

Key indicators of economic development

	2002	2003	2004	2005	2006 f
(increase over the previous year, in per cent)					
Gross domestic product	6.5	7.2	8.5	10.2	8.5
Consumer prices	1.9	2.9	6.2	6.7	5.5
(% of GDP)					
General government budget fiscal balance	-2.3	-1.6	-1.1	-1.0 *	-1.5
Central government debt	13.1	13.2	13.2	10.7 *	10.5
Current account balance	-6.6	-8.1	-12.9	-12.5 e	-9.8
Exchange rate, LVL per US dollar	0.618	0.571	0.540	0.550 *	0.560
Exchange rate, LVL per euro	0.583	0.645	0.671	0.703 *	0.703
Unemployment rate (rate of job seekers as % of economically active population, aged 15-74 years)	12.0	10.6	10.4	9.3 e	8.8

	2004				2005			
	I	II	III	IV	I	II	III	IV
(increase over the corresponding period of the previous year, in per cent)								
Gross domestic product	8.7	7.8	9.1	8.6	7.3	11.4	11.4	10.5
Consumer prices	4.3	5.8	7.4	7.3	6.7	6.5	6.5	7.3
(% of GDP)								
General government budget fiscal balance	2.4	-1.5	4.2	-8.2	3.3	3.1	3.0	-11.2 *
Current account balance	-9.5	-18.9	-13.4	-10.0	-10.9	-10.6	-12.7	...
Exchange rate, LVL per US dollar	0.538	0.548	0.545	0.530	0.535	0.557	0.576	0.591 *
Exchange rate, LVL per euro	0.673	0.660	0.666	0.685	0.703	0.703	0.703	0.703 *
Unemployment rate (rate of job seekers as % of economically active population, aged 15-74 years)	11.5	9.9	10.0	10.3	9.9	9.2	8.7	7.8

f - forecast of the Ministry of Economics; e - estimate of the Ministry of Economics; * - provisional data.

Economic policy

The aim of the government's economic policy is to ensure sustainable and balanced economic and social development, implement the transition from a labour-intensive economy to a knowledge-based one attaining in this way the EU average GDP per capita level within the next 20-30 years.

EU accession provides Latvia with new opportunities for economic growth. By joining the single EU market Latvia can benefit from the advantages provided by a broad and stable market, free movement of goods and services, labour and capital, i.e., the most favourable terms on the EU market. Support from the EU funds mitigates, in turn, the effect of structural changes in the economy and helps to reduce the social and economic disproportion.

In October 2005 the government adopted the *National Lisbon Programme of Latvia for 2005-2008* which shows what Latvia is going to do in the medium term to foster growth and employment. The aim is to ensure GDP growth at 6-8% annually in the next years and to raise the employment rate up to 67% by 2010.

To ensure balanced development the government is resolved to reduce the budget deficit gradually intending in this way to reduce the current account deficit. The Bank of Latvia implements de facto the policy of the fixed exchange rate of the national currency. This reduces uncertainty, averts the currency risks and provides a stable ground to entrepreneurs for planning. The aim of Latvia is to become a full-fledged member of the European Economic and Monetary Union (EMU) already in the nearest future. Latvia's joining the European Exchange Rate Mechanism II on May 2, 2005 marks the first step on the road to EMU.

One of the main economic policy challenges for Latvia is to set up an effective and competitive sectoral structure by implementing structural reforms to boost productivity and to support research and development and innovation, improving efficiency of the educational and training system, its quality and accessibility.

In recent years the business environment in Latvia has been substantially improved by introducing the requirements of the EU body of legislative acts (*acquis communautaire*) and implementing the *Action Plan for Improvement of Business Environment*. The *Commercial Law* testifying to a fundamental reform of the business environment became effective in 2002. Currently the corporate income tax in Latvia (15%) is among the lowest in the EU. Legislation provides special corporate income tax relief to enterprises operating within the special economic zones. In order to create an optimal administrative and organisational structure of local governments, the administrative territorial reform is under way in Latvia with the intention to complete it before the local government elections in 2009.

Latvia is consistent in its efforts to open to competition the monopolist markets such as telecommunications, electricity and gas supply, post and railway. The government continues to improve the basic infrastructure paying close attention to the development of the energy sector, building of the electronic communications and information systems, as well as to the improvement of the quality of transport infrastructure and creation of an effective network. The utilisation of EU structural funds and the Cohesion Fund offers broader opportunities to improve infrastructure. The aim of the government is to ensure full absorption of the EU funds.

