OFFERING CIRCULAR

REPUBLIC OF LATVIA, ACTING THROUGH THE TREASURY

€400,000,000
5.50 PER CENT. NOTES DUE 2018

The issue price of the €400,000,000 5.50 per cent. Notes due 2018 (the "**Notes**") of the Republic of Latvia, acting through the Treasury, ("**Latvia**" or the "**Republic**") is 99.774 per cent. of their principal amount.

Unless previously redeemed or cancelled, the Notes will be redeemed at their principal amount on 5 March 2018. See "*Terms and Conditions of the Notes – Redemption and Purchase*".

The Notes will bear interest from and including 5 March 2008 at the rate of 5.50 per cent. per annum payable annually in arrear on 5 March each year, commencing on 5 March 2009. Payments on the Notes will be made in euro 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 regulated market of the Luxembourg Stock Exchange pursuant to the rules and regulations of the Luxembourg Stock Exchange.

The Notes have not been, and will not be, registered under the United States Securities Act of 1933 (as amended) (the "**Securities Act**") in accordance with Regulation S under the Securities Act ("**Regulation S**"), 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.

The Notes will be in bearer form and in the denomination of €1,000. The Notes will initially be represented by a temporary global note (the "**Temporary Global Note**"), without interest coupons, which will be issued in new global note form. The Temporary Global Note is expected to be deposited with a common safekeeper (the "**Common Safekeeper**") for Euroclear Bank S.A./N.V. ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**") for credit on or about 5 March 2008 (the "**Closing Date**") to the accounts of such clearance systems. The Temporary Global Note will be exchangeable, in whole or in part, for interests in a permanent global note (the "**Permanent Global Note**"), without interest coupons, not earlier than 40 days after the Closing Date upon certification as to non-U.S. beneficial ownership. Interest payments in respect of the Notes cannot be collected without certification of non-U.S. beneficial ownership. The Permanent Global Note will be exchangeable in certain limited circumstances in whole, but not in part, for Notes in definitive form with interest coupons attached. See "*Summary of Provisions Relating to the Notes in Global Form*".

JOINT-LEAD MANAGERS

HSBC **UBS Investment Bank**

CO-MANAGERS

BIIS - Bank of the Intesa Sanpaolo Group **DEPFA BANK plc**

DZ BANK AG **SEB**

Dated: 4 March 2008

The Republic has confirmed to the Managers named under "*Subscription and Sale*" (the "**Managers**") 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 material fact necessary to make such information not misleading in any material respect; and all proper enquiries have been made to ascertain and to verify the foregoing. The Republic accepts responsibility for the information contained in this document 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 Managers.

Neither the delivery of this Offering Circular or the offering, sale or delivery of any Note shall in any circumstances create any implication 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 to subscribe for or purchase, any Notes. Each investor contemplating purchasing any Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Republic.

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 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 and references to "**Euro**", "**euro**" and "**€**" are to the currency of the member states of the European Union that adopt the single currency in accordance with the Treaty establishing the European Communities, 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. The Bank of Latvia's foreign exchange rate for U.S. dollars on 31 December 2007 was LVL 0.4840 = U.S.$1.00, whilst the Bank of Latvia's foreign exchange rate for Euro since 1 January 2005 has been fixed at LVL 0.702804 = €1.00.

Unless otherwise stated, all annual information, including budgetary information, is based on calendar years. Government budget execution is compiled on a cash flow basis. 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 2007 should be treated as preliminary and statistical information for this and prior years may be subject to future adjustment.

Certain figures including 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.

This Offering Circular neither constitutes a prospectus 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 of the European Parliament and of the Council of 4 November 2003 (the "**Prospectus Directive**") nor a simplified prospectus pursuant to Chapter 2 of 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, issued pursuant to this Offering Circular, will therefore not qualify for the benefit of the single European passport pursuant to the Prospectus Directive.

In connection with the issue of Notes, UBS Limited (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.

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TERMS AND CONDITIONS OF THE NOTES

The following is the text of the Terms and Conditions of the Notes which (subject to completion and amendment) will be endorsed on each Note in definitive form:

The €400,000,000 5.50 per cent. Notes due 2018 (the "**Notes**", which expressions includes any further notes issued pursuant to Condition 14 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 5 March 2008 (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) 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**") and the holders of the related interest coupons (the "**Couponholders**" and the "**Coupons**", respectively) are bound by, and are deemed to have notice of, all the provisions of the Fiscal Agency Agreement 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.

1. Form, Denomination and Title

The Notes are in bearer form in the denomination of €1,000 with Coupons attached at the time of issue. Title to the Notes will pass by delivery. The holder of any Note shall (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 other interest therein, any writing thereon or any notice of any previous loss or theft thereof) and no person shall be liable for so treating such holder. No person shall have any right to enforce any term or condition of the Notes under the Contracts (Rights of Third Parties) Act 1999.

2. Status

The Notes constitute direct, general, (subject to the provisions of Condition 3) 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.

3. 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 Riga Stock Exchange and issued in dematerialised form into the Latvian Central Depositary system.

4. Interest

The Notes bear interest from, and including, 5 March 2008, the "**Issue Date**" at the rate of 5.50 per cent. per annum, payable on 5 March in each year (each, an "**Interest Payment Date**"), subject as provided in Condition 6.

Each Note will cease to bear interest from the due date for final redemption unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate (as well after as before judgment) until the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder.

Where interest is required to be calculated in respect of a period ending on a date other than an Interest Payment Date, it shall be calculated on the basis of the number of days in the period from and including the most recent Interest Payment Date (or, if none, the Issue Date) to but excluding the relevant payment date divided by the number of days in the period from and including the most recent Interest Payment Date (or, if none, the Issue Date) to but excluding the next scheduled Interest Payment Date.

5. Redemption Purchase

(a) *Scheduled redemption*

Unless previously redeemed, repaid or purchased and cancelled, the Notes will be redeemed at their principal amount on 5 March 2018, subject as provided in Condition 6.

(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 may be cancelled or held and resold (provided that such resale is outside the United States, as defined in Regulation S under the United States Securities Act of 1933, as amended). 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 cancelled will not be reissued.

In this Condition 5(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.

6. Payments

(a) *Principal and Interest*

Payments of principal and interest shall be made only against presentation and (*provided that* payment is made in full) surrender of Notes and/or Coupons at the specified office of any Paying Agent outside the United States in euro by cheque or by transfer to an account to which euro may be credited or transferred specified by the payee. Payments of interest due in respect of any Note other than on presentation and surrender of matured Coupons shall be made only against presentation and (if appropriate) surrender of the relevant Note.

(b) *Payments subject to fiscal laws*

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 7. No commissions or expenses shall be charged to the Noteholders or Couponholders in respect of such payments.

(c) *Deduction for unmatured Coupons*

If a Note is presented without all unmatured Coupons relating thereto, a sum equal to the aggregate amount of the missing unmatured Coupons will be deducted from the amount of principal due for payment; *provided, however, that,* if the gross amount available for payment is less than the principal amount of such Note, the sum deducted will be that proportion of the aggregate amount of such missing Coupons which the gross amount actually available for payment bears to the principal amount of such Note. Each sum of principal so deducted shall be paid in the manner provided in Condition 6(a) against presentation and (provided that payment is made in full) surrender of the relevant missing Coupons.

(d) *Payments on business days*

If the due date for payment of any amount in respect of any Note or Coupon is not a business day, the holder shall not be entitled to payment of the amount due until the next succeeding business day in such place and shall not be entitled to any further interest or other payment in respect of any such delay. In this paragraph, "**business day**" means, in respect of any place of presentation, any day on which banks are open for presentation, and payment of bearer debt securities and for dealings in foreign currencies in such place of presentation and, in the case of payment by transfer to a euro account as referred to above, on which the Trans-European Automated Real-time Gross Settlement Express Transfer (TARGET) System is operating.

7. Taxation

All payments of principal and interest in respect of the Notes and the Coupons shall be made free and clear of, and 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 and the Couponholders 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 or Coupon:

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

8. *Events of Default*

(a) *Declaration of Acceleration*

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

(i) *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

(ii) *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 30 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.

(b) *Rescission of Declaration of Acceleration*

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.

9. 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 Coupons are presented for payment within five years of the appropriate Relevant Date.

10. Replacement of Notes and Coupons

If any Note or Coupon 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 may require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

11. Paying Agents

In acting under the Fiscal Agency Agreement and in connection with the Notes and Coupons, 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 or Couponholders.

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, (b) a paying agent in Luxembourg, and (c) 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 15 below.

12. 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 2;

(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 16;

(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, 66⅔ 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, and all Couponholders.

(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 66⅔ 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, and on all Couponholders.

(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 or the Couponholders 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 12 and Schedule 5 to the Fiscal Agency Agreement, (iii) Condition 13 and (iv) Condition 8, 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 13 or 8, 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.

13. 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 8 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 15 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 fees and expenses of any such committee (including, without limitation, the costs of giving notices to Noteholders and the reasonable 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.

14. Further Issues

The Republic may from time to time, without the consent of the Noteholders or the Couponholders, 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.

15. 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 *d'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. Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the Noteholders.

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.

16. Governing Law and Jurisdiction

(a) *Governing law*

The Notes and the Coupons are governed by, and shall be construed in accordance with, English law.

(b) *Jurisdiction*

The Republic agrees for the benefit of the Noteholders and the Couponholders 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 or the Coupons (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 or any Couponholder 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 or any Couponholder 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.

SUMMARY OF PROVISIONS RELATING TO THE NOTES IN GLOBAL FORM

The Notes will initially be in the form of the Temporary Global Note which will be deposited on or around the Closing Date with a common safekeeper for Euroclear and Clearstream, Luxembourg.

The Notes will be issued in new global note ("**NGN**") form. On 13 June 2006 the European Central Bank (the "**ECB**") announced that Notes in NGN form are in compliance with the "Standards for the use of EU securities settlement systems in ESCB credit operations" of the central banking system for the euro (the "**Eurosystem**"), provided that certain other criteria are fulfilled. At the same time the ECB also announced that arrangements for Notes in NGN form will be offered by Euroclear and Clearstream, Luxembourg as of 30 June 2006 and that debt securities in global bearer form issued through Euroclear and Clearstream, Luxembourg after 31 December 2006 will only be eligible as collateral for Eurosystem operations if the NGN form is used.

The Notes are intended to be held in a manner which would allow Eurosystem eligibility that is, in a manner which would allow the Notes to be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria and no assurance can be given that such criteria will be satisfied at any time.

The Temporary Global Note will be exchangeable in whole or in part for interests in the Permanent Global Note not earlier than 40 days after the Closing Date upon certification as to non-U.S. beneficial ownership. No payments will be made under the Temporary Global Note unless exchange for interests in the Permanent Global Note is improperly withheld or refused. In addition, interest payments in respect of the Notes cannot be collected without such certification of non-U.S. beneficial ownership.

The Permanent Global Note will become exchangeable in whole, but not in part, for Notes in definitive form ("**Definitive Notes**") in the denomination of €1,000 each at the request of the bearer of the Permanent Global Note if (a) Euroclear and Clearstream, Luxembourg are both closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announce an intention permanently to cease business or (b) either of the circumstances described in Condition 8(a) occurs and the Notes are declared due and payable by the appropriate number of Noteholders in accordance with that Condition.

Whenever the Permanent Global Note is to be exchanged for Definitive Notes, the Republic shall procure the prompt delivery (free of charge to the bearer) of such Definitive Notes, duly authenticated and with Coupons in respect of all payments of interest which have not then fallen due attached, in an aggregate principal amount equal to the principal amount of the Permanent Global Note to the bearer of the Permanent Global Note against the surrender of the Permanent Global Note to or to the order of the Fiscal Agent within 45 days of the bearer requesting such exchange.

If:

(a) Definitive Notes have not been delivered by 5.00 p.m. (London time) on the 45th day after the bearer has duly requested exchange of the Permanent Global Note for Definitive Notes; or

(b) the Permanent Global Note (or any part of it) has become due and payable in accordance with the Conditions or the date for final redemption of the Notes has occurred and, in either case, payment in full of the amount of principal falling due with all accrued interest thereon has not been made to the bearer in accordance with the Fiscal Agency Agreement on or within seven days of the due date for payment,

then the Permanent Global Note (including the obligation to deliver Definitive Notes) will become void at 5.00 p.m. (London time) on such 45th day (in the case of (a) above) or at 5.00 p.m. (London time) on the seventh day after such due date (in the case of (b) above) and the bearer of the Permanent Global Note will have no further rights thereunder (but without prejudice to the rights which the bearer of the Permanent Global Note or others may have under a deed of covenant dated 5 March 2008 (the "**Deed of Covenant**") executed by the Republic). Under the Deed of Covenant, persons shown in the records of Euroclear and/or Clearstream, Luxembourg as being entitled to an interest in the Permanent Global Note will acquire directly against the Republic all those rights to which they would have been entitled if, immediately before the Permanent Global Note became void, they had been the holders of Definitive Notes in an aggregate principal amount equal to the principal amount of Notes they were shown as holding in the records of Euroclear and/or (as the case may be) Clearstream, Luxembourg at that time.

In addition, the Temporary Global Note and the Permanent Global Note will contain provisions which modify the Terms and Conditions of the Notes as they apply to the Temporary Global Note and the Permanent Global Note. The following is a summary of certain of those provisions:

Payments

All payments in respect of the Temporary Global Note and the Permanent Global Note will be made against presentation and (in the case of payment of principal in full with all interest accrued thereon) surrender of the Temporary Global Note or (as the case may be) the Permanent Global Note to or to the order of any Paying Agent and will be effective to satisfy and discharge the corresponding liabilities of the Republic in respect of the Notes. No payment will, however, be made under the Temporary Global Note unless exchange for interests in the Permanent Global Note is improperly withheld or refused. On each occasion on which a payment of principal or interest is made in respect of the Temporary Global Note or (as the case may be) the Permanent Global Note, the Republic shall procure that the payment is entered *pro rata* in the records of Euroclear and Clearstream, Luxembourg.

Notices

Notwithstanding Condition 15, while all the Notes are represented by the Permanent Global Note (or by the Permanent Global Note and/or the Temporary Global Note) and the Permanent Global Note is (or the Permanent Global Note and/or the Temporary Global Note are) deposited with a common safekeeper for Euroclear and Clearstream, Luxembourg, notices to Noteholders may be given by delivery of the relevant notice to Euroclear and Clearstream, Luxembourg and, in any case, such notices shall be deemed to have been given to the Noteholders in accordance with Condition 15 on the date of delivery to Euroclear and Clearstream, Luxembourg except that, for so long as such Notes are admitted to trading on the Luxembourg Stock Exchange and it is a requirement of applicable law or regulations, such notices shall be published in a leading newspaper having general circulation in Luxembourg (which is expected to be *d'Wort* or the *Tageblatt*) or published on the website of the Luxembourg Stock Exchange (*www.bourse.lu*).

Whilst any of the Notes held by a Noteholder are represented by a Global Note, 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.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, expected to amount to €398,936,000, will be used for the refinancing of indebtedness and general funding purposes of the Republic.

DESCRIPTION OF THE ISSUER
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, with which the country has a 494 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 64,589 square kilometres. The capital city is Riga, the largest city in the Baltic countries, making it the leading regional centre.

The country is low-lying and generally flat, rising steadily from west to east, reaching its highest point of 312m above sea level at Gaizinkalns. Latvia shares the longest border with Lithuania in the south (576 km), followed by Estonia in the north (343 km), Russia in the east (282 km) and Belarus in the south-east (167 km).

