



Ministry of Economics
Republic of Latvia

MACROECONOMIC REVIEW OF LATVIA

October 2021

ISSN 2592-8538

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Central Statistical Bureau of Latvia

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ISSN 2592-852X



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ECONOMIC DEVELOPMENT TRENDS

Until the outbreak of Covid-19 pandemic, Latvia's economic growth remained stable, exceeding the EU average. From 2011-2019, GDP on average increased by 3.3% annually.

The Covid-19 pandemic, which began in March 2020, has a significant impact on the global and Latvian economies. On a quarterly basis, the largest decline was observed in the Q2 of 2020, when the economy shrank by 8.9%. However, it was a relatively modest decline, as the EU GDP contracted by 13.9% on average. In Q3 and Q4 of 2020, the annual rate of economic decline continued to deteriorate. Overall, in 2020, GDP decreased by 3.6%, compared to 2019. With the epidemiological constraints remaining, the economy will decline in the first

quarter of 2021 as well (by 0.7%). With the epidemiological constraints remaining, the economy will decline in the first quarter of 2021 as well. However, with the resumption of seasonal work in the spring and the improvement of the epidemiological situation, which will be facilitated by vaccination, economic activity is expected to increase gradually. In Q2 of 2021, GDP was by 10.8% higher than a year ago. According to seasonally adjusted data, GDP increased by 2.6%, compared to the corresponding period last year, exceeding the level of the 4th quarter of 2019 (the last period prior to the Covid-19 pandemic) by 1.3%. The Ministry of Economics forecasts that in 2021 economic growth could reach 5%. However, uncertainty due to the Covid-19 pandemic remains elevated.

Key Economic Development Indicators

	2016	2017	2018	2019	2020	2021p
Gross domestic product, at current prices, billion euro	25.4	27.0	29.2	30.6	29.5	31.9
<i>Changes against the previous year, as per cent</i>						
Gross domestic product	2.4	3.3	4.0	2.5	-3.6	5.0
Private consumption	3.4	2.9	3.0	0.2	-7.6	7.0
Public consumption	2.3	3.3	1.7	3.4	2.6	4.5
Gross fixed capital formation	-8.2	11.4	11.8	6.9	0.2	4.5
Exports	3.9	6.4	4.5	2.1	-2.2	6.1
Imports	3.6	8.6	6.4	3.0	-2.5	10.4
Consumer prices	0.1	2.9	2.5	2.8	0.2	2.9
<i>as per cent</i>						
Changes in the number of employed	-0.3	0.2	1.6	0.1	-1.9	-2.5
Employment rate	61.6	62.9	64.5	65.0	64.2	62.9
Unemployment rate	9.6	8.7	7.4	6.3	8.1	7.5
<i>as per cent of GDP</i>						
General government balance	0.2	-0.8	-0.8	-0.6	-4.5	-6.8
General government debt	40.4	39.0	37.1	36.7	43.2	45.9
Net exports	0.3	-0.6	-0.8	-0.8	1.2	-2.0

e - estimation

The Covid-19 crisis has had a significant impact on consumption. With rising employment and wages, private consumption has grown steadily in recent years. In 2020, the increase in unemployment and the fall in income caused by the Covid-19 crisis have significantly reduced household consumption. In 2020, it was 7.6% lower than a year ago. In the first half of 2021, compared to the corresponding period last year, private consumption rose by 2.3%, largely due to the base effect. However, compared to 2019, private consumption still remains low.

Government support measures to mitigate the negative effects of Covid-19, which have been largely financed at the expense of increasing government deficits, have maintained positive growth in government consumption.

In 2020, it was by 2.6% higher than a year ago and continued to grow in the first half of 2021 (by 5.2% annually).

The Covid-19 crisis has had a relatively more moderate impact on investment. Despite the decline in total economic activities in 2020, investments increased by 0.2%. Positive trends are also observed this year - in the first half of 2021, investments in gross fixed capital formation increased by 4.2%. Also, investments in machinery and equipment and investments in intellectual property products rose by 16.2% and 16.6%, compared to the first half of the year, respectively. Investment is anticipated to continue to increase, driven by improving economic sentiment and a significant inflow of EU funds.

Exports of goods has been instrumental in mitigating the negative effects of the Covid-19 pandemic. In 2020, due to Covid-19 restrictions in foreign markets, exports decreased by 2.2%. However, in the first half of 2021, as the situation in foreign markets stabilized, exports increased by 6.9% annually. Trends in exports of goods and services remain highly disparate. In 2020, Latvia's exports of goods increased by 6.4%. Also, in the first half of 2021, exports of goods rose by 9.6%. The largest contribution to the growth of exports of goods was provided by the growth of exports of machinery and electrical equipment. In 2020, a significant increase in exports in the group of food and agricultural goods, as well as plastics and plastic products was observed. In the first half of 2021, a significant increase in exports of wood and wood products was recorded.

At the same time, exports of services lag significantly behind pre-crisis levels. In 2020, it decreased by 21.7%. The decline was largely due to exports of the aviation and tourism services sectors affected by the Covid-19 pandemic, as well as declining exports of transit services. Although the situation has stabilized in 2021 and in the first half of the year, exports of services decreased by 0.9% annually, its return to the pre-crisis level will take a longer period of time.

Since 2011, Latvia has experienced a low current account deficit, thus indicating the external sustainability of the Latvian economy. In 2020, the current account surplus of 2.9% of GDP was observed. Despite the negative impact of Covid-19 pandemic on economic development, it is anticipated that in the coming years the current account will be with a small deficit, not comprising the external sustainability of Latvia's economy.

Development trends are highly variant across sectors. Due to the Covid-19 crisis, the most significant decline in 2020 was observed in the accommodation and food service activities, the arts, entertainment, and recreation sectors. The restrictions imposed on Covid-19 also had a significant impact on aviation, land transport, and railway companies. Also, a significant decline in financial and insurance activities, information and communication services, and commercial services was observed. A slight decline in 2020 was observed in the manufacturing, which was largely influenced by the significant slowdown of the sector during the first wave of the pandemic in March, April and May 2020. At the same time, volumes increased in agriculture and forestry, construction, and public services.

At the beginning of 2021, the Covid-19 pandemic continued to affect sectors with a high share of social contact. However, sectors that are more export-oriented endured the second wave of the Covid-19 crisis much more successfully. As the summer approached and the epidemiological situation gradually improved, economic activity in the worst-affected sectors steadily began to recover. However, in Q2 of 2021, compared to Q4 of 2019 (prior to the crisis), the volumes in the air transport sector were 76% lower. Also, in accommodation sector the

volumes were by 52% lower. In addition, in Q2 of 2021, compared to Q4 of 2019, catering, as well as the arts and entertainment sectors increased by 35%. At the same time, in Q2 of 2021, the volumes in an increasing number of sectors already significantly exceeded the pre-crisis levels. These include a number of manufacturing sub-sectors, healthcare, information and communication services, etc.

The Covid-19 pandemic has led to significant changes in fiscal policy. In 2020, the general opt-out clause of the Stability and Growth Pact was activated in the EU, allowing EU countries to increase the general government deficit in 2020 and 2021 to the extent necessary to reduce the economic damage caused by the pandemic. **As a result of the Covid-19 pandemic, in 2020 the budget deficit increased to 4.5% of GDP or 1.3 billion euro.** The Saeima approved the budget for 2021 with a deficit of 9.3% of GDP.

Due to the negative impact of the Covid-19 epidemic on economic development, **the average annual inflation in 2020 was only 0.2%, which is significantly lower than in 2019.** As the pandemic recedes, consumer prices have begun to rise. In September 2021, compared to the corresponding month last year, consumer prices increased by 4.8%. The average annual inflation was 1.3%. **In 2021, the average annual inflation could reach 2.9%.** However, it will still be largely determined by world price fluctuations.

The introduction of Covid-19 restrictive measures has a significant impact on the labour market. Since the introduction of the Covid-19 restrictive measures in mid-March 2020, labour-intensive sectors directly related to population movements and assembly have been hit hardest. Overall, in 2020, the number of employees decreased by 1.9% or approximately 17 thousand, representing the largest decline in the number of employees since 2010. Along with the decrease in employment, unemployment also increased significantly. In 2020, the unemployment rate in Latvia was 8.1%, significantly exceeding the level of 2019 (i.e., by 1.8 percentage points).

In 2021, with the gradual improvement of the epidemiological situation, improvements in the labour market have been observed. Since April 2021, employment has returned to growth, as well as unemployment continues to fall. However, the crisis has left its mark on the labour market. The number of employees and the employment rate still significantly lag behind the level of 2019. The crisis has affected the economic activity of the population, which, in addition to demographic processes, has reduced the supply of labour in the labour market and increased the risks of labour shortages. As the crisis persists, the share of long-term jobseekers has risen, which, along with regional labour market disparities, may pose risks of structural unemployment in the coming years, as well as exacerbate the problem of labour supply. In Q2 of 2021, 861.6 thousand people aged 15-74 were

employed, which was by 3.4% or 30.5 thousand less than in Q2 of 2020.

Overall, the labour market situation is expected to continue to improve, leading to more jobs and lower unemployment. It should be noted that it may become increasingly difficult to find qualified specialists, especially in such sectors as construction and manufacturing, which may be further aggravated by regional labour market disparities. However, it is forecast that the unemployment rate will decline to 7.5% on average annually.

With the return of economic activity, the average wage has been growing rapidly. In Q2 of 2021, the average monthly gross wage increased by 10.2%, rising to an average of EUR 1,237 per month and representing the most rapid monthly wage growth rate during the last 13 years. It should be noted that a significant increase in wages in Latvia has been observed in previous years - the average rise in wages over the last five years has been close to 7% annually. Positive pressure on wages continues to be maintained both by the process of wage convergence closer to the level of economically developed EU countries and by the increasing shortage of skilled labour (i.e., shrinking labour market, which makes it

necessary for entrepreneurs to consider how to not only maintain but also attract more qualified specialists (also by reviewing wage rates)).

The further development of the economy in the medium term depends on the situation in the external environment and the pace of reforms. The largest risk to Latvia's growth is related to the development of the global economy, especially the cessation of the expansion of the Covid-19 epidemic. The further development of the EU's common economic space is also vitally important. Latvia's economic advantages in the medium term will be mainly based on the achieved macroeconomic stability (as a result of which Latvia's credit ratings have improved), the efficiency of the planned EU support programs, and improvements in the business environment.

The competitive advantages of the Latvian economy mainly rely on technological factors, improvements in production efficiency and innovations; however, to a lesser extent on low labour and resource prices. In the medium term, Latvia's growth rates may reach 4-5% annually. Economic recovery could slow down if growth in Europe weakens and virus control measures endure.

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WORLD ECONOMIC OUTLOOK

According to the OECD (OECD Interim Economic Outlook Forecasts, 2021), **global economic** growth prospects have improved, driven by the introduction of vaccines, fiscal support, and signs that the economy is coping better with anti-virus measures. However, uncertainty remains elevated. New waves of the pandemic and the spread of the most contagious strains of the virus raise concerns for further development. In 2021, global GDP is projected to grow by 5.8%. However, in 2022, the growth rate will slow down to 4.4%.

GDP Growth Rate
as per cent

	2020	2021e	2022e
World	-3.5	5.8	4.4
G20	-3.1	6.3	4.7
Eurozone	-6.7	4.3	4.4
United States	-3.5	6.9	3.6
Germany	-5.1	3.3	4.4
China	2.3	8.5	5.8

Source: OECD Interim Economic Outlook Forecasts (2021); further – OECD
e – estimate

In **China**, the recovery has been rapid. Growth is expected to reach 8.5% in 2021, assuming that the epidemiological situation remains under control. In **India**, after a sharp decline in GDP in 2020 (by 7.7%), the economy is projected to return to growth in 2021, driven by rising demand for consumer and investment goods.

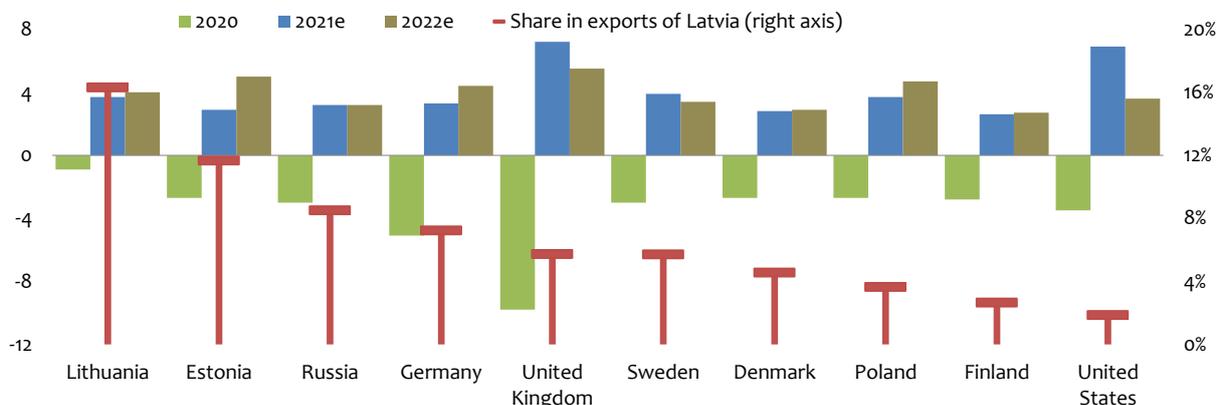
Economic growth in the **United States**, supported by strong fiscal support and rapid progress in vaccination, has stabilized. In 2021 and 2022, real GDP is expected to grow by 6.9% and 3.6%, respectively.

In the **euro area**, GDP in 2021 and 2022 is projected to increase by 4.3% and 4.4%, respectively. However, the pace of recovery will vary significantly between Member States due to structural factors in the economies. Rising energy and raw material prices, shortages of some raw materials and their components, as well as capacity constraints in response to growing demand, will put pressure on consumer prices this year.

In the **United Kingdom**, in 2021 and 2022, real GDP is expected to grow by 7.2% and 5.5%, respectively. Growth is driven by increase in private consumption, especially in services. The increased costs of the UK's exit from the EU's single market will continue to affect external trade.

In 2021 and 2022, real GDP in **Germany** is projected to increase by 3.3% and 4.4%, respectively. Virus outbreaks and related containment measures have delayed the recovery of service sectors, while export-oriented manufacturing is growing strongly. In **Sweden**, real GDP is expected to reach 3.9% in 2021, while GDP growth rate is anticipated to slow down slightly to 3.4% in 2022. Labour market schemes and additional fiscal support have significantly mitigated the effects of the crisis. In 2020, **Estonia** withstood the pandemic shock better than most other EU member states, as GDP shrank by merely 2.7%. In 2021 and 2022, GDP is projected to increase, mainly due to private consumption and a gradual increase in private investment, by 2.9% and 5%, respectively. The **Lithuanian** economy has also been relatively resilient to the shock of the pandemic. In 2021 and 2022, GDP is projected to grow by 3.7% and 4%, respectively. Rising demand and stronger investment will contribute to economic recovery.

Growth of Latvia's Largest Trade Partners
GDP changes against the corresponding period last year, as per cent – left axis; share as per cent in 2020 – right axis

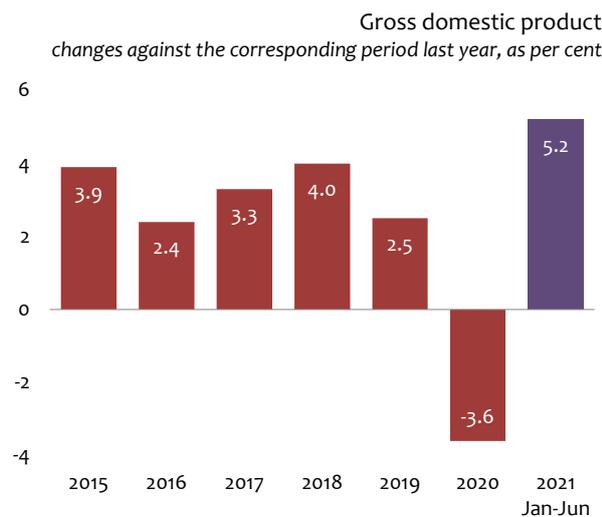


Source: CSB, OECD (2020), World Bank (2020), e – estimate

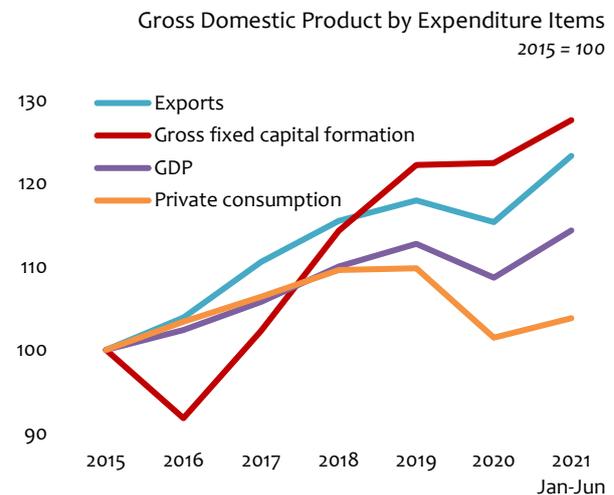
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GROSS DOMESTIC PRODUCT

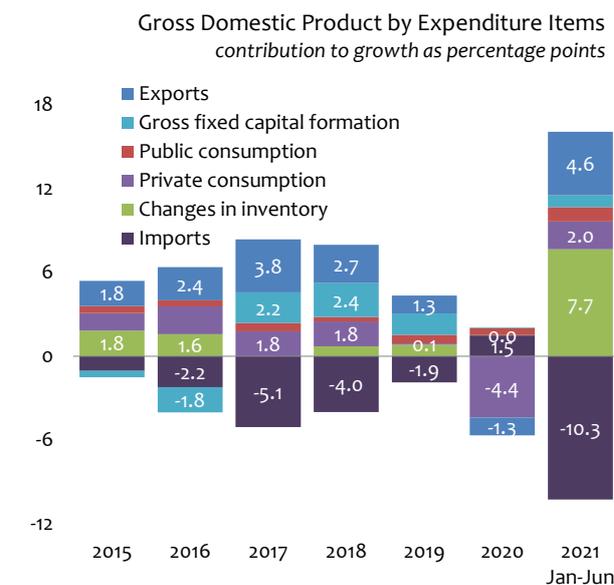
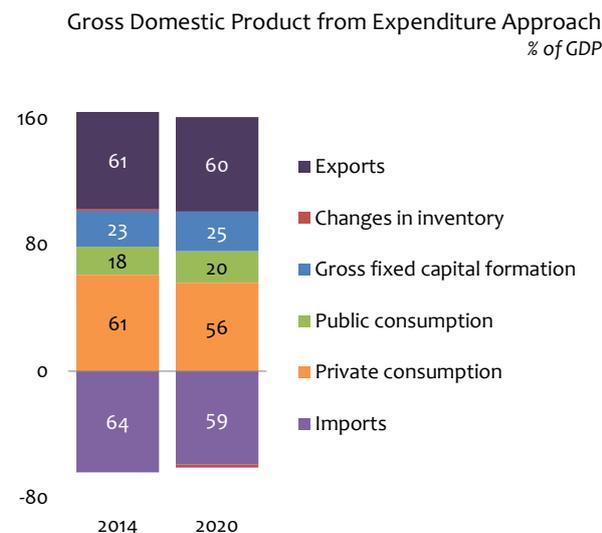
In 2021, the economy will grow. In the first half of 2021, GDP grew by 5.2%, representing the largest growth over the last nine years.



services lagged significantly behind the pre-crisis level, which was mainly determined by a significant decline in exports of tourism and transport services. Due to the base effect, household consumption also increased rapidly. In 2020, investment volumes under Covid-19 conditions were relatively stable and even increased slightly, and positive trends can be observed this year as well. Government consumption also continued to increase, driven mainly by the continuation of government support measures to mitigate the effects of Covid-19.



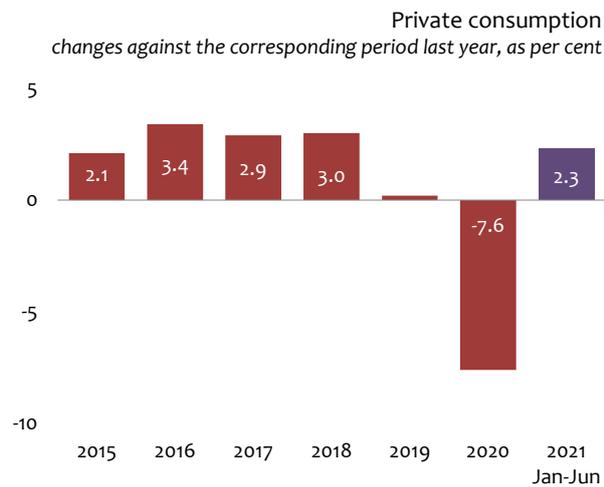
In Q1 of 2021, economic development was still determined by the negative impact of Covid-19. However, in Q2 of 2021, largely due to the base effect, the economy experienced rapid growth. The largest impact provided the increase in exports due to the favorable economic situation in Latvia's largest export markets.



Trends in exports have been highly disparate. In 2020, while exports of goods grew very rapidly, exports of

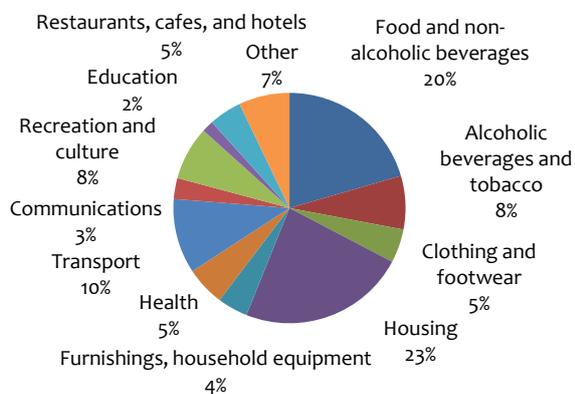
CONSUMPTION

Private consumption grew rapidly in the spring of 2021. From 2014 to 2019, it increased on average by 2.3% annually, which was mainly facilitated by employment and wage growth. However, in 2020, private consumption declined sharply due to Covid-19 restrictions. Q1 of 2021, the decline endured. However, in Q2 of 2021, due to the base effect, it increased rapidly.

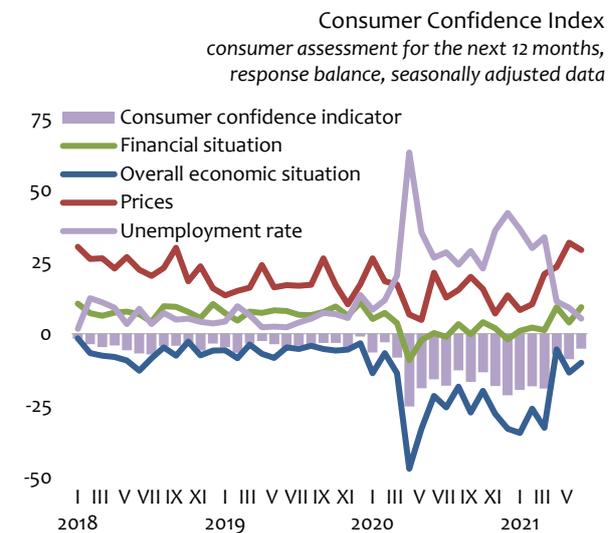


Expenditure on housing accounts for the largest share of household consumption. In 2020, compared to 2019, due to the restrictions imposed by the Covid-19, the largest decreases were observed in consumption groups such as recreation and culture, restaurants and hotels, and transport. This was due to the state of emergency, during which various services were not available in person. Expenditure on alcoholic beverages decreased by 10%, compared to the previous year. As people stayed more at home, food consumption and housing expenditure increased. In particular, expenditure on food and housing rose by 2.8% and 1.2%, respectively.

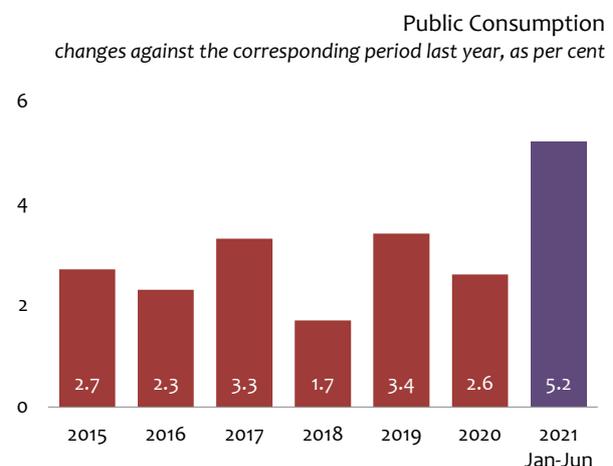
Structure of Household Expenditures
2020, as per cent



In the first half of 2021, consumer sentiment has recovered, reaching the level of the beginning of 2020. In March 2020, with the declaration of a state of emergency, consumer sentiment began to deteriorate. The most pessimistic consumer sentiment was observed in April 2020, when various aspects of the development outlook for the next 12 months deteriorated. However, in April and May 2021, inflation expectations reached their lowest level in the last three years. At the beginning of 2021, consumer confidence began to improve in all key positions of the indicator. As the epidemiological situation continues to improve and restrictions are gradually revoked, consumers in the first half of 2021 have become significantly more optimistic in their assessments. The assessment of future outlook has returned to pre-Covid-19 levels.

