LATVIJAS BANKA

PRESS RELEASE

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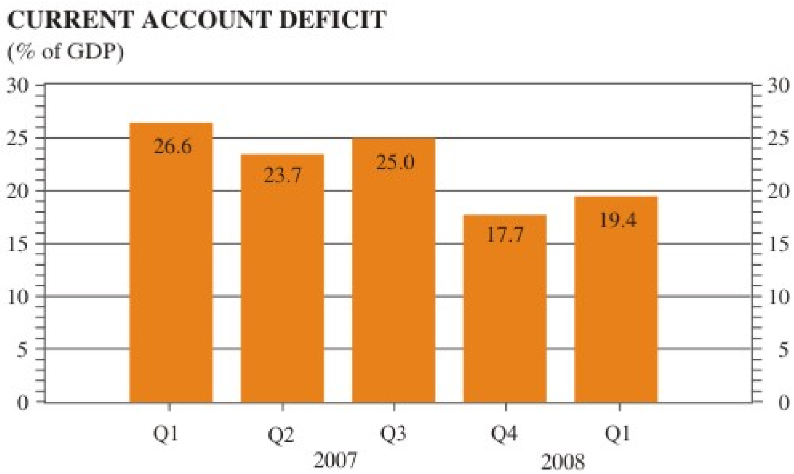
Latvia's Balance of Payments in the First Quarter of 2008

In the first quarter of 2008, the current account deficit of Latvia's balance of payments was 666.2 million lats or **19.4% of GDP** (765.5 million lats or 26.6% of GDP in the corresponding period of the previous year). The goods deficit to GDP decreased by 6.2 percentage points and was the primary source for the shrinking current account deficit (on account of export growth exceeding import growth by 61.7 million lats). The services surplus to GDP remained broadly unchanged, notwithstanding the expansion in services turnover (24.8%).



The current account deficit was fully covered by long-term capital. Net inflow of foreign direct investment in Latvia maintained its year-on-year level (248.1 million lats, of which almost a half as reinvested earnings). Portfolio investment recorded a net inflow largely resulting from the issue of government long-term debt securities in the amount of 400 million euro.

Net inflow of other investment stood at 301.1 million lats (8.8% of GDP). Long-term borrowing of the banking sector picked up 1 003.0 million lats, while short-term bank loans shrank by 409.7 million lats.

As the government deposited the receipts from the euro bond issue with the Bank of Latvia, the reserve assets grew by 201.4 million lats in the first quarter.

Evaluation and Outlook

With capital inflows exceeding the current account deficit in the first quarter of 2008, Latvia's balance of payments was positive. The deceleration of economic growth that was primarily associated with moderating domestic demand was reflected in the subdued import demand. Despite an unfavourable external environment and abating dynamics of foreign demand, the growth in exports of goods and services was steady. This contributed to a year-on-year decrease in goods and current account deficits in the first quarter. The exporters' ability to adjust to the changing external demand was evidenced by growing market shares in almost all major trade partner countries; concerns, however, arise regarding the drivers behind export growth, with the price factor dominating due to high world commodity prices. The relatively solid expansion of services exports, transportation services in particular, is a favourable development, while, at the same time, swiftly rising imports of construction and financial services were an obstacle towards an improved services balance.

The financing of the current account deficit was dominated by long-term capital. The banking sector, having in part restructured the outstanding debt obligations by replacing the existing short-term debt with a long-term one owing to a reduced minimum reserve requirement for bank liabilities with a maturity of over 2 years, accounted for a significant part of the long-term financing. Foreign direct investment continues to be a significant source for financing the current account deficit.

The decrease in the current account deficit is primarily the reflection of a decelerating pace of economic growth in Latvia; it is likely to persist also in the coming quarters. To achieve a substantial ongoing improvement in the current account, export potential should be strengthened and a less buoyant rise in labour costs not outstripping productivity gains ensured. Investment in manufacturing and transport supports expansion of exports; however, government's policy to enhance resilient competitiveness of exporters in the environment of growing labour costs is also valid. The fiscal policy of the government with its commitment to long-term macroeconomic stability and expenditure constraints when revenues increase at a slower pace continues to be a major instrument in ensuring sustainability of the economic development.

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