

MACROECONOMIC AND BUDGETARY REVIEW

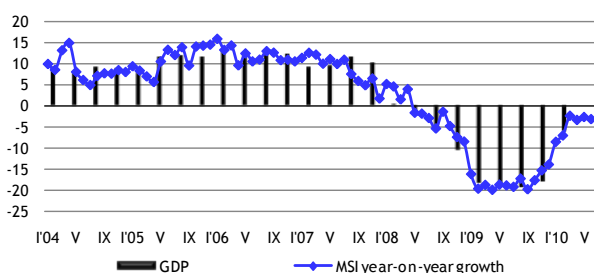


MINISTRY OF FINANCE
REPUBLIC OF LATVIA

June, 2010

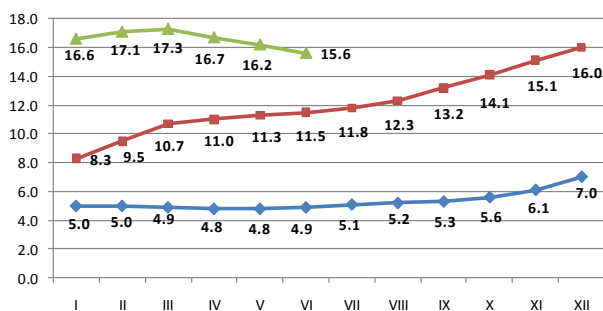
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According to the estimations of the Ministry of Finance, the **Composite Index of Macroeconomic Indicators** (index is calculated using operative data on economy, in order to get a view of possible GDP growth) in June 2010 shrunk by 3.1% at constant prices. The decrease of index was caused by a slowdown in retail trade turnover, reduction of the amount of loaded/unloaded cargos and decrease of the employment level.



Composite Index of Macroeconomic Indicators

The improvement of **unemployment** indicators that started in April has persisted in June as well. Nature of these changes partially originates from seasonal factors. Officially registered unemployment rate in June 2010 comparing to the previous month decreased by 0.6 percentage points and at the end of June estimated as 15.6% of the economically active population. The number of registered unemployed during the month fell by 6.6 thsd people and amounted 176.9 thsd people at the end of the June. During this period status of unemployed has been assigned to 11.7 thsd people, which is 885 people less than in previous period. To be noted, amount of registered vacancies in State Employment Agency (further – SEA) has increased by 4.3% and reached 2.7 thousand.



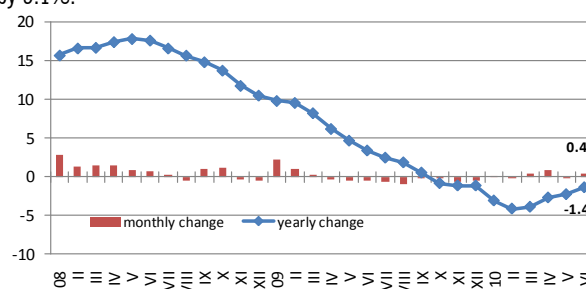
Officially registered unemployment rate, %

In June 2010 unemployment rate has decreased in all of the state regions. The highest unemployment rate still can be observed in Latgale – 22.4% (15.5% in June 2009), Vidzeme – 17.4% (12.0%), Zemgale – 17.0% (12.3%) and Kurzeme – 16.7% (12.7%). Lowest unemployment rate can be observed in region of Riga – 12.6% (9.8%).

Significant to mention is that unemployed actively participate in employment programme provided by SEA thus improving their competitiveness in market. In June 2010 there were 45.7 thsd

participants which is 2.5 thsd less than in May. Most of participants chose a provided job in local government – 22 thsd people in total which is 2.7 thsd more than in May.

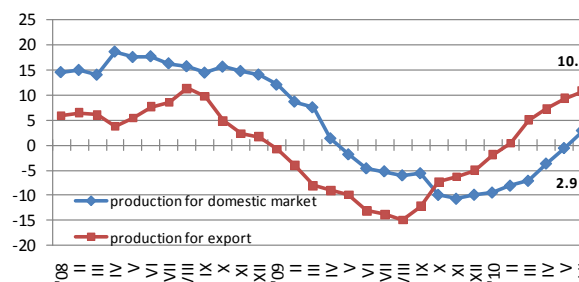
Consumer Price Index (CPI) in June of 2010, compared with May of 2010, increased by 0.4%. Average price levels for both goods and services increased by 0.5% and 0.1% respectively. Comparing with the corresponding month of the previous year, consumer prices decreased by 1.4%, average prices for goods rose by 0.1%, for services it declined – by 5.1%.



