

Latvia's Macro Profile

January 2019



Latvia's Economic Developments and Outlook

Last year's growth – robust and balanced

Latvia's economic growth was robust and balanced in 2018, retaining the momentum achieved already in 2017. It continued to be driven by domestic demand underpinned by robust wage and employment growth, strong investment flows as well as fiscal policy support. The Eurosystem's monetary policy stance remained accommodative, ensuring favourable financing conditions to economic agents. Despite stable economic growth and low level of private sector indebtedness as well as sound performance indicators of the domestic lenders, credit growth remains subdued. Investment was mostly financed from the European Union (EU) funds and own funds of businesses in 2018. In the course of the year, economic growth decelerated in several Latvia's trade partners, and the economic and geopolitical risks associated with the external developments remain significant. This is likely to weaken the economic growth momentum in 2019.

GDP growth expected to exceed 3%

Nevertheless, Latvijas Banka remains optimistic with regard to Latvia's economic growth prospects: its GDP growth forecast for 2018 has been upgraded considering the high rates reported in the first three quarters of 2018. The future outlook, however, remains broadly unchanged. Against the background of a weakening external demand, GDP growth is projected to decelerate gradually in the coming years, albeit still remaining above 3%. We expect that actual output will slightly exceed the potential over the forecasting horizon. The positive output gap, however, is going to narrow as also the domestic demand is likely to moderate somewhat as a result of a negative impetus from external demand.

Several high technology sectors with a good export potential gathering strength

Against the background of weakening external demand, manufacturing and export growth are expected to decelerate. Meanwhile, several export-oriented high technology production and services sectors (information and communication services, manufacture of electronic and electrical equipment) have improved their performance considerably over the past years and their contribution to economic growth is expected to increase further. At the same time, the performance of transport services is likely to weaken in comparison with the good results achieved in 2018, due to Russia increasingly rerouting freight flows to its own ports. With significant investment made into its development, passenger transportation by air is expected to continue growing steadily. In the circumstances of a weaker external demand, the role of domestic demand in supporting economic growth will increase. EU funds inflows and private investment will continue to support the development of the real estate and construction sectors in the coming years. With the growth of employment and wages gradually decelerating, however, the expansion of private consumption and retail trade could also moderate.

Inflation consistent with economic recovery

Strong economic growth gradually increases the domestic pressure on consumer prices, although not as quickly as previously expected. The current and projected annual inflation ranging between 2–3% reflects a healthy economy and sustainable income convergence as well as the fact that the economy is operating slightly above its potential.

Wage growth expected to moderate

Strong economic growth and shrinking unemployment are pushing up wages. At the same time, Latvia's export market share continues to expand, together with healthy and growing profit margins in the tradable sector pointing to sustainable competitiveness. Although we expect the increase in wages to moderate in the circumstances of weaker economic growth and gradually closing output gap, labour market conditions will remain tight and in combination with the demographic trends are likely to make productivity enhancements increasingly more important in the context of medium-term and longer-term economic development.

Macroeconomic Data

Macroeconomic indicators – actual data and forecasts

Latvijas Banka's forecasts, December 2018

	2015	2016	2017	2018*	2018F	2019F	2020F
ECONOMIC ACTIVITY (%; year-on-year; in real terms; seasonally adjusted)							
GDP	2.8	1.6	5.0	4.9	4.9	3.5	3.1
Private consumption	2.4	1.4	3.9	4.6	4.3	3.9	3.5
Government consumption	2.0	3.5	4.4	3.9	5.4	2.3	2.1
Investment	-1.0	-9.9	15.0	16.1	14.1	4.8	5.2
Exports	3.3	4.4	5.9	3.2	4.0	3.1	3.4
Imports	2.1	4.4	8.9	4.6	4.7	4.3	4.3
INFLATION (%; year-on-year; HCPI)							
Inflation	0.2	0.1	2.9		2.6**	2.9	2.5
Core inflation (excluding, food, energy, administrative prices, taxes)	0.9	0.5	1.3		1.9**	2.3	2.4
LABOUR MARKET							
Unemployment (% of economically active population)	9.9	9.6	8.7	7.6	7.4	7.0	6.9
Nominal gross wage (%; year-on-year; gross)	6.8	5.0	7.9	8.4	8.5	6.5	5.7
EXTERNAL SECTOR (% of GDP)							
Current account	-0.5	1.6	0.7	-1.0	0.9	-0.4	-1.1
PUBLIC FINANCES (% of GDP)							
General government debt	36.8	40.3	40.0		37.2	36.5	37.7
Government budget surplus/deficit	-1.4	0.1	-0.6		-0.5	-0.7	-0.7

* Actual data for the first nine months of 2018.

