Mainly, numerical information and data, except of particularly indicated cases, are received from Central Statistical Bureau of the Republic of Latvia. European Union data are taken from Eurostat database. Data from the Bank of Latvia and Financial and Capital Market Commission are used in characterizing Latvia's Balance of Payments, banking and monetary indicators. Data from the Treasury are used in characteristics of public finances.

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ECONOMIC DEVELOPMENT TRENDS

The Covid-19 pandemic has had a significant impact on global economic development, including in Latvia. As a result of the pandemic, in 2020, GDP in Latvia shrank by 3.8%. On a quarterly basis, the largest decline was observed in Q2 of 2020, when the economy contracted by 9.1%. However, this was a relatively good indicator, as in Q2 of 2020, the EU average declined by 13.8%.

With epidemiological constraints remaining, the economy declined slightly in the first quarter of 2021 (by 0.1%). However, with the resumption of seasonal work in the spring and the improvement in the epidemiological situation due to vaccination, economic activity gradually increased. In Q2 of 2021, GDP was by 10.6% higher than a year ago.

Growth continued in Q3 and Q4 of 2021. Overall, in 2021, GDP increased by 4.7%, compared to 2020 (by 0.7%, compared to 2019).

Thanks to extensive support measures from the government and European Union funds, the Latvian economy will continue to recover in 2022. However, with the Russian invasion of Ukraine on February 24, 2022, the geopolitical situation has deteriorated and there is a great deal of uncertainty about how the war and the associated sanctions will affect economic development. The Ministry of Economics forecasts that in 2022 economic growth will decrease by at least 3 percentage points, compared to the previous forecast due to geopolitical factors. However, growth will remain positive and may reach 2-3% on an annual basis.

Key Economic Development Indicators

	2017	2018	2019	2020	2021	2022f
Gross domestic product, at current prices, billion euro	27.0	29.2	30.6	29.5	32.9	36.1
Changes against the previous year, as per cent						
Gross domestic product	3.3	4.0	2.5	-3.8	4.7	2.4
Private consumption	2.9	3.0	0.2	-7.4	4.8	2.9
Public consumption	3.3	1.7	3.4	2.6	4.4	2.2
Gross fixed capital formation	11.4	11.8	6.9	0.2	2.9	1.3
Exports	6.4	4.5	2.1	-2.2	6.2	1.4
Imports	8.6	6.4	3.0	-2.5	13.5	2.4
Consumer prices	2.9	2.5	2.8	0.2	3.3	11.7
as per cent						
Changes in the number of employed	0.2	1.6	0.1	-1.9	-3.2	0.9
Employment rate	62.9	64.5	65.0	64.2	62.5	63.6
Unemployment rate	8.7	7.4	6.3	8.1	7.6	7.1
as per cent of GDP						
General government balance	-0.8	-0.8	-0.6	-4.5	-7.3	-4.9
General government debt	39.0	37.1	36.7	43.3	44.8	50.0
Net exports	-0.6	-0.8	-0.8	1.2	-2.1	-1.2

f-– forecast

The Covid-19 crisis has had a significant impact on consumption. In 2020, private consumption was 7.4% lower than in 2019. In 2021, due to the easing of Covid-19 restrictions, an increase in the average wage and government support measures, private consumption increased by 4.8%. However, compared to 2019, private consumption is still low.

The government's support measures to mitigate the negative effects of Covid-19, which have been largely financed at the expense of increasing the general government deficit, have maintained positive growth in government consumption. In 2020, it was 2.6% higher than a year ago. In 2021, it continued to grow by 4.4%.

The Covid-19 crisis has had a relatively more moderate impact on investment. Despite the decrease in total economic activities in 2020, investments increased by 0.2%. In 2021, investments rose by 2.9%. The increase was driven by a rise in investment in machinery and equipment, as well as intellectual property products. Investments are expected to increase further, driven by a significant inflow of EU funds into the Latvian economy.

