

# Unique case of Latvia: internal adjustment

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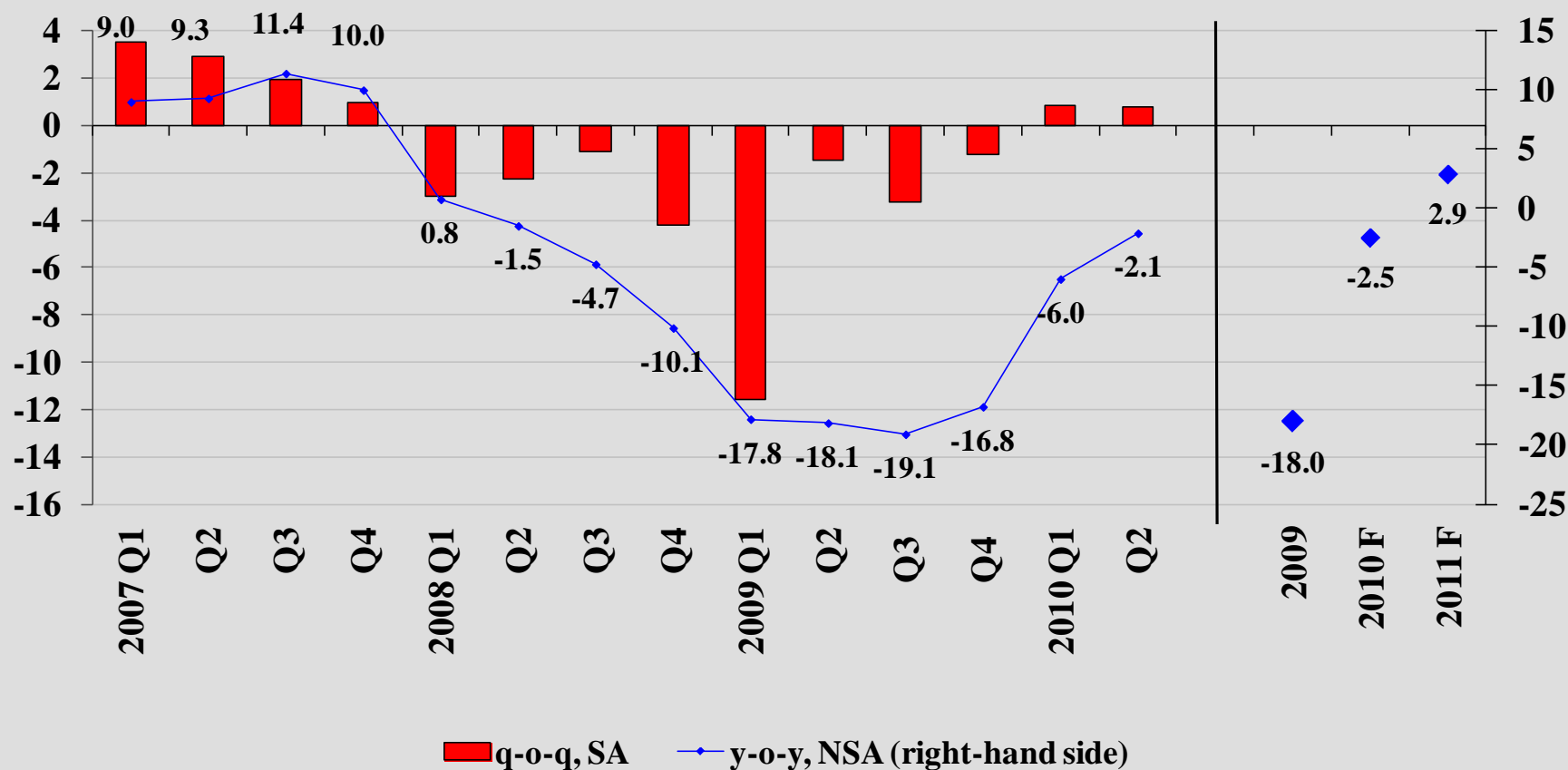
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# After sharp economic adjustment in terms of GDP, Latvian economy is back on export-based growth track

GDP growth (%)



# A mix of fiscal, income and structural policy as key adjustment mechanisms in Latvia

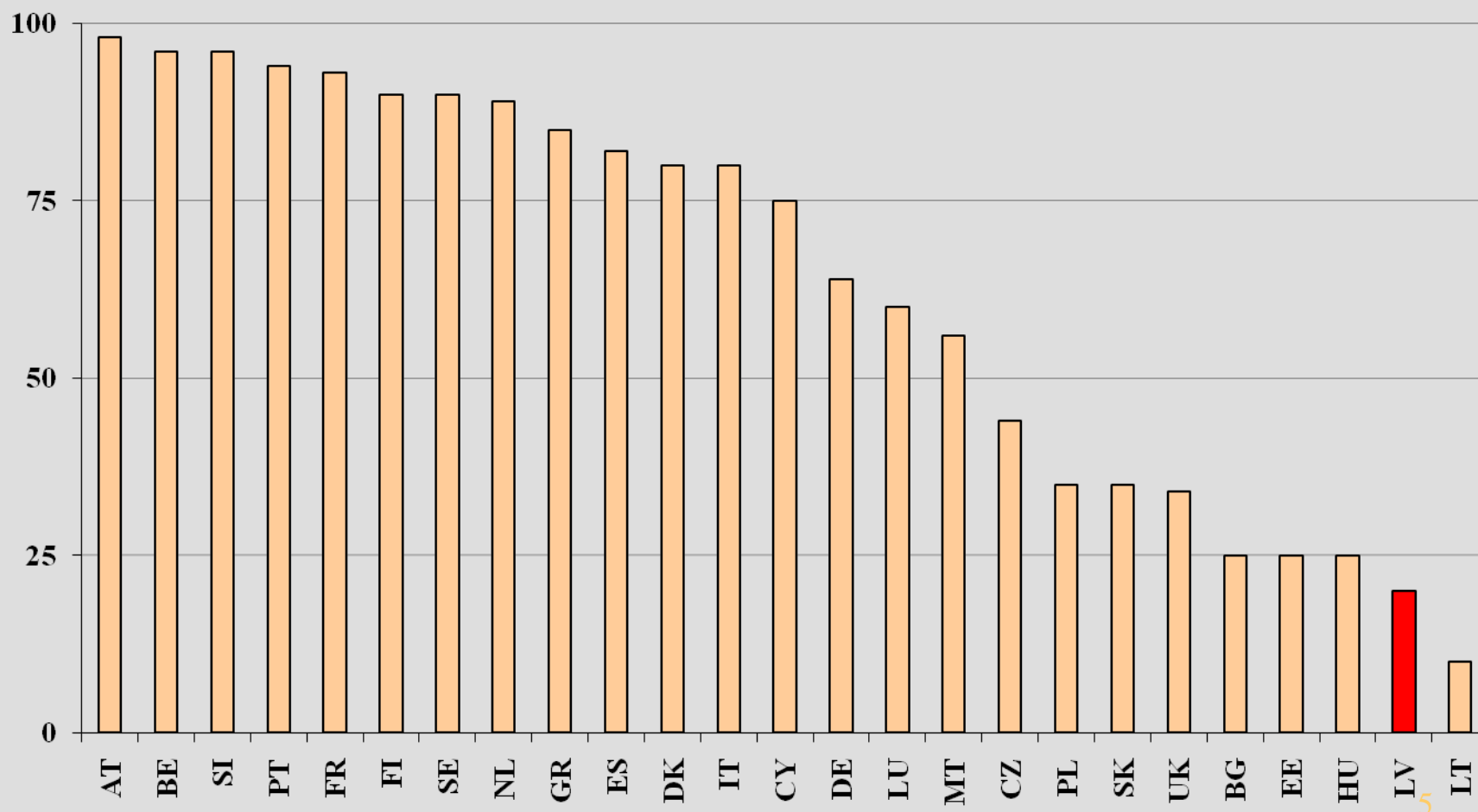
- **The fixed narrow band exchange rate** of the lats as the anchor for monetary policy until the euro adoption.
- **Policy mix** as tools for restoration of competitiveness and a precondition for an export-based economic recovery in Latvia:
  - Sizeable **fiscal consolidation**;
  - Fiscal consolidation measures designed with the focus on **structural reforms** and **wage/employment cuts** in the public sector;
  - **Cost optimisation** and **productivity enhancement** in private sector.