At the beginning of 2007, the total population of Latvia was 2,281,000. Since early 2000, the total population has decreased by approximately 100 thousand persons or by 4.2 per cent.

The urban/rural ratio of the total population has not changed during the last 5 years – 68 per cent. of the total population live in urban areas, while 32 per cent. live in rural areas. The population density is 35.3 persons per square kilometre.

The highest population concentration is in the capital city, Riga. At the beginning of 2007, the population of Riga was 722 thousand or 31.7 per cent. of the national population. The population of Riga has decreased by 44 thousand or by 5.7 per cent. since 2000.

As at the beginning of 2007, approximately 65.3 per cent. of the population was of working age.

The average life expectancy of those born in 2006 is 71.3 years (65.9 years for males and 76.8 years for females).

Historical Background

Latvia's origins lie in the 12th century with the arrival of western Europeans, mainly German crusaders, who 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. The capital of Latvia – Riga – was also founded in 1201.

The territory of Latvia is a strategically important territory with access to the Baltic Sea trade routes. Therefore, throughout the middle ages, Latvia (or parts of its territory) were controlled by such states as Denmark, Poland-Lithuania, Sweden and Russia. From the middle of the 16th century until the end of the 18th century part of Latvia's territory was known as the Duchy of Courland, a semi-independent state paying tribute to Poland.

As a consequence of the First World War, Latvia's independence from Russia was declared on 18 November 1918. In 1922, the Constitutional Assembly (*Satversmes Sapulce*, a special meeting convened to approve a constitution) adopted the Constitution (*Satversme*) which proclaimed the country a democratic republic. With the outbreak of the Second World War, Latvia was annexed by the Soviet Union in 1940 and was invaded by Germany between 1941 and 1944.

After rapid political change in Eastern Europe and the Soviet Union in the late 1980s, the Supreme Council of Latvia (the Latvian Parliament) 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 of Lithuania, Latvia and Estonia was recognised by the Soviet Union.

On 17 September 1991, following the collapse of the Soviet Union, Latvia, Estonia and Lithuania were admitted to the United Nations. On 29 March 2004, Latvia joined NATO, and on 1 May 2004 became a member of the European Union.

Political System and Developments

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

The main function of the Saeima is to pass legislation. 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 is entitled to elect, appoint, approve or dismiss various state officials. The Saeima elects the President of Latvia for a term of four years. One of the president's main functions is to represent the state internationally. The President of Latvia nominates the Prime Minister and, if necessary, may propose the dissolution of the Saeima. The Cabinet of Ministers is the country's highest executive power.

The 5th Saeima elections took place on 5-6 June 1993. These were the first truly democratic elections since 1931. The Constitution of the Republic of Latvia was fully re-instituted on 6 July 1993 when the 5th Saeima convened for its first session following the elections. On 7 July 1993, the 5th Saeima elected Guntis Ulmanis as the President of Latvia. On 18 June 1996, Guntis Ulmanis was re-elected for a second term. On 17 June 1999, the 7th Saeima elected Vaira Vike-Freiberga as the President of Latvia, and she was re-elected for a further four years on 20 June 2003. On 31 May 2007, the 9th Saeima elected Valdis Zatlers as the President of Latvia. Valdis Zatlers assumed office on 8 July 2007.

According to the Constitution of the Republic of Latvia, any person who enjoys full rights of citizenship and who has attained the age of forty years may be elected President of Latvia. A person with dual citizenship is not eligible. The same person may not hold office as President of Latvia for more than eight consecutive years. On 3 May 2007 the 9th Saeima adopted a law on Election of the State President, which sets forth a detailed procedure and related issues for electing the President of Latvia.

The elections of the 9th Saeima were held on 7 October 2006 with a turnout of 908,979 voters (60.98 per cent. of those eligible to vote).

The composition of the 9th Saeima is as follows:

Name of party	Number of seats
People's Party	21
Greens and Farmers Union	17
New Era Party	18
Union of political organisations (parties) *Concord Centre*	17
Latvia's First Party/Latvia's Way Party	10
For Fatherland and Freedom/LNNK	7
Union of political organisations *For Human Rights in a United Latvia*	6
Unaffiliated members of parliament	4

Source: Mandate, Ethics and Submissions Committee

On 7 November 2006, the 9th Saeima convened for its first session and elected Indulis Emsis (Greens and Farmers Union) as its Speaker. On 22 September 2007 Indulis Emsis gave up his Saeima mandate and resigned from the office of Speaker.

On 24 September 2007, the 9th Saeima elected Gundars Daudze (Greens and Farmers Union) as its Speaker (with 52 votes in favour).

The 9th Saeima has seventeen standing committees and seven parliamentary groups. It has established seven permanent delegations to international parliamentary organisations, as well as 56 groups for facilitating cooperation with foreign parliaments.

On 7 November 2006, with 58 votes in favour, 41 against and no abstentions the 9th Saeima gave a vote of confidence to the Cabinet of Ministers formed by Aigars Kalvitis (People's Party). The coalition government consisted of four parties: People's Party, Greens and Farmers Union, Latvia's First Party/Latvia's Way Party and For Fatherland and Freedom/LNNK (together they have 58 votes).

Aigars Kalvitis was the Prime Minister from 2 December 2004 to 6 December 2007 making him the Prime Minister of Latvia for the longest uninterrupted period since the restoration of independence in the Republic.

On 6 December 2007, Aigars Kalvitis announced his resignation as Prime Minister and the resignation of the whole Cabinet.

On 20 December 2007, with 54 votes in favour, 43 against and no abstentions, the Saeima gave its vote of confidence to the Cabinet of Ministers formed by Ivars Godmanis. Ivars Godmanis was the first Prime Minister after the restoration of Latvia's independence appointed on 7 May 1990.

The new government still consists of four parties: the People's Party, Greens and Farmers Union, Latvia's First Party/Latvia's Way Party and For Fatherland and Freedom/LNNK (together they have 55 votes).

Local Governments

In Latvia, there are two types of local governments – territorial local governments (cities, counties and parishes) and district local governments. Territorial local governments are elected directly, but district local governments are elected indirectly. If a county local government is formed by amalgamating several territorial local governments (parishes, cities), each of them becomes a territorial unit of the county, however decision-making power in the county is held by only one of such units – the directly elected power. In the Constitution of the Republic of Latvia, it is set out that local governments are elected by citizens of Latvia and the European Union who permanently reside in Latvia. Every citizen of the European Union who permanently resides in Latvia has the right to participate in the activities of local governments as prescribed by law. The working language at local governments is Latvian.

To ensure inhabitants have good quality services, and to create administrative territories which are capable of economic development, the administrative-territorial reform is being implemented in Latvia. The process of amalgamation of local governments is voluntary until 2009. Pursuant to the administrative-territorial reform, after amalgamating administrative territories and decreasing the number of territorial local governments inhabitants of a county will have a possibility to receive local government services not only in the administrative centre of a county, but also in service centres located in territorial units of a county – parishes and towns.

In accordance with the task set in the Administrative-Territorial Reform Law, the Ministry of Regional Development and Local Governments consulted local governments and worked out the project of administrative territorial division of local governments, which was accepted by The Cabinet of Ministers in June 2006. On the basis of this project of administrative-territorial division, the Cabinet of Ministers in September 2007 issued regulations regarding the administrative-territorial division of territorial local governments.

At present, in Latvia there are:

– 26 district local governments; and

– 525 territorial local governments consisting of:

  - 52 local governments of district cities and 7 local governments of republican cities;
  - 36 local governments of counties with included territorial units; and

- 430 local governments of parishes.

Corruption Prevention and Combating Bureau:

In recent years Latvia has undertaken a number of fundamental, pro-active steps to address the problem of corruption in the public service. The crucial turning point in this regard was the establishment of a single independent institution aimed at the prevention and combating of corruption, and the monitoring of political parties' financing – the Corruption Prevention and Combating Bureau (the "**Bureau**"). The Bureau was established at the end of 2002 and currently employs 146 people.

The establishment of the Bureau and its effective operation lead to the successful implementation of anti-corruption legislation. One of reasons for the Bureau's success is its independent status. According to the Law on the Corruption Prevention and Combating Bureau, the Bureau is a public administration institution supervised by the Cabinet of Ministers.

In order to ensure a comprehensive, coherent and accountable anti-corruption policy the Bureau is responsible for the co-ordination and implementation of the National Strategy and the National Programme for Corruption Prevention and Combating for 2004-2008. These two documents are fundamental as the basis of national anti-corruption policy: the first one identifies the basic principles, objectives and main priorities, and the second one comprehensibly defines the precise tasks, responsible institutions and timeframe for implementation of the strategy. The Bureau regularly reports to the government on the implementation status.

In general, the scope of work of the Bureau has increased considerably. The progress achieved by the Bureau's officers in charge of investigation and detecting of corruption or conflict of interest cases has increased the level of trust in the work of public institutions and has created a common understanding that the impunity of law breakers is no longer possible.

Opinion polls and results of the Bureau's work show that administrative corruption has decreased considerably since the establishment of the Bureau. At the same time, it should be noted that offences related to corruption are becoming more sophisticated and therefore the investigation into such criminal offences has become more time-consuming.

The progress in many investigations related to corruption conducted by the Bureau in recent years has caused wide publicity.

International Relations

Latvia's accession to the European Union (the "**EU**") on 1 May 2004 and to the North Atlantic Treaty Organization ("**NATO**") on 29 March 2004, signalled the achievement of the country's main goals in terms of institutional membership. Through these accessions, Latvia has acquired unprecedented security. Latvia's integration into the EU is proceeding actively, and relations with EU member states and institutions are of the greatest importance in Latvia's foreign policy. As such, in the first half of 2006, the Latvian Embassy in the Republic of Belarus represented the EU Presidency in that country. The most significant event in Latvian foreign and internal affairs policy was the NATO Summit in Riga in November 2006.

Participation in global and regional organisations, especially membership of the EU, NATO and other European organisations (such as the Council of Europe and the Organisation for Security and Co-operation in Europe) is becoming more important in terms of meeting new challenges and is advantageous for Latvia, allowing Latvia to contribute to the resolution of specific problems whilst also representing its national interests in global politics.

Latvia became a member state of the United Nations sixteen years ago, thus creating a global dimension for Latvian foreign policy. In 2005, Latvian President Vaira Vīķe-Freiberga became the UN Secretary-General's special envoy on UN reform matters. Membership of the World Trade Organization ("**WTO**") has improved the mechanism of Latvia's economy, as the country is now a part of global trade processes.

By acceding to international declarations such as the Millennium Development Declaration and the Cairo Declaration, Latvia has demonstrated its readiness to become actively involved in the resolution of global problems.

Latvia, being part of the region of Baltic Sea states, has actively shaped good relations with its neighbouring countries, both at bilateral level and through membership of regional organisations such as the Council of Baltic Sea States ("**CBSS**"). The Latvian Presidency of the CBSS from 1 July 2007 to 30 June 2008 considers the region's competitiveness and sustainable development as the main goals of regional co-operation. This is the foundation for the main three priorities of the CBSS Latvia Presidency: education, energy and civil security institutions that have been established by all three countries such as the Baltic Assembly and the Baltic Council of Ministers ("**BCM**") contribute greatly to harmonising the foreign policies of the Baltic States and to promoting practical co-operation.

On 1 January 2007 Latvia was appointed to the role of Presidency of the BCM for the duration of 2007. Presidency of the BCM provided Latvia with the opportunity to practically and rationally resolve the most significant issues of co-operation among the Baltic States and to ensure the implementation of our common goals and interests in various sectors. The EU Neighbourhood Policy focuses on closer engagement with direct neighbours of the EU based on common values of democracy, human rights and the rule of law. The goal of the Neighbourhood Policy is to support a stable and prosperous Europe through ensuring broad and enhanced cooperation between the EU and its neighbouring countries. On 23 November 2007, the Ministry of Foreign Affairs and the Baltic Assembly, in co-operation with the Representation of the European Commission in Latvia, organised a high-level conference *The Baltic States and the EU Neighbourhood Policy*, the purpose of which was to emphasise the role of the Baltic States in implementing the Neighbourhood Policy, and to encourage exchange-of-experience with countries in the Mediterranean region in implementing the aforesaid policy.

Active bilateral and multilateral dialogue and close co-operation between the Baltic States and the Nordic countries, as well as their participation in the implementation of regional programmes, projects and initiatives, serves to enhance the greater influence of the Baltic Sea region at European and global levels and strengthens regional co-operation.

At the bilateral level, relations between Latvia and Latvia's neighbour Russia are based on pragmatic foundations and co-operation, with particular emphasis on the need to resolve important and practical issues which affect both countries, and to strengthen the role of the Baltic Sea region. On 27 March 2007 the Border Treaty between Latvia and Russia was signed, this was ratified by the Latvian Parliament on 17 May 2007, by the State Duma of the Russian Parliament on 5 September 2007, and by the Russian Parliament Federation Council on 19 September 2007. The ratification procedure was finalised on 2 October 2007 when the President of Russia, Vladimir Putin signed the agreement on ratification.

On 18 December 2007, Sergey Lavrov, Foreign Minister of the Russian Federation, paid a historically significant visit to Latvia during which the Foreign Ministers of both countries exchanged the ratification documents for the Republic of Latvia and the Russian Federation Treaty on the State Border of Latvia and Russia.

The legal framework of relations between the two countries is based on approximately twenty inter-governmental agreements. A number of new agreements have been drafted, including the Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, the Agreement for the Promotion and Protection of Investments, Latvia also promotes its interests with regard to Russia within the framework of EU-Russia relations, by participating actively in the work of the relevant EU institutions, dealing with specific issues and developing a joint strategy of relations.

The United States of America is Latvia's strategic partner. Latvia considers it important to maintain ongoing dialogue with the United States on both traditional and new security challenges, including energy security.

THE LATVIAN ECONOMY

Background

Reforms implemented in Latvia and accession to, and integration in, the EU have had a positive impact on the economic development of the country. Latvia has experienced rapid economic growth since 2000, supported by one of the highest productivity growth rates in the EU.

The dynamics of domestic demand is stable and is supported by the growth of income, stability of the financial system, expansion of credit opportunities and the formation of positive future expectations.

Economic development in Latvia during recent years has made a positive impact on the labour market. In recent years, the employment rate has increased substantially and reached 66.3 per cent. in 2006, which is above the average EU indicator.

Latvia has low government debt and a good fiscal position. Rapid economic growth over recent years has helped keep government deficits low whilst allowing investment in structural reforms, such as the pension system, which contribute to the sustainability of public finances in the longer term.

One of the main economic development risks in Latvia is high inflation and the current account deficit, the underlying cause being comparatively high domestic demand.

Since 2004, the annual average inflation has exceeded 6 per cent. and in 2007 it reached 10.1 per cent. In the first nine months of 2007 the balance of payments' current account deficit slightly increased reaching 24.8 per cent. of GDP. The current account deficit is mainly due to a negative balance of trade.

To maintain stable convergence and to control risks that arise from rapid growth, which are indicated by the external deficit and high inflation, the Latvian government has adopted the "Inflation restriction plan" which is aimed at curbing excessive growth of domestic demand and ensuring sustainable medium-term growth.

