

Republic of Latvia

Rating Review Annex



A-

STABLE
OUTLOOK

Credit strengths

- Sound institutional setup, underpinned by memberships in the euro area and NATO
- Solid economic growth prospects
- Moderate public debt

Credit challenges

- Moderate income
- Adverse demographic trends
- Exposure to external economic and financial shocks

Rating rationale:

Sound institutions: Latvia's effective policymaking is underpinned by euro area membership, which ensures a robust framework for fiscal and economic policy. Its membership in NATO strongly mitigates external security risks in the context of the heightened geopolitical tensions.

Strong economic fundamentals despite Russia-Ukraine war: We expect economic growth to decelerate to 0.8% in 2023 due to the impact of persistent inflationary pressures and tightening financing conditions on private demand. It should recover to 2.8% and 3.2% in 2024 and 2025, respectively, before converging towards an estimated potential growth of 2.5% in subsequent years.

Solid fiscal position: The shocks related to Covid-19 and the war in Ukraine have resulted in a deterioration in fiscal metrics since 2020. We expect a gradual reduction of fiscal deficits from 4.4% of GDP in 2022 to 1-1.5% over the medium term, while public debt should stabilise around 39% of GDP over the coming five years, one of the lowest levels in the euro area.

Rating challenges: Latvia's ratings remain constrained by challenges relating to continued moderate per-capita income, unfavourable demographic trends constraining growth and the exposure to external economic and financial shocks, given a large export sector relative to the size of the economy and the dependence of its financial sector on large Nordic banks.

Latvia's sovereign rating drivers

Risk pillars	Quantitative		Reserve currency	Qualitative*	Final rating	
	Weight	Indicative rating	Notches	Notches		
Domestic Economic Risk	35%	bb+	EUR [+1]	0	A-	
Public Finance Risk	20%	aa		0		
External Economic Risk	10%	ccc		0		
Financial Stability Risk	10%	aaa		0		
ESG Risk	Environmental Factors	5%		aaa		0
	Social Factors	7.5%		b-		0
	Governance Factors	12.5%		a		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 reflects our view that risks to the ratings are balanced.

Positive rating-change drivers

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

Negative rating-change drivers

- Deterioration in public debt dynamics
- Increasing macroeconomic imbalances, weakening growth prospects
- Deterioration in external position and/or re-emergence of financial sector risks
- Heightened geopolitical risk 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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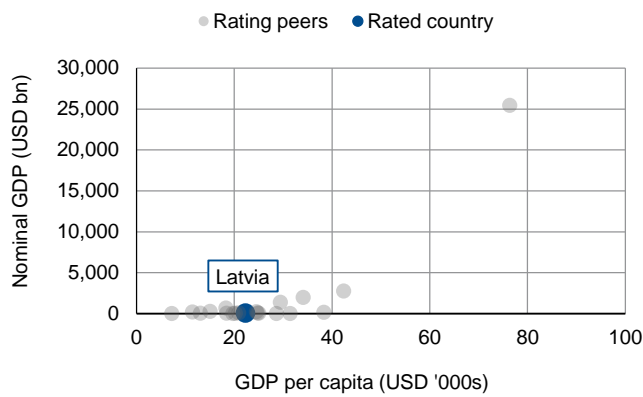
Bloomberg: RESP SCOP

Domestic Economic Risk

Overview of Scope's qualitative assessments for Latvia's *Domestic Economic Risk*

