NOT FOR GENERAL CIRCULATION IN THE UNITED STATES OF AMERICA

OFFERING CIRCULAR DATED 10 DECEMBER 2012

REPUBLIC OF LATVIA, ACTING THROUGH THE TREASURY

U.S.$1,250,000,000 2.750 PER CENT. NOTES DUE 2020

The issue price of the U.S.$1,250,000,000 2.750 per cent. Notes due 2020 (the "**Notes**") of the Republic of Latvia, acting through the Treasury (the "**Issuer**", "**Latvia**" or the "**Republic**") is 99.113 per cent. of their principal amount.

Unless previously redeemed or cancelled, the Notes will be redeemed at their principal amount on 12 January 2020. See "*Terms and Conditions of the Notes – Redemption and Purchase*".

Except for the first payment, interest will be payable on the Notes semi-annually in arrear on 12 January and 12 July in each year. The first payment of interest on the Notes will be made in respect of the period from and including 12 December 2012 (the "**Issue Date**") to but excluding 12 July 2013 and will be paid on 12 July 2013. Interest will be paid at a rate of 2.750 per cent. per annum, in each case as further described, and except as mentioned, under "*Terms and Conditions of the Notes – Interest*". Payments on the Notes will be made in U.S. dollars without deduction for or on account of any Latvian withholding taxes and the Republic will pay additional amounts if any such taxes are imposed, as described under "*Terms and Conditions of the Notes – Taxation*".

Application has been made to list the Notes on the Official List of the Luxembourg Stock Exchange and to admit the Notes to trading on the Luxembourg Stock Exchange's regulated market pursuant to the rules and regulations of the Luxembourg Stock Exchange.

This Offering Circular neither constitutes an offering circular pursuant to Part II of the Luxembourg law on prospectuses for securities (*loi relative aux prospectus pour valeurs mobilières*) dated 10 July 2005 (the "**Luxembourg Prospectus Law**") which implements Directive 2003/71/EC, as amended (the "**Prospectus Directive**") nor a simplified offering circular pursuant to Part III of the Luxembourg Prospectus Law. Accordingly, this Offering Circular does not purport to meet the format and the disclosure requirements of the Prospectus Directive and Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive, and it has not been, and will not be, submitted for approval to any competent authority within the meaning of the Prospectus Directive and in particular the Supervisory Commission of the Financial Sector (*Commission de Surveillance du Secteur Financier*), in its capacity as competent authority under the Luxembourg Prospectus Law.

The Notes are expected to be rated BBB by Fitch Ratings Limited ("**Fitch**"), Baa3 by Moody's Investors Service Limited ("**Moody's**") and BBB by Standard & Poor's Credit Market Services Europe Limited ("**S&P**"). A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

Fitch, Moody's and S&P are established in the European Union and are registered under Regulation (EU) No 1060/ 2009 (the "**CRA Regulation**"). In general, European regulated investors are restricted from using a rating for regulatory purposes if such rating is not issued by a credit rating agency established in the European Union and registered under the "**CRA Regulation**" unless the rating is provided by a credit rating agency operating in the European Union before 7 June 2010 which has submitted an application for registration in accordance with the CRA Regulation and such registration is not refused.

SEE "*RISK FACTORS*" STARTING ON PAGE 6 FOR A DISCUSSION OF CERTAIN FACTORS TO BE CONSIDERED IN CONNECTION WITH AN INVESTMENT IN THE NOTES.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the "Securities Act") or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Notes are being offered, sold or delivered: (a) in the United States only to qualified institutional buyers ("QIBs") (as defined in Rule 144A ("Rule 144A") under the Securities Act) in reliance on, and in compliance with, Rule 144A; and (b) to Persons (other than U.S. Persons) (each as defined in Regulation S) outside the United States in reliance on Regulation S ("Regulation S") under the Securities Act. Each purchaser of the Notes will be deemed to have made the representations described in "*Subscription and Sale*" and is hereby notified that the offer and sale of Notes to it is being made in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A. In addition, until 40 days after the commencement of the offering, an offer or sale of any of the Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if the offer or sale is made otherwise than in accordance with Rule 144A. For a summary of certain restrictions on resale, see "*Subscription and Sale*", "*Transfer Restrictions*" and "*The Global Certificates*".

The Notes will be in registered form in denominations of U.S.$200,000 and integral multiples of U.S.$1,000 in excess thereof. The Notes will initially be represented by two global certificates in registered form (the "**Global Certificates**"), one of which will be issued in respect of the Notes offered and sold in reliance on Rule 144A (the "**Restricted Global Certificate**") and will be registered in the name of Cede & Co., as nominee for The Depository Trust Company ("**DTC**") and the other of which will be issued in respect of the Notes offered and sold in reliance on Regulation S (the "**Unrestricted Global Certificate**") and will be registered in the name of a nominee of a common depositary for Euroclear Bank SA/NV ("**Euroclear**") and Clearstream Banking, *société anonyme* ("**Clearstream, Luxembourg**"). It is expected that delivery of the Global Certificates will be made on 12 December 2012 or such later date as may be agreed (the "**Closing Date**") by the Republic and the Joint Lead Managers (as defined under "*Subscription and Sale*").

JOINT LEAD MANAGERS

BARCLAYS **DEUTSCHE BANK** **J.P. MORGAN**

10 December 2012

The Republic has confirmed to the Joint Lead Managers named under "*Subscription and Sale*" that all information regarding the Republic and the Notes contained in this Offering Circular is true and accurate in all material respects and is not misleading in any material respect; this Offering Circular does not omit to state any fact necessary to make such information not misleading in any material respect; and all reasonable enquiries have been made to ascertain and to verify the foregoing. The Republic accepts responsibility for the information contained in this Offering Circular accordingly.

The Republic has not authorised the making or provision of any representation or information regarding the Republic or the Notes other than as contained in this Offering Circular or as approved for such purpose by the Republic. Any such representation or information should not be relied upon as having been authorised by the Republic or the Joint Lead Managers.

None of the Joint Lead Managers has separately verified the information contained in this Offering Circular. Accordingly, no representation, warranty or undertaking, express or implied, is made (to the fullest extent permitted by law) and no responsibility or liability is accepted by any of the Joint Lead Managers as to the accuracy or completeness of the information contained in this Offering Circular or by any other information provided by the Republic in connection with the Republic or the issue and offering of the Notes or for any other statement, made or purported to be made by a Joint Lead Manager or on its behalf, in connection with the Republic or the issue and offering of the Notes. No Joint Lead Manager accepts any liability whether arising in tort or contract or otherwise in relation to the information contained in this Offering Circular or any other information provided by the Republic or any such statement.

Information included herein which is identified as being derived from a publication of, or supplied by, the Republic of Latvia or one of its agencies or instrumentalities is included herein on the authority of such publication as a public official document of the Republic of Latvia. All other information herein is included as a public official statement made on the authority of Andris Vilks, Minister of Finance, Ministry of Finance, Republic of Latvia.

Neither the delivery of this Offering Circular or the offering, sale or delivery of any Note shall in any circumstances constitute a representation that there has been no adverse change, or any event reasonably likely to involve any adverse change, in the condition (financial, economic or otherwise) of the Republic since the date of this Offering Circular.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Republic or any Joint Lead Manager to subscribe for or purchase, any Notes. Each investor contemplating purchasing any Notes should make its own independent investigation and analysis of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Republic, and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience and any other factors which may be relevant to it in connection with such investment.

The distribution of this Offering Circular and the offering, sale and delivery of Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Republic and the Joint Lead Managers to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers, sales and deliveries of Notes and on distribution of this Offering Circular and other offering material relating to the Notes, *see "Subscription and Sale"*.

In this Offering Circular, unless otherwise specified, references to "**U.S.$**", "**U.S. dollars**" and "**dollars**" are to the lawful currency for the time being of the United States of America, references to "**LVL**", "**Lats**" and "**Ls**" are to the lawful currency for the time being of the Republic of Latvia, all references to "**SDR**" are to Special Drawing Rights against the International Monetary Fund (the "**IMF**") and references to "**Euro**", "**euro**" and "**€** " are to the single currency introduced at the start of the third stage of European economic and monetary union, and as defined in Article 2 of Council Regulation (EC) No. 974/98 of 3 May 1998 on the introduction of the euro, as amended. Translations of amounts from Lats to U.S. dollars are solely for the convenience of the reader and, unless otherwise stated, are made at year end exchange rates. No representation is made that Lats or dollar amounts referred to herein could have been or could be converted into dollars or Lats, as the case may be, at any particular rate at all.

Unless otherwise stated, all annual information, including budgetary information, is based on calendar years. Statistical data appearing in this Offering Circular has, unless otherwise stated, been obtained from the Central Statistical Bureau of Latvia (the "**Central Statistical Bureau**"), the Ministry of Finance, the Bank of Latvia, the Financial and Capital Market Commission and the Treasury. Similar statistics may be obtainable from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source. Certain statistical information relating to 2011 and 2012 should be treated as preliminary and statistical information for these and prior years may be subject to future adjustment.

Certain figures included in this Offering Circular have been subject to rounding adjustments; accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

Latvia is a sovereign state. Consequently, it may be difficult for investors to obtain judgments of courts in countries outside Latvia against Latvia. Enforcement of such judgments in Latvia may be refused in certain circumstances in the absence of an applicable treaty facilitating such enforcement. Any judgement obtained in a court in Latvia against the Republic by a holder of any Note would be expressed in the lawful currency of the Republic of Latvia.

The Republic will waive certain sovereign immunity under the Notes (see further Condition 17(g) for the extent to which sovereign immunity is waived). See "*Risk Factors—Risk Factors Relating to an Investment in the Notes—A claimant may not be able to enforce a court judgment against certain assets of the Republic in certain jurisdictions*".

In connection with the issue of Notes, Deutsche Bank AG, London Branch (the "Stabilising Manager") (or persons acting on behalf of any Stabilising Manager) may over allot Notes or effect transactions with a view to supporting the price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. Any stabilisation action or over-allotment must be conducted by the Stabilising Manager (or person(s) acting on behalf of any Stabilising Manager) in accordance with all applicable laws and rules.

The Notes have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities reviewed or passed upon the accuracy or adequacy of this Offering Circular. Any representation to the contrary is a criminal offence in the United States.

This Offering Circular is being submitted on a confidential basis in the United States to a limited number of QIBs for informational use solely in connection with the consideration of the purchase of the Notes. It may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is originally submitted.

Each purchaser or holder of interests in the Notes will be deemed, by its acceptance or purchase of any such Notes, to have made certain representations and agreements as set out in "*Subscription and Sale*".

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER CHAPTER 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Offering Circular, as well as written and oral statements that Republic and its representatives make from time to time in reports, filings, news releases, conferences, teleconferences, web postings or otherwise, are or may be deemed to be forward-looking statements. Statements that are not historical facts, including, without limitation, statements about the Republic's beliefs and expectations, are forward-looking statements. These statements are based on current plans, objectives, assumptions, estimates and projections. When used in this Offering Circular, the words "anticipates", "estimates", "expects", "believes", "intends", "plans", "aims", "seeks", "may", "will", "should" and any similar expressions generally identify forward-looking statements. Therefore, undue reliance should not be placed on them. The Republic has based these forward-looking statements on its current view with respect to future events and financial results.

Forward-looking statements speak only as of the date on which they are made and the Republic undertakes no obligation to update publicly any of them in light of new information or future events. Forward-looking statements involve inherent risks and uncertainties the Republic cautions that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Forward-looking statements include, but are not limited to: (i) plans with respect to the implementation of economic policy, including privatisations, and the pace of economic and legal reforms; (ii) expectations about the behaviour of the economy if certain economic policies are implemented; (iii) the outlook for gross domestic product, inflation, exchange rates, interest rates, foreign investment, trade and fiscal accounts; and (iv) estimates of external debt repayment and debt service.

EXCHANGE RATES

The rate of exchange of the Lat has been fixed since February 1994. Initially it was pegged to the IMF's SDR basket of currencies within fluctuation bands of +/-1 per cent. Following Latvia's accession to the European Union (the "**EU**") and further integration with other EU countries, in January 2005 the Lat was re-pegged from the SDR basket of currencies to the euro, again within fluctuation bands of +/-1 per cent.

Since May 2005, Latvia has participated in the Exchange Rate Mechanism II ("**ERM II**"). The central rate for the Lat in ERM II was set at LVL 0.702804 per euro (the same level as the rate adopted since the beginning of 2005). The unilateral +/-1 per cent. fluctuation bands have been maintained within the ERM II arrangement.

Through a currency board arrangement, the Bank of Latvia maintains the monetary base with foreign exchange reserves that consist of liquid foreign assets. The Bank of Latvia offers market participants the opportunity to conduct foreign exchange interventions of unlimited amount whenever the market exchange rate hits the +/-1 per cent. fluctuation bands.

Latvia remains committed to maintaining the exchange rate peg with a view to adopting the euro as the national currency in 2014 as soon as the necessary criteria for adoption are met. See "*Monetary and Financial System — Bank of Latvia*" and "*Public Finance — Impact of the Global Financial Crisis on Latvia's Budgets since 2009*".

The following table sets out the Lat to U.S. dollar and the U.S. dollar to euro exchange rates for the last day of the periods indicated and the average exchange rates during the periods indicated. At 30 September 2012, the U.S. dollar to Lat exchange rate was 0.546 LVL per U.S.$1.00.

	Year ended 31 December					Nine months ended 30 September
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
			(LVL per U.S.$)			
Period end	0.484	0.495	0.489	0.535	0.544	0.546
Average for period	0.514	0.480	0.505	0.531	0.505	0.549
			(U.S.$ per €)			
Period end	1.458	1.395	1.433	1.337	1.296	1.288
Average for period	1.371	1.471	1.394	1.327	1.392	1.282

Source: Bank of Latvia, Bloomberg

The Bank of Latvia's foreign exchange rate for U.S. dollars on 4 December was LVL 0.539 = U.S.$1.00.

CONTENTS

SUMMARY

This Summary does not purport to be complete and must be read as an introduction to this Offering Circular and any decision to invest in the Notes should be based on a consideration of this Offering Circular as a whole.

Words and expressions defined in "Terms and Conditions of the Notes" shall have the same meanings in this Summary.

THE REPUBLIC OF LATVIA

Geography and Population

Latvia is located in the Baltic region of northern Europe and is bordered by Estonia to the north, Russia to the east, Lithuania to the south and Belarus to the south-east. The western border of the country is the Baltic Sea, along which the country has a 498 kilometre ("**km**") coastline. Latvia is divided into four historical districts: Kurzeme (western Latvia), Zemgale (southern Latvia), Vidzeme (northern Latvia) and Latgale (eastern Latvia). Latvia covers an area of approximately 64,559 km^2. The capital city is Riga.

As at 1 January 2012, the total population of Latvia was approximately 2,041,800. Since early 2000, the total population has decreased by approximately 340,000 persons, or 14.3 per cent. of the population in early 2000, principally as a result of ageing, a low birth rate and emigration. The highest population concentration is in Riga. As at 1 January 2012, 650,480 people resided there, representing 31.9 per cent. of the total population. As of the same date, 63.6 per cent. of the population was of working age.

Government Structure

In accordance with the constitution of the Republic of Latvia (as amended the "**Constitution**"), the Saeima is the highest legislative body. The Saeima is a unicameral parliament consisting of 100 members, elected in general, equal, direct, secret and proportional elections for a four-year term. All Latvian citizens who are 18 years of age and over are entitled to vote.

The eleventh Saeima was elected in September 2011. The current ruling coalition consists of the centre-right Reform Party (16 seats) and Unity Alliance (20 seats), and the conservative-nationalist National Alliance (14 seats). Valdis Dombrovskis was re-elected as Prime Minister. The coalition does not have a formal majority, holding 50 of the 100 seats of the Saeima, although the coalition currently has the support of six unaffiliated members of the Saeima who were elected as members of the Reform Party. The next Saeima elections are scheduled to take place in October 2014.

The Saeima is entitled to elect, appoint, approve or dismiss a range of state officials and also elects the president of Latvia (the "**President**") for a term of four years. The current President is Andris Berzinš who was elected on 2 June 2011.

International Relations

Latvia is a member state of the United Nations ("**UN**"), the IMF, the World Trade Organisation (the "**WTO**"), the Council of Baltic Sea States (the "**CBSS**"), the EU and the North Atlantic Treaty Organisation ("**NATO**"). Latvia's relations with Russia are based on good, practical cooperation and Latvia regards the United States of America as a strategic partner and ally.

GDP

During 2007, Latvia experienced strong growth with real gross domestic product ("**GDP**") growing by 9.6 per cent., principally driven by private consumption and investment, which was largely based on a substantial inflow of foreign capital. The global financial crisis that commenced at the end of 2007 significantly adversely affected Latvia's economy throughout 2008 and 2009, with real GDP falling by 3.3 per cent. and by 17.7 per cent. in 2008 and 2009, respectively.

Since the fourth quarter of 2009, Latvia's economy has returned to growth, witnessing quarter-on-quarter real GDP growth, although, on an annual basis, Latvia's real GDP fell by 0.9 per cent. in 2010. In 2011, real GDP increased by 5.5 per cent. in comparison to 2010. In the first half of 2012, real GDP grew by 5.9 per cent. compared to the equivalent period of 2011.

Inflation

Inflation measured on a year-on-year basis peaked at 17.9 per cent. in May 2008 and then declined steadily until February 2010 (when it was -4.2 per cent.). The decline in inflation reflected both significant

weakening of domestic demand as a result of increasing unemployment, wage reductions and other measures taken to combat the effects of the global financial crisis on Latvia, and a decline in global energy and food prices as a result of the deterioration in the global economic environment. Although domestic demand remained fragile in 2010, increases in world energy and food prices and in indirect tax rates in Latvia resulted in increased inflation from February 2010 to May 2011, when the inflation rate peaked at 5.0 per cent. year on year. The year on year increase in consumer prices subsequently declined to 4.0 per cent. in 2011, while the 12-month average inflation rate increased to 4.4 per cent. in that year from an average deflation rate of 1.1 per cent. in 2010. The 12-month average inflation rate in October 2012 was 2.7 per cent. The decrease in inflation since May 2011 has generally reflected more moderate increases in world energy prices than those in the prior period, a gradual decrease in world food prices until July 2012, sustainable wage productivity developments and less impact from indirect taxes than in the prior period.

Financial Assistance

Deteriorating economic conditions in Latvia in 2008 and a banking crisis at the end of that year significantly adversely affected State budget revenues and, as a result, Latvia sought financial assistance from the IMF and other international bodies towards the end of 2008.

The IMF Stand By Arrangement which Latvia entered into in December 2008 was part of the wider financial assistance package agreed with the EU, the International Bank for Reconstruction and Development (the "**World Bank**"), the European Bank for Reconstruction and Development (the "**EBRD**") and a number of Nordic and other EU countries, bringing the total financial assistance package to approximately €7.5 billion (equal to approximately U.S.$10.5 billion). By the end of 2011, only €4.5 billion of this financial assistance had been disbursed to Latvia. A significant contributor to Latvia's emergence from recession has been the economic reforms implemented, including those required under the conditions of the financial assistance package. The principal aims of this economic reform programme were to arrest the liquidity crisis prevailing in late 2008, to stabilise the financial sector and to make structural adjustments with a view to ensuring economic recovery, while maintaining the exchange rate peg. Following the successful implementation of this reform programme, Latvia is now reorienting its borrowing strategy towards market funding and the financial assistance package has expired. On 14 September 2012, Latvia repaid early €211.1 million of funds borrowed from the IMF under the financial assistance package.

SUMMARY OF THE TERMS OF THE NOTES

Issuer:	The Republic of Latvia, acting through the Treasury.
Risk Factors:	There are certain factors that may affect the Republic's ability to fulfil its obligations under the Notes. These are set out under "*Risk Factors*" below and include, among other risks, certain potential factors which could adversely affect Latvia's economy and banking sector in the future and risks relating to the strength and sustainability of Latvia's economic recovery. In addition, there are certain factors which are material for the purpose of assessing the market risks associated with the Notes. These are set out under "*Risk Factors*" and include the fact that the Notes may not be a suitable investment for all investors.
Description of Notes:	U.S.$1,250,000,000 2.750 per cent. Notes due 2020, to be issued by the Republic on the Issue Date.
Joint Lead Managers:	Barclays Bank PLC Deutsche Bank AG, London Branch J.P. Morgan Securities plc
Non-US Registrar:	Deutsche Bank Luxembourg S.A.
US Registrar:	Deutsche Bank Trust Company Americas
Interest:	Except for the first payment, interest will be payable on the Notes semi-annually in arrear on 12 January and 12 July in each year. The first payment of interest on the Notes will be made in respect of the period from and including 12 December 2012 to but excluding 12 July 2013 and will be paid on 12 July 2013. Interest will be paid at a rate of 2.750 per cent. per annum, in each case as further described, and except as mentioned, in Condition 5 (*Interest*).
Events of Default:	Events of default under the Notes include the non-payment of any interest due in respect of the Notes or any of them for a period of 14 days from the due date for payment thereof and breach of other obligations or undertakings under the Notes (which breach is not remedied within 45 days). Notes may only be declared immediately due and payable, upon an Event of Default, if holders of at least 25 per cent. in aggregate principal amount of the outstanding Notes give notice in writing to the Republic (with a copy to the Fiscal Agent). Furthermore if the Republic receives notice in writing from holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to the effect that the event of default giving rise to a declaration of acceleration is cured and that such holders wish the relevant declaration to be withdrawn, the relevant declaration shall be withdrawn and shall have no further effect.

Negative Pledge:	The terms of the Notes contain a negative pledge provision given by the Republic in respect of Relevant Indebtedness as described in Condition 4 (*Negative Pledge*).
Status of the Notes:	The Notes will constitute direct, general, (subject to the provisions of Condition 4 (*Negative Pledge*)) unsecured and unconditional obligations of the Republic and will rank *pari passu* and without any preference among themselves and at least (save for certain obligations required to be preferred by law) equally in right of payment with all other present and future unsecured and unsubordinated indebtedness of the Republic.
Meetings of Noteholders:	The Conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally (see Condition 13 (*Meetings of Noteholders; Written Resolutions*)). These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The Conditions of the Notes also contain provisions for the appointment of a Noteholders' representative committee (see Condition 14 (*Noteholders' Representative Committee*)).
Modification:	The Conditions of the Notes contain a provision permitting the Notes and the Conditions of the Notes to be amended without the consent of the Noteholders to correct a manifest error.
Taxation:	All payments in respect of the Notes by or on behalf of the Republic shall be made without withholding or deduction for, or on account of any Taxes, unless required by law. In that event, the Republic shall pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, subject to certain exceptions as provided in Condition 8 (*Taxation*).
Listing and admission to trading:	Application has been made to list the Notes on the Official List of the Luxembourg Stock Exchange and to admit the Notes to trading on the Luxembourg Stock Exchange's regulated market.
Governing Law:	The Notes and any non-contractual obligations arising out of or in connection with the Notes are governed by and shall be construed in accordance with, English law, **provided**, **however**, **that** the due authorisation and execution of the Notes by and on behalf of the Republic shall be governed by the laws of the Republic.
Form and Denomination:	The Notes will be issued in registered form in denominations of U.S.$200,000 and integral multiples of U.S.$1,000 in excess thereof.

Credit Ratings:	The Notes are expected to be assigned a rating of BBB by Fitch, Baa3 by Moody's and BBB by S&P. Fitch, Moody's and S&P are established in the European Union and are registered under the CRA Regulation (EU) No 1060/2009. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.
Selling Restrictions:	The Notes have not been and will not be registered under the Securities Act and are subject to certain restrictions on transfers. See "*Subscription and Sale*" below.
Use of Proceeds:	The net proceeds of the issue of the Notes will be used for the refinancing of indebtedness and general funding purposes of the Republic.

RISK FACTORS

Investment in the Notes involves risk. Prospective investors should carefully consider the following risk factors, together with the other information set out in this Offering Circular, before making a decision to invest in the Notes and should understand that the risks set forth below could, individually or in the aggregate, have a material adverse effect on Latvia's capacity to repay principal and make payments of interest on the Notes or otherwise fulfil its obligations under the Notes. Most of these factors are contingencies which may or may not occur and the Republic is not in a position to express a view on the likelihood of any such contingency occurring. Additional risks and uncertainties not currently known to the Republic or that the Republic currently deems to be immaterial may also materially affect the Republic's economy and its ability to fulfil its obligations under the Notes. In any such case, investors may lose all or part of their investment in the Notes. Words and expressions defined in ''Terms and Conditions of the Notes'' or elsewhere in this Offering Circular have the same meanings in this section.

Risk Factors Relating to Latvia

Latvia's economy was significantly adversely affected by the global financial crisis. Any similar future global economic downturns, or difficulties experienced by Latvia's major regional trading partners or caused by more general "contagion" effects, could have a material adverse effect on Latvia's economy and public finances

Latvia experienced adverse economic and financial effects as a result of the global financial crisis which began in the second half of 2008 and the resulting correction of macroeconomic imbalances. For example, Latvia's GDP declined by 17.7 per cent. in real terms in 2009 compared to 2008 and the downturn also caused the registered unemployment rate in Latvia to increase from 7.0 per cent. as at 31 December 2008 to 16.0 per cent. as at 31 December 2009. As a result, Latvia agreed a financial assistance package with the EU, the IMF, the World Bank, the EBRD and a number of Nordic and other EU countries (the "**financial assistance package**"). Although Latvia's economy grew by 5.5 per cent. in real terms in 2011 and by 5.9 per cent. in real terms in the first six months of 2012 compared with the comparable period of 2011, the unemployment rate over the medium-term is expected to remain at levels which are considerable higher than those prevailing before the global financial crisis. As at 30 June 2012, the registered unemployment rate was 11.0 per cent. On 9 November 2012, the Central Statistical Bureau released a flash estimate showing that Latvia's real GDP growth in the third quarter of 2012 compared to the comparable period of 2011 was 5.3 per cent. The latest preliminary estimates by the Ministry of Finance of real GDP for 2012 indicate growth of 4.0 per cent.

A significant contributor to Latvia's emergence from recession has been the economic reforms implemented, including those required under the conditions of the financial assistance package. The principal aims of this economic reform programme were to arrest the liquidity crisis prevailing in late 2008, to stabilise the financial sector and to make structural adjustments with a view to ensuring economic recovery, while maintaining the exchange rate peg. Following the successful implementation of this reform programme, Latvia is now reorienting its borrowing strategy towards market funding and the financial assistance package has expired. However, any failure to continue to maintain and improve the current level of economic and fiscal reforms may have an adverse effect on Latvia's economy and public finances.

Latvia's economic recovery since 2009 has also been dependent on the recovery of several of Latvia's major trading partners. Latvia's economic improvement in 2010 and 2011 was driven in significant part by export growth as a result of increased competitiveness stemming from wage restraint and deflation in Latvia in the 2009 – 2010 period. Latvia's current account, which had recorded deficits equal to 22.4 per cent. of nominal GDP and 13.1 per cent. of nominal GDP in 2007 and 2008, recorded surpluses of 8.6 per cent. and 2.9 per cent. of nominal GDP in 2009 and 2010. In 2011 and the first half of 2012, Latvia's current account again recorded deficits, equal to 2.2 per cent. and 2.9 per cent. of nominal GDP, respectively. The declining trend in Latvia's current account balance is driven by increased imports related to domestic investment and increasing foreign bank profitability (which worsens the income account). Latvia's improvement in competitiveness has slowed since mid-2010, with gross monthly wages for the six months ended 30 June 2012 reaching the peak levels recorded in 2009. This level of wages, if sustained or increased, and any significant increase in inflation in the future, for example as a result of increased international energy and food prices, is likely to erode Latvia's competitiveness. In addition, if Latvia is unable to increase its exports in line with its imports, which will require further improvements in competitiveness, this could result in further current account deterioration and could restrict Latvia's

ability to continue to grow after it has adopts the euro as its sole currency (targeted for 1 January 2014). Since 2011, the rate of growth in Latvia's exports has fallen behind the rate of growth in its imports.

In addition, because international investors' reactions to events occurring in one market can result in a "contagion" effect, in which an entire region or class of investment is disfavoured by international investors, Latvia could be adversely affected by negative economic or financial developments in neighbouring countries and other EU member states in general (including, among others, Lithuania and Estonia). Latvia has been adversely affected by such contagion effects on a number of occasions, including following the 1998 Russian financial crisis and during the global financial crisis and subsequent European sovereign debt crisis. The occurrence of any similar events is likely to affect the Latvian economy and banking sector in the same way.

In the second half of 2011 and for extended periods during 2012, the situation in the international financial markets deteriorated significantly, there have been several EU sovereign rating downgrades and in general the instability has caused doubts over the sustainability of the Eurozone. The resulting higher rates for sovereign debt have disrupted national economies and the risk of a further credit crisis and a squeeze on liquidity has risen significantly. As a small open economy, Latvia is vulnerable to external shocks such as the global financial crisis and the European sovereign debt crisis. Although Latvia's economy has improved since the global financial crisis, any further escalation of the European sovereign debt crisis may result in an enhanced risk of deleveraging and credit contraction and the resulting adverse effect on Latvia's economy could be significant.

There can be no assurance that the occurrence of any future crises such as those described above will not negatively affect investor confidence in Latvia, Latvia's economy, its banking sector or its ability to raise capital in the external debt markets in the future. Should any of these effects occur, this could adversely affect Latvia's ability to service its public debt, including the Notes.

Latvia's banking sector continues to face challenges and could be materially adversely affected in certain circumstances as a result

The recession in Latvia adversely affected the financial position of both corporate and retail borrowers resulting in a deterioration of loan quality and an increase in the provisions made by Latvian banks, with the share of non-performing loans (being loans with payments overdue more than 90 days) ("**NPLs**") in the total Latvian bank loan portfolio being 16.4 per cent., 19.0 per cent. and 17.3 per cent. as at 31 December 2009, 2010 and 2011, respectively, compared to 3.6 per cent. as at 31 December 2008. As at 30 September 2012, NPLs stood at 12.0 per cent. Reflecting the adverse economic conditions, the total amount of bank loans outstanding fell by 7.0 per cent., by 7.1 per cent. and by 8.1 per cent. at 31 December 2009, 2010 and 2011, respectively, compared to 31 December in the previous year. See "*Monetary and Financial System – Banking Sector Development*". In addition, Parex Bank, the largest Latvian-owned bank, was rescued by way of nationalisation in November 2008, insolvency proceedings have been instituted against another Latvian bank, JSC Latvijas Krajbanka ("**Krajbanka**") and a reorganisation plan has been implemented in relation to the Latvian-owned Mortgage and Land Bank of Latvia.

The challenging macroeconomic climate in Europe continues to pose challenges to the stability of Latvia's banking sector. While NPLs have gradually declined from mid-2010 and banks have been substantially recapitalised, prolonged balance sheet pressures emanating from high unemployment and reduced incomes, and low credit growth and profitability, particularly in the event of worsened operating conditions, could cause some banks to require further recapitalisation, which may not be available on commercially acceptable terms or at all. Additional risks include the fact that significant external assets are held by banks in Latvia and the quality of these assets is harder to verify than the quality of domestic assets, for example the failure of Krajbanka was triggered by the discovery of the fact that significant assets held by the bank in correspondent accounts were encumbered. Additionally, because a significant percentage of their assets and liabilities are denominated in euro, Latvian banks are subject to changes in interest rates determined by the European Central Bank and not by the Bank of Latvia. As a result, in the event of any significant mismatch between their euro-denominated assets and liabilities, Latvian banks could be exposed to the effect of these changes. Further, a large number of smaller banks in Latvia are reliant on non-resident deposits for a significant part of their funding which presents a risk to these banks as non-resident deposits are generally more sensitive to changes in the financial and economic conditions of a country, as was the case in the 12-month period following August 2008 when non-resident deposits fell by 30.0 per cent. As a result, any perceived concerns about the strength of the Latvian economy could result in withdrawals by such non-resident depositors. If any such withdrawals were substantial in size,

they could worsen domestic liquidity conditions, potentially affecting the ability of the Latvian government (the "**Government**") to repay principal or make payments of interest on the Notes. For further information on the banking sector in Latvia, see "*Monetary and Financial System – Banking Sector Development*".

Any depreciation of the Lat could adversely affect Latvia's economy

Latvia's central Government debt as at 31 October 2012 amounted to LVL 5,388.3 million, equal to 35.7 per cent. of projected nominal GDP for 2012, of which LVL 5,054.5 million (or 87.4 per cent.) was denominated in foreign currencies, principally the euro, see "*Indebtedness*". As a result, Latvia is vulnerable to currency risk. Since 2005, the Lat has been pegged to the euro and maintaining the peg has been a key Governmental policy and a condition in the financial assistance package. Thus Latvia considers a devaluation of the Lat (whether pursuant to a "re-pegging" or otherwise) to be unlikely. Nevertheless, in the event of a significant devaluation of the Lat, the negative impact on Latvia's service obligations in respect of its central Government debt denominated in foreign currencies could be significant and would not be significantly offset by the positive impact on its service obligations in respect of central Government debt denominated in Lats. As at 30 September 2012, all external central Government debt, which comprised 87.7 per cent. of total central Government debt, is denominated in currencies other than the Lat. Any significant devaluation of the Lat may have an adverse effect on Latvia's ability to repay its central Government debt denominated in foreign currencies, including the amounts due under the Notes.

In addition, as at 31 October 2012, private sector credit was LVL 10.4 billion (of which LVL 9.1 billion was foreign currency-denominated) and approximately LVL 2.5 billion of private sector deposits were foreign currency-denominated. Any devaluation of the Lat against foreign currencies would also therefore be likely to affect negatively the capacity of private sector borrowers to repay their debt and, as a result, adversely affect the financial and economic condition of Latvia in general.

Further, a devaluation of the Lat would not necessarily have a material positive effect on Latvia's current account, as a significant portion of the value of goods and services exported by Latvia reflects the cost of raw materials imported by Latvia which are denominated in other currencies, primarily the euro. Consequently, devaluation may not result in a significant decrease in the costs of Latvia's exports.

Any deterioration in Latvia's relations with its major energy suppliers may adversely affect the supply of energy resources and therefore have a negative effect on the Latvian economy

In 2011, Latvia was 33.1 per cent. self-sufficient in its energy requirements. As a result, Latvia imports a large percentage of its energy requirements, including all of its natural gas requirements, from Russia. Any significant increases in the prices of its major energy imports or adverse changes in relations with its major energy suppliers could have an adverse effect on certain sectors of Latvia's economy.

Latvia has significant debt repayment obligations in the next few years and any inability to obtain funding to meet those obligations could adversely affect Latvia in a number of ways

Latvia's central Government debt repayment obligations are LVL 553.4 million in 2013, LVL 1,152.5 million in 2014 and LVL 1,088.5 million in 2015, principally driven by the requirement to repay moneys advanced under the financial assistance package. Latvia currently expects to finance those repayments by borrowings in the international capital markets and elsewhere. In recent years, funding conditions in the international capital markets have been volatile, principally as a result of the ongoing European sovereign debt crisis. Should these conditions continue, Latvia may not be able to access the international capital markets at the times when it requires funding or may only be able to do so at a higher cost than it would otherwise be required to pay. In extreme cases, the need to make principal payments when other funding is not readily available could result in Latvia needing to negotiate with its creditors or seeking to obtain international financial assistance.

Official economic data may not be directly comparable with data produced by other sources

Although a range of Government ministries, including the Ministry of Finance, along with the Bank of Latvia and the Central Statistical Bureau, produce statistics on Latvia and its economy, there can be no assurance that these statistics are comparable with those compiled by other bodies, or in other countries, which use different methodologies. Prospective investors in the Notes should be aware that figures relating to Latvia's GDP and many other aggregate figures cited in this Offering Circular may differ from figures prepared by international bodies, such as the EU or the IMF, which may use different methodologies. In addition, the existence of an unofficial or unobserved economy may affect the accuracy

and reliability of statistical information. Prospective investors should be aware that none of the statistical information in this Offering Circular has been independently verified.

Risk Factors Relating to an Investment in the Notes

The Notes may not be a suitable investment for all investors

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained in this Offering Circular;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where the currency for principal or interest payments is different from the potential investor's currency;
- understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant financial markets; and
- be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

The Conditions of the Notes may be modified, waived or substituted without the consent of all the Noteholders

The Conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally and for the passing of written resolutions of Noteholders without the need for a meeting. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting or sign the relevant written resolution and Noteholders who voted in a manner contrary to the majority. Any such change in the Conditions of the Notes may adversely affect the trading price of the Notes.

The Conditions of the Notes contain a provision permitting the Notes and the Conditions of the Notes to be amended without the consent of the Noteholders to correct a manifest error or where the amendment is of a formal, minor or technical nature or is not materially prejudicial to the interests of the Noteholders.

The Conditions of the Notes restrict the ability of an individual holder to declare a default and permit a majority of holders to rescind a declaration of default

The Conditions of the Notes contain a provision which, if an Event of Default occurs, allows the holders of at least 25 per cent. in aggregate principal amount of the outstanding Notes to declare all the Notes to be immediately due and payable by providing notice in writing to the Republic, whereupon the Notes shall become immediately due and payable, at their principal amount with accrued interest, without further action or formality.

The Conditions of the Notes also contain a provision permitting the holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to notify the Republic to the effect that the Event of Default or Events of Default giving rise to any above-mentioned declaration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn. The Republic shall give notice thereof to the Noteholders, whereupon the relevant declaration shall be withdrawn and shall have no further effect.

The EU Savings Directive may result in certain holders not receiving the full amount of interest

Under EC Council Directive 2003/48/EC (the "**EU Savings Directive**") on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income (within the meaning of the EU Savings Directive) paid by a paying agent in the meaning of the EU Savings Directive within its jurisdiction to, or collected by such a paying agent for, an individual resident or certain limited types of entity established in that other Member State; however, for a transitional period, Austria and Luxembourg may instead apply a withholding

system in relation to such payments, deducting tax at a rate of 35 per cent., unless in the case of Luxembourg the beneficial owner of the interest payments opts for one of the two information exchange procedures available. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

A number of non-EU countries and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a paying agent within its jurisdiction to, or collected by such a paying agent for, an individual resident in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

The European Commission (the "**EC**") has proposed certain amendments to the EU Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Republic nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. The Republic is required to maintain a Paying Agent in a Member State that is not obliged to withhold or deduct tax pursuant to the EU Savings Directive.

The law governing the Conditions of the Notes may change

The Conditions of the Notes are based on English law in effect as at the date of this Offering Circular. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Offering Circular.

There may be no active trading market for the Notes

Although an application has been made to list on the Official List of the Luxembourg Stock Exchange and to trade the Notes on the Luxembourg Stock Exchange's regulated market, there is no assurance that such application will be accepted or that an active trading market for the Notes will develop or, if one does develop, that it will be liquid or maintained. If an active trading market in the Notes does not develop or is not maintained, the market price and liquidity of the Notes may be adversely affected.

The market for securities issued by the Republic is influenced by economic and market conditions in Latvia and, to a varying degree, economic conditions in other Eastern European markets as well as global, emerging and developed markets generally. There can be no assurance that events which would cause volatility of the sort that occurred in worldwide financial markets in 1998 and 2008 will not occur again, or that any such volatility will not adversely affect the price or liquidity of the Notes.

In addition, if the Notes are traded after their initial issuance, they may trade at a discount to their initial offering price, depending upon prevailing interest rates, the market for similar securities, general economic conditions and the financial condition of the Republic. As a result of the above factors, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market.

A claimant may not be able to enforce a court judgment against certain assets of the Republic in certain jurisdictions

Latvia is a sovereign state. Consequently, it may be difficult for investors to obtain judgments of courts in countries outside Latvia against the Republic. Enforcement of such judgments in Latvia may be refused in certain circumstances in the absence of an applicable treaty facilitating such enforcement. There is also a risk that, notwithstanding the waiver of sovereign immunity by the Republic (see further Condition 17(g) for the extent to which sovereign immunity is waived), a claimant will not be able to enforce a court judgment against certain assets of the Republic in certain jurisdictions (including the imposition of any arrest order or attachment or seizure of such assets and their subsequent sale) without the Republic having specifically consented to such enforcement at the time when the enforcement is sought.

The foreign exchange reserves of Latvia are controlled and administered by the Bank of Latvia, which is an independent central bank legally distinct from the Government. Accordingly, such reserves would not be available to satisfy any claim or judgment in respect of the Notes.

Court judgements in Latvia

Any judgment obtained in a court in Latvia against the Issuer by a holder of any Note would be expressed in the lawful currency of the Republic of Latvia.

Fluctuations in exchange rates and interest rates may adversely affect the value of the Notes

The Republic will pay principal and interest on the Notes in U.S. dollars. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than U.S. dollars. These include the risk that exchange rates may significantly change (including changes due to devaluation of the U.S. dollar or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the U.S. dollar would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency-equivalent value of the principal payable on the Notes and (3) the Investor's Currency-equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal. In addition, investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Notes are legal investments for it, (2) the Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of the Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

Credit ratings may not reflect all risks

Moody's, S&P's and Fitch are expected to assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. Fitch, Moody's and S&P are established in the European Union and are registered under the CRA Regulation. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

In general, European regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU registered credit rating agency or the relevant non EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended).

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the Terms and Conditions of the Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the Notes:

The U.S.$1,250,000,000 2.750 per cent. Notes due 2020 (the "**Notes**", which expressions includes any further notes issued pursuant to Condition 15 (*Further Issues*) and forming a single series therewith) of the Republic of Latvia, acting through the Treasury (the "**Republic**") are the subject of a fiscal agency agreement dated 12 December 2012 (as amended or supplemented from time to time, the "**Fiscal Agency Agreement**") between the Republic, Deutsche Bank AG, London Branch as fiscal agent (the "**Fiscal Agent**", which expression includes any successor fiscal agent appointed from time to time in connection with the Notes), Deutsche Bank Luxembourg S.A. as non-US registrar (the "**Non-US Registrar**", which expression includes any successor non-US registrar appointed from time to time in connection with the Notes), Deutsche Bank Trust Company Americas as US registrar (the "**US Registrar**"), which expression includes any successor US registrar appointed from time to time in connection with the Notes, and together with the Non-US Registrar, the "**Registrars**"), the transfer agents named therein (the "**Transfer Agents**", which expression includes any successor or additional transfer agents appointed from time to time in connection with the Notes) and the paying agents named therein (together with the Fiscal Agent, the "**Paying Agents**", which expression includes any successor or additional paying agents appointed from time to time in connection with the Notes). Certain provisions of these Conditions are summaries of the Fiscal Agency Agreement and subject to its detailed provisions. The holders of the Notes (the "**Noteholders**") are entitled to the benefit of a deed of covenant dated 12 December 2012 (the "**Deed of Covenant**") and made by the Republic. The original of the Deed of Covenant is held by the Fiscal Agent on behalf of the Noteholders at its specified office. The holders of the Notes (the "**Noteholders**") are bound by, and are deemed to have notice of, all the provisions of the Fiscal Agency Agreement and the Deed of Covenant applicable to them. Copies of the Fiscal Agency Agreement are available for inspection during normal business hours at the Specified Offices (as defined in the Fiscal Agency Agreement) of each of the Paying Agents, the initial Specified Offices of which are set out below. References in these Conditions to the Fiscal Agent, the Registrar, the Paying Agents and the Agents shall include any successor appointed under the Fiscal Agency Agreement.

*The owners shown in the records of Euroclear Bank SA/NV ("**Euroclear**"), Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**") and the Depository Trust Company ("**DTC**") of book-entry interests in Notes are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Fiscal Agency Agreement applicable to them.*

1. **Form, Denomination and Title**

(a) ***Form and denomination***

The Notes are issued in registered form in amounts of U.S.$200,000 and integral multiples of U.S.$1,000 in excess thereof (referred to as the "**principal amount**" of a Note). A note certificate (each a "**Certificate**") will be issued to each Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the Register (as defined below) which the Republic will procure to be kept by the Registrar.

The Notes are not issuable in bearer form.

(b) ***Title***

Each Registrar will maintain a register (the "**Register**") in respect of the Notes in accordance with the provisions of the Fiscal Agency Agreement. Title to the Notes passes only by registration in the Register. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions "**Noteholder**" and (in relation to a Note) "**holder**" means the person in whose name a Note is registered in the Register.

For a description of the procedures for transferring title to book-entry interests in the Notes, see the Fiscal Agency Agreement and Condition 2.

2. **Transfers of Notes and Issue of Certificates**

(a) ***Transfers***

A Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed, at the specified office of the Registrar or any of the Agents.

For a description of certain restrictions on transfers of interests in the Notes, see ''Transfer Restrictions'' and the Fiscal Agency Agreement.

(b) ***Delivery of new Certificates***

Each new Certificate to be issued upon transfer of Notes will, within five business days of receipt by the Registrar or the relevant Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, ''**business day**'' shall mean a day on which commercial banks and foreign exchange markets are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer is located.

Except in the limited circumstances described herein (see ''The Global Certificates – Registration of Title'' and ''The Global Certificates – Exchange For Certificates'') owners of interests in the Notes will not be entitled to receive physical delivery of Certificates. Issues of Certificates upon transfer of Notes are subject to compliance by the transferor and transferee with the certification procedures described above and in the Fiscal Agency Agreement and, in the case of Restricted Notes, compliance with the Securities Act legend as set out under ''Subscription and Sale''.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the Register or as specified in the form of transfer.

(c) ***Formalities free of charge***

Registration of transfer of Notes will be effected without charge by or on behalf of the Republic or any Agent but upon payment (or the giving of such indemnity as the Republic or any Agent may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

(d) ***Closed periods***

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal, premium or interest on that Note.