Gross Domestic Product

During the last three years Latvia has experienced buoyant economic growth with an average GDP growth rate of 10.4 per cent. since Latvia's accession to the European Union in 2004. In 2006 GDP rose by 11.9 per cent. and by 11.0 per cent. in the first nine months of 2007, as compared with the same period in 2006 (in constant prices). Such dynamic growth is based on previously implemented economic reforms and a favourable economic environment. High growth rates were promoted by several interlinked factors – accession to the EU, inflows of foreign direct investment ("**FDI**"), absorption of EU funds, dynamic development of lending and of the real estate market, improved employment and expectations of further strong economic growth. Rapid economic development was mainly due to the strength of the domestic demand – private consumption in the period from 2004 to 2006 has increased on average by 13.5 per cent. per year, while gross fixed capital formation has increased by 21.9 per cent. GDP per capita reached 53.8 per cent. of the EU average in 2006.

The following table sets out the structure and real growth rates of GDP from the expenditure side:

GDP, its structure and real growth from the expenditure side

	2002			2003			2004		
	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)
Public consumption	1,207.6	20.9	2.2	1,371.2	21.5	1.9	1,451.2	19.5	2.1
Private consumption	3,575.9	62.1	7.4	3,987.6	62.4	8.2	4,688.1	63.1	9.8
Gross capital formation	1,536.0	26.7	5.8	1,837.9	28.7	22.1	2,455.8	33.0	22.4
Gross fixed capital formation	1,370.6	23.8	13.0	1,559.8	24.4	12.3	2,041.8	27.5	23.8
Exports of goods and services	2,353.7	40.9	5.4	2,689.5	42.0	5.2	3,268.2	44.0	9.4
Imports of goods and services	2,914.9	50.6	4.7	3,493.4	54.7	13.1	4,428.9	59.6	16.6
GDP	5,758.3	100	6.5	6,392.8	100	7.2	7,434.5	100	8.7

	2005			2006			2007 nine months		
	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)
Public consumption	1,580.8	17.4	2.7	1,910.4	17.0	4.0	1,723.4	17.2	5.5
Private consumption	5,666.1	62.5	11.2	7,364.6	65.4	19.8	6,759.6	67.4	17.5
Gross capital formation	3,115.3	34.4	9.0	4,262.7	37.8	18.7	3,736.2	37.2	21.6
Gross fixed capital formation	2,773.8	30.6	23.6	3,871.3	34.4	18.3	3,412.2	34.0	14.6
Exports of goods and services	4,334.7	47.9	20.3	4,980.9	44.2	5.3	4,487.1	44.7	9.4
Imports of goods and services	5,637.8	62.2	14.8	7,254.0	64.4	17.5	6,673.2	66.5	22.2
GDP	9,059.1	100	10.6	1,1264.7	100	11.9	10,033.1	100	11.0

Source: Central Statistical Bureau of Latvia

The following table shows the total and per capita GDP of Latvia for the years 2002 to 2006 and for the first nine months of 2007, in both current and constant 2000 prices.

	2002	2003	2004	2005	2006	First nine months of 2007
Total:						
At current prices (LVL mln)	5,758.3	6,392.8	7,434.5	9,059.1	11,264.7	10,033.1
At constant 2000 prices (LVL mln)	5,465.1	5,858.4	6,366.8	7,041.4	7,881.3	6,466.9
per cent. change over previous periods (at constant 2000 prices)	6.5	7.2	8.7	10.6	11.9	11.0
EUR millions*	8193.3	9096.1	10,578.3	12,889.9	16,028.2	14,275.8
Per Capita:						
At current prices (LVL)	2,462.3	2,749.1	3,214.3	3,938.2	4,923.8	4,408.0
At constant 2000 prices (LVL)	2,336.9	2,519.3	2,752.7	3,061.1	3,444.9	2,842.0
At current prices (EUR)*	3503.5	3911.6	4573.5	5,603.6	7,005.9	6,272.0

* The Bank of Latvia exchange rate used here (1 EUR=0.702804 LVL).

Source: Central Statistical Bureau of Latvia

Principal Sectors of the Economy

Domestic demand determines the development of sectors of the national economy. The leading sectors are private services (trade, commercial services, financial services and communication) and construction. Currently, the rate of industry growth is comparatively low indicating that price competitiveness and gradual adoption of conditions in the economic environment are influenced by the increase in costs when converting to the production of higher added value goods.

Services and construction have been the main drivers of the GDP growth. The following table sets out nominal GDP in current prices, annual percentage and real growth rates of GDP by sector for the years 2002 to 2006 and for the first nine months of 2007:

Nominal GDP in current prices, annual percentage and real growth rates by sector

	2002			2003			2004		
	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)
Agriculture, Hunting, Forestry and Fishing	238.7	4.2	4.4	236.1	3.7	-2.4	294.5	4.0	3.4
Industry	722.4	12.5	9.1	775.7	12.1	6.3	894.8	12.0	6.7
Electricity, Gas, Water Supply	168.8	2.9	4.2	179.2	2.8	4.5	200.5	2.7	5.0
Construction	287.4	5.0	10.8	320.9	5.0	13.7	387.6	5.2	13.3
Public Services	1,019.0	17.7	2.8	1,157.8	18.1	4.0	1,275.2	17.2	4.3
Private Services	2,752.3	47.8	7.2	3,045.9	47.7	8.5	3,609.4	48.5	10.9
Taxes on products (minus subsidies)	569.7	9.9	5.5	677.2	10.6	8.4	772.5	10.4	8.0
Total GDP	5,758.3	100	6.5	6,392.8	100	7.2	7,434.5	100	8.7

	2005			2006			2007 Nine months		
	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)	GDP (LVL, millions)	Structure (per cent.)	Growth (per cent.)
Agriculture, Hunting, Forestry and Fishing	318.4	3.5	9.3	364.9	3.2	–0.3	333.6	3.3	8.6
Industry	1,037.0	11.4	6.4	1,210.4	10.8	6.3	1023.6	10.2	1.0
Electricity, Gas, Water Supply	204.5	2.3	1.8	244.3	2.2	4.0	209.1	2.1	1.9
Construction	490.9	5.4	15.5	678.8	6.0	13.6	675.5	6.7	15.1
Public Services	1,511.1	16.7	5.5	1,834.3	16.3	6.5	1,514.6	15.2	7.2
Private Services	4,467.4	49.3	13.7	5,598.5	49.7	15.1	5,079.3	50.6	12.5
Taxes on products (minus subsidies)	1,029.8	11.4	8.9	1,333.5	11.8	16.2	1,197.4	11.9	20.5
Total GDP	9,059.1	100	10.6	11,264.7	100	11.9	10,033.1	100	11.0

Source: Central Statistical Bureau of Latvia

Inflation

Following a period of low and stable increases in consumer prices (on average 2.5 per cent. annually between 1999 and 2003), inflation started to accelerate in the second half of 2003. Since 2004 inflation has been exceeding 6 per cent. per annum (6.5 per cent. on average in the years 2004 to 2006 and 10.1 per cent. in 2007 (further growth was caused by intensifying several cost factors (including energy prices), tax harmonisation (cigarettes) and domestic demand)).

The following table shows growth rates of the average rate of inflation for the period 2002 to 2007:

	2002	2003	2004	2005	2006	2007
CPI (annual 12-months average rate of change, per cent.)	1.9	2.9	6.2	6.7	6.5	10.1
CPI (end of period compared to the corresponding month in previous year, per cent.)	1.4	3.6	7.3	7.0	6.8	14.1
PPI (over the previous year, per cent.)	1.0	3.2	8.6	7.8	10.3	16.1

Source: Central Statistical Bureau of Latvia

Rates of inflation accelerated initially mainly due to higher import prices both due to the developments in world energy prices and the continuous appreciation of the euro. In 2004, adjustments in administered prices and factors related to EU accession, such as changes in indirect taxes, implementation of the Common Agricultural Policy and heightened inflation expectations have caused a further acceleration of consumer prices.

During the last four years inflationary developments should be viewed against the background of strong real GDP growth and the EU convergence process. Rapid economic growth, together with labour emigration flows following EU accession have contributed to the decline in the rate of unemployment and accelerated income convergence. Rapid credit development has stimulated the growth of domestic demand and, consequently, a rise in inflation. Changes in indirect taxes and administered prices, along with rising oil prices globally, have also contributed to the increase in the rate of inflation.

Inflation restriction plan

On 6 March 2007, the Cabinet of Ministers approved the action plan developed by the working group chaired by the Minister of Finance, Oskars Spurdzins, for the restriction of inflation, that envisaged several activities in various sectors of the national economy.

The plan aimed to achieve a balanced budget in 2007, using additional revenues to decrease the state budget deficit as well as planning a budget for 2008 without a deficit and with a budget surplus for 2009 and 2010. The government also planned to review the basic budget expenditures of each of the ministries, removing unsuitable expenditures and ending the increase in the number of public sector employees.

Changes in tax policy, particularly for transactions involving real estate are significant in facilitating the slowdown of the inflation rate in the medium term by influencing demand. It has been deemed necessary to impose a tax on income from the sale of real estate (including income from the sale of shares of real estate companies, foundations and trusts) owned by individuals for less than 5 years (60 months). A tax exemption is applicable in the case of the home owner's place of residence. Furthermore, in order to restrict speculations, there was introduced a differentiation between the state fee for registration of ownership of real estate in the Land Register depending on the number of properties owned (on registration of a third property, a higher fee is imposed and the limit on fees to be paid is removed) and the fee for registration of mortgages in the Land Register (depending on the borrower, the number of mortgages and the loan contract price).

One of the significant sources of inflation was rapidly growing consumption and a credit boom. The third significant block of activities under the inflation restriction plan aims to control the increase in the granting of credit. Banks and lending services providers are obliged to evaluate the ability of each client to repay the loan and to provide loans only on the basis of the client's legal income. The legal income is that which is confirmed by a statement from the State Revenue Service ("SRS"). Such statement will be requested from the SRS if the amount of a loan requested exceeds an amount equivalent to 100 times the state minimum salary in Latvia. The obligatory minimum first repayment required is set at the amount of not less than 10 per cent. of the value of the loan, as well as the maximum permitted credit amount against which the mortgage value should be calculated. Additionally, a central borrower register covering all financial institutions (covering both mortgage loans and consumer loans) has been developed to enable financial institutions to be aware of the actual debt obligations of their clients.

It is anticipated that the growth in energy prices would have a material impact on prices for both households and enterprises. The Ministry of Economics is therefore in the process of developing a programme to promote the more efficient use of energy by both domestic and commercial consumers.

The inflation restriction plan also envisages activities in the labour market to facilitate economic activity in the labour market and increase productivity. Development of competitiveness is planned, particularly in retail, trade and construction. These are long-term activities which cannot be achieved solely on the basis of amendments to certain regulatory enactment, and the results of which may be seen following a longer time period.

It is possible to divide all the activities into two groups: (1) proposed measures regarding the restriction of fiscal, tax and the increase in credit are envisaged following the implementation of a short and medium-term policy; and (2) the return from activities regarding the labour market, productivity, energy and competitiveness which are planned for the medium and long-term.

Monetary issues are also significant for price stability, and the inflation restriction policy was based also on the monetary policy implemented by the Bank of Latvia under which a strict Lats exchange rate and tightening of the corresponding activities in the field of monetary policy (for example, reserve requirement norms and the refinancing rate) are imposed.

Necessary legislative amendments (amendments in six laws and in one rule of the Cabinet of Ministers) included in the plan have been approved by the Saeima and the Cabinet of Ministers and have come into force.

Fiscal policy targets set in the inflation restriction plan have been met – the central government budget in 2007 was executed with a surplus of 0.8 per cent of GDP. In 2008 a central government budget surplus is expected to be at 1 per cent. of GDP, reaching 1.5 per cent. of GDP in 2010.

Measures for enhancing macroeconomic stability

Short-term policy changes defined in the inflation restriction plan have been successfully accomplished, and a range of indicators already point to the improved stabilisation of the macroeconomic situation, such as stabilisation which has already been seen in the real estate market and the slowdown of credit growth and imports to a sustainable level. Furthermore, there is awareness that an appropriate structural policy has to be implemented in order to maintain the positive tendency and to ensure growth sustainability. Thus, work groups established in the Ministry of Finance and in the Ministry of Economics have cooperated to develop measures for enhancing macroeconomic stabilisation, which will be submitted to the Cabinet of Ministers following coordination process with the interested parties.

The inflation restriction plan emphasises the importance of a responsible fiscal policy and sets strict targets for the balance of the budget.

To prevent macroeconomic imbalances, the main aim of the structural policy is to ensure that reserves accumulated in the economy and foreign capital inflows are used for investments facilitating development, restructuring of production and the necessary productivity growth. To change private capital flow is one of the main tasks for economic policy. The impact of these measures can be expected to be seen in the long-term.

Another activity that will promote stable growth in the future, thus ensuring a balanced economic development, is the shift, from an economic model focused on taking advantage of a cheap labour force, to a knowledge-based economy.

To achieve the aforemention goals, the inflation restriction plan envisages more than 50 activities. One of them will be the elaboration of a draft law on the creation and utilization of a stabilisation reserve. Other activities will include the improvement of the tax system, the promotion of business activity, competition, export, minimisation of administrative obstacles and the development of a flexible labour market.

Wages

Economic growth and productivity gains have enabled rapid wage growth over the last three years. After accession to the EU, wages in Latvia have grown substantially, on average by 16 per cent. per year for the years 2004 to 2006. Recent estimates show that in the first half of 2007 wage increases comprise almost 33 per cent. in gross and net terms. Following entry to the EU, labour migration to other EU countries with a higher rate of income has tightened the Latvian labour market and fostered income convergence, adding pressure to the rate of wages. Improvements in wage reporting have also contributed to the increased wage growth figures.

Although the growth rates in wages over the last three years have been among the highest in the EU, the level still remains very low if compared to the EU average. The real income of employees in the period from 2004 to 2006 has increased by 26.8 per cent. and in 2006 alone by a further 15.6 per cent.

As from 1 January 2006, the minimum monthly wage has been increased from LVL 80 to LVL 90, to LVL 120 as from 1 January 2007 and to LVL 160 as from January 2008. The monthly non-taxable minimum wage has been increased from LVL 22 to LVL 32 as from 1 January 2006, to LVL 50 as from 1 January 2007, and to LVL 80 as from 1 January 2008. The monthly tax allowance for dependent person has been raised from LVL 18 to LVL 22 as from 1 January 2006, to LVL 35 as from 1 January 2007 and to LVL 56 as from 1 January 2008.

The following table shows the average monthly gross and net wages and salary dynamics for the periods indicated:

	2002	2003	2004	2005	2006	First nine months of 2007
Gross	173	192	211	246	302	404
Gross growth, per cent.	*8.5*	*11.4*	*9.6*	*16.5*	*23.0*	*32.9*
Net	124	138	150	176	216	290
Net growth, per cent.	*8.0*	*10.9*	*8.8*	*17.0*	*23.1*	*33.3*
Real wage index, per cent. of previous year	106.0	107.8	102.4	109.7	115.6	120.9

Source: Central Statistical Bureau of Latvia

The rise of wages reflects the present situation in the labour market, where rapid growth has increased in line with demand.

Employment

Demand for labour has been growing at a high rate in recent years due to robust economic development. The number of persons employed has grown by 2.0 per cent. annually (in the years 2004 to 2006), while the unemployment rate has fallen from 10.4 per cent. (Labour Force survey (“LFS”) results) in 2004 to 4.9 (LFS results) per cent. in 2007.

The number of economically active persons has increased and the employment rate has grown. The labour market has also been tightened by the gradual opening of the other EU labour markets to Latvian citizens after accession in 2004. In the years (2004 to 2006) the employment rate has increased by 4.0 percentage points. In 2003 the employment rate in Latvia was 1.2 percentage points lower than the EU (EU-25) average, while in 2006 it exceeded the EU average by 1.5 percentage points.

