

# The Baltic Outlook: Update

Macro Outlook, The Baltic Region, January 2009

HANSABANK MARKETS

## Introduction

When we wrote our Baltic Outlook in October, the memories of September's collapse of the global financial system were fresh and its consequences was only starting to reveal its dramatic nature. Expectations continued to dwindle rapidly and forecasts were cut in every month and week. It seems that for now the signs of panic have retreated, albeit expectations continue to worsen and one cannot see the stabilisation or improvement of forecasts yet. Optimists have left the scene and people are adjusting their actions for a gloomier future.

The three Baltic countries were moving toward recession even before September's developments shook the global financial system. However the global financial and economic crisis has made the outlook for these three economies much worse and now the possible outcomes are between bad and worse. Domestic factors are now less important than external ones, as external financing and expectations are those which set the scope of actions in the region. However, good intentions and ideas can not materialize if the external environment remains extremely hostile towards the three countries.

Our expectations about the Estonian, Latvian and Lithuanian economic developments have worsened significantly. We expect a significant economic decline due to falling domestic and external demand this year, and even the year 2010 will not bring positive growth, albeit the year-end growth rates may turn positive. Negative processes in the economy mean that prices of goods, services, labour and assets will continue to fall, and annual deflation a very possible scenario in 2009-10. The global economic situation will make it extremely difficult to increase exports, but weak domestic demand and shrinking external financing will mean a fall in the amounts of imports, which will end up with a significant improvement in foreign balances.

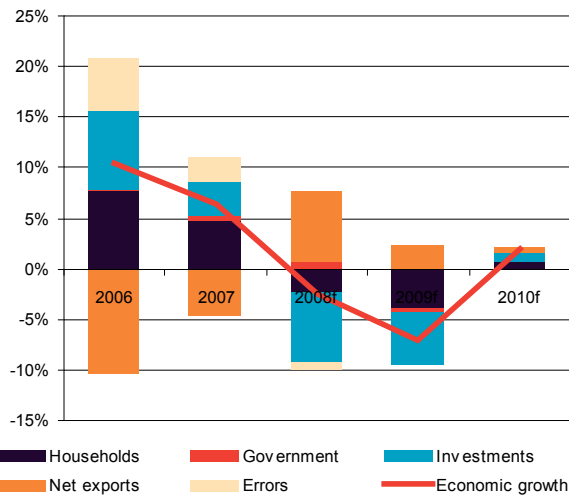
The governments' opportunities to help their economies are narrow and hence they have concentrated mostly on stabilising the situation and then, if possible, helping businesses. Social tensions are increasing, and if political problems are not solved or get worse, the situation in the economies might turn extremely bad. An open dialogue between the public, the corporate sector and authorities is a must as this could ease tensions and bring up good ideas for change and improvement.

	2003	2004	2005	2006	2007	2008f	2009f	2010f
<b>Economic growth, %</b>								
Estonia	7.1	7.5	9.2	10.4	6.3	-2.6	-7.0	1.0
Latvia	7.2	8.7	10.6	12.2	10.3	-2.2	-10.0	-2.0
Lithuania	10.2	7.4	7.8	7.8	8.9	3.2*	-6.0	-3.0
<b>Average consumer price growth, %</b>								
Estonia	1.3	3.1	4.1	5.1	6.6	10.4*	1.0	1.2
Latvia	2.9	6.2	6.9	6.6	10.1	15.4*	0.0	-6.5
Lithuania	-1.1	1.2	2.7	3.7	5.7	10.9*	5.0	3.0
<b>Current and capital account balance, % of GDP</b>								
Estonia	-10.6	-11.0	-9.2	-14.6	-16.9	-8.5	-0.5	0.0
Latvia	-7.5	-11.8	-11.2	-21.3	-21.8	-13.3	-3.3	0.1
Lithuania	-6.4	-6.4	-5.8	-9.5	-12.8	-11.0	-3.2	-2.5
* actual								

# Estonia

We have cut our expectations substantially due to the worsening global economic situation and the hostile financial environment. We expect the Estonian economy to fall 5-8% in 2009 with a slight recovery in 2010 (with a possible decline in the 1<sup>st</sup> half of that year). The economy is about to see monthly deflation turn into an annual price decrease in the 2<sup>nd</sup> half of 2009, a rapid correction of the current account deficit and growing unemployment.

Contributions to Real GDP Growth



Source: ESA, HBM calculations and forecast

The economy will decline in 2009, due to falling domestic demand, by 6-9% as household spending declines by 5-8%, government consumption by 2-3% and investments by 13-16%. Exports are expected to fall, but imports' decline will be deeper and net exports will contribute positively to GDP growth like what happened in 2008. In 2010 the economy is expected to grow 0.5-3% as investments are expected to show a recovery, household consumption to shift into slightly positive territory and net exports to contribute positively. The government's contribution may be slightly positive or negative depending on policy choices they are about to do in 2009.