# Sizeable fiscal consolidation in Latvia has taken place already in 2009

Country	Year	Total consolidation	Revenue measures	Current expenditure measures	Capital expenditure measures
<b>Latvia</b>	<b>2009</b>	<b>9.9</b>	<b>1.8</b>	<b>5.7</b>	<b>2.4</b>
	<b>2010</b>	<b>4.2</b>	<b>2.2</b>	<b>1.6</b>	<b>0.4</b>
<b>Lithuania</b>	<b>2009</b>	<b>3.5</b>	<b>0.2</b>	<b>1.3</b>	<b>1.9</b>
	<b>2010</b>	<b>5.6</b>	<b>0.5</b>	<b>3.9</b>	<b>1.2</b>
<b>Estonia</b>	<b>2009</b>	<b>7.7</b>	<b>2.8</b>	<b>4.2</b>	<b>0.7</b>
	<b>2010</b>	<b>2.3</b>	<b>2.3</b>	<b>0.0</b>	<b>0.0</b>
<b>Ireland</b>	<b>2009</b>	<b>2.0</b>	<b>1.1</b>	<b>0.5</b>	<b>0.4</b>
	<b>2010</b>	<b>2.4</b>	<b>0.0</b>	<b>1.8</b>	<b>0.6</b>
<b>Hungary</b>	<b>2009</b>	<b>2.8</b>	<b>0.6</b>	<b>1.0</b>	<b>1.2</b>
	<b>2010</b>	<b>1.4</b>	<b>0.0</b>	<b>1.4</b>	<b>0.0</b>
<b>Romania</b>	<b>2009</b>	<b>3.8</b>	<b>0.9</b>	<b>2.9</b>	<b>0.0</b>
	<b>2010</b>	<b>3.1</b>	<b>1.0</b>	<b>2.1</b>	<b>0.0</b>
<b>Greece</b>	<b>2010</b>	<b>2.5</b>	<b>0.5</b>	<b>1.7</b>	<b>0.3</b>

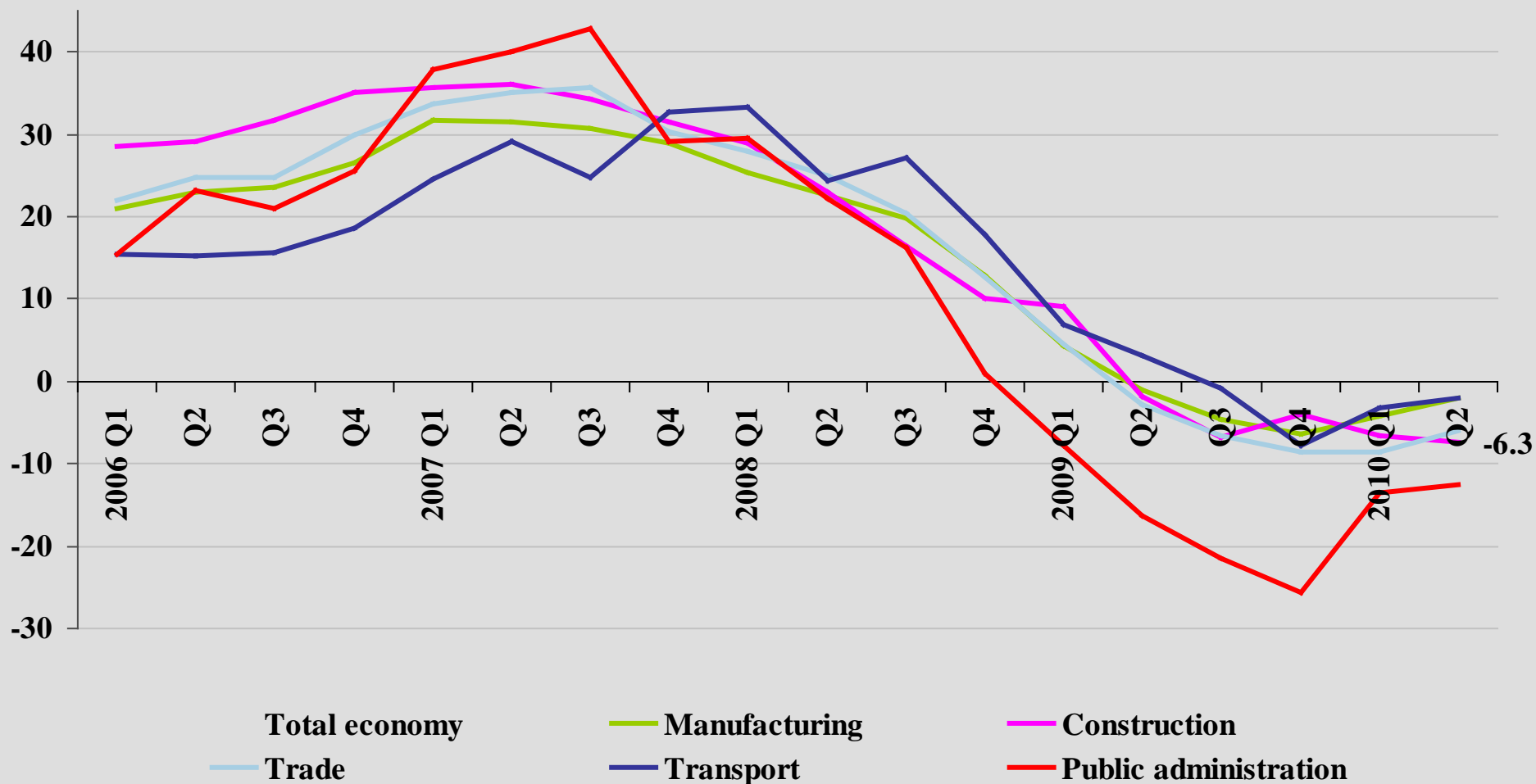
# Institutional fundamentals ensure smooth economic adjustment through wage flexibility in Latvia