The following table shows the registered unemployment rate and labour participation rate in Latvia in the period from 2002 to 2006.

	2002	2003	2004	2005	2006
Registered Unemployment rate, at the end of period, per cent.	8.5	8.6	8.5	7.4	6.5
Labour participation rate (persons aged 15-64), per cent.	68.8	69.2	69.6	69.5	71.3

Source: State Employment Agency, Central Statistical Bureau of Latvia

The officially registered unemployment rate continues to fall. At the end of December 2007, the officially registered unemployment rate amounted to 4.9 per cent. of the economically active population. As compared with the corresponding month of the previous year, the unemployment rate has declined by 1.6 per cent. For the third quarter of 2007 alone the labour participation rate was 73.4 per cent.

The number of people registered as unemployed in December 2007 amounted to 52.3 thousand people, which was 16.6 thousand lower than in December 2006.

The rate of unemployment in Latvia varies considerably across the regions. The highest registered unemployment rates are in Latvia's eastern region for instance the Rezeknes district (16.6 per cent. at the end of December 2007). The lowest registered unemployment rate is in Riga (3.1 per cent. at the end of December 2007).

The following table sets out the employment rate split by gender in Latvia at the end of the indicated periods:

	2002	2003	2004	2005	2006
Rate of Employment, per cent.	60.5	61.8	62.3	63.4	66.3
Men, per cent.	64.3	66.0	66.4	67.6	70.5
Women, per cent..	57.0	57.8	58.4	59.5	62.3

Source: Central Statistical Bureau of Latvia and State Employment Agency

Female employment in Latvia is higher than the EU average. This difference has increased: the female employment rate in Latvia exceeded the EU rate (EU-25) by 2.7 percentage points in 2003 and by 4.8 percentage points in 2006. Male employment in Latvia tends to increase every year but still lags behind the average EU rate (by 4.8 percentage points in 2003 and 1.7 percentage points in 2006). For the third quarter of 2007 alone the rate of employment was 69 per cent.; the percentage of men employed being 73.6 per cent. and the percentage of women being 64.7 per cent.

Exchange Rates

The exchange rate for Lats has been fixed since February 1994. Initially it was pegged to the IMF's SDR basket of currencies with narrow fluctuation bands of +/- 1 per cent. Following the entry into the EU and further integration with other EU countries, on January 2005 the lats was repegged from the SDR basket of currencies to the Euro. As the fixed exchange rate arrangement had proved to be beneficial for the small and open economy of Latvia, the narrow +/-1 per cent. fluctuation bands were preserved.

Since May 2005, Latvia has successfully participated in the Exchange Rate Mechanism II (ERM II). The central rate for the lats in the ERM II was set at 0.702804 lats 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.

The exchange rate regime of Latvia functions similarly to the currency board, as the monetary base is fully covered by foreign reserves and the Bank of Latvia performs automatic interventions to maintain the fluctuation limits set by the Bank of Latvia.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments

Current Account

With domestic demand remaining strong, the significant need for investment and increasing capital inflows in the country, the current account deficit widened from 12.8 per cent. of GDP in 2004 and 12.5 per cent. in 2005 to 22.3 per cent. of GDP in 2006 and 24.8 per cent. in the first nine months of 2007.

The current account deficit mainly reflects the high trade deficit. The trade deficit has increased (from 20.2 per cent. of GDP in 2004 to 26.40 per cent. in the first nine months of 2007) as imports of goods grew on average by 26.8 per cent. yearly in the period from 2004 while exports have increased by 23.5 per cent. on average per year.

Growth in imports stemmed from the buoyant domestic demand and several large investment projects, including the modernisation of the energy sector and renewal of the fleet by the Latvian Shipping Company. The increase in world oil prices has also added to the cost of imports.

Income deficit has increased with the non-resident income level in Latvia achieving a higher level compared to that of resident income abroad.

In the meantime, services and current transfers continued to post surpluses. However, while the surplus of transportation services has increased during the last three years, negative travel balance has also increased. Thus services account surplus decreased from 4.4 per cent. of GDP in 2004 to 3.6 per cent. in the first nine months of 2007. Current transfers' surplus decreased from 5.0 per cent. in 2004 to 1.2 per cent. in the first nine months of 2007, mostly due to an increase in the amount of debit transactions.

Capital and Financial Account

The surplus on the capital and financial account from 2004 to 2007 more than covered the current account deficit, resulting in a rapid increase of reserve assets (by LVL 2,114.0 million since 2004). The inflows of FDI and banking sector borrowing have been key sources of current account financing. Banking sector assets have also risen fast, mainly in the form of loans.

The following table sets out Latvia's current account and capital and financial account for the years 2002-2007 (please note that the 2007 figures are preliminary figures only):

	2002	2003	2004	2005	2006	2007 Preliminary
			(LVL million)			
Current account	(382.5)	(522.8)	(954.9)	(1,131.6)	(2,510.0)	(3,278.7)
Net goods and NF services	(576.9)	(810.9)	(1,178.0)	(1,372.6)	(2,484.1)	(2,939.6)
Exports	2,334.1	2,668.3	3,238.7	4,256.3	4,908.3)	6,016.8
Imports	(2,911.0)	(3,479.4)	(4,416.9)	(5,628.8)	(7,392.2)	(8,956.4)
Income	32.5	(14.1)	(149.7)	(97.9)	(297.8)	(536.5)
Credit	178.3	210.5	269.4	437.5	601.9	750.8
Debit	(145.9)	(224.6)	(419.1)	(535.4)	(899.7)	(1,287.3)
FDI	(65.3)	(121.2)	(286.3)	(348.3)	(550.3)	(708.9)
Other	(80.6)	(103.4)	(132.8)	(187.1)	(349.4)	(578.4)
Transfers	162.0	302.2	372.9	338.9	271.9	197.3
Credit	330.7	526.1	694.2	778.2	1,002.8	1,091.8
Debit	(168.8)	(223.9)	(321.3)	(439.3)	(730.8)	(894.5)
Capital and financial account	426.0	529.4	945.9	1,303.0	2,438.4	3,720.1
Direct investment	154.6	145.7	284.6	326.7	836.6	1,096.7
Portfolio investment	(125.8)	(126.6)	121.4	(72.0)	17.3	(199.0)
Other investment	375.3	501.6	702.1	1,266.8	2,520.9	2,920.8
Assets	(288.4)	(388.2)	(957.4)	(241.2)	(1,079.1)	(3,039.1)
Trade credits	(13.7)	(12.0)	(67.5)	(92.6)	(75.2)	(100.4)
Bank assets	(286.0)	(357.7)	(862.4)	83.1	(368.5)	(1,937.4)
Liabilities	663.7	889.8	1,659.5	1,508.0	3,600.0	5,959.9
Trade credits	33.6	30.8	104.2	70.8	71.6	172.5
IMF loans	(6.1)	(6.1)	(3.0)	–	–	–
Government loans	(1.9)	(36.6)	(2.7)	(39.2)	37.2	103.7
Bank liabilities	601.1	839.0	1,368.1	1,424.4	2,837.6	4,320.5
Net other assets and liabilities	48.4	44.1	165.4	(179.7)	18.2	361.8
Reserve assets	1.0	(38.3)	(214.7)	(294.1)	(1,103.0)	(502.2)
Errors and omissions	(43.5)	(6.5)	8.9	(171.4)	71.6	(441.4)

Source: Bank of Latvia

The following table sets out Latvia's current and capital and financial accounts as a percentage of GDP for the years 2002 to 2006 and for the first nine months of 2007:

	2002	2003	2004	2005	2006	30 Sept 2007
			(as percentage of GDP)			
Current account	(6.6)	(8.2)	(12.8)	(12.5)	(22.3)	(24.8)
Net Goods and NF services	(10.0)	(12.7)	(15.8)	(15.2)	(22.1)	(22.4)
Exports	40.5	41.7	43.6	47.0	43.6	44.2
Imports	(50.6)	(54.4)	(59.4)	(62.1)	(65.6)	(66.6)
Income	0.6	(0.2)	(2.0)	(1.1)	(2.6)	(3.6)
Credit	3.1	3.3	3.6	4.8	5.3	5.5
Debit	(2.5)	(3.5)	(5.6)	(5.9)	(8.0)	(9.0)
FDI	(1.1)	(1.9)	(3.9)	(3.8)	(4.9)	(5.0)
Other	(1.4)	(1.6)	(1.8)	(2.1)	(3.1)	(4.0)
Transfers	2.8	4.7	5.0	3.7	2.4	1.2
Credit	5.7	8.2	9.3	8.6	8.9	7.9
Debit	(2.9)	(3.5)	(4.3)	(4.8)	(6.5)	(6.8)
Capital and financial account	7.4	8.3	12.7	14.4	21.6	28.1
Direct investment	2.7	2.3	3.8	3.6	7.4	8.2
Portfolio investment	(2.2)	(2.0)	1.6	(0.8)	0.2	(2.6)
Other investment	6.5	7.8	9.4	14.0	22.4	24.8
Assets	(5.0)	(6.1)	(12.9)	(2.7)	(9.6)	(20.5)
Trade credits	(0.2)	(0.2)	(0.9)	(1.0)	(0.7)	(0.9)
Bank assets	(5.0)	(5.6)	(11.6)	0.9	(3.3)	(10.8)
Liabilities	11.5	13.9	22.3	16.6	32.0	45.3
Trade credits	0.6	0.5	1.4	0.8	0.6	1.7
IMF loans	(0.1)	(0.1)	(0.0)	–	–	0.0
Government loans	(0.0)	(0.6)	(0.0)	(0.4)	0.3	0.3
Bank liabilities	10.4	13.1	18.4	15.7	25.2	31.6
Net other assets and liabilities	0.8	0.7	2.2	(2.0)	0.2	2.9
Reserve assets	0.0	(0.6)	(2.9)	(3.2)	(9.8)	(3.9)
Errors and omissions	(0.8)	(0.1)	0.1	(1.9)	0.6	(3.3)

Source: Bank of Latvia

Foreign Trade

Latvia's main trading partners are EU member states, which represented 77.2 per cent. of foreign trade turnover in 2007. The largest export partners are Lithuania, Estonia, Russia, Germany, Sweden and the UK, and import partners – Germany, Lithuania, Russia, Estonia, Poland and Finland. The highest trade growth rates have been with the recently acceded fast growing EU member countries (mainly Lithuania, Estonia and Poland) and the CIS countries (mainly neighbouring Russia).

After Latvia's accession to the EU, foreign trade of Latvia with Lithuania and Estonia continued to grow. In comparison with 2003, Latvian foreign trade with these countries has increased fourfold, but a considerable negative balance still remains.

Compared to 2005, exports to the EU-25 countries increased by 11.9 per cent. in 2006, with growth in almost all commodity groups, except mineral products. The most significant growth in exports to EU-25 countries was provided by metal-working products. In 2007 the volume of exports to EU-25 countries was slightly higher by 23.6 per cent. compared to 2006.

In 2006 exports to the CIS countries increased by 30.4 per cent. compared to 2005. The biggest increases were in the machinery and chemical industry sectors. In 2007 exports to the CIS countries grew by 27.1 per cent. compared to 2006.

The following table illustrates the geographic distribution of Latvian exports of goods for the years 2002 to 2007.

	2002	per cent.	2003	per cent.	2004	per cent.
	(LVL million, except for percentages)					
EU						
Germany	218.3	15.5	245.3	14.9	267.5	12.4
UK	205.4	14.6	256.6	15.5	278.5	13.0
Sweden	148.6	10.5	174.2	10.6	222.2	10.3
Denmark	80.4	5.7	99.0	6.0	123.0	5.7
Lithuania	117.7	8.4	135.1	8.2	203.5	9.5
Estonia	84.5	6.0	108.5	6.6	180.2	8.4
Poland	22.0	1.6	24.6	1.5	79.6	3.7
Other EU*	217.9	15.5	265.6	16.1	306.3	14.2
Total*	1,094.9	77.7	1,308.9	79.3	1,660.8	77.2
EU - 27	1,095.4	77.4	1,310.7	79.4	1,662.9	77.3
CIS						
Russia	82.5	5.9	88.8	5.4	137.5	6.4
Ukraine	25.8	1.8	34.3	2.1	34.2	1.6
Belarus	21.2	1.5	23.9	1.5	45.1	2.1
Other CIS	11.1	0.8	15.3	0.9	26.9	1.2
Total	140.6	10.0	162.4	9.8	242.8	11.3
Other	173.3	12.3	179.4	10.9	246.4	11.5
Total	1,408.8	100.0	1,650.6	100.0	2,150.0	100.0

	2005	per cent.	2006	per cent.	2007	per cent.
	(LVL million, except for percentages)					
EU						
Germany	295.9	10.2	332.3	10.1	354.8	8.8
UK	291.7	10.1	257.2	7.8	279.1	6.9
Sweden	225.0	7.8	212.9	6.5	312.0	7.7
Denmark	153.5	5.3	164.8	5.0	160.3	4.0
Lithuania	317.8	11.0	483.0	14.7	623.9	15.5
Estonia	312.3	10.8	419.1	12.7	573.6	14.2
Poland	150.7	5.2	79.7	2.4	146.2	3.6
Other EU*	458.4	15.9	518.7	15.7	600.6	15.1
Total*	2,205.4	76.4	2,467.7	74.9	3,050.5	75.8
EU - 27	2,210.8	76.5	2,472.4	75.1	3,061.7	76.1
CIS						
Russia	228.3	7.9	291.9	8.9	386.2	9.6
Ukraine	39.8	1.4	57.7	1.8	59.8	1.5
Belarus	57.6	2.0	75.9	2.3	92.6	2.3
Other CIS	27.9	1.0	35.7	1.1	47.8	1.2
Total	353.7	12.2	461.2	14.0	586.4	14.6
Other	329.1	11.4	364.3	11.1	388.5	9.6
Total	2,888.2	100.0	3,293.2	100.0	4,025.4	100.0

* Data on EU countries contain information about the EU - 25

Source: Central Statistical Bureau of Latvia

The following table illustrates the geographic distribution of Latvian imports of goods for the years 2002 to 2007.

	2002	per cent.	2003	per cent.	2004	per cent.
			(LVL million, except for percentages)			
EU						
Germany	429.5	17.2	479.8	16.1	556.9	14.6
Finland	200.2	8.0	220.9	7.4	247.1	6.5
Sweden	159.5	6.4	187.1	6.3	239.7	6.3
Italy	104.4	4.2	130.3	4.4	131.0	3.4
Lithuania	245.8	9.8	289.7	9.7	476.6	12.5
Estonia	153.9	6.2	191.8	6.4	272.3	7.2
Poland	125.8	5.0	152.7	5.1	213.7	5.6
Other EU	509.6	20.4	600.7	20.1	734.0	19.3
Total	1,928.5	77.2	2,253.0	75.4	2,871.3	75.5
EU - 27	1,934.6	77.5	2,259.2	75.6	2,878.4	75.6
CIS						
Russia	218.8	8.8	260.7	8.7	332.0	8.7
Belarus	68.2	2.7	110.8	3.7	181.5	4.8
Other CIS	40.5	1.6	62.2	2.1	110.1	2.9
Total	327.5	13.1	433.7	14.5	623.6	16.4
Other	241.4	9.7	302.5	10.1	310.3	8.2
Total	2,497.4	100.0	2,989.2	100.0	3,805.3	100.0

	2005	per cent.	2006	per cent.	2007	per cent.
			(LVL million, except for percentages)			
EU						
Germany	679.0	14.0	988.5	15.5	1,169.4	15.1
Finland	284.9	5.9	363.0	5.7	389.2	5.0
Sweden	248.5	5.1	321.0	5.0	381.3	4.9
Italy	163.5	3.4	216.8	3.4	285.5	3.7
Lithuania	665.5	13.7	827.7	13.0	1,073.1	13.9
Estonia	383.3	7.9	494.1	7.7	624.4	8.1
Poland	309.9	6.4	459.4	7.2	538.4	7.0
Other EU	923.9	19.0	1,218.8	19.1	1,525.4	19.8
Total	3,658.5	75.2	4,889.4	76.7	5,986.7	77.5
EU - 27	3,664.0	75.3	4,898.1	76.8	6,001.5	77.7
CIS						
Russia	413.8	8.5	499.1	7.8	653.5	8.5
Belarus	281.5	5.8	297.7	4.7	256.7	3.3
Other CIS	118.2	2.4	105.9	1.7	118.9	1.5
Total	813.5	16.7	902.7	14.2	1,029.1	13.3
Other	395.0	8.1	586.4	9.2	705.1	9.2
Total	4,867.0	100.0	6,378.5	100.0	7,720.9	100.0

* Data on EU countries contain information about EU - 25

Source: Central Statistical Bureau of Latvia.

