

MACROECONOMIC AND BUDGETARY REVIEW

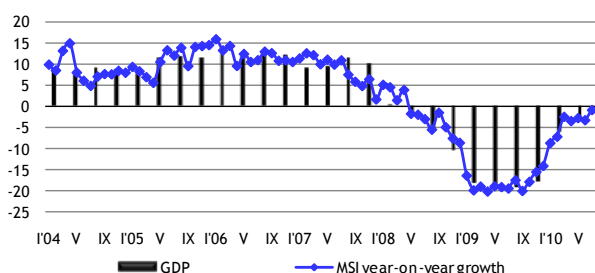


MINISTRY OF FINANCE
REPUBLIC OF LATVIA

July, 2010

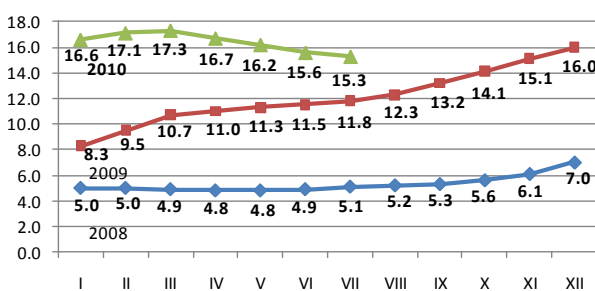
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According to the estimations of the Ministry of Finance, the **Composite Index of Macroeconomic Indicators** (index is calculated using operative data on economy, in order to get a view of possible GDP growth) in July 2010 shrunk by 0.7% at constant prices. The decrease of index was caused by a slowdown in retail trade turnover and reduction of the amount of loaded/unloaded cargos in ports.



Composite Index of Macroeconomic Indicators

The improvement in unemployment indicators persisted also in July 2010, when **unemployment rate** decreased by 0.3 percentage points and reached 15.3% of the economically active population. The number of the registered unemployed fell by 3.6 thsd people from the previous month and amounted to 173.3 thsd people at the end of July 2010. During this period status of unemployed was assigned to 400 less people than in June an amounted to 12.1 thsd. In July 2010 The number of registered vacancies in the State Employment Agency (further – SEA) increased rapidly - by 22.3% compared to June and reached 3.3 thsd.



Officially registered unemployment rate, %

In July 2010 compared to July 2009 unemployment rate has increased in all of the state region, but it is significant to mention that there was a gradual monthly decrease in unemployment rate since April 2010. The highest unemployment was still registered in Latgale – 22.4% (15.7% in July 2009), Vidzeme – 17.1% (12.2%), Zemgale – 16.4% (12.5%) and Kurzeme – 16.4% (13.1%). In July 2010 in common with previous months lowest unemployment rate was registered in region of Riga – 12.3% (10.1%).

To be noted, the increase in number of persons who have lost status of unemployed is mainly determined by the growth in number of those unemployed who don't fill unemployed duties without legitimate reason (from 7.6 thsd. people in April 2010 till 9.4 thsd. in July 2010). But it should be taken into account that this group of people includes also

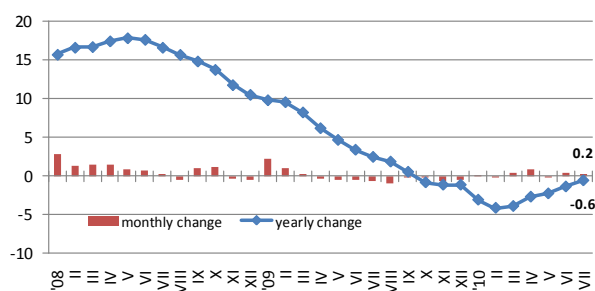
those persons who have found a job and haven't informed SEA about it as a result losing their status of unemployed.

Although the number of unemployed is decreasing, the amount of long-term jobseekers in the second quarter of 2010 increased almost twice (by 84.8%) compared to the same period of the previous year and reached 93.8 thsd. people or 41.6% of the total number of jobseekers. Wherewith more inhabitants have to adjust to the existent structure of labour market which, accordingly to the information of SEA, is just partly fitting and the unemployed have to retrain to meet the demand of labourforce.

