

LATVIJAS BANKA

BANK OF LATVIA

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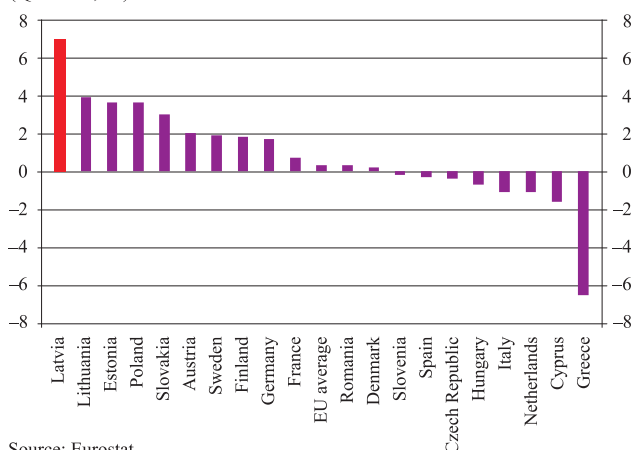
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1. Highlights

Revised GDP figures confirm rapid growth in 1Q

GDP growth in EU
(Q1 2012; %)



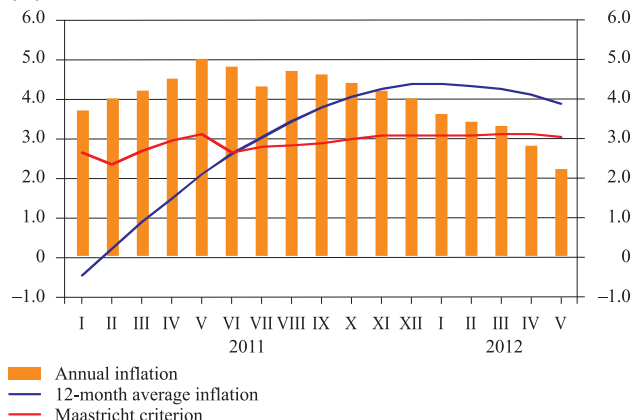
Source: Eurostat.

Latest GDP figures confirm rapid growth in the first quarter of the year (1.1% quarter-on-quarter and 6.9% year-on-year). Both figures are by 0.1% higher than the previously reported flash estimates. Thus, according to Eurostat data Latvia was the European leader in terms of economic growth in the first quarter of 2012.

The economic growth of the first quarter was mostly driven by investment (which increased by 39.0%), whereas the growth of exports gradually decelerated. On a more positive note, however, the export growth outpaced that of the imports which stands in contrast to the previous quarters.

Inflation declines again, 12-month average moves closer to the Maastricht threshold

Inflation rate in Latvia
(%)

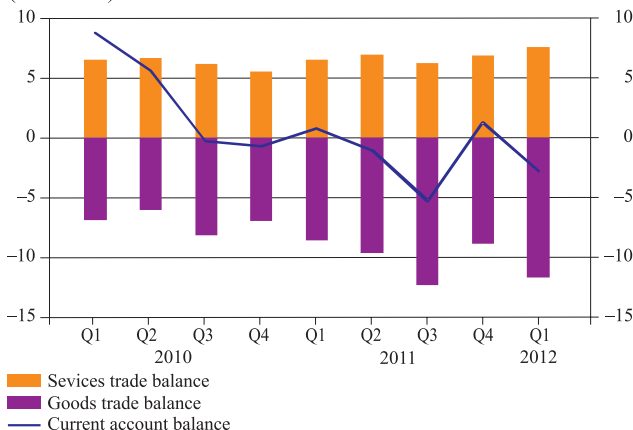


The rise in consumer prices abated and their average level went down 0.2% in May, with the annual inflation thus dropping to 2.2%.

The declining fuel prices were the most significant contributor to the decreases in the monthly and annual inflation figures. The prices of other tradable goods also dropped substantially over the month. As a result, the annual core inflation decreased substantially. In May, this was additionally supported by the fact that the prices of processed foods had a smaller effect than in April and that the food prices partially mirrored the developments in the global food prices. No rise in administered prices was observed in May this year and their annual growth decelerated due to the base effect.

Negative current account reflects Latvia's faster-than-average growth

Current account balance and its main components
(% of GDP)



In the first quarter of 2012, the current account deficit of Latvia's balance of payments totalled 2.9% of GDP. The quarter-on-quarter decline in exports of goods was faster than that in imports of goods, thereby increasing the foreign trade deficit. This can be explained by both the weakening external demand in major trade partners against the background of Latvia's economic growth remaining strong and the sizeable rise in oil prices observed in the first months of 2012. However, as usual, the foreign trade surplus of services offset almost two thirds of the foreign trade deficit.

The decline in the oil prices observed in the previous months and having a decreasing influence on the value of goods imports is expected to have a positive effect on the balance of payments; therefore, the current account deficit will not be increased significantly in the next few months.