Composition of Trade

The following table illustrates the composition of Latvia's exports of goods for the years 2002 to 2007.

	2002	per cent.	2003	per cent.	2004	per cent.
	(LVL million, except for percentages)					
Live animals and animal products	23.7	1.7	28.0	1.7	46.8	2.2
Prepared foodstuffs	100.8	7.2	94.1	5.7	132.4	6.2
Mineral products	24.1	1.7	26.4	1.6	114.1	5.3
Products of the chemical and allied industries	81.5	5.8	96.7	5.9	123.5	5.7
Plastics, rubber and articles thereof	22.1	1.6	30.3	1.8	46.3	2.2
Wood and articles of wood	472.8	33.6	581.8	35.2	655.3	30.5
Textiles and textile articles	180.1	12.8	208.7	12.6	230.0	10.7
Base metals and articles of base metals	185.4	13.2	207.4	12.6	303.3	14.1
Machinery and mechanical appliances; electrical equipment	91.0	6.5	116.8	7.1	169.2	7.9
Transport vehicles	26.6	1.9	34.2	2.1	54.4	2.5
Miscellaneous manufactured articles	83.0	5.9	97.3	5.9	114.3	5.3
Other goods	117.8	8.4	128.9	7.8	160.5	7.5
Total	1,408.8	100	1,650.6	100	2,150.0	100

	2005	per cent.	2006	per cent.	2007	per cent.
	(LVL million, except for percentages)					
Live animals and animal products	71.0	2.5	115.3	3.5	149.8	3.7
Prepared foodstuffs	200.1	6.9	245.2	7.4	313.6	7.8
Mineral products	265.2	9.2	182.2	5.5	165.4	4.1
Products of the chemical and allied industries	160.3	5.5	222.6	6.8	299.5	7.4
Plastics, rubber and articles thereof	73.3	2.5	100.8	3.1	119.2	3.0
Wood and articles of wood	717.6	24.8	739.5	22.5	906.9	22.5
Textiles and textile articles	249.0	8.6	269.3	8.2	269.5	6.7
Base metals and articles of base metals	379.3	13.1	488.1	14.8	595.7	14.8
Machinery and mechanical appliances; electrical equipment	269.4	9.3	324.0	9.8	426.2	10.6
Transport vehicles	111.2	3.9	198.5	6.0	284.6	7.1
Miscellaneous manufactured articles	128.1	4.4	149.3	4.5	157.0	3.9
Other goods	263.6	9.1	258.4	7.8	338.0	8.4
Total	2,888.2	100	3,293.2	100	4,025.4	100

Source: Central Statistical Bureau of Latvia.

The following table illustrates the composition of Latvia's imports of goods for the years 2002 to 2007.

	2002	per cent.	2003	per cent.	2004	per cent.
	(LVL million, except for percentages)					
Live animals and animal products	64.7	2.6	69.1	2.3	82.7	2.2
Vegetable products	82.2	3.3	87.5	2.9	105.8	2.8
Prepared foodstuffs	165.3	6.6	180.7	6.0	229.0	6.0
Mineral products	243.2	9.7	296.9	9.9	481.6	12.7
Products of the chemical and allied industries	261.1	10.5	300.5	10.1	350.1	9.2
Plastics and articles thereof; rubber and articles thereof	124.0	5.0	153.4	5.1	190.2	5.0
Wood and articles of wood	41.8	1.7	70.2	2.3	114.8	3.0
Pulp of wood; paper and paperboard	107.7	4.3	112.8	3.8	126.3	3.3
Textiles and textile articles	171.5	6.9	193.9	6.5	216.6	5.7
Articles of stone, plaster, cement, glassware, ceramic	64.8	2.6	76.0	2.5	91.7	2.4
Base metals and articles of base metals	210.8	8.4	277.3	9.3	388.4	10.2
Machinery and mechanical appliances; electrical equipment	530.8	21.3	629.6	21.1	755.7	19.9
Transport vehicles	244.5	9.8	313.6	10.5	413.7	10.9
Miscellaneous manufactured articles	75.0	3.0	96.7	3.2	105.8	2.8
Other goods	110.0	4.4	130.9	4.4	152.9	4.0
Total	2,497.4	100	2,989.2	100	3,805.3	100

	2005	per cent.	2006	per cent.	2007	per cent.
	(LVL million, except for percentages)					
Live animals and animal products	112.8	2.3	140.8	2.2	164.7	2.1
Vegetable products	131.2	2.7	153.4	2.4	188.9	2.4
Prepared foodstuffs	293.8	6.0	379.2	5.9	476.5	6.2
Mineral products	752.8	15.5	854.8	13.4	906.1	11.7
Products of the chemical and allied industries	409.2	8.4	530.4	8.3	621.2	8.0
Plastics and articles thereof; rubber and articles thereof	250.3	5.1	322.6	5.1	376.8	4.9
Wood and articles of wood	142.9	2.9	161.0	2.5	257.3	3.3
Pulp of wood; paper and paperboard	143.7	3.0	164.5	2.6	185.5	2.4
Textiles and textile articles	236.6	4.9	297.0	4.7	333.4	4.3
Articles of stone, plaster, cement, glassware, ceramic	126.7	2.6	171.0	2.7	205.2	2.7
Base metals and articles of base metals	447.6	9.2	606.7	9.5	747.2	9.7
Machinery and mechanical appliances; electrical equipment	967.7	19.9	1,257.0	19.7	1,579.5	20.5
Transport vehicles	523.1	10.7	868.3	13.6	1,132.3	14.7
Miscellaneous manufactured articles	142.6	2.9	213.8	3.4	256.9	3.3
Other goods	186.0	3.8	258.0	4.0	289.4	3.7
Total	4,867.0	100	6,378.5	100	7,720.9	100

Source: Central Statistical Bureau of Latvia.

Trade Policy

Common trade policy is implemented within the EU, where the European Commission negotiates bilaterally and multilaterally on behalf of the 27 EU member states. The European Commission voices a common position that is co-ordinated with member states under the Article 133 Committee of the EU Council.

The renewed Lisbon Strategy of 2005 envisages measures promoting growth and employment in all EU member states. In addition to this internal agenda, measures aimed at improving the external competitiveness of the EU were approved at the beginning of 2007. Using trade policy instruments and the opportunities created by international trade liberalisation for facilitating access to markets of goods and services, several initiatives were determined, which would ensure that European trade policy adjusts to competitive challenges in the future.

Since 1 May 2004, trade relations between Latvia and other countries have been regulated by agreements concluded by the EU. Bulgaria and Romania joined the European Union on 1 January 2007 increasing the EU internal market, where capital and persons may freely move, to 490 million consumers. The increased market for goods and services has opened new opportunities for Latvian exporters.

In order to continue to activate bilateral economic co-operation after accession to the EU, Latvia has concluded bilateral economic co-operation agreements with Russia, China, Belarus, Ukraine, Kazakhstan, Azerbaijan, Georgia, Moldova and Uzbekistan.

These agreements are the most important umbrella agreements that regulate bilateral economic co-operation and comprise co-operation in industry, tourism, transport, pharmaceuticals, agriculture, financial services, communications, professional training, investment policy, technologies and innovation and other fields, thereby promoting economic co-operation.

Foreign Direct Investment

With Latvia's accession to the EU, the volume of FDI inflow has increased considerably. In the last four years, foreign entrepreneurs have invested in the Latvian economy in the form of direct investment almost seven times more than in the period from 2001 to 2003.

Over the last four years, the key sectors receiving FDI have been financial intermediation, real estate, trade (largely wholesale) and manufacturing. At the end of the first nine months of 2007, accumulated FDI reached LVL 5.0 billion (LVL 2,197 per capita). The significance of reinvested earnings from foreign investment has increased as the financial performance of direct investment projects has improved; 41.6 per cent. of total direct investment in Latvia has been in the form of reinvested earnings on average since the beginning of 2004.

The inflow of investment has been an important source of the current account deficit financing - the net FDI inflow during the last four years (2004 to 2007) covered on average, one third of the current account deficit.

The following table shows FDI stock for the years 2002 to 2006 and for the first nine months of 2007.

	2002	2003	2004	2005	2006	first nine months of 2007
			(LVL million)			
Foreign investment stock	1,634.3	1,772.8	2,336.9	2,923.0	4,007.2	4,992.3
in equity capital	1,219.8	1,301.9	1,771.6	2,274.9	3,103.8	4,044.9
in other capital	412.7	469.7	564.0	648.0	903.4	947.5

Source: Bank of Latvia

The following table sets out the distribution of accumulated FDI by sector and as a percentage of total FDI in enterprises for the years 2002 to 2006 and for the first nine months of 2007.

	2002		2003		2004	
	Total	per cent. of total FDI	Total	per cent. of total FDI		per cent. of total FDI
			(LVL million, except for percentages)			
Financial intermediation	255.9	15.7	268.0	15.1	375.9	16.1
Real estate, renting and business activities	389.2	23.8	420.5	23.7	415.5	17.8
Wholesale and retail trade, repair	282.9	17.3	318.3	18.0	368.3	15.8
Manufacturing	248.4	15.2	277.5	15.7	275.8	11.8
Electricity, gas and water supply	59.7	3.7	61.6	3.5	164.7	7.0
Transport, storage and communication	230.8	14.1	221.4	12.5	333.2	14.3
Hotels and restaurants	23.4	1.4	22.5	1.3	27.4	1.2
Other business	143.91	8.8	183.02	10.3	376.1	16.1
Total	1,634.3	100	1,772.8	100	2,336.9	100

	2005		2006		first nine months of 2007	
	Total	per cent. of total FDI	Total	per cent. of total FDI		per cent. of total FDI
				(LVL million, except for percentages)		
Financial intermediation	625.4	21.4	964.7	24.1	1,339.9	26.8
Real estate, renting and business activities	483.1	16.5	743.8	18.6	916.6	18.4
Wholesale and retail trade, repair	409.7	14.0	525.3	13.1	618.2	12.4
Manufacturing	375.8	12.9	395.3	9.9	457.0	9.2
Electricity, gas and water supply	327.6	11.2	348.1	8.7	381.8	7.6
Transport, storage and communication	336.5	11.5	347.1	8.7	374.6	7.5
Hotels and restaurants	28.1	1.0	36.9	0.9	43.5	0.9
Other business	336.8	11.5	646.0	16.1	860.64	17.2
Total	2,923.0	100	4,007.2	100	4,992.3	100

Source: Bank of Latvia

The most significant amount of investment comes from Estonia, Sweden, Germany and Denmark. FDI stock from these four countries made up 48.1 per cent. of the total FDI stock in the Latvian economy at the end of the third quarter of 2007.

Swedish FDI was focused in financial services (46.0 per cent.) of Swedish FDI stock in Latvia at the end of the third quarter of 2007 and commercial services (17.6 per cent); 68.2 per cent. of Estonian FDI comprised financial services; and German entrepreneurs mainly invested in the energy sector (comprising of 38.5 per cent. of German FDI stock in the Latvian economy).

The following table sets out the distribution of the accumulated FDI by country and as a percentage of total accumulated FDI for the years 2002 to 2006 and for the first nine months of 2007.

	2002		2003		2004	
	Total	per cent. of total FDI	Total	per cent. of total FDI		per cent. of total FDI
	(LVL million, except for percentages)					
European Union						
Estonia	102.1	6.2	121.4	6.8	198.0	8.5
Sweden	211.9	13.0	232.3	13.1	287.3	12.3
Germany	205.4	12.6	202.1	11.4	358.0	15.3
Denmark	179.2	11.0	156.4	8.8	203.4	8.7
Finland	118.0	7.2	156.5	8.8	182.9	7.8
Netherlands	89.2	5.5	126.2	7.1	167.9	7.2
Cyprus	3.3	0.2	4.5	0.3	19.9	0.9
Lithuania	9.1	0.6	12.7	0.7	15.2	0.7
Other EU	120.2	7.4	105.9	6.0	113.4	4.9
Total European Union	1,038.36	63.5	1,118.06	63.1	1,546.04	66.2
Russian Federation	80.6	4.9	96.0	5.4	163.7	7.0
United States	115.6	7.1	122.2	6.9	175.4	7.5
Norway	109.4	6.7	108.0	6.1	108.7	4.7
Switzerland	31.2	1.9	41.0	2.3	34.4	1.5
Other countries	144.7	8.9	157.9	8.9	144.3	6.2
Exterritorial societies[(1)]	8.5	0.5	8.9	0.5	3.4	0.1
Countries not classified	105.9	6.5	120.7	6.8	161.0	6.9
Total	1,634.27	100	1,772.79	100	2,336.9	100

Source: Bank of Latvia

(1) EBRD, European Commission and other international organisations.

	2005		2006		2007	
	Total	per cent. of total FDI	Total	per cent. of total FDI	First nine months of	per cent. of total FDI
	(LVL million, except for percentages)					
European Union						
Estonia	293.1	10.0	466.5	11.6	708.9	14.2
Sweden	448.4	15.3	606.2	15.1	624.5	12.5
Germany	369.8	12.7	443.2	11.1	509.4	10.2
Denmark	251.6	8.6	331.6	8.3	424.6	8.5
Finland	191.5	6.6	233.9	5.8	311.9	6.2
Netherlands	209.7	7.2	222.7	5.6	268.3	5.4
Cyprus	36.8	1.3	167.4	4.2	240.9	4.8
Lithuania	71.7	2.5	100.9	2.5	135.8	2.7
Other EU	172.4	5.9	295.6	7.4	446.2	8.9
Total European Union	2,045.0	70.0	2,868.0	71.6	3,670.4	73.5
Russian Federation	241.5	8.3	264.8	6.6	288.6	5.8
United States	193.5	6.6	234.9	5.9	251.2	5.0
Norway	79.4	2.7	152.7	3.8	183.4	3.7
Switzerland	67.7	2.3	72.8	1.8	183.4	1.3
Other countries	168.7	5.8	209.2	5.2	285.0	5.7
Exterritorial societies[(1)]	3.9	0.1	0.0	0.0	0.0	0.0
Countries not classified	123.3	4.2	204.8	5.1	247.2	5.0
Total	2,923.0	100	4,007.2	100	4,992.3	100

Source: Bank of Latvia

(1) EBRD, European Commission and other international organisations.