In the second quarter of 2010 **employment rate** comparing to the previous period increased by 1.1 percentage points for the first time during last two years and was 52.8% of total number of working age population. There were 63.4 thsd. or 6.3% employed people less than in the same period of 2009 and in total 935.9 thsd. people were employed in the country.

Also the number of economically inactive people decreased by 1.5% in the second quarter of 2010 comparing to the previous period and amounted to 611.2 thsd. people. But the number of people who have lost their expectations to get a job has decreased rapidly – by 27.1% and reached 44.1 thsd. people or 7.2% of the number economically inactive people.

Consumer Price Index (CPI) in July 2010, compared with May 2010, increased by 0.2%. Average price levels for both goods and services increased by 0.2% and 0.1% respectively. Comparing with the corresponding month of the previous year, consumer prices decreased by 0.6%. Average prices for goods rose by 1.1%, for services it declined – by 4.8%.

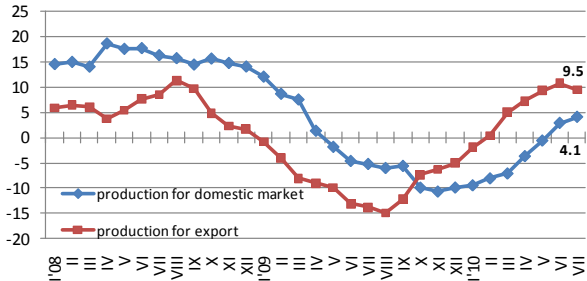


Consumer price index, %

Consumer price changes in July for the most part were influenced by increase in natural gas and food product prices and decrease in clothing prices. Due to implementation of an excise tax, price on natural gas increased by 31.5%. Prices also increased for food products – by 0.8%, mostly for milk – by 4.1% and cheese – by 3.5%. Seasonal campaigns made the average price on clothing to drop by 4.5%.

Producer prices in July 2010 comparing with June 2010 have remained stable. In July 2010 comparing with according month of the previous year producer prices increased by 6.2%. During the year substantial contribution to upward price change comes from manufacturing of basic

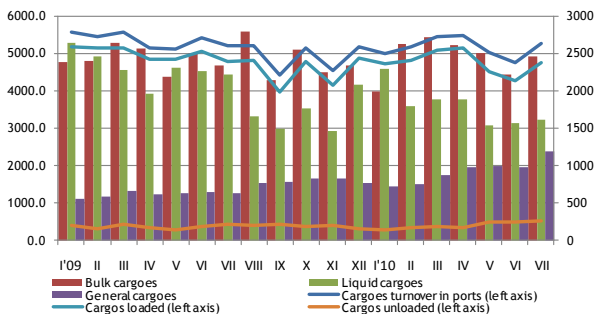
metals where prices increased by 32.1%, also wood and wood product (except furniture) manufacturing – by 14.0%. Downward pressure of producer prices comes from textile manufacturing – by 4.3% and mining industry – by 1.3%. Yearly increase of producer prices for exports is growing faster than prices for local market (accordingly 9.5% and 4.1%), in its turn the monthly change showed 0.7% decrease for exports and 0.4% increase for local market.



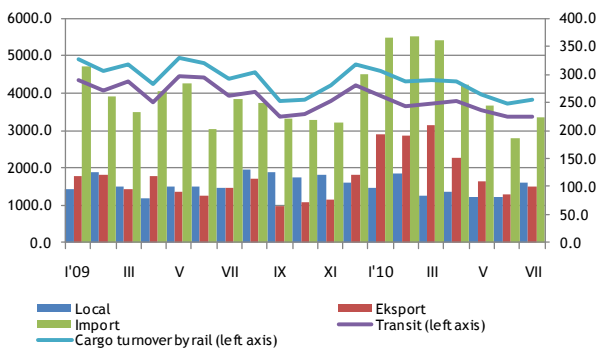
Producer price index, %

The volume of **cargo transhipped in Latvian ports** in July amounted to 5.3 mln t, up by 1.5% from the corresponding month of 2009 and by 10.7% more than a month in advance. Cargo turnover growth during the year was mainly due to increased turnover of loaded cargoes. Positive that ports cargo turnover has increased for goods with greater added value – general cargoes.

