



LATVIJAS BANKA

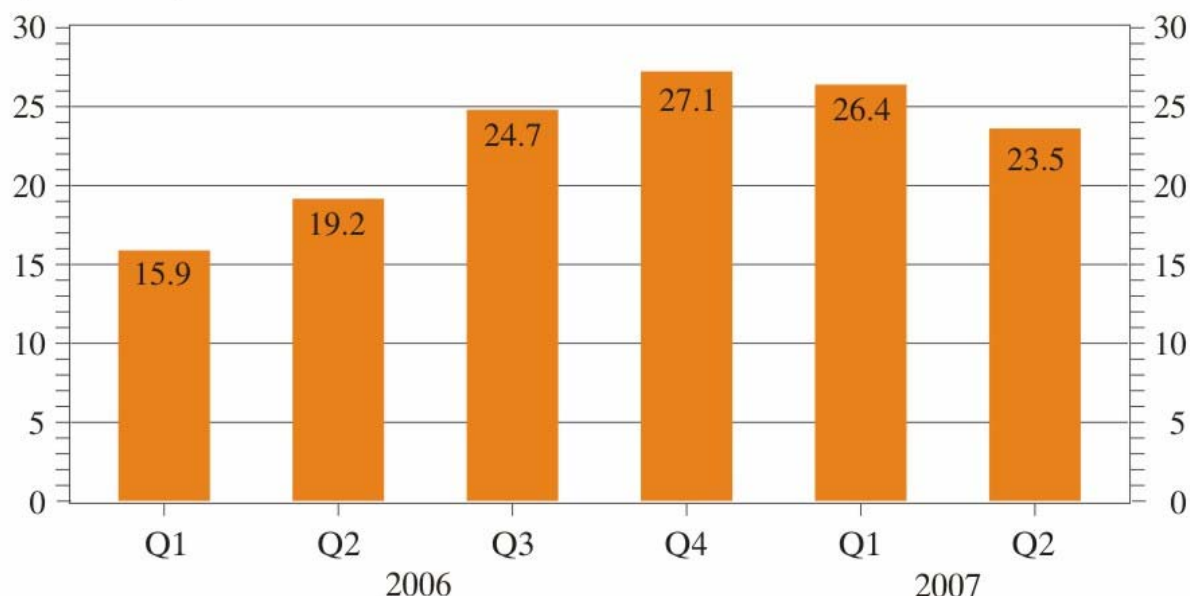
PRESS RELEASE

Riga, 20 September 2007

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

CURRENT ACCOUNT DEFICIT

(% of GDP)



In the second quarter of 2007, the current account deficit of the balance of payments amounted to 795.6 million lats or **23.5% of GDP** (765.5 million lats or 26.4% of GDP in the first quarter of 2007 and 517.7 million lats or 19.2% of GDP in the corresponding period of the previous year). The widening of the current account deficit resulted from an increase in the ratio of goods deficit to GDP, as the growth of imports exceeded that of exports, and from higher income deficit ratio to GDP, with the non-residents' income from investment on a continuous upward trend. As the volume of transfers received expanded, the current transfers surplus to GDP was the only growth-recording position. It offset the shrinkage in the ratio of services surplus to GDP, with imports of services posting a higher increase.

The current account deficit of **the first six months** of 2007 accounted for **24.8%** of GDP (17.7% a year earlier) and was determined by deterioration in all current account positions to GDP, by the goods deficit to GDP to the largest extent.

In the second quarter, the current account deficit was fully covered by long-term capital, wherein the share of foreign direct investment expanded notably. Net inflow of the second quarter direct investment amounted to 10.7% of GDP and was only slightly lower than in the first six months of the year. Net inflow of other investment was 770.4 million lats in the second quarter, and the reserve assets grew by 156.8 million lats.

Evaluation and Outlook

Serious risks of economic overheating are still in place; in some areas, e.g. inflation, they have even increased. However, the economy is also sending out signals that are positive. Thus, for instance, in the second quarter the current account deficit was by 2.9 percentage points lower than in the first quarter, primarily due to a notable acceleration in current transfers and some deceleration in the pace of import growth, with exports of goods remaining stable since the beginning of the year. A lower ratio of current account deficit to GDP in the second quarter than in the first quarter has been achieved for the first time in the last six years. In the second quarter, the growth in inflow of direct investment in Latvia was exceptionally strong (11.8% of GDP) and was mainly triggered by an increase in banks' share capital. The growth in foreign borrowing by the Latvian banks slowed down somewhat under the impact of anti-inflation measures, moderation in foreign bank financing and a tighter credit policy pursued by banks particularly in the real estate related sectors. In addition, in the second quarter, long-term borrowing of the banks increased at a more rapid pace than their short-term borrowing. Moreover, the borrowing of other sectors is starting to play an ever growing role in the current deficit financing: it grew notably in 2007, predominantly due to the pickup in the borrowing by leasing companies from foreign credit institutions. The reserve assets continued to grow as a result of interventions conducted by the Bank of Latvia.

The efforts aimed at curbing domestic demand, enhancing competitiveness of Latvian producers and supporting a balanced development of the national economy by all involved parties will be of paramount importance in the near future. The Government's commitments to pursue a tighter fiscal policy to ensure a higher budget surplus and the recent credit policy of the banks that has made credit expansion moderate suggest a promising beginning. Undertaking a more active role in the economic stabilisation process and using a package problem solving approach, the Government has showed wisdom of making correct choices.



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