(e) ***Regulations***

All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Fiscal Agency Agreement. The regulations may be changed by the Republic with the prior written approval of the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3. **Status**

The Notes constitute direct, general, (subject to the provisions of Condition 4 (*Negative Pledge*) unsecured and unconditional obligations of the Republic and will at all times rank *pari passu* and without any preference among themselves. The full faith and credit of the Republic is pledged for the due and punctual payment of the principal of, and interest on, the Notes and the performance of all the Republic's other obligations under the Notes. The payment obligations of the Republic under the Notes will at all times rank at least equally with all the other present and future unsecured and unsubordinated indebtedness of the Republic.

4. **Negative Pledge**

So long as any of the Notes remains outstanding the Republic will not grant or permit to be outstanding, and will procure that there is not granted or permitted to be outstanding, any mortgage, charge, lien, pledge or other security interest over any of its present or future assets or revenues or upon the official external reserves of the Republic (which expression includes the gold and the reserves of the Republic by whomsoever and in whatever form owned or held or customarily regarded and held out as the official external reserves thereof) or any part thereof, to secure any Relevant Indebtedness or any guarantee thereof unless the Republic shall, in the case of the granting of the security, before or at the same time, and in any other case, promptly, procure that all amounts payable in respect of the Notes are secured equally and rateably, or such other security or other arrangement is provided as shall be approved by an Extraordinary Resolution (as defined in the Fiscal Agency Agreement) of the Noteholders.

For this purpose, "**Relevant Indebtedness**" means any indebtedness, present or future, (A) evidenced by notes, bonds or other similar instruments which are or may be quoted, listed or ordinarily purchased and sold on any stock exchange and (B) which is not listed on the NASDAQ OMX Riga (or any successor Latvian stock exchange) and issued in dematerialised form into the Latvian Central Depositary system.

5. **Interest**

(a) ***Interest rate and Interest Payment Dates***

Each Note bears interest on its outstanding principal amount from, and including, 12 December 2012 (the "**Issue Date**") at the rate of 2.750 per cent. per annum, such interest (except for the first payment) being payable semi-annually in arrear on 12 January and 12 July in each year (each, an "**Interest Payment Date**"), subject as provided in Condition 7 (*Payments*). The first payment of interest on the Notes will be made in respect of the period from and including the Issue Date to but excluding 12 July 2013 and will be paid on 12 July 2013.

(b) ***Interest accrual***

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment. In such event, interest will continue to accrue until whichever is the earlier of:

(i) the date on which all amounts due in respect of such Note have been paid; and

(ii) the day on which notice has been given to the Noteholders that the Fiscal Agent or the Registrar has received all sums due in respect of the Notes up to such day (except, in the case of payment to the Fiscal Agent or the Registrar to the extent that there is any subsequent default in payment in accordance with these Conditions).

(c) ***Calculation of broken interest***

The amount of interest payable per U.S$1,000 nominal amount of Notes on any Interest Payment Date (except the first Interest Payment Date) shall be U.S.$13.75. The amount of interest payable per U.S.$1,000 nominal amount of Notes on the first Interest Payment Date shall be U.S.$16.04. When interest is required to be calculated in respect of any other period of less than a half-year, it shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

6. **Redemption Purchase**

(a) ***Scheduled redemption***

Unless previously redeemed, repaid or purchased and cancelled, the Republic will redeem the Notes at their principal amount on 12 January 2020, subject as provided in Condition 7 (*Payments*).

(b) ***Purchase and cancellation***

The Republic and its Agencies may at any time purchase Notes in the open market or otherwise and at any price. Any Notes so purchased, while held by or on behalf of the Republic or any Agency, shall not entitle the holder to vote at any meeting of Noteholders and shall not be deemed to be outstanding for the purposes of calculating quorums at meetings of Noteholders.

Any Notes so purchased may be cancelled or held and resold by the Republic. Any Notes so cancelled will not be reissued or resold.

In this Condition 6(b), "**Agency**" means any political sub-division, regional government, ministry, department, authority or statutory corporation of the Republic and the government thereof (whether or not such statutory corporation is autonomous) and "**Agencies**" shall be construed accordingly.

7. **Payments**

(a) ***Payments in respect of Notes***

Payment of principal and interest will be made by transfer to the registered account of the Noteholder or by U.S.$ cheque drawn on a bank that processes payments in U.S.$ mailed to the registered address of the Noteholder if it does not have a registered account. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of any of the Agents.

Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the Register at the close of business on the date (the "**record date**") being the fifteenth day before the due date for the payment of interest.

For the purposes of this Condition 7(a), a Noteholder's registered account means the U.S.$ account maintained by or on behalf of it with a bank that processes payments in U.S.$, details of which appear on the Register at the close of business, in the case of principal, on the second Business Day (as defined below) before the due date for payment and, in the case of interest, on the relevant record date, and a Noteholder's registered address means its address appearing on the Register at that time.

(b) ***Payments subject to applicable laws***

Payments in respect of principal and interest on Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 8 (*Taxation*).

(c) ***Payment on Business Days***

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day (as defined below), for value the first following day which is a Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed, on the Business Day preceding the due date for payment or, in the case of a payment of principal or a payment of interest due otherwise than on an Interest Payment Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition arrives after the due date for payment.

In this Condition 7 (*Payments*) "**Business Day**" means a day (other than a Saturday or Sunday) on which commercial banks are open for business in London, New York City and, in the case of presentation of a Note Certificate, in the place in which the Note Certificate is presented.

(d) ***Partial Payments***

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the Register with a record of the amount of principal, premium (if any) or interest in fact paid.

8. **Taxation**

All payments of principal and interest in respect of the Notes shall be made without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature imposed, levied, collected, withheld or assessed by the Republic of Latvia or any political sub-division or any authority thereof or therein having power to tax (together, "**Taxes**"), unless such withholding or deduction is required by law. In that event, the Republic shall pay such additional amounts as will result in the receipt by the Noteholders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such additional amounts shall be payable in respect of any Note:

(a) presented for payment by a holder which is liable to such Taxes in respect of such Note by reason of its having some connection with the Republic of Latvia other than the mere holding of such Note; or

(b) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(c) presented for payment by or on behalf of a holder who would not be liable for or subject to such withholding or deduction (A) by making a declaration of non-residence or other similar claim for exemption to the relevant tax authority if, after having been requested to make such a declaration or claim, such holder fails to do so, or (B) by presenting the relevant Note to another Paying Agent in a member state of the European Union; or

(d) presented for payment more than 30 days after the Relevant Date except to the extent that the relevant holder would have been entitled to such additional amounts if it had presented such Note on the last day of such period of 30 days.

In these Conditions, "**Relevant Date**" means whichever is the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received by the Fiscal Agent as provided in the Fiscal Agency Agreement on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders.

Any reference in these Conditions to principal or interest shall be deemed to include any additional amounts in respect of principal or interest (as the case may be) which may be payable under this Condition.

9. **Events of Default**

If either of the following events (each an "**Event of Default**") occurs and is continuing:

(a) ***Non-payment***

Any default is made in the payment of any interest due in respect of the Notes or any of them when due and the default continues for a period of 14 days; or

(b) ***Breach of other obligations or undertakings***

The Republic fails to perform or observe any of its other obligations under these Conditions and (except in any case where the failure is incapable of remedy when no continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 45 days next following the service by any Noteholder on the Republic of notice requiring the same to be remedied,

then the holders of at least 25 per cent. in aggregate principal amount of the outstanding Notes may, by notice in writing to the Republic (with a copy to the Fiscal Agent), declare all the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their

principal amount together with accrued interest without further action or formality. Notice of any such declaration shall promptly be given to all other Noteholders by the Republic.

If the Republic receives notice in writing from holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to the effect that the Event of Default or Events of Default giving rise to the above mentioned declaration of acceleration is or are cured following any such declaration, the Republic shall give notice thereof in writing to the Noteholders (with a copy to the Fiscal Agent), the Notes shall cease to be due and payable. No such rescission shall affect any other or any subsequent Event of Default or any right of any Noteholder in relation thereto.

10. **Prescription**

Claims for principal shall become void unless the relevant Notes are presented for payment within ten years of the appropriate Relevant Date. Claims for interest shall become void unless the relevant Notes are presented for payment within five years of the appropriate Relevant Date.

11. **Replacement of Certificates**

If any Note is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the Fiscal Agent, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Republic and the Fiscal Agent may require. Mutilated or defaced Notes must be surrendered before replacements will be issued.

12. **Paying Agents**

In acting under the Fiscal Agency Agreement and in connection with the Notes, the Paying Agents act solely as agents of the Republic and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders.

The initial Paying Agents and their initial Specified Offices are listed below. The Republic reserves the right at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor fiscal agent and additional or successor paying agents; *provided, however, that* the Republic shall at all times maintain (a) a fiscal agent and (b) a paying agent in a member state (if any) of the European Union that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC.

Notice of any change in any of the Paying Agents or in their Specified Offices shall promptly be given to the Noteholders in accordance with Condition 16 (*Notices*) below.

13. **Meetings of Noteholders; Written Resolutions**

(a) ***Convening meetings of Noteholders***

The Fiscal Agency Agreement contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions or the provisions of the Fiscal Agency Agreement. Such a meeting may be convened by the Republic and shall be convened by the Republic at any time upon the request in writing of holders of at least 10 per cent. of the aggregate principal amount of the outstanding Notes.

(b) ***Quorum***

The quorum at any meeting of Noteholders convened to vote on an Extraordinary Resolution (as defined below) will be:

(i) one or more persons present and holding or representing at least 50 per cent. of the aggregate principal amount of the outstanding Notes; or

(ii) where a meeting is adjourned and rescheduled owing to a lack of quorum, at any rescheduled meeting of Noteholders, one or more persons present and holding or representing at least 25 per cent. of the aggregate principal amount of the outstanding Notes; *provided, however, that* any proposals relating to a Reserved Matter (as defined below) may only be approved by an Extraordinary Resolution passed at a meeting of Noteholders at which one or more persons present and holding or representing at least 75 per cent. of the aggregate principal amount of the outstanding Notes form a quorum.

(c) ***Reserved Matters***

In these Conditions, "**Reserved Matter**" means any proposal:

(i) to change the date, or the method of determining the date, for payment of principal, interest or any other amount in respect of the Notes, to reduce or cancel the amount of principal, interest or any other amount payable on any date in respect of the Notes or to change the method of calculating the amount of principal, interest or any other amount payable in respect of the Notes on any date;

(ii) to change the currency in which any amount due in respect of the Notes is payable;

(iii) to change the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, Written Resolution or any other resolution of Noteholders or the number or percentage of votes required to be cast, or the number or percentage of Notes required to be held, in connection with the taking of any decision or action by or on behalf of the Noteholders or any of them;

(iv) to change this definition, the definition of "**Extraordinary Resolution**", the definition of "**outstanding**" or the definition of "**Written Resolution**" in these Conditions or in the Fiscal Agency Agreement;

(v) to change or waive the provisions of the Notes set out in Condition 3 (*Status*);

(vi) to change the law governing the Notes, the courts to the jurisdiction of which the Republic has submitted in the Notes, the Republic's obligation to maintain an agent for service of process in England or the Republic's waiver of immunity, in respect of actions or proceedings brought by any Noteholder, set out in Condition 17 (*Governing Law and Jurisdiction*);

(vii) to approve any exchange or substitution of the Notes for, or the conversion of the Notes into, any other obligations or securities of the Republic or any other person; or

(viii) in connection with any proposed exchange, substitution or conversion of the type referred to in paragraph (vii) to amend any of the provisions of the Notes describing circumstances in which Notes may be redeemed or declared due and payable prior to their scheduled maturity date.

(d) ***Modifications***

Any modification of any provision of these Conditions may be made if approved by an Extraordinary Resolution or a Written Resolution (as defined below). In these Conditions,

"**Extraordinary Resolution**" means a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least:

(i) in the case of a Reserved Matter, 75 per cent. of the aggregate principal amount of the outstanding Notes; or

(ii) in the case of a matter other than a Reserved Matter, $66^2/_3$ per cent. of the aggregate principal amount of the outstanding Notes which are represented at that meeting. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and whether they voted in favour or not.

(e) ***Written Resolutions***

In addition, the Fiscal Agency Agreement contains provisions relating to Written Resolutions. A "**Written Resolution**" is a resolution in writing signed by or on behalf of the holders of at least 75 per cent. of the principal amount of the outstanding Notes, in the case of a Reserved Matter, or $66^2/_3$ per cent. of the principal amount of the outstanding Notes, in the case of a matter other than a Reserved Matter. Any Written Resolution may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders. Any Written Resolution shall be binding on all of the Noteholders, whether or not signed by them.

(f) ***Manifest error, etc.***

The Notes, these Conditions and the provisions of the Fiscal Agency Agreement may be amended without the consent of the Noteholders to correct a manifest error. In addition, the parties to the Fiscal Agency Agreement may agree to modify any provision thereof, but the Republic shall not agree, without the consent of the Noteholders, to any such modification unless it is of a formal, minor or technical nature or it is not materially prejudicial to the interests of the Noteholders.

(g) ***Outstanding Notes***

For the purposes of (i) ascertaining the right to attend and vote at any meeting of Noteholders, (ii) this Condition 13 (*Meetings of Noteholders; Written Resolutions*) and Schedule 5 to the Fiscal Agency Agreement, (iii) Condition 14 (*Noteholders' Representative Committee*) and (iv) Condition 9 (*Events of Default*), those Notes (if any) which are for the time being held by or on behalf of the Republic or by any person owned or controlled directly or indirectly by the Republic, or by any public sector instrumentality of the Republic shall (unless and until ceasing to be so held) be disregarded and be deemed not to remain outstanding. "**Public sector instrumentality**" means the Republic of Latvia, any department, ministry or agency of the government of the Republic of Latvia or any corporation, trust, financial institution or other entity owned or controlled by the government of the Republic of Latvia. "**Control**" means the power, directly or indirectly, through the ownership of voting securities or other ownership interests or otherwise, to direct the management of or elect or appoint a majority of the board of directors or other persons performing similar functions in lieu of, or in addition to, the board of directors of a corporation, trust, financial institution or other entity.

(h) ***Written requests etc.***

Before any request is made or notice is delivered or Written Resolution is signed by any Noteholder in accordance with the provisions of this Condition or Conditions 14 (*Noteholders' Representative Committee*) or 9 (*Events of Default*), the relevant Noteholder must deposit its Notes with any Paying Agent and obtain two copies of an acknowledgment of receipt (an "**Acknowledgment**") signed and dated by the relevant Paying Agent and certifying the principal amount of Notes so deposited. Any request so made, notice so given or Written Resolution so signed by any Noteholder must be accompanied by an Acknowledgment issued to the Noteholder. Notes so deposited will not be released until the earlier of (i) the thirtieth day after the date of deposit and (ii) the request, notice or Written Resolution becoming effective in accordance with these Conditions and will only be released against surrender of a relevant Acknowledgment.

14. **Noteholders' Representative Committee**

(a) ***Appointment***

The Noteholders may, by a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, or by notice in writing to the Republic (with a copy to the Fiscal Agent) signed by or on behalf of the holders of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, appoint any person or persons as a committee to represent the interests of the Noteholders if any of the following events has occurred:

(i) an Event of Default;

(ii) any event or circumstance which could, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfilment of any other requirement provided for in Condition 9 (*Events of Default*) become an Event of Default; or

(iii) any official public announcement by the Republic to the effect that the Republic is seeking or intends to seek a restructuring of the Notes (whether by amendment, exchange offer or otherwise),

provided, however, that no such appointment shall be effective if the holders of more than 25 per cent. of the principal amount of the outstanding Notes have either (A) objected to such appointment by notice in writing to the Republic (with a copy to the Fiscal Agent) during a

specified period following notice of the appointment being given (if such notice of appointment is made by notice in writing to the Republic) where such specified period shall be either 30 days or such other longer or shorter period as the committee may, acting in good faith, determine to be appropriate in the circumstances, or (B) voted against such resolution at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement.

(b) ***Powers***

Such committee shall, if appointed by notice in writing to the Republic, give notice of its appointment to all Noteholders in accordance with Condition 16 (*Notices*) as soon as practicable after the notice is delivered to the Republic. Such committee in its discretion may, among other things, (i) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders, (ii) adopt such rules as it considers appropriate regarding its proceedings and (iii) enter into discussions with the Republic and/or other creditors of the Republic. The Republic shall pay any agreed fees and expenses of any such committee (including, without limitation, the costs of giving notices to Noteholders and the agreed fees and expenses of the committee's legal advisers and financial advisers, if any) within 30 days of the delivery to the Republic of a reasonably detailed invoice and supporting documentation.

15. **Further Issues**

The Republic may from time to time, without the consent of the Noteholders, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects except for the amount and date of the first payment of interest) so as to form a single series with the Notes *provided, however, that* the Notes are either (i) not issued with original issue discount, (ii) issued with less than a *de minimis* amount of original issue discount, or (iii) issued in a ''qualified reopening'' for U.S. federal income tax purposes.

16. **Notices**

Notices to the Noteholders shall be valid if published (i) in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort* or the *Tageblatt*) or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe or (ii) to the extent and in the manner permitted by the rules and regulations of the Luxembourg Stock Exchange, by posting such notices on the official website of the Luxembourg Stock Exchange (www.bourse.lu). Any such notice shall be deemed to have been given on the date of first publication or, if so published more than once on different dates, on the date of the first publication.

All notices to the Republic will be valid if sent to the Republic at the Treasury of the Republic of Latvia, Riga or such other address as may be notified by the Republic to the Noteholders in accordance with the above paragraph of this Condition.

17. **Governing Law and Jurisdiction**

(a) ***Governing law***

The Notes and any non-contractual obligations arising out of or in connection with them are governed by English law.

(b) ***Jurisdiction***

The Republic agrees for the benefit of the Noteholders that the courts of England shall have jurisdiction to hear and determine any suit, action or proceedings, and to settle any disputes, which may arise out of or in connection with the Notes (respectively, ''**Proceedings**'' and ''**Disputes**'') and, for such purposes, irrevocably submits to the jurisdiction of such courts.

(c) ***Appropriate forum***

The Republic irrevocably waives any objection which it might now or hereafter have to the courts of England being nominated as the forum to hear and determine any Proceedings and to settle any Disputes, and agrees not to claim that any such court is not a convenient or appropriate forum.

(d) ***Service of process***

The Republic irrevocably appoints the Ambassador of the Republic of Latvia to the Court of St. James's as its authorised agent for the service of process in England in respect of any Proceedings or Disputes. Nothing in this paragraph shall affect the right of any Noteholder to serve process in any other manner permitted by law.

(e) ***Non-exclusivity***

The submission to the jurisdiction of the courts of England shall not (and shall not be construed so as to) limit the right of any Noteholder to take Proceedings in any other court of competent jurisdiction, nor shall the taking of Proceedings in any one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not) if and to the extent permitted by law.

(f) ***Consent to enforcement etc***

For the purposes of the State Immunity Act 1978, the Republic consents generally in respect of any Proceedings to the giving of any relief or the issue of any process in connection with such Proceedings including (without limitation) the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use) of any order or judgment which may be made or given in such Proceedings.

(g) ***Waiver of immunity***

To the extent that the Republic may in any jurisdiction claim for itself or its assets or revenues immunity from suit, execution, attachment (whether in aid of execution, before judgment or otherwise and whether or not on the grounds of sovereignty or otherwise) or other legal process and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Republic or its assets or revenues, the Republic agrees not to claim and irrevocably waives such immunity to the full extent permitted by the laws of such jurisdiction *provided, however, that* immunity is not waived in respect of present or future "premises of the mission" as defined in the Vienna Convention on Diplomatic Relations signed in 1961, "consular premises" as defined in the Vienna Convention on Consular Relations signed in 1963 or military property or military assets or property or assets of the Republic related thereto.

There will appear at the foot of the Conditions endorsed on each Note in definitive form the names and Specified Offices of the Paying Agents as set out at the end of this Offering Circular.

THE GLOBAL CERTIFICATES

The Global Certificates contain the following provisions which apply to the Notes in respect of which they are issued whilst they are represented by the Global Certificates, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning in paragraphs 1 to 7 below.

1. FORM OF THE NOTES

The Notes sold in reliance on Regulation S under the Securities Act will be represented on issue by the Unrestricted Global Certificate, which will be deposited with, and registered in the name of a nominee for the common depositary for, Euroclear and Clearstream, Luxembourg. Beneficial interests in an Unrestricted Global Certificate may be held only through Euroclear or Clearstream, Luxembourg or their participants at any time. By acquisition of a beneficial interest in the Unrestricted Global Certificate, the purchaser thereof will be deemed to represent, among other things, that it acquired such beneficial interest in accordance with Regulation S and that it will only offer, sell, pledge or otherwise transfer such beneficial interest in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S. See "*Subscription and Sale*" and "*Transfer Restrictions*".

The Notes sold in reliance on Rule 144A will be represented on issue by the Restricted Global Certificate, which will be deposited with a custodian for, and registered in the name of a nominee of, DTC. Beneficial interests in a Restricted Global Certificate may only be held through DTC or its participants at any time. Beneficial interests in a Restricted Global Certificate may only be held by persons who are QIBs, holding their interests for their own account or for the account of one or more QIBs. By acquisition of a beneficial interest in a Restricted Global Certificate, the purchaser thereof will be deemed to represent, among other things, that it is a QIB and that, if in the future it determines to transfer such beneficial interest, it will transfer such interest in accordance with the procedures and restrictions contained in the Restricted Global Certificate. See "*Subscription and Sale*".

Beneficial interests in Global Certificates will be subject to certain restrictions on transfer set out therein and under "*Transfer Restrictions*" and in the Fiscal Agency Agreement and such Global Certificates will bear a legend as set out under "*Subscription and Sale*". On or prior to the 40th day after the later of the commencement of the offering and the Issue Date, ownership of interests in an Unrestricted Global Certificate will be limited to persons who have accounts with Euroclear or Clearstream, Luxembourg, or persons who hold interests through Euroclear or Clearstream, Luxembourg, and any sale or transfer of such interests to U.S. persons shall not be permitted during such period unless such resale or transfer is made pursuant to Rule 144A as provided below.

No beneficial interest in an Unrestricted Global Certificate may be transferred to a person who takes delivery in the form of a beneficial interest in a Restricted Global Certificate unless (i) the transfer is to a person that is a QIB, (ii) such transfer is made in reliance on Rule 144A, and (iii) the transferor provides the Registrar with a written certification substantially in the form set out in the Fiscal Agency Agreement to the effect that the transferor reasonably believes that the transferee is a QIB, that the transfer is being made in a transaction meeting the requirements of Rule 144A and that such transaction is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction. No beneficial interest in the Restricted Global Certificate may be transferred to a person who takes delivery in the form of a beneficial interest in an Unrestricted Global Certificate unless the transfer is to a non-U.S. person in an offshore transaction in reliance on Regulation S and the transferor provides the Registrar with a written certification substantially in the form set out in the Fiscal Agency Agreement to the effect that the transfer is being made to a person who is a non-U.S. person in accordance with Regulation S.

Any beneficial interest in an Unrestricted Global Certificate that is transferred to a person who takes delivery in the form of an interest in a Restricted Global Certificate will, upon transfer, cease to be an interest in such Unrestricted Global Certificate and become an interest in the Restricted Global Certificate, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in a Restricted Global Certificate for as long as it remains such an interest. Any beneficial interest in a Restricted Global Certificate that is transferred to a person who takes delivery in the form of an interest in an Unrestricted Global Certificate will, upon transfer, cease to be an interest in each Restricted Global Certificate and become an interest in the Unrestricted Global Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in an Unrestricted Global

Certificate for so long as it remains such an interest. No service charge will be made for any registration of transfer or exchange of Notes, but the Republic may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

Except in the limited circumstances described below, owners of beneficial interests in the Global Certificates will not be entitled to receive physical delivery of Notes.

2. **ACCOUNTHOLDERS**

For so long as any of the Notes are represented by the Global Certificates, each person (other than another clearing system) who is for the time being shown in the records of DTC or Euroclear or Clearstream, Luxembourg (as the case may be) as the holder of a particular aggregate principal amount of such Notes (each an "**Accountholder**") (in which regard any certificate or other document issued by DTC or Euroclear or Clearstream, Luxembourg (as the case may be) as to the aggregate principal amount of such Notes standing to the account of any person shall be conclusive and binding for all purposes) shall be treated as the holder of such aggregate principal amount of such Notes (and the expression "**Noteholders**" and references to "**holding of Notes**" and to "**holder of Notes**" shall be construed accordingly) for all purposes other than with respect to payments on such Notes, the right to which shall be vested, as against the Republic, solely in the nominee for the relevant clearing system (the "**Relevant Nominee**") in accordance with and subject to the terms of the Global Certificates. Each Accountholder must look solely to DTC or Euroclear or Clearstream, Luxembourg, as the case may be, for its share of each payment made to the Relevant Nominee.

3. **CANCELLATION**

Cancellation of any Note following its redemption or purchase by the Republic will be effected by reduction in the aggregate principal amount of the Notes in the Register and by the annotation of the appropriate schedule to the relevant Global Certificate.

4. **PAYMENTS**

Payments of principal and interest in respect of Notes represented by a Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the Notes, against presentation and surrender of such Global Certificate to or to the order of the Fiscal Agent or such other Agent as shall have been notified to the holders of the Global Certificates for such purpose.

Distributions of amounts with respect to book-entry interests in the Unrestricted Notes held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by the Fiscal Agent, to the cash accounts of Euroclear or Clearstream, Luxembourg participants in accordance with the relevant system's rules and procedures.

Holders of book-entry interests in the Restricted Notes holding through DTC will receive, to the extent received by the Fiscal Agent, all distribution of amounts with respect to book-entry interests in such Notes from the Fiscal Agent through DTC. Distributions in the United States will be subject to relevant U.S. tax laws and regulations.

A record of each payment made will be endorsed on the appropriate schedule to the relevant Global Certificate by or on behalf of the Fiscal Agent and shall be *prima facie* evidence that payment has been made.

Each payment in respect of a Global Certificate will be made to the person shown as the Noteholder in the Register at the close of business on the Clearing System Business Day before the due date for such payment (the "**record date**"), where "**Clearing System Business Day**" means a day on which each clearing system for which the Global Certificate is being held is open for business.

5. **NOTICES**

So long as the Notes are represented by a Global Certificate and such Global Certificate is held on behalf of a clearing system, notices to Noteholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled Accountholders in substitution for notification as required by Condition 16 (*Notices*) except that, so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that Exchange so require, notices shall also be published in a daily newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort* or the *Tageblatt*). Any such notice shall be deemed to have been given to the

Noteholders on the second day after the day on which such notice is delivered to Euroclear and/or Clearstream, Luxembourg (as the case may be) as aforesaid.

Whilst any of the Notes held by a Noteholder are represented by a Global Certificate, notices to be given by such Noteholder may be given by such Noteholder (where applicable) through Euroclear and/or Clearstream, Luxembourg and otherwise in such manner as the Fiscal Agent and Euroclear and Clearstream, Luxembourg may approve for this purpose.

6. REGISTRATION OF TITLE

The Registrar will not register title to the Notes in a name other than that of the Relevant Nominee for a period of 15 calendar days preceding the due date for any payment of principal, or interest in respect of the Notes.

7. EXCHANGE FOR CERTIFICATES

(a) ***Exchange***

Each Restricted Global Certificate will be exchangeable, free of charge to the holder, in whole but not in part, for Restricted Certificates and each Unrestricted Global Certificate will be exchangeable, free of charge to the holder, in whole but not in part, for Unrestricted Certificates upon the occurrence of an Exchange Event.

For these purposes an "**Exchange Event**" means that:

(i) circumstances described in Condition 9 (*Events of Default*) have occurred;

(ii) in the case of an Unrestricted Global Certificate only, if Euroclear and/or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announces that it is permanently to cease business or does in fact do so and no successor or alternative clearing system is available; or

(iii) in the case of a Restricted Global Certificate only, if DTC notifies the Republic that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the relevant Global Certificate or DTC ceases to be a "clearing agency" registered under the U.S. Securities Exchange Act of 1934, as amended (the "**Exchange Act**") or is at any time no longer eligible to act as such and no qualified successor clearing system has been identified within 90 days of receipt of such notice from DTC, *provided that*, in the case of any exchange pursuant to (b) or (c) above, the holder has given the Registrar not less than 30 days' notice at its specified office of such holder's intention to effect such exchange.

In exchange for the relevant Global Certificate, as provided in the Fiscal Agency Agreement, the Registrar will deliver or procure the delivery of an equal aggregate principal amount of duly executed Certificates in or substantially in the form set out in the Fiscal Agency Agreement.

(b) ***Delivery***

In such circumstances, the relevant Global Certificate shall be exchanged in full for Certificates and the Republic will, at the cost of the Republic (but against such indemnity as the Registrar or Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Certificates to be executed and delivered to the Registrar for completion and dispatch to the relevant Noteholders. A person having an interest in a Global Certificate must provide the Registrar with (a) a written order containing instructions and such other information as the Republic and the Registrar may require to complete, execute and deliver such Certificates and (b) in the case of the Restricted Global Certificate only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A to a purchaser that the transferor reasonably believes to be a QIB. Certificates issued in exchange for a beneficial interest in the Restricted Global Certificate shall bear the legend applicable to transfers pursuant to Rule 144A, as set out under "*Subscription and Sale*".

(c) ***Legends and transfers***

The holder of a Certificate may transfer the Notes represented thereby in whole or in part in the applicable denomination by surrendering it at the specified office of any Transfer Agent, together with the completed form of transfer thereon. Upon the transfer, exchange or replacement of a Certificate bearing the legend referred to under "*Subscription and Sale*", or upon specific request for removal of the legend on a Certificate, the Republic will deliver only Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Republic and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Republic that neither the legend nor the restrictions on transfer set out therein are required to ensure compliance with the provisions of the Securities Act. Restricted Certificates will bear the same legend as the legend for the Restricted Global Certificates set out under "*Subscription and Sale*". The Restricted Certificates may not at any time be held by or on behalf of U.S. persons that are not QIBs. Before any Unrestricted Certificate may be offered, resold, pledged or otherwise transferred to a person who takes delivery in the form of a Restricted Certificate, the transferor and/or transferee, as applicable, will be required to provide the Registrar with a written certification substantially in the form set out in the Fiscal Agency Agreement to the effect that the transferor reasonably believes that the transfer is (i) to a person that is a QIB and (ii) such transfer is made in reliance on Rule 144A. Unrestricted Certificates will bear the same legend as the legend for the Unrestricted Global Certificates set out under "*Subscription and Sale*". Before any Restricted Certificates may be offered, resold, pledged or otherwise transferred to a person who takes delivery in the form of an Unrestricted Certificate, the transferor and/or transferee, as applicable, will be required to provide the relevant Registrar with a written certification substantially in the form set out in the Fiscal Agency Agreement to the effect that the transfer is being made to a person who is a non-U.S. person in accordance with Regulation S.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, expected to amount to U.S.$1,237,662,500, will be used for the refinancing of indebtedness and general funding purposes of the Republic.

DESCRIPTION OF THE REPUBLIC OF LATVIA

Geography and Population

Latvia is located in the Baltic region of northern Europe and is bordered by Estonia to the north, Russia to the east, Lithuania to the south and Belarus to the south-east. The western border of the country is the Baltic Sea, along which the country has a 498 km coastline. Latvia is divided into four historical districts: Kurzeme (western Latvia), Zemgale (southern Latvia), Vidzeme (northern Latvia) and Latgale (eastern Latvia). Latvia covers an area of approximately 64,559 km^2. The capital city is Riga.

The country is low lying and generally flat, rising steadily from west to east, reaching its highest point of 312 metres above sea level at GaizinaKalns. Latvia shares its longest border with Lithuania (588 km), followed by Estonia (343 km), Russia (276 km) and Belarus (161 km).

As at 1 January 2012, the total population of Latvia was approximately 2,041,800. Since early 2000, the total population has decreased by approximately 340,000 persons, or 14.3 per cent. of the population in early 2000, principally as a result of ageing, a low birth rate and emigration. In terms of age profile, 19.7 per cent. of the population was under 20 as at 1 January 2012, 55.7 per cent. was between 20 and 59 and 24.6 per cent. was aged 60 and over. The equivalent proportions at 1 January 2005 were 22.8 per cent., 54.6 per cent. and 22.2 per cent., respectively.

The urban/rural ratio of the total population has remained constant since 2000 with 68 per cent. of the total population living in urban areas as at 1 January 2012 and 32 per cent. in rural areas. The population density is 31.6 persons per square kilometre as of 1 January 2012.

The highest population concentration is in Riga. As at 1 January 2012, 31.9 per cent. of the total population, 650,478 people, resided in Riga. Since 2000, the population in Riga has decreased by 115,903, or 15.1 per cent.

As at 1 January 2012, 63.5 per cent. of the Latvian population was of working age, 60.5 per cent. was Latvian and 26.6 per cent. was Russian, with a range of other ethnic groups making up the balance.

The average life expectancy weighted for gender balance of those born in 2011 is 74.0 years (68.8 years for males and 78.7 years for females).

Historical Background

Latvia's origins lie in the 12th century with the arrival of western Europeans, mainly German crusaders spreading the Catholic faith, although records of inhabitants date back to the ancestors of Baltic Finns in around 3000 BC and the formation of the Baltic and Finno-Ugrian tribes in 2000 BC.

The crusaders established the State of Livonia as a political union of territories belonging to the Livonian Order of Knights and to the Catholic church by the 1270s. Riga was founded in 1201. In 1285, Riga was admitted into the Hanseatic League of northern Germany, thereby assuming a central mediating role in east-west trade.

The territory of Latvia, through its access to the Baltic Sea trade routes, is strategically positioned. As a result, throughout the middle ages, Latvia (or parts of it) was controlled by other states, including Denmark, Poland-Lithuania, Sweden and Russia. From the middle of the 16th century until the end of the 18th century, part of Latvia was known as the Duchy of Courland, a semi-independent state paying tribute to Poland.

In 1721, Russia took control of the Latvian territories following its victory over Sweden in the Great Northern War. In the 1860s, the Young Latvian Movement was formed in order to promote the indigenous language and oppose Russification policies and to publicise and counteract the socio-economic oppression of Latvians. In 1903, the Latvian Social Democratic Union was formed, which continued to champion national interests and Latvia's national self-determination, particularly during the failed 1905 revolution in Russia.

Latvia's independence from Russia was declared on 18 November 1918 following the end of the First World War. In 1922, the Constitutional Assembly (*Satversmes Sapulce*, a special meeting convened to approve a constitution) adopted the constitution (*Satversme*) of the Republic of Latvia which proclaimed the country to be a democratic republic. In May 1934, the Parliament was dismissed and the activities of the political parties were suspended following a coup d'etat engineered by the then Prime Minister. With the outbreak of the Second World War, Latvia was annexed by the Soviet Union in 1940 and was invaded and occupied by Germany between 1941 and 1944. The Soviet Union reacquired control of Latvia in 1944 although its annexation of Latvia in 1940 was never recognised by most western democracies, including the United States.

After rapid political change in Eastern Europe and the Soviet Union in the late 1980s, the Supreme Council of Latvia re-established legal independence with the Declaration of the Renewal of the Independence of the Republic of Latvia on 4 May 1990. On 6 September 1991, the independence of the Baltic Republics (including Latvia) was recognised by the Soviet Union.

In September 1991, following the collapse of the Soviet Union, Latvia was admitted to the UN. On 29 March 2004, Latvia joined NATO and, on 1 May 2004, it became a Member State of the EU.

In 2007, a border treaty between Latvia and Russia was signed and has subsequently been fully ratified by both states.

Political System and Developments

In accordance with the Constitution, the Saeima is the highest legislative body. The Saeima is a unicameral parliament consisting of 100 members, elected in general, equal, direct, secret and proportional elections for a four-year term. All Latvian citizens who are 18 years of age and over are entitled to vote.

The main function of the Saeima is to pass legislation. In addition, the Saeima approves the national budget, determines the size of the armed forces and oversees the work of the Government. International agreements, which include matters that are decided by a legislative process, require ratification by the Saeima.

The Saeima has the power to amend the Constitution. This requires the approval of two-thirds of the members present at three separate readings, provided that at least two-thirds of all members of the Saeima are in attendance at each reading.

The Saeima is entitled to elect, appoint, approve or dismiss a range of state officials and also elects the head of state, the President, for a term of four years. According to the Constitution, any person who enjoys full rights of citizenship and who has attained the age of 40 years may be elected President. A person with dual citizenship is not eligible. The same person may not hold office as President for more than eight consecutive years or two consecutive terms.

One of the President's main functions is to represent Latvia internationally. In addition, the President nominates the Prime Minister and, if necessary, may initiate a referendum to approve the dissolution of the Saeima.

The Cabinet of Ministers, which consists of 13 ministers appointed by the Prime Minister is the highest executive power in Latvia. The Prime Minister determines the general direction of the Government's activities and ensures that the Cabinet of Ministers works in a coordinated and purposeful manner. The Prime Minister is responsible for the work of the Cabinet of Ministers and is answerable to the Saeima. The Prime Minister or his nominee chairs Cabinet meetings and meetings of Cabinet committees.

Government and Politics

On 2 June 2011, the Saeima elected Andris Bērziņš as the fourth President of Latvia since 1993.

The elections for the eleventh Saeima were held in September 2011 with a turnout of 908,214 (or 59.5 per cent. of eligible voters). The following table shows the name of each political party or alliance, and the number of seats currently held by them, in the eleventh Saeima:

Name of party or party alliance	Number of seats in eleventh Saeima
Alliance of political organisations: Concord Centre	31
Reform Party	16
Alliance of political parties: Unity	20
National alliance of: All for Latvia and Union For Fatherland and Freedom/LNNK	14
Union of Greens and Farmers	13
Unaffiliated members of parliament(1)	6
Total	**100**

Source: The Saeima

Note:

(1) Elected as members of the Reform Party but subsequently left that party.

The current ruling coalition consists of the centre-right Reform Party (16 seats) and Unity Alliance (20 seats), and the conservative-nationalist National Alliance (14 seats), with Valdis Dombrovskis as Prime Minister. The coalition does not have a formal majority, holding 50 of the 100 seats of the Saeima, although the coalition currently has the support of the six unaffiliated members of the Saeima who were elected as members of the Reform Party.

Each Saeima elects a Presidium which supervises the work of that Saeima. The Presidium consists of five members of parliament: the Speaker, two Deputy Speakers, the Secretary and the Deputy Secretary. Five parliamentary groups have been established in the eleventh Saeima and there are 15 standing committees. In addition, groups of members of parliament and permanent delegations to international organisations have been established to promote cooperation with the governments of other countries.

Pursuant to the Constitution, the next Saeima elections are scheduled to take place in October 2014.

Local Authorities

At the end of 2008, a system of new administrative divisions was adopted in Latvia to reduce the number of municipalities from over 500 to 119. This single tier comprises nine cities (*republikas pilsēta*) and 110 municipalities (*novads*). The purpose of this reform was to improve the efficiency and effectiveness of local government. Local authorities are elected for a term of four years by direct universal suffrage, under proportional representation on the basis of a list system.

In June 2009, local elections were held in accordance with the new administrative division of Latvia. Riga is the largest municipality and has 60 deputies on its city council. Out of the 1,490,923 citizens who were entitled to vote 801,348 (53.75 per cent.) exercised their right and took part in local elections. The next municipal elections are scheduled to take place in June 2013.

Local authorities in Latvia are responsible for a wide range of functions, including organising utility services, providing some education and health facilities, social assistance and social care for residents and maintaining cultural activities. See "*Indebtedness—Local Government Debt*" for a discussion on local government funding.

The Judicial System

Latvia's three tier judicial system is independent of the other branches of the Government. The first level comprises 35 district (city) courts, including the Administrative district court, as the courts of first instance for civil and criminal cases. The second level comprises six regional courts, including the Administrative regional court, that act as courts of appeal and courts of first instance for certain cases. The third level comprises the Supreme Court. The administrative courts were introduced to the Latvian

judicial system in 2004. They consider cases relating to the exercise of executive power by state, municipal and other public institutions which relate to the rule of law and public law issues.

The highest court in Latvia is the Supreme Court. The Supreme Court comprises two separate judicial bodies: the Senate, which has authority to accept cassation appeals in all types of cases (civil, criminal and administrative) and is the final and supreme judicial body in Latvia, and the Supreme Court Chambers. The total number of Supreme Court judges is established by the Saeima, upon the recommendation of the Board of Justice. The total number of judges in the Senate and the Supreme Court Chambers is determined by the Board of Justice, upon the recommendation of the Chief Justice. There are currently 28 Senators (judges of the Senate) and 23 judges in the Supreme Court Chambers, who together form the Plenum of the Supreme Court. The Chief Justice is selected from among the judges, approved by the Saeima and serves a seven year term. The current Chief Justice has been in office since 2008.

In addition, the Constitutional Court of Latvia consists of seven judges who are each elected by the Saeima for a 10-year term. This court is authorised to hear cases involving legislative acts and international agreements, including cases relating to the compliance of such acts and agreements with law and the Constitution. The Constitutional Court hears cases following the filing of a petition by an eligible party in accordance with the law. Members of the Constitutional Court elect a president for a three-year term who presides over the Court's sessions, organises the work of the Court and represents the Court.

Prevention and Combating of Corruption

In 2002, the Corruption Prevention and Combating Bureau (the "**Bureau**") was established as an independent institution for the prevention and combating of corruption and to monitor the financing of political parties. The Bureau is supervised by the Cabinet of Ministers and, as of 1 October 2012, employed 136 employees.

The Bureau:

- develops and implements Latvia's mid-term anti-corruption policy (which is set out in two documents: the Guidelines for the Prevention and Combating of Corruption and the Corruption Prevention and Combating Programme, both covering the period 2009 to 2013 (together, the "**Anti-corruption Programme**"));
- monitors compliance with the Law on Prevention of Conflicts of Interest in Activities of Public Officials;
- controls party financing;
- screens draft legislation in order to identify any risk of corruption; and
- is mandated to investigate corruption-related offences in the public sector, such as bribery, the trading of influence and exceeding public authority in bad faith.

The Bureau reports on a regular basis to the Government and the Saeima.

By the end of the first half of 2012, the Bureau had initiated a total of 194 criminal cases against 462 people. Since the Bureau's establishment in 2002 up to 30 June 2012, and following investigations by the Bureau into the financing of political parties in Latvia, donations in excess of LVL 2,100,000 had been declared illegal and approximately LVL 420,000 of this illegal funding had been reimbursed to the State budget.

The Bureau has also investigated a number of cases of aggravated corruption which have led to a number of high ranking officials (including several judges, senior prosecutors, local government heads, board members of one of the largest state companies, a former head of the Customs Criminal Board and high level officials of the Riga City Council) being arrested and charged. In order to decrease the influence of specific individuals or groups, the Bureau has initiated and administers a system of state funding for political parties. The Bureau also introduced a programme of whistle blower protection in June 2010.

The Bureau's strategy is to focus on improving the control of funding for political parties, ensuring appropriate use of state resources and funding provided by international organisations (such as the EU and foreign countries), increasing awareness of, and providing guidance in relation to preventing, conflicts of interest, and strengthening internal control measures in line with the stated policy in the Anti-corruption Programme.

Combating Terrorism

In April 2003, a Government action plan for combating terrorism was introduced. The plan aims to improve cooperation between state institutions when seeking to prevent or combat terrorism. In particular, the plan aims to prevent terrorists from using the territory of Latvia or its banking system to achieve their goals. All of the measures identified in the plan have been implemented and completed.

In particular, a counter-terrorism centre has been established which started operations in February 2005. The centre seeks to co-ordinate the actions of institutions fighting terrorism, seeking to ensure the timely exchange of information and the compilation and analysis of information on counter-terrorist activities. In order to improve the efficiency of the national counter-terrorism system, the Ministry of the Interior and the counter-terrorism centre have prepared a conceptual rating scale of levels of terrorism threat.

Latvia also participates in the efforts of international organisations, including the UN, NATO, the EU, the Organisation for Security and Cooperation in Europe and the Council of Europe, to combat global terrorism. Latvia has ratified and introduced all 13 UN Conventions and Protocols which form the basis of international legislation on issues of counter-terrorism.

Within the EU, Latvia has become involved in a range of practical counter-terrorism initiatives which provide for an increased level of cooperation between investigatory and security services, as well as in judicial matters. In accordance with the EU Declaration on Combating Terrorism (adopted 25 March 2004) and the EU Plan of Action on Combating Terrorism (2004), Latvia has introduced a number of provisions in its legislation aimed at promoting practical cooperation among EU Member States in combating terrorism and is participating in the preparation of other EU regulations relating to the exchange of information, witness protection and funding for the fight against terrorism.

International Relations

Supranational Organisations

Participation in global and regional organisations, especially membership of the EU, NATO, the IMF and other organisations (such as the Council of Europe and the Organisation for Security and Cooperation in Europe) is becoming increasingly important for Latvia. Such participation enables Latvia to meet new challenges and to contribute to the resolution of specific problems, while also representing the country's national interests in global politics.

Latvia became a member state of the UN in 1991, thus creating a global dimension for Latvian foreign policy. By acceding to international declarations such as the Millennium Development Declaration and the UN Cairo Declaration, Latvia has demonstrated its readiness to become involved in the resolution of global problems.

In October 2010, Latvia was elected to the United Nations Economic and Social Council ("**ECOSOC**") for the period 2011 to 2013. As an ECOSOC member, Latvia participates in the decision making process relating to current international matters, including the implementation of the Millennium Development Goals.

Membership of the World Trade Organisation (the "**WTO**"), which was achieved in 1998, has contributed to the development of Latvia's economy. Latvia continues to cooperate actively with the Organisation for Economic Cooperation and Development (the "**OECD**") which facilitates the development of Latvian national policy and provides a forum for Latvia's experts to become involved in different universal issues. Achieving OECD membership is one of Latvia's foreign policy priorities. A formal application for such membership was renewed by Latvia's Prime Minister on 26 June 2012.