Successful implementation of structural reforms in Latvia will ensure the stability of economic growth, promote the catch-up process and deeper integration into the European and world economy.

Macroeconomic development

Growth rates in the Latvian economy have been very rapid in recent years. The reforms carried out in the country and integration into the EU have made a positive impact on economic development. In the period between 2001-2005 GDP grew on average by 8% annually, but the growth rate in 2005 was 10.2%. These growth indicators are the highest in the European Union. The high growth rates in Latvia are based on the steady increase of domestic demand and export growth.

Economic activity is improving in all main economic sectors. Domestic demand invigorates the development of services especially the development of trade and construction. High growth rates can also be observed in the transport and communications sectors. Manufacturing output in the period between 2001-2004 rose on average by 9% per year. Due to the storm in January, which negatively affected the growth of the manufacturing sector, especially the largest exporting sector - manufacturing of wood and articles of wood, increased less rapidly - by 6.3% in 2005. Since June, however, the monthly growth rates in manufacturing are 8-10%. The competitiveness of Latvian manufacturers can be explained by the rapid rise in productivity spurred by the investments that were made in previous years.

Economic growth in Latvia was achieved in a stable macroeconomic environment. The general government budget deficit in Latvia is low and does not exceed the level set by the Maastricht criteria. The Parliament has confirmed the general government budget deficit for 2006 at 1.5% of GDP. Although the current account deficit is comparatively large, it should not be considered today as critical as it is covered by foreign direct investment and long-term loans. Net foreign reserves of the Bank of Latvia fully cover the reserve money.

A relatively high level of inflation has been observed in recent two years. Its rise in 2004 was accounted for by a combination of several one-off effects (an increase in the administratively regulated prices, harmonisation of the indirect tax rates, inflation expectations due to EU accession and the high oil prices on the global scale). Inflation in 2005 remained on a high level owing mainly to the rises in the global oil prices and the second phase of inflation (spiral). According to forecasts, due to the diminishing influence of the aforementioned price-raising factors, inflation will decrease gradually.

The employment and unemployment indicators are gradually improving. In recent years the number of employed has been rising every year while the unemployment rate has decreased from 14.4% in 2000 to 10.4% in 2004 and in the 4th quarter of 2005 it was 7.8%.

The economic growth potential is best characterised by the investment increase. In the period from 2000 to 2004 gross fixed capital formation rose 1.7 times. The investment growth rate and its share in GDP are among the highest in the EU. Investment continued to accelerate rapidly in 2005 promoting the modernisation of production and transition to new more productive technologies. Latvia's accession to the EU is a particularly stimulating factor for the country's economy. This strengthens confidence that growth in the coming years will also be sustainable. If there are no external shocks GDP can be expected to grow by 6-8% annually in the medium term. The Ministry of Economics forecasts the growth of GDP in 2006 at 8.5%.

Gross domestic product

2005	
GDP, at current prices	
mln lats	8904
mln US dollars	15759
mln euro	12665
GDP per capita	
lats	3871
US dollars	6851
euro	5506
GDP by sector, %:	
Agriculture¹	3.8
Industry	16.1
Construction	6.3
Trade²	21.4
Transport and communications	15.9
Public services³	14.6
Other services	21.9

In recent years Latvia has shown high GDP growth rates. The growth rate in 2005 was very rapid - 10.2%.

Similarly as in the previous periods, the main reason for growth was the stable domestic demand and, to a lesser degree, the increasing export of commodities and services.

The volume of private consumption has increased. Private consumption is spurred not only by the annual wage increase but also by the availability of consumer credits to private persons at acceptable interest rates as well as credits for dwelling purchase and repair. Private consumption in the three quarters of 2005 exceeded the level of the corresponding period of 2004 by 8.8%.

The favourable financial situation (low interest rates on loans and expanding mortgage lending) encourages investing. Gross fixed capital formation in the three quarters of 2005 was considerably higher (by 21.5%) than in the corresponding period of the previous year.

Nearly 80% of GDP growth was on account of the development of the services sector fostered mainly by the development of the trade and communications sectors.