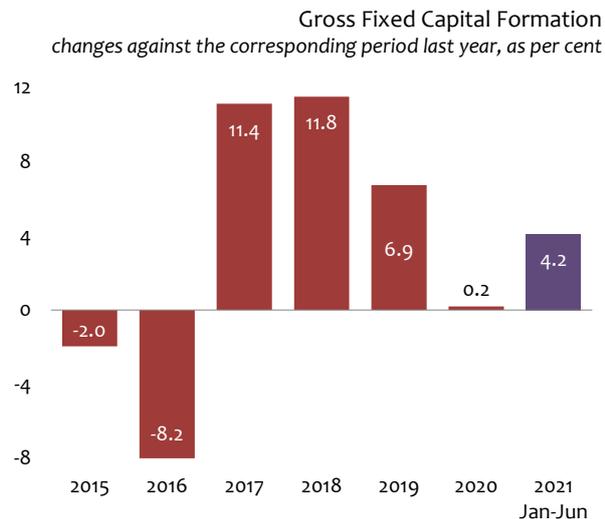


Public consumption continues to increase. With budget revenues rising, public consumption has grown more rapidly since 2014. From 2014 to 2019, public consumption increased by 2.7% annually. In 2021, public consumption continued to grow, mainly due to government support measures to reduce the negative impact of Covid-19.



INVESTMENT

In the last three years before the Covid-19 pandemic (2017-2019), investment increased by an average of 10% annually. EU-funded public investment accounted for a large share of investment. As the absorption of EU structural funds approached the final phase, investment activities declined.



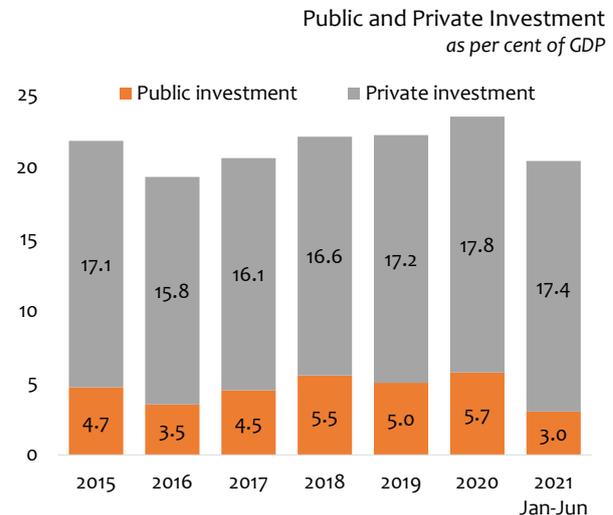
Due to the Covid-19 pandemic, investment activity in 2020 was lacklustre. Compared to 2019, the amount of investments increased by only 0.2%. Nevertheless, it was one of the highest growth rates in the EU countries. In 2021, investment activities have gradually started to increase. In the first half of 2021, the amount of investments was 4.2% higher than a year ago.

Private investment, albeit slowly, is increasing. The recovery in private investment following the global financial crisis has been long-lasting. Positive dynamics resumed only since 2017 and was quite rapid. From 2017 to 2019, investment increased on average by 6.5% annually and accounted for almost 17% of GDP, which is lower than in the years of rapid economic growth. In 2020, the volume of private sector investments decreased by 1.7%. In the first half of 2021, investment activities increased and were 10.8% higher than a year ago.

In the long run, low levels of private investment are largely driven by weak credit, low demand, and high uncertainty. The negative impact of these factors on investment was significantly exacerbated by the Covid-19 crisis.

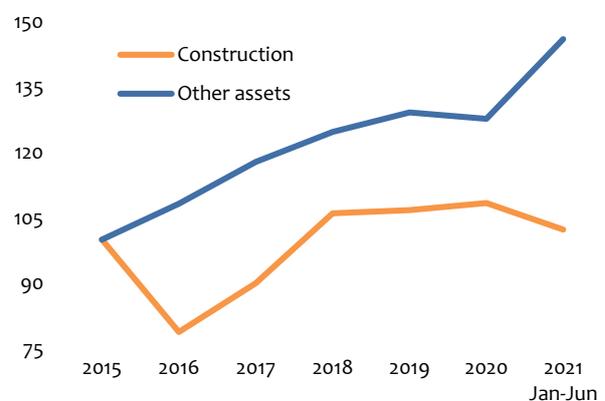
Public investment in Latvia is relatively high. Public investment accounts for almost 1/5 of the total investment in the Latvian economy and its dynamics are largely related to the cyclical nature of the absorption of EU structural funds. Between 2017-2019, public investment increased on average by 16% annually. With the EU funding reaching its peak, the volume of public investment in 2019 decreased significantly and was 9.2% lower than a

year ago. In 2020, despite the Covid-19 crisis, public investment increased by almost 7%. In Q1 of 2021, compared to the corresponding period last year, public investment declined by almost 24%.



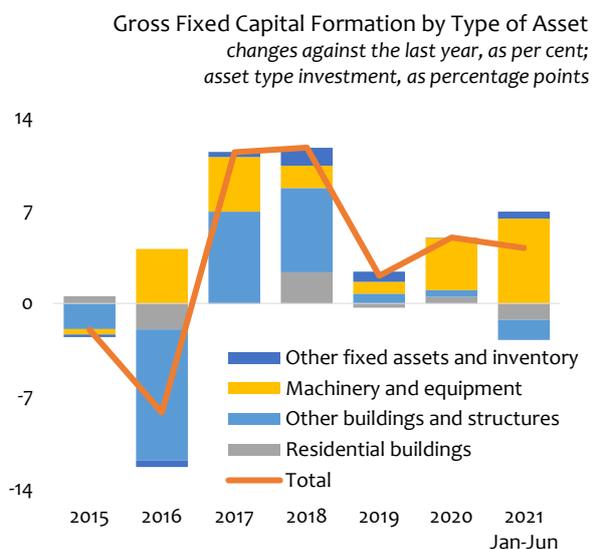
Most of investments has been made in construction assets. These are mainly investments in buildings and structures, which in the last three years accounted for almost 45% of total gross fixed capital formation expenditure. In 2020, investments in construction assets (at constant prices) were 1.5% higher than a year ago, which was determined by an increase in investments in engineering structures and buildings – by 2.5%. However, investments in housing declined by 2.3%. Overall, in the first half of 2021, investment in construction assets declined by 5.6%, compared to the corresponding period last year.

Gross Fixed Capital Formation by Type of Assets
2013 = 100



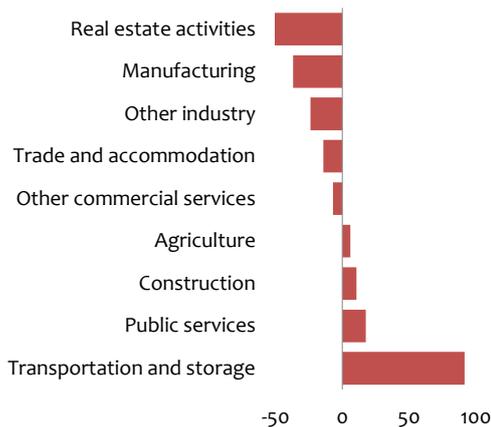
Between 2017-2019, investments in machinery and technological equipment (excl. vehicles) did not exceed 40% of total investments and their dynamics were slower

than in other assets. In 2020, entrepreneurs invested in machinery and equipment by 2.8% more than a year ago. However, the volume of investments in vehicles declined significantly – by 22.3%.



In the first half of 2021, investments in machinery and equipment rose by 16.2%, compared to the corresponding period last year. The increase in investment was largely due to investment in vehicles, as well as information and communication technology equipment, which is a necessary equipment for remote work.

Non-financial Investment Dynamics
in Jan-Jun 2021*, compared to the corresponding period last year, as per cent*



* – calculated using quarterly data, at current prices

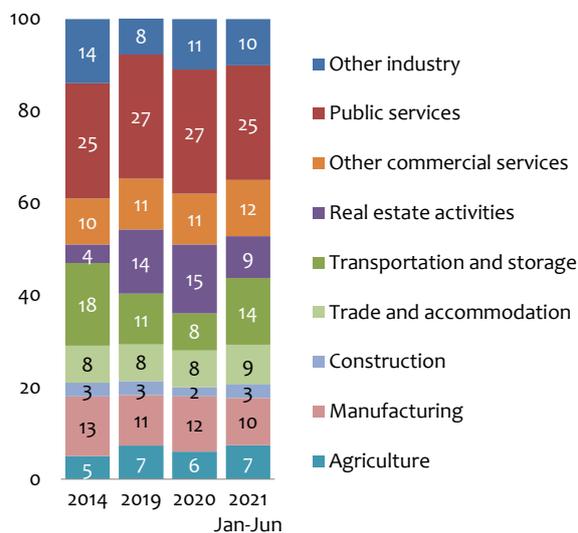
Investment in intellectual property products averaged 1.7% of GDP over the last three years before the Covid-19 crisis. In 2020, investment in intellectual property products rose by 2.8%. Positive investment dynamics have been also observed in 2021. In the first half of 2021, investment in intellectual property products rose by 16.6%, reaching 2.3% of GDP.

In the first half of 2021, compared to the corresponding period last year, capital investment in tangible fixed assets in the goods production sectors declined by 21.5%.

The largest declines were observed in investment in manufacturing (by 36.7%) and in the energy and heat supply sector (by 24%). This was partly offset by an increase in capital investment in tangible assets in transportation and storage and health care sectors, where investment volumes rose by 92% and 53%, respectively.

The results of the survey of managers of industrial enterprises reveal that the most crucial factor promoting investment is the growth of demand. Access to finance is vital in stimulating investment. In 2021, financial conditions are also estimated as a critical factor supporting investment, evaluated equivalently to technical factors, such as technological development, availability of qualified labour, etc.

Gross capital investment Structure
by sectors, as per cent*



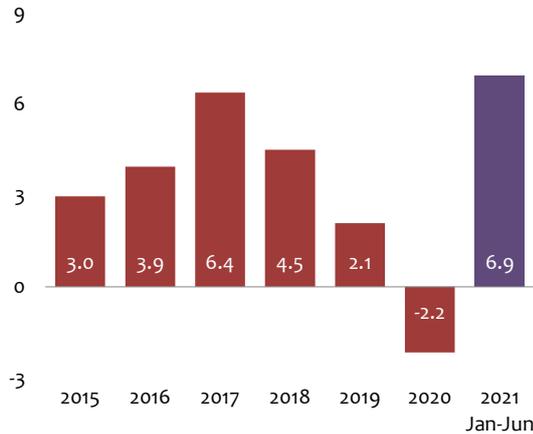
* Gross capital investment in tangible assets (calculated using quarterly data)

Investment dynamics will continue to be affected by uncertainty regarding the international environment, including measures to limit the spread of Covid-19. Increasing the loan portfolio, which has been low for a long time, will also be critical. Investment dynamics will be positively influenced by EU funding, which remains vital for the economy to raise the level of investment. It is anticipated that investment activities will rise more rapidly with the launch of the *Rail Baltica* project. A number of projects funded under the Renewal and Sustainability Facility will also make a significant contribution to rising investment activity. With increasing economic activity, the growth of investment may be slowed down by the limited availability of labour.

EXPORTS

Export growth is one of the main drivers of economic development. It is closely linked to external demand and economic development of key partner countries.

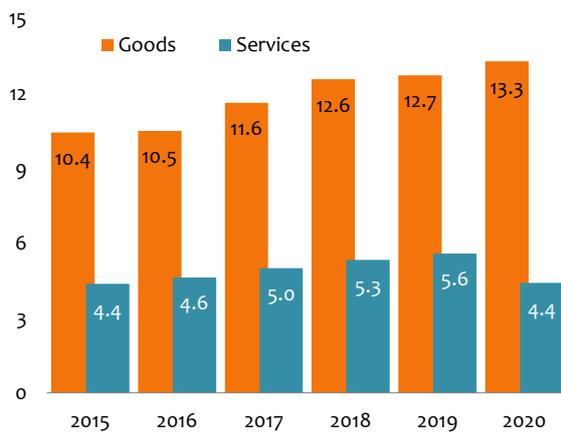
Exports of Goods and Services changes against the last year, as per cent



In 2020, exports of goods and services decreased, mainly due to the Covid-19 pandemic. In Q1 and Q4 of 2020, export volumes increased. However, in Q2 of 2020, exports of goods and services significantly declined, which determined the overall decrease in exports for the year.

In Q1 of 2021, exports slightly decreased. However, in Q2 of 2021, it rose by 15.5%. Overall, in the first half of 2021, export volumes were 6.9% higher than a year ago.

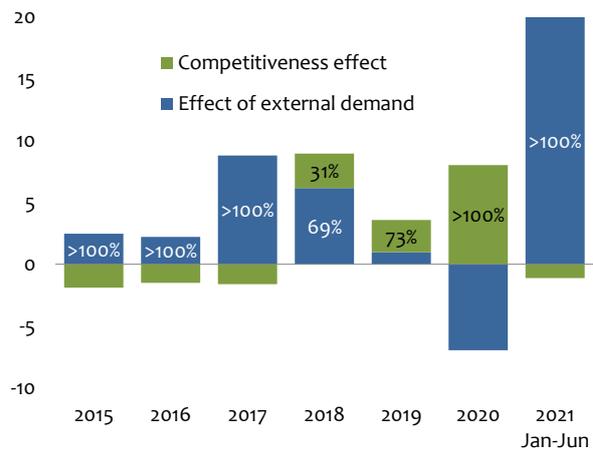
Exports of Goods and Services at current prices, billion euro



Between 2015-2018, export growth was mainly driven by external demand. The role of price competitiveness was

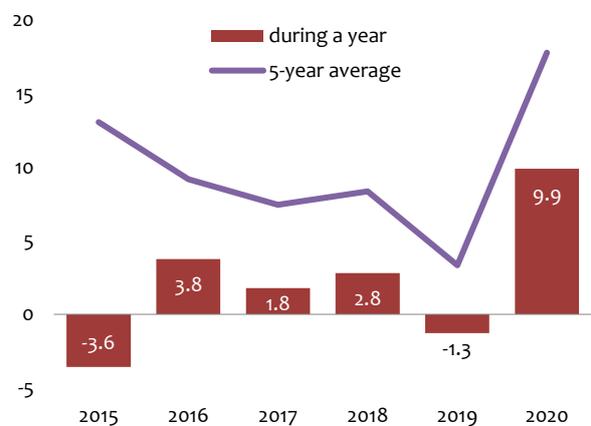
negligible. On the other hand, in 2019, the growth of exports was more influenced by the competitiveness effect, which is related to the successful acquisition of new markets. However, in 2020, due to the spread of Covid-19, external demand is rapidly declining, which is partially offset by the increase in competitiveness in certain sectors. In turn, the growth of exports in 2021 is promoted by a rapid increase in external demand.

Changes of Exports by the Constant Market Share structure of exports' changes to the EU countries, as per cent



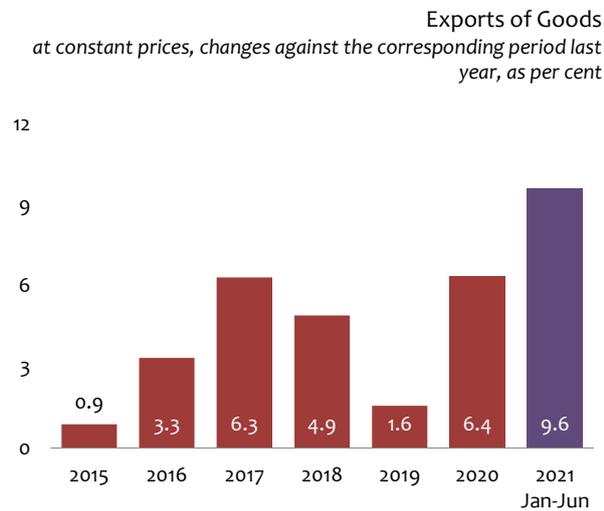
Since 2016, the share of Latvia's exports in world trade has been growing, indicating that Latvian entrepreneurs have remained competitive despite the rapid increase in labour costs. In 2019, the growth rates of Latvia's exports were lower than the global average. Therefore, the share of Latvia's exports in the world decreased slightly.

Share of Exports in World Trade changes as per cent



Exports of Goods

Exports of goods have remained stable, constituting around 70% of total Latvia's exports. It should be noted that in 2020 and the first half of 2021, with exports of goods growing rapidly and exports of services declining, the share of goods in total exports increased slightly.

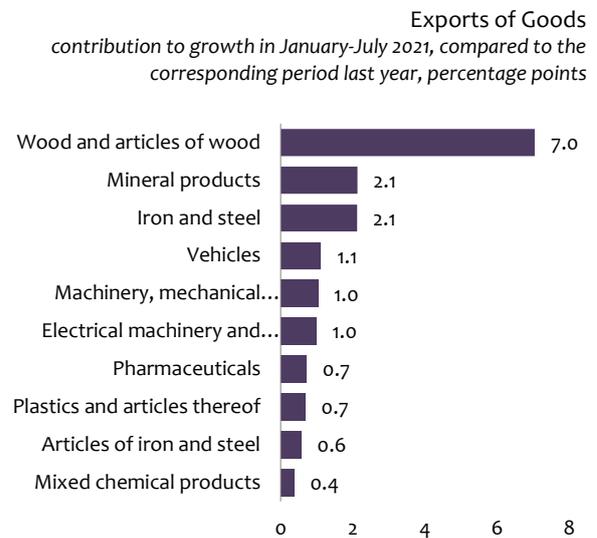


In 2020, and specially in the first half of 2021, exports of goods increased rapidly – at constant prices it rose by 9.6%. Also, with a notable rise in export prices, growth in real prices was even more rapid - by 20.5 percent.



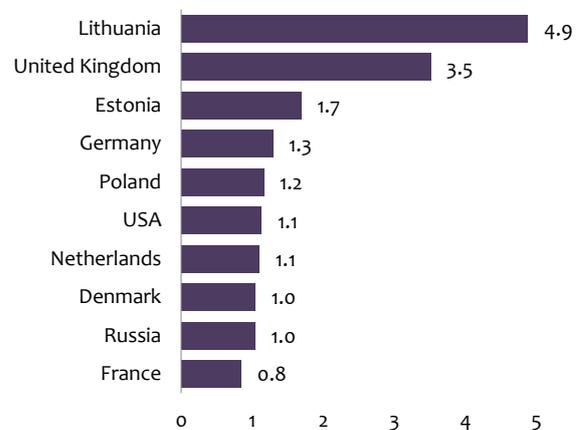
In 2020, the rise in the value of exports of goods was mostly affected by the rise in exports of electrical appliances and equipment. In January-July 2021, exports of goods increased by 21.2%, mainly driven by the rise in the

value of exports of wood and wood products, mineral products, and iron and steel.



In January-July 2021, exports of goods rose to all main partner countries. Although it grew modestly to the CIS countries, the rise was higher to the EU and other countries.

Exports of Goods by Country
contribution to growth in January-July 2021, compared to the corresponding period last year, changes as per cent



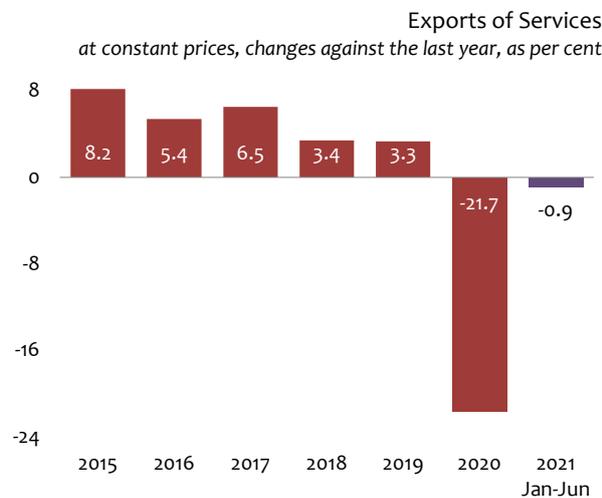
In 2021, the largest Latvia's export partner countries in goods were Lithuania, Estonia, Russia, the United Kingdom, Germany, Sweden, Denmark, and Poland. Latvia exported 2/3 of all goods to these countries.

In January-July 2021, the main export groups to the EU countries were wood and wood products and electrical appliances. Alcoholic beverages, electrical appliances, machinery and equipment, and pharmaceutical products accounted for a large share of exports to the CIS countries. The largest export groups to other countries were wood and wood products, electrical machinery and equipment, and cereals.

Exports of Services

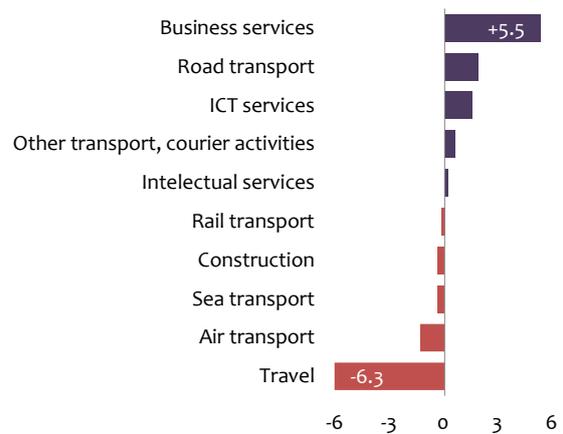
Until 2019, exports of services have increased at a higher rate than exports of goods. Transport services, ICT, trade intermediation, and travel services provide a major contribution to export growth. However, since 2016, the share of finance and insurance activities in exports is declining.

Due to the spread of Covid-19, the year 2020 was especially unfavorable for the export of services, the value of exports at current prices was 21.6% lower than a year ago. In the first half of 2021, exports of services at current prices were 0.9% higher than a year ago. However, considering price changes, exports of services at constant prices declined slightly.

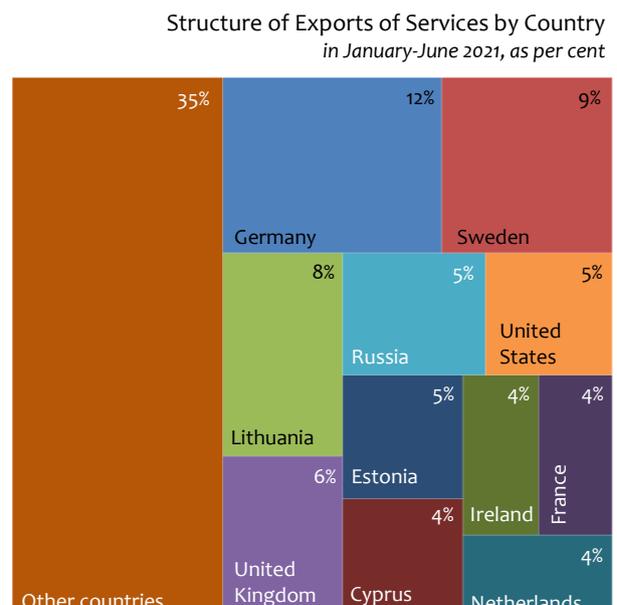
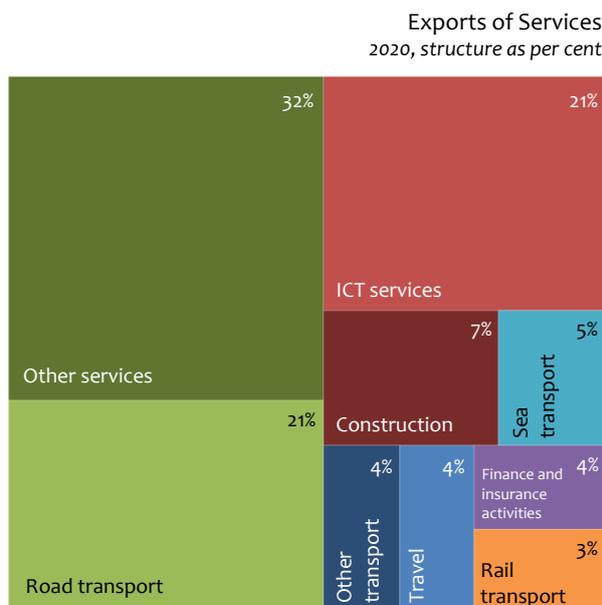


In 2020, only exports of construction and other economic services increased. Exports of transport services, on the other hand, declined significantly, especially in air transport and travel services. The value of financial and insurance and ICT export services declined more moderately. In January-June 2021, exports of travel and air transport services declined markedly. Nevertheless, exports of economic and ICT services increased.

Exports of Services contribution to growth in January-June 2021, changes as per cent

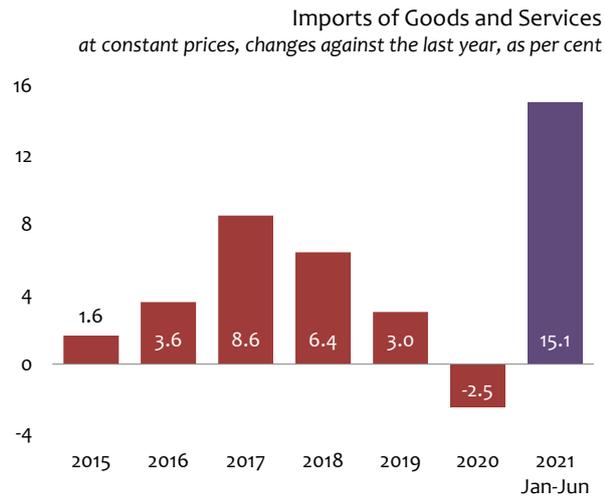


Each year the share of exports of services to EU countries has increased. Exports of services to CIS countries (mainly transit services) still comprise a significant share of total export volume. It should be noted that exports of services to CIS countries in recent years have slightly declined.