** Actual data for 2018.

Foreign Direct Investment

In the first three quarters of 2018, inflows of foreign direct investment in Latvia amounted to 365 million euro.

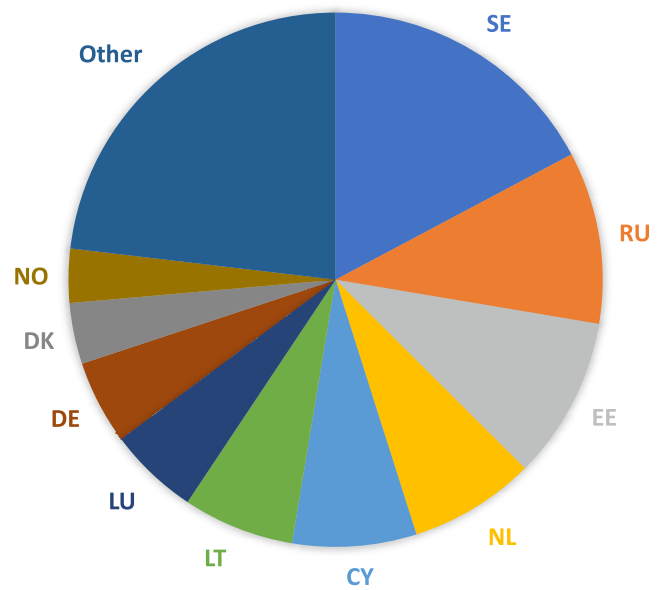
Stock of foreign direct investment accounts for 51.7% of GDP in Latvia, with the financial and insurance activities, trade, real estate activities, and manufacturing dominating in the investment structure.

The major investors are Sweden, Russia, Estonia, and the Netherlands.

FDI stock in Latvia

(Q3 2018; %)

Breakdown by country



Breakdown by sector



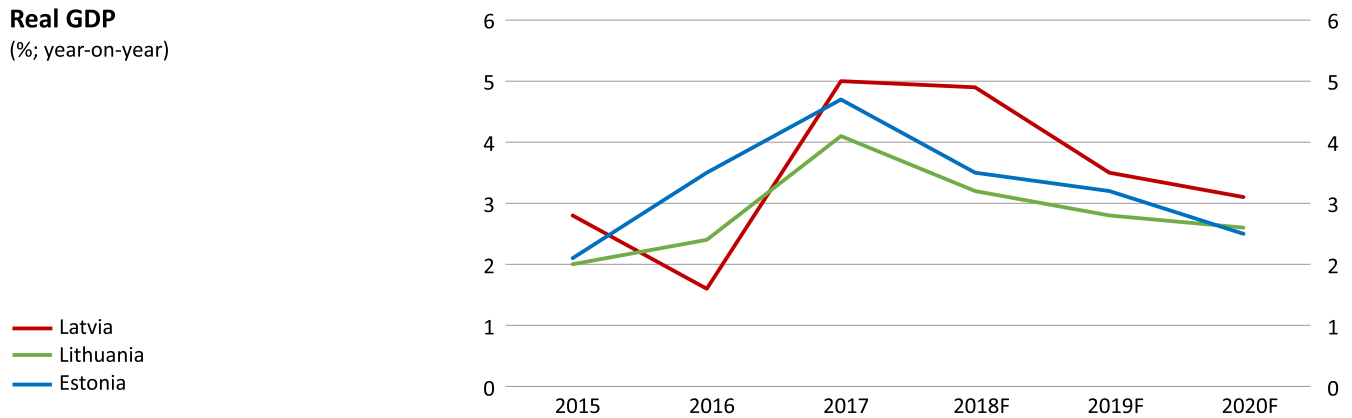
Source: Latvijas Banka.