In July 2010 **freight carried by rail** was 3.8 mln tons, a decrease of 13.1% compared to the same period of the previous year and by 2.8% over this year June. During the year, have increased domestic and export cargo turnover by rail, but decreased import and transit cargo turnover by rail.



Cargo turnover in ports, thsd tons



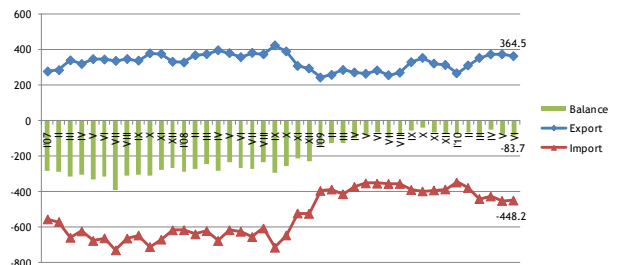
Cargo turnover by rail, thsd tons

In June 2010 the total **foreign trade** turnover at current prices reached 812.7 mln lats – by 12.6 mln lats or 1.5% more than a month before

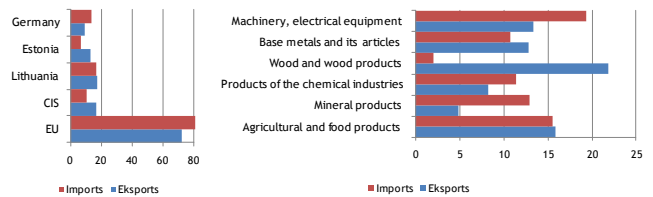
and by 149.9 mln lats or 22.6% more than in June 2009, according to provisional data of Central Statistical Bureau.

In January-June 2010 total volume of goods in foreign trade of Latvia at current prices reached 4562.0 mln lats – an increase of 69.3 mln lats or 14.5%, if compared to January-June 2009. Of which exports volume grew by 383.9 mln lats or 22.9% and was 2057.9 mln lats, but imports volume – increased by 192.3 mln lats or 8.3% and was 2504.1 mln lats.

In June 2010, as compared to the June 2009, due to more rapid export than import decrease the trade balance deficit decreased by 16.5 mln lats and amounted to -83.7 mln lats. The main foreign trading country groups remained the same also in July 2010 – EU countries (72.3% of total exports volume and 80.9% of total imports volume) and CIS countries (16.9% and 10.2%), but the main exports and imports partner was Lithuania (17.3% and 16.9%).

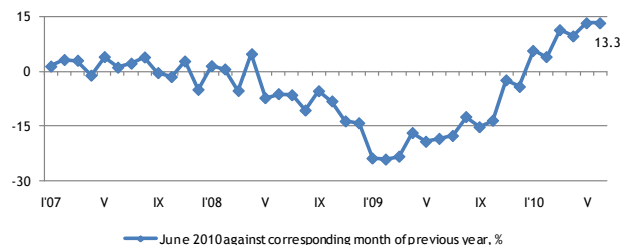


Foreign trade balance, mln lats

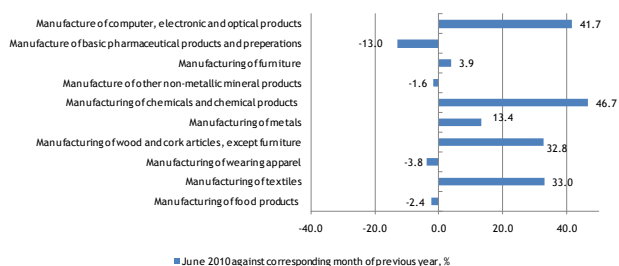


Main trading partners and commodities in Latvia's foreign trade in June, % of total foreign trade volume

Seasonally adjusted industrial production output in June 2010, comparing to the previous period has decreased by 0.1%, comparing to the according period of the previous year by working day adjusted data has increased by 13.3%. The growth was influenced by the production increase in mining and quarrying – by 30.1%, in manufacturing – by 13.8%, in electricity and gas supply – by 5.9%.

