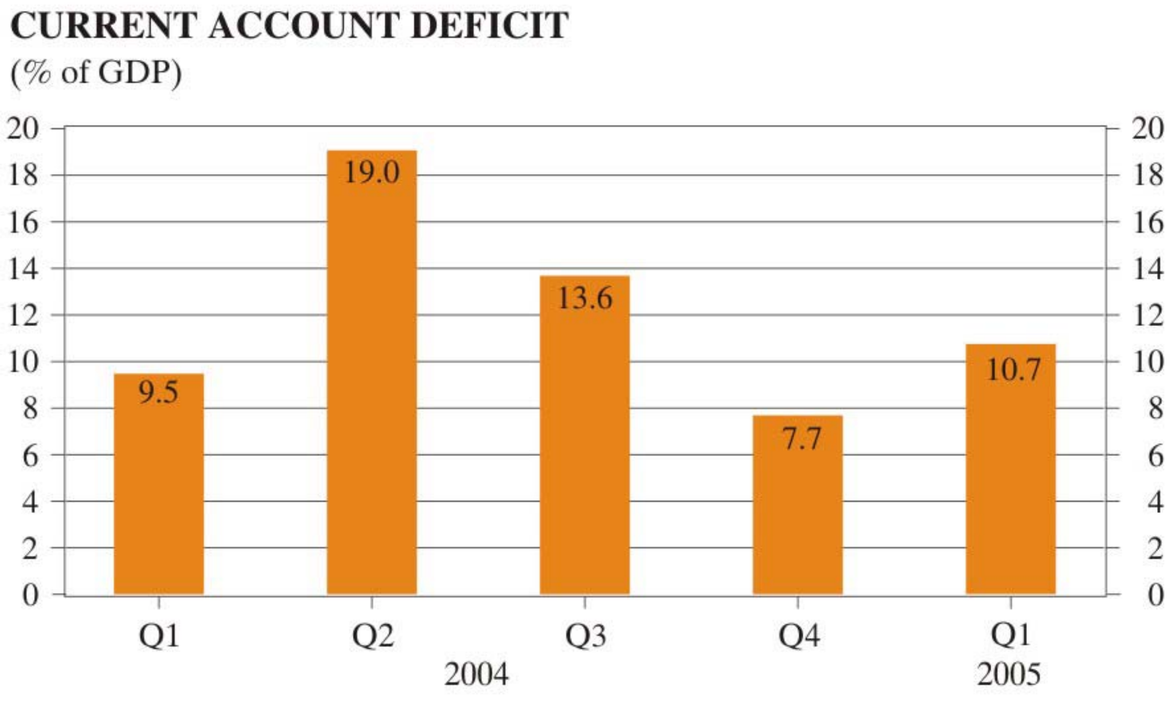
Press Release of June 30, 2005
Latvia's Balance of Payments in the First Quarter of 2005

In the first quarter of 2005, the current account deficit of the balance of payments was 198.0 million lats or 10.7% of gross domestic product (GDP; 151.8 million lats or 9.5% in the corresponding period of 2004). The ratio of goods deficit to GDP decreased year-on-year in the first quarter. The growth of the current account deficit was underpinned by a decrease in the ratio of services and current transfers surpluses to GDP and a slight increase in the ratio of income deficit to GDP.



Evaluation and Outlook

As forecast, the current account deficit of Latvia's balance of payments remained high in the first quarter of 2005, slightly exceeding the ratio to GDP of the corresponding period of 2004. Nevertheless, the current account deficit was largely covered by rapidly growing foreign direct investment indicating high investor confidence and by significant net inflow of other investment as a result of banks attracting external funds.

The decline of the foreign trade deficit ratio to GDP is also a positive sign determined by the rapid growth of exports and slightly slower growth of imports (caused, in part, by the high base prior to Latvia's accession to the EU). Robust demand in the economically rapidly growing region of the new EU Member States fuelled a significant rise in Latvia's exports to Poland, Lithuania and Estonia. Moreover, the growth of the export volume exceeded that of the prices. This development suggests that Latvia's producers have maintained their ability to compete on the major export markets.
At the same time, the fact that Latvia's traditional exports (wood and textiles) have grown only slightly and, as a result of weak demand, the growth of exports to the major EU export markets has also been insignificant raises some concern.
Exports are expected to continue to pick up notably in the subsequent quarters of 2005, supported by the euro exchange rate which is favourable to the exporters. Nevertheless, with the fading effect of the base factors on imports, persistently high domestic demand facilitated by lending and further drawdown from the EU structural funds, no significant decrease of the current account deficit (below 10% of GDP) can be expected.

Notes to Latvia's Balance of Payments for the First Quarter of 2005

Foreign trade continued the trend from the second half 2004 developing buoyantly (most notably manifested by export growth), as a result of high domestic economic activity and growing external demand. In the first quarter, exports and imports of Latvia's goods grew 35.4% and 24.7%, respectively, year-on-year.
Exports expanded on account of mineral products, base metals and articles of base metals, agricultural and food products, machinery and mechanical appliances, electrical equipment. In the first quarter, Latvia's exports to the EU countries increased by 32.6%, whereas the share of these countries in total exports contracted slightly. Exports to the CIS countries (Russia) and other countries (Switzerland) expanded rapidly. In the EU countries group, growth of exports was the most notable to the new EU Member States (Lithuania, Estonia and Poland).
In the first quarter, the export growth was supported by improved terms of trade, with the year-on-year rise in export prices exceeding that of the import prices. The real effective exchange rate of the lats also continued its downward trend, securing favourable conditions for foreign trade competitiveness.
Growth of imports in the first quarter was affected by the persistently high domestic demand and rapidly growing exports. The highest rise was recorded for imports of mineral products, agricultural and food products, machinery and mechanical appliances, electrical equipment, and base metals and articles of base metals.
In the first quarter, the services surplus decreased slightly year-on-year, as the growth rate of services received (45.8%) was higher than that of services rendered (24.6%). The increase of the transportation surplus (15.2 million lats; mainly due to a rise in sea transport) did not offset the growth of the travel services deficit (18.8 million lats) due to a significant increase in spending of travellers from Latvia abroad, and the slight decrease of other services surplus.
The income deficit grew by 8.2 million lats year-on-year in the first quarter, as the increase of non-residents' income in Latvia (a rise in direct investment income in the form of reinvested earnings) exceeded that of resident income abroad in the form of investment income and compensation to employees.
The current transfers surplus decreased by 9.8 million lats year-on-year, because of contributions to the EU budget made by Latvia's Government in the first quarter.
The surplus of the capital and financial account amounted to 172.3 million lats. With foreign direct investment inflows in Latvia growing significantly, their surplus covered 52.1% of the current account deficit in the first quarter. Portfolio investment balance was negative due to an increase in resident (bank) investment in debt securities.

In the first quarter, the current account deficit was partly covered also by the inflow of other investment (149.0 million lats). Other investment of residents abroad grew, with banks increasing their demand deposits abroad and at the same time reducing short-term loans to non-residents and increasing short-term trade credit to other sectors. Liabilities to non-residents expanded, mainly with banks granting long-term loans to non-residents and receiving demand deposits.
Reserve assets expanded by 75.2 million lats in the first quarter.

Mārtiņš Grāvītis
Press Secretary of the Bank of Latvia

Phone: +371 702 2349
Fax: +371 702 2429
E-mail: Martins.Gravitis@bank.lv
http://www.bank.lv