Macroeconomic Indicators: Latvia, Lithuania and Estonia

In 2018, Latvian economy maintained the high growth momentum achieved in the previous year, unemployment declined, employment rate rose, and the real net wages also posted an increase. For a regional comparison of these indicators and outlook in Latvia and the other Baltic States, see the charts below.

Real GDP

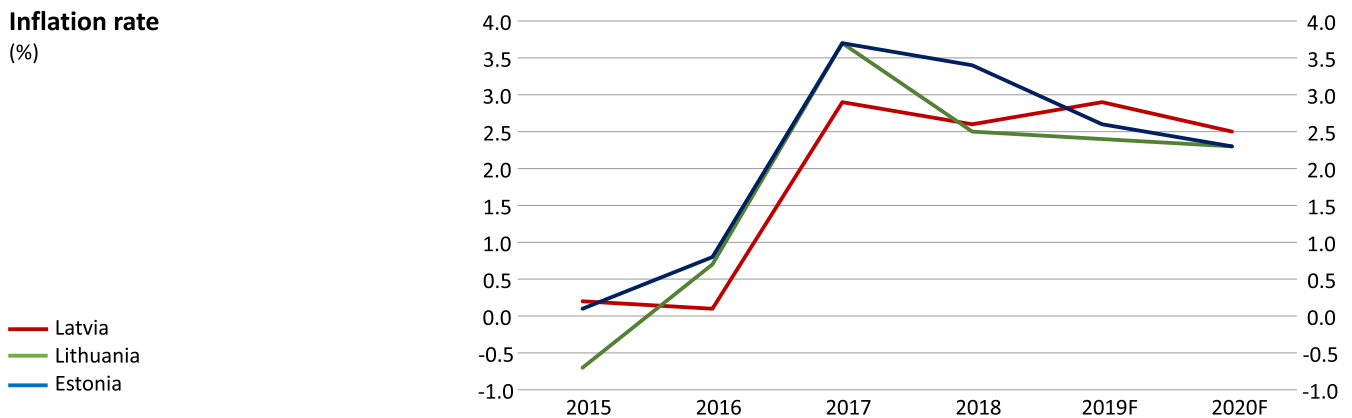
(%; year-on-year)



Source: Eurostat; F: Eurosystem staff macroeconomic projections, December 2018.

Inflation rate

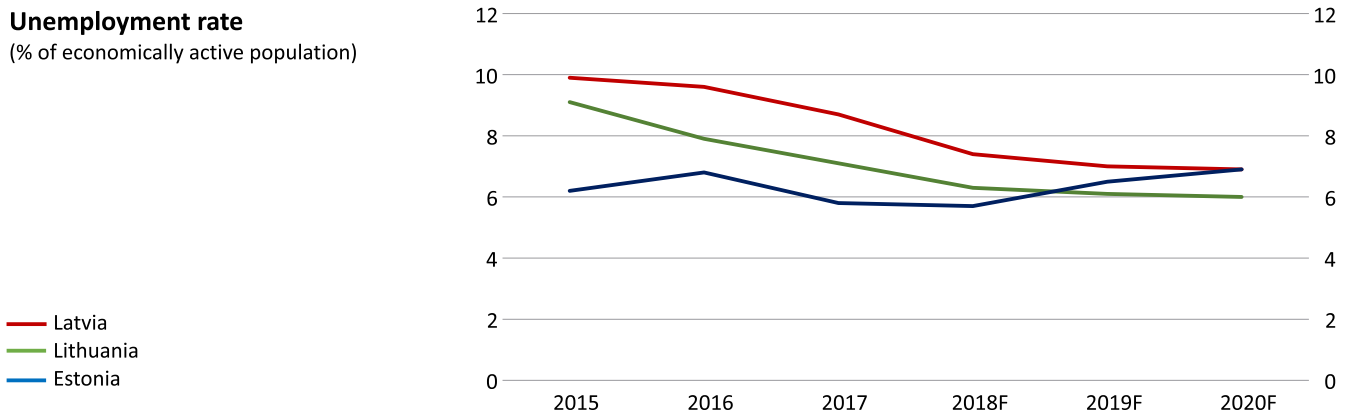
(%)



Source: Eurostat; F: Eurosystem staff macroeconomic projections, December 2018.

