

LATVIJAS BANKA

PRESS RELEASE

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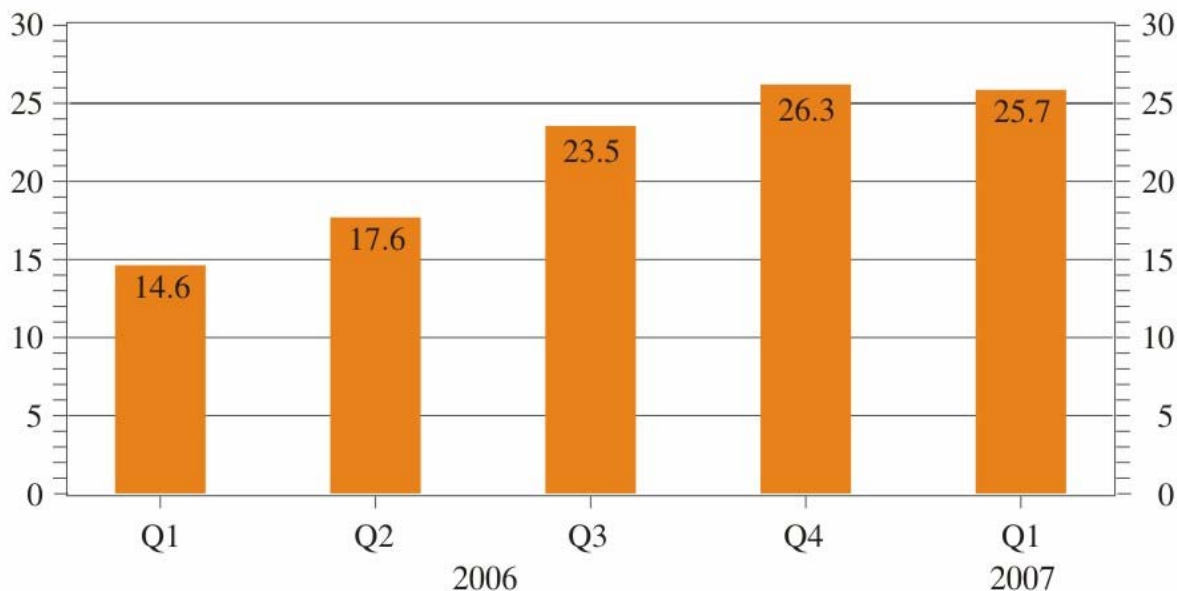
Latvia's Balance of Payments in the First Quarter of 2007

In the first quarter of 2007, the current account deficit of the balance of payments amounted to **25.7% of GDP** (in the previous quarter – 26.3% of GDP and 14.6% of GDP in the corresponding period of the previous year). The widening of the current account deficit to 746.2 million lats resulted from an increase in the ratio of deficit of goods to GDP, as the growth of imports exceeded that of exports, and narrowing of the current transfers surplus, with the amount of transfers leaving Latvia growing and that of incoming transfers -- decreasing. The ratio of services surplus to GDP declined to a lesser extent as the imports of services posted a higher increase. The ratio of income deficit to GDP increased as income from investment received by non-residents continued to expand.

In the first quarter, total direct investment in Latvia grew by 7.3% year-on-year, covering one third of the current account deficit. The largest part of the current account deficit was financed by borrowing from foreign banks. Reserve assets increased by 45.5 million lats.

CURRENT ACCOUNT DEFICIT

(% of GDP)



Evaluation and outlook

The Government-approved measures aimed at stabilising the macroeconomic situation are at the very beginning of their implementation -- the first indications of its effectiveness are beginning to appear over the last couple of months, with the pace of GDP growth, lending

expansion and price increases moderating. This allows one to conclude that the lowest indicators of the balance of payments belong to the past and Latvia faces a gradual improvement in this respect in the future, securing a smooth transition towards growth levels sustainable in the longer term and the trust of investor community. The robust GDP growth was mostly fuelled by an increase in the domestic consumption, while a high annual rate of increase of 36.7% in imports of goods and services persisted. Despite the robust growth of 25.9% in exports, the external imbalance could not be notably reduced, and the current account deficit of the balance of payments remained high in the first quarter.

In the first quarter, direct investment in Latvia reached 8.1% of GDP, with investments in equity instruments accounting for less than one tenth of total direct investment. Reinvested earnings and other investment formed most of direct investment capital. Other investment surplus almost fully offset the current account deficit; however, unlike the previous year, the share of short-term investment expanded persistently. In previous months, parent banks of Latvian major commercial banks in Scandinavia expressed their readiness to reduce the lending growth gradually. That could be a positive step towards reducing the current account deficit; however, it would be too early to expect resulting moderation in lending rates already in the performance indicators of the first quarter: net loans to Latvian banks reached 23.9% of GDP, a 4.2 percentage point increase over the average of 2006.

Although the situation on the Latvian financial markets was quite tense in February and March, requiring the Bank of Latvia to conduct interventions and sell euro, the overall results of the first quarter were positive -- the reserve assets of the central bank increased.

A crucial role in reducing the macroeconomic imbalances in the future will be played by consistent implementation of the action plan for curbing inflation and stabilising the macroeconomic situation in Latvia. The plan was adopted by the Government in March this year, and subsequently enacted by the Saeima (Parliament) in May, making the relevant amendments to the legislation.



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