



LATVIJAS BANKA

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1 Highlights

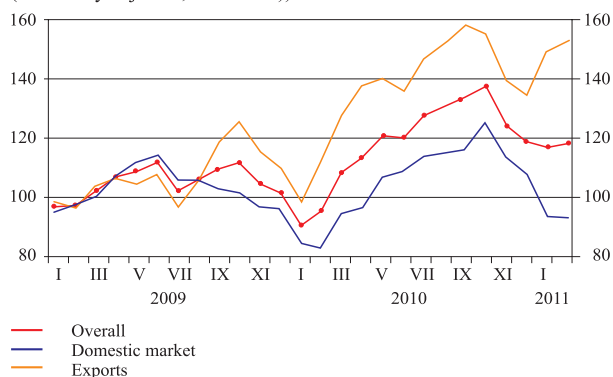
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1. Highlights

Growth returns to manufacturing

Industrial turnover index for manufacturing
(seasonally adjusted; 2005=100)

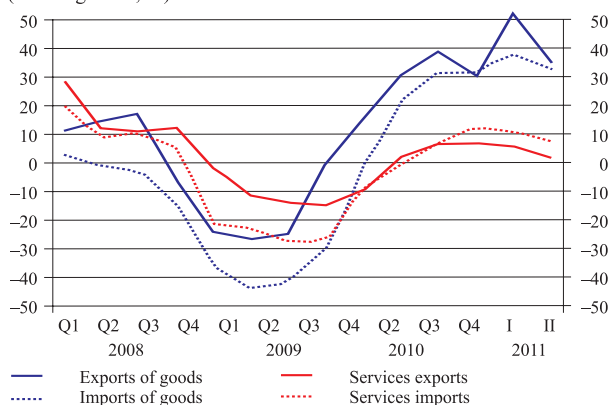


Manufacturing output grew by 1.5% month-on-month and 13.3% year-on-year in February. The trends observed in manufacturing point to the perseverance of the dominating role of exports in industrial growth. The turnover in the export markets is at a record-high level, whereas the domestic turnover, following an improvement in the second half of last year, is shrinking again.

At the same time, the low level of investment does not allow any further increase in the volume of output, and many companies have reached the maximum level of capacity utilisation. While price rises in the export markets currently provide many businesses with the opportunity to earn more with the same or even less output, further investment in expanding production capacity is of paramount importance going forward.

Foreign trade up in February

Goods and services trade
(annual growth; %)



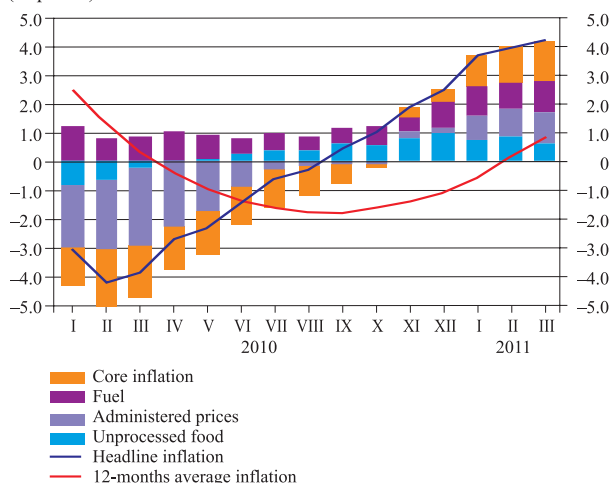
In February, exports and imports expanded by 35.5% and 31.0% year-on-year respectively. The 3.4% month-on-month growth in the exports of goods suggests that Latvian exporters, despite higher raw material and energy costs, still managed to increase their income as a result of both competitiveness gains and rising global prices in several groups of Latvian export goods.

Significant growth was achieved by Latvia's main export partners; therefore, the shares of these countries in Latvia's export structure continued to expand, i.e. exports to Germany, Russia, Sweden and the Baltic countries increased.