Exports of goods play an important role in mitigating the negative effects of a pandemic. In both 2020 and 2021, exports of goods increased. In 2021, compared to 2019, exports of goods increased by 12.6%. In 2021, the largest positive impact on growth yielded the exports of wood and wood products, mineral products, and iron and steel products.

At the same time, exports of services lag far behind pre-crisis levels. In 2020, it decreased by 21.7%. The decline was largely driven by declining exports of aviation and tourism services affected by the Covid-19 restriction, as well as exports of transit services. In 2021, the situation stabilized, and overall exports of services increased by 7.2%. Transport services were exported the most. However, the decline continued in tourism, whose export volumes lagged behind both the 2020 and 2019 levels.

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. Nevertheless, in 2021, a minor deficit 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 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.

In 2021, the volumes of agriculture and forestry decreased by 6.8%, which was especially affected by the unfavourable weather conditions in crop yield in the summer. In 2021, the sharp rise in construction material prices (mainly for wood products and metals) had a negative impact on the construction, where production volumes decreased by 6.1%. In 2021, a decline in catering and accommodation, as well as arts, entertainment, and recreation sectors, primarily determined by the restrictions of the Covid-19 infection, was observed. However, for a number of other sectors, year 2021 can be assessed as successful. The manufacturing sector grew by 7.4% due to export growth. The rapid growth in wholesale trade affected the growth of the trade sector by 8.9%. The volume of services provided in the transport and storage sector increased by 5.9%, mainly due to the increase in the volume of services provided in support activities of transportation and storage.

In 2021, the value added of the information and communication services sector increased by 10.9% (incl., in computer programming - by 14.0%; in the provision of information services – by 11.2%; in telecommunications services – by 6.5%). Also, in 2021, a rapid growth in the health care and financial services sectors was observed.

Although in 2021 GDP slightly exceeded the pre-crisis level of 2019, economic activity in several sectors was well below the pre-crisis level. In particular, compared to the pre-crisis level, accommodation and food services have declined by 45%; arts and leisure services - by 31%; transportation and storage – by 9.6%; agriculture and forestry – by 6.1%; and construction – by 6%. The largest increases in this period were in the health care, public administration, and financial services sectors. Also, a moderate growth was observed in manufacturing.

The Covid-19 pandemic has led to significant changes in fiscal policy. In 2020, the general exemption clause of the Stability and Growth Pact was activated in the EU, allowing EU countries to increase the general government budget deficit in 2020-2022 to the extent necessary to reduce the economic damage caused by the pandemic. Due to the Covid-19 pandemic, the budget deficit in Latvia in 2020 increased to 4.5% of GDP or 1.3 billion. euro. However, in 2021, it increased to 7.3% of GDP or 2.4 billion. euro. The Covid-19 crisis is gradually ending; therefore, the amount of support is decreasing and the Saeima approved the budget for 2022 with a deficit of 4.8% of GDP. However, in view of the Russia-Ukraine war and all its consequences, changes could be made to the budget.

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 receded, consumer prices began to rise, mainly due to rising world prices for energy and food. In 2021, the average annual inflation was 3.3%. In the first half of 2022, price changes are anticipated to significantly exceed the level of seasonal fluctuations. The primary two reasons: the Russian invasion of Ukraine leads to higher world energy prices; and higher world food prices, as both Russia and Ukraine are major food producers. In the second half of 2022, the situation will gradually return to normalcy and inflation rates will begin to gradually decline.

The imposition of restrictive measures on Covid-19 had 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.

In 2021, with the gradual improvement of the epidemiological situation, improvements in the labour market have been observed. 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. Overall, in 2021, the number of employees decreased by 3.2% or approximately 29 thousand, compared to 2020, representing the largest decrease since 2010. In 2021, the unemployment rate decreased to 7.6%, (i.e., by 0.5 percentage points lower than in 2020).

