Creditreform Sovereign Rating

Creditreform Rating
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Rating Object	Rating Information		
REPUBLIC OF LATVIA	Assigned Ratings/Outlook: **A /stable**		Type: Follow-up Rating, 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:	26-08-2016 29-06-2018 “Sovereign Ratings”	

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Rating Action

Neuss, 29 June 2018

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of “A” for the Republic of Latvia. Creditreform Rating has also affirmed Latvia’s unsolicited ratings for foreign and local currency senior unsecured long-term debt of “A”. The outlook is “stable”.

Key Rating Drivers

1. Economic growth accelerated and is expected to remain robust, thanks to strong domestic demand which should be buttressed by slowly diminishing support from EU fund absorption and strong wage growth; high degree of macroeconomic volatility
2. Per capita income convergence towards EU levels resumed but faces considerable medium- to long-term challenges pertaining to productivity and demographics
3. Generally high institutional quality, though institutional set-up needs to be enhanced to close gap towards EU levels; reform-oriented policy-making which we expect to continue following general elections in October 2018
4. Despite somewhat more expansionary fiscal policies, public finances remain sound as we expect government debt to decline from already low levels in the medium term
5. Susceptibility to external events, mirrored by large and negative, but improving NIIP; moderate current account deficit should widen on the back of vivid import growth going forward

Reasons for the Rating Decision

The Republic of Latvia’s macroeconomic profile balances robust growth and resuming income convergence against a high degree of macroeconomic volatility and structural impediments to growth associated with the demographic development, health and social issues, and productivity.

Latvia’s economy continues to be subject to a high degree of volatility, largely driven by the small size of the domestic economy in combination with its relatively high trade openness. Additionally, the economy is highly dependent on European structural and investment funds (ESIF) which make up for roughly two-thirds of public investment in the programming period 2014-20.

Although Latvia's convergence process towards the European Union (EU) tended to progress rather slowly in 2014-16 and the economy still displays per capita income levels which are considerably below the EU average as well as the levels of other peers, it has been reinvigorated more recently. GDP per capita is estimated to have increased to USD 27,644 in 2017 (IMF data, PPP terms), and now makes up 67% of the EU-28 average, after 65% in 2016 (2012: 60%). Having said this, Latvia's economy not only stood well below the GDP p.c. levels seen in other Central and Eastern European (CEE) countries such as the Slovak Republic (USD 33,025) and Slovenia (USD 34,407). It also lags its Baltic peers Estonia and Lithuania, which recorded per capita income levels of USD 31,750 and 32,299 corresponding to 77 and 78% of the EU average.

The pronounced pick-up in GDP p.c. came on the back of accelerating real GDP growth which more than doubled from 2.2% in 2016 to 4.5% in 2017, one of the highest growth rates among the EU-28 members and the fastest growth since 2011 (6.4%). Last year's output expansion was mainly driven by domestic demand. After a steep downturn a year before (-15.0%), investment activity rebounded sharply, partly reflecting base effects and soaring by 16.0% in 2017. Gross fixed capital formation thus added 2.9 p.p. to growth, after detracting 3.2 p.p. in 2016, as EU fund absorption eventually gained traction. Drawing on EU data on the ESIF implementation progress one can see that financial resources allocated to selected projects rose from 32.7% of planned investment (EUR 2.3bn) at the end of 2016 to 55.8% (EUR 3.9bn) by the end of last year. Private consumption spending remained robust and edged up by 5.1% (2014-16 avg.: 2.4%), reflecting a further improving labor market and brisk wage growth. Growth in average monthly gross wages increased from 5.0% to 7.8% in 2016-17 (CSB Latvia data), and was particularly strong in the private sector (+8.3%). In turn, growth was curbed by net foreign trade (-3.0 p.p. GDP), as import growth (9.5%) was boosted by vivid domestic demand, outpacing export growth (4.8%) by far.

