

SEB Lithuania  
June 30, 2010

## Macroeconomic Outlook of Baltic States



# The Baltics – one region, three countries



## ESTONIA

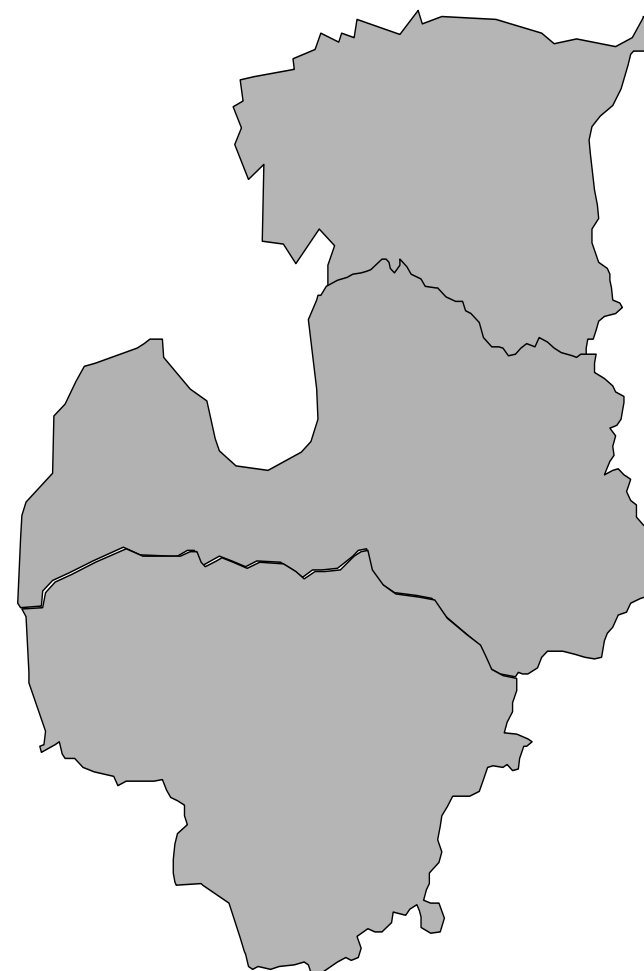
- Smallest market, most service-oriented
- Close economic ties with Finland and Sweden
- Euro zone member in 2011; almost OECD member
- Steady fiscal discipline, best sovereign ratings

## LATVIA

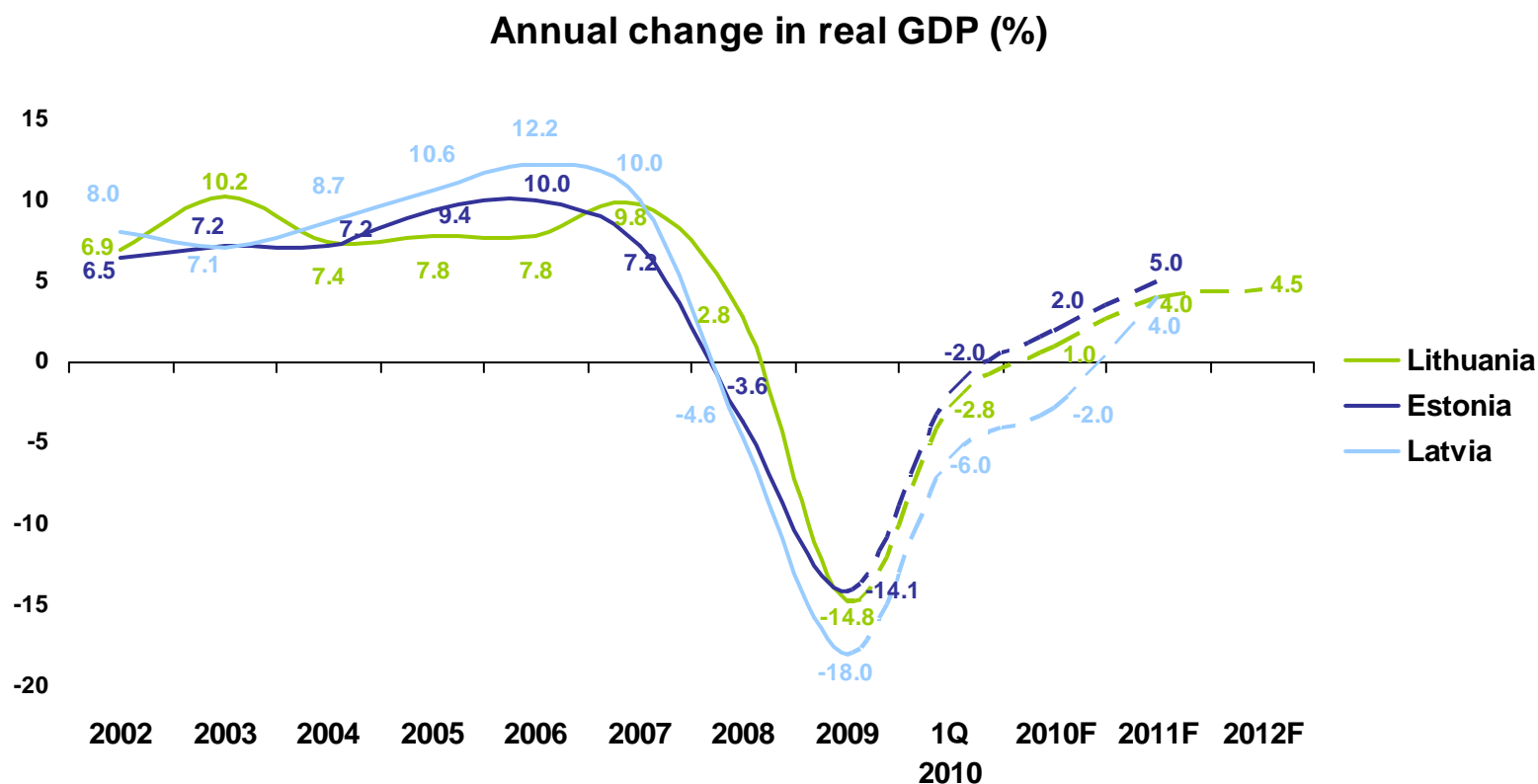
- Deepest recession and previously highest growth in overheating period
- Had problems with banking sector, applied for IMF funds
- Highest share of Russian population
- Most developed transport infrastructure

## LITHUANIA

- Largest market, most diversified economy and exports
- Lowest real estate and lending bubble in 2005-2007 and indebtedness of households and business
- Shortest recession among Baltic States (thus far)