Latvia joined NATO and the EU in 2004 and is contributing to the UN-mandated and NATO-led International Security Assistance Force (ISAF) mission in Afghanistan and the EU maritime operation offshore Somalia (ATALANTA). Latvia also continues to participate in the EU Police Mission in Afghanistan (EUPOL Afghanistan) and the EU Monitoring Mission in Georgia (EUMM Georgia). Ensuring and developing relations with EU Member States and institutions plays a major role in Latvia's foreign policy; see "- *EU Membership*".

Latvia has been a member of the Schengen Area since 21 December 2007. This allows the free movement of people and goods within the Schengen Area, comprising 26 European countries, without any passport controls or customs formalities.

Regional Relationships

The Baltic

Latvia seeks good relations with its neighbouring countries, both at a bilateral level and through membership of regional organisations such as the Council of the Baltic Sea States (the "**CBSS**"). The CBSS is the most comprehensive organisation for regional cooperation around the Baltic Sea. It includes three Baltic States, five Nordic countries (Denmark, Finland Iceland, Norway and Sweden), Germany, Poland, Russia and a representative from the European Commission (the "**EC**"). Latvia values the work of the Task Force against Trafficking in Human Beings and the activities of the Baltic 21 Expert Group on Sustainable Development formed by the CBSS. Latvia also supports the Baltic Sea Region Energy Cooperation (BASREC), a ministerial process under the umbrella of the CBSS, which supports the development of competitive, efficient and well-functioning energy markets to promote sustainable growth, security and prosperity in the Baltic Sea region.

The CBSS has the following five long-term topical priorities which were first set out in the Riga Declaration under Latvia's presidency in 2008:

- the environment;
- education and culture;
- economic development;
- energy; and
- civil security and the human dimension.

Substantial and institutional reform of the CBSS is currently taking place in order to assist the development of the CBSS Secretariat's functional capacities.

The institutional frameworks that have been established by Latvia, Lithuania and Estonia (such as the Baltic Assembly and the Baltic Council of Ministers (the "**BCM**")) promote practical cooperation between the parliaments and the governments of the three Baltic countries. Major issues related to strategic cooperation between these countries, including the Rail Baltica project (see "*Economy of Latvia – Infrastructure – Rail*"), the energy sector, the establishment of a digital single market in accordance with the EU's Digital Agenda, internal and external security cooperation and social issues, were discussed in the framework of the BCM's meeting of prime ministers on 20 September 2012 in Vilnius. The joint statement from the three Prime Ministers, which was then adopted, agreed to further strengthen cooperation in the implementation of the digital single market, the energy sector, transport, security and defence, border control and on social issues. The Prime Ministers also signed a Memorandum reiterating their support for the Visagina nuclear power plant project, see "*Economy of Latvia – Infrastructure – Energy*".

Active bilateral and multilateral Baltic-Nordic dialogue, as well as participation in the implementation of regional programmes, projects and initiatives, also serves to enhance a greater influence of the Baltic region at the European and global levels. A Nordic Baltic Eight ("**NB8**") Wise Men report, released in 2010, identified the advantages of regional unity and suggested a range of actions to be taken in order to enhance the Baltic-Nordic cooperation. For example, a joint NB8 nuclear safety exercise will take place in 2013 in Finland. The NB8 grouping comprises the three Baltic States and five Nordic countries (Denmark, Finland Iceland, Norway and Sweden).

Baltic and Nordic countries have also started to implement the Memorandum of Understanding on locating Baltic-Nordic diplomats to the parties' missions abroad (signed on 30 August 2011 in Helsinki). For, example, Latvia cooperates with Lithuania on the common use of diplomatic premises in Moldova and Kazakhstan.

The European Parliament published a report in late 2006 calling for a strategy for the Baltic region (the "**Baltic Strategy**"). The Baltic Strategy was adopted by the EC on 10 June 2009 and endorsed by the European Council in October 2009. The Baltic Strategy provides an integrated framework for improving the environmental condition of the sea, transport bottlenecks and energy interconnections as well as facilitating the development of competitive markets across borders and common networks for research and innovation. Latvia expects the Baltic Strategy to facilitate the sustainability and competitiveness of the region by seeking to enhance balanced growth of the east coast of the Baltic sea. Latvia and Denmark are co-ordinating the Baltic Strategy's energy-related programme, including the implementation of the Baltic Energy Market Interconnection Plan (BEMIP). Latvia also supports the new structural framework of Baltic Strategy which sets concrete aims, targets and indicators for its further implementation.

Russia

Relations between Latvia and Russia are based on good, practical co-operation. Trade between the two countries is growing. Both exports and imports between Latvia and Russia increased by more than 20 per cent. in the first eight months of 2012 compared to the same period in 2011 and Russia is Latvia's second largest trade partner after Lithuania. In addition, the border demarcation process continues to advance, there is good co-operation between Latvia and the Russian regions (see ''*Balance of Payments and Foreign Trade – Foreign Trade – Trade Policy*'') and cultural exchange is intensive. Latvia also plays an active role in building relations between Russia and the EU and NATO.

United States of America

Latvia regards the United States of America as a strategic partner and ally and believes that it is important to maintain an ongoing dialogue with the United States on both traditional and new security challenges, including in areas such as money laundering and international terrorism.

EU Membership

As a Member State of the EU since 2004, Latvia actively participates in the EU decision making process at European Council meetings and at the meetings of the Council of the European Union. Representatives of Latvia participate in the working groups of the Council of the European Union as well as in meetings of the Committee of Permanent Representatives. Latvia is also represented in the European Parliament, the Committee of Regions and the European Economic and Social Committee. Latvia will assume the rotating presidency of the Council of Ministers during the first half of 2015.

As of 1 December 2011, Latvia had nine parliamentary seats in the European Parliament out of a total of 754, representing 1.2 per cent. The Group of the European People's Party (Christian Democrats) holds four Latvian seats in the European Parliament. The Group of the Alliance of Liberals and Democrats for Europe, the Group of the Progressive Alliance of Socialists and Democrats in the European Parliament, the Confederal Group of the European United Left – Nordic Green Left, and the Group of the Greens/ European Free Alliance and the European Conservatives and Reformists each hold one Latvian seat.

As membership of the European Economic and Monetary Union and the adoption of the single currency are both required by the terms of Latvia's accession to the EU and have been set as objectives by the Latvian Government, Latvia is in a continuing dialogue with the EU on these matters. As a Member State, Latvia is subject to multilateral surveillance by the Council of the European Union. Latvia is obliged to prepare an annual Convergence Programme covering fiscal policy, Latvia's main assumptions underlying its economic outlook and an assessment of economic policy measures and their budgetary impact. This information must cover the current and previous year and include forecasts for at least the next three years. On 31 May 2012, the Saeima ratified the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union that will require 25 of the 27 EU countries (the UK and the Czech Republic did not join this treaty) to maintain a balanced budget, see ''*Economy of Latvia – Impact of the Global Financial Crisis and Response – Economic Reform Programme*''.

Latvia's membership in the EU has resulted in a major inflow of EU funds. The total amount of financing allocated to Latvia for the period between 2007 and 2013 equals €6.6 billion, of which €4.6 billion is intended for cohesion and structural funds and €2.0 billion is intended for agricultural development. At the date of this Offering Circular, Latvia, in common with other EU countries, is currently in negotiations with the EC in relation to the next period of funding from 2014 to 2020 and the Ministry of Finance of Latvia is currently drawing up plans for the allocation of EU funds for this period.

Structural funds provided by the EU are used by Latvia to fund infrastructure projects within the country. The use of such funds, as well as the engagement and payment of contractors, are monitored and controlled by the Ministry of Finance of Latvia in its capacity as the managing authority for these EU funds. In this capacity, the Ministry of Finance uses intermediary bodies to deal directly with the infrastructure projects and contractors. Following audits of the system conducted by the European Commission, the European Court of Auditors and the National Audit Authority during 2011, the level of identified errors in Latvia amounted to 1.7 per cent. This level is within the 2 per cent. threshold set by the EC and is considerably lower than the average EU rate of approximately 11 per cent.

On 27 January 2012, the EC interrupted payments of structural funds to Latvia on the basis of an audit of Latvia's internal management and control systems carried out by the Ministry of Finance of Latvia which identified systemic problems. As a result, Latvia implemented an action plan to address these issues. In

June 2012, the EC informed Latvia that it would lift the interruption. During the period of the interruption, Latvia continued to make full payments to its contractors.

Latvia currently intends to adopt the euro as its national currency in 2014. In order to achieve this goal, Latvia will need to demonstrate compliance with the Maastricht criteria, including a budget deficit of less than 3.0 per cent. of GDP, Government debt of less than 60 per cent. of GDP and average inflation over a 12-month period of less than 3.0 per cent. As at 30 September 2012, Latvia was in compliance with these and other Maastricht criteria.

In July 2012, Latvia executed a partnership agreement with the EC as part of its euro adoption strategy. The partnership agreement is intended to assist Latvia in implementing its communications strategy in connection with euro adoption, with approximately 50 per cent. of the communications costs being financed by the EC. Latvia is also currently preparing the necessary legislation to adopt the euro in conjunction with the EC and the European Central Bank.

The table below sets out the inflow of EU funds to Latvia for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the nine months ended 30 September 2012.

	2007	**2008**	**2009**	**2010**	**2011**	**2012**[1]
			(LVL thousands)			
Pre-accession funds[2]	369	227	15	0	0	0
Structural funds[3]	214,537	143,115	245,437	208,334	266,360	245,970
Cohesion policy[4]	123,117	113,613	97,187	143,566	113,602	122,486
Common agricultural policy[5]	106,043	161,052	165,037	198,920	184,205	218,649
Transition policy	4,595	1,749	558	0	0	0
Other funds	9,309	7,865	13,875	27,234	26,390	31,616
Non-EU facilities	859	3,660	8,647	22,113	23,816	5,704
Reversed back to EU		(4,219)	(6,244)	(1,640)	(657)	0
Total	458,829	427,062	524,512	598,527	613,716	624,425

Source: The Treasury

Notes:

(1) Nine months ended 30 September.

(2) Pre-accession funds help to finance a Member State's expenditure on conforming its laws to the existing body of European Community law and on development in general.

(3) Structural funds allow the EU to grant financial assistance to help resolve a Member State's structural economic and social problems.

(4) Cohesion policy funds are designed to offset the burden of the single market for the less favoured Member States or regions of Member States.

(5) Common agricultural policy funds represent agricultural subsidies paid to a Member State.

The table below sets out the use of EU funds by Latvia for the period between 1 January 2007 and 30 September 2012 (not including state co-financing).

	(LVL thousands)
Current expenditure	2,747,435
Capital expenditure	675,340
Funds received but not yet spent	(175,705)
Total	**3,247,070**

Source: The Treasury

Note:

(1) Calculated based on statistical assumptions used in EDP (Excessive Deficit Procedure) tables prepared for Eurostat.

The table below summarises Latvia's own resource payments to the EU for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the nine months ended 30 September 2012.

	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
GNI[2]	82.4	94.8	107.7	90.7	95.6	102.7
VAT[3]	24.6	24.8	15.8	9.7	11.2	14.5
UK correction[4]	10.5	13.6	10.8	7.6	7.2	7.9
Traditional own resources[5]	21.6	20.4	13.1	11.9	16.0	17.6
Agricultural levies	1.0	1.1	0.5	–	–	–
Customs duties	19.4	18.7	12.0	11.9	16.0	17.6
Sugar levies	1.2	0.6	0.6	–	–	–
Total	**139.1**	**153.5**	**147.4**	**119.9**	**130.0**	**142.7**

Source: Ministry of Finance

Notes:

(1) Nine months ended 30 September.

(2) Gross National Income, charged on each Member State's gross national income at a uniform rate determined pursuant to the budgetary procedure.

(3) Charged at 0.3 per cent. of Latvia's VAT revenue (harmonised to reflect VAT rate differences between Member States).

(4) Reflecting Latvia's contribution to the EU compensation paid to the UK in respect of its lower agricultural fund receipts.

(5) This represents duties that are charged on imports of relevant products into Latvia from a non-EU state.

ECONOMY OF LATVIA

Background

Since 1991 when Latvia regained independence, a consistent economic policy has laid the foundations, and established good macroeconomic preconditions, for a market economy and future economic growth.

From mid-1999, the Latvian economy began to recover from the Russian crisis. Despite the global economic slowdown starting in 2000, the Latvian economy continued to grow steadily. Its programme of reforms and integration into the EU had a positive impact on the country's economic development, with Latvia achieving at the time the highest economic growth rates in the EU. From 2000 to 2006, real GDP increased annually by an average of approximately 8 per cent. per year, although growth accelerated towards the end of the period. These high levels of growth were primarily achieved through stable domestic demand based on growth in incomes, financial stability, an expansion of credit opportunities, accession to the EU and an overall positive outlook within the country.

During 2007, Latvia continued to experience strong growth with real GDP growing by 9.6 per cent., principally driven by private consumption and investment which was largely based on a substantial inflow of foreign capital. The global financial crisis that commenced at the end of 2007 significantly adversely affected Latvia's economy throughout 2008 and 2009, with real GDP falling by 3.3 per cent. in 2008 and 17.7 per cent. in 2009. Since the fourth quarter of 2009, Latvia's economy has returned to growth, witnessing quarter-on-quarter real GDP growth, although on an annual basis Latvia's real GDP fell by 0.9 per cent. in 2010. In 2011, Latvia's economy grew by 5.5 per cent. and during the first six months of 2012, it grew by 5.9 per cent. compared to the same period in 2011, the fastest growth rate over the period among EU countries. On 9 November 2012, the Central Statistical Bureau released a flash estimate showing that Latvia's real GDP growth in the first nine months of 2012 compared to the comparable period of 2011 was 5.3 per cent. The latest preliminary estimates by the Ministry of Finance of real GDP for 2012 indicate growth of 4.0 per cent.

Impact of the Global Financial Crisis and Response

The global financial crisis significantly adversely impacted Latvia's economy. Comparing the last quarter of negative real growth (which was the third quarter of 2009) with the preceding last quarter of positive real growth (which was the fourth quarter of 2007), real GDP decreased by 24.6 per cent., according to seasonally adjusted data, with the steepest period of decline being the first half of 2009. Although the economic downturn continued in the second half of 2009, the rate of negative real growth slowed significantly and slight increases in both exports and manufacturing output became apparent.

Positive growth on a quarter-on quarter basis returned in the last quarter of 2009, with real GDP growing by 1.0 per cent. In 2010, real GDP grew by 0.7 per cent., 0.4 per cent., 0.7 per cent. and 0.1 per cent. in the first, second, third and fourth quarters of the year, respectively, in each case compared to the previous quarter, although, on an annual basis, in 2010, real GDP decreased by 0.9 per cent. in comparison to 2009. In 2011, real GDP grew by 1.5 per cent., 2.0 per cent., 1.4 per cent. and 0.8 per cent. in the four quarters of the year, respectively, in each case compared to the previous quarter, and, on an annual basis, in 2011 real GDP increased by 5.5 per cent. in comparison to 2010. In the first half of 2012, real GDP grew by 5.9 per cent. compared to the equivalent period of 2011. From and including the last quarter of 2009, real GDP had grown by 12.4 per cent. as at 30 June 2012.

Economic sentiment and confidence in Latvia were both adversely affected by developments commencing in early 2007. The general economic sentiment index in Latvia showed a declining trend on a quarter-on-quarter basis from March 2007 (when it stood at 114.1, indicating that more respondents had a positive outlook than a negative outlook) to March 2009 (when it stood at 73.4). Economic sentiment in Latvia has improved since March 2009 and the index stood at 104.3 at 30 September 2012. Confidence indicators in the industry, retail trade, services, construction and consumer sectors have all demonstrated improved confidence since early- to mid-2009.

The table below shows the growth trend in selected economic indicators as at the end of each quarter in the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the first half of 2012, in each case compared to the preceding year or equivalent period of the preceding year.

	2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
				(per cent.)				
Household consumption....	28.1	19.7	14.5	0.3	0.5	(3.0)	6.7	3.1
Retail trade turnover.....	23.2	21.9	14.8	5.5	(2.3)	(4.6)	(7.6)	(13.8)
First registered passenger cars.....	53.4	23.3	0.6	(20.6)	(39.1)	(46.0)	(50.6)	(62.4)

	2009				2010			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
				(per cent.)				
Household consumption....	(22.8)	(25.0)	(24.5)	(18.1)	(2.7)	0.0	5.3	6.7
Retail trade turnover.....	(24.1)	(27.0)	(28.7)	(28.9)	(12.9)	(4.9)	2.2	7.2
First registered passenger cars.....	(75.7)	(71.9)	(66.5)	(50.2)	(13.0)	36.2	81.7	108.9

	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
			(per cent.)			
Household consumption.....	3.3	5.0	5.7	4.1	5.4	7.2
Retail trade turnover.....	1.2	0.8	6.9	6.0	11.7	8.0
First registered passenger cars	118.3	64.2	52.2	50.7	41.0	21.8

Source: Central Statistical Bureau

Note:

(1) Growth measured against the equivalent period of the preceding year.

During the recession, the situation in the labour market deteriorated significantly. Based on Labour Force Survey ("**LFS**") data, from 2008 to 2010, the number of employed persons aged 15-64 decreased by 14.6 per cent., or by 157,300 people and the unemployment rate (in respect of persons aged 15-64) grew from 6.2 per cent. at the end of 2007 to 19.0 per cent. at the end of 2010. The lowest point in the labour market was at the end of the first quarter of 2010, when the number of employed fell to 893,400 and the unemployment rate reached 20.7 per cent. Since the first quarter of 2010, conditions in the labour market have gradually improved and, according to LFS data for 2011 and 2012 (which is not directly comparable with prior periods as such data is based on population figures derived from the 2010 population census whilst the population figures used in earlier data have not yet been recalculated), the unemployment rate for persons aged 15-64 at the end of 2011 and at 30 June 2012 was 16.5 per cent. and 16.4 per cent., respectively.

The global financial crisis did, however, positively affect Latvia's foreign trade balance and its current account balance of payments. In 2009, Latvia's imports fell by 37.7 per cent. while its exports fell by 19.2 per cent. both as compared to 2008. As a result, Latvia's negative foreign trade balance fell significantly, from LVL 2,862.3 million in 2008 (17.8 per cent. of GDP) to LVL 931.6 million in 2009 (7.1 per cent. of GDP). The foreign trade balance continued to fall in 2010 but at a slower rate as exports increased faster than imports, with the deficit being 7.0 per cent. of GDP in that year. Along with the increase in economic activity in 2011, there was an increase in the trade deficit which amounted to 10.8 per cent. of GDP. Latvia's current account balance of payments was additionally significantly positively affected by a slowdown in the inflow of foreign direct investment from the second half of 2007 due to the global financial crisis and, as a result, the current account balance moved from a deficit equal to 24.7 per cent. of GDP in the third quarter of 2007 to a surplus equal to 10.5 per cent. of GDP in the fourth quarter of 2009. In 2010, the current account balance showed a surplus equal to 2.9 per cent. of GDP. In 2011, the current account balance turned negative reflecting both the increased trade deficit and increasing profitability in foreign-owned enterprises (including, in particular, banks) which increases the deficit on the income account through dividend payments and retained earnings. This trend has continued in the first half of 2012, resulting in the current account deficit being equal to 2.9 per cent. of GDP in the six months ended 30 June 2012.

In addition, inflation (measured in terms of changes in the consumer price index (the "**CPI**")) fell from a peak of 17.7 per cent. in May 2008 to deflation of 4.3 per cent. in February 2010 (in each case when compared with the corresponding month of the previous year). The decrease in consumer prices over this period principally reflected reduced private consumption (as a result of increased unemployment, wage reductions and other factors) and falling global energy and food prices. Since the end of 2009, Latvian inflation has been significantly influenced by increasing world energy and food prices and domestic indirect tax rate increases. As a result, despite domestic demand remaining fragile in 2010, inflation increased to 2.4 per cent. at the end of 2010 and to 3.9 per cent. at the end of 2011, with the 12-month average inflation rate for 2011 being 4.4 per cent. compared to negative 1.1 per cent. in 2010. Compared to December 2011, the average consumer price level in September 2012 increased by 1.6 per cent. In September 2012, the inflation rate was 1.9 per cent. compared with the level in September 2011 reflecting more moderate increases in world food and energy prices in 2012 and the impact of changes in indirect tax rates. In 2011, the standard VAT rate increased from 21 per cent. to 22 per cent. and the reduced VAT rate increased from 10 per cent. to 12 per cent. The number of items covered by the reduced rate was reduced and there were also increases in excise duty on fuel, alcohol, tobacco and natural gas. As the fiscal situation improved in 2012, the standard rate of VAT was lowered by 1 per cent. to 21 per cent. in July 2012. However, the impact of this reduction on inflation is expected to be limited given that at the same time, both heating tariffs and oil prices increased which resulted in some businesses not passing on the VAT reduction to their customers in full.

Financial Assistance

Deteriorating economic conditions in Latvia in 2008 and a banking crisis at the end of that year significantly adversely affected State budget revenues and, as a result, Latvia sought financial assistance from the IMF and other international bodies towards the end of 2008. The IMF Stand-By Arrangement which Latvia entered into in December 2008 was part of the wider financial assistance package agreed with the EU, the World Bank, the EBRD and a number of Nordic and other EU countries, bringing the total financial assistance package to approximately €7.5 billion (equal to approximately U.S.$10.5 billion). By the end of 2011, only €4.5 billion of this financial assistance had been disbursed to Latvia and the financal assistance package has now lapsed. On 14 September 2012, Latvia repaid early €211.1 million of funds borrowed from the IMF under the financial assistance package. See "*Indebtedness—Financial Assistance from International Lenders*".

Economic Reform Programme

As part of the financial assistance package, Latvia agreed to implement an economic reform programme whose principal objectives were to arrest the immediate liquidity crisis and then to restructure Latvia's economy and improve its competitiveness to reach sustainable GDP growth and a balanced budget as soon as practicable, while maintaining the exchange rate peg which is a key policy of both the Government and the Bank of Latvia. The programme included a range of measures to stabilise and strengthen the financial sector as well as substantial fiscal tightening to reduce financing needs and foster real depreciation.

The economic reform programme also aimed to develop structural reforms and other policies to increase competitiveness and facilitate external adjustment, through tax incentives as well as improved property registration, construction approval and insolvency and liquidation processes. Close supervision of the financial sector and strengthening of banking regulations is continuing in Latvia, in line with EU directives.

Latvia's tax compliance strategy has been revised with the aim of increasing revenue and reducing the shadow economy. According to 2011 operative results set out in the State Budget Law, tax revenues for 2011 were higher than budgeted and the tax compliance strategy is believed to have contributed to this. Work on the tax compliance strategy is continuing to further combat the shadow economy.

Following the establishment of a Reform Management Group in July 2009, there have been structural reforms in three major areas: (i) promoting the economic competitiveness of the State; (ii) developing management within the public administration system; and (iii) balancing the social sector through the provision of social protection for the poor, revision of the social insurance system and an incentive-driven and targeted labour market policy. Attention has also been given to improving the business environment in Latvia, strengthening fiscal discipline and reforming the education system, public administration and the provision of health and social care.

Fiscal discipline is also being strengthened through the introduction of a Fiscal Discipline Law that was submitted to the Saeima on 6 December 2011. This law was approved in its first reading but, prior to the second reading, Latvia ratified the European Fiscal Stability Treaty (the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union) and so passage of the Fiscal Discipline Law was halted as further work is being undertaken to make it consistent with the Fiscal Stability Treaty. Once in force, the Fiscal Stability Treaty will require ratifying member states to maintain their national budgets in balance or in surplus within the treaty's definition. The treaty defines a balanced budget as one which has a general budget deficit that is less than 3 per cent. of GDP and a structural deficit that is less than either 0.5 per cent. or 1 per cent. of GDP, depending on the country's debt-to-GDP ratio. The Fiscal Discipline Law (and the Fiscal Stability Treaty) are intended to preserve Latvia's and other ratifying Member States' medium-term fiscal stability through the implementation of a counter-cyclical fiscal policy, whereby a restrictive fiscal policy is implemented during times of economic growth and a fiscal stimulus policy is implemented during a downturn.

Amendments to the Law on Budget and Financial Management came into force on 1 January 2012 which implemented the legal framework for the Medium-term Budget Framework Law, see "*Public Finance – Preparation and Approval of Central Government Budgets*".

The reform of public administration involves evaluating the services and functions provided by the public sector with a view to developing proposals for the centralisation, streamlining and improvement of similar functions of public administration. In 2011, two action plans for reducing bureaucracy and ensuring the more effective use of public service finances and resources were drawn up and approved by the Cabinet of Ministers. Reforms of the social sector have focused on increasing long-term rather than short-term active labour participation and the protection of the most vulnerable members of society. An evaluation of existing wage subsidy schemes took place in mid-2012 and the outcome was a decision to continue existing schemes and not to introduce any new tax incentives. Currently, wage subsidy schemes are being implemented to encourage hiring of vulnerable groups of unemployed (such as the long-term unemployed, both younger and older unemployed persons and those with disabilities), to support practical training in priority areas such as manufacturing, transport and logistics, information and communications technology and tourism, and to support job creation.

In the World Bank's Doing Business 2013 report, Latvia was ranked 25th out of 183 countries on ease of doing business and seventh among EU Member States. Latvia is among 29 of the countries surveyed which have made it easier for local entrepreneurs to operate in more than three areas: business start-up, property transfer and insolvency procedures, and ease of securing electricity supply. Latvia continues to focus on improving the business environment, with recently approved measures including the reduction of time required for the coordination of construction projects, improved property registration and rights and improved investor protection regulations.

Gross Domestic Product

Growth in nominal GDP in 2007 was principally driven by private consumption, which showed a real growth rate of 14.3 per cent. in 2007, and by investment, with gross fixed capital formation growing by 7.9 per cent. in 2007 in real terms. By contrast, public consumption grew at 4.9 per cent. in real terms in 2007.

The global financial crisis severely affected the economy of Latvia in the period from 2008 to 2010. The effects of the financial crisis were intensified by the unbalanced position of the Latvian external sector, which had developed during the previous period of rapid growth. The growth in private consumption and investment, which was more rapid than overall economic growth, was largely based on a substantial inflow of foreign capital and gave rise to a high current account deficit of the balance of payments which in turn increased the vulnerability of the Latvian economy. With the onset of the global financial crisis, financial inflows to Latvia fell significantly leading to rapid declines in private consumption and investment.

Latvia's real GDP declined on a quarter-on-quarter basis from and including the first quarter of 2008 until and including the third quarter of 2009, but has been growing on a quarterly basis since the fourth quarter of 2009. The recession in Latvia ended in the fourth quarter of 2009 when real GDP according to seasonally adjusted data grew by 1.0 per cent. compared to the previous quarter. Although growth continued in each quarter of 2010, reflecting the fact that growth resumed from a very low level, real GDP in 2010 as a whole was still 0.9 per cent. lower than in 2009. In 2011, real GDP increased by 5.5 per cent. compared to 2010 and in the first half of 2012 it increased by 5.9 per cent. compared to the same period in 2011.

Latvia's real GDP for 2012 is forecast to grow at a rate of 4.0 per cent. according to the most recent Ministry of Finance forecast.

The table below sets out Latvia's nominal GDP determined using the expenditure method in each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012 and the percentage contribution to such GDP of each sector specified.

	Year ended 31 December					
	2007		2008		2009	
	(LVL millions)	*Contribution (per cent.)*	*(LVL millions)*	*Contribution (per cent.)*	*(LVL millions)*	*Contribution (per cent.)*
Private consumption	9,181.5	62.4	10,049.2	62.4	8,025.7	61.4
Public consumption	2,618.0	17.8	3,223.8	20.0	2,557.2	19.6
Gross fixed capital formation	5,013.3	34.0	4,769.6	29.7	2,820.3	21.6
Changes in inventories	868.9	5.9	251.6	1.6	(139.1)	(1.1)
Exports of goods and services	6,258.7	42.5	6,931.1	43.1	5,741.7	43.9
Imports of goods and services	(9,219.7)	(62.6)	(9,140.6)	(56.8)	(5,935.3)	(45.4)
GDP	**14,720.7**	**100.0**	**16,084.7**	**100.0**	**13,070.4**	**100.0**

	Year ended 31 December			
	2010		2011	
	(LVL millions)	*Contribution (per cent.)*	*(LVL millions)*	*Contribution (per cent.)*
Private consumption	8,070.8	63.1	8,835.7	61.9
Public consumption	2,349.1	18.4	2,296.1	16.1
Gross fixed capital formation	2,329.7	18.2	3,044.5	21.3
Changes in inventories	207.9	1.6	787.3	5.5
Exports of goods and services	6,847.0	53.6	8,392.4	58.8
Imports of goods and services	(7,020.3)	(54.9)	(9,080.7)	(63.6)
GDP	**12,784.1**	**100.0**	**14,275.3**	**100.0**

	Six months ended 30 June			
	2011		2012	
	(LVL millions)	*Contribution (per cent.)*	*(LVL millions)*	*Contribution (per cent.)*
Private consumption	4,199.1	63.6	4,626.4	64.2
Public consumption	1,104.5	16.7	1,161.9	16.1
Gross fixed capital formation	1,095.6	16.6	1,504.3	20.9
Changes in inventories	422.8	6.4	260.5	3.6
Exports of goods and services	3,913.9	59.3	4,375.3	60.7
Imports of goods and services	(4,130.8)	(62.5)	(4,721.5)	(65.5)
GDP	**6,605.0**	**100.0**	**7,207.0**	**100.0**

Source: Central Statistical Bureau

The table below sets out the real growth rates of each sector specified to Latvia's nominal GDP determined using the expenditure method for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					Six months ended 30 June	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
				(per cent.)			
Private consumption	14.3	(5.8)	(22.6)	2.4	4.5	4.2	6.3
Public consumption	4.9	1.6	(9.4)	(7.9)	1.1	1.5	1.1
Gross fixed capital formation	7.9	(13.8)	(37.4)	(18.1)	27.9	29.9	28.4
Exports of goods and services	10.0	2.0	(14.1)	11.6	12.7	15.0	7.4
Imports of goods and services	16.1	(10.8)	(33.3)	11.4	22.7	25.2	7.0
GDP	**9.6**	**(3.3)**	**(17.7)**	**(0.9)**	**5.5**	**4.7**	**5.9**

Source: Central Statistical Bureau

The table below sets out the total and per capita GDP of Latvia for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012, in both current and constant prices.

	Year ended 31 December					Six months ended 30 June	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
At current prices (*LVL millions*)	14,720.7	16,084.7	13,070.4	12,784.1	14,275.3	6,605.0	7,207.0
At constant prices (*LVL millions*)	8,530.1	8,250.7	6,787.9	6,724.0	7,092.3	3,267.8	3,460.0
Percentage change over previous period (constant prices)	9.6	(3.3)	(17.7)	(0.9)	5.5	4.7	5.9
Per capita[(1)]							
At current prices (*LVL*)	6,468	7,098	5,797	5,690	6,936	1,713	1,870
At constant prices (*LVL*)	3,748	3,641	3,010	3,022	3,446	849	903
Resident population							
At beginning of year	2,281,305	2,270,894	2,261,294	2,248,374	2,074,605	2,074,605	2,041,763
Average for the period	2,276,100	2,266,094	2,254,834	2,239,008	2,058,184	2,065,300	2,037,676

Source: Central Statistical Bureau

Note:

(1) Based on average population for the relevant period.

Principal Sectors of the Economy

In terms of broad sectoral classification, Latvia's primary sector (agriculture, forestry and fishing) accounted for 5.1 per cent. of total value added in 2011 and 5.2 per cent. of total value added in the first half of 2012.

The secondary sector (manufacturing, other industry (mining and quarrying, electricity, gas, steam and conditioning supply, water supply, sewage, waste management and remediation activities) and construction) accounted for 24.7 per cent. of total value added in 2011 and 25.3 per cent. of total value added in the first half of 2012. Within this sector, the share of construction has fallen as a result of the global financial crisis although the share of manufacturing increased significantly in 2010, 2011 and the first half of 2012.

The tertiary sector (services) accounted for 70.2 per cent. of total value added in 2011 and 69.5 per cent. of total value added in the first half of 2012. Within the services sector, the main activities are wholesale and retail trade and repair services, transport and storage, real estate activities and a range of other commercial and public services. Trade grew in real terms by 11.7 per cent. in 2007 before falling in real terms by 7.0 per cent. in 2008 and by 25.2 per cent. in 2009. Trade subsequently grew at real rates of 0.2 per cent. in 2010, 9.5 per cent. in 2011 and 7.2 per cent. in the first half of 2012 compared to the same period of 2011. Transportation and storage grew at a real rate of 11.4 per cent. in 2007, fell in real terms by 0.5 per cent. in 2008, grew in real terms by 1.1 per cent. in 2009, fell in real terms by 1.8 per cent. in 2010 and grew at real rates of 8.1 per cent. in 2011 and 5.9 per cent. in the first half of 2012 compared to the same period of 2011. Real estate activities grew in real terms by 8.9 per cent. in 2007 and by 3.5 per cent. in 2008, fell in real terms by 0.9 per cent. in 2009, grew in real terms by 15.2 per cent. in 2010, fell in real terms by 1.8 per cent. in 2011 and grew in real terms by 3.8 per cent. in the first half of 2012 compared to the same period of 2011.

Outside the services sector, the principal contributors to total value added are manufacturing and construction which accounted for 14.1 per cent. and 5.5 per cent., respectively, of total value added in 2011 and for 15.3 per cent. and 4.3 per cent., respectively, of total value added in the first half of 2012. Manufacturing grew at real rates of 0.8 per cent. in 2007 before falling at real rates of 8.6 per cent. in 2008 and 17.8 per cent. in 2009 and increasing at real rates of 19.1 per cent. in 2010, 11.7 per cent. in 2011 and 12.3 per cent. in the first half of 2012 compared to the same period of 2011. Construction grew at a real rate of 19.1 per cent. in 2007 before falling at real rates of 3.5 per cent. in 2008, 32.0 per cent. in 2009 and 31.1 per cent. in 2010. Thereafter, construction grew at real rates of 11.9 per cent. in 2011 and 25.2 per cent in the first half of 2012 compared to the same period of 2011.

The table below sets out nominal GDP (calculated using the production method) by primary, secondary and tertiary sector (and by each principal sub-sector within those sectors) for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					Six months ended 30 June	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
	(LVL millions)						
Primary sector	**456.1**	**431.4**	**444.5**	**575.9**	**653.0**	**313.1**	**332.2**
Secondary sector	**3,294.5**	**3,638.8**	**2,804.6**	**2,735.5**	**3,160.9**	**1,407.4**	**1,627.6**
Manufacturing	1,517.8	1,559.2	1,280.8	1,526.7	1,806.2	859.1	986.5
Other industry[1]	429.8	617.4	582.0	602.3	657.4	338.0	362.2
Construction	1,346.9	1,462.2	942.7	606.5	697.2	210.3	278.9
Tertiary sector	**9,257.5**	**10,361.7**	**8,545.7**	**8,151.7**	**8,977.2**	**4,219.0**	**4,469.6**
Trade[2]	2,768.6	2,718.1	1,990.0	1,981.8	2,254.3	1,010.0	1,102.8
Transportation and storage	1,018.6	1,165.9	1,304.8	1,306.4	1,570.0	750.6	800.9
Real estate activities	1,069.3	1,215.6	1,094.0	1,117.5	1,150.1	582.1	604.0
Other commercial services[3]	2,422.7	2,880.7	2,282.6	2,006.4	2,212.1	1,008.8	1,076.1
Public services[4]	1,978.2	2,381.4	2,002.8	1,739.5	1,790.7	867.5	885.8
Total value added	13,008.0	14,432.0	11,794.8	11,463.1	12,791.1	5,939.5	6,429.4
Taxes on products (minus subsidies)	1,712.7	1,652.7	1,275.7	1,321.0	1,484.2	665.5	777.6
Nominal GDP	**14,720.7**	**16,084.7**	**13,070.4**	**12,784.1**	**14,275.3**	**6,605.0**	**7,207.0**

Source: Central Statistical Bureau

Notes:

(1) Includes mining and quarrying, electricity, gas, steam and conditioning supply, water supply, sewage, waste management and remediation activities.

(2) Includes wholesale and retail trade, repair of motor vehicles and motorcycles and accommodation and food service activities.

(3) Includes information and communication, financial and insurance activities, professional, scientific and technical activities, administrative and support service activities, arts entertainment and recreation and other service activities.

(4) Includes public administration, defence and compulsory social security, education and human health and social work activities.

The tables below set out the percentage contribution of each sector, by primary, secondary and tertiary sector (and by each principal sub-sector within those sectors), to total value added for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					Six months ended 30 June	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
	Contribution (per cent.)						
Primary sector	**3.5**	**3.0**	**3.8**	**5.0**	**5.1**	**5.3**	**5.2**
Secondary sector	**25.3**	**25.2**	**23.8**	**24.7**	**24.7**	**23.7**	**25.3**
Manufacturing	11.7	10.8	10.9	13.3	14.1	14.5	15.3
Other industry[1]	3.3	4.3	4.9	5.3	5.1	5.7	5.6
Construction	10.4	10.1	8.0	5.3	5.5	3.5	4.3
Tertiary sector	**71.2**	**71.8**	**72.5**	**71.1**	**70.2**	**71.0**	**69.5**
Trade[2]	21.3	18.8	16.9	17.3	17.6	17.0	17.2
Transportation and storage	7.8	8.1	11.1	11.4	12.3	12.6	12.5
Real estate activities	8.2	8.4	9.3	9.7	9.0	9.8	9.4
Other commercial services[3]	26.8	28.4	27.5	27.3	26.3	26.8	26.1
Public services[4]	15.2	16.5	17.0	15.2	14.0	14.6	13.8
Total value added	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Central Statistical Bureau

Notes:

(1) Includes mining and quarrying, electricity, gas, steam and conditioning supply, water supply, sewage, waste management and remediation activities.

(2) Includes wholesale and retail trade, repair of motor vehicles and motorcycles and accommodation and food service activities.

(3) Includes information and communication, financial and insurance activities, professional, scientific and technical activities, administrative and support service activities, arts entertainment and recreation and other service activities.

(4) Includes public administration, defence and compulsory social security, education and human health and social work activities.

The table below sets out the real growth rate of each GDP sector and principal sub-sector (calculated using the production method) for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					Six months ended 30 June	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
				(per cent.)			
Primary sector	**7.6**	**(2.2)**	**9.1**	**(8.9)**	**(0.5)**	**1.7**	**5.9**
Secondary sector	**8.6**	**(4.7)**	**(21.5)**	**(1.2)**	**9.5**	**7.5**	**11.4**
Manufacturing	0.8	(8.6)	(17.8)	19.1	11.7	14.7	12.3
Other industry[1]	9.6	6.0	(3.9)	2.8	(0.9)	0.7	(3.8)
Construction	19.1	(3.5)	(32.0)	(31.1)	11.9	(6.3)	25.2
Tertiary sector	**9.0**	**(0.5)**	**(14.7)**	**(0.7)**	**4.6**	**4.6**	**3.7**
Trade[2]	11.7	(7.0)	(25.2)	0.2	9.5	9.3	7.2
Transportation and storage	11.4	(0.5)	1.1	(1.8)	8.1	8.4	5.9
Real estate activities	8.9	3.5	(0.9)	15.2	(1.8)	1.1	(1.6)
Other commercial services[3]	8.9	5.4	(14.7)	2.5	1.2	1.3	1.3
Public services[4]	2.2	(0.1)	(9.3)	(8.2)	0.6	0.9	0.5
Taxes on products (minus subsidies)	16.2	(16.4)	(37.8)	2.2	4.9	(1.5)	11.7
GDP	**9.6**	**(3.3)**	**(17.7)**	**(0.9)**	**5.5**	**4.7**	**5.9**

Source: Central Statistical Bureau

Notes:

(1) Includes mining and quarrying, electricity, gas, steam and conditioning supply, water supply, sewage, waste management and remediation activities.

(2) Includes wholesale and retail trade, repair of motor vehicles and motorcycles and accommodation and food service activities.

(3) Includes information and communication, financial and insurance activities, professional, scientific and technical activities, administrative and support service activities, arts, entertainment and recreation and other service activities.

(4) Includes public administration, defence and compulsory social security, education and human health and social work activities.

Primary Sector

The primary sector accounted for between 3.0 per cent. and 5.1 per cent. of Latvia's total value added in the period from 2007 to 2011. The real growth rates in the primary sector were 7.6 per cent. in 2007, negative 2.2 per cent. in 2008, 9.1 per cent. in 2009, negative 8.9 per cent. in 2010, negative 0.5 per cent. in 2011 and 5.9 per cent. in the first half of 2012 compared to the comparable period in 2011. Forests cover about 45 per cent. of Latvia and are the country's most important natural resource, while wood production is one of Latvia's principal exports. Agriculture plays a significant role as a source of employment, see "- *Employment*", and agricultural products (comprising live animals, prepared foodstuffs, principally fish and dairy products, and vegetable products) are a significant contributor to Latvia's exports, see "*Balance of Payments – Foreign Trade*". Agriculture also provides additional income for many families. According to the 2010 agricultural census, there were 180,263 farmsteads of all sizes spread over 2.2 million hectares of land, giving an average farm size of around 20 hectares. According to the results of the 2010 agricultural census, the number of agricultural holdings in Latvia is reducing year by year, but the area cultivated is increasing. In comparison with data from the 2007 Farm Structure Survey, the number of economically active agricultural holdings has diminished by 26.5 per cent., but the agricultural area has grown by 2,900 hectares or 0.2 per cent. The utilised agricultural area has risen by 20,500 hectares or 1.2 per cent. The average size of an agricultural holding has risen from 25.5 hectares in 2007 to 34.5 hectares in 2010 or by 35.3 per cent. The average utilised agricultural area per holding has grown from 15.7 hectares to 21.5 hectares or by 36.9 per cent. These areas are mainly used as arable land (13.4 hectares on average per holding) and meadows and pastures (7.8 hectares on average per holding). Between 2001 and 2011, the total area of arable land in the country has decreased by 10 per cent. while 2,800, or 3 per cent., of the surveyed farms have ceased to be engaged in agriculture. The main reasons for this are the use of what was previously agricultural land for forestry and construction.

Secondary Sector

Manufacturing

The table below sets out the contribution of manufacturing to Latvia's total value added, as well as the real growth rate in manufacturing (in each case, calculated using the production method) for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					Six months ended 30 June	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
Manufacturing *(LVL millions)*	1,517.8	1,559.2	1,280.0	1,526.7	1,806.2	859.1	986.5
Contribution *(per cent.)*	11.7	10.8	10.9	13.3	14.1	14.5	15.3
Real growth rate *(per cent.)*	0.8	(8.6)	(17.8)	19.1	11.7	14.7	12.3

Source: Central Statistical Bureau

Latvia's industrial strength is principally in labour-intensive sectors such as wood processing, the food industry, metalwork and the production of metal goods, and the chemical and pharmaceutical industry, which together constituted 70.3 per cent. of the manufacturing sector's value added in 2011.

The table below shows the structure of manufacturing based on the percentage proportion of value added in the year ended 31 December 2011 and changes in production volumes in manufacturing in each of the years ended 31 December 2008, 2009, 2010 and 2011 and for the eight months ended 31 August 2011 and 2012.

	Year ended 31 December					8 months ended 31 August	
	Structure	**Changes in production volumes**					
	2011	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
				(per cent.)			
Wood processing	23.1	(12.1)	1.6	33.0	12.6	11.9	8.5
Food industry	25.2	(2.0)	(16.1)	(0.1)	(0.2)	0.1	2.7
Metals and metal articles	14.2	1.4	(27.1)	24.2	28.3	32.0	21.6
Chemical, rubber, plastics and pharmaceuticals	7.8	(2.0)	(18.5)	5.2	4.4	3.7	12.6
Paper industry and publishing	3.9	(3.9)	(17.1)	19.8	(0.5)	3.8	10.5
Light industry	4.3	(2.2)	(38.6)	19.4	19.4	28.9	0.0
Machinery and equipment	2.2	10.4	(35.5)	17.8	37.1	40.2	10.2
Non-metallic mineral products	5.8	(14.4)	(40.1)	17.6	24.2	29.6	11.4
Transport vehicles	3.7	5.8	(49.7)	59.0	37.0	52.0	14.4
Electrical and optical equipment	4.6	14.1	(34.8)	33.2	29.6	27.3	24.0
Other industries	5.3	(5.5)	(20.1)	(4.9)	9.5	8.8	36.8
Total	**100.0**	**(3.4)**	**(20.2)**	**16.5**	**11.7**	**12.9**	**12**

Source: Ministry of Economics

In the wood industry, declining production in 2008 reflected decreased demand in Europe for processed wood products in that year. Approximately 73 per cent. of the wood processing industry's production is exported, principally to EU countries. The decline in the food industry since 2008 reflected both weaker domestic and export demand. Approximately 70 per cent. of the goods produced by the food industry are sold in the domestic market. The majority of the metal and metal products produced in Latvia are exported, principally to EU countries, and demand in these markets for these products did not

significantly decline until mid-2008. In the chemical industry, production volumes declined in 2008 and 2009 before recovering in 2010. Around 77 per cent. of Latvia's chemical, rubber, plastics and pharmaceutical production is exported.

The general recovery in production volumes in most industries in 2010 reflects the fact that from the second half of 2009, many of Latvia's trade partner countries began to experience economic growth. This increase in external demand provided a positive growth stimulus to Latvian producers.

