



# Weekly Briefing

## **Latvia economy briefing:**

### **Latvia's credit rating upgraded to the historically highest level**

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## **Latvia's credit rating upgraded to the historically highest level**

In the recent months Latvia's credit rating was upgraded twice by international credit rating agency S&P Global Rating, in 2019 the credit rating raised from "A-" level to "A" level and for the second time the rating was upgraded to "A+" level therefore reaching historically highest level ever since the Year 1997, when Latvia was first assigned with a credit rating. The improvement of the credit rating is mainly explainable due the successful national fiscal policies.

In the latest years, the government of Latvia has paid a lot of focus to raise the credit rating of the country due to various reasons. Credit rating is an independent opinion of the rating agency on the solvency by that meaning the ability to meet financial obligations at a specified time and in the full amount of a State or another entity. In addition, in recent years the credit rating has become an internationally recognized indicator describing the level of investment risk. Because of that, the credit rating is often used by investors for evaluation and comparison purposes prior to investment. To create attracting investment environment Latvia has worked on the improvements of more stable economic, finance and governance indicators of the State since it has a direct impact on the credit rating of the country. As a result of the improvement of the credit rating Latvia and the companies based in Latvia will be able to attract investments on more favorable terms.

In the report regarding credit rating, S&P Global has stated that stricter regulations for commercial banks and that the measures taken to reduce non-resident deposits in the Latvian banking system do not pose a threat to the stability of Latvia's financial sector and has no significant impact on the Latvian economy.<sup>1</sup> The S&P Global agency had additionally noted that the reduction of non-residents deposits in the Latvian banking sector also reduces external risks, such as short-term external debt amount. The mentioned measures which were taken by the government of Latvia served as a cause for the upgrade of the credit rating of Latvia in the Year 2019.

Because of the continuous improvements on the flaws in governance, economy and fiscal policies in 2020 the credit rating agency S&P Global Ratings raised the credit rating of Latvia from "A" level to "A+" level maintaining a stable outlook for the future of economic

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<sup>1</sup> <https://www.lsm.lv/raksts/zinas/ekonomika/sp-paaugstina-latvijas-kreditreitingu-vesturiski-augstakajalimeni.a349294/>

development of Latvia. In its assessment, S&P Global Ratings agency highlighted two major factors which contributed to the upgrade of rating. Since Latvia has determined stricter fiscal policy which, despite moderate economic growth in medium term, it will allow to reduce the country's current public debt, the S&P Global Agency concluded that the vulnerability of the Latvian financial system is limited.<sup>2</sup>

“This is a historical moment. For the first time in Latvian financial history we have been rated with such high credit rating. This is a clear international confirmation of Latvia's public finance management policy. An increase in the national credit rating is the basis for further attraction of investments to our country as a reliable and secure cooperation partner” emphasized Minister of Finance Janis Reirs.

At the same time the Agency recognized that despite the current fragmentation of political parties in Latvia, the progress regarding the implementation of Moneyval recommendations over the past 2 years has been significant. The input of government regarding the creation of appropriate framework for preventing money laundering and financial crime and restoring the reputation of the public financial system has been valuable. Furthermore, the credit rating agency had stated that both in good times and times of crisis, the government of Latvia has been able to demonstrate its ability to implement effective policies.

In the Year 2018 Moneyval published a report regarding the effectiveness of the Latvian system of money laundering and terrorism financing, analyzing 11 efficiency indicators which concluded that series of improvements are required to ensure transparent financial system. At that time only one indicator regarding international cooperation was marked as high, the other 10 indicators showed inconsistencies from which two of the indicators – “Legal persons and entities” and “Targeted financial sanctions to prevent proliferation financing” - were marked as low.<sup>3</sup> It was concluded that the system of identifying the true beneficiaries and system of prevention for the financing of proliferation of weapons of mass destruction was ineffective. Because of that Moneyval established a supervisory status for Latvia in 2018.

The restoration process of financial sector in Latvia was necessary to strengthen the ability to prevent money laundering and terrorist financing and to meet international standards in this area. In the latest years both government and banks have made a significant input to sort the financial sector of Latvia and implement the tools for financial crime prevention. To ensure

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<sup>2</sup> <https://fm.gov.lv/lv/aktualitates/jaunumi/kreditreitings/61710-latvijas-kreditreitingu-paaugstina-vesturiski-visaugstakaja-limeni>

<sup>3</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Moneyval-Mutual-Evaluation-Report-Latvia-2018.pdf>

sustainable and safe financial system in Latvia, there were introduced and passed draft laws, which provided law amendments to both to the Financial and Capital Market Law and the Law on Credit Institutions.

