Latvia – Markets update and future outlook

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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)