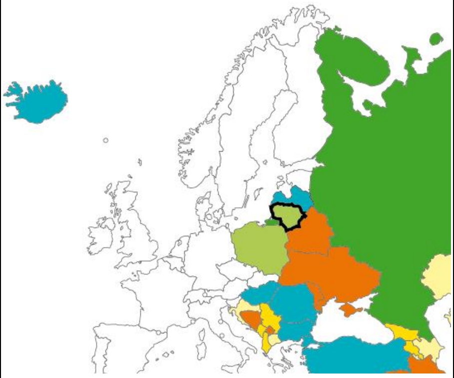
COUNTRY RISK ANALYSIS

Lithuania

CREATING CONFIDENCE IN YOUR EXPORTS



COUNTRY RISK CATEGORY

2/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY

SHORT-TERM TRANSACTIONS: -

MEDIUM AND LONG-TERM TRANSACTIONS:
SEK 600.2 MILLION

DATE

12/02/2015

Geopolitical tensions slowing down growth

Lithuania went from being a heavily regulated planned economy to a well-functioning market economy in a relatively short period of time. The country has stayed on course toward greater EU integration since it regained independence. The journey there has been quite turbulent at times and put the economy's ability to transform to the test. The economy's vulnerability was exposed during the global financial crisis. After a deep slowdown, the country is back on its feet and its economic recovery is progressing at a faster rate than most other EU countries. The country is once again one of the fastest-growing EU member states. Growth has shifted to a lower gear in comparison to the pre-crisis years. The economy is now growing in line with its growth potential, thus avoiding the risk of creating imbalances and the economy overheating again. This in turn ensures that the country can permanently get closer to the rest of the EU in terms of GDP per capita and living standards. Joining the monetary union next year is expected to foster Lithuania's investment and business environment and give the country access to the ECB's large lending facilities. An escalation of the conflict between Russia and Ukraine is a risk factor, but the baseline scenario is that the negative impact on the export sector and transport industry will be relatively small.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- A reform-friendly, stable political climate, strong government administration and a favourable regulatory environment.
- Healthy and sustainable public finances and low private debt.
- Well-capitalised banking sector with high liquidity, solid integration into the EU's financial system and a strong presence of powerful Nordic banks.

Weaknesses

- Small open economy with high international dependence which has been subject to substantial fluctuations in growth and inflation since independence.
- From an EU perspective, low GDP per capita and high unemployment, largely of a structural nature.

EKN'S POLICY

General risk assessment

Lithuania is in country risk category 2 under EKN's country risk categorisation and under the OECD's country risk categorisation. Lithuania is a high-income country and also uses the euro as of 1 January 2015. As of 1 July 2015, the country is therefore no longer expected to be categorised within the scope of the OECD's country risk categorisation. Lithuania's membership in the euro zone gives it a low transfer and conversion risk. There are no other financial and economic circumstances that justify any restrictions on the country policy. Instead, each transaction is assessed on its own merits. In accordance with the EU's competition regulations, EKN and other export credit institutions may not cover payment risks for transactions where the risk term is less than two years.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- An improvement in the economy's inherent strength, creating a lasting period of high and stable growth.
- Stronger public finances that give the government greater fiscal flexibility.

The policy may be made more restrictive in the event of

- Weaker public finances, resulting in an increase in public debt and a rise in public financing costs.
- An escalation of the conflict between Russia and Ukraine, which would have a negative impact on the country's export sector and create security turbulence.

EKN'S EXPOSURE AND EXPERIENCE

Limited inflow of new transactions

EKN's total exposure to Lithuania is SEK 630 million, with outstanding guarantee accounting for just over SEK 600 million and outstanding offers accounting for the rest. EKN has mainly guaranteed transactions in the power industry.

COUNTRY ANALYST

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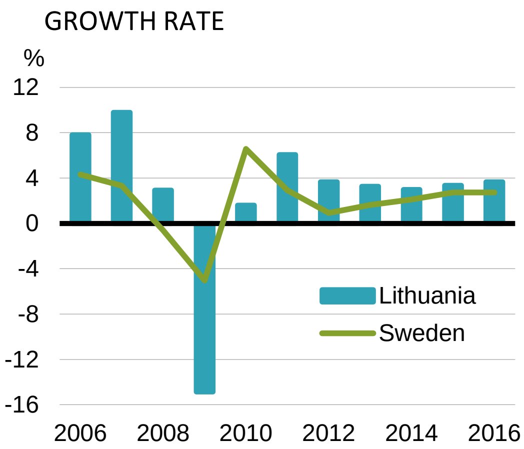
DISCLAIMER

The country analysis is based on a range of sources and reflects information that is relevant to EKN at the time of publication. The responsibility for how the informa ion is used or interpreted rests solely with the user, and EKN cannot be held responsible for any loss or damage.

Recovery on solid ground

The country's transition to a market economy has been lined with both successes and setbacks since it regained independence in 1990. Since independence, the country's policies have been directed toward greater economic integration with the EU and closer security relations with the West. The country has been a member of both the EU and NATO since 2004. Starting in 2015, an additional step toward greater economic integration will be taken when the country abandons its own currency and joins the monetary union. The country's historic bonds and geographic proximity to the Nordic countries have been key factors behind growing Nordic-Baltic cooperation and many Swedish companies and banks have operations in the country.

