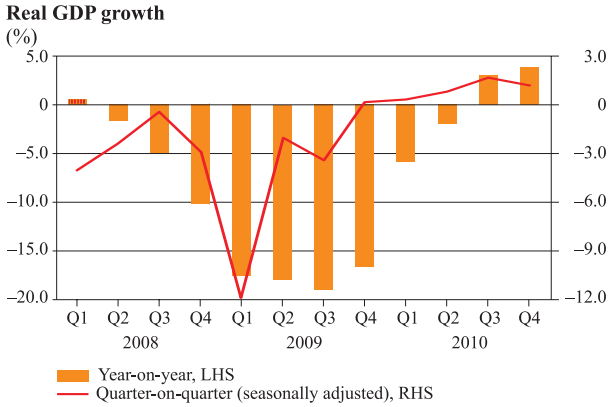
# 1. Highlights

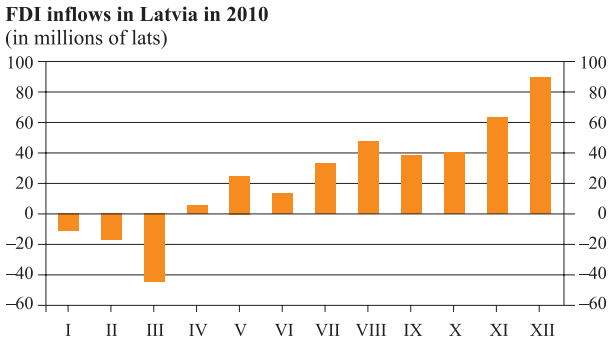
## Gross domestic product grows for a fifth consecutive quarter




Latest estimates of GDP growth in the fourth quarter of 2010 (up 3.7% year-on-year) point to an overall GDP contraction by 0.2% at constant prices in 2010. This would be a substantially better outcome than predicted by market participants at the beginning of the year. The quarterly GDP growth has been positive throughout 2010.

Further growth will depend on several domestic and external factors. The most important external factors are developments in both global food and oil prices. Moreover, fiscal consolidation in some of Latvia's foreign trade partners may have implications on their economic growth and, consequently, import demand for Latvian goods. Domestically, the recent tax raises are likely to slightly slow down consumption. Overall, however, we expect growth rates in the economy for 2011 to be well above 3%.

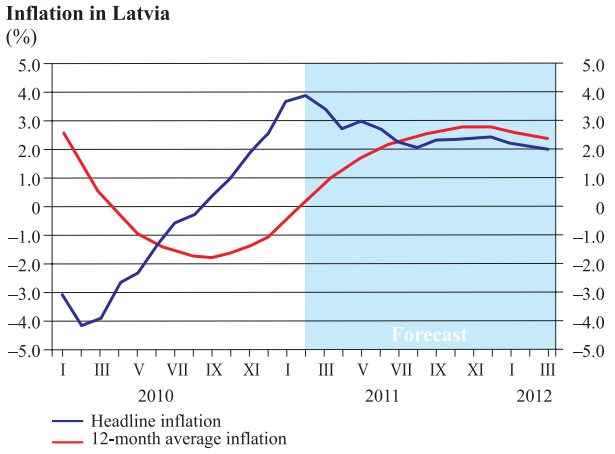
## End of 2010 sees more foreign investment in Latvia




According to the preliminary data on Latvia's balance of payments and GDP forecast, a small surplus was maintained in the current account in the fourth quarter of 2010, with the respective annual surplus amounting to 4%.

The financial account experienced positive changes: its surplus in December resulted from growing foreign direct investment in the share capital of Latvian enterprises. This contrasts strongly with the net outflows still observed at the beginning of 2010. In the course of the year, the situation improved substantially. The recent evaluations by *Fitch* IBCA and *Standard&Poor's* (an improved rating outlook and upgraded rating respectively) suggest that the investment environment in Latvia has stabilised and point to potential investment inflows in the future.

## Prices in Latvia driven up by higher taxes as well as global energy and food prices




For some months now price increases have been observed in shops despite a rather high unemployment. Until recently it was explained by fluctuations in world energy and food prices but a new factor has appeared as of the beginning of the year: value added tax. A higher VAT rate accounted for the greatest part of price rises in January, with the consumer price index growing by 1.3% within a month. The annual inflation growth has thus reached 3.7%.

Such developments are consistent with the current Bank of Latvia inflation forecast: we expect a rise in the annual inflation in the first months of the year followed by a subsequent gradual decline. The average annual inflation remained negative in January at –0.5% and we expect that the average inflation this year will be 2.7%. Soft labour market conditions and weak domestic demand will act to restrict the development of a wage-price spiral.