Consumer price index, %

Consumer price changes in June for the most part were influenced by increase in heating and vegetable prices and decrease in clothing and gasoline prices. The ongoing rise of heating tariffs increased their price during the month by 8.3%. Due to seasonal price changes – prices for fruits increased by 4.0%, for vegetables – by 1.8%, also prices for clothing increased by 1.1%.

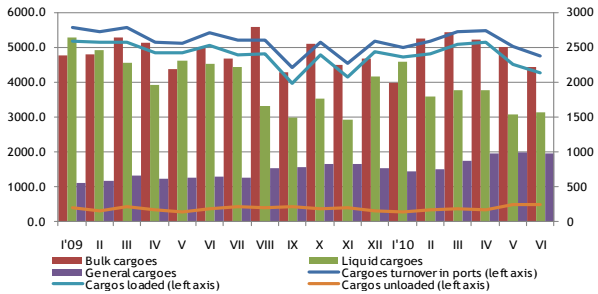
Producer prices in June 2010 comparing with May 2010 increased by 0.8%. In June 2010 comparing with according month of the previous year producer prices increased by 6.0%. Substantial contribution to the price changes came from manufacturing of basic metals that showed a rise by 35.9%, wood and wood product (except furniture) prices gained 14.0%. There was also a decrease in producer prices for mining industry – by 2.2% and food product manufacturing – by 2.7%. Yearly increase of producer prices for exports is growing faster than prices for local market (accordingly 10.8% and 2.9%), in its turn the monthly change showed 0.4% decrease for exports and 1.7% increase for local market.



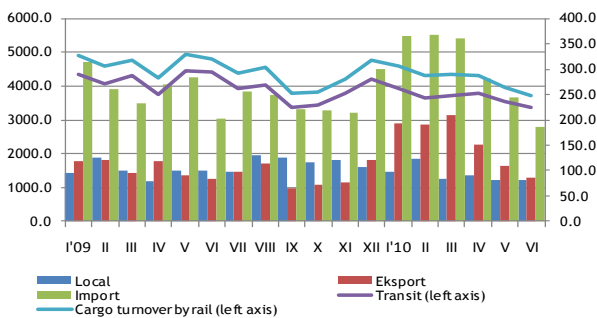
Producer price index, %

The volume of **cargo transhipped in Latvian ports** in June amounted to 4.8 mln t, down by 11.9% from the corresponding month of 2009. Positive that ports cargo turnover has increased for goods with greater

added value – general cargoes. In June 2010 **freight carried by rail** was 3.7 mln tons, a decrease of 22.6% compared to the same period of the previous year. The big drop in the June 2010 is partly due to high freight turnover growth by railway in June 2009. Compared with May of this year turnover of freight by rail has dropped by 6.7%.



Cargo turnover in ports, thsd tons

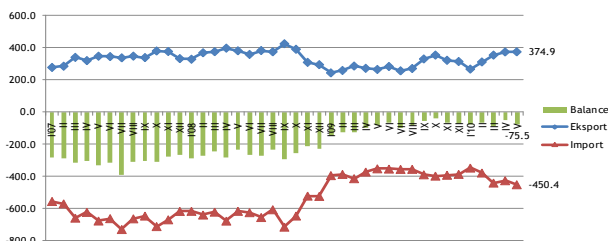


Cargo turnover by rail, thsd tons

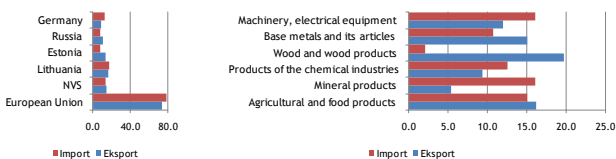
In May 2010 the total **foreign trade** turnover at current prices reached 825.3 mln lats – more by 25.8 mln lats or 3.2% than a month before and more by 187.0 mln lats or 29.3% than in May 2009, according to provisional data of Central Statistical Bureau.

In January - May 2010 total volume of goods in foreign trade of Latvia at current prices reached 3723.3 mln lats – an increase of 400.4 mln lats or 12.0%, if compared to January – May 2009. Of which exports volume grew by 303.8 mln lats or 22.0% and was 1682.3 mln lats, but imports volume – increased by 96.0 mln lats or 5.0% and was 2041.0 mln lats.

