Republic of Lithuania
Rating Report

A — STABLE OUTLOOK

Credit strengths

- Sound institutional set-up underpinned by euro area and NATO memberships
- Improved economic resilience; solid medium-run growth prospects
- Moderate public debt

Credit challenges

- Moderate income levels
- Exposure to external shocks
- Adverse demographic trends
- Financial spill-over risks

Rating rationale:

Sound institutions: Lithuania's effective policymaking is underpinned by its euro area and NATO memberships, which ensure a robust framework for fiscal and economic policy and banking supervision. They also strongly mitigate external security risks in the context of the heightened geopolitical tensions.

Solid growth prospects: the country's solid economic growth and improved macroeconomic resilience has favoured a rapid convergence to euro area income levels over the past years. Despite a significant hit from the energy crisis, we expect the economy to grow by 0.5% and 2.8% this and next year, respectively, before converging towards an estimated potential growth of 2.5%.

Moderate public debt: Lithuania's record of prudent fiscal policies has resulted in the country having one of the lowest debt-to-GDP ratios in the euro area, at 38.4% by end-2022. Contained deficits and resilient growth should keep the debt ratio moderate in the medium run.

Rating challenges include: i) moderate income levels despite continued convergence over the past decades; ii) the exposure to external shocks given the small size and openness of the economy; iii) adverse demographic trends that increase labour shortages and fiscal pressures; and iv) financial sector risks related to the dependence on Nordic banks and elevated cross-border financial flows.

Lithuania's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	bbb-	EUR [+1]	0	A
Public Finance Risk		20%	aa		0	
External Economic Risk		10%	b		0	
Financial Stability Risk		10%	aaa		0	
ESG Risk	Environmental Factors	5%	aa+		0	
	Social Factors	7.5%	b-		0	
	Governance Factors	12.5%	aa-		0	
Indicative outcome		**a**			**0**	
Additional considerations					**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's Sovereign Rating Methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook represents our view that risks to Lithuania's ratings over the next 12 to 18 months are balanced.

Positive rating-change drivers

- Geopolitical risks in the region declining
- Solid economic growth and income convergence continuing through structural reform and investment
- Debt-to-GDP being anchored to moderate levels thanks to broadly balanced government finances
- External and financial sector vulnerabilities continuing to decline

Negative rating-change drivers

- Fiscal fundamentals weakening, leading to a significant increase in debt-to-GDP
- Macroeconomic imbalances increasing, weakening growth prospects
- External and financial sector vulnerabilities increasing substantially
- Heightened geopolitical risks undermining macroeconomic stability

