MACROECONOMIC AND BUDGETARY REVIEW

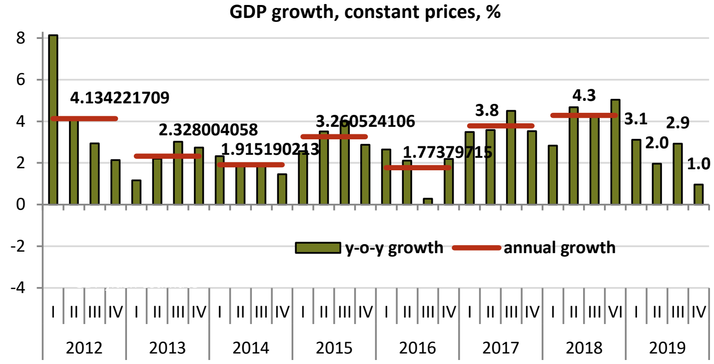
February 2020

Main macroeconomic indicators	2019*	Forecasts** 2020	2021	2022	2023
Gross domestic product (GDP)					
current prices (mln euro and growth, %)	30476	5.0	5.3	5.1	4.6
constant prices (mln euro and growth, %)	27497	2.2	2.8	2.8	2.4
GDP deflator *(y-o-y), %*	2.6	2.7	2.4	2.3	2.2
Consumer price index *(y-o-y), %*	2.8	2.3	2.1	2.0	2.0
Average monthly gross wage *(euro and growth at current prices, %)*	1076	6.0	5.5	5.0	5.0
Employment *(thsds and growth rate, %)*	910	-0.1	-0.1	-0.1	-0.1
Jobseeker rate *(annual average), %*	6.3	6.4	6.2	5.8	5.7
Exports of goods and services					
current prices (mln euro and growth, %)	18257	3.5	4.8	4.7	3.9
constant prices (mln euro and growth, %)	17387	2.5	3.5	3.4	2.6
Imports of goods and services, mln euro					
current prices (mln euro and growth, %)	18232	3.5	5.3	4.7	3.9
constant prices (mln euro and growth, %)	18426	3.0	4.4	3.7	3.0

** GDP for 2019 according to CSB data published on 28/02/2020*

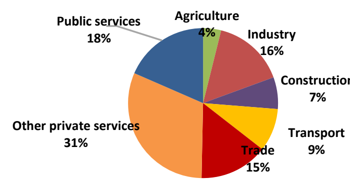
*** Projections developed in February 2020 for the preparation of Latvia's Stability Programme 2020-2023*

GDP growth, constant prices, %



GDP

Structure of value-added in 2019, %

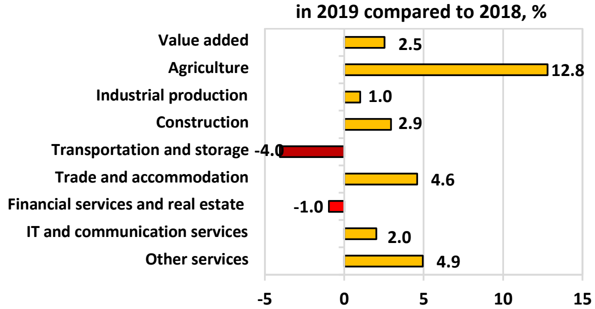


GDP growth of the Baltic states, % y-o-y

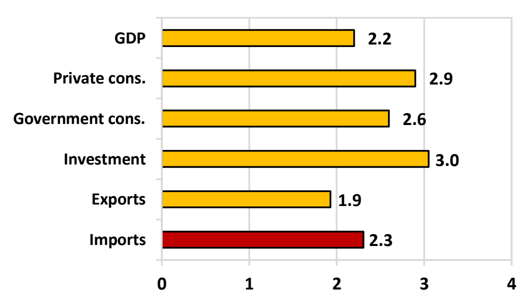
	19'I	II	III	VI
Latvia	3.1	2.0	2.9	1.0
Lithuania	4.2	3.8	3.8	3.8
Estonia	4.8	3.9	4.8	3.9

In the fourth quarter of 2019, Latvia's economic growth slowed down to 1% which was the lowest quarterly economic growth rate during the last year and the weakest growth since Q3 2016. Thus, in 2019 overall Latvia's gross domestic product increased by 2.2%. Growth weakening at the end of 2019 was determined by negative developments in several sectors, including, transport, financial services and manufacturing. Last year, weak external environment and global economic slowdown determined worsening of foreign demand which affected Latvia's economic performance. Economic growth this year will be severely affected by the spread of novel coronavirus and the restrictions introduced to limit Covid-19 pandemic in Latvia. The latest economic sentiment figures reflect the negative effects caused by the virus - in March, Latvia's ESI dropped to its lowest level of the last decade.