Collective bargaining coverage (%)



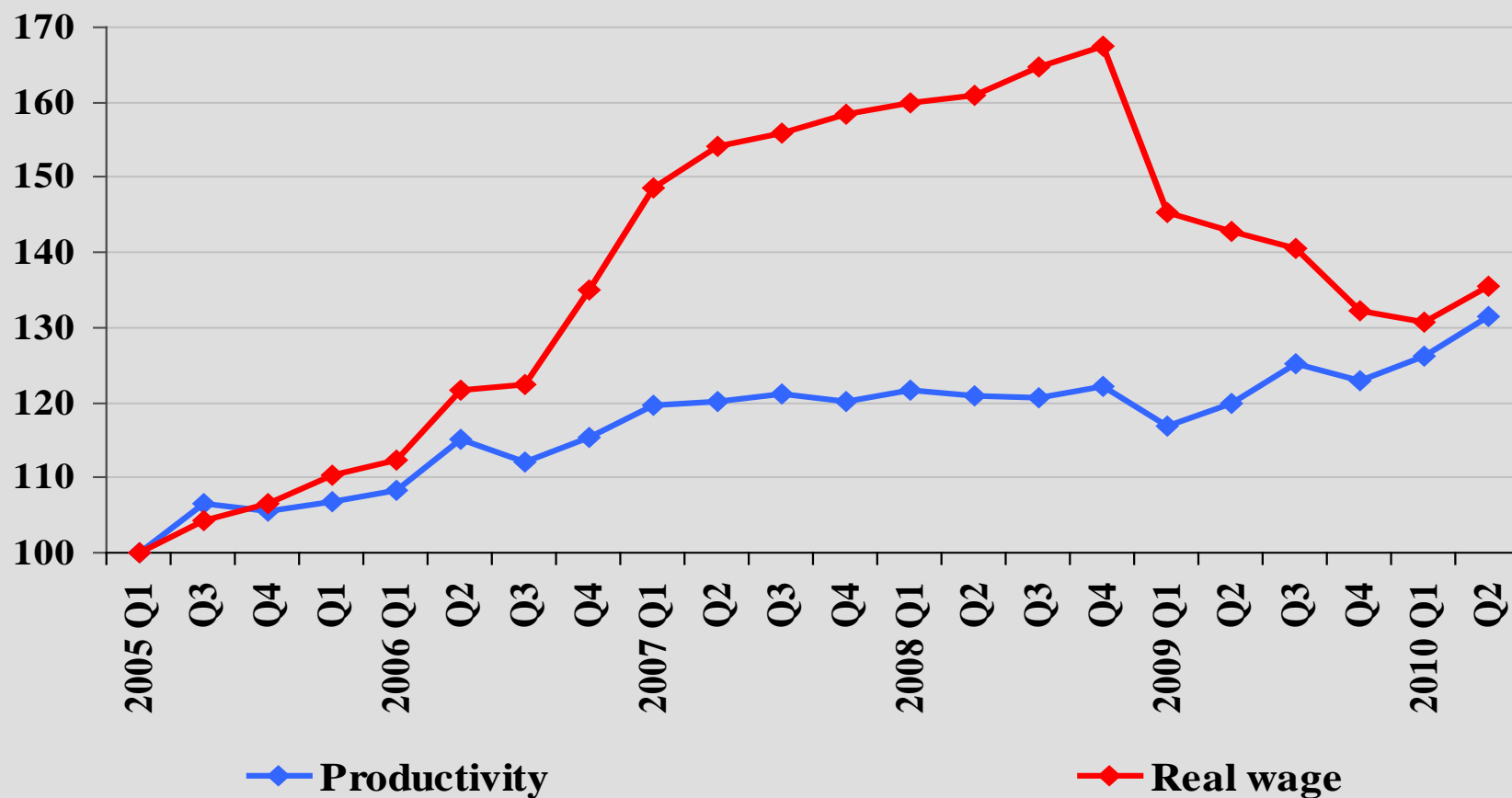
# Wage elasticity allows to restrain wages in both public and private sector

Gross nominal hourly wage y-o-y growth (%)