Given the worsening geopolitical situation, the situation in the labour market in the first half of 2022 is expected to be cautionary. The resilience of the Latvian economy to external shocks has strengthened significantly in recent years, especially in the financial sector. Thus, the direct impact of the tightening of sanctions and export markets on the Latvian labour market is expected to be limited. In 2022, the labour market will continue to be supported both by the phasing out of the restrictions introduced by the Covid-19 pandemic and by the construction of the already started state infrastructure facilities.

With the return of economic activity, the average wage is growing rapidly. In 2021, the average monthly gross salary rose by 11.8% - increasing to an average of 1,277 euros per month, which has been the most rapid growth of the average salary 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 increase in wages over the last 5 years has been close to 7% per year. The process of wage convergence closer to the level of wages in the economically developed countries of the EU and the growing shortage of skilled labour - the shrinking labour market, which makes it necessary for entrepreneurs to think more actively not only about attracting new specialists, but also how to keep existing ones, continue to maintain positive pressure on wages. incl. reviewing wage rates.

The further development of the economy in the medium term depends on 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 halt in the expansion of the Covid-19 epidemic and the geopolitical situation. The further development of the EU's common economic space is vitally important. Latvia's medium-term economic benefits will be based mainly on the achieved macroeconomic stability, which has led to improvements in Latvia's credit ratings, as well as on the effectiveness of the planned EU support programs and improvements in the business environment.

The competitive advantages of the Latvian economy are mainly based on technological factors, improvement of production efficiency and innovations, to a lesser extent on cheap labour and low resource prices. In the medium term, Latvia's growth rates may reach 4-5% per annum. Prolongation of war in Ukraine and Covid-19 pandemic could slow down economic recovery.

2022 | 1 WORLD ECONOMIC OUTLOOK

Prior to Russia's invasion of Ukraine, the global recovery from the pandemic was projected to continue in 2022 and 2023, supported by continued progress in vaccination, supportive macroeconomic policies in major economies, and favourable financial conditions. World GDP growth in 2022 and 2023 was forecast at 4.5% and 3.2%.[1]

The Russia-Ukraine war has already caused significant economic and financial turmoil, especially in commodity markets, with soaring oil, gas and wheat prices. The extent of the economic impact of the conflict on the world economy is very uncertain and will depend on the length of the war and political reactions. However, it is clear that the war will significantly hamper global growth and increase inflationary pressures.

The effects of the shocks vary from region to region, and the European economies, especially those sharing a border with Russia or Ukraine, will be hit hardest by the relatively stronger links between business and energy. If the commodity and financial market turmoil in the first weeks of the conflict continues for at least a year, global GDP growth is projected to slow by more than 1 percentage point over the year and global consumer price inflation to rise by around 2.5 percentage points over the same period. If additional energy exports from Russia to the EU cease completely, the OECD forecasts it will increase the overall inflation shock in the euro area to more than 3.5 percentage points and reduce European growth by more than 1.5 percentage points.

The GDP projections of the countries do not include an assessment of the consequences of the war in Ukraine.

China's GDP is expected to slow to 5.1% in 2022 and 2023. Developments in the construction and manufacturing sectors will have a negative impact on growth. In India, economic growth could reach 5.5% in 2022 and 2023.

