Latvia
Rating Report

A- STABLE OUTLOOK

Credit strengths

- Sound economic performance and commitment to structural reforms
- Effective fiscal consolidation
- Euro area membership

Credit weaknesses

- Vulnerabilities to external shocks
- Subdued potential growth
- Unfavourable demographics

Rating rationale and Outlook: Latvia’s ‘A-’ rating is underpinned by its sound economic performance supported by the absorption of European Union (EU) funds, commitment to structural reform, effective fiscal consolidation and prudent debt management contributing to the reduction in debt ratios post-crisis, and euro area membership. The ratings are constrained by challenges stemming from the large share of short-term debt in external liabilities, subdued potential growth and unfavourable demographics. The Stable Outlook reflects Scope’s view that risks going forward are balanced.

Figure 1: Sovereign scorecard results

Scope's sovereign risk categories	Latvia	Peer comparison: Average	Lithuania	Slovenia
Domestic economic risk				
Public finance risk				
External economic risk				
Financial risk				
Political and institutional risk				
Qualitative adjustment (notches)	-1		-1	-1
Final rating	A-		A-	A-

AAA AA A BBB BB B CCC CC C

Source: Scope Ratings AG

NB. The comparison is based on Scope’s Core Variable Scorecard (CVS), which is determined by the relative rankings of key sovereign credit fundamentals. The CVS peer group average is shown together with two selected countries chosen from the entire CVS peer group. The CVS rating can be adjusted by up to three notches depending on the size of relative credit strengths or weaknesses.

Positive rating-change drivers

- Sustained reduction of short-term external debt
- Further reduction of public debt
- Implementation of structural reforms driving higher growth potential

Negative rating-change drivers

- Reversal of fiscal consolidation
- Lower-than-expected absorption of EU funds, lowering growth

Ratings and outlook

Foreign currency

Long-term issuer rating	A-/Stable
Senior unsecured debt	A-/Stable
Short-term issuer rating	S-1/Stable

Local currency

Long-term issuer rating	A-/Stable
Senior unsecured debt	A-/Stable
Short-term issuer rating	S-1/Stable

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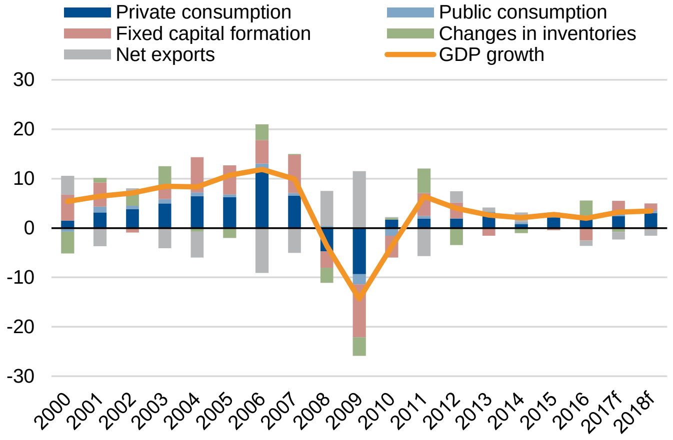
Bloomberg: SCOP

Domestic economic risk

Economic growth is gaining momentum

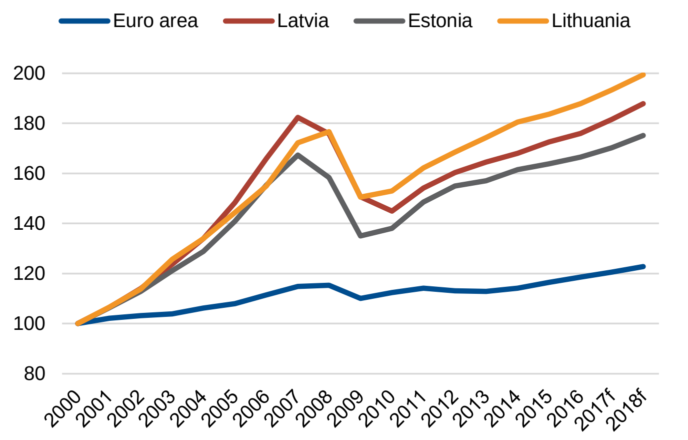
Latvia's economic growth is gaining momentum. Following modest performance in 2016 due to a lower-than-excepted absorption of EU funds, Latvia's GDP growth has accelerated in 2017 driven by strong consumption, exports and a recovery in investment. In the first half of 2017, real GDP grew by 4.0% compared to the previous year. Scope expects the Latvian economy to continue growing vigorously through 2017 and 2018, by around 4% annually. The main drivers of growth include the more active absorption of EU funded investments and robust private consumption buoyed by an upturn in domestic credit and real wages. Despite the recent recovery in the trade balance due to an improvement in the terms of trade, net trade is projected to make a negative contribution to growth in the coming years. The efficient use of EU funds remains key to enhancing economic performance in the medium term.

Figure 2: Percentage-point contribution to real growth



Source: European Commission

Figure 3: Real GDP, 2000=100



Source: European Commission, calculations Scope Ratings AG

Progress with structural reforms

Latvia has progressed with structural reforms. Notably, the country ranks first on actions taken on structural reform priorities of the OECD's 2017 Going for Growth. In July 2017, a tax reform package was introduced proposing modifications to income and excise taxes, aimed at making taxation more equitable and supporting inclusive growth. In Scope's view, the reform is likely to have a positive effect on economic growth. Measures designed to improve the quality of education and reduce administrative and regulatory barriers to business have also been introduced.

Latvia has experienced private-sector deleveraging in the post-crisis period. Private debt has steadily decreased, to around 88% of GDP in 2016, a 46 pp reduction since 2010 (Figure 4). Furthermore, the credit-to-GDP gap[1] stood at -24.3% at the end of 2016, indicating significant space for domestic credit to fuel economic activity. In line with this development, Scope expects credit growth to gain pace over the coming years propelled by improved financial balance sheets of borrowers and decreasing financing costs. Very low inflation of 0.1% owing to low energy and food prices in 2016 is set to rebound to 3% in 2017, driven by increases in real wages and excise taxes, alongside recovering energy prices.