Our forecast, which may look too positive regarding 2010, is based on several assumptions. First, we expect that foreign direct investments will start to increase in the 2<sup>nd</sup> half of 2009 as asset prices continue falling, making them attractive to investors. Falling wages and growing unemployment should support production transfers to Estonia (e.g. from Finland, Sweden, Germany) especially when taking into account the lower wage costs here (now ca EUR 7.5 per hour) and room for productivity improvement. However, those investments should take into account the long-term convergence process (e.g. diminishing labour supply which eventually results in higher wage level).

The second factor, which we count as positively affecting the economy, is transfers from different EU funds. The amount available from this source is substantial, and if Brussels' promise of earlier distribution of some funds

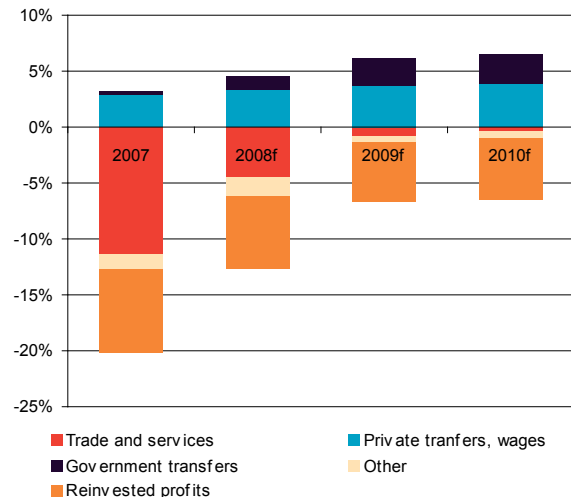
along with diminishing its bureaucracy stands (contingent on the improvement of administrative work in Estonia), we can expect that 60-70% of EU funds currently planned in the budget will be used. However, this scenario also requires that the problem of finding co-financing of related projects can be solved. For this, different types of government actions are needed (e.g. extending guarantees for bank loans, etc).

The third factor, which affects our economic processes negatively, but has very important implications for overall economic development, especially in 2009, is external financing through commercial banks. We are highly sceptical about forecasting that domestic banks will have to rely on domestic sources (i.e. deposits and back-payment of loans). This and an increasing level of bankruptcies will end up with domestic and external debt falling in 2009 and 2010. Interest rates will continue to fall but are to remain high due to the cost of funding and elevated risk assumptions, and that will make private investments difficult without governmental support. Poor access to loans and the high cost of borrowing will be one reason we expect that takeovers of domestic companies will increase in 2009-2010.

The EU funds and FDI are sources which will gradually start to support investments. However, the decline in investments will be sharp as residential construction, which we now expect to remain minimal for 2-3 years, gained elevated shares during 2006-2007's construction boom. Increasing competition and lower prices may end up with a real growth in public investment, although the sums available for investments will diminish (practically the only way to make public investments is from EU funding). Falling prices of construction should help investments, but investments into machinery and equipment require positive outlook besides finances. Recent months have deeply undermined companies' confidence, which will affect investments in the 1<sup>st</sup> half of 2009 significantly.

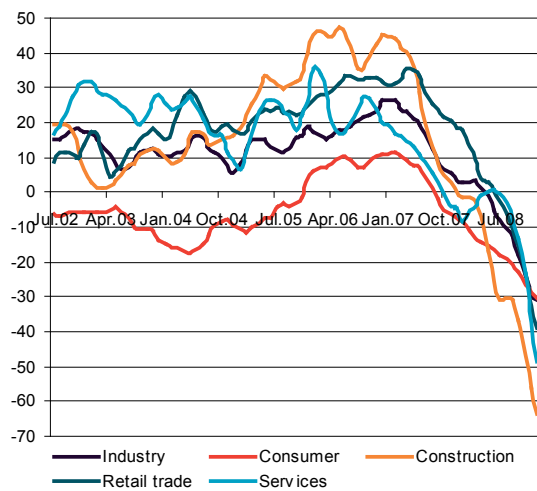
We expect the number of employed persons to decrease 4-6% and total wage payments to fall up to 15% in 2009. Still, we also expect non-activity to increase and labour outflow as well (e.g. to non-attractive Finnish regions;

Current And Capital Account, % of GDP



Source: EP, HBM calculations and forecast

Confidence (3-months average, s.a.)



Source: EKI; HBM calculations

mostly in 2010). Wage payments will decrease due to their lowering along with diminished working hours. This process (supported by changes in the labour market regulations from July 2009) is expected to improve the efficiency of production and grant the survival of stronger companies even in this extremely difficult economic situation.

The build up of precautionary reserves, which started in late 2007 and early 2008, may stop at the most difficult times, but a few months after forecasts stabilize (i.e. not turning worse) households may start timidly increase their spending and savings as well. The stabilisation of unemployment rate (maybe in the 1<sup>st</sup> half of 2010) should increase confidence, and the lower prices of goods and services will leave households with higher disposable income.

Producer price deflation arrives already in early 2009 and construction prices are already falling, but consumer price deflation in annual comparison may arrive in the 3<sup>rd</sup> quarter of the year; cuts in heating tariffs (ca 40%) will contribute significantly to consumer price deflation and also to disposable income growth. The end of administrative price increases and lowering wages make possible, and weak demand and increasing competition will force companies to cut prices. Weakening currencies of Sweden, Poland and Russia will increase pressure on exporters and retail prices even more - so success in cutting prices might be a key to survival for many companies. Those developments are about to cut required profitability levels, which in 2006-2007 reached extraordinarily high levels, even remaining relatively high in the 3<sup>rd</sup> quarter of 2008 (6.8% in average on 12-month basis).

