

LATVIJAS BANKA

PRESS RELEASE

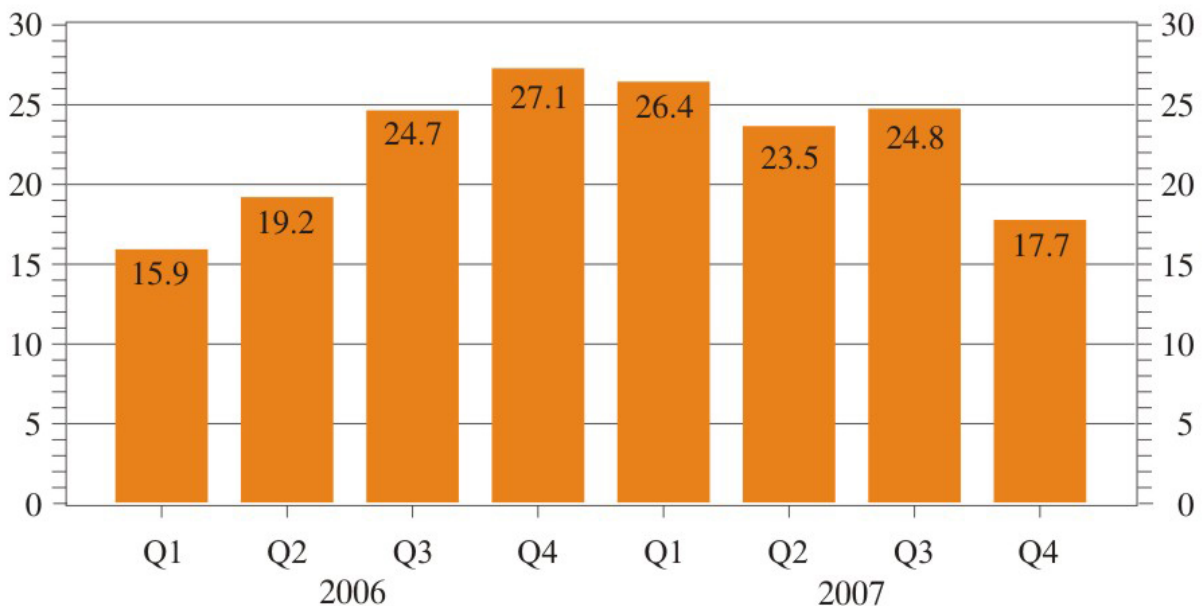
Riga, 25 March 2008

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

In the **fourth quarter** of 2007, the current account deficit of Latvia's balance of payments decreased to 708.8 million lats or **17.7% of GDP** (891.4 million lats or 27.1% of GDP in the corresponding period of the previous year). The goods deficit to GDP shrank notably, with the annual growth in imports decelerating (to 4.5%) and a stable export expansion continuing (19.1%). The services surplus to GDP increased due to the volume of services rendered, transport services in particular, dynamically expanding. The increase in the income deficit to GDP was offset by a pickup in current transfers surplus to GDP.

CURRENT ACCOUNT DEFICIT

(% of GDP)



This notable current account improvement in the fourth quarter underpinned the reversal of its deficit to **22.8% of GDP** in 2007 (22.3% in 2006). In 2007, goods and services to GDP improved, whereas income and current transfers to GDP deteriorated.

In the fourth quarter, net inflow of foreign direct investment in Latvia (majority (66.5%) as reinvested earnings) accounted for 5.7% of GDP. Net inflow of other investment also shrank considerably, including bank loans which dropped 51.5% year-on-year.

In 2007, other investment inflow, the majority of which (93.1%) was made up of long-term other investment (primarily bank loans from associated non-resident banks), was the principal source for covering the current account deficit (89.9%). Net direct investment inflow covered 31.2% of the current account deficit and foreign direct investment in Latvia accounted for 8.0% of GDP. The bulk of direct investment in Latvia was in the form of equity capital (59.4%) and went to financial intermediation and real estate, renting and business activities.

Despite interventions aimed at maintaining the stability of exchange rate of the lats at the beginning of 2007, the reserve assets of the Bank of Latvia increased by 502.2 million lats (3.6% of GDP) in the course of the year.

Evaluation and outlook

In the fourth quarter of 2007, Latvia's balance of payments confirms a gradual cooling of the economy, with the current account deficit shrinking notably year-on-year and banks' non-resident borrowing growth decelerating by half.

Falling domestic demand has had a strong downward pressure on imports, simultaneously encouraging businesses to more dynamic activities in foreign markets. However, maintaining a stable export growth in the coming periods requires adherence to and consistent implementation of the government's export promotion plan in the name of ensuring international competitiveness. It should be acknowledged that the narrowing external demand resulting from the global financial turmoil and the rising domestic costs as a factor weakening exporters' ability to compete may have a braking effect on Latvia's export growth, with higher competitiveness of Latvian producers and services providers earning greater importance in the future.

With foreign direct investment inflow remaining strong in the fourth quarter, reinvested earnings made up its majority. It suggests that the investors' assessment of growth potential and returns continues to be positive and the income earned is reinvested in companies' future development. At the same time, there has been no notable increase in new investors entering the Latvian market, which means that in the near future foreign investors should be attracted not only to such sectors of Latvia's economy as financial intermediation and real estate, but also to production and export-oriented areas. Long-term capital inflows to ensure financing for the current account deficit considerably reduce the economic development risks. A more moderate economic growth in the coming periods is expected to reduce imbalances.



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