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: RESP SCOP

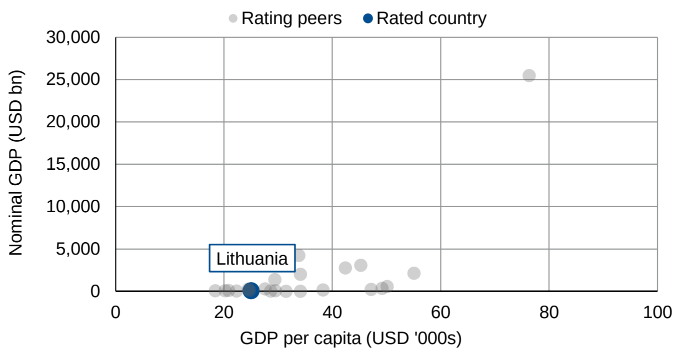
Domestic Economic Risks

- **Growth outlook:** Lithuania's economy proved remarkably resilient to the Covid-19 pandemic. In 2021 and 2022, GDP grew by 6.0% and 1.9%, respectively, and did not contract (0%) in 2020. However, the economy slowdown was significant last year. Growth was mostly driven by carryover effects, while average quarterly growth was negative (-0.1%) driven by weaker private consumption and net exports. Tightening financing conditions will further weigh on growth in 2023. At the same time, energy prices are declining while the deployment of EU funds will support investment, which should help avert a recession, though a rapid rebound is unlikely. Scope expects GDP growth of 0.5% and 2.8% in 2023 and 2024. In the medium-term, we estimate a growth potential of about 2.5% for Lithuania, underpinned by ample access to EU funds, exceeding 22% of (2021) GDP over 2021-27 (Recovery and Resilience Facility, Cohesion and Common Agricultural Policy). Also, the Lithuanian economy benefits from sound economic policies and an attractive business environment set to support continued convergence to euro area income and productivity levels.
- **Inflation and monetary policy:** Lithuania, along with the other Baltic states, is heavily affected by the exceptional inflationary pressures owing to the large share of energy and food items in its consumption basket and the deregulation of gas and electricity markets. A normalisation over the coming months is likely following the marked decline in energy prices and the rapid tightening of monetary policy. The harmonised inflation rate stood at 15.2% in March 2023, down from the peak of 22.5% in September 2022. Core inflation is also declining, though from high levels (above 12%) and at a moderate pace. We expect price pressures to ebb rapidly this year, with annual inflation declining to about 9.0% from 18.9% in 2022 and then approaching the ECB's 2% target in 2024-2025. The ECB is tightening monetary policy, with rate hikes of 350 bp since July 2022, on top of the halt of net asset purchases under quantitative easing.
- **Labour market:** Employment was at a record high in Q4 2022, counting over 1.4m workers. This was supported by record net migration, mainly from Ukrainian refugees, who were swiftly integrated into the labour market. Participation remains high, with the active population at close to 80% of the labour force, while the unemployment rate remains moderate at 6.5%. As economic growth will remain subdued, Scope expects the unemployment rate to stabilise at an average of 6.5% in 2023-2024. Despite favourable aspects including flexibility and wide participation, Lithuania's labour market faces labour and skill shortages. This is not only an obstacle to growth but is also fuelling wage growth, at double digits over recent years.

Overview of Scope's qualitative assessments for Lithuania's *Domestic Economic Risks*

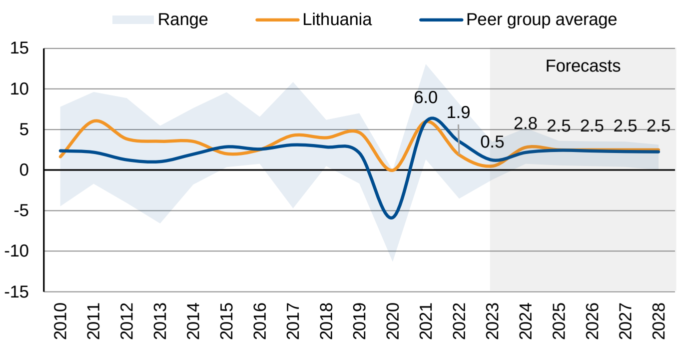
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Growth potential of the economy	Neutral	0	Robust economic prospects supported by EU funds, although adverse demographic trends are a challenge
	Monetary policy framework	Neutral	0	ECB is a credible and effective central bank
	Macro-economic stability and sustainability	Neutral	0	Improved macroeconomic resilience and flexible labour market, but labour shortages, overheating risks and large regional disparities