The expansion of exports due to increased competitiveness and external demand is the principal reason for the increase in the production volume of manufacturing overall which, in 2010, was 16.5 per cent. higher than in 2009 and, in 2011, was 11.7 per cent. higher than in 2010. The total revenues from manufacturing sales in 2011 were 17.8 per cent. higher than in 2010. The production volume of manufacturing in the first eight months of 2012 was 12 per cent. higher than in the corresponding period of 2011 and the total revenues from manufacturing sales in the first eight months of 2012 were 14.8 per cent. higher than the corresponding period of 2011. Latvia's increased competitiveness was principally due to wage restraint and deflation, particularly in the 2009 – 2010 period. However, see "*Risk Factors – Latvia's economy was significantly adversely affected by the global financial crisis. Any similar future global economic downturns, or difficulties experienced by Latvia's major regional trading partners or more general contagion effects could have a material adverse effect on Latvia's economy and public finances*".

Construction

The table below sets out the contribution of construction to Latvia's total value added, as well as the real growth rate in construction (in each case, calculated using the production method) for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					**Six months ended 30 June**	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
Construction *(LVL millions)*	1,346.9	1,462.2	942.7	606.5	697.2	210.3	278.9
Contribution *(per cent.)*.....	10.4	10.1	8.0	5.3	5.5	3.5	4.3
Real growth rate *(per cent.)*	19.1	(3.5)	(32.0)	(31.1)	11.9	(6.3)	25.2

Source: Central Statistical Bureau

The construction sector grew strongly in real terms in 2007, driven by both residential and commercial private construction in turn boosted by the availability of bank credit. In addition, construction was also boosted by public infrastructure projects, including port improvements, road repairs and sewage processing works, many of which were supported by EU financing. Construction contracted in real terms in each of 2008, 2009 and 2010 as bank financing ceased to be readily available as a result of the liquidity crisis in Latvia. Growth resumed in the construction sector in 2011, with real growth rates of 11.9 per cent. in 2011 and 25.2 per cent. in the first six months of 2012 compared to the corresponding period of 2011. Notwithstanding the growth in construction in 2011 and the first half of 2012, contruction's contribution to total value added has continued to decline from 10.4 per cent. in 2007 to 4.3 per cent. in the first half of 2012.

Tertiary Sector

The table below sets out a breakdown of the contribution of the services sector (calculated using the production method) to total value added by significant sub-sectors for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					
	2007		**2008**		**2009**	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Wholesale and retail trade, repair services	2,542.0	19.5	2,488.2	17.2	1,805.7	15.3
Transportation and storage	1,018.6	7.8	1,165.9	8.1	1,304.8	11.1
Real estate activities	1,069.3	8.2	1,215.6	8.4	1,094.0	9.3
Public administration and defence, compulsory social security	1,021.2	7.9	1,176.7	8.2	992.1	8.4
Professional, scientific and technical activities[1]	914.5	7.0	1,218.3	8.4	965.6	8.2
Education	598.5	4.6	750.4	5.2	633.6	5.4
Information and communication	507.7	3.9	601.2	4.2	513.3	4.4
Financial and insurance activities	702.5	5.4	714.2	4.9	472.7	4.0
Human health and social work activities	358.5	2.8	454.2	3.1	377.2	3.2
Remaining services[2]	524.6	4.0	577.0	4.0	386.7	3.3
All services	9,257.5	71.2	10,361.7	71.8	8,545.7	72.5

	Year ended 31 December			
	2010		**2011**	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Wholesale and retail trade, repair services	1,811.5	15.8	2,034.0	15.9
Transportation and storage	1,306.4	11.4	1,570.0	12.3
Real estate activities	1,117.5	9.7	1,150.1	9.0
Public administration and defence, compulsory social security	865.7	7.6	893.4	7.0
Professional, scientific and technical activities[1]	929.9	8.1	999.8	7.8
Education	521.9	4.6	536.6	4.2
Information and communication	511.1	4.5	537.5	4.2
Financial and insurance activities	367.6	3.2	453.9	3.5
Human health and social work activities	351.9	3.1	360.6	2.8
Remaining services[2]	368.1	3.2	441.3	3.4
All services	**8,151.7**	**71.1**	**8,977.2**	**70.2**

	Six months ended 30 June			
	2011		2012	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Wholesale and retail trade; repair services	913.8	15.4	994.3	15.5
Transportation and storage	750.6	12.6	800.9	12.5
Real estate activities	582.1	9.8	604.0	9.4
Public administration and defence; compulsory social security	404.0	6.8	413.3	6.4
Professional, scientific and technical activities[1]	469.3	7.9	481.2	7.5
Education	287.1	4.8	294.6	4.6
Information and communication	251.9	4.2	283.8	4.4
Financial and insurance activities	186.3	3.1	204.6	3.2
Human health and social work activities	176.4	3.0	178.0	2.8
Remaining services[2]	197.6	3.3	215.0	3.3
All services	**4,219.0**	**71.0**	**4,469.6**	**69.5**

Source: Central Statistical Bureau

Notes:

(1) Includes professional, scientific and technical activities; administrative and support service activities; and other service activities.

(2) Includes accommodation and food services activities; arts, entertainment and recreation.

The table below sets out a breakdown of the real rates of growth of each significant sub-sector within the services sector (calculated using the production method) for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					Six months ended 30 June	
	2007	2008	2009	2010	2011	2011	2012
				(per cent.)			
Wholesale and retail trade; repair services	11.2	(6.9)	(25.5)	0.5	8.7	8.3	7.1
Transportation and storage	11.4	(0.3)	1.1	(1.8)	8.1	8.4	5.9
Real estate activities	8.9	3.5	(0.9)	15.2	(1.8)	1.1	(1.6)
Public administration and defence; compulsory social security	1.6	(0.7)	(8.8)	(11.3)	0.6	0.4	(0.9)
Professional, scientific and technical activities[1]	12.5	14.3	(22.8)	(8.3)	5.0	3.3	3.9
Education	2.4	(0.7)	(9.9)	(5.8)	(0.1)	(0.6)	3.3
Information and communication	1.2	1.7	(17.6)	(1.5)	3.1	(2.2)	7.0
Financial and insurance activities	10.8	7.6	(14.2)	(9.1)	(0.4)	(1.2)	(1.5)
Human health and social work activities	3.3	2.9	(9.7)	(3.2)	1.6	4.6	(1.0)
Remaining services[2]	14.9	(9.1)	(31.9)	(0.7)	13.2	16.6	6.5
Services total	**9.0**	**(0.5)**	**(14.7)**	**(0.7)**	**4.6**	**4.6**	**3.7**

Source: Central Statistical Bureau

Notes:

(1) Includes professional, scientific and technical activities, administrative and support service activities; and other service activities.

(2) Includes accommodation and food services activities, arts, entertainment and recreation.

Within the tertiary services sector, the principal sub-sectors by contribution are wholesale and retail trade and repair services (“**trade**”); transport and storage (“**transport**”); real estate activities (“**real estate**”); and public administration and defence and compulsory social security (“**public administration**”). Within

the tertiary services sector, together these activities accounted for 61.0 per cent. of total services in 2007, 58.4 per cent. of total services in 2008, 60.8 per cent. of total services in 2009, 62.6 per cent. of total services in 2010, 62.9 per cent. of total services in 2011 and 62.8 per cent. and 62.9 per cent. of total services for the first half of 2011 and 2012, respectively.

Wholesale and retail trade; repair services

The table below shows a breakdown of trade (calculated using the production method) for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December				
	2007	**2008**	**2009**	**2010**	**2011**
	(LVL millions)				
Wholesale trade, except trade in and repairs for motor vehicles and motorcycles	1,164.4	1,206.0	906.1	1,002.3	1,105.5
Retail trade, except trade in and repairs for motor vehicles and motorcycles	1,071.4	1,067.7	714.9	649.3	706.1
Motor vehicles and motorcycles trade and repair services	306.2	214.4	184.7	159.9	222.4
Wholesale and retail trade; repair services	**2,542.0**	**2,488.2**	**1,805.7**	**1,811.5**	**2,034.0**

	Six months ended 30 June	
	2011	**2012**
Wholesale trade, except trade in and repairs for motor vehicles and motorcycles	490.7	535.7
Retail trade, except trade in and repairs for motor vehicles and motorcycles	325.8	360.1
Motor vehicles and motorcycles trade and repair services	97.3	98.5
Wholesale and retail trade; repair services	**913.8**	**994.3**

Source: Central Statistical Bureau

For the purposes of calculating GDP, wholesale trade is defined as an intermediate process in the distribution of merchandise, whereas retail trade is defined as the final process in the distribution of merchandise. Repair services comprise the maintenance and repair of goods associated with wholesale and retail trade.

Both wholesale trade and repair services grew slightly in real terms in 2007, declined slightly in real terms in 2008 and declined significantly in real terms in 2009. Each category then grew in real terms in each of 2010, 2011 and the first half of 2012 compared to the same period in 2011. By contrast, in real terms retail trade grew strongly in 2007, declined slightly in 2008, declined significantly in 2009, did not change in 2010 and grew slightly in each of 2011 and the first half of 2012 compared to the same period in 2011. As a result, as a percentage of trade as a whole, retail trade was 42.1 per cent. in 2007 and 36.2 per cent. in the first half of 2012; wholesale trade was 45.8 per cent. in 2007 and 53.9 per cent. in the first half of 2012; and repair services was 12.0 per cent. in 2007 and 9.9 per cent. in the first half of 2012.

In overall terms, wholesale and retail trade and repair services grew strongly in real terms in 2007, fell in 2008 and then fell significantly in 2009 and grew in real terms in each of 2010, 2011 and the first half of 2012 compared to the comparable period of 2011. These trends reflected the fact that consumer demand was negatively affected in 2009 by declining disposable income as a result of increased unemployment, wage cuts and tax increases as well as by the effects of the liquidity crisis and reduced bank lending which adversely impacted the consumption of durable goods. During the first half of 2012, retail trade turnover

increased by 10.1 per cent. (in real terms on a seasonally adjusted basis) compared to the comparable period of 2011.

In terms of real growth rates, the wholesale and retail trade and repair services sector outperformed services as a whole in each of 2007, 2010, 2011 and the first half of 2012 but was significantly more adversely affected in each of 2008 and 2009.

Transportation and storage

Transportation and storage contributed 7.8 per cent. to Latvia's total value added in 2007, 8.1 per cent. in 2008, 11.1 per cent. in 2009, 11.4 per cent. in 2010, 12.3 per cent. in 2011 and 12.5 per cent. in the first half of 2012. In terms of real growth, transportation and storage grew in 2007 (by 11.4 per cent.), fell by 0.3 per cent. in 2008, grew by 1.1 per cent. in 2009, fell by 1.8 per cent. in 2010 and grew by 8.1 per cent. in 2011 and by 5.9 per cent. in the first half of 2012 compared to the same period of the previous year. Certain freight transport statistics are set out below under ''—*Infrastructure*''.

Real estate activities

The real estate sector developed rapidly in the years before 2008, due to an increase in available credit and levels of demand which substantially exceeded supply. Due to the global financial crisis, the demand for real estate has decreased since 2008 as evidenced by a significant decline in apartment prices in Riga since early 2007. However, growth rates for the real estate sector have remained above average in comparison to growth rates for the services sector as a whole, principally as result of the fact that demand for business services such as tax advisory, information technology and security services has remained steady as these services are less sensitive to declining economic conditions. Reflecting this trend, the contribution of the real estate sector to Latvia's total value added grew from 8.2 per cent. in 2007 to 9.7 per cent. in 2010 before falling to 9.0 per cent. in 2011 as other sectors recovered. The contribution of the real estate sector to Latvia's total value added was 9.4 per cent. in the first half of 2012.

Public administration and defence; compulsory social security

Public administration contributed 7.9 per cent. to Latvia's total value added in 2007, 8.2 per cent. in 2008, 8.4 per cent. in 2009, 7.6 per cent. in 2010, 7.0 per cent. in 2011 and 6.4 per cent. in the first half of 2012. In terms of real growth, public administration grew by 1.6 per cent. in 2007, fell by 0.7 per cent. in 2008, 8.8 per cent. in 2009 and 11.3 per cent. in 2010, grew by 0.6 per cent. in 2011 and fell by 0.9 per cent. in the first half of 2012 compared to the same period of the previous year.

Since Latvia's accession to the EU, real growth rates for the public administration sector have been lower than those for the services sector as a whole. However, in 2008 and 2009, the percentage of Latvia's total value added attributable to the public administration sector was higher than in other periods reflecting the fact that this sector is not as sensitive to global economic conditions as certain other services sectors. See also ''*Public Finance— Impact of the Global Financial Crisis on Latvia's Budgets since 2009*'' for a discussion of budget cuts affecting the public sector since 2009.

Financial and insurance activities

Financial intermediation, which is dominated by Latvia's banking sector, contributed 5.4 per cent. to Latvia's total value added in 2007, 4.9 per cent. in 2008, 4.0 per cent. in 2009, 3.2 per cent. in 2010, 3.5 per cent. in 2011 and 3.2 per cent. in the first half of 2012. The real growth rate for this sector was 10.8 per cent. in 2007 and 7.6 per cent. in 2008. Since 2008, the financial intermediation sector has declined at real rates of 14.2 per cent. in 2009, 9.1 per cent. in 2010, 0.4 per cent. in 2011 and 1.5 per cent. in the first half of 2012 compared to the comparable period of 2011.

In 2008, bank lending in Latvia slowed reflecting increased reserve requirements imposed by the Bank of Latvia in response to concerns about the overheating of the economy and reduced availability of finance to Latvian banks due to concerns about Latvia's economic vulnerability. Most Latvian banks are owned by non-Latvian groups and the only significant Latvian-owned bank, Parex Bank, was nationalised by the State in late 2008. In 2009, the level of financial intermediation fell compared to the equivalent period in the previous year as slackening economic activity led to lower levels of lending and other banking services. Declining financial intermediation activity continued in 2010 and 2011, although at a reduced pace. These declines resulted from banks' deleveraging their balance sheets as well as reduced demand for credit from corporations and households. In addition, a lack of sustainable preconditions for lending recovery and write-offs of bad loans also contributed to the decline in lending. See ''*Monetary and Financial System—Financial Sector Supervision*''.

Education and health

Together, education and health and social work contributed 7.4 per cent. to Latvia's total value added in 2007, 8.3 per cent. in 2008, 8.6 per cent. in 2009, 7.7 per cent. in 2010, 7.0 per cent. in 2011 and 7.4 per cent. in the first half of 2012. In terms of real growth, education grew by 2.4 per cent. in 2007, fell by 0.7 per cent. in 2008, fell by 9.9 per cent. in 2009, fell by 5.8 per cent. in 2010 and fell by 0.1 per cent. in 2011. In the first half of 2012, education grew by 3.3 per cent. compared to the same period of the previous year. The health and social work subsector grew in real terms by 3.3 per cent. in 2007 and 2.9 per cent. in 2008. Health and social work declined by 9.7 per cent. in real terms in 2009 and by 3.2 per cent. in 2010, grew in real terms by 1.6 per cent. in 2011 and fell in real terms by 1.0 per cent. in the first half of 2012 compared to the same period of the previous year.

The decline from 2008 to 2010 was due to a reduction in available funding following the implementation of a budget consolidation policy. The decline in education and health was also affected by demographic changes. However, the value added from health care increased in 2011 as a result of reforms implemented since 2008 taking effect.

Tourism

Tourism in Latvia was noticeably affected by the global economic downturn in 2009 when the number of non-resident travellers in Latvia decreased by almost 14 per cent. to 4.7 million compared to 5.5 million in 2008. However, the industry showed a moderate resilience and non-resident travellers increased by 6.7 per cent. and overnight travellers increased by 3.8 per cent. in 2010. In 2011, the number of non-resident travellers in Latvia increased by 9.8 per cent. to 5.5 million, and the total expenditure of those travellers increased to LVL 379.5 million. In addition, the number of overnight travellers in 2011 increased by 8.7 per cent. compared to 2010.

At 30 September 2012, there were 635 hotels and other accommodation establishments in Latvia, of which 118, or approximately 19 per cent., were located in Riga. The number of visitors in Latvia's hotels and other accommodation establishments also increased in 2012 in comparison to 2011. In the nine months to 30 September 2012, the number of visitors in hotels and other establishments grew by approximately 4 per cent. and the number of foreign visitors increased by approximately 3 per cent., in each case when compared to the corresponding period of 2011. The top six countries accounting for the largest proportion of visitors to Latvia in 2011 were Russia, Lithuania, Sweden, Germany, Estonia and Finland, accounting for approximately 62 per cent. of all overnight arrivals.

The Government is targeting tourism as one of its priority industries for development. The Latvian Tourism Marketing strategy for 2010-2015 has been developed by the Latvian Tourism Development Agency in cooperation with tourism associations and tourism educational institutions. It has identified the 'high priority markets' of Germany, Russia, Finland, Sweden, Lithuania and Estonia and the 'priority markets' of the United Kingdom, The Netherlands, Norway, Italy, Denmark and Spain, as well as the 'prospective markets' of America, Japan, China and India. All of these markets are targeted through a three-year project implemented in 2010 and co-financed by EU structural funds, although particular attention is focussed on marketing in the high priority markets.

Inflation

In 2007 and 2008, inflation (as measured by changes in the CPI) in Latvia increased sharply as a result of high domestic demand fuelled by rapid credit growth. The increase in inflation initially reflected increased import prices and the effect of EU accession (including increases in indirect taxes and heightened inflation expectations). Thereafter, demand-driven pressure and increases in global food and energy prices (which together constitute around 36 per cent. of Latvia's consumer price basket) also became significant contributors to the increase in inflation.

Inflation measured on a year-on-year basis peaked at 17.7 per cent. in May 2008 and then declined steadily until February 2010 (when it was -4.2 per cent.). The decline in inflation reflected both significant weakening of domestic demand as a result of increasing unemployment, wage reductions and other measures taken to combat the effects of the global financial crisis on Latvia, and a decline in global energy and food prices as a result of the deterioration in the global economic environment. Although domestic demand remained fragile in 2010, increases in world energy and food prices and in indirect tax rates in Latvia resulted in increased inflation from February 2010 to May 2011, when the inflation rate peaked at 5.0 per cent. year-on-year. The year on year increase in consumer prices subsequently declined to 3.9 per cent. in 2011, while the 12-month average inflation rate increased to 4.4 per cent. in that year from an average deflation rate of 1.1 per cent. in 2010. The 12-month average inflation rate in

October 2012 was 2.7 per cent. The decrease in inflation since May 2011 has generally reflected more moderate increases in world energy prices than those in the prior period, a gradual decrease in world food prices until July 2012, sustainable wage productivity developments and less impact from indirect taxes than in the prior period.

The table below sets out the growth rates of the CPI for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the 12-month period ended 30 September 2012.

	2007	2008	2009	2010	2011	2012[1]
CPI *(annual 12-month average rate of change in per cent.)*	10.1	15.4	3.5	(1.1)	4.4	2.7
CPI *(end of period compared to the end of the previous period in per cent.)*	14.1	10.5	(1.2)	2.4	3.9	1.6

Source: Central Statistical Bureau
Note:
(1) As at/12-month period ended 31 October.

On 8 November 2012, the Central Bureau of Statistics announced that, compared to October 2011, consumer prices had increased by 1.6 per cent. in October 2012, reflecting a 1.8 per cent. increase in the price of the goods, and a 1.0 per cent. decrease in the price of the services, included in the CPI.

Wages

Average monthly wages increased sharply in Latvia in the period before the global financial crisis reflecting economic growth and productivity gains, with average monthly gross wage growth reaching 31.5 per cent. in 2007. In 2008, the rate of increase in average monthly gross wages in Latvia declined to 20.5 per cent. as a result of the economic downturn and average monthly gross wages fell in both 2009 and 2010. In 2011, average monthly gross wages grew only marginally before increasing significantly in the first six months of 2012 to reach a level slightly above that in 2008.

Although the growth rates in average monthly wages in Latvia since EU accession were among the highest in the EU according to Eurostat, the nominal wage level in Latvia remains low if compared to the EU average. In 2010, and according to Eurostat, the average annual gross earnings of full time employees in enterprises with 10 or more employees were €8,596, the fourth lowest among the EU-27 countries (being all the existing Member States of the EU).

The table below sets out the average monthly gross and net wages in Latvia and their growth rates, together with the real wage index, for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2011 and 2012.

	Year ended 31 December					Nine months ended 30 September	
	2007	2008	2009	2010	2011	2011	2012
Average monthly gross wages *(LVL)*	398	479	461	445	464	467	484
Gross growth (per cent.)...	31.5	20.5	(3.9)	(3.5)	4.3	4.3	3.6
Average monthly net wages *(LVL)*	286	350	342	316	330	353	345
Growth *(per cent.)*.....	32.0	22.5	(2.3)	(7.5)	4.4	4.5	3.6
Real wage index *(per cent. of previous year)*.....	119.9	106.2	94.4	93.5	100.1	100.0[1]	102.1[1]

Source: Central Statistical Bureau
Note:
(1) As at 30 June 2012.

Between January 2007 and January 2012, the minimum monthly wage in Latvia increased from LVL 120 to LVL 200, or by 66.7 per cent., and the real hourly wage in Latvia increased from LVL 3.25 to LVL 3.86, or by 18.8 per cent., while over the same period labour productivity increased from LVL 4.7 to LVL 5.5 per hour worked, or by 17.0 per cent. The minimum monthly wage will remain at LVL 200

during 2012. Between January 2007 and January 2009, the basic personal (tax-free) allowance was increased from LVL 50 to LVL 90 per month, although from 1 July 2009 this was decreased to LVL 35 as part of a general Government budget consolidation in Latvia. In January 2011, the basic personal allowance was increased from LVL 35 to its current level of LVL 45.

In the first nine months of 2012, the average monthly gross wage increased by 3.6 per cent. to LVL 484 from LVL 457 for the same period in the previous year. This increase was primarily due to the improved conditions in the economy compared to the previous year.

The monthly tax allowance for dependent persons has increased from LVL 35 on 1 January 2007 to LVL 70 on 1 January 2012.

Employment

In 2007 and 2008, the number of employed persons (aged between 15-64) increased by 2.9 per cent. and by 0.5 per cent., respectively. During the same period, the labour participation rate (which measures the active population (that is, persons aged 15-64 who are employed or actively seeking a job) as a percentage of the total population) and the employment rate (the number of employed persons aged 15-64 expressed as a percentage of the total population) both increased. The labour participation rate increased from 72.9 per cent. in 2007 to 74.5 per cent. in 2008 and the employment rate increased from 68.4 per cent. in 2007 to 68.6 per cent. in 2008.

Due to the impact of the global financial crisis, the unemployment rate increased rapidly after 2008 while the labour participation and the employment rates declined. The unemployment rate increased from 7.8 per cent. in 2008 to 19.0 per cent. in 2010 before falling to 16.4 per cent. in the first half of 2012. The employment rate fell from 68.6 per cent. in 2008 to 59.3 per cent. in 2010 (having reached 57.7 per cent. in the first quarter of that year) before increasing to 62.4 per cent. in the first half of 2012. The labour participation rate fell from 74.5 per cent. in 2008 to 72.8 per cent. in 2011 before increasing to 74.9 per cent. in October 2012.

The table below sets out the LFS unemployment rate, the registered unemployment rate, the labour participation rate and the employment rate (by gender) in Latvia as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	2007	2008	2009	2010	2011	2012[1]
Unemployment rate[2]	6.2	7.8	17.3	19.0	16.5	13.8
Registered unemployment rate, end of period *(per cent.)*[3]	4.9	7.0	16.0	14.3	11.5	10.7[6]
Labour participation rate, annual data *(per cent.)*[4]...	72.9	74.5	73.9	73.2	72.8	74.9
Employment rate *(per cent.)*[5]	68.4	68.6	61.1	59.3	60.8	64.5
Men.....	72.6	72.0	61.3	59.2	61.5	66.7
Women	64.4	65.5	60.9	59.4	60.2	62.6

Sources: State Employment Agency, Central Statistical Bureau

Notes:

(1) As at 31 October 2012.

(2) LFS data. Data for 2011 and 2012 is not directly comparable with prior periods as such data is based on population figures derived from the 2010 population census whilst the population figures used in earlier data have not yet been recalculated.

(3) Unemployed non-working persons (aged 15-64) actively seeking a job, registered with the State Employment Agency as a percentage of the active population.

(4) The active population (aged 15-64) as a percentage of the total population.

(5) Employed persons (aged 15-64) expressed as a percentage of the total population.

(6) As at 30 September 2012.

The recession in Latvia impacted male employment (aged 15-64) more significantly than female employment. The male employment rate fell marginally in 2008 and then decreased from 72.0 per cent. in 2008 to 61.3 per cent. in 2009. The female employment rate increased marginally in 2008 before falling from 65.5 per cent. in 2008 to 60.9 per cent. in 2009. In 2010 these rates equalised and stood at around 59 per cent. (59.2 per cent. for men and 59.4 per cent. for women). Reflecting Latvia's emergence from recession, from 2010 the male employment rate increased faster than the female employment rate and was 66.7 per cent. at 31 October 2012 compared to the female employment rate of 62.6 per cent.

Female unemployment (LFS) did not change significantly in 2010 (remaining at around 15.3 per cent.) while male unemployment fell to 18.6 per cent. in the fourth quarter of 2010 compared to 26.0 per cent. in the first quarter of 2010. As at 31 October 2012, male unemployment was 11.0 per cent. while unemployment for women was 9.7 per cent.

The following table shows employment by sector in Latvia as at 31 December 2007, 2008, 2009, 2010 and 2011.

	Year ended 31 December				
	2007	**2008**	**2009**	**2010**	**2011**
	(Thousands of employees)				
Agriculture, forestry and fishing	100.7	82.3	80.3	78.1	88.3
Mining and quarrying	5.8	2.7	3.2	4.5	-
Manufacturing	160.8	157.7	132.3	127.6	130.5
Electricity, gas, steam and air conditioning supply	20.6	16.9	12.9	13.8	12.9
Water supply; sewage, waste management and remediation activities	–	11.5	12.7	11.3	8.9
Construction	124.2	126.9	78.2	65.7	70.3
Wholesale and retail trade; repair services	–	178.6	161.7	148.4	150.3
Transportation and storage	99.3	91.6	86.5	80.5	83.7
Accommodation and food service activities	30.8	30.5	24.8	29.2	28.8
Information and communication	–	27.1	22.7	28.8	28.4
Financial and insurance activities	21.0	19.1	19.6	18.2	20.2
Real estate activities	68.8	8.5	12.6	16.9	18.1
Professional, scientific and technical activities	–	25.8	25.6	25.5	25.9
Administrative and support service activities	–	29.2	29.5	29.7	35.0
Public administration and defence; compulsory social security	83.2	84.0	67.5	61.8	61.2
Education	76.8	85.8	86.2	92.8	97.3
Human health and social work activities	46.2	48.8	43.4	44.7	46.0
Arts, entertainment and recreation	–	25.8	23.7	19.8	17.9
Other service activities	51.1	19.9	23.2	18.3	20.4
Activities of households as employers; undifferentiated goods and services producing activities of households for own use	–	3.2	3.7	–	–

Source: Eurostat; Age 15 to 64

The Latvian sectors which were the biggest employers at 31 December 2011 were the trade sector, manufacturing, education, agriculture, transport and construction which together accounted for 65.7 per cent. of total employment based on Eurostat figures. Most of these sectors experienced declining numbers of employees between 2008 and 2010 with small increases in 2011. The principal exception was education where the number of employees has increased in each year since 2007.

See also "– *Impact of the Global Financial Crisis and Response – Economic Reform Programme*" for a discussion of certain measures designed to increase employment.

Social Security System

Social Insurance

The State social security system guarantees a defined amount of compensation for loss of income in certain situations to persons paying social insurance contributions. The amount of compensation depends on the income from which the amount of the contribution has been calculated. The receipt of social benefits requires contributions to have been made.

The types of social insurance available in Latvia are state pension insurance; unemployment insurance; insurance for work-related accidents and diseases; disability insurance; maternity, paternity and sickness insurance; and parents' insurance.

In 2011, an employee insured for all types of social insurance had a compulsory contribution rate of 35.09 per cent. of his gross wage. The total social insurance contribution is split between the employer and the employee at 24.09 per cent. and 11.00 per cent., respectively.

Social insurance contribution payments are calculated based on the likely risks for various groups of tax payers. As a result, certain categories of payers do not make contributions for certain types of insurance. For example, pensioners would not pay for unemployment and disability insurance. These types of exemptions reduce the rate of contribution for many payers.

The benefits and contributions which are paid are financed by the State Social Insurance special budget and, where necessary, social security costs can also partly be financed by accumulated budget resources. At the end of 2008, the State Social Insurance special budget had an accumulated surplus of LVL 951.1 million. With the start of the recession and the subsequent fall in wages and rise in unemployment in 2009, the State Social Insurance special budget expenditures exceeded revenues in each of 2009, 2010 and 2011, by LVL 213.1 million, LVL 335.7 million and LVL 124.9 million, respectively. For 2012, the State Social Insurance special budget is planned with an LVL 78.2 million deficit. The reduced deficit reflects a number of measures taken with a view to balancing the budget and creating a sustainable social insurance framework, including an increase in social contribution; a general reduction in certain types of compensation and setting upper limits for compensation amounts. In addition, the retirement age will increase by three months a year from 62 to 65 years between 2014 and 2025.

Pension System

In 1996, Latvia commenced reform of its pension system in order to create greater flexibility with regard to demographic fluctuations and to provide long-term stability given the ageing population. The pension system focuses on incentives for the working age population to remain in the labour market as long as possible beyond the minimum retirement age (currently 62 years for both men and women, although see "– *Social insurance*" above). Since July 2001, a three-tier pension system has been in operation in Latvia. The first tier comprises a state compulsory unfunded pension scheme, the second tier comprises a state funded pension scheme and the third tier comprises a private voluntary pension scheme. All persons making social insurance contributions are included in the first tier. Contributions paid by the members are used for the payment of old age pensions to the existing generation of pensioners. Social insurance contributions paid by those who participate in the second pension tier are invested by selected fund managers and saved for the pension of the individual making the contribution. The third pension tier allows every individual to create additional savings for his pension in private pension funds.

The first tier has been in operation since 1 January 1996. The pension amount paid under this tier depends on the recipient's accumulated pension capital, age at retirement and forecasted life expectancy after retiring. The number of contributors to this scheme in the second quarter of 2012 was approximately 948,000 or 90.6 per cent. of the economically active population (for this purpose defined as people aged 15-74), of which 88.1 per cent. were employees (including employees of micro-enterprises) and 1.0 per cent. were self-employed. Expenditures for old age pensions under this tier equalled 6.7 per cent. of GDP in the second quarter of 2012.

The second tier has been in operation since 1 July 2001. Under this tier, the participant's contributions are invested in capital markets instruments in Latvia and abroad by his selected private fund manager. The assets of this tier are managed by nine private investment management companies which offer 27 investment plans. The number of participants in the second tier scheme at the end of the second quarter of 2012 was over 1.1 million. The net assets of the investment plans of the scheme equalled 6.1 per cent. of GDP at the end of 2011. In 2012, the contribution rate is 2.0 per cent. of gross wages, although this share is expected to increase up to 6.0 per cent. by 2016.

The third tier has been in operation since 1 July 1998. The third tier gives any person the free choice to create additional savings for his pension by paying contributions into private pension funds. At the end of the second quarter of 2012, there were seven private pension funds operating in Latvia, consisting of six open pension funds and one closed pension fund, offering 21 pension plans to approximately 202,000 participants, or 19 per cent. of Latvia's economically active population. In the first two quarters of 2012, 39.3 per cent. of total contributions were made by employers and 60.7 per cent. were made by individual participants. The net capital of the scheme equalled 0.84 per cent. of GDP at the end of 2011.

Infrastructure

Since EU accession, Latvia has been investing in improving its transport infrastructure with the help of EU structural funds. A number of transport and communications sectors have also been liberalised and competition and service levels are increasing.

The table below sets out certain transport and communications statistics for Latvia for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six months ended 30 June 2012.

	2007	2008	2009	2010	2011	2012[1]
Road						
Passenger cars (*thousands*) (*no. at period end*)	904.9	932.8	904.3	636.7[2]	612.3	617.6
Goods vehicles (*thousands*) (*no. at period end*)	129.6	129.8	120.6	71.6[2]	72.6	75.8
Freight (*million tonnes*)	59.9	54.5	37.8	46.8	53.9	39.1
Rail						
Freight traffic (*million tonnes*)	52.2	56.1	53.7	49.2	59.4	47.3
International freight						
Exports (*million tonnes*)	2.4	2.7	2.2	3.2	4.9	3.7
Imports (*million tonnes*)	42.8	47.1	47.1	41.0	48.4	38.7
Air						
Cargo loaded and unloaded (*thousand tonnes*)	11	12	14	14.5	13	–[3]
Passenger turnover in Riga airport (*million passengers*)	3.2	3.7	4.1	4.7	5.1	3.6
Sea						
Outward cargo handled (*million tonnes*)	55.2	57.7	57.6	55.7	61.0	51.1
Inward cargo handled (*million tonnes*)	7.3	6.0	4.4	5.4	7.8	7.0
Telecommunications						
Fixed lines (*per 100 inhabitants*)	28.2	26.1	24.8	23.6	23.0	–[3]
Mobile subscribers (*per 100 inhabitants*)	97.2	101.2	101.9	102.4	102.9	–[3]
Estimated internet users (*per 100 inhabitants*)	59.2	63.4	66.8	68.4	71.7	–[3]

Source: Central Statistical Bureau; International Telecommunications Union.

Notes:

(1) Nine months ended 30 September.

(2) In September 2009, new regulations allowing vehicles to be removed from the register of vehicles were introduced. Vehicles can be removed from the register if the vehicle is permanently registered in a foreign country or if the vehicle is five or more years old and has not satisfied technical inspection requirements.

(3) Data only available on an annual basis.

Road

The number of registered passenger cars in Latvia grew from 904.9 thousand at 31 December 2007 to 932.8 thousand at 31 December 2008 before falling in each of 2009, 2010 and 2011 to 612.3 thousand at 31 December 2011, principally as a result of new regulations introduced in 2009 that allow vehicles to be removed from the register of vehicles if, for example, the vehicle is permanently registered in a foreign

country or the vehicle has not undergone the requisite technical inspection. The number of registered passenger cars in Latvia rose slightly in the first nine months of 2012 to 617.6 thousand.

Road transport freight fell in each of 2008 and 2009 to 37.8 million tonnes in 2009 from 59.9 million tonnes in 2007. In each of 2010 and 2011, road transport freight increased and amounted to 53.9 million tonnes in 2011. Road transport freight in the first nine months of 2012 amounted to 39.1 million tonnes.

Two significant road transport links in Latvia are the Via Baltica, a motorway linking the Baltic States to Germany through Poland, and the east-west road transport corridor, which links Latvia's three major ports with Russia and which is being upgraded using EU funding.

Rail

Latvia had 1,832 km of broad gauge railways at 31 December 2011, linking it with the other Baltic States, Russia and, through Poland, western Europe. The main rail corridor connects Moscow with Latvia's three ports. In October 2008, the Government created an independent state-owned company to manage the passenger component of the State-owned Latvian Railways with a view to promoting passenger rail travel and relieving road congestion. Overall freight traffic carried by rail was 52.2 million tonnes in 2007, 56.1 million tonnes in 2008, 53.7 million tonnes in 2009, 49.2 million tonnes in 2010 and 59.4 million tonnes in 2011. The principal reason for the decrease in 2009 was a fall in domestic freight carried while in 2010 and 2011 the principal reason for the changes was movements in international freight imports. In the first nine months of 2012, freight traffic carried by rail amounted to 47.3 million tonnes.

Rail Baltica is a project intended to create a direct transport link between Poland, the Baltic States and Finland. The project currently envisages a continuous rail link of approximately 950 km which is intended to connect Warsaw to Tallinn and pass through Riga and Kaunas, while Helsinki to Tallinn will be connected by existing commercial ferries. Currently, a number of feasibility studies are being initiated in different countries through which the route will pass and negotiations are ongoing in relation to the amount of co-financing available from EU sources.

As at the date of this Offering Circular, negotiations are ongoing between Estonia, Latvia, Lithuania and Poland to reach an agreement on the coordination and full implementation of the route for Rail Baltica. In December 2011, the Prime Ministers of the three Baltic states released a joint statement outlining the creation of a special task force formed of two representatives from each of Estonia, Latvia and Lithuania to focus on establishing a Rail Baltica joint venture and to draw up detailed plans on the management structure, legal status and shareholders' agreement and identify any foreseeable financial issues and operational costs.

Air

At present Latvia has one international airport. Riga International Airport is the largest international airport and the main air traffic centre in the three Baltic states. In 2007, Riga International Airport had 3.2 million passengers. This number had increased to 5.1 million in 2011, reflecting increased business travel and tourism. On 20 October 2012, there were flights to 79 destinations from Riga International Airport.

On 4 August 2010, a project to develop the airport infrastructure and improve the environmental protection and safety standards at Riga International Airport commenced. The project envisages an increase in the overall airport capacity from five million to six million passengers and is supported by co-funding from the EU Cohesion Fund.

The national airline of Latvia is airBaltic which, as at the date of this Offering Circular, has a fleet of 34 aircraft and flies to 50 different countries. Following a default on a loan repayment by Baltic Aviation Systems, who had used their minority shareholding in airBaltic as collateral for a loan to Krajbanka, the bank took ownership of the shares. Upon the insolvency of Krajbanka, this minority shareholding was sold to the Government (already a majority shareholder) by the bank's administrators at its nominal price in November 2011. Consequently, the Government has held 99.8 per cent. of the share capital of airBaltic since November 2011. New management appointed by the Government has initiated a plan to return airBaltic to profitability by 2014 and, as at 30 September 2012, the results achieved were ahead of target. As the major shareholder, the Government is likely to have to inject up to approximately LVL 83 million to recapitalise the airline in accordance with the terms of a shareholders' agreement made before the insolvency of Baltic Aviation Systems. The Government is currently seeking a strategic investor to purchase new equity shares in airBaltic so as to provide additional capital. The Government's intention is to continue to hold at least 50 per cent. of the shares in airBaltic.

Sea

Latvia has three major ports, Ventspils, Riga and Liepaja, which are central to the country's transit trade. Ventspils and Liepaja are year round ice-free ports. Riga accounted for approximately 49 per cent., Ventspils for approximately 43 per cent. and Liepaja for approximately 6 per cent.of total sea cargo loaded in 2011. In terms of cargo unloaded in 2011, Riga accounted for approximately 55 per cent., Ventspils for approximately 29 per cent. and Liepaja for approximately 15 per cent. The total cargo handled in Latvia's ports increased from 61.1 million tonnes in 2010 to 68.8 million tonnes in 2011 and was 58.1 million tonnes in the first nine months of 2012.

Telecommunications

The expansion of mobile telephone services has caused a decline in the number of fixed lines in Latvia from 644,043 in 2007 to 516,344 in 2011, resulting in a penetration rate (defined as the number of lines per 100 inhabitants) of 23.0 per cent. in 2011 (according to International Telecommunication Union ("**ITU**") statistics). Over the same period, the number of mobile subscribers grew from 2,217,008 to 2,309,000, resulting in a penetration rate of 102.9 per cent. in 2011, according to ITU statistics. According to the same source, the estimated number of internet users per 100 inhabitants in Latvia in 2011 was 71.7.

The number of telecommunications operators in Latvia has grown significantly since the fixed line market opened to competition in 2003 although State-owned Lattelecom remains the dominant fixed line operator.

Energy

Both imported (natural gas, electricity, petroleum products, coal and coke) and local (hydropower, fuel-wood, charcoal, straw, biogas, bioethanol, biodiesel, peat, used tyres, municipal waste for heating and wind power) energy resources are used in Latvia to supply fuel, electricity and heat to commercial and residential consumers. Electricity is generated in Latvia by hydro power plants ("**HPPs**"), combined heat and power plants, biomass, biogas and wind power plants ("**WPPs**") and is also imported. Heat is generated in Latvia using both local (fuel-wood) and imported fuels (including natural gas and fuel oil). In 2011, the total consumption of primary energy resources in Latvia amounted to 188.7 petajoules ("**PJ**"), and self-sufficiency in the total consumption of primary energy resources was 33.1 per cent. Fuel-wood was the most widely used local energy resource (46.9 PJ), and natural gas was the principal imported energy resource, in the total consumption of primary energy sources. Electricity generated by HPPs and WPPs accounted for 10.6 PJ, or 5.6 per cent., of total energy consumption in Latvia in 2011.

The volume of electricity generation in Latvia depends directly on the flow in the Daugava River. After the closure of the Ignalina Nuclear Power Plant in Lithuania at the end of 2009, Latvia no longer imports nuclear energy from Lithuania and now imports electricity only from Estonia and Russia. However, Latvia is considering its involvement in a potential new nuclear energy project, the Visagina project, in conjunction with its regional neighbours and the EU.

The Visagina project comprises a single 1350 MWe Advanced Boiling Water Reactor to be built in Visagina in Lithuania and which is not expected to become operational before 2020. The project is a joint project between Latvia, Lithuania and Estonia. In March 2012, the prime ministers of Estonia and Latvia reiterated their support for the project and a concession agreement with Hitachi was signed in May 2012, providing the contractual framework for the project with an envisaged 20 per cent. stake for Hitachi as the designated contractor and strategic investor. In May 2012, the Lithuanian parliament approved the project and the concession agreement. Latvia expects to have a 20 per cent. share in the project company. A combined construction and operating licence is expected to be issued by July 2015 when a final investment decision is also expected to be made. The cost of the project is currently estimated at around €5.0 billion. In September 2012, the prime ministers of each of the Baltic countries reiterated their support for the project at a meeting of the Baltic Council of Ministers. In October 2012, a non-binding referendum, held in conjunction with a national election in Lithuania, resulted in 63 per cent. of the respondents indicating they did not want a reactor in Visagina.

In 2011, 4.48 PJ of Latvia's electricity requirements were net imported (electricity imports and electricity exports were 14.43 PJ and 9.95 PJ, respectively).

The consumption structure of Latvia's centralised heat supply has remained relatively constant in past years, with central heating comprising between 65 and 70 per cent. and hot water accounting for between 30 and 35 per cent. of total supplies. In 2011, 1.3 per cent. of the total final amount of heat sold was sold to industrial users, 70.4 per cent. was sold to residential users and 28.3 per cent. was sold to other consumers.

Centralised heat is produced in 663 boiler houses and 83 co-generation stations, which in 2011 produced 6.94 terawatt hours of centralised heat. The principal fuel source for heat production is natural gas which accounted for 80.9 per cent. of total centralised heat production in 2011.

Energy Policy

Latvia's energy policy is aimed at improving the security of the country's energy supply by diversifying energy supply sources and by creating conditions for increasing Latvia's own electricity generation. In addition, Latvia is seeking to increase competition in the energy market, promote the use of renewable and local energy resources, and ensure environmental protection. In 2006, the Cabinet of Ministers approved Latvia's Energy Development Guidelines for 2007 to 2016. These guidelines contain the Government's policy, development objectives and priorities in the sphere of energy over both the medium- and long-term, although the guidelines have become outdated as a result of regional energy projects and the global financial crisis which were not anticipated at the time the guidelines were prepared. As a result and acknowledging the importance of long-term planning in energy policy, the Ministry of Economics has prepared a draft policy planning document (titled ''Latvian Energy Strategy 2030'') which sets out the main goals in order to achieve a competitive national economy, sustainable energy and security of supply. It is expected that the document will be submitted to the Cabinet of Ministers in the beginning of 2013.

In 2011, approximately 72 per cent. of all gross electricity consumption in Latvia was generated by the State-owned JSC Latvenergo (''**Latvenergo**''), which was also responsible for all electricity imports and, through its subsidiaries, the transmission and disribution of electricity in Latvia.

JSC LatvijasGaze (''**Latvia Gas**'') carries out almost all natural gas transmission, distribution, storage and sale activities in Latvia in compliance with licences issued by the Public Utilities Commission. The gas supply system of Latvia is not connected to the EU common gas supply system, and Latvia has only one gas supplier, JSC Gazprom (''**Gazprom**''), which also is a majority shareholder in Latvia Gas. In February 2009, Latvia Gas signed new gas supply contracts with Gazprom and a company owned by Gazprom which provide for the supply of Latvia's forecasted gas requirements until 2030, although the pricing is subject to tariffs which are adjusted on an annual basis. Latvia is currently in discussions with a number of regional countries and the EC relating to the construction of a regional liquefied natural gas terminal. These discussions are at a preliminary stage and no decision has yet been taken on a site for the proposed terminal.

Geological conditions in Latvia are favourable for creating underground storage facilities for natural gas and Latvia has been using its Inčukalns gas storage facility, with an active capacity of 2.32 billion m^3, since 1968. A project to increase the storage capacity at Inčukalns by 2020 to between 2.6 and 2.8 billion m^3 is identified as crucially important for the regional liquefied natural gas terminal and an application for co-financing has been submitted to the EU as part of the new EU budget for 2014-2020.

Latvia is seeking to increase the proportion of energy produced from renewable resources in the total final gross consumption of energy from 32.6 per cent. in 2005 to 40 per cent. by 2020. In 2011, 33.1 per cent. of the total final gross consumption of energy in Latvia was produced from renewable sources. According to the draft energy strategy, Latvia intends to achieve a share of energy from renewable sources in the gross final consumption of energy of at least 50 per cent. by 2030. To reach this target, it will be necessary to establish an effective long-term state support scheme for renewable energy technologies and a proposal for this is being prepared by the Ministry of Economics. The basic principle of the new support mechanism is that renewable energy should become competitive and exposed to market prices as soon as possible by eliminating subsidies and creating a level playing field for all low emission energy sources.

In 2011, the proportion of renewables used in transport in Latvia was 4.8 per cent. of the total amount of energy used in the transport sector.

For a discussion of risks related to Latvia's imports of energy from Russia, see ''*Risk Factors -Any deterioration in Latvia's relations with its major energy suppliers may adversely affect the supply of energy resources and therefore have a negative effect on the Latvian economy*''.