Confidence indicators improved markedly in March. The assessment of export orders has also improved recently. Investment activity is expected to gain momentum this year, but some time will pass before it finds its reflection in industrial and export outputs. Growing global energy and food prices and potential capacity constraints represent the main risks in the short term.

Fuel prices contributing to pick-up in inflation

Annual inflation by components
(% points)




In March, the consumer prices went up 0.7%. The annual inflation rose by a mere 0.2 percentage point reaching 4.2%. The 12-month average inflation is currently at 0.8%.

The soaring global oil price is the largest contributor to the March price rises. The increases in food prices have, in turn, moderated: both shops and producers have already managed to renew most of their supply agreements; therefore, for the time being prices are not subject to major changes.

Under the influence of the base effect, the annual inflation is expected to stabilise, yet several factors will continue to exert an upward impact on prices in the near future: global prices, the new electricity tariffs and the tax rise scheduled for summer. Private consumption has a downward effect: its recovery is weak and cautious, with prices rising under the influence of supply factors and unemployment remaining high.

2. Macroeconomic Data

	Reporting period	Data (%)
Gross Domestic Product (GDP) (quarter-on-quarter growth, seasonally adjusted)	2010 Q4	1.1
State budget		
Tax revenue (current month; year-on-year growth)	2011 III	6.6
General government expenditure (since the beginning of the year, year-on-year growth)	2011 III	-1.9
Consumer price changes		
Consumer Price Index CPI (month-on-month growth)	2011 III	0.7
12-month average annual inflation (to comply with the Maastricht Criteria)	2011 III	0.7
08.04.2011 Food price rises have abated, but fuel prices rising fast 		
Foreign trade		
Exports (year-on-year growth)	2011 II	35.5
Imports (year-on-year growth)	2011 II	31.0
12.04.2011 Foreign trade up in February; investment crucial for export growth 		
Balance of payments		
Current account balance (ratio to GDP)	2010 Q4	-0.3
Foreign direct investment in Latvia (net flows; % of GDP)	2010 Q4	2.7
12.04.2011 The current account surplus in February determined by the amount of transfers 		
Industrial output		
Working day-adjusted industrial output index (year-on-year growth)	2011 II	13.3
04.04.2011 After a downturn of previous months, growth returns to manufacturing 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2011 II	3.6
30.03.2011 No sensation: retail up in February 		
Employment and unemployment		
Registered unemployment (share of working age population)	2011 III	14.4
11.04.2011 The number of occupied posts is likely to increase also in construction 		
Monetary indicators		
Broad money M3 (year-on-year)	2011 III	7.1
20.04.2011 A pause in the growth of money supply 		

Sources: Treasury, Central Statistical Bureau of Latvia, and Bank of Latvia data.

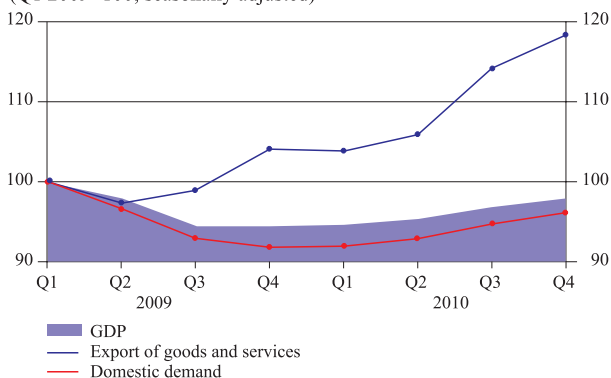
3. In Focus

Exports bring Latvia back on growth track

Latvia has returned to the growth path as the economy has been expanding for five consecutive quarters in seasonally adjusted terms. The recovery from the trough at the end of 2009 was gradual and thus the GDP for 2010 as a whole still remained slightly (0.3%) below the 2009 level.

