

**COUNTRY PROFILE:****REPUBLIC OF LATVIA****DATED:****MAY 2008****CREDIT GUARANTEE:**

IES: ATTACHMENT A

	<i>Country Rating</i>	<i>U/W Method</i>
<i>Short-term</i>	2B	No Restrictions

*Recent Political Highlights*

- ❑ The October 2006 election produced a four-party, centre-right coalition government led by Aigars Kalvitis. The government had to resign in December 2007 after Mr Kalvitis' attempts to have the head of the anti-corruption agency sacked, seemingly for political motives, led to popular protests. Ivars Godmanis was voted in as head of government in December 2007. Prime Minister Godmanis said his priorities would include helping Latvia achieve 'European living standards' within 10 years and curbing inflation.
- ❑ According to the EIU, corruption scandals will continue to create instability and because of that, the government is unlikely to last until the next election that is due in October 2010; there is also a good chance of an early election. Although relations with Russia have improved they remain vulnerable to tensions over sensitive historical questions and over the status of Latvia's large ethnic Russian minority.

*Recent Economic Highlights*

- ❑ In Q1'08 industrial output in Latvia declined by 3.1% compared to the same period a year ago. In March, industrial output in Latvia fell 5.5% when compared with March 2007. Output in mining and quarrying shrunk 21.1% and output in the manufacturing sector was down by 9.2%. Only output in the power, gas and water sector increased by 3.6%. Compared to February, March's industrial output contracted by 1.5% on a seasonally adjusted basis.
- ❑ The EIU expects real GDP to slow sharply from 10.2% in 2007 to 4% in 2008 and pick up slightly in 2009 to 4.2%. The risks of a slowdown are high should domestic demand growth weaken more than expected. After relying on domestic consumption for growth, the Latvian economy will have to depend on its competitiveness and exports for growth. The Latvian export-oriented manufacturing sectors have performed very badly during the past couple of years of high growth in the overall economy. The finance ministry predicts that Latvia's GDP growth will be 5.6% this year while the IMF has predicted that Latvia's GDP could increase 3.6% this year. In 2009, the IMF expects growth to fall to 1.45% and 0.28% in 2010.
- ❑ Latvia's April inflation rate showed another strong up tick and rose to the highest level in nearly 12 years. It rose to 17.5% in April from 16.8% in March, the highest in the 27-nation EU. Electricity prices grew 39.2% in April, adding significantly to the figure; food prices, which make up a quarter of the consumer-price basket, rose about 20.8% from a year ago. Rising inflation, coupled with slower growth is increasingly clouding the economic prospects for the small nation, once known as one of the Baltic Tigers along with Estonia and Lithuania. Inflation has risen in the three Baltic States, driven by increased costs of food, housing, utilities and fuel. The IMF believes that inflation will remain high this year, averaging about 15.3% from 10.1% last year. In 2009 inflation is forecast to decrease to 9.2% and 6.7% in 2010.
- ❑ Most Estonian businessmen with businesses in Latvia are extremely worried about the high inflation rate in Latvia. They say the devaluation of any Baltic currency would have disastrous repercussions in all three Baltic countries. The economy is overheated and the country must slow down rapidly or devalue or both. Eurozone entry has been delayed by high inflation; the authorities have not set a formal target date for entry, but the government has said it sees 2012-13 as realistic.
- ❑ Sharply slowing economic growth means that plans for sizeable budget surpluses in 2008-09 are unlikely to be realised and the EIU now expects the budget to be close to balance this year.
- ❑ The current account deficit remains a major concern and it widened to 22.8% of GDP in 2007, mainly owing to a deterioration of the trade deficit. The country has been slow to move up the value chain, so Latvia's exports are still dominated by low value-added goods. The current account deficit is expected to narrow to 15% of GDP in 2008 and 13.6% of GDP in 2009, due to a slowdown in domestic demand.
- ❑ Amid concerns about Latvia's future energy security, the government has reached preliminary agreement to build two new 400-MW power stations in Latvia, a coal-fired plant in Kurzeme region and a gas-fired plant in Riga.

*Recent trade developments*

- ❑ Main exports: wood and wood products, machinery and equipment, metals, textiles and foodstuffs.
- ❑ Main imports: machinery and equipment, chemicals, fuels and vehicles.
- ❑ Major trade partners: Lithuania, Germany, Russia, Estonia, Poland, Finland, Belarus and Sweden.
- ❑ South African exports to Latvia totalled R19.9m in 2006 and R19.6m in 2007.

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