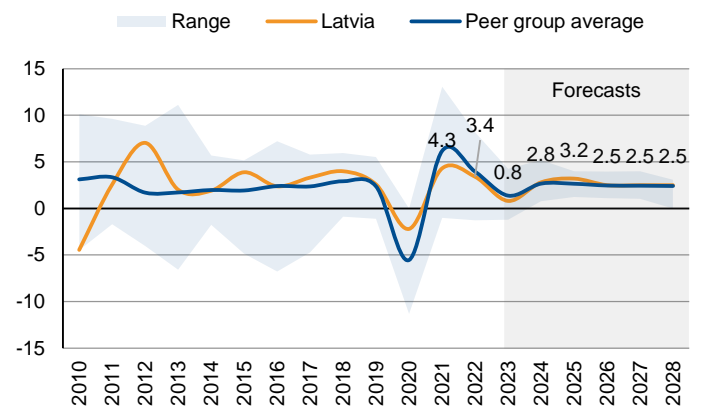
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Growth potential of the economy	Neutral	0	Solid economic growth prospects, although constrained by adverse demographics and barriers to employment growth
	Monetary policy framework	Neutral	0	ECB is a credible and effective central bank; effective policy framework and transmission over the cycle
	Macro-economic stability and sustainability	Neutral	0	Limited economy size and diversification, solid productivity and labour market metrics

Nominal GDP and GDP per capita



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

Real GDP growth, %



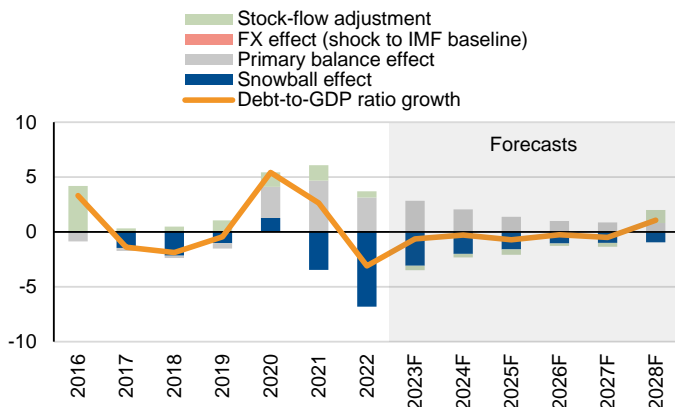
Source: IMF WEO, Scope Ratings forecasts

Public Finance Risk

Overview of Scope's qualitative assessments for Latvia's *Public Finance Risk*

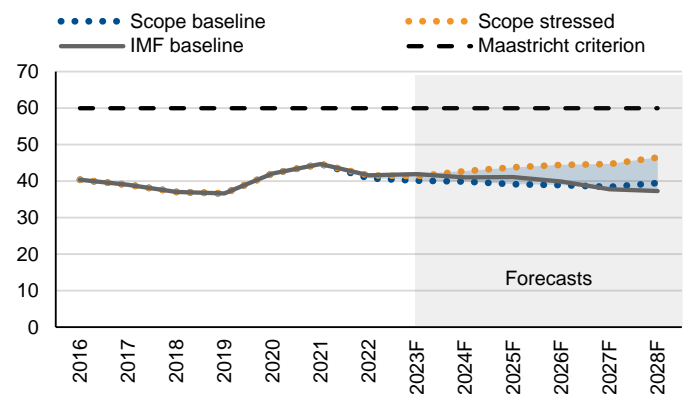
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa	Fiscal policy framework	Neutral	0	Record of fiscal prudence, but large shadow economy and comparatively restricted tax base
	Debt sustainability	Neutral	0	Moderate debt levels, expected to remain stable in the medium term
	Debt profile and market access	Neutral	0	Robust debt structure, moderate funding needs, and ability to issue on favourable terms in the capital markets

Contributions to changes in debt levels, pp of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