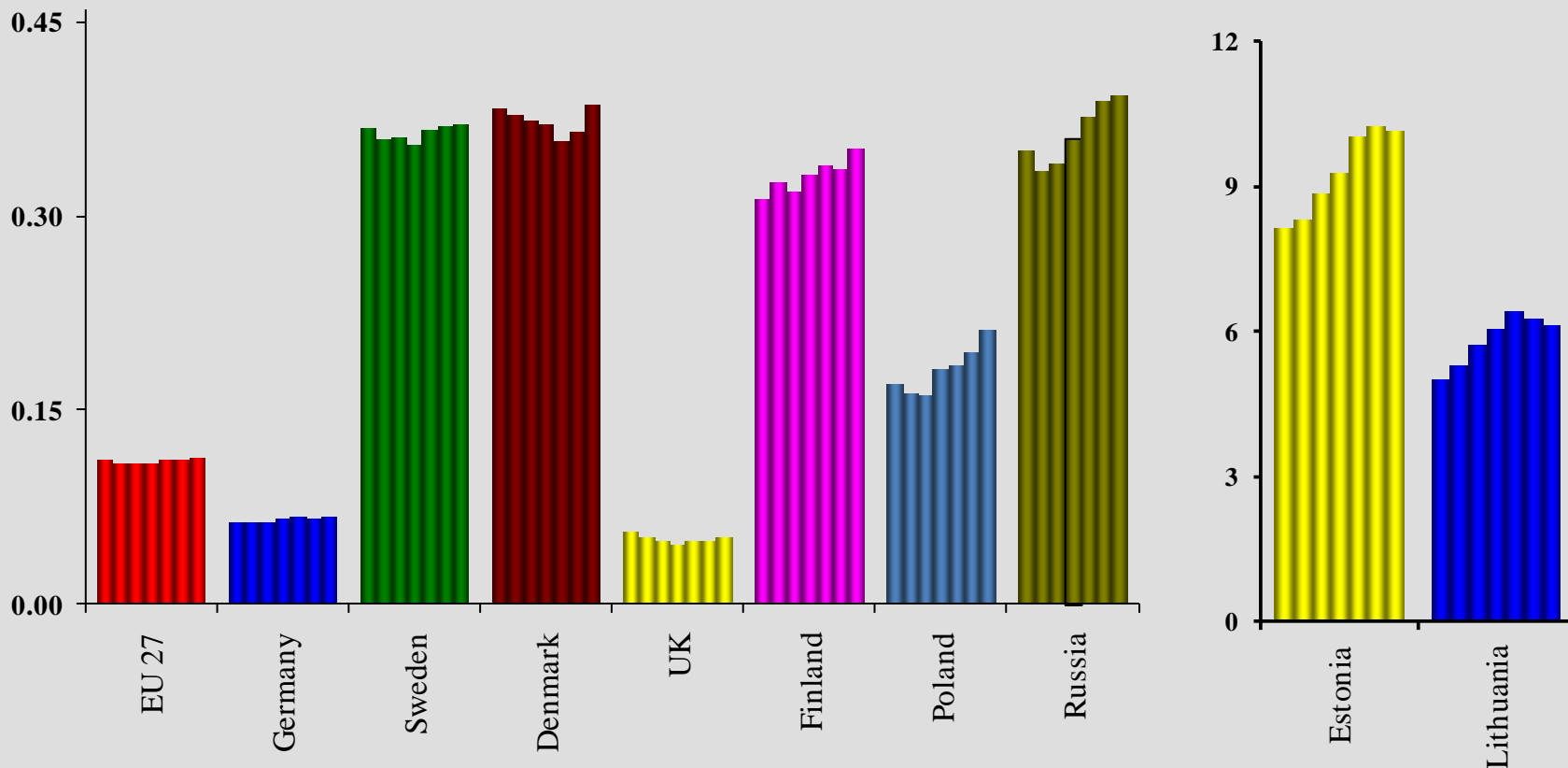
# Cost optimisation and productivity enhancement contributed to narrowing the wage-productivity gap

**Wages and productivity**  
(whole economy, seasonally adjusted, expressed per hours worked, Q1 2005=100)



# Gains in competitiveness are reflected by increase in market shares in major trading partner countries

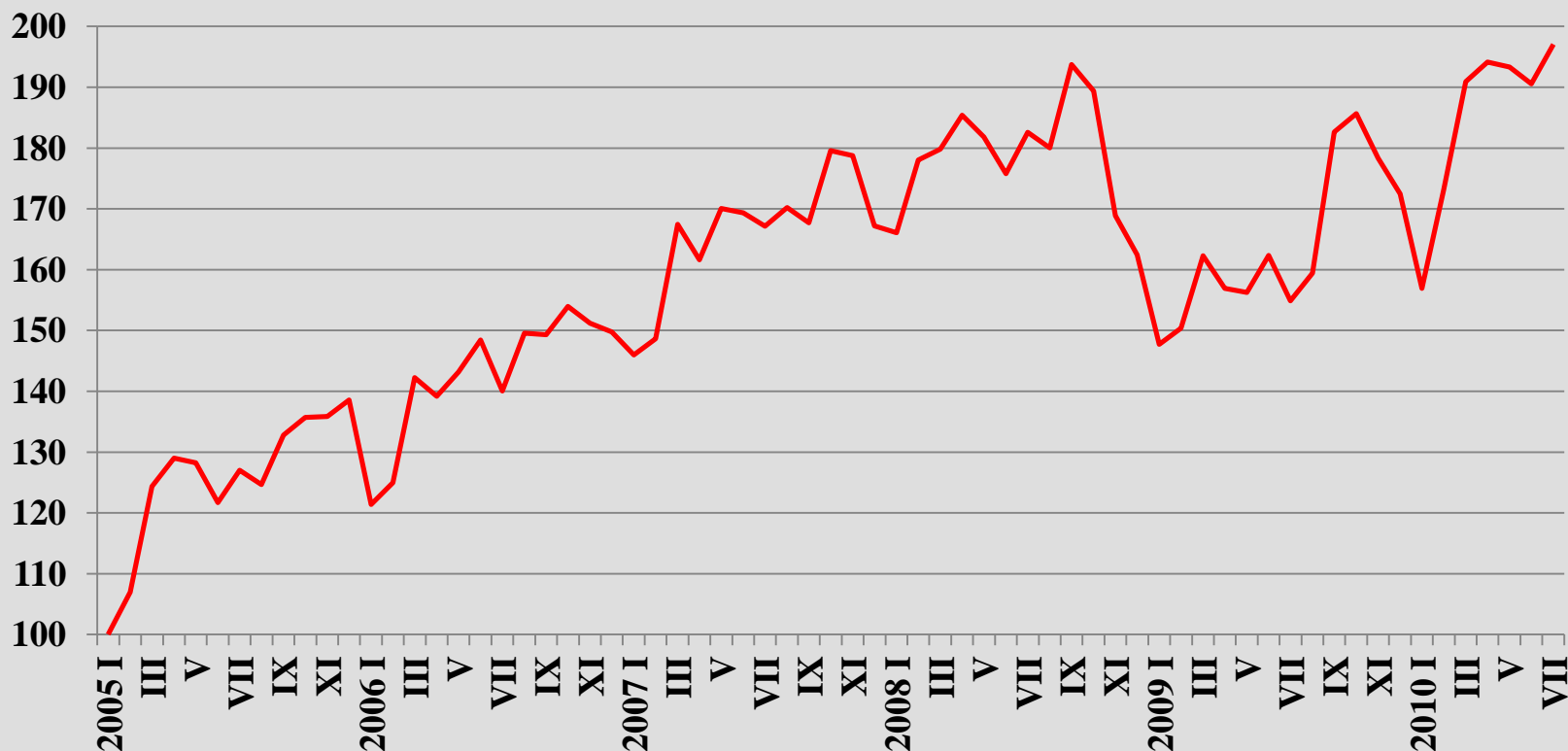
**Export market shares  
(% of major trading partners' imports in Q4 2008 – Q2 2010;  
3-months moving average)**





