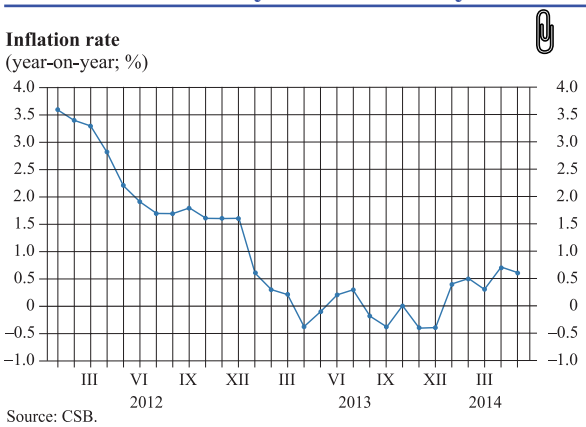
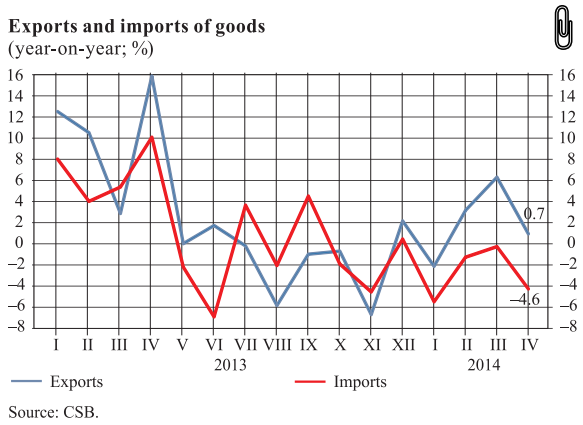
Annual inflation dynamics in May affected by temporary factors



Annual inflation dropped slightly in May reaching 0.6%, yet this reflects the impact of temporary rather than fundamental factors. The annual inflation contracted on account of falling food prices, whereas the core inflation remained at its April level. External supply-side factors had mostly a downward effect on prices, with oil prices remaining stable and global food prices dropping. Domestic demand-side factors, like the rise in minimum wage and the drop in labour taxes could have a gradual effect.

With the discussions on the power market abating and the first quarter data not seeming to indicate a drop in the economic activity because of Ukraine, inflation expectations have stabilised and have remained broadly unchanged in May.

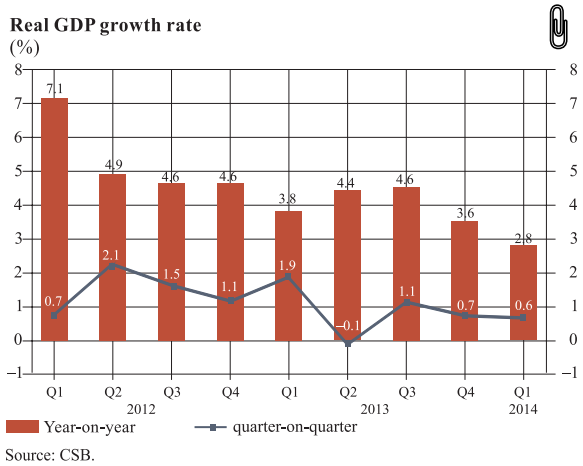
Latest foreign trade data confirm the flexibility of Latvian exporters and their ability to survive



In April 2014, the turnover of Latvian foreign trade in goods dropped by 2.8% month-on-month. Within a month, the export and import value of goods fell by 1.8% and 3.6% respectively. As the drop in the exports of goods was smaller, Latvia's balance of foreign trade in goods improved slightly.

The year-on-year rise in the export value of goods totalled 0.7%. In April, a year-on-year rise was reported in practically all significant groups of Latvia's export goods, except transport vehicles, base metals and food products. The country breakdown of exports, however, has changed, e.g. a drop in the demand for Latvian export goods in Estonia, Finland and Germany has been offset by a rather substantial rise in exports and growth in export market shares in the United Kingdom, Poland, Sweden and other countries where the domestic demand remains stable. According to the first quarter data, the shares of the Latvian export market in total global imports continued to grow, confirming the mobility of Latvian exporters and their ability to reorient their goods to other markets. In maintaining Latvian export growth, investments aimed at increasing the productivity of enterprises, improving competitiveness and creating products with a higher value added are of crucial importance. The May decision of Standard & Poor's to upgrade Latvia's credit rating allows us to hope that this will improve the investor confidence and encourage the much-needed investment inflows for developing the export potential.

GDP growth rate dropping, mood turns more cautious



The revised GDP figure for the first quarter has confirmed earlier estimates. GDP grew by 0.6% quarter-on-quarter, remaining practically the same as in the fourth quarter of 2013. Year-on-year, however, a gradual deceleration of growth has been observed, by about one percentage point each subsequent quarter: from 4.6% in the third quarter of last year to 2.8% in the first quarter of this year.

The Russia-Ukraine conflict has provoked deterioration in the mood of investors and weakened external demand. At the moment, that is the main external risk factor which, in turn, is exacerbating the domestic risks. Currently, the influence of this factor is mostly evident in the confidence data, while a drop in exports is only seen in a few industrial branches. The largest contributor to GDP growth was construction. After the positive first quarter preliminary data, growth in the transport branch is also hardly a surprise. Despite a small quarterly drop in retail trade, the value added in trade has increased slightly overall. The value added in manufacturing has decreased quarter-on-quarter, yet the year-on-year growth of the sector remains positive.

As regards the forecasts for 2014 overall, private consumption and exports will help to keep GDP growth at about 3.3%. Yet exporters' performance can be substantially affected by the future investment developments currently surrounded by a considerable degree of uncertainty.