Subdued potential growth rates represent a significant challenge. Over the past three years, potential growth averaged 1.7% and is expected to reach 3.7% in 2018 spurred by

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[1] The credit-to-GDP gap is defined as the difference between the credit-to-GDP ratio and its long-run trend. The credit-to-GDP gap could serve as an early-warning indicator for a banking crisis; it points to the build-up of financial vulnerabilities within an economy.

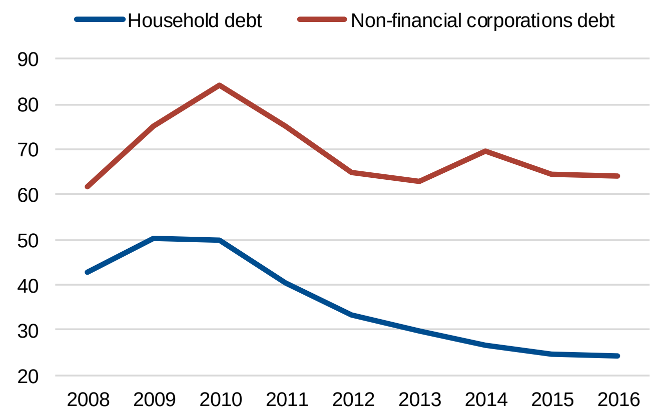
Subdued potential growth rates

productivity gains. However, in the pre-crisis period (2003-2007), potential GDP grew by 7.6% on average on the back of a rapid catch up process from notably lower levels of per capita GDP (Figure 5). This decline in potential growth is mostly due to decreasing capital accumulation, which Scope expects to improve gradually along with the rebound in investment.

The labour market has made a modest recovery with the unemployment rate falling to around 8% in August 2017. The unemployment rate is somewhat higher than that in Estonia (6%) and Lithuania (7.5%), reflecting persistent rigidities in the sector. While the size of the labour force continues to decline (by an annual average of 1% between 2012-2016) as a result of negative demographics and net emigration, labour force participation remains stable, with only a small drop in the first half of 2017. The structural component of unemployment (defined as long-term unemployment as a % of total unemployment) has been on a downward trajectory and is well under the EU average of 45%. Real wage growth was robust in 2016, owing to minimum wage hikes, the declining labour force and demand for high-skilled labour, averaging 4.6%. This is around 2.4% higher than productivity growth and poses a challenge to the price competitiveness of Latvian exports. Nevertheless, the gap between growth in wages and productivity has almost halved since 2013.

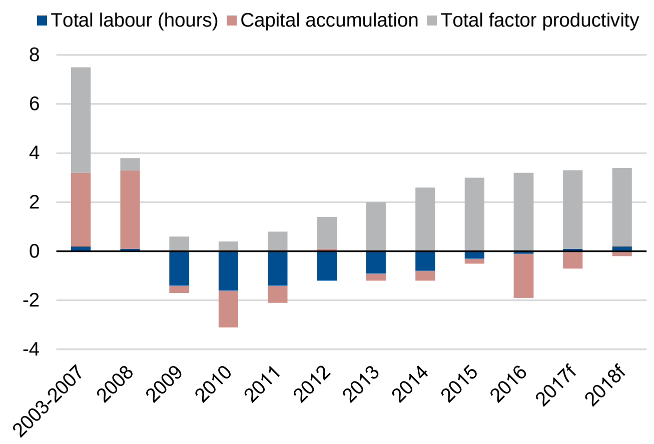
The economy benefits from a favourable business environment and an improving energy infrastructure in the Baltic region following the launch of the Klaipėda liquid natural gas terminal in Lithuania at the end of 2014, decreasing dependence on Russian gas.

Figure 4: Consolidated private-sector debt, % of GDP



Source: European Commission, ECB, Scope Ratings AG

Figure 5: Percentage-point contribution to potential GDP growth



Source: European Commission, ECB

Latvia's A- rating is supported by the country's euro area membership, affording the advantages of a large common market, strong reserve currency, independent European Central Bank (ECB) effectively acting as a lender of last resort, and an economic governance and macro prudential framework supporting credible macroeconomic policies. Scope believes that these are important elements which reflect better protection of Latvia from external shocks, underpinning the sovereign's resilience, effectiveness of policymaking and creditworthiness.

Latvia is a major beneficiary of European Structural and Investment Funds and is expected to receive up to EUR 5.6bn by 2020, making it one of the largest recipients in relation to GDP. Scope notes that Latvia has met the Europe 2020[2] objectives for

[2] The European Union's ten-year jobs and growth strategy, launched in 2010.

employment and is making substantial progress towards reaching targets for renewable energy use. However, progress on R&D intensity remains limited and dependent on EU funds.

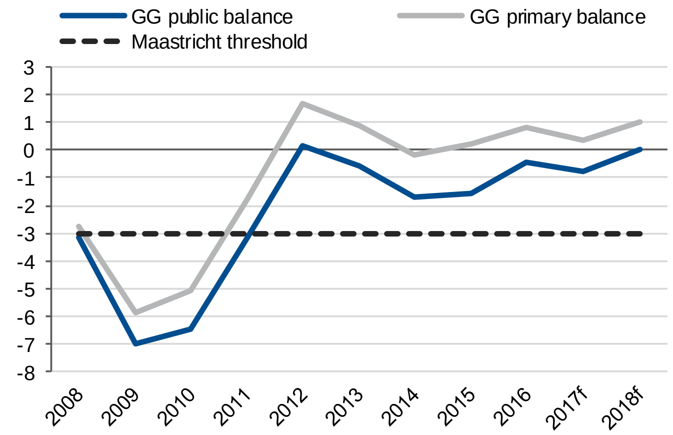
Public finance risk

Latvia has a track record of effective fiscal policy and a prudent fiscal framework, which has contributed to a sizeable reduction in public debt in the post-crisis period.