Unemployment rate

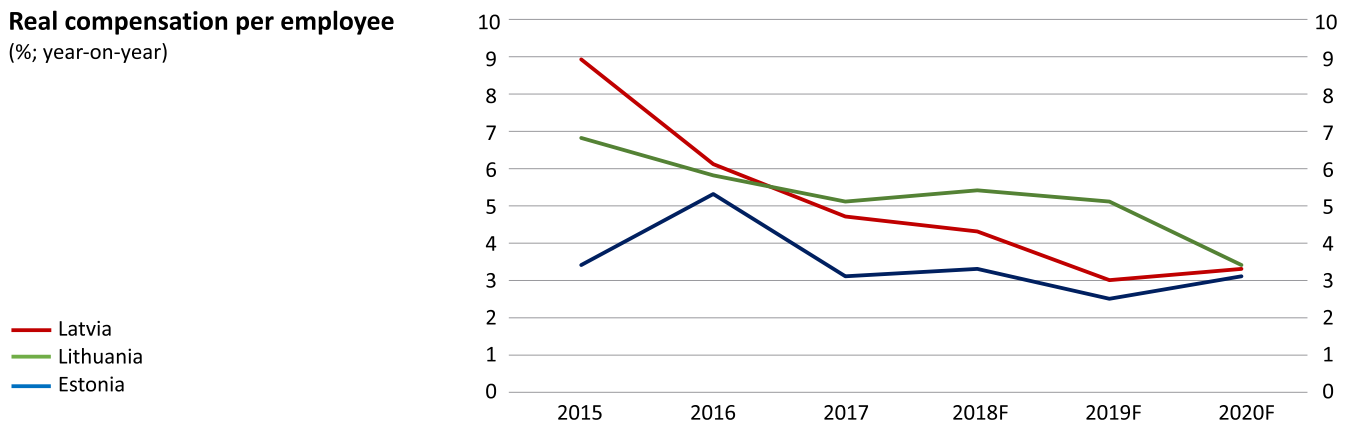
(% of economically active population)



Source: Eurostat; F: Eurosystem staff macroeconomic projections, December 2018.

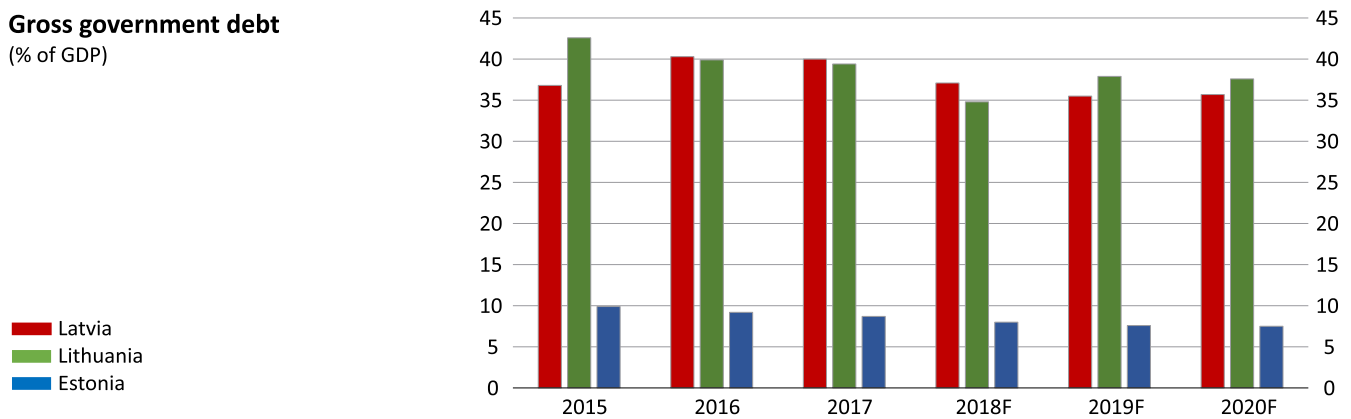
Macroeconomic Indicators: Latvia, Lithuania and Estonia

Real compensation per employee (%; year-on-year)