Construction is growing fast while industrial growth has been more moderate. Construction output in 2005 were 15.5% higher than in 2004. There are substantial increases in the construction of private single dwelling and multi-dwelling residential houses as well as in the construction of public buildings.

The growth of trade is mainly determined by the domestic demand, although slightly more than one tenth is related to intermediary trade services provided to non-residents. This share is growing annually.

After EU accession freight transport grew particularly quickly and passenger transport services including air transport services were also on the rise. Transport and communications services in 2005 increased by 16.2% compared to the previous year.

¹ Including forestry and fishing

² Including hotels and restaurants

³ Public administration including healthcare and education

Gross domestic product

GDP by Sectors
(growth over the corresponding period of the previous year, %)

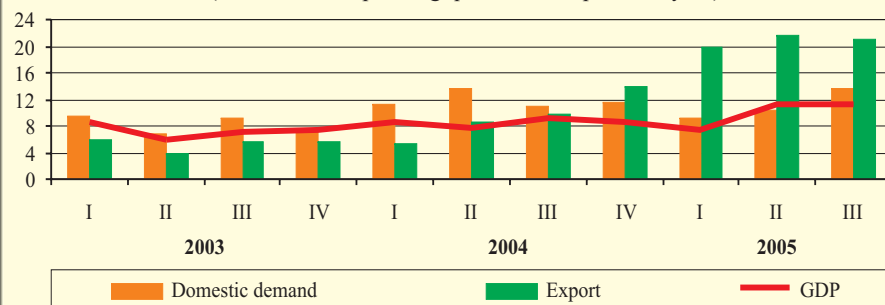
	2004				2005				2002	2003	2004
	I	II	III	IV	I	II	III	IV			
GDP	8.7	7.8	9.1	8.6	7.3	11.4	11.4	10.5	6.5	7.2	8.5
Agriculture ¹	6.5	4.8	3.5	3.3	-0.9	5.2	4.8	4.5	4.4	-2.4	4.4
Industry	10.6	7.4	6.2	5.4	0.2	8.0	8.0	7.7	8.1	6.0	7.3
Construction	13.0	12.0	11.4	15.7	16.2	15.8	15.6	14.4	10.8	13.7	13.0
Trade ²	11.2	8.2	10.4	11.2	15.2	18.7	17.5	17.6	11.9	10.9	10.3
Transport and communications	8.3	10.9	17.0	15.8	11.1	18.8	18.4	15.9	3.4	8.9	12.9
Public services ³	4.5	4.0	3.2	3.8	2.7	4.0	1.5	2.8	2.4	3.8	3.9
Other services	7.6	7.4	9.3	6.7	5.4	8.2	9.9	8.7	5.4	5.7	7.7

¹ Including forestry and fishing

² Including hotels and restaurants

³ Public administration including healthcare and education

Quarterly Changes in Real GDP and Major Expenditure Items
(% of the corresponding quarter of the previous year)



6

Manufacturing

2005

Growth rate: 6.5%

Recent years (2001-2005) have witnessed steady growth in manufacturing, and with the annual growth rate reaching 8%, the increase in manufacturing can be put on the same level as the overall economic growth.

Straight after EU accession growth rates in manufacturing decreased and some time had to pass until the enterprises adjusted to the new trade conditions. A remarkable growth started again in May 2005.

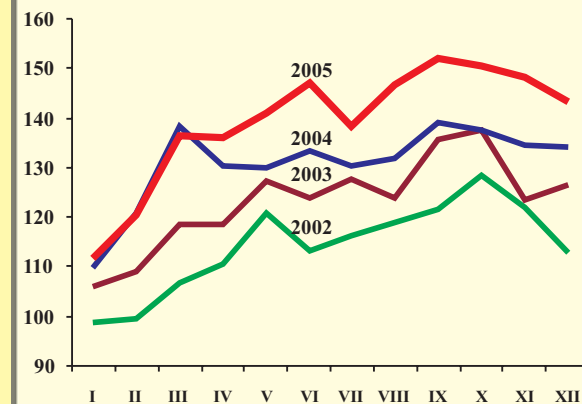
Those sectors, where trade outlets were relatively less connected with exports, witnessed faster growth in 2005, except the food industry. For example, the growth rates were about 25% in the manufacture of construction materials, 12% in printing and 15% in the chemical industry. Manufacturing output rose on average by 6.5% per year.

