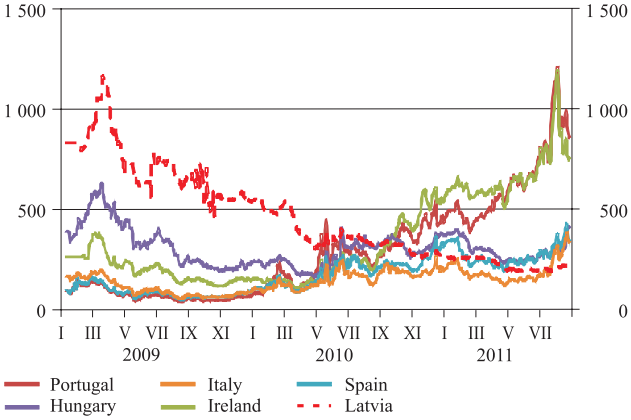
3. In Focus

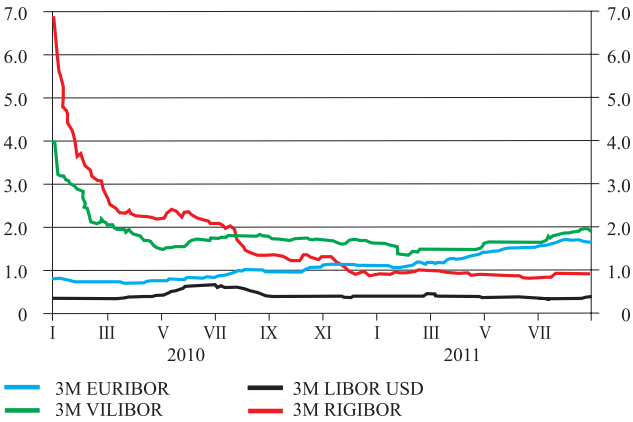
The recent political development has no effect on the economy of Latvia

5-year credit default swaps
(basis points)



Government euro bond yields
(%)

Money market indices
(%)



This year has marked unprecedented developments in Latvian politics. On 28 May, Valdis Zatlers, the President of Latvia, proposed a referendum to dissolve the Saeima (Parliament of Latvia), a move taken never before in Latvia's history. The referendum was held on 23 July and the results were more than convincing: 94.3% of the population voted in favour of the dismissal of the Parliament. New elections will take place on 17 September and the re-elected Parliament will first convene presumably in October.

While Latvia has managed to stop recession and bring its economy back on a sustainable growth track, in this respect being internationally acknowledged as a success story, progress on some other issues was less remarkable. Namely, much stronger progress on moral issues has been requested by the population, particularly in bringing down the influence of money on politics. Thus the recent political developments were triggered by the Parliament voting against allowing the Corruption Prevention and Combating Bureau to search the residence of one of the MPs in a criminal proceeding.

In the meantime, the developments in the political arena have not led to any negative consequences or spill-over effects on the real economy. The financial markets remain calm. Credit default swap spreads are relatively low even despite the escalating uncertainty in the global financial markets in response to the US and the Euro area debt issues. Latvia continues successfully refinancing and extending the maturity profile of its debt: on 28 July, 5-year government bonds were sold with the weighted average yield of 4.083%. Earlier this year, on 29 June 10-year government bonds were sold with the weighted average yield of 5.705%. These developments demonstrate an ongoing decline of yields. Money market rates are stable and recently stay at historically low levels. At the same time, the economy continues its recovery, with the GDP growth reaching 5.3% in the 2nd quarter of 2011, underpinned by strong export performance and robust job creation that brings down unemployment and supports domestic demand.

The experience with the previous elections last October and the subsequent smooth adoption of the 2011 budget suggests that these September elections are unlikely to cause any delays in the adoption of the 2012 budget neither. Moreover, this time the required consolidation amount is considerably smaller than in the previous years. The worst consolidation decisions are already behind and a set of possible consolidation measures for the forthcoming year has already been detailed out at a technical level. Usually, extraordinary elections are perceived as an unnecessary and additional challenge to potential investors and market participants. However, in the Latvian case, they might result in more transparency and better business environment over medium-term, if the incoming government will complete the reforms required by the majority of citizenry.