Looking forward, we assume solid growth of 3.8 and 3.2% in 2018 and 2019 respectively, laying the foundation for further income convergence. Investment activity should remain sustained in view of a continued drawdown on ESIF and high levels of capacity utilization. Capacity utilization in the industry sector climbed to historically high levels over the recent quarters, reaching 76.3% in Q2-18, significantly above the long-term average of 68.4% (2000-17). Latest survey data on sentiment, order books and business development also bode well for fixed investment in the industry and construction sectors. Still, growth in gross fixed capital formation, and with it real GDP growth, is likely to decelerate, partly due to base effects and slowing support from EU fund disbursements beyond 2019. We do not expect NFC lending to significantly aid investment growth at this stage. Apart from the reorganized loan portfolio of the Latvian Nordea branch and the subsequent merger of Nordea and DNB (into the Luminor Bank) which led to a substantial reduction in the outstanding volume of loans to NFCs (Apr-18: -10.1% y-o-y, Latvijas Banka data), loan growth appeared to evolve rather sluggish over the last six months.

Despite surfacing trade tensions and the impact of the ABLV liquidation (see below) on services exports, we believe that solid growth in the EU-28 and in Russia, where the recession came to an end (GDP growth 2017: 1.5%), should foster exports and investment.

According to CSB data, exports to the CIS economies grew vividly in the months up to April 2018, increasing by 16% on the year, while export growth to EU-28 members (+6%) also points to a favorable development of foreign trade. However, net trade should remain a drag on growth as domestic demand is likely to boost imports, albeit to a decreasing degree going forward. In this vein, private household spending is set to remain strong, due to higher real disposable income, as we expect vividly rising wages and the benign effects of the proposed tax reform (see below) to outweigh rising consumer prices.

The readings for the first quarter broadly confirm our view of solid growth in 2018. The yearly growth rate of real GDP got off to a good start for the year and came in at a strong 4.9% (Q1-17: 4.1%), mainly driven by gross fixed capital formation. Higher EU fund absorption translated into double-digit growth in construction investment which remained on its buoyant growth trajectory, with gross fixed capital formation in (total) construction surpassing its previous year's level by 36.1% in Q1-18 (Q4-17: +22.9%, Q1-17: +0.5%), while investment in machinery and equipment was still anemic (Q1-18: -2.2% y-o-y).

We continue to assess that Latvia's convergence process will become more challenging, as structural impediments may hamper the economy's dynamic growth momentum in the medium- to long-term, putting the catch-up process at risk, or at least resulting in a deceleration if not adequately addressed. The Latvian economy retained productivity growth rates which compare very favorably in an EU perspective. Last year real labor productivity increased by 3.9% and stood 8.2% above the level seen in 2014, thus recording significantly higher productivity growth than Baltic peers Estonia (2014-17: +2.6%) and Lithuania (+2.6%), or the EA-19 as a whole (+2.3%).

Notwithstanding high productivity growth witnessed over the last two decades, economic growth is likely to become even more dependent on productivity growth, since investment still appears relatively low as measured by GDP. To be sure, investment-to-GDP picked up from 18.2% in 2016 to 19.9% in 2017 (EU Commission data). However, Latvian investment activity has consistently fallen short of investment levels seen before the crises (annual average 2000-08: 29.4%), and stood well below the levels seen in other transformation economies trying to catch up, e.g. Estonia (23.7%), Czech Republic (25.2%) and Hungary (21.5%). We also note that private investment-to-GDP remains comparatively low, with 15.9% well below EU-28 and EA-19 levels at 17.3 and 17.9% respectively. This applies even more, as nominal labor productivity per person stands only at 64.8% of the EU-28 average (2016 Eurostat data), the third lowest reading in the EU-28.

More importantly, demographic challenges are here to stay and have intensified over the recent years. As Eurostat data illustrates, Latvia is the country with the second largest population decline in Europe, with the number of inhabitants plummeting by 11.0% in 2008-17 (behind Lithuania with 11.4%). Latvia's population has thus continued on its downward trajectory, exhibiting an average population decline of 1.0% per month over the last five years (CSB data). In 2017 net outward migration was still stubbornly high at 7,808, albeit being the lowest reading since 2007. Unfavorable demographics are compounded by a rapidly ageing population. According to the EU's 2018 ageing report, the old-age dependency ratio is projected to rise from 30.5 to 43.5% between 2016 and 2030, and Latvian working-age population is forecast to drop to 58.5% of total population

(-6.4 p.p.), one of the sharpest declines in Europe. In this regard it has to be highlighted that projections have deteriorated as compared to the 2015 edition of the ageing report. Looking forward, we believe that ageing and migration will put a lid on employment growth, which may curtail economic growth.