Output of the food industry, the biggest manufacturing sector of Latvia contributing on average a quarter of the total value added in manufacturing, increased in 2005 by 5.1%. Approximately 80% of the products manufactured in this sector are consumed on the local market and the rest is exported, mainly to Estonia, Lithuania and Russia. Growth in the food industry in 2005 was slightly less vigorous than in the previous year owing to a more moderate export expansion. The export of food products increased mainly in the direction of Lithuania and Estonia.

Wood processing is the second largest industrial sector in Latvia (approximately one fifth of the total value added in manufacturing). About 70% of the production output of this sector are exported. The output volume is therefore basically determined by external demand. The main export markets are located in the EU member states. At the beginning of 2005 exports of wood products decreased owing to a great degree to the storm raging in the Scandinavian countries and Latvia in the beginning of 2005, as a result of which output in this sector decreased. The situation changed in the second half of the year and exports have increased again.

The share of these two sectors in the total manufacturing output is declining year by year, while other sectors including the chemical and machine building industries are growing faster.

Manufacturing Output
(average monthly output in 2000 = 100)



7

Investments

2004

Foreign direct investment stock per capita, at the end of the year: 1984 US dollars

Gross fixed capital formation (% of GDP): 27.5

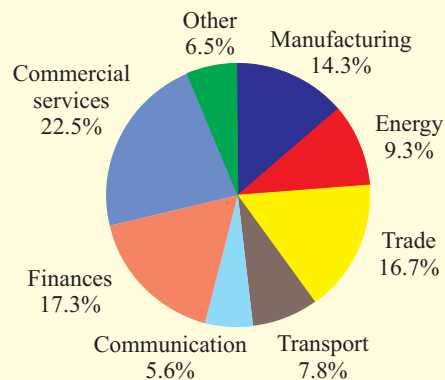
Rapid economic growth and the stable macroeconomic and financial environment are the basis for the strong investment dynamics persisting in Latvia for already several years. In the period from 2001 to 2004 gross fixed capital formation rose by 75.2%, that is on average by 15% per year. Strong investment dynamics continued also in 2005. Compared to the nine months of the previous year, investments in the nine months of 2005 increased by 21.6% accounting for 28.2% of GDP.

At the end of 2004 foreign direct investment stock comprised 2360.8 mln lats or 31.8% of GDP and the incoming foreign direct investment covered in the last four years on average 17% of the gross fixed capital formation.

In the nine months of 2005 the value of incoming foreign direct investment in Latvia was 299.5 mln lats, an increase of 12% compared to the nine months of 2004.

Investments in the services sector account for the largest share in the sectoral structure of foreign direct investment (FDI) stock. By contrast, in the three quarters of 2005 FDI increased more rapidly in the commodity manufacturing sectors, but the increase was particularly fast in construction and energy generation.

Foreign Direct Investment Stocks by Industry
(end of September 2005, per cent)



Foreign trade

2005

Structure of export, %:

Wood and products of wood -	24.8
Metalworking, machine building and transport equipment -	26.3
Light industry goods -	9.0
Chemical goods and articles of plastics -	8.1
Agricultural and food products -	12.2
Other goods -	19.6

The value of Latvian commodity exports in 2005 was much higher (by 34%, at current prices, in lats) than in the previous year. The increase in the value of imports was, in turn, slightly less conspicuous by 27%.

The sharp increase in the export unit value in 2005, which in comparison with the previous year exceeded 10%, made a favourable impact on commodity exports. The price increase was accounted for by the rise in world prices for several commodity groups, especially for food and mineral products.

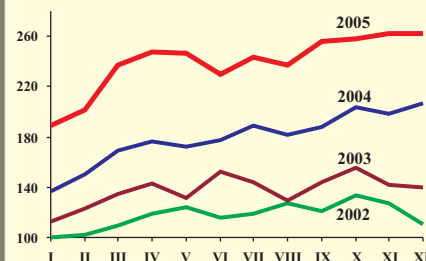
Exports in 2005 increased substantially on all the markets trading Latvian goods, especially in the direction of the new EU member states.

The exports of mineral products (one third of the total export growth to EU member states) and exports of food products as well as base metals and articles of base metals contributed most to the rising volume of exports.

