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Atradius Country Report

Lithuania – March 2009

Overview

General information

Capital:	Vilnius
Government type:	Parliamentary democracy
Currency:	Litas (LTL)
Population:	3.5 million
Status:	Upper middle income country (GDP/capita: US-$ 14,204 in 2008)

Most important sectors (% of GDP, 2007)

Services:	62 %
Industry/mining:	34 %
Agriculture:	4 %

Main import sources (2007)

Russia:	24 %
Germany:	16 %
Poland:	9 %
Latvia:	4 %

Main export markets (2007)

Russia:	15 %
Latvia:	13 %
Germany:	11 %
Poland:	6 %

Main expenses of foreign exchange

Manufactured goods (66 %), mineral products (23 %)

Main sources of foreign exchange

Mineral products (refined oil, gas: 21 %), food and animal products (12 %), timber and furniture

Key indicators

	2005	2006	2007	2008*	2009**
GDP (US-$ million)	25,977	30,085	38,882	47,867	42,390
Real GDP growth (%)	7.9	7.7	8.7	3.7	-3.5
GDP per capita (US-$)	7,573	8,822	11,470	14,204	12,579
Inflation p.a. (%)	2.7	3.8	5.7	11.1	4.7
Fiscal balance (% of GDP)	-0.5	-0.5	-1.2	-0.9	-2.4
Total foreign debt (US-$ million)	12,561	18,955	29,648	36,828	35,694
Foreign debt/GDP (%)	48	63	76	77	84
Foreign debt/XGS (%)	82	103	135	130	156
Short-term debt/inter. reserves (%)	138	139	116	171	281
Debt service ratio (%)	17	23	22	29	45
Current account balance (US-$ m.)	-1,831	-3,218	-5,260	-6,373	-3,700
Current account/GDP (%)	-7.0	-10.7	-13.5	-13.3	-8.7
Nom. exchange rate to US-$ (average)	2.77	2.75	2.52	2.36	2.69
International reserves (US-$ million)	3,854	5,540	7,339	5,389	3,384
In months of merchandise imports	3.0	3.4	3.6	2.1	1.4

* estimated ** forecast Source: Economist Intelligence Unit (EIU)

Political situation: Unstable coalition

Head of state: President Valdas Adamkus (since July 2004)
Head of government: Prime Minister Andrius Kubilius (since November 2008)
Form of government: Coalition of the conservative Homeland Union-Christian Democrats (TS-LKD), National Resurrection Party (TPP), Liberal Movement (LS) and Liberal and Centre Union (LCS)

Internal situation

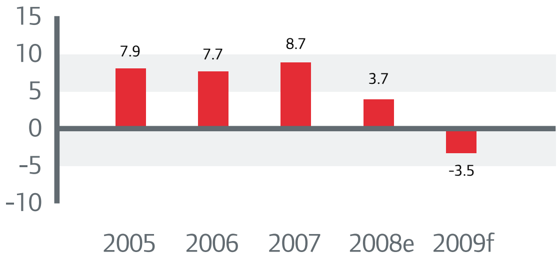
Since its independence in 1991, Lithuania has been governed by frequently changing coalitions. Despite this, the country's broad political consensus aimed at market-oriented economic policies and close alignment to the West has not been at risk. The general elections of October 2008 resulted again in a fragmented parliament in which TS-LKD became the largest party at the expense of the ruling Social Democrats. The new coalition is again an unstable partnership with different interests between its four composite parties. In January 2009 popular dissatisfaction with the economic policy led to violent street protests.

International relations

In contrast to the other Baltic states, Lithuania has only a small Russian speaking minority. But relations with Russia have deteriorated since the Russian state-owned pipeline operator Transneft stopped oil supplies to the Mazeikiu Nafta complex in 2006. Another bilateral issue has been Lithuania's condemnation of the Russian invasion of Georgia.

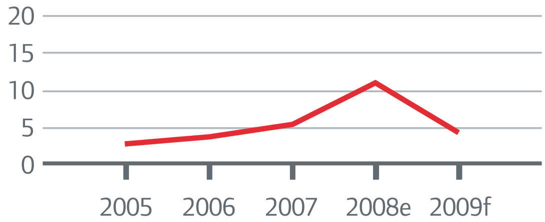
Internal economic situation: Hard landing and deep recession

Real GDP growth (%)



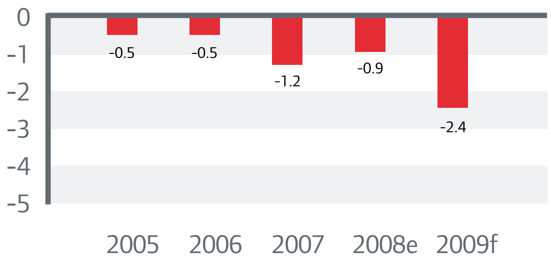
Source: EIU

Inflation p.a. (%)



Source: EIU

Fiscal balance (% of GDP)



Source: EIU

General situation

After years of high GDP-growth until the first half of 2008, the economy entered a recession in the last quarter of 2008, which will deepen in 2009. A collapse of export markets, falling consumer and investor demand on the back of restricted bank lending after years of exuberance and plummeting property prices are the cause of this drastically weakened business climate. A hike in bankruptcies in 2009 and beyond is a realistic scenario. Capacity bottlenecks, strongly rising wages and oil/food prices propelled inflation to 12 % in May 2008, decreasing only slowly to 9 % in November 2008.

