

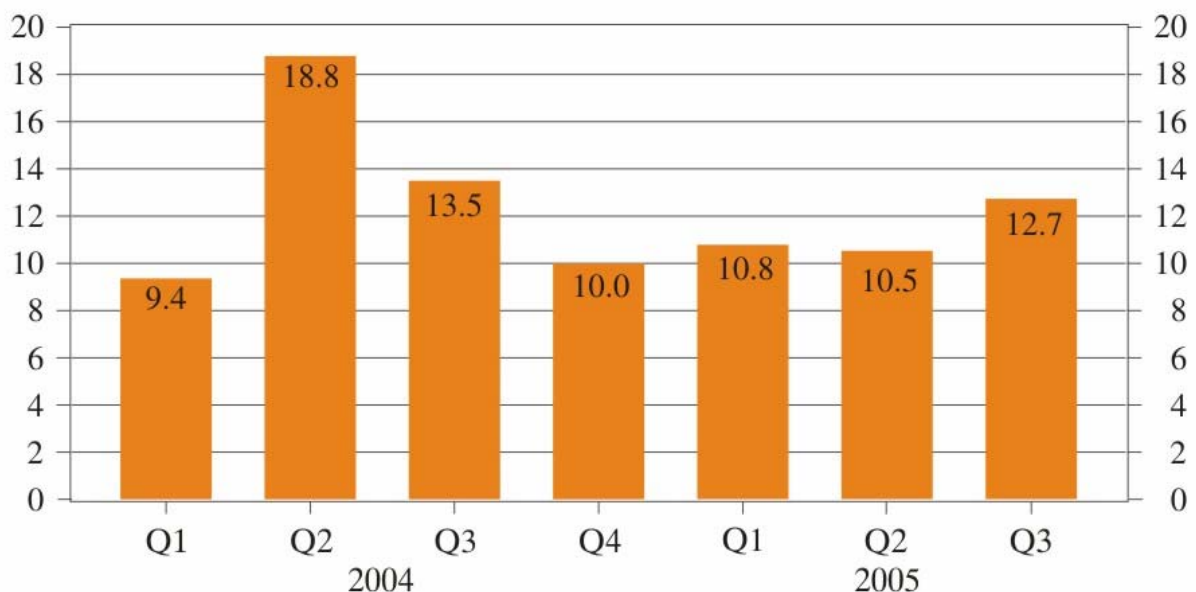
Press Release of December 30, 2005

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

In the third quarter of 2005, the current account deficit of the balance of payments amounted to 12.7% of GDP (13.5% in the corresponding period of the previous year). With growth of exports exceeding that of imports, the goods deficit to GDP decreased. Income deficit to GDP also shrank. The surplus of services and current transfers to GDP contracted.

CURRENT ACCOUNT DEFICIT

(% of GDP)



Evaluation and outlook

In the third quarter and in the first nine months of 2005, the overall growth of the external sector experienced rapid growth, driven both by high domestic and external demand. In the third quarter, the annual growth rate of exports declined somewhat due to its high base last year, with the expansion of exports of goods nevertheless exceeding that of imports. The goods deficit to GDP decreased in the first nine months.

Along the rapid export growth, contributing to the reduction in the goods deficit, the income deficit also shrank in the first nine months of this year. This can be attributed to a substantial rise in the compensation of employees abroad, corroborating the increasing interest of Latvian residents in working abroad.

Although in the first nine months the current account deficit to GDP was lower year-on-year, one-off effects driving the import growth in 2004 related to Latvia's accession to the EU should be taken into account when assessing the situation. In view of the above effects, estimates indicate that the external imbalances have slightly increased.

Both in the third quarter and in the first nine months of 2005 the current account deficit was fully covered by long-term capital, with the amount of the long-term borrowings abroad by the banking sector dominant and increasing, as well as due to expanding foreign direct investment inflows in Latvia.

Bank of Latvia:

Latvia's Balance of Payments, Q3, 2005

This year, the rapid economic growth and the high domestic demand, further fuelled by more active drawdown from EU structural funds, underlay a significant increase in imports. Export growth has been spurred by a combination of equally salient factors, including increased external demand, especially from the new EU member states, as well as the favourable lats peg rate to the euro for exporters using the common currency, and returns from investment, including sizeable non-financial investment into industry. However, despite the rapid rise in exports and the increasing contribution of the external demand to the economic growth, a considerable drop in the current account deficit is not expected in the near future.

Notes to Latvia's Balance of Payments for the Third Quarter of 2005 and the first nine months of 2005

In the third quarter, Latvia's foreign trade continued to develop buoyantly driven by high domestic demand relating to the rapid economic growth and by expanding external demand in several EU Member States. Export growth exceeded that of imports (29.6% and 24.7%, respectively).