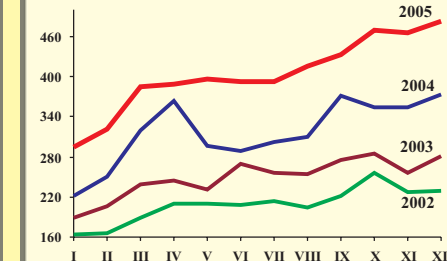
Imports in 2005 also considerably exceeded the level of the previous year. The imports of mineral products, mainly from the CIS countries, rose particularly quickly (one third of the total import growth) as did the imports of machinery and food products.

After accession to the EU Latvia's foreign trade with Lithuania and Estonia has increased very rapidly. A comparison with EU pre-accession period shows that within two years Latvia's foreign trade with other Baltic states has more than doubled.

Commodity Exports by Months
(mln lats)



Commodity Imports by Months
(mln lats)



Balance of payments

2004

Current account balance

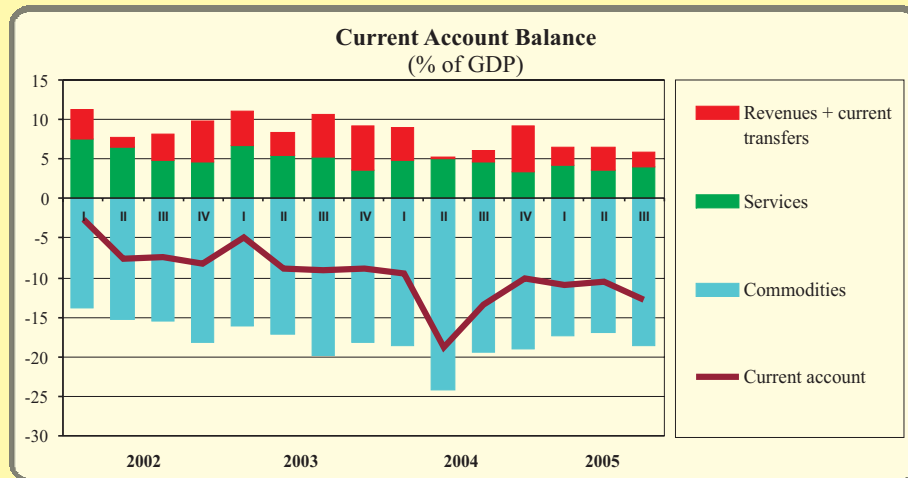
mln LVL: -957.2

mln US dollars: -1766.1

There is a relatively large current account deficit in Latvia. The main source of the deficit is the markedly negative trade balance. About one fifth of the deficit is covered by the positive balance on services. The negative current account balance is covered mainly by foreign direct investment and other long-term capital flows. The reserve assets of the Bank of Latvia are increasing.

In 2004 the trade balance worsened, with commodity imports outpacing commodity export growth. This was primarily due to the growing domestic demand and stockpiling of goods before accession to the EU, as well as owing to several one-off purchases of large-scale investment goods.

Compared to the corresponding period of the previous year, the negative trade balance against GDP in the 9 months of 2005 decreased because of the improving trade balance. The balance on services in the 9 months of 2005 worsened in comparison with the corresponding period of the previous year despite the improvement of the traffic balance due to the more rapid increase in the expenditures of resident travellers abroad than in the expenditures of foreign tourists in Latvia. The exports of various other services (communications, construction, financial, information and computer services) likewise increased at a slower pace than imports.



Inflation

January 2006

(12-month inflation)

CPI: 7.5%

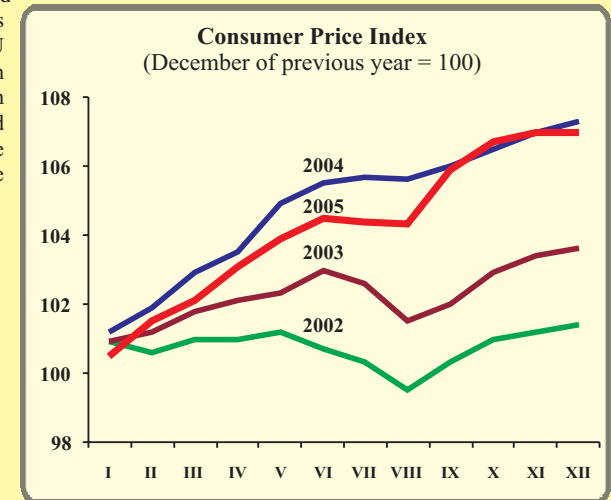
PPI: 7.1%

In the period between 1998-2003 consumer price growth in Latvia was close to the inflation level in the developed countries and was one of the lowest among the central- and east-European countries.

