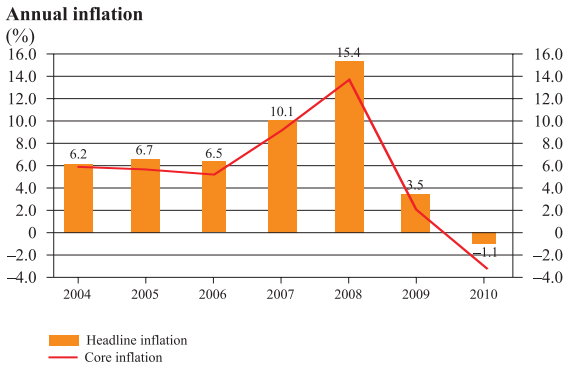
1. Highlights

Deflation in 2010 confirms the flexibility of the Latvian economy

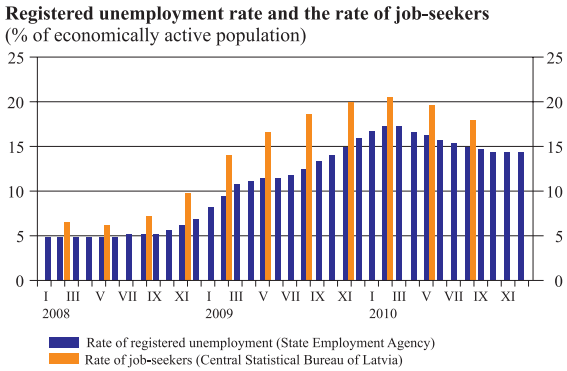


The average level of consumer prices in 2010 was overall 1.1% lower than in the year before. To a great extent, this resulted from the low domestic demand and the drop in production prices: with labour costs down and productivity on the rise, businesses had the opportunity to respond to the weakening demand with lower prices.

The rising global oil prices had a significant effect on fuel prices: in 2010, they exceeded the 2009 level by 14.6%. Moreover, the natural gas and heating tariffs also went up. Furthermore, global prices have pushed up the prices of unprocessed foods (particularly those of vegetables). By contrast, the prices have dropped persistently in those groups of goods and services that have been substantially affected by the fall in labour costs and demand in Latvia. The low domestic demand had the largest effect on prices of services, which continued to decline at the end of the year as well.

The changes in the value added tax rates in effect as of January this year are expected to have the most pronounced effect on inflation in 2011. The low demand, however, will continue to limit this increase and in the second half of the year inflation will resume a downward trend.

Drop in unemployment is stable: it is determined by renewed competitiveness

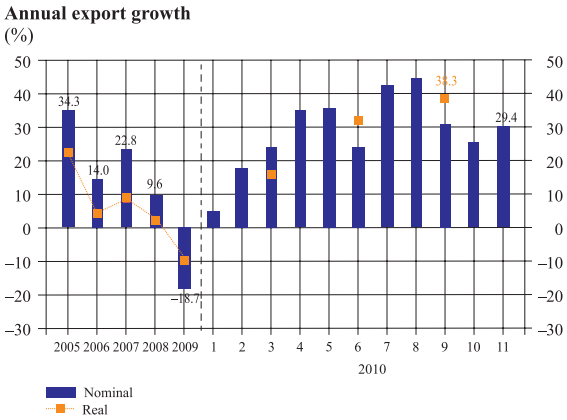


The rate of registered unemployment at the end of 2010 was at 14.3%. Compared to its historic peak in March 2010, it had dropped three percentage points by the end of the year.

According to Eurostat, in the second and third quarters of 2010 Latvia had the fastest growing employment among the members of the European Union. The explanation: renewed competitiveness in recent years not only on account of the drop in prices and costs but also increased productivity. The rise in productivity in Latvia has been the highest among the EU countries.

The largest contributor to the rise in employment was manufacturing which has also posted the biggest rise in productivity so far. During the crisis, the dry-up of investment precluded any rise in accumulated capital; moreover, the level of production capacity utilisation decreased. The current rise in productivity was thus achieved primarily by raising the organisational efficiency of businesses.

Exports continue to grow but the need for higher added value is also growing



The annual export growth accelerated from 24.9% in October to 29.4% in November 2010. The highest annual rise in goods exports was posted by base metals, plastics, machinery and mechanical appliances as well as wood. In addition to the persistent foreign demand, the rise in exports of all the above industries was also stimulated by the improved competitiveness of Latvian producers, which was based on both competitive prices and higher productivity.

Taking into account the looming debt crisis risks in the euro area and the planned fiscal austerity measures in EU countries, the economic growth of Latvia's trading partners will moderate in 2010. Since the market capacity will grow slowly while the competition in the foreign markets will tighten substantially, the Latvian export producers will have to look increasingly for new niche products and develop products with a higher added value.