Since regaining its independence, Lithuania has seen a large inflow of foreign investment, mainly to the country's construction and property sectors. The presence of foreign banks, especially Nordic banks, contributed to a major expansion in the financial sector in the 2000s, which led to a rapid credit expansion and a high rate of investment. The country's competitiveness was undermined and the current account deficit got deeper as a result of the accelerating wage increase rate and rising inflation. The country's economy was overheated when the financial crisis had its full impact in Europe in 2009, which made the resulting beating taken by the real economy substantial. The property bubble burst, capital inflows stopped in their tracks and investments took a dive. GDP fell by around 15%, which was a substantially sharper drop than in other EU countries.



Source: IMF, forecast years 2014-2016

Since the crisis years, the economy has strengthened and the country is back on its feet, but the considerable austerity enforced to resolve the imbalances created before the crisis has left a major mark on a large part of the population. Several factors have contributed to the country nevertheless being able to work its way relatively quickly out of the deep slowdown it was in.

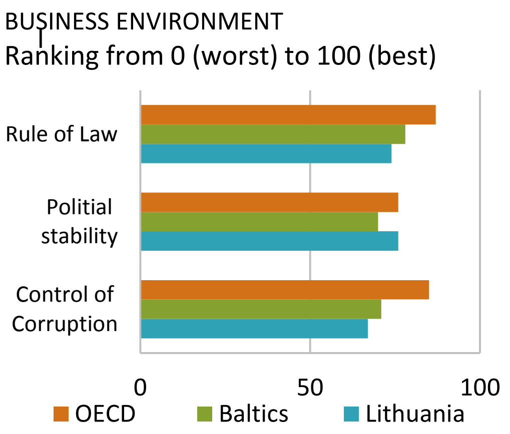
Public debt was very low at the onset of the crisis, which gave the country scope to increase its public debt without running the risk of being sucked into a budget crisis. The government launched extensive cost-cutting plans, which stipulated budget cuts and pay cuts for public employees. A fiscal policy with a strong element of austerity contributed to bringing down costs and thus strengthening the country's competitiveness, which especially benefited the export industry. The fact that a large portion of the public and private debt was in euro contributed to the government's decision to refrain from devaluing its way out of the crisis. Devaluation would also likely postpone joining the monetary union, which the government wanted to avoid. High unemployment, weak international demand, weaker profitability in the oil sector and the escalation of the conflict between Russia and Ukraine is holding back growth over the coming years. As the recovery in Europe gains momentum, growth is expected to increase and then stabilise at levels that are sustainable in the long term.

The energy sector and the food industry in particular have been fraught with difficulties recently. The price pressure on the world market price of oil has made it difficult for the country's largest oil exporter, the Orlen Lietuva refinery, to compete with stiffer competition and it has therefore cut down its production. Since this refinery accounts for nearly 1/4 of the country's total goods exports, this is having an impact on the export outlook for the entire economy. It is highly likely that the price pressure on oil will persist in the short term. The food industry is suffering from the Russian food import ban introduced in August 2014. Nearly 1/5 of the country's exports go to Russia, but they are largely goods that are not of Lithuanian origin, as Lithuania is the transit country for such goods. Even though both the EU sanctions and the Russian food embargo will have a negative impact on the profitability of the food and transport sectors in the short term, the cumulative effects on these sectors is estimated to be relatively limited. In a situation where the Russian embargo is expected to remain in place for a long period of time, it is estimated that Lithuanian food industry can redirect its sales to other markets.

The banking sector in Lithuania mainly consists of bank subsidiaries, especially of Nordic banks. A small number of major Nordic banks have around 90% of the market. The banks saw the loan quality of their loan portfolios deteriorate significantly during the crisis and a systemic crisis was avoided thanks to the support of the Nordic parent banks. The proportion of bad loans fell as the turbulence on the global financial markets died down, the country's economic situation improved and housing prices took an upward turn, but the proportion of bad loans is still relatively high. The banks are generally well-capitalised with rising profitability. As opposed to other European banks, especially the Nordic ones, the Lithuanian banks have a high degree of deposit financing, and a lesser degree of capital market financing. Increased independence from foreign parent companies reflects a brighter economic situation. The resilience of the banking system is expected to increase, in part due to domestic factors, and in part due to membership in the monetary union giving it access to the ECB's lending facilities. Overall, no major changes to the current banking structure are expected, and the presence of foreign banks will likely decrease, but not for a while.

BUSINESS ENVIRONMENT

The country's operating environment has gradually improved as a part of its pursuit of greater economic and institutional integration with the EU. Deregulation, privatisation and improved competition regulations have brought the country closer to being a fully developed market economy. The country has good financial transparency and follows EU standards. The country's improved ranking in the World Bank's Doing Business Index in recent years has been driven by increased flexibility on the labour market, improved credit access and simplified rules for starting companies. Lithuania is largely in line with the Baltic average. One area that requires greater effort is control of corruption. Membership in the monetary union enables export companies to avoid conversion costs and makes it cheaper for companies to insure themselves against credit risks.



Source: Worlbank