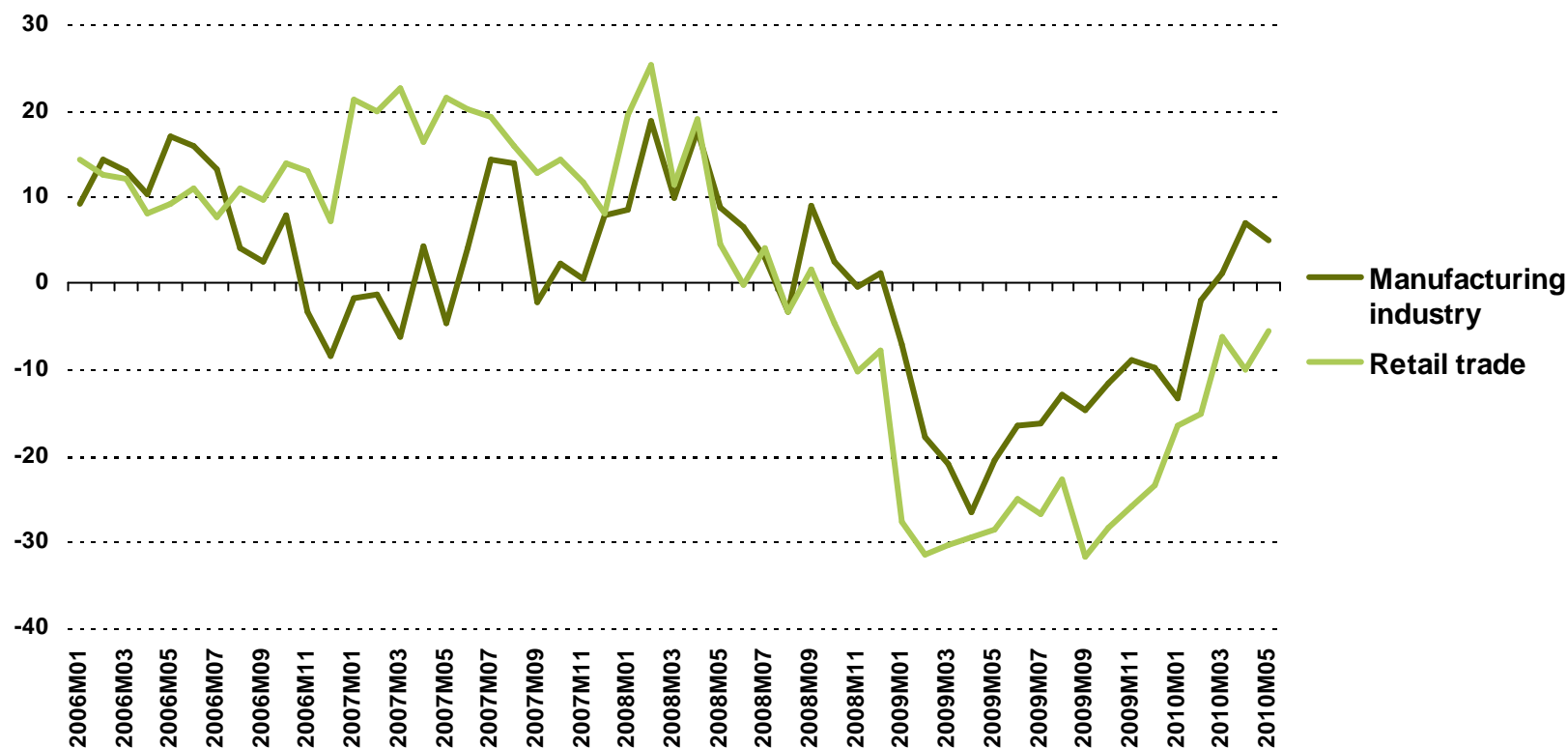
# Baltic economies start recovering after severe contraction last year



Source: national statistical bureaus, calculations of SEB Bank.

# Manufacturing industry is turning around while retail trade lags behind

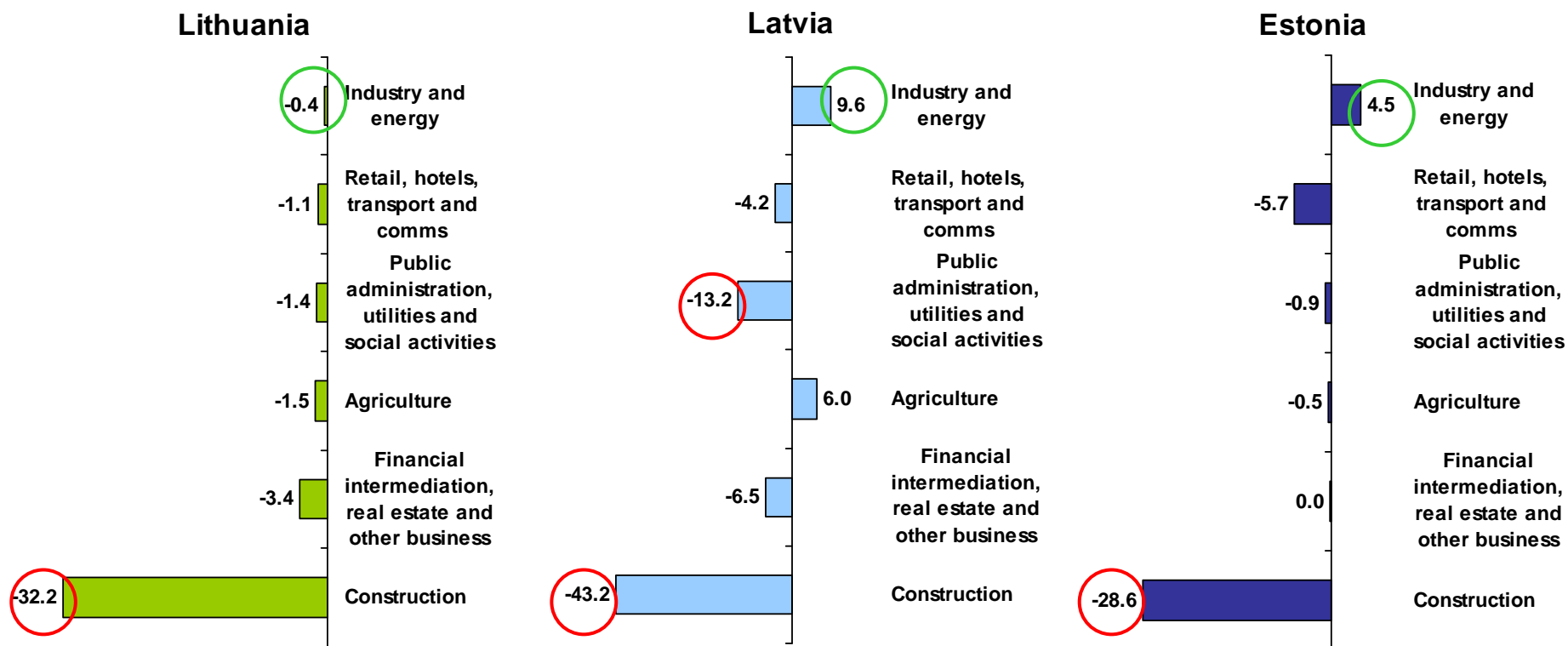
Y-o-y change in turnover (constant prices, %)



Source: Statistics Lithuania.

