

**LATVIJAS BANKA**  
EIROSISTĒMA



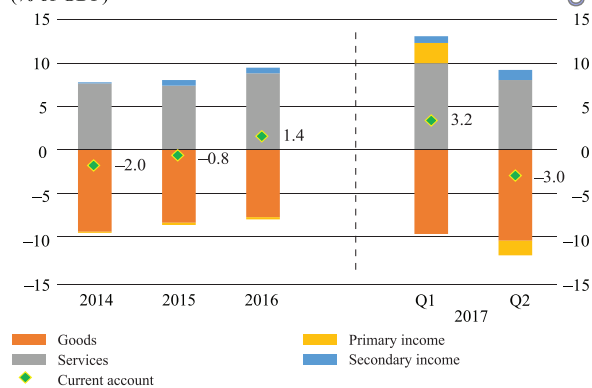
**LATVIJAS BANKA**  
**MONTHLY NEWSLETTER**

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**SEPTEMBER 2017**

## Current account reflects the recovering investment activity

**Current account balance**  
(% of GDP)



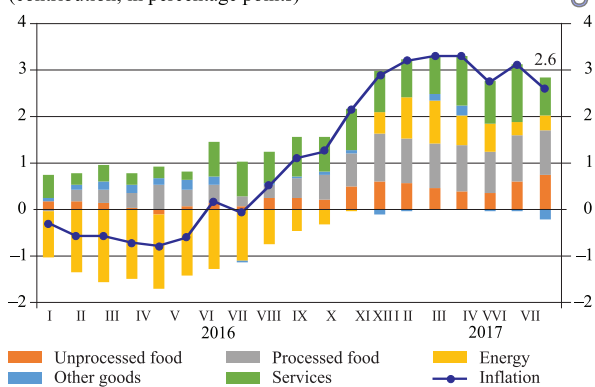
Source: Latvijas Banka.

As the recovery takes hold, imports of both goods and services expanded more than exports in the second quarter. Furthermore, smaller inflows from agricultural funds of the European Union were recorded, since a large part of the overall inflows expected this year were received already in the first quarter. This resulted in a current account deficit of 3.0% of GDP in the second quarter, whilst in the first half of the year the current account was close to balance. Overall, construction, IT and transportation (air transport in particular) were the key drivers of services exports. Transportation along with financial services were also the main contributors to the services import growth.

The main growth drivers in the case of exports of goods were prepared foodstuffs, articles of metal as well as animal products, whereas import growth was determined by higher investment activity and imports of aircraft. It is also important to note that this year exports are growing chiefly due to rising domestic exports rather than re-exports.

## Annual inflation continues hovering around 3%

**Year-on-year inflation**  
(contribution; in percentage points)



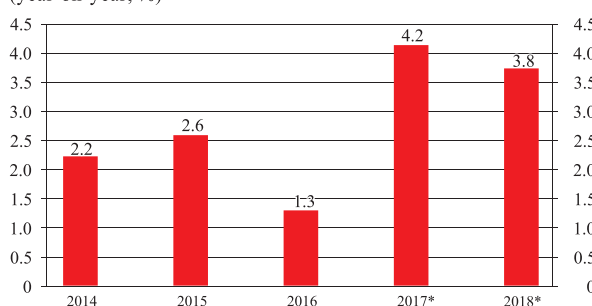
Source: CSB.

Global prices were divergent in August. Oil prices increased as OPEC's output fell and the International Energy Agency revised up its global oil demand forecasts. Concurrently, food prices decreased due to better cereal harvest forecasts, with dairy prices continuing to rise due to a higher demand for butterfat in Europe and North America. Overall, food prices remain the largest contributor to the year-on-year inflation in Latvia. Albeit fluctuating, core inflation (inflation excluding the direct impact of food and energy prices) is also on the rise this year. This reflects the increasing impact of domestic demand on inflation, which is an expected consequence, considering that unemployment is currently below the natural rate and

salaries are steadily rising. According to the September forecast of Latvijas Banka, inflation is to stand at 2.9% this year and 2.8% in 2018.

## GDP growth exceeds expectations and leads to revised forecasts

**GDP growth**  
(year-on-year; %)






Source: CSB and forecasts by Latvijas Banka.  
\* Latvijas Banka forecasts.