Privatisation

The Law on Completion of the State and Local Government Property Privatisation and Use of Privatisation Certificates (the "**Privatisation Completion Law**") came into force on 1 September 2005. The central provisions of this law prescribe how the privatisation process and land reforms are to be completed and the result of using privatisation certificates. The law also provides that state joint-stock companies such as Latvian Post, Latvian Railway, Latvijas Gaisa Satiksme (Latvian air traffic) and the Latvian State Forest, the International Airport Riga and Latvenergo (a state owned energy supply group) will not be privatised. Under the Privatisation Completion Law, various areas of reform including the privatisation of state property, local government property, apartment houses and land reform each have separate timescales, although the law has a final implementation deadline of 28 February 2008. After this date neither the Cabinet of Ministers nor local governments will be allowed to assign any property for privatisation.

A number of large state enterprises were privatised between 1995 and 2003, including the state's share in the Latvian Shipping Company and Latvian Gas. Nineteen other smaller enterprises, where the state held between 10 and 50 per cent. of shares were also privatised in this period. One of the largest privatisation deals since 2004 was the sale of the state's 38 per cent. share in Ventspils Oil.

Currently, the privatisation of Latvian Mobile Telephone (which is owed 5 per cent. directly by the state, 23 per cent. by enterprises which themselves are state owned and 23 per cent. by Lattelecom) and Lattelecom (which is 51 per cent. owned by the state) is being negotiated, dependent on negotiations with the second shareholder, the Swedish company "Telia Sonera". It is also possible that the Air Baltic Corporation (in which the state owns a 53 per cent. share) will be privatised pending a decision from the Ministry of Transport which is expected in the next six months.

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 USSR. The Bank of Latvia was liquidated in October 1940 following the annexation of Latvia to the USSR in August 1940.

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 USSR and other state credit institutions. The legal status of the Bank of Latvia, and its role as an independent central bank, was reinforced by the Law on Banks and the Law on the Bank of Latvia passed in May 1992. The Law on the Bank of Latvia did not stipulate that the Bank of Latvia had the right to conduct commercial operations, resulting in a resolution to divest the Bank of Latvia of its commercial operations through the restructuring and privatisation of its 49 branches.

The Law on the Bank of Latvia formally sets out the role of the Bank of Latvia and confers authority on it to operate as an independent institution which is solely responsible to the Parliament. The Bank of Latvia is administered by the Council and the Board. The Council consists of eight members: the Governor (who is also the Chairman of the Council), the Deputy Governor and six members of the Council. The Council makes decisions on behalf of the Bank of Latvia. The Board, which is nominated by the Council and 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 Parliament for a six-year term and can only be removed by the Parliament in limited circumstances provided under the Law on the Bank of Latvia.

Since accession to the EU on 1 May 2004, the Bank of Latvia has become a member of the System of the European Central Banks and has started the preparatory work for the introduction of the Euro. On 2 May 2005, Latvia joined the Exchange Rate Mechanism II, which is a necessary precondition for the entry into the European Monetary System.

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 control the amount of bank reserves so as to limit the creation of excessive credit. The exchange rate policy of the Bank of Latvia is similar to that of a currency board, and the monetary base is fully backed by gold and foreign currency reserves. The Bank of Latvia may grant loans to the banking sector but the Law on the Bank of Latvia prohibits the issuance of credits to the government and the purchase of government securities on the primary market. Full convertibility of the national currency has been ensured since its introduction, 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 a deposit facility as a tool for withdrawing liquidity from the system and main refinancing operations as a liquidity providing instrument. Reserve requirements ensure stability in the demand for central bank balances. Monetary policy instruments of the Bank of Latvia are already in line with those used in the euro area.

Tracking interest rate increases in the euro area and considering the macroeconomic development trends in Latvia, the Bank of Latvia has been tightening monetary policy over the prior years. The Bank of Latvia's main refinancing rate was gradually raised from 3.0 per cent. at the beginning of 2004 to 6.0 per cent. in May 2007. The reserve ratio was increased from 3 per cent. at the beginning of 2004 to 8 per cent. as at December 2005.

Considering the slowdown in lending growth and the gradual unwinding of domestic demand pressures the Bank of Latvia cuts the reserve ratio for liabilities with maturity over 2 years by one percentage point to

7 per cent. as of February 2008 in order to help the financial sector attract long-term funding. In addition the Bank of Latvia increased the interest rate of the central bank on overnight deposit facility from 2.0 per cent. to 3.0 per cent.

Money supply

Broad money supply (M3) grew from LVL 2,221.3 million at the end of 2003 to LVL 6,311.6 million at the end of 2007 with average annual growth per year of 30.2 per cent.

The overall growth of M3 reflects the expansion of the most liquid components of the narrow monetary aggregate (M1), with overnight deposits with banks in all currencies growing 3.1 times during the period from 2004 to 2007. Because M3 has expanded mainly on account of bank deposits, the cash component of M3 continued to shrink, contracting from 27.1 per cent. at the end of 2003 to 14.3 per cent. at the end of 2007. In the second half of 2007 overnight deposits with banks also reduced while time deposits and savings deposits expanded together with the increase of the respective interest rates.

From the demand side, monetary expansion has been mainly driven by bank loans to the private sector, alongside buoyant economic growth, increasing funding of banks and decreasing interest rates. Loans granted to domestic enterprises and households grew by 47.0 per cent. in 2004, 64.3 per cent. in 2005, and 58.4 per cent. in 2006. As a result of the government's efforts to reduce credit expansion, credit growth has started to decelerate as of mid 2007, with the annual growth rate falling to 56.2 per cent. in June and 34.2 per cent. in December 2007.

The stability of the banking sector, growing incomes and further consolidation of the real sector of the economy, has enabled the banking sector to increase funding from domestic enterprises and households at a rapid pace (by 34.1 per cent. in 2004, by 43.9 per cent. in 2005, by 41.0 per cent. in 2006 and by 16.9 per cent. in 2007.

Borrowing from foreign banks (mainly parent banks of the Latvian banks) was an increasing source of financing for loan growth. The negative net foreign assets of the banking sector (excluding the Bank of Latvia) grew by LVL 6.5 billion during 2004 to 2007. Banks' foreign liabilities increased on account of significant borrowing from non-resident credit institutions, which grew by LVL 7.0 billion, including borrowing from parent banks of LVL 5.2 billion. At the same time, non-resident non-bank deposits posted a smaller change (which grew by LVL 2.5 billion), as well as foreign assets of banks (which grew by LVL 3.3 billion).

The following tables set out the base money supply and the monetary aggregates for the years 2002 to 2007 (in LVL million):

	2002	2003	2004	2005	2006	2007
Currency in circulation	622.6	682.1	727.4	877.3	1,073.9	1,049.5
Overnight deposits at the Bank of Latvia	132.5	124.6	229.9	473.4	1,174.9	1,421.7
Base Money	755.1	806.8	957.2	1,350.7	2,248.8	2,471.2

	2002	2003	2004	2005	2006	2007
Currency in circulation (less vault cash balances)	543.1	601.1	645.4	786.4	969.3	900.0
Overnight deposits......................	801.2	990.2	1,354.7	2,083.8	3,096.5	3,035.2
Total M1	1,344.3	1,591.3	2,000.1	2,870.2	4,065.8	3,935.2
Deposits with agreed maturity of up to 2 years	447.4	582.4	744.6	929.1	1,241.9	1,971.9
Deposits redeemable at notice of up to 3 months	35.5	44.9	71.8	106.6	148.2	335.0
Total M2	1,827.2	2,218.6	2,816.5	3,905.8	5,456.0	6,242.0
Debt securities issued with maturity of up to 2 years	6.1	2.7	0.4	3.4	4.8	28.2
Money market fund shares and units.......................................	0	0	0	16.1	46.1	41.3
Total M3	1,833.3	2,21.3	2,817.0	3,925.4	5,506.8	6,311.6

Source: Bank of Latvia

Foreign Assets

Foreign assets held by the Bank of Latvia as for the years 2002 to 2007 are set out in the table below (LVL million, except for Imports of Goods):

	2002	2003	2004	2005	2006	2007
Gold	51.0	55.5	56.9	76.2	83.7	99.1
Foreign Exchange	737.3	774.8	986.5	1,320.5	2,333.3	2,687.7
Net foreign assets	777.8	824.0	1,039.3	1,390.2	2,414.4	2,776.0
Months of Imports of Goods	3.7	3.3	3.3	3.4	4.5	4.3

Source: Bank of Latvia

At the end of 2003 Latvia's gold and foreign currency reserves amounted to LVL 830.3 million. Since that time the country's foreign reserves have increased and as of 31 December 2007, foreign currency reserves amounted to LVL 2,786.8 million. During the period from 2003 to 2007 foreign reserves of the central bank grew mainly through the Bank of Latvia net purchases of foreign currency totalling LVL 1.7 billion. Selling of foreign currencies to the Bank of Latvia was largely fostered by inflows of foreign investment and the EU structural funds in the economy. Large amounts of foreign currency sold to the Bank of Latvia were also determined by the continued rapid growth of euro loans subsequently converted into lats and by the expansion of the minimum reserve base which created an additional demand for lats liquidity. The backing of the monetary base with the Bank's net foreign assets was 112.3 per cent. at the end of 2007 compared with 102.1 per cent. at the end of 2003.

Interest Rates

Interest rates applied in banks' transactions with domestic enterprises and private persons were relatively stable in 2004. From the beginning of 2005, the interest rates started to decline, which was reversed by the end of 2005 and the beginning of 2006. The dynamics of these interest rates has been determined mainly by the euro and domestic money market interest rates.

The weighted average interest rate of short-term deposits in lats increased from 2.8 per cent. in January 2004 to 7.8 per cent. in December 2007. Also, the weighted average interest rate of short-term deposits in euro increased from 2.0 per cent, in January 2004 to 4.2 per cent. in December 2007. The weighted average interest rate of long-term deposits denominated in lats grew from 4.4 per cent. to 10.4 per cent, and the rate of long-term deposits denominated in euro, from 3.7 per cent. to 4.1 per cent.

After a declining trend, lending rates started to increase at the middle of 2005. Overall, the weighted average interest rates on loans in lats to domestic enterprises and private persons increased by 6.0 percentage points to 12.6 per cent. for short-term transactions and by 4.8 percentage points to 16.2 per cent. for long-term transactions in the period from January 2004 to December 2007. The weighted average interest rate of short-term loans in euro increased from 5.3 per cent. to 7.1 per cent, while the weighted average interest rate of long-term loans declined from 7.9 per cent. to 6.5 per cent. in this period.

Financial Sector Supervision

The Financial and Capital Market Commission (the "**FCMC**") is a unified supervisory authority for the financial sector in Latvia. The FCMC commenced its activities on 1 July 2001, taking over responsibilities of the Insurance Supervision Inspectorate, the Securities Market Commission, administration of the Deposits Guarantee Fund as well as the rights, obligations and liabilities of the Bank of Latvia regarding the supervision of credit institutions.

The FCMC is an autonomous public institution and the purpose of its activities is to promote the protection of interests of investors, depositors and the insured 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 activities of its participants. The FCMC's objectives and responsibilities are defined in the Law on the Financial and Capital Market Commission.

The organisational and management structure of the FCMC was set up as functional divisions, rather than along sectoral lines, and consists of the following three departments: the Supervision Department; the Legal and Licensing Department and the Regulations and Statistics Department.

The FCMC continues to harmonise the regulatory framework for the financial sector with the requirements of EU Financial Sector Assessment Programme Directives ("**FSAP**") and measures falling within its competence. Out of 24 FSAP directives the transposition deadline of which was 15 December 2007, 23 directives including the CRD[1], Directive on prospectus, Transparency Directive and MIFID[2], have been fully implemented. Transposition of MIFID was finalised in November 2007. However, the Reinsurance Law and the new Law on Prevention of Money Laundering and Terrorism Financing will be approved by the end of May 2008. The FCMC participates in activities of the Committees within the Lamfalussy structure and closely follows discussions on further developments in the regulatory framework proposed by the international organisations and best supervisory practices, and is strongly committed to ensuring the practical implementation of the related Latvian regulations.

Banking Sector Development

The Latvian banking sector maintained growth momentum in 2007. At the end of December 2007, the banking sector in Latvia comprised 21 banks and four branches of foreign banks (Allied Irish Banks p.l.c. Latvia branch, Latvian branch of Nordea Bank Finland Plc, Skandinaviska Enskilda Banken AB Riga branch, Svenska Handelsbanken AB Latvia branch). All the banks in Latvia are licensed as universal and can provide all financial services specified by the Law on Credit Institutions and Investment Services according to the Law on the Financial Instruments Market. Over the past three years, five Latvian banks have expanded their international activities through opening eight new branches in the EU.

In 2007, total paid-up capital of banks grew by 53 per cent. The share of foreign owners increased from 58 per cent. at the end of 2006 to 78 per cent. at the end of 2007, reflecting foreign investors' confidence in the banking sector. 11 banks are foreign-owned banks (with participation exceeding 50 per cent. of a banks paid-up capital), 10 of them are foreign banks' subsidiaries with 56 per cent. share in total banking assets. The government holds shares only in one medium-sized joint stock company, the Mortgage and Land Bank of Latvia (these holdings in total account for 5.5 per cent. of the paid-up share capital of banks).

Over the past three years, annual average banking assets have grown by 41 per cent., while loans by 51 per cent., deposits by 26 per cent. and equity by 40 per cent. The period also saw a rapid growth in the volume of borrowing, basically from the EU parent banks. As at the end of 2007, 88 per cent. of total loans were granted to domestic borrowers, whereas 87 per cent. of total lending was made up of medium and long-term loans and the bulk of total loans to the national economy sectors were issued for real estate transactions (30 per cent.), financial intermediation (13 per cent.), manufacturing (14 per cent.) and trade (12 per cent.). Mortgage lending developed particularly rapidly: 53 per cent. of total loans were mortgage loans. The growth rate of mortgage lending during 2007 amounted to 41 per cent. The quality of the loan portfolio remained good. The share of non-performing loans over the past three years decreased from 1.1 per cent. of total loans at the end of 2004 to 0.4 per cent. as at the end of 2007. Loans classified as non-performing loans were covered by more than 100 per cent. (130 per cent.) by special loan impairment provisions.

At the end of 2007, the non-audited profit of the banking sector reached LVL 371 million (EUR 528 million), or 40 per cent. up from the previous year (the audited profit of the banking sector at the end of 2006 made up LVL 256 million or EUR 364 million). Banks were highly profitable, the return on equity (ROE) and the return on assets (ROA) at the end of 2007 accounted for 24.2 per cent. and 2.0 per cent., respectively.

As at 31 December 2007, the net interest margin was 2.7 per cent. Banks were well capitalized and the capital adequacy ratio was 11.1 per cent., exceeding the required minimum of 8 per cent.

1 Capital Requirements Directives – Directives 2006/48/EC and 2006/49/EC

2 Markets in Financial Instruments Directive

There is an increasing tendency for banks to orientate towards the domestic market, especially regarding their lending activities. This results in a greater competition in the banking sector. To meet competitive challenges, the banks have broadened the range of services they offer to their customers (mainly focusing on investment products) and have increased cost efficiency.