In 2004 the inflation rate accelerated sharply in Latvia. Inflation in 2004 reached 7.3% (12-month inflation, December over December) and was one of the highest among the EU member states.

In 2005 inflation was 7% (12-month inflation, December over December), of which 7% for goods and 6.9% for services. In the first half of 2005 the inflation rate showed a decreasing trend, but the steep rise in the prices of fuel raised the overall price level substantially by 1.5% (compared to August 2005) and as a result the 12-month inflation mounted to the high level of the previous year.

In parallel with the increase in oil product prices the sharp price rise in 2005 was also due to the increase in the prices of food products related to Latvia's alignment with the common EU agricultural policy, the high exchange rate of the euro, which raised the prices of imported goods considerably and the sufficiently high second-phase effect of inflation.



Monetary indicators

2005

Domestic enterprises and private persons

Loans:	69% of GDP
Deposits:	35.9% of GDP

The stability of the banking sector, the rising welfare and economic activity of the population are the reasons stimulating steady growth of the basic monetary indicators of the banking system of Latvia. A high growth rate of the monetary indicators persisted also in 2005.

Compared with December 2004, the amount of broad money M2X in December 2005 rose by 38.9%, currency in circulation increased by 20.6% and deposits rose by 43.9%. In the same period credits to enterprises and private persons also continued to increase (by 64.3%). Although the amount of crediting is rising the quality of loans does not deteriorate. At the end of September 2005

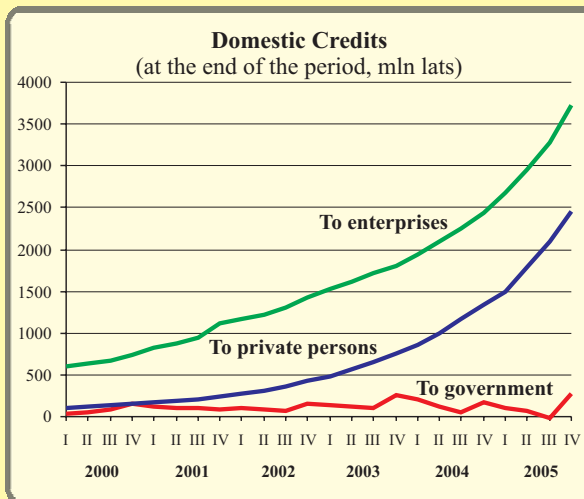
the share of loans generating no income in the total number of loans granted by non-banks was only 0.9%.

Reacting to the increasing domestic demand and in order to slacken the growth of crediting, the Bank of Latvia in March and November 2004 raised its re-financing rate by 0.5 percentage points to 4% and increased in July its reserve requirement from 3% to 4%, in August 2005 to 6% and in December 2005 to 8%. However, the effectiveness of these measures in Latvia is limited by the fixed exchange rate regime and several other specific factors, such as the low share of loans granted to resident borrowers in GDP, the relatively easy access by the banks to foreign resources and the relatively large share of loans issued in foreign currency in the total structure of loans.

In December 2005 the average weighted interest rate on short-term credits in lats was 15.7%, but on long-term credits 9.5%. For credits in the currencies of foreign countries these rates were 14.7% and 5.7% respectively.

¹ Short-term and with a changing interest rate.

* Provisional data.



Budget and central government debt

2005

General government budget (% of GDP):

Revenues:	36.0*
of which taxes:	28.6*
Expenditures:	37.3*
of which capital investment:	2.9*

The Parliament has confirmed the general government budget for 2005 with a fiscal deficit of 1.68% of GDP. Provisional data on the implementation of the budget show that the year 2005 was successfully concluded with a considerably lower budget deficit than planned - 91.6 mln lats or approximately 1% of GDP. The revenues of the general government budget in 2005 were 27.1% higher than in 2004 and expenditures were 27.7% higher.