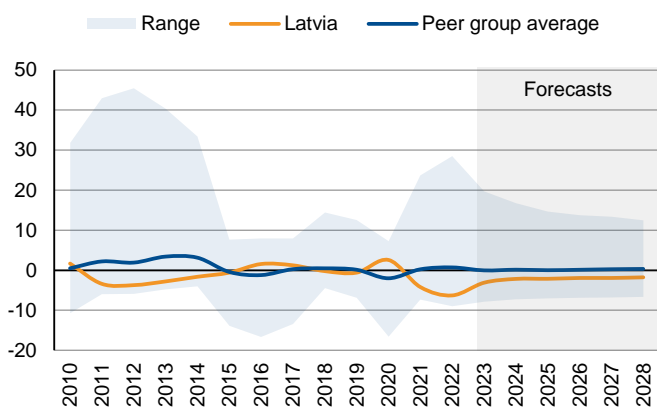
Source: IMF WEO, Scope Ratings forecasts

External Economic Risk

Overview of Scope's qualitative assessments for Latvia's *External Economic Risk*

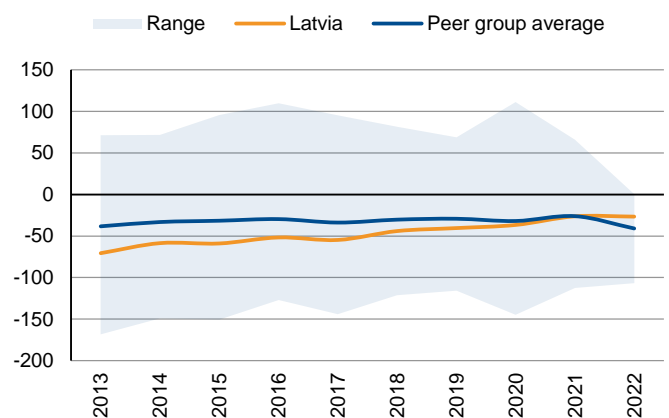
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Neutral	0	Improvements in export diversification but high share of lower value-added exports
	External debt structure	Neutral	0	Elevated, albeit declining, external debt, but limited risks of capital flows
	Resilience to short-term external shocks	Neutral	0	Very 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



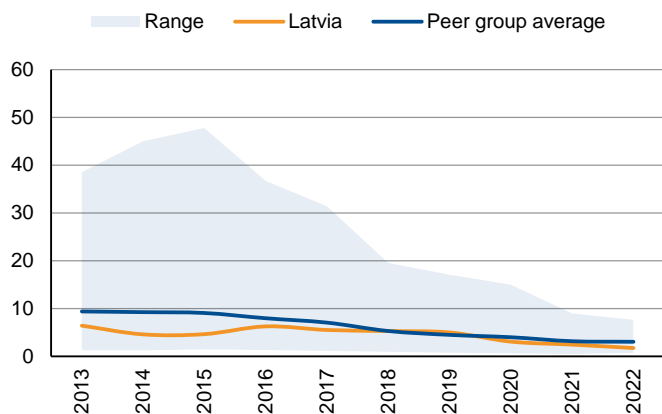
Source: IMF, Scope Ratings

Financial Stability Risk

Overview of Scope's qualitative assessments for Latvia's *Financial Stability Risk*

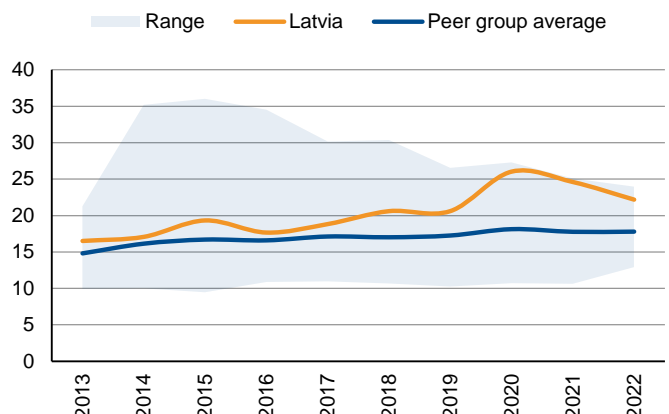
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Well-capitalised and profitable banking sector with moderate non-performing loans
	Banking sector oversight	Neutral	0	Oversight under the Bank of Latvia and the ECB as part of the Banking Union
	Financial imbalances	Neutral	0	Concentration and spillover risks in the banking system from Nordic banking groups, moderate private debt