In May 2010, compared to the previous month, faster rise in import than in export impaired trade balance. In May 2010, as compared to the May 2009, the trade balance deficit decreased by 5.6 mln lats and amounted to 75.5 mln lats.

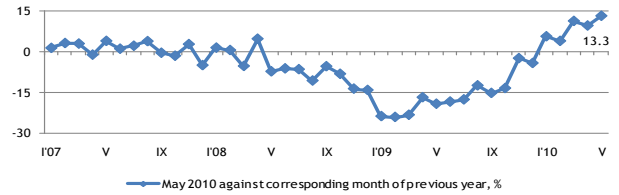


Foreign trade balance, mln lats

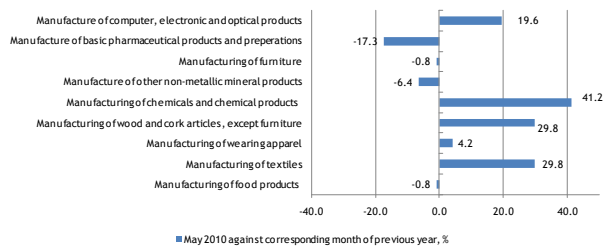


Main trading partners and commodities in Latvia's foreign trade, in May

Compared to May of previous year **industrial production output** in May 2010 has increased by 13.3%, according to working day adjusted data at constant prices. The growth was influenced by the production increase in electricity and gas supply by 16.3%, in manufacturing – by 13.3%, in mining and quarrying – by 2.8%. Wherewith there can be observed continuation of the positive trend that started in the beginning of the year.

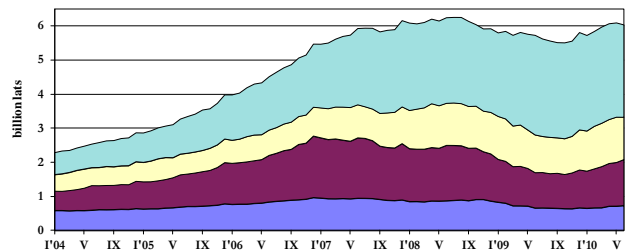


Industrial production index (seasonally adjusted data)



Most important changes in volume indices of industrial production (seasonally adjusted data)

Amount of the broad money (M2X) in June, after more than a half year of constant increase, has shown a minor decline, which for the most part can be explained by decreased deposits of public sector corporations. In its turn, deposits of households have been increasing from the beginning of the year.



Broad money M2X, structure and dynamic, bil. lats

3 month RIGIBOR rate, after a small climb in May, continued to decline reaching the lowest ever point in June, in its turn EURIBOR 3 month rate, after reaching the lowest point in March, carried on to gain and reached the level of September 2009.

	10'I	II	III	IV	V	VI
RIGIBOR (3men)	4.00	2.81	2.25	2.08	2.27	1.99
EURIBOR (3men)	0.67	0.66	0.64	0.65	0.697	0.74

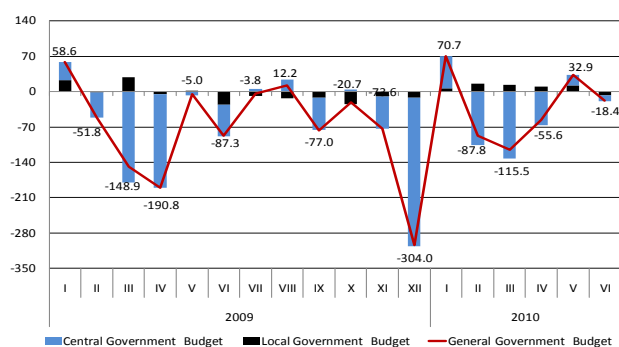
Money Market Indexes RIGIBID and EURIBOR for last 6 month on 25th date of each month

In the first six months of 2010 the amount of money received in the budget continued to decline in comparison with the same period of 2009, which mainly was due to tax revenue decline as a result of economic recession.