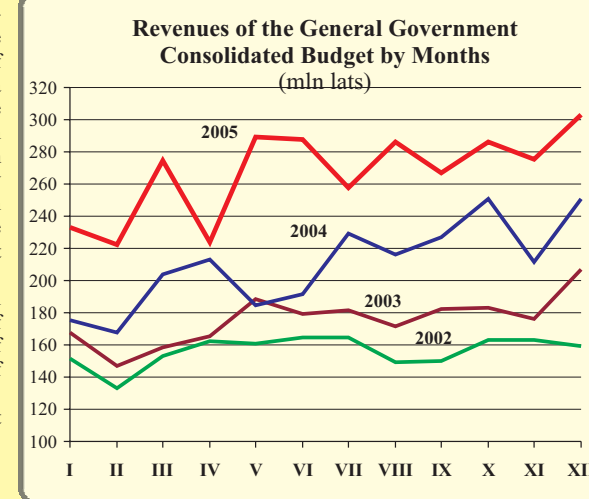
The Parliament has confirmed the general government budget for 2006 with a deficit of 145.2 mln lats (1.5% of GDP). The priorities of the budget for 2006 are: raising the welfare level of the population, integration into the EU and NATO, effective and full absorption of the allotted resources from the EU funds, balancing at the same time the government's support to the social needs of the society. The major budget priorities include resources envisaged for the national co-

funding in connection with the EU funds. By means of rational and effective utilisation of the money coming

from the EU funds, strong support will be provided for the encouragement of business activity and the development and improvement of infrastructure. By implementing a socially responsible policy, the minimum monthly wage has been raised as of January 1, 2006 from 80 to 90 lats, the minimum monthly untaxable income of the population from 26 lats to 32 lats and the monthly allowance for a dependent person from 18 lats to 22 lats.

The level of the central government debt in Latvia is one of the lowest in the EU. At the end of 2004 it was 975 mln lats or 13.2% of GDP. At the end of December 2005 the central government debt comprised 955.1 mln lats.

* Provisional data.



Personal income

2005

Average monthly net wage:

lats 176
US dollars 311

Average monthly old-age pension (paid):

lats 71
US dollars 131

In recent years the structure of household disposable income has changed little: the percentage share of wages that on average accounts for 64% of the total income has decreased slightly. The share of income from business activity and property income has, in turn, increased reaching nearly 9% of the total income. Pensions make up one fifth of the total household income in Latvia.

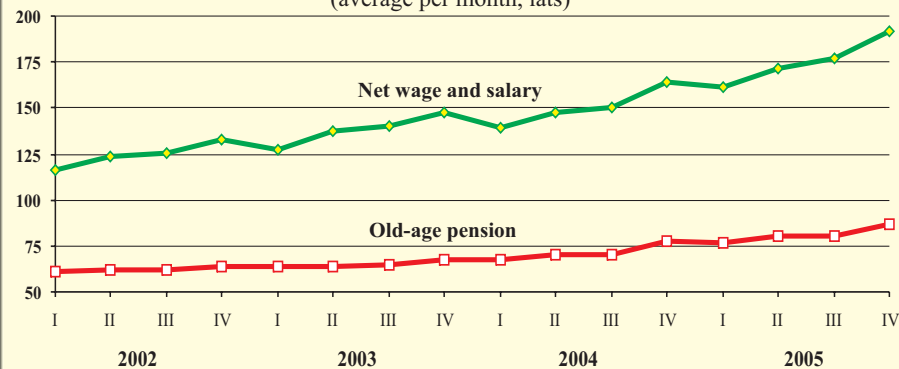
The average net monthly wage in 2005 was by 26 lats or 17% higher than in the previous year. However, with inflation taken into account, real wage in 2005 rose only minimally - by 9.7%.

By implementing a socially responsible policy, the minimum monthly wage has been raised as of January 1, 2006 from 80 to 90 lats, the minimum monthly untaxable income of the population from 26 lats to 32 lats and the monthly allowance for a dependent person from 18 lats to 22 lats.

Compared with the previous year, the average size of the monthly pension paid in 2004 to old-age pensioners registered with the social security institutions increased by 6.55 lats or 10.2%.

The increase in the size of old-age pensions in 2005 was also noteworthy. Pensions in December 2005 were on average 12% higher than in December 2004.