Year-on-year, the largest growth was recorded for exports of agricultural and food products, machinery and mechanical appliances, electrical equipment and mineral products (more than one half of total export growth). Imports of goods grew mainly on account of mineral products, transport vehicles, machinery and mechanical appliances, electrical equipment and agricultural and food products.

Trade with the EU Member States accounted for $\frac{3}{4}$ of foreign trade turnover, with the highest growth reported in trade with the EU10 countries. Latvia's principal export partners were Lithuania, Estonia, Germany, the United Kingdom, Russia and Sweden for exports, whereas Lithuania, Germany, Estonia, Russia and Poland were the main import partners.

Services surplus increased by 6.1 million lats year-on-year. The growth of transportation services surplus (22.8 million lats) was underpinned by a rise in freight transportation services delivered by road and by rail as well as services rendered at ports. The travel services deficit increased by 22.3 million lats, with imports of services growing at a more rapid rate. The surplus of other services expanded slightly.

Income deficit decreased by 19.8 million lats year-on-year, due to a substantial rise in compensation of employees received by residents abroad.

Surplus of the capital and financial account amounted to 361.5 million lats in the third quarter.

Net inflow of foreign direct investment grew in the third quarter and amounted to 3.9% of GDP. Foreign direct investment in Latvia (mainly in the form of reinvested earnings and equity capital) totalled 5.3% of GDP. Direct investment abroad also increased.

Portfolio investment recorded a net outflow as a result of foreign securities purchases made by Latvian banks.

In the third quarter, the current account deficit was mainly covered by the net inflow of other investment (578.5 million lats). The surplus of other investment was determined by transactions in the banking sector. The banks mainly increased their long-term borrowing abroad. Non-residents cut down on their demand deposits with banks, which, in turn, facilitated a decline in banks' demand deposits abroad.

In the third quarter, reserve assets increased by 136.9 million lats, mainly as a result of the Bank of Latvia's spot transactions on the foreign exchange market.

In the first nine months of 2005, the current account deficit of the balance of payments totalled 11.4% of GDP (14.0% in the corresponding period of the previous year). The goods deficit and income deficit to GDP shrank due to exports growing more rapidly than imports. The surplus of services and current transfers to GDP decreased. The services and current transfers surplus covered 40.1% of the goods and income deficit.

Bank of Latvia:

Latvia's Balance of Payments, Q3, 2005

In the first nine months of 2005, exports and imports of goods increased by 34.8% and 24.8%, respectively. In January–September, the export growth was dominated by mineral products, agricultural and food products, base metals and articles of base metals, as well as machinery and mechanical appliances, electrical equipment, which are mainly exported to the EU Member States. Imports of goods grew on account of mineral products, machinery and mechanical appliances, electrical equipment, and agricultural and food products.

Services surplus contracted by 9.9 million lats year-on-year in the first nine months of 2005. An increase in transportation services surplus did not fully offset the rise in the travel services deficit. Surplus in transportation services increased by 59.5 million lats year-on-year, primarily due to an expansion of the volume of freight transportation services rendered by sea, rail and road and other services delivered by sea. Travel services deficit expanded by 66.0 million lats, as the growth of Latvian travellers' spending abroad was three times higher than that of non-resident spending in Latvia.

Compensation of employees received by residents abroad grew almost twofold year-on-year, supporting a decline in the income deficit by 40.8 million lats in the first nine months of 2005. The rise of investment income deficit resulted from growing non-resident income from direct investment (primarily in the form of reinvested earnings).

The surplus of the capital and financial account amounted to 748.6 million lats in the first nine months of 2005.

The current account deficit was covered by long-term capital. The net inflow of foreign direct investment covered 31.9% of the current account deficit in the first nine months of 2005 and amounted to 3.6% of GDP. Financial intermediation, trade and manufacturing were the sectors reporting investment growth in Latvia. Investment from Estonia, Lithuania, Russia, Sweden, the Netherlands, the USA, Ireland and the United Kingdom expanded.

In the first nine months of 2005, portfolio investment recorded a net outflow (166.5 million lats) reflecting banks' investment in foreign debt securities.

The current account deficit was mainly covered by the net inflow of other investment (936.1 million lats). Banking sector mainly increased its long-term borrowing abroad (from parent banks). Other investment of enterprises recorded a net outflow in the first nine months of 2005, as trade credit and loans granted to non-residents expanded at a more rapid pace than those received from non-residents.

In the first nine months of 2005, with the Bank of Latvia purchasing foreign currency, reserve assets grew by 298.8 million lats.



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