Furthermore, concerns regarding Latvia's cost competitiveness are still prevalent. Real compensation per employee continued to rise, posting a 4.7% growth in 2017, after rates of 7.7 and 6.5% in 2015 and 2016 respectively. Vivid real wage growth resulted in a significant increase of real unit labor costs which leapt by 11.1% in 2014-17, whereas real ULC declined by 1.4% in the EA-19. Moreover, real ULC growth was even more pronounced than in Estonia (+4.4%) and Lithuania (+10.1%). While Latvia is a catching-up economy and we view real wage growth as welcome from the perspective of enhancing the appeal of Latvia to foreign workers and returning migrants, wage growth should be aligned with productivity growth and the export structure should become more diversified. The Latvian economy still has scope to enhance its export industry as exports of goods in services stand for a lower share in GDP (2017: 61%) than in other CEE peers (EE: 78%, LT: 81%) and exports are still heavily biased towards low value-added industries such as wood, paper and agricultural goods as well as transport and logistics. The OECD reckons that Latvia participates to a significantly lower degree in global value chains than other CEE peers.

Meanwhile, rapidly rising wages were buttressed by the increase in minimum wages (2017-18: +13%) as well as the tightening labor market, evidenced by falling unemployment rates and indications of labor shortages. The harmonized unemployment rate (s.a.) continued to recede, edging down from 9.0% in Q1-17 to 7.8% in Q1-18. The decline was largely driven by the declining working-age population, and less by employment growth, which was broadly unchanged (2017: +0.2%, 2016: -0.3%). We expect the jobless rate to decline gradually going forward and labor shortages to exert further upward pressure on wages, as the vacancy rate (industry, construction, services) has risen rapidly over the recent quarters (Q1-18: 2.3%) and the industry and construction sectors increasingly cite labor shortages as a factor limiting production.

Our assessment of Latvia's creditworthiness also reflects the generally high quality of its institutional framework, which is primarily mirrored in the World Bank's Worldwide Governance Indicators (WGIs). Despite the fact that improvements are evident along all WGI indicators we assess and that the sovereign features WGI ranks which are broadly aligned with the respective median rankings of its CEE peer economies, the quality of the institutional set-up needs to be enhanced to close gaps towards EU levels. When it comes to the degree to which public power is exercised for private gain, Latvia is ranked at 69 out of 209 economies as compared to an EU median rank 48, being suggestive of considerable room for improvement. This also applies to the freedom of expression and the quality of checks and balances, where the sovereign is scored at 53/209 (EU median rank 37).

Still, Latvia posts below the ranks of its Baltic peers along all WGI dimensions. By the same token, Latvia scores worse on the World Economic Forum's global competitiveness index, having fallen to rank 54 out of 137 economies, down from rank 49/138 a year ear-

lier and well below the respective ranks of 29 (EE) and 41 (LT). While the sovereign underperforms, in particular on institutional aspects such as favoritism in decisions of government officials (rank 103), efficiency of government spending (rank 119), and efficiency of legal framework in settling disputes (rank 120), inefficient government bureaucracy is identified as the most problematic factor for doing business.

Against this backdrop it appears vital that authorities vigorously implement the reform plan targeted at improving the efficiency of public administration adopted in November 2017. The government plans to reduce bureaucracy and red tape by streamlining regulatory and administrative processes and scaling down employees in the public sector and administrative costs. It is noteworthy that the government continues to pursue reforms geared towards enhancing its business environment. According to the latest Doing Business report compiled by the World Bank, Latvia's economy can be considered as business-friendly, being ranked 19th out of 190 economies, behind Estonia and Lithuania, but 5th among euro area members.

The government is also pushing ahead with reforms addressing the labor market, health care and social inclusion, which we view as priorities to stimulate long-term growth and raise productivity. Need for reform is also being reflected by the budgetary allocation of scarce funds. At the latest count, Latvia spends only 3.7% of GDP on health and 12.0% of GDP on social protection, the second and fifth lowest reading in the EU, while public expenditure on active labor market policies (ALMP) only accounts for 0.64% of GDP (OECD average 1.31%). Thus, the Minimum Income Level Introduction Plan envisages a set of measures intended to improve the support for families with children and pensioners. The guaranteed minimum income level was also changed. As regards the labor market, reform efforts to improve existing ALMP are ongoing as authorities envisage clarifying suitable job criteria and expanding the coverage of support to groups such as long-term unemployed and disabled persons. Also, with the support of EU funds decision makers continue to push ahead the vocational education and training reform, as new modular programs as well as a qualification exam are planned to be developed. In addition, we observe progress on the health care reform, with the Conceptual Report on the Reform of the Health Care System being decided last July and the Law on Healthcare Financing in December 2017.