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

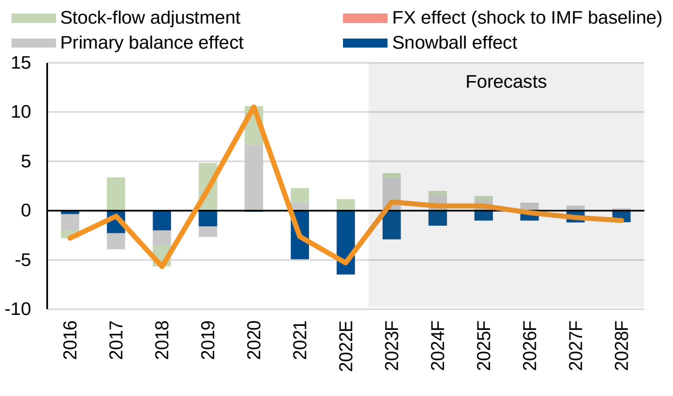
Public Finance Risks

- **Fiscal outlook:** The Lithuanian government has a record of solid fiscal performance before Covid-19, with consistent budget surpluses. The budget recovery from the pandemic was rapid: the deficit narrowed to 1.2% of GDP in 2021 from 6.5% of GDP in 2020. While the 2022 deficit was contained to just 0.6% of GDP, the combined impact of the war and cost-of-living shock is likely to keep the budget in deficit over the coming years. This year we expect about 1pp of GDP outperformance against the budget target of -4.9% of GDP, given energy support measures are unlikely to be used in full. We also expect a rapid recovery in 2024-25 as about half of the 2023 deficit refers to temporary measures. The government budget would then converge to a 1% of GDP deficit by 2028, although low social spending amid high inflation and the burden of an ageing population could slow consolidation further. The government is reforming budgetary processes to strengthen collection and the effectiveness of public spending, given a still sizeable shadow economy and restricted tax base.
- **Debt trajectory:** We anticipate that general government debt will initially slightly increase to 39.5% of GDP this year, or just 3.5 pp above the level before Covid-19. The public debt ratio should then stabilise at about 40% of GDP in 2024-2026 and then slightly decline to 38.5% by 2028. According to our estimates, Lithuania will preserve strong debt affordability vis-à-vis peers despite the high interest rate environment. The debt ratio would remain below the EU's 60% Maastricht threshold even under an adverse scenario incorporating weaker economic growth and fiscal consolidation. Over the long run, Lithuania faces mounting fiscal pressures from unfavourable demographic dynamics, however. The IMF estimates the present value of changes in healthcare and pension spending through to 2050 at over 60% of GDP.
- **Debt profile and market access:** Lithuania's prudent policy limits on debt management are reflected in its low-risk debt profile. The average maturity of its debt portfolio is high at nine years and almost all of Lithuania's debt is at fixed rates. The Treasury can issue at favourable terms in domestic and international capital markets, although yields have markedly increased since last year. Lithuania also has access to EU funding and recently announced plans to request additional loans totalling EUR 1.8bn under the NGEU programme. Government borrowing needs will remain moderate at around 5-8% of GDP annually over the coming years. Prudent liquidity management including pre-funding and an ample cash buffer further mitigate risks in the current volatile environment.

Overview of Scope's qualitative assessments for Lithuania's *Public Finance Risks*

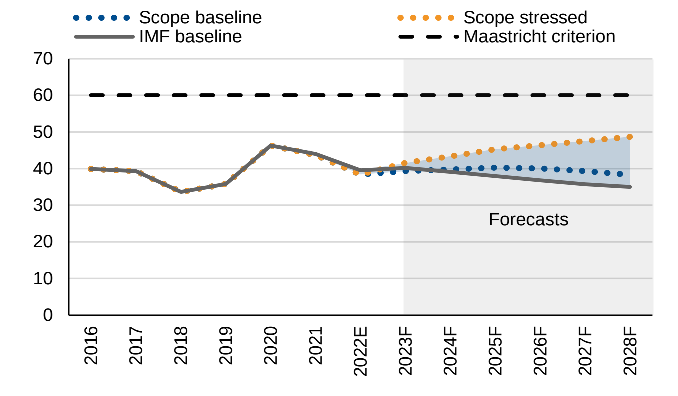
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Fiscal policy framework	Neutral	0	Track record of fiscal prudence, but sizeable shadow economy and restricted tax base
	Debt sustainability	Neutral	0	Moderate debt; stabilization and gradual fall of the debt ratio in the medium run
	Debt profile and market access	Neutral	0	Prudent debt management, low funding needs, ability to issue on favourable terms

