

**S&P downgrades Latvia to "BBB-", on watch negative**

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NEW YORK, Nov 10 (Reuters) - Standard & Poor's on Monday lowered its long-term foreign and local currency sovereign credit ratings on **Latvia** to "BBB-" from "BBB" on increased risk facing **Latvian** banks of a weakening deposit base. The long- and short-term ratings have been placed on CreditWatch with negative implications. "High external indebtedness and substantial, but declining, current account financing needs remain the key constraints on the ratings on **Latvia**," S&P said in a statement. The flow of external financing depends on the willingness and ability of foreign parent banks to roll over intra-bank lending, as well as the stability of nonresident deposits in domestic banks, S&P said. Although the central bank's foreign exchange reserves more than fully cover **Latvia**'s monetary base as of Nov. 10, 2008 the expected further use of reserves to defend the currency raises further concerns regarding **Latvia**'s external liquidity.

The downgrade also reflects a weaker-than-expected economy, as third-quarter economic growth data indicates a much steeper contraction in the second half of 2008 as well as in 2009. S&P expects a substantial reduction in tax revenue intake and for the general government deficit to surge to 4.5 percent in 2008, which includes the cost of a cash injection to **Parex** Bank equivalent to 2 percent of gross domestic product. The deficit could exceed 6 percent in 2009. As a result, the government debt burden is expected to double from its current level at less than 10 percent of GDP to nearly 20 percent by year-end 2009. "As a result of the weaker economy and support to the banking system, we expect the **Latvian** government's fiscal flexibility to erode rapidly in the next few years," S&P said. The short-term ratings of "A-3" were affirmed. At the same time, Standard & Poor's also lowered its Transfer & Convertibility assessment on **Latvia** to "A-" from "A". (Editing by James Dalglish) Keywords: RATINGS **LATVIA**/SANDP (manuela.badawy@thomsonreuters.com; +1 646-223-6055; Reuters Messaging: manuela.badawy.reuters.com@reuters.net)

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