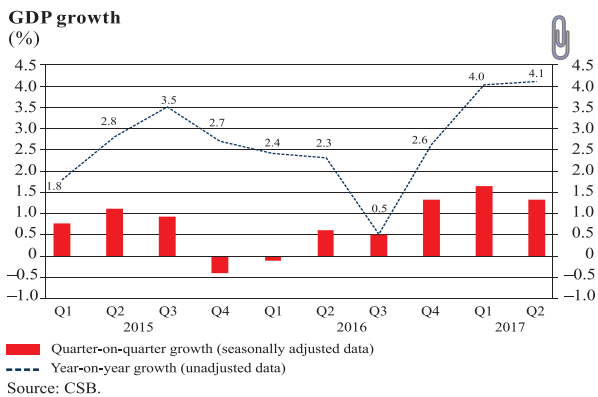




LATVIJAS BANKA
MONTHLY NEWSLETTER

AUGUST 2017

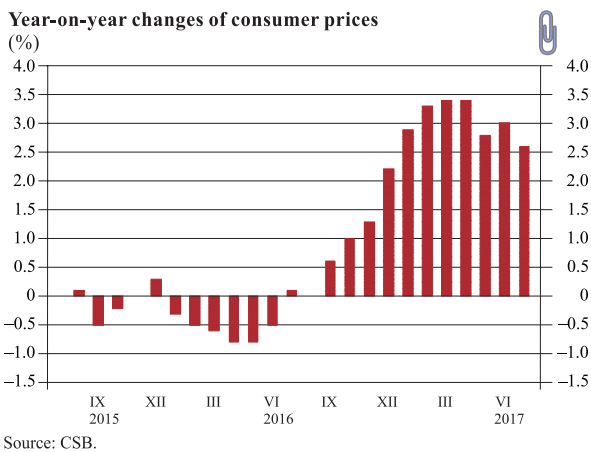
Strongest growth since 2012



The flash estimate published by the Central Statistical Bureau of Latvia, reveals that the economy has achieved the highest growth rate since the beginning of 2012. In the second quarter of 2017, unadjusted year-on-year growth of GDP was quite impressive at 4.1%. After the last year's significant drop, the growth of construction sector and investment seem to have accelerated in first half of this year. This is happening against the backdrop of a gradual recovery in the lending market and improved absorption of the EU structural funds. Supported by favourable economic conditions in major trading partners, manufacturing

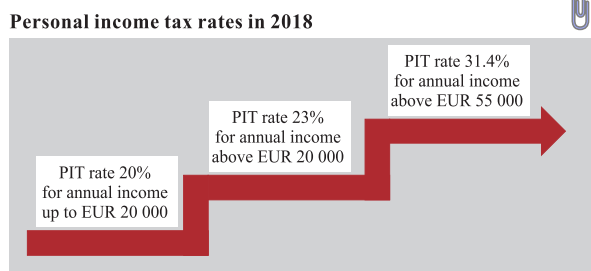
continues to be a positive contributor to growth. Retail sector has also picked up the pace in the second quarter after relatively moderate growth rates reported in the second half of 2016 and first quarter of 2017. If these trends continue to persist, GDP growth could turn out to be higher than previously expected.

Annual growth of consumer prices slightly lower in July



According to the Central Statistical Bureau data, the annual growth in consumer prices decelerated to 2.6% in July, to a level lower than that observed in June or in May. This drop can be mostly explained by the base effect: last July, housing management services became subject to VAT and hence contributed to higher consumer price growth for 12 consecutive months up to July this year. From a broader perspective, however, the inflation dynamics shows the same trends as before: world prices of several food commodities continue to rise, economic growth and labour market conditions remain favourable and the oil price is hovering around 50 US dollars per barrel.







Tax reform approaching its final stage



Parliamentary approval marks the beginning of the last stage of the "tax reform". Major changes are foreseen regarding most of the taxes, including: (a) introduction of progressive personal income tax (PIT) rates (20% for annual income up to EUR 20 000; 23% for annual income up to EUR 55 000 and 31.4% for annual income exceeding EUR 55 000); (b) 1% increase in the social security contributions;

(c) implementation of a reverse charge mechanism for value added tax on several product groups; (d) higher excise tax rates; and (e) higher minimum wage etc.

Most significant alterations will concern the corporate income tax (CIT). Currently, corporate profits are taxed annually based on the profit shown in profit and loss statement. Following the reform, reinvested profits will not be subject to CIT and only the profits distributed to stakeholders, e.g. as dividends or non-business expenses, will be taxed at a 20% rate.