GDP growth by sectoral breakdown and from expenditure side in 2019 compared to 2018, %



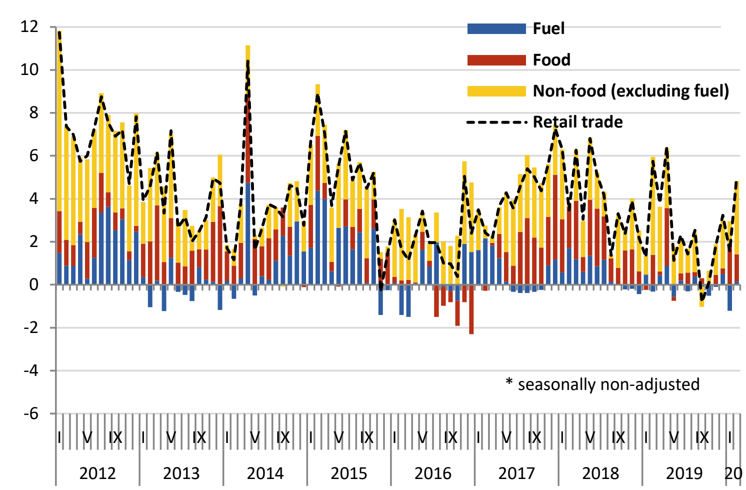
GDP breakdown



In 2019, the fastest growing sectors in the economy of Latvia were agriculture as well as several service sectors. Value added of trade increased by 4.1% determined by rising income and falling unemployment. Thus, private consumption expanded by 2.9% indicating that in 2019 Latvia's economic growth was stimulated by domestic demand. At the same time exports of goods and services increased slower - by 2.0%, determined by global growth slowdown and weakening of external demand. Thus, growth rates of export-oriented sectors last year were lower - manufacturing growth constituted 2.1%, while contraction of transport sector was determined by significantly lower freight volumes in Latvia's ports. Transit flows were negatively affected by Russia's policy to re-direct freight flows to its Baltic Sea ports and falling global demand for coal from Russia. In 2019, shrinking of non-resident serving bank business and financial services exports determined fall of financial and insurance services' value added (-8.8%). In 2019, imports of goods and services increased stronger than exports - by 2.3%.

Source: CSP, Eurostat, Ministry of Finance of the Republic of Latvia

Retail trade growth contributions by product type*, y-o-y, %



Retail trade

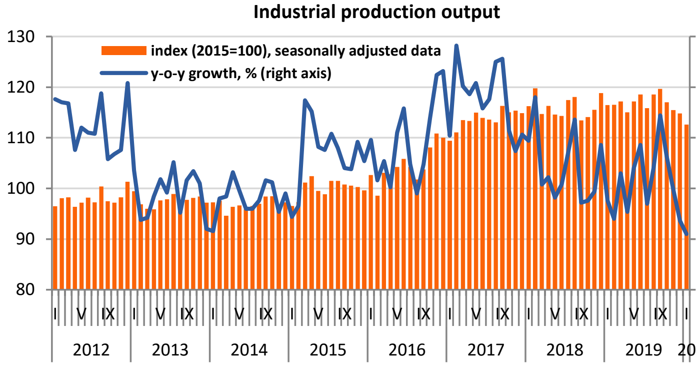
Structure of retail trade turnover in 2019, %

Y-o-y growth, c.a., 2020 Jan.-Feb.

Total	+3.3%	Non-food (excl. fuel)	+5.3%
Food	+3.8%	Fuel	-3.3%

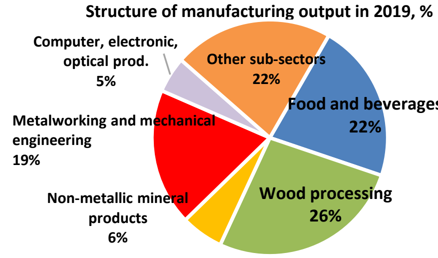
In February 2020 compared to a corresponding month in 2019, retail trade turnover in constant prices in Latvia increased by 5%. It is three times higher growth rate than in January and the strongest growth since April 2019. Thus, in the two months of 2020 trade volumes have risen by 3.3% y-o-y, largely stimulated by increasing sales of non-food products, especially, retail sales of medical goods, ICT equipment, electrical household appliances. However, the future outlook of the retail trade is less promising due to the spread of Covid-19 when consumers have become more cautious about their financial situation as a result of which less important purchases are going to be postponed and more savings are going to be made which will hamper private consumption in Latvia.

Industrial production output



Industry

Structure of manufacturing output in 2019, %

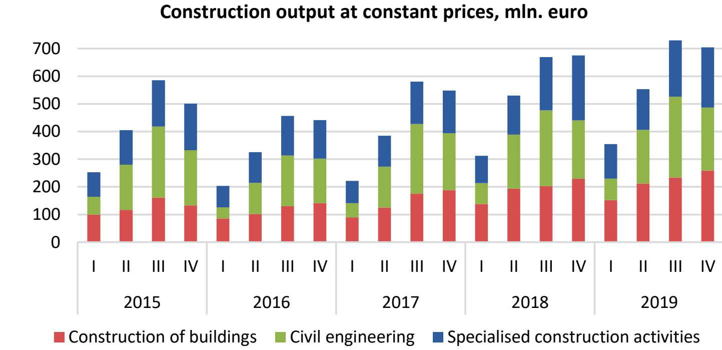


Industry, y-o-y growth, 2020 Jan., c.a.