This year the Latvian economy is growing at rates well above those seen in the last couple of years (4.0% year-on-year growth (in non-adjusted terms) in the first and second quarters). A pick-up was expected after a weak 2016, but the pace is faster than projected. Cyclical recovery is observed throughout Europe resulting in growth of Latvian exports and a related commendable performance of the manufacturing sector. Furthermore, investment is rebounding swiftly from the lows observed in 2016 due to both higher private investor activity and better absorption of EU funds. Consequently, in September Latvijas Banka

increased the growth forecasts from 3.3% to 4.2% in 2017, and from 3.4% to 3.8% in 2018 (in non-adjusted terms). However, in order to achieve higher growth and living standards in the long-term, the supply-side capacity needs to be boosted. One key element is the labour market, where some tensions are already forming as evidenced by the high wage growth. Another potential growth bottleneck is investment which, despite currently increasing, is still at a rather low level.



	Reporting period	Data (%)
<b>Gross domestic product (GDP)</b>		
Real GDP (year-on-year growth; seasonally adjusted)	2017 Q2	4.8
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2017 Q2	1.2
04.09.2017 <a href="#">Growth shifting into higher gear</a> 		
<b>Public finances</b>		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2017 VIII	4.7
Tax revenue (since the beginning of the year; year-on-year growth)	2017 VIII	7.5
<b>Consumer price changes</b>		
Consumer Price Index (CPI; year-on-year growth)	2017 VIII	3.2
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2017 VIII	2.0
12-month average inflation (HICP)	2017 VIII	2.4
11.09.2017 <a href="#">Because of hurricane destruction in the USA, we will pay a few more cents for fuel</a> 		
<b>Foreign trade</b>		
Exports (year-on-year growth)	2017 VII	6.9
Imports (year-on-year growth)	2017 VII	20.5
13.09.2017 <a href="#">Stable growth in partner countries helps export growth</a> 		
<b>Balance of payments</b>		
Current account balance (ratio to GDP)	2017 Q2	-3.0
Foreign direct investment in Latvia (net flows; ratio to GDP)	2017 Q2	2.4
05.09.2017 <a href="#">Current account deficit totalled 203.7 million euro or 3.0% of GDP in the second quarter of 2017</a> 		
<b>Industrial output</b>		
Working day-adjusted manufacturing output index (year-on-year growth)	2017 VII	8.2
<b>Retail trade turnover</b>		
Retail trade turnover at constant prices (year-on-year growth)	2017 VII	3.9
<b>Labour market</b>		
Registered unemployment (share in working age population)	2016 VIII	6.9
Jobseekers rate (share in working age population)	2017 Q2	8.9
29.08.2017 <a href="#">Steady wage growth confirms the first signs of economic overheating</a> 		
<b>Monetary indicators</b>		
Resident deposits (year-on-year growth)	2017 VII	2.5
28.08.2017 <a href="#">Lending continues to foster stable growth</a> 		

Sources: Treasury, CSB and Latvijas Banka.

## Latvia 2017: back to growth and structural reforms



**Mārtiņš Grāvītis,**  
Communication  
project manager,  
Latvijas Banka

**Latvia's economic growth reached 4.0% in the second quarter (in non-adjusted terms), which is the highest level in the last five years. In general, this acceleration in growth is positive: its pace is far from the exaggerations of the super-charged growth of 2005-2007. The recovery from the recent low growth period is finally gaining momentum.**

The recovery of Latvia's national economy is determined by a growing range of factors. Underpinned by the strengthening of both the external and the domestic demand, following the episodes of overheating and the global financial crisis, a cyclical recovery from low growth is observed.

**It is also encouraging that the government, which has already received recognition from the OECD for the work done on structural reforms, keeps them on the agenda. Reforms must continue, especially in maintaining the labor market capacity.**

Moreover, such a growth rate is quite characteristic of a country developing from a lower base, with income levels lagging behind the EU average. At the moment, we can say that the good times have arrived again in the Latvian economy.

This is a point where the policy makers have to remember that we should avoid pro-cyclical fiscal policy. It is also encouraging that the government,

which has already received recognition from the OECD for the work done on structural reforms, keeps them on the agenda. Reforms must continue, especially in maintaining the labor market capacity.

This will help to reduce the constraints on the supply side of the economy, so that the economic growth is not hampered by a shortage of workers, lack of qualifications or health issues. Mass immigration is not a solution for Latvia in such circumstances as we already have our own low-skilled people, who swell the dole queues.

What remains to be done are reforms aimed at improving the human capital. To put it simply, for the sake of shaping a more efficient and healthy workforce, the government is steering changes in education, health care and its financing, considering the introduction of a national health insurance scheme.

The unemployed, including the long-term unemployed, should be pushed back into jobs. This should be done with due consideration rather than by mechanically increasing the government funding for retraining. A better result should be achieved within the existing resources, by changing the priorities and spending the public funds in a wise manner.