| | Reporting period | Data (%) |
|---|------------------------------------|-------------|
| Gross domestic product (GDP) | | |
| Real GDP (year-on-year growth) | 2017 Q2 <i>(flash estimate)</i> | 4.8 |
| Real GDP (quarter-on-quarter growth; seasonally adjusted) | 2017 Q2 <i>(flash estimate)</i> | 1.3 |
| 01.08.2017 Economic growth in Latvia shoots up  | | |
| Public finances | | |
| General government budget expenditure (since the beginning of the year; year-on-year growth) | 2017 VII | 4.6 |
| Tax revenue (since the beginning of the year; year-on-year growth) | 2017 VII | 7.1 |
| Consumer price changes | | |
| Consumer Price Index (CPI; year-on-year growth) | 2017 VII | 2.6 |
| Harmonised Index of Consumer Prices (HICP; year-on-year growth) | 2017 VII | 1.0 |
| 12-month average inflation (HICP) | 2017 VII | 2.2 |
| 09.08.2017 Inflation abates, yet this does not mark a new trend  | | |
| Foreign trade | | |
| Exports (year-on-year growth) | 2017 VI | 12.2 |
| Imports (year-on-year growth) | 2017 VI | 25.1 |
| Balance of payments | | |
| Current account balance (ratio to GDP) | 2017 Q1 | 2.7 |
| Foreign direct investment in Latvia (net flows; ratio to GDP) | 2017 Q1 | 2.4 |
| Industrial output | | |
| Working day-adjusted manufacturing output index (year-on-year growth) | 2017 VI | 10.1 |
| 04.08.2017 Export momentum supports manufacturing in the first half of the year  | | |
| Retail trade turnover | | |
| Retail trade turnover at constant prices (year-on-year growth) | 2017 VI | 3.1 |
| 31.07.2017 Activity in retail trade is on the rise  | | |
| Labour market | | |
| Registered unemployment (share in working age population) | 2016 VII | 7.1 |
| Jobseekers rate (share in working age population) | 2017 Q2 | 8.9 |
| 16.08.2017 Unemployment: lowest in the last nine years  | | |
| Monetary indicators | | |
| Resident deposits (year-on-year growth) | 2017 VI | 2.1 |
| 28.07.2017 Households grow accruals  | | |

Sources: Treasury, CSB and Latvijas Banka.

Instant payments: experience the future today!



Harijs Ozols,
Member of the
Board of
Latvijas Banka



Deniss Filipovs,
Head of Payment
Systems Policy
Division,
Latvijas Banka

Thus Latvia will be the one of the first euro area countries to provide an instant payments infrastructure compatible with the pan-European instant payments scheme in euro.

On 28 August 2017, Latvijas Banka is launching the instant payments infrastructure for the participants of Latvijas Banka's electronic clearing system (EKS system). This will promote the development of innovative payment solutions and the use of cashless cash in Latvia. Instant payments are electronic payments and their most important benefit is that they are available 24/7/365. The money is credited to the beneficiary's account immediately (in a few seconds) and the funds are available for use at once. It does not matter which credit institution's customer you are as long as your credit institution offers instant payment services.

It is quite common nowadays for a money transfer to take hours instead of several days. Internet and smartphones provide easier access to financial services and a visit to a local branch of the bank is no longer a must. Making and receiving calls is no longer the primary function of a mobile phone and it can be used to accomplish various operations, including the management of own finances and making payments.

At the moment, the existing technological potential in the area of payments is not used to its full capacity; therefore, Latvijas Banka is introducing instant payments as of 28 August 2017. The most important benefit of those payments is that they are available 24/7/365, the money is credited to the beneficiary's account immediately – even if it is an account held with a different credit institution – and the funds are available for use at once. Thus Latvia will be the one of the first euro area countries to provide an instant payments infrastructure compatible with the pan-European instant payments scheme in euro.

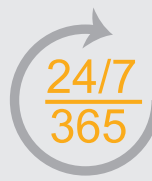
Latvijas Banka offers a secure and modern infrastructure for interbank payments and its EKS system is the only operational clearing (net settlement) system in Latvia for bulk retail credit transfers in euro. Latvijas Banka's instant payments solution is based on the existing EKS system infrastructure. It is compliant with the Single Euro Payments Area (SEPA) Instant Credit Transfer (SCT INST) scheme and will ensure interoperability with other Instant payments solutions in Europe, promoting further integration of Latvia's payment market in the euro area.

Instant payments is not only a Latvian but also a euro area project. European credit institutions will start operating within the framework of the instant payments scheme as of 21 November 2017. Thus the customers of all Latvian payment service providers (including those credit institutions which do not participate in the EKS system but will use other European solutions) will have access to instant payments and their mutual reachability across Europe will be ensured.

INSTANT PAYMENTS



INSTANT PAYMENTS: electronic payments between the customers of various banks executed **within a few seconds**.



Available **24/7/365**.

The customers of the payment service providers will be able to make instant payments in the same way as they currently make regular payments: by submitting a payment order via their internet bank, mobile bank, mobile application, e-purse as well as by using other solutions offered by the credit institutions and other payment service providers.

An instant payment is completed within a matter of seconds with the payer receiving an online confirmation that the money has been credited to the payee's account. The requirement of 24/7 availability will also apply to the participants of the instant payment service when they provide this service to their customers.

Instant payments provide significant benefits in the area of payments to individuals as well as to companies and the economy at large. For the payer, it is immediate money transfers available on a pan-European scale 24 hours a day regardless of holidays and weekends. This will reduce the individual's need of making large cash payments as well as making a payment before one actually sees the purchased goods when pre-ordering goods or purchasing them online. At the same time, being a convenient and efficient alternative for cash, instant payments will contribute to reducing the grey economy. For the payee and merchants in particular, it is the possibility to receive payment quicker and re-use the money immediately. For the country, it is more efficient cash cycle processes and better integration into the European payments area.