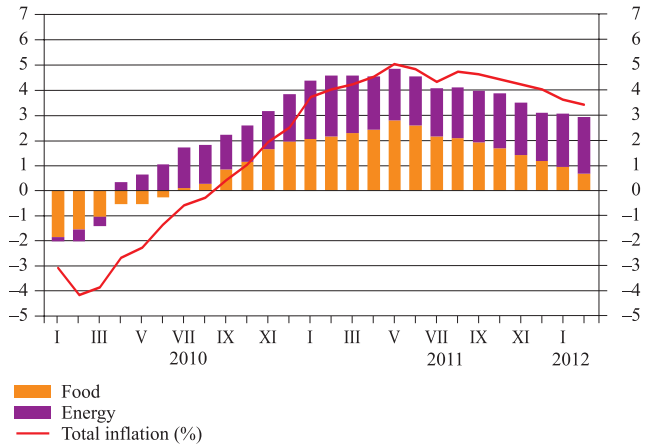
3. In Focus

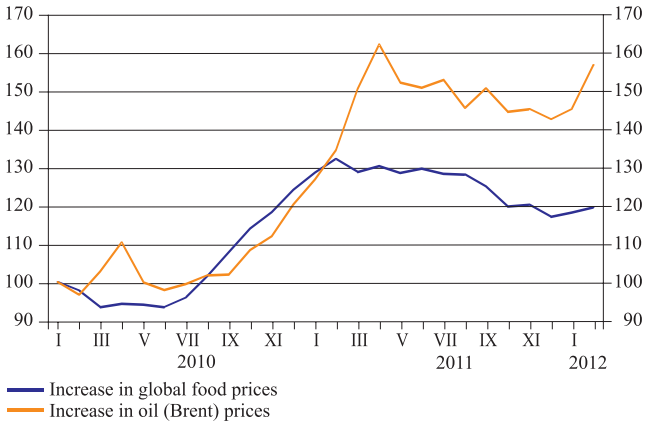
Inflation rate remains on a downward trend

Contribution of food and energy prices to inflation (pp) and the y-o-y inflation rate
(%)



Sources: FAO, Reuters.

World food and oil price developments
(%; Jan 2010 = 100%)



Sources: FAO, Reuters.

The annual inflation rate has been declining since August 2011 and was 3.4% in February 2012. Both external and domestic factors contributed to the deceleration of consumer prices. Firstly, this year the domestic tax policy is more favourable: no new tax measures affecting consumer prices have been introduced as was the case in 2011. Thus the impact of the increases in VAT and excise tax on fuel, tobacco and alcoholic beverages implemented over 2011 is gradually fading out (the so-called base effect). Secondly, a relatively smaller rise in global food prices in the beginning of 2012 (as compared to January-February 2011) also contributes to the slowdown of the headline inflation (see Chart 1 and Chart 2). Even though the so-called administered prices still contribute around 1.5 percentage points to the headline inflation, they contain the impact of electricity tariffs raised in April 2011; therefore, the impact of administered prices on inflation is about to decrease as early as in Q2 2012.

Domestic factors other than indirect taxes and administered prices (highly dependent on world energy prices) seem to have a relatively small impact on the average annual inflation in 2012 as the economic growth is about slow down both domestically and in Latvia's major trading partner countries. This is reflected by the decreasing core inflation. Looking at the external factors, the political unrest in oil-producing countries seems to have taken on a more permanent character and is unlikely to be solved in the nearest months, thus adding to the uncertainty about the precise impact on the average annual inflation. Persistently high energy costs may affect the total costs of other industries, including food production. The uncertainty surrounding the food prices is aggravated also by the weather conditions such as the drought in South America affecting crops as well as the harsh winter influencing the expected grain harvest in the CIS countries. In recent months, however, the food prices levelled out as a result of the good harvest of the previous season and hence sufficient stocks. Despite some uncertainty regarding the impact of external factors, the actual 2012 inflation rate is expected to remain on a downward trend and reach 2.4% in 2012 on average.