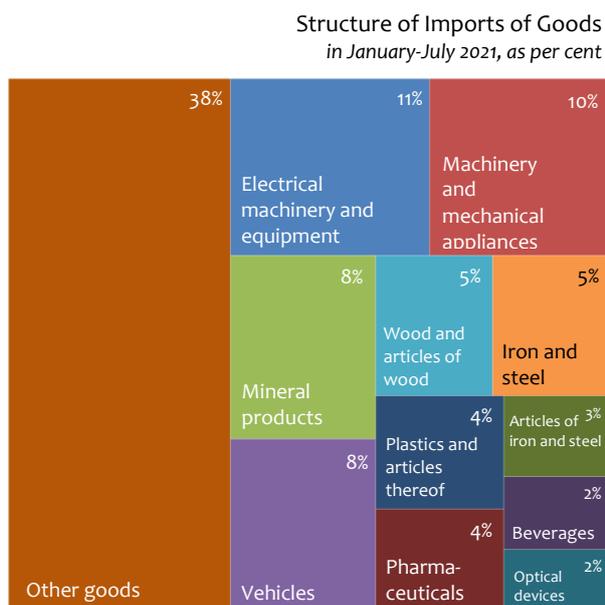


IMPORTS

In recent years, imports of goods and services experience a similar growth as exports. Since 2017, imports of goods increased at a higher rate than imports of services. However, in 2020, under the influence of Covid-19, imports of services decreased significantly, while imports of goods essentially remained at the previous year's level. **In the first half of 2021, imports of both goods and services increased significantly.**



In 2020, due to lower prices, imports of goods at current prices declined by 4.7%. In Q2 of 2021, similar to exports of goods, imports also significantly decreased. In 2020, the fall in imports of goods was affected by the decline in imports of mineral products, aircraft and their parts, and land vehicles. The value of imports of electrical machinery and equipment increased significantly. However, imports of cereals rose moderately.



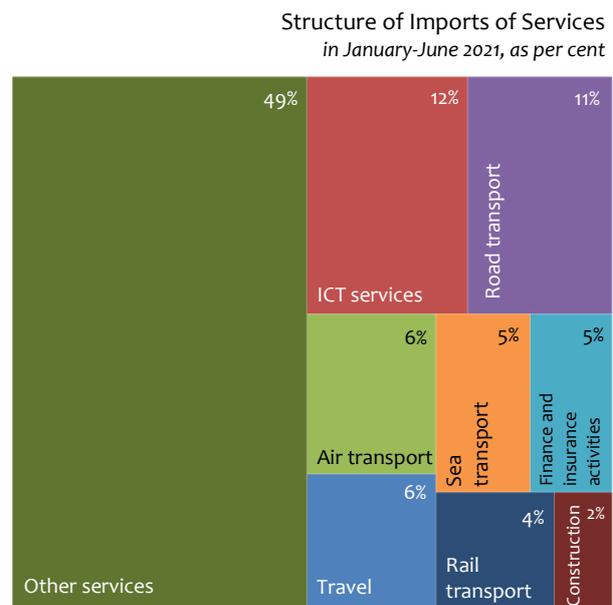
In January-July 2021, imports of goods increased by 25.6%. It was significantly affected by the rise in the value of imports of mineral products, land vehicles, wood and wood products, iron and steel, and machinery.

Latvia's main imports of goods partner countries are Lithuania, Germany, Poland, Russia, Estonia, China, the Netherlands, and Finland. In 2020, Latvia imported 2/3 of all goods from these countries.

After the end use of goods approach, the structure of imports has not changed significantly since 2012. The share of intermediate goods decreased slightly due to the decrease in the value of fuel imports. The share of fuel in the group of intermediate consumer products has decreased from 34% in 2012 to 21% in 2019 and to 15% in 2020, which can be explained both by a marked drop in world oil price and, especially in 2020, by declining demand. In the first half of 2021, the share of intermediate goods increased slightly. Nevertheless, the share of imports of consumer goods declined.

In 2017-2019, imports of services developed dynamically, similarly to exports of services. During this period, imports of services increased by 8.5% on average per year (at current prices).

In 2020, due to the spread of Covid-19, imports of services at current prices decreased by 19.4%. In 2020, the decline in imports of services was influenced by the decrease in imports of travel and transport services, especially air transport. However, in the first half of 2021, largely due to the base effect, imports of services rose by 11.2%. This was mainly due to an increase in the value of imports of business services. Also, imports of transport (excluding air) and ICT and construction services increased.

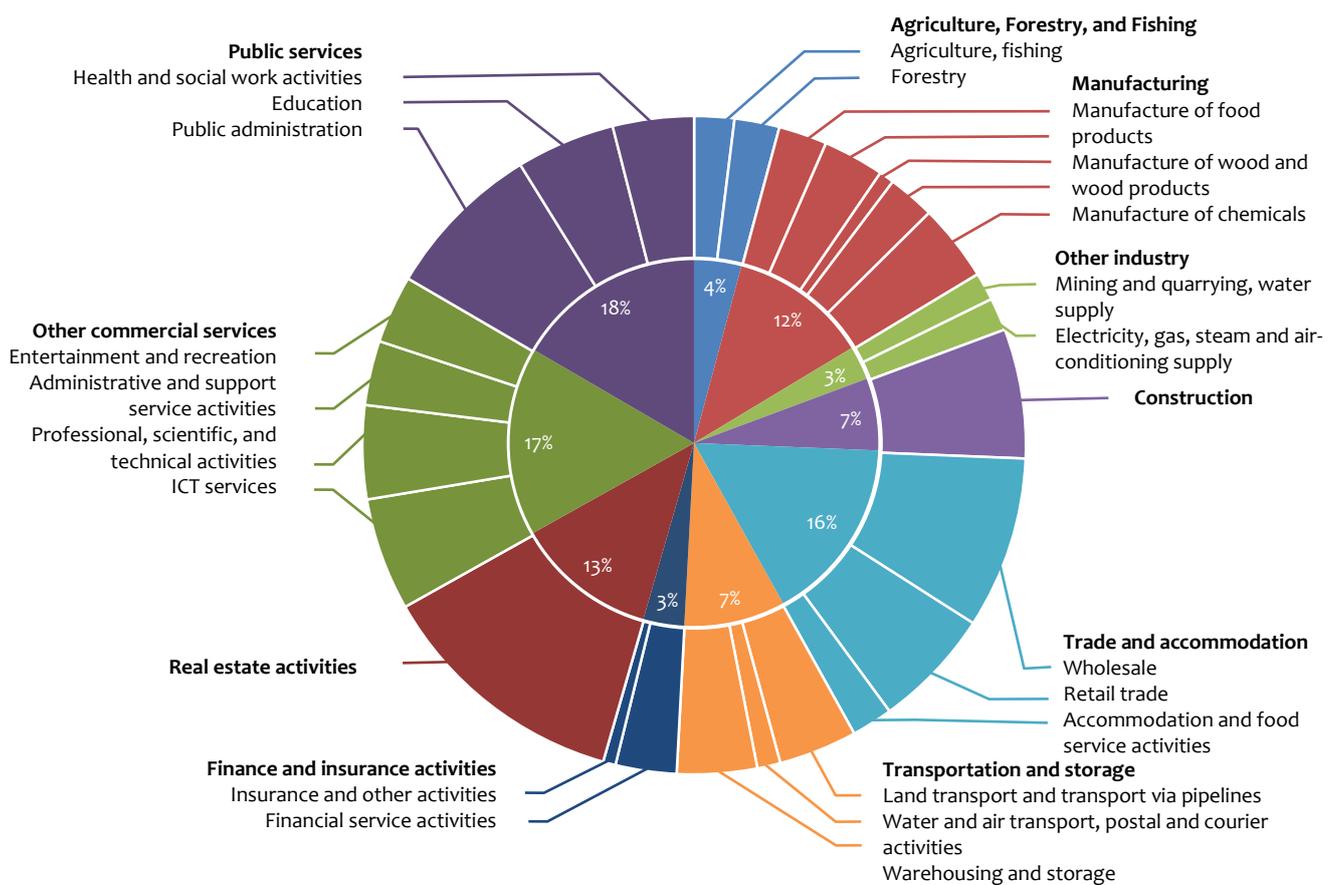


2021 | 2 SECTOR DEVELOPMENT

In 2009-2010, as labour costs declined, the competitiveness of Latvian producers improved, which significantly stimulated export growth and hence the development of tradable sectors. The structure of the economy changed. In 2010, the share of these sectors reached 33.1% of the total value added. However, in 2020, the share of these sectors has declined to 26.7%. In 2010, tradable sectors (i.e., agriculture, forestry, and fishing, manufacturing, and construction) constituted 27.6% of the total value added. In 2020, it slightly declined to 26.7%. In 2020, compared to 2010, the share has dropped in essentially all sectors, except construction, commercial services, and public service sectors.

In 2015-2019, growth was observed in all sectors, except for electricity, gas, steam, and air conditioning supply, and finance and insurance activities. Growth in trade and manufacturing had the largest impact on growth. However, in 2020, the Covid-19 crisis had negatively affected practically all sectors of the economy. Growth was observed only in agriculture, forestry, and fishing, construction, and public services. The largest decline was recorded in transport, accommodation and food service activities, the arts, entertainment, and recreation. Nevertheless, in the first half of 2021, growth was already observed in manufacturing, other industry, trade, transport, finance and insurance activities, ICT, and public services.

Structure of Value Added 2020*, as per cent



* calculations by the Ministry of Economics

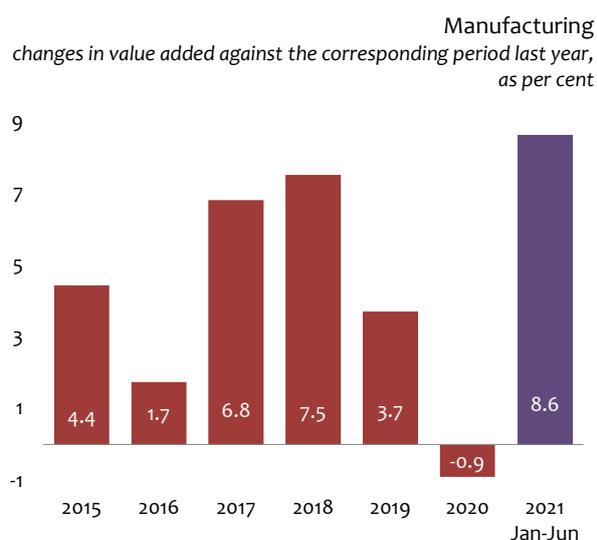
Development of Sectors
changes against the last year, as per cent

	2015	2016	2017	2018	2019	2020	2021 Jan-Jun
Gross domestic product	4.0	2.4	3.3	4.0	2.5	-3.6	5.2
Agriculture, forestry, and fishing	2.7	-4.3	9.0	-3.6	19.8	0.6	-3.7
Mining and quarrying	14.8	-2.8	9.1	9.1	-5.2	8.8	5.9
Manufacturing	4.4	1.7	6.8	7.5	3.7	-0.9	8.6
Manufacture of food products	-4.6	1.8	5.2	-2.9	-0.7	-1.7	-0.7
Light industry	-13.2	2.1	7.6	-0.8	-2.6	-9.5	13.1
Manufacture of wood and articles of wood	7.1	8.0	2.1	4.5	0.0	4.5	9.7
Manufacture of paper and paper products	0.0	3.6	4.5	-3.7	5.7	4.7	14.8
Manufacture of chemicals and chemical products	-4.1	10.7	11.4	7.0	3.9	-1.8	10.3
Manufacture of non-metallic mineral products	-9.8	11.6	11.1	1.3	-2.1	-1.4	4.6
Manufacture of basic metals	34.8	5.4	12.0	3.6	13.5	-5.6	4.1
Manufacture of computer, electronic and optical products	16.7	12.6	15.8	12.1	11.3	12.1	15.2
Manufacture of machinery and equipment	7.9	8.5	21.5	7.0	-1.9	-2.7	23.9
Manufacture of motor vehicles	3.5	-2.9	22.8	7.3	-7.7	-15.3	14.9
Other manufacturing	3.5	0.8	4.3	-1.8	2.8	-14.2	13.0
Electricity, gas, steam, and air-conditioning supply	22.1	17.5	-1.9	-38.8	2.6	-6.0	7.4
Construction	-0.4	-9.6	14.7	12.4	1.3	1.9	-4.4
Construction of buildings	-1.6	-9.5	11.7	16.1	9.3	0.9	-10.3
Civil engineering	-0.5	-15.9	26.6	6.5	-10.6	-1.5	-3.1
Trade	7.0	4.5	2.6	3.9	6.2	-3.0	8.9
Retail trade	4.9	2.3	4.3	3.8	2.3	1.5	2.0
Transportation and storage	1.2	1.7	6.6	3.8	3.5	-13.8	4.3
Freight rail transport	-2.4	-14.1	-8.4	12.5	-15.8	-42.3	-11.9
Cargo handling	-6.2	-9.3	-2.0	6.9	-5.7	-28.0	-9.6
Freight transport by road	0.5	1.3	7.0	12.8	-3.8	2.6	11.1
Accommodation and food service activities	8.9	4.4	9.3	7.6	-3.9	-38.0	-20.4
Information and communication services	2.3	5.0	8.7	9.6	4.4	-6.9	8.6
Finance and insurance activities	13.3	-0.2	-17.1	-2.4	-9.6	-3.0	8.8
Real estate activities	-2.4	1.6	-1.6	2.3	-3.6	-0.6	-2.2
Other service activities	1.9	3.9	4.6	2.7	0.6	-3.6	-1.8
Public administration and defence; compulsory social security	2.4	1.5	3.8	2.8	3.6	1.5	3.4
Education	3.2	1.1	4.3	3.0	2.7	0.8	4.5
Health and social work activities	5.2	1.2	4.4	9.3	9.6	2.4	30.1
Arts, entertainment, and recreation	8.2	5.0	5.1	6.1	2.8	-27.7	-13.7

MANUFACTURING

The development of manufacturing is driven by improvements in the competitiveness of Latvian producers and favourable demand dynamics in export markets. In 2017 and 2018, a rapid growth in production volumes was observed. In 2019, the growth rates have moderated.

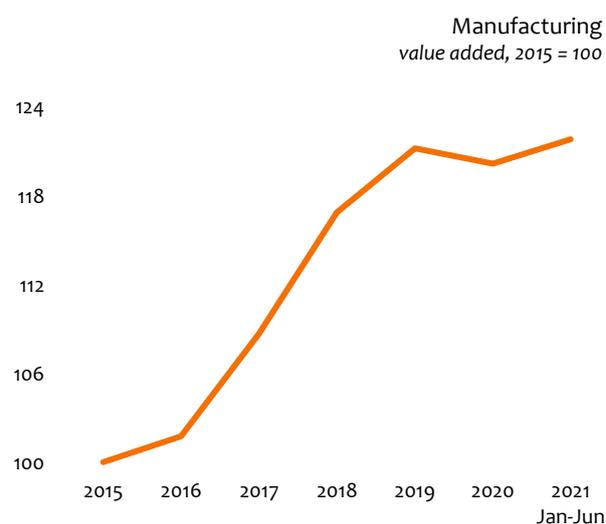
In 2020, manufacturing output was 0.9% lower than a year ago. Manufacture of motor vehicles, basic metals, and food products declined at a higher rate. However, manufacture of wood, electronic and optical products, paper and paper products increased.



In 2021, a rapid growth in manufacturing can be observed. In January-July 2021, production volumes of manufacturing increased by 8.3%, compared to the corresponding period last year. The growth of manufacturing was significantly affected by the increase in

production volumes of wood processing, electronic and optical products, and chemical industry.

In January-July 2021, the turnover of manufacturing at current prices increased by 18.4%. The volumes of products sold domestically rose moderately. However, the volumes of exported products grew more rapidly.

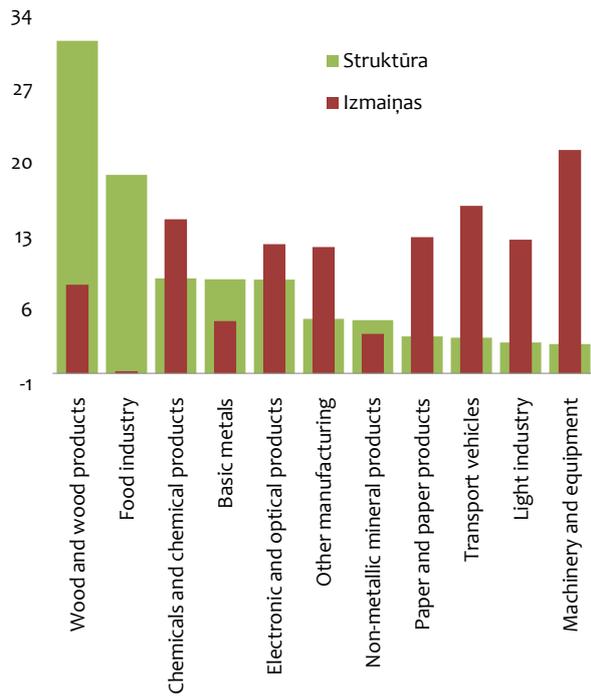


In 2018 and 2019, the number of occupied posts in manufacturing remained practically unchanged. However, in 2020, the number of occupied posts in manufacturing decreased by 6.8 thousand. The occupied posts declined more rapidly in light industry. In the first half of 2021, the number of occupied posts increased by 3.1 thousand. A significant growth was observed in wood processing, chemical industry, and paper production and printing.

Structure of Manufacturing and Development Trends by Field as per cent

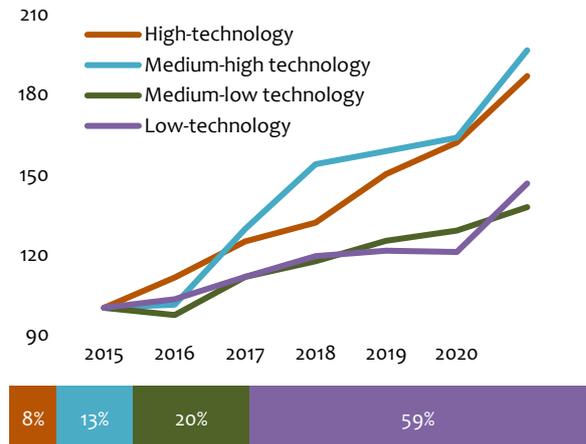
	Structure in 2020			Changes in production volumes			
	Output	Occupied posts	Exports in total sales	2018	2019	2020	2021 Jan-Aug
Manufacturing	100	100	66.0	2.7	2.1	-0.9	8.6
Food industry	21.5	20.1	38.5	-2.9	-0.7	-1.7	0.2
Light industry	3.1	8.5	82.1	-0.8	-2.6	-9.5	12.7
Manufacture of wood and wood products	26.5	20.0	72.5	4.5	0.0	4.5	8.4
Manufacture of paper and paper products	3.9	4.3	66.2	-3.7	5.7	4.7	12.9
Manufacture of chemicals and chemical products	8.7	7.1	73.5	7.0	3.9	-1.8	14.6
Manufacture of non-metallic mineral products	5.8	5.3	51.8	1.3	-2.1	-1.4	3.7
Manufacture of basic metals	9.6	11.2	67.8	3.6	13.5	-5.6	5.0
Manufacture of electronic products	9.8	5.2	89.3	12.1	11.3	12.1	12.3
Manufacture of machinery and equipment	2.7	3.1	85.2	7.0	-1.9	-2.7	21.2
Manufacture of motor vehicles	3.4	3.1	90.1	7.3	-7.7	-15.3	15.9
Other manufacturing	4.9	12.1	67.1	-1.8	2.8	-14.2	12.0

Growth of Manufacturing structure and changes in January-August 2021, compared to the corresponding period last year, as per cent



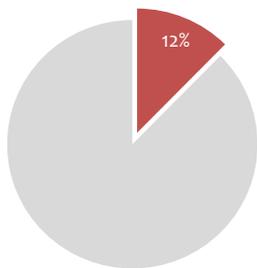
Stable demand in the EU enables manufacturing companies to maintain positive growth rates. Manufacturing continues to have the potential for growth, especially at the expense of rising exports. However, external risks, such as new strains of the virus, which may affect global economic processes, remain prevalent.

Manufacturing Volume Index and Structure by Levels of Technology
2015 = 100, structure in 2020, as per cent

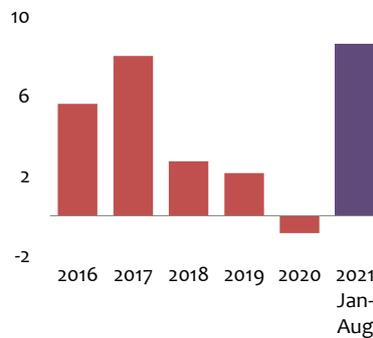


Main Indicators of Manufacturing¹

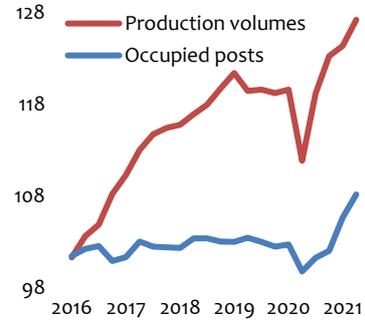
Share in total value added 2020, as per cent



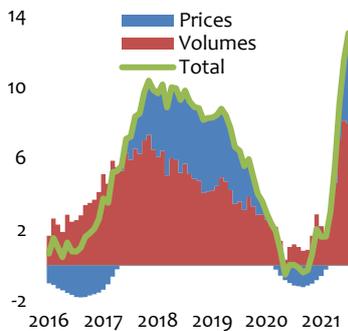
Changes in production volumes as per cent



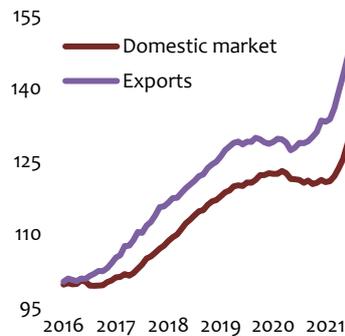
Production volumes and occupied posts Q4 2015 = 100



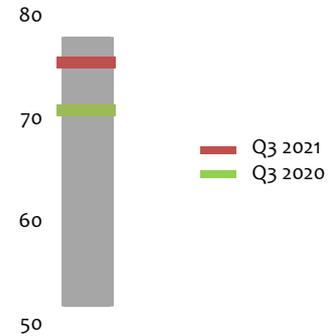
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average



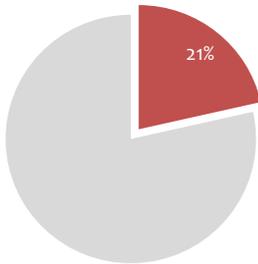
Capacity utilization rate Historically highest/ lowest level, as per cent



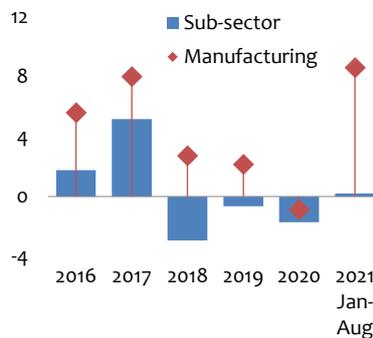
¹Sales data available until August 2021

Manufacture of food products and beverages

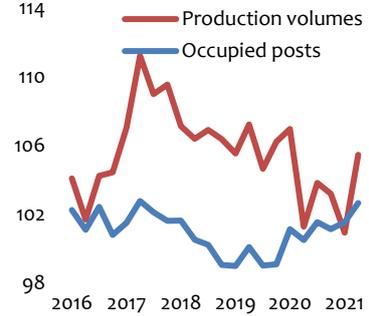
Share of manufacturing 2020, as per cent



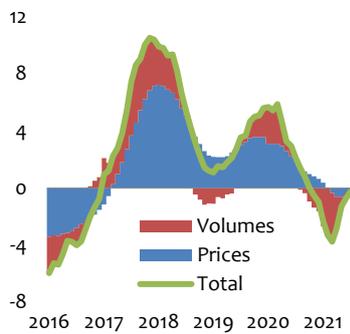
Changes in production volumes as per cent



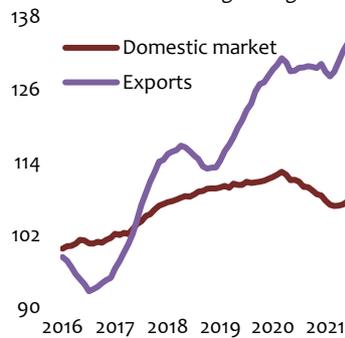
Production volumes and occupied posts Q4 2015 = 100



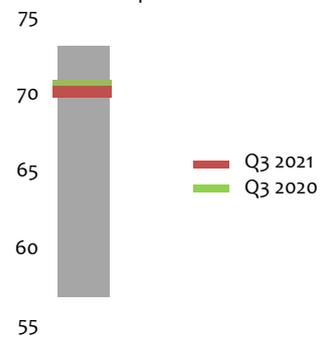
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

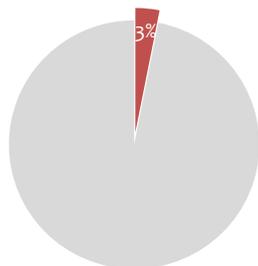


Capacity utilization rate Historically highest/ lowest level, as per cent

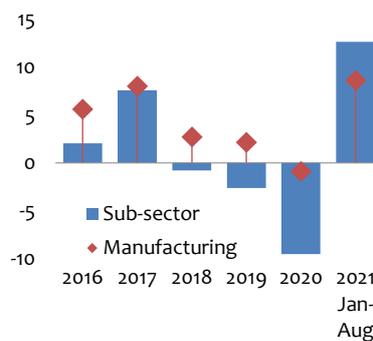


Light Industry

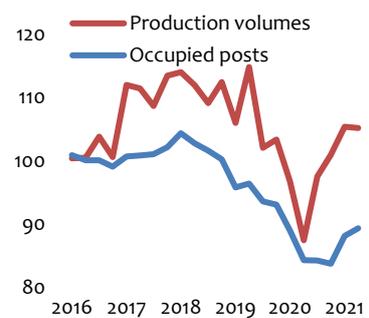
Share of manufacturing 2020, as per cent



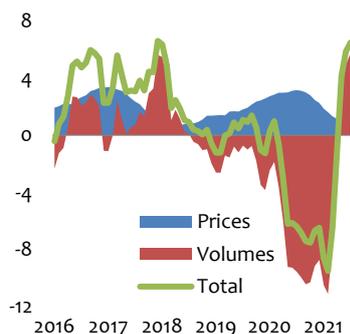
Changes in production volumes as per cent