The Estonian government is about to cut budget spending plans in February-April. This is not only because the government is targeting Euro adoption (and related to that the 3% of GDP budget deficit limit). Although the Estonian government has reserves, they are not big enough to cover the budget deficit for more than 1-2 years if existing spending plans are continued, as tax revenues are weak. Hence, borrowing is required, but with current lending terms it is difficult and economically unreasonable. Therefore, one may say that the Estonian government is forced to cut spending to avoid a troubled financial situation in 2010-11. But we also expect that budget cuts will be made so that they improve the efficiency of public services, and spending will be increased in areas important for recovery (e.g. granting the use of EU funds, labour market activities, education, etc.). Supportive monetary policy measures would be highly welcome (e.g. lowering reserve and capital requirement).

Maris Lauri

	2003	2004	2005	2006	2007	2008f	2009f	2010f
Economic growth, %	7.1	7.5	9.2	10.4	6.3	-2.6	-7.0	1.0
GDP, EURm	8,693	9,651	11,091	13,104	15,270	15,860	15,000	15,900
GDP per capita, th kroons	100.5	111.9	128.9	152.6	178.1	185.0	180.0	180.0
euros	6,424	7,153	8,239	9,754	11,381	11,830	11,200	11,900
Growth of industrial production, %	11.0	10.5	10.9	10.0	6.8	-6.0	-10.0	2.0
Growth of GDP deflator, %	4.6	3.3	5.3	7.0	9.6	6.8	2.5	3.0
Growth of consumer prices, %	1.3	3.1	4.1	5.1	6.6	10.4*	1.0	1.2
Growth of harmonized consumer price index, %	1.4	3.0	4.1	4.5	6.7	10.6*	1.2	1.3
Growth of producer prices, %	0.2	2.9	2.1	4.5	8.3	7.2*	-1.5	1.5
Harmonized unemployment rate (average), %	10.0	9.7	7.9	5.9	4.7	5.8	9.5	9.0
Real growth of average monthly gross wage, %	8.0	5.1	6.1	10.5	13.0	3.5	-3.0	1.0
Growth of exports of goods and services, %	9.3	16.8	26.0	19.2	6.9	6.8	-6.5	3.0
Growth of imports of goods and services, %	10.0	16.2	23.5	26.6	7.5	-2.0	-12.0	2.0
Balance of goods and services, % of GDP	-7.4	-7.4	-6.4	-11.8	-11.3	-4.2	-1.0	-0.5
Balance of current and capital account, % of GDP	-10.6	-11.0	-9.2	-14.6	-16.9	-8.5	-0.5	0.0
Inflow of FDI, % of GDP	9.5	7.4	20.8	14.6	12.8	8.0	7.8	7.0
Foreign gross debt, % of GDP	64.5	76.1	86.2	97.4	112.3	110.0	105.0	94.0
General government budget position, % of GDP	1.8	1.7	1.9	3.6	3.3	-1.8	-3.4	-2.5
General government debt, % of GDP	5.5	5.0	4.4	4.0	3.0	2.7	3.5	4.0

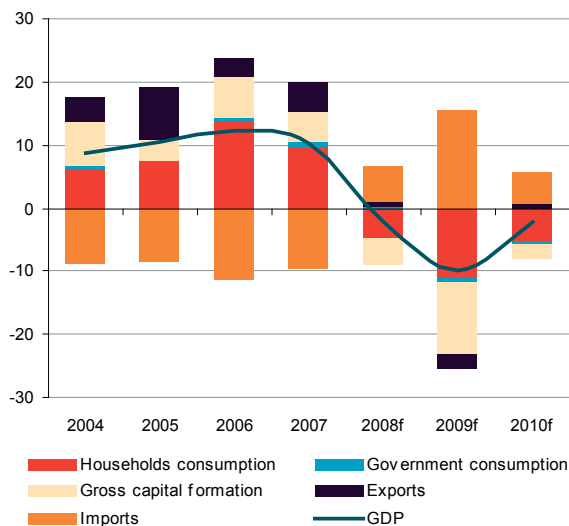
\*actual

# Latvia

We foresee a deep and long recession. There will be no growth support from the exports side and deflation is inevitable. Our forecasts are based on the assumption that the world economy will start to recover in mid 2010.

We expect GDP to fall ca 2% in 2008 and ca 10% in 2009 (we forecasted -1% and -4% before). In line with global developments, Latvian economy is expected to start recovering only in the 2<sup>nd</sup> half of 2010; however, growth for the whole of 2010 will still be negative. Productivity deterioration might continue in 2009, nevertheless, with weaker businesses going bankrupt, it will improve in 2010. It has to be noted that there are strong downside risks attached to this forecast.