	I-VI 2010 execution, mln lats	I-VI 2010 execution changes against I-VI of 2009, %
GENERAL GOVERNMENT CONSOLIDATED BUDGET		
Revenue	2333.92	-6.7
Expenditure	2507.57	-14.3
<i>Financial Balance</i>	-173.65	
CENTRAL GOVERNMENT CONSOLIDATED BUDGET		
Revenue	1939.09	-5.5
Expenditure	2170.60	-13.2
<i>Financial Balance</i>	-231.51	
Central government basic budget		
Revenue	1375.16	-3.2
Expenditure	1396.65	-21.3
<i>Financial Balance</i>	-21.49	
Central government special budget		
Revenue	585.92	-9.5
Expenditure	802.55	6.6
<i>Financial Balance</i>	-216.64	
LOCAL GOVERNMENT CONSOLIDATED BUDGET		
Revenue	616.89	-18.6
Expenditure	565.99	-23.0
<i>Financial Balance</i>	50.91	

Budget revenue and expenditure

In accordance with the State Treasury's official monthly report for the period of January - June 2010 (I-VI), **general government consolidated budget** revenue in the first half-year of 2010 was 2 333.9 mln lats, which was by 6.7% less than in the same period of 2009. In this period expenditure declined more rapidly than revenue and in the first six months of 2010 was 2 507.6 mln lats, which is by 14.3% less than in the same period of 2009. In the first six months of 2010 general government consolidated budget financial deficit amounted to 173.7 mln lats, which still was determined by the high level of deficit in the central government special budget. In comparison with the first six months of 2009, when financial deficit was 425.2 mln lats, general government consolidated budget deficit was by 251.5 mln lats less than in the same period of 2010.



General government consolidated budget balance, mln lats

Central government consolidated budget revenue (including grants, donations and derived public persons) in the first half-year of 2010 composed 50.4% of planned annual revenue amount while still maintaining revenue decrease observed in the previous months compared with the same period of 2009. Revenue decreased by 112.9 mln lats or 5.5%, which mainly was due to the tax revenue (decreased by 147.9 mln lats or 10.2%) and revenue from paid services and self-earned revenue (decreased by 16.0 mln lats or 20.3%) decline. However, in the first half-year of 2010 non-tax revenue increased by

56.8 mln lats or 32.3% in comparison with the same period of 2009, which mainly was due to non-tax revenue increase in the central government basic budget.

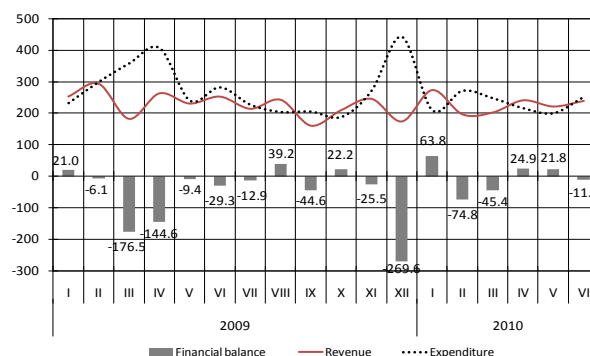
In the first six months of 2010 central government consolidated budget expenditure was 45.7% of planned annual expenditure amount, but, in comparison with the same period of 2009, expenditure decreased by 331.3 mln lats or 13.2%.

In the first six months of 2010 central government consolidated budget expenditure amount exceeded the revenue amount, creating financial deficit much lower than planned – in amount of 231.5 mln lats

Change in **central government basic budget** revenue in the first six months of 2010 was influenced by the tax revenue decrease by 87.3 mln lats or 10.0% and decrease of revenue from paid services and self-earned revenue - by 12.3 mln lats or 31.5% in comparison with the same period of 2009. However, in the first six months of 2010 non-tax revenue increased by 58.7 mln lats or 33.8%. In the first half-year of 2010 total revenue amount composed 50.9% of the planned central government basic budget annual revenue.

Central government basic budget expenditure reduction by 377.1 mln lats mainly was influenced by cost decline for the coverage of maintenance expenditure in amount of 319.4 mln lats (including significant cost reduction for the coverage of current expenditure, subsidy and grant distribution) and capital expenditure in amount of 57.7 mln lats (including reduction in expenditure for capital formation, decline of total amount of transfers). In the first half of this year central government basic budget total amount of expenditure composed 42.8% of planned annual amount of expenditure.

In the first six months of 2010 central government basic budget financial deficit was in amount of 21.5 mln lats, which was by 331.0 mln lats less than in the same period of 2009.