Adequate fiscal space supported by low indebtedness

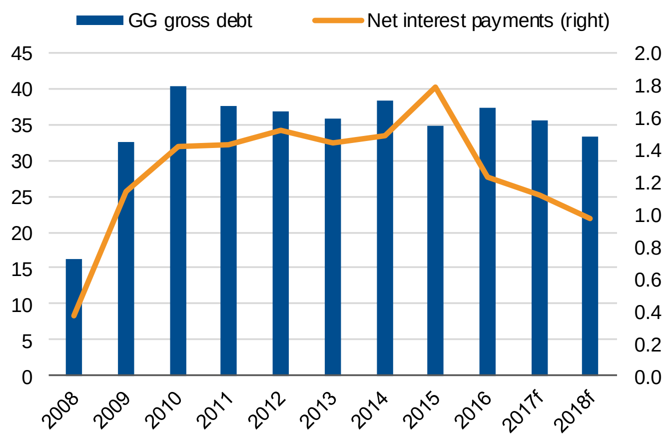
In Scope's opinion, Latvia has adequate fiscal space, supported by low and decreasing levels of debt. In 2016, Latvia recorded a balanced budget, representing a 1.2 pp improvement on the previous year. The primary balance stood at 1.0% of GDP, compared to 0.1% in 2015. This improvement was mostly driven by below-expected levels of expenditures, reflecting lower-than-expected absorption of EU funds, which has delayed public investments. On the other hand, some revenue-enhancing measures, as well as improved tax compliance, have helped to increase total budgetary receipts. Scope considers the drop in public expenditures to be temporary, and expects the headline balance to be -0.8% in 2017 (with a primary balance of 0.3% of GDP), fuelled by an upturn in EU-funded investments.

Figure 6: Budget balances, % of GDP



Source: IMF

Figure 7: Debt and interest payments, % of GDP



Source: IMF, Calculations Scope Ratings AG

Scope assesses Latvia's medium-term public debt dynamics as sound – the result of relative robustness across several scenarios, including a 'stressed scenario' in which Scope stressed the IMF's underlying assumptions with combined financial and economic shocks, including lower economic growth, higher interest payments and fiscal loosening over the projection horizon to 2022 (Figure 9). According to IMF, general government debt stood at 37.2% of GDP in 2016[3]. Scope expects this figure to fall to under 28% by 2022, in line with the IMF's baseline scenario, driven by robust economic performance and low financing costs (interest expenditures relative to GDP are expected to remain at around 1% over this horizon). Unfavourable demographics and the need to improve the quality and accessibility of healthcare are likely to place some pressure on public finances, however. Scope notes that authorities have adopted an indexation of pension growth to 50% of national wage growth to address the issue of low pension levels.

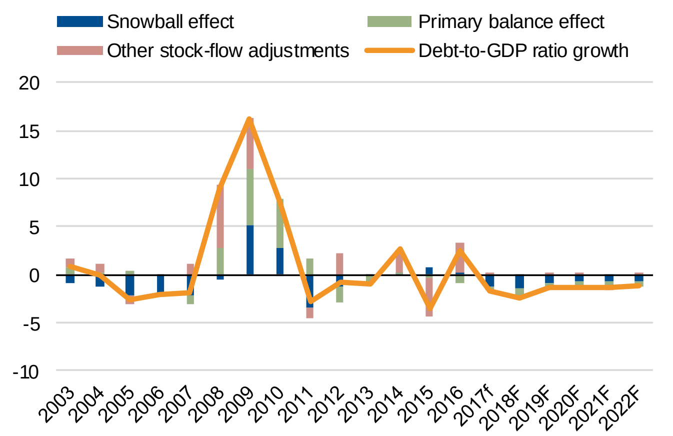
Much-needed tax reform package adopted

In Scope's view, the tax reform package, adopted by parliament in July 2017, is likely to have a positive effect on growth. The package involves modifications to personal income, corporate income and excise taxes in order to lower the tax wedge, stimulate investment

[3] According to eurostat, general government gross debt was 40.6% in 2016.

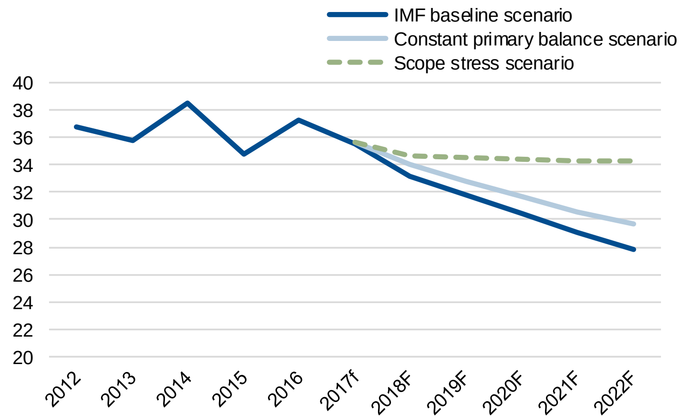
and ensure sufficient budget revenues. The main proposals are: i) the replacement of the current personal income tax rate of 23% with progressive rates of 20%, 23% and 31.4%; ii) an increase in social security contributions by 1 pp to 35.09%; iii) a lower 20% tax on distributed profits (current tax rate for CIT[4] is 15% and dividends are taxed at 10 % PIT[5] rate, resulting in effective tax rate of 23.5% for distributed profits), together with 0% corporate income tax on undistributed (reinvested) profits; iv) a rise in excise duties; and v) the introduction of measures to fight the shadow economy (currently estimated to be around 20.3%[6] of the economy), such as the expansion of the reverse-charging VAT mechanism. The ultimate success of this reform will depend partly on its effective communication to society by authorities.