# Baltic States begin their economic recovery with exports while construction remains under squeeze

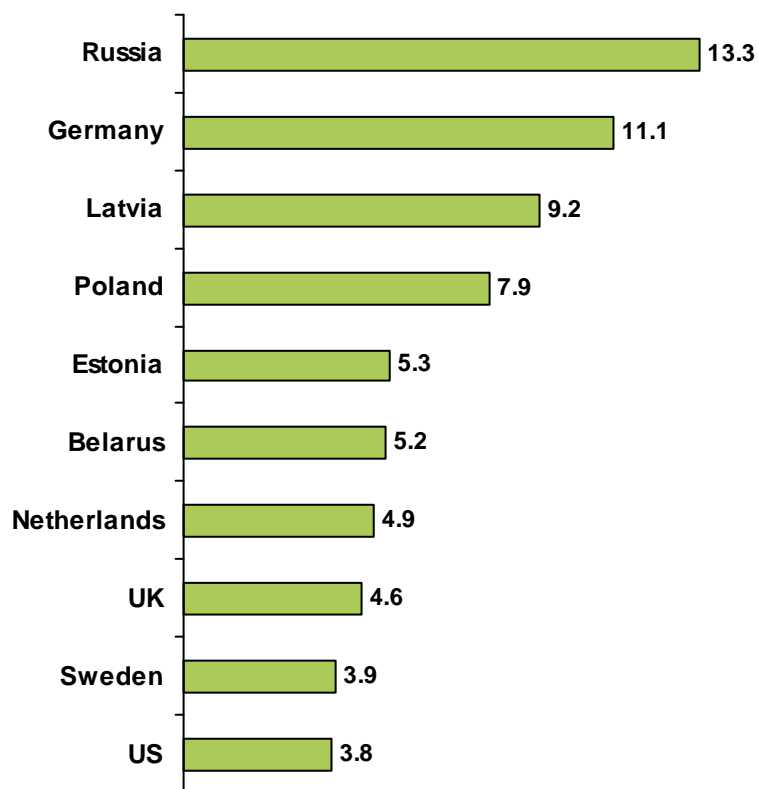
Real value added in 1Q 2010 by production approach (y-o-y, %)



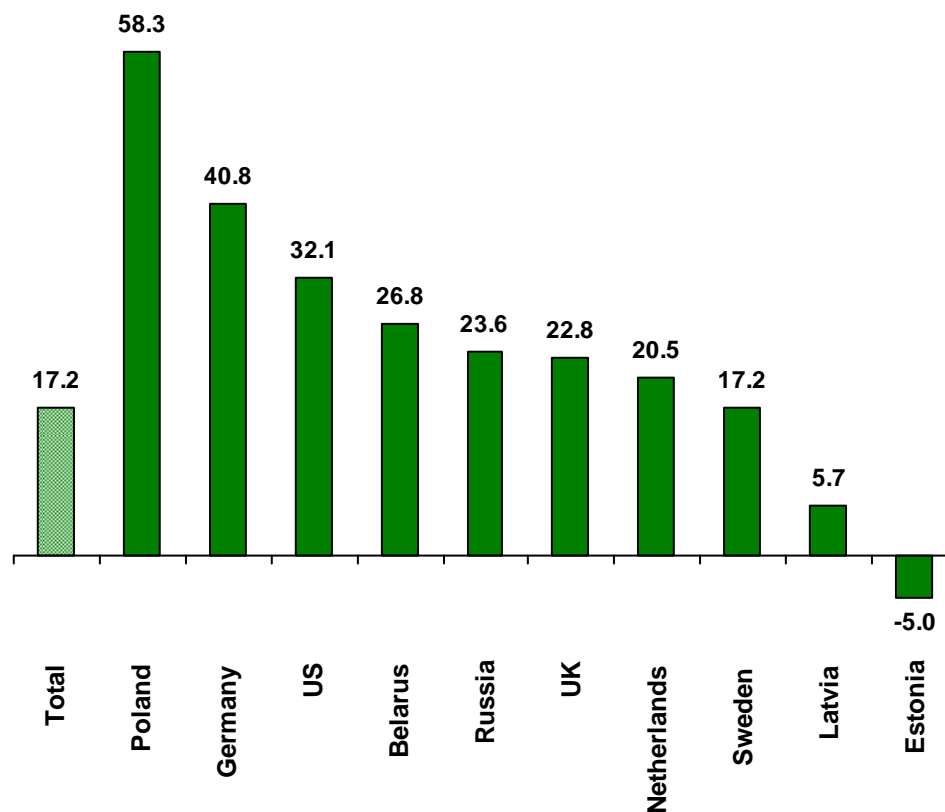
Source: national statistical bureaus, calculations of SEB Bank.