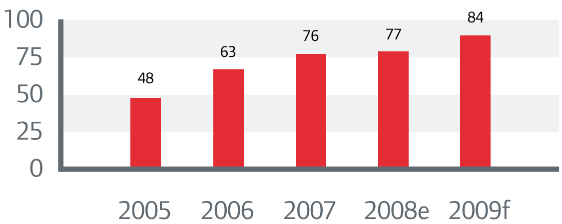
The deteriorating business climate has increased the portfolio of non-performing loans in the banking sector, which is in wholly Nordic hands. Falling property prices and rising borrower risk will erode the profitability of the structurally healthy financial sector. More than 60 % of the outstanding credits are denominated in Euros.

Economic policy

The litas is pegged to the euro, continuing the currency board system and the surrender of a discretionary monetary policy. The government aims to cut spending and boost revenue in order to narrow the budget deficit. A package of fiscal anti-crisis measures has been approved, e.g. raising profit taxes and VAT while at the same time lowering the rate of personal income tax to 20 %. But those measures cannot prevent the budget deficit from rising to 2.4 % of GDP in 2009. Additional austerity measures are urgent to redress the large external imbalance.

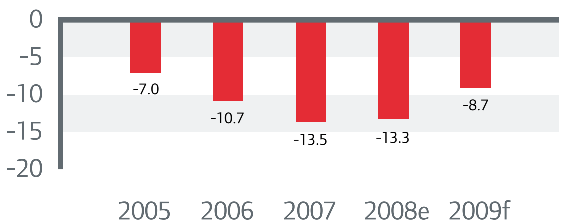
External economic situation: Decreasing deficits – but still risky

Foreign debt/GDP (%)



Source: EIU

Current account/GDP (%)



Source: EIU

Foreign debt

Level:	Strongly increased to US-$ 36.8 billion by the end of 2008 (77% of GDP, 130 % of exports of goods and services)
Structure:	Unfavourable: approx. 25 % short-term
Debt service ratio:	High: 45 %, very high including short-term deposits (85 %)

Remarks:
(Private sector) foreign debt has more than trebled since 2004. The debt largely comprises funds from foreign (parent) banks and from Russians. Investment ratings have been downgraded. A € 600 million 10-year eurobond was heavily subscribed in October 2007. Since then there were no more issues.

Balance of payments

Trade balance:	Very large deficits, reaching US-$ 6.4 billion in 2008
Current account:	Decreasing, but still high deficits
Capital account:	Positive
Total Account:	Probably negative in 2008

Remarks:
In 2009 imports are shrinking faster than exports, causing a lower trade/current account deficit. Some foreign direct investment, EU funds and notably external borrowing by local banks (mainly from their Nordic parents) have financed the current account deficits so far. The litas is pegged to the euro within a 30 %-margin, but the central bank aims to keep it within a +/- 1 %-band.

International reserves

In months of imports (cif):	Declined to 2 months of import cover by the end of 2008. A high short-term debt/reserve ratio, climbing to 280 % in 2009.

Prospects: Very vulnerable for the time being

Political situation

Despite some discontent within the coalition, the government remains committed to its austerity programme for the time being. But a worsening economic climate and growing social tensions will put the unity of the government to the test. The coalition must be reappointed after the forthcoming presidential elections in mid-2009. It will probably not rule for its whole term.

Internal economic situation

Lithuania will face a recession in 2009 (a real GDP-decline of at least 3.5 %) as most export markets are underperforming (eurozone, Latvia, Estonia, Russia) and tighter credit conditions will dampen domestic activities. The outlook for a recovery in 2010 remains rather uncertain. Growth could be restrained even further because of a lack of energy supply due to the closure of the Ignalina nuclear power plant in 2009 (As a condition of EU-entry Lithuania has committed itself to close the existing units).

External economic situation

Lithuania will remain dependent on the ability and willingness of the Nordic (mainly Swedish)-owned local banks to roll-over the debt service due. In fact, these banks will largely determine economic developments in the coming years: the country is faced with a very high foreign debt service burden. The major part of those short-term obligations consists of credits that were granted from parent-banks in Sweden to their affiliates in Lithuania during the boom years. A failure to roll-over these credits would not only bring Lithuania to the brink of default, but would also severely hit the viability of those banks themselves. It is expected that Lithuania will be able to stave off such a default, but at the cost of a deep recession. The falling current account deficits are to be funded by (low) foreign investments and multilateral support (EU).

Downside scenarios are a further collapse of Lithuanian export markets and/or a sudden devaluation of the lat in neighbouring Latvia. In such a case the currency board would have to be revised, probably with a correction of the exchange rate of the litas, thus unfolding new economic problems.