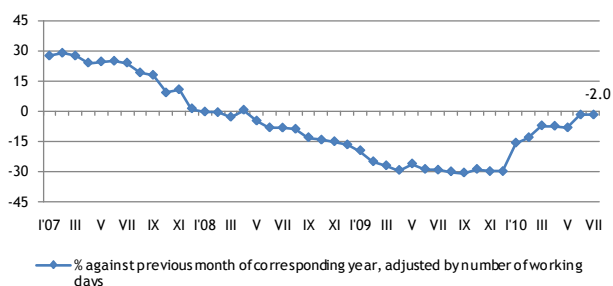


Industrial production index (seasonally adjusted data)

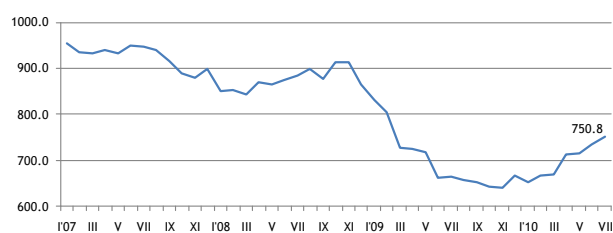


Most important changes in volume indices of industrial production (seasonally adjusted data)

According to working (trade) day adjusted data, retail trade turnover in constant prices in July 2010, compared to previous month, has decreased by 0.5%. Retail trade turnover for food products has increased by 2.1%, while for non-food products it decreased by 1.8%. Most notable change comes from turnover of fuel, that during this period decreased by 3.7%. If influence of fuel was ignored, total retail turnover in given period would increase by 0.2%. In July 2010, compared to according period of previous year, retail trade turnover has decreased by 2%. Turnover decreased for both - food and non-food products by 1.8% and 2.2% accordingly.



Turnover indices of retail trade (at constant prices)



Cash in circulation, mln lats

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

	10'II	III	IV	V	VI	VII
RIGIBOR (3month)	2.81	2.25	2.08	2.27	1.99	1.53
EURIBOR (3month)	0.66	0.64	0.65	0.70	0.75	0.89

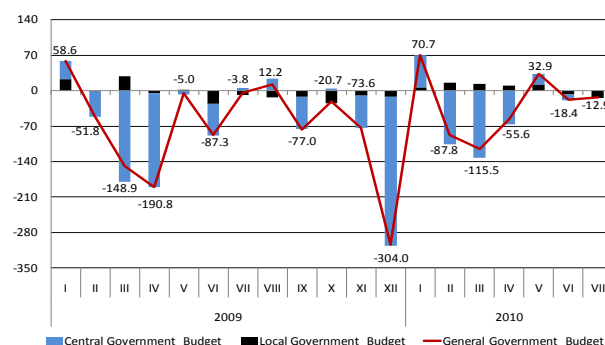
Money Market Indexes RIGIBID and EURIBOR for last 6 month on 25th date of each month

In the first seven months of 2010 the amount of money received in the budget was smaller in comparison with the same period of 2009, which mainly was due to tax revenue decline.

	I-VII 2010 execution, mln lats	I-VII 2010 execution changes against I-VII of 2009, %
GENERAL GOVERNMENT CONSOLIDATED BUDGET		
Revenue	2 714.56	-4.5
Expenditure	2 901.10	-11.3
Financial Balance	-186.54	
CENTRAL GOVERNMENT CONSOLIDATED BUDGET		
Revenue	2 256.07	-5.2
Expenditure	2 487.12	-12.0
Financial Balance	-231.05	
Central government basic budget		
Revenue	1 591.10	-2.7
Expenditure	1 593.48	-20.4
Financial Balance	-2.38	
Central government special budget		
Revenue	683.78	-11.1
Expenditure	918.56	7.4
Financial Balance	-234.78	
LOCAL GOVERNMENT CONSOLIDATED BUDGET		
Revenue	711.09	-16.2
Expenditure	674.04	-19.3
Financial Balance	37.05	