Non-performing loans (NPLs), % of total loans



Source: World Bank, Scope Ratings

Tier 1 capital, % of risk-weighted assets



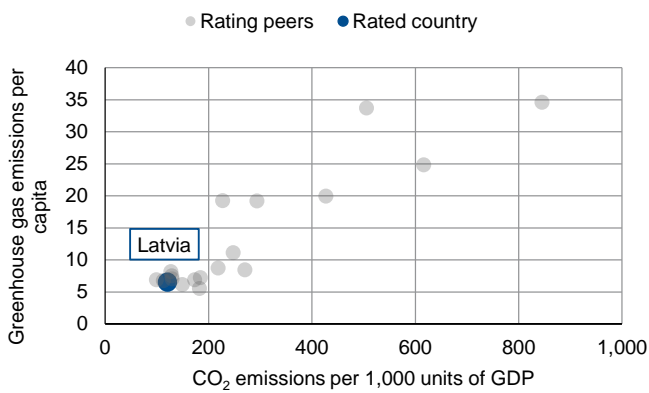
Source: IMF, Scope Ratings

ESG Risk

Overview of Scope's qualitative assessments for Latvia's ESG Risk

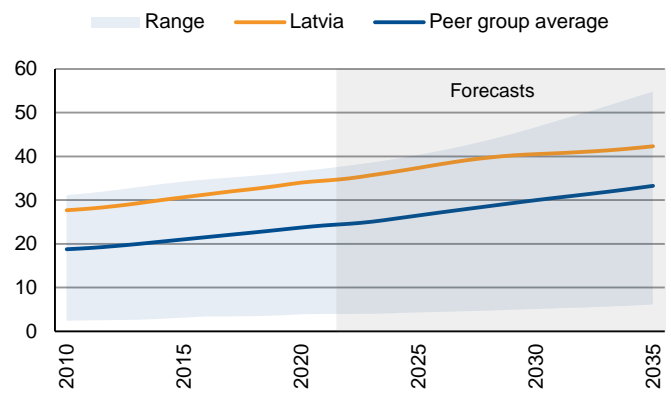
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb+	Environmental factors	Neutral	0	High share of renewables in the energy mix; transition risks in line with peers
	Social factors	Neutral	0	Inclusive labour market but still elevated poverty and income inequality; unfavourable demographic trends
	Governance factors	Neutral	0	Stable governance, supported by EU, euro area and NATO memberships

