

LATVIJAS BANKA

BANK OF LATVIA

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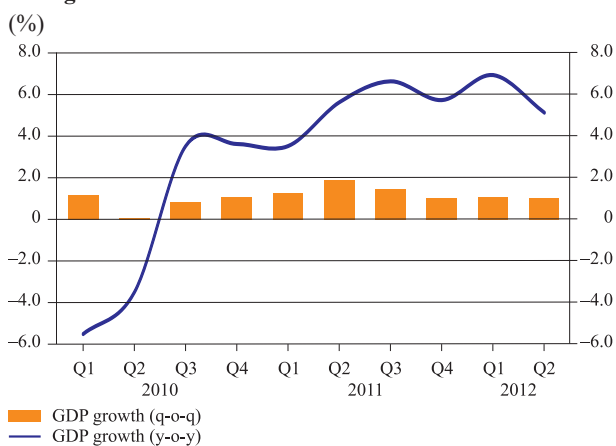
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1. Highlights

GDP growth declines in Q2 but still robust

GDP growth in Latvia



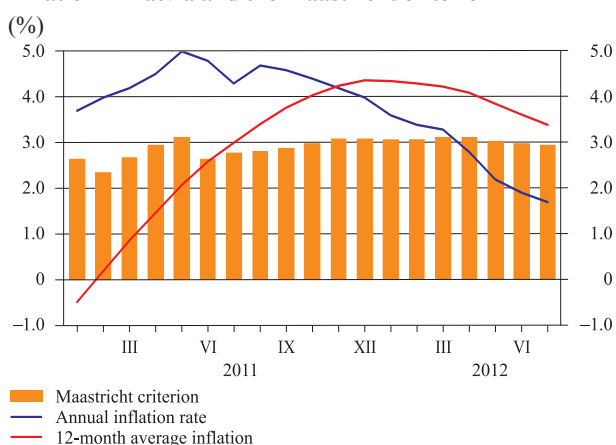
According to the flash estimate, in the second quarter the seasonally adjusted GDP grew 1.0% quarter-on-quarter or 5.1% year-on-year.

This is a notable achievement, particularly in comparison with other countries whose growth has slowed substantially under the impact of the European debt crisis. The development, however, also points to gradual deceleration of the Latvian economy, particularly if compared to the rapid growth in the middle of last year when the quarterly GDP growth rates were one-and-a-half to two times higher.

The observed slowdown in growth is likely to persist in the near future. While convincing solutions to the European economic problems are yet to be found, real drops in the output of particular sectors cannot be ruled out as well as a further drop in the GDP growth rate.

Average annual inflation approaching the Maastricht criterion

Inflation in Latvia and the Maastricht criterion

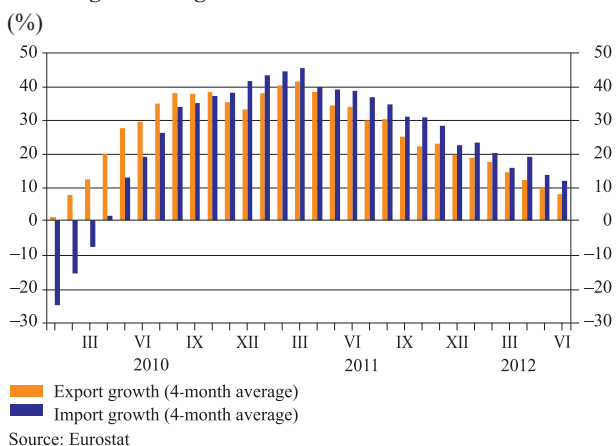


In July, the annual inflation continued to drop in Latvia, reaching a mere 1.7%. Within a month, consumer prices decreased by 0.5% and the 12-month average inflation (national data) at 3.4% approached the level of the Maastricht criterion.

Seasonal sales of clothing and footwear as well as the reduction of the VAT rate by 1 percentage point were the main downward pressures on the monthly inflation, whereas the energy prices had an opposite impact. Thus, although the annual inflation will remain low, a steep downward trend will no longer be observed.

Foreign trade: growth still robust but slowdown visible

Annual growth in goods trade



The annual growth rate of the export value of goods remained robust in June 2012 (9.6%). Substantial annual growth in exports was observed in such commodity groups as prepared foodstuffs, base metals as well as machinery and mechanical appliances.

The preliminary monthly data on the second quarter suggest that, compared to the first quarter of the year, exports have grown in the principal as well as the small commodity groups and thus the structure of Latvian export goods has become more diversified.

The annual growth of the import value of goods reached 15.0%. This reflects the structure of Latvian GDP growth where exports still have a substantial role, while the significance of investment is also increasing.