Privatisation

A Privatisation Completion Law was introduced in Latvia in September 2005. The law determines how, and the suggested timescale for, the completion of the privatisation process (which is substantially complete) and land reform in Latvia. The law also deals with how any remaining privatisation certificates

may be utilised pending their expiry and provides that certain state companies (including the Latvian post office, the Latvian railways, Latvian air traffic control, the Latvian state forestry company, Riga International Airport and Latvenergo) will not be privatised. One of the significant privatisations yet to be completed by the State is the privatisation of the 51 per cent. State-owned Lattelecom. The State may also sell its remaining 5 per cent. shareholding in Latvia Mobile Telephone.

The Government is also considering the sale of Citadele bank, which was created to hold the performing assets of Parex Bank which was nationalised as a result of financial difficulties, see "*Monetary and Financial System – Financial Sector Supervision*. In addition, a working group has been established to investigate the possibility of attracting a strategic investor to purchase shares in airBaltic.

Environment

Environmental protection in Latvia is primarily the responsibility of the Ministry of Environmental Protection and Regional Development.

Within the National Sustainable Development Strategy 2030, the strategic goals are to create an attractive living environment for the citizens and to preserve the natural ecosystems, to become an EU leader in the area of nature conservation, to increase sustainable use of nature capital and to fully strengthen Latvia's position in the EU as well as to efficiently exploit the local renewable energy potential.

The overall purpose of the environmental policy, set out in the Environment Policy Strategy 2009-2015 in 2009, is to provide the public with the opportunity to live in a clean and well-arranged environment through sustainable development, preservation of environmental quality and biological diversity, and sustainable use of natural resources, as well as to encourage participation by the public in environmental decision-making and to increase their awareness of the environmental situation.

Latvia's relatively underdeveloped national economy and tradition of environmental protection have contributed to the conservation of many species and habitats in Latvia which no longer exist in other parts of Western Europe. There are 712 specially protected natural areas ("**SPNA**") in Latvia, which include nature reserves, national parks, conservation areas, natural monuments as well as one biosphere reserve. Approximately, 16 per cent. of Latvia's area is considered to be SPNA.

In general, the air quality in Latvia is considered to be good. Pursuant to the requirements of the UN Economic Commission for Europe and the EU, Latvia has established limits for total emissions of sulphur dioxide, nitrogen dioxide, volatile organic compounds and ammonia.

The quality of Latvian coastal waters and the water of the Gulf of Riga have been improving, largely due to a reduction in the concentration of nitrogen. This reflects the success of programmes to improve the treatment of sewage, a decline in industry and agriculture, along with an improvement in agricultural practices which include the construction of new manure storage facilities and a limit on the use of fertilisers.

The Natural Resources Tax Law was adopted in 2005 to encourage the economically efficient use of natural resources, promote energy efficient technology, restrict pollution and reduce damage to the environment. For example, a tax has been levied on industries involved in the extraction of natural resources and in pumping and storage of gases in subterranean structures.

Since EU accession, Latvia has been investing in improving its environment infrastructure with the help of EU funds. A number of waste water treatment and drinking water quality improvement projects have been implemented and the country's waste management infrastructure has been gradually improved.

In 2009, Latvia established a Green Investment Scheme called the Climate Change Financial Instrument to administer and manage revenues from the International Emission Trading Scheme. It was decided that all revenues obtained by Latvia in this framework would be used to finance activities related to the reduction of carbon dioxide emissions, investing in the areas like energy efficiency and waste management, as well as promoting the use of renewable energy sources, such as solar, wind, hydro and geothermal energy. Funding is given to projects selected through open calls for proposals and there are different deadlines for the funds received under the framework to be disbursed.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments

Current Account

Latvia's trade deficit increased significantly in 2007 as imports (financed by the easy availability of credit) increased at a significantly greater rate than exports. However, the onset of the global financial crisis and the significant contraction of liquidity in Latvia in 2008, meant that imports fell slightly in 2008 and significantly in 2009, before increasing gradually in each of 2010, 2011 and the first half of 2012 compared to the comparable period of 2011 as an increase in exports and industrial production took place requiring more intermediate and capital goods. Exports increased in 2007 and 2008 before falling in 2009 and growing strongly in 2010. The increase in exports in 2010 was underpinned by a gradual recovery in the economies of Latvia's major trading partners as well as Latvia's improved competitiveness. Exports continued to grow in 2011 and, in the first half of 2012, exports increased significantly compared to the comparable period of 2011 with one of the highest growth rates of the EU-27 countries. In both periods, the growth was driven more by competitiveness gains than by external demand. Reflecting the above trends and, in particular, the fact that imports have grown more strongly than exports since 2011, the trade deficit narrowed in each of 2008, 2009 and 2010, before increasing in 2011 and in the first half of 2012 compared to the comparable period of 2011. As a percentage of nominal GDP for the relevant period, Latvia's trade deficit was 24.0 per cent. in 2007, 17.8 per cent. in 2008, 7.1 per cent. in 2009, 7.0 per cent. in 2010, 10.8 per cent. in 2011 and 11.7 per cent. in the first half of 2012.

Latvia's services balance has been positive in all periods since 2007 and increased in nominal terms in each year up to 2009. In 2010, Latvia's services balance was marginally lower than its 2009 level in nominal terms, but that was followed by strong growth in exports of services in 2011 leading to an increase in the services balance. In addition, in the first half of 2012, the services balance increased compared with the comparable period of 2011 as a result of the strong performance of exports in the transportation sector and an increase in exports in several smaller services sectors such as communication, construction and computer and information services. As a percentage of nominal GDP for the relevant period, Latvia's services balance was 3.5 per cent. in 2007, 4.0 per cent. in 2008, 6.0 per cent. in 2009, 6.1 per cent. in 2010, 6.1 per cent. in 2011 and 7.3 per cent in the first half of 2012.

Latvia's income account was negative in 2007 and 2008, but turned positive in 2009. The principal reason for this reversal was significant foreign direct investment ("**FDI**") losses experienced in the banking sector, in particular, reflecting the fact that Latvia's banking sector was predominantly foreign-owned which was reflected in the income account as an increase in income. In 2010, this trend reversed gradually and, in 2011 and the first half of 2012, Latvia's income account again became negative, principally as result of the increased profitability of foreign-owned banks reflected in dividend payments and reinvested earnings.

Latvia's balance of transfers (reflecting remittances from Latvians working abroad and including certain fiscal transfers from the EU) has remained positive since 2007. In 2010 and 2011, the transfers balance was equal to 3.6 per cent. and 3.1 per cent. of nominal GDP, respectively. In the first half of 2012, current transfers remained at a similar level of 3.2 per cent. of nominal GDP for the period.

Reflecting the above factors, and primarily driven by the trade balance, Latvia's current account balance showed deficits in 2007 and 2008, surpluses in 2009 and 2010, and deficits in 2011 and in the first half of 2012. As a percentage of nominal GDP for the relevant period, Latvia's current account deficit was 22.4 per cent. in 2007 and 13.1 per cent. in 2008. Latvia's current account surplus was equal to 8.6 per cent. of nominal GDP in 2009 and 2.9 per cent. of nominal GDP in 2010. In 2011, Latvia's current account deficit equalled 2.2 per cent. of nominal GDP and, in the first half of 2012, it equalled 2.9 per cent. of nominal GDP.

Capital and Financial Account

Latvia's capital account has been positive in each period since 2007. Latvia's financial account was positive in 2007 and 2008, negative in 2009 and 2010, and positive in each of 2011 and the first half of 2012. In 2009, the principal outflows recorded in the financial account were related to decreases in the short-term and long-term liabilities of the banking sector (both outflows of foreign deposits and loans). In 2009, the corporate sector also tended to reduce its long and short-term liabilities to reduce the risks associated with the recession. In addition, corporate foreign deposits created significant financial outflows in 2009. In 2010, the outflow of funds reduced although a decrease in the long-term liabilities of the banking sector was still evident. In 2011, the inflows of direct investments in Latvia increased and there was also an

increase in long-term borrowings in the other sectors. In the first half of 2012, there was a strong inflow of FDI, although not so high as in the same period of 2011.

Latvia saw significant funding inflows covering the current account deficit until late 2008 when the full effects of the global financial crisis on the country's large external imbalances (principally a lack of liquidity in international markets and a collapse of both external and domestic demand) became apparent. Latvia's funding inflows are principally in the form of equity investment and reinvested earnings and other investment, which, prior to 2008, were principally lending by non-Latvian banks to their subsidiaries in Latvia. For more information, see "- *Foreign Direct Investment*". In December 2008, the EC, the IMF, the World Bank, the EBRD and several Member States of the EU agreed to provide financial support to Latvia in an amount of €7.5 billion. See "*Indebtedness—Financial Assistance from International Lenders*". In 2008, Latvia received the first tranche of the IMF Stand-By Arrangement (in an amount of €600 million). In 2009, Latvia received €2,700 million in assistance, in 2010 it received €1,100 million and in 2011 it received €100 million. This assistance, together with the actions taken by Latvia to stabilise its banking system and ensure economic recovery, contributed to restoring the confidence of foreign investors and other non-residents. As a result, Latvia experienced an increase in both foreign deposits and net FDI in 2010, both of which contributed to the reduction in the financial account deficit. In 2011 and the first half of 2012, Latvia raised U.S.$500 million and U.S.$1 billion, respectively, in the international capital markets.

Reflecting the above, Latvia's capital and financial account surplus as a percentage of nominal GDP for the relevant period was 23.2 per cent. in 2007 and 14.9 per cent. in 2008 while its capital and financial account deficit amounted to 9.4 per cent. of nominal GDP in 2009 and 4.1 per cent. of nominal GDP in 2010. Latvia's capital and financial account recorded a surplus equal to 2.5 per cent. of nominal GDP both in 2011 and in the first half of 2012.

The table below sets out Latvia's balance of payments for the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the nine month periods ended 30 September 2011 and 2012.

	Year ended 31 December					Nine months ended 30 September	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
	(LVL millions)						
Current account	**(3,297.0)**	**(2,113.4)**	**1,128.5**	**375.8**	**(307.7)**	**(263.9)**	**(282.0)**
Trade balance	(3,536.1)	(2,862.3)	(931.6)	(899.5)	(1,544.9)	(1,106.3)	(1,208.4)
Exports	4,214.4	4,587.1	3,708.2	4,830.0	6,058.5	4,436.4	4,967.6
Imports	(7,750.5)	(7,449.4)	(4,639.7)	(5,729.6)	(7,603.4)	(5,542.7)	(6,176.0)
Services balance	512.8	644.2	790.6	785.9	927.2	665.3	786.4
Exports	1,894.7	2,169.7	1,937.3	1,952.3	2,246.4	1,627.4	1,841.3
Imports	(1,382.0)	(1,525.4)	(1,146.7)	(1,166.4)	(1,319.2)	(962.0)	(1,054.9)
Income balance	(466.3)	(254.8)	826.2	30.0	(127.9)	(148.0)	(211.3)
Credit	760.8	857.1	670.5	525.7	632.3	460.7	519.7
Debit	(1,277.1)	(1,111.9)	155.6	(495.6)	(760.2)	(608.7)	(730.9)
Current transfers	192.6	359.5	443.3	459.4	437.9	325.1	351.3
Credit	1,035.4	1,043.1	997.9	867.0	918.6	653.3	729.1
Debit	(842.7)	(683.6)	(554.6)	(407.6)	(480.7)	(328.2)	(377.8)
Capital and financial account	**3,415.2**	**2,404.5**	**(1,229.0)**	**(525.5)**	**358.5**	**286.8**	**315.7**
Capital account	288.1	239.8	317.3	247.5	301.3	244.9	322.4
Financial account	3,127.1	2,164.8	(1,546.4)	(773.0)	57.2	41.9	(16.6)
Direct investment	1,003.6	489.6	78.9	191.2	703.7	563.0	302.8
Portfolio investment	(347.0)	178.2	86.8	(216.8)	(320.9)	(366.8)	32.6
Other investment	2,857.0	1,226.8	(1,277.3)	(95.6)	(1,021.5)	(235.4)	(73.9)
Reserve assets	(502.2)	320.2	(647.6)	(509.3)	(634.9)	14.0	(240.7)
Errors and omissions	**(118.2)**	**(291.2)**	**100.6**	**149.7**	**(50.7)**	**(22.9)**	**(33.8)**

Source: Bank of Latvia

The table below sets out Latvia's balance of payments as a percentage of nominal GDP for the relevant period for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the six month periods ended 30 June 2011 and 2012.

	Year ended 31 December					Six months ended 30 June	
	2007	**2008**	**2009**	**2010**	**2011**	**2011**	**2012**
	(as a percentage of GDP)						
Current account	**(22.4)**	**(13.1)**	**8.6**	**2.9**	**(2.2)**	**(0.5)**	**(2.7)**
Trade balance	(24.0)	(17.8)	(7.1)	(7.0)	(10.8)	(9.3)	(11.7)
Services balance	3.5	4.0	6.0	6.1	6.5	6.6	7.3
Income balance	(3.2)	(1.6)	6.3	0.2	(0.9)	(1.4)	(1.7)
Current transfers	1.3	2.2	3.4	3.6	3.1	3.6	3.2
Capital and financial account	**23.2**	**14.9**	**(9.4)**	**(4.1)**	**2.5**	**0.0**	**2.5**
Capital account	2.0	1.5	2.4	1.9	2.1	0.3	0.9
Financial account	21.2	13.5	(11.8)	(6.0)	0.4	(0.3)	1.6
Reserve assets	(3.4)	2.0	(5.0)	(4.0)	(4.4)	1.2	(1.5)
Errors and omissions	**(0.8)**	**(1.8)**	**0.8**	**(1.2)**	**(0.4)**	**0.5**	**0.4**

Source: Bank of Latvia

Foreign Trade

Reflecting the impact of the global financial crisis, Latvia's imports started to fall on a year-on-year basis in the second quarter of 2008 although its exports only started to fall from the fourth quarter of 2008. The earlier decline in imports reflected the fact that economic conditions in Latvia deteriorated more significantly than in its principal trading partners and the fact that the share of cyclically sensitive goods (such as capital goods) in imports is higher than in exports. In addition, as Latvia emerged from recession its exports recovered faster than its imports. On a year-on-year basis, Latvia's exports have increased since the end of 2009 although its imports only started to grow from March 2010. Increased foreign demand, price increases in foreign markets and competitiveness gains by Latvian producers have all contributed to export growth in nearly all types of goods exported in all of Latvia's main export markets, although the rate of growth in exports has slowed recently as external demand weakens. In terms of imports, after the sharp fall in 2009, imports began to increase from March 2010 and, in 2011, the real annual growth rates of exports and imports were quite similar. In 2011, real annual growth rates of exports and imports were 27.8 per cent. and 30.6 per cent., respectively. The increase in imports has been closely related to export growth as reflected in strong growth in imports of intermediate goods since mid-2009 and, to a lesser extent, capital goods used in export-orientated manufacturing expansion and investment activities.

Provisional data released by the Central Statistical Bureau on 9 November 2012 indicates that in the nine months to 30 September 2012, exports amounted to LVL 4,941.3 million, an increase of 12.6 per cent. over the comparable period of 2011, whilst imports amounted to LVL 6,326.4 million, an increase of 12.8 per cent. over the comparable period of 2011.

The principal product groups exported by Latvia are wood products (principally sawn wood, fuel wood and round wood), metal products (principally iron and steel), machinery (principally appliances and electronic equipment) and agricultural products (comprising live animals, prepared foodstuffs, principally fish and dairy products, and vegetable products). As a percentage of exports, wood products were 22.5 per cent. in 2007, but since then have become slightly less significant amounting to 16.8 per cent. of exports in 2011 and 16.1 per cent. in the nine months ended 30 September 2012. Machinery exports increased from 11.0 per cent. of exports in 2007 to 14.1 per cent. in 2009 and then fell to 12.7 per cent. in 2011 and were 13.1 per cent. in the nine months ended 30 September 2012. The contribution of metal products to exports between 2007 and 2011 fluctuated with the highest level being 16.7 per cent. in 2008 and the lowest level being 12.4 per cent. in 2009. The level was 15.3 per cent. in the nine months ended 30 September 2012. The contribution of agricultural and food products also fluctuated with the highest level being 18.5 per cent. in 2009 and the lowest level being 14.2 per cent. in 2007. The level was 17.9 per cent. in the nine months ended 30 September 2012.

The principal product groups imported by Latvia are machinery (principally machine parts, electrical equipment, office equipment and cables and wires), mineral products (principally oil, petroleum and gas), base metal products (principally iron and steel) and chemical products (principally pharmaceuticals). Machinery product imports declined from 20.8 per cent. of imports in 2007 to 15.7 per cent. in 2009 and then increased to 17.3 per cent. in the nine months ended 30 September 2012. The contribution of mineral products, chemical products and base metal products to imports all fluctuated over the period from 2007 to 2011. For mineral products, the highest level was 17.3 per cent. in 2011 and the lowest level was 11.5 per cent. in 2007 with the level in the nine months ended 30 September 2012 being 18.0 per cent. For chemical products, the lowest level was 8.1 per cent. in 2007 and the highest level was 11.8 per cent. in 2009 with the level in the nine months ended 30 September 2012 being 9.5 per cent. For base metal products, the lowest level was 8.1 per cent. in 2009 and the highest level was 10.9 per cent. in 2011 with the level in the nine months ended 30 September 2012 being 11.4 per cent.

Latvia's main trading partners are the 27 EU Member States, which accounted for between 71 and 76 per cent. of Latvia's exports and for between 75 and 78 per cent. of its imports for each year in the period between 2007 and 2011. Within the EU Member States, the principal export destinations for Latvia's goods in 2011 were Lithuania (which accounted for 18.1 per cent. of Latvia's total exports in that year), Estonia (13.6 per cent.) and Germany (8.3 per cent.). In terms of imports, the principal EU sources of imports for Latvia in 2011 were Lithuania (which accounted for 18.8 per cent. of Latvia's total imports in that year) and Germany (12.1 per cent.). Latvia's exports to Italy accounted for 1.2 per cent. of its total exports in the nine months to 30 September 2012 and its export exposure to Greece, Portugal, Ireland and Spain was minimal in the same period. Together, the five countries accounted for 2 per cent. of Latvia's exports in the nine months ended 30 September 2012.

Outside the EU, the share of the states comprising the Commonwealth of Independent States (the "**CIS**") in Latvia's exports was 14.5 per cent. in 2007 and 14.6 per cent. in 2011. Within the CIS states, Russia is the principal export market for Latvian goods, accounting for 72.4 per cent. of Latvian exports to the CIS states in 2011. In terms of imports, the CIS states accounted for 13.2 per cent. of Latvia's imports in 2007 and 14.6 per cent. in 2011. As with exports, within the CIS, Russia is the principal source of Latvia's imports, accounting for 58.4 per cent. of CIS imports to Latvia in 2011.

Other countries accounted for 12.9 per cent. of Latvian exports and 8.6 per cent. of its imports in 2011. Outside the EU and the CIS states, Latvia primarily trades with countries in Asia and the Americas. Asia accounted for 7.7 per cent. of Latvia's exports and 5.6 per cent. of its imports in 2011. The Americas accounted for 1.6 per cent. of Latvia's exports and 1.0 per cent. of its imports in 2011.

The table below sets out the geographic distribution of Latvian exports of goods for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the nine months ended 30 September 2011 and 2012.

	Year ended 31 December			
	2007		2008	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
EU				
Germany	353.1	8.7	358.4	8.1
UK	277.1	6.9	166.7	3.8
Sweden	313.0	7.7	293.4	6.6
Denmark	161.1	4.0	202.1	4.6
Lithuania	638.6	15.8	739.8	16.7
Estonia	581.8	14.4	621.7	14.0
Poland	146.0	3.6	165.5	3.7
Other EU[1]	595.2	14.8	676.4	15.3
Total[2]	**3,065.9**	**75.9**	**3,224.0**	**72.8**
Total[3]	**3,076.7**	**76.2**	**3,245.4**	**73.3**
CIS				
Russia	386.2	9.6	442.2	10.0
Ukraine	59.8	1.5	64.5	1.5
Belarus	92.6	2.3	98.0	2.2
Other CIS	47.7	1.2	59.4	1.3
Total	**586.4**	**14.5**	**664.0**	**15.0**
Other	377.3	9.3	519.5	11.7
Total	**4,040.3**	**100.0**	**4,428.9**	**100.0**

	Year ended 31 December					
	2009		2010		2011	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*
EU						
Germany	314.0	8.7	409.6	8.7	496.4	8.3
UK	115.3	3.2	164.7	3.5	183.1	3.1
Sweden	219.5	6.1	295.5	6.3	380.5	6.3
Denmark	148.6	4.1	181.7	3.9	201.4	3.4
Lithuania	590.4	16.4	762.2	16.2	1,086.7	18.1
Estonia	518.4	14.4	633.0	13.5	818.3	13.6
Poland	138.3	3.8	232.4	5.0	351.9	5.9
Other EU[1]	526.6	14.6	661.8	14.1	803.0	13.3
Total[2]	**2,571.1**	**71.4**	**3,340.9**	**71.2**	**4,321.3**	**72.0**
Total[3]	**2,586.9**	**71.8**	**3,363.5**	**71.6**	**4,347.7**	**72.5**
CIS						
Russia	316.4	8.8	497.1	10.6	633.6	10.6
Ukraine	37.7	1.1	52.8	1.1	52.9	0.9
Belarus	92.2	2.6	99.8	2.1	107.4	1.8
Other CIS	58.6	1.6	57.8	1.2	81.8	1.4
Total	**501.4**	**13.9**	**701.7**	**15.0**	**875.7**	**14.6**
Other	514.0	14.2	629.7	13.4	775.1	12.9
Total	**3,602.2**	**100.0**	**4,694.9**	**100.0**	**5,998.5**	**100.0**

	Nine months ended 30 September			
	2011		2012	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
EU				
Germany	370.4	8.4	364.8	7.4
UK	136.6	3.1	174.9	3.5
Sweden	272.7	6.2	264.7	5.4
Denmark	143.4	3.3	199.2	4.0
Lithuania	798.3	18.2	787.9	15.9
Estonia	602.6	13.7	642.5	13.0
Poland	250.0	5.7	321.1	6.5
Other EU(1)	603.4	13.7	681.6	13.8
Total(2)	**3,177.4**	**72.4**	**3,436.7**	**69.6**
Total(3)	**3,195.7**	**72.8**	**3,455.7**	**69.9**
CIS				
Russia	449.7	10.2	549.2	11.1
Ukraine	39.7	0.9	45.2	0.9
Belarus	81.7	1.9	92.5	1.9
Other CIS	55.1	1.3	57.3	1.2
Total	**626.2**	**14.3**	**744.2**	**15.1**
Other	566.8	12.9	741.4	15.0
Total	**4,388.7**	**100.0**	**4,941.3**	**100.0**

Source: Central Statistical Bureau

Notes:

(1) Excludes Bulgaria and Romania which joined the EU in 2007.

(2) Excludes Bulgaria and Romania (EU-25).

(3) Includes Bulgaria and Romania (EU-27).

The table below sets out the geographic distribution of Latvian imports of goods for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the nine months ended 30 September 2011 and 2012.

	Year ended 31 December			
	2007		2008	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
EU				
Germany	1,218.0	15.7	981.7	13.0
Finland	397.3	5.1	330.8	4.4
Sweden	379.8	4.9	332.6	4.4
Italy	285.9	3.7	218.0	2.9
Lithuania	1,080.6	13.9	1,241.4	16.5
Estonia	629.9	8.1	535.7	7.1
Poland	544.0	7.0	540.7	7.2
Other EU[1]	1,510.7	19.4	1,521.3	20.2
Total[2]	**6,046.2**	**77.7**	**5,702.2**	**75.8**
Total[3]	**6,060.8**	**77.9**	**5,716.5**	**75.9**
CIS				
Russia	653.5	8.4	801.3	10.6
Belarus	256.7	3.3	250.0	3.3
Other CIS	118.9	1.5	145.0	1.9
Total	**1026.8**	**13.2**	**1196.3**	**15.9**
Other	690.4	8.9	614.9	8.2
Total	**7,780.2**	**100.0**	**7,527.7**	**100.0**

	Year ended 31 December					
	2009		2010		2011	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*
EU						
Germany	543.1	11.5	680.1	11.5	935.5	12.1
Finland	168.6	3.6	290.0	4.9	355.6	4.6
Sweden	168.3	3.6	209.9	3.6	295.6	3.8
Denmark	126.6	2.7	135.4	2.3	172.4	2.2
Lithuania	800.9	17.0	1,008.1	17.1	1,449.6	18.8
Estonia	375.7	8.0	422.9	7.2	574.9	7.4
Poland	397.2	8.4	465.6	7.9	624.9	8.1
Other EU(1)	943.7	20.0	1,235.0	23.6	1,492.8	19.4
Total(2)	**3,524.1**	**74.8**	**4,469.6**	**75.6**	**5,901.3**	**76.5**
Total(3)	**3,541.3**	**75.2**	**4,484.3**	**75.9**	**5,927.1**	**76.8**
CIS						
Russia	505.7	10.7	591.8	10.0	659.1	8.7
Belarus	163.3	3.5	202.4	3.4	341.3	4.5
Other CIS	79.2	1.6	105.5	1.8	127.6	1.7
Total	**748.2**	**15.8**	**899.7**	**15.2**	**1,128.0**	**14.6**
Other	421.0	9.0	530.5	9.0	664.0	8.6
Total	**4,709.8**	**100.0**	**5,911.9**	**100.0**	**7,719.1**	**100.0**

	Nine months ended 30 September			
	2011		2012	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
EU				
Germany	670.5	12.0	724.6	11.5
Finland	261.4	4.7	285.8	4.5
Sweden	210.4	3.8	219.9	4.5
Denmark	130.4	2.3	140.8	2.2
Lithuania	1,037.6	18.5	1,289.2	20.4
Estonia	409.7	7.3	472.4	7.6
Poland	458.1	8.2	539.5	7.5
Other EU(1)	1,091.7	19.5	1,186.1	18.7
Total(2)	**4,269.8**	**76.1**	**4,858.5**	**76.8**
Total(3)	**4,288.5**	**76.5**	**4,879.1**	**77.1**
CIS				
Russia	481.4	8.6	595.6	9.4
Belarus	262.4	4.7	228.3	3.6
Other CIS	99.3	1.8	133.4	2.1
Total	**843.1**	**15.0**	**958.2**	**15.1**
Other	476.0	8.5	489.2	7.7
Total	**5,607.6**	**100.0**	**6,326.4**	**100.0**

Source: Central Statistical Bureau

Notes:

(1) Excludes Bulgaria and Romania which joined the EU in 2007.

(2) Excludes Bulgaria and Romania (EU-25).

(3) Includes Bulgaria and Romania (EU-27).

Composition of Trade

The table below sets out the composition of Latvia's exports of goods for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the nine months ended 30 September 2011 and 2012.

	Year ended 31 December									
	2007		2008		2009		2010		2011	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Live animals and animal products	149.4	3.7	165.9	3.8	157.3	4.4	200.7	4.2	263.8	4.4
Vegetable products	110.7	2.7	224.1	5.1	214.9	6.0	267.7	5.7	257.5	4.3
Prepared foodstuffs	314.1	7.8	349.1	7.9	290.3	8.1	353.8	7.5	441.7	7.4
Mineral products	165.4	4.1	184.0	4.2	199.6	5.5	283.1	6.0	548.6	9.1
Products of the chemical and allied industries	300.3	7.4	371.4	8.4	307.0	8.5	348.5	7.4	443.6	7.4
Plastics, rubber and articles thereof	119.5	3.0	126.3	2.9	102.9	2.9	154.3	3.3	186.5	3.1
Wood and articles of wood	908.5	22.5	735.0	16.6	595.4	16.5	890.3	19.0	1,010.1	16.8
Textiles and textile articles	271.0	6.7	242.8	5.5	178.8	5.0	206.7	4.4	242.8	4.0
Base metals and articles of base metals	589.7	14.6	738.9	16.7	447.8	12.4	650.0	13.8	868.0	14.5
Machinery and mechanical appliances; electrical equipment	444.0	11.0	553.7	12.5	509.4	14.1	609.1	12.9	763.1	12.7
Transport vehicles	281.4	7.0	326.5	7.4	254.7	7.1	283.1	6.0	401.7	6.7
Miscellaneous manufactured articles	157.8	3.9	154.4	3.5	121.0	3.4	134.1	2.9	153.4	2.6
Other goods	228.5	5.6	256.9	5.8	223.2	6.2	313.6	6.7	417.6	7.0
Total	**4,040.3**	**100.0**	**4,428.9**	**100.0**	**3,602.2**	**100.0**	**4,694.9**	**100.0**	**5,998.5**	**100.0**

	Nine months ended 30 September			
	2011		2012	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Live animals and animal products	189.4	4.3	222.6	4.5
Vegetable products	171.4	3.9	247.5	5.0
Prepared foodstuffs	303.3	6.9	398.7	8.1
Mineral products	391.1	8.9	457.9	9.3
Products of the chemical and allied industries	329.7	7.5	319.0	6.5
Plastics and articles thereof; rubber and articles thereof	138.3	3.2	154.6	3.1
Wood and articles of wood	763.4	17.4	796.5	16.1
Textiles and textile articles	184.1	4.2	200.8	4.1
Base metals and articles of base metals	662.1	15.1	755.9	15.3
Machinery and mechanical appliances; electrical equipment	539.0	12.3	645.7	13.1
Transport vehicles	295.4	6.7	263.7	5.3
Miscellaneous manufactured articles	111.0	2.5	131.6	2.7
Other goods	310.6	7.1	346.8	7.0
Total	**4,388.8**	**100.0**	**4,941.3**	**100.0**

Source: Central Statistical Bureau

The table below sets out the composition of Latvia's imports of goods for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and for the nine months ended 30 September 2011 and 2012.

	Year ended 31 December			
	2007		2008	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Live animals and animal products	165.1	2.1	204.2	2.7
Vegetable products	196.8	2.5	264.2	3.5
Prepared foodstuffs	475.5	6.1	514.2	6.8
Mineral products	896.7	11.5	1,171.2	15.6
Products of the chemical and allied industries	631.5	8.1	732.8	9.7
Plastics and articles thereof; rubber and articles thereof	371.9	4.8	356.3	4.7
Wood and articles of wood	262.3	3.4	139.9	1.9
Wood pulp; paper and paperboard	184.4	2.4	180.1	2.4
Textiles and textile articles	335.6	4.3	303.4	4.0
Articles of stone, plaster, cement, glassware, ceramic	203.1	2.6	157.8	2.1
Base metals and articles of base metals	747.8	9.6	775.2	10.3
Machinery and mechanical appliances; electrical equipment	1,618.6	20.8	1,374.0	18.3
Transport vehicles	1,136.2	14.4	807.8	10.6
Miscellaneous manufactured articles	261.0	3.2	227.3	3.0
Other goods	295.7	4.2	332.6	4.4
Total	**7,675.7**	**100.0**	**7,527.7**	**100.0**

	Year ended 31 December					
	2009		2010		2011	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Live animals and animal products	181.7	3.9	211.9	3.6	265.9	3.4
Vegetable products	222.9	4.7	266.0	4.5	315.3	4.1
Prepared foodstuffs	416.9	8.9	435.3	7.4	510.5	6.6
Mineral products	808.6	17.2	907.6	15.4	1,337.9	17.3
Products of the chemical and allied industries	557.3	11.8	663.0	11.2	736.8	9.5
Plastics and articles thereof; rubber and articles thereof	237.8	5.0	333.2	5.6	416.2	5.4
Wood and articles of wood	66.0	1.4	96.2	1.6	115.3	1.5
Wood pulp; paper and paperboard	134.6	2.9	165.1	2.8	189.4	2.5
Textiles and textile articles	230.4	4.9	269.0	4.6	328.1	4.2
Articles of stone, plaster, cement, glassware, ceramic	97.9	2.1	99.7	1.7	126.8	1.6
Base metals and articles of base metals	379.6	8.1	605.9	10.2	843.7	10.9
Machinery and mechanical appliances; electrical equipment	740.3	15.7	972.3	16.4	1,337.1	17.3
Transport vehicles	304.6	6.5	423.8	7.2	694.4	9.0
Miscellaneous manufactured articles	115.2	2.4	142.4	2.4	167.9	2.2
Other goods	215.8	4.6	320.5	5.4	333.9	4.3
Total	**4,709.8**	**100.0**	**5,911.9**	**100.0**	**7,719.1**	**100.0**

	Nine months ended 30 September			
	2011		2012	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Live animals and animal products	189.6	3.4	218.2	3.4
Vegetable products	229.6	4.1	261.3	4.1
Prepared foodstuffs	371.8	6.6	434.4	6.9
Mineral products	951.3	17.0	1,163.0	18.4
Products of the chemical and allied industries	550.6	9.8	569.5	9.0
Plastics and articles thereof; rubber and articles thereof	309.6	5.5	336.9	5.3
Wood and articles of wood	84.9	1.5	103.4	1.6
Wood pulp; paper and paperboard	139.5	2.5	134.3	2.1
Textiles and textile articles	248.7	4.4	265.0	4.2
Articles of stone, plaster, cement, glassware, ceramic	92.9	1.7	102.6	1.6
Base metals and articles of base metals	640.1	11.4	697.7	11.0
Machinery and mechanical appliances; electrical equipment	952.4	17.0	1,098.0	17.4
Transport vehicles	495.7	8.8	499.7	7.9
Miscellaneous manufactured articles	118.3	2.1	155.0	2.5
Other goods	232.5	4.1	287.5	4.5
Total	**5,607.4**	**100.0**	**6,326.4**	**100.0**

Source: Central Statistical Bureau

Trade Policy

Member States of the EU benefit from a common trade policy negotiated on their behalf by the EC, which establishes a common position that is co-ordinated with all Member States through the Trade Policy Committee of the Council of Ministers. The Trade Policy Committee plays a key role in shaping the EU's external trade policy, is made up of trade experts from each Member State and is chaired by whichever country holds the EU presidency. Latvia's trading relations with other non-EU countries are regulated under agreements concluded by the EU where such agreements exist.

The principal priority of EU common trade policy has been its participation in the WTO's Doha Development Agenda negotiations, in which the EC seeks to provide leadership and facilitate consensus. This and other key EU common trade policy issues, such as the negotiation of new WTO-compatible free trade agreements with certain priority trading partners, including ASEAN countries, India, Ukraine, Canada, Georgia and Moldova; regulatory convergence with strategic economic partners such as the United States of America, China, Japan and Russia; successful implementation of the Common EU Investment Policy and the EU Market Access Strategy; and enforcement of intellectual property rights, are set out in the EU's mid-term trade policy strategy titled ''Trade, Growth and World Affairs''. Within this context, Latvia's principal trade goals include general liberalisation of trade, increasing Latvia's external competitiveness and strengthening traditional democratic values through regional co-operation and the development of bilateral economic relations.

Latvia has concluded bilateral economic cooperation agreements with the Republic of Armenia, the Republic of Azerbaijan, the Republic of Belarus, the People's Republic of China, Georgia, the Republic of Kazakhstan, the Republic of Kyrgyzstan, the Republic of Moldova, the Russian Federation, the Republic of Tajikistan, Turkmenistan, Ukraine and the Republic of Uzbekistan. These agreements are aimed at enhancing bilateral economic cooperation between Latvia and countries outside the EU in industry, transport, pharmaceuticals, agriculture, financial services, communications, tourism, professional training, investment policy, technologies and innovation, among other fields. Although Latvia and Russia have concluded an agreement on economic cooperation, active cooperation is also carried out with the regions of the Russian Federation and agreements on economic cooperation have been concluded with the governments of the Vologda Region, the Kirov Region and the administration of the Pskov Region. Negotiations are currently ongoing with the governments of the Kaluga Region, the Ivanovo Region and the Yaroslavl Region, as well as with the government of the Republic of Bashkortostan.

Latvia believes that the accession of Russia to the WTO in August 2012 is a major step forward both for Russia and the multilateral trading system as a whole, and a welcome development for Latvia's bilateral economic and trade relations with Russia.

During 2011, Latvia conducted an assessment of its competitiveness which identified a number of principal challenges, including reducing the size of the shadow economy, improving the education system, addressing the inequalities between different parts of Latvian society and increasing the share of manufacturing in GDP. A further competitiveness assessment is currently ongoing. During 2012, guidelines for a Latvian national industrialisation policy were prepared and the Ministry of Economics expects to publish a detailed industrial policy within the next several months. In addition, a number of concrete steps have been taken to foster the promotion of exports including measures designed to improve Latvian exporters' access to foreign markets, such as enhanced export marketing measures, improving public-private co-ordination of export promotion activities, making available short-term export guarantees and extending Latvia's network of Foreign Economic Representative Offices.

Latvia currently has 14 Foreign Economic Representative Offices, located in Germany, Great Britain, Sweden, France, Russia, The Netherlands, Denmark, Norway, Japan, Poland, Lithuania, Ukraine, China and Belarus, which provide an important contribution to Latvia's export promotion and attraction of FDI.

Foreign Direct Investment

At 30 September 2012, the sectors with the largest accumulated FDI inflows in Latvia were real estate, financial intermediation, real estate, trade and manufacturing which together accounted for 71.7 per cent. of accumulated FDI at 30 September 2012. Prior to the global financial crisis, FDI inflows were more concentrated in the financial intermediation and real estate sectors. However, with an improvement in the business climate and gains in competitiveness as Latvia emerged from recession, investors' interest in Latvia's manufacturing sector has revived. In 2011 and 2012, FDI inflows in manufacturing were the fourth largest FDI inflows in Latvia (after the real estate sector, financial intermediation and trade) and

were principally aimed at expanding existing production units and building new units. In 2009, net FDI inflows to Latvia amounted to 0.4 per cent. of Latvia's nominal GDP. In 2010, net FDI inflows to Latvia were 1.6 per cent. of its nominal GDP, in 2011 net FDI inflows to Latvia were 5.5 per cent. of its nominal GDP and, in the first half of 2012, net FDI inflows to Latvia were 3.2 per cent. of its nominal GDP.

In 2007, cumulative FDI in the real estate sector increased by 55.5 per cent. Cumulative FDI in the real estate sector remained almost unchanged in 2008 and then grew by 6.5 per cent. in 2009, 16.8 per cent. in 2010 and 12.6 per cent. in 2011. During the first nine months of 2012, cumulative FDI in the real estate sector fell by 5.1 per cent.

In 2007, cumulative FDI in the financial intermediation sector increased by 54.0 per cent., in 2008 it increased by 10.8 per cent. and in 2009 it increased by 0.4 per cent. In 2010, cumulative FDI in the financial intermediation sector fell by 18.2 per cent. reflecting significant losses incurred by the banking sector in that year. In 2011 and the first nine months of 2012, cumulative FDI in the financial intermediation sector grew by 12.5 per cent. and by 5.6 per cent., respectively.

In 2007, cumulative FDI in the trade sector increased by 19.0 per cent. and in 2008 it increased by 27.9 per cent. In 2009, cumulative FDI in the trade sector fell by 4.9 per cent. and in 2010 it fell by 9.3 per cent. Cumulative FDI in the trade sector grew by 28.5 per cent. in 2011 and fell by 6.2 per cent. in the first nine months of 2012.

In 2007, cumulative FDI in the manufacturing sector increased by 31.1 per cent., in 2008 it increased by 18.4 per cent., in 2009 it increased by 6.9 per cent., in 2010 it increased by 10.6 per cent., in 2011 it increased by 7.9 per cent. and in the first nine months of 2012 it increased by 4.5 per cent.

In 2011 and 2012, with the assistance of the Investment and Development Agency of Latvia (the "**LIAA**"), 23 foreign entities, including Statoil Fuel & Retail (Norway), AKG ThermothechnikLettland (Germany), Malmar Sheet Metal (Belgium), Bucher Schoerling Baltic (Switzerland) and Bank DNB (Norway) announced their intention to invest in aggregate approximately €75 million in new or existing business structures in Latvia. During the first three quarters of 2012, 328 investment project requests were received, indicating that foreign countries' interest in investment opportunities in Latvia had doubled compared to the levels of 2008, when 158 applications for investment projects were received. Out of the 2012 investment project applications, six investors had, at 30 September 2012, decided to implement investment projects in Latvia which amount to €2.6 million and are expected to result in approximately 240 new jobs.

Latvia is focused on attracting new investment that will strengthen production and exports as the main driving forces of the Latvian economy as well as creating new jobs. The Large-Scale and Strategic Investment Project Coordination Council (the "**LSIPCC**") in Latvia was established in August 2010 under the auspices of the Prime Minister. In August 2011, the LSIPCC approved an Investment Attraction Strategy (the "**Strategy**") which aims to change the structure of the national economy of Latvia by developing external demand and innovation as well as attracting FDI in export-oriented sectors in order to achieve the highest productivity level among the Baltic countries.

The Strategy identifies eight key prospective sectors for FDI and sets out action plans to encourage the creation of attractive business environments and marketing. These sectors are wood processing; metal processing; machine building; transport and logistics; information technology; green technology; health-care; and life-sciences.

Latvia has also developed a single, dynamic cooperation-based investment attraction process known as Polaris. The Polaris process is based on an alliance between the public sector (including national and local governments), the private sector (including national and international companies and investors willing to invest in Latvia) and major Latvian academic institutions (including the main universities and research institutions). The Polaris process was instrumental in the development of the Strategy. The LIAA is responsible for coordinating the Polaris process. The principal source of FDI into Latvia is from EU countries which, at 31 December 2006, accounted for 71.6 per cent. of cumulative Latvian FDI. This percentage had increased to 77.2 per cent. at 31 December 2008. From 2009, cumulative FDI from EU countries decreased and, at 30 September 2012, it was 72.9 per cent. The decrease in the share of FDI represented by the EU countries reflects their reduced financial resources. Apart from EU member states, Norway, Russia and the United States have each been important sources of FDI for Latvia, accounting for 5.5 per cent., 4.2 per cent. and 2.6 per cent., respectively, of cumulative FDI into Latvia at 30 September 2012.

The table below sets out the cumulative FDI stock as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 30 September 2012.

	Year ended 31 December					As at 30 September
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
	LVL millions					
Foreign investment stock	5,247.4	5,711.0	5,673.4	5,751.6	6,578.1	6,838.6
in equity capital	4,158.7	4,236.8	3,932.0	4,366.8	4,928.5	5,264.7
in other capital	1,088.7	1,474.3	1,741.4	1,386.3	1,649.6	1,573.9

Source: Bank of Latvia

The table below sets out the distribution of cumulative FDI by sector and as a percentage of total FDI in enterprises as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 30 September 2012.

	Year ended 31 December					
	2007		**2008**		**2009**	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Financial intermediation	1,486.0	28.3	1,647.0	28.8	1,653.4	29.1
Real estate, renting and business activities	1,156.4	22.0	1,157.2	20.3	1,232.0	21.7
Wholesale and retail trade, repair	625.6	11.9	800.0	14.0	760.6	13.4
Manufacturing	517.3	9.9	612.4	10.7	654.6	11.5
Transport, storage and communication	392.3	7.5	466.1	8.2	431.6	7.6
Electricity, gas and water supply	270.6	5.2	204.9	3.6	190.5	3.4
Construction.....	85.5	1.6	107.1	1.9	124.8	2.2
Hotels and restaurants	50.4	1.0	61.4	1.1	61.7	1.1
Other.....	663.3	12.6	654.9	11.5	564.2	9.9
Total.....	**5,247.4**	**100.0**	**5,711.0**	**100.0**	**5,673.4**	**100.0**

	As at 31 December				As at 30 September	
	2010		2011		2012	
	(LVL millions)	(per cent.)	(LVL millions)	(per cent.)	(LVL millions)	(per cent.)
Financial intermediation	1,352.6	23.5	1,521.3	23.1	1,606.1	23.5
Real estate, renting and business activities	1,439.0	25.0	1,619.6	24.6	1,537.1	22.5
Wholesale and retail trade, repair	690.0	12.0	886.4	13.5	941.1	13.8
Manufacturing	724.1	12.6	781.6	11.9	816.4	11.9
Transport, storage and communication	420.2	7.3	464.5	7.1	499.8	7.3
Electricity, gasand water supply	216.2	3.8	213.4	3.2	245.3	3.6
Construction	109.9	1.9	90.4	1.4	90.7	1.3
Hotels and restaurants	41.3	0.7	49.6	0.8	48.5	0.7
Other	758.3	13.2	951.3	14.5	1,053.6	15.4
Total	**5,751.6**	**100.0**	**6,578.1**	**100.0**	**6,838.6**	**100.0**

Source: Bank of Latvia

The table below sets out the distribution of cumulative FDI by country and as a percentage of total cumulative FDI as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 30 September 2012.