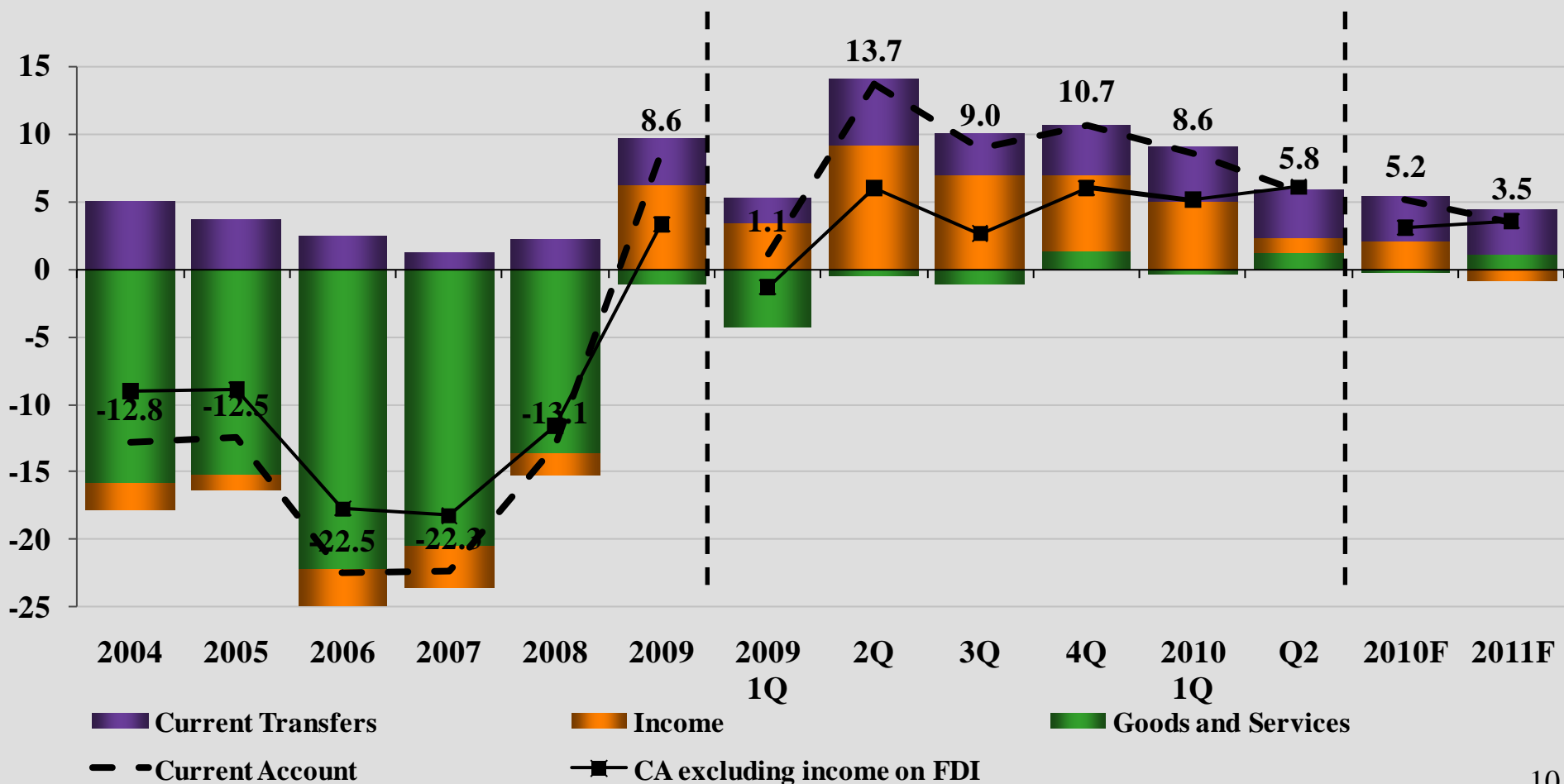
# Improvement in competitiveness boosted export growth since mid-2009

**Nominal export growth (I 2005=100)**



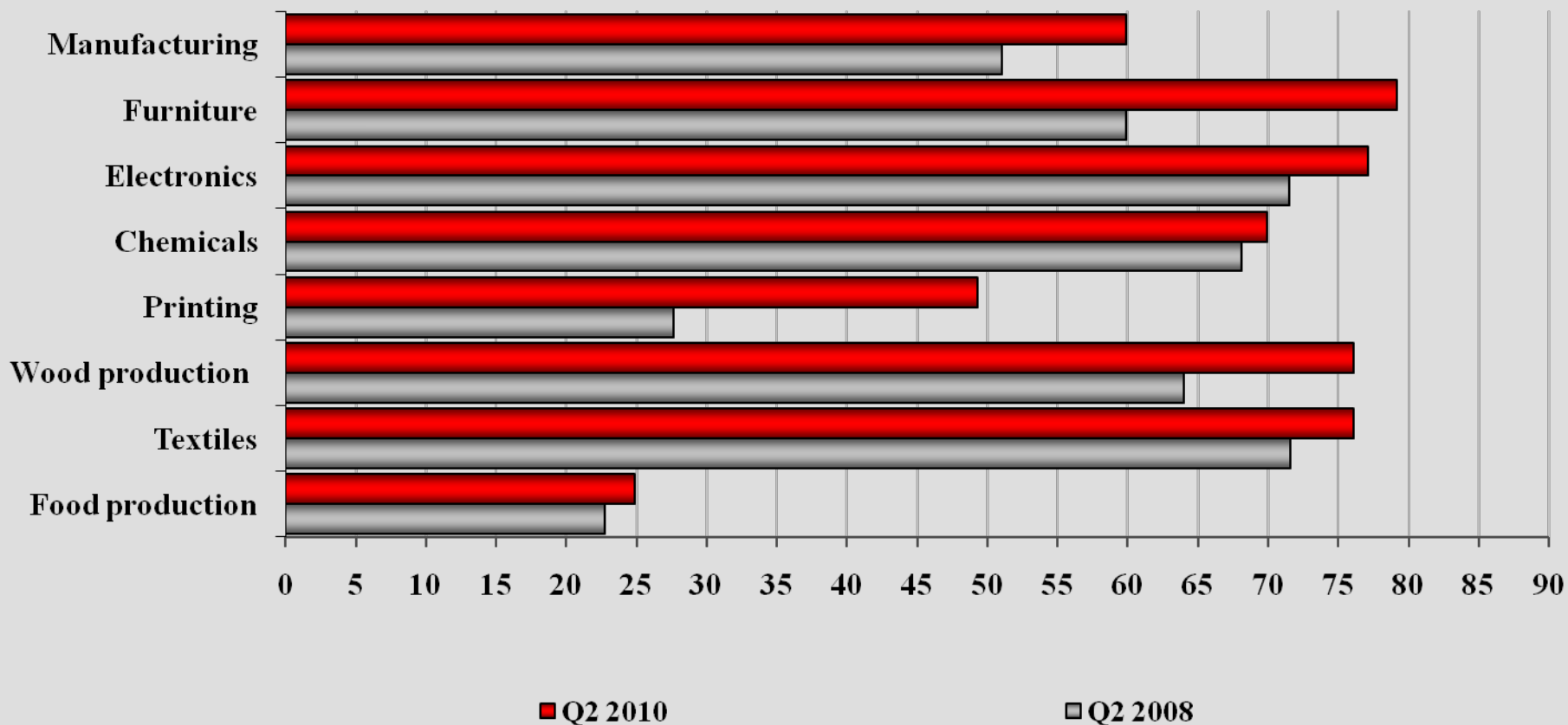
# Current account in surplus; goods and services balance is expected to improve further