We note that Latvia's next parliamentary elections will take place on 6 October 2018. Since the end of 2016 polls had predicted that the Social Democratic Harmony Party would receive the most votes by a considerable margin. According to the latest polls in May, the Social Democrats and the Union of Greens and Farmers may be on par, while the Unity Party, having won 21% of the votes in the previous election in 2014, lags behind. Irrespective of the election outcome we assume broad policy continuity and the pursuance of reforms aimed at structural weaknesses to be given.

In general, we believe that the Latvian economy continues to greatly benefit from EU and EMU membership, which entails broader and deeper capital markets and a significant trade integration as well as advantages associated with the respective set of standards and rules. At the same time, we view the risk of resurfacing tensions with Russia or an escalation in the Russia-EU conflict as credit negative.

By contrast, we continue to view Latvia's sustainable fiscal policy and moderate levels of public debt as the sovereign's key credit strengths. The government has made significant strides with regard to budget consolidation in the aftermath of the financial crisis. The general government headline balance averaged at a moderate -1.3% of GDP in 2012-15 before turning positive in 2016 (+0.1% of GDP). However, in 2017 Latvia's fiscal balance entered negative territory again, posting at a modest -0.5% of GDP. To be sure, last year's dip in the budget balance was a result of a one-off payment to state-owned electric utility Latvenergo (0.5% of GDP), while the actual budgetary performance surprised on the upside. Mainly owing to higher-than-expected GDP growth which resulted in strong revenue dynamics, the fiscal deficit came in significantly lower than targeted by the government in its 2017 stability program (0.8% of GDP).

Nevertheless, last year's expansion in revenues (+8.7%) was outstripped by briskly growing expenditures. Growth in government spending leapt to 10.3%, with all major expenditure items contributing to the increase except for interest expenses. Above all, public investment witnessed a strong rebound. After a sharp decrease of 23.2% in 2016, government investment grew by 21.4%, mirroring an acceleration in the absorption of ESI funds. According to EU Commission data, Latvia's spending under the current 2014-20 funding period doubled from EUR 616m in 2016 to EUR 1.21bn in 2017. Meanwhile, rapid wage growth was observed not only in the private sector, but also in the public sector. Driven by a minimum wage hike and higher wages for healthcare workers, compensation for state employees rose by 8.4% on the year (2016: 5.4%). Turning to the revenue side, strong wage developments and vivid domestic demand translated into briskly growing tax receipts. Net social security contributions and taxes on income and wealth increased by 9.1 and 9.6% respectively.

This year we expect Latvia's fiscal stance to ease somewhat. Most importantly, the tax reform, which was adopted by the Saeima in July 2017, should put a strain on revenues. The main purpose of the reform, which is to be gradually implemented in 2018-20, is to lower income inequality and improve the competitiveness of the corporate sector. As regards personal income taxation, the former flat rate of 23% was replaced by a more progressive regime with three tax brackets. Furthermore, the tax-free allowance and the minimum wage were raised. To stimulate corporate investment, reinvested profits are exempted from taxation under the revised tax code, while distributed profits will be subject to a 20% rate. According to the EU Commission, revenue losses associated with the PIT and CIT-reform should total at about 1.0% of GDP in the first year. At the same time, vivid expenditure growth should weigh on this year's fiscal performance. Recently, the Latvian government decided to ramp up defense spending faster than originally planned. The Latvian government intends to comply with the NATO's defense spending target of 2% GDP already in 2018 (previously 2020), implying a 0.4 p.p. of GDP increase from 2016 levels (1.6% of GDP). Likewise, it remains one of the government's top spending priorities to strengthen its weak social safety net. We believe that the ongoing implementation of pension and healthcare reforms, as well as an increase in child benefits, should continue to absorb significant funds.

We note that the government's 2018 budget also includes some revenue-enhancing measures. At the beginning of the year, Latvian authorities raised excise duties on oil, tobacco and alcoholic beverages, as well as the gambling tax. In addition, the social security contribution rate was increased from 34.09 to 35.09%. To combat tax fraud and to improve VAT collection, the government lowered the VAT-registration threshold and extended the split-payment regime to construction materials and household appliances. We assume, however, that these measures will not be sufficient to fully finance the tax reform and additional spending. As a result, we anticipate the budget deficit to widen to a modest 1.0% of GDP in 2018 and to remain at this level in 2019.

