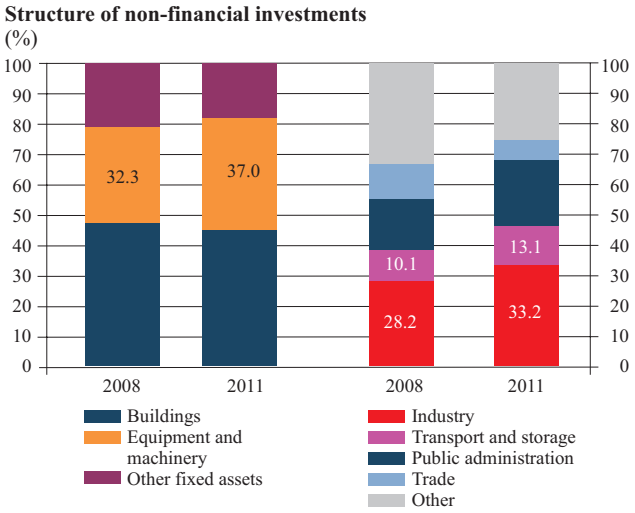
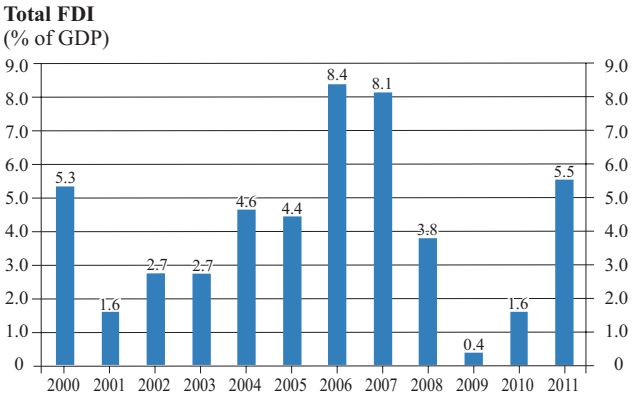
3. In Focus

Investment activity is picking-up



Latvia experienced a strong rebound in economic activity and investment in 2011. The economy was growing quite rapidly: real GDP expanded by 5.5% y-o-y, real manufacturing output grew by 11.5%. Capacity utilisation rates increased, reaching historical highs in some manufacturing sub-sectors. It was just a matter of time before a new rise in investment activity. As a result of the economic growth, the need for new capacity in manufacturing, implementation of some large infrastructure projects and availability of EU funds, investment rose by a stunning 28.7% in 2011.

Moreover, the structure of investment has changed. After the crisis, the flow of non-financial investment was notably diverted towards tradable sectors. In 2011, the non-financial investment grew primarily on account of the contributions by manufacturing (5.6 percentage points), energy (6.3 percentage points) and transport (2.9 percentage points). Quite a significant contribution was also made by public investment (8.4 percentage points): mostly in infrastructure construction projects (especially roads) co-financed from EU funds. It is expected that investment activity will continue to strengthen in 2012: a number of large investment projects in the energy and transport sectors have already been scheduled; moreover, manufacturing and construction will contribute notably to the growth of non-financial investment.



Regained investor confidence manifested itself also in the growing foreign direct investment (FDI) inflows in 2011 (LVL 783.0 million or 5.5% of GDP; largest since 2007 and close to the average pre-crisis level). The overall level of FDI inflows reached in 2010 was exceeded already in the first half of 2011, and in the third and fourth quarters investment inflows remained considerable. With FDI growing, its structure also changed: investment inflows into manufacturing and in the sectors of energy and transport increased their share.

Historically, most of Latvia's FDI inflows comes from neighbouring countries in the Baltic Sea region and other EU Member States. Investment from EU countries accounted for 84% of all FDI in 2011, with the largest contributors being Estonia, Sweden and the Netherlands. A large proportion of the Estonian FDI results from 'transit investment' by Scandinavian and other investors made through regional head offices established in Estonia.

As for 2012, we see the following factors driving the investment activity. Investment growth will be supported by large projects (e.g., in the energy sector, infrastructure projects) launched in 2011 and ongoing this year, as well as the inflows of EU funds that are expected to remain similar to the level of 2011. A factor of particular importance is the robust and still rather high business confidence at the beginning of 2012. Industrial confidence and manufacturing output was surprisingly stable in Latvia compared to the rest of the EU and other trade partners over the past 1½ years, and the good competitive position of Latvia's businesses should help to maintain high business activity also going forward even on a backdrop of weak performance of many European economies.