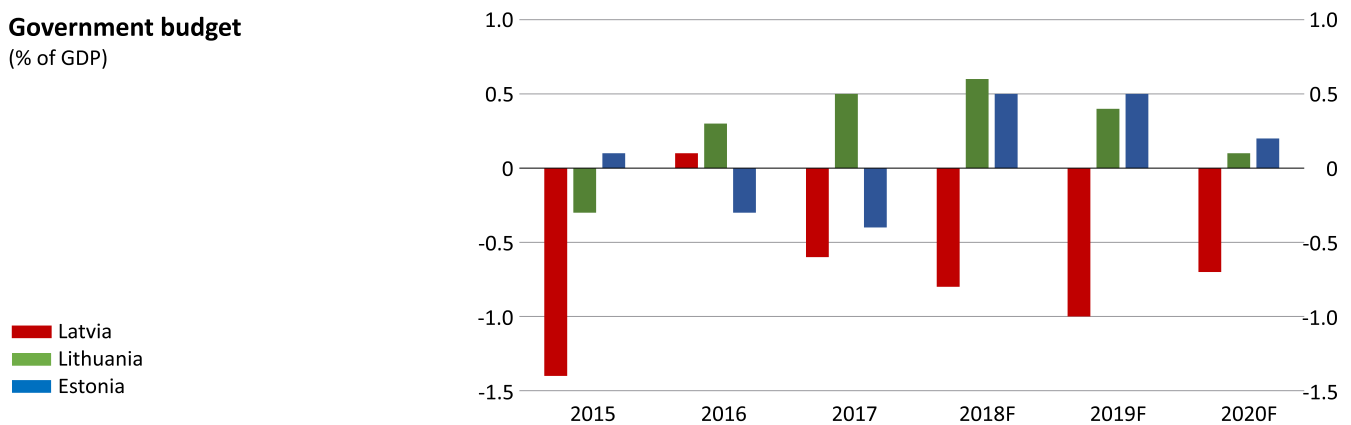
Source: European Commission; F: European Commission's Autumn 2018 Economic Forecast.

Gross government debt (% of GDP)



Source: European Commission; F: European Commission's Autumn 2018 Economic Forecast.

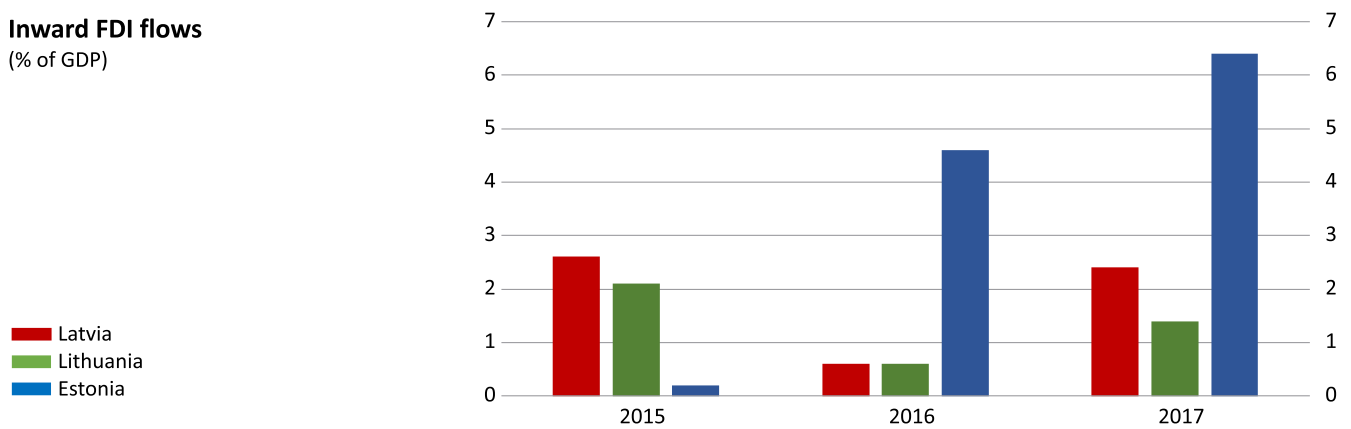
Government budget (% of GDP)



Source: European Commission; F: European Commission's Autumn 2018 Economic Forecast.