2. Macroeconomic Data

	Reporting period	Data (%)
Gross Domestic Product (GDP) (quarter-on-quarter growth; seasonally adjusted) 08.06.2012 The adjusted indicator supports rapid GDP growth in the first quarter 	2012 Q1	1.1
State budget Tax revenue (current month; year-on-year growth) General government expenditure (since the beginning of the year; year-on-year growth)	2012 V 2012 V	11.8 -6.2
Consumer price changes Consumer Price Index (CPI; month-on-month growth) 12-month average annual inflation (to comply with the Maastricht Criteria) 08.06.2012 Fuel: the main factor in dropping consumer prices in May 	2012 V 2012 V	-0.2 3.7
Foreign trade Exports (year-on-year growth) Imports (year-on-year growth) 11.06.2012 External trade shrinks in April 	2012 IV 2012 IV	5.7 16.9
Balance of payments Current account balance (ratio to GDP) Foreign direct investment in Latvia (net flows; % of GDP) 04.06.2012 Latvia's Balance of Payments in the First Quarter of 2012  13.06.2012 Current account balance still negative in April 	2012 Q1 2012 Q1	-2.9 3.8
Industrial output Working day-adjusted industrial output index (year-on-year growth) 04.06.2012 Manufacturing takes a half-step back in April 	2012 IV	8.5
Retail trade turnover Retail trade turnover at constant prices (year-on-year growth) 30.05.2012 Retail turnover down in April 	2012 IV	7.8
Employment and unemployment Registered unemployment (share of working age population)	2012 V	12.3
Monetary indicators Broad money M3 (year-on-year) 20.06.2012 Money supply growth impeded by revoking "Latvijas Krājbanka's" licence 	2012 V	-0.3

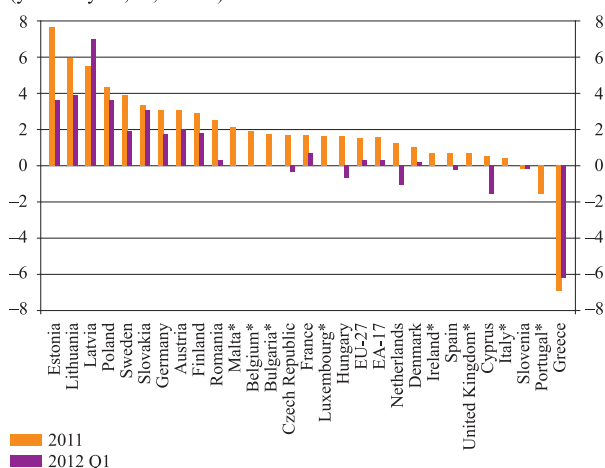
Sources: Treasury, Central Statistical Bureau of Latvia, and Bank of Latvia data.

3. In Focus

Latvia – a European leader in terms of economic growth

GDP growth

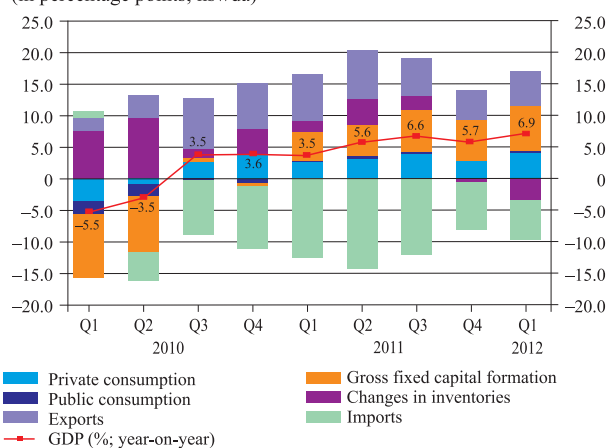
(year-on-year; %, nswda)



Source: Eurostat; * no data for Q1 of 2012

Real GDP growth and contributions

(in percentage points; nswda)



Source: Central Statistical Bureau of Latvia

this growth should be considered moderate for Latvia. Weak purchasing power and high household indebtedness are set to weigh on the private consumption growth. Although improvements in employment, average wages and salaries resulted in higher disposable income, the gains in the households' purchasing power were diminished by higher taxes and global price rises.

- The upward trend in rebuilding inventories that were depleted during the economic downturn ended in 2011, hence the positive contribution of changes in inventories to GDP growth declined to 2.1 percentage points in 2011 (from 4.5 percentage points in 2010), whereas in the first quarter of 2012 these changes accounted for a 3.7 percentage point negative contribution to GDP growth.
- Imports of goods and services expanded by 20.7% in 2011 and 9.5% in the first quarter of 2012, primarily on account of imports of intermediate goods for export production. Steeply rising investment contributed substantially to the pick-up in capital goods imports as well.

The GDP growth rate is expected to moderate during the year as high uncertainty in the global environment prevails and weakening in external demand is evident. The GDP growth rate, however, is expected to be higher than projected earlier, exceeding 3% this year overall.

Latvia is among the most rapidly growing economies in the EU. In 2011, real GDP grew by 5.5% which was the third highest result after Estonia and Lithuania. At the beginning of 2012, despite stagnating GDP in the euro area and EU-27 in q-o-q terms, GDP growth in Latvia even accelerated. Eurostat data indicate that in the first quarter Latvia became the European leader in terms of economic growth: its GDP grew by 1.1% q-o-q and 6.9% y-o-y (5.6%, seasonally and working day adjusted).

The strength of the economic growth in Latvia is not the only accomplishment: it has also become more balanced and resistant to shocks. Real GDP growth was driven by a significant recovery in gross fixed capital formation (especially in the productive segment), further expansion of exports as well as resuming private consumption.

- Despite adverse developments in Europe, Latvian exports posted a strong increase (12.6% in 2011 and 9.9% in the first quarter of 2012). This expansion in exports was supported by regained competitiveness and a solid advance in investment.

- In the second half of 2011, gross fixed capital formation replaced exports as the main driver of growth. In the first quarter of 2012, the annual growth of investment continued to accelerate and reached 39.0%. Moreover, the structure of investment changed. Investment in industry and transport sector accounted for a half of the non-financial investment in 2011 and increased to 55.2% of total investment in the first quarter of 2012. The robust upswing in gross fixed capital formation and the shift towards productive investment are expected to spur the growth potential.

- Private consumption rose to 4.4% in 2011 and 5.4% in the first quarter of 2012. However, due to the low base and a stronger increase in other GDP expenditure components,