Source: Eurostat

2. Macroeconomic Data

	Reporting period	Data (%)
Gross Domestic Product (GDP) (quarter-on-quarter growth; seasonally adjusted) 09.08.2012 Latvian gross domestic product continued to grow in the second quarter 	2012 Q2 <i>(flash estimate)</i>	1.0
State budget Tax revenue (current month; year-on-year growth) General government expenditure (since the beginning of the year, year-on-year growth)	2012 VII 2012 VII	5.9 2.1
Consumer price changes Consumer Price Index CPI (month-on-month growth) 12-month average annual inflation (to comply with the Maastricht Criteria) 08.08.2012 Average annual inflation approaching Maastricht criterion 	2012 VII 2012 VII	-0.5 3.3
Foreign trade Exports (year-on-year growth) Imports (year-on-year growth) 09.08.2012 Exports and imports grow annually, monthly changes negligible 	2012 VI 2012 VI	9.6 15.0
Balance of payments Current account balance (ratio to GDP) Foreign direct investment in Latvia (net flows; % of GDP) 10.08.2012 A small deficit in the current account in June 	2012 Q1 2012 Q1	-2.9 3.8
Industrial output Working day-adjusted industrial output index (year-on-year growth) 03.08.2012 Surprises in manufacturing 	2012 VI	8.1
Retail trade turnover Retail trade turnover at constant prices (year-on-year growth) 30.07.2012 June trade data enjoyable, but more moderate growth to be expected 	2012 VI	8.4
Employment and unemployment Registered unemployment (share in working age population) 14.08.2012 Rapid economic growth and broadly unchanged unemployment rate. Why? 	2012 VII	11.6
Monetary indicators Broad money M3 (year-on-year) 20.08.2012 Money supply level stable in July 	2012 VII	3.3

Source: Treasury, Central Statistical Bureau of the Republic of Latvia, and Bank of Latvia data.

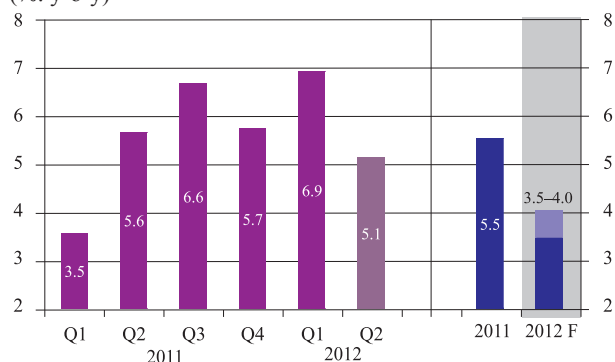
3. In Focus

Latvian macroeconomic developments and forecasts for 2012

In the first half of 2012, the pace of the Latvian economic development remained buoyant, with investment and exports being the key drivers of growth. Moreover, private consumption also picked up as it was supported by employment growth and a moderate increase in wages. Competitiveness that was regained in the recent years allowed the Latvian producers to increase their export market shares, which, to some extent, compensated the slower growth in the external demand.

Real GDP growth

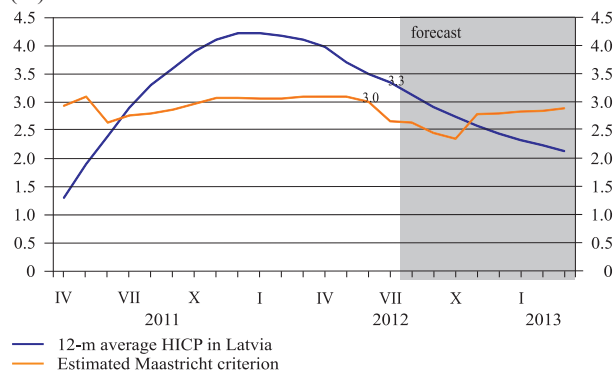
(%: y-o-y)



Source: CSB; F – BoL forecast; * – CSB flash estimate.

12-m average HICP and the estimated level of Maastricht inflation criterion

(%)



Source: Eurostat, EC and BoL estimates.

With capacity utilisation returning to its pre-crisis levels, investment started growing substantially as early as in the second half of 2011. In the first quarter of 2012, its share in GDP rose to 30% in real terms. In contrast to the end of 2011, private investment growth was very rapid. Compared to the boom years the structure of investment also has improved substantially: now investment tends to concentrate in export sectors and an increasing share of investment is made in technological equipment and infrastructure.

Economic growth this year will be more rapid than estimated previously. GDP growth is expected to range between 3.5 and 4.0% in 2012. The risks to the forecast are broadly balanced and they are largely related to external factors, mainly the developments in Europe associated with the debt crisis and their effect on Latvia's external demand.

As expected, the year-on-year inflation rate decreased over the first seven months of 2012 and was 1.7% in July. A number of factors could be mentioned behind these favourable inflation developments: for instance, the loose labour market and absence of domestic pressures on inflation, a weaker impact of world commodity prices (mainly food and energy), gradually fading base effects of the administered prices and indirect taxes raised in 2011 and others.

With the year-on-year inflation rate decreasing, the 12-month average HICP inflation also dropped notably, reaching 3.3% in June and thus nearly approaching the level of the Maastricht criterion.

In the nearest months, the inflation rate is expected to remain low, with no distinct downward trend, however, as there are some risks on the upside. The world oil prices have resumed growth as a result of political unrest in the Middle East and tensions between this region and the Western countries regarding nuclear armament as well as changing news about the levels of oil reserves. Moreover, the prices of agricultural products and food (mainly sugar and cereals) have picked up as a result of either persistent drought in some areas or rains impeding the harvesting. Nevertheless, the average annual inflation is expected to be 2.4% in 2012, which is almost twice as low as in 2011. As no upward pressure on inflation is expected from the demand side factors over the forecasting horizon, the key drivers of the price level in the near-term are likely to be the developments in the global food and energy prices.