Figure 8: Contribution to gov't debt changes, % of GDP



Source: IMF, Calculations Scope Ratings AG

Figure 9: General government debt, % of GDP



Source: IMF, Scope Ratings AG

Debt sustainability scenarios, average 2017-2022	Real GDP growth (% change)	Primary balance (% of GDP)	Real eff. interest rate (%)	Debt End Period (% of GDP)
Historical values (2013-16 average)	2.4	0.4	3.0	36.6
IMF baseline	3.4	0.6	0.5	27.8
Constant primary balance scenario	3.4	0.4	0.5	29.6
Scope stress scenario	1.1	0.3	1.4	34.3

Source: Scope Ratings AG

Favourable debt structure, low refinancing risks

Latvia benefits from a favourable public-debt portfolio structure reflected in a large portion of fixed-rate debt (92% of the total stock in Q2 2017) and low financing costs, as the share of debt due within the next 12 months stood at only 11.4% of the total stock in Q2 2017. Debt is mainly issued in local currency (euros), with only 12% in foreign currency. The capital market in Latvia is regionally well-integrated, although it is still relatively small and dominated by government issuance.

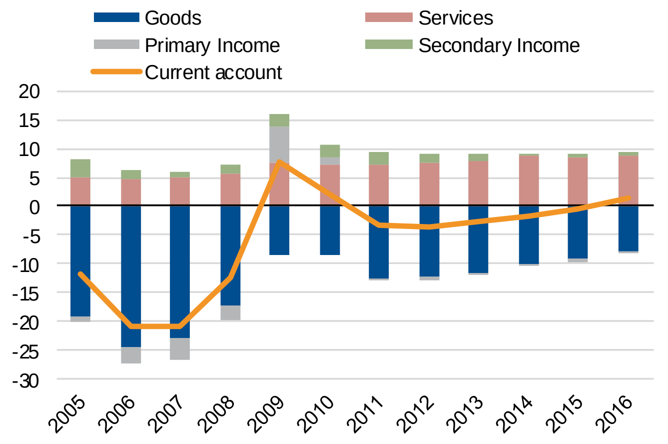
[4] Corporate income tax
[5] Personal income tax
[6] Stockholm School of Economics, 'Shadow Economy Index for the Baltic Countries 2009-2016'.

External economic risk

Latvia's small open economy is vulnerable to external shocks

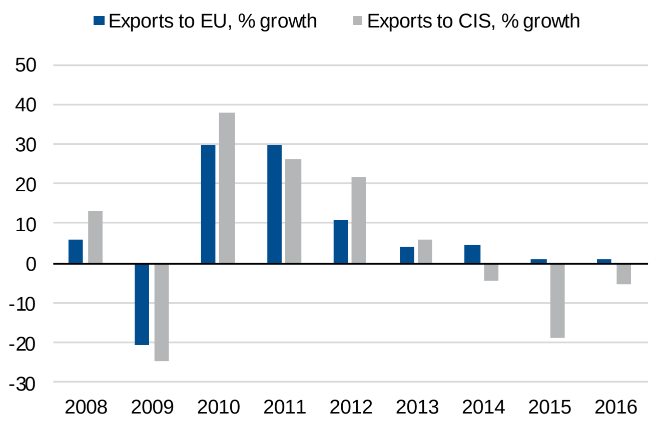
Latvia's small, open economy remains vulnerable to external shocks, and is reliant on external demand, reflected in a large negative net international investment position of around -60% of GDP at the end of 2016. Inward foreign direct investment accounts for 30% of external liabilities, with the financial sector holding the largest share of the foreign direct investment stock.

Figure 10: Composition of current account balance, % of GDP



Source: Eurostat, calculations by Scope Ratings AG

Figure 11: Export performance by destination



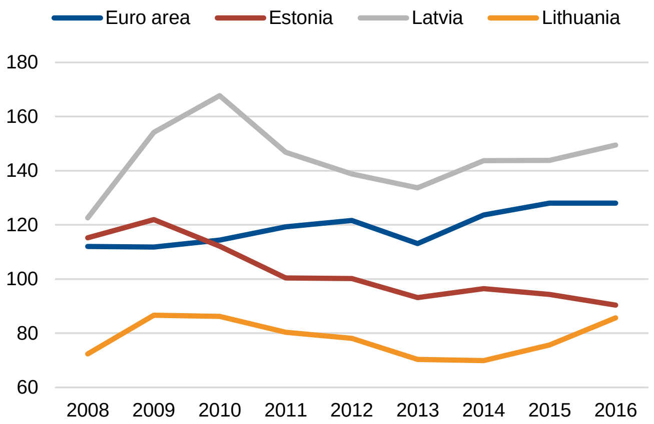
Source: Central Statistical Bureau of Latvia, calculations by Scope Ratings AG

Latvia's current account and trade balances improved in 2016 driven mostly by falling energy prices (the current account balance by 2.3 pp to 1.5% of GDP; the trade balance by 1.4 pp to -7% of GDP). Scope believes that this improvement is temporary, and expects a decline in external balances over the medium term in line with a stabilisation in energy prices. The export base of the economy remains diversified, both in terms of goods and destination markets.