	As at 31 December					
	2007		2008		2009	
	(LVL millions)	(per cent.)	(LVL millions)	(per cent.)	(LVL millions)	(per cent.)
Estonia	775.6	14.8	921.6	16.1	959.6	16.9
Sweden	707.1	13.5	820.8	14.4	782.8	13.8
Germany	446.5	8.5	360.8	6.3	362.3	6.4
Denmark	463.0	8.8	459.4	8.0	390.9	6.9
Finland	334.6	6.4	335.3	5.9	235.0	4.1
Netherlands	295.8	5.6	312.1	5.5	326.1	5.7
Cyprus	263.0	5.0	205.6	3.6	234.8	4.1
Lithuania	128.6	2.5	212.2	3.7	193.3	3.4
Other EU	539.4	10.3	782.9	13.7	853.8	15.0
Total EU	**3,953.6**	**75.3**	**4,410.7**	**77.2**	**4,338.6**	**76.5**
Russian Federation	242.2	4.6	262.1	4.6	260.0	4.6
United States	233.0	4.4	222.5	3.9	214.3	3.8
Norway	187.8	3.6	171.4	3.0	169.2	3.0
Switzerland	64.4	1.2	54.1	0.9	60.9	1.1
Other countries	316.5	6.0	342.3	6.0	375.7	6.6
Ex-territorial societies[1]	–	–	–	–	53.6	0.9
Countries not classified	250.0	4.8	247.9	4.3	201.1	3.5
Total	**5,247.4**	**100.0**	**5,711.0**	**100.0**	**5,673.4**	**100.0**

	As at 31 December				As at 30 September	
	2010		2011		2012	
	(LVL millions)	*(per cent.)*	*(LVL millions)*	*(per cent.)*	*(LVL millions)*	*(per cent.)*
Estonia	813.7	14.1	366.4	5.6	383.3	5.6
Sweden	742.1	13.0	1,566.2	23.7	1,660.7	24.3
Germany	296.8	5.2	320.5	4.9	323.0	4.7
Denmark	404.8	7.0	290.2	4.4	304.5	4.5
Finland	257.0	4.5	259.8	3.9	258.1	3.8
Netherlands	387.5	6.7	535.2	8.1	536.5	7.8
Cyprus	281.7	4.9	399.9	6.1	418.1	6.1
Lithuania	178.5	3.1	162.6	2.5	214.8	3.1
Other EU	886.0	15.4	890.4	13.5	1,423.3	20.8
Total EU	**4,248.1**	**73.9**	**4,781.2**	**72.7**	**4,986.8**	**72.9**
Russian Federation	236.7	4.1	272.1	4.1	285.3	4.2
United States	183.6	3.2	193.5	2.9	179.8	2.6
Norway	175.3	3.0	352.0	5.4	373.8	5.5
Switzerland	105.2	1.8	103.0	1.6	108.2	1.6
Other countries	350.9	6.1	350.2	5.3	296.1	4.3
Ex-territorial societies[1]	35.2	0.6	26.6	0.5	24.0	0.4
Countries not classified	416.6	7.2	499.5	8.5	584.6	8.5
Total	**5,751.6**	**100.0**	**6,578.6**	**100.0**	**6,838.6**	**100.0**

Source: Bank of Latvia

Note:

(1) EBRD, EU and other international organisations.

MONETARY AND FINANCIAL SYSTEM

The Bank of Latvia

The Bank of Latvia was established as the central bank of Latvia on 7 September 1922, following the proclamation of the Republic of Latvia in 1918. The Bank of Latvia operated as a central bank and a commercial bank until June 1940 when Latvia was occupied by the Soviet Union. The Bank of Latvia was liquidated in October 1940 following the annexation of Latvia to the Soviet Union in August of that year.

After regaining independence in 1991, the Bank of Latvia once again became Latvia's central bank with the right to issue the national currency. The Bank of Latvia took over and incorporated into its structure the Latvian Republican Bank of the State Bank of the Soviet Union present in Latvia and other state credit institutions present in Latvia. The legal status of the Bank of Latvia, and its role as an independent central bank, were reinforced by legislation passed in May 1992. Following the introduction of this legislation, the Bank of Latvia was divested of its commercial operations through the restructuring and privatisation of its 49 branches.

The law regulating the Bank of Latvia sets out its role and confers authority on it to operate as an independent institution which is solely responsible to the Saeima. The Bank of Latvia is administered by its Council and its Board. The Council consists of eight members: the Governor (who is also the Chairman of the Council), the Deputy Governor and six other members. The Council makes decisions on behalf of the Bank of Latvia. The Board, which is nominated by the Council and also consists of six members, is responsible for the management and day-to-day functions of the Bank of Latvia. The Governor and the members of the Council are appointed by the Saeima for a six-year term and can only be removed by the Saeima in limited circumstances.

Following EU accession in May 2004, the Bank of Latvia has become a part of the European System of Central Banks and has started preparations for the introduction of the euro. Latvia joined ERM II in May 2005 as a necessary precondition for its entry into the European Monetary System. The Bank of Latvia is the only institution responsible for exchange rate policy in Latvia and remains committed to pursuing a fixed narrow band exchange rate strategy prior to the country's adoption of the euro as its national currency. Maintenance of the fixed exchange rate was also the central goal of the economic reform programme agreed with the EU and the IMF as part of the financial assistance package.

Monetary Policy

The main task of the Bank of Latvia is to maintain price stability. To achieve this, the Bank of Latvia's monetary policy aims to maintain exchange rate stability and to control the amount of bank reserves. The exchange rate policy of the Bank of Latvia is similar to that of a currency board, and the monetary base is backed by gold and foreign currency reserves. The Bank of Latvia may grant loans to the banking sector but is prohibited by law from issuing credits to the Government or purchasing Government securities on the primary market. The national currency, the Lat, is fully convertible and there are no restrictions for current or capital account transactions.

The Bank of Latvia uses a wide range of instruments to implement its monetary policy, the main one being the buying and selling of foreign exchange, including through swap operations. The Bank of Latvia uses reserve requirements and a deposit facility as tools for withdrawing liquidity from the system and refinancing operations as a liquidity providing instrument. These monetary policy instruments of the Bank of Latvia are in line with those used in the Eurozone.

Reflecting interest rate increases in the Eurozone and macroeconomic development trends in Latvia, the Bank of Latvia generally tightened monetary conditions in 2007 as shown by increases in its principal refinancing rate from 5.0 per cent. at the beginning of 2007 to 6.0 per cent. in May 2007. The Bank of Latvia's reserve ratio was 8.0 per cent. at the start of 2007.

As economic activity weakened domestically and globally in 2008 and inflationary pressures were expected to ease significantly, the Bank of Latvia began to reduce its reserve requirements so that by January 2012 the reserve ratio for liabilities with a maturity over two years was 2.0 per cent. and the reserve ratio for other liabilities was 4.0 per cent.

As a result of these reductions, a considerable liquidity surplus built up. In order to stimulate the absorption of this excess liquidity, the Bank of Latvia reduced its overnight deposit facility rate from 3.0 per cent. at the end of 2008 to 0.05 per cent. at 31 October 2012. In addition, the refinancing rate was cut in five stages and stood at 2.5 per cent. at 31 October 2012.

Money Supply

Overall domestic liquidity (M3) grew by 14.6 per cent. in 2007 to LVL 6,311.6 million at 31 December 2007. Since then, reflecting the sharp downturn in the Latvian economy with both domestic and external demand shrinking, as well as the impact of the global financial crisis on the Latvian banking system and money market, M3 decreased by 4.3 per cent. in 2008 and by 2.8 per cent. in 2009.

The decrease in the most liquid assets, comprised in the base money aggregate (M0), contributed significantly to the shrinking of M3 in 2008 and 2009. Against a background of inflation deceleration and rising interest rates on time deposits and savings deposits, and the wider use of cashless payment methods, M0 decreased by 14.6 per cent. in 2008 and by 22.1 per cent. in 2009.

The components of M1 are overnight deposits (which contracted by 18.3 per cent. in 2008 and by 6.7 per cent. in 2009) and currency in circulation (which contracted by 3.8 per cent. in 2008 and 23.0 per cent. in 2009). M1 as a percentage of M3 declined from 55.4 per cent. at the end of 2008 to 50.7 per cent. at 31 December 2009.

By contrast, the demand for longer-term monetary components increased. Partly reflecting increased interest rates, time deposits up to two years (included in the M2 aggregate) increased in 2008 by 19.5 per cent. and, in 2009, by 8.9 per cent.

Along with real economy indicators, the growth in money supply also marked the end of the recession in Latvia and M3 increased by 11.5 per cent. in 2010 and by 1.7 per cent. in 2011. At 31 October 2012, M3 was LVL 6,682.8 million, up 0.3 per cent. from the level at 31 December 2011 as a result of a slight increase of household and non-financial enterprise deposits with banks. In 2010 and 2011, M0 increased by 6.6 per cent. and 23.6 per cent., respectively, and M1 increased by 26.6 per cent. and 15.6 per cent., respectively, reflecting increased use of cash payments and greater overnight cash deposits driven by growth in industrial sectors. In contrast to these developments, the demand for longer-term monetary components included in M2 decreased. Partly reflecting low interest rates, time deposits up to two years decreased by 5.2 per cent. in 2010 and by 22.4 per cent. in 2011. M1 as a percentage of M3 was 65.4 per cent. at 31 December 2011.

At 31 October 2012, M0 was LVL 2,310.7 million, up from LVL 2,168.9 million at 31 December 2011. At the same date, M1 was LVL 4,602.5 million, up from LVL 4,357.4 million at 31 December 2011 and M2 was LVL 6,566.7 million, up from LVL 6,462.4 million at 31 December 2011. At 31 October 2012, M1 as a percentage of M3 was 68.9 per cent. due to substantial growth of more liquid monetary aggregates which reflected the cautious attitude to longer-term accruals as well as the growing demand for cash currency and record low deposit interest rates.

Loans to domestic enterprises (including financial institutions and public non-financial corporations) and households in Latvia (''**private sector credit**''), which had increased in each of 2007 and 2008, fell in 2009, 2010 and 2011 and continued to fall in the first nine months of 2012, reflecting gradual deleveraging in many of the heavily indebted sectors of the economy. Private sector credit in Latvia had expanded significantly in 2006. As a result, the Government and the Bank of Latvia implemented measures to restrict this growth and, as a result of these measures and a more conservative approach to lending by banks in Latvia as concerns about an overheating economy grew, credit growth started to slow from the middle of 2007, with the annual growth rate of private sector credit in Latvia falling to 34.2 per cent. in 2007 and 11.7 per cent. in 2008. In 2009, 2010 and 2011, private sector credit in Latvia declined by 7.3 per cent., 8.3 per cent. and 8.3 per cent., respectively. At 31 October 2012, private sector credit was LVL 10,408.8 million, 8.4 per cent. lower than the level at 31 December 2011. Despite the continued drop in aggregate private sector credit levels, private sector credit to non-financial enterprises improved as the rate of decline slowed and the amount of new lending grew, in each case reflecting stronger credit supply and demand in the domestic enterprise sector.

On the liability side of the Latvian banking sector's balance sheet, deposits from private domestic enterprises (excluding public non-financial corporations and financial institutions) and households (''**private sector deposits**'') grew in 2007 by 12.1 per cent. However, concerns about the stability of the banking sector (and in particular Parex Bank) towards the end of 2008 saw total private sector deposits fall by 6.5 per cent. in 2008 and by 5.7 per cent. in 2009. In 2010, private sector deposits grew by 12.6 per cent. and, in 2011, by 0.9 per cent. (with the growth in Lat-denominated private sector deposits being 27.4 per cent. in 2010 and 1.8 per cent. in 2011) as confidence in Latvia's banking sector began to increase. At 31 October 2012, private sector deposits were LVL 4,720.7 million, 1.1 per cent. higher than the level at 31 December 2011, despite the fact that, on 15 March 2012, the Latvian Financial and Capital Market Commission (the ''**FCMC**'') cancelled Parex Bank's banking licence and, on 10 May 2012,

cancelled Krajbanka's licence and, as a result, the assets and liabilities of these institutions were excluded from the consolidated balance sheet of the Latvian banking sector.

The negative net foreign assets of the Latvian banking sector (excluding the Bank of Latvia) decreased by LVL 924.0 million between 31 December 2007 and 31 December 2009. Latvian banks' foreign liabilities decreased by LVL 1,543.9 million over the same period as a result of reduced borrowing by non-resident credit institutions, which fell by LVL 0.5 billion (although borrowing from parent banks increased by LVL 0.1 billion). Over the same period, the foreign assets of Latvian banks decreased by LVL 619.9 million.

In 2010 and 2011, the negative net foreign assets of Latvian banks (excluding the Bank of Latvia) declined by LVL 2.7 billion, reflecting an LVL 2.7 billion fall in liabilities to non-resident credit institutions, of which the fall in liabilities to parent banks was LVL 1.4 billion as these entities stabilised the availability of funding to their subsidiaries. Over the same period, the growth in foreign assets of Latvian banks (excluding the Bank of Latvia) was LVL 1.2 billion.

In the first ten months of 2012, the negative net foreign assets of Latvian banks (excluding the Bank of Latvia) broadly stabilised, although there was a further fall in liabilities to non-resident credit institutions of LVL 0.8 billion due to parent banks reducing the availability of funding to their subsidiaries. Over the same period, non-resident non-bank deposits grew by LVL 0.8 billion, while the foreign assets of Latvian banks (excluding the Bank of Latvia) grew by LVL 0.2 billion.

The table below sets out certain Latvian liquidity indicators as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	As at 31 December					As at 31 October
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Currency in circulation	1,049.5	1,018.1	788.2	937.9	1,160.2	1,167.7
Overnight deposits at the Bank of Latvia	1,421.7	1,093.4	857.6	817.3	1,008.8	1,143.0
Base money (M0)	2,471.2	2,111.5	1,645.8	1,755.2	2,168.9	2,310.7
Currency in circulation (less vault cash balances)	900.0	866.1	667.3	807.4	1,040.0	1,053.4
Overnight deposits	3,035.2	2,479.0	2,312.0	2,963.2	3,317.4	3,549.1
Money supply (M1)	3,935.2	3,345.1	2,979.3	3,770.6	4,357.4	4,602.5
Deposits with agreed maturity of up to 2 years	1,971.9	2,356.1	2,565.2	2,430.6	1,885.5	1,754.3
Deposits redeemable at notice of up to 3 months	335.0	263.7	251.6	244.4	219.5	209.9
Private domestic liquidity (M2)	6,242.0	5,964.9	5,796.2	6,445.6	6,462.4	6,566.7
Debt securities issued with maturity of up to 2 years	28.2	4.4	0.9	20.6	133.1	50.0
Money market fund shares and units	41.3	70.2	76.1	81.4	64.2	66.2
Overall domestic liquidity (M3)	6,311.6	6,039.5	5,873.1	6,547.6	6,659.7	6,682.8
Broad money (M2) to nominal GDP *(per cent.)*	42.4	37.1	44.3	50.4	45.3	44.0[(1)]
Private sector credit	13,050.6	14,577.7	13,514.9	12,399.3	11,369.4	10,408.8
Private sector credit to nominal GDP *(per cent.)*	88.7	90.6	103.4	97.0	79.6	70.2[(1)]
Private sector deposits	4,666.8	4,360.6	4,110.4	4,628.5	4,670.0	4,720.7

Source: Bank of Latvia

Note:

(1) Based on nominal GDP for the first half of 2012.

Foreign Assets

The table below sets out a breakdown of the foreign assets held by the Bank of Latvia as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	As at 31 December					As at 31 October
	2007	2008	2009	2010	2011	2012
	(LVL millions, except for months of imports of goods)					
Gold	99.1	109.0	134.4	187.2	210.1	231.4
Convertible foreign currencies	2,687.7	2,488.7	3,151.0	3,782.2	3,184.9	3,438.4
Net foreign assets	2,776.0	2,332.3	3,313.1	4,032.1	3,435.2	3,759.8
Reserve assets (in months of imports of goods)	4.2	3.8	8.1	7.9	5.0	5.0[(1)]

Source: Bank of Latvia
Note:
(1) As at 30 June 2012

As at 31 December 2007, Latvia's gold and convertible foreign currency assets amounted to LVL 2,786.8 million. Latvia's net foreign assets (being its foreign assets less its foreign liabilities) were LVL 2,776.0 million as at 31 December 2007.

As at 31 December 2008, Latvia's net foreign assets declined to LVL 2,332.3 million, reflecting significant sales of euro by the Bank of Latvia in an effort to enhance liquidity and to defend the exchange rate against speculation relating to a possible devaluation of the Lat although the effect of these sales was partially offset through the receipt of the first tranche of funds under the IMF Stand-By Arrangement agreed at the end of 2008. During 2009 and 2010, net foreign assets grew, principally as a result of foreign assistance funding received and, as at 31 December 2010, Latvia's net foreign assets amounted to LVL 4,032.1 million. At 31 December 2011, Latvia's net foreign assets had declined to LVL 3,435.2 million due to the State Treasury sales of euro to commercial banks to finance the State Treasury's expenditures in Lat. In the first ten months of 2012, as a result of a U.S.$ 1 billion bond issue by the Treasury in February and net purchases by the Bank of Latvia of foreign currency, the net foreign assets of the Bank of Latvia grew and, at 31 October 2012, reached LVL 3,759.8 million. In the same period, this growth was partly offset by the first repayments of financial assistance to the IMF, which were made in March, June and September and totalled LVL 317.2 billion in aggregate. As part of the Bank of Latvia's monetary policy, it maintains net foreign assets in excess of the monetary base to ensure the credibility of the exchange rate is preserved and, at 31 October 2012, net foreign assets amounted to approximately 160 per cent. of the monetary base.

At 31 December 2009 and 31 December 2010, Latvia's reserve assets were equal to around eight months of imports of goods, although this figure declined to around 5.0 per cent. at 31 December 2011 and at 30 June 2012.

Interest Rates

The following table sets out the Latvian inter-bank interest rates (RIGIBOR) and spreads over EURIBOR as at 31 December in each of 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	As at 31 December										As at 31 October	
	2007		2008		2009		2010		2011		2012	
	Level	Spread	Level	Spread	Level	Spread	Level	Spread	Level	Spread	Level	Spread
	(per cent)											
Overnight	6.33	+2.41	7.78	+5.55	1.42	+1.01	0.48	-0.34	0.46	+0.06	0.16	+0.08
3 months	10.53	+5.85	13.54	+10.61	6.80	+6.10	0.85	-0.16	0.53	+0.31	0.53	+0.33
6 months	11.24	+6.53	14.10	+11.10	8.81	+7.82	1.39	+0.16	1.14	+0.70	1.09	+0.70
12 months	11.68	+6.93	15.24	+12.15	10.72	+9.47	2.24	+0.73	1.64	+0.96	1.50	+0.88

Source: Bank of Latvia, Reuters

In Latvia, Monetary Financial Institution ("**MFI**") interest rates for loans and deposits in Lats generally increased up to the second half of 2009, after which they generally decreased (although they remained volatile in both periods). MFI interest rates for loans and deposits in euro grew gradually from 2007 until

2008. Since October 2008, interest rates for euro-denominated loans and deposits have substantially declined as Latvia's financial and economic position improved.

The weighted average interest rate for short-term time deposits in Lats was 3.6 per cent. in January 2007 and 0.2 per cent. in October 2012. The corresponding interest rate on deposits in euro was 3.1 per cent. in January 2007 and 0.3 per cent. in October 2012. The weighted average interest rate for long-term time deposits denominated in Lats was 4.8 per cent. in January 2007 and 2.0 per cent. in October 2012, while the equivalent rate for long-term deposits in euro was 4.5 per cent. in January 2007 and 2.2 per cent. in October 2012.

In the period from January 2007 to October 2012, the weighted average interest rate on loans in Lats to domestic enterprises and households decreased by 1.3 per cent. to 5.4 per cent. for new transactions with floating interest rates and interest rates with an initial fixed period of less than one year and increased by 1.1 per cent. to 10.7 per cent. for transactions with fixed interest rates in excess of one year. The weighted average interest rate on loans in euro declined from 5.7 per cent. in January 2007 to 3.0 per cent. at October 2012 for transactions with short-term fixed rates of interest, while the weighted average interest rate on loans in euro with long-term fixed rates of interest increased from 5.6 per cent. to 9.2 per cent. over the same period.

Financial Sector Supervision

The FCMC is a unified supervisory authority for the financial sector in Latvia. The FCMC is an autonomous public institution and its purpose is to promote the protection of the interests of investors, depositors and insured persons as well as the development and stability of the financial and capital markets. To this end, the FCMC regulates and supervises the financial and capital markets and the activities of participants in those markets. In addition, the FCMC administers the Latvian Deposit Guarantee Fund, the Fund for the Protection of Insured Persons and the Investor Protection Scheme. The FCMC's objectives and responsibilities are stipulated by law.

Latvia has implemented the EU Financial Sector Assessment Programme ("**FSAP**") Directives and post FSAP Directives, which were required to be implemented in Member States by 30 July 2012. The FCMC is involved in the work of the European Systemic Risk Board and the European Supervisory Authorities and also closely follows discussions on further developments in the regulatory framework proposed by the EC and international organisations. The FCMC is committed to ensuring the effective implementation of the regulatory framework for the financial sector.

Since the beginning of 2009, in response to the global financial crisis, a number of steps have been taken to improve the intervention capacity of the FCMC. In particular, a new law on bank takeovers and amendments to laws relating to credit institutions, deposit guarantees and the FCMC, as well as the Bank of Latvia's regulations on emergency liquidity support, have enhanced the ability of the authorities to intervene in the banking sector. The FCMC has enacted new regulations on bank asset quality assessment and provisioning and has issued supervisory guidance relating to banks' internal capital adequacy assessment procedures, with a view to improving capital reserves.

Amendments to the deposit guarantee law have resulted in increasing the amount of qualifying deposits guaranteed by the State up to €100,000. The FCMC has also introduced amendments to regulations on liquidity risk management and credit risk management. Reflecting the risks assumed by certain Latvian banks which rely significantly on non-resident deposits as a funding tool, the FCMC has introduced enhanced capital requirements in respect of these deposits which will be calculated annually, monitored quarterly and adjusted where relevant, for example when there are material changes in a bank's business model.

The FCMC continues to closely monitor the banking sector, based on increased bank reporting frequencies. During inspections, particular attention has been paid to factors such as capital adequacy, lending standards and risk management, as well as loan restructuring processes and remuneration policies. Cooperation with parent banks' supervisory authorities has also been strengthened.

Following the nationalisation of Parex Bank in November 2008, the Government participated in a rescheduling agreement of the bank's syndicated loans in March 2009 and, in April 2009, agreed with the EBRD that the EBRD would take a 25 per cent. shareholding in Parex Bank and advance the bank new subordinated funds as its contribution to the financial assistance package. This investment was made in September 2009. In July 2009, the EC commenced an investigation in relation to state aid to Parex Bank and, in September 2010, the EC confirmed that the state aid rules had been complied with and the restructuring of Parex Bank was successfully completed. As part of the restructuring process, on 1 August

2010, Parex Bank was split into two banks, with the performing assets being transferred to the newly established Citadele Bank and the non-performing assets remaining in Parex Bank. The EBRD became a shareholder of Citadele Bank at the same time and currently owns 25 per cent. and one share in Citadele Bank.

On 15 March 2012, the FCMC approved a request by Parex Bank to have its banking licence cancelled. Since 8 May 2012, Parex Bank has operated as a distressed asset management company, under the new brand Reverta. Reverta will continue to manage its assets with a view to maximising the return from them although it will not originate any new business and so is expected to be gradually run down. Reverta will not be sold and is continuing the orderly recovery of State funds. Reverta is 84.15 per cent. owned by the Latvian Privatisation Agency, 12.74 per cent. owned by the EBRD and 3.11 per cent. owned by other shareholders.

The Government's exposure to Reverta and Citadele Bank as at 30 September 2012 was LVL 612 million and LVL 140 million, respectively.

A reorganisation plan in respect of the Government-owned Mortgage and Land Bank of Latvia ("**MLB**") was approved by the Cabinet of Ministers in April 2011 which aimed to recapitalise and stabilise MLB and to sell MLB's commercial assets which are not required to fulfil its development function. In addition, it is envisaged that MLB may be merged with other development-oriented institutions in Latvia. On 26 January 2011, the EC gave temporary approval of the state aid, but also opened an investigation to see whether the financing is in line with competition rules.

The sales strategy in relation to Citadele Bank was approved by the Government on 17 May 2011. Citadele Bank was expected to be sold through a broad auction and two rounds of bidding. Initial bids for Citadele Bank were received and a shortlist was approved by the Latvian Privatisation Agency in November 2011. However, on 27 December 2011, the Government decided to postpone the sale of Citadele Bank until there is an improvement in the financial markets and, as of the date of this document, the postponement remains in effect. This decision was taken in light of ongoing volatility in the European financial market.

In November 2011, all financial services provided by Krajbanka were suspended by the FCMC after establishing a deficiency of assets in Krajbanka as well as a deficiency of own funds due to fraud. As a result, compensation in respect of guaranteed deposits of up to €100,000 was paid to depositors with Krajbanka. The total compensation amount paid amounted to LVL 328 million. On 10 May 2012, the FCMC withdrew the banking licence granted to Krajbanka following bankruptcy proceedings being initiated by the Riga Regional Court on 8 May 2012.

Money Laundering and Terrorist Financing Regulations

The money laundering prevention framework in Latvia is based on legal regulations promulgated by the Cabinet of Ministers, regulations for enhanced customer due diligence approved by the FCMC and recommendations made by the Bank of Latvia to licensed foreign exchange dealers. A new anti-money laundering and anti-terorist financing law was introduced in July 2008 and amended in June 2012 and is compliant with applicable EU Council Directives. With effect from 1 August 2012, FCMC regulations for enhanced customer due diligence apply to payment institutions, payment service providers and electronic money institutions.

Banking Sector Development

Banks account for about 91 per cent. of the total assets of the Latvian financial sector. At 30 September 2012, there were 20 Latvian licensed banks operating in Latvian as well as eight additional banks licensed in other EU Member States which only have a branch presence in Latvia. All of the Latvian-licensed banks have been licensed as universal banks and can provide a full range of financial and investment services.

Currently, approximately 71 per cent. of the Latvian banking share capital is owned by foreign investors. Four subsidiaries of EEA banks (Skandinaviska Enskilda Banken AB (publ), Swedbank AB (publ), DNB Bank ASA and UniCredit Bank Austria AG)) and eight branches of EU banks (Nordea Bank Finland plc, Skandinaviska Enskilda Banken AB (publ), Svenska Handelsbanken AB (publ), Danske Bank A/S, BIGBANK plc, Scania Finans Aktiebolag, AS Eesti Krediidipank and Pohjola Bank plc) accounted for 56.1 per cent. of total banking sector assets and 79.5 per cent. of the total resident loan portfolio at 30 September 2012. All banks in Latvia are privately owned, except for two banks that are

controlled by the Government (Citadele Bank and MLB). The market share of these state-owned banks was 10.3 per cent. of the total assets in the Latvian banking sector at 30 September 2012.

The global financial crisis had a materially adverse effect on the Latvian banking sector. In particular, the growth rate of loans, which was 11.2 per cent. in 2008 was negative in each of 2009 and 2010 (by 7.0 per cent. and 7.1 per cent, respectively) as low household income, a high unemployment rate and uncertain future prospects resulted in a significantly reduced demand for loans in those years. The banking sector was also affected by a significant deterioration in loan quality with NPLs increasing from 3.6 per cent. at 31 December 2008 to 16.4 per cent. at 31 December 2009 and 19.0 per cent. at 31 December 2010. As a result, loan loss provisions increased and the banking sector recorded significant losses in 2009 and 2010, amounting to LVL 773.4 million and LVL 360.7 million, respectively

Since 2011, lending has gradually recovered. In the first nine months of 2012, banks have granted new loans amounting to LVL 1.3 billion in total, including LVL 770 million to residents. The new loans have predominantly been granted to companies. Despite the increase in banks' lending activity, their loan portfolios declined by 11.1 per cent. in September 2012 compared to September 2011 (although if Parex Bank's and Krajbanka's loans were excluded from the September 2011 figure the decline would only have been 3.2 per cent.). As at 30 September 2012, loans to resident corporates had increased for four months in a row.

The quality of the Latvian banking sector's loan portfolio has also stabilised. The share of NPLs in total loans started to decline from September 2010 (when it peaked at 19.4 per cent.) and was 12.0 per cent. in September 2012). The improvements have been greater in corporate loans as the slow improvement in the labour market situation and rising energy prices continue to exert pressure on households' loan repayment capacity.

Loan restructuring continues but at a much slower pace than in 2009 and 2010. By 30 September 2012, restructured loans amounted to LVL 1.8 billion, or 14.7 per cent. of the total banking sector loan portfolio (compared to 19.9 per cent. at 31 December 2010) and loans in a work-out process amounted to LVL 1.2 billion, or 10.4 per cent. of the total banking loan sector portfolio (compared to 15.3 per cent. at 31 December 2010).

The total amount of loan loss provisions has also been gradually decreasing since July 2010 as banks have released previously created provisions which are no longer required. Loan loss provisions were LVL 1.03 billion, comprising 8.6 per cent. of the banking sector loan portfolio at 30 September 2012. The coverage ratio (provisions as a percentage of NPLs) remains high but stable at 71.8 per cent. at 30 September 2012.

After experiencing large losses in 2009 through 2011, the Latvian banking sector recorded a profit of LVL 119.3 million in the nine months ended 30 September 2012 (compared to a loss of LVL 179 million in the comparable period of 2011, although that loss included both Parex Bank and Krajbanka). Banking profitability has returned largely due to an improvement in the economy resulting in lower loan provisioning, the reversal of previously made provisions and through a slowly improving net interest margin.

The liquidity ratio of the banking sector remains high; it was 59.4 per cent. at 30 September 2012 and is well above the minimum requirements. Banks are required to maintain liquid assets in amounts of not less than 30 per cent. of liabilities with a maturity of up to 30 days. However, the minimum liquidity ratio is even higher for banks that focus on providing payment services.

The banking sector is well capitalised: following the ongoing capital strengthening and reduction in risk weighted assets (due to subdued lending), the capital adequacy ratio reached 17.7 per cent. at 30 September 2012 (the regulatory minimum is 8 per cent.). The Tier I ratio, which predominantly consists of top quality own funds, was at 15.2 per cent. as at 30 September 2012. Since 2009, 20 banks have raised their capital to a total of LVL 1.5 billion, while, since the beginning of 2012, 11 banks have increased their capital by a total amount of LVL 98.1 million. At 30 September 2012, the banking sector's total capital and reserves was LVL 1.9 billion.

The share of securities portfolios in banking sector assets is gradually increasing (having reached 10.3 per cent. at 30 September 2012). At 30 September, 2012, government securities comprised 50.6 per cent. of the total securities portfolio of Latvian banks. The Latvian banking sector does not have any significant exposure to the Eurozone countries which are currently considered to be higher risk, such as Portugal, Italy, Ireland, Spain, Greece and Hungary. These countries accounted for approximately 0.9 per cent. of Latvia's total banking sector investments at 30 September 2012.

The share of non-resident deposits, principally from the CIS countries, in the funding structure has been increasing. As at 30 September 2012, the amount of deposits in the Latvian banking sector was LVL 11.9 billion with an annual growth rate of 6.1 per cent. Both the amounts of residents' and non-residents' deposits currently exceed the peak level reached before the global financial crisis, although the risks posed by this situation are in part mitigated by the fact that non-resident deposits are principally invested in foreign liquid assets (such as highly-rated debt securities and current accounts with large European banks) and the foreign assets and foreign liabilities of the banks with large non-resident depsoits are substantially balanced. In addition, Bank of Lavia regulations require banks with significant non-resident deposits are required to maintain higher capital ratios than other banks in Latvia. See ''*Risk Factors – Latvia's banking sector continues to have significant weaknesses and could be materially adversely affected in certain circumstances as a result*''.

Due to the current low levels of lending activity, the deleveraging process continues and funding from parent banks is gradually shrinking. Refinancing risk has also diminished as banks have repaid most of their liabilities to foreign non-affiliated lenders. As at 30 September 2012, nine banks had liabilities which would require refinanancing within one year at a total amount of LVL 44.2 million, or 0.4 per cent. of those banks' total assets.

All statistical data under the heading ''*Banking Sector Developments*'' in this section has been derived from FCMC reports.

The tables below sets out certain performance indicators of the Latvian banking sector and the quality of its loan portfolio as at the last day of each quarter from 1 January 2007 to 30 September 2012.

	2007				2008				2009			
	31 Mar	*30 Jun*	*30 Sep*	*31 Dec*	*31 Mar*	*30 Jun*	*30 Sep*	*31 Dec*	*31 Mar*	*30 Jun*	*30 Sep*	*31 Dec*
Liquidity (per cent.)												
Liquidity ratio	51.0	48.1	54.7	55.7	51.4	50.7	49.1	52.8	48.0	49.6	54.4	62.8
Loans issued to non-banks/total assets	69.4	70.6	69.5	68.1	71.3	71.1	73.0	71.4	73.8	73.6	73.1	71.2
Loans to non-banks/deposits	150.6	151.2	158.1	146.5	158.9	154.5	164.8	170.0	169.8	173.0	175.1	161.6
Long-term loans to non-banks/ total loans	53.7	55.0	55.8	56.5	57.2	57.9	58.1	59.1	58.9	59.7	59.8	60.2
Demand deposits/total deposits	68.1	66.9	65.2	60.9	58.1	59.8	55.9	49.7	46.7	47.4	45.2	45.0
Capital adequacy (per cent.)												
Capital adequacy	10.4	10.5	11.0	11.1	12.6	12.2	12.3	11.8	11.4	12.4	13.6	14.6
Risk weighted assets/total assets	73.0	74.0	71.1	68.5	67.4	65.8	66.6	65.0	68.0	69.2	66.6	65.0
Profitability (per cent.)												
Return on equity	27.7	25.9	24.2	24.2	19.5	17.7	14.7	3.6	(11.2)	(38.1)	(42.1)	(41.6)
Return on assets	2.1	2.1	2.0	2.0	1.6	1.5	1.2	0.3	(0.9)	(3.1)	(3.5)	(3.5)
Net interest rate margin	2.6	2.7	2.7	2.7	2.5	2.5	2.5	2.5	2.0	1.9	1.8	1.6
Quality of the loan portfolio (per cent. of principal amount)												
Not yet due for repayment	94.3	95.1	92.8	93.2	90.9	89.5	88.3	85.0	79.5	76.5	74.8	74.5
Up to 30 days overdue	4.6	3.6	5.6	4.9	5.6	6.6	6.7	7.2	7.4	7.3	7.2	5.2
31 – 90 days overdue	0.6	0.7	0.9	1.2	2.0	1.9	2.5	4.2	6.0	4.2	3.5	3.9
91 – 180 days overdue	0.1	0.2	0.3	0.4	0.8	1.2	1.0	1.5	3.8	5.4	3.9	3.3
More than 180 days overdue	0.3	0.3	0.4	0.4	0.6	0.9	1.4	2.1	3.3	6.6	10.6	13.1

	2010				2011				2012		
	31 Mar	*30 Jun*	*30 Sep*	*31 Dec*	*31 Mar*	*30 Jun*	*30 Sep*	*31 Dec*	*31 Mar*	*30 June*	*30 Sep*
Liquidity (per cent.)											
Liquidity ratio	62.8	64.5	66.4	67.9	65.1	62.5	60.1	63.9	63.2	59.3	59.4
Loans issued to non-banks/total assets	70.7	70.1	69.6	65.3	65.5	65.4	65.1	62.9	60.9	60.4	60.5
Loans to non-banks/deposits	155.0	145.7	143.6	129.0	129.0	124.0	119.9	119.0	109.5	103.0	100.5
Long-term loans to non-banks/total loans	60.3	60.6	60.3	61.0	61.8	62.1	62.3	62.5	63.2	63.3	62.4
Demand deposits/total deposits	46.8	49.0	49.4	53.2	53.5	56.2	57.8	63.1	66.0	67.7	68.7
Capital adequacy (per cent.)											
Capital adequacy	14.2	14.2	15.2	14.6	15.2	15.1	17.0	17.4	18.1	17.2	17.7
Risk weighted assets/total assets	64.6	63.5	62.5	59.9	59.9	60.0	58.1	56.5	54.3	55.9	55.7
Profitability (per cent.)											
Return on equity	(29.8)	(28.7)	(24.5)	(20.4)	7.2	7.7	4.7	-11.2	10.9	8.4	7.7
Return on assets	(2.5)	(2.3)	(2.0)	(1.6)	0.6	0.7	0.4	-0.9	1.0	0.8	0.8
Net interest rate margin	1.0	1.0	1.1	1.1	1.3	1.3	1.4	1.5	1.6	1.6	1.6
Quality of the loan portfolio (per cent. of principal amount)											
Not yet due for repayment	72.5	71.4	71.5	73.4	73.3	72.9	73.8	75.5	77.8	80.4	80.2
Up to 30 days overdue	6.1	7.0	6.8	5.1	5.4	6.3	6.1	5.0	5.6	5.2	5.9
31 – 90 days overdue	3.6	2.6	2.2	2.5	2.6	2.5	2.1	2.3	2.9	1.9	1.9
91 – 180 days overdue	2.8	2.3	1.8	1.8	1.4	1.4	1.4	1.3	1.8	1.1	1.0
More than 180 days overdue	15.1	16.7	17.6	17.2	17.3	16.9	16.6	16.0	11.9	11.4	11.0

Source: Financial and Capital Market Commission

NASDAQ OMX Riga

NASDAQ OMX Riga is the only licensed stock exchange in Latvia. It was established in 1993 and commenced trading in 1995. NASDAQ OMX Riga also owns the Latvian Central Depository (the "**LCD**"). The LCD is the national depository for public securities responsible for custody and settlement of all public securities issued in Latvia.

NASDAQ OMX is the major shareholder of NASDAQ OMX Riga, with a 92.98 per cent. ownership interest.

Only licensed NASDAQ OMX Riga members, being banks and brokerage companies, may trade on the exchange. As at 30 September 2012, NASDAQ OMX Riga had 27 trading members. NASDAQ OMX Riga operates four lists: the Main List, the Secondary List, the Bond List and the Funds List.

As at 30 September 2012, 31 Latvian companies' equity securities, ten corporate debt securities, 23 Government treasury bill and bond issues and 21 investment funds were listed on NASDAQ OMX Riga.

The table below sets out certain information relating to NASDAQ OMX Riga as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 30 September 2012.

	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
Equity market capitalisation.....	1,474.8	819.8	925.6	661.7	580.2	579.2
Debt market capitalisation.....	428.9	804.9	782.6	745.3	722.6	725.7
Total market turnover.....	100.5	46.9	26.6	22.7	27.1	13.8
Equity market turnover.....	69.3	20.0	9.8	14.6	26.1	7.6
Debt market turnover	31.3	26.9	16.8	8.0	1.0	6.2

Source: NASDAQ OMX

Note:

(1) As at 30 September.

During each trading session, online price information is distributed via Reuters, Bloomberg, FT Interactive Data, Infront, SIX Financial Information and other market data customers.

NASDAQ OMX Riga has a guarantee fund (the "**Guarantee Fund**") that is financed through an initial contribution and a variable contribution which depends on an individual member's trading activity. The Guarantee Fund is used when a member has not made timely settlement and the delayed settlement poses a risk to the continuous and safe operation of the market or in the event that a member is declared insolvent or if a member has been restricted by a Government institution from dealing freely with its monetary or financial instrument accounts.

The LCD is the sole central securities depository in Latvia. The LCD provides safe-custody of all publicly issued securities in Latvia, clearing and settlement services for securities trading on NASDAQ OMX Riga and also manages corporate actions related to securities. The proprietary accounts of the LCD's intermediaries and custodians are segregated from their client accounts, thus reducing risk in case of a default by a bank or a brokerage company. The LCD is a member of ANNA (the Association of National Numbering Agencies) and has obtained National Numbering Agency status in Latvia. As a result, the LCD assigns ISIN codes and CFI codes for all issues registered with the LCD. The LCD also administers the State funded pension (the second pillar of the pension system), see "*Economy of Latvia – Social Security System – Pension System*". The LCD has established relationships with the Estonian and Lithuanian central depositories and also with the International Central Securities Depository, Clearstream Banking, société anonyme, allowing LCD's participants to act as custodians of financial instruments registered with those depositories. In June 2012, the LCD also established links with the Polish National Depository for Securities (Krajowy Depozyt Papierów Wartościowych S.A. – KDPW).

Capital Markets

The Financial Instruments Markets Law governs the procedure whereby securities are publicly offered in Latvia, the provision of investment services and ancillary (non-core) investment services, the licensing

and supervision of participants in the capital market and also establishes the rights and obligations of those participants and liability for any infringement of the requirements of the law.

In March 2012, amendments to this law were approved by the Saeima. These amendments reflect recent changes to the European Union directives and regulations which the law implements in Latvia. Further amendments to the law have been submitted to the Saeima for approval. These amendments are aimed at strengthening the FCMC's powers to request and receive from any person the information necessary for the execution of its functions and also set requirements relating to information regarding beneficial owners of companies.

Collective Investment Undertakings

Activities related to investment management in Latvia are regulated by the Law on Investment Management Companies, which regulates the procedures for public accumulation of monetary assets in Latvia and for the performance of their joint investment. The law provides for two types of collective investment undertakings in Latvia, open-end investment funds and closed-end investment funds.

The latest amendments to the Law on Investment Management Companies were adopted in October 2011 and came into force in November 2011 to implement the UCITS Directive into Latvian legislation. New regulations governing the content of the agreement between an investment management company and a custodian bank and governing the merger of funds, the dealing between master–feeder structures and the procedure for marketing investment certificates have also been adopted by the FCMC.

On 8 June 2011, the EU Parliament and the Council adopted Directive 2011/61/EU on Alternative Investment Fund Managers. A new law setting regulation and supervision principles and provisions for alternative investment (or so-called non-UCITS funds managers) drafted by the FCMC is in a consultation phase. This legislation is expected to come into force before mid-2013.

At 30 June 2012, 15 investment management companies manage 44 investment funds (22 open funds and 22 closed funds).

The net assets of investment funds amounted to LVL 259 million (open-end funds: LVL 136 million and closed-end funds: LVL 123 million) as at 30 June 2012. This reflected 29.9 per cent. year-on-year growth influenced by the registration of new closed-end funds during the period.

As of 30 June 2012, the total investments of investment funds amounted to LVL 260 million. Approximately 25 per cent. of the investment portfolio was held in deposits with credit institutions, approximately 22 per cent. was invested in debt securities, approximately 30 per cent. was invested in shares and other variable-yield securities and the balance comprised demand deposits with credit institutions, investments in real estate and other investments.

Insurance Sector

Activities related to insurance and reinsurance in the Republic of Latvia are regulated by a number of laws which govern the provision of insurance and reinsurance services, the legal status of these services and their providers, the operation of service providers, reorganisation measures and winding-up proceedings, the legal status of insurance and reinsurance intermediaries, and the activities and supervision thereof.

New legislation implementing both the Solvency II Directive and the Omnibus II Directive has been drafted and is expected to be adopted by June 2013.

The insurance market is supervised by the FCMC. The Motor Third Party Liability Compulsory Insurance is supervised by the Motor Insurers' Bureau of Latvia.

Nine insurance companies (two of which are engaged in life insurance and seven of which are engaged in non-life insurance business) and 10 branches of EU insurance companies are operating in Latvia.

In the first half of 2012, gross premiums written by insurers (insurance companies and branches of foreign insurance companies) rose by 3 per cent. compared to the same period in 2011 and totalled LVL 81 million (life insurance companies accounted for LVL 14 million and non-life insurance companies for LVL 66 million), predominantly supported by insurance companies activities outside Latvia. In the same period, the gross number of claims paid grew by only 3 per cent. and amounted to LVL 81 million (life insurance companies accounted for LVL 6 million and non-life insurance companies accounted for LVL 58 million).

At 30 June 2012, the solvency ratio for life insurance companies was 144 per cent. and that for non-life insurance companies was 189 per cent.

Total investments by insurance companies at 30 June 2012 amounted to LVL 292 million. These investments are predominantly in securities (52 per cent. of total investments) and in deposits with credit institutions (27 per cent.).

In the first half of 2012, insurance companies generated LVL 2.3 million profit, of which non-life insurance companies generated LVL 1.8 million and life insurance companies generated LVL 0.5 million.

PUBLIC FINANCE

The general Government budget consists of central Government budgets and local government budgets. The central Government budget is made up of a basic budget and the social security budget, which is a special central Government budget. The consolidated general Government budget is prepared on a cash flow basis but is also determined according to the European System of National and Regional Accounts ("**ESA 95**"), which differs significantly from the cash flow-basis, for EU reporting purposes, Unless specifically stated otherwise, all budget information in this section is presented on a cash flow basis.

Prior to the supplementary budget of June 2009, Latvia maintained a privatisation fund (which was liquidated during 2009 in accordance with the Privatisation Law) and a long-term stabilisation fund (the "**Stabilisation Fund**"). The privatisation fund was established from funds obtained following the privatisation of State property and the Stabilisation Fund is an instrument of fiscal policy created from assets of the central Government budget. The Stabilisation Fund was established to provide financing to reduce or prevent the effects of elevated fiscal, economic and social risks caused by macroeconomic processes.

The operations of the Stabilisation Fund have been suspended since 2008 due to fiscal constraints. A new Fiscal Discipline Law, which aims to limit the effect of economic cycles through, among other measures, setting targets for allowable deficits, is currently under preparation, see "*Economy of Latvia – Impact of the Global Financial Crisis and Response – Economic Reform Programme*".

Preparation and Approval of the Central Government Budget

The annual budget formulation process involves the Cabinet of Ministers, the Ministry of Finance, the State Chancellery, other Government ministries and the Latvian Association of Local and Regional Governments. Until the end of 2011, the IMF and the EC also exerted substantial influence over budgetary decisions through their influence on structural reforms to various sectors, including the public sector, the education sector and the social sector, as part of the financial assistance package. See "*Indebtedness—Financial Assistance from International Lenders*".

Prior to the 2012 budget, annual budgets were submitted to the Saeima together with a framework for medium-term macroeconomic development and fiscal policy for the next three financial years (the "**Medium-term Framework**"). On 15 December 2011, amendments to the Law on Budget and Financial Management (the "**Budget Management Law**") were adopted which substituted the Medium-term Framework with a requirement to prepare and submit with the annual budget a Medium-term Budget Framework Law (the "**Medium-term Budget Law**"). The first Medium-term Budget Law was submitted to the Saeima on 28 September 2012 together with the 2013 Annual Law on the State Budget (the "**State Budget Law**") and covers the period 2013 to 2015.

