

**LATVIJAS BANKA**
EIROSISTĒMA

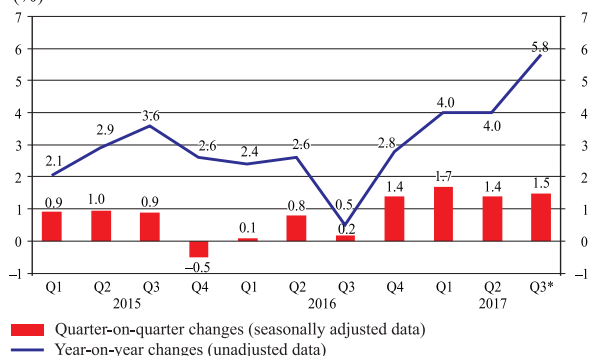


LATVIJAS BANKA
MONTHLY NEWSLETTER

NOVEMBER 2017

GDP - Growth rate accelerated in a number of sectors

GDP at constant prices (calendar adjusted) and quarterly (seasonally adjusted) changes (%)



* – flash estimate.

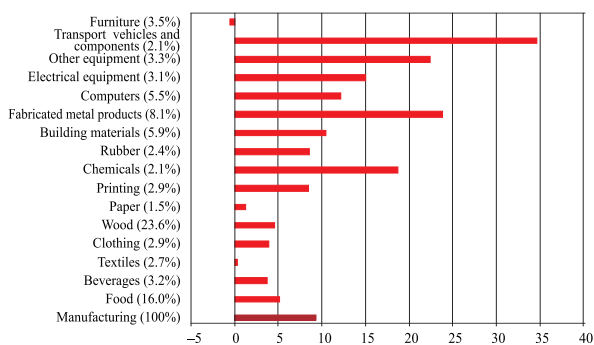
Sources: CSB, Latvijas Banka's calculations.

The flash estimate of the Central Statistical Bureau suggests that the third quarter of 2017 saw **GDP** growth by 5.8% year-on-year (non-adjusted) and by 1.5% quarter-on-quarter (seasonally adjusted). **Construction** has recovered as a result of the renewed availability of European Union (EU) funds and the growing private investment. With the absorption of EU funds continuing and increasing, construction volumes will most likely grow further next year. In addition, **retail trade** turnover growth points to a solid increase in purchasing power and consumption. Furthermore, in the third quarter, **goods exports** picked up by 7.7% year-on-year. The good performance of goods exports is associated with the strengthening of external demand

and rising global prices. Moreover, an increase in foreign and domestic demand has a positive effect on the **manufacturing industry**.

Manufacturing has maintained dynamic growth

Volume indices in manufacturing sub-sectors (Q3 2017; output weights; %)



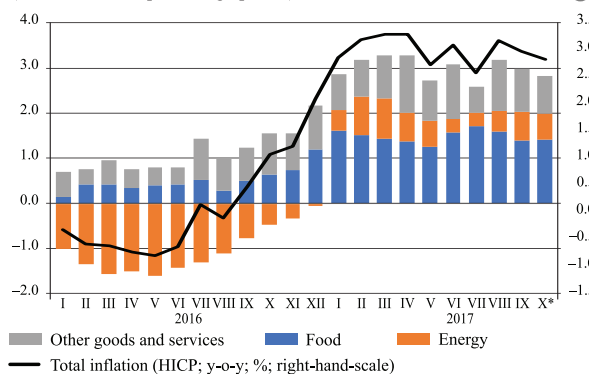
Sources: CSB, Latvijas Banka's calculations.

In the third quarter, manufacturing output increased substantially by 9.3% year-on-year in calendar adjusted terms. Development was driven by both higher external demand and, to an increasingly greater extent, growing domestic demand, largely in construction. The construction-related manufacturing sectors such as manufacture of fabricated metal products and building materials as well as the wood industry developed rapidly in the third quarter. At the same time, external markets have been mostly interested in food, chemical products, pharmaceutical preparations, electrical equipment, fabricated metal products, transport vehicles and their components.

The level of investment in manufacturing is comparatively low, whereas capacity utilisation in some sub-sectors is at its historical highs or approaching. Therefore, investment in the productive sector as well as in education and health of human capital is becoming increasingly more important.

Prices are on the rise, albeit at a slower pace

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








* based on Consumer Price Index data for October.

Sources: CSB, Latvijas Banka's calculations.

In October, the annual rate of inflation continued on its downward trend reaching 2.8% mainly due to the deceleration in the growth rate of food prices. The monthly rise in food prices was affected by seasonal factors in October. In annual terms, the main driver behind the high food prices is the rise in global prices. Energy prices continued to go up in October on account of the rising oil prices. Since October last year, transport costs have grown significantly, including an increase in fuel prices by 5.6% and an uptrend in insurance prices by 51.7%. Core inflation remains stable. In the future, the rise in core inflation will be affected by higher wages and salaries, which, in addition to the increase in the minimum wage planned

by the government, will be influenced by the limited availability of labour.