High external debt levels, large share of short-term debt

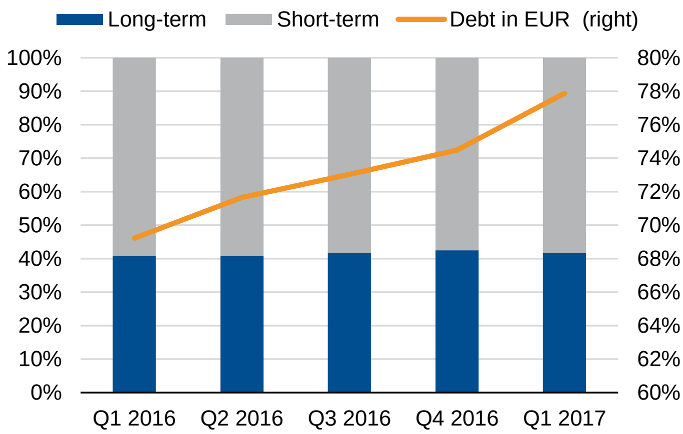
Gross external debt stood at 148.5% of GDP at the end of 2016, around 5 pp higher than the same period in the previous year. This level is materially above Estonia's 91% of GDP and Lithuania's 86% (Figure 13). Much of the external debt represents borrowing from and by banks. About 27% of the stock consists of short-term deposits, leaving the economy vulnerable to shifts in external investor confidence. However, Latvia's external debt is mainly in local currency, with only 22% in foreign currency, bolstering resilience to exchange rate movements. Furthermore, a large share of external liabilities is counterbalanced by external assets, reflected in a significantly lower net external debt position of 28.6% of GDP in 2016.

Figure 12: External debt, % of GDP



Source: ECB, Eurostat, calculations by Scope Ratings AG

Figure 13: Breakdown of external debt position, % of total



Source: IMF, WB, calculations by Scope Ratings AG

Financial stability risk

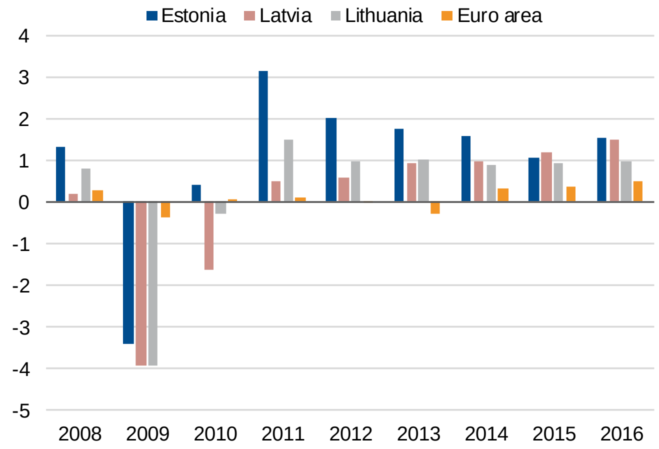
Profitable and well-capitalised banking sector

With assets of around 117% of GDP in 2016, Latvia's banking sector is the largest in the Baltic region. The sector's profitability remained robust over the period of accommodative monetary policy in the euro area. A return on assets of 1.5% (the second highest in the euro area) was well above the euro area average of 0.48% at the end of 2016 (Figure 14). Bank lending spreads have declined slightly over the past months, driven by improvements in the balance sheets of borrowers and tightening competition in the sector. Nevertheless, lending spreads remain among the highest in the euro area.

Large share of non-resident deposits poses risks

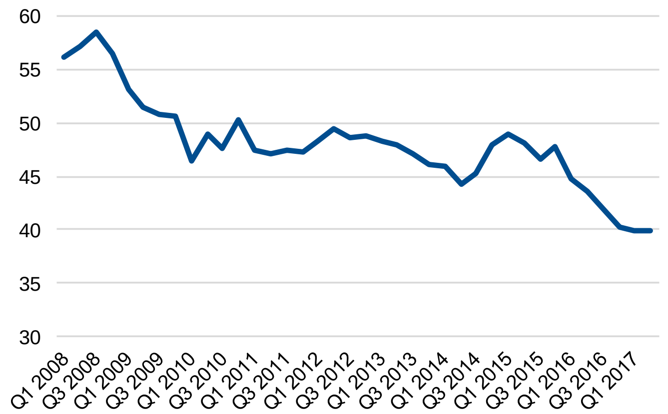
Banks continue to be well-capitalised, reflected in average tier 1 ratios of around 18% over the past three years. Nordic banks dominate the sector and provide most of the credit to the economy. However, the large share of non-resident deposits (mostly from Russia and other CIS countries, and Scandinavian parent bank funding), amounting to 39% of total banking assets (Figure 15) and concentrated in banks servicing foreign clients, poses potential risks. Scope notes that non-resident banks are subject to more stringent capital requirements, and the share of deposits from non-residents has significantly declined since 2015 as a result of regulatory initiatives by the Financial and Capital Market Commission as well as the economic slowdown in Russia.

Figure 14: Return on assets, %



Source: Eurostat, calculations by Scope Ratings AG

Figure 15: Non-resident deposits, % of banking sector assets



Source: Bank of Latvia, calculations by Scope Ratings AG

Institutional and political risk

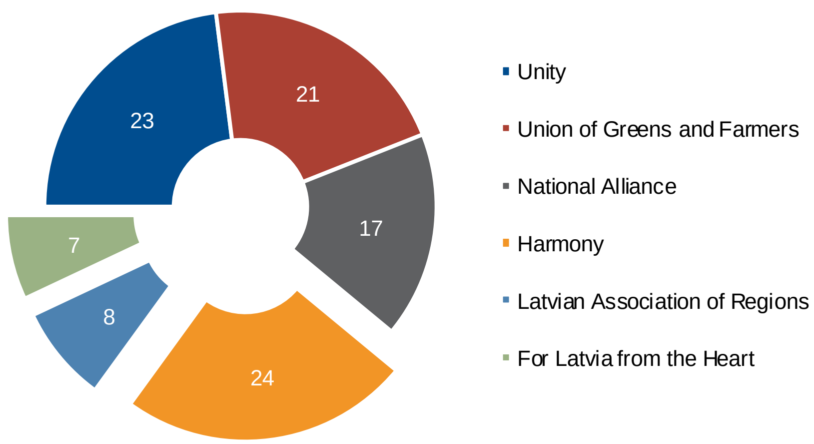
Sound political institutions

Latvia's political system has been characterised by the rule of centre-right, pro-EU parties. Notwithstanding the succession of short-lived governments, policymaking has enjoyed continuity and been able to build upon relatively stable institutions. The current government, led by Māris Kučinskis of the Union of Greens and Farmers (ZZS), took office in February 2016, following the resignation of Laimdota Straujuma of the Unity party due to intra-coalition divisions. Since then, the coalition has remained unchanged and includes the ZZS, Unity and the National Alliance (NA). The government's agenda includes plans to improve the health and education systems, enhance the investment environment, promote border security and cooperation with NATO forces, and protect Latvian interests in Brexit negotiations.