The following table shows the banking sector performance indicators and the quality of the loan portfolio:

	2002				2003				2004				2005				2006				2007			
	31 Mar	30 Jun	30 Sep	31 Dec	31 Mar	30 Jun	30 Sep	31 Dec	31 Mar	30 Jun	30 Sep	31 Dec	31 Mar	30 Jun	30 Sep	31 Dec	31 Mar	30 Jun	30 Sep	31 Dec	31 Mar	30 Jun	30 Sep	31 Dec
Performance Indicators (per cent.)																								
Asset quality																								
Specific provisions for claims on non-banks over loans	1.9	1.7	1.7	1.5	1.6	1.5	1.5	1.2	1.3	1.2	1.1	1.1	1.1	0.9	0.9	0.7	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Share of non-performing loans granted to non-banks in total loans	2.8	2.6	2.3	2.0	1.9	1.8	1.7	1.4	1.5	1.4	1.2	1.1	1.1	1.0	0.9	0.7	0.6	0.6	0.4	0.5	0.4	0.4	0.4	0.4
Liquidity																								
Liquidity	66.0	64.9	61.6	62.1	59.3	57.9	60.0	57.9	55.8	54.0	55.4	58.1	56.8	51.8	51.5	52.3	49.0	51.5	51.1	51.1	51.0	48.1	54.7	55.7
Share of loans issued to non-banks in total assets	47.0	47.9	48.2	48.1	49.8	50.2	50.2	52.5	54.5	55.4	54.8	55.8	57.8	60.7	62.7	63.6	65.9	65.2	66.9	68.4	69.4	70.6	69.5	68.1
Loans to non-banks over deposits	67.8	68.9	70.6	69.2	71.9	74.1	74.8	80.4	82.9	83.0	83.5	86.0	90.5	97.8	105.6	112.3	119.6	124.1	134.3	140.2	150.6	151.2	158.1	146.5
Long term loans to non-banks over total loans	30.4	32.3	35.7	36.9	37.5	37.8	39.0	41.6	42.5	42.6	42.0	47.4	45.4	47.0	48.0	48.3	49.2	49.7	51.0	52.1	53.7	55.0	55.8	56.5
Share of demand deposits in total deposits	68.7	70.8	70.4	71.9	69.8	71.8	72.6	73.2	71.7	72.6	73.2	72.2	73.1	71.9	70.6	70.6	67.5	67.5	68.4	68.3	68.1	66.9	65.2	60.9
Capital adequacy																								
Capital adequacy	14.9	14.1	14.0	13.1	13.8	12.6	12.2	11.7	12.5	12.1	11.6	11.7	11.7	10.7	10.2	10.1	10.9	10.5	10.5	10.2	10.4	10.5	11.0	11.1
Capital over total assets	10.4	10.5	10.7	10.0	10.1	10.1	9.8	9.6	9.5	9.3	8.8	9.1	9.0	8.8	8.7	8.4	8.4	8.4	8.4	8.2	7.9	8.6	8.5	8.5
Capital over total liabilities	11.6	11.7	11.9	11.1	11.2	11.3	10.8	10.7	10.5	10.3	9.7	10.1	10.0	9.6	9.5	9.2	9.2	9.2	9.1	8.9	8.6	9.4	9.3	9.2
Risk weighted assets over total assets	47.6	52.8	55.1	53.1	54.0	53.5	56.8	57.5	58.4	57.8	57.7	62.3	64.2	66.7	68.7	71.4	72.5	73.1	74.0	72.9	73.0	74.0	71.1	68.5
Profitability																								
Return on equity	15.3	14.5	15.6	16.4	14.7	16.3	16.9	16.7	20.0	19.7	21.2	21.4	31.7	28.1	28.0	27.1	28.6	24.0	24.5	26.3	28.5	25.9	24.2	24.2
Return on assets	1.4	1.3	1.4	1.5	1.3	1.4	1.5	1.4	1.7	1.6	1.7	1.7	2.5	2.2	2.2	2.1	2.2	1.9	1.9	2.1	2.1	2.1	2.0	2.0
Effective loan costs	5.9	5.8	5.3	5.1	4.0	3.9	3.8	3.6	3.0	3.1	3.1	3.3	3.3	3.4	3.3	3.3	3.3	3.5	3.7	3.8	4.2	4.5	4.7	4.9
Effective deposit rate	2.2	2.1	2.0	1.9	1.6	0.9	1.5	1.5	1.3	1.3	1.3	1.4	1.4	1.4	1.5	1.5	1.7	1.8	1.9	1.9	2.3	2.4	2.5	2.6
Effective lending rate	8.2	8.0	7.8	7..5	6.5	6.4	6..3	6.3	5.8	5.8	5.8	5.9	5.9	5.8	5.7	5.6	5.5	5.6	5.8	5.9	6.2	6.5	6.7	6.9
Ratio of financial efficiency	58.8	60.0	58.1	57.6	57.8	56.4	55.6	56.1	50.9	52.3	50.9	51.5	42.3	44.8	44.3	45.9	41.6	46.2	45.0	44.1	41.1	42.1	42.6	43.5
Net interest rate margin	2.9	3.0	3.0	2.9	2.6	2.6	2.6	2.6	2.7	2.7	2.7	2.7	2.8	2.8	2.8	2.7	2.6	2.6	2.6	2.7	2.6	2.7	2.7	2.7
Quality of the Loan Portfolio																								
Standard Loans	95.7	96.1	96.4	97.1	96.9	97.0	97.3	97.6	97.7	97.8	97.9	98.0	98.1	98.3	98.5	98.8	99.0	98.9	99.2	99.3	99.4	99.3	99.3	99.2
Close-watch loans	1.5	1.3	1.3	0.9	1.1	1.2	1.0	1.0	0.9	0.8	0.9	0.9	0.8	0.7	0.6	0.5	0.4	0.5	0.4	0.3	0.2	0.3	0.3	0.4
Non-performing loans	2.8	2.6	2.3	2.0	1.9	1.8	1.7	1.4	1.4	1.4	1.2	1.1	1.1	1.0	0.9	0.7	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Substandard	1.7	1.6	1.3	0.9	0.9	0.7	0.7	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Doubtful	0.7	0.7	0.7	0.7	0.7	0.7	0.5	0.5	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Lost	0.4	0.4	0.4	0.4	0.3	0.4	0.5	0.3	0.3	0.3	0.3	0.3	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Financial Capital Market Commission

Riga Stock Exchange

The Riga Stock Exchange ("**RSE**") is the only licensed stock exchange in Latvia offering trading, listing and information services. It was established in 1993 and commenced trading in 1995. OMX Group is the RSE's major shareholder, with a 92.98 per cent. ownership interest. Through its exchanges in Copenhagen, Stockholm, Helsinki, Reykjavik, Riga, Tallinn and Vilnius OMX offers access to approximately 80 per cent. of the Nordic and Baltic securities markets. The RSE is the 100 per cent. owner of the Latvian Central Depository ("**LCD**"). The LCD has the status of a national depository for public securities, and its business is accounting, custody and settlement of public securities issued in Latvia.

RSE uses the Nordic-Baltic trading system SAXESS, which is also used by the exchanges in Sweden, Finland, Denmark, Norway, Iceland, Estonia, and Lithuania. As a part of the OMX and NOREX alliance, the RSE started trading on SAXESS platform in September 2004. Only licensed RSE members – banks and brokerage companies – may trade on the RSE. Presently, the RSE has 27 trading members. The RSE operates three lists: the Main List, Secondary List and Bond List.

Shares, Government Treasury bills and bonds, corporate bonds and investment fund units are listed on the RSE (altogether 40 equities, 34 debt securities and 7 investment fund units as of 31 January 2008). As on 29 December 2006, the equity market capitalisation was LVL 1,154.74 million, reaching LVL 1,226.78 million on 30 December 2005, while on 28 December 2007 it was LVL 1, 474.82 million.

The debt market capitalisation on 29 December 2006 was LVL 460.50 million, on 30 December 2005 it was LVL 484.52 million, and on 28 December 2007 it totalled LVL 428.88 million. The total market turnover in 2006 amounted to LVL 62.68 million (LVL 61.62 million equity and LVL 1.05 million debt trading). As on 28 December 2007, the total market turnover was LVL 103.55 million (LVL 72.25 million equity trading and LVL 31.29 million debt trading).

During each trading session, on-line price information is distributed via Reuters, Bloomberg, Thomson Financial, FT Interactive Data, Infront, Royal Blue Financial and Telekurs Financial.

OMX uses a common classification of indexes for the Nordic and Baltic markets. A uniform index standard enhances the understanding of the Nordic and Baltic indexes and facilitates comparisons between the different markets. The OMX Baltic index group includes Benchmark, Tradable, All Share and Sector indexes. All indexes are chain-linked, meaning that they are always calculated based on the price level of the previous trading day. The indexes are market weighted, calculated on the basis of the change in the total market value from one point in time to another of all the shares included in the index.

The RSE has a guarantee fund (the "**Guarantee Fund**"), financed through an initial contribution and a variable contribution, which depends on an individual member's trading activity. The Guarantee Fund is used in case of a member's cash default.

The LCD is responsible for accounting and safe custody of public securities registered in Latvia, and for providing a delivery-versus-payment service for all trades executed on the RSE. Intermediaries' and custodians' proprietary accounts are segregated from their clients' accounts, thus eliminating risks in a case of default by a bank or a brokerage company.

PUBLIC FINANCE

General government budget

The general government budget consists of the central government budget and local government budgets.

The central government budget includes the central government basic budget and the central government special budget. In 2003, the Cabinet of Ministers took a decision to abolish all special budgets, except the Social Security Fund and to integrate them in the central government basic budget. For the consolidated central government budget, the calculation eliminates any mutual transfers among the budgets.

The main goal of the government fiscal policy is to ensure sustainable macroeconomic development. In March 2007, the government adopted the inflation restriction plan which aims to strengthen fiscal policy resulting in budget surpluses in the medium term.

According to the Law On State Budget 2008, it is planned that the budget surplus for 2008 would be 1.0 per cent. of GDP. For 2009 and 2010, budget surpluses of 1.2 per cent. and 1.5 per cent. of GDP, respectively, are planned.

The structure of the general government budget, LVL million

	2004	2005	2006	2007
General government budget revenues	**2,522.2**	**3,199.8**	**4,015.6**	**5,378.0**
1. Tax revenues	2,025.4	2,545.7	3,299.0	4,363.0
1.1 Direct taxes	1,261.3	1,502.3	1,935.8	2,626.9
of which: Corporate income tax	127.8	180.7	253.8	399.8
Personal income tax	435.5	509.1	657.2	888.0
Social security contributions	641.2	751.0	958.4	1,265.0
Taxes of property	56.8	61.6	66.4	74.2
1.2 Indirect taxes	745.7	1,019.9	1,331.1	1,696.1
of which: Valued added tax	486.7	677.1	930.5	1,202.9
Excise tax	236.9	314.0	366.2	448.1
Car tax	4.9	9.5	13.7	16.7
Electricity tax				0.5
Customs duties	17.1	19.2	20.7	27.8
1.3 Other taxes	18.5	23.5	32.0	39.9
2. Non-tax revenues	190.8	218.3	242.7	303.8
3. Grants and donations	9.9	8.7	12.4	12.7
4. Self-earned revenues	142.0	175.3	196.6	237.2
5. Foreign financial assistance	154.2	251.8	265.0	461.3
General government budget expenditures	**2,599.6**	**3,297.8**	**4,070.7**	**5,283.9**
1. Non-capital expenditure	2,366.5	2,924.4	3,551.1	4,516.8
2. Capital expenditure	233.0	373.3	519.6	767.1
3. Losses from the exchange rate fluctuations				0.1
Financial balance	**-77.4**	**-97.9**	**-55.1**	**94.0**

Source: The Ministry of Finance

The structure of the general government budget as a percentage of GDP

	2004	2005	2006	2007*
General government budget revenues	**33.9**	**35.3**	**35.6**	**38.5**
1. Tax revenues	27.2	28.1	29.3	31.2
1.1 Direct taxes	17.0	16.6	17.2	18.8
1.2 Indirect taxes	10.0	11.3	11.8	12.1
1.3 Other taxes	0.2	0.3	0.3	0.3
2. Non-tax revenues	2.6	2.4	2.2	2.2
3. Grants and donations	0.1	0.1	0.1	0.1
4. Self-earned revenues	1.9	1.9	1.7	1.7
5. Foreign financial assistance	2.1	2.8	2.4	3.3
General government budget expenditures	**35.0**	**36.4**	**36.1**	**37.8**
1. Non-capital expenditure	31.8	32.3	31.5	32.3
2. Capital expenditure	3.1	4.1	4.6	5.5
Financial balance	**-1.0**	**-1.1**	**-0.5**	**0.7**

** Forecasted GDP for 2007 is LVL 13,985.8 million*

Source: The Ministry of Finance

The structure of the consolidated central government budget, LVL million

	2004	2005	2006	2007
Consolidated central government budget revenues	**2,056.3**	**2,632.5**	**3,301.5**	**4,387.3**
1. Tax revenues	1,652.1	2,107.1	2,731.8	3,577.3
2. Non-tax revenues	158.0	173.2	194.9	234.5
3. Self-earned revenues	92.3	103.1	110.5	116.6
4. Foreign financial assistance	153.8	249.0	264.3	458.8
Consolidated central government budget expenditures	**2,127.5**	**2,702.1**	**3,354.9**	**4,271.0**
1. Non-capital expenditure	1,993.2	2,460.6	3,025.8	3,853.6
2. Capital expenditure	134.3	241.5	329.2	417.5
Financial balance	**-71.3**	**-69.6**	**-53.5**	**116.2***

Source: The Ministry of Finance

** excluding grants and donations (LVL 117.2 million including grants and donations)*

The structure of the consolidated central government budget as a percentage of GDP

	2004	2005	2006	2007*
Consolidated central government budget revenues	**27.7**	**29.1**	**29.3**	**31.4**
1. Tax revenues	22.2	23.3	24.3	25.6
2. Non-tax revenues	2.1	1.9	1.7	1.7
3. Self-earned revenues	1.2	1.1	1.0	0.8
4. Foreign financial assistance	2.1	2.7	2.3	3.3
Consolidated central government budget expenditures	**28.6**	**29.8**	**29.8**	**30.5**
1. Non-capital expenditure	26.8	27.2	26.9	27.6
2. Capital expenditure	1.8	2.7	2.9	3.0
Financial balance	**-1.0**	**-0.8**	**-0.5**	**0.8**

** Forecasted GDP for 2007 is LVL 13,985.8 million*

Source: The Ministry of Finance

Budget process

The Law on Budget and Financial Management has been amended to set the deadlines in budgetary planning process.

Every year the Ministry of Finance, together with the State Chancellery, prepares a normative act on medium term budget goals and priority development directions for the following 3 years by February 28. The Cabinet of Ministers adopted the above mentioned normative act by 15 March.

Ministries and other central government institutions submit developed or revised institution action strategies to the Cabinet of Ministers, including a list of prioritised new policy initiatives by 1 March.

The Ministry of Finance, together with the Ministry of Economy and consulting the Bank of Latvia, updates the medium-term macroeconomic development and fiscal policy framework for the next 3 consecutive financial years and submits this to the Cabinet of Ministers by 15 April. The Cabinet of Ministers adopted medium-term macroeconomic development and fiscal policy framework by 1 May. Thereafter, the Minister of Finance informs the Saeima about the medium term macroeconomic development and fiscal policy framework by 5 May.

The Cabinet of Ministers approves instructions on principles of developing budget requests (including maximum central government budget expenditure ceilings for each ministry and other central government institutions over the medium term) by 5 May. Pursuant to these instructions, ministries and other central government institutions develop and submit to the Ministry of Finance central government budget requests by 1 July.

The Ministry of Finance submits the central government budget proposal, its explanations, and updated medium term macroeconomic development and fiscal policy framework to the Cabinet of Ministers by 1 September. The Cabinet of Ministers submits to the Saeima the State Budget Law proposal for the following year by 1 October.