Current Account (% of GDP)



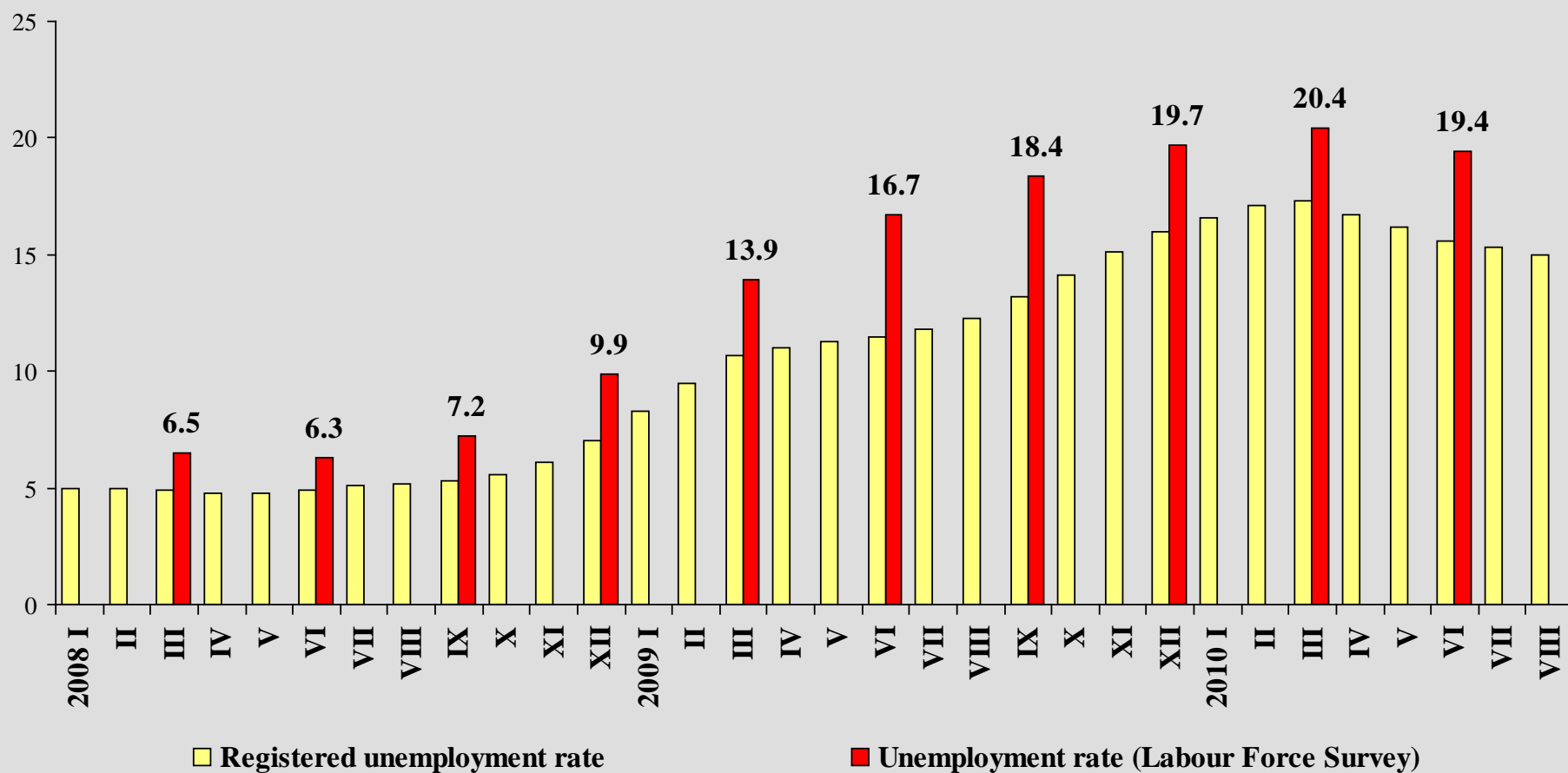
# In manufacturing, structural changes towards re-orientation to export markets are taking place