Scope views Latvia's accession to the OECD (on 1 July 2016) positively. Membership could make the country more attractive to investors as well as improve economic prospects. The compliance process for Latvian adherence to OECD principles has already brought significant benefits in the field of state-owned enterprise management.

Scope expects the dominance of the centre-right to continue following the 2018 parliamentary elections.

Figure 16: Political party representation in the parliament (Saeima)



Source: Central Election Commission of Latvia

Methodology

The methodology applicable for this rating and/or rating outlook, 'Public Finance Sovereign Ratings', is available at www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on at https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA.

Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA) at http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

A comprehensive clarification of Scope's definition of default and definitions of rating notations can be found in Scope's public credit rating methodologies at www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is not automatically ensured, however.

I. Appendix: CVS and QS results

Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on the relative rankings of key sovereign credit fundamentals, signals an indicative "A" ("a") rating range for Latvia. This indicative rating range can be adjusted by up to three notches on the Qualitative Scorecard (QS) depending on the size of relative credit strengths or weaknesses versus peers based on analysts' qualitative findings.

For Latvia, the QS signals relative credit strengths for the following analytical categories: i) debt sustainability. Relative credit weaknesses are signalled for: i) macroeconomic stability and imbalances; ii) external debt sustainability; iii) vulnerability to short-term external shocks; iv) geo-political risks; and v) macro-financial vulnerabilities and fragility. Relative credit strengths and weaknesses generate a downward adjustment of one notch and signal a sovereign rating of A- for Latvia. The results have been discussed and confirmed by a rating committee.

Rating overview

CVS category rating range	a
QS adjustment	A-
Final rating	A-

To calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 22 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest rating score. The score result translates to an indicative rating range that is always presented in lower-case.

Within the QS assessment, analysts conduct a comprehensive review of the qualitative factors. This includes but is not limited to economic scenario analysis, a review of debt sustainability, fiscal and financial performance assessments, and policy implementation assessments.

There are three assessments per category for a total of 15. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment, which is the basis for the analysts' recommendation to the rating committee.

Foreign- versus local-currency ratings

Latvia's debt is predominantly issued in euros. Because of its history of openness to trade and capital flows, and the euro's reserve currency status, Scope sees no evidence that Latvia would differentiate among any of its contractual debt obligations based on currency denomination.

II. Appendix: CVS and QS results

CVS

Rating indicator	Category weight
Domestic economic risk	**35%**
Economic growth	
Real GDP growth	
Real GDP volatility	
GDP per capita	
Inflation rate	
Labour & population	
Unemployment rate	
Population growth	
Public finance risk	**30%**
Fiscal balance	
GG public balance	
GG primary balance	
GG gross financing needs	
Public debt	
GG net debt	
Interest payments	
External economic risk	**15%**
International position	
International investment position	
Importance of currency	
Current-account financing	
Current-account balance	
T-W effective exchange rate	
Total external debt	
Institutional and political risk	**10%**
Control of corruption	
Voice & accountability	
Rule of law	
Financial risk	**10%**
Non-performing loans	
Liquid assets	
Credit-to-GDP gap	
Indicative rating range	**a**
QS adjustment	**A-**
Final rating	**A-**

QS

Maximum adjustment = 3 notches

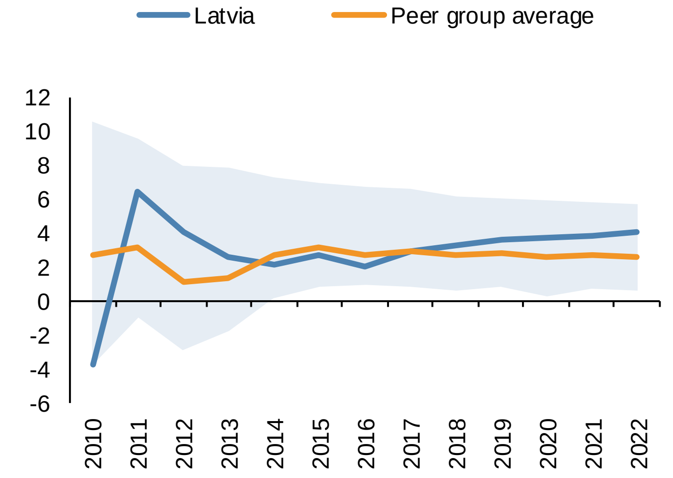
	+2 notch	+1 notch	0 notch	-1 notch	-2 notch
Growth potential of the economy	○ Excellent outlook, strong growth potential	○ Strong outlook, good growth potential	◉ Neutral	○ Weak outlook, growth potential under trend	○ Very weak outlook, growth potential well under trend or negative
Economic policy framework	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Macroeconomic stability and imbalances	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Fiscal performance	○ Exceptionally strong performance	○ Strong performance	◉ Neutral	○ Weak performance	○ Problematic performance
Debt sustainability	○ Exceptionally strong sustainability	◉ Strong sustainability	○ Neutral	○ Weak sustainability	○ Not sustainable
Market access and funding sources	○ Excellent access	○ Very good access	◉ Neutral	○ Poor access	○ Very weak access
Current-account vulnerabilities	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
External debt sustainability	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Vulnerability to short-term shocks	○ Excellent resilience	○ Good resilience	○ Neutral	◉ Vulnerable to shock	○ Strongly vulnerable to shocks
Perceived willingness to pay	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Recent events and policy decisions	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Geo-political risk	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Financial sector performance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Financial sector oversight and governance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Macro-financial vulnerabilities and fragility	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate