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

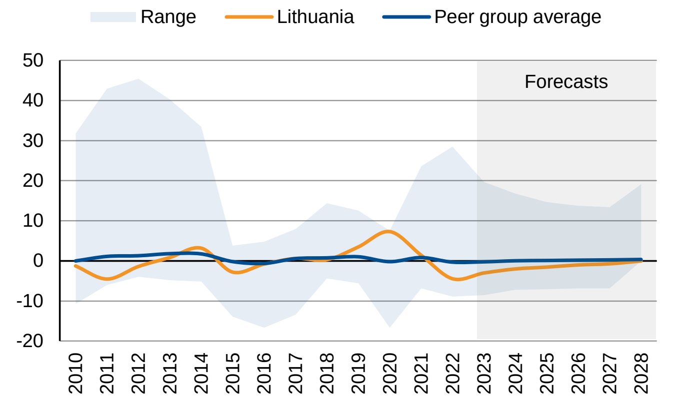
External Economic Risks

- **Current account:** Lithuania has gained global export market share over the past years, thanks to improvements in the value-added structure of its exports. The decreasing importance of trade with Russia has mitigated the impact of trade sanctions on Lithuania, as most exports to the country were re-exports already before the war escalated. The current account, however, deteriorated significantly last year, following the surge in commodity prices, and turned to a 5.1% of GDP deficit, from a 1.1% surplus in 2021. In the coming years, we expect the current account to recover but remain in deficit of 2-3% of GDP due to persistent pressures from elevated energy and commodity prices. The ongoing economic shift from lower value-added export sectors to the more technology- and knowledge-intensive sectors of information, technology and cyber security and financial services should support a rebalancing of the current account in the medium term. Still, the very high inflation of current years could cause permanent weakening in external competitiveness.
- **External position:** Lithuania's net international investment position improved to -6.6% of GDP last year from below -40% in 2017. The country's external debt stood at 67.8% of GDP last year, one of the lowest in the euro area, down 15 pp from five years ago. Around 45% of external liabilities relate to inward foreign direct investment, which curbs the risk of sudden capital flows in times of global stress and enhances the long-term sustainability of the external position.
- **Resilience to shocks:** Lithuania's small, open economy remains vulnerable to external shocks due to large export and import sectors, each representing close to 90% of GDP. The Russia-Ukraine war is having significant direct and indirect negative impacts on the country's economy, primarily due to shortages in raw materials and weaker growth in main trading partners. At the same time, we do not expect the conflict to cause permanent economic scarring, thanks to the continued improvement of Lithuania's energy security, which has allowed a rapid substitution of Russian energy imports. Further, the connection of the Baltic states' and continental Europe's electricity networks is due for completion by 2025, with synchronisation under emergencies already possible. Lithuania benefits from the euro's status as an international reserve currency, significantly mitigating risk from currency sell-off and sudden stops of capital flows.

Overview of Scope's qualitative assessments for Lithuania's *External Economic Risks*

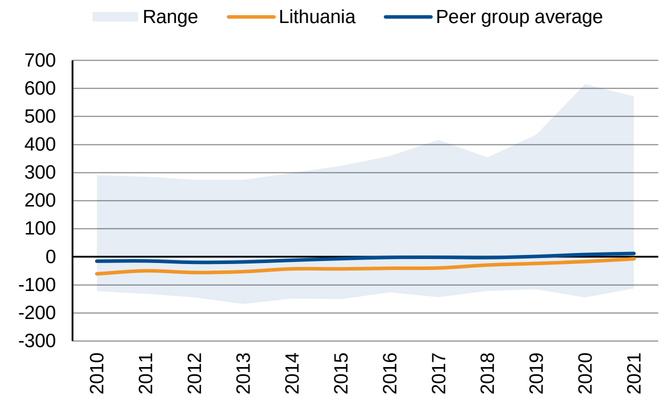
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Current account resilience	Neutral	0	Risks from reliance on low value-added export sectors, though competitiveness and diversification are improving
	External debt structure	Neutral	0	Falling levels of net external debt, sizeable share of foreign direct investments in external liabilities
	Resilience to short-term external shocks	Neutral	0	Small and open economy; euro-area membership mitigates exposure to international markets