Contributions to GDP Annual Growth, pp



Source: CSBL; HBM calculations and forecast

The fall in household consumption was deepened in the 4<sup>th</sup> quarter and will continue to do so throughout 2009. A slow recovery is expected only in the 2<sup>nd</sup> half of 2011. The share of household consumption in GDP went up to an unsustainable 72% in 2007 and we expect it to fall to the historical average of ca 60% by the end of current crisis. Thus a fall in household consumption by 16% will exceed the GDP decline. Consumption will be cut by:

- Delining employment - unemployment rate will reach its peak in 2010 at ca 16%.
- Wage cuts for many of those who keep their jobs, enabled by disappearing bargaining power of employees and a low degree of unionisation. The average fall in nominal wages will be ca 15% in 2009, partly through the virtual disappearance of bonuses. The fall will decelerate in 2010.
- Credit squeeze. Loan stock started to fall in November and will probably continue to do so in 2009-2010, driven by pessimism, tighter loan conditions and high risk premiums.

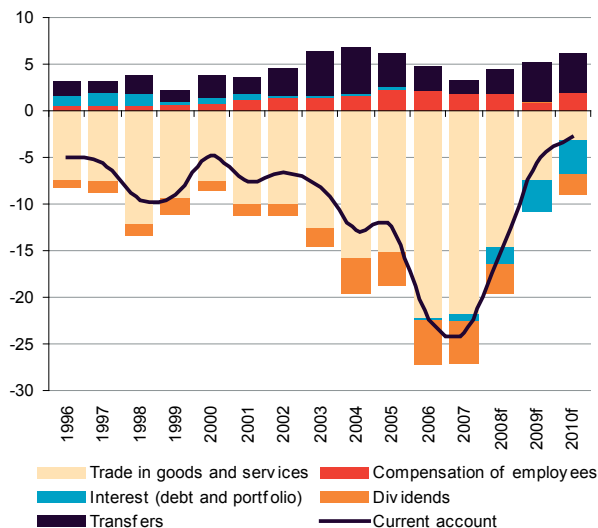
Government consumption will diminish in 2009-2010 as well, suppressed both by the terms of the IMF Stand-By Arrangement and weak tax revenues (see below).

As margins and profits fall, credit is scarce and expensive, and demand outlook is unfavourable, businesses will be neither able nor willing to sustain investments at previous levels. In 2009 investments will fall by 30%. However, investments will recover ahead of household consumption, already by the 2<sup>nd</sup> half of 2010. Nevertheless, the overall number for 2010 will be negative. Construction activity is expected to be very low for several years.

After surprisingly strong export performance in early 2008 it swiftly deteriorated as global crisis deepened. Imports were falling already in the 1<sup>st</sup> half of the year but the decline accelerated in the 3<sup>rd</sup> quarter. With decrease in world demand being bigger than anticipated before, appreciating EUR as well as credit squeeze, exports are expected to decline in 2009 and remain stable or grow slowly in 2010 in nominal terms. Falling domestic demand will accelerate the reduction of nominal imports in 2009 and, unlike for exports, the trend will remain negative also in 2010. Consequently, current account deficit is expected to improve swiftly, reaching ca 5.5% and 3% in 2009 and 2010, respectively. We expect external financing to remain limited in 2009 and 2010 due to global credit crunch.

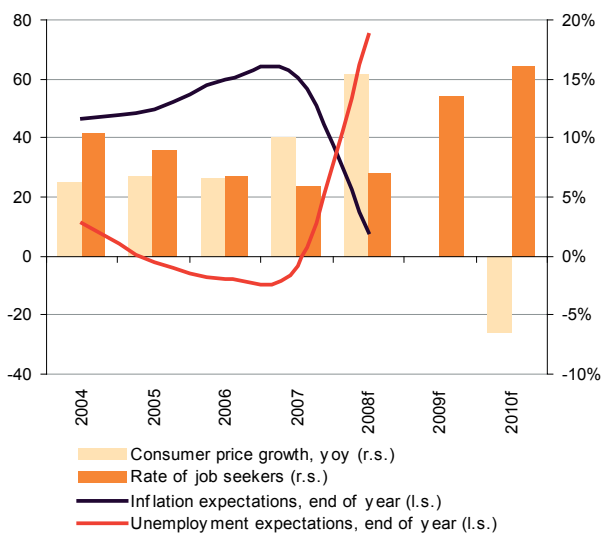
With current global deflationary pressures and planned wage cuts, deflation, mentioned as the November Outlook, is now very likely for the 2<sup>nd</sup> half of 2009. The year will start with double-digit annual inflation, yet it will decelerate even more sharply than in 2008 (except in January-February, due to tax changes). Thus average CPI growth in 2009 is forecast to be around 0%. World price decreases, depreciation of currencies in Latvia's trade partner countries and fall in domestic consumption will force Latvian companies to cut prices and wages, as they are preconditions for restoring international competitiveness. In 2010 we forecast prices to remain stable on average; however, due to the base effect of 2009 adjustments, we expect prices also to fall on average in 2010. The exchange rate regime is expected to stay intact, making the implementation of activities set out in Stand-By Agreement crucial.