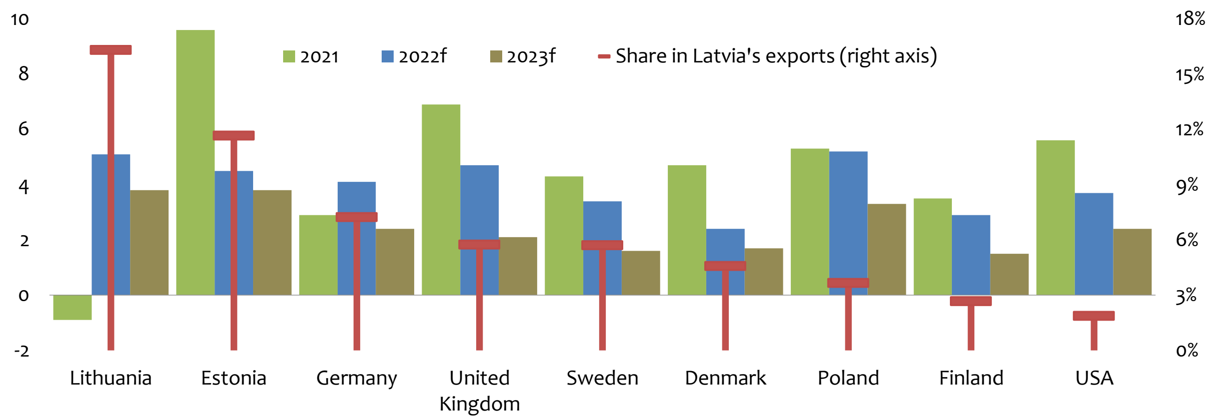
In the US, real GDP could grow by 3.7% and 2.4% in 2022 and 2023, respectively. On March 16, 2022, the Federal Open Market Committee (FOMC) reduced its GDP forecast for this year by more than 1 percentage point.

UK's GDP could grow by 4.7% and 2.1% in 2022 and 2023, respectively. Consumption is expected to be the main driver of growth. Business investment will improve; however, it will still be hampered by uncertainty.

Germany's GDP could grow by 4.1% and 2.4% in 2022 and 2023, respectively. The recovery is hampered by a shortage of key inputs, although high backlogs point to a strong potential recovery as supply constraints ease. The Swedish economy is expected to grow by 3.4% in 2022, driven by rising consumption and investment. In turn, in 2023, growth will slow down to 1.6%. In Estonia, GDP will grow by 4.5% and 3.8% in 2021 and 2022, respectively, driven by private consumption, a gradual decline in household savings, and the absorption of EU funds. However, the Lithuanian economy in 2022 and 2023 could grow by 3.8% and 3.5%, respectively. Rapid wage growth, EU fund flows will continue to be the main drivers of domestic activity.

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 2021 – right axis



Source: CSB, OECD Economic Outlook Database (2021); f – forecast; without an assessment of the consequences of the war in Ukraine

[1] In this section, unless otherwise indicated, data are taken from OECD Interim Economic Outlook Forecasts (2021)

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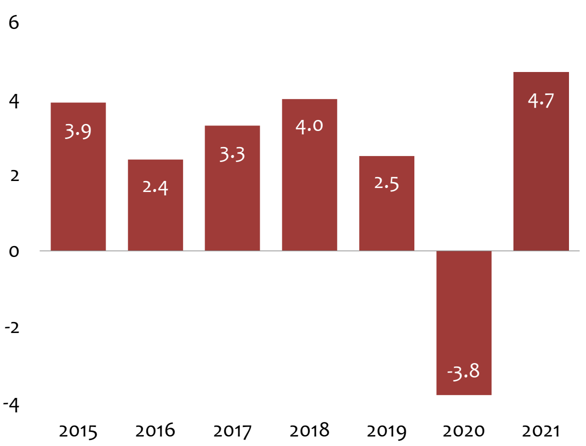
GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

GROSS DOMESTIC PRODUCT

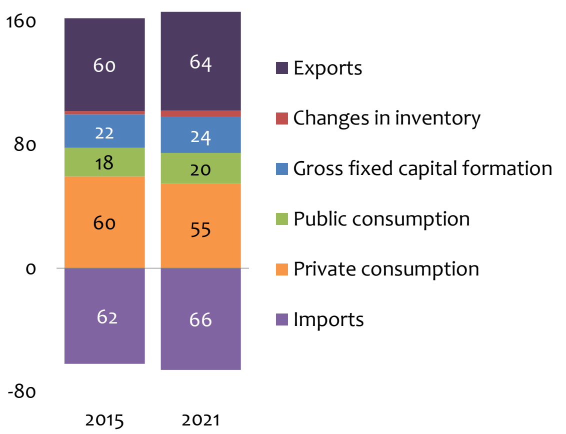
In 2021, economic growth was observed. In 2021, GDP grew by 4.7%, representing the largest growth in nine years.

