LATVIJAS BANKA

PRESS RELEASE

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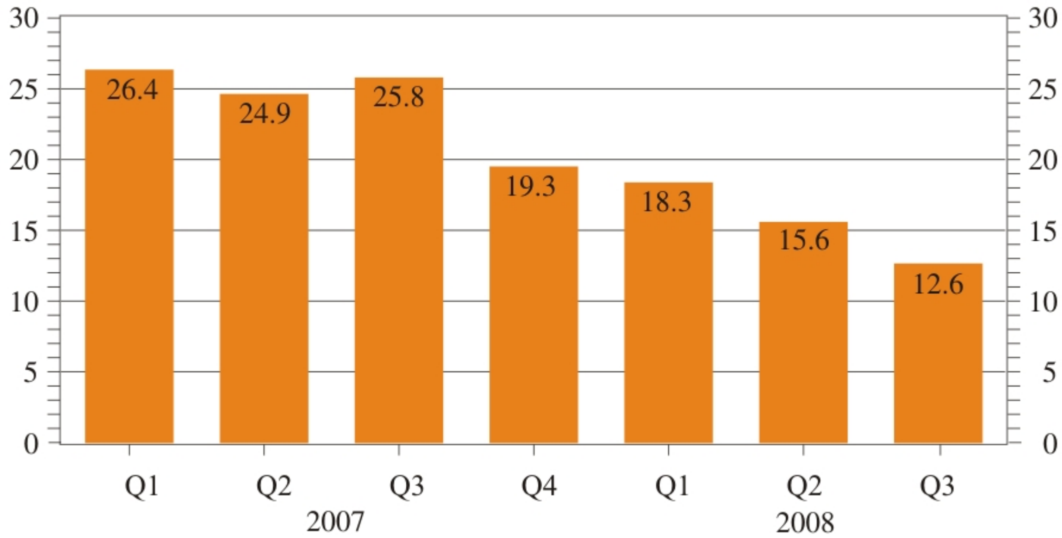
Latvia's Balance of Payments in the Third Quarter of 2008

In the third quarter, the current account deficit of the balance of payments continued to diminish and amounted to 489.0 million lats or **12.6% of GDP** (959.5 million lats or 25.8% in the corresponding period of the previous year).

CURRENT ACCOUNT DEFICIT
(% of GDP)



The significant narrowing of the current account deficit was the result of a decrease by 7.8 percentage points in the goods deficit to GDP ratio, as imports declined by 5.5%, while exports continued to grow at a moderate albeit steady pace of 14.6%. The pickup in the ratio of current transfers surplus to GDP by 3.1 percentage points had a positive effect as well, with transfers from private persons' accounts in Latvia to foreign countries subsiding. The ratio of services surplus to GDP increased less buoyantly, while the ratio of income deficit to GDP went down.

Overall, in the first nine months of 2008 the current account deficit of the balance of payments dropped to 15.4% of GDP, down from 25.7% in the respective period of the previous year. Given the weakening domestic demand, imports of goods have been shrinking ever since the beginning of the year; consequently, the narrowing of the current account deficit was on the account of decline in the deficit of goods.

The current account deficit continued to be covered prevailingly by long-term capital. Foreign direct investment in Latvia stood at 5.1% of GDP in the third quarter, down from 7.3% in the respective period of the previous year. Other investment recorded a net inflow of 9.7% of GDP (26.9% of GDP in the respective period of the previous year). Most of capital inflows were from banks' long-term and short-term (similar as to volumes) borrowings, as well as a decline in banks' loans and deposits abroad. Most of capital outflows were caused by a decline in non-resident deposits with Latvian banks (10.4% of GDP).

In the third quarter, reserve assets declined by 25.5 million lats, while all in all they have grown by 225.5 million lats since the beginning of the year.

Evaluation and Outlook

As expected, together with the slowdown of economic growth, the current account deficit has been narrowing very visibly already for the fourth quarter running – mainly on account of a decline in the imports of goods. With credit institutions tightening their lending standards, domestic demand continued to shrink, in particular for durable goods, including motor vehicles. Exports, on the contrary, have been moving up for nearly all commodity groups, so far displaying little response to the declining external demand in the wake of global financial crisis. Exports grew mostly on account of price rises, while the group of wood and articles of wood reported a decline both in volume and in prices.

The declining demand and toughening competition in external markets in future is expected to restrict the growth of export prices and weaken the capability of conquering new markets. Furthermore, the deteriorating availability of financial resources and the declining inflows of foreign direct investment will be a constraint to further growth of export volumes. The decreasing labour costs and prices of raw materials recorded during the past few months, combined with labour force availability, right now are in favour to the growth of exports of goods; yet, their positive effect is dampened by the downturn of economy both in Latvia and its major trade partners.

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