Current Account, % of GDP



Source: LaB; HBM calculations and forecast

Unemployment and Inflation



Source: CSBL, Eurostat; HBM calculations and forecast

## Economic policy

Latvia now faces two main issues to deal with:

- In the short run: removing the liquidity squeeze, exacerbated by the Parex takeover. It is an urgent issue for both, the government and businesses. As the government at least has some access to finance, it should try to alleviate the situation of companies, for example, through tax postponements.
- In the medium and long run: regaining competitiveness as well as moving the economy's product mix towards goods and services demanded in external markets

In order to improve competitiveness, both wage restraints or outright reductions as well as productivity gains and efficiency enhancements are necessary. While falling real incomes are undesirable, in the short run they are unavoidable as the other, more pleasant route – doing more with less – cannot be implemented rapidly enough.

**IMF Stand-By Arrangement\*** (SBA) was released in

January, supplemented by EU and several neighbouring countries and totalling EUR 7.5b for the period of 27 months. SBA tackles liquidity problem by providing financing for rolling over commercial bank debt and financing the budget deficit. In order to make the currency peg sustainable, public payroll cost decreases and structural reforms are imposed as a pre-condition. The government implemented several other measures. For instance, changes in tax policy and aggressive cuts on other spending besides payroll, bringing the total impact on the earlier 2009 budget up to 7% of GDP. 1/3 of this adjustment is coming from the revenue side (e.g. VAT and excise increase, capital income tax from 2010) and 2/3 from cutting expenditures. The government is required to reduce public sector wage bill by ca 30% from 2008 level, of which ca. 5 pp is through lay-offs, 25 pp through wages, partly by elimination of bonuses. Most of the other current spending positions of the general government are to be cut by ca 25%.

The program also requires the government to implement measures aimed at higher GDP growth in the future – to continue co-financing for EU structural funds, export promotions, more efficient insolvency regimes, and tighter bank supervision. In addition, there are several quantitative performance criteria to be constantly checked by the IMF (e.g. a floor on net international reserves), as well as structural benchmarks with specific deadlines (e.g. the development of a comprehensive debt restructuring strategy by April 30, 2009).

The intended exit strategy is euro accession by 2012 made possible by rapid elimination of inflationary pressures; however, this will require strict budget policy under extraordinarily difficult circumstances. In our opinion, IMF forecast for 2009 is quite optimistic (regarding GDP and inflation), which puts 5% budget deficit target at risk and further expenditure cut is required.

Mārtiņš Kazāks  
Ivonna Slapiņa  
Dainis Stikuts  
Lija Strašuna  
Pēteris Strautiņš

\* The full text of SBA: <http://www.imf.org/external/pubs/cat/longres.cfm?sk=22586.0>

	2002	2003	2004	2005	2006	2007	2008f	2009f	2010f
Economic growth, %	6.5	7.2	8.7	10.6	12.2	10.3	-2.2	-10.0	-2.0
GDP, mln euros	9,911	9,978	11,176	13,012	16,047	19,936	21,837	18,199	17,247
GDP per capita, euro	4,251	4,302	4,846	5,671	7,034	8,779	9,646	8,081	7,699
Growth of GDP deflator, %	3.6	3.6	7.0	10.2	9.9	13.3	12.0	-7.4	-3.3
Growth of consumer prices, %	2.0	2.9	6.2	6.7	6.6	10.1	15.4*	0.0	-6.5
Growth of harmonized consumer price index, %	2.0	2.9	6.2	6.9	6.6	10.1	15.4*	0.0	-6.5
Growth of producer prices, %	1.0	3.1	8.6	7.8	10.3	16.1	11.5*	na	na
Harmonised unemployment level, %	12.2	10.5	10.4	8.9	6.8	6.0	7.0	13.5	16.0
Real growth of average net monthly wage, %	6.0	7.8	2.4	9.7	15.6	19.9	5.0	-15.0	-2.0
Growth of exports of goods and services, %	8.6	14.3	21.4	31.4	15.3	24.1	11.0	-14.0	0.0
Growth of imports of goods and services, %	9.0	19.5	27.0	27.4	31.3	23.5	-1.5	-25.0	-8.0
Balance of goods and services, % of GDP	-10.0	-12.7	-15.8	-15.2	-22.2	-21.8	-14.6	-7.3	-3.2
Current account balance, % of GDP	-6.6	-8.2	-12.8	-12.5	-22.5	-23.8	-15.0	-5.5	-2.7
Current and capital account balance, % of GDP	-6.4	-7.5	-11.8	-11.2	-21.3	-21.8	-13.3	-3.3	0.1
Net FDI, % of GDP	2.7	2.3	3.8	3.6	7.5	7.1	6.0	2.0	2.0
Foreign gross debt, % of GDP	72.7	79.6	93.3	99.4	114.0	135.1	137.0	138.3	136.2
General government budget, % of GDP (ESA)	-2.3	-1.6	-1.0	-0.4	-0.2	0.1	-3.5	-7.5	-6.0
General government debt, % of GDP	13.5	14.6	14.9	12.4	10.7	9.5	16.0	37.0	47.0