Budget revenue and expenditure

In accordance to the State Treasury's official monthly report for the period of January-July 2010 (I-VII), **general government consolidated budget** revenue in the first seven months of 2010 was 2 714.6 mln lats, which was by 4.5% less than in the same period of 2009. In this period expenditure declined more rapidly than revenue and in the first seven months of 2010 was 2 901.1 mln lats, which is by 11.3% less than in the same period of 2009. In the first seven months of 2010 general government consolidated budget financial deficit amounted to 186.5 mln lats, which still was determined by the high level of deficit in the central government special budget. In comparison with the first seven months of 2009, when financial deficit was 428.9 mln lats, general government consolidated budget deficit was by 242.4 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 seven months of 2010 composed 58.4% 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 124.0 mln lats or 5.2%, which mainly was due to the tax revenue (decreased by 164.5 mln lats or 9.6%) and revenue from paid services and self-earned revenue (decreased by 16.7 mln lats or 18.4%) decline. However, in the first seven months of 2010 non-tax revenue increased by 17.9 mln lats or 7.5% in comparison with the same period of 2009, which mainly was due to non-tax revenue increase in the central

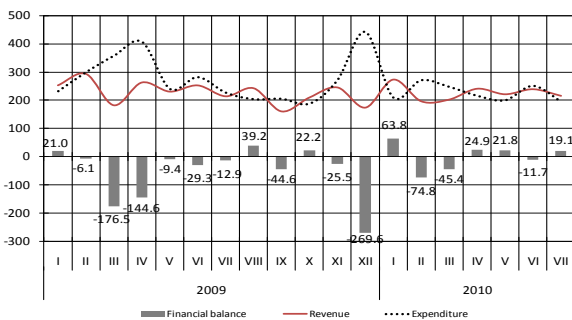
government basic budget. Change in revenue amount was influenced by increase in foreign financial assistance revenue, which in comparison with the first seven months of 2009 increased by 38.4 mln lats or 11.1%.

In the first seven months of 2010 central government consolidated budget expenditure was 51.9% of planned annual expenditure amount, but, in comparison with the same period of 2009, expenditure decreased by 337.7 mln lats or 12.0%. In the first seven months of 2010 central government consolidated budget expenditure amount exceeded the revenue amount, creating financial deficit much lower than planned – in amount of 231.0 mln lats

Change in **central government basic budget** revenue in the first seven months of 2010 was influenced by the tax revenue decrease by 90.2 mln lats or 8.9% and decrease of revenue from paid services and self-earned revenue - by 58.5 mln lats or 64.4% in comparison with the same period of 2009. However, in the first seven months of 2010 foreign financial assistance revenue increased by 36.2 mln lats or 10.5% and non-tax revenue increased by 18.1 mln lats or 7.7%. In the first seven months of 2010 total revenue amount composed 58.7% of the planned central government basic budget annual revenue.

Central government basic budget expenditure reduction by 407.5 mln lats or 20.4% mainly was influenced by cost decline for the coverage of maintenance expenditure in amount of 341.2 mln lats or 18.2% (including significant cost reduction for the coverage of current expenditure, subsidy and grant distribution) and capital expenditure in amount of 66.3 mln lats or 52.4% (including reduction in expenditure for capital formation, decline of total amount of transfers). In the first seven months of this year central government basic budget total amount of expenditure composed 48.4% of planned annual amount of expenditure.

In the first seven months of 2010 central government basic budget financial deficit was in amount of 2.4 mln lats, which was by 363.0 mln lats less than in the same period of 2009.



Central government basic budget, mln lats

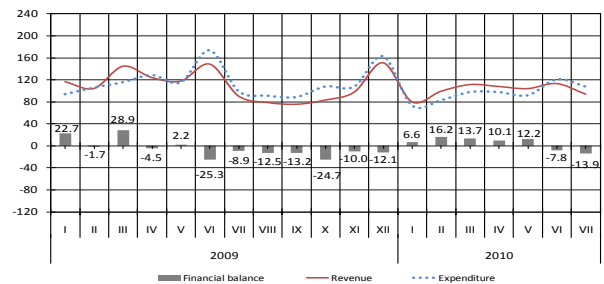
Unlike central government basic budget, local government basic budget and special budget expenditure decline, the **central government special budget** expenditure continued to grow and in the first seven months of 2010 increased by 63.3 mln lats or 7.4% compared with the same period of 2009. Expenditure 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 62.9 mln lats and in the first seven months of 2010 expenditure for social benefits amounted to 59.7% of planned this year's total expenditure amount. In the first seven months of 2010

central government special budget expenditure composed 57.5% of planned this year's special budget expenditure.