## Share of export (% of total turnover in particular sectors)



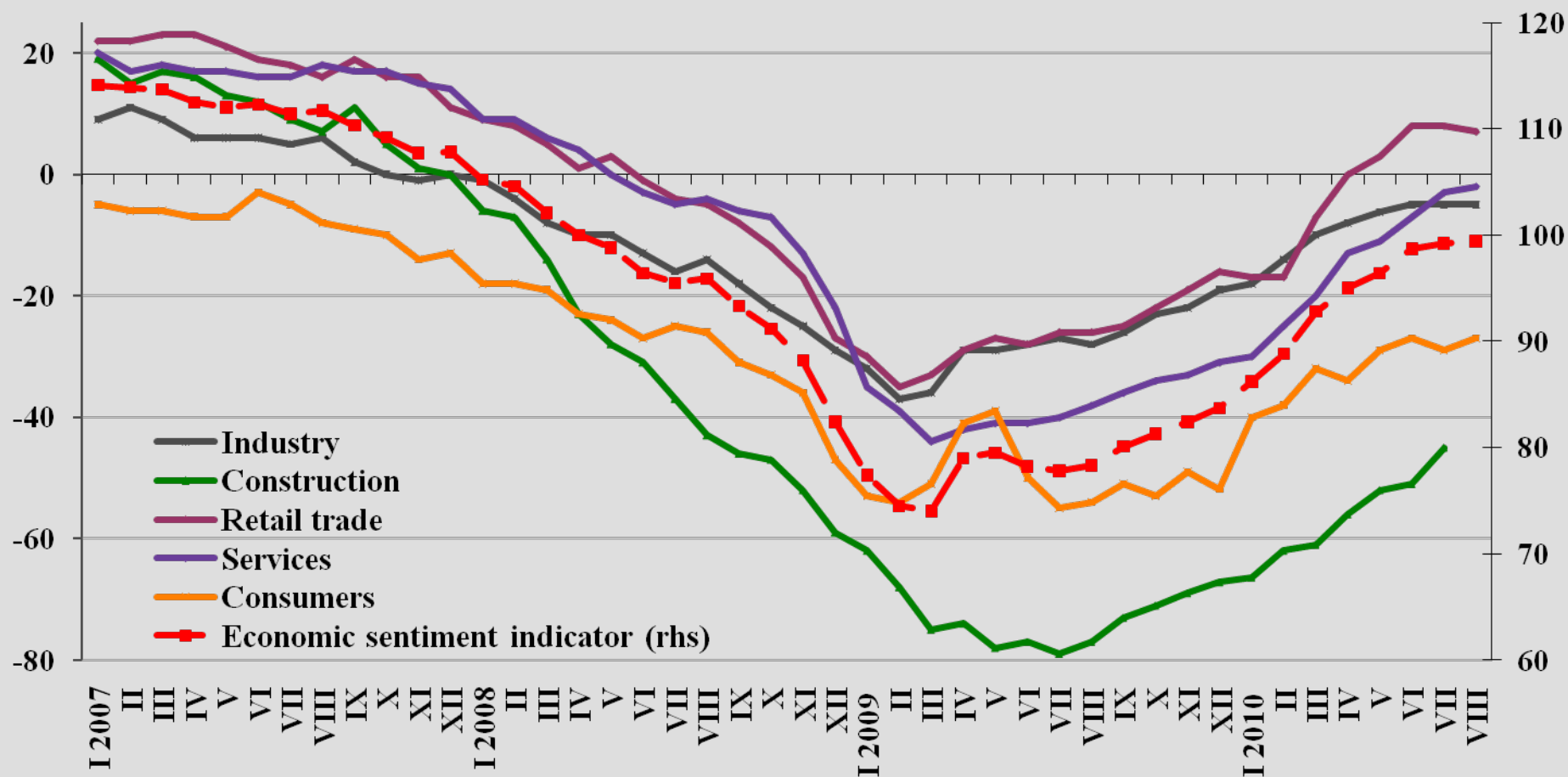
# With improvements in employment prospects in export-oriented sectors, unemployment started to decline

## Unemployment rate (% of economically active population)



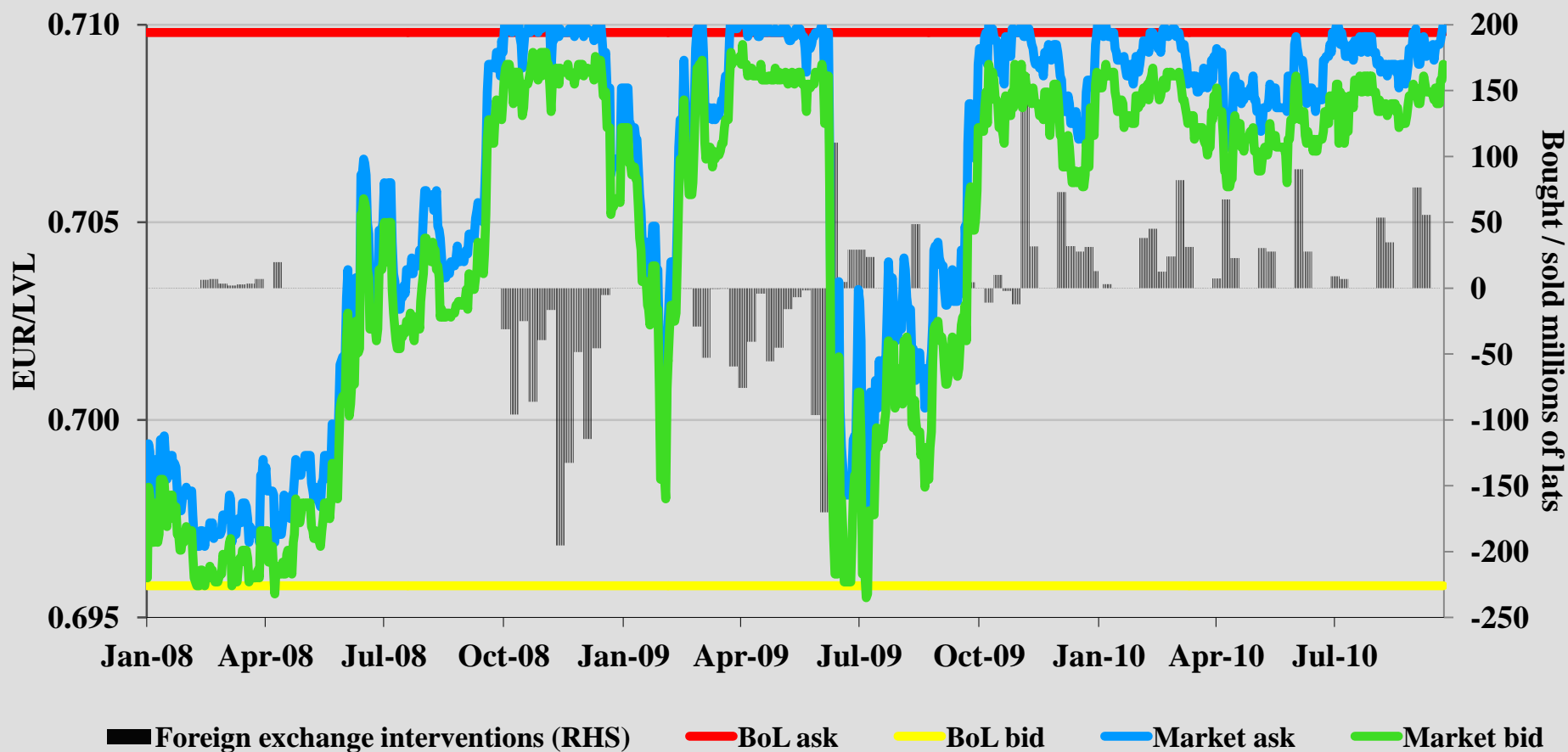
# Improvement in business and consumer sentiment supports ongoing economic recovery