Industry total	-4.5%	Mining, quarrying	+10.7%
Manufacturing	-3.6%	Energy	-11.0%

In January 2020, strong output contraction was registered in industrial production that was determined by negative developments in the largest manufacturing sub-sector - wood processing as well as output decline in energy sector. Thus, total industrial production output in January compared to January of the last year declined by 4.5% - this is the strongest fall in the sector since the end of 2009. Wood-processing output decreased by 10.7% y-o-y determined by wet weather conditions in Latvia's forests that hampered forestry works, as well as due to high output volumes in the sub-sector in January of 2019. Output volumes fell significantly also in several sub-sectors related to mechanical engineering, for instance, output in manufacture of motor vehicles and trailers declined by 13.1% y-o-y and manufacture of machinery and equipment was by 19.1% lower than a year ago. Even stronger output contraction was registered in repair and installation of machinery and equipment (-24.2% y-o-y) which is highly fluctuating sub-sector. At the same time, in a number of other important manufacturing sub-sectors output increased, for instance, manufacture of construction materials rose by 7.9% y-o-y, manufacture of fabricated metal products - by 11.2% y-o-y, manufacture of computers and electronic products - by 19.2%. Following the five months of consecutive output contraction, in January an increase was finally registered in the second largest manufacturing sub-sector - manufacture of food products (+1.0%).

Construction output at constant prices, mln. euro

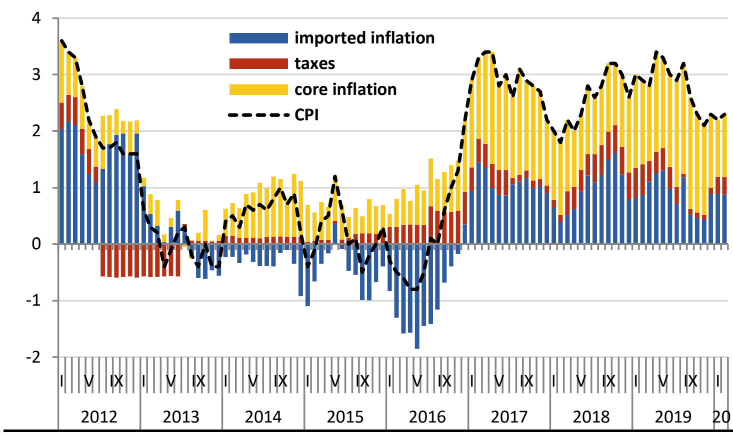


Construction

In 2019, construction output measured in current prices increased by 7.1% compared to the output level a year ago. Sector's growth was stimulated by construction of buildings that rose by 12.2%, at the same time civil engineering and output of specialised construction activities increased slower - by 4.7% and 4.0% respectively. Construction growth last year was weaker than in 2018, and it was associated with stabilisation of EU funds investment. In 2019, the expected construction space as indicated in the granted building permits continued to increase - compared to 2018 it rose by 37.1% y-o-y suggesting that construction volumes could potentially increase in the next periods. However, taking into account the latest developments and uncertainties regarding the spread of Covid-19, future prospects also in construction sector are unclear which is confirmed by the falling construction sentiment indicator published on 30 March 2020.

Source: CSP, Eurostat, Ministry of Finance of the Republic of Latvia

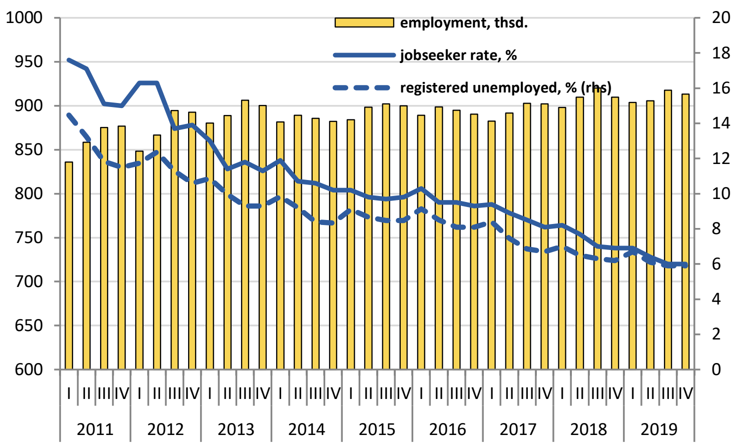
Inflation breakdown by origin, y-o-y, %



Inflation

In February 2020 compared to February of 2019, consumer prices in Latvia increased by 2.3%, thus in the first two months of the year inflation in Latvia constituted 2.2%. At the beginning of the year inflation growth in Latvia was largely supported by prices for food which increased by 4.3% compared to Jan-Feb 2019 mainly due to increasing prices for meat and meat products (+9.7% y-o-y). Significant contribution to consumer price growth in the first two months of 2020 was also provided by rising fuel prices (+6.8% y-o-y) determined by excise tax hike as of January 2020. However, in the forthcoming months fuel prices are expected to increase slower and even decrease in the light of falling oil prices in the global markets. Overall, in the two months of 2020 prices for goods increased by 1.9%, while prices for services rose faster - by 2.9% y-o-y.

