

Latvia



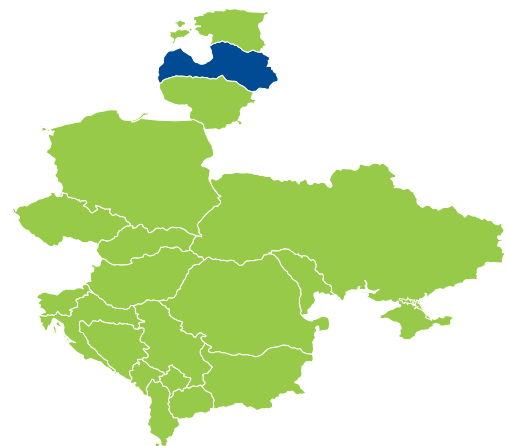
The structure of the Latvian economy is similar to that of most developed countries, with services accounting for some 74%, industry (including construction) for 22% and agriculture for 4%. Booms in the country's property and construction markets were the main causes of Latvia's exceptionally high growth rates, which was followed by sharp reverses in 2008, when the construction sector nearly stopped resulting in an approximate 30% fall in property prices. As a result, the banks' over-exposure to the property sector has called into question the value of their assets. In November 2008, the government announced the nationalisation of the country's second-largest bank, Parex Banka.

The political situation in Latvia remains unstable following the collapse of its government in early 2009, which was replaced by a new five-party centre-right coalition led by the New Era party. Latvia as a member of the EU and NATO has encouraged both the organisations to take a tougher stance in dealing with Russia, whose activities in Georgia it condemned in October 2008. Its close alliance with the US resulted in November 2008 in the granting of visa-free travel between the two countries.

Latvia has a declining population, driven by a falling birth rate and large-scale emigration to other EU countries, which the Central Statistical Bureau estimated in 2008 to stand at 2.2 million – down by 15% since 1990. Recession, too, is having a significant effect on Latvian society. By the end of 2008, 7% of the workforce was without a job, many households were saddled by debts incurred during recent economic overheating, inflation stood at 10.6%, wage growth was slowing sharply and a public sector salary freeze was on the horizon.

Such factors have seen the annual per capita income level of almost EUR 10,000, achieved in 2008, fall sharply in 2009.

Domestic consumption, traditionally the driving force behind most economies, has therefore fallen sharply. With virtually all markets in the Euro zone and other Baltic states also suffering from economic downturn or recession, Latvian exports have also fallen following their robust 10% real growth in 2007. For these and other reasons, Latvia has received a USD 10.5 billion support package from the EU and the IMF, equivalent to 35% of the country's GDP. This is helping to stabilise the economy, allowing debt-servicing obligations to be met and the agreed currency peg within the EU exchange rate mechanism to be maintained.



However, the IMF has demanded in return unprecedented cuts in government expenditure, including public-sector lay-offs and wage cuts, which in turn are expected to deepen the current recession and lead to a rise in business insolvencies. These demands are additional to the country's need to cut its current account deficit, which stood at 13% of GDP in 2008, down from 24% in 2007. The government is still aiming to meet the Maastricht criteria and to join the Eurozone in mid-2012, but this might be subject to delay as long as the economy remains in recession.

The factors underlying a contraction in investment activities at the level of companies were several, including the deteriorating financial position of Latvia's enterprises, falling real estate prices, a decrease in construction activity, a negative outlook for external and domestic demand and the moderating pace of lending due to the financial turmoil in global and domestic financial markets. Retail turnover has decreased by 11%, due to weakened domestic demand and reduced consumer spending. At the beginning of 2008, production declined primarily due to a fall in domestic demand, which was exacerbated by weakening

external demand during the second half of the year. The construction industry too experienced significant change, with output decreasing by 3.7% in 2008.

Investment dynamics reflected this ongoing economic downturn. Growing non-financial investment in the public sector, most notably in public administration and defence, manufacturing, transport, storage and communication, did not compensate for a parallel fall in the private sector.

In 2008, the global financial crisis led to a significant deterioration in the financing opportunities and conditions facing Latvian banks, which led to a substantial tightening in lending standards. Rumours concerning potential devaluation of the local currency also acted to encourage withdrawal of deposits. As a consequence, the banks faced significantly higher liquidity and financing risks. The key performance indicators of the financial sector slowed markedly alongside the rapid decline in domestic economic activity. Assets still grew due to higher loans granted to home-owners, yet this increase declined sharply in late 2008.



Latvia	2005/2007 Average Values	2007-2008	2008
	Change (%)	Change (%)	
Population (mil.)	-0.7	-0.6	2.2
Average monthly gross wage (EUR)	27.2	11.4	372.3
EUR Exchange rate vis-à-vis	-0.1	1.7	0.7
USD Exchange rate vis-à-vis	-1.6	6.0	0.5
	Real change (%)	Real change (%)	EUR mil.
GDP	11.1	-10.3	21,594
Private consumption	15.7	-11.0	13,396
Public consumption	3.7	1.5	4,587
Gross fixed capital investments	15.8	-13.2	6,939
Exports (goods and services)	12.3	-1.3	9,596
Imports (goods and services)	16.3	-13.6	12,603
	Nominal change (EUR mil.)	Nominal change (EUR mil.)	EUR mil.
Trade balance	-1,000	994	-4,379
Current account balance	-791	1,276	-2,052
General government balance	97	-885	-750
General government gross debt	102	2,406	4,211
External debt	68	866	1,932
Foreign currency reserves	801	-216	3,591
	Percentage point change	Percentage point change	%
Economic activity rate	0.9	1.4	62.0
Unemployment rate	-1.2	2.1	7.0
CPI rate (previous year = 100%)	2.2	-3.5	10.6
Central bank interest rate	0.7	0.0	6.0
Interbank RIGIBOR 12M	2.5	3.6	15.2
10-year yield on Treasury Bond	0.6	0.2	6.5

Sources used: Reuters EcoWin Pro

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