Central government basic budget, mln lats

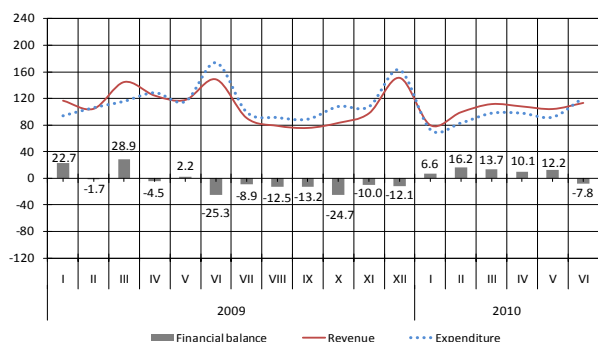
Unlike central government basic budget, local government basic budget and special budget expenditure decline, the **central government special budget** expenditure continued to grow and in the first six months of 2010 increased by 49.9 mln lats or 6.6% compared with the same period of 2009. Expenditure increase was determined by the increase in unemployment rate compared with the same period of 2009 and pension detention reimbursement, which was made in April of 2010. As a result social benefits and public pensions total costs increased by 52.6 mln lats and in the first six months of 2010 expenditure for social benefits amounted to 52.1% of planned this year's total expenditure amount. In the first half-year of 2010 central

government special budget expenditure composed 52.0% of planned this year's special budget expenditure.

In the first six months of 2010 **local government consolidated budget** revenue decreased compared with the same period of 2009, mainly due to tax revenue decline by 2.8% (personal income tax revenue decreased by 2.6% and tax revenue from goods and services decreased by 34.8%). Local government basic budget revenue decline by 46.2% was influenced by significant change in the amount of transfers – earmarked grants received in local government budget from central government budget reduced by 68.5 mln lats or 33.2%, as well the transfers between local governments' budgets – by 94.1 mln lats or 93.5%. In the first six months of 2010 local government consolidated budget received 54.1% of planned annual revenue.

The decrease of local government consolidated budget expenditure in the first six months of 2010 mainly was due to the local government basic budget maintenance expenditure reduction by 31.4% (remuneration expenditure decreased by 32.8%, expenditure for goods and services – by 10.4%). However, local government basic budget expenditure for social benefits increased by 53.1% in comparison with the same period of 2009.

In the first six months of 2010 the local government consolidated budget had financial surplus in amount of 50.9 mln lats, which was by 28.4 mln lats or 128.6% more than in the same period of 2009.



Local government consolidated budget, mln lats

According to information of the State Revenue Service in the first six months of 2010 major **tax revenue** exceeded planned revenue amount by 2.3%, because value added tax and lottery and gambling tax revenue was higher than expected.

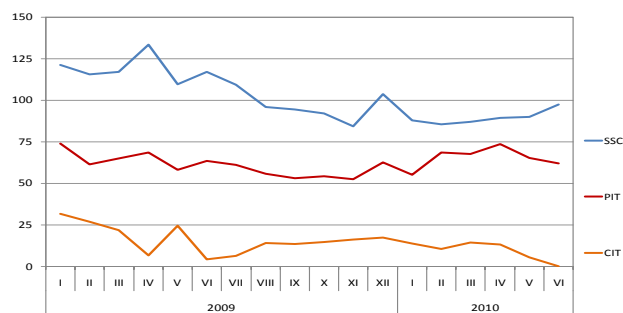
	I-VI 2010 execution, mln lats	I-VI 2010 execution of the same period plan, %	VI 2010 execution of VI 2010 plan, %	I-VI 2010 execution changes against I-VI 2009, %
Personal income tax	378.5	95.5	83.6	-3.1
Social security contributions*	558.1	97.8	92.8	-21.9
Corporate income tax	56.9	102.6	-102.9	-50.7
Value added tax	410.7	124.5	137.0	-0.9
Excise tax	220.9	93.9	98.3	-11.3
Lottery and gambling tax	8.2	100.9	71.5	-35.2
Customs duty	7.3	100.7	120.1	-17.0
Natural resources tax	4.1	102.7	263.2	1.7
Total	1 644.8	102.3	99.0	-13.8

Major tax revenue

*Including social security contributions for funded pension scheme (I-VI 2010 32.5 mln lats)

Social security contributions (SSC) (including contributions into the State Funded Pension Scheme) and **personal income tax** (PIT) revenue in the first six months of 2010 continued to decline. In the first half-year of 2010 revenue plan of SSC was executed by 97.8%, which was by 12.5 mln lats less than planned. PIT revenue was by 17.9 mln lats less than planned.