By 30 November in each year, the Minister of Finance submits to the Cabinet of Ministers a draft schedule for the preparation and submission of the State Budget Law and the Medium-term Budget Law during the following year. If, in accordance with the Medium-term Budget Law, funds for new policy initiatives are expected to be required, the ministries and other central State bodies prepare and submit their new policy initiatives on the basis of priorities and goals envisaged by the National Development Plan and the State Defence Concept. The National Development Plan targets economic growth through full utilisation of EU funds, tax policy measures and additional funding for highway maintenance; human resilience through the implementation of demographic policy measures and measures to promote social unity and integration; and promoting regional growth, particularly in Latgale and through the utilisation of EU rural funds.

With effect from 2013, the Cabinet of Ministers must submit to the Saeima by 15 May of each year a draft of the Medium-term Budget Law for the following year and the Cabinet of Ministers is required to submit to the Saeima by 1 October of each year a draft of the State Budget Law for the following year, together with appropriate explanations and proposals for amendments to laws to conform them with budgetary requests and the Medium-term Budget Law.

The Medium-term Budget Law sets out the maximum permitted amount of expenditures for ministries and other central state institutions for the following three years. The Medium-term Budget Law also includes medium-term budget goals and priorities, expected macroeconomic developments, fiscal policy goals, budget revenue forecasts and other medium-term budgetary issues. According to the Budget Management Law, the Ministry of Finance may suspend or reduce the expenditure of budget institutions in any of the following cases:

- Actual revenues are lower than budgeted by an amount equal to at least 0.5 per cent. of nominal GDP for a three-month period;
- The actual deficit is higher than budgeted by an amount equal to at least 0.5 per cent. of nominal GDP for a three-month period; or
- There are insufficient resources in the Treasury's accounts to meet the following month's due payments in full.

If any suspension or reduction of expenditure exceeds three months, the Cabinet of Ministers is required to submit a supplementary budget.

Ministries and other state central institutions prepare budget requests according to the scope of the maximum permitted expenditure amount. Budget requests are reviewed and collated by the Budget Department of the Ministry of Finance. The Minister of Finance seeks to obtain agreement on these draft budgets with the heads of ministries and other central institutions. Should agreement not be obtained, the Cabinet of Ministers may resolve the dispute by a majority vote.

The Saeima is authorised to amend the draft State Budget Law proposed by the Cabinet of Ministers. However, the Constitution restricts the amendment powers of the Saeima by providing that decisions involving additional expenditures must allocate funds to cover such expenditures. The budget adopted by the Saeima enters into force at the beginning of the year in respect of which the law has been prepared. If a budget has not come into force in due time, the Minister of Finance approves the State budget expenditures, provided that the monthly amount of expenditures cannot exceed one-twelfth of the appropriations of the previous year until the relevant State Budget Law has been passed.

Execution of the Central Government Budget

The Budget Management Law authorises the Treasury to organise the execution and financial accounting of the central Government budget. The Treasury grants spending allocations to all entities financed from the budget and ensures that payments executed by those entities comply with the limits set out in the central Government budget.

As part of its implementation of the central Government budget, the Treasury opens budget accounts for budget executors, grants allocations based on financial plans, ensures payments made by entities financed from the budget and maintains records of budget execution transactions effected by entities financed from the budget.

The Treasury prepares monthly, quarterly and annual reports on the execution of the central Government budget and local government budgets as well as daily reports on the execution of the central government budget. Reports on budget execution are compiled and submitted by the central Government budget entities and local governments in accordance with the Budget Management Law and other relevant laws and regulations.

As prescribed by law, local governments independently prepare, approve and implement their respective budgets. According to procedures specified by the Cabinet of Ministers, local governments prepare and submit to the Treasury monthly and annual reports regarding the implementation of their budgets, financing and the amount of their borrowings and guarantees, and the Ministry of Finance prepares a financial year report which is submitted to the Cabinet by the Minister for Finance (the "**Annual Report**"). The submission of the Annual Report is accompanied by an opinion of the State Audit Office (the "**SAO**") as required by law. The Cabinet then submits the Annual Report and the opinion of the SAO to the Saeima by 15 October of the financial year following the relevant budget year.

The Annual Report is prepared in accordance with the requirements and structure stipulated in Article 31 of the Budget Management Law and associated Cabinet Regulations. Article 31 and the regulations also govern the form of the financial and budget execution information to be included in the Annual Report, as well as the explanations to be provided for significant changes in the accounting year.

The SAO conducts a financial audit and renders an opinion on the correctness of the preparation of the Annual Report according to the Budget Management Law and the Law on the State Audit Office. The audit is conducted in accordance with international auditing standards as recognised by the Republic of Latvia. The SAO inspects the preparation of the Annual Report and the correspondence of transactions with regulatory requirements. The audit also assesses the accounting principles applied.

The SAO sends draft audit reports relating to the Ministry of Finance for review to the units and subordinated institutions of the Ministry of Finance which are responsible for the evaluation of audit

proposals and problematic issues. The Internal Audit Department of the Ministry of Finance supervises the implementation of the SAO recommendations related to the Ministry of Finance and its subordinated institutions.

Relationship between Central Government and Local Government Budgets

Local governments prepare, approve and execute their budgets independently. The central Government budget is consolidated with local government budgets in the general Government budget.

An Equalisation Fund for Local Government Finance, formed from local government payments and grants from the central Government budget, focuses on providing equal conditions for the execution of local government functions by transferring financial resources from certain local governments with higher socio-economic conditions to local governments with lower socio-economic conditions.

During the initial phases of the budget preparation process, the Ministry of Finance, together with local governments, determines the amount of equalisation grants to be provided to local governments and the total amount of central Government budget financing as well as its distribution to local governments for the next financial year. Local governments are represented by The Latvian Association of Local and Regional Governments. The Cabinet of Ministers includes a protocol setting out the results of any negotiations between the Ministry of Finance and the local governments with the draft State Budget Law when it is submitted to the Saeima.

The State Budget Law may provide for grants and subsidies from the central Government budget to ensure the execution of State functions.

Local governments are empowered to take loans and provide guarantees, but the State Budget Law sets a maximum amount for total increases of such loans and guarantees.

Impact of the Global Financial Crisis on Latvia's Budgets since 2009

When originally passed in November 2008, the central Government 2009 budget envisaged a central Government fiscal deficit equal to 1.5 per cent. of projected nominal GDP. However, as economic conditions worsened, it became apparent that the assumptions underlying the original 2009 central Government budget were too optimistic and a significantly higher central Government deficit would be likely to result. As a result, in December 2008, the original central Government budget was revised to indicate a central Government deficit of 4.7 per cent. of projected nominal GDP. To achieve this, the Government envisaged a programme of shifting the tax burden from direct to indirect taxation over the 2008 to 2011 period, tax increases (principally in VAT and excise duties), broadening the direct tax base for capital gains and real estate taxes in 2010 and improvements in tax collection. On the expenditure side, the revised budget set out targets for cuts in public sector wages and in other areas of current expenditure, but left the detail of these cuts to a further supplementary budget to be prepared during 2009. In addition, the Government agreed a protocol with local governments in December 2008 in relation to the adjustments to be made by them to their own budgets although, again, the detail was left for later agreement.

On 16 June 2009, the Latvian Parliament adopted a second supplementary budget which aimed to restrict the central Government deficit to around 5.1 per cent. of projected nominal GDP and the general Government deficit to around 7.1 per cent. of projected nominal GDP (compared to an eventual outcome of a deficit equal to 6.9 per cent. of nominal GDP). The June supplementary budget envisaged revenue increases, including through increased dividends from state-owned companies, increased excise duties, reductions in the basic personal income tax allowance and increases in gambling tax. On the expenditure side, cuts were introduced across all ministry and state agency budgets. The cuts also sought to increase the efficiency and quality of education and healthcare services, make limited and targeted pension reductions and reduce less targeted social security spending.

On 1 December 2009, the Saeima passed the 2010 State Budget Law. This budget targeted a central Government deficit of 4.4 per cent., and a consolidated general Government deficit of 7.6 per cent. of projected nominal GDP (compared to an eventual outcome of a consolidated general Government deficit equal to 6.1 per cent. of nominal GDP) and assumed a deflation rate of 3.7 per cent., anticipated economic growth in the second half of the year and stabilisation of the unemployment rate at 13.8 per cent. To achieve this, on the revenue side, the Government proposed the introduction of measures to broaden the personal income tax base and increase the rate of personal income tax, to introduce a progressive real estate tax on dwellings, to increase the annual vehicle tax, to extend excise duty to natural gas, to remove a number of exemptions in the tax system and to reform the real estate tax

base. On the expenditure side, the 2010 budget proposed a number of structural reforms, including consolidating state agencies and ministries, reducing state support to agriculture, cutting defence procurement costs, reducing the level of social benefits whilst expanding the social safety net, reducing road maintenance and improving the targeting of public transport subsidies.

In December 2010, the 2011 State Budget Law was approved by the new Saeima. This budget targeted a central Government deficit of 4.4 per cent., and a consolidated general Government deficit of 5.4 per cent., of projected nominal GDP and assumed an inflation rate of 1.1 per cent., continued economic growth throughout the year and an unemployment rate of 17.1 per cent. The 2011 budget included a number of revenue raising measures including an increase in the rates of the real estate tax on dwellings, an increase in dividends from state-owned enterprises, an increase in the standard rate of VAT from 21 per cent. to 22 per cent. and changes in the application and rate of certain reduced rates of VAT, the introduction of a financial stability levy and an action plan to combat the gray economy (aimed at improving the business environment and increasing tax revenues). On the expenditure side, the expenditure of certain ministries (including Transport, Welfare, Health, Defence, Agriculture, Justice, Education and Science and Interior) was reduced and a net expenditure cut in the budgets of local governments was proposed.

Key aspects of the 2011 budget included measures to promote growth in the economy, the stabilisation of the State social budget through the freezing of pension indexation and not increasing contributions to the second tier and an emphasis on social fairness in tax policy by gradually switching the tax burden from payroll taxes to consumption and increasing progressivity in the tax system.

On 14 April 2011, the Saeima adopted a supplementary budget which targeted a reduced central Government deficit of 3.7 per cent., and a reduced consolidated general Government deficit of 4.2 per cent., of projected nominal GDP (compared to an eventual outcome of a consolidated general Government deficit equal to 3.2 per cent. of nominal GDP) and assumed an average inflation rate of 3.5 per cent., continued economic growth throughout the year and an unemployment rate of 16.4 per cent. The 2011 supplementary budget principally aimed to increase revenues through a number of measures including increases in excise duties on alcoholic beverages, tobacco products and petrol, the abolition of the reduced rate of VAT for natural gas and medicines and an increase in gambling tax.

The 2012 budget was submitted to the Saeima on 6 December 2011 and was approved by the Saeima on 15 December 2011. The 2012 budget targeted a central Government deficit of 0.8 per cent. of projected nominal GDP (calculated according to cash flow methodology) and a consolidated general Government deficit of 2.5 per cent., of projected nominal GDP (calculated according to ESA 95 methodology) and assumed an average inflation rate of 2.4 per cent., continued economic growth throughout the year and an unemployment rate of 14.6 per cent. The 2012 budget included measures to raise revenue (including changes in the real estate tax base), for tax support and measures to strengthen the capacity of tax administration. On the expenditure side, the expenditure of certain ministries (Transport, Health, Defence, Agriculture, Welfare, Interior, Culture, Education and Science) was reduced as were borrowing allowances for local authorities.

Reflecting a better than expected macroeconomic performance in the first half of 2012, a supplementary budget based on updated macroeconomic assumptions was submitted to the Saeima on 13 September 2012. The supplementary budget proposed modest expenditure increases for areas that had adjusted the most in the period following the global financial crisis. Accordingly, additional financing was provided for social integration, demography, investment in public infrastructure and healthcare. The supplementary budget targets a consolidated general Government deficit for 2012 of 0.9 per cent. of nominal GDP according to cash flow methodology and 1.9 per cent. of nominal GDP according to ESA 95 methodology. In comparison to the initial budget for 2012, the supplementary budget envisaged an increase in revenue of LVL 309.5 million and an increase in expenditure of LVL 314.7 million.

The 2013 budget was submitted to the Saeima on 28 September 2012 and was approved by the Saeima on 15 November 2012. The 2013 budget targets a central Government deficit of 0.8 per cent., and a consolidated general Government deficit of 1.0 per cent. of projected nominal GDP and assumes an average inflation rate of 2.0 per cent., continued economic growth throughout the year and a job seeker rate of 14.3 per cent. According to ESA 95 methodology, the consolidated general Government budget deficit is projected to be 1.4 per cent. of projected nominal GDP. The 2013 budget includes priority measures for which additional financing is provided principally in the areas of healthcare, transport and the implementation of demographic policy. The 2013 budget reflects the Government's commitment to move towards a balanced budget during the economic cycle and its obligations to comply with fiscal policy conditions set out in the EU Stability and Growth Pact.

As a percentage of nominal GDP, the general Government budget deficits calculated according to ESA 95 were 0.4 per cent. in 2007, 4.2 per cent. in 2008, 9.7 per cent. in 2009, 8.1 per cent. in 2010 and 3.4 per cent. in 2011. Latvia's initial budget in 2012 projected an ESA 95 deficit level of 2.1 per cent. of nominal GDP and this was subsequently revised to 1.9 per cent. of nominal GDP in the supplementary budget. Under current assumptions, it is expected that the general Government budget deficit will not exceed 1.4 per cent. of nominal GDP and 0.8 per cent. of nominal GDP in 2013 and 2014, respectively, which is well below the 3.0 per cent. deficit ceiling required for adoption of the euro and reflects Latvia's commitment to fiscal discipline and debt sustainability and its intention to adopt the euro as its national currency in 2014, see "- *Budget Deficits*".

As part of the terms of the financial assistance package, the Government agreed general Government budget deficit targets of 10 per cent. of nominal GDP in 2009, 8.5 per cent. of nominal GDP in 2010, 6 per cent. of nominal GDP in 2011, below 3 per cent. of nominal GDP in 2012, 1.9 per cent. of nominal GDP in 2013 and 1.1 per cent. of nominal GDP in 2014, in each case according to ESA 95 methodology.

Consolidated General Government Budget

The table below sets out a summary of the consolidated general Government budget outcome for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 a summary of the consolidated general Government budgets for each of the years ended 31 December 2012 and 2013.

	Year ended 31 December						
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
	(LVL millions)						
General Government budget revenues	**5,350.0**	**5,727.1**	**4,728.4**	**4,603.8**	**5,085.5**	**5,765.2**	**5,666.0**
1. Tax revenues	4,388.3	4,764.9	3,535.9	3,442.3	3,881.1	4,228.2	4,354.1
1.1 Direct taxes of which:	2,626.9	3,004.6	2,161.1	2,073.9	2,328.4	2,534.3	2,602.0
Corporate income tax	*399.8*	*503.1*	*197.2*	*112.2*	*196.4*	*246.2*	*267.0*
Personal income tax	*888.0*	*1,029.1*	*724.1*	*778.8*	*792.2*	*854.6*	*872.9*
Social security contributions	*1,265.0*	*1,401.7*	*1,166.7*	*1,093.2*	*1,229.6*	*1,314.5*	*1,343.1*
Property tax	*74.2*	*70.7*	*73.1*	*89.7*	*110.2*	*119.0*	*119.0*
1.2 Indirect taxes of which:	1,721.3	1,722.3	1,347.0	1,344.4	1,526.3	1,660.9	1,718.0
Valued added tax	*1,202.9*	*1,117.2*	*798.4*	*825.2*	*958.7*	*1,070.4*	*1,116.3*
Excise duty	*448.1*	*540.9*	*504.1*	*458.1*	*481.5*	*500.7*	*507.3*
Car tax	*16.7*	*9.5*	*2.6*	*3.6*	*5.5*	*6.2*	*6.5*
Customs duties	*27.8*	*26.4*	*15.1*	*17.3*	*20.9*	*22.7*	*23.8*
Vehicle tax	*25.2*	*27.5*	*26.2*	*39.5*	*46.7*	*47.5*	*48.8*
Corporate vehicle tax					*12.1*	*12.5*	*14.4*
Electricity tax	*0.8*	*0.6*	*0.7*	*0.7*	*0.9*	*0.9*	*0.9*
1.3 Other taxes[(1)]	40.1	38.0	27.8	24.0	26.4	33.0	34.1
2. Non-tax revenues	240.7	269.5	397.9	340.9	326.1	381.6	294.5
3. Grants and donations	12.9	12.9	6.0	7.1	6.6	0.0	0.0
4. Self-earned revenues	227.6	237.3	249.0	213.2	208.2	223.2	218.2
5. Foreign financial assistance	461.5	430.8	528.1	600.0	663.6	932.2	799.2
6. Other local government payments	19.0	12.1	11.5	0.3	0.0	0.0	0.0
General Government budget expenditures	**5,255.4**	**6,266.5**	**5,626.3**	**5,401.8**	**5,540.2**	**5,898.6**	**5,824.4**
1. Non-capital expenditure	4,495.0	5,523.2	5,191.1	5,012.4	4,936.5	5,280.1	5,313.3
2. Capital expenditure	760.3	743.3	435.0	389.2	586.2	618.5	511.1
3. Other expenditure	0.1	0.0	0.2	0.2	17.6	0.0	0.0
Financial balance	**94.6**	**(539.4)**	**(897.9)**	**(798.0)**	**(454.8)**	**(133.4)**	**(158.4)**

Source: Ministry of Finance

Note:

(1) Including taxes on lotteries, gambling and nature resources tax.

The table below summarises the outcome of the consolidated general Government budget for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and the consolidated general Government budgets for each of the years ended 31 December 2012 and 2013, in each case as a percentage of nominal GDP (calculated on a cash flow based budget basis).

	Year ended 31 December						
	2007	**2008**	**2009**	**2010**	**2011**	**2012**[(1)]	**2013**[(2)]
				(per cent.)			
General Government budget revenues	**36.2**	**35.6**	**36.2**	**36.0**	**35.6**	**38.2**	**35.4**
1. Tax revenues	29.8	29.6	27.1	26.9	27.2	28.0	27.2
1.1 Direct taxes	17.8	18.7	16.2	16.2	16.3	16.8	16.3
1.2 Indirect taxes	11.7	10.7	10.3	10.5	10.7	11.0	10.7
1.3 Other taxes	0.3	0.2	0.2	0.2	0.2	0.2	0.2
2. Non-tax revenues	1.6	1.7	3.0	2.7	2.3	2.5	1.8
3. Grants and donations	0.1	0.1	0.0	0.1	0.0	0.0	0.0
4. Self-earned revenues	1.5	1.5	1.9	1.7	1.5	1.5	1.4
5. Foreign financial assistance	3.1	2.7	4.0	4.7	4.6	6.2	5.0
6. Other local government payments	0.1	0.1	0.1	0.0	0.0	0.0	0.0
General Government budget expenditures	**35.7**	**39.0**	**43.0**	**42.3**	**38.8**	**39.0**	**36.4**
1. Non-capital expenditure	30.5	34.3	39.7	39.2	34.6	34.9	33.2
2. Capital expenditure	5.2	4.6	3.3	3.0	4.1	4.1	3.2
3. Other expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial balance	**0.6**	**(3.4)**	**(6.9)**	**(6.2)**	**(3.2)**	**(0.9)**	**(1.0)**

Source: Ministry of Finance

Notes:

(1) Based on an assumed nominal GDP number for 2012 of LVL 15,108.3 million.

(2) Based on an assumed nominal GDP number for 2013 of LVL 15,985.5 million.

Revenues

Latvia's general Government budget revenues comprise tax revenues and revenues from a limited number of other sources. The Government's tax revenues are described below. The Government's principal non-tax revenues are derived from a range of fees (such as licensing and land registration fees), dividends and interest income. The Government's self-earned revenues reflect income from services provided by budget institutions (for example, guarantee fees for guarantees provided by the Treasury). Foreign financial assistance reflects infrastructure funds from the EU and other similar assistance.

Latvia's general Government budget revenues increased by 7.0 per cent. in 2008 as the effects of the recession began to be felt. In 2009, Latvia's general Government budget revenues decreased by 17.4 per cent., notwithstanding the revenue enhancement measures implemented by the Government in its December 2008 and June 2009 supplementary budgets. In 2010, Latvia's general Government budget revenues decreased by 2.6 per cent. compared to 2009. In 2011, Latvia's general Government budget revenues increased by 10.5 per cent. compared to 2010. In 2012 and 2013, Latvia's general Government budget revenues are budgeted to increase by 13.4 per cent. and to decrease by 1.7 per cent., respectively, in each case compared to the previous year.

Tax revenues

The majority of the Government's revenues are derived from taxes. As a percentage of total general Government revenues, tax revenues were 82.0 per cent. in 2007, 83.2 per cent. in 2008, 74.8 per cent. in 2009, 74.8 per cent. in 2010 and 76.3 per cent. in 2011. The declines in percentage terms in 2009 and 2010 reflected increased non-tax revenues and foreign financial assistance. In 2012 and 2013, tax revenues are budgeted to account for 73.3 per cent. and 76.8 per cent., respectively, of total general Government

revenues, with the decline in percentage terms in 2012 principally resulting from increased foreign financial assistance.

Latvia's tax revenues are principally made up of direct taxes and indirect taxes. Direct taxes comprise social security contributions, personal income tax, corporate income tax and real estate tax. As a percentage of total general Government tax revenues, revenues from direct taxes were 59.9 per cent. in 2007, 63.1 per cent. in 2008, 61.1 per cent. in 2009, 60.2 per cent. in 2010 and 60.0 per cent. in 2011. In 2012 and 2013, revenues from direct taxes are budgeted to equal 59.9 per cent. and 59.8 per cent., respectively, of total general Government tax revenues.

The tax rate for social security contributions represents employer and employee contributions which, in 2012, aggregate 35.1 per cent. of salary. These contributions are paid by the employer and recorded in a special budget (which is consolidated into the general Government budget). The special budget is used to pay a range of social benefits, including sickness benefit, unemployment benefit, incapacity benefit and maternity benefit. Social security contributions equalled 48.2 per cent. of direct tax revenues (excluding contributions to the State funded pension scheme) in 2007, 46.7 per cent. in 2008, 54.0 per cent. in 2009, 52.7 per cent. in 2010 and 52.8 per cent. in 2011. In 2012 and 2013, social security contributions are budgeted to equal 51.9 per cent. and 51.6 per cent., respectively, of direct tax revenue.

Personal income tax is levied on employees' salaries and is deducted at source by employers and paid to the Treasury. Prior to 2009, personal income tax was charged at a flat rate of 25 per cent., although this decreased to 23 per cent. in the January 2009 supplementary budget and increased to 26 per cent. in the 2010 budget. In the 2011 budget, the personal income tax rate was reduced to 25 per cent. and this did not change in the 2012 or 2013 budgets. Personal income tax equalled 33.8 per cent. of direct tax revenues in 2007, 34.3 per cent. in 2008, 33.5 per cent. in 2009, 37.6 per cent. in 2010 and 34.0 per cent. in 2011. In 2012 and 2013, personal income tax revenues are budgeted to equal 33.7 per cent. and 33.5 per cent., respectively, of direct tax revenue. In May 2012, the Saeima approved a staged reduction in personal income tax from 25 per cent. to 24 per cent. on 1 January 2013, 22 per cent. on 1 January 2014 and 20 per cent. on 1 January 2015 and an increase of LVL 10 in the non-taxable allowance for dependants from LVL 70 to LVL 80 with effect from 1 July 2013.

Corporate income tax is levied at a rate of 15 per cent. on company profits. Corporate income tax equalled 15.2 per cent. of direct tax revenues in 2007, 16.7 per cent. in 2008, 9.1 per cent. in 2009, 5.4 per cent. in 2010 and 8.4 per cent. in 2011. The reduced proportion since 2008 reflected decreasing profitability of companies in Latvia with the increase in 2011 indicating recovering profitability. In 2012 and 2013, revenues from corporate income tax are budgeted to equal 9.7 per cent. and 10.3 per cent., respectively, of direct tax revenue.

Real estate tax is levied on the value of land and buildings used for business purposes at a rate of 1.5 per cent. in each case. The Government reformed real estate tax in its 2010 budget by increasing the tax rate on unused agricultural land and broadening the real estate tax base by including residential property and civil engineering structures. From 2011, the real estate tax rate for residential property was increased from between 0.1 and 0.3 per cent. to between 0.2 and 0.6 per cent., depending on cadastral value. Revenues from real estate tax have been less than 5.0 per cent. of total revenues from direct taxes in each year since 2007 and are budgeted to equal 4.7 per cent. and 4.6 per cent., respectively, of total revenues from direct taxes in 2012 and 2013.

Indirect taxes principally comprise value added tax and excise duties. In addition, customs duties, car tax and, since 2007, electricity tax also generate a small proportion of the revenues from indirect taxes. In 2011, new indirect taxes on vehicles were introduced. As a percentage of total general Government tax revenues, revenues from indirect taxes were 39.2 per cent. in 2007, 36.1 per cent. in 2008, 38.1 per cent. in 2009, 39.1 per cent. in 2010 and 39.3 per cent. in 2011. In 2012 and 2013, revenues from indirect taxes are budgeted to equal 39.3 per cent. and 39.5 per cent., respectively, of total general Government tax revenues.

VAT in Latvia is charged on a wide range of goods and services. Prior to 2009, VAT was charged at rates of 18 per cent. except for certain reduced rate goods where it was charged at 5 per cent. In 2009 and 2010, VAT was charged at 21 per cent. with the reduced rate being increased to 10 per cent. and the range of goods benefitting from the reduced rate being significantly narrowed. In 2011 and in the first six months of 2012, VAT was charged at 22 per cent. with the reduced rate being increased to 12 per cent. From 1 July 2012, the VAT rate has been reduced to 21 per cent. Revenues from VAT equalled 69.9 per cent. of total revenues from indirect taxes in 2007 and 64.9 per cent. in 2008. In 2009, notwithstanding the changes described above, revenues from VAT equalled 59.3 per cent. of total revenues from indirect taxes,

reflecting the impact of the recession on personal spending habits. In 2010, revenues from VAT increased to 61.4 per cent. of total revenues from indirect taxes as the economy emerged from recession. As the economy continued to recover, revenues from VAT were higher in 2011 in absolute terms than in 2010 and equalled 62.8 per cent. of total revenues from indirect taxes. In 2012 and 2013, revenues from VAT are budgeted to equal 64.4 per cent. and 65.0 per cent., respectively, of total revenues from indirect taxes.

Excise duty in Latvia is charged on alcoholic beverages (including beer), tobacco products, mineral oils, natural gas, non-alcoholic beverages and coffee. There is a wide range of different charges which have generally increased over the period since 2007. Revenues from excise duty equalled 26.0 per cent. of total revenues from indirect taxes in 2007, 31.4 per cent. in 2008, 37.4 per cent. in 2009, 34.1 per cent. in 2010 and 31.5 per cent. in 2011. In 2012 and 2013, revenues from excise duty are budgeted to equal 30.1 per cent. and 29.5 per cent., respectively, of total revenues from indirect taxes.

Expenditure

Under the Medium-term Budget Law, substantial additional funding for expenditure in the 2013 to 2015 period has been allocated to:

- the health sector, including to ensure the availability of health care services and the provision of diagnostic services;
- the transport sector, including maintenance of highways and subsidies for public transport providers;
- the education sector, including the reform of teachers' salaries;
- measures designed to implement the national demographic policy; and
- national events and international obligations, including Latvia's presidency of the EU Council in the first six months of 2014.

Latvia's general Government budget classifies expenditure as either capital expenditure or non-capital (or maintenance) expenditure. As a percentage of total expenditure, non-capital expenditure was 85.5 per cent. in 2007, 88.1 per cent. in 2008, 92.3 per cent. in 2009, 92.8 per cent. in 2010 and 89.1 per cent. in 2011. In 2012 and 2013, non-capital expenditure is expected to equal 89.5 per cent. and 91.2 per cent., respectively, of total expenditure.

Non-capital expenditure principally comprises current expenditure and subsidies, grants and social support. Together, these two expenditure classifications made up 95.5 per cent. of total non-capital expenditure in 2007, 95.8 per cent. in 2008, 93.9 per cent. in 2009, 93.6 per cent. in 2010 and 92.8 per cent. in 2011. In 2012 and 2013, current expenditure and subsidies, grants and social support are together budgeted to account for 91.9 per cent. and 91.4 per cent., respectively, of total non-capital expenditure. In addition, interest payments on Latvia's outstanding debt and international collaboration payments and Latvia's contributions to the EU budget makes up the balance of non-capital expenditure. The increase in interest payments from 2008 principally reflects the cost of foreign financial assistance received.

Non-capital expenditure grew by 26.6 per cent. in 2007 and by 22.9 per cent. in 2008. Non-capital expenditure declined by 6.0 per cent. in 2009, by 3.4 per cent. in 2010 and by 1.5 per cent. in 2011. Non-capital expenditure is expected to increase by 7.0 per cent. and 0.6 per cent., respectively, in 2012 and 2013.

The table below provides a breakdown of non-capital expenditure in the consolidated general Government budget for each of the years ended 31 December 2007, 2008, 2009, 2010 and 2011 and of budgeted non-capital expenditure for each of the years ended 31 December 2012 and 2013.

	Year ended 31 December						
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
	(LVL millions)						
Current expenditure	2,191.7	2,612.8	2,009.3	1,775.4	1,860.0	1,903.6	1,920.9
Remuneration	1,392.5	1,679.2	1,338.2	1,087.1	1,130.9	1,157.5	1,197.5
Wages and salaries	1,059.7	1,269.8	1,028.7	846.4	887.8	901.5	936.7
Employers' social security contributions	332.8	409.4	309.5	240.7	243.1	256.0	260.8
Goods and services	799.2	933.6	675.1	688.3	729.2	746.1	723.4
Interest payments	51.7	64.0	150.5	177.1	204.0	238.8	278.3
Subsidies, grants and social support	2,101.0	2,680.8	2,870.0	2,915.3	2,720.1	2,949.7	2,935.8
Subsidies and grants	1,012.5	1,296.2	1,222.4	1,171.0	1,110.9	1,318.7	1,302.3
Social support	1,088.5	1,384.6	1,647.6	1,744.3	1,609.2	1,631.0	1,633.5
Pensions	768.9	954.2	1,081.9	1,251.8	1,206.5	–	–
Other social support	319.6	430.4	564.3	492.5	402.7	–	–
International collaboration	11.5	12.0	13.1	14.6	18.3	35.3	19.4
Payments to EU budget	139.1	153.5	148.2	121.3	131.3	152.7	159.0
Total non-capital expenditure	**4,495.0**	**5,523.1**	**5,195.0**	**5,012.4**	**4,936.5**	**5,280.1**	**5,313.3**

Source: Ministry of Finance

Current expenditure

Current expenditure comprises remuneration of central and local government employees as well as payments for goods and services used by central and local government. As a percentage of total non-capital expenditure, current expenditure was 48.8 per cent. in 2007, 47.3 per cent. in 2008, 38.7 per cent. in 2009, 35.4 per cent. in 2010 and 37.7 per cent. in 2011. Current expenditure is budgeted to be 36.1 per cent. and 36.2 per cent., respectively, of total non-capital expenditure in 2012 and 2013.

Remuneration includes both wages and employers' social security contributions. In 2008, remuneration increased by 20.6 per cent. whereas in 2009 and 2010, remuneration fell by 20.3 per cent. and 18.8 per cent., respectively, reflecting the effects of wage reductions and rationalisation measures set out in budgets since 2009. In 2011, remuneration increased by 4.0 per cent., reflecting an increase in the minimum monthly wage from LVL 180 to LVL 200, salary increases for judicial staff and other factors. In 2012 and 2013, remuneration is budgeted to increase by 2.4 per cent. and 3.5 per cent., respectively. As a percentage of total current expenditure, remuneration was 63.5 per cent. in 2007, 64.3 per cent. in 2008, 66.6 per cent. in 2009, 61.2 per cent. in 2010 and 60.8 per cent. in 2011 and is budgeted to be 60.8 per cent. and 62.3 per cent., respectively, in 2012 and 2013.

In 2008, payments for goods and services increased by 16.8 per cent. and then fell by 27.7 per cent. in 2009 in accordance with the overall budget expenditure reduction. In 2010 and 2011, payments for goods and services increased by 2.0 per cent. and 5.9 per cent., respectively, and these payments are budgeted to increase by 2.3 per cent. in 2012 and to decrease by 3.0 per cent. in 2013, respectively. As a percentage of total current expenditure, payments for goods and services were 36.5 per cent. in 2007, 35.7 per cent. in 2008, 33.6 per cent. in 2009, 38.8 per cent. in 2010 and 39.2 per cent. in 2011. Latvia's payments for goods and services are budgeted to be 39.2 per cent. and 37.7 per cent., respectively, of total current expenditure in 2012 and 2013.

Subsidies, grants and social support

As a percentage of total non-capital expenditure, subsidies, grants and social support was 46.7 per cent. in 2007, 48.5 per cent. in 2008, 55.2 per cent. in 2009, 58.2 per cent. in 2010 and 55.1 per cent. in 2011. Subsidies, grants and social support are budgeted to be 55.9 per cent. and 55.3 per cent., respectively, of total non-capital expenditure in 2012 and 2013.

Subsidies and grants principally comprise payments by Government to enterprises for ensuring certain functions which are necessary to society (for example, subsidising the costs of mail delivery in rural areas). In addition, subsidies for agriculture and payments to non-Governmental organisations make up the balance of subsidies and grants expenditure. Subsidies and grants increased by 28.0 per cent. in 2008 before falling by 5.7 per cent. and 4.2 per cent., respectively, in 2009 and 2010, reflecting general cuts in expenditure designed to minimise the level of the projected deficit. In 2011, these payments declined by 5.1 per cent. In 2012 and 2013, subsidies and grants are budgeted to increase by 18.7 per cent. and to decrease by 1.2 per cent., respectively, due to EU funds expenditures. As a percentage of total subsidies, grants and social support, subsidies and grants were 48.2 per cent. in 2007, 48.4 per cent. in 2008, 42.6 per cent. in 2009, 40.2 per cent. in 2010 and 40.8 per cent. in 2011. Subsidies and grants are budgeted to be 44.7 per cent. and 44.4 per cent., respectively, of total subsidies, grants and social support in 2012 and 2013.

Social support principally comprises pensions and other social insurance payments made from the Central Government Social Security Budget. Social support increased by 27.2 per cent. in 2008, by 19.0 per cent. in 2009 and by 5.9 per cent. in 2010 before falling by 7.7 per cent. in 2011 due to better conditions in the labour market. Social support is budgeted to increase by 1.4 per cent. and 0.2 per cent., respectively, in 2012 and 2013. The significant increases in social support in 2008 and 2009 reflect the effects of the recession in Latvia, including significantly rising unemployment levels.

As a percentage of total subsidies, grants and social support, social support was 51.8 per cent. in 2007, 51.6 per cent. in 2008, 57.4 per cent. in 2009, 59.8 per cent. in 2010 and 59.2 per cent. in 2011. Social support is budgeted to be 55.3 per cent. and 55.6 per cent., respectively, of total subsidies, grants and social support in 2012 and 2013.

Budget Deficits

Since its accession to the EU in 2004, Latvia has been obliged to observe the euro convergence criteria for Eurozone entry (the "**Maastricht criteria**") which limit the general Government sector budget deficit to no more than 3.0 per cent. of nominal GDP (on an ESA 95 basis).

Between 2004 to 2007, Latvia kept within the Maastricht criteria, with a sustained budget deficit of 3 per cent. of GDP. However, due to the global financial crisis in 2008 and a continuous pro-cyclical fiscal policy, Latvia's budget deficit increased to 4.2 per cent. of nominal GDP and to 9.8 per cent. of nominal GDP in 2009, both of which were above the budget deficit limit set by the Maastricht criteria. In July 2009, the EU implemented an excessive deficit reduction procedure for Latvia. Deficit compliance will be achieved by the end of 2012 and the process to discontinue the procedure will begin accordingly.

Following Latvia's acceptance of the financial assistance package, Latvia implemented significant budget consolidation measures as part of the conditions attached to that package. Through these and a strong fiscal policy, the budget deficit has decreased. In 2010, the budget deficit was 8.1 per cent. of nominal GDP and in 2011 it was 3.4 per cent. of nominal GDP. These steps contributed to the closure of Latvia's international loan programme under the financial assistance package at 31 December 2011. Since 2008, the budget deficit has been reduced through the implementation of austerity measures that amount to over €3.2 billion in five years, or 16.9 per cent. of nominal GDP.

For 2012, Latvia's budgetary aim is for the general Government deficit to fall to 1.9 per cent. of nominal GDP, well within the 3.0 per cent. limit of the Maastricht criteria. Under current assumptions, it is expected that the general Government budget deficit will not exceed 1.4 per cent. of nominal GDP and 0.8 per cent. of nominal GDP in 2013 and 2014, respectively, which reflects Latvia's commitment to fiscal discipline and debt sustainability.

This target-driven approach is designed to allow Latvia to meet the Maastricht criteria in a sustainable manner, it is the basis of Latvia's economic stabilisation and growth recovery strategy and is line with Latvia's aim of adopting the euro as its national currency in 2014.

INDEBTEDNESS

All central Government debt and cash management activities are entrusted to the Treasury, which is an independent administrative institution but reports to the Minister of Finance. The main objective for central Government medium-term debt management has been to provide the Government with the necessary financial resources at the lowest possible cost, including through the use of appropriate hedging tools, but also to take into account the proposed introduction of the euro in the medium-term and the need to develop the Latvian capital markets and financial system. This latter objective is an important reason for the Government's issues of domestic debt securities. The Treasury prepares both a medium-term and a more detailed annual funding plan.

Central Government debt is issued to ensure the financial liquidity of the central Government, to finance the central Government budget deficit and to refinance central Government debt.

The ceiling on total central Government debt (comprising both domestic and external debt incurred by the central Government) is set out in the State Budget Law. The ceiling of central Government debt outstanding at the end of 2012 is LVL 6.2 billion (at nominal value).

The table below sets out Latvia's outstanding central Government debt in Lats and as a percentage of nominal GDP as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
Central Government debt	**1,031.8**	**2,645.4**	**4,182.0**	**4,955.3**	**5,216.3**	**5,388.3**
External	635.1	1,260.4	3,261.3	4,146.5	4,498.3	4,712.5
Domestic	396.7	1,385.0	920.7	808.8	717.9	675.8
			(as a percentage of nominal GDP)			
Central Government debt	**7.0**	**16.4**	**32.0**	**38.8**	**36.5**	**35.7**
External	4.3	7.8	25.0	32.6	31.5	31.2
Domestic	2.7	8.6	7.0	6.3	5.0	4.5

Source: The Treasury

Note:

(1) As at 31 October. Percentage of GDP has been calculated using the Ministry of Finance's most recent nominal GDP forecast for 2012 of LVL 15,108.3 million.

Latvia has met all principal and interest obligations on its central Government debt since the renewal of its independence in 1991.

The table below sets outs Latvia's debt service payments (excluding interest amounts) in respect of its total outstanding central Government debt as at 31 October 2012, expressed in millions of Lats, and as a percentage of the total amount outstanding at 31 October 2012, for each of the years indicated. The data contained in the table does not assume any refinancing of existing debt.

	2012[1]	2013	2014	2015	2016	2017	2018	2019
				(*LVL millions*)				
Total principal payments	**92.1**	**553.4**	**1,152.5**	**1,088.5**	**157.3**	**653.6**	**371.9**	**424.1**
Securities	20.8	269.3	310.1	127.9	74.2	574.0	295.0	3.3
Loans	61.8	306.7	841.8	960.3	83.1	77.6	76.9	420.8
As percentage of total outstanding central Government debt as at 30 September 2012	1.5%	10.7%	21.4%	20.2%	2.9%	12.1%	6.9%	7.9%

	2020	2021	2022	2023	2024	2025	2026[2]	Total
				(LVL millions)				
Total principal payments	**20.4**	**340**	**99.4**	**4.7**	**110.2**	**196.2**	**116.1**	**5,380.4**
Securities	0	333.2	41.3	0	0	0	0	2,049.1
Loans	20.4	5.8	58.0	4.7	110.2	196.2	115.2	3,339.2
As percentage of total outstanding central Government debt as at September 2012	0.4%	6.3%	1.8%	0.1%	2.0%	3.6%	2.2%	100.0%

Source: The Treasury

Notes:

(1) Period from 1 October to 31 December only.

(2) Amount due to be repaid from and including 2026 onward.

As at 30 June 2012, Latvia's general Government debt as measured by the EU constituted 43.0 per cent. of Latvia's GDP for 2012 (as most recently forecast by the Ministry of Finance) compared to 42.2 per cent. as at 31 December 2011, 44.5 per cent as at 31 December 2010 and 36.7 per cent. as at 31 December 2009. As at 31 December 2011, Latvia had the eighth lowest ratio of general Government debt to GDP among the 27 Member States of the EU.

Central Government External Debt

Latvia's central Government external debt (the "**External Debt**") comprises borrowings from the international financial markets and from international financial institutions. Latvia has issued six series of international bonds, four of which were denominated in euro and two in U.S. dollars. The issues which took place in 1999 and 2001 have both been redeemed in accordance with their terms. The following issues are currently outstanding:

Aggregate Outstanding Principal Amount	Original Issue Date	Maturity Date	Coupon
			(per cent.)
U.S.$1,000 million	22 February 2012	22 February 2017	5.25
U.S.$500 million	16 June 2011	16 June 2021	5.25
€400 million	5 March 2008	5 March 2018	5.50
€400 million	2 April 2004	2 April 2014	4.25

As at 31 October 2012, these bonds totalled 29 per cent. of Latvia's External Debt. The balance of the External Debt consisted of IMF loans (13 per cent.), an EU loan (43 per cent.), European Investment Bank loans (4 per cent.) and loans from other international financial institutions (11 per cent.).

The servicing cost of Latvia's External Debt varies based upon interest rate fluctuations. Currently, the Latvian Central Government debt management strategy (the "**Debt Management Strategy**") envisages that the rates of at least 60 per cent. of the central Government debt will be fixed and, at 30 September 2012, the fixed rate proportion was 88 per cent. The fixed rate proportion of the External Debt was 92 per cent. at the same date.

The table below sets out Latvia's projected debt service payments in respect of its External Debt for each year from 2013, based on the External Debt outstanding at 31 October 2012 and using an assumed interest rate based on rates prevailing on 29 November 2012 for the variable rate proportion.

	2013	2014	2015	2016	2017	2018	2019
				(LVL millions)			
Principal payments	**305.6**	**1,122.9**	**960.3**	**83.0**	**621.6**	**358.0**	**420.8**
Loans	303.6	841.8	960.3	83.0	77.6	76.9	420.8
Securities[1]	0.0	281.1	0.0	0.0	544.0	281.1	0.0
Interest payments	**165.7**	**160.6**	**123.9**	**94.8**	**77.8**	**60.8**	**42.7**
Loans	95.5	90.4	65.5	36.6	33.8	31.1	28.4
Securities	70.2	70.2	58.3	58.3	44.0	29.7	14.3

	2020	2021	2022	2023	2024	2025	2026[2]
				(LVL millions)			
Principal payments	**20.4**	**278.8**	**58.0**	**4.7**	**110.2**	**196.2**	**115.5**
Loans	20.4	5.8	58.0	4.7	110.2	196.2	115.5
Securities[1]	0.0	272.0	0.0	0.0	0.0	0.0	0.0
Interest payments	**28.8**	**21.1**	**13.8**	**11.2**	**11.1**	**6.3**	**0.1**
Loans	14.5	13.9	13.8	11.2	11.1	6.3	0.1
Securities	14.3	7.2	0.0	0.0	0.0	0.0	0.0

Source: The Treasury
Notes:
(1) Nominal value
(2) Debt service for the period from and including 2026 onwards.

The table below sets out Latvia's External Debt broken down by currency, calculated based on the issue value plus amortisation of discount (+)/premium (-) as at 31 December in each of 2007, 2008, 2009, 2010 and 2011 and calculated based on the nominal value as at 31 October 2012.

	As at 31 December					As at 31 October
	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
CHF	0.55	0.56	0.52	0.57	0.53	0.47
EUR	608.05	824.24	2,591.19	3,210.97	3,274.97	3,277.8
SEK	–	–	–	–	–	–
USD	25.68	23.66	20.56	19.38	283.72	832.92
XDR[2]	–	409.00	639.31	904.51	925.47	608.04
Total	**634.28**	**1,257.46**	**3,251.58**	**4,135.43**	**4,484.69**	**4,719.20**

Source: The Treasury
Notes:
(1) As at 31 October in nominal value.
(2) IMF special drawing rights.

Central Government Domestic Debt

As at 31 October 2012, central Government domestic debt ("**Domestic Debt**") amounted to LVL 675.8 million as compared to LVL 717.9 million, LVL 808.8 million and LVL 920.7 million as at 31 December 2011, 2010 and 2009, respectively.

Domestic Debt currently comprises tradable Government securities, although it may also include short-term funding facilities (such as overdrafts and credit lines) which are used for liquidity management purposes. Domestic Debt is principally denominated in Lats and a small part is denominated in euro. Historically, domestic Government securities were used both as a financing instrument and with a view to furthering the development of a domestic securities market in Latvia. As part of its debt management objectives, the Treasury seeks to ensure that at least 35 per cent. of the Government's overall outstanding debt is denominated in Lats. As at 31 October 2012, the Government has six-month and 12-month short-term treasury bills, two, three- and five-year medium-term treasury bonds and 10- and 11-year long-term treasury bonds outstanding in the domestic market. The short-term bills are issued at a discount and redeemed at par on maturity. The medium- and long-term bonds are issued with a fixed interest rate, which is paid annually, and are redeemed at par on maturity. The legal issuer of the domestic securities is the Minister of Finance, but all the conditions of each issue are set by the Treasury, which acts on behalf of the Minister of Finance.

The Government's domestic debt securities are issued in dematerialised form and sold through NASDAQ OMX Riga's Genium INET trading system at competitive multi-price and non-competitive uniform price auctions at a discount for bills or yield for bonds. All Government domestic debt securities are registered with the LCD and are listed on NASDAQ OMX Riga.