# Germany is the core market for recovery of Lithuanian exports

10 main Lithuania's export markets in Jan-April 2010 (% of total exports)

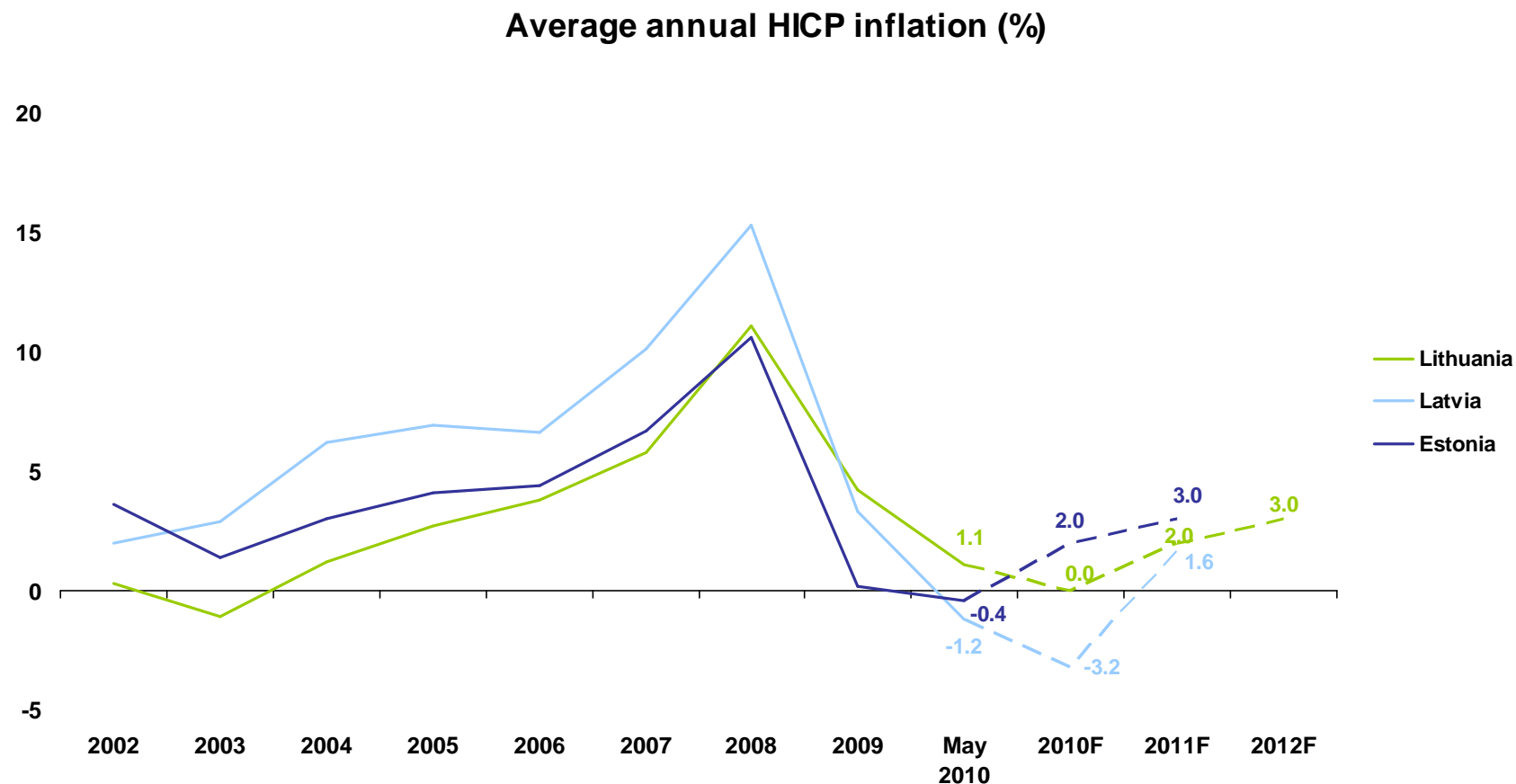


Y/y change in exports in Jan-April 2010 (%)



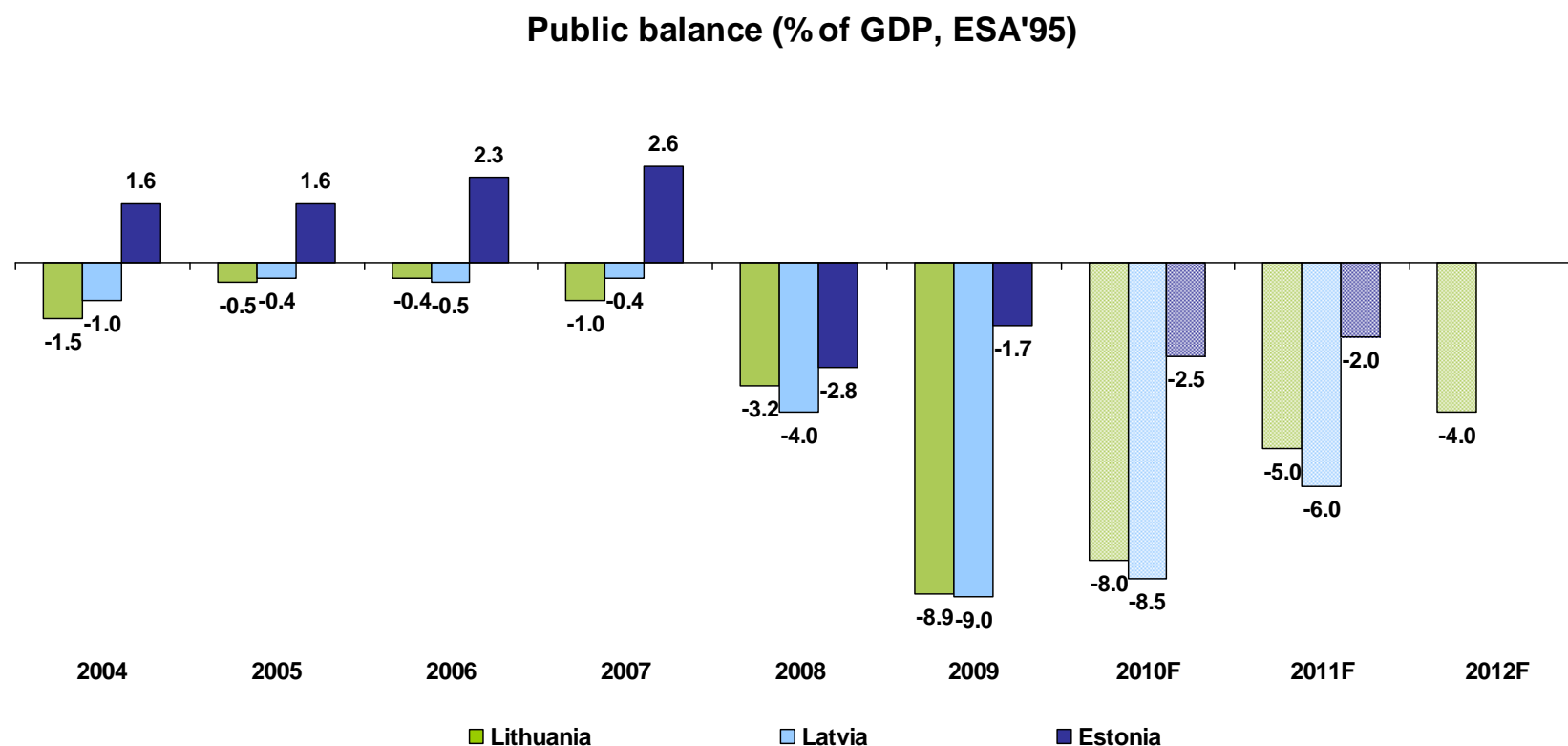
Source: Statistics Lithuania.

