



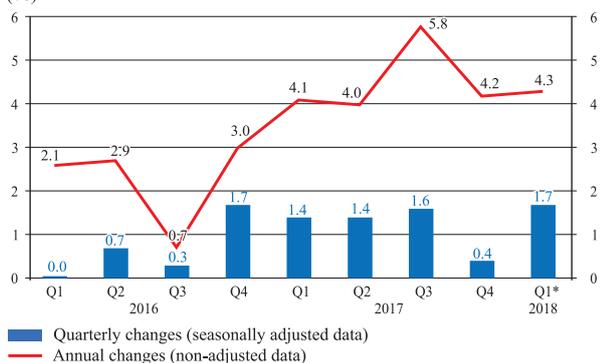
**LATVIJAS BANKA**  
**MONTHLY NEWSLETTER**

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**MAY 2018**

## Growth is still strong

**GDP at constant prices**  
(%)



\* – flash estimate.

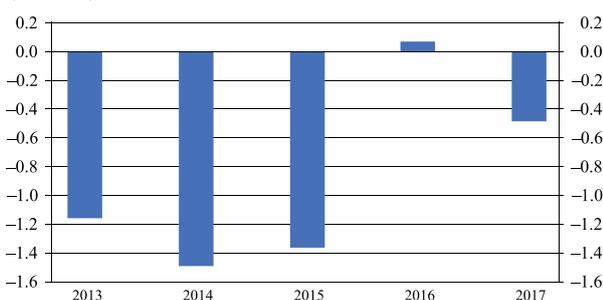
Source: CSB.

The flash estimate of the Central Statistical Bureau suggests that the first quarter of 2018 saw **GDP** growth of 4.3% year-on-year (non-adjusted data) and of 1.7% quarter-on-quarter (seasonally adjusted data). **Construction** expanded by 35% year-on-year on account of further development of private projects and those related to EU funds. **Retail sales** rose by 5% year-on-year, pointing to steadily growing private consumption. In nominal terms, **exports of goods** increased by 6.6% year-on-year, primarily owing to strong exports of machinery and electrical equipment, articles of wood and food products. **Manufacturing** posted a broad-based increase by 4.5% year-on-year, with almost all subsectors continuing to report growth.

The largest year-on-year upswing was observed in the following subsectors: the manufacture of motor vehicles, trailers and semi-trailers – 29.3% the manufacture of electrical equipment – 22.7% and the manufacture of chemical products – 16.7%. The major economic challenges relate to a gradual tightening in Latvia's labour market and elevated downside risks to the global outlook due to trade and geopolitical tensions.

## Revenue grew faster than expenditure in the first quarter of 2018

**General government budget balance**  
(% of GDP)



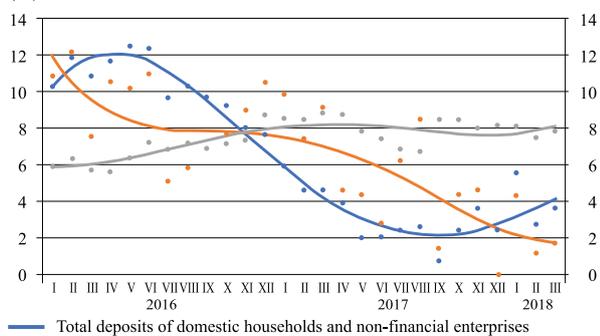
Source: Ministry of Finance.

In 2017, the general government budget balance recorded a deficit of 0.5% of GDP. Despite the surge in revenue generated by both direct and indirect taxes, the budget balance returned to a deficit after posting a small surplus in 2016. Deterioration of the budget balance is partly attributable to recovery of EU structural funds and the one-off payment to electricity producers. In the first quarter of 2018, the budget balance turned into a financial surplus of 228 million euro due to good tax revenue and payments received from the European Commission to cover expenses related to the implementation of EU-funded projects. Direct tax revenue is expected to decrease in

2018 on account of recent changes in corporate income tax and personal income tax legislation. Given these legislative changes and continuous recovery of government investment, the general government budget deficit is expected to remain broadly unchanged.

## Domestic deposits have resumed growth

**Annual changes in domestic deposits**  
(%)



Source: Latvijas Banka.

In March 2018, both businesses and households increased their domestic deposits by 0.5% month-on-month, with the annual growth rate moving up by 0.9 percentage points to reach 3.7%. The domestic loan portfolio of non-financial corporations and households had remained broadly unchanged already for the third consecutive month. The annual rate of decrease was 0.5%<sup>1</sup> in March 2018. New loans to both non-financial corporations and households posted slightly higher levels than in February 2018, albeit did not reach the amounts recorded in March 2017. **Lending recovery is still slow; nevertheless, economic development requires financing.** The results of the euro area bank lending survey conducted in April 2018 suggest positive trends in the demand for loans.

<sup>1</sup> Data exclude one-off effects due to structural changes in the banking sector.

