



Latvia – Markets update and future outlook

Aku Hentilä
10 March 2009



Markets

CONTENTS

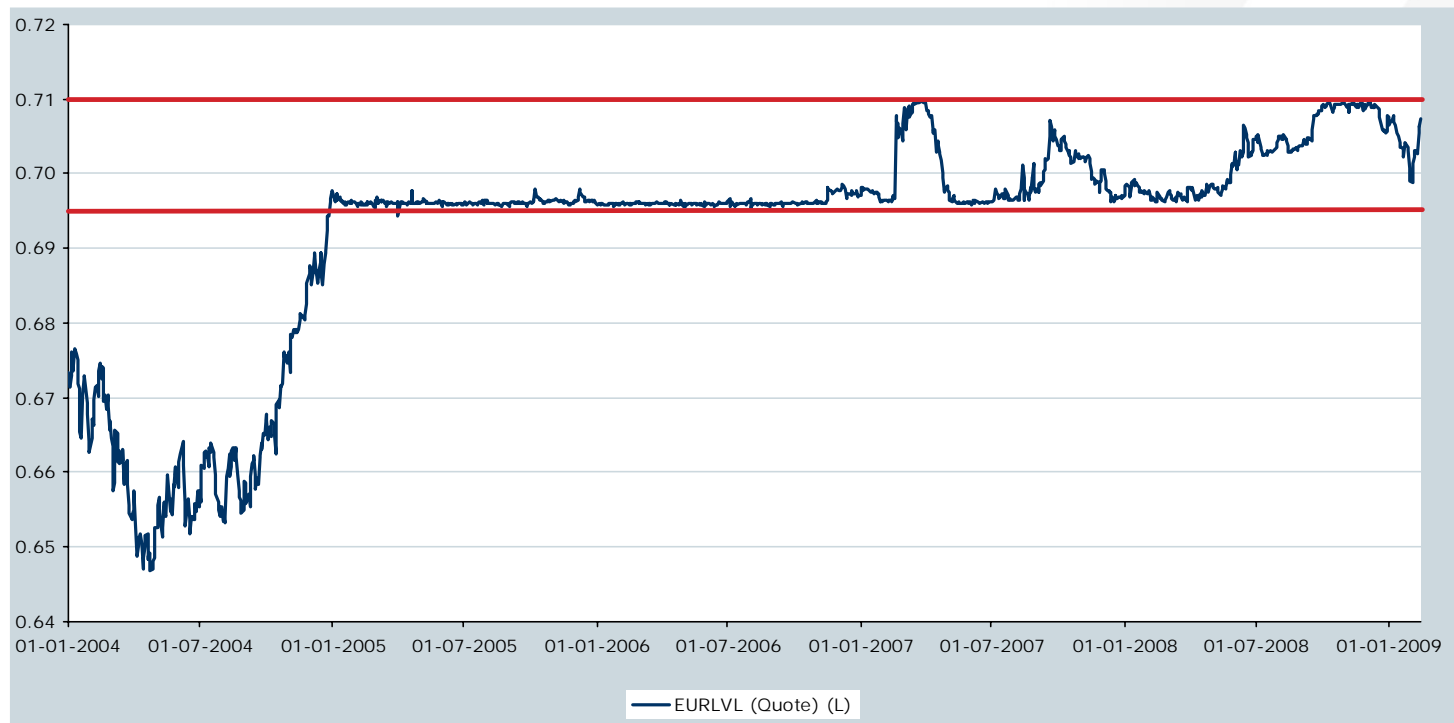
- **Currency board regimes of the Baltic's**
- **FX & MM - Latest developments in the area**
- **Future outlook**
 - **Challenges**
 - **Possible Euro introductions**

CURRENCY BOARD REGIMES OF THE BALTIC'S

- **Estonia and Lithuania run pure currency board regime, Latvia runs “quasi currency board regime”**
- **The Central banks in the Baltic's are committed to exchange local currency to EUR with the fixed peg rate (in Latvia + - 1% around the fixed parity)**
- **Main tool to regulate banks' lending is the reserve requirement for the commercial banks**
 - **Estonia: 15% (half can be EUR nominated)**
 - **Lithuania 4% up to 2Y, 0% above 2Y**
 - **Latvia 5% up to 2Y, 3% above 2Y**