# Inflation is rapidly shrinking as domestic demand stumbles



Source: Eurostat, SEB forecasts.

# Latvia and Lithuania are planning speedy reduction of budget deficit in order to introduce euro



Source: national statistical bureaus, SEB forecasts.



# What was already done to contain budget deficit?

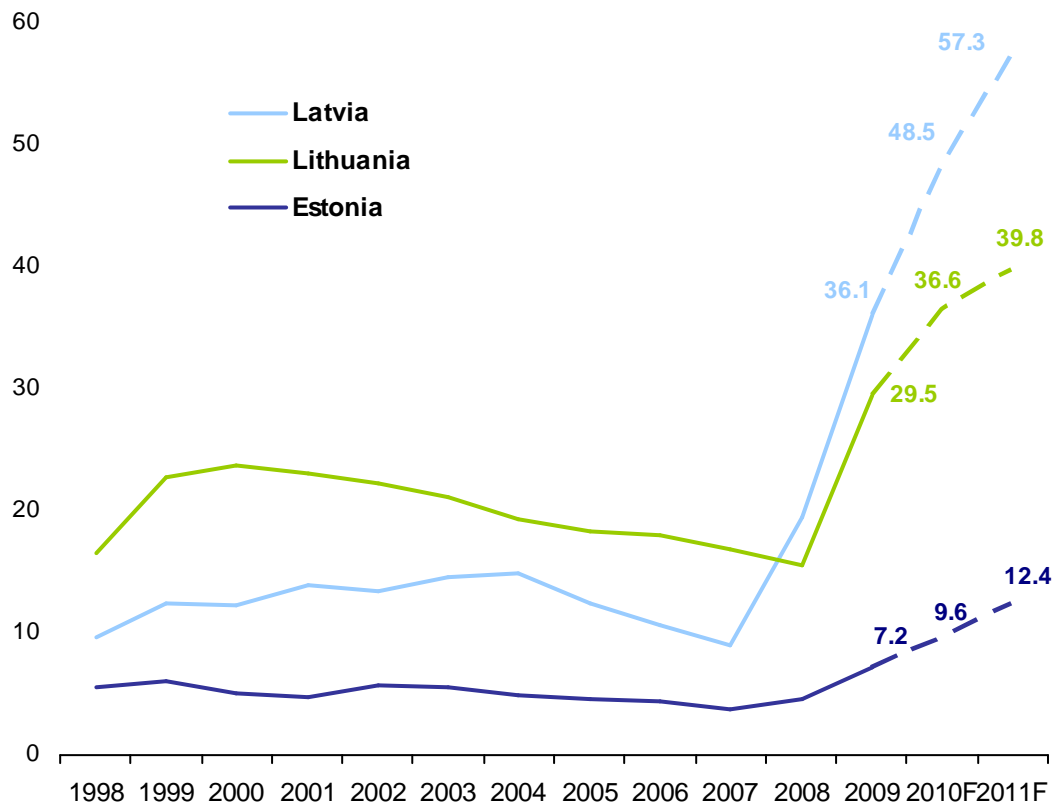
## Budget measures implemented compared to the end of 2008

	Estonia	Latvia	Lithuania
<b>Revenues</b>			
<b>VAT</b>	<b>Increased</b>	<b>Increased</b>	<b>Increased</b>
Personal income tax	No change	Increased	Decreased
Excise duties	Increased	Increased	Increased
Dividends from state companies	1.5% of GDP	n/a	n/a
<b>Expenditures</b>			
<b>Social benefits</b>	Increased	<b>Decreased</b>	<b>Decreased</b>
<b>Wages of state servants</b>	<b>Decreased</b>	<b>Decreased</b>	<b>Decreased</b>
Social insurance contributions to private pension funds	Temporarily decreased	Temporarily decreased	Temporarily decreased

**More to come?**

# State debt continues increasing...

State debt (% of GDP)



- **Estonia:**

- loan from EIB (EUR 700mn in 2009)

- **Latvia:**

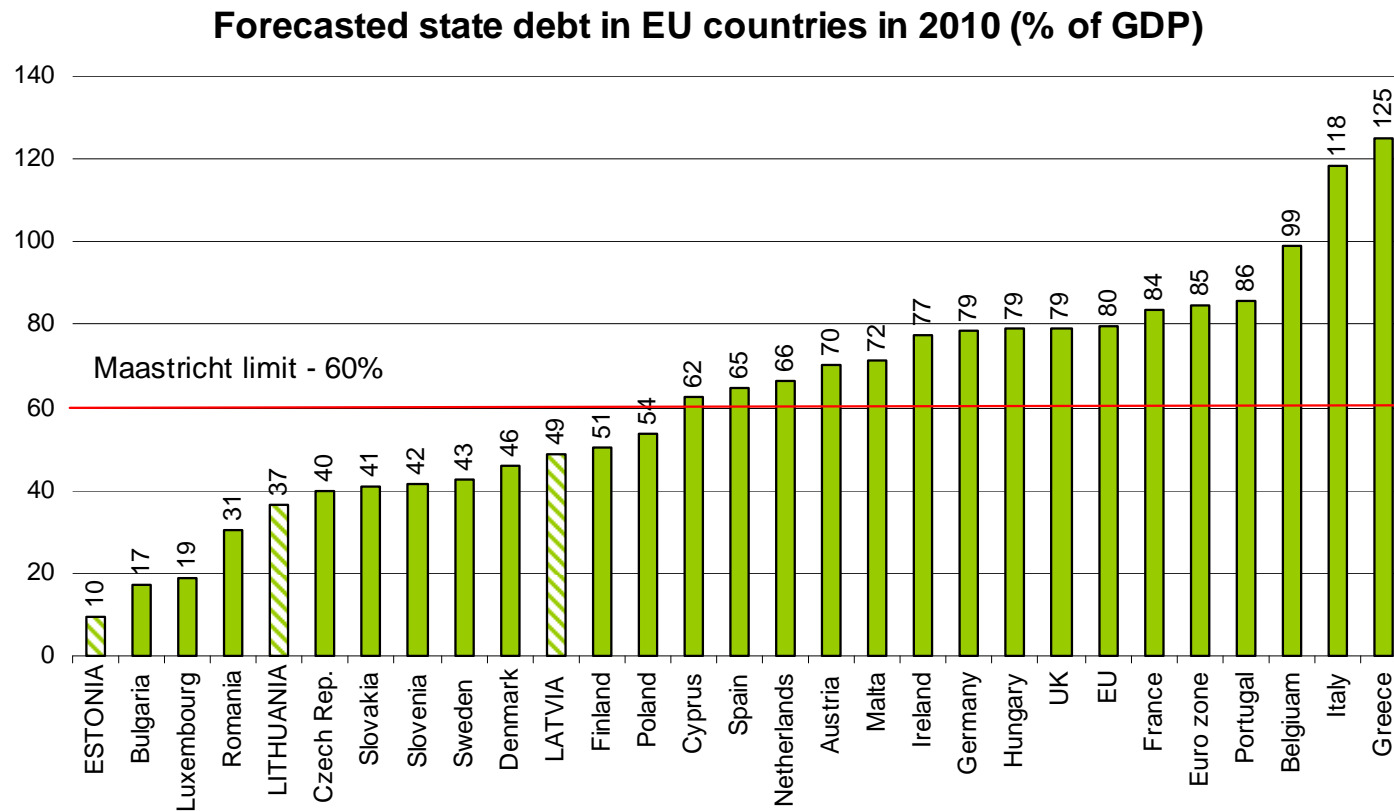
- mostly loans from IMF, EU, EBRD, World Bank (EUR 4bn in 2009-now; EUR 7.5 bn in 2008-2011)