	Reporting period	Data (%)
<b>Gross domestic product (GDP)</b>		
Real GDP (year-on-year growth, seasonally and calendar adjusted)	2018 Q1 <i>(flash estimate)</i>	<b>5.2</b>
Real GDP (quarter-on-quarter growth, seasonally adjusted) 08.05.2018 <a href="#">Rapid GDP growth like in spring, with moderation to follow</a>	2018 Q1 <i>(flash estimate)</i>	<b>1.7</b>
<b>Public finances</b>		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2018 IV	<b>8.8</b>
Tax revenue (since the beginning of the year; year-on-year growth)	2018 IV	<b>8.7</b>
<b>Consumer price changes</b>		
Consumer Price Index (CPI; year-on-year growth)	2018 IV	<b>2.0</b>
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2018 IV	<b>2.1</b>
12-month average inflation (HICP) 14.05.2018 <a href="#">Inflation moves up moderately in April</a>	2018 IV	<b>2.5</b>
<b>Foreign trade</b>		
Exports (year-on-year growth)	2018 III	<b>-6.1</b>
Imports (year-on-year growth)	2018 III	<b>0.2</b>
<b>Balance of payments</b>		
Current account balance (ratio to GDP)	2017 Q4	<b>1.6</b>
Foreign direct investment in Latvia (net flows; ratio to GDP)	2017 Q4	<b>-1.0</b>
<b>Sectoral performance</b>		
Working day-adjusted manufacturing output index (year-on-year growth) 08.05.2018 <a href="#">Manufacturing struggles not to fall from the last year's peaks</a>	2018 III	<b>1.5</b>
Retail trade turnover at constant prices (year-on-year growth) 03.05.2018 <a href="#">2018 started with good news for retail trade</a>	2018 III	<b>6.5</b>
<b>Labour market</b>		
Average monthly wage (year-on-year growth)	2018 Q1	<b>7.5</b>
Jobseekers rate (share in working age population) 24.05.2018 <a href="#">The temperature on Latvia's labour market: comfortable for the country's economic growth</a>	2018 Q1	<b>8.2</b>
<b>Monetary indicators</b>		
Resident deposits (year-on-year growth)	2018 III	<b>3.7</b>
Loans to residents (year-on-year growth) 02.05.2018 <a href="#">Domestic deposits have resumed growth</a>	2018 III	<b>-2.9</b>

Sources: Treasury, CSB and Latvijas Banka.

## Is Latvia's residential construction ready to pick up?



**Guntis Kalniņš,**  
Senior Economist,  
Latvijas Banka

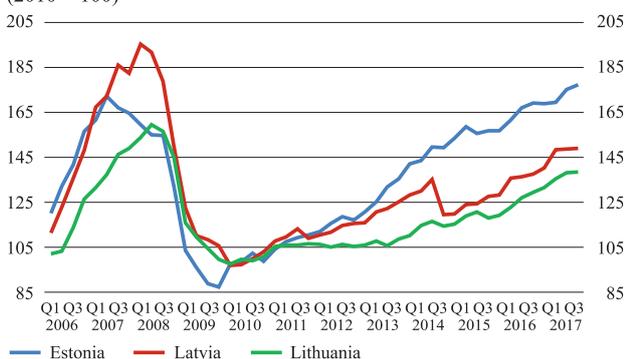


**Kristofers Pone,**  
Economist,  
Latvijas Banka

**In recent years, dwelling construction in Latvia has lagged behind that of its Baltic neighbours. Increasing income in Latvia and comparatively poor housing conditions point to unsatisfied demand for higher quality apartments.**

Over the past years, housing prices in Latvia have been on a steady rise. They, compared to its Baltic peers, have increased faster than in Lithuania but have trailed behind Estonia since 2010. It is only in Estonia that prices have exceeded the highs of 2007–2008. The current housing price levels are lower in other Baltic countries, especially in Latvia.

**House price index**  
(2010 = 100)

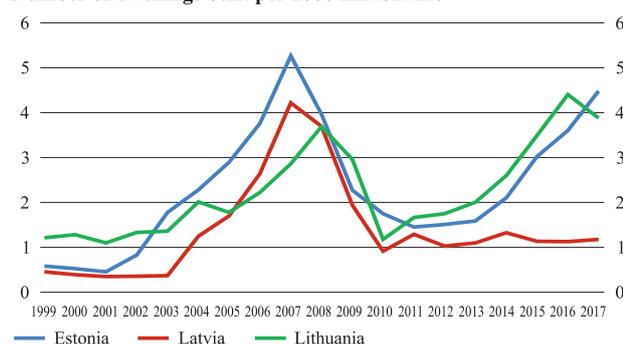


Sources: Central Statistical Bureaus of the mentioned countries.

However, the prices of newly-built dwellings in Latvia have already reached the pre-crisis levels. According to price information provided by real estate companies, market prices for new dwellings in Riga lag behind those in Tallinn but exceed those in Vilnius where the construction of budget class apartments is more active. A faster pace of price growth in Latvia that continued until the third quarter of 2014 has been attributed to the increased demand from residence permit seekers for real estate investment in exchange for residence permits.

The non-resident demand sparked construction in the high price segment up to the end of 2014, but overall Latvia has been lagging behind its neighbours in dwelling construction investment in the post-crisis period. Thus, the supply of new apartments has been limited, and the potential home buyers have been put in a price taker position, backing the resumption of house price growth since 2015. The largely overlooked demand for budget class dwellings has put upward pressure on prices of the soviet-time apartments as well.

**Number of dwellings built per 1000 inhabitants**



Sources: Central Statistical Bureaus of the mentioned countries.

Lack of investment, especially in the post-crisis period, has left Latvia with the highest proportion of soviet-time buildings in the housing stock among Baltic countries. Quite expectedly, the reported condition of dwellings is also the lowest in Latvia with higher overcrowding rate and lower overall housing quality.

**However, the rising income in Latvia provides an opportunity for people to improve their living conditions.**

In addition, the state support programme for house purchase for families with children is being implemented by the Development Finance Institution ALTUM since 2015. In 2018, this programme has been complemented by the inclusion of young professionals as well. The support programme is aimed at helping the above families and professionals to purchase their first housing (state-backed loan for making a reduced first down payment). This measure helps to stoke new mortgage lending, which has started to pick up in the last couple of years. Developers recognise the potential of residential construction, particularly in the budget class dwelling segment. This is evidenced by the rising number of construction permits issued for the construction of multi-apartment buildings since 2016.