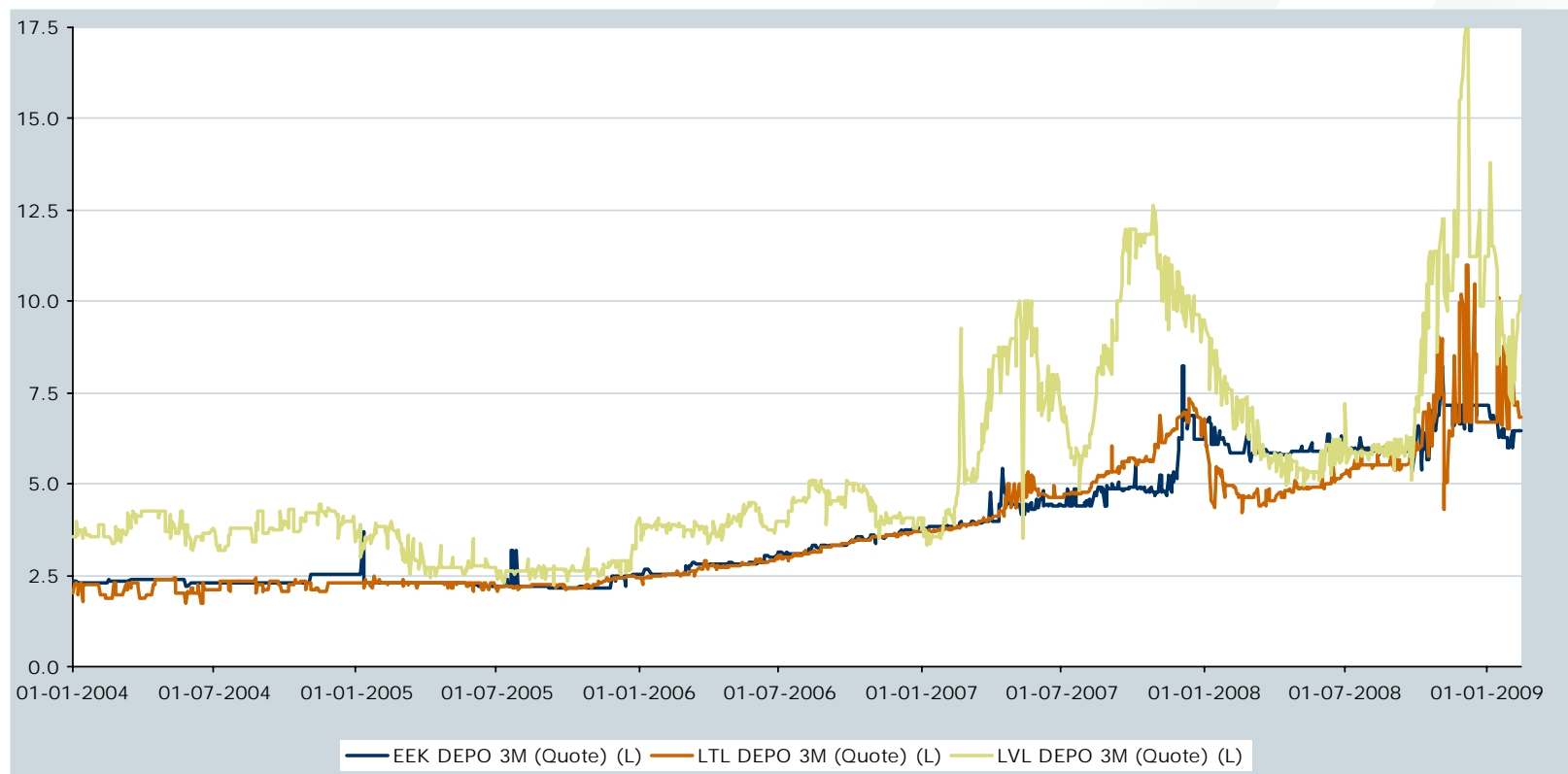
FX & MM – Latest developments in the area

- FX markets
 - Very retail driven flow in all 3 countries
 - State a major player in the FX market



- Money markets

- Movements derive from the FX market under the currency board
- Official rates vs. the reality

