

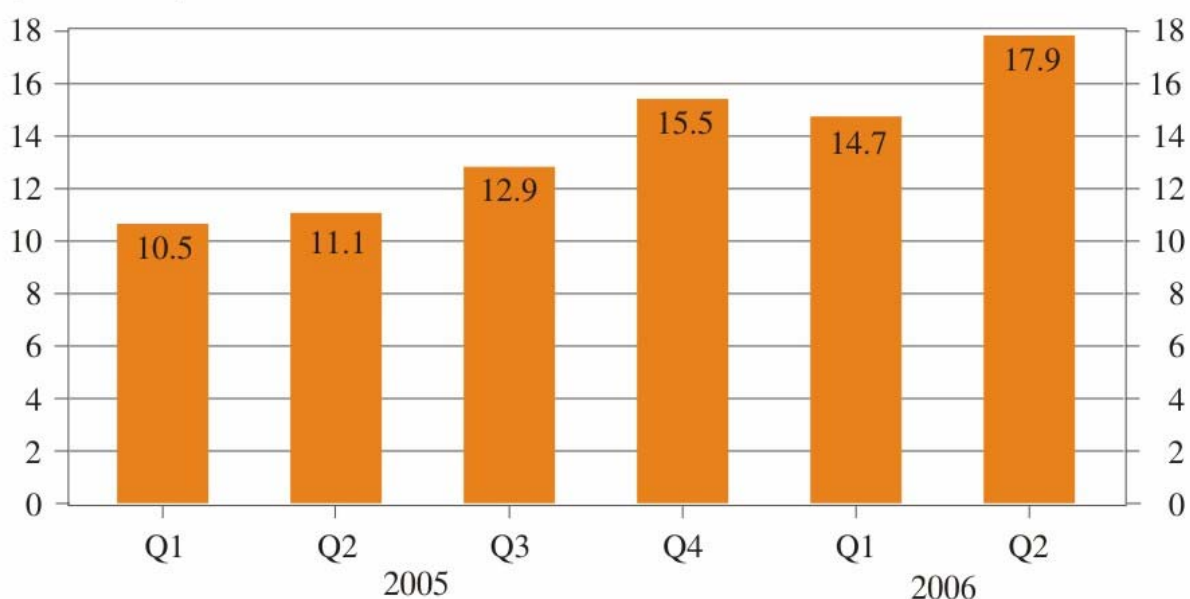
Press Release of September 29, 2006

Latvia's Balance of Payments in the Second Quarter of 2006

In the second quarter of 2006, the current account deficit of the balance of payments reached 474.4 million lats or **17.9% of GDP** (up from 240.6 million lats or 11.1% in the corresponding period of the previous year). The growth of exports of goods (12.1%) continued on a downward trend, while the import growth, fuelled by persistently strengthening domestic demand, remained robust (26.3%) and pushed up the goods deficit to GDP substantially. The income deficit to GDP increased, current transfers surplus contracted, and services surplus grew.

CURRENT ACCOUNT DEFICIT

(% of GDP)



Evaluation and outlook

The strong domestic demand due to a rise in lending and real income has been the driving force behind a steep and steady expansion of imports, while the contribution of exports to overall economic growth diminished, leading to stronger upward risks associated with unbalanced development. Due to the nominal exchange rate and higher inflation, the real effective rate of the lats appreciated; the terms of trade deteriorated, exerting a negative effect upon the trade balance. Overall, Latvia's market shares in the EU countries contracted, causing concerns about sustainability of country's competitiveness.

Deceleration in the growth of exports of goods continued to drive the pickup in the current account deficit of the balance of payments, which amounted to 17.9% of GDP in the second quarter of 2006. Though the surplus on services continued to increase, it could not offset goods and income deficit and the reduction in the surplus on current transfers.

The pickup in the inflow of foreign direct investment this year, with direct investment covering a half of the current account deficit, is a positive trend. Borrowings from foreign banks, another type of long-term capital, are maintaining their significance.