Gross domestic product
changes against the last year, as per cent



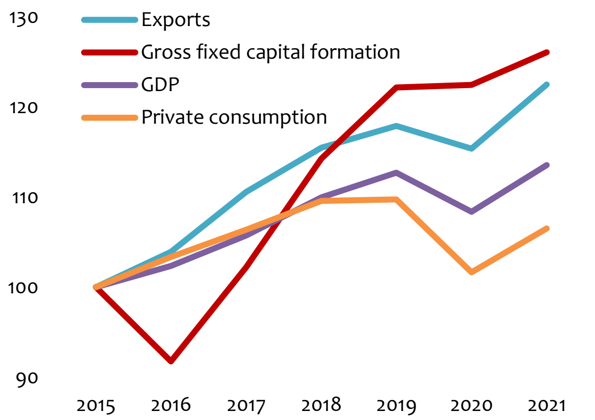
In 2021, economic development continued to be affected by the Covid-19 pandemic and measures to contain it. However, in the middle of the year the economy showed rapid growth, largely due to the base effect. The increase in exports had the largest impact due to the favorable economic situation in Latvia's largest export markets.

Gross Domestic Product from Expenditure Approach
% of GDP

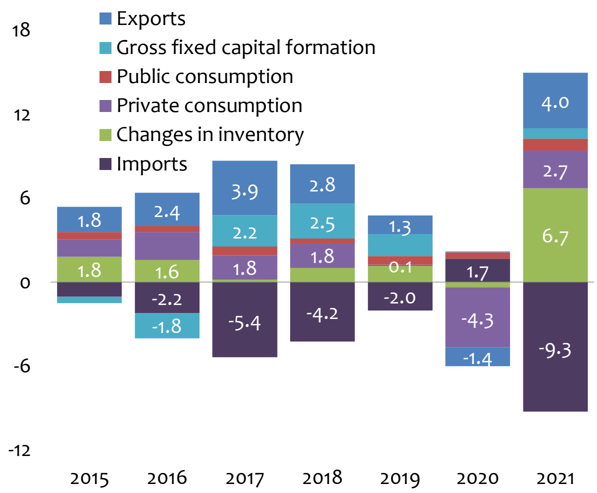


Trends in exports are highly variant – exports of goods grew very rapidly, reaching the historically highest export value. However, exports of services lag significantly behind the pre-crisis level, which was mainly determined by a significant decline in exports of tourism and transport services in 2020. Household consumption made a significant contribution to GDP growth. In 2020, investment volumes under Covid-19 conditions were relatively stable and positive trends continued in 2021. Government consumption also continued to increase, driven mainly by the continuation of government support measures to mitigate the effects of Covid-19.

Gross Domestic Product by Expenditure Items
2015 = 100



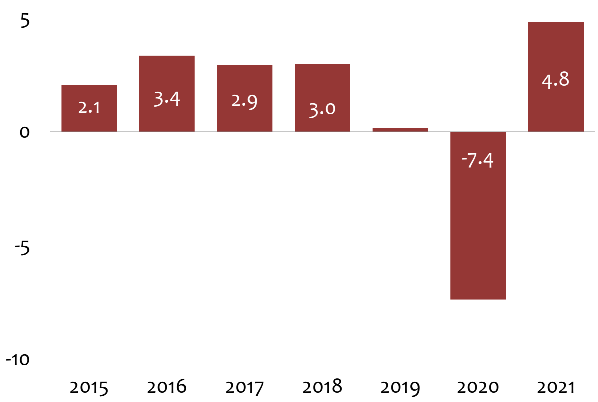
Gross Domestic Product by Expenditure Items
contribution to growth as percentage points