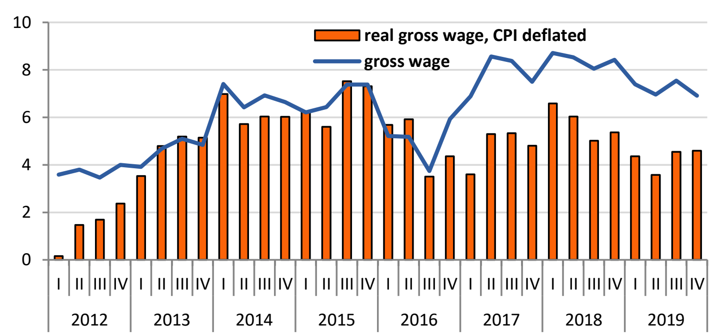
Unemployment rate, % of economically active population (15-74)



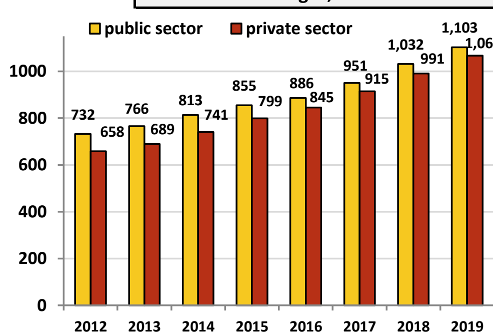
Employment

The number of employed persons, according to the labour force survey data, remained almost unchanged at 910 thsd in 2019, increasing only by 0.1%, compared to the previous year. Unemployment rate decreased by 1.1 percentage point to 6.3% of economically active population in 2019, labour force survey data shows. Registered unemployment rate, having fallen by 0.4 percentage points in 2019, declined at the same pace in the first two months of 2020 - to 6.3% at the end of February. However, due to the Covid-19 crisis, unemployment started to rise sharply in March, with the number of registered unemployed growing by 2903 and registered unemployment rate rising to 6.6% by March 30. Up to that date, 17 companies have already announced collective redundancies, which will result in 3197 employees being laid off. Number of job vacancies at the CV Online internet recruitment agency have fallen by 40% in the last three weeks.

Wage dynamics, changes year over year, %



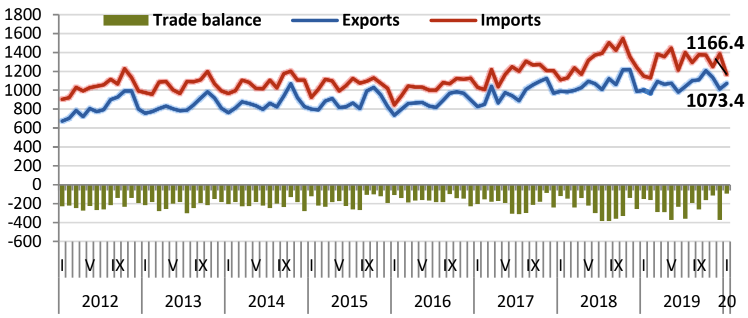
Wages, euro



In 2019, average gross wage increased by 7.2% to 1076 euro, showing a slightly lower growth than in the previous two years, when average gross wage increased by 7.9% in 2017 and by 8.4% in 2018 respectively. In 2019, wage growth rates declined gradually - to 6.9% in the fourth quarter of the year. Last year, wages grew faster in the private sector - by 7.6%, while in the public sector wage growth constituted 6.8%. Higher salary still remained in the public sector, where the average wage was 1103 euro, while in the private sector it constituted 1067 euro. Real net wage increased by 3.9% in 2019, showing weaker growth than in the previous year (+7.2%), when real net wage growth was stimulated by income tax cuts that took place in January 1, 2018.

Source: CSP, Eurostat, Ministry of Finance of the Republic of Latvia

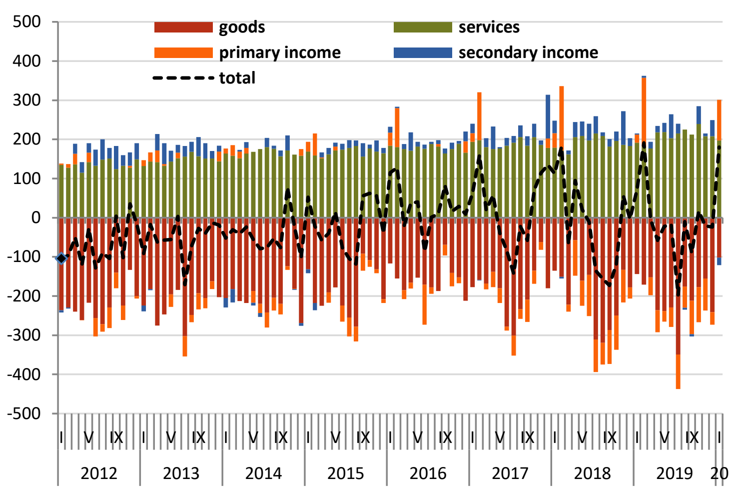
Foreign trade, current prices, euro



Foreign trade		
Exports, 2020 Jan	Structure	Annual growth
Total	100%	7.2%
Food	21.4%	25.2%
Mech/Electr appl	18.3%	23.3%
Wood	17.8%	-8.6%
Metals	7.5%	3.5%
Chemical manuf.	7.2%	6.1%
Transport vehicles	5.2%	-18.7%
Mineral products	4.7%	-19.2%
Plastics	3.5%	20.9%
Others	14.5%	13.3%