Real GDP

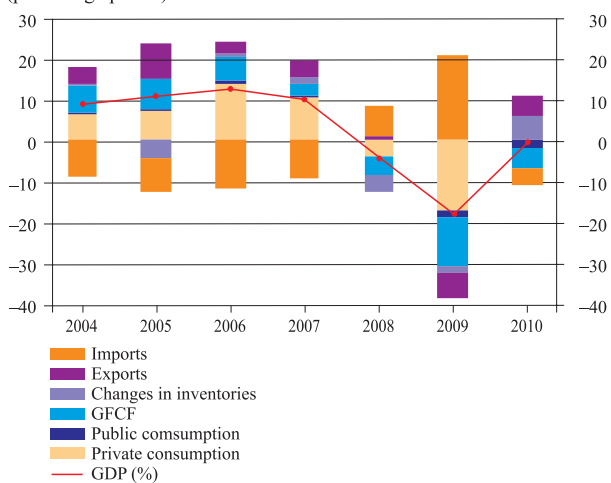
(Q1 2009=100; seasonally adjusted)



Source: Central Statistical Bureau of Latvia.

Contribution to real GDP growth

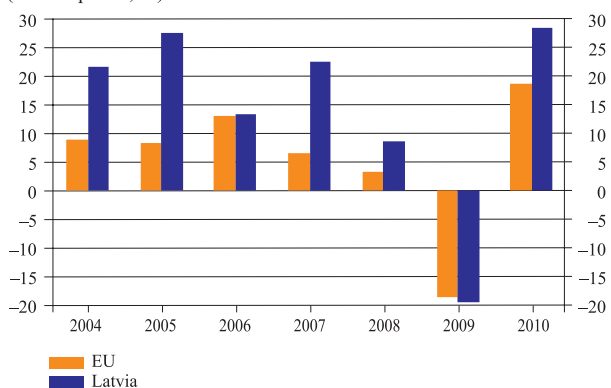
(percentage points)



Source: Central Statistical Bureau of Latvia.

Growth in exports of goods

(current prices; %)



Source: Eurostat.

Improved external demand and regained competitiveness revived export growth which was a major factor behind the economic recovery. At the same time, improved prospects of both global and domestic economic outlook turned around the inventory cycle. Following in the footsteps of the external developments, the dynamics of domestic demand turned positive during 2010. However, the recovery in consumer confidence and private consumption was fragile and was dampened by the fiscal consolidation. Consequently, private consumption remained broadly unchanged in 2010, while the biggest drag on growth was the reduction in public consumption as a result of austerity measures.

The strength of export growth was based on the pick-up in the export of goods. Latvian export growth was one of the fastest in the EU and considerably exceeded the EU average as Latvian exporters regained competitiveness increasing their shares in the markets of its main trading partners. Export recovery benefitted also from favourable developments in the terms of trade. Based on the strength of the main export-oriented industries at the end of 2010, the robust export growth is expected to persist in the short term.

According to the European Commission forecast, the Latvian economy is projected to expand by 3.3% in 2011 placing the country among the fastest growing economies in the EU. The recovery will continue to be driven by exports of goods and services that are projected to retain a robust growth rate. The strong pick up in export-targeted manufacturing resulted in a surge in capacity utilisation in 2010; therefore, sustained export growth will require investment in production capacity. Albeit limited by the reaction to fiscal austerity commitments, gradual recovery in consumer confidence will add a positive contribution from domestic consumption.

Noteworthy, some risks to external demand remain related to potential further adverse effects from the sovereign risk situation in Europe and fiscal consolidation needs in some export partner countries. On the other hand, Latvia's main trading partner countries have recently been on a track of consistent growth projection upgrades. Rating agencies added an additional vote of confidence in Latvia's return to long-term economic growth and fiscal sustainability as the country's credit rating was raised to investment grade by Fitch, while Standard & Poor's assigned a positive outlook to its BB+ rating in March.