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

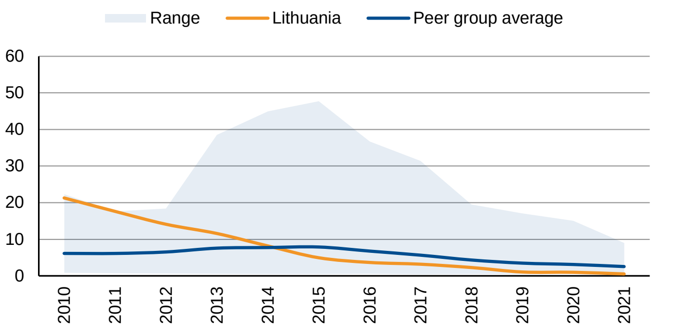
Financial Stability Risks

- **Banking sector:** Lithuania's Nordic-dominated banking sector presents limited contingent risk to the government balance sheet. The sector's resilience is underpinned by comfortable capitalisation and liquidity, with CET 1 and liquidity coverage ratios of 18.8% and 390.7%, respectively, in Q4 2022, as reported by the EBA. Profitability is also strong, although somewhat weaker than before the pandemic, as reflected in an average aggregate return on equity ratio of 9.6% in Q1-Q4 2022. Strong asset quality, with a non-performing loan ratio of 0.5%, and low cost-to-income ratios should support the resilience of Lithuania's financial institutions over the coming years, although the weaker economic outlook and rising uncertainties in the global banking sector following rapid monetary policy normalisation represent risks. Lithuania has also a dynamic fintech sector, one of the largest in the EU, which fosters innovation in the industry, though also requires continued efforts in oversight.
- **Private debt:** Private sector indebtedness is low relative to euro area peers. Household and corporate debt stood at 22.0% and 40.0% of GDP, respectively, as of Q4 2022. Total private debt is thus just above 62% of GDP, against 163% for the euro area. Still, households and businesses are exposed to interest rate risks, because almost 90% (on average) of new loans since 2015 were on variable rate terms. Debt service ratios are thus expected to increase with the ECB's tightening of monetary policy, but we expect the overall burden to be manageable thanks to the low debt-to-income ratio of Lithuanian households (about 44%), one of the lowest in the EU. Low private debt also reflects obstacles in access to finance, in particular for SMEs.
- **Financial imbalances:** Lithuania's banking sector is exposed to concentration and spill-over risks due to its integration with Nordic and Baltic banking systems. Two Swedish banking groups, Swedbank and SEB, account for over half of Lithuanian bank assets. Capital flight and cross-border money-laundering risks are reduced by the moderate share of non-euro area foreign deposits (8.1% of total). Deposits from residents of other euro area countries have, however, rapidly increased since last year, to over 16%, following the relocation of financial institutions from the UK due to Brexit and as a consequence of the rapidly growing fintech industry. These trends require a continued upgrade of anti-money laundering policies. The boom in residential real estate resulted in rapid price growth in the years leading up to the Covid-19 pandemic. After rising throughout the Covid-19 crisis, we expect price dynamics to moderate as a result of tightening financing conditions and the central bank's roll-out of macro-prudential measures, including lower limits to loan-to-value ratios.

Overview of Scope's qualitative assessments for Lithuania's *Financial Stability Risks*

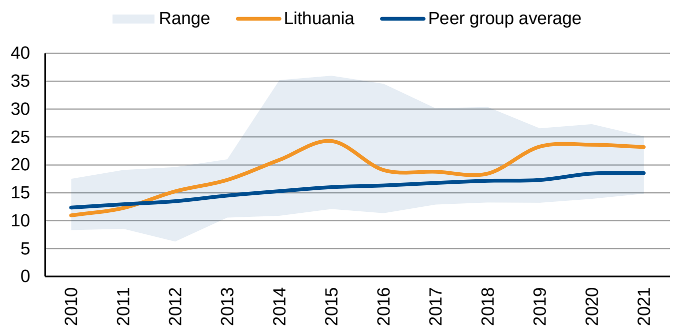
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Well-capitalised and profitable banking sector
	Banking sector oversight	Neutral	0	Oversight under the Bank of Lithuania and the ECB as part of Banking Union
	Financial imbalances	Neutral	0	Concentration and spill-over risks from dominant Nordic banking groups; elevated cross-country financing flows; low private debt

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

ESG Risks

- **Environment:** Lithuania has progressed well in the development of renewable energy. The share of energy from renewable sources in gross final energy consumption exceeded 28% in 2021, higher than the EU average of below 19%. Lithuania has an ambitious plan to increase this share to 50% by 2030. By that year, renewables would cover 70% of electricity production. However, reducing the carbon footprint of the economy has proved challenging in recent years, especially due to rising emissions in the transport sector. Also, resource productivity and the circular economy rate lag the EU average and require further policies and investments. Lithuania has dedicated 38% of its Recovery and Resilience Plan to climate actions and will allocate the resources to upgrade its building stock, enhance the sustainability of the transport sector and further develop renewable energy.