Medium-term budget planning is introduced as of 2008. Cabinet Order No. 703 of 14 September 2006, approved the Concept on implementation of strategic planning and medium term budget planning in public administration, which sets the medium-term (3 year) budget framework:

- Annual law on budget for 1 year; and
- Maximum permitted amount of expenditure for ministries and other central state institutions for the following 2 years.

Local government budget

Since 1992, the system of local government financing in Latvia has undergone a continuous process of reform. Under the terms of the local government reform, a concept approved in 1993, a legal base for the establishment of local government budgets was established.

The Law on Budget and Financial Management and the Law on Local Governments were adopted in 1994 and the Law on Local Government Budgets was adopted in 1995.

Due to substantial differences in the financial resources of local governments, since 1995 there has been a mechanism for financial equalisation to create equal opportunities for local governments to fulfill the functions prescribed by law. Initially, the Law on Local Government Financial Equalisation was adopted annually, but since 1998 a single Law on Local Government Financial Equalisation has been in force.

The system envisages equalisation of the estimated revenue and financial needs of an individual local government.

The structure of the local government budget, LVL million

	2004	2005	2006	2007
Local government budget revenues	**679.0**	**805.7**	**1,032.6**	**1,428.9**
1. Local government basic budget revenues	631.4	752.8	963.7	1,327.0
1.1 Tax revenues	369.8	435.3	563.4	783.1
1.1.1 Personal income tax	310.6	370.6	491.9	701.5
1.1.2 Taxes from property	56.8	61.6	66.4	74.3
1.1.3 Internal taxes on goods and services	2.5	3.2	5.1	7.3
1.2 Non-tax revenue	27.0	28.6	34.4	40.2
1.3 Foreign financial assistance	5.5	3.1	8.2	2.3
1.4 Self-earned revenue	47.5	61.6	73.7	94.2
1.5 Transfers from other budgets	181.6	224.2	284.0	407.2
2. Local government special budget revenues	47.6	52.8	68.8	101.9
2.1 Tax on natural resources	2.2	2.2	2.6	2.6
2.2 Other revenues	54.3	59.5	92.9	125.5
of which: Grants and donations	3.5	3.3	3.5	4.0
Transfers from other budgets	25.4	26.4	39.1	67.1
Local government budget expenditures	**687.5**	**823.4**	**1,038.5**	**1,461.9**
1. Local government basic budget expenditures	631.6	764.5	965.5	1,348.8
1.1 Non-capital expenditure	540.7	640.9	781.1	1,032.4
1.2 Capital expenditure	90.9	123.6	1,84.4	316.3
1.3 Losses from the exchange rate fluctuations				0.1
2. Local government special budget expenditures	55.9	58.9	73.0	113.1
2.1 Non-capital expenditure	33.7	37.1	40.1	60.0
2.2 Capital expenditure	22.2	21.7	33.0	53.1
2.3 Losses from the exchange rate fluctuations				0.0
Financial balance	**-8.5**	**-17.7**	**-6.0**	**-33.0**

Source: The Ministry of Finance

The structure of the local government budget as a percentage of GDP

	2004	2005	2006	2007*
Local government budget revenues	**9.1**	**8.9**	**9.2**	**10.2**
1. Local government basic budget revenues	8.5	8.3	8.6	9.5
1.1 Tax revenues	5.0	4.8	5.0	5.6
1.1.1 Personal income tax	4.2	4.1	4.4	5.0
1.1.2 Taxes from property	0.8	0.7	0.6	0.5
1.1.3 Internal taxes on goods and services	0.0	0.0	0.0	0.1
1.2 Non-tax revenue	0.4	0.3	0.3	0.3
1.3 Foreign financial assistance	0.1	0.0	0.1	0.0
1.4 Self-earned revenue	0.6	0.7	0.7	0.7
1.5 Transfers from other budgets	2.4	2.5	2.5	2.9
2. Local government special budget revenues	0.6	0.6	0.6	0.7
2.1 Tax on natural resources	0.0	0.0	0.0	0.0
2.2 Other revenues	0.7	0.7	0.8	0.9
of which: Grants and donations	0.0	0.0	0.0	0.0
Transfers from other budgets	0.3	0.3	0.3	0.5
Local government budget expenditures	**9.2**	**9.1**	**9.2**	**10.5**
1. Local government basic budget expenditures	8.5	8.4	8.6	9.6
1.1 Non-capital expenditure	7.3	7.1	6.9	7.4
1.2 Capital expenditure	1.2	1.4	1.6	2.3
2. Local government special budget expenditures	0.8	0.6	0.6	0.8
2.1 Non-capital expenditure	0.5	0.4	0.4	0.4
2.2 Capital expenditure	0.3	0.2	0.3	0.4
Financial balance	**-0.1**	**-0.2**	**-0.1**	**-0.2**

* *Forecasted GDP for 2007 is LVL 13,985.8 million*

Source: The Ministry of Finance

INDEBTEDNESS

Conservative debt management is a clear objective for the Latvian Government. In Latvia, Central government debt and cash management is entrusted to the Treasury, which is subordinated to the Ministry of Finance. The main objective for central government medium term debt management has been to provide the Latvian government with the necessary financial resources at the lowest possible costs, by hedging the financial risks and taking into account the development of both the Latvian capital market and the entire financial system. In order to improve central government debt management, in 2006 the Treasury extended a three-year period for the government's 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, i.e. central government domestic debt and central government external debt is set out in the annual Law on Central Government Budget. The ceiling of central government debt outstanding at the end of 2008 specified in the central government budget is LVL 1.19 billion.

The following table sets out Latvia's outstanding central government debt in millions of LVL and as a percentage of GDP at the end of each period indicated in the table:

	2002	2003	2004	2005	2006	2007*
			(LVL million)			
Central government debt	761.6	852.6	980.6	967.6	1001.1	1031.8
External	468.5	424.0	554.9	543.7	581.5	635.1
Domestic	293.1	428.6	425.7	423.9	419.6	396.7
(As per cent. of GDP)						
Central government debt	13.2	13.3	13.2	10.7	8.9	7.4
External	8.1	6.6	7.5	6.0	5.2	4.5
Domestic	5.1	6.7	5.7	4.7	3.7	2.8
GDP (LVL million)	5,758.3	6,392.8	7,434.5	9,059.1	11,264.7	13,985.8

* *Forecasted GDP for 2007 is LVL 13,985.5 million*

Source: The Treasury

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

Central government external debt

Central government external debt comprises borrowing from international financial markets as well as from international financial institutions. Several euro denominated international bond issues have taken place in 1999, 2001 and in 2004. Currently, EUR 200 million Notes due 2008 and EUR 400 million Notes due 2014 are outstanding. As at 31 December 2007, the central government external debt was comprised of 66 per cent. of bonds from the international financial markets, 19 per cent. of European Investment bank loans, 7 per cent. of World Bank loans and 8 per cent. of loans from other international financial institutions.

Central government external debt servicing costs depend on the fluctuations of interest rates in the financial markets, although the proportion of debt with a floating interest rate is minor in the debt portfolio. Fixed rate central government debt portion in the portfolio is maintained between 60-70 per cent. and at 31 December 2007 it was close to the bottom of the corridor at 60.2 per cent.

The following tables set out the historical and projected central government external debt service payments with respect to principal and interest for the periods indicated:

	2002	2003	2004	2005	2006	2007
			Type of Payment (LVL million)			
Principal Payments	21.77	77.71	160.04	47.72	14.72	13.55
Interest Payments	23.20	24.01	22.89	24.26	27.06	26.63
Total	44.97	101.72	182.93	71.98	41.78	40.18

Source: The Treasury

Projection	2008	2009	2010	2011	2012
		Type of Payment (LVL million)			
Principal Payments	170.90	15.30	13.45	9.12	7.13
Interest Payments	28.33	35.67	40.44	45.38	44.99
Total	199.23	50.97	53.89	54.50	52.12

Source: The Treasury

The following table sets out Latvia's central government foreign currency debt broken down by currency for each of the years:

	2002	2003	2004	2005	2006	2007
			(LVL million)			
CHF	0.0	0.6	0.6	0.6	0.6	0.6
DKK	0.6	0.5	0.3	0.1	0	0
EUR	315.0	351.0	492.0	496.0	542.0	621.9
JPY	18.0	9.0	8.0	0	0	0
SEK	0.2	0.2	0.1	0.07	0.03	0
USD	120.0	54.0	51.0	38.0	31.0	25.7
XDR	9.0	3.0	0	0	0	0
Total	462.8	418.3	552.0	534.8	573.6	648.1

Source: The Treasury at book values

Central government domestic debt

Central government domestic debt is mainly comprised of tradable government securities and some short-term funding facilities (overdrafts, credit lines etc.). Historically domestic government securities were used as a basic financing instrument. A strategic emphasis is put on maintaining the development of the government domestic securities market. A significant debt management objective is to ensure that the outstanding debt in lats is not less than 25 per cent. Currently, there are 12 month short term T-bills, 2 and 5 year medium term T-bonds and 10 and 11 year long term T-bonds outstanding. Overdrafts and credit lines are used for short term liquidity management. Short term T-bills are issued at a discount and redeemed at a par on maturity. Medium and long term T-bonds are issued with a fixed interest rate (coupon paid annually) and redeemed at par on maturity. The legal issuer of government domestic securities is the Ministry of Finance, but all conditions for a new issue are set by the Treasury which acts on behalf of the Ministry of Finance. The securities are issued in dematerialised form and sold via the RSE SAXESS trading system at competitive multi-price and non-competitive (uniform price since 2002) auctions at a discount for T-bills or yield for T-bonds. All government domestic securities are registered with the LCD and the majority are listed on the RSE.

The following table shows the structure of Central government domestic debt as a percentage at 31 December 2007:

Type of Instrument	per cent.	LVL million (nominal values)
12 month T-bills	11.4	45.3
2 year T-bonds	0.6	2.2
5 year T-bonds	30.2	119.9
10 year T-bonds	53.9	213.8
11 year T-bonds	0.5	2.1
Other borrowings	3.4	13.4
Total	100	396.7

Source: The Treasury

Central government debt portfolio

Parameters	Parameters 31.12.2006		Parameters 31.12.2007		Strategy	
The share of the lats debt in the portfolio per cent.	42		37		> 25 *	
Maturity profile per cent.	< up to 1 y 13	< up to 3 y 30	< up to 1 y 22	< up to 3 y 30	< up to 1 y < 25	< up to 3 y < 50
Optimum share of fixed rate in the portfolio	64.7		60.2		60 - 70	
Duration (years)	3.07		3.38		3.25 (+/- 0.25)	
Foreign currency net debt currency composition per cent.	EUR	98.9	EUR	99.8	EUR	100% +/- 5

*if the yield of medium-term and long-term lats issues in the government domestic securities market made by the Treasury in a 6 month period is less than 100 basis points above the EUR standard (respective term EUR SWAP) rates, not later than in one year's time the minimum share of the lats debt has to be ensured at a level of at least 35 per cent.

Source: The Treasury

Central government debt has complied with the strategic parameters. In order to examine the validity of the strategic indicators set, and to determine whether the defined indicator performance levels are optimal and financially justified for the mid-term period, the Treasury has developed and applies a Cost-at-Risk model. Plain vanilla derivatives are used to meet portfolio strategic benchmarks.

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 of interest on the Notes to an individual who is a non-resident of Latvia or to a legal entity that does not maintain 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 by Non-Latvian Holders will not be subject to any Latvian income or capital gains tax, and no Latvian stamp duty, registration, transfer or similar taxes will be payable in connection with the acquisition, ownership, sale or disposal of Notes by Non-Latvian Holders providing that the sale or exchange of Notes will take place outside the territory of Latvia.

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, Belgium and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 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.

SUBSCRIPTION AND SALE

HSBC Bank plc, UBS Limited, Banca Infrastrutture Innovazione e Sviluppo, Depfa Bank plc, DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main and Skandinaviska Enskilda Banken AB (publ) (the "**Managers**") have in a subscription agreement dated 4 March 2008 (the "**Subscription Agreement**") and made between the Republic and the Managers upon the terms and subject to the conditions contained therein, agreed to subscribe and pay for the Notes at an issue price of 99.774 per cent of their principal amount less a combined management and underwriting commission of 0.04 per cent of their principal amount. The 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 are subject to U.S. tax law requirements. Subject to certain exceptions, Notes may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons. The Managers have agreed that, except as permitted by the Subscription Agreement, they will not offer, sell or deliver the Notes within the United States or to, or for the account or benefit of U.S. persons. In addition, until 40 days after commencement of the offering, an offer or sale of Notes within the United States by a dealer whether or not participating in the offering may violate the registration requirements of the Securities Act.

Selling Restrictions Addressing Additional United Kingdom Securities Laws

Each Dealer has represented, warranted and agreed that:

(a) *Financial promotion*: 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 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) *General compliance*: 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 Managers have represented and agreed that the Notes have not been registered under the Law on the Financial Instruments Market of Latvia and may not be publicly offered or sold within the territory of Latvia. The Managers have represented and agreed that they have not publicly offered or sold, and will not offer or sell, any Note within Latvia and 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 directed public selling efforts in Latvia with respect to the Notes. The Managers have further represented and agreed that they (A) have not offered or sold, and will not offer or sell, the Notes to a person who is a resident of Latvia other than in accordance with the laws of the Republic of Latvia and the Rules of the Financial and Capital Market Commission in Latvia and (B) have not delivered and will not deliver within Latvia any Notes in definitive form that are sold.

General

No action has been or will be taken in any jurisdiction by the Republic or the 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 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.

GENERAL INFORMATION

1. Under the Law on Budget and Financial Management adopted on 24 March 1994, the Treasury, on behalf of the Republic of Latvia, is entitled to borrow up to the aggregate limit of borrowing set down in the budget law for the respective year. The budget law for 2008 has set a debt ceiling outstanding of LVL 1,190.0 million for the year end 2008. The Minister of Finance, in a letter dated 3 March 2008, has confirmed that this issue of €400,000,000 5.50 per cent. Notes due 2018 does not breach the budget law for 2008.

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 for the admission to trading of the Notes on the Luxembourg Stock Exchange's regulated market. For so long as any of the Notes are admitted to trading on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange shall so require, the Republic will maintain a Paying Agent in Luxembourg. 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 Paying Agent in Luxembourg:

   (a) the Fiscal Agency Agreement;

   (b) the Subscription Agreement;

   (c) the Deed of Covenant;

   (d) certified English translations of an extract from the Law on Budget and Financial Management adopted on 24 March 1994;

   (e) the letter of the Minister of Finance dated 3 March 2008 2008 confirming that the issue of Notes does not breach the budget law for 2008;

   (f) the regulations of the Treasury of the Republic of Latvia;

   (g) the Decree of the Ministry of Finance of the Republic of Latvia No. 19 dated 9 January 2006 "On the Treasury's Authorisation"; and

   (h) the current version (relating to 2008) and any future publications (in English) of "The National Budget".

4. The Notes and any Coupons appertaining thereto will bear a legend to the following effect: "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code". The sections referred to in such legend provide that a United States person who holds a Note or Coupon will generally not be allowed to deduct any loss realised on the sale, exchange or redemption of such Note or Coupon and any gain (which might otherwise be characterised as capital gain) recognised on such sale, exchange or redemption will be treated as ordinary income.

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 (hereinafter – the Regulation) 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. The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The Notes will have the ISIN XS0350977244 and the common code 035097724.

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