## Economic sentiment and confidence indicators (balance, %)



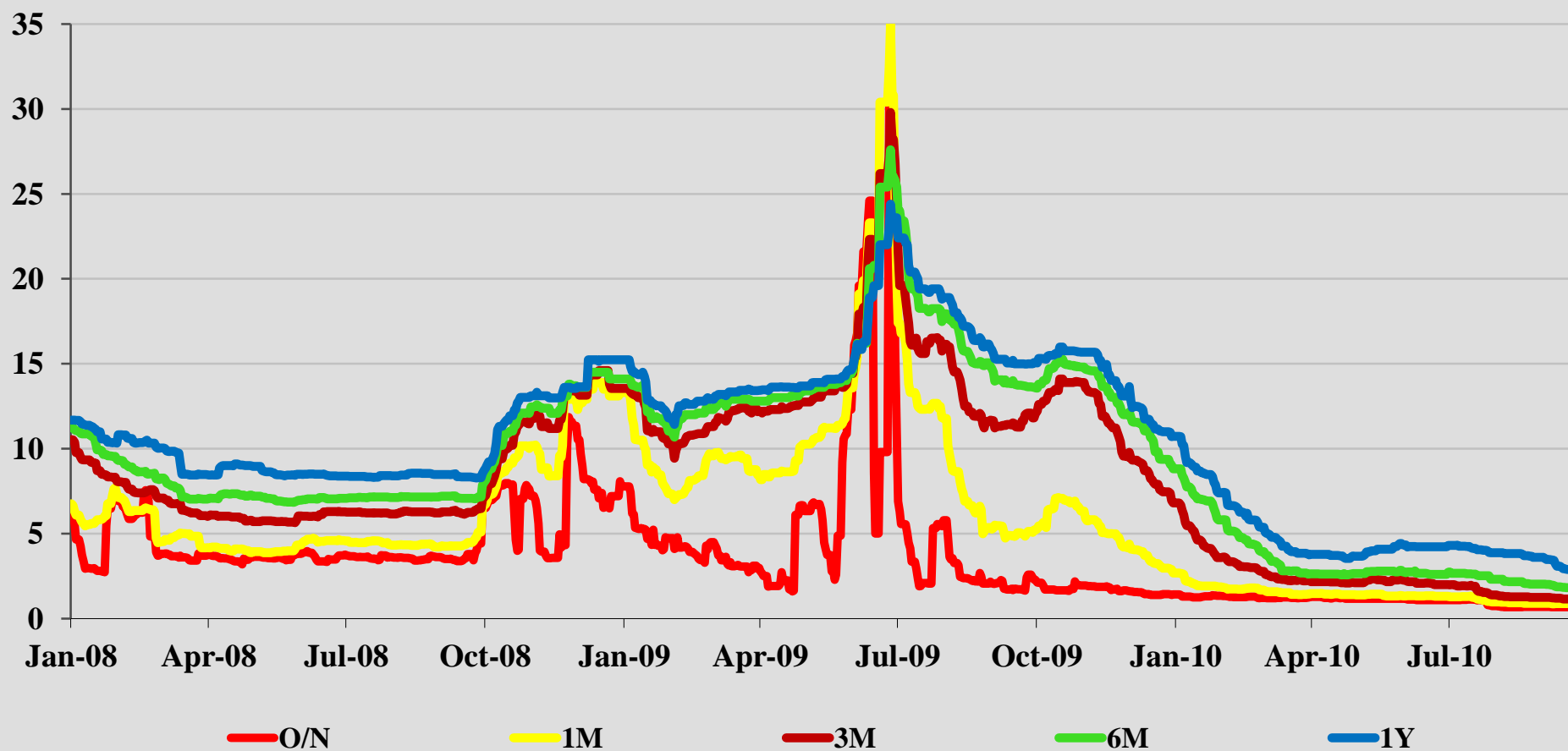
# Central bank has replenished its foreign currency reserves which were drained in the market turmoil following Lehman's collapse in 2008

## Lats exchange rate against euro and Bank of Latvia interventions



Money market rates have reached their historical lows reflecting inter alia the significant improvement in financial market sentiment

### Money Market Index RIGIBOR (%)

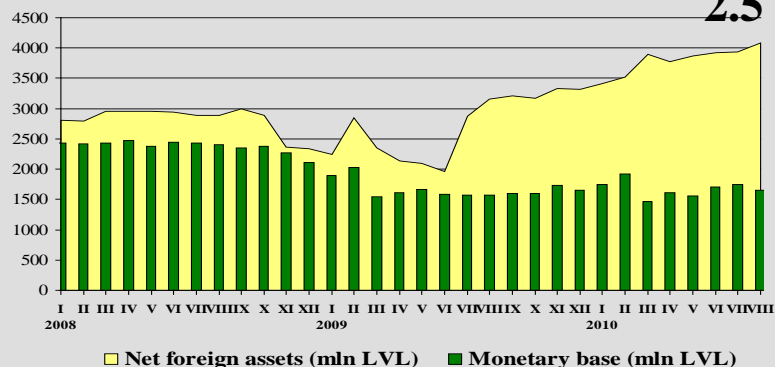


# Capacity to confront changes in market sentiment has improved significantly

## Selected indicators (at the end of VIII 2010)

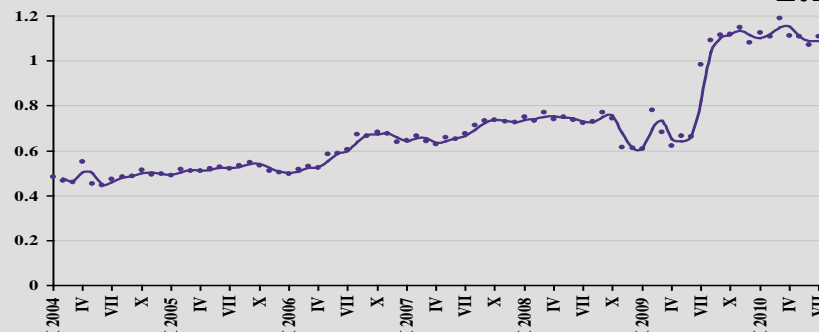
**NFA\* / monetary base**

**2.5**



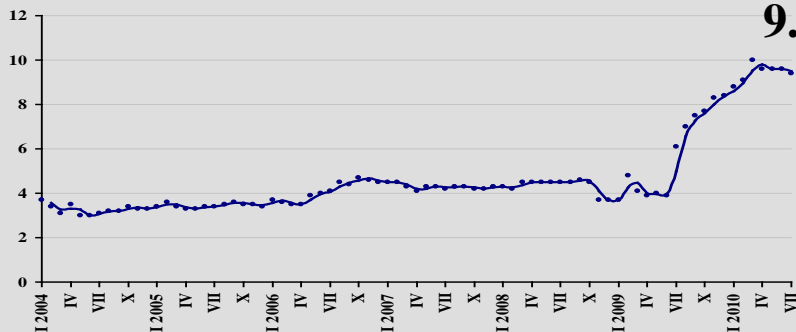
**NFA / cash and non-bank deposits in lats**

**1.1**



**NFA in the months of imports of goods**

**9.4**



**Short-term external debt/NFA**

**1.5\*\***

