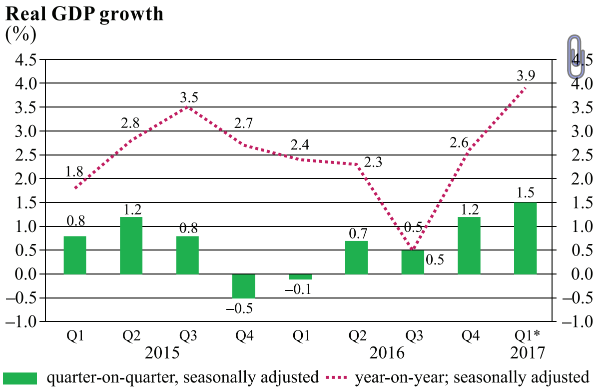
LATVIJAS BANKA
EIROSISTĒMA

LATVIJAS BANKA MONTHLY NEWSLETTER

MAY 2017

Broad-based growth drives GDP acceleration

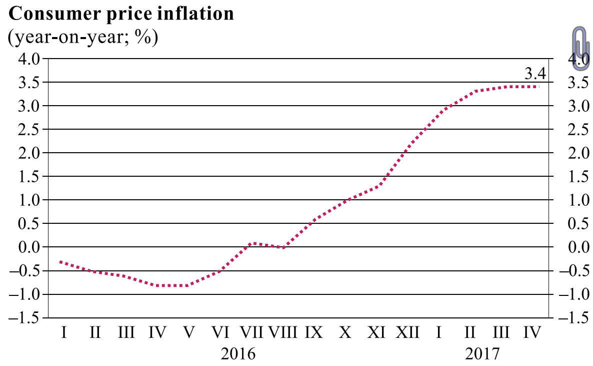


Source: CSB.
* – flash estimate.

In early 2017, gross domestic product (GDP) resumed growing at a faster pace than in previous years. This was due to relatively good results yielded by the trade and manufacturing sectors coupled with outstanding results achieved in the energy sector and the long-awaited growth in the construction industry. In the first quarter, after a prolonged contraction, construction volumes expanded by 8% year-on-year.

The beginning of the year marks the start of the medium term period when GDP growth should pick up and rise faster compared to the increase in GDP seen in recent years. A number of factors point to an acceleration of growth, i.e. the improving situation in external markets, resumption of investment activity facilitated by increased availability of EU funding, stronger credit growth and further improvements in the labour market.

Inflation has reached its upswing potential



Source: CSB.

In April, annual inflation remained unchanged at 3.4%. It was the first time in eight months that the inflation rate did not climb.

At the beginning of May, the Brent oil price dropped slightly below 50 US dollars per barrel, reaching the lowest level since November 2016, thus limiting the energy price pressure on inflation. In addition, global food prices edged down for the second consecutive month. This decline will affect retail prices of food in the coming months.

If the increased economic activity pushes up labour costs a little faster, the impact of the domestic demand on inflation, which currently is not felt, could somewhat augment. However, even in such a case, the stabilisation of world oil and food prices will keep this year's inflation close to the previously forecasted rate of 2.7%.

Increase in external demand accelerates external trade

Source: CSB.

The stabilisation of economic growth in the largest export markets, recovery in the external demand along with an improved foreign consumer confidence significantly contributed to a rise in income from exports of goods. This uptrend in the above income was also facilitated by increased competitiveness of Latvian entrepreneurs and climbing export prices at the beginning of the year.

In the first quarter of 2017, exports of goods posted a substantial increase of 10.1%, making a positive contribution to economic growth at the beginning of the year. Imports of goods picked up by 13.3% year-on-year and recorded an increase in imports of both consumer and capital goods. This suggests that domestic consumption is strengthening and activity in the investment environment is on the rise.

	Reporting period	Data (%)
Gross domestic product (GDP)		
Real GDP (year-on-year growth)	2017 Q1 *(flash estimate)*	**3.9**
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2017 Q1 *(flash estimate)*	**1.5**
03.05.2017 At the beginning of 2017, gross domestic product growth accelerates		
Public finances		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2017 IV	**0.5**
Tax revenue (since the beginning of the year; year-on-year growth)	2017 IV	**5.8**
Consumer price changes		
Consumer Price Index (CPI; year-on-year growth)	2017 IV	**3.4**
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2017 IV	**2.3**
12-month average inflation (HICP)	2017 IV	**1.4**
11.05.2017 Inflation was still high in April but will decrease soon		
Foreign trade		
Exports (year-on-year growth)	2017 III	**13.2**
Imports (year-on-year growth)	2017 III	**15.2**
10.05.2017 Under the impact of global trends, Latvian exports continue to grow		
Balance of payments		
Current account balance (ratio to GDP)	2016 Q4	**2.4**
Foreign direct investment in Latvia (net flows; ratio to GDP)	2016 Q4	**2.5**
Industrial output		
Working day-adjusted manufacturing output index (year-on-year growth)	2017 III	**7.4**
08.05.2017 Manufacturing continues to underpin economic growth		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2017 III	**1.5**
02.05.2017 Retail trade grows slowly: can we consume even more?		
Labour market		
Registered unemployment (share in working age population)	2016 IV	**7.8**
Jobseekers rate (share in working age population)	2017 Q1	**9.4**
Monetary indicators		
Resident deposits (year-on-year growth)	2017 III	**4.7**
28.04.2017 Lending to businesses picks up pace		

Sources: Treasury, CSB and Latvijas Banka.

