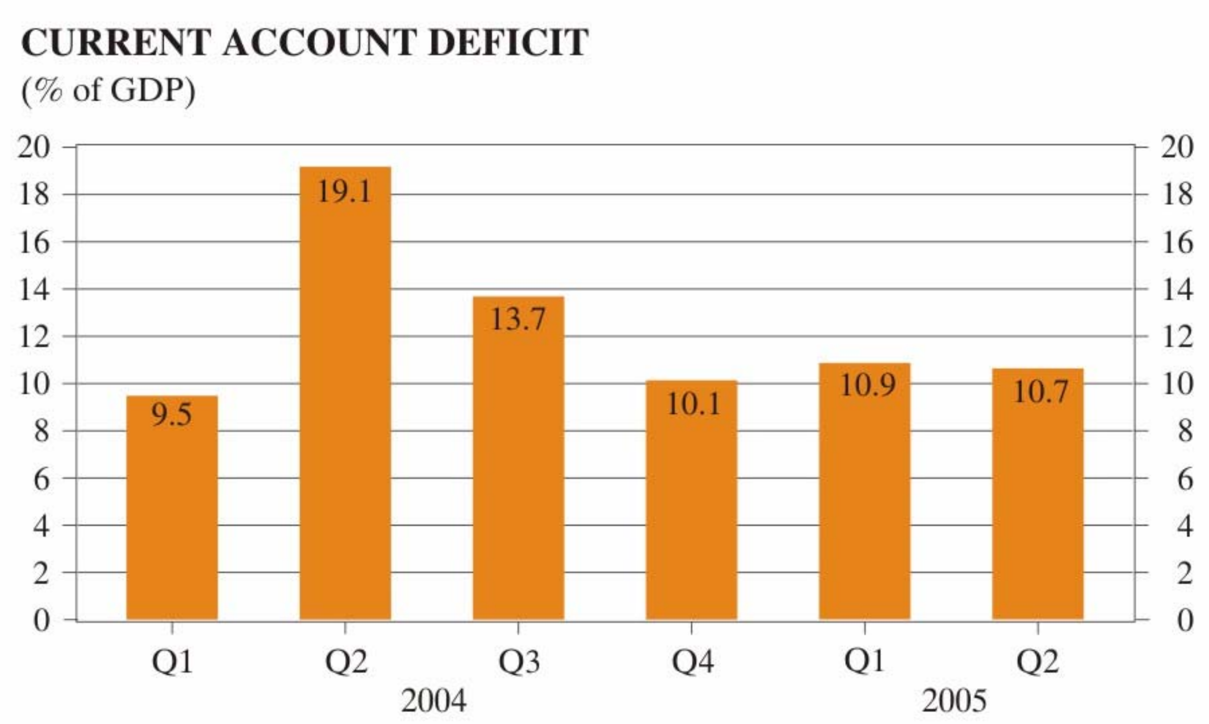
LATVIJAS BANKA

Press Release of September 30, 2005

Latvia's Balance of Payments in the Second Quarter of 2005

The current account deficit of Latvia's balance of payments was 228.8 million lats or 10.7% of gross domestic product (GDP) in the second quarter of 2005 (336.5 million lats or 19.1% in the second quarter of 2004 when the high deficit was primarily a result of expanding imports of goods in the period preceding Latvia's accession to the EU). Year-on-year, exports of goods rose by 35.6%, while imports recorded an increase of 13.6%, with the goods deficit ratio to GDP falling. The income deficit ratio to GDP shrank substantially, that of the current transfers surplus slightly increased, but the services surplus to GDP decreased.



Evaluation and outlook

The positive impact of the external sector on GDP, observed from the beginning of the year, persisted also in the second quarter of 2005, with the external demand contribution to the total demand even exceeding that of the domestic demand.

The growth rate of exports remained higher than that of imports; nevertheless, foreign trade deficit ratio to GDP did not improve (given the import-related one-off effects of the corresponding period of 2004 related to Latvia's accession to the EU), with the demand for imports remaining high. Overall, the current account deficit in the first half of the year was close to that of the previous year, given the above effects.

The increase in compensation of employees offset the deterioration in the services balance. Bank of Latvia's interventions in the foreign exchange market indicated capital inflows which exceeded the financing necessary for covering the current account deficit.

Although inflows of foreign direct investment in Latvia remained at the same level as in the previous year, dividend distribution of some major companies to their foreign shareholders reduced the positive impact of investment as it covered only one third of the current account deficit. Debt liabilities accounted for the largest share in the current account financing; nevertheless, the long-term capital dominating their maturity profile served as a macroeconomic risk-reducing factor of external imbalances.