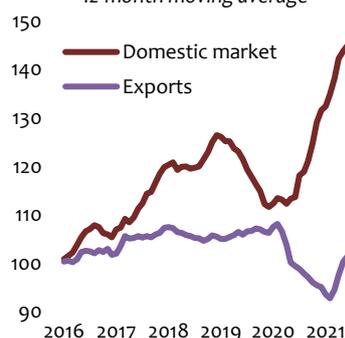
Production volumes and occupied posts Q4 2015 = 100



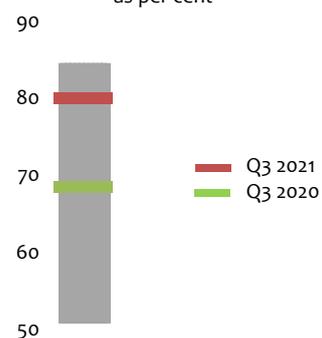
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

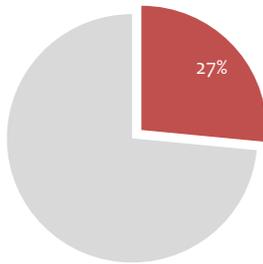


Capacity utilization rate Historically highest/ lowest level, as per cent

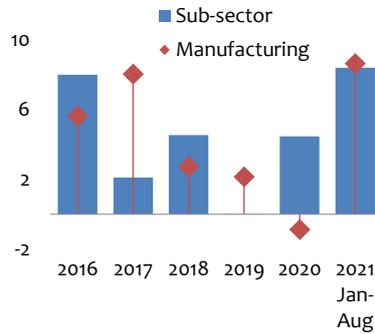


Manufacture of wood and wood products

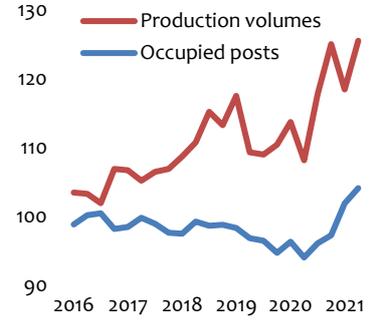
Share of manufacturing 2020, as per cent



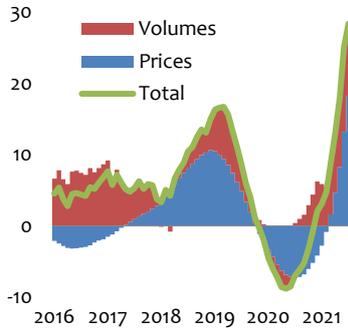
Changes in production volumes as per cent



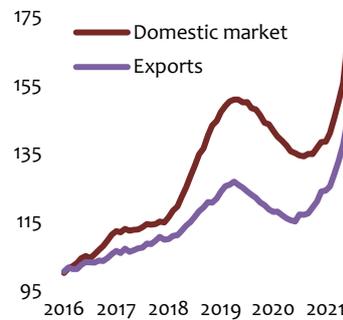
Production volumes and occupied posts Q4 2015 = 100



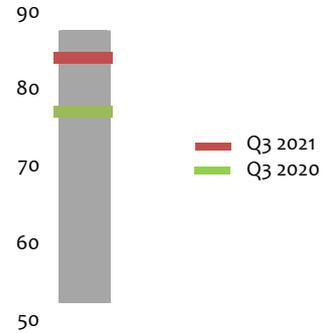
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

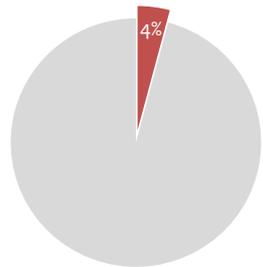


Capacity utilization rate Historically highest/ lowest level, as per cent

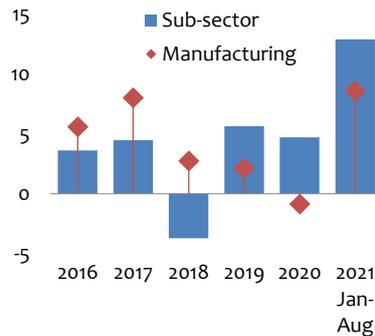


Manufacture of paper and paper products

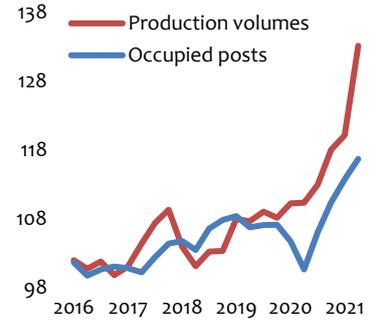
Share of manufacturing 2020, as per cent



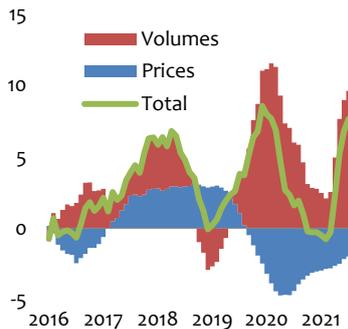
Changes in production volumes as per cent



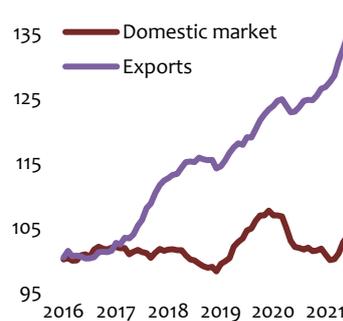
Production volumes and occupied posts Q4 2015 = 100



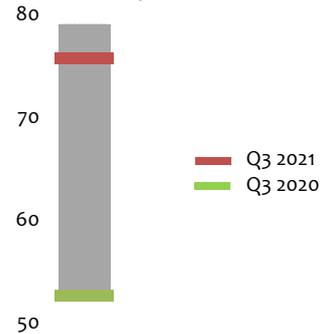
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

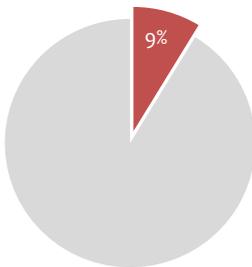


Capacity utilization rate Historically highest/ lowest level, as per cent

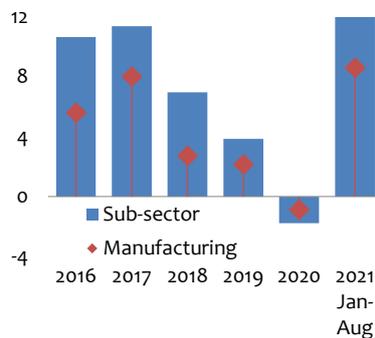


Manufacture of chemicals and chemical products

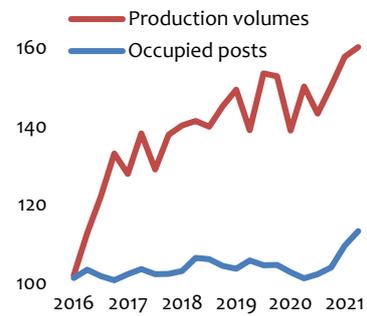
Share of manufacturing 2020, as per cent



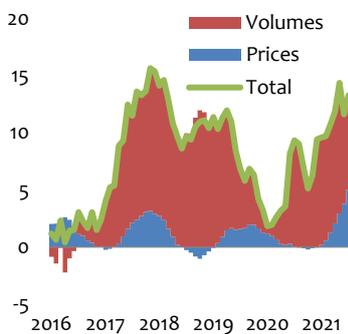
Changes in production volumes as per cent



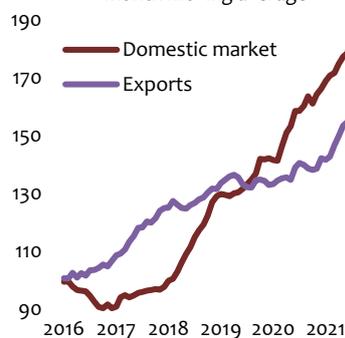
Production volumes and occupied posts Q4 2015 = 100



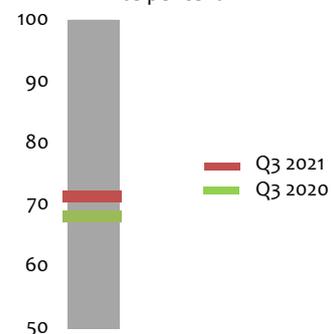
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

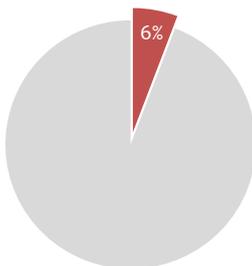


Capacity utilization rate Historically highest/ lowest level, as per cent

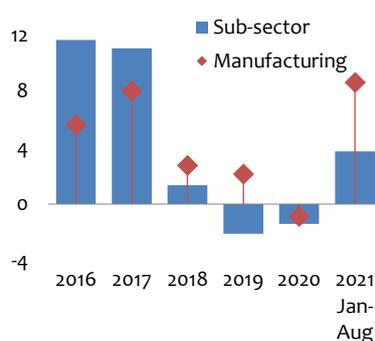


Manufacture of non-metallic mineral products

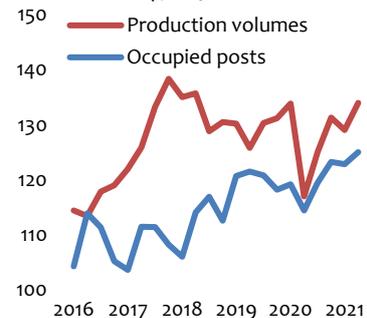
Share of manufacturing 2020, as per cent



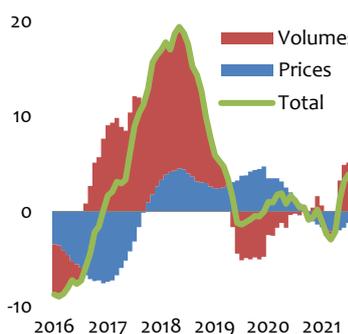
Changes in production volumes as per cent



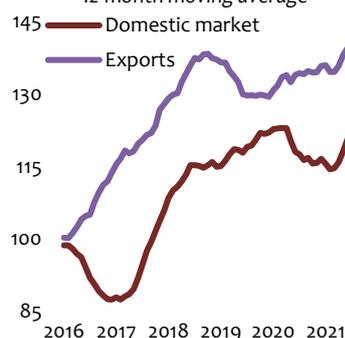
Production volumes and occupied posts Q4 2015 = 100



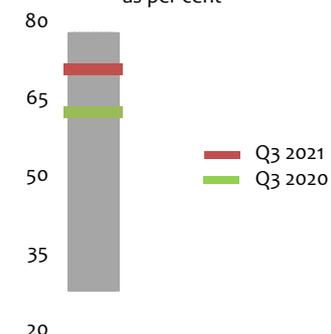
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

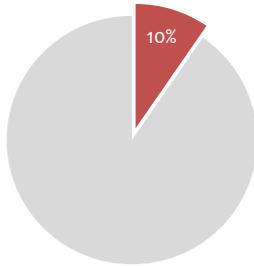


Capacity utilization rate Historically highest/ lowest level, as per cent

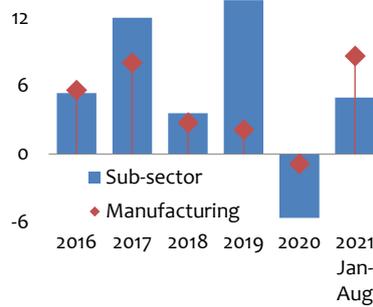


Manufacture of basic metals and fabricated metal products

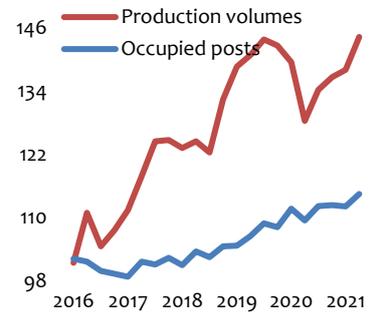
Share of manufacturing 2020, as per cent



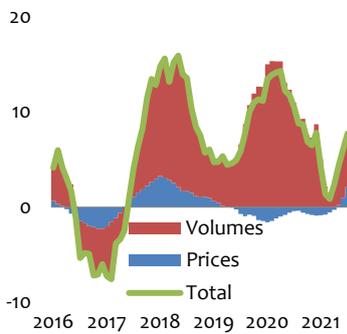
Changes in production volumes as per cent



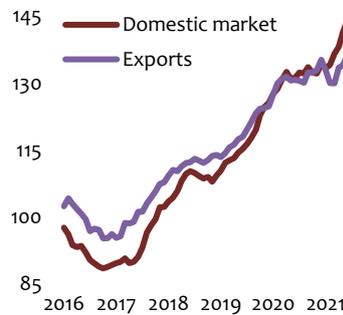
Production volumes and occupied posts Q4 2015 = 100



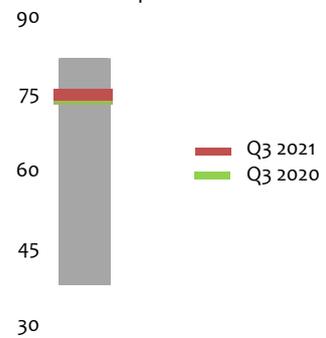
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

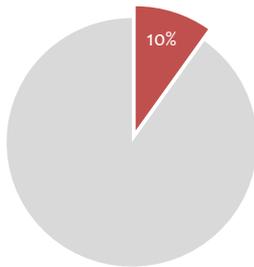


Capacity utilization rate Historically highest/ lowest level, as per cent

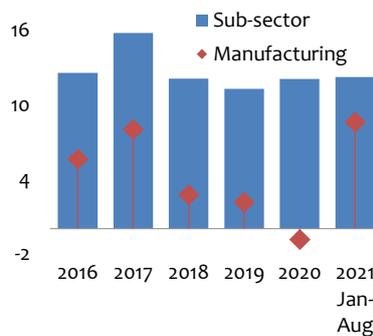


Manufacture of electronic and optical products

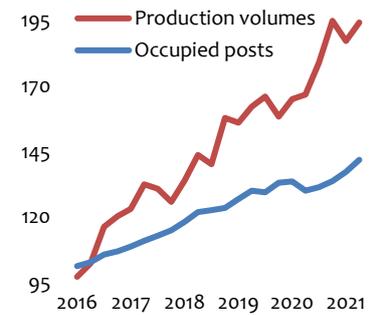
Share of manufacturing 2020, as per cent



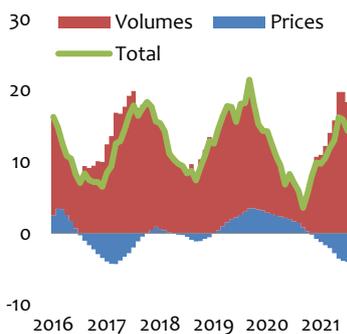
Changes in production volumes as per cent



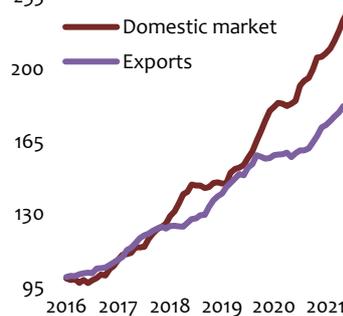
Production volumes and occupied posts Q4 2015 = 100



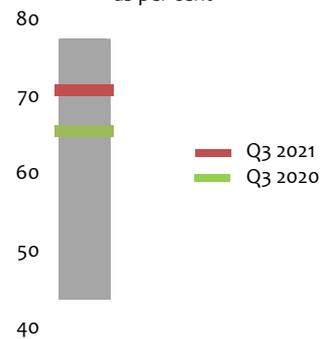
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

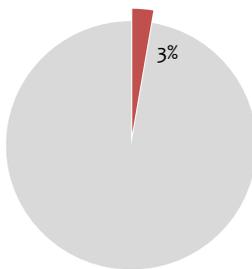


Capacity utilization rate Historically highest/ lowest level, as per cent

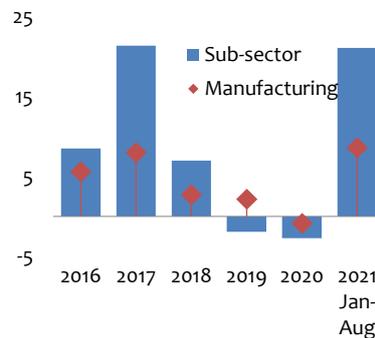


Manufacture of machinery and equipment

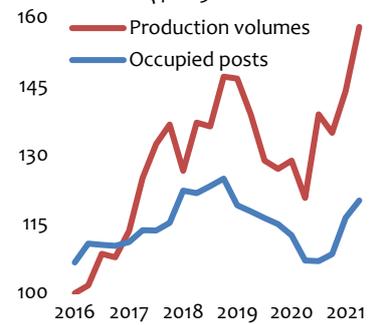
Share of manufacturing 2020, as per cent



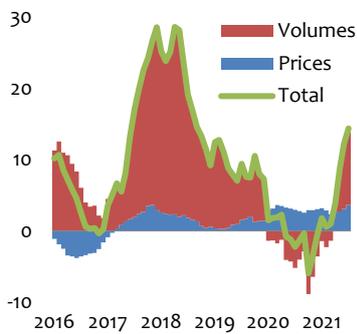
Changes in production volumes as per cent



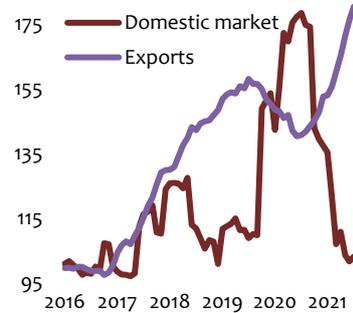
Production volumes and occupied posts Q4 2015 = 100



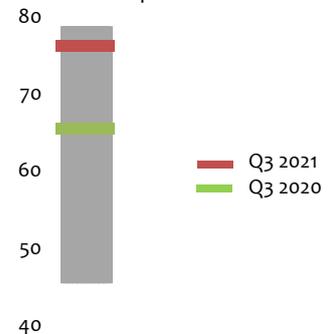
Changes in sales of production 12-month moving average



Production sales December 2015 = 100, 12-month moving average

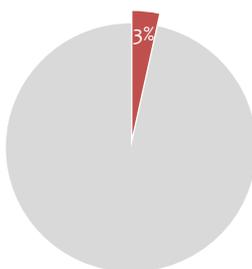


Capacity utilization rate Historically highest/ lowest level, as per cent

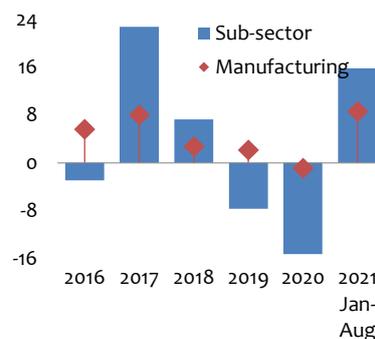


Manufacture of motor vehicles

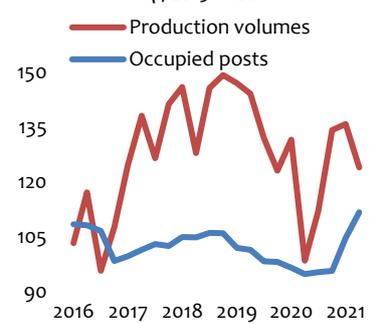
Share of manufacturing 2020, as per cent



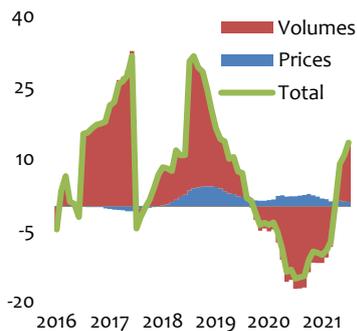
Changes in production volumes as per cent



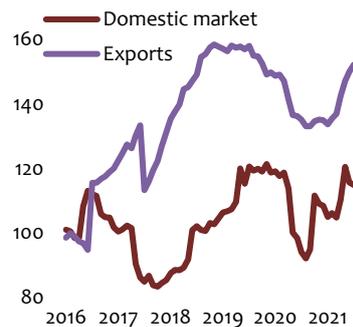
Production volumes and occupied posts Q4 2015 = 100



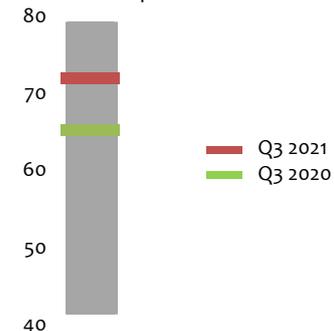
Changes in sales of production 12-month moving average



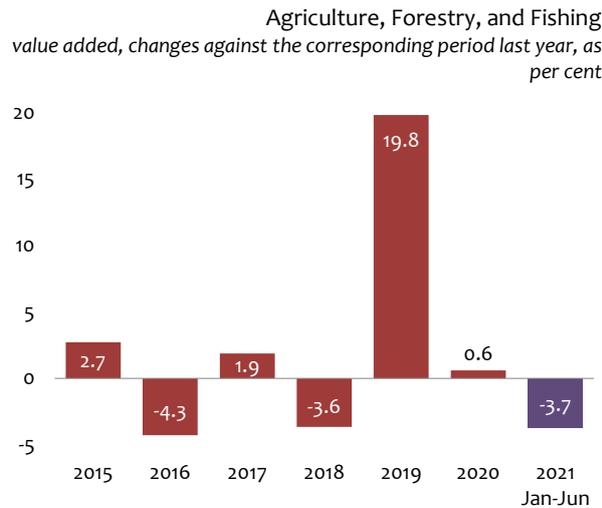
Production sales December 2015 = 100, 12-month moving average



Capacity utilization rate Historically highest/ lowest level, as per cent

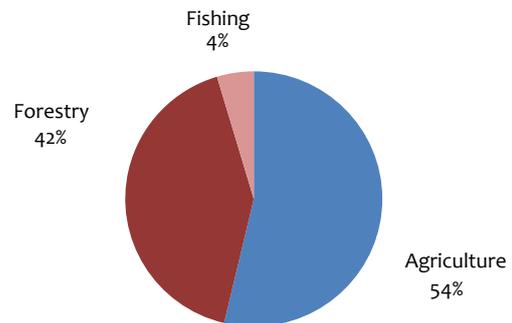


AGRICULTURE, FORESTRY, AND FISHING



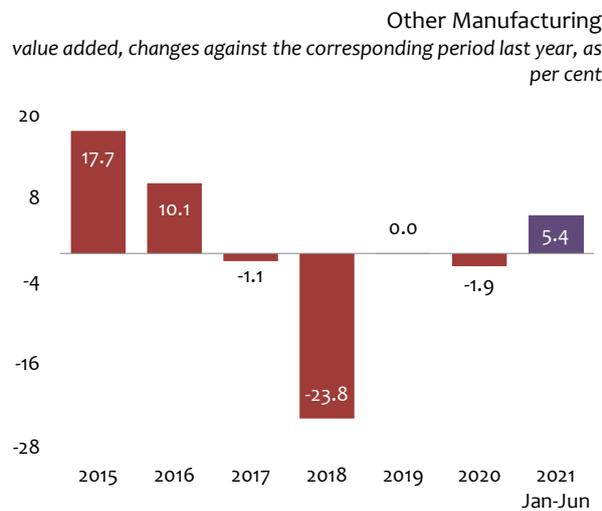
production volumes decreased in forestry and logging and fishing. In the first half of 2021, the volumes of the sectors decreased. Production volumes declined in agriculture and forestry. Nevertheless, fishing increased sharply. Until the pandemic, the number of occupied posts in the sector had grown steadily. However, in 2020, the number of occupied posts, especially in forestry, declined due to Covid-19 crisis. In the first half of 2021, occupied posts grew more rapidly, exceeding the pre-Covid-19 crisis level.

Structure of Agriculture, Forestry, and Fishing 2020, as per cent



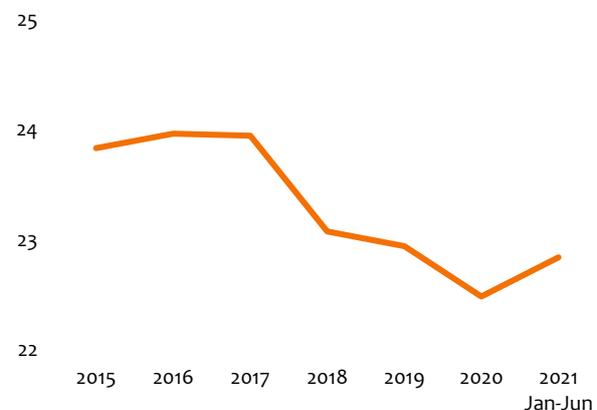
Agriculture and forestry provide the largest contribution to growth within the sector. The economic activity of the sector is closely tied to weather conditions. Thus, volatile growth within the sector can be observed. In 2020, the sector volumes increased slightly. Production volumes increased in crop and livestock production. However,

OTHER MANUFACTURING



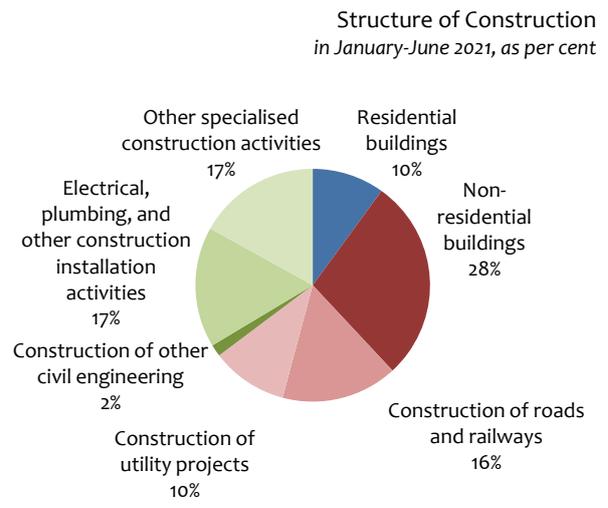
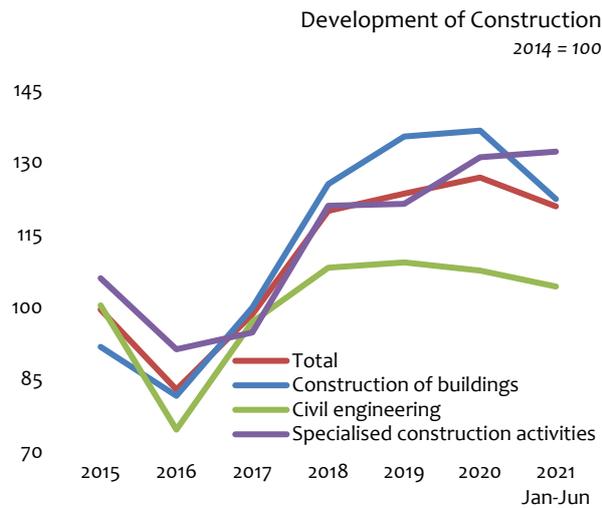
the beginning of the year increased the supply of natural gas and electricity, while favorable weather conditions in the spring contributed to the development of the mining and quarrying. The number of occupied posts has increased in recent years in mining and quarrying and water supply and waste management sectors. Nevertheless, the number of occupied posts has not significantly changed in the electricity, gas, steam, and air conditioning supply sector.