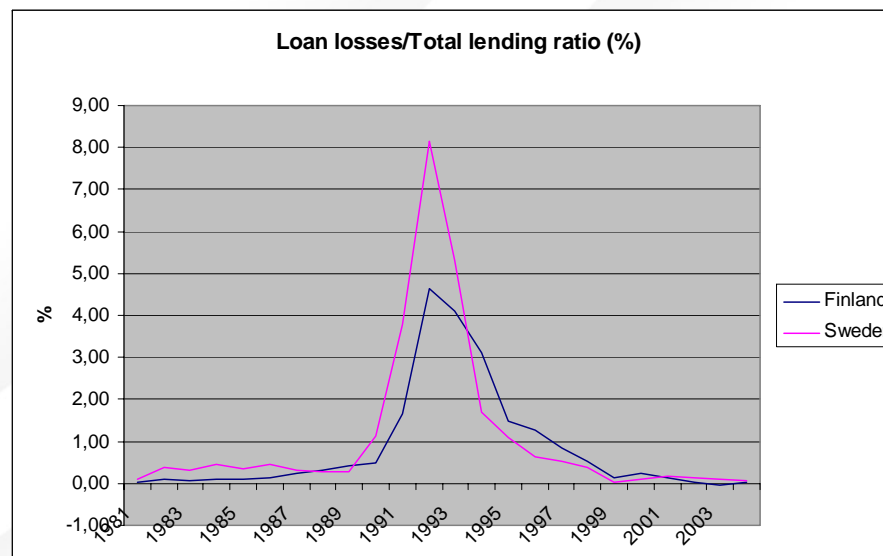
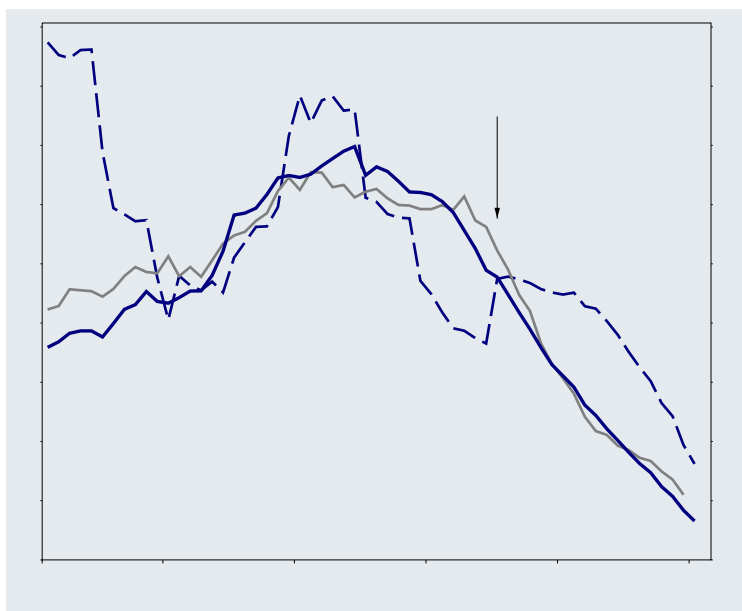
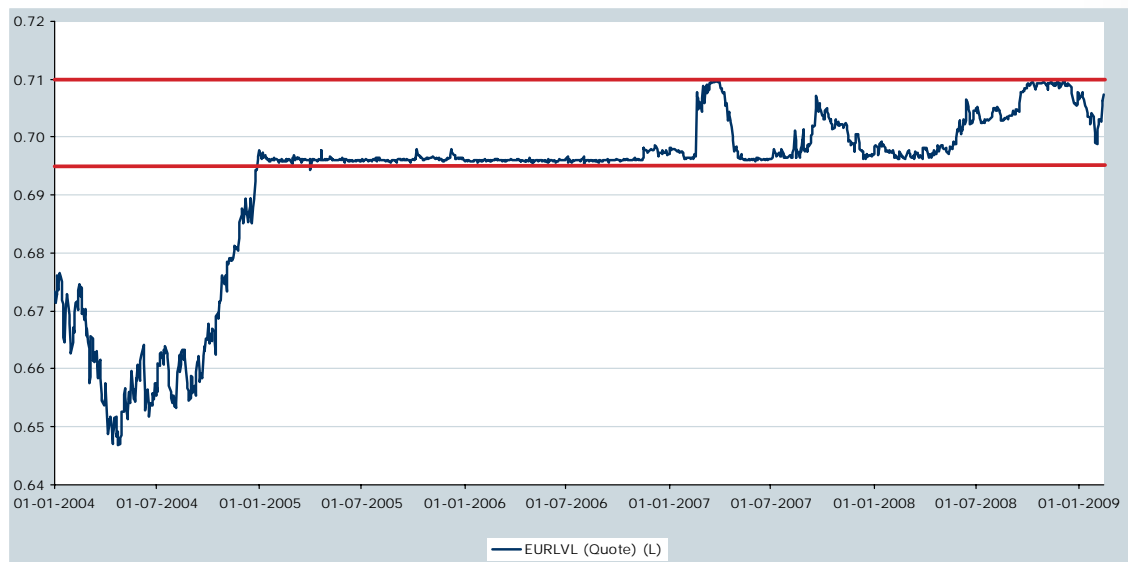


FUTURE OUTLOOK

CHALLENGES

- **7.5 bio EUR bailout package for Latvia:**
 - Primary used for the State budget and saving the Parex bank; Is there any money left for boosting the economy?
 - Calculations were based on -5% GDP contraction → further budget cuts needed
 - Lithuania and/or Estonia to follow??

- FX flows are heavily biased to LVL/LTL/EEK selling at the moment



- **Credit ratings of the Baltic countries under pressure**

- Latvia was cut to BB+ at the end of February by S&P, junk bond status, and outlook remains negative
- Lithuania and Estonia are on WatchNeg on S&P's list
- Negative effects: syndicated loans, FDI, etc.

POSSIBLE EURO INTRODUCTIONS

- **Unofficial targets set around 2011-13**
- **Maastricht criteria = Euro convergence criteria**
 1. Inflation
 2. National budget deficit
 3. National public debt
 4. Long term interest rates
 5. Currency stability (ERM-2)