

Flash Comment

Lithuania: another cut in ratings

Ratings agency Moody's last night downgraded Lithuania's rating by a notch to Baa1 from A3 and maintained its 'negative outlook'. This is the second time this year that Lithuania's rating has been cut. The current downgrading of the rating reflects concerns about the sustainability of fiscal policy. According to Moody's, the economic recession "continues to place a severe pressure" on the fiscal policy. The ratings agency predicted that budget deficits are likely to be in the "high single digits" of GDP in 2009-10 and that the earliest date of euro adoption is likely to be pushed back to 2014-15.

The downgrade is obviously bad, but not unexpected, news. Economic development in Lithuania has shown some signs of stabilisation as declines in industrial production and retail trade growth have slowed, but mainly due to positive base effects. Moody's cannot rule out the possibility of further downgrades in the future. However, it mentioned that "the outlook could move to stable if the economy recovers more quickly than expected, and the government is able to engineer a meaningful fiscal adjustment". We agree with Moody's analysts and believe that a more positive external outlook could result in a less pronounced economic slowdown next year and that the economic recovery could start sooner than projected in our base scenario.

Latvia remains the most risky Baltic country with a Baa3 (negative) rating. In its report *Latvia, Hungary & Iceland: Fragile Stabilization But Far from Recovery*, Moody's says that Latvia "still carry negative outlooks, signalling the possibility of further downgrades in the next 12 to 18 months". Estonia is a more sustainable economy which continues to enjoy an A1 (negative outlook) rating. This is mainly due to a less pro-cyclical fiscal policy stance and positive outlook regarding euro adoption in 2011.

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Disclosure

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