An unexpectedly high export growth was registered at the beginning of 2020 – in January of this year goods exports increased by 7.2% compared to export value registered in January of the last year. Export growth was driven by the largest goods export category – agricultural and food products which export value rose by 21.4% y-o-y determined by strong export growth of cereals and oil seeds. In January, export performance was also positively affected by exports of machinery and mechanical appliances as well as electrical machinery and equipment that expanded by 18.3% y-o-y. It was largely determined by re-exports because the strongest export growth rates were registered for such goods as mobile phones, monitors, projectors, data storage devices, automatic data processing equipment – namely, goods that are not produced in Latvia. Exports of furniture also expanded significantly – by 37.9% compared to January 2019 stimulated by export growth of furniture and stuffed furnishings to Denmark, Sweden and Estonia. At the same time, exports of mineral products declined by 19.2% y-o-y mainly affected by export contraction of electricity. While export volume of wood and articles of wood decreased by 8.6% y-o-y due to the high export volumes in January of 2019 when Brexit, expected to take place at the end of March, fostered the United Kingdom to strongly increase its stocks. However, further prospects for external trade are not optimistic due to rapid spread of coronavirus and the uncertainties it has created around the world as a result of which economic activity has been hampered globally as well as in Latvia.

Balance of payments, current account, mln euro



Current account

In January 2020, Latvia's balance of payments current account recorded a surplus of 180 mln euro. In annual terms surplus expanded by 109 mln euro. Changes in the current account were determined by rapid growth of goods exports and higher investment inflow from the EU Agricultural funds. Since the value of exported goods increased faster than imports of goods, goods account deficit declined by 42 mln euro y-o-y to 102 mln euro. The growth of exports and imports of services was similar, thereby the surplus in the services account largely did not change. In January, services account recorded a surplus of 197 mln euro, which was almost twice as high as the goods account deficit. On the back of the higher investment inflow from the EU Agricultural funds and foreign residents' income decline from financial assets in Latvia, the primary income account surplus grew by 84 mln euro y-o-y to 104 mln euro. While the secondary income account balance deteriorated and deficit increased to 19 mln euro due to the higher payments to the EU budget.

Main macroeconomic indicators, annual growth rates (unless stated otherwise)

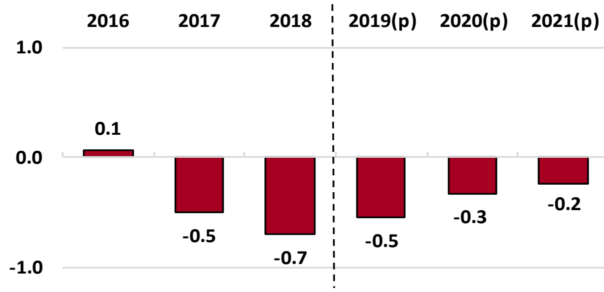
	17'III	IV	18'I	II	III	IV	19'I	II	III	IV
GDP, constant prices, %	4.5	3.5	2.8	4.7	4.4	5.0	3.1	2.0	2.9	1.0
GDP, current prices, %	8.2	6.5	6.8	8.6	8.7	9.3	7.2	5.2	5.3	2.4
Inflation, %	2.9	2.6	2.0	2.4	2.9	2.9	2.9	3.3	2.9	2.2
Nominal wages, %	8.3	7.5	8.7	8.4	8.1	8.3	7.4	7.1	7.6	6.9
Real wages, CPI deflated, %	5.4	4.9	6.7	6.0	5.2	5.4	4.5	3.8	4.7	4.7
Employed persons, %	0.9	1.3	1.8	2.0	1.9	0.8	0.6	-0.4	-0.2	0.4
Unemployed, % of active pop.	8.5	8.1	8.2	7.7	7.0	6.9	6.9	6.4	6.0	6.0
Productivity, %	3.6	2.2	1.1	2.6	2.4	4.2	2.5	2.4	3.2	0.6
Retail trade, %	4.9	5.8	5.4	5.0	3.0	2.8	3.5	3.2	1.1	1.5
Industrial production, %	11.4	4.9	4.5	0.2	2.9	0.9	-0.8	1.4	2.6	0.0
Goods exports, %	10.4	11.8	9.2	14.7	7.9	7.3	3.2	-2.3	2.0	-1.9
Goods imports, %	19.9	9.5	6.8	11.7	14.2	12.3	5.3	4.1	-5.7	-3.3
Trade balance, mln euro	-820.5	-503.0	-507.5	-664.1	-1124.2	-723.7	-596.7	-894.4	-812.3	-651.4
Current account, % of GDP	-3.2	4.5	3.6	1.4	-6.1	-0.8	3.8	-1.3	-3.7	-0.3