- **Lithuania:**

- Eurobonds on international market (EUR 3bn in 2009-now, or ½ of total new borrowing)
- domestic securities (EUR 2bn in 2009-now, or 1/3 of total new borrowing)

Source: Eurostat, forecasts of European Commission and Lithuanian Ministry of Finance.

## ... but still remains among the lowest in the European Union



Source: European Commission, Lithuanian Ministry of Finance.

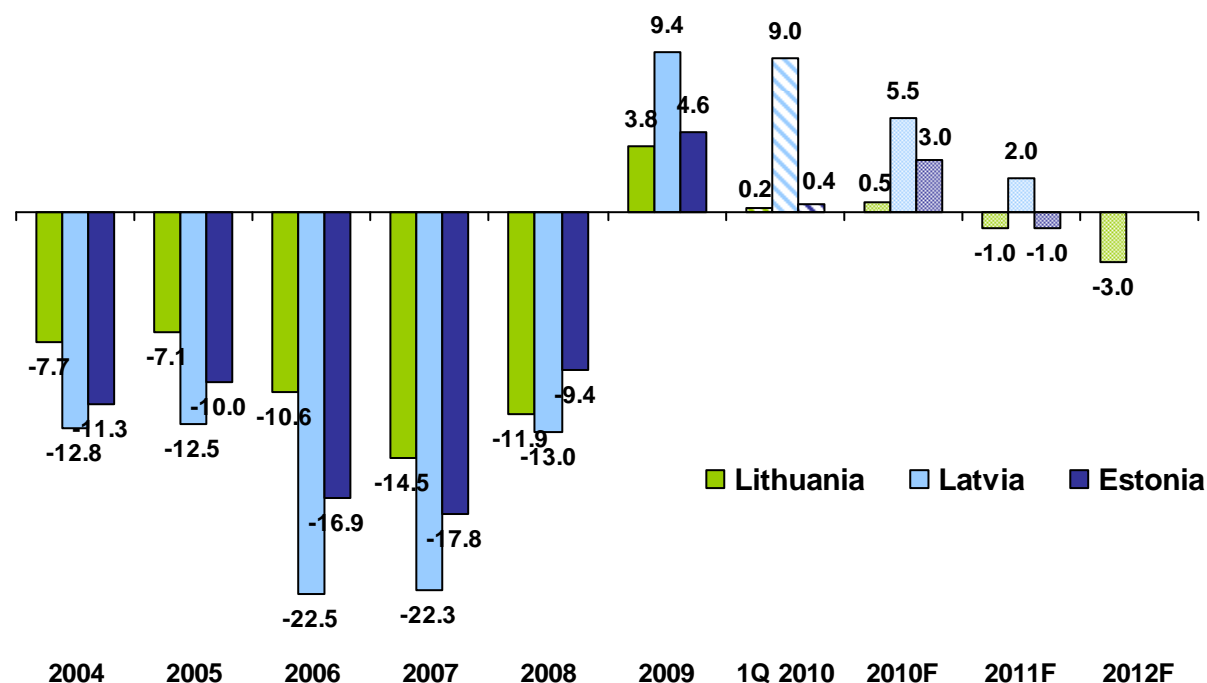
# Estonia is to join euro zone in 2011, while Lithuania and Latvia are striving to make it in 2014

## Earliest possible date of euro introduction

<u>Estonia</u>	2011	Astonishing progress with fiscal consolidation in 2009
<u>Lithuania</u>	2014	High budget deficit
<u>Latvia</u>	2014	High budget deficit
<u>Bulgaria</u>	2015	Pushing for euro entry in 2013, but political resistance from Brussels is likely to delay the process
<u>Romania</u>	2015	High budget deficit
<u>Hungary</u>	2015	High state debt and budget deficit
<u>Czech Rep.</u>	2015	Little political appetite for euro; high budget deficit
<u>Poland</u>	2015	Little political appetite for euro; high budget deficit

# In 2009, current account deficit turned to surplus in all three Baltic States

Current account balance (% of GDP)