The table below sets out the structure of the outstanding Domestic Debt as at 31 October 2012.

	31 October 2012	
	nominal (LVL millions)	*(per cent.)*
3 month T-bills	0.0	0.0
6 month T-bills	30.2	4.5
12 month T-bills	121.0	17.9
2 year bonds	0.0	0.0
3 year bonds	42.4	6.3
5 year bonds	167.2	24.7
10 year bonds	293.0	43.4
11 year bonds	17.2	2.5
Other borrowings	4.8	0.7
Total	**675.8**	**100.0**

Source: The Treasury

During 2012, the Treasury successfully completed 20 competitive multi-price auctions of six-month and 12-month treasury bills and of five-year and 10-year bonds.

The Treasury has been increasing the average maturity of its domestic securities portfolio since the end of 2009. During 2011, the Treasury auctions were principally of longer-term securities, with a view to decreasing the refinancing risks related to Domestic Debt and ensuring that debt servicing costs were fixed at relatively lower levels. On 25 January 2012 and on 25 April 2012, the Government established new five-year and 10-year bond programmes. In 2012, short-term six- and 12-month treasury bills represented only 22.4 per cent. of the Treasury's total domestic securities portfolio. In the 12-month period to 31 October 2012, all competitive multi-price auctions were fully subscribed with bid cover ratios ranging between 1 and 6 times.

During 2012, the average weighted yields of short-term treasury bills in the domestic primary market remained near their historically lowest level. By way of example, the rates of six-month Government bills were fixed at 0.315 per cent. on 24 October 2012 and the rates of 12-month Government bills were fixed at 0.618 per cent. on 19 September 2012.

Residual Maturities of External and Domestic Securities

The table below sets out the distribution of the principal amount of external and domestic Government securities by residual maturity as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
Up to 1 year	185.9	917.0	498.6	377.3	318.8	290.1
1-3 years	48.4	121.7	75.6	209.2	449.0	370.2
3-5 years	73.7	100.0	410.0	457.9	202.1	716.0
5-11 years	497.0	711.4	401.3	313.6	622.5	672.9
Total	**805.0**	**1,850.1**	**1,385.5**	**1,358.0**	**1,592.4**	**2,049.1**

Source: The Treasury
Note:
(1) As at 31 October.

Debt Management Strategy

Latvia pursues a strategy of central Government debt management through a dual framework of central Government debt portfolio management and central Government borrowing management. Central Government debt portfolio management is aimed at optimising central Government debt service costs

over the long-term while hedging and preventing financial risks in relation to the central Government debt portfolio. Central Government borrowing management is aimed at ensuring borrowing opportunities, liquidity and favourable terms and conditions, focusing on the long-term development of the financial market and promoting relationships with financial market participants.

The Debt Management Strategy targets a number of key parameters, including the following:

- *The amount of Lat denominated debt.* The Debt Management Strategy envisages that the proportion of the debt portfolio denominated in Lats should not be less than 35 per cent. of the total portfolio if (i) this is consistent with Latvian macroeconomic developments, the condition of the capital markets and the overall financial systems and (ii) the weighted average yield of medium-term and long-term Government domestic securities offered at auctions held by the Treasury is less than 100 basis points above the yield that could be achieved by the Treasury borrowing in euro;
- *The maturity profile of the portfolio.* The Debt Management Strategy envisages that not more than 25 per cent. of the portfolio should mature within one year and that not more than 50 per cent. should mature within three years;
- *The fixed rate proportion.* The Debt Management Strategy envisages that not less than 60 per cent. of the portfolio should have fixed rates of interest;
- *The Macaulay Duration of the portfolio* (which, in relation to each security, is determined as the weighted average maturity of the security where the weights are the relative discounted cash flows in each period). The Debt Management Strategy envisages that the Macaulay Duration should be within a corridor of between 3.4 and 4.0 years; and
- *The foreign currency net debt composition.* The Debt Management Strategy envisages that foreign currency-denominated net debt (which is foreign currency-denominated debt incurred less foreign currency-denominated loans made by the Treasury that are not classified as risky and cash in foreign currencies held by it, increased by the foreign currency guarantees classified as risky) should be 100 per cent. in euro plus or minus 5 per cent.

The Treasury typically uses hedging instruments to help it achieve the above parameters. The Treasury has developed and applies a cost-at-risk model the outputs of which, along with the Treasury's expert assessment, financial market analysis, results of econometric modelling and other factors, are used to evaluate the parameters set and to determine whether the defined performance levels are optimal and financially justified over time. The Treasury's debt management committee, which includes the Treasurer and the Deputy Treasurer, meets at least monthly to review the portfolio and its performance against the parameters. The strategy itself is reviewed at least annually. The last review took place in March 2012 and the current strategy was approved by the Minister of Finance on 2 April 2012.

The table below sets out the key parameters for the central Government overall debt portfolio discussed above and the actual parameters achieved as of 31 December 2011 and 31 October 2012.

Parameters	**31 December 2011**		**31 October 2012**		**Strategy**	
Amount of Lat denominated debt[1]	14%		12%		⩾35%	
	1 year or less	3 years or less	1 year or less	3 years or less	1 year or less	3 years or less
Maturity profile	10%	43%	5%[1]	47%[2]	⩽25%	⩽50%
Fixed rate proportion	80%		88%		⩾60	
Macaulay Duration[3]	3.50 years		3.66 years		from 3.4 to 5.0 years	
Foreign currency net debt composition	EUR 99.74%		EUR 99.76%		EUR 100% +/- 5%	

Source: The Treasury

Notes:

(1) The Debt Management Strategy permits the proportion of Lat-denominated debt to be below 35 per cent. if (i) this is consistent with Latvian macroeconomic developments, the condition of the capital markets and the overall financial systems and (ii) the weighted average yield of medium-term and long-term Government domestic securities offered at auctions held by the Treasury is less than 100 basis points above the yield that could be achieved by the Treasury borrowing in euro. The proportions at 31 December 2011 and 30 September 2012 reflect these factors.

(2) Maturity profile taking into account the debt refinancing reserve (LVL 270 million).

(3) The Macaulay Duration in relation to each security is determined as the weighted average maturity of the security where the weights are the relative discounted cash flows in each period.

Ratings

In 2012, Latvia was rated at investment grade by all three major rating agencies, S&P, Moody's and Fitch. Latvia's current ratings are BBB (positive outlook) from Fitch and S&P and Baa3 (positive outlook) from Moody's.

Reflecting the deterioration in the global economy and the effects of the recession in Latvia, Latvia's credit ratings were reduced as follows:

- by S&P from BBB+ to BBB in October 2008, to BBB- in November 2008, to BB+ in February 2009 and to BB in August 2009;
- by Moody's from A2 to A3 in November 2008, to Baa1 in January 2009 and to Baa3 in April 2008; and
- by Fitch from BBB+ to BBB in October 2008, to BBB- in November 2008 and to BB+ in April 2008.

Since August 2009, the following rating actions have occurred:

- S&P upgraded Latvia's rating to BB+ in December 2010, to BBB- with stable outlook in May 2012 and to BBB (positive outlook) in November 2012;
- Moody's affirmed its Baa3 rating but changed the outlook from stable to positive in June 2011;
- Fitch upgraded Latvia's rating from BB+ to BBB- with a positive outlook in March 2011, revised its outlook to stable from positive in December 2011 and upgraded Latvia's rating to BBB with a positive outlook in November 2012; and
- Rating and Investment Information Inc upgraded Latvia's rating from BB+ to BBB- with a stable outlook in January 2012.

Financing and Liquidity Strategy

The Treasury's financing strategy focuses on the maintenance of liquidity, the minimisation of central Government debt refinancing risk and the optimisation of central Government debt servicing costs over the medium-term.

The central Government's financing requirement, including central Government debt repayments, are expected to be funded by the regular issue of securities in the domestic financial market and by borrowing in international financial markets. The Treasury currently anticipates that the central Government's total borrowings in the international markets over the three years 2013 to 2015 will be approximately LVL 2.9 billion and in the domestic market will be approximately LVL 1.1 billion.

As at 31 October 2012, Latvia's liquid resources in Treasury accounts were approximately LVL 1.1 billion. In accordance with a cash management strategy approved by the Minister of Finance in April 2012, these liquid resources are held predominantly with the Bank of Latvia. In addition, resources are also held with a number of commercial banks and a small proportion is invested in fixed income securities.

Financial Assistance from International Lenders

In the second half of 2008, due to the global financial crisis, Latvia's limited financial resource availability and the liquidity support provided by the Government to stabilise the banking sector, the Government sought financial assistance from the IMF and other members of the international community. At the end of December 2008, the IMF, the EU, the World Bank, the EBRD and certain Nordic countries and other EU Member States agreed to provide a package of support to Latvia in an amount of up to approximately €7.5 billion (equal to approximately U.S.$10.5 billion).

At the end of 2011, loans amounting to €4.5 billion had been made by international lenders within the scope of the financial assistance programme. The funds received have principally been used to finance deficits, make State loans and finance debt repayment. In addition, a portion of the funds received has been used to support Parex Bank and ensure the stability of the Latvian banking sector. Latvia decided not to make any further borrowings after 1 November 2011 and the programme facility has now lapsed.

The table below sets out planned and distributed financing provided by the international lenders under the financial assistance package.

	Total	
	Planned[1]	**Disbursed**
	(€ billions)	
EU	3.1	2.9
Nordic countries	1.9	0
IMF	1.7	1.1
World Bank	0.4	0.4
Other countries	0.4	0.1
Total	**7.5**	**4.5**

Source: The Treasury

Note:

(1) Financing planned at the start of the programme.

On 11 July 2012, the IMF's Executive Board concluded its first Post-Programme Monitoring Discussions with Latvia. The Executive Board welcomed Latvia's economic recovery since the crisis and determined policy implementation that has facilitated Latvia's successful return to the international capital markets and enabled it to move closer to euro adoption.

On 14 September 2012, Latvia repaid early €211.1 million of monies disbursed to it by the IMF. The support made available to Latvia under the financial assistance package has a range of interest costs. Latvia has generally sought to borrow the concessional funding first. As a result, as and when this less expensive funding is repaid, if and to the extent that Latvia refinances it from other sources, this may give rise to a limited increase in Latvia's overall debt servicing costs depending on the price at which Latvia is able to secure refinancing at the time. See also, "*Risk Factors – Risk Factors Relating to Latvia – Latvia has significant debt repayment obligations in the next few years and any inability to obtain funding to meet these obligations could adversely affect Latvia in a number of ways*".

State Guarantees and Loans Granted by the State

Each State Budget Law sets a limit on the amount of the net increase of loans granted by the State for the year. Under the 2012 State Budget Law, the net increase of state loans granted is planned to be LVL 208.0 million (including the state loan limit for municipalities in an amount of LVL 76.0 million). In addition, under the Budget Management Law, the Minister of Finance is authorised to issue state loans in accordance with a decision of the Cabinet of Ministers, provided the loans are borrowed for the purposes specified in the Budget Management Law and do not exceed 10 per cent. of nominal GDP as specified in the annual State Budget Law.

Under the State Budget Law, the State may make loans to local governments, special state budget executors, certain state or local government-owned companies, scientific institutes and higher education establishments that have been assigned the status of a derived public entity and port authorities. On 31 October 2012, the amount of such loans outstanding was LVL 692.8 million.

Each State Budget Law also lists the state guarantees planned for the relevant year. In 2012, the authorised amount of those guarantees was LVL 124.1 million. In addition, the 2012 State Budget Law makes provision for the issuance of a State guarantee of up to LVL 49.0 million to guarantee the existing contractual liabilities of the Mortgage and Land Bank of Latvia to international creditors. Until 2009, State guarantees were issued only for project financing and for commercial bank financing advanced to students. Starting in 2009, the Budget Management Law permits State guarantees to be issued to reduce general economic risks, to avoid a social-economic crisis or to mitigate its effects and to ensure the availability of financial resources in an emergency situation. On 31 October 2012, the total amount of State guarantees issued and outstanding was LVL 551.2 million.

The table below shows the cumulative amount of State guarantees outstanding and the amount of State loans made as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
State guarantees outstanding	158.1	208.3	713.8	597.1	498.5	551.2
As a percentage of GDP.....	1.1	1.3	5.5	4.7	3.5	3.6
State loans made	335.4	432.8	537.9	786.7	743.4	692.8
As a percentage of GDP.....	2.3	2.7	4.1	6.1	5.8	4.6

Source: The Treasury

Note:

(1) As at 31 October. Percentages of GDP have been calculated using the Ministry of Finance's most recent nominal GDP forecast for 2012 of LVL 15,108.3 million.

Local Government Debt

Local authorities in Latvia have the right to borrow and issue guarantees only in amounts provided for in the annual State Budget Law. Any borrowing or guarantee by a local authority can only be made after having been approved by the Council for the Control and Surveillance of Local Government Borrowing and Guarantees (the "**Council**"). Before approving a proposed borrowing or guarantee, the Council evaluates the relevant proposal and assesses the financial capacity of the local government concerned to repay any loans received or comply with the terms of the relevant guarantee.

The table below sets out Latvian local government borrowing by principal source as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 31 October 2012.

	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
Total local government debt...	379.6	480.4	495.4	535.0	562.7	558.5
From the Treasury	250.8	354.5	369.7	396.6	430.2	433.1
From other lenders	128.8	125.9	125.7	138.3	132.5	125.4

Source: The Treasury

Note:

(1) As at 31 October.

The Treasury is the main lender to local governments. Local governments may borrow from other lenders only if the financial terms of the other lender are more advantageous than those of the Treasury and after receiving permission from the Minister of Finance.

Under the 2012 State Budget Law, local governments may only borrow in limited circumstances, including to:

- implement projects co-financed by the EU and other providers of financial assistance;
- stabilise the finances of the local government;
- fund infrastructure projects in which the local government is responsible for at least 75 per cent. of the total costs and the loan comprises not more than 25 per cent. and where the project is implemented within the budget year;
- fund social programmes and boarding-school investment projects;
- fund fuel purchases; and
- fund completion of the third stage of Riga City Southern Bridge's construction.

Gross External Debt

Latvia's gross external debt is determined, in accordance with IMF methodology, as the total of all direct liabilities (including debt securities, loans, deposits and trade credits) of Latvia's residents to non-residents requiring future principal and/or interest payments based on a prior agreement.

The table below sets out certain information with respect to Latvia's gross external debt as at 31 December 2007, 2008, 2009, 2010 and 2011 and as at 30 June 2012.

	2007	2008	2009	2010	2011	2012[1]
			(LVL millions)			
General Government	749	1,376	3,314	4,201	4,549	5,020
Short-term	18	0	46	61	60	39
Long-term	731	1,376	3,268	4,140	4,489	4,981
Bank of Latvia	11	386	53	24	29	33
Short-term	11	386	53	24	29	33
Long-term	0	0	0	0	0	0
MFIs (excluding Bank of Latvia)	12,930	13,250	11,278	10,933	9,792	9,943
Short-term	6,852	5,358	3,869	5,389	5,051	5,848
Long-term	6,078	7,892	7,409	5,544	4,741	4,095
Other sectors	5,166	5,904	5,805	5,911	6,332	6,448
Short-term	1,203	1,256	1,066	1,271	1,337	1,670
Long-term	3,963	4,648	4,739	4,640	4,995	4,778
Direct investment	1,464	1,917	2,144	1,829	2,164	2,047
Debt liabilities to affiliated enterprises	21	21	24	19	25	21
Debt liabilities to direct investors	1,443	1,896	2,120	1,810	2,139	2,026
MFIs (excluding Bank of Latvia).	171	215	396	0	0	0
Other sectors	1,272	1,681	1,724	1,810	2,139	2,026
Gross external debt	**18,856**	**20,916**	**20,450**	**21,069**	**20,702**	**21,444**
As a percentage of GDP	128.1	130.0	156.5	164.8	145.0	144.1[2]

Source: *Bank of Latvia*

Notes:

(1) As at 30 June.

(2) As a percentage of the sum of the last four quarters' nominal GDP.

As at 30 June 2012, Latvia's gross external debt was LVL 21.4 billion accounting for 144.1 per cent. of GDP (calculated as the sum of the previous four quarters' nominal GDP). At 31 December 2010 and 31 December 2011, the debt-to-GDP ratios were 164.8 per cent. and 145.0 per cent., respectively. As at 30 June 2012, the contribution of the Government sector to the Latvia's gross external debt was 23.4 per cent, the contribution of the financial sector was 46.5 per cent, the debt of other sectors contributed 30.1 per cent. and the contribution of direct investment liabilities (debts owed by domestic and foreign enterprises to each other) was 9.5 per cent.

As at 30 June 2012, Latvia's net external debt (calculated as its gross external debt less its external debt assets) was LVL 6.4 billion, representing 43.3 per cent. of the sum of the last four quarters' nominal GDP.

TAXATION

The following is a general description of certain tax considerations relating to the Notes. It does not purport to be a complete analysis of all tax considerations relating to the Notes. Prospective purchasers of Notes should consult their tax advisers as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of the Republic of Latvia of acquiring, holding and disposing of Notes and receiving payments of interest, principal and/or other amounts under the Notes. This summary is based upon the law in effect on the date of this Offering Circular and is subject to any change in law that may take effect after such date.

Latvian Taxation

Under existing Latvian laws and regulations, payments of principal and interest on the Notes to an individual who is a non-resident of Latvia or to a legal entity that is neither resident in Latvia nor maintains, or is engaged in trade or business through, a permanent establishment in Latvia (together "**Non-Latvian Holders**") will not be subject to taxation in Latvia and no withholding of any Latvian tax will be required on any such payments. In addition, gains realised by Non-Latvian Holders derived from the sale or exchange of the Notes will not be subject to any Latvian income or capital gains tax.

Under existing Latvian laws and regulations, payments of principal and interest on the Notes to an individual who is a resident of Latvia will not be subject to taxation at source in Latvia and no withholding of any Latvian tax will be required on any such payments. In addition, gains from the sale or exchange of the Notes realised by individuals who are residents of Latvia will not be subject to any Latvian income or capital gains tax. For legal entities which are resident in Latvia or maintain a permanent establishment in Latvia payments of principal and interest under the Notes will not be subject to taxation at source in Latvia and no withholding of any Latvian tax will be required on any such payments, however, the interest on the Notes, as well as gains realised from the sale or exchange of the Notes would be included in the tax payer's annual taxable income (subject to 15 per cent. corporate income tax). **Provided that** if the Notes are listed on a regulated market of the European Union or the European Economic Area, then, until 31 December 2012, the gains realised from the sale or exchange of the Notes may be excluded from the taxpayer's annual taxable income in Latvia. However, thereafter this concession is currently scheduled to lapse on 1 January 2013, but the Ministry of Finance has submitted to the Cabinet of the Ministers proposed amendments to the Corporate Income Tax Law, providing that the gains realised from the sale or exchange of the Notes may be excluded from the taxpayer's annual taxable income also after 31 December 2012. It is anticipated that such amendments will come into force as of 1 January 2013.

No Latvian stamp duty, registration, transfer or similar taxes will be payable in connection with the acquisition, ownership, sale or disposal of Notes by the Non-Latvian Holders of Notes providing that any sale or exchange of Notes takes place outside the territory of Latvia.

United States

TO ENSURE COMPLIANCE WITH INTERNAL REVENUE SERVICE (IRS) CIRCULAR 230, EACH TAXPAYER IS HEREBY NOTIFIED THAT: (A) ANY TAX DISCUSSION HEREIN IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, BY THE TAXPAYER FOR THE PURPOSE OF AVOIDING U.S. FEDERAL INCOME TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER; (B) ANY SUCH TAX DISCUSSION WAS WRITTEN IN CONNECTION WITH THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) THE TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

The following is a summary of certain U.S. federal income tax considerations relevant to U.S. Holders (as defined below) acquiring, holding and disposing of Notes. This summary addresses only the U.S. federal income tax considerations for initial purchasers of Notes at their issue price (as defined below) that will hold the Notes as capital assets (generally, property held for investment). This summary is based on the U.S. Internal Revenue Code of 1986 (the "**Code**"), final, temporary and proposed U.S. Treasury regulations and, administrative and judicial interpretations, all of which are subject to change, possibly with retroactive effect.

This summary does not discuss all aspects of U.S. federal income taxation that may be relevant to investors in light of their particular circumstances, such as investors subject to special tax rules (including, without limitation: (i) certain financial institutions; (ii) insurance companies; (iii) dealers or traders in

stocks, securities, or notional principal contracts; (iv) regulated investment companies; (v) real estate investment trusts; (vi) tax-exempt organisations; (vii) partnerships, pass-through entities, or persons that hold Notes through pass-through entities; (viii) investors that hold Notes as part of a straddle, hedge, conversion, constructive sale or other integrated transaction for U.S. federal income tax purposes; (ix) investors that have a functional currency other than the U.S. dollar and (x) U.S. expatriates and former long-term residents of the United States), all of whom may be subject to tax rules that differ significantly from those summarised below. This summary does not address U.S. federal estate, gift or alternative minimum tax considerations, or non-U.S., state or local tax considerations.

For the purposes of this summary, a "**U.S. Holder**" is a beneficial owner of Notes that is for U.S. federal income tax purposes (i) an individual who is a citizen or resident of the United States, (ii) a corporation created in, or organised under the laws of, the United States, any state thereof, or the District of Columbia, (iii) an estate the income of which is includible in gross income for U.S. federal income tax purposes regardless of its source or (iv) a trust that is subject to U.S. tax on its worldwide income regardless of its source.

Payments of interest

Interest on a Note, including the payment of any additional amounts, will be taxable to a U.S. Holder as ordinary income at the time it is received or accrued, in accordance with the holder's method of accounting for tax purposes. Interest paid by the Republic on the Notes and payments of any additional amounts will generally constitute income from sources without the United States.

Sale or other disposition of Notes

A U.S. Holder generally will recognise gain or loss on the sale or other disposition of a Note equal to the difference between the amount realised on the sale or other disposition and the tax basis of the Note. A U.S. Holder's tax basis in a Note will generally be its cost. The amount realised will not include any amount attributable to accrued but unpaid interest, which will be taxed as described in "– *Payments of interest*" above. Gain or loss recognised on the sale or other disposition of a Note will be capital gain or loss and will be treated as from U.S. sources for purposes of the U.S. foreign tax credit limitation. In the case of a U.S. Holder that is an individual, estate or trust, the maximum marginal federal income tax rate applicable to capital gains is currently lower than the maximum marginal rate applicable to ordinary income if the Notes are held for more than one year. The deductibility of capital losses is subject to significant limitations.

Backup withholding and information reporting

In general, payments of principal, interest on, and the proceeds of a sale, redemption or other disposition of, the Notes, payable to a U.S. Holder by a U.S. paying agent or other U.S.-related intermediary will be reported to the IRS and to the U.S. Holder as may be required under applicable regulations. Backup withholding will apply to these payments if the U.S. Holder fails to provide an accurate taxpayer identification number or certification of exempt status or otherwise to comply with the applicable backup withholding requirements. Certain U.S. Holders are not subject to information reporting and backup withholding.

Foreign Asset Reporting

Certain U.S. Holders who are individuals are required to report information relating to an interest in the Notes, subject to certain exceptions (including an exception for Notes held in accounts maintained by certain financial institutions). U.S. Holders are urged to consult their tax advisors regarding their information reporting obligations, if any, with respect to their ownership and disposition of the Notes. Failure to comply with certain reporting obligations could result in the imposition of substantial penalties.

EU Savings Tax Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in that other Member State; however, for a transitional period, Austria and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at a rate of 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

A number of non-EU countries and certain dependent or associated territories of certain Member States, have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident or certain limited types of entity established in a Member State. In addition, the Member States have entered into provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident or certain limited types of entity established in one of those territories.

On 13 November 2008 the EC published a proposal for amendments to the Directive, which included a number of suggested changes which, if implemented, would broaden the scope of the requirements described above. Investors who are in any doubt as to their position should consult their professional advisers.

CLEARING AND SETTLEMENT ARRANGEMENTS

*The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC, Euroclear or Clearstream, Luxembourg (together, the "**Clearing Systems**") currently in effect. The information in this section concerning the Clearing Systems has been obtained from sources that the Republic believes to be reliable, but neither the Republic or the Joint Lead Managers takes any responsibility for the accuracy of this section. Investors wishing to use the facilities of any of the Clearing Systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. None of the Republic and any other party to the Fiscal Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Notes held through the facilities of any Clearing System or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.*

Clearing Systems

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions by electronic book-entry transfer between their respective account holders. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depositary and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective participants may settle trades with each other.

Euroclear and Clearstream, Luxembourg customers are worldwide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an account holder of either system.

DTC

DTC has advised the Republic that it is a limited purpose trust company organised under the New York Banking Law, a member of the Federal Reserve System, a "banking organisation" within the meaning of the New York Banking Law, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to Section 17A of the Exchange Act. DTC holds securities that its participants ("**Direct Participants**") deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerised book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("**Indirect Participants**" and, together with Direct Participants, "**Participants**"). More information about DTC can be found at www.dtcc.com and www.dtc.org.

Under the rules, regulations and procedures creating and affecting DTC and its operations (the "**DTC Rules**"), DTC makes book-entry transfers of Registered Notes among Direct Participants on whose behalf it acts with respect to Notes accepted into DTC's book-entry settlement system ("**DTC Notes**") as described below and receives and transmits distributions of principal and interest on DTC Notes.

The DTC Rules are on file with the Securities and Exchange Commission. Direct Participants and Indirect Participants with which beneficial owners of DTC Notes ("**Owners**") have accounts with respect to the DTC Notes similarly are required to make book-entry transfers and receive and transmit such payments on behalf of their respective Owners. Accordingly, although Owners who hold DTC Notes through Direct Participants or Indirect Participants will not possess Registered Notes, the DTC Rules, by virtue of the requirements described above, provide a mechanism by which Direct Participants will receive payments and will be able to transfer their interest in respect of the DTC Notes.

Purchases of DTC Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the DTC Notes on DTC's records. The ownership interest of each actual purchaser of each DTC Note ("**Beneficial Owner**") is in turn to be recorded on the Direct and Indirect Participant's records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the DTC Notes are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in DTC Notes, except in the event that use of the book-entry system for the DTC Notes is discontinued.

To facilitate subsequent transfers, all DTC Notes deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorised representative of DTC. The deposit of DTC Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the DTC Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such DTC Notes are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the DTC Notes within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to DTC Notes unless authorised by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Republic as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the DTC Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the DTC Notes will be made to Cede & Co., or such other nominee as may be requested by an authorised representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Republic or the relevant agent (or such other nominee as may be requested by an authorised representative of DTC), on the relevant payment date in accordance with their respective holdings shown in DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, relevant agents or the Republic, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Republic, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of Direct and Indirect Participants.

Under certain circumstances, including if there is an Event of Default under the Notes, DTC will exchange the DTC Notes for definitive Registered Notes, which it will distribute to its Participants in accordance with their proportionate entitlements and which, if representing interests in a Rule 144A Global Note, will be legended as set forth under "*Subscription and Sale*" and "*Transfer Restrictions*".

A Beneficial Owner shall give notice to elect to have its DTC Notes purchased or tendered, through its Participant, to the relevant agent, and shall effect delivery of such DTC Notes by causing the Direct Participant to transfer the Participant's interest in the DTC Notes, on DTC's records, to the relevant agent. The requirement for physical delivery of DTC Notes in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the DTC Notes are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered DTC Notes to the relevant agent's DTC account.

DTC may discontinue providing its services as depository with respect to the DTC Notes at any time by giving reasonable notice to the Republic or the relevant agent. Under such circumstances, in the event

that a successor depository is not obtained, DTC Note certificates are required to be printed and delivered.

The Republic may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, DTC Note certificates will be printed and delivered to DTC.

Since DTC may only act on behalf of Direct Participants, who in turn act on behalf of Indirect Participants, any Owner desiring to pledge DTC Notes to persons or entities that do not participate in DTC, or otherwise take actions with respect to such DTC Notes, will be required to withdraw its Registered Notes from DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that Republic believes to be reliable, but Republic takes no responsibility for the accuracy thereof.

Registration and Form

Book-entry interests in the Notes held through Euroclear and Clearstream, Luxembourg will be represented by the Unrestricted Global Certificate registered in the name of a nominee of, and held by, a common depositary for Euroclear and Clearstream, Luxembourg. Book-entry interests in the Notes held through DTC will be represented by the Restricted Global Certificate registered in the name of Cede & Co., as nominee for DTC, and held by a custodian for DTC. As necessary, the Registrar will adjust the amounts of Notes on the Register for the accounts of Euroclear, Clearstream, Luxembourg and DTC to reflect the amounts of Notes held through Euroclear, Clearstream, Luxembourg and DTC, respectively. Beneficial ownership of book-entry interests in Notes will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream, Luxembourg and DTC.

The aggregate holdings of book-entry interests in the Notes in Euroclear, Clearstream, Luxembourg and DTC will be reflected in the book-entry accounts of each such institution. Euroclear, Clearstream, Luxembourg or DTC, as the case may be, and every other intermediate holder in the chain to the beneficial owner of book-entry interests in the Notes will be responsible for establishing and maintaining accounts for their participants and customers having interests in the book-entry interests in the Notes. The Registrar will be responsible for maintaining a record of the aggregate holdings of Notes registered in the name of a common nominee for Euroclear and Clearstream, Luxembourg, a nominee for DTC and/or, if individual Certificates are issued in the limited circumstances described under "*The Global Certificates – Registration of Title*", holders of Notes represented by those individual Certificates. The Fiscal Agent will be responsible for ensuring that payments received by it from the Republic for holders of book-entry interests in the Notes holding through Euroclear and Clearstream, Luxembourg are credited to Euroclear or Clearstream, Luxembourg, as the case may be, and the Fiscal Agent will also be responsible for ensuring that payments received by the Fiscal Agent from the Republic for holders of book-entry interests in the Notes holding through DTC are credited to DTC.

The Republic will not impose any fees in respect of holding the Notes; however, holders of book-entry interests in the Notes may incur fees normally payable in respect of the maintenance and operation of accounts in Euroclear, Clearstream, Luxembourg or DTC.

Clearing and Settlement Procedures

Initial Settlement

Upon their original issue, the Notes will be in global form represented by the two Global Certificates. Interests in the Notes will be in uncertified book-entry form. Purchasers electing to hold book-entry interests in the Notes through Euroclear and Clearstream, Luxembourg accounts will follow the settlement procedures applicable to conventional Eurobonds. Book-entry interests in the Notes will be credited to Euroclear and Clearstream, Luxembourg participants' securities clearance accounts on the business day following the Closing Date against payment (value the Closing Date). DTC participants acting on behalf of purchasers electing to hold book-entry interests in the Notes through DTC will follow the delivery practices applicable to securities eligible for DTC's Same Day Funds Settlement system. DTC participants' securities accounts will be credited with book-entry interests in the Notes following confirmation of receipt of payment to the Republic on the Closing Date.

Secondary Market Trading

Secondary market trades in the Notes will be settled by transfer of title to book-entry interests in the Clearing Systems. Title to such book-entry interests will pass by registration of the transfer within the records of Euroclear, Clearstream, Luxembourg or DTC, as the case may be, in accordance with their respective procedures. Book-entry interests in the Notes may be transferred within Euroclear and within Clearstream, Luxembourg and between Euroclear and Clearstream, Luxembourg in accordance with procedures established for these purposes by Euroclear and Clearstream, Luxembourg. Book-entry interests in the Notes may be transferred within DTC in accordance with procedures established for this purpose by DTC. Transfer of book-entry interests in the Notes between Euroclear or Clearstream, Luxembourg and DTC may be effected in accordance with procedures established for this purpose by Euroclear, Clearstream, Luxembourg and DTC.

General

None of Euroclear, Clearstream, Luxembourg or DTC is under any obligation to perform or continue to perform the procedures referred to above, and such procedures may be discontinued at any time.

None of the Republic or any of their agents will have any responsibility for the performance by Euroclear, Clearstream, Luxembourg or DTC or their respective participants of their respective obligations under the rules and procedures governing their operations or the arrangements referred to above.

SUBSCRIPTION AND SALE

Barclays Bank PLC, Deutsche Bank AG, London Branch and J.P. Morgan Securities plc (together, the "**Joint Lead Managers**") have in a subscription agreement dated 10 December 2012 (the "**Subscription Agreement**") and made between the Republic and the Joint Lead Managers upon the terms and subject to the conditions contained therein, jointly and severally agreed to subscribe and pay for the Notes at an issue price of 99.113 per cent. of their principal amount less a combined management and underwriting commission of 0.10 per cent. of their principal amount. The Joint Lead Managers are entitled in certain circumstances to be released and discharged from their obligations under the Subscription Agreement prior to the closing of the issue of the Notes.

United States of America

The Notes have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States or to or for the account or benefit of a U.S. person except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only (a) outside the United States to persons other than U.S. persons as defined in Regulation S in offshore transactions in reliance on, and in compliance with, Regulation S and (b) in the United States to a limited number of QIBs as defined in the Securities Act in connection with resales by the Joint Lead Managers, in reliance on, and in compliance with, Rule 144A. In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering of the Notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

Each Joint Lead Manager has severally and not jointly represented and agreed that it has offered and sold, and will offer and sell, the Notes (a) as part of its distribution at any time and (b) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, only in accordance with Rule 903 of Regulation S or Rule 144A. Accordingly, neither such Joint Lead Manager nor its affiliates, nor any persons acting on its or their behalf, have engaged or will engage in any directed selling efforts (as defined in Regulation S) with respect to the Notes, and such Joint Lead Manager, its affiliates and all persons acting on its or their behalf have complied and will comply with the offering restrictions requirement of Regulation S. Each Joint Lead Manager has severally and not jointly agreed that, at or prior to confirmation of sale of the Notes (other than a sale pursuant to Rule 144A), it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases the Notes from it during the restricted period a confirmation or notice to substantially the foregoing effect.

Each purchaser of a Note, by its acceptance thereof, will be deemed to have acknowledged, represented to and agreed with the Republic and the Joint Lead Managers as follows:

(a) It understands and acknowledges that the Notes have not been registered under the Securities Act or any other applicable securities law, and that the Notes are being offered for sale in transactions not requiring registration under the Securities Act or any other securities laws, including sales pursuant to Rule 144A and Regulation S and, unless so registered, may not be offered, sold or otherwise transferred except in compliance with the registration requirements of the Securities Act or any other applicable securities laws, pursuant to an exemption therefrom or pursuant to a transaction not subject thereto.

(b) It is either (i) a QIB and is aware that any sale of the Notes to it will be made in reliance on Rule 144A and it is acquiring the Notes for its own account or for the account of another QIB with respect to which it exercises full investment discretion, or (ii) it is not a U.S. person (as defined in Regulation S) or purchasing for the account or benefit of a U.S. person and is purchasing the Notes in an offshore transaction (as defined in Regulation S) in accordance with Regulation S.

(c) It is purchasing the Notes for its own account or for the account of investors meeting the requirements of paragraph (b) above for which it is acting as a fiduciary or agent and with respect to which it has the authority to make these acknowledgements, representations and agreements, in each case not with a view to, or for offer or sale in connection with, any distribution thereof in violation of the Securities Act.

(d) If it is a QIB purchasing the Notes pursuant to Rule 144A, it will not offer, sell, pledge or otherwise transfer the Notes except (i) (A) to the Republic, (B) to a person whom the purchaser reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, (C) in an offshore

transaction complying with Rule 903 or Rule 904 of Regulation S or (D) in a transaction that is otherwise exempt from the registration requirements of the Securities Act but only upon delivery to the Republic of an opinion of counsel in form and scope satisfactory to the Republic and (ii) in accordance with all applicable securities laws of the States of the United States.

(e) It acknowledges that certificates in respect of Notes purchased pursuant to Rule 144A, unless otherwise agreed by the Republic, will bear a legend to the following effect:

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT). THE HOLDER HEREOF, BY PURCHASING THE NOTES IN RESPECT OF WHICH THIS CERTIFICATE IS ISSUED, AGREES, FOR THE BENEFIT OF THE REPUBLIC, THAT SUCH NOTES MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A)(1) TO THE REPUBLIC, (2) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (4) IN A TRANSACTION THAT IS OTHERWISE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT BUT ONLY UPON DELIVERY TO THE REPUBLIC OF AN OPINION OF COUNSEL IN FORM AND SCOPE SATISFACTORY TO THE REPUBLIC; AND (B) IN COMPLIANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES.

(f) It acknowledges that certificates in respect of Notes purchased pursuant to Regulation S, unless otherwise agreed by the Republic, will bear a legend to the following effect:

THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE US SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED OR SOLD, PLEDGED OR OTHERWISE TRANSFERRED WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT

(g) Each purchaser further acknowledges that the Joint Lead Managers and their affiliates and otherwise will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Restricted Global Certificates for the account of one or more QIBs, the purchaser thereof represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

United Kingdom

Each Joint Lead Manager has severally and not jointly represented, warranted and agreed that:

(a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the "**FSMA**") received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Republic; and

(b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom.

Latvia

The Joint Lead Managers have severally and not jointly represented and agreed that neither they nor any of their affiliates, nor any persons acting on their or their affiliates behalf, have engaged or will engage in any selling efforts in Latvia with respect to the Notes, other than in accordance with the laws of the Republic of Latvia and the Regulations of the Financial and Capital Market Commission.

General

No action has been or will be taken in any jurisdiction by the Republic or the Joint Lead Managers that would, or is intended to, permit a public offering of the Notes, or possession or distribution of this Offering Circular or any other offering material, in any country or jurisdiction where action for that purpose is required. Persons into whose hands this Offering Circular comes are required by the Republic and the Joint Lead Managers to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or have in their possession, distribute or publish this Offering Circular or any other offering material relating to the Notes, in all cases at their own expense.

Delivery of the Notes will be made against payment therefor on or about the date specified in the last paragraph of the cover page of this Offering Circular, which will be the fifth business day following the date of pricing of the Notes (such settlement being herein referred to as "T+5"). Under Rule 15c6-1 under the Exchange Act, trades in the secondary market generally are required to settle in three business days, unless the parties to any such trades expressly agree otherwise. Accordingly, purchasers who wish to trade the Notes on the date of pricing or the next succeeding business day will be required, by virtue of the fact that the Notes initially will settle in T+5, to specify an alternate settlement cycle at the time of any such trade to prevent failed settlement. Purchasers of the Notes who wish to trade the Notes on the date of pricing or the next succeeding business day should consult their own adviser.

TRANSFER RESTRICTIONS

Due to the following significant transfer restrictions applicable to the notes, investors are advised to consult legal counsel prior to making any reoffer, resale, pledge, transfer or disposal of the Notes.

The Notes have not been registered under the Securities Act, and may not be offered or sold in the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold (1) in the United States only to persons reasonably believed to be ''qualified institutional buyers,'' which are referred to as QIBs, as defined in Rule 144A under the Securities Act in compliance with Rule 144A and (2) to persons outside the United States (''**foreign purchasers**'') in offshore transactions pursuant to Regulation S under the Securities Act.

By its purchase of Notes, each purchaser of Notes (other than the Joint Lead Managers) will be deemed to:

(a) represent that it is purchasing the Notes for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is (i) a QIB, and is aware that the sale to it is being made in reliance on Rule 144A or (ii) a foreign purchaser that is outside the United States;

(b) acknowledge that the Notes have not been registered under the Securities Act and may not be offered or sold within the United States except as set forth below;

(c) if it is a person other than a foreign purchaser outside the United States after the expiration of the distribution compliance period, agree that if it should resell or otherwise transfer the Notes within the time period referred to in Rule 144(k) under the Securities Act after the original issuance of the Notes, it will do so only (i) to the Republic, (ii) to a QIB in compliance with Rule 144A, (iii) outside the United States in an offshore transaction in compliance with Rule 903 or 904 of Regulation S under the Securities Act, (iv) pursuant to a transaction that is otherwise exempt from the registration requirements of the Securities Act but only if available and upon delivery to the Republic of an opinion of counsel in form and scope satisfactory to the Republic or (v) pursuant to an effective registration statement under the Securities Act; in each case in accordance with any applicable securities laws of any state of the United States. Subject to the procedures set forth in the Fiscal Agency Agreement, prior to any proposed transfer of the Notes (other than pursuant to an effective registration statement) within the time period referred to in Rule 144(k) under the Securities Act after the original issuance of the Notes, the holder thereof must check the appropriate box set forth on the reverse of its Notes relating to the manner of such transfer and submit the Notes to the Fiscal Agent;

(d) agree that it will deliver to each person to whom it transfers Notes notice of any restriction on transfer of such Notes;

(e) understand and agree that Notes initially offered in the United States to QIBs will be represented by one or more Restricted Global Certificates and that Notes offered outside the United States in offshore transactions pursuant to Regulation S will be represented by one or more Unrestricted Global Certificates;

(f) understand that unless registered under the Securities Act, the Notes (other than those issued to foreign purchasers after expiration of the distribution compliance period) will bear a legend to the following effect, unless otherwise agreed by the Republic and the holder thereof:

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT), OR ANY SECURITIES LAW OF ANY STATE IN THE UNITED STATES OF AMERICA, AND MAY NOT BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT AS PERMITTED BY THE FOLLOWING SENTENCES. THE HOLDER HEREOF, BY PURCHASING THE NOTES IN RESPECT OF WHICH THIS CERTIFICATE IS ISSUED, ACKNOWLEDGES AND AGREES, FOR THE BENEFIT OF THE REPUBLIC, THAT SUCH NOTES MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A)(1) TO THE REPUBLIC, (2) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING

FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, (4) IN A TRANSACTION THAT IS OTHERWISE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT BUT ONLY IF AVAILABLE AND UPON DELIVERY TO THE REPUBLIC OF AN OPINION OF COUNSEL IN FORM AND SCOPE SATISFACTORY TO THE REPUBLIC OR (5) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT; AND (B) IN EACH CASE IN COMPLIANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES;

(g) acknowledge that the Republic and the Joint Lead Managers will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements, and agree that if any of the acknowledgments, representations or warranties deemed to have been made by it by its purchase of Notes are no longer accurate, it shall promptly notify the Republic and the Joint Lead Managers; and

(h) if it is acquiring Notes as a fiduciary or agent for one or more investor accounts, represent that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.

GENERAL INFORMATION

1. Under the Law on Budget and Financial Management adopted on 24 March 1994, the Regulations of the Treasury of the Republic of Latvia issued by the Cabinet of Ministers on 3 August 2004 and the Internal Regulation of Ministry of Finance of the Republic of Latvia No.12-29/52 dated 29 October 2010 ''Procedure of Exercising the Treasury Authorisation'', the Treasury, on behalf of the Republic of Latvia, is entitled to borrow up to the aggregate limit of borrowing set down in the State Budget Law for the respective year. The 2012 State Budget Law has set a debt ceiling outstanding of LVL 6,200 million for the year end 2012. The Minister of Agriculture, acting on behalf of the Minister of Finance, in a letter dated 12 December 2012, has confirmed that this issue of U.S.$1,250,000,000 2.750 per cent. Notes due 2020 does not breach the 2012 State Budget Law and the Law on Budget and Financial Management and conforms with the Latvian Central Government Debt Management Strategy and the Resource Attraction Plan approved by the Minister of Finance.

2. The Republic is not involved in any litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Notes nor, so far as the Republic is aware, is any litigation or arbitration pending or threatened.

3. Application has been made to list the Notes on the Official List of the Luxembourg Stock Exchange and to admit the Notes to trading on the Luxembourg Stock Exchange's regulated market. Copies (and certified English translations where the documents in question are not in English) of the following documents may be obtained during normal business hours at the offices of the Listing Agent in Luxembourg:

   (a) the Fiscal Agency Agreement;

   (b) the Deed of Covenant;

   (c) certified English translations of an extract from the Law on Budget and Financial Management adopted on 24 March 1994;

   (d) the letter of the Minister of Agriculture, acting on behalf of the Minister of Finance, dated 12 December 2012 confirming that the issue of Notes does not breach the 2012 State Budget Law and the Law on Budget and Financial Management and conforms with the Latvian Central Government Debt Management Strategy and the Resource Attraction Plan approved by the Minister of Finance;

   (e) the Regulations of the Treasury of the Republic of Latvia issued by the Cabinet of Ministers on 3 August 2004;

   (f) the Internal Regulation of Ministry of Finance of the Republic of Latvia No.12-29/52 dated 29 October 2010 ''Procedure of Exercising the Treasury Authorisation''; and

   (g) the current summary version (relating to 2012) of the Latvian consolidated and general government budget.

4. Application has been made for acceptance of the Restricted Global Certificates into DTC's book-entry settlement system. The Unrestricted and Restricted Global Certificates have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN for the Unrestricted Global Certificates is XS0863522149 and for the Restricted Global Certificates is US518417AC46. The Common Code for the Unrestricted Global Certificates is 086352214 and for the Restricted Global Certificates is 086356856. The CUSIP number for the Restricted Global Certificates is 518417 AC4.

5. As at the date of this Offering Circular, a judgment obtained in an English court against the Republic should be enforceable against the Republic in Latvia, as Council Regulation 44/2001 is directly applicable in Latvia. According to the Civil Procedure law of the Republic of Latvia the application of the recognition and enforcement of the foreign judgment in Latvia shall be submitted for decision to a district (city) court. The judgment of a foreign court after its recognition in Latvia shall be executed according to the procedures specified in the Latvian Civil Procedure Law.

6. Information relating to ''The National Budget'' is available on the Ministry of Finance of the Republic of Latvia website at www.fm.gov.lv and on the Treasury of the Republic of Latvia website at www.kase.gov.lv.

7. From time to time, each of the Joint Lead Managers and its affiliates have or may have engaged, and may continue to engage, in investment banking and/or commercial banking transactions with, and may perform services for, the Republic and its affiliates in the ordinary course of business.

ISSUER

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