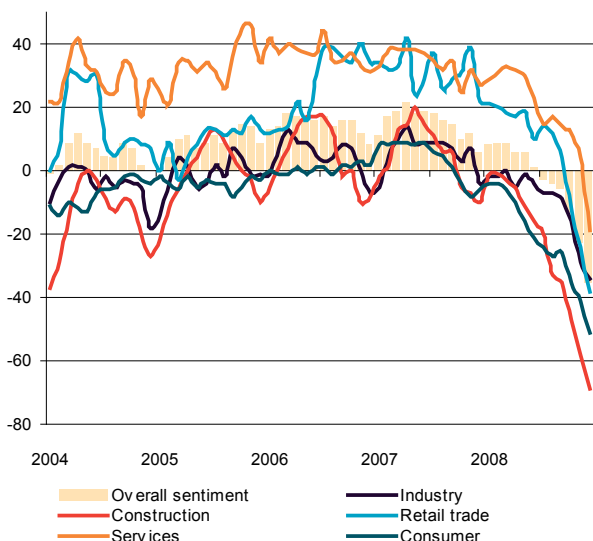
\* fact

# Lithuania

Economic downturn in Lithuania will be deeper and longer than assumed before, given a substantially weakening global environment, especially shrinking economies of the main trading partners of Lithuania, and fast changing downward processes in Lithuania itself. A decline in all components of the domestic demand is anticipated and positive effect of net exports will not be enough to compensate for it. We expect the economy to contract by ~6% this year (the previous expectation was in the range of -1.5-0.5%) and by ~3% next year. Thus, Lithuania is entering a protracted recession, which is forecast to continue next year. Declining demand in local markets and faltering external demand will halt companies' investment plans. Household consumption will be impaired by lower incomes, unemployment fears and limited borrowing possibilities.

We do not rule out a possibility, however, of an even sharper drop in economic growth in the next 1-2 years, considering the current business and consumer pessimism and uncertainty in the global environment.

## Confidence Indicators



Source: LDS

Household consumption will be negatively influenced by a rise in unemployment, negative growth of real wages and an increase in pessimism. An increase in expenditures on utilities and more expensive foodstuffs (especially meat) will force households to reduce consumption on non-essentials goods and services. We forecast household consumption to decrease ~7% (strong downside risks remain). The major factors that will discourage consumption are the following:

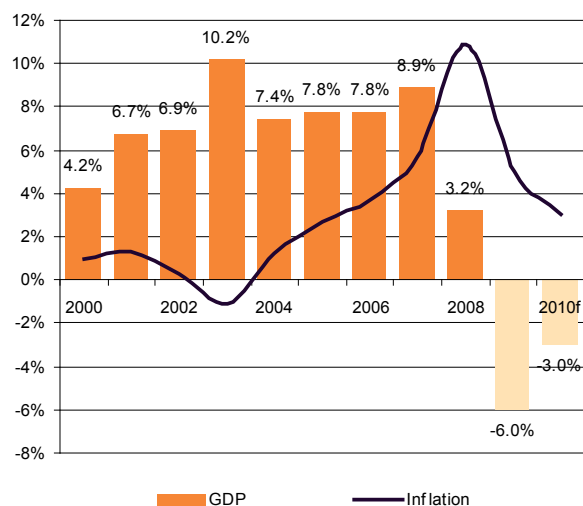
- Unemployment is expected to be ~9.5% in 2009 and ~12% in 2010. This means ca 65 thousand new unemployed this year and additional 40 thousand next year. Layoffs, which started in the 4Q 2008, will continue: almost half of local companies are planning to lay off workers, with the largest dismissals in industry and construction. The total cut in employment will be ~4-5%.
- We expect a ~3-4% decline of real net wage for

2009-10. Despite a drop in wages in some companies, the average gross wage is expected to remain unchanged due to structural changes and layoffs of low-wage workers. The modest positive effect on nominal net wage growth this year will come from the personal income tax rate cut to 21% from 24%, starting in January, but this effect will be lessened by the changes in the general non-taxed minimum (LTL 320 before Jan. 1 2009). The decrease in gross salaries in the public sector (but an increase in net wages due a drop in personal income tax burden) will push the average wage growth slightly downward.

Government consumption is expected to decrease by ca 5% this year. We forecast that the budget deficit will reach ~3% of GDP and thus fit under Maastricht criteria. The new government introduced the anti-crisis plan, which, among other measures, includes many tax changes, which are intended to reduce the budget deficit. VAT rate was increased from 18% to 19%, personal income tax was cut and excise duties for fuel, alcoholic beverages and cigarettes were raised even more than is required by the EU at the end of the given transitional period. The majority of income tax and VAT exemptions were repealed. The majority of measures of the plan are meant to eliminate distortions present in the previous tax system, broaden the tax base and target needed protection for the most vulnerable groups.