CO₂ emissions per GDP, mtCO₂e



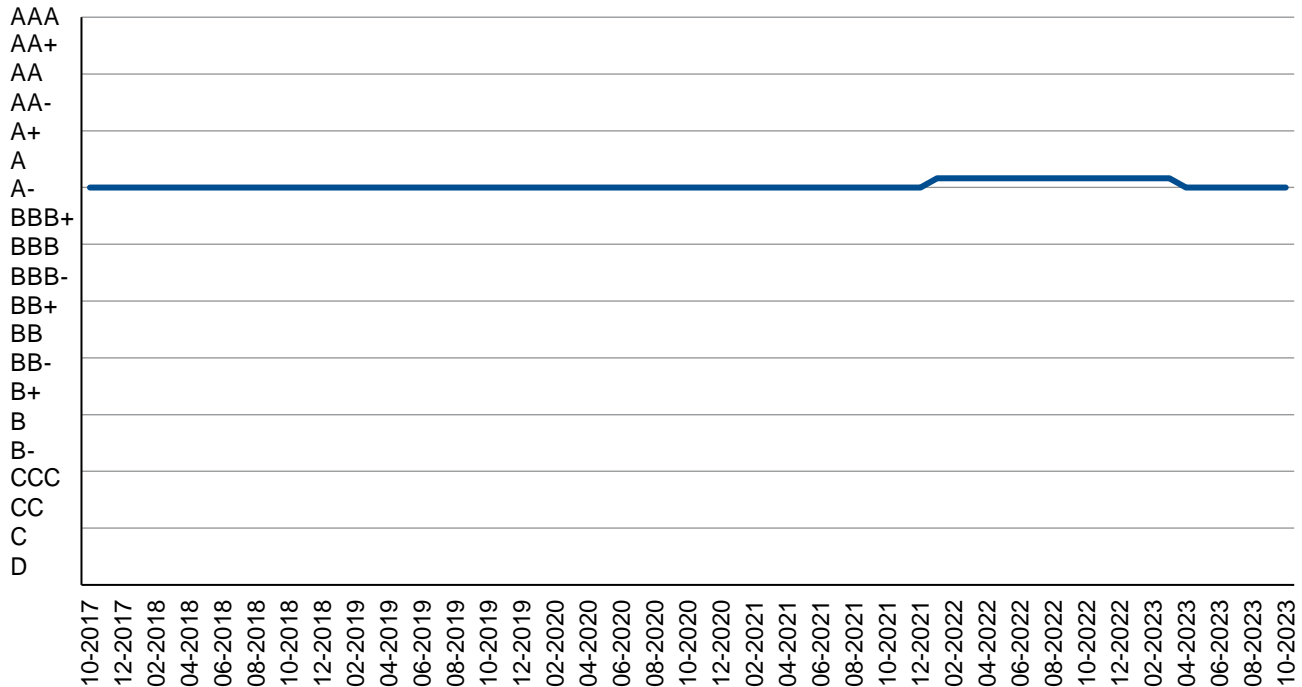
Source: European Commission, Scope Ratings

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 adjacent categories, with Scope's core variable scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Bulgaria
Croatia
Cyprus
Estonia
France
Italy
Lithuania
Poland
Portugal
Slovakia
Spain
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
Domestic Economic	GDP per capita, USD '000s	IMF	17.8	17.9	18.1	21.0	22.3
	Nominal GDP, USD bn	IMF	34.4	34.3	34.6	39.8	42.2
	Real growth, %	IMF	4.0	2.6	-2.2	4.1	2.0
	CPI inflation, %	IMF	2.6	2.7	0.1	3.2	17.2
	Unemployment rate, %	WB	7.4	6.3	8.1	7.5	6.4
Public Finance	Public debt, % of GDP	IMF	37.1	36.7	42.1	44.7	41.6
	Net interest payment, % of revenue	IMF	2.5	2.3	2.3	2.0	1.4
	Primary balance, % of GDP	IMF	0.2	0.5	-2.8	-4.7	-3.1
External Economic	Current-account balance, % of GDP	IMF	-0.2	-0.6	2.6	-4.2	-6.3
	Total reserves, months of imports	WB	2.2	2.3	2.9	2.3	1.6
	NIIP, % of GDP	IMF	-44.0	-40.5	-36.7	-26.3	-26.7
Financial Stability	NPL ratio, % of total loans	IMF	5.3	5.0	3.1	2.5	1.8
	Tier 1 ratio, % of risk-weighted assets	IMF	20.1	21.5	24.0	24.1	24.1
	Credit to the private sector, % of GDP	WB	36.6	34.3	33.5	-	-
ESG	CO ₂ per EUR 1,000 of GDP, mtCO ₂ e	EC	143.3	136.2	121.5	120.9	-
	Income share of bottom 50%, %	WID	17.4	18.0	17.9	17.9	-
	Labour-force participation rate, %	WB	78.1	77.7	79.0	76.6	-
	Old-age dependency ratio, %	UN	32.6	33.2	34.0	34.4	34.9
	Composite governance indicators*	WB	0.8	0.9	0.8	0.9	-

* 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) as of 9 October 2023

61.95



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