Occupied Posts in Other Manufacturing in thousands



The largest share of added value in other manufacturing (incl. mining and quarrying, electricity, gas, steam, and air-conditioning supply, water supply, and waste management) provide electricity and gas supply sub-sectors. In 2017-2020, the volumes of other manufacturing decreased, primarily determined by the decline in the electricity and gas supply due to warm weather conditions. In the first half of 2021, the volumes of other manufacturing grew rapidly. Cold weather conditions at

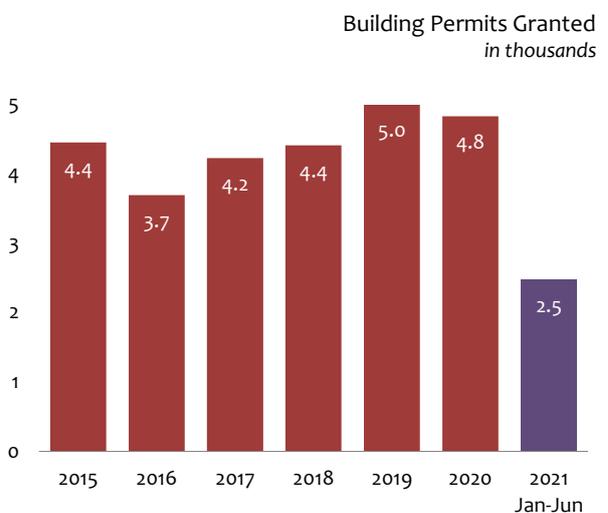
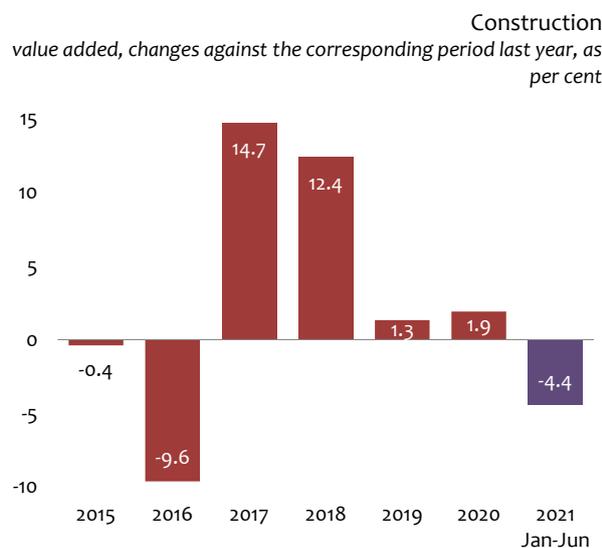
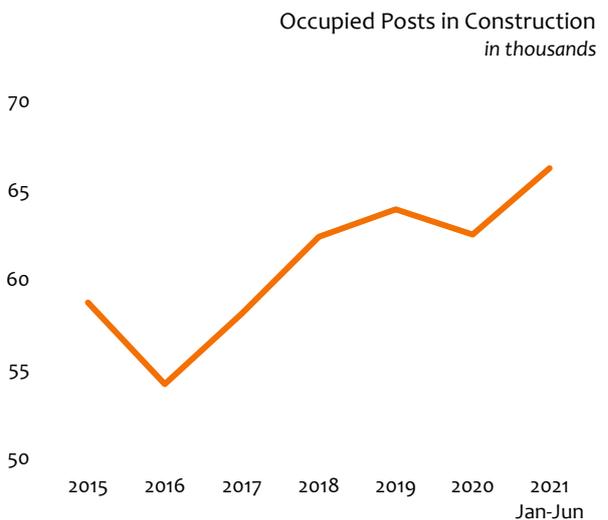
CONSTRUCTION



In the first half of 2021, the growth rate of construction declined. Construction output decreased by 4.7%, compared to the corresponding period last year. The decline can be largely attributed to the base effect (i.e., the unusually warm winter of 2020 favourable for construction), as well as the restrictions on the movement of goods caused by the declared state of emergency in the country, etc.

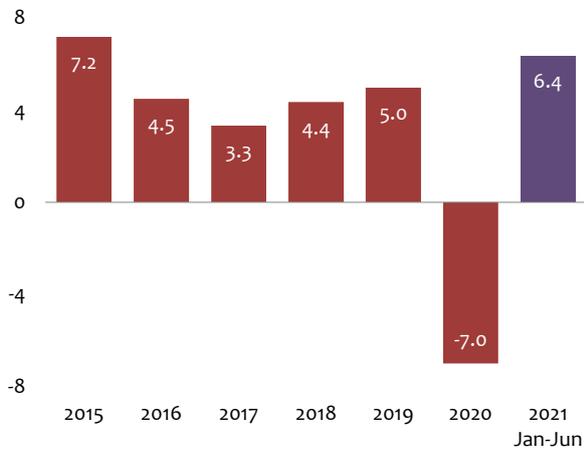
In 2021, specialized construction works will continue to be the driving force of the sector, as it was the only sub-sector that increased. In the first half of 2021, construction of buildings and civil engineering declined.

In the first half of 2021, 2,470 building permits were issued, representing a 12.3% increase, compared to the corresponding period last year. In Q2 of 2021, customers became significantly more active. Also, in the first half of 2021, the expected floor space increased by 5.3%.



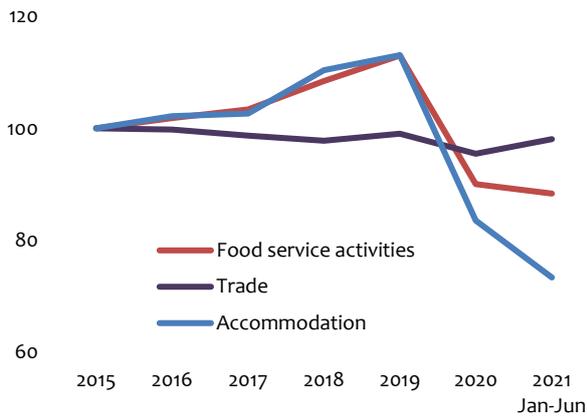
TRADE, ACCOMMODATION, AND FOOD SERVICE ACTIVITIES

Trade, Accommodation, and Food Service Activities value added, changes against the corresponding period last year, as per cent

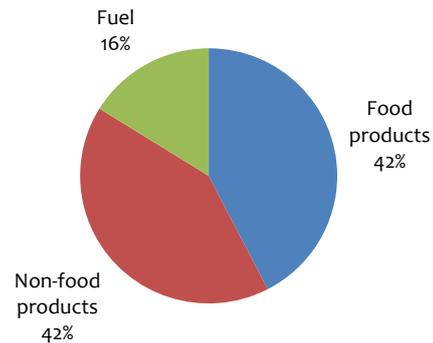


In 2021, the volumes of services provided in the trade, accommodation, and food service activities are rising. The trade has been positively affected by the easing of Covid-19 restrictions. In the first half of 2021, it increased by 8.9%. Compared to 2020, the growth in retail trade turnover was more rapid, increasing by 2%. Retail sales of food and non-food products grew moderately. However, fuel prices rose sharply. The turnover of the wholesale sector at current prices increased by 19.8%. Although in Q2 of 2021 accommodation and food service activities increased rapidly, it should be noted that these sectors are recovering from a very deep recession and still significantly lag behind the pre-crisis level. In the first half of 2021, the sector volumes declined by 20.4%. The largest share of occupied posts remains in trade. In the first half of 2021, under the influence of Covid-19, the decline in the number of occupied posts endured in the accommodation and food service activities. However, the number of occupied posts increased in trade.

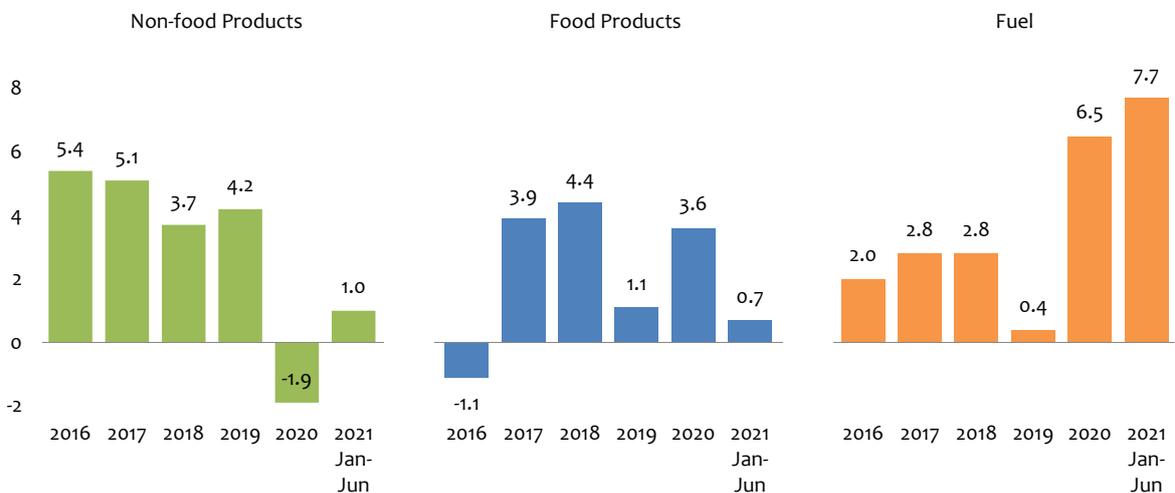
Occupied Posts in Trade, Accommodation, and Food Service Activities 2015 = 100



Structure of Retail Turnover 2020, as per cent



Retail Turnover changes against the corresponding period last year, as per cent



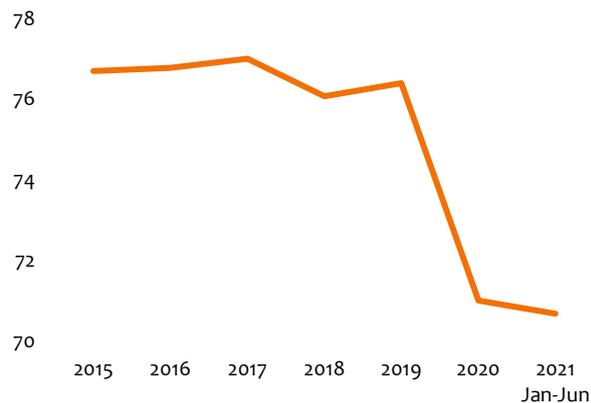
TRANSPORTATION AND STORAGE

Transportation and Storage value added, changes against the corresponding period last year, as per cent

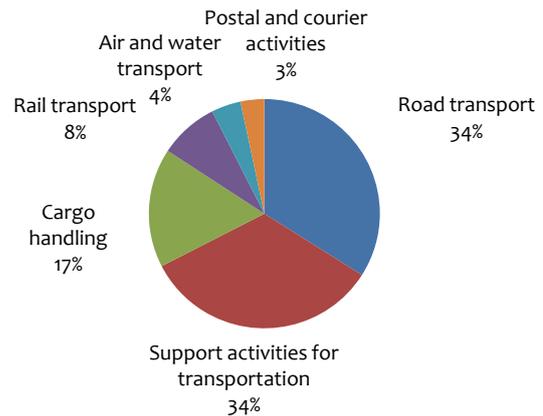


The transportation and storage sector is closely linked to international transportation. In 2020, the sector volumes declined sharply due to Covid-19 restrictions. Also, in Q1 of 2021, the volumes continued to decrease. Nevertheless, in Q2 of 2021, as the epidemiological situation improved and the restrictions were lifted, volumes of the sector increased rapidly. In the first half of 2021, the volumes of the sector increased. The volumes of freight rail transport and cargo loaded and unloaded at ports declined. However, the volume of freight transport by road increased sharply, which was determined by the rise in the volume of freight transport both domestically and internationally. Despite the rapid growth in Q2 of 2021, overall passenger traffic declined in all modes of transport during the first half of the year due to traffic restrictions. The number of passengers in air transport decreased by 69.3%. Also, the number of passengers at ports and in land transport declined by 51.7% and 22.5%, respectively.

Occupied Posts in Transportation and Storage in thousands

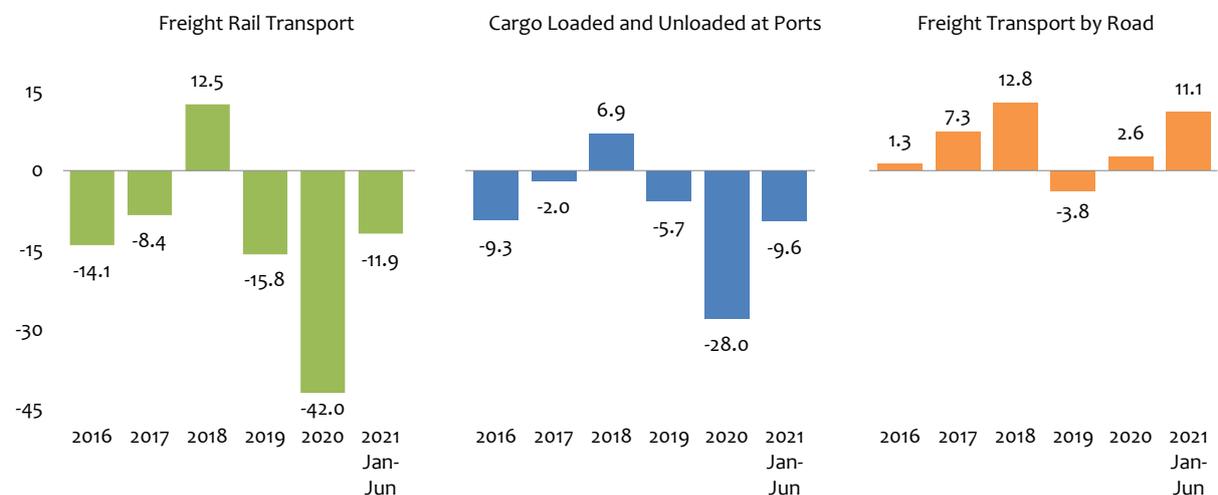


Structure of Transportation and Storage 2020*, as per cent

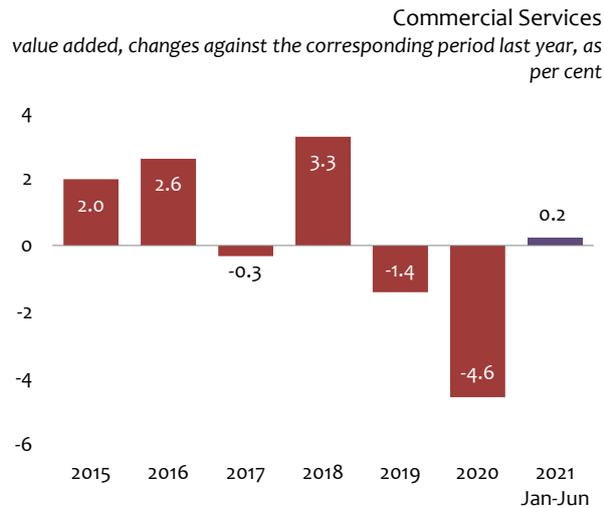


* – forecast by the Ministry of Economics

Freight Traffic changes against the corresponding period last year, as per cent

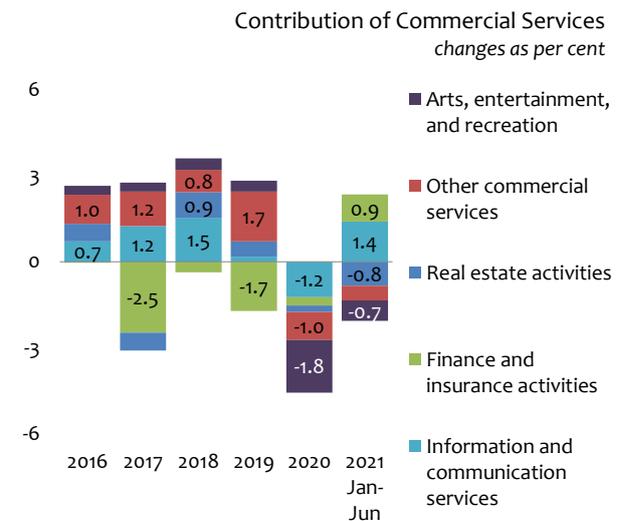


COMMERCIAL SERVICES

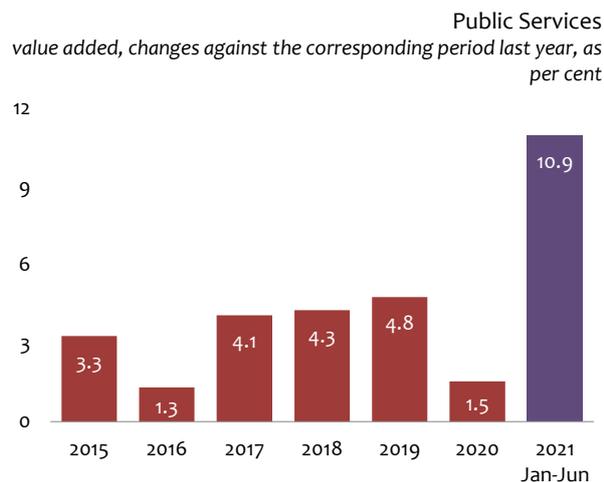


The largest share of added value in commercial services (incl. information and communication services, financial and insurance activities, real estate activities, professional, scientific, and technical services, administrative and support service activities, arts, entertainment, and recreation) provide real estate activities. In 2020, due to the Covid-19 crisis, the volume of commercial services decreased rapidly in all sectors. However, in the first half of 2021, the volumes remained essentially unchanged, compared to the corresponding period last year.

The largest contribution provided the increase in services in finance and insurance activities and information and communication services. Also, the decline was observed in the arts, entertainment, and recreation and real estate activities. The largest share of occupied posts remains in professional, scientific, and technical services, administrative and support service activities, and information and communication services. In the first half of 2021, the number of occupied posts grew rapidly in the information and communication services sector. However, a decline was observed in finance and insurance activities.

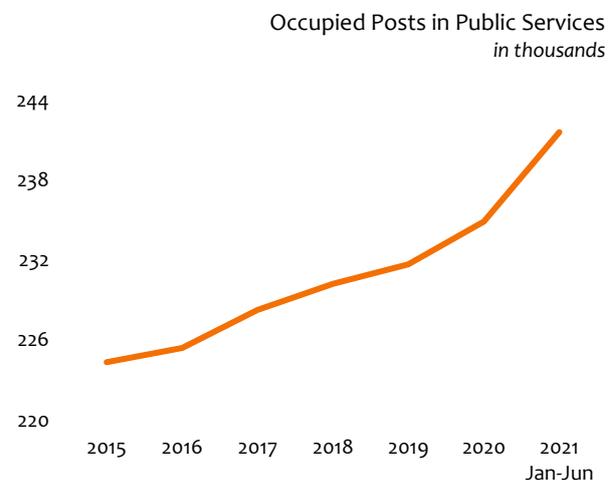


PUBLIC SERVICES



The largest share of value added in public services (incl. public administration and defence, education, health and social work activities) provide public administration and defence. In 2020, due to the Covid-19 crisis, the volumes of public service sectors grew slightly. However, in the first half of 2021, the volumes of services increased sharply, determined by the increase in health and social care

(by 30.1%). Public administration and defence rose by 3.4%. Education services increased by 4.5%. The largest share of occupied posts remains in education. In the first half of 2021, a rapid rise in the number of occupied posts in health care (and the largest within the sector in recent years) has been observed. A significant rise was also recorded in public administration and education.

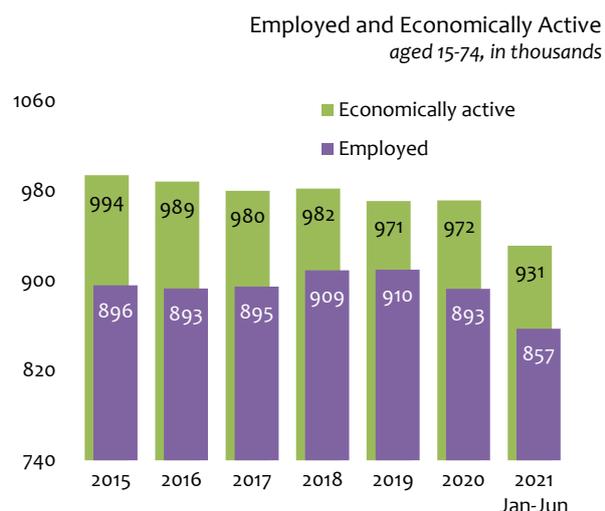


2021 | 2

LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

With the increase in economic activity, employment has returned to growth since April 2021. Also, unemployment continues to fall. At the same time, the crisis has left its mark on the labour market. The number of employees and the employment rate still significantly lag behind the level of 2019. The crisis has also affected the economic activity of the population, which, in addition to demographic processes, is narrowing the supply of labour in the labour market and increasing the risks of labour shortages. As the crisis endures, the share of long-term jobseekers has increased, which, along with regional labour market disparities, may pose risks of structural unemployment in the coming years, as well as exacerbate the problem of labour supply.



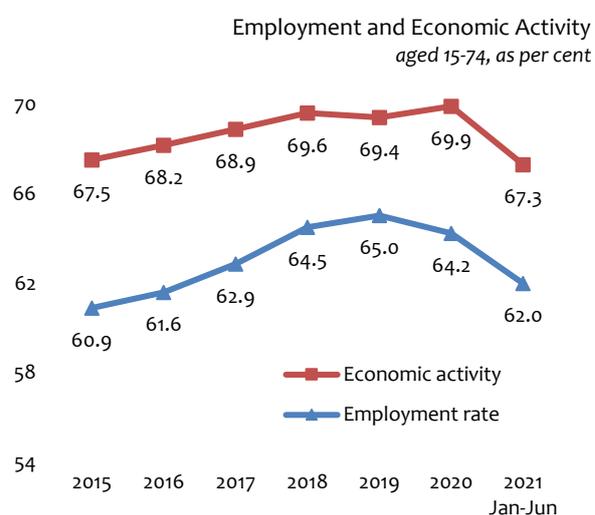
Considering the declining labour demand, which was affected by the overall fall in economic activity due to the Covid-19 crisis, in the first half of 2021, the number of employees declined by 4.4% (i.e., almost 40 thousand), compared to the corresponding period last year, representing the largest decrease since 2010.

The annual employment rate declined by 1.8 percentage points. It lags behind the highest pre-crisis level (i.e., in Q2 of 2019) by 2.4 percentage points.

As the pandemic shock subsides and the economy gradually adjusts to new conditions, **significant improvements in the labour market have been observed since April 2021**. From March-August 2021, the number of employees has increased by 23 thousand. Also, in

August 2021, the unemployment rate decreased to 6.9% (i.e., by 1.5 percentage points less than in August 2020).

Overall, in Q2 of 2021, 861.6 thousand people aged 15-74 were employed, representing 62.3% of the total population in private households aged 15-74. The employment rate in Latvia still remained significantly lower than in neighboring countries. In Q2 of 2021, the share of the employed population in Estonia and Lithuania reached 65.8% and 64.8% of the total population aged 15-74, respectively.



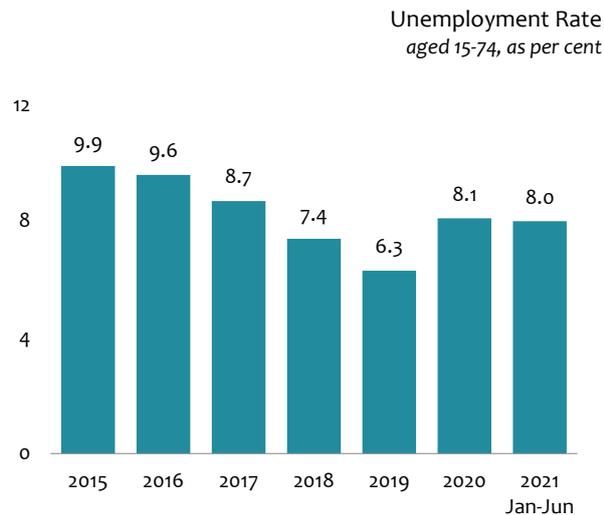
Although the overall negative impact of Covid-19 on employment has been mitigated by the state aid measures, which have partially preserved jobs and incomes for the population during the emergency period, **the impact of the pandemic on the labour market has widened as the crisis persists**.