In the first seven months of 2010 **local government consolidated budget** revenue decreased by 16.2% in comparison with the same period of 2009, mainly due to tax revenue decline by 1.0% and significant change in the amount of transfers – earmarked grants received in local government budget from central government budget reduced by 32.4 mln lats or 71.2%, as well the transfers between local governments' budgets – by 92.5 mln lats or 97.7%. In the first seven months of 2010 local government consolidated budget received 62.0% of planned annual revenue.

The decrease of local government consolidated budget expenditure in the first seven months of 2010 mainly was due to the local government basic budget maintenance expenditure reduction by 28.4% (remuneration expenditure decreased by 30.4%, expenditure for goods and services – by 7.6%). However, local government basic budget expenditure for social benefits increased by 58.8% in comparison with the same period of 2009. In the first seven months of 2010 local government consolidated budget expenditure composed 44.0% of the planned annual expenditure.

In the first seven months of 2010 the local government consolidated budget had financial surplus in amount of 37.1 mln lats, which was by 23.5 mln lats or 174.3% 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 seven months of 2010 major **tax revenue** exceeded planned revenue amount by 2.3%, because value added tax, lottery and gambling tax and natural resources tax revenue was higher than expected.

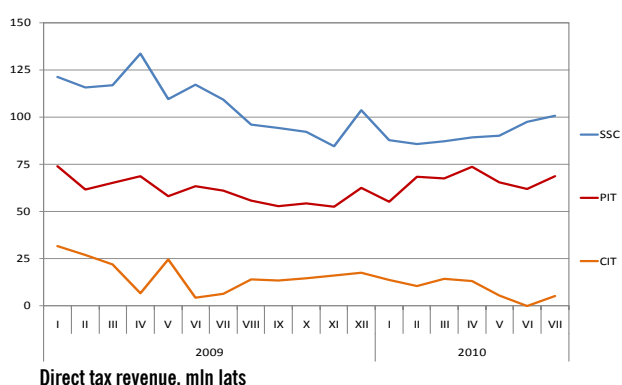
	I-VII 2010 execution, mln lats	I-VII 2010 execution of the same period plan, %	VII 2010 execution of VII 2010 plan, %	I-VII 2010 execution changes against I-VII 2009, %
Personal income tax	447.1	95.1	92.9	-1.0
Social security contributions*	658.9	97.6	96.4	-20.6
Corporate income tax	62.1	106.2	73.8	-49.0
Value added tax	484.5	124.3	122.9	-0.8
Excise tax	262.1	94.1	94.9	-11.3
Lottery and gambling tax	9.2	96.6	74.1	-33.9
Customs duty	8.7	103.4	126.5	-12.2
Natural resources tax	5.8	116.3	169.2	13.3
Total	1 938.4	102.3	101.9	-12.5

Major tax revenue (Including social security contributions for funded pension scheme (I-VII 2010 37.8 mln lats))

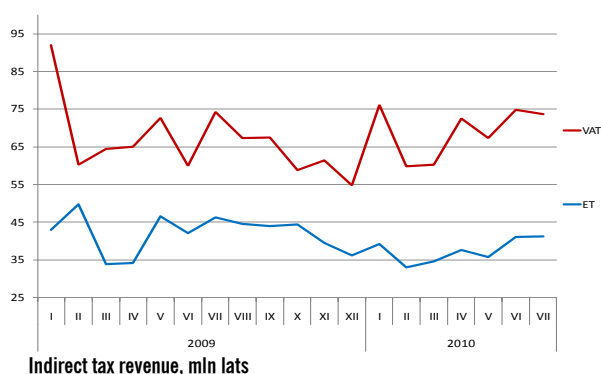
Social security contributions (SSC) (including contributions into the State Funded Pension Scheme) and **personal income tax** (PIT) revenue in the first seven months of 2010 continued to decline. In the first

seven months of 2010 revenue plan of SSC was executed by 97.6%, which was by 16.2 mln lats less than planned. PIT revenue was by 23.1 mln lats less than planned.

