

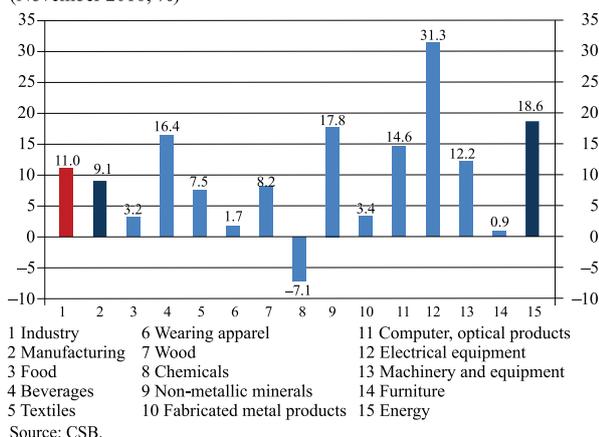


LATVIJAS BANKA
MONTHLY NEWSLETTER

JANUARY 2017

Macroeconomic recovery expected in 2017

Annual percentage changes in volume of manufacturing output
(November 2016; %)

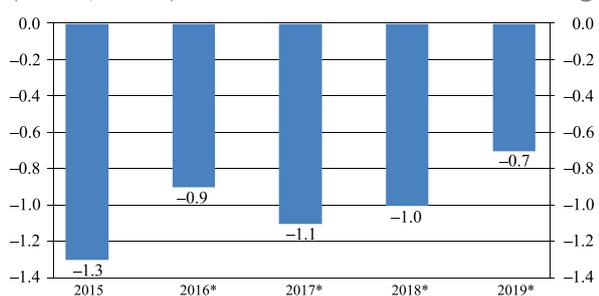


Latvia's economic growth projections for 2016 remain prudent at around 1%, yet a higher rate of 3.0% is expected in 2017. In November 2016, the volume of output in manufacturing increased by 11.0% year-on-year continuing the positive trend from the previous months. Across the sub-sectors, respectable results were reported by the wood industry and the production of construction materials with their respective year-on-year growth rates at 8.0% and 18.0%, the latter pointing to a potential recovery in the construction sector. Exceptional growth at 19.0% was also observed in the energy sector. The strong performance of the manufacturing sector was reflected by the growth of nominal exports following a positive annual trend. The positive data on the fourth quarter of 2016 (two-month data) could point to an imminent recovery of the overall economy.

In 2017, risks will be mostly related to acceleration of the absorption of the EU funds. It has a significant positive effect on the GDP, yet the timing of the EU investment inflows benefitting the economy remains uncertain. On the other hand, as an indirect effect, higher public sector expenditure may result in an increase of domestic demand.

Budget deficit target met; financing of priorities in 2017

General government budget balance
(% of GDP, ESA 2010)

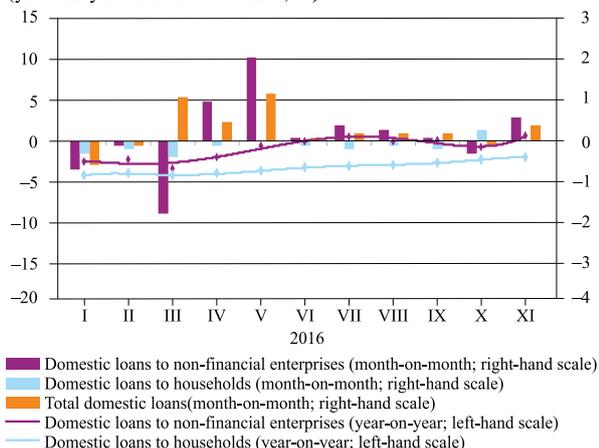


The annual growth rate of revenue from taxes is expected to exceed 5% in 2016, reaching the budget target and considerably outpacing the economic growth. The main drivers of revenue windfalls have been "profit-related-taxes" and excise duty. In addition, there were expenditure shortfalls influenced by the delayed implementation of EU projects and lower expenditure on goods and services due to a lag in the election cycle. Hence, the budget deficit target at 0.9% of GDP is likely to be met.

The Latvian government is committed to keep the budget deficit low in 2017, at 1.1% of GDP. The general government spending will grow by 8.3%, and the entire increase will be allocated to priority sectors such as the financing for educational and health reforms, while the spending on national defence will reach 2% of GDP already in 2018.

Stable growth in both loans and deposits

Loan developments
(year-on-year/month-on-month; %)



In November, a moderate increase in banks' balance sheets was observed both in terms of loans granted and deposits received. The annual growth of total domestic loans reached 2.3% in November, representing the highest year-on-year increase since April 2009. Overall 2016 was marked by a substantial change: the prolonged period of post-crisis stagnation in lending ended. With the annual rise in new loans exceeding 30.0%, the corporate loan portfolio resumed growth. The same development can probably be expected in the household sector in 2017.

Bank deposits by households and non-financial enterprises increased, with the overall year-on-year growth rate at 8.1%, whereas those by financial institutions, particularly by pension funds, decreased.