From March-August 2021, the number of employees aged 15-74 in Latvia, according to seasonally adjusted data, has decreased by 43.3 thousand. Therefore, each month of the crisis has brought an average decrease of 2.4 thousand employees. It should be borne in mind that public intervention measures compensate for the decline in economic activity mainly in the short term. Thus, as economic activity remains depressed for a long time, the impact of the crisis on the labour market will aggravate.

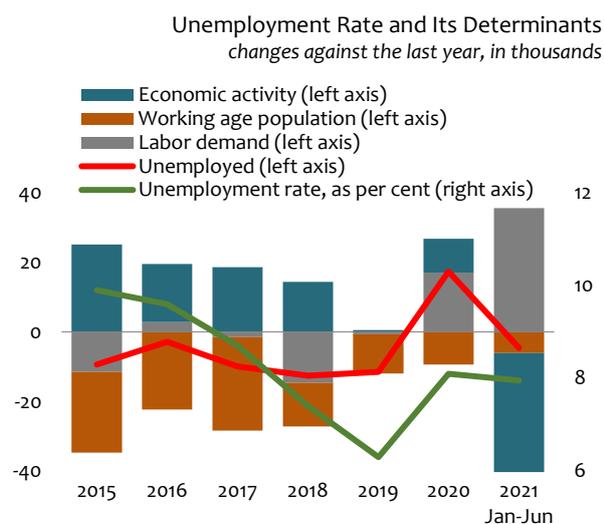
With prolonged uncertainty regarding the potential exit from the pandemic crisis, the impact of the crisis is felt on both the demand and supply side of the labour market.

Although the growth in overall economic activity was still observed in 2020, **since Q4 of 2020, the labour market participation has been gradually declining**. In Q2 of 2021, the economic activity of the aged 15 to 74 was by 2.5 percentage points lower than a year ago.

In the first half of 2021, the downturn in economic activity was the primary factor causing the fall in unemployment. It should be noted that unemployment rates have been steadily declining since mid-2020, as unemployment is rapidly approaching pre-crisis levels.



In Q2 of 2021, the unemployment rate declined to an average of 7.9%, as 73.4 thousand people aged 15-74 were in search of work, which is by 1.7% (or 1.3 thousand) less, compared to Q1 of 2021. However, compared to Q2 of 2020, the number of jobseekers has declined by 12.1% (or 10.1 thousand). At the same time, in Q2 of 2021, the unemployment rate in Latvia remained higher than in Lithuania (7.4%) and Estonia (6.9%).



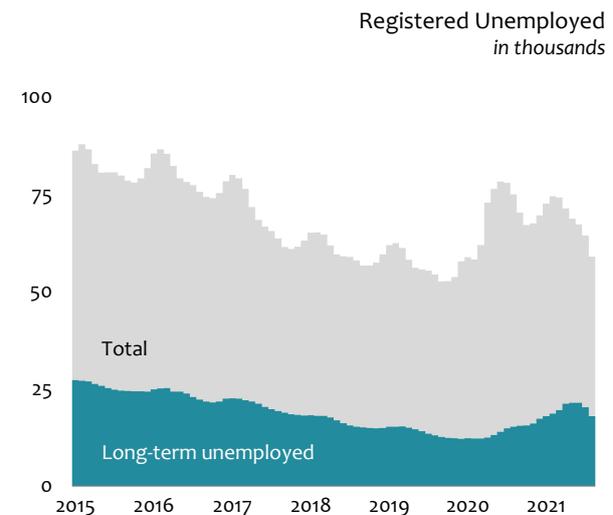
Along with the decline in the economic activity of the population, **demographic processes significantly affect unemployment rates**. In particular, demographic processes

have led to a decline in the working age population, which has a negative impact on the total labour supply (i.e., economically active population).

In Q2 of 2021, compared to the corresponding period last year, economically active population aged 15-74 declined by 40.5 thousand (i.e., by 4.2%), reaching 935.1 thousand. Therefore, it remained close to the historically lowest level.

Given the gradual decline in labour supply, alongside the importance to overcome the effects of the crisis and promote employment, the shortage of skilled labour has become an increasingly significant problem, especially in the most rapidly growing sectors.

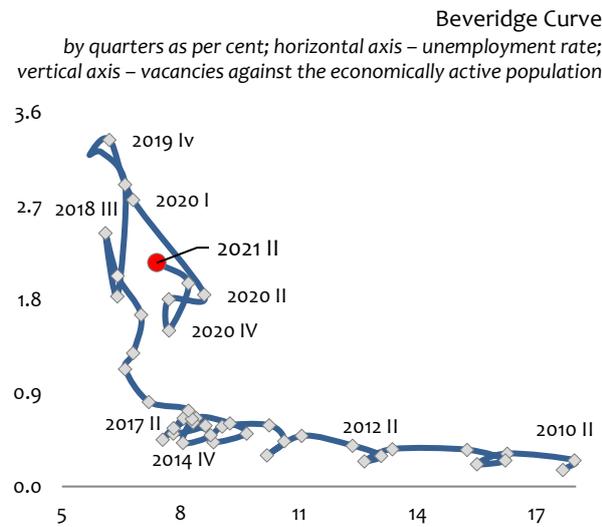
The protracted crisis and the decline in the number of job vacancies in the labour market have reduced the chances of the unemployed to return to work quickly, which has contributed to the rise in long-term unemployment. Since the end of April 2020, the share of long-term job seekers has been on the rise. Between the end of April 2020 and the end of August 2021, the share of registered long-term jobseekers (i.e., unemployed for more than a year) has nearly doubled. In particular, the share of long-term unemployed has increased from 17.2% to 30.5%. At the end of August 2021, approximately 18 thousand jobseekers were unemployed for more than a year.



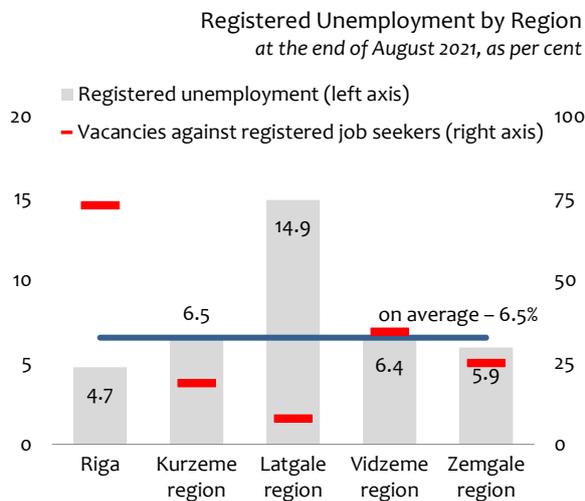
It should be borne in mind that **high long-term unemployment can lead to an increase in structural unemployment**, i.e., the longer these people remain unemployed, the greater the risk of losing their previous skills and abilities, and the more difficult it will be for them to adapt to new labour market needs. A risk that some of the unemployed may have difficulty finding a job that matches their skills in the future, as recovery in the sectors directly affected by the Covid-19 crisis may be slow, persists. However, previously required skills may not be in demand in sectors with potential job opportunities.

The crisis has accelerated the digitalisation of the economy and the automation of jobs, thus increasing the productivity potential of the labour force, as the structure

of skills demand in the labour market would change. Skills needs in some specialties could differ significantly from those prior the crisis.

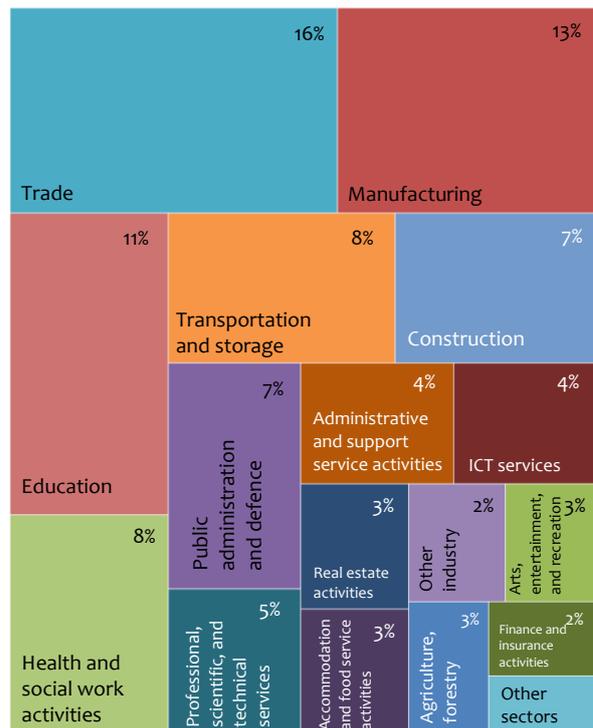


Structural problems may also exacerbate regional labour market disparities, which may hamper future recovery. Although regional labour market disparities have leveled off during the crisis, the unemployment rate in Latgale region is still more than twice as high as the Latvian average. Also, it remains 3 times higher than in Riga, which along with low geographical labour mobility increase the risks of structural unemployment.



In the first half of 2021, the most significant increase in occupied posts was observed in trade and construction. With the increase in economic activity, the rise in occupied jobs was observed in most sectors of the economy. In Q2 of 2021, compared to Q1 of 2021, it increased by 26.2 thousand (or 2.9%), thus reaching 940.2 thousand.

Occupied Posts by Sector structure in 2020, as per cent



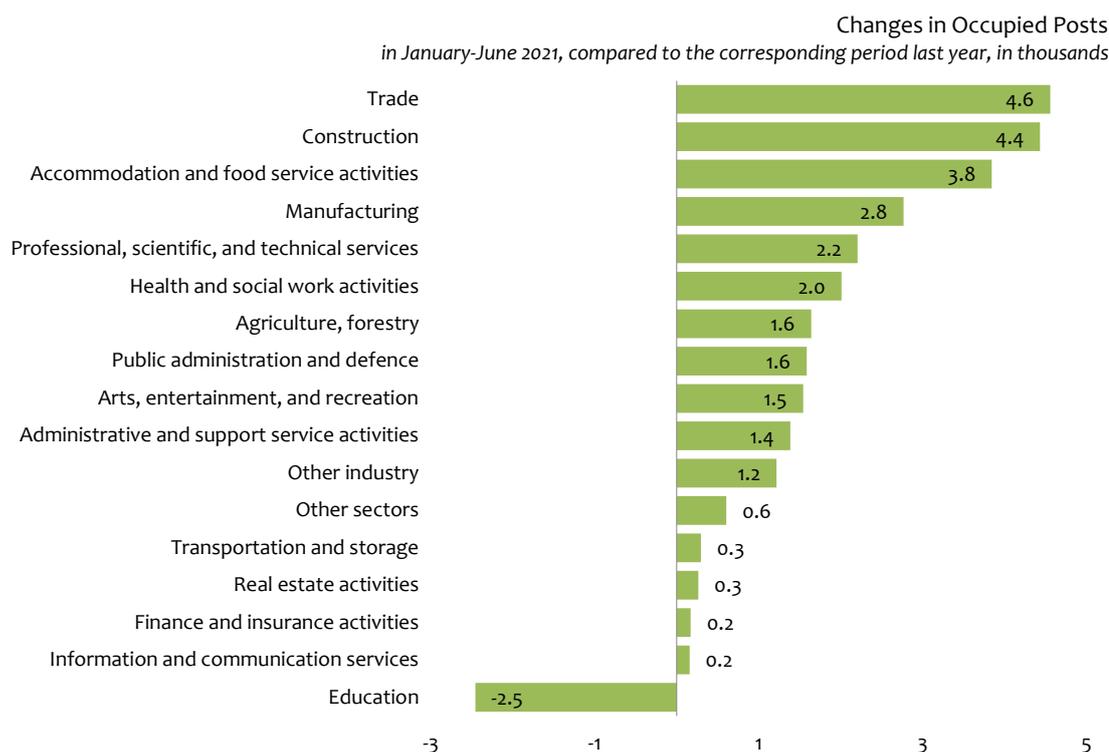
In Q2 of 2021, compared to Q1 of 2021, the largest increase in occupied posts, was observed in trade, construction, accommodation and food service activities, and manufacturing. At the same time, it should be noted that the number of occupied posts in accommodation and food service activities and trade still lagged significantly behind the pre-crisis period. In Q2 of 2021, their number of occupied posts in accommodation and food service activities declined by nearly 8 thousand, compared to Q2 of 2019. However, in trade the number of occupied posts over the same period declined by almost 1.1 thousand.¹

In Q2 of 2021, compared to Q1 of 2021, the most significant increase in the number of occupied posts was observed in the private sector, which provided about 94% of the total increase (or 24.8 thousand) in occupied posts.

Compared to the pre-crisis period, the largest job growth was observed in ICT services, health and social work activities, professional, scientific and technical services.

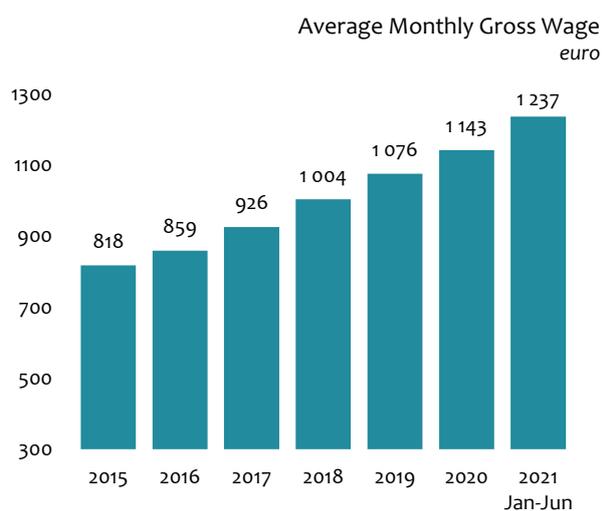
In conjunction with the above mentioned sectors (i.e., accommodation and food service activities and trade), the most significant decline in labour demand, compared to the pre-crisis period, has also been observed in such sectors as transportation and storage, finance and insurance activities, administrative and support service activities, and the arts, entertainment, and recreation.

¹ The comparison of the number of occupied posts with previous years may be affected by a structural break in the data. Starting from Q1 of 2021, SRS data are used to calculate occupied posts



WAGES AND SALARIES

With the return of economic activity, the average wage is growing rapidly. In Q2 of 2021, the average monthly gross wage increased by 10.2% - rising to an average of EUR 1,237 per month and representing the largest wage growth over the last 13 years.



In 2021, the increase in the average wage was significantly influenced by the rise of the minimum wage rate by 16.3% (i.e., to EUR 500 from EUR 430 in 2020). Wage growth has been driven in part by a decline in the share of lower paid jobs in the labour market, given the significant decline in both the accommodation and food service activities and

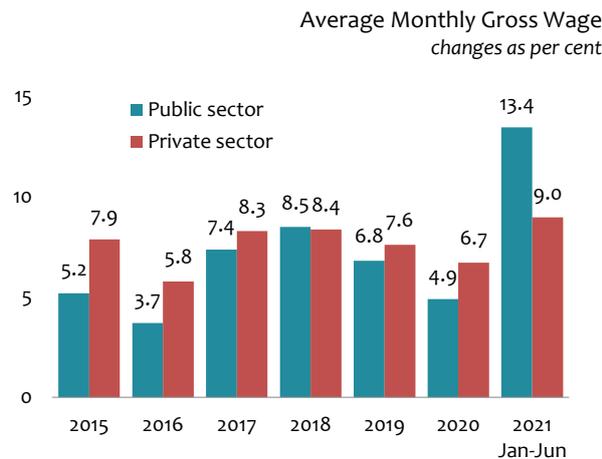
the retail sector, wherein average wage levels have so far been significantly lower than the national average.

At the same time, it should be noted that a significant increase in wages in Latvia has been observed in previous years - the average rise in wages over the last 5 years has been close to 7% annually. Consequently, the process of wage convergence closer to the level of wages in the economically developed EU countries and the growing shortage of skilled continue to maintain positive pressure on wages. The narrowing of the labour market makes it necessary for entrepreneurs to consider how to not only maintain but also attract more qualified specialists (also by reviewing wage rates).

Although in Q2 of 2021 wages have grown significantly in both the private and public sectors, **a more rapid increase in wages was observed in the public sector**. In Q2 of 2021, compared to Q2 of 2020, the average gross wage in the public sector increased by 13.4% (to an average of EUR 1,291). However, in the private sector it rose by 9% (to an average of EUR 1,215). A more rapid wage growth in the public sector has been largely driven by revised wage rates in the education and health sectors.

Since 2010, wages have increased in both the private and public sectors. At the same time, in the previous two years, wage growth in the private sector has been on average larger, primarily due to a more significant increase in labour demand - between 2011-2020, the number of occupied posts in the private sector has increased by

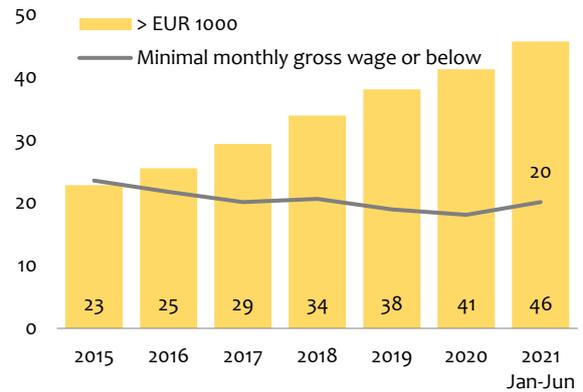
15.8%. However, wages in the public sector over the same period have risen only by 0.6%.



Although the share of minimum wage recipients has slightly increased in Q2 of 2021, which has been largely influenced by the rise in the minimum wage rate, overall the trend of low-paid employees to decline endured, as evidenced by increasing trends in the share employees that receive over EUR 1,000 per month. In Q2 of 2021, almost half (46%) of all employees had a gross wage over EUR 1,000.

In Q2 of 2020, an increase in wages was observed in all sectors of the economy. The most significant wage rise was observed in health and social work activities (i.e., by nearly 35%) and education (by 12.5%), which was affected by both the allowances paid for work during the Covid-19 pandemic and the revision of wage rates in the sectors.

Employee Gross Wage as per cent of total number employed

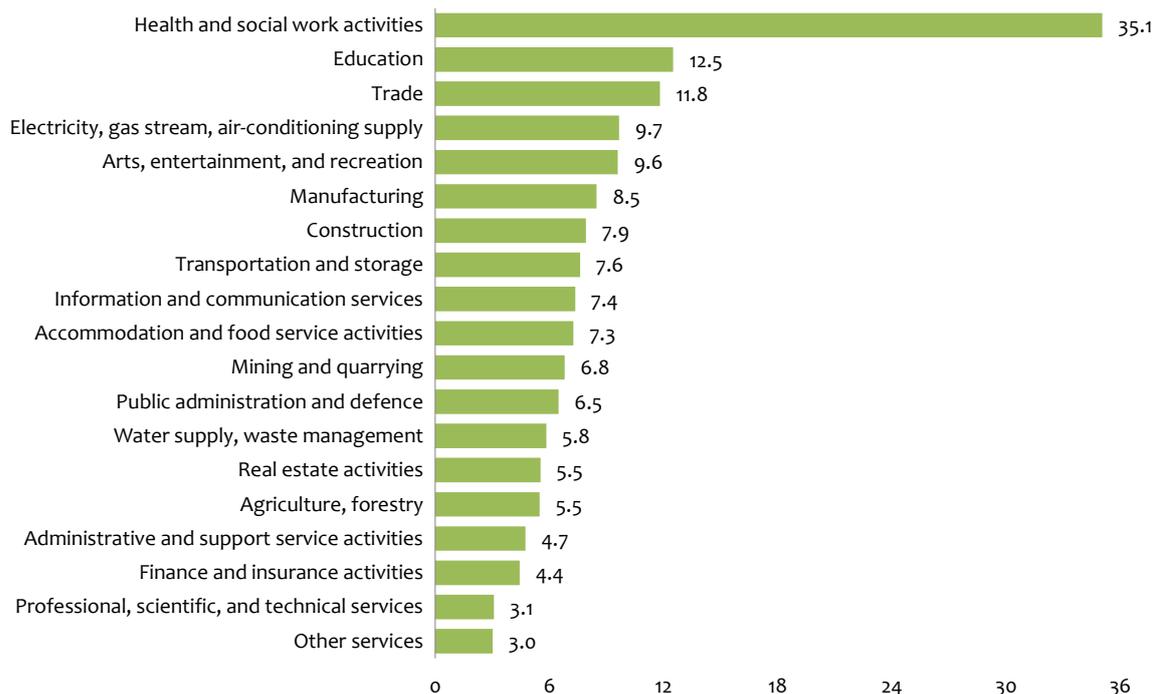


At the same time, wages continue to stagnate in the sectors most directly affected by the crisis. Although the level of remuneration in accommodation and food service activities has returned to growth, it still remains 4.5% lower, compared to Q2 of 2019. It should be noted that the lowest average wage remains in accommodation and food service activities – in Q2 of 2021, it reached EUR 778.

Also, the average monthly gross wage exceeds the pre-crisis level by merely 1.9% in the transport sector, which is the second lowest wage increase among all sectors of the economy, immediately after the accommodation and food service activities.

Meanwhile, in Q2 of 2021, the highest level of remuneration was observed in finance and insurance activities - the average monthly gross wage reached EUR 2,258.

Changes in Monthly Gross Wage in January-June 2021, compared to the corresponding period last year, as per cent



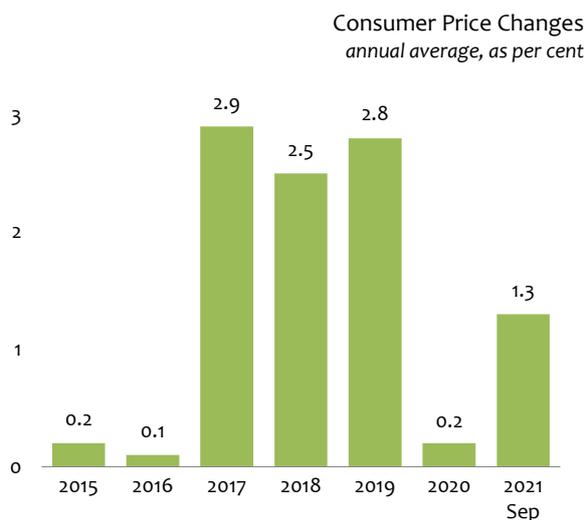
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ECONOMIC STABILITY AND COMPETITIVENESS

PRICES

In 2020, a sharp fall in prices was observed. Consumer prices fell by 0.5%, while average annual inflation reached 0.2%. The fall in demand due to the Covid-19 crisis had a major impact on the level of consumer prices.

In January-September 2021, prices rose rapidly. In September 2021, compared to December 2020, consumer prices increased by 5.2%, representing the largest rise since 2008. The increase was mainly determined by the economic recovery and the rise in world prices. Compared to September 2020, consumer prices rose by 4.8%. In September 2021, the average annual inflation reached 1.3 percent.



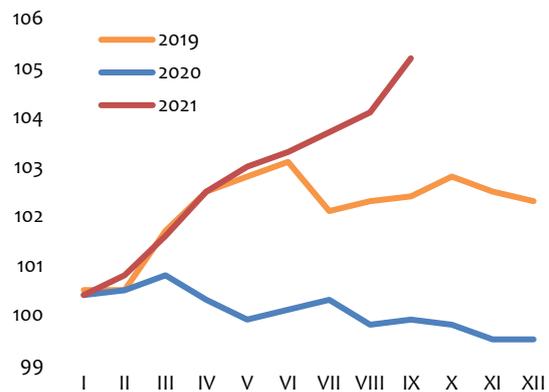
Key factors affecting overall price level in January-September 2021:

- (1) The rise in prices for natural gas and heat due to the increase in tariffs caused by higher world oil prices. Prices also rose for electricity following higher demand due to colder winter earlier this year. Also, lower hydropower development due to weather conditions affected the overall price level;
- (2) Rising fuel prices due to higher world oil prices. Overall, in January-September 2021, oil prices increased by 50%. The rise in oil prices was driven by higher oil demand and declining oil production;
- (3) Rising food prices affected by increased global food prices. The largest impact provided the rise in prices for fresh vegetables, potatoes, and dairy products. In January-September 2021, world food

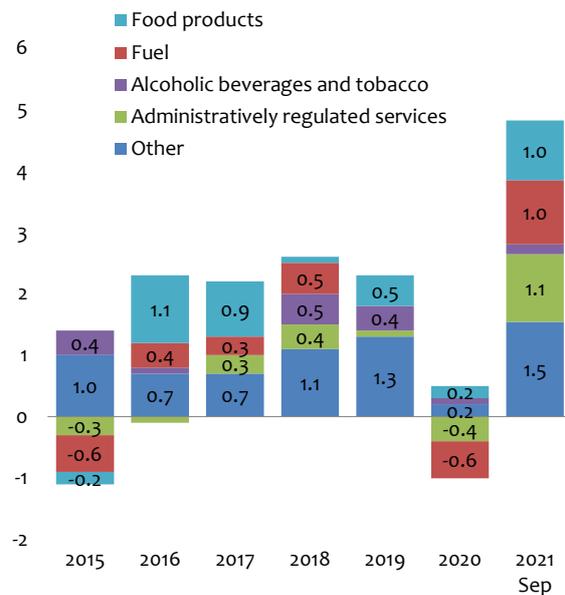
prices rose by 20%. Prices rose in all major food groups. In particular, prices for sugar rose most rapidly, whereas the lowest price increase was observed for dairy products;

- (4) price increases for services: the largest impact provided price increases for recreation and culture, outpatient, accommodation and food service activities, and telecommunications;
- (5) rising prices for clothing and footwear.