The persistence of a large current account deficit anticipated this year and in 2007 will be determined by strong domestic demand associated with the growing need for imports, and

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Latvia's Balance of Payments, Q2, 2006

implementation of large-scale investment projects in the transport and energy sectors at the end of the year and in 2007.

The steep rise in the current account deficit indicates that the economic policy should aim at restricting domestic demand and enhancing saving, with a simultaneous focus on extensive structural reforming of the economy that would lead, in medium term, to improved competitiveness in terms of technology and production efficiency.

Notes to Latvia's Balance of Payments for the Second Quarter of 2006 and the first half of 2006

In the second quarter, year-on-year, exports of base metals and articles of base metals, transport vehicles, products of the chemical and allied industries, as well as agricultural and food products recorded the strongest growth. Exports of mineral products shrank, and those of wood and articles of wood also decreased somewhat. The expansion in volume accounted for one third and price rises for two thirds of the overall growth in exports. In the second quarter, growth in exports moderated particularly to the EU countries, decelerating (4.8%) to the EU15 countries and achieving the highest growth (22.4%) to the EU10 countries. Exports to the CIS and other countries continued to grow. As to imports, all major groups of imported commodities recorded the highest growth. Behind the growth in imports was both the expanding volume and rising prices.

The services surplus increased significantly in the second quarter, the rise primarily a result of a pickup in freight transportation by road, travel and financial services rendered.

The income deficit grew on account of higher non-resident income in Latvia from direct investment in the form of reinvested earnings.

In the second quarter, the surplus of the capital and financial account was 494.4 million lats.

Net inflow of foreign direct investment in Latvia continued on a strong upward trend in the second quarter, with its surplus accounting for 8.2% of GDP and covering 45.7% of the current account deficit.

As Latvian banks issued securities, portfolio investment liabilities increased and portfolio investment net inflow was in the amount of 71.9 million lats.

Net inflow of other investment was 494.4 million lats on account of banks' long-term borrowing (primarily from parent banks). Long-term borrowing of the corporate sector also grew considerably.

In the second quarter, reserve assets increased by 352.8 million lats as a result of the Bank of Latvia's interventions in the foreign exchange market.

In the first half of 2006, the current account deficit, which was up to 16.4% of GDP from 10.8% in the corresponding period of the previous year, was determined by the same factors which affected the overall performance in the second quarter.

Year-on-year, the pace of export growth decelerated to 14.3% due to a fall by one third in mineral product exports and a slight decline in exports of wood and articles of wood, the largest export commodity group. Nevertheless, exports of agricultural and food products, base metals and articles of base metals, transport vehicles and products of the chemical and allied industries expanded significantly. Import growth (27.5%), however, maintained the pace of the previous year, with the strongest rise recorded for imports of transport vehicles, machinery and mechanical appliances, electrical equipment, mineral products, products of the chemical and allied industries, agricultural and food products, as well as base metals and articles of base metals.

In the first half of the year, the services surplus posted an 83.1 million lats increase year-on-year due to the rise in services rendered twice exceeding that in services received.

The income deficit rose notably by 68.5 million lats as a result of non-resident income from direct investment in the form of reinvested earnings, with income from other investment also growing.

The surplus on current transfers grew by 16.8 million lats under the impact of transactions in the government and other sectors.

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The surplus on the capital and financial account was 885.5 million lats in the first half of the year. The current account deficit was fully covered by foreign direct investment (53.8%) and other long-term investment.

Net inflow of foreign direct investment in Latvia increased 2.4 times year-on-year and was in the amount of 436.8 million lats or 8.8% of GDP.

In the first half of the year, net outflow of portfolio investment was 59.5 million lats due to investment in foreign debt securities by Latvian banks and investment in equity securities by other sectors exceeding non-residents' investment in debt securities issued by Latvian banks.

Along with a notable rise in foreign liabilities, the other investment surplus amounted to 942.9 million lats. Liabilities to non-residents grew primarily as a result of short-term and long-term borrowing of banks and the corporate sector. With banks increasing their long-term lending abroad, the volume of residents' other investment outside Latvia expanded.

In the first half of the year, reserve assets increased by 530.8 million lats as a result of the Bank of Latvia's interventions in the foreign exchange market.