* Implied QS notch adjustment = (QS notch adjustment for domestic economic risk)*0.35 + (QS notch adjustment for public finance risk)*0.30 + (QS notch adjustment for external economic risk)*0.15 + (QS notch adjustment for institutional and political risk)*0.10 + (QS notch adjustment for financial stability risk)*0.10

Source: Scope Ratings AG

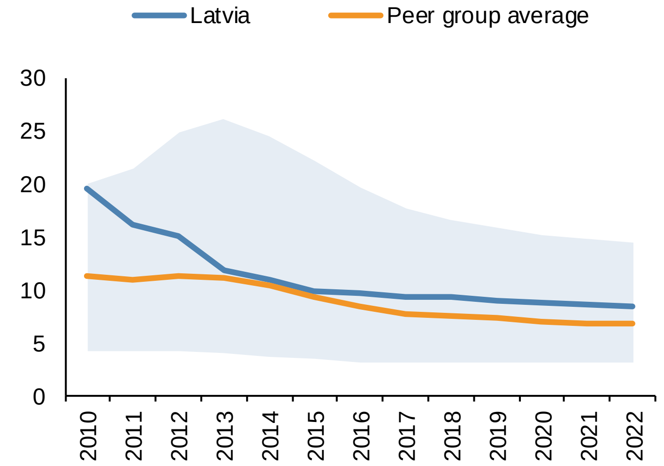
III. Appendix: Peer comparison

Figure 17: Real GDP growth



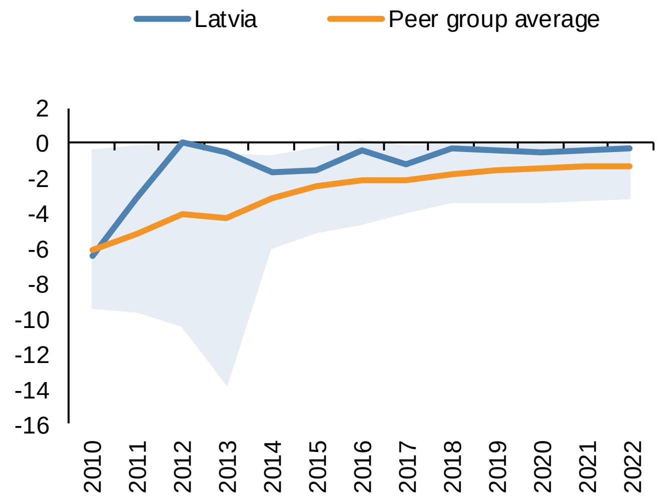
Source: IMF, Calculations Scope Ratings AG

Figure 18: Unemployment rate, % of total labour force



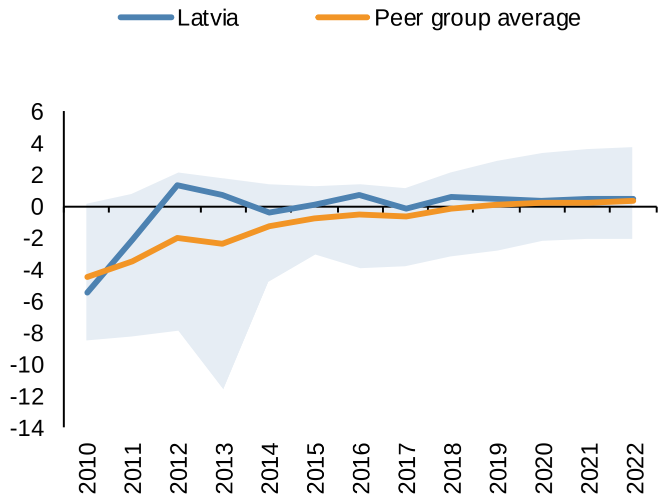
Source: IMF, Calculations Scope Ratings AG

Figure 19: General government balance, % of GDP



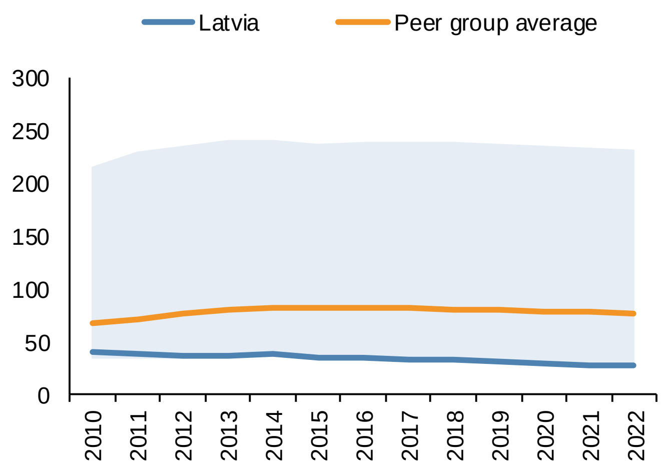
Source: IMF, Calculations Scope Ratings AG

Figure 20: General government primary balance, % of GDP



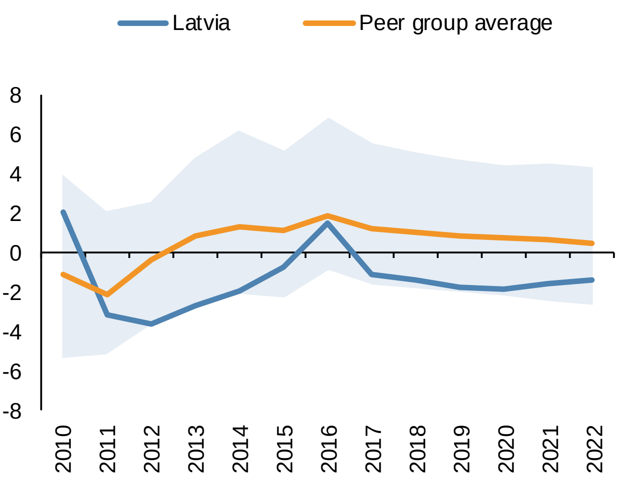
Source: IMF, Calculations Scope Ratings AG