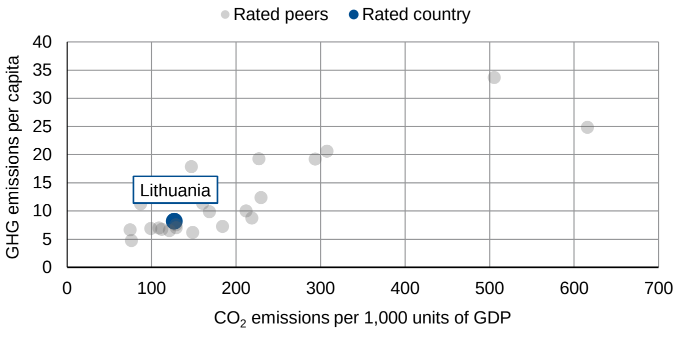
- **Social:** Lithuania's performance across key social factors is mixed. The country's labour market is inclusive, with high labour-force participation rates and a nil gender employment gap. Still, income inequality is high (quintile share ratio of above six) and poverty risks, while declining, are above the EU average, with 24% of the population at risk of poverty or social exclusion. The European Commission's Digital Economy and Society Index 2022 assessing digital competitiveness ranks Lithuania as median (14th) among the 27 EU member states. Adverse demographics are a challenge. Lithuania's working-age population is projected to decline by close to 30% over the next 20 years; at that point the old-age dependency ratio would approach 50.

- **Governance:** Policymaking in Lithuania has largely been effective and enjoyed relative continuity. Lithuania's EU and euro area memberships enhance the quality of macroeconomic policies and its macroprudential framework. The centre-right coalition government led by Prime Minister Ingrida Šimonytė took office in 2020, with next parliamentary elections due in 2024. External security risks for Lithuania have increased since the escalation of the war in Ukraine. However, we believe that Lithuania's and other Baltic states' NATO memberships strongly limit the risk that the conflict could expand into the Baltic region. Both NATO and Lithuania have continually confirmed their commitments to Article 5, which states that if one member of the Alliance is subject to an armed attack, other members will consider this as an armed attack against all members and provide necessary support.

Overview of Scope's qualitative assessments for Lithuania's *ESG Risks*

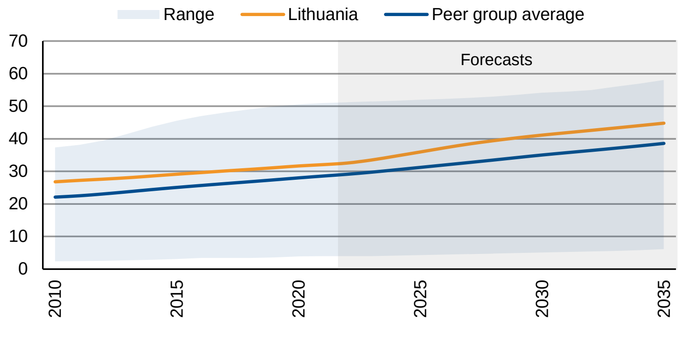
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Environmental factors	Neutral	0	Transition risks in line with peers, ambitious climate agenda
	Social factors	Neutral	0	Improving social indicators and inclusive labour market, adverse demographics
	Governance factors	Neutral	0	Stable institutional set-up, supported by EU and euro area memberships; external security risks mitigated by NATO membership