	Reporting period	Data (%)
Gross domestic product (GDP)		
Real GDP (year-on-year growth)	2016 Q3	0.3
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2016 Q3	0.2
Public finances		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2016 XII	-0.3
Tax revenue (since the beginning of the year; year-on-year growth)	2016 XII	6.0
Consumer price changes		
Consumer Price Index (CPI; year-on-year growth)	2016 XII	2.2
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2016 XII	2.2
12-month average inflation (HICP)	2016 XII	0.1
12.01.2017 Inflation rises faster than expected 		
Foreign trade		
Exports (year-on-year growth)	2016 XI	3.4
Imports (year-on-year growth)	2016 XI	3.2
13.01.2017 November was a record month in the export of wood products 		
Balance of payments		
Current account balance (ratio to GDP)	2016 Q3	1.5
Foreign direct investment in Latvia (net flows; ratio to GDP)	2016 Q3	3.6
Industrial output		
Working day-adjusted manufacturing output index (year-on-year growth)	2016 XI	9.1
04.01.2017 In November, good results in manufacturing, outstanding in the energy sector 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2016 XI	4.6
Labour market		
Registered unemployment (share in working age population)	2016 XII	8.4
Jobseekers rate (share in working age population)	2016 Q3	9.5
Monetary indicators		
Resident deposits (year-on-year growth)	2016 XI	8.1
29.12.2016 Stable growth in both loans and deposits in November 		

Sources: Treasury, CSB and Latvijas Banka.

The tourism industry in Latvia as a mirror of the economy

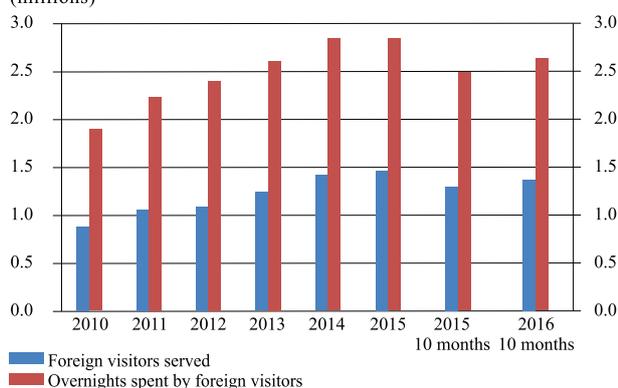


Linda Vecgaile,
Economist,
Latvijas Banka

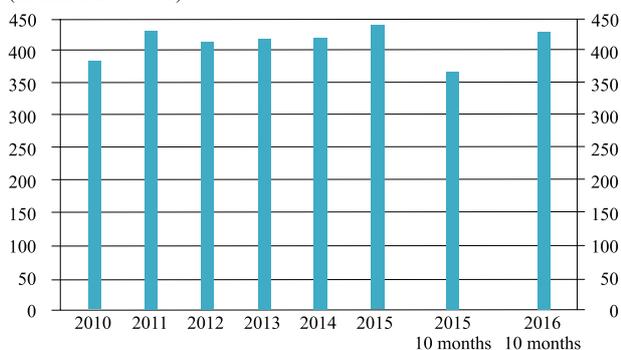
Tourism in Latvia has shown a positive development recently which is good news since it is related to many industries of the national economy, thus affecting positively the general economic trend. The tourism data, for example, those concerning the number of tourist arrivals in Latvia and the number of nights spent by foreign visitors, show an upward trend.

According to preliminary data for the first 10 months of 2016, the respective increase stands at 6.2% and 5.7% compared to the corresponding period in the previous year. Moreover, one can see that not only the income of the tourism sector is on the rise, but also residents' private spending abroad shows an increase of 16.7%. Could travelling activities point to improvement of economic welfare in Latvia?

Number of visitors and nights spent in hotels and other accommodation establishments (millions)



Residents' travel expenditure abroad (in millions of euro)



If we look at Latvia's balance of payments data on imports of services covering residents' expenditure abroad, we can see that they also point to an upward movement. The increase in spending in Lithuania, the US, Denmark and Norway has been the main contributor to the above trend. Overall, the majority of spending has been reported in Lithuania, Germany, the United Kingdom and Russia. If spending abroad rises, on the one hand, it could be assumed that this implies an increase in free financial resources. On the other hand, travelling abroad is often affected not only by material values like increased or decreased income, but also by different psychological aspects which are not always easy to quantify and capture visually.

To conclude, although changes in the tourism-related macroeconomic data can be used to measure the overall economic sentiment rather than to make strict conclusions, the favourable developments in both exports and imports of tourism, however, suggest positive trends in Latvia's economy.

The institutions related to tourism are active in attracting visitors from abroad, and the media more often report on the progress achieved. Despite the fact that no significant international events such as those seen over the last two years (the status of Riga as the European Capital of Culture in 2014 and the Latvian Presidency of the EU Council in 2015) were organised in Latvia in 2016, the positive trend towards a flourishing tourism sector continues. This is reflected in the increasing number of both foreign visitors and nights spent by foreign visitors if we compare with the previous year. In 2014, the declining number of Russian visitors in Latvia contributed to the worsening of the tourism data. This was a result of the deceleration of Russia's economy and the dramatic depreciation of the Russian ruble against the euro. However, the deterioration came to a halt in 2016, and the first nine months of 2016 showed an upward trend compared with the previous year. This has been in terms of both the number of Russian visitors increasing by 0.9% and the duration of their stay – by 4.4%. In addition, there have been changes in the composition of hotel guests, with the reduced share of tourists from Russia being offset by the rising number of travellers from EU countries, particularly Finland, the United Kingdom, Germany, Lithuania, and from the US.

The number of tourist arrivals in Latvia and the number of nights spent by foreign visitors, show an upward trend. In addition, residents' travel related spending abroad also shows an increase. The favourable developments in both exports and imports of tourism suggest positive trends in Latvia's economy.