In first seven months of 2010 **corporate income tax (CIT)** revenue exceeded planned revenue amount by 6.2%. However, CIT revenue in the first seven months of 2010 decreasing by 49.0% in comparison with the same period of 2009 composed the biggest total tax revenue decline. Decline in CIT revenue still continued to be subject to financial service industry, which ensured the biggest share of CIT revenue in previous years. In the first seven months of 2010 refunds for financial service industry were by 9.59 mln lats more than in the same period of 2009. The biggest share of CIT revenue in the first seven months of 2010 was made by taxpayers of electricity, gas supply, heat supply and air condition industry – 10.32 mln lats, which was 16.6% from total CIT revenue.



Value added tax (VAT) revenue in the first seven months of 2010 exceeded planned revenue amount by 94.6 mln lats. In comparison with the same period of 2009, total VAT revenue was by 4.1 mln lats or 0.8% less. Decline was due to the decrease in transaction value by 14.7%, 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 11.6%, but tax revenue for goods released for free circulation decreased by 49.9%



In the first seven months of 2010 **excise tax (ET)** revenue plan was executed by 93.9% and by 16.6 mln lats less than planned. Decrease in the first seven months 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 6.4%, tobacco products – by 30.4%, alcoholic beverages – by 3.6%. In

comparison with the first seven months of 2009 ET revenue increase by 54.1% was observed in beer products sale in the same period of 2010.

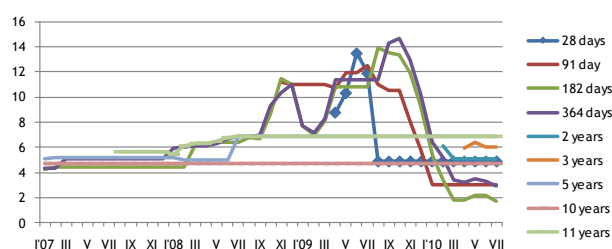
In the first seven months of 2010 general government consolidated budget **non-tax revenue** increased by 1.7 mln lats or 0.5%, in comparison with the same period of 2009, which mainly was influenced by the revenue from dividends for the use of state capital (increased by 1.4%) and revenue from the payment of the Bank of Latvia (increased by 39.2%) in April of this year. In the first seven months of 2010 the total amount of general government consolidated budget non-tax revenue was 322.8 mln lats.

In the first seven months of 2010, revenue from paid services and self-earned revenue was 122.8 mln lats, which was by 20.8% less than in the first seven months of 2009. Foreign financial assistance revenue was 383.7 mln lats, which was by 10.7% more than in the same period of 2009.

In the end of July 2010 **government debt** was 4 676.9 mln lats and in the first seven months of 2010 increased by 537.6 mln lats. Domestic government debt decreased by 66.3 mln lats in the first seven months of 2010 and in the end of July was 820.3 mln lats. However, in the end of July of 2010 the total amount of external government debt was 3 856.6 mln lats and since the beginning of this year it increased by 603.9 mln lats.

The Treasury in July sold **treasury bills** for a total amount of 10.0 mln lats. Overall investor demand for bonds in this period reached 65.1 mln lats in a nominal value. The six-month bills average weighted interest rate in last auction was 1.748%, 12-month bills average weighted interest rate was - 2.910%.

The Treasury in July sold **three-year bonds** for a total amount of 10.1 mln lats. Overall investor demand for bonds in this period reached 36.3 mln lats in a nominal value. The weighted average interest rate for 3-year bonds was 6.022%.



In July 2010 government medium and long term bond weight in the domestic debt portfolio amounted to 48.0% (45.0% in July 2009), but short-term government bond proportion reached 52.0% (55.0%).