Emissions per GDP and per capita, $mtCO_2e$



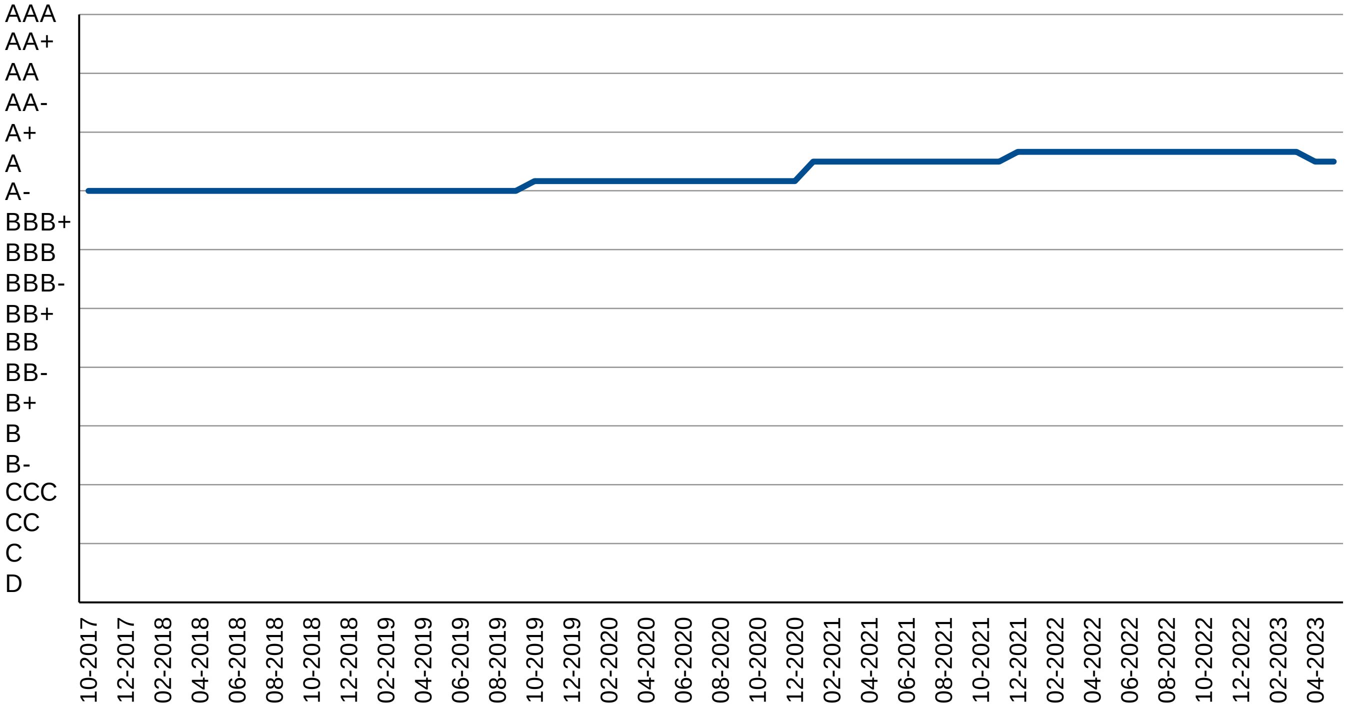
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Belgium
Croatia
Cyprus
Czech Republic
Estonia
France
Italy
Japan
Latvia
Malta
Portugal
Slovakia
Slovenia
Spain
United Kingdom
United States

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022	2023
Domestic Economic	**GDP per capita, USD '000s**	IMF	19.2	19.6	20.3	23.7	25.0	28.1
	Nominal GDP, USD bn	IMF	53.8	54.8	56.8	66.5	70.5	78.3
	Real growth, %	IMF	4.0	4.6	0.0	6.0	1.9	-0.3
	CPI inflation, %	IMF	2.5	2.2	1.1	4.6	18.9	10.5
	Unemployment rate, %	WB	6.2	6.3	8.5	7.1	-	-
Public Finance	**Public debt, % of GDP**	IMF	33.7	35.8	46.3	44.0	39.6	40.2
	Interest payment, % of revenue	IMF	2.8	2.3	1.7	0.7	-0.2	0.7
	Primary balance, % of GDP	IMF	1.5	1.1	-6.6	-0.7	-0.9	-4.2
External Economic	**Current account balance, % of GDP**	IMF	0.3	3.5	7.3	1.4	-4.5	-3.0
	Total reserves, months of imports	IMF	1.6	1.4	1.5	1.2	-	-
	NIIP, % of GDP	IMF	-29.2	-23.6	-16.8	-7.1	-	-
Financial Stability	**NPL ratio, % of total loans**	IMF	2.3	1.0	1.0	0.5	-	-
	Tier 1 ratio, % of risk-weighted assets	IMF	18.4	23.3	23.6	23.2	19.6	-
	Credit to private sector, % of GDP	WB	40.4	39.0	37.4	-	-	-
ESG	**CO_2 per EUR 1,000 of GDP, $mtCO_2e$**	EC	138.6	135.1	130.7	127.0	-	-
	Income share of bottom 50%, %	WID	17.9	18.1	18.1	18.1	-	-
	Labour-force participation rate, %	WB	77.6	78.2	-	-	-	-
	Old-age dependency ratio, %	UN	30.6	31.1	31.7	32.1	32.6	33.5
	Composite governance indicators*	WB	0.9	0.9	1.0	1.0	-	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps)	92

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