# Latvia's Credit Ratings – the Impact of Euro Introduction on Credit Ratings and Debt Service Reduction

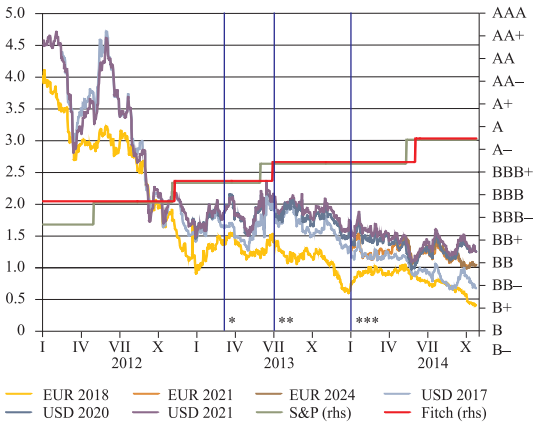
**Anete Bērziņa**
*Economist,*
*Latvijas Banka*

Country's sovereign credit ratings are widely used as benchmarks for evaluating its ability to meet its financial obligations. To assess the impact of Latvia's joining the euro area on credit ratings, the research horizon is to be extended beyond 1 January 2014, the date when Latvia joined the European Economic and Monetary Union (EMU).

The first positive post-financial crisis signal came in December 2011 when Latvia successfully concluded its international bailout programme. Standard&Poor's (S&P) upgraded its long-term rating for Latvia from BB+ in May 2012 to BBB-, recognising Latvia's political commitment to fiscal discipline. In November 2012, S&P rewarded Latvia with yet another upgrade acknowledging both the country's strong, resilient and balanced economic recovery and improvement in its public finances. At the same time, S&P expressed increased likelihood of Latvia joining the euro area in 2014 due to moderating inflation. Fitch Ratings followed the suit. On 9 July 2013, the EU Economic and Financial Affairs Council made the final decision approving Latvia as the 18th member of the euro area. On the same day, Fitch Ratings upgraded Latvia's credit rating. Altogether, since December 2011, Standard&Poor's has upgraded Latvia's sovereign credit rating by 4 notches (from BB+ in 2012 to A-), Fitch Ratings by 3 notches (from BBB- to A-), while Moody's Investors Service has been the most conservative, upgrading Latvia's sovereign credit rating by 2 notches (from Baa3 to Baa1).

One would expect that with a country's credit rating going up, the value of its debt securities also increases, and investors would require less remuneration for taking the risk of investing in these securities. Decomposition of sovereign bond rates shows how the investors' risk perceptions towards the Latvian government debt have decreased. When stripping away the risk-free component by looking at the Latvian government bond spreads with corresponding risk free sovereign bond[1], we obtain the risky component of the Latvian government debt. It has decreased considerably since December 2011, as Latvia steered closer to the euro adoption and even after that. This year, Latvia successfully organised two Eurobond issues with fixed coupon rates at record lows of 2.875% and 2.625%. For comparison, the previous euro denominated Eurobond issue in 2008 was with a fixed coupon rate of 5.5%.

**Latvian Government Bond Spreads With Corresponding Risk Free Bond and Credit Ratings**
(in percentage points)




Sources: Bloomberg, Latvijas Banka, EC.
**5 March - Latvia makes a request to the EC and the ECB to carry out an assessment*
*** 9 July - EC invites Latvia to join the euro area*
**** 1 January - Latvia joins the euro aera*

Borrowing at lower costs in international financial markets is particularly important now when Latvia has started to refinance its bailout. From the 4.5 billion euro rescue package Latvia repaid 1.1 billion euros to the IMF in 2012, 0.2 billion euros to the EC in 2013, and 1.0 billion euros to the EC this year. As Latvia has managed to refinance these loans at lower rates, to date, it has saved around 80 billion euros and is likely to save another 720 billion euros by 2022, according to Latvijas Banka calculations.

As a member of the monetary union, Latvia has benefited from the euro area's highly developed capital market and strong credibility of the ECB monetary policy. However, the improvements in Latvia's finances have not solely been brought about by the accession to the euro area, for the underlying preconditions comprise also a set of bold reforms, fiscal austerity measures and strong commitment of Latvia to be a part of the EMU.

[1] In the case of debt denominated in USD, we use the corresponding US Treasury note, but in the case of debt denominated in EUR, we use the corresponding German bond.