Fitch Changes Bulgaria, Estonia, Latvia and Romania Outlooks to Negative

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Fitch Ratings-London-31 January 2008: Fitch Ratings has today revised Bulgaria's, Estonia's, Latvia's and Romania's Outlooks to Negative from Stable for their Long-term foreign and local currency Issuer Default ratings (IDRs). At the same time, the agency has affirmed the Long-term foreign and local currency IDRs, Short-term foreign currency IDR and Country Ceilings of all four countries. The ratings are listed below.

"Current account deficits in the Baltic States, Bulgaria and Romania have risen to levels that look disconcertingly stretched by current global or historical standards," says Edward Parker, Head of Emerging Europe sovereigns at Fitch. "External deficits that were easy to fund in times of abundant liquidity and risk appetite may be harder to finance following the global credit shock. The Negative Outlooks reflect the heightened downside risk of an abrupt slowdown in capital inflows and a costly macroeconomic adjustment."

Fitch will be publishing a report entitled "Emerging Europe's Current Account Deficits: Mind the Gap!" on the agency's website, www.fitchratings.com, within 24 hours. Fitch estimates 2007 current account deficits (CADs) at 25% of GDP in Latvia, 19.5% in Bulgaria, 16% in Estonia, 14% in Romania and 13.7% Lithuania. Along with Georgia (rated 'BB-' (BB minus)/Stable), Fitch estimates these to be the highest CADs out of all of the 105 Fitch-rated sovereigns.

Substantial CADs, external financing requirements and rapid credit growth have been long-standing rating weaknesses that Fitch has highlighted. However, concerns have heightened over the past 12 months as macroeconomic imbalances have widened and, in some case, remain on a deteriorating trend. Against this backdrop, the global credit crunch represents a significant negative shock. In addition, inflation has risen sharply, weaker euro area GDP growth will adversely affect exports, while delays to euro adoption timetables exacerbate external financial risks. Fitch believes the outlook for the region has, therefore, weakened and rating dynamics have shifted. Fitch downgraded Latvia's Long-term foreign currency IDR to 'BBB+' from 'A-' (A minus) in August, revised the Outlook on Lithuania's Long-term foreign currency IDR of 'A' to Negative from Stable in December and revised the Outlook on Kazakhstan's Long-term foreign currency IDR of 'BBB' to Negative from Stable in December.

There are valid grounds for believing that fast-growing transition countries can sustain high CADs, but history suggests it can be dangerous to think "it's different this time". CADs mainly reflect buoyant private sector capital inflows, including significant foreign direct investment, rather than budget deficits, though fiscal policy loosening in Romania is a concern. Most countries are still gaining export market share, but tightening labour markets are starting to affect competitiveness. However, rapid bank credit growth and external borrowing, often from foreign parent banks, has played a key role in both fuelling and financing CADs. High rates of foreign bank ownership have been a net positive for the region, but could open a channel of contagion, should the global credit squeeze persist.

The global credit shock could help to engineer a welcome moderation in credit growth and a gradual unwinding of external imbalances. However, economic adjustment may not be smooth, particularly after such a strong financial boom. GDP and credit growth has already started to cool in Estonia and, to a lesser extent, Latvia from high levels, but will take time to feed through to inflation, wages, CADs and external debt dynamics. Fitch believes that a broadly soft landing remains the most likely scenario in each of the four countries. But the downside risk of a hard landing has increased. A hard landing - particularly if it involved the abandonment of a currency peg - would entail significant economic costs and likely lead to rating downgrades. In that event, high levels of euroisation would be a vulnerability, but strong public finances, flexible economies and foreign bank ownership could ease the costs of adjustment. Conversely, sufficient evidence of macroeconomic rebalancing and soft landings could see a reversion to Stable Outlooks. Fitch expects that the resolution of Outlooks will be largely driven by country specific developments.

Bulgaria:
Long-term foreign currency IDR: affirmed at 'BBB'; Outlook changed to Negative from Stable
Long-term local currency IDR: affirmed at 'BBB+'; Outlook changed to Negative from Stable
Short-term foreign currency IDR: affirmed at 'F3'
Country Ceiling: affirmed at 'A-' (A minus)

Estonia:
Long-term foreign currency IDR: affirmed at 'A'; Outlook changed to Negative from Stable
Long-term local currency IDR: affirmed at 'A+'; Outlook changed to Negative from Stable
Short-term foreign currency IDR: affirmed at 'F1'
Country Ceiling: affirmed at 'AA'

Latvia:
Long-term foreign currency IDR: affirmed at 'BBB+'; Outlook changed to Negative from Stable
Long-term local currency IDR: affirmed at 'A-' (A minus); Outlook changed to Negative from Stable
Short-term foreign currency IDR: affirmed at 'F2'
Country Ceiling: affirmed at 'A+'

Romania:
Long-term foreign currency IDR: affirmed at 'BBB'; Outlook changed to Negative from Stable
Long-term local currency IDR: affirmed at 'BBB+'; Outlook changed to Negative from Stable
Short-term foreign currency IDR: affirmed at 'F3'
Country Ceiling: affirmed at 'A-' (A minus)

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