Source: CSP, Eurostat, Ministry of Finance of the Republic of Latvia, Bank of Latvia

General government budget balance, % of GDP

General government budget balance

According to the latest assessment of the Ministry of Finance the general government budget balance for 2019 was a deficit of 0.5% of GDP (according to the ESA methodology). Official data on the general government budget balance in 2019 will be available in the end of April 2020, when calculations of all general government sector transactions will be completed, including the results of operations of companies that have been reclassified into the general government, and the CSB will have finished clarification process with Eurostat. According to the Law “On State Budget 2020”, the permissible general government budget deficit for this year was set at 0.3% of GDP, whereas, taking into account the approved economic support measures to address the consequences of COVID-19, the expected deficits will be higher. Updated calculations of the general government budget balance will be included in the Latvia's Stability Programme for 2020-2023.



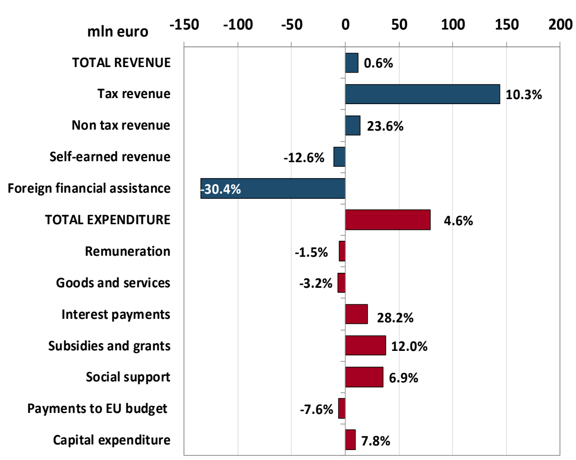
Consolidated General Budget

Budget Revenue and Expenditure

	2019 I-II execution mln euro	2020 I-II execution mln euro	Execution changes 2020/2019, mln euro	Execution changes 2020/2019, %
CONSOLIDATED GENERAL BUDGET**				
Revenue	1982.1	1994.2	12.1	0.6%
Expenditure	1699.7	1778.6	79.0	4.6%
Financial Balance	***282.5***	***215.6***	***-66.9***	
CONSOLIDATED STATE BUDGET*				
Revenue	1669.2	1630.1	-39.1	-2.3%
Expenditure	1506.4	1566.7	60.3	4.0%
Financial Balance	***162.8***	***63.4***	***-99.4***	
State basic budget				
Revenue	1202.3	1119.8	-82.5	-6.9%
Expenditure	1102.5	1129.1	26.6	2.4%
Financial Balance	***99.8***	***-9.3***	***-109.1***	
State special budget				
Revenue	466.8	506.7	39.8	8.5%
Expenditure	430.4	465.0	34.6	8.0%
Financial Balance	***36.4***	***41.7***	***5.2***	
CONSOLIDATED LOCAL GOVERNMENT BUDGET**				
Revenue	481.4	541.8	60.4	12.6%
Expenditure	361.7	389.6	27.9	7.7%
Financial Balance	***119.6***	***152.2***	***32.5***	

According to cash flow methodology
**Including grants, donations and derived public persons*
***Including grants and donations*

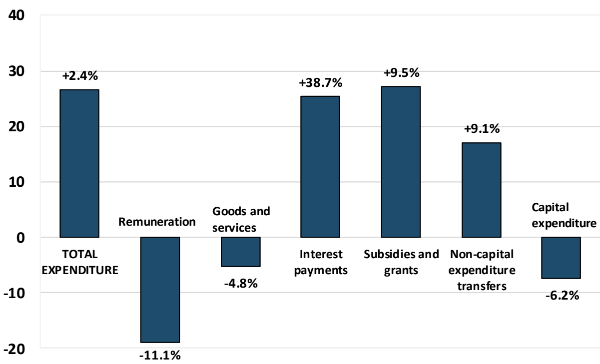
Revenue and Expenditure in I-II 2020 (cash based changes in mln euro and in per cent against respective period of 2019)



