also supported by current account developments. Lithuania’s current account shifted into a surplus of 0.9% of GDP last year, up from -0.8% of GDP in 2016. The surplus was underpinned by a significant widening in the trade of services surplus, which leapt from 5.8 to 7.4% of GDP in 2016-17 (2007-16 average 3.8%). Going forward, we expect the current account to re-enter negative territory and moderately widening deficits on the grounds of strong domestic demand boosting imports.

Rating Outlook and Sensitivity

Our Rating outlook on the long-term sovereign rating is positive, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – is likely to improve over the next 12-24 months.

We could raise Lithuania’s sovereign rating if general government debt and interest outlays continue on their expected gradual downward trajectory, if Lithuanian medium-term growth remains robust and per capita income continues to converge towards EU levels, or if we observe signs that structural reforms make growth more inclusive and have a bearing on adverse demographic trends and labor productivity.

While the positive outlook indicates that a downgrade is rather unlikely, downward pressure on the outlook or rating could arise if medium-term growth contracts significantly, resulting from structurally weak growth in key trading partners over a protracted period of time, or from reemerging financial imbalances, driven by e.g. unsustainable credit and/or house

price growth. Credit ratings may also be lowered if fiscal measures employed in the course of the comprehensive structural reform package lead to significantly derailed public finances, if the geo-political situation with regard to Russia escalates, or if unabated rapid wage growth was not met by labor productivity growth, undermining competitiveness and Lithuanian potential output.

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Ratings*

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

*) Unsolicited

Economic Data

	2013	2014	2015	2016	2017	2018e	2019e
Real GDP growth	3.5	3.5	2.0	2.4	4.1	3.3	2.8
GDP per capita (PPP, USD)	25,959	27,622	28,755	30,131	32,379	34,829	37,162
HICP inflation rate, y-o-y change	1.2	0.2	-0.7	0.7	3.7	2.6	2.3
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	74.1	74.7	74.6	74.9	n.a.	n.a.	n.a.
Fiscal balance/GDP	-2.6	-0.6	-0.3	0.3	0.5	0.6	0.4
Current account balance/GDP	0.8	3.2	-2.3	-0.8	0.9	n.a.	n.a.
External debt/GDP	70.4	69.9	75.7	85.2	83.6	n.a.	n.a.

Source: International Monetary Fund, Eurostat, own estimates

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

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.

This sovereign rating is an unsolicited credit rating. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party.

The rating was conducted on the basis of CRAG´s "Sovereign Ratings" methodology in conjunction with its basic document "Rating Criteria and Definitions". 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 the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

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, 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 to 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.

Disclaimer

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