	Reporting period	Data (%)
Gross domestic product (GDP)		
Real GDP (year-on-year growth; seasonally adjusted)	2017 Q3 <i>(flash estimate)</i>	6.2
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2017 Q3 <i>(flash estimate)</i>	1.5
03.11.2017 The GDP estimate suggests accelerated economic growth in Latvia 		
Public finances		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2017 X	6.1
Tax revenue (since the beginning of the year; year-on-year growth)	2017 X	7.6
Consumer price changes		
Consumer Price Index (CPI; year-on-year growth)	2017 X	2.8
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2017 X	1.5
12-month average inflation (HICP)	2017 X	2.8
09.11.2017 Prices are on the rise, albeit at a slower pace 		
Foreign trade		
Exports (year-on-year growth)	2017 IX	7.7
Imports (year-on-year growth)	2017 IX	18.4
Balance of payments		
Current account balance (ratio to GDP)	2017 Q2	-3.0
Foreign direct investment in Latvia (net flows; ratio to GDP)	2017 Q2	2.4
Industrial output		
Working day-adjusted manufacturing output index (year-on-year growth)	2017 IX	7.1
06.11.2017 A déjà vu in manufacturing 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2017 IX	4.9
Labour market		
Registered unemployment (share in working age population)	2016 X	6.6
Jobseekers rate (share in working age population)	2017 Q3	8.5
21.11.2017 Unemployment remains below its natural rate 		
Monetary indicators		
Resident deposits (year-on-year growth)	2017 IX	0.8
27.10.2017 Structural changes in the banking sector shuffle the data, but leave the trends unaltered 		

Sources: Treasury, CSB and Latvijas Banka.



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Does the financing from the EU structural funds improve the competitiveness of Latvian businesses?

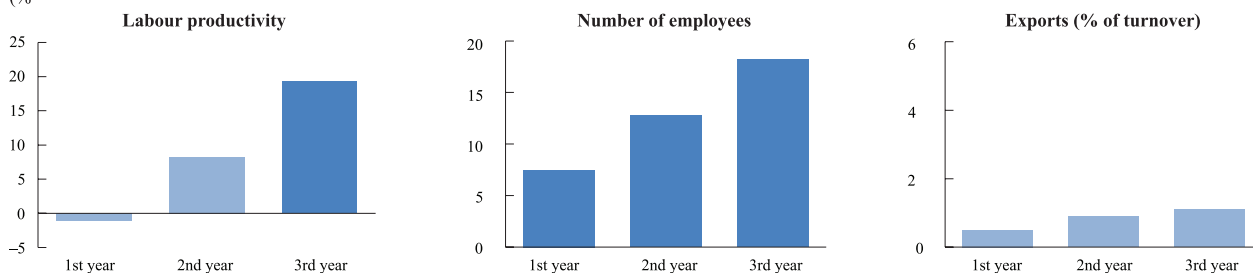
The absorption of the ERDF funds would have a stronger impact on the performance of Latvian businesses if they had sufficient knowledge regarding the use of the newly acquired equipment, the projects were more consistent with the goal and the businesses had more possibilities to expand their sales in the international market.

The European Regional Development Fund (ERDF) is an instrument of EU structural funds. One of its goals is to enhance the competitiveness of private companies in the less developed regions of the Union. So far, we have not had sufficient evidence on the progress towards this goal since there has not been enough firm-level data for conducting such micro-level studies. However, owing to the fact that currently such data is available in Latvia, Latvijas Banka conducted a study. It showed that businesses participating in the activities financed by the ERDF see an increase in the number of employees, capital as well as productivity, albeit productivity growth is evident only in the third year as from the inception of the project (see Chart). Neither the location of a project nor the type of activity affect the increase in the number of its employees, capital intensity or productivity.

The immediate positive impact on the capital without simultaneous productivity growth may, at first, seem surprising. This is only possible in the case where the utilisation of newly installed production equipment has not been optimal in the first two years following the project's inception. However, it could also happen that the productivity gains generated from the project become really apparent only towards the conclusion stage of the project. This is especially true for projects with a long period of implementation. Moreover, the low level of capital utilisation after purchasing the equipment may also suggest a lack of knowledge and experience necessary for the use of the newly acquired technology.

Businesses participating in the activities financed by the ERDF see an increase in the number of employees, capital as well as productivity.

Chart
Mean values of differences in changes in firm performance indicators among businesses participating in ERDF co-financed projects and non-beneficiaries (%)



Note. The light blue colour denotes statistically insignificant mean values; the dark blue colour denotes statistically significant mean values (the minimum level of statistical significance is 10%).

An alternative explanation could be that the businesses may lack access to wider export markets which would allow them to realise their potential to a greater degree. This may be supported by our estimations suggesting that businesses, as they engage in ERDF co-financed projects, do not increase the share of exports in their turnover (see Chart). In view of the direct goal of several ERDF projects, i.e. the penetration into external markets foreseeing participation in international exhibitions and other external marketing activities, this result is quite surprising. From the economic policy point of view, more significant improvements in productivity would result from supporting activities stimulating closer involvement of businesses in international markets.