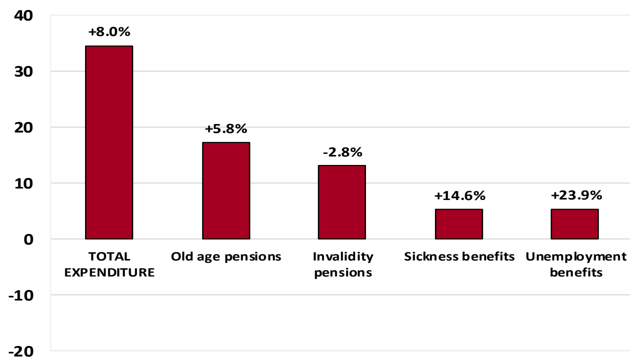
In the first two months of the year, the impact of COVID-19 coronavirus on the general budget was not yet observed. The revenue of the budget was 0.6% higher than in January-February of the previous year, but the expenditure increased by 4.6%, while the surplus of the general budget reached 215.6 mln euro which was by 66.9 mln euro lower than in the corresponding period of 2019. Consolidated general budget revenue was 1994.2 mln euro which was for 12.1 mln euro or 0.6% more than in January-February 2019. At the beginning of the year there was a strong increase in tax revenue (+ 10.3%), which was related to the increase in labor tax revenue. On the other hand, foreign financial assistance (FFA) revenue decreased significantly (-30.4%) due to the high level of revenue received at the end of 2019, which also contributed to the modest increase of revenue in the general government budget in the first months of the year. FFA revenue contributed 308.8 mln euro, which was by 134.7 mln euro less compared to January-February 2019. General budget expenditure in the first two months of this year amounted to 1778.6 mln euro, which was by 79 mln euro or 4.6% more than in the corresponding period of 2019. We should highlight the increase of subsidies and grants by 37.6 mln euro or 12%, which was related to higher spending on health sector financing and higher spending on FFA projects in the agricultural sector. Capital expenditure in the general budget for two months of this year was by 9.5 mln euro or 7.8% higher than a previous year.

Source: The Treasury, Ministry of Finance of the Republic of Latvia, Eurostat, Medium Term Budget Framework Law 2020.-2022.

State Basic Budget Expenditure in I-II 2020
(cash based changes in mln euro and in per cent against respective



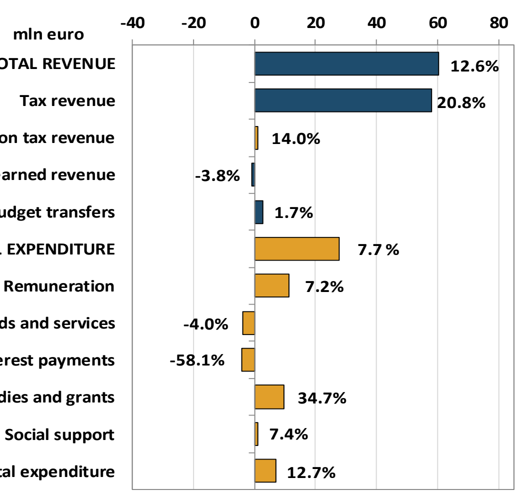
State Special Budget Expenditure in I-II 2020
(cash based changes in mln euro and in per cent against



With FFA revenues declining, the central government basic budget in January-February amounted to 9.3 mln euro deficit, while last year in the corresponding period was 99.8 mln euro surplus. In January-February of this year central government basic budget revenue reached 1119.8 mln euro and compared to January – February 2019 revenue decreased by 85.5 mln euro or 6.9%. In turn, expenditure in two months increased by 26.6 mln or 2.4% euro compared to two months of 2019. Expenditure growth was observed for subsidies and grants, which increased by 27.1 mln euro or 9.5% y-o-y, amounting 312.3 mln euro. In January-February of 2020 the basic budget remuneration (151.7 mln euro) was significantly lower, which was by 18.9 mln euro or 11.1% less, compared to two months of 2019. It should be noted that at the beginning of 2019, benefits were paid to officials of the Internal Affairs and Justice Department with special grades, which significantly increased the reimbursement expenses in the first two months of 2019.

The state special budget, as labor tax revenue increased, in the first two months of this year formed a surplus of 41.7 mln euro which was by 5.2 mln euro higher than in January-February 2019. Expenditure on social benefits in January-February this year was by 35.4 mln euro or 6.9% higher than previous year. There was a promt increase in the expenditure on sickness benefits (+ 14.6%) and unemployment benefits (+ 23.9%) in the first two months of this year. It should be noted, that in the last quarter of the previous year, before the changes in the duration and amount of unemployment benefits, there was an increase in the number of newly granted unemployment benefits. Expenditure on sickness and unemployment benefits is expected to increase more intensively in the coming months, given the consequences of the spread of COVID-19, which will affect the state special budget, where a high level of surplus has been observed in recent years.

Revenue and Expenditure in I-II 2020 (changes in mln euro and in per cent against respective period of 2019)



Consolidated Local Government Budget

The first two months of 2020 ended with a surplus of 152.2 mln euro in the local government budget, which was by 32.5 mln euro more than in the corresponding period of the previous year. Local Government Budget revenue showed significant growth and reached 541.8 mln euro, which was by 60.4 mln euro or 12.6% more than in previous year. The most significant increase was provided by tax revenue, which was attributed to personal income tax (PIT) income, which increased by 52.2 mln euro. Income from PIT reached 285.8 mln euro. It should be noted that the fulfillment of PIT revenue was driven by a more rapid increase in employee's income and by the amount of dividends paid, which was due to the possibility to distribute (till end of 2019) the profits earned by 31 December 2017 at 10% rate. Local government budget expenditure in January- February this year grew up to 27.9 mln euro or 7.7% and reached 389.6 mln euro. The largest increase was due to subsidies and grants, which increased by 9.7 mln euro or 34.7% and reached 37.6 mln euro. The growth was due to subsidies and grants to businesses to provide public transport services. Capital expenditures (62.0 mln euro) increased by 7.0 mln euro or 12.7% compared to January-February of the previous year due to EU fund investments.

