LATVIJAS BANKA

PRESS RELEASE

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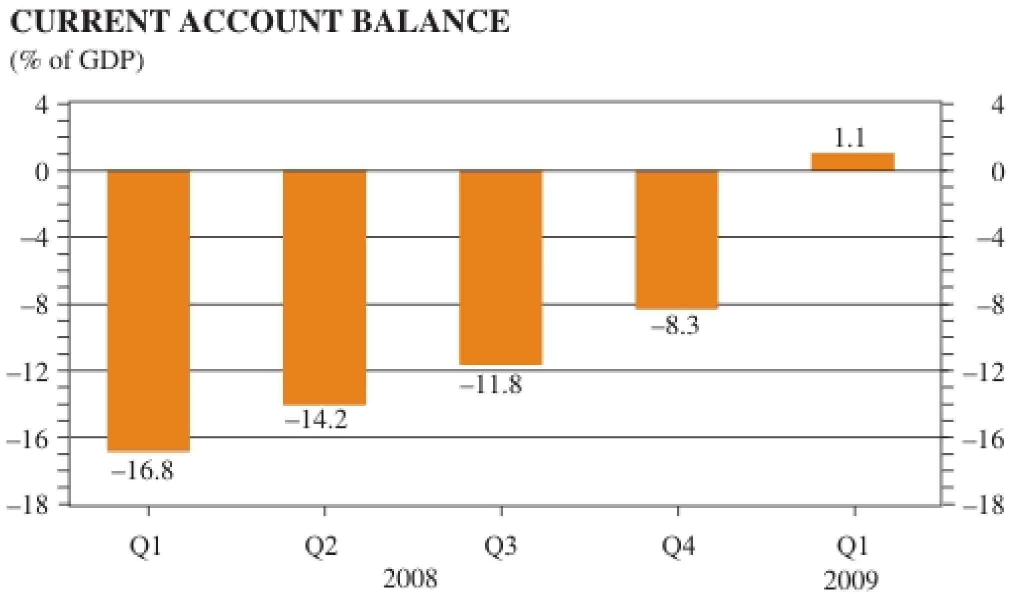
Latvia's Balance of Payments in the First Quarter of 2009

With imports of goods declining rapidly, current account of the balance of payments was **in surplus in the first quarter of 2009** (37.7 million lats or **1.1% of GDP**; a deficit of 627.6 million lats or 16.8% of GDP in the corresponding period of the previous year).



Quarter-on-quarter, the ratio of goods deficit to GDP decreased notably (by 4.9 percentage points). Year-on-year, the decline was 7.9 percentage points of GDP. The annual decline in exports of goods was 26.8% and that in imports – 35.5%.
The income balance was positive for the second quarter running as non-resident direct investment companies in Latvia continued to operate at a loss. Year on year, this translated in a 6.6 percentage point of GDP improvement in the current account balance.
As to services, the ratio of surplus to GDP increased since imports of services shrank while exports remained broadly unchanged. The ratio of current transfer surplus to GDP improved somewhat.
The movements in the financial and capital account were largely the result of a fast reduction in foreign liabilities of the banking sector arising from transactions. The decline was as large as nearly 1.3 billion lats, mostly on account of moderating borrowing from foreign financial institutions. It was offset by shrinking foreign assets across the banking sector as a result of funds returning to Latvia (564.0 million lats in total) and the government borrowing (752.7 million lats).

The EU funds received by the government generated capital inflow in the amount of 98.4 million lats (a 2.5 times year-on-year increase). Foreign direct investment contributed as equity or other capital increased by 149.9 million lats (143.9 million lats in the corresponding period of the previous year). This increase was offset by reinvested losses (133.4 million lats). Financial derivatives recorded a net inflow of 174.7 million lats as a result of the transactions performed by the Bank of Latvia.

The decrease of reserve assets by 331.0 million lats was caused by a change in the government deposits with the Bank of Latvia and the Bank of Latvia interventions in the foreign exchange market.

Latvia's both gross and net foreign debt declined for the first time since 1995 (by 2.9%, to 20.2 billion lats and by 1.2%, to 9.1 billion lats respectively).

Evaluation and outlook

Latvia recovered its import/export balance already in the first quarter – way ahead of forecasts. A further economic downturn was the reason for a decline in imports and exports and a credit squeeze, which was more pronounced in Latvia than in the trade partner economies. Following more cuts in government expenditure and private consumption moderating, further decline in imports of consumer goods can be expected in the next quarters of 2009. An increase in exports and higher imports of intermediate goods is anticipated provided the growth in major trade partner economies stabilises in the second half of 2009.

The current import volume and structure is expected to change over the next few years. Among other, this is suggested by a 60% year-on-year decline in imports of capital goods (a 31% decrease in imports of consumer goods). With stocks running low, loans becoming available again and the economic activity recovering in Latvia as well as in other countries, an import boom is possible. Therefore, to sustain the external balance in a longer term, it is critical that export companies remain competitive and have sufficient capacities ready for the moment when external demand starts to climb.

The effects of the export credit guarantee programme launched in June should show soon. Amidst crisis, foreign direct investment is nevertheless equally important as the driver of exports and economic growth. A stable business environment, particularly promoted by a rapid and consistent implementation of government fiscal policies that are aimed at containing ineffective costs, continues to be a prerequisite for attracting deferred and new foreign direct investment.

Mārtiņš Grāvītis
Press secretary
Bank of Latvia

Telephone: +371 670 22 349
Mobile: +371 265 10 385
Martins.Gravitis@bank.lv
www.bank.lv