To strengthen the supervision over money laundering activities and both prevention of terrorist finance and proliferation financing activities the responsible institutions of Latvia have focused their attention especially in the latest years to ensure safer financial system. The changes to the regulatory framework have strengthened the risk-based approach to supervision in all supervisory and control authorities, and the resources of all those authorities have also been increased. With the amendments of Law regarding financial system the supervisory authorities now use specific risk identification and profiling to identify the highest risks in the sectors. In order to carry out targeted monitoring, the number of on-site inspections have been increased.<sup>4</sup>

A significant part of the strategy for strengthening the supervision over money laundering activities and both prevention of terrorist finance and proliferation financing activities was decrement of the risk of banking sector and consolidation. The current amendments to the Law prohibit enterprises to cooperate with shell companies that do not have a legal entity associated with their actual economic activities, and is incorporated in a country where statutory requirements do not include the preparation and submission of financial statements. Additional measures that were taken specifically to prevent both importation and exportation of undeclared or criminally acquired cash from Latvia were the amendments to the law on declaration cash at the State border.

Following the evaluation report of the 5th round of Moneyval, Latvia has taken various actions and steps to improve the system of strengthening the supervision over money laundering activities and both prevention of terrorist finance and proliferation financing activities and in particular has raised the awareness of risks and the comprehension of the subject of law. The report of Moneyval stated that additional resources and effective supervision have let to improve the adequacy of the subject of law about the risks and the effectiveness of the application of preventive measures.<sup>5</sup>

During the previous plenary session Moneyval had inspected technical compliance progress report of Latvia providing the information and expert assessment of Latvia's progress in developing its regulatory framework to meet the 40 recommendations of Financial Action Task Force. Because the implementation of these recommendations in each country's

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<sup>4</sup> [https://www.fid.gov.lv/images/Downloads/useful/Pasakumu\\_plans\\_Moneyval.pdf](https://www.fid.gov.lv/images/Downloads/useful/Pasakumu_plans_Moneyval.pdf)

<sup>5</sup> <https://www.la.lv/makoni-atkapjas-latviju-neieklauj-pelekaja-saraksta>

regulatory framework provides a basis for effective anti-money laundering and terrorist financing prevention system the recommendations became a crucial importance to the government of Latvia and in the last two years the responsible institutions has been working on implementing a regulatory that would meet the recommendations. Following the evaluation of the progress report, 7 out of 40 recommendations are currently rated as fully compliant and 33 as mostly compliant.<sup>6</sup>

The implementation of the Law amendments can be considered as one of the most ambitious finance sector reforms programs in Europe and has proved that Latvia is willing to ensure stable and transparent financial system as a basis of sustainable growth and welfare for all Latvian citizens.

The upcoming challenges for Latvia to an even further upgrade of credit rating would be the contribution to the economy of Latvia by the improvement of balance of payments rates above the ones forecasted by the credit rating agency. Additional challenges will be caused by the relatively low-income rate and long-term demographic difficulties, which currently limits the upgrade of credit rating. However, the credit rating of Latvia could be downgraded if there will be a significant change in the current strict fiscal policy that could cause increment of the national net debt or would affect the stability or economic growth of the financial sector.<sup>7</sup>

## **Summary**

The work of government of Latvia on financial sector regulation in the last two years to strengthen the supervision over money laundering activities, prevention of terrorist and proliferation financing activities has resulted in an upgrade of the credit rating of Latvia reaching historically highest level. Since the Moneyval report in 2018 on effectiveness of the Latvian system of money laundering and terrorism financing the government of Latvia has been paying a lot of focus to international finance institution recommendations regarding improvement of financial system of Latvia. The statement of S&P Global Ratings both in 2019 and 2020 certifies that the implementation on stricter regulations regarding banking system and financial supervisions for illegal financing activities has contributed to minimization of threats to the economy and sustainability of Latvia.

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<sup>6</sup> [https://www.mk.gov.lv/sites/default/files/editor/Finansu\\_sektors/financial\\_sector\\_update\\_no\\_21.pdf](https://www.mk.gov.lv/sites/default/files/editor/Finansu_sektors/financial_sector_update_no_21.pdf)

<sup>7</sup> <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/s-p-upgrades-latvia-to-a-on-expected-sustained-fall-in-public-debt-57232086>