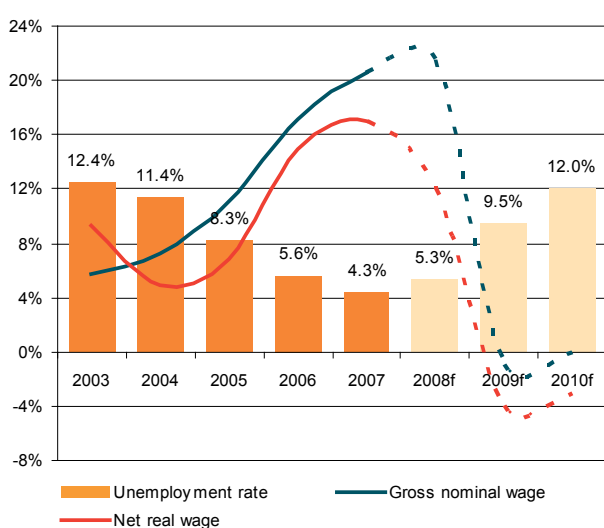
Although all expenditure items are expected to fall in 2009, investments are expected to decline the most and thus contribute extensively to the fall in domestic demand. We forecast investment in fixed assets to contract by ~20% this year. The forecast is due to a sharp downturn in the construction sector, which was the most salient source of investment in the previous boom years, and credit conditions, which, although eased to a certain extent towards the end of 2008, will remain tight. New funding from parent banks is expected to decline from the elevated levels of recent years, and thus credit to the private sector will decrease substantially. Weakening demand both in Lithuania and its main trading partners will shrink profit margins and further limit business investment. We expect negative investment growth to continue in 2010.

## Economic Growth and Inflation



Source: LDS, HBM forecast

Labour Market, annual growth rates



Source: LDS, HBM calculations

After having peaked in the 1<sup>st</sup> half of the year, the current-account deficit narrowed in the 2<sup>nd</sup> half of last year owing to weakening demand and weaker global conditions, which slowed down import (and export) growth significantly. A sharper economic slowdown is expected to alleviate external imbalances even more this year: mainly due to the narrowing of the trade balance, the current account is forecast to reach ~ -5% of GDP in 2009. Even though the Lithuanian export outlook is certainly not reassuring, imports are expected to fall even more. Export prospects have declined significantly as the slowdown has become more severe than expected in Lithuania's main trading partners. The export boom to CIS countries (Russia, Ukraine, Belarus) is likely to slow significantly due to a weaker global economy and lower commodity prices. On the positive side, the country's competitiveness is going to improve through wage and employment cuts, which will improve productivity growth. Exports will decline by less next year as the global economy recovers; however, the correction in the external imbalances is not going to continue due to a substantial increase in imports for fossil

fuels, as Ignalina NPP is to be closed at the end of the year. The services account will remain in surplus, but demand for transport services and tourism will weaken significantly. Inflows of EU structural funds should maintain the surplus on current transfers. Given the vulnerability of emerging market economies to the current economic downturn, we do not expect significant FDI and other investment flows. Nevertheless, in order to raise funds, the Lithuanian government has also announced its plans to sell the rest (9.98%) of Mazeikiu nafta shares to Poland's PKN Orlen for approximately LTL 705 million (EUR 204.18 m.), which will, at 0.6% of GDP, be an important source to finance the CAD.

Weakening domestic and external demand resulted in a decline of consumer price inflation from the 4<sup>th</sup> quarter of 2008. We expect the process to continue and anticipate that annual average inflation will moderate to ~5% this year. Sharper disinflation, however, is prevented by significant administrative price increases. Rises in energy prices alone - electricity by 12%, gas by 26%, and the termination of the VAT exemption on heating services in autumn could push inflation upwards by ~1-1.5% percentage points. An increase in excise duties on alcohol, cigarettes and fuel (although the effect of fuel excise tax increases could be mitigated by stabilization in oil prices) will further push inflation upwards. An increase in the standard VAT rate and termination of all preferential VAT rates could raise average annual inflation by ~3%, however, the effect is likely to be significantly smaller as price increases are not going to be passed onto consumers fully so as to prevent a critical fall in demand. We do expect, however, monthly deflation in some months of the second and third quarters. Next year, solely due to cost-push pressures, inflation will remain high and only mitigate to ~3%. Weak domestic demand will continue to exert a downward pressure; however, energy price increases together with the second-round effects will push inflation upwards.