Figure 21: General government gross debt, % of GDP



Source: IMF, Calculations Scope Ratings AG

Figure 22: Current account balance, % of GDP



Source: IMF, Calculations Scope Ratings AG

IV. Appendix: Statistical tables

	2012	2013	2014	2015	2016	2017E	2018F
Economic performance							
Nominal GDP (EUR bn)	21.9	22.8	23.6	24.4	25.0	26.8	28.6
Population ('000s)	2,045.0	2,024.0	2,001.0	1,986.0	1,969.0	1,959.0	1,953.0
GDP-per-capita PPP (USD)	21,252.7	22,696.8	23,907.7	24,919.5	26,031.0	-	-
GDP per capita (EUR)	10,703.0	11,259.1	11,806.9	12,269.4	12,707.9	13,657.4	14,656.0
Real GDP growth, % change	4.0	2.6	2.1	2.7	2.0	3.8	3.9
GDP growth volatility (10-year rolling SD)	8.4	8.3	8.1	7.6	6.7	6.0	6.0
CPI, % change	2.3	0.0	0.7	0.2	0.1	3.0	3.0
Unemployment rate (%)	15.0	11.9	10.8	9.9	9.6	9.0	8.7
Investment (% of GDP)	26.2	23.9	23.2	22.1	19.9	21.2	22.6
Gross national savings (% of GDP)	22.6	21.2	21.2	21.3	21.4	20.9	21.1
Public finances							
Net lending/borrowing (% of GDP)	-1,2	-1,0	-1,2	-1,2	0,0	-0.8	-1.8
Primary net lending/borrowing (% of GDP)	0,5	0,5	0,2	0,1	1,0	0.3	-0.8
Revenue (% of GDP)	36,8	36,8	37,1	37,3	37,4	37.2	37.9
Expenditure (% of GDP)	38,0	37,7	38,3	38,5	37,4	36.5	36.2
Interest payments (% of GDP)	1,7	1,5	1,4	1,3	1,0	1.0	0.9
Interest payments (% of revenue)	4.5	4.1	4.0	3.7	3.1	2.7	2.4
Gross debt (% of GDP)	41.2	39.0	40.9	36.9	40.6	39.5	37.0
Net debt (% of GDP)	24.2	26.0	27.7	29.7	28.6	27.6	25.8
Gross debt (% of revenue)	113.6	108.6	113.8	102.1	110.4	106.2	97.6
External vulnerability							
Gross external debt (% of GDP)	138.2	133.9	144.0	143.3	148.2	-	-
Net external debt (% of GDP)	39.5	36.4	33.6	29.2	28.8	-	-
Current-account balance (% of GDP)	-3.6	-2.7	-2.0	-0.8	1.5	-0.3	-1.5
Trade balance [FOB] (% of GDP)	-	-11.1	-9.3	-8.4	-7.0	-8.9	-10.5
Net direct investment (% of GDP)	-3.3	-1.6	-1.2	-2.6	0.0	-	-
Official forex reserves (EOP, Mil.USD)	5,684.1	5,783.2	2,658.4	3,165.1	3,334.5	-	-
REER, % change	-1.7	-0.9	2.8	1.1	1.2	-	-
Nominal exchange rate (EOP, USD/EUR)	1.3	1.4	1.2	1.1	1.1	-	-
Financial stability							
Non-performing loans (% of total loans)	7.9	5.6	7.7	5.1	5.2	-	-
Tier 1 Ratio (%)	14.5	16.5	17.5	19.0	17.3	-	-
Consolidated private debt (% of GDP)	97.9	92.4	96.0	88.8	88.3	-	-
Domestic credit-to-GDP gap (%)	-30.7	-32.7	-35.2	-28.0	-24.3	-	-

Source: IMF, European Commission, European Central Bank, The Bank of Latvia, Central Statistical Bureau of Latvia, World Bank, Scope Ratings AG.

V. Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings AG.

Rating prepared by John Francis Opie, Lead Analyst.

Person responsible for approval of the rating: Dr Stefan Bund, Chief Analytical Officer.

The ratings/outlook were first assigned by Scope as a subscription rating in January 2003. The subscription ratings/outlooks were last updated on 05.05.2017.

The senior unsecured debt ratings as well as the short-term issuer ratings were assigned by Scope for the first time.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on Latvia are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Sovereign Ratings Calendar of 2017" published on 21.07.2017 on www.scoperatings.com). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the deviation was due to the recent revision of Scope's Sovereign Rating Methodology and the subsequent placement of ratings under review, in order to conclude the review and disclose ratings in a timely manner, as required by Article 10(1) of the CRA Regulation.

The main points discussed by the rating committee were: (1) Latvia's growth potential and outlook, (2) demographics and productivity growth, (3) public finance performance and debt sustainability, (4) external position and resilience, (5) economic imbalances and structural reforms, (6) financial sector performance, (7) recent geo-political developments, (8) peer considerations.

Solicitation, key sources and quality of information

The rating was initiated by Scope and was not requested by the rated entity or its agents. The rated entity and/or its agents did not participate in the ratings process. Scope had no access to accounts, management and/or other relevant internal documents for the rated entity or related third party.

The following material sources of information were used to prepare the credit rating: public domain and third parties. Key sources of information for the rating include: The Bank of Latvia, Central Statistical Bureau of Latvia (CSB), Ministry of Finance of Latvia, European Commission, Eurostat, ECB, IMF, OECD, WB and Haver Analytics.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds upon which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

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