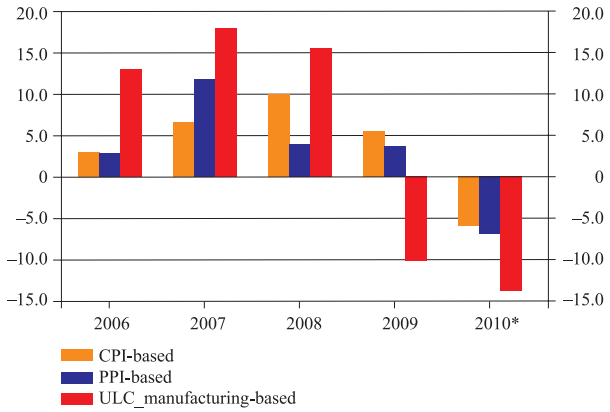
# 3. In Focus

## Latvia has regained cost competitiveness

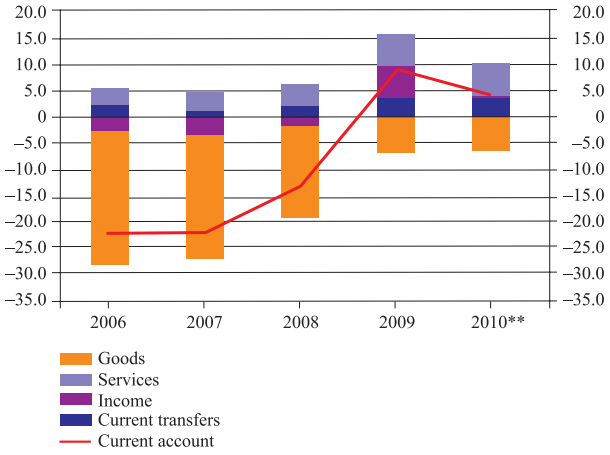
In 2010, a significant improvement in cost competitiveness supported Latvia's economic recovery. This improvement that started already in 2009 was reflected by a number of economic indicators (for instance, real export growth and increasing export market shares). Moreover, it was recognized also by international institutions and rating agencies.

**Y-o-y changes in real effective exchange rate measures**
(%)




* Whole year for CPI-based index; 12-m average y-o-y change in November 2010 for PPI-based index and 4-q average y-o-y change in Q3 2010 for ULC-based index.
Source: Bank of Latvia.

**Current account and its main components**
(in % to GDP)




** Preliminary data.
Source: Bank of Latvia.

Growing productivity in manufacturing and declining domestic price and cost levels relative to that of major trading partner countries reflected the successful process of internal adjustment which allowed the competitive position of Latvian producers to improve. The ULC-based REER was down by almost 20% in Q3 2010 compared to its peak in Q3 2008, with decreases of CPI- and PPI-based indexes against their peaks amounting to around 10% (recently they were more influenced by world commodity prices)*. The ability of firms to shift from the domestic to the external market and favourable developments in relative prices have resulted in stable or growing market shares in most major trading partner countries. In the first 11 months of 2010 (as compared to 2009), Latvian export market shares grew noticeably, for example, in Poland, Finland, the UK, Russia, Germany, Denmark.

In Q4 2010, exports of goods exceeded the pre-crisis level noticeably (by more than 13% in real terms), with the respective import developments still lagging behind. Stable y-o-y growth of goods exports since the second half of 2009 has been broad-based across the product groups, with the highest y-o-y increases recorded for wood and paper, base metals and articles thereof as well as products of chemical industry, machinery and mechanical appliances, plastics, and a number of products of food industry and agriculture.

The current account of the balance of payments has remained in surplus since Q1 2009, returning to more sustainable levels in Q3 and Q4 2010 after a surge in 2009: the pick-up in manufacturing and exports urged a need for imports of intermediate and capital goods, and losses incurred by the FDI companies in Latvia decreased.

The unwinding of past imbalances and investment environment improvement have been recognized by international rating agencies: in September 2010, *Fitch* IBCA changed the outlook of its rating from negative to stable, while in December 2010 S&P upgraded the Sovereign Credit Rating from BB/Stable/B to BB+/Stable/B. Preliminary data (monthly statistics) point to an increasing investors' confidence, and net FDI inflows tended to increase at the end of the year 2010.