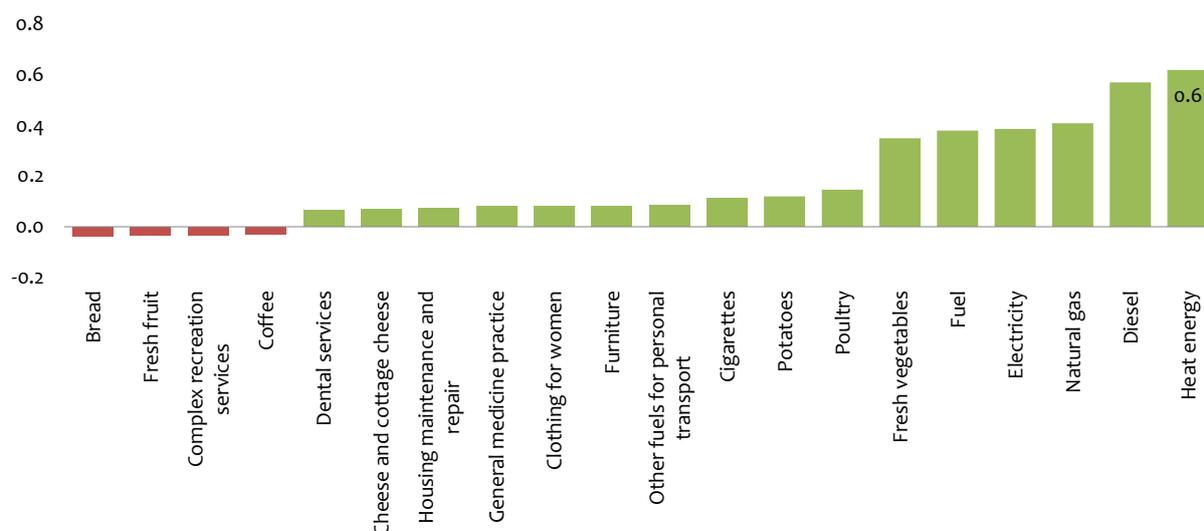
Consumer Price Index
December of the previous year = 100



Consumer Prices by Goods and Services
contribution to 12-month changes, as per cent

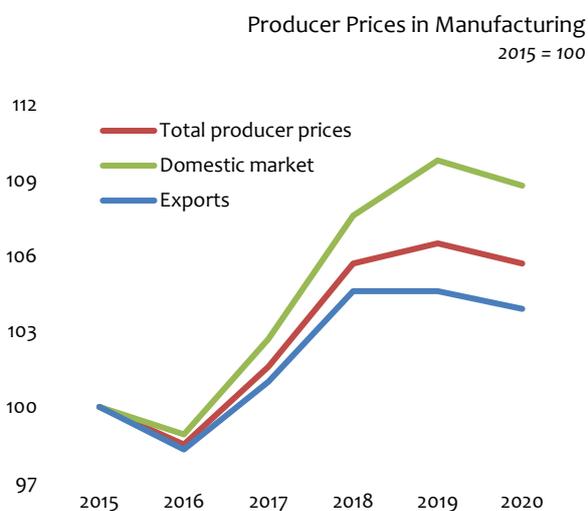


Consumer Price Changes by Goods and Services
September 2021, contribution to 12-month changes, as per cent



Overall, in 2021, the average annual inflation will be higher, compared to 2020, and may reach 2.9%. As the pandemic recedes and the economy recovers, consumer prices will stabilize. At the same time, this process will continue to be associated with fluctuations in world prices.

In 2020, producer prices in manufacturing decreased slightly.



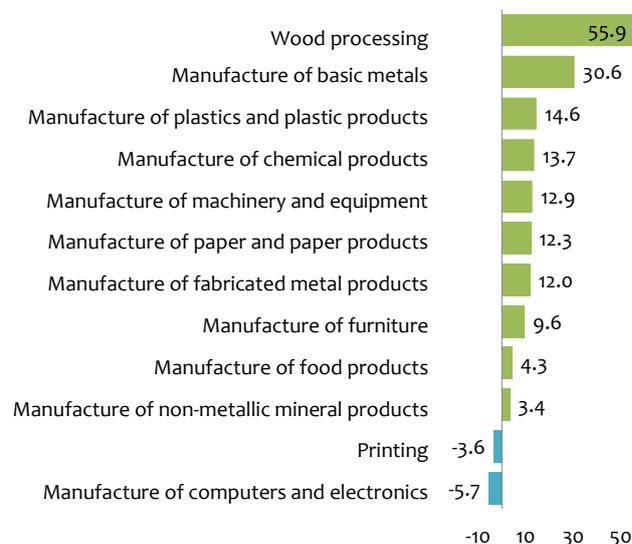
In 2021, a sharp rise in producer prices in manufacturing was observed. In January-August 2021, producer prices increased by 17.1%. Prices for products sold on the domestic market rose by 14.6%. However, prices for exported products increased by 18.3%.

In January-August 2021, producer prices rose in all sub-sectors of manufacturing, except printing and the manufacture of other transport equipment. The most

significant price increase was observed in wood processing.

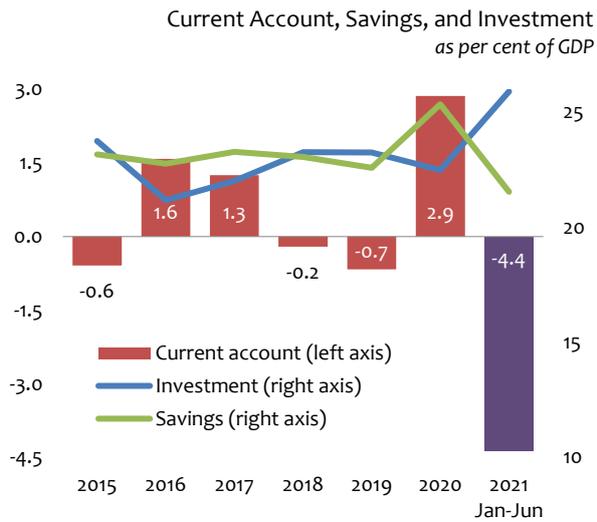
In 2021, manufacturing producer prices will rise very rapidly. The level of producer prices is largely influenced by fluctuations in the producer prices of exported products, which are mainly determined by the dynamics of world raw material prices. Fluctuations in raw material supply and demand in the context of the Covid-19 pandemic will also have a significant impact on producer prices. It should be noted that world energy and raw material prices rose sharply in January-August 2021. At the same time, the dynamics of producer prices for products sold domestically will continue to be affected by growth rates.

The Most Rapid Producer Price Changes in Manufacturing
in August 2021
against the corresponding period last year, as per cent



BALANCE OF PAYMENTS

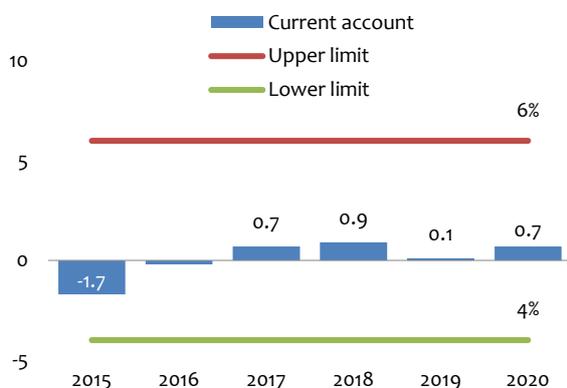
As a small open economy, Latvia is susceptible to external shocks, as demonstrated by the current account situation. Between 2017-2019, the annual fluctuations of the current account were modest, and the balance remained positive - on average at the level of 0.1% of GDP. In 2020, the current account position was determined by the shock caused by the Covid-19 pandemic, with various implications on cross-border flows of goods, services, and income.



In 2020, the current account reached a surplus of 2.9% of GDP. However, in the first half of 2021, the current account deficit amounted to 4.4% of GDP.

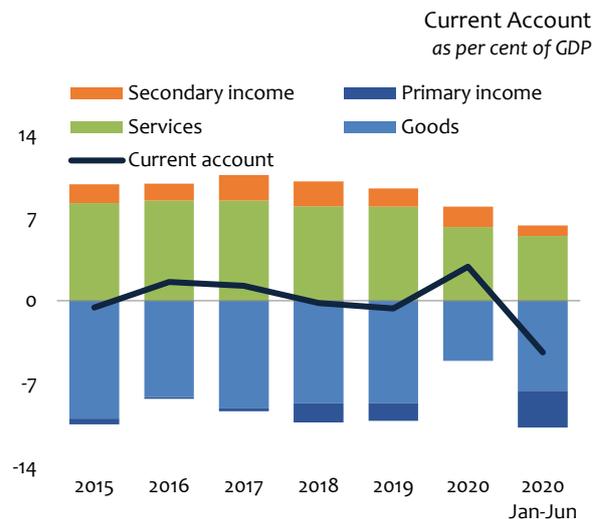
The current account does not exceed the indicative thresholds set by the EU alert mechanism and thus is considered sustainable.

EU Alert System Indicative Threshold and Current Account three-year average, as per cent of GDP



In recent years, external trade flows have weakened. It can primarily be attributed to the uncertainty in the external environment and declining external demand. Measures to limit the spread of the Covid-19 pandemic also had a

strong negative impact on trade intensity. In 2020, compared to 2019, the value of exports of goods at current prices increased by 5.2%. However, the value of imports declined by 3.1%, as the trade deficit reached 5% of GDP. In the first half of 2021, the foreign trade deficit amounted to 7.6% of GDP, mainly determined by the more rapid growth of imports.



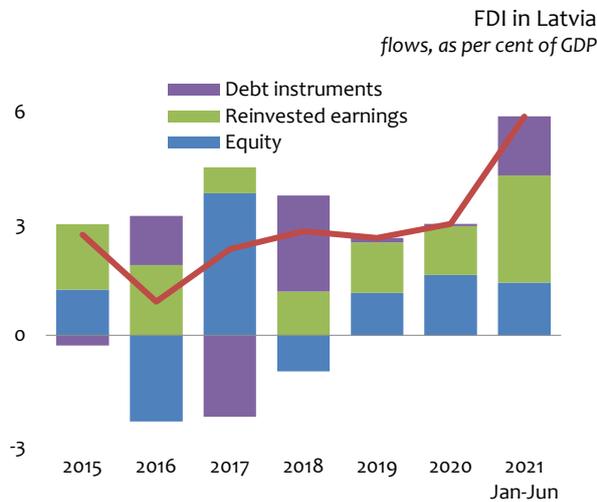
Cross-border trade in services is more strongly affected by the Covid-19 shock than trade in goods. Although the balance of services is positive, almost completely covering the foreign trade deficit, in 2020, the balance declined, reaching the level of 6.2% of GDP (in 2019 - 8%). The decline in cross-border flows of services was largely due to restrictions on movement and the population's caution regarding leisure and business travel, which led to a decline in the value of travel, air, and road transport services. In the first half of 2021, imports of services at current prices were 11% higher than a year ago. However, exports increased by only 1%. Consequently, the services surplus declined to 5.5% of GDP.

Changes in income and capital accounts are primarily due to variations in the absorption activities of EU funds. In 2020, the capital account surplus reached 1.8% of GDP. In the first half of 2021, it amounted to 1.3% of GDP.

In recent years, the financial account balance has been largely affected by financial sector stabilization measures, public sector debt restructuring, and the Bank of Latvia's measures under the expanded asset purchase program. Fluctuations in the financial account were also affected by a decline in non-residents' deposits within Latvian credit institutions. In the first half of 2021, financial account assets increased more than liabilities, and the financial account position (with reserve assets) reached -2.4% of GDP. The balance of payments position in the near future will be determined by the extent and duration of the Covid-19 pandemic and the restrictions imposed to combat it.

FOREIGN DIRECT INVESTMENT

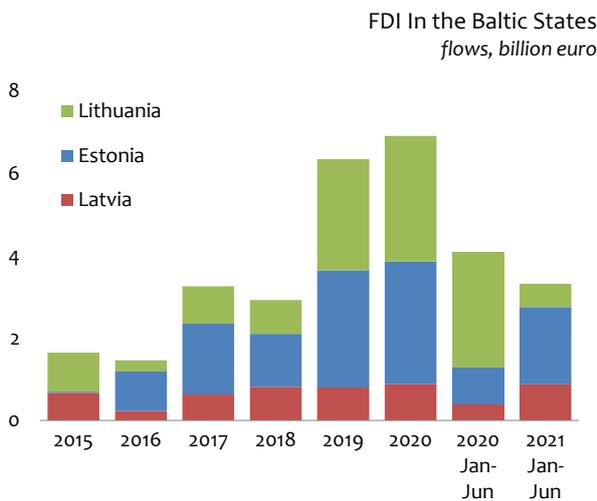
The dynamics of foreign direct investment (FDI) flows in Latvia remain moderate. Instability in the global economy, and restrictions on the spread of the Covid-19 pandemic, are a major barrier to cross-border investment flows.



In the Baltic States, cross-border direct investment flows in the first half of 2021 were more moderate than a year ago.

In 2020, attracted FDI flows in the Baltic States reached 6.6% of GDP, yet most of the FDI flows were in the Estonian economy.

In the first half of 2021, the total net FDI inflows in the Baltic States reached nearly 3.4 billion euros. Latvia attracted 27% of all FDI (Estonia - 56%; Lithuania- 17%).

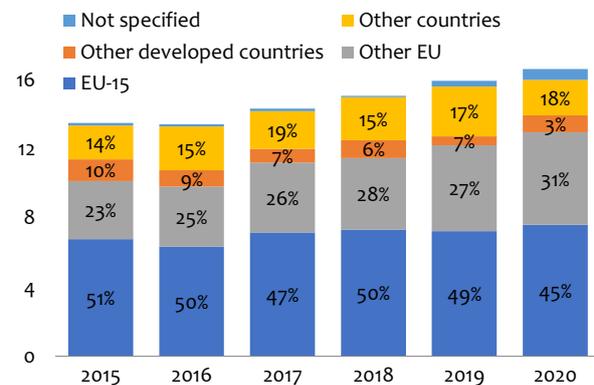


The intensity of attracted FDI flows is higher than a year ago. In the first half of 2021, the volume of FDI transactions reached 882 million euros, mainly due to reinvested earnings flows (443 million euros). Non-residents' investments in the equity of companies registered in Latvia were slightly lower than a year ago, reaching 212 million

euros. Overall, in the first half of 2021, the net flows of attracted FDI were almost 2.5 times higher than a year ago, amounting to 5.9% of GDP.

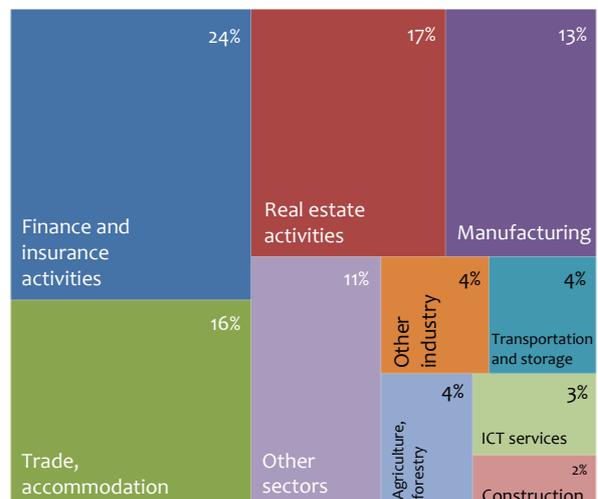
At the end of June 2021, the accumulated FDI in the Latvian economy reached 17.5 billion euros (almost 59% of GDP). In 2021, the accumulated FDI rose by 6.3%. The largest investor in Latvia's economy is Sweden. Since the end of 2020, the accumulated investments from Sweden have increased by 5.1%. At the end of June 2021, it accounted for 16.6% of the total FDI, mainly constituting investments in financial intermediation. Also, significant FDI flows have come from Estonia, Russia, Lithuania, Germany, Cyprus, the Netherlands, Denmark and Luxembourg. At the end of June 2021, investments of those countries accounted for 60.8% of the total accumulated FDI.

FDI Stock in Latvia By Groups of Countries closing balance at the end of the year, billion euro and per cent



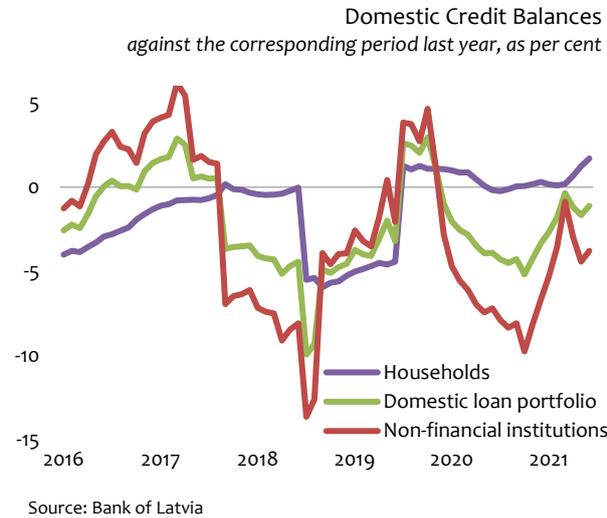
The largest share of accumulated FDI represent investments in financial intermediation services (24% of accumulated FDI), trade (15.4%), real estate activities (17.1%), and manufacturing (12.8%).

FDI by Sector closing balance at the end of June 2021

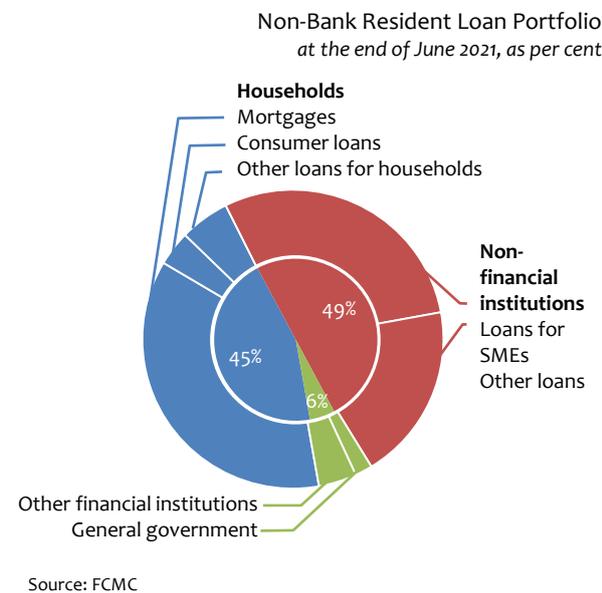


MONETARY INDICATORS

The financial sector remains stable. Deposits increased, while the situation in lending remained essentially unchanged. The total loan portfolio remains negative.



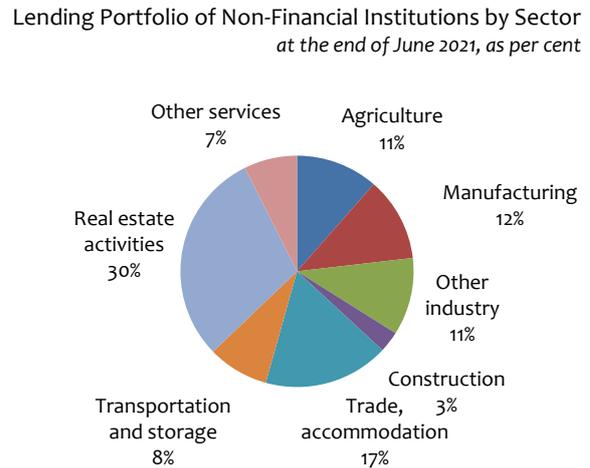
At the end of June 2021, the domestic loan portfolio declined by 1.1% annually. The loan portfolio of non-financial corporations decreased by 3.8%. The situation in household lending remained essentially unchanged, as the household loan portfolio grew by only 1.7% (data from the Bank of Latvia).



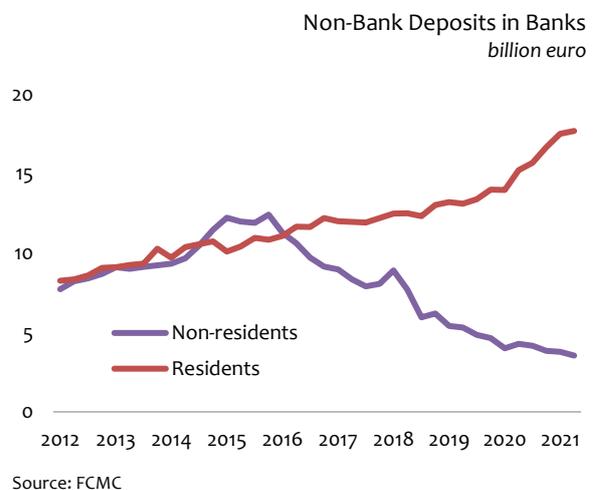
The breakdown of loans by sector has not significantly changed – At the end of Q2 of 2021, more loans were issued in real estate activities (30% of total), trade and accommodation (17%), manufacturing (12%), and other industry (11%).

Interest rates (balances) on loans to non-financial corporations denominated in euro have been relatively

stable since 2016. In June 2021, they were 2.46% for long-term loans and 3.38% for short-term loans. Interest rate fluctuations on long-term loans to households for house purchase remain minimal and amounted to 2.27% in July 2021. However, short-term interest rates fell slightly, reaching 3.39%.



At the end of June 2021, the amount of deposits increased to 21.2 billion euros (i.e., by 8.9% more than a year ago). A more rapid growth of deposits was observed in Q2 of 2020, with the beginning of the Covid-19 crisis, when people were more cautious in their spending and tried to save more due to the uncertainty regarding the future development of the situation. The volume of foreign deposits was 17.4% lower than a year ago, accounting for slightly less than 1/5 of all deposits (for comparison, in Q2 of 2015 - 53% of all deposits). Domestic deposits increased by 16.3% during the same period. Banks working with non-resident deposits are subject to higher liquidity and capital adequacy requirements.



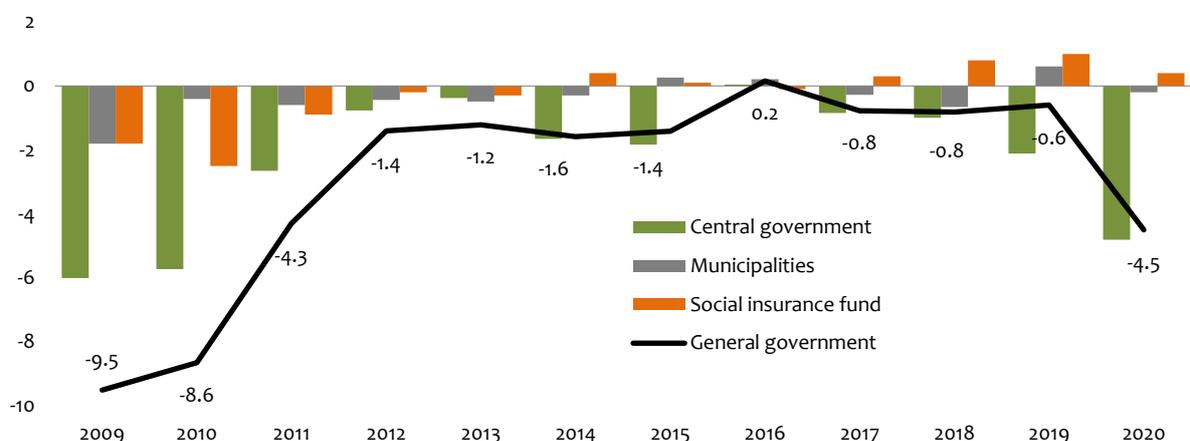
BUDGET AND GOVERNMENT DEBT

In the years prior to the Covid-19 pandemic, the general government deficit was in the range of 0.6% -0.8% of GDP. The Covid-19 pandemic has led to significant changes in fiscal policy, based on compliance with the structural deficit target of -0.5% of GDP. In 2020, the general opt-out clause of the Stability and Growth Pact was activated in the EU, allowing EU countries to increase the general government deficit in 2020 and 2021 to the extent necessary to reduce the economic damage caused by the pandemic. As a result of the Covid-19 pandemic, in 2020, the budget deficit increased to 4.5% of GDP (or 1.3 billion euro). The Saeima approved the budget for 2021 with a deficit of 9.3% of GDP.

General Government Budget

	2016	2017	2018	2019	2020
Revenues, bln euro	9.5	10.2	11.2	11.5	11.4
% of GDP	37.5	37.9	38.5	37.6	38.6
Expenditures, bln euro	9.5	10.4	11.5	11.7	12.7
% of GDP	37.4	38.7	39.3	38.2	43.1
Net, bln euro	0.04	-0.21	-0.23	-0.17	1.34
% of GDP	0.2	-0.8	-0.8	-0.6	-4.5

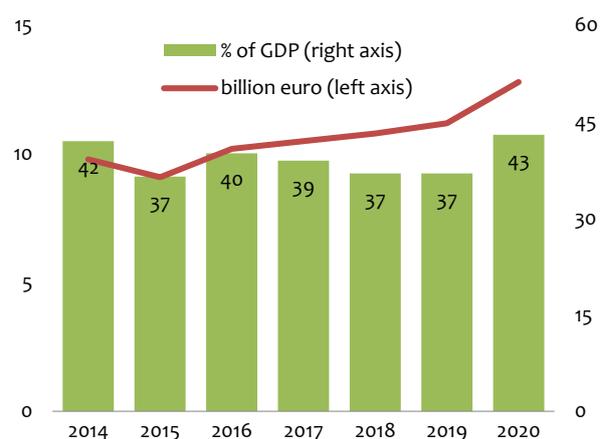
General Government Budget Balance by Sector
as per cent of GDP



In Latvia, general government debt level remains one of the lowest amongst EU. Prior to the Covid-19 pandemic, general government debt tended to decline. In 2019, it reached 11.2 billion euros (i.e., 36.7% of GDP). In 2020, the Covid-19 outbreak necessitated a significant amount of funding to mitigate the effects of the Covid-19 crisis. In 2020, the amount of government debt increased to 43.2% of GDP (or 12.8 billion euro).