Despite our expectation of somewhat higher fiscal deficits in the near term, fiscal sustainability risks appear limited in the medium term against the backdrop of low government indebtedness. In 2017, government debt fell from 40.5 to 40.1% of GDP, mainly due to strong economic growth, as nominal gross debt rose by EUR 691m or 6.8% on the year. Thus, Latvia's debt-to-GDP ratio remains among the lowest in the euro area, comparing well to similarly rated peers. Together with Lithuania (39.7% of GDP), Latvia featured by far the lowest debt-to-GDP ratio among our A-rated sovereigns. As regards 2018-19, we anticipate that debt will stabilize slightly below the 40%-mark before debt consolidation resumes. Interest sensitivity of Latvia's government debt appears limited. According to the Latvian treasury, the share of fixed-rate debt in Latvia's debt portfolio has increased from an already high 90.5% at the end of 2017 to 93.8% in Q1-18.

Having said this, Latvia still faces some challenges with regard to public finances. Firstly, the Fiscal discipline council, which is monitoring compliance with the provisions of the national Fiscal discipline law (FDL), drafted several non-conformity reports in 2017/18. Secondly, the sovereign exhibits a relatively narrow and volatile revenue base. Although Latvia's revenue-to-GDP-ratio edged up from 37.2 to 37.5% of GDP last year, the ratio remained well below EA-19 levels (46.2% of GDP). In particular, the Latvian government generates relatively low tax receipts by European standards. Low tax revenue can be partly attributed to the presence of a large shadow economy. According to estimations of SSE Riga, the size of Latvia's shadow economy reached 22% of GDP last year. Hence, a vigorous implementation of tax compliance measures (see above) in the 2018 budget appears even more important. Improving tax collection and broadening the tax base would also enhance the resilience of the state budget in the event of a sharp economic downturn. Empirical evidence shows that government revenues were subject to elevated volatility in the past. As measured by the standard deviation of general government revenue in 2008-17, volatility in Latvia was approx. 2.6 times higher than the EU-28 average.

Turning to the financial sector, lending to the domestic economy is dominated by subsidiaries of Nordic banks, while so called non-resident deposit (NRD) banks primarily provide services to clients in the CIS countries. In general, we consider the asset quality of Latvian banks to be high and their capital buffers to be sufficient to weather adverse economic shocks. The NPL ratio continued to decline in 2017, having almost halved since the end of 2015. Recently, Latvia reported an NPL ratio of only 2.3% (Q4-17). Meanwhile, the CET1 ratio saw a further increase from 18.9 to 20.9% between Q4-16 and Q4-17. Thus, capital buffers of Latvian banks were among the strongest in the EU-28 (average: 14.8%).

Notwithstanding that financial soundness indicators point to a generally high resilience of Latvian banks, we believe that some reputational damage to the financial system has been caused by allegations against the governor of Bank of Latvia and the recent failure of ABLV, the country's third largest lender in terms of assets. To be sure, the banks' failure did not have an adverse impact on public finances. The ECB's SSM assessed that the bank was failing or likely to fail on 23 Feb 2018. Given that ABLV does not provide critical services and its failure is not expected to have a significant adverse impact on financial stability, the SSM decided to wind up the bank. Currently, ABLV is in the process of voluntary liquidation. Following allegations against ABLV and in view of tighter government regulation foreign depositors started to withdraw significant funds from Latvian NRD banks. Non-resident deposits sharply declined from EUR 7.9bn at the beginning of the year to EUR 5.3bn in April and we expect a further decline in non-resident deposits over the rest of the year. To be sure, liquidity in the banking sector as a whole remains sufficient.

In the aftermath of ABLV's failure, the Saeima adopted an amendment to the Law on the Prevention of Money Laundering and Terrorism Financing, forcing banks to conduct more severe customer due diligence. A new article added to the AML/CFT Law prohibits financial institutions from cooperating with entities that show signs of being a shell arrangement, defined as an entity registered in a jurisdiction without requirements to disclose financial statements and which is not economically active. Banks are obliged to terminate business relations with such entities by 8 July 2018 latest. The new provisions also intend to improve the exchange of information between financial institutions and law enforcement agencies. Given its limited links with the domestic economy, we believe that a shrinking NRD sector should not result in a significant tightening of credit supply. As highlighted by the Bank of Latvia, banks servicing foreign clients accounted for only 12% of domestic lending in Q1-18.