This year the current account deficit is not expected to drop significantly, with the economic growth continuing on its trend and the high domestic demand underpinning the need for imports. It will also be fuelled by more active drawdown from EU structural funds.

Notes to Latvia's Balance of Payments for the Second Quarter of 2005 and the first half of 2005

In the Second Quarter, year-on-year, exports of mineral products (accounting for one third of the total exports growth), as well as those of agricultural products and foodstuffs recorded the largest pickup. Exports of base metals and articles of base metals, wood and articles of wood, machinery and mechanical appliances, electrical equipment, and also transport vehicles grew substantially. Of imports, mineral products, machinery and mechanical appliances, electrical equipment, and agricultural products and foodstuffs recorded the largest growth.
In the second quarter, Latvia's foreign trade turnover with the EU countries accounted for 76.2% of total exports and 74.8% of total imports. The largest growth was observed in exports to Poland, Russia, Estonia and Lithuania, and imports from Lithuania, Belarus, Russia and Poland.
Services surplus decreased by 15.7 million lats in the second quarter due to a year-on-year increase in the travel services deficit and a decrease in the other services surplus. The growth in the transportation services surplus was primarily triggered by an increase in freight, mainly for the exported transportation services by road and sea. The travel services deficit grew due to a more rapid expansion of the received travel services.
Given the increased resident income abroad both in the form of compensation of employees and investment income, the income deficit contracted two times year-on-year. Non-resident income in Latvia remained broadly unchanged.
The current transfer surplus grew by 22.9 million lats year-on-year because of the transfers from the EU funds to the Government of Latvia and the increase in current transfers received by other sectors.
The surplus of capital and financial account was 200.9 million lats in the second quarter.
Compared to the previous quarter, the inflow of foreign direct investment decreased significantly, with the surplus covering only 13.9% of the current account deficit.
Due to an increase in portfolio investment liabilities (resulting from security issuances by the Latvian banks), the inflow of net portfolio investment was in the amount of 53.6 million lats in the second quarter.
In the second quarter, the largest share of the current account deficit was covered by the surplus of other investment (206.0 million lats). Resident other investment abroad shrank, as banks decreased the amount of demand deposits abroad. Liabilities to non-residents increased, with mainly banks receiving non-resident long and short-term loans (from parent banks).
Reserve assets gained 86.7 million lats in the second quarter due to the Bank of Latvia's spot transactions on the foreign exchange market.

In the first half of 2005, the current account deficit of the balance of payments accounted for 10.8% of GDP (14.5% in the corresponding period of the previous year). Year-on-year, the ratio of goods deficit to GDP shrank because both exports and imports of goods expanded, by 35.9% and 18.8%, respectively. Excluding the one-off effects of the corresponding period of the previous year due to Latvia's accession to the EU and the purchase of ships and other investment goods, the trade deficit slightly increased. The ratio of income deficit as well as those of services and current transfers surpluses to GDP became smaller.
Exports of all groups of commodities, most notably those of mineral products, agricultural products and foodstuffs, base metals and articles of base metals, machinery and mechanical appliances, electrical equipment, and also transport vehicles, expanded year-on-year. Of imports, mineral products, machinery and mechanical appliances, electrical equipment, agricultural products and foodstuffs, as well as base metals and articles of base metals recorded the largest growth.

In the first half of the year, services surplus decreased by 16.0 million lats year-on-year. The growth in the transportation services surplus was primarily observed in transportation services by sea, rail and road, triggered by a more impressive growth in transportation services exports. The travel services deficit grew due to a more rapid increase in the received travel services. The decrease in the surplus of other services was a result of construction services exports, which narrowed, and the financial services whose exports declined but imports rose.
Compared to the first half of 2004, the income deficit dropped, mainly determined by an increase in compensation of employees abroad.
The current transfer surplus grew year-on-year, the growth being accounted for by the EU funds received by the Government of Latvia.
The surplus of capital and financial account was 387.1 million lats in the first half of the year.
In the first half of 2005 over the corresponding period of the previous year, the inflow of foreign direct investment decreased slightly. Foreign direct investment covered 32.7% of the current account deficit in the first half of the year.
With portfolio investment liabilities increasing to a greater extent (resulting from security issuances by the Latvian banks) than portfolio investment assets abroad, net portfolio investment inflow was positive in the first half of the year (16.1 million lats).
The financing of the current account deficit was dominated by long-term capital. Other investment surplus amounted to 357.6 million lats. Resident other investment abroad shrank with banks decreasing the amount of their short-term loans abroad. Liabilities to non-residents increased, with mainly banks receiving non-resident long-term loans (from parent banks).
Reserve assets gained 161.9 million lats in the first half of the year, and the rise was driven by the Bank of Latvia's spot transactions on the foreign exchange market.

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