Wages and Salaries and Old-Age Pensions
(average per month, lats)



Employment and unemployment¹

2005

Unemployment rate (rate of unemployed, aged 15-74): 7.8%

Registered unemployment rate (at the end of the year): 7.4%

Economic development in recent years has positively influenced the situation in the labour market. Although the number of working age population decreases, the number of economically active population is rising and the employment rate is also increasing.

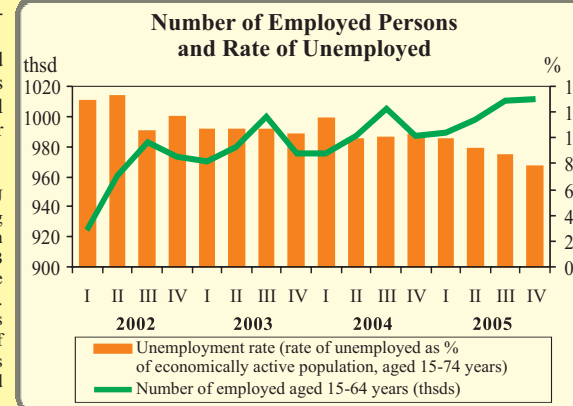
In the last five years (2000-2004) the employment rate increased by 4.8 percentage points. In comparison with EU average, the employment rate in Latvia was lower by 4.9 percentage points, whereas in 2004 it lagged behind only by 1 percentage point. The employment rate in 2005 continued to rise and reached 63.1% (results of the first three quarters), which is by 0.8 percentage points higher compared to the corresponding period of 2004.

The level of female employment in Latvia is still higher than the EU average, besides this difference tends to increase: the female employment rate in 2002 rose by 2.1 percentage points and in 2004 it was already by 2.8 percentage points higher than in the EU. This can be explained by the small share of manufacturing in the economy and the dominance of sectors with higher female employment (trade, hotels, restaurants and other services).

According to CSB Labour Force Survey data, the unemployment rate has decreased from 14.4% to 10.4% in 2004 in comparison with 2000. The unemployment rate in the 4th quarter of 2005 was 7.8%. The highest unemployment prevails in the Latgale region (12.8% in 2004) and this is due to the poorly developed entrepreneurship, the low number of self-employed and bad traffic infrastructure.

At the end of 2005 the registered unemployment rate in Latvia was 7.4%, a considerably lower level compared with the previous year (8.5%).

¹ To achieve compliance with EU requirements, various changes including those in the age of respondents have been made in the organisation of the CSB Labour Force Survey since 2002. The age of the respondents was set at 15-74 years. Previously the age of respondents was 15 years and more. The analysis of employment and labour market trends deals with people aged 15-64 years and this corresponds to the EU practice.



Baltic States

Main socio-economic indicators of the Baltic States

	Estonia	Latvia	Lithuania
Territory, thsd km ²	45.2	64.6	65.3
Population as of January 1, 2006, thsd **	1344.0	2294.2	3403.2
Gross domestic product, % of corresponding period of the previous year			
2004	107.8	108.5	107.0
2004: 1 st quarter	109.3	108.7	107.5
2 nd quarter	107.3	107.8	107.9
3 rd quarter	108.3	109.1	105.6
4 th quarter	106.6	108.6	107.2
2005: 1 st quarter	107.2	107.3	104.4
2 nd quarter	109.9	111.4	108.4
3 rd quarter	110.6	111.4	107.9
4 th quarter	...	110.5	108.2 **
Industrial output index, %			
2004 against 2003	108.0 *	106.0 *	110.8
2005 against 2004	109.7 *	105.6 *	107.3
Unemployment rate (rate of unemployed as % of economically active population, aged 15 -74 years) *			
2004	9.7	10.4	11.4
2005: 1 st quarter	9.5	9.9	10.2
2 nd quarter	8.1	9.2	8.5
3 rd quarter	7.0	8.7	7.2
4 th quarter	7.0	7.8	6.9
Consumer price changes, % against previous year			
2004	3.0	6.2	1.2
2005	4.1	6.7	2.7
Producer price changes in industry, % against previous year			
2004 against 2003	2.9	8.6	6.0
2005 against 2004	2.1	7.8	11.5
December 2005 against December 2004	2.2	7.0	13.5

* Short-term statistics for 2004 and 2005.

** Provisional data.