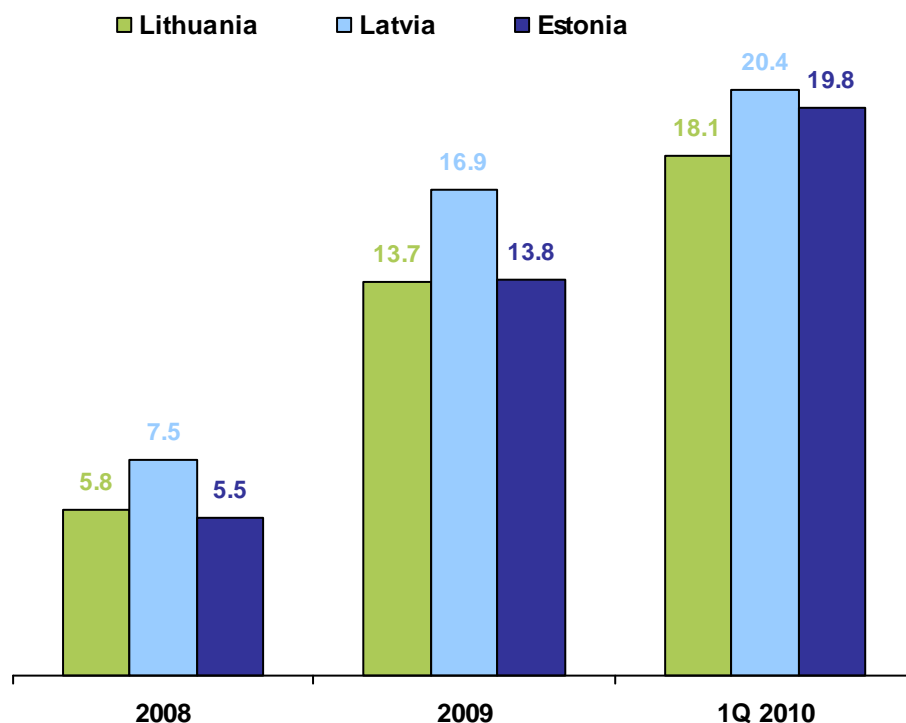


- Sharp contraction of foreign trade deficit
- Losses of foreign-owned companies
- No need even to think about devaluation

Source: national central banks, SEB forecasts.

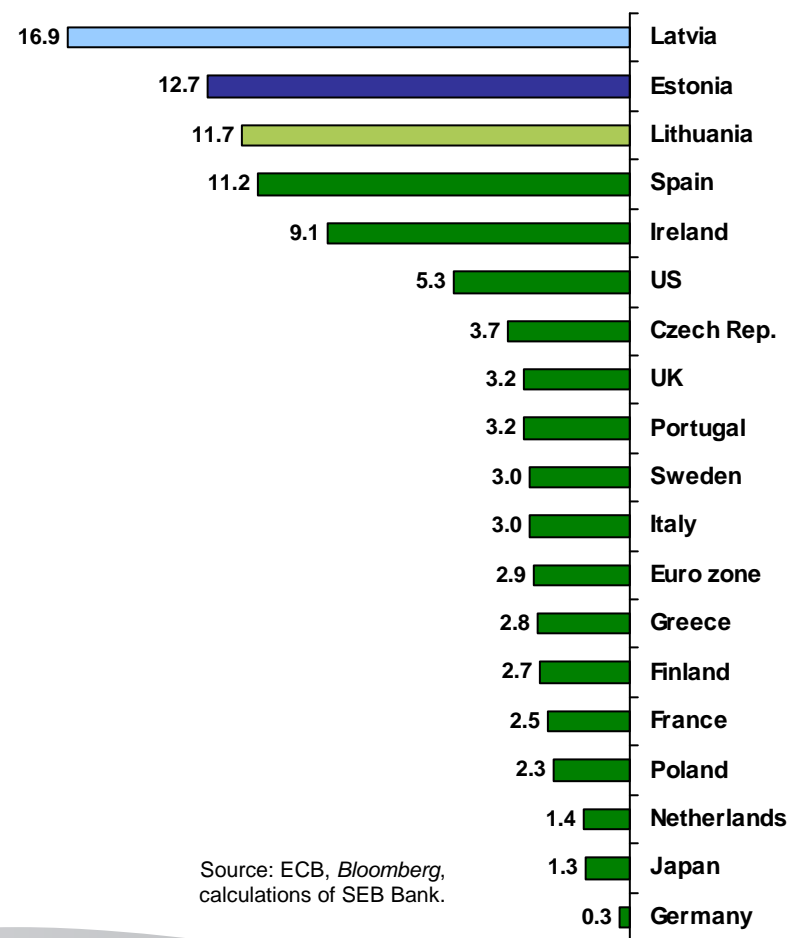
# Double-sided shock in labour market: increasing unemployment and emigration

Unemployment level (%)



Source: Statistics Lithuania.

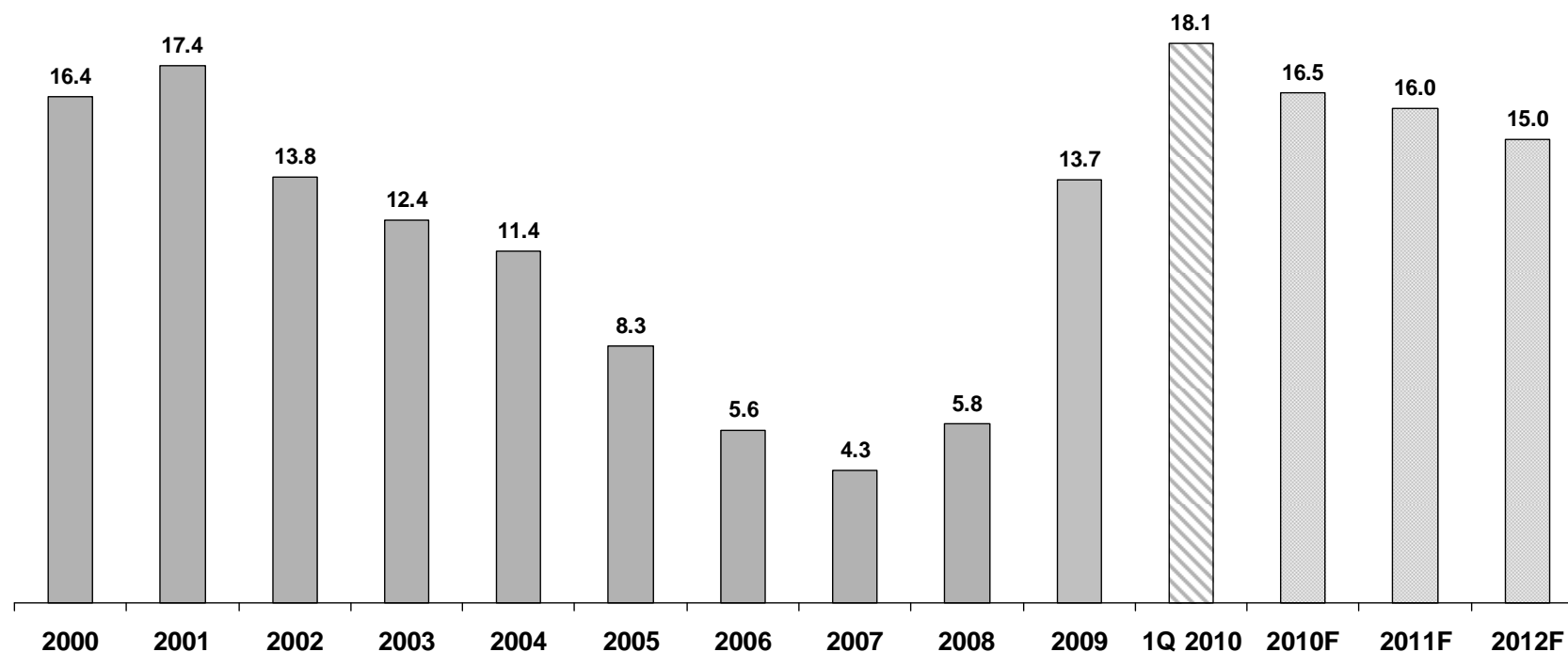
Increase in unemployment rate from lowest pre-crisis point (percentage points)