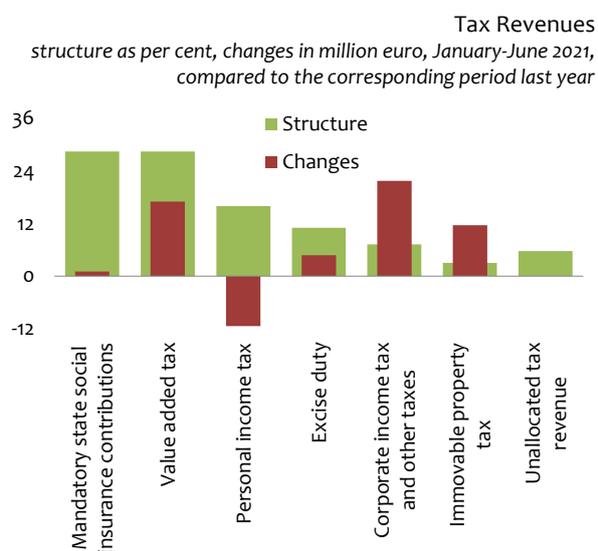
According to the Ministry of Finance, the need to provide financial resources due to the spread of Covid-19 will lead to an increase in general government debt to 49% of GDP in 2021 and to 50% of GDP in 2022. After the planned repayment of government debt in 2022-2023, as well as stabilization of the situation due to the impact of the Covid-19 outbreak on the fiscal impact of the state budget, it is anticipated that the general government debt will slightly start to decline from 2023 onwards and stabilize relative to GDP in the medium term.

General Government Consolidated
Gross Debt nominal value at the year end



BUDGET REVENUES AND EXPENDITURES

Since 2011, general government budget revenues have increased. Overall, in 2020, compared to 2019, budget revenues fell by 0.8%. As the economy recovers, in 2021, budget revenues resumed to grow. In the first half of 2021, budget revenues rose by 8.8%, compared to the corresponding period last year.



In the first half of 2021, an increase in revenue can be observed in almost all tax categories. Revenues from mandatory state social insurance contributions were 1.1% higher than a year ago. Also, revenues from personal income tax declined by 11.4%, mainly due to an increase in tax refunds and an increase in the non-taxable base.

Consolidated General Government Budget

	Billion euro			Changes as per cent
	2019	2020	2021 Jan-Jun	2021 Jan-Jun
Revenues:	11.4	11.3	6.0	8.8
Tax revenues:	9.1	9.0	4.6	11.2
Mandatory State Social Insurance Contributions	2.8	2.8	1.3	1.1
Value added tax	2.6	2.5	1.3	17.1
Personal Income Tax	1.9	1.8	0.7	-11.4
Corporate Income Tax	0.0	0.2	0.2	54.5
Excise Duty	1.1	1.1	0.5	4.8
Immovable Property Tax	0.2	0.2	0.1	11.6
Other taxes	0.3	0.3	0.2	0.2
Other revenues	2.3	2.3	1.4	1.3
Expenditures	11.5	12.5	7.0	23.1

The growth of economic activity is also reflected in the dynamics of consumption taxes. Revenues from value

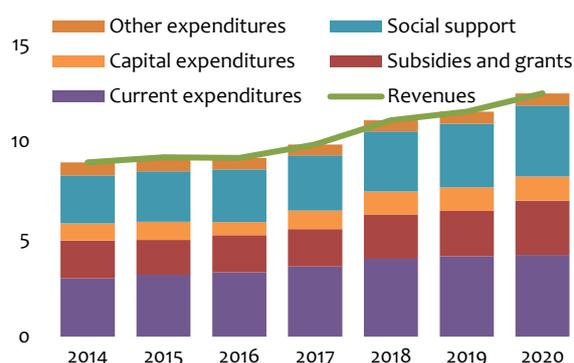
added tax increased by 17.7%. Also, revenues from excise duty rose by 4.8%.

In 2021, capital tax revenues also continued to increase. In the first half of 2021, the corporate income tax revenue rose by 54.5%.

In 2020, compared to 2019, consolidated general government budget expenditures increased by 8.2%. In the first half of 2021, expenditures continued to rise, and amounted to 7 billion euro (i.e., an increase of 23.1%). The increase can be attributed to the costs incurred in implementing the Covid-19 support measures, as evidenced by the increase of the social support item by 53.5%. Expenditures on subsidies and grants and current expenditure increased by 13.2% and 9%, respectively. In contrast, capital expenditures over the same period rose by 4%.

Consolidated General Government Budget Expenditures

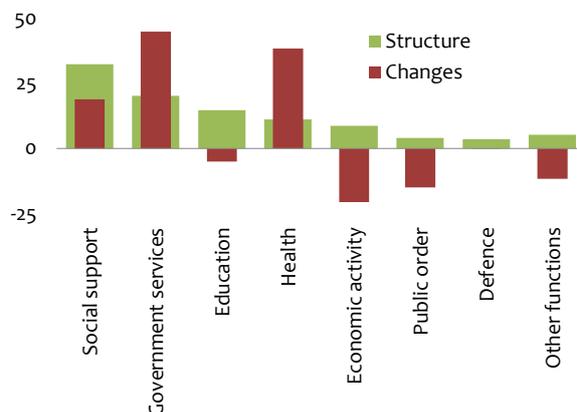
billion euro



Budget expenditures by functional categories reveal that in the first half of 2021 the largest growth rate was observed in expenditures on general government services and health. However, expenditures for economic activity, public order and defence declined the most.

Consolidated General Government Budget Expenditures by Functions

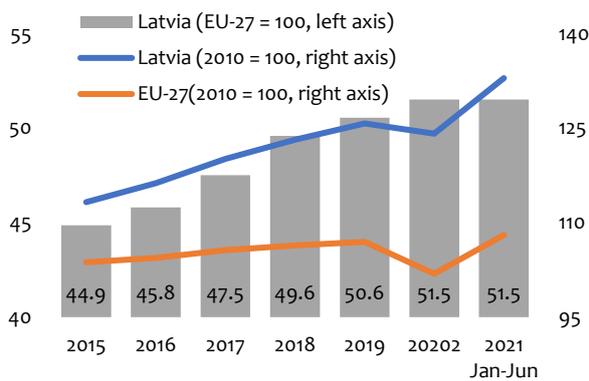
structure and changes in January-June 2021, as per cent



PRODUCTIVITY AND COMPETITIVENESS

The Covid-19 pandemic has a negative impact on productivity. As a result of COVID-19 pandemic control measures, in 2020, productivity was 1.3% lower than a year ago (EU average - 4.6%) and GDP per employee reached 51.5% (almost 71.4% after PPS) from the EU average. Overall, over the last ten years (since 2010), productivity has grown at an average rate of 2.2% annually (i.e., almost 3.5 times faster than the EU average). The productivity gap has narrowed by almost 12.2 percentage points since 2010.

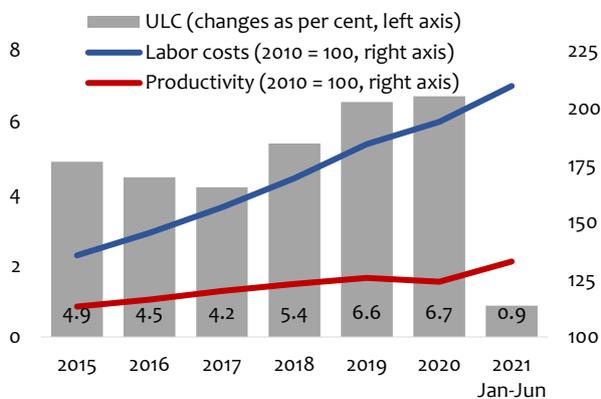
Productivity Dynamics



Labour costs continue to rise. The decline in economic activity also affected the dynamics of labour costs. In 2020, labour costs increased by 5.3%. Despite more moderate labour cost developments, it did not offset the decline in productivity, which led to a 6.7% increase in unit labour costs (ULC).

In the first half of 2021, labour costs continued to rise and were 8.2% higher than a year ago. This did not put a significant pressure on unit labour costs due to a 7.1% rise in productivity. In the first half of 2021, unit labour costs (ULC) increased by merely 0.9%.

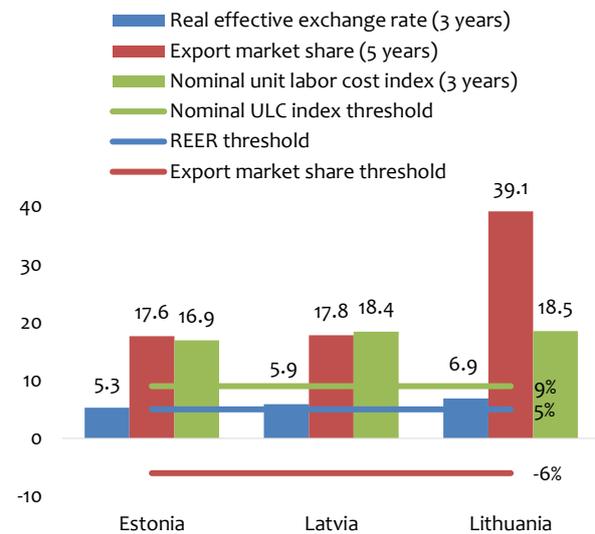
Labour Costs and Productivity



In recent years, strong growth in nominal ULC has been observed in all Baltic countries. In 2020, compared to 2017,

the nominal ULC in Latvia increased by 18.4%; in Estonia - by 16.9%; and in Lithuania - by 18.3%. The ULC growth in Baltic countries exceeds the EU average (by 8.3%) and the threshold set by the EU Alert Mechanism (MIP) (by 9%).

Competitiveness Indicators changes as per cent



REER dynamics have been positive. Between 2017-2020, the consumer price index (CPI) (based on REER against 42 trading partners) has increased by 6.9%. The indicator exceeds the threshold set by the EU Alert Mechanism.

Despite the negative trend of cost competitiveness indicators, the long-term dynamics of Latvia's export market share is improving. On average, in the last five years (2016-2020), the share of Latvia's exports in world markets increased by 17.8%, which was largely influenced by the positive changes in 2020. Although, in 2019, Latvia's export market share in world markets decreased by 1.27%, in 2020, it rose by 9.87%, primarily determined by a significant increase in the export market share of goods (by 14.9%). In Estonia and Lithuania, the share of exports of goods and services increased by 5.82% and 9.15%, respectively.

Productivity growth is a key determinant of competitiveness. Although the share of Latvia's exports in world markets is growing, the risks of declining competitiveness remain elevated, as the crisis caused by the Covid-19 pandemic has widened the gap between productivity and labour costs. In 2021, the level of productivity is lower than in 2019. However, labour costs are constantly increasing. In the near future, the dynamics of productivity and labour costs will be largely determined by measures to combat the Covid-19 pandemic and to stimulate economic activity.

EU ALERT MECHANISM

In line with the economic and fiscal policy surveillance rules adopted in 2011, a macroeconomic imbalances procedure was also established in the EU alongside the Excessive Deficit Procedure, aimed at identifying (through the Alert Mechanism Scoreboard) and correcting macroeconomic imbalances.

The Alert Mechanism Report for 2021 did not identify Latvia amongst those 12 EU Member States, where macroeconomic imbalances were present, and further in-depth study – required. Unlike previous reports, the analysis was based on annual data up to 2019 and short-term data for 2020 and projections. In the list of indicators (see table), in 2019, Latvia had two indicators that exceed the set thresholds. The net international investment position exceeded the threshold. However, it continued to improve. The nominal unit labour cost index also exceeded the threshold, similarly to 7 other EU Member

States, as wages continued to rise (in Latvia, mainly in non-tradable sectors in the private sector). However, wage growth is not expected to be as strong due to the Covid-19 crisis. House price growth remained high in 2019, slightly below the threshold. Nevertheless, it is expected to slow down as a result of the Covid-19 crisis. The banking sector entered the crisis on a strong footing, with both capital and liquidity ratios above the EU average. It is expected that with the cessation of government support measures, the amount of non-performing loans will increase, which has been relatively low for Latvia so far.

In 2020, the relative effective exchange rate also slightly exceeded the threshold. This is due to the appreciation of the euro against other currencies and indicates a possible loss of competitiveness. Nevertheless, in 2020, Latvia's exports have not been significantly affected. Also, Latvia's export world market share increased.

List of Indicators for the Macroeconomic Imbalances Procedure for Latvia

	Robežvērtības	2015	2016	2017	2018	2019	2020
External imbalances and competitiveness							
Current account (% of GDP, 3-year average)	-4%/6%	-1.7	-0.2	0.7	0.9	0.1	0.7
Net international investment position (% of GDP)	-35%	-61.7	-55.8	-53.1	-46.5	-41.7	-36.6
Real effective exchange rate – 42 partner countries, HICP deflator (% changes over the last 3 years)	±5%* & ±11%	2.5	4.8	1.7	5.1	3.8	5.9
Export market share – % of world export (% changes over the last 5 years)	-6%	13.0	9.1	7.4	8.3	3.3	17.8
Nominal unit labour costs index (% changes over the last 3 years)	9%* & 12%	17.3	16.2	14.2	14.7	15.4	18.4
Internal imbalances							
House price index (% annual changes)	6%	-2.8	7.2	5.6	6.4	5.8	2.6
Private sector credit flow (% of GDP, consolidated)	14%	-0.8	2.5	2.7	-0.2	1.5	-
Private sector debt (% of GDP, consolidated)	133%	78.4	78.4	75.7	69.8	67.2	-
General government debt (% of GDP)	60%	37.1	40.4	39.0	37.1	37.0	43.5
Unemployment rate (3-year average)	10%	10.9	10.1	9.4	8.6	7.5	7.3
Financial sector liabilities (% annual changes)	16.5%	13.3	4.7	6.2	-3.5	4.6	-
Employment indicators							
Economically active population – % of population aged 15-64 (% over the last 3 years)	-0.2 percentage points	1.3	2.3	2.4	2.0	1.0	1.2
Long-term unemployment rate – % economically active population (% changes over the last three years)	0.5 percentage points	-3.3	-1.7	-1.3	-1.4	-1.6	-1.1
Youth unemployment rate – % of economically active population (% over the last 3 years)	2 percentage points	-12.2	-5.9	-2.6	-4.1	-4.9	-2.1

* – Euro area countries.

Note: highlighted numbers exceed the thresholds set out in the Early Alert Mechanism Report.

Source: List of Indicators for the Macroeconomic Imbalances Procedure for Latvia, Eurostat

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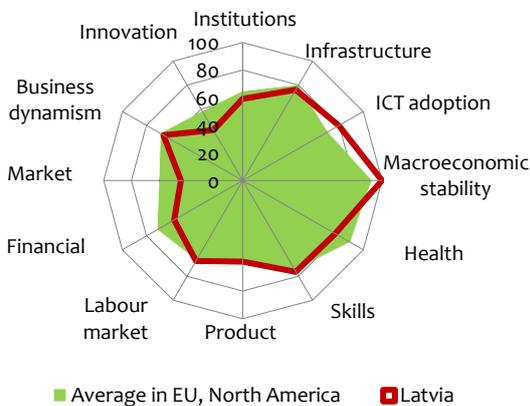
LATVIA IN INTERNATIONAL RANKINGS

Ratings from the United Nations, the World Bank Group, the World Economic Forum, and other organisations described Latvia as a country that makes a lot of reforms to improve its competitiveness via e-government, the business environment, ICT infrastructure, and other areas, while providing free press and not militarily endangering other countries of the world.

In World Economic Forum report and the **Global Competitiveness Index (GCI 4.0) for 2019** Latvia is ranked 41st between 141 surveyed countries.

In terms of macroeconomic stability, Latvia ranks 1st (along with other 33 countries). Based on well-developed infrastructure and a larger share of internet users, Latvia ranks 15th in the ICT adoption index. Latvia also ranks high in skills and labour market indexes – 22nd and 28th place, respectively. An average performance can be observed in business dynamism (40th), infrastructure (43rd), institutions (47th), product market (47th), and innovation capability (54th) indexes. However, the worst assessment has been received for health (84th), financial system (85th), and market size (95th) indicators.

Latvia GCI 4.0 2019
in scale from 0 to 100



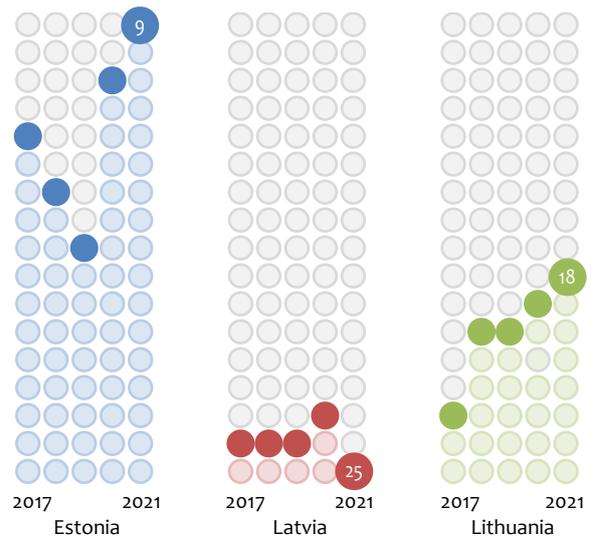
Source: World Economic Forum, The Global Competitiveness Report 2019

The 2020 edition of the GCI was dedicated to countries' responses to the Covid-19 crisis. As obtaining information was an impediment, only the lists of the highest performing countries with some indicators were published, in which Latvia has not entered.

In the **European Innovation Scoreboard 2021**, published annually by the European Commission, Latvia ranks 25th among the 27 EU countries and has declined to group of emerging innovators. The relative strong decrease in innovation performance between 2020 and 2021 is the

result of a sharp decline in Venture capital investments (from 0.215% to 0.019% of GDP). At the same time, it is noted that the proportion of non-innovators with innovation potential is above the EU average.

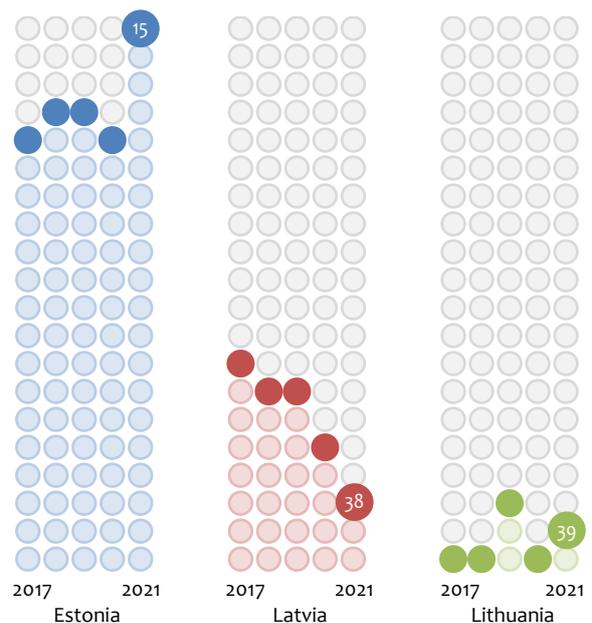
Baltic Countries in the European Innovation Scoreboard*



Source: European Commission, European Innovation Scoreboard 2021
* Since 2020, the UK is excluded.

In turn, in **Global Innovation Index 2021** Latvia is ranked 38th between 132 surveyed countries.

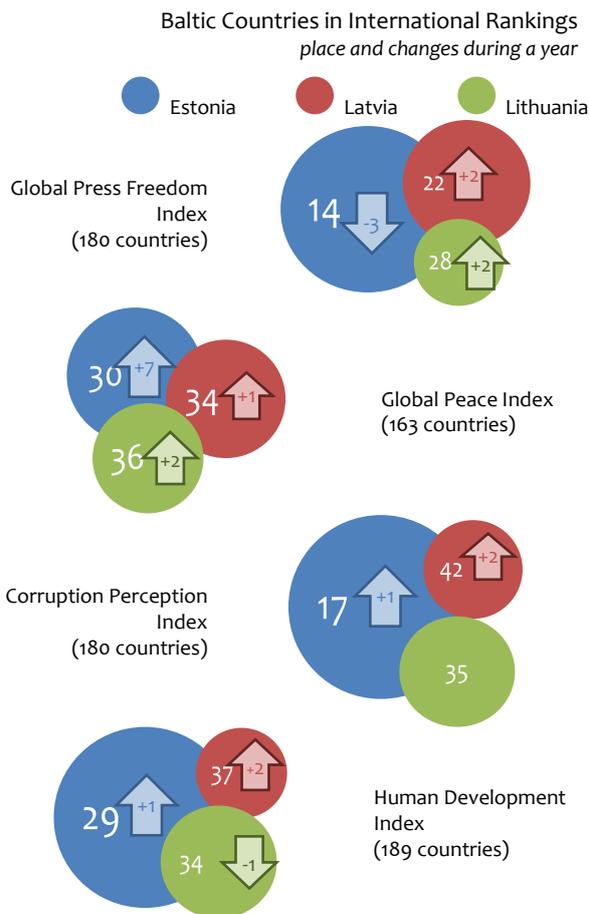
Baltic Countries in Global Innovation Index



Source: Cornell University, INSEAD, WIPO, The Global Innovation Index 2021: Tracking Innovation through the COVID-19 Crisis

The strengths of Latvia are highlighted: the ratio of students and teachers in secondary education institutions, the share of secondary school graduates, compliance with environmental management system standards, ease of obtaining credit, the share of women with higher education, gross domestic expenditure on research and development financed from abroad, imports of high-level technologies, increase in labour productivity, exports of ICT services, as well the rise in the volume of products of creative industries.

In **World Press Freedom Index 2021 by Reporters Without Borders (RWB)** Latvia ranks 22nd (amongst 180 countries), maintaining its position, compared to 2020.



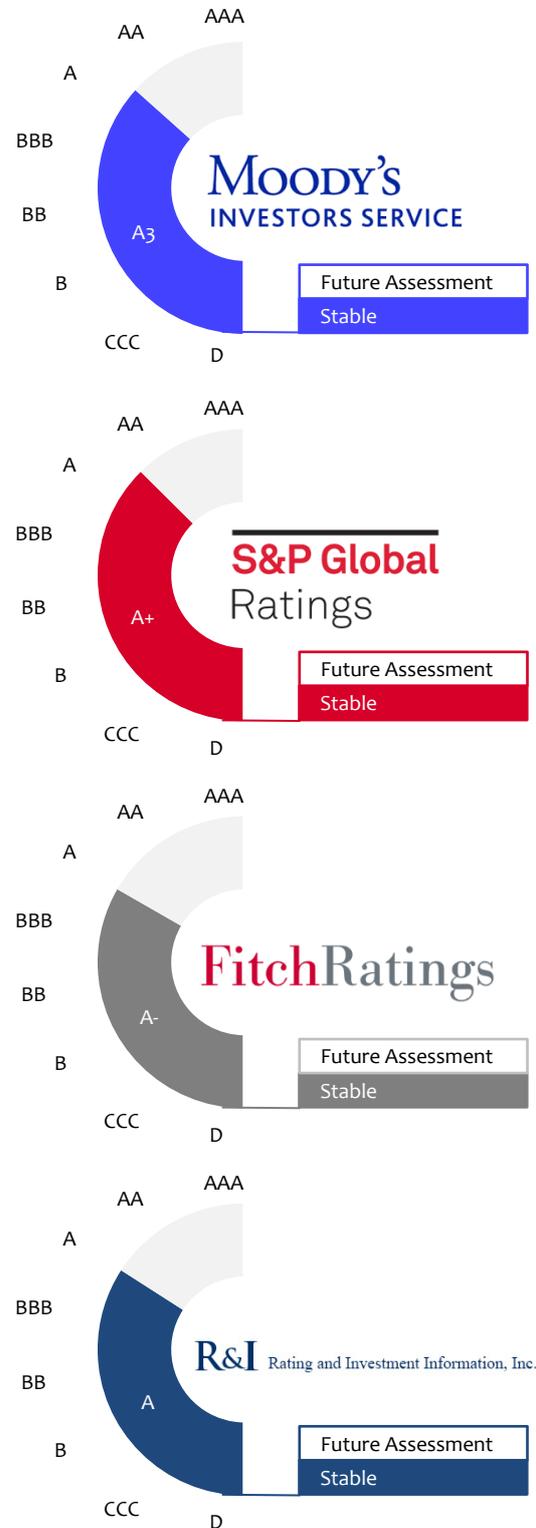
Source: Reporters Without Borders, 2021 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2021; Transparency International, Corruption Perceptions Index 2020; United Nations Development Programme, Human Development Report 2020.

In **Global Peace Index (GPI)** produced by the Institute for Economics and Peace (IEP) in 2021 Latvia was ranked 35th (amongst 163 countries). Compared to 2020, Latvia's has been ranked one position lower, although the score had improved in terms of the number of points obtained.

In **Corruption Perceptions Index 2020** produced by The Global Anti-Corruption Organisation *Transparency International* Latvia ranked 42nd (among 180 countries), improving its position by 2 places, compared to 2019.

In the **Human Development Index (HDI)** produced by the United Nations Organization Latvia ranks 37th (amongst 189 countries) in 2020, thus achieving by two places higher position than in 2019.

Credit Rating of Latvia for Long-Term Liabilities in Foreign Currency



Source: Treasure Republic of Latvia

In February 2020, the international rating agency S&P Global Ratings raised Latvia's credit rating from "A" to "A +", which marks the historically highest credit rating for Latvia. In August 2020 and February 2021, the agency confirmed that Latvia meets the "A +" level with a stable future assessment. In 2020, other rating agencies did not change their ratings.

The agencies concluded that the fundamentals of the Latvian economy have not been significantly affected by the Covid-19 crisis. Therefore, as the impact of the pandemic diminishes, economic growth will resume. Owing to the funds available from the European Recovery and Sustainability Mechanism and the implementation of large-scale investment projects, more rapid economic growth could be anticipated from 2022 onwards.