Assessing its external position, we believe that Latvia's high degree of trade openness and still sizeable external liabilities increase the economy's susceptibility to external shocks. After having reported the first surplus in six years in 2016, Latvia's current account turned negative again in 2017. Last year's decline in the current account balance from 1.4 to -0.8% of GDP was mainly driven by a deteriorating trade in goods balance. The trade in goods deficit increased from an already high 7.7 to 9.7% of GDP in 2017. Looking ahead, we anticipate a further widening in Latvia's current account deficit, mainly due to higher fiscal deficits as well as higher domestic demand.

Persistent current account deficits in the past have resulted in a highly negative net international investment position (NIIP). To be sure, Latvia's external asset position has improved in terms of size and composition since the financial crisis. Latvia's NIIP gradually moved up from -82.9% of GDP in 2010 to -58.9% in 2016 and to -56.5% in 2017. We note that Latvia's NIIP remained relatively stable in absolute terms, hovering around EUR 15bn in 2010-17. Meanwhile, we believe that deleveraging in the domestic financial sector helped to reduce risks pertaining to the liability side of Latvia's external accounts. The MFI share in total external liabilities fell from 42.8 to 23.1% in 2010-17, mirroring a lower

reliance on foreign deposits. Concurrently, the FDI share in external liabilities rose from 24.1 to 30.9%.

Rating Outlook and Sensitivity

Our Rating outlook on the long-term sovereign rating is stable, 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 remain fundamentally unchanged in the next 12 months.

Our rating could be lowered if we observed prolonged stagnation or a reversal in income convergence towards EU-28 levels, or if adverse developments lead to lower-than-expected medium-term growth. As a small, open economy, decelerating economic activity in the euro area could adversely affect GDP growth given Latvia's strong trade linkages with its neighboring countries. Growth could also be hampered by escalating tensions with Russia, which could lead to a tightening of trade sanctions on the EU level. Apart from the materialization of external risks, accelerating net migration could result in a faster-than-anticipated decline in the Latvian workforce, thereby weakening the economy's growth potential. We could also consider a downgrade if, contrary to our expectations, a significant deterioration in public finances occurred, mirrored by significant budget deficits and a steep increase in government debt.

By contrast, upward pressure on our ratings could arise if the volatility of macro-financial variables was significantly reduced or if we observed higher-than-expected growth rates in the medium term, leading to accelerating income convergence. In the same vein, we could raise our ratings if we see sustained and credible fiscal consolidation complemented by a durable reduction of debt at the general government level.

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Ratings*

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

*) Unsolicited

Economic Data

	2012	2013	2014	2015	2016	2017	2018e
Real GDP growth	4.0	2.4	1.9	3.0	2.2	4.5	3.8
GDP per capita (PPP, USD)	21,302	22,402	23,487	24,637	25,725	27,644	29,490
HICP inflation rate, y-o-y change	2.3	0.0	0.7	0.2	0.1	2.9	2.7
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	74.3	74.5	74.8	74.9	n.a.	n.a.
Fiscal balance/GDP	-1.2	-1.2	-1.5	-1.4	0.1	-0.5	-1.0
Current account balance/GDP	-3.6	-2.7	-1.7	-0.5	1.4	-0.8	n.a.
External debt/GDP	138.2	133.9	144.1	143.6	148.8	140.9	n.a.

Source: International Monetary Fund, Eurostat, own estimates

Appendix

Rating History

Event	Publication Date	Rating /Outlook
Initial Rating	26.08.2016	A /stable
Follow-up Rating	18.08.2017	A /stable
Follow-up Rating	29.06.2018	A /stable

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. The Treasury of the Republic of Latvia participated in the credit rating process as the Treasury provided additional information and commented on a draft version of the report. Thus, this report represents an updated version which was augmented in response to the factual remarks of the treasury during their review. However, the rating outcome as well as the related outlook remained unchanged.

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, Central Statistical Bureau of Latvia, Central Bank of Latvia, Republic of Latvia - Ministry of Finance Latvia, Latvijas Republikas Fiskalas Disciplinas Padome (Fiscal Discipline Council).

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.

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