The importance of high value added services exports is growing for Latvia's economy

Linda Vecgaile,
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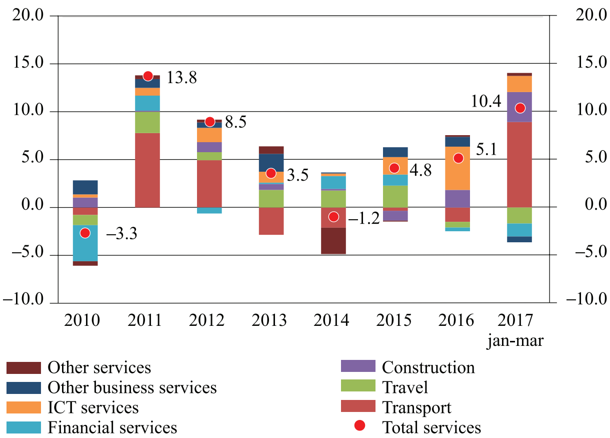
In Latvia's economy, the sectors specialising in services activities generate around 65% of total value added. Their contribution is substantial in financial terms. Services play a decisive role also from the point of view of employment: over 60% of the total number of employed are engaged in services activities. Moreover, the importance of services providing industries is amplified by the income earned from exporting respective services. For the last 10-year period, services exports have accounted for around 30% of total Latvian exports or 16% of GDP on average.

The share of services exports in total exports has not changed notably over years, yet mention should be made of the changing structure of provided services. The analysis of services export data of Latvia's balance of payments shows that for long the dominating services export groups have been as follows (in descending order of importance):

1. transport services;
2. travel services or foreign visitors' spending in Latvia;
3. other business services (primarily legal, accounting and advertising services);
4. information and communication technology (hereinafter, ICT) services;
5. financial services.

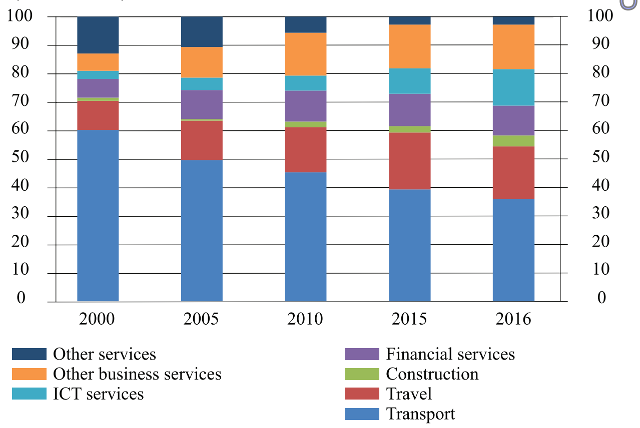
The share of transport services in total services exports has persistently been most notable. However, diversification of services exports has increased markedly, driven in the last two years by rapid expansion of services with high value added, particularly those related to ICT activities.

Year-on-year growth in services exports and contributions of services groups
(in nominal terms; %; percentage points)



Source: Latvijas Banka

Services exports
(structure; %)



Source: Latvijas Banka

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Of late, Latvia has taken special pride in ICT services exported by the country. These services have high value added which in 2016 grew particularly dynamically. Thus against 2015, exports of telecommunications services have increased by 100.6%, of computer services by 30.8%, and of information services by 22.5%. The growth is determined mainly by the external demand for these Latvian services and driven by the evolving trend of moving the IT infrastructure from Western Europe to Latvia. The most likely reasons why foreign companies are opting to move to Latvia and why the Latvian services are in high demand in foreign countries are related to three main factors – high-level IT know-how of the employed, dominating proficiency of several foreign languages, and price competitiveness of offered services.

In addition to the income from expanding ICT services exports, the income from construction services and other business services, particularly bookkeeping, auditing, accounting and tax consulting services, also increased in 2016 (by 83.0% and 7.6% respectively). On a positive note, the ICT services and construction services continued to expand also in January–March of 2017 (according to preliminary data). In addition, the income from transport services exports has also grown, thus underpinning the total export growth of 10.4%, a high of the last four years.