Lina Vrubliauskienė  
Ieva Vyšniauskaitė

	2003	2004	2005	2006	2007	2008f	2009f	2010f
Economic growth, %	10.2	7.4	7.8	7.8	8.9	3.2*	-6.0	-3.0
GDP, mln euros	16,452	18,159	20,870	23,978	28,423	32,272*	31,095	30,765
GDP per capita, euros	4,776	5,285	6,113	7,065	8,420	9,606*	9,297	9,235
Growth of industrial sales, %	16.1	10.8	7.1	7.3	4.0	2.7*	-2.0	-2.0
Growth of GDP deflator, %	-0.8	2.5	6.6	6.5	8.8	10.0*	2.5	2.0
Growth of consumer prices, %	-1.1	1.2	2.7	3.7	5.7	10.9*	5.0	3.0
Growth of harmonized consumer price index, %	-1.1	1.2	2.7	3.8	5.8	11.1*	5.0	3.0
Growth of producer prices, %	-0.5	6.0	11.5	7.4	7.0	18.2*	-8.0	4.5
Harmonized unemployment level, %	12.4	11.4	8.3	5.6	4.3	5.6	9.5	12.0
Growth of real net wage, %	9.3	4.9	6.8	14.9	17.7	11.2	-4.0	-3.0
Growth of exports of goods and services, %	6.2	12.0	27.0	17.9	9.2	25.0	-4.0	-2.0
Growth of imports of goods and services, %	6.9	14.2	26.1	23.1	15.9	20.8	-12.7	-0.9
Balance of goods and services, % of GDP	-5.7	-7.0	-7.2	-10.3	-13.4	-11.9	-5.7	-6.4
Current account, % of GDP	-6.8	-7.7	-7.1	-10.6	-14.6	-12.8	-5.0	-5.5
Current and capital account, % of GDP	-6.4	-6.4	-5.8	-9.5	-12.8	-11.0	-3.2	-2.5
FDI inflow, % of GDP	1.0	3.4	4.0	6.0	5.2	3.6	3.8	3.8
Foreign gross debt, % of GDP	40.5	42.4	50.7	60.2	72.3	73.8	76.7	76.0
General government budget position, % of GDP	-1.3	-1.5	-0.5	-0.4	-1.2	-2.9*	-3.0	-2.5
General government debt, % of GDP	21.1	19.4	18.4	18.0	17.0	17.2	19.5	20.0

\* actual results

## Disclaimer:

Hansabank Markets a brokerage division of AS Hansabank in Estonia, AS Hansabanka in Latvia and AB Bankas Hansabankas in Lithuania (hereinafter the above banks and any of their division or affiliate collectively referred to as Hansabank Group) is responsible for preparation of research reports. The opinions contained within this report are the opinions of the persons responsible for preparation of this report and may differ from those of Hansabank Group. Hansabank Group is regulated by the Financial Supervision Authorities in Estonia, Latvia and Lithuania.

Hansabank Group may make a market in, or may, as principal or agent, buy or sell securities or derivatives of the companies mentioned in this report. Hansabank Group or its officers and employees may serve or have served as an officer, director or in an advisory capacity for any company mentioned in this report and from time to time, solicit, perform or have performed investment banking, underwriting or other services (including acting as an adviser, manager, underwriter or lender) within last 12 months for any company referred to in this report. Hansabank Group may receive or intend to seek compensation from investment banking services in the next three months from any issuer mentioned in this report. Hansabank Group may also perform or seek to perform banking services for those companies

Neither Hansabank Group nor any of their directors, officers or employees will accept responsibility for any direct or indirect losses arising from the use of this report without limitation any loss of profits even if Hansabank Group has expressly advised of the possibility or likelihood of such loss. Hansabank Group or its directors, officers or employees may have financial interest in the companies mentioned in this report, including a long or short positions in their securities, and/or options, futures or other derivative instruments based thereon.

Hansabank Group draws your attention to the fact that past performance does not necessarily indicate the future performance and the indications of future performance are based on assumptions, which may not be realized. The value of and income from your investment may change due to the changes of interest rates, changes of foreign exchange rates, securities prices or market indexes or other factors that may change the conditions of the securities market.

This report is not a tender to buy or sell, nor is it a solicitation to buy or sell any securities. This report has been prepared without regard to the individual financial circumstances and objectives of persons who receive this report. Therefore, the report does not provide individual investment advice. The securities referred to in this report may not be suitable for all investors. Investors should independently and carefully evaluate every particular investment and seek the advice of financial adviser, if needed. The distribution of this report may be restricted in certain jurisdictions and persons into whose possession this report comes should inform themselves about and act pursuant to such restrictions.

This report is based upon information available to the public. The information contained within this report has been compiled from sources deemed to be both expert and reliable, however no statement is made which guarantees the accuracy, completeness, nor the timelessness of this information and this information should not be relied upon as such. Any opinions expressed herein reflect a professional judgement at the date of publication and are subject to change. Any company mentioned in this report may have a position in Hansabank Group. Also, any company mentioned in this report may have been provided with section of this report prior to its publication in order to verify its factual accuracy and the report may have been amended after that, if necessary. Hansabank Group may to the extent permitted by law, have acted upon or used the information contained herein, or the research or analysis on which it was based, before its publication.

In preparation of this report different valuation methods have been used including but not limited to discounted free cash-flow and comparative analysis. The selection of methods depends on different circumstances. This report is amended periodically, once a month/quarter or more often if required.

The research analysts responsible for the preparation of this report receive compensation, based upon various factors, including quality and accuracy of the research, client feedback, competitive factors and overall Hansabank Group revenues. Hansabank Group's overall revenues include revenues from its investment banking and fixed income business units. The analysts do not own securities mentioned in this report.



Maris Lauri  
+372 888 1202  
maris.lauri@swedbank.ee

Mārtiņš Kazāks  
+371 67 445 859  
martins.kazaks@swedbank.lv

Lina Vrubliauskienė  
+370 5 268 4275  
lina.vrubliauskiene@swedbank.lt

Hansabank Markets  
Tel.+372 6 131 670 , Fax. +372 6 132 099  
Liivalaia 8, 15040, Tallinn, Estonia