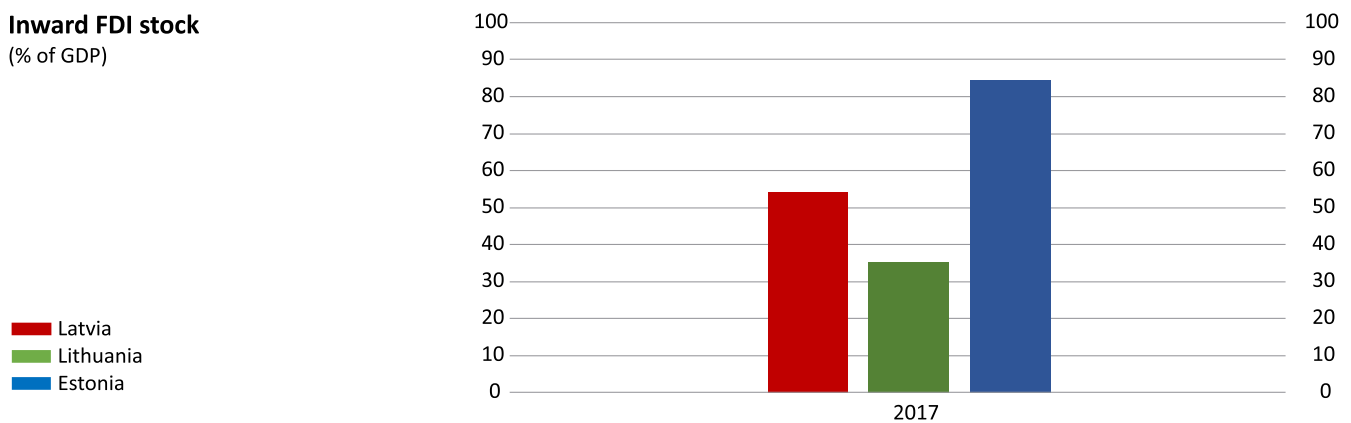
Macroeconomic Indicators: Latvia, Lithuania and Estonia

Inward FDI flows (% of GDP)



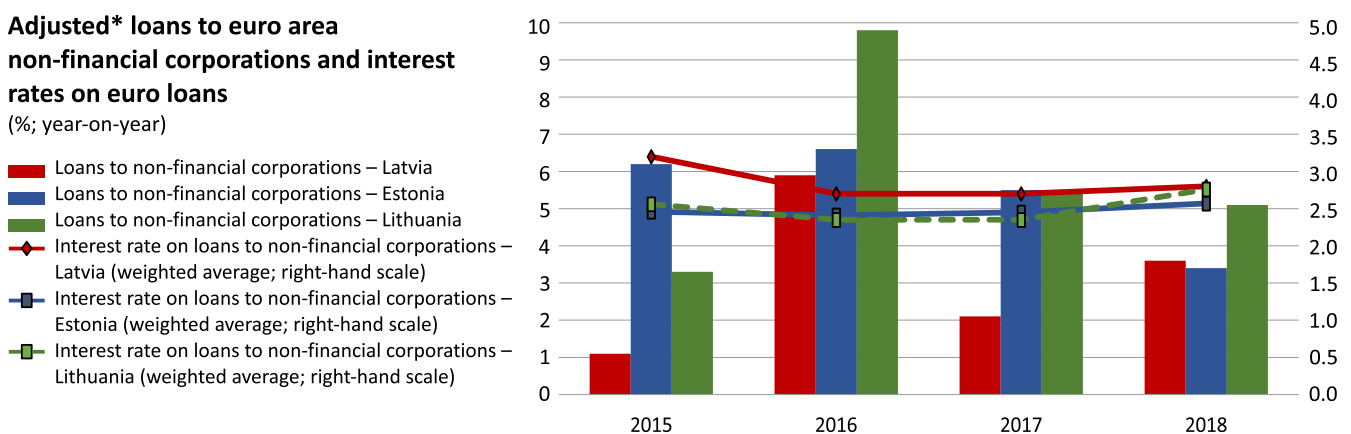
Source: OECD.

Inward FDI stock (% of GDP)



Sources: Latvijas Banka, Eesti Pank and Lietuvos bankas.

Adjusted* loans to euro area non-financial corporations and interest rates on euro loans (%; year-on-year)



* The effects of reclassifications and other adjustments have been deducted.

Source: ECB, Latvijas Banka, Eesti Pank and Lietuvos bankas.

For further information on the analysis of the developments in Latvian economy, please refer to the Macroeconomic Developments Report. 