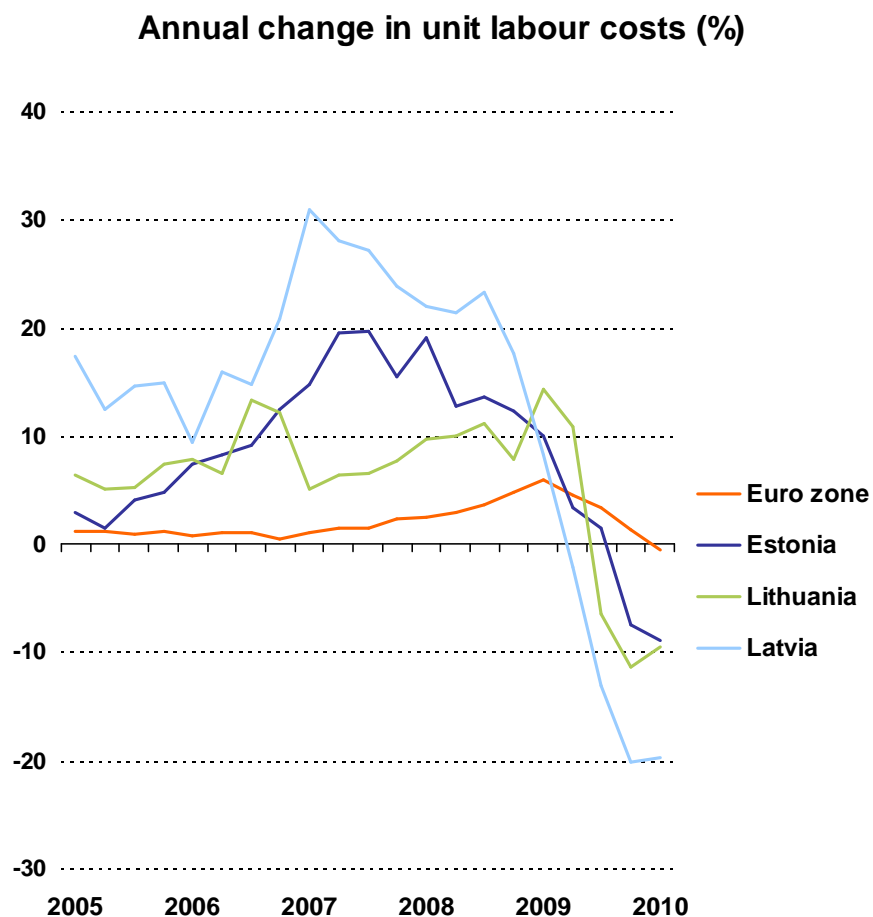
Source: ECB, Bloomberg, calculations of SEB Bank.

# The most painful recession's aftermath is difficulties in labour market

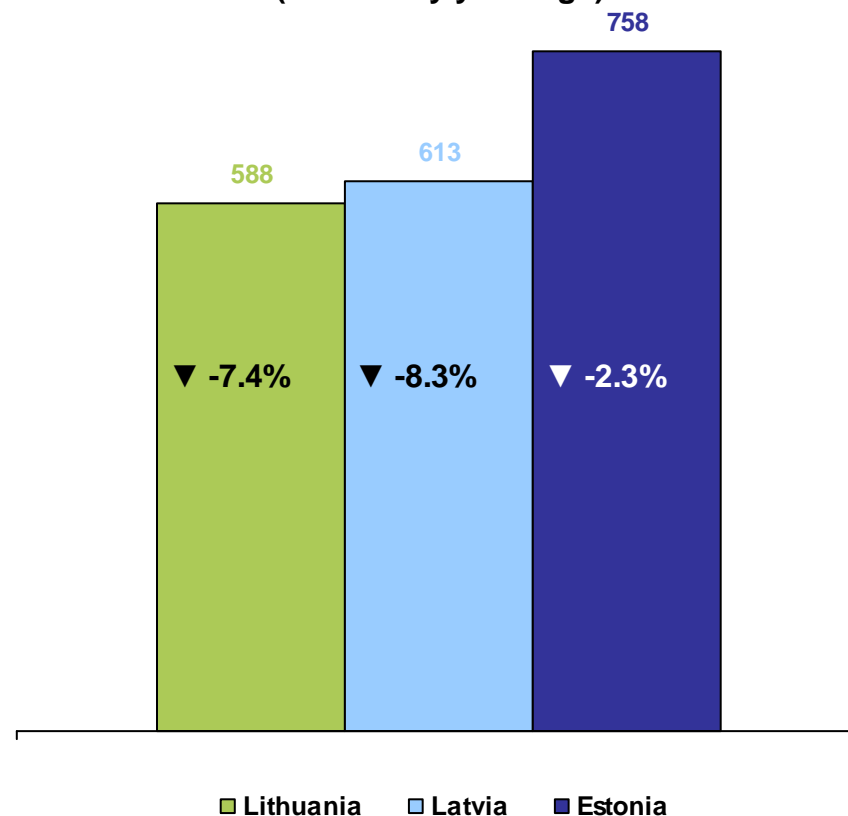
Unemployment level (average, survey data, %)



# Decrease in wages and salaries made up an important part of 'internal devaluation'



Monthly gross wages and salaries in 1Q 2010  
(EUR and y/y change)



Source: ECB, national statistical offices.



# In 2010, wages and salaries will slightly decrease

Annual change in average gross nominal wages and salaries  
(4Q, entrepreneurs excluded, %)