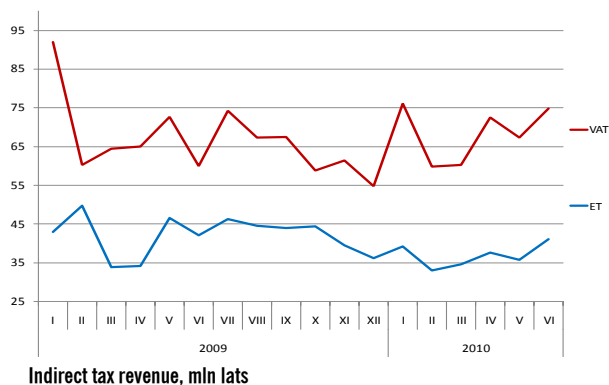
In first six months of 2010 **corporate income tax** (CIT) revenue exceeded planned revenue amount by 2.6%. However, CIT revenue in the first six months of 2010 decreasing by 50.7% in comparison with the same period of 2009 composed the biggest total tax revenue decline. According to the State Revenue Service's information CIT revenue plans were overachieved until May of this year, reaching 9.6 mln lats in four months, but later, in May, significantly increasing tax refunds and in June – tax refunds exceeding the collected amount, revenue plan overachievement declined. Decline in CIT revenue still continued to be subject to financial service industry (decreased by 42.0% or 24.6 mln lats), which ensured the biggest share of CIT revenue in previous years. In the first half-year of 2010 refunds for financial service industry were by 10.4 mln lats more than in the same period of 2009. The biggest share of CIT revenue in the first six months of 2010 was still made by taxpayers of post and telecommunication industry – 8.8 mln lats, which was 14.4% from total CIT revenue.



Direct tax revenue, mln lats

Value added tax (VAT) revenue in the first half-year of 2010 exceeded planned revenue amount by 80.8 mln lats. In comparison with the same period of 2009, total VAT revenue was by 3.5 mln lats or 0.9% less. Decline was due to the decrease in transaction value by 12.3%, which was influenced by the turnover decline in the economy in previous periods, as well as the decline in consumer prices. According to the State Revenue Service's information it should be noted that domestic revenue from VAT increased by 11.3%, but tax revenue for goods released for free circulation decreased by 49.3%

In the first six months of 2010 **excise tax** (ET) revenue plan was executed by 93.9%, and by 14.4 mln lats less than planned was received. Decrease in the first half-year of 2010 was still affected by the ET rate increase for practically all excise goods in the beginning of 2009 and decline in the excise goods sale caused by the economic downturn. In comparison with the same period of 2009 ET revenue showed reduction in such excise commodity groups as oil products – decline by 4.8%, tobacco products – by 31.3%, alcoholic beverages – by 7.1%. In comparison with the first-half of 2009 ET revenue increase by 36.1% was observed in beer products sale in the same period of 2010.

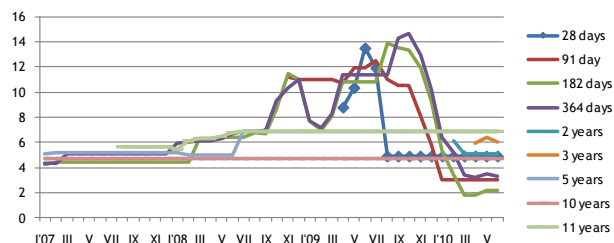


In the first six months of 2010 general government consolidated budget **non-tax revenue** increased by 53.0 mln lats or 21.7%, in comparison with the same period of 2009, which mainly was influenced by the revenue from dividends for the use of state capital (increased by 42.0%) and revenue from the payment of the Bank of Latvia (increased by 39.2%) in April of this year. In the first six months of 2010 the total amount of general government consolidated budget non-tax revenue was 297.1 mln lats.

In the first six months of 2010, revenue from paid services and self-earned revenue was 105.3 mln lats, which was by 23.2% less than in the first six months of 2009. Foreign financial assistance revenue was 333.0 mln lats, which was by 6.8% less than in the same period of 2009.

In the end of June 2010 **government debt** was 4 726.1 mln lats and in the first six months of 2010 increased by 586.8 mln lats. Domestic government debt decreased by 50.1 mln lats in the first six months of 2010 and in the end of June was 836.4 mln lats. However, in the end of June of 2010 the total amount of external government debt was 3 889.7 mln lats and since the beginning of this year it increased by 636.9 mln lats.

The Treasury in June sold treasury bills for a total amount of 20.7 mln lats. Overall investor demand for bills in this period reached 59.9 mln lats in a nominal value. The six-month bills average weighted interest rate in last auction was 2.178%, 12-month bills average weighted interest rate was - 3.260%.



In June 2010 government medium and long term bond weight in the domestic debt portfolio amounted to 49.0%, but short-term government bond proportion reached 51.0%.