CONSUMPTION

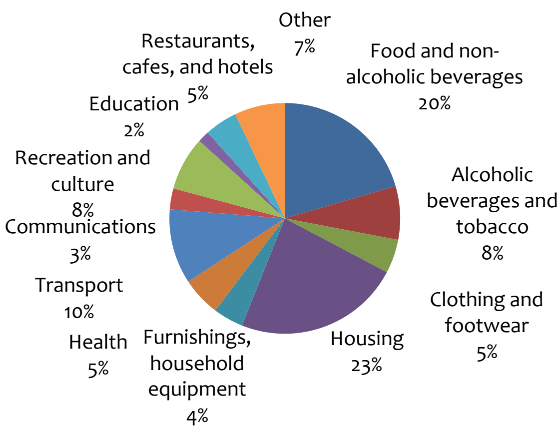
Private consumption has returned to growth. From 2015 to 2019, private consumption increased by 2.3% on average per year. However, in 2020, private consumption declined sharply due to Covid-19 restrictions. As the economy recovered, in 2021, a sharp rise in private consumption, driven by both the easing of Covid-19 restrictions and the rise in average wages and government support measures, was observed.

Private consumption
changes against the last year, as per cent



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 emergency determined in the country, during which various on-site services were not available.

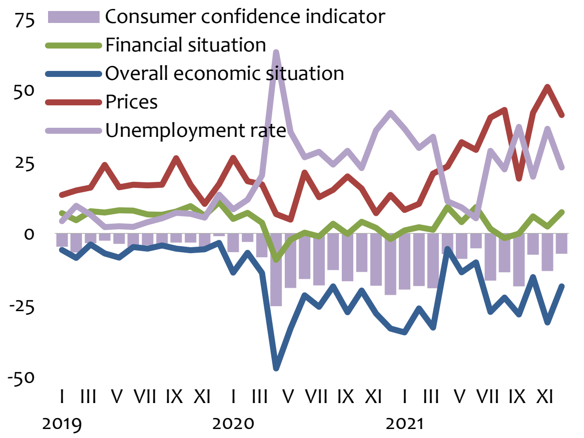
Structure of Household Expenditures
2020, as per cent



As a result of the Covid-19 pandemic, in 2020, consumer confidence fell sharply. In 2021, consumer sentiment was volatile.

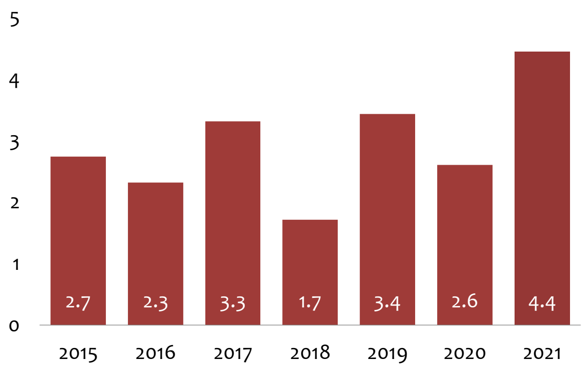
As the epidemiological situation of Covid-19 improved and restrictions eased, in the first half of 2021, consumers became significantly more optimistic and felt safer about their lives. The outlook for key items other than inflation expectations had returned to pre-Covid-19 levels in the second quarter. However, optimism waned in the third quarter, as the confidence indicator deteriorated due to growing concerns about the future. It can be attributed to the uncertainty and concerns regarding the development of Covid-19, as well as the upward trend in prices. In turn, in Q4 of 2021, consumer confidence indicators improved, returning to the level of the beginning of 2020 at the end of the year. At the same time, a more pessimistic assessment regarding rising prices and unemployment was observed.

Consumer Confidence Index
consumer assessment for the next 12 months, response balance, seasonally adjusted data



Public consumption continues to increase. Since 2014, with budget revenues rising, public consumption has grown more rapidly. From 2015 to 2020, public consumption increased by 2.7% on average per year. In 2021, public consumption continued to grow, mainly due to government support measures to reduce the negative impact of Covid-19.