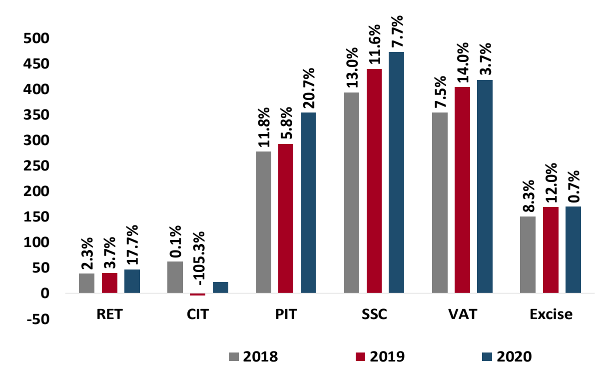
Source: The Treasury

Tax Revenue

Consolidated General budget Tax Revenue

	2019 I-II execution, mln	2020 I-II execution, mln euro	Execution changes 2020/2019, mln euro	Execution changes 2020/2019, %	January execution of the same period plan
Consolidated general budget tax revenue	**1395.2**	**1538.9**	**143.7**	**10.3%**	**105.6%**
Social security contributions	439.4	473.3	33.8	7.7%	*104.8%*
in State special budget	*423.9*	*457.2*	*33.3*	*7.9%*	*104.7%*
1% for the health financing	*15.5*	*16.1*	*0.5*	*3.5%*	*105.0%*
Value added tax	403.8	418.7	14.9	3.7%	99.1%
Personal income tax	293.4	354.2	60.7	20.7%	*125.6%*
in State budget	*59.9*	*68.4*	*8.5*	*14.2%*	*121.2%*
in Local government budget	*233.6*	*285.8*	*52.2*	*22.4%*	*126.7%*
Excise tax	168.6	169.7	1.1	0.7%	92.3%
Corporate income tax	-3.3	21.9	x	x	78.3%
Real estate tax	39.9	46.9	7.1	17.7%	*115.8%*
Informative:					
Social security contributions to the state funded pension scheme	95.5	99.5	3.9	*4.1%*	*x*

Total Tax Revenue I-II 2020 (mln euro and % change in comparison with the previous year)

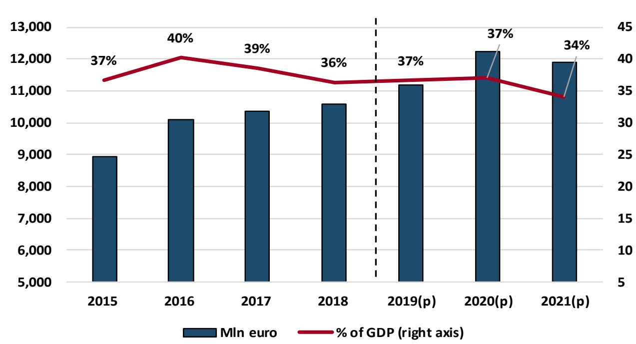


In the first two months of the year, tax revenue was 1538.9 mln euro, which was by 143.7 mln euro more than at the beginning of 2019. It should be noted, that in the first two months of this year, the general budget tax revenues were received higher than planned. The tax revenue plan in the consolidated general budget was fulfilled of 105.6% or by 81.3 mln euro exceeded revenue plan. The overrun of the plan was mainly facilitated by higher revenues from PIT, which was received in the amount of 72.2 mln euro or 25.6% above the plan. It was mainly affected by the settlement of corporate dividend payments to individuals in the end of 2019. Revenues from social security contributions (+21.9 mln euro) and real estate tax (+6.4 mln euro) were also higher than planned at the beginning of the year. Revenues from value added tax (VAT) were received almost in the planned amount (99.1%). The VAT revenue were 3.8 mln euro short to the implementation of the plan due to declining VAT revenues in sectors such as electricity, gas, heating and air conditioning, as well as storage and transportation services and wood processing. The largest non-fulfillment of the tax revenue plan was for the excise tax, where the revenue of 14.1 mln euro or 7.7% did not reach the target. As in 2019, it is still observed that lower-than expected revenue are received from excise duties on oil products and alcoholic beverages.

General Government Debt

General Government Debt, mln euro,% of GDP

According to the State Treasury, the general government debt was 36.6% of GDP in 2019 and is projected to increase to about 37% of GDP in 2020. On February 2020 an international credit rating agency S&P Global Ratings (S&P) upgraded Latvia from ‘A’ to ‘A+’ level with a stable outlook. S&P in it`s evaluation has highlighted two main driving factors for the upgrade: (a) Latvia`s prudent fiscal policy, which, despite softer medium-term growth outlook, will allow to reduce already modest debt also further and (b) vulnerabilities of Latvia's financial system are contained. Taking into account the approved economic support measures to prevent the consequences of COVID-19, the general government debt will be updated and will be included in the Latvia's Stability Programme for 2020-2023.



According to cash flow methodology

Source: The Treasury, Ministry of Finance of the Republic of Latvia, Eurostat, Medium Term Budget Framework Law 2020.-2022.