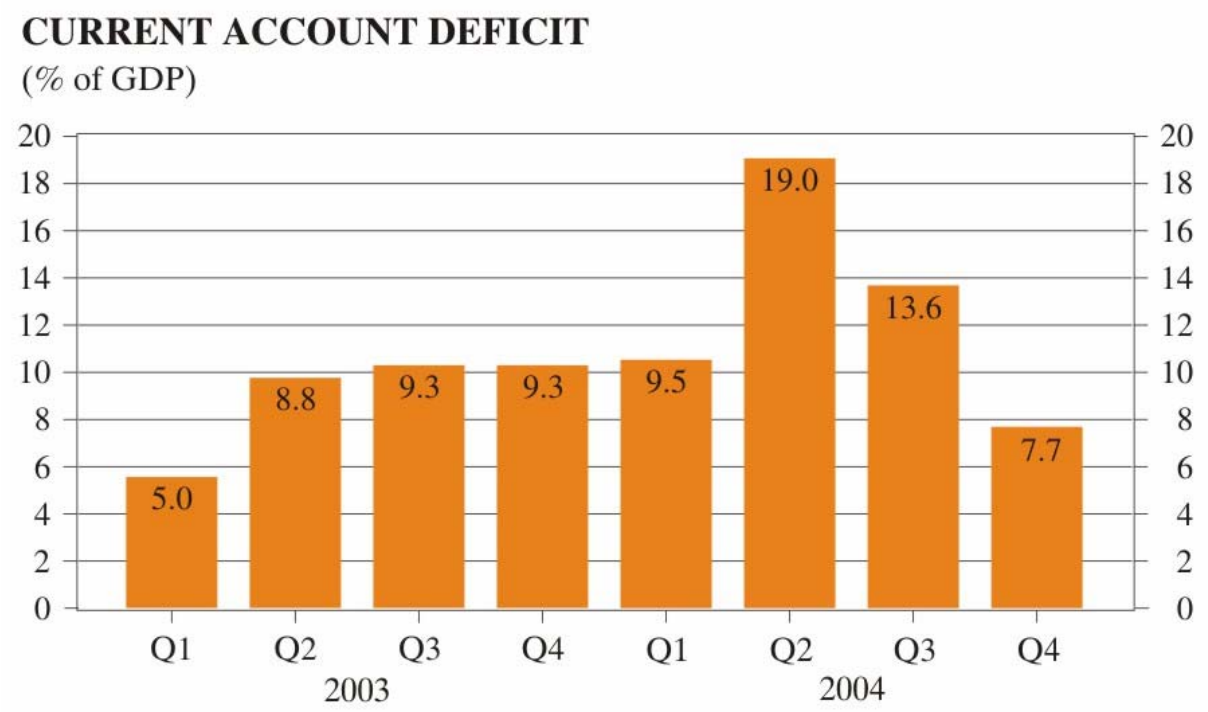
Press Release of March 31, 2005
Latvia's Balance of Payments in the Fourth Quarter of 2004 and in the Year 2004

The current account deficit of Latvia's balance of payments was 7.7% of gross domestic product (GDP) **in the fourth quarter of 2004** (9.3% in the corresponding period of the previous year). The goods deficit and the income surplus ratios to GDP remained broadly unchanged, the current transfers surplus increased substantially, but the services surplus decreased.

In 2004 on the whole, the current account deficit of the balance of payments accounted for 12.3% of GDP (8.2% in 2003). This increase resulted from a higher ratio to GDP of the goods and income deficit and a decline in services surplus. The surplus in current transfers improved slightly.



Evaluation and outlook

Latvia's balance of payments was positive in 2004. Foreign direct investment and other long-term capital, indicators of investors' confidence in the economy of Latvia, continued to cover the current account deficit. In 2004, foreign direct investment in Latvia more than doubled year-on-year.
Foreign trade strengthened buoyantly in the second half of the year. Similar to the third quarter, exports of goods in the fourth quarter expanded at a more rapid pace than imports (34.7% and 26.7%, respectively), suggesting an exceptionally strong growth. For the year as a whole, however, growth in imports of goods outpaced that in exports of goods due to the growing domestic demand and accumulation of stocks prior to the EU accession, as well as one-off purchases of investment goods, collectively pushing up the current account deficit by more than 3 percentage points.
It should be noted, however, that to a great extent the strong growth rates were triggered by substantial price rises for import and export goods as a result of global price rises for certain commodities and the strong euro. Price rises notwithstanding, the growth in exports and imports, in real terms, was around 4 percentage points above that in the previous year. This implies that, on the one hand, the Latvian

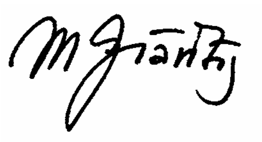
producers have retained their ability to compete on the major global markets, and, on the other, that the domestic demand continues to be strong.
It is quite likely that in 2005 the effects of a number of the factors above on the current account deficit will weaken or disappear. The lats peg to the euro is expected to mitigate the impact of foreign exchange volatility and to have a positive influence on foreign trade.
Progress in goods producing and services exporting sectors that are likely to be supported by a more dynamic expansion of corporate lending, and the acquisition of the EU structural funds figure as important prerequisites for improving Latvia's balance of payments. However, a number of projects associated with the EU structural funds and the persisting strong domestic demand dampen the hope for a substantial decline in the current account deficit. In these circumstances, it is extremely important to retain the interest of foreign investors in Latvia and to attest the strong stance towards maintaining macroeconomic stability in the country with the aim to ensure foreign direct investment coverage for the current account deficit.

Notes to Latvia's Balance of Payments for the Fourth Quarter and the Year 2004

Latvia's foreign trade developed dynamically in **the fourth quarter of 2004**. The last quarter of the year saw the most impressive export growth, which was equally fostered by a rise in the prices and the volume of export goods. Wood and articles of wood, base metals and articles of base metals, agricultural products and foodstuffs, textiles and textile articles as well as machinery and mechanical appliances, electrical equipment continued to dominate goods exports.
Of imports, mineral products, base metals and articles of base metals, and agricultural products and foodstuffs recorded the most marked year-on-year growth. On the whole, the growth in imports was primarily triggered by the expanding volume of imported goods.
Year-on-year, exports of services strengthened and imports of services followed suit, albeit to a slightly lesser extent. The increase in the current transfers surplus was determined by a stronger current transfers inflow in the Latvian Government sector (primarily the EU funds) and other sectors (primarily private persons).
With foreign direct investment in Latvia increasing, net inflows in the amount of 70.8 million lats were recorded in the fourth quarter. The most substantial share of funds invested in Latvia (in manufacturing and financial intermediation) went to equity capital and reinvested earnings. In portfolio investment, net inflows of the fourth quarter resulted from contracting investment in debt securities by residents (banks). Substantial net inflows were recorded for other investment. As banks increased the volume of short-term loans to foreign credit institutions and decreased their demand deposits with foreign banks, residents' other investment abroad went up. Liabilities to non-residents increased as a result of banks receiving non-residents' long-term time deposits.
Reserve assets increased by 80.8 million lats in the fourth quarter primarily as a result of the Bank of Latvia's interventions in the foreign exchange market.

According to Latvia's Central Statistical Bureau's statistics for foreign trade **in 2004**, growth in exports of goods (28.1%) outpaced that in imports (25.2%), with the weight of imports over exports shrinking from 81.1% in 2003 to 77.1% in 2004. The economic growth in Europe triggered an increase in the market demand for Latvia's output. As Latvian goods competed well in the global market, exports expanded buoyantly. The growth in exports was also supported by improvements in the market situation in line with rising export prices due to the rapid appreciation of the euro. Both the commodity price rise and expanding volume had an equal effect upon the growth of exports. Imports, in turn, were driven by the strengthening domestic demand and accumulation of stocks prior to the EU accession and bulky one-off purchases of investment goods supported the experienced rapid expansion of imports. Two thirds of the growth in imports in 2004 resulted from the expanding volume, whereas one third was a result of rising commodity prices.

In 2004, mostly goods dominating exports contributed to the overall growth in exports; in addition, exports of mineral products and goods with a higher value added also increased rapidly. Major export partners of Latvia were the EU countries, with exports to them growing by 25.4%. Exports to the new EU Member States (Lithuania, Estonia and Poland) recorded the most dynamic increase (68.8%). Exports also increased substantially to CIS countries and the other countries.
The real effective exchange rate of the lats remained broadly unchanged in 2004, as the depreciation of the nominal effective exchange rate of the lats was offset by an increase in the value of the price changes index. Consequently, cardinal changes in the competitiveness were not observed.
Imports of mineral products, machinery and mechanical appliances, electrical equipment, base metals and articles of base metals, as well as transport vehicles recorded the most marked growth. Moreover, these goods dominated imports.
With the surplus of transportation services shrinking, the surplus of services decreased slightly year-on-year. The deficit of travel services remained almost unchanged, and the surplus of other services increased mostly due to an expansion of the volume of other business activities, financial, communication, and construction services rendered to non-residents. The income deficit increased year-on-year, due to a notable rise in non-residents' income from investment in Latvia.
The surplus of both the current transfers and the capital account increased year-on-year and was determined by the fund inflows in the Latvian Government sector (primarily the EU funds) and other sectors (primarily private persons).
The capital and financial account recorded an inflow of 922.0 million lats for 2004. The bulk of the fund inflows were in the form of foreign direct investment and other investment (mostly long-term). The major share of direct investment in Latvia went to equity capital and reinvested earnings. With portfolio investment abroad slightly increasing and the Latvian Government issuing Eurobonds, portfolio investment posted an inflow.
Net inflows of other investment were in the amount of 649.2 million lats. Other investment of residents abroad increased, primarily due to banks pushing up their loans to and demand deposits with foreign credit institutions. Likewise, liabilities to non-residents grew as banks made borrowings (time deposits) and received non-residents' demand deposits.
Reserve assets increased by 214.7 million lats in 2004, such a rise being primarily determined by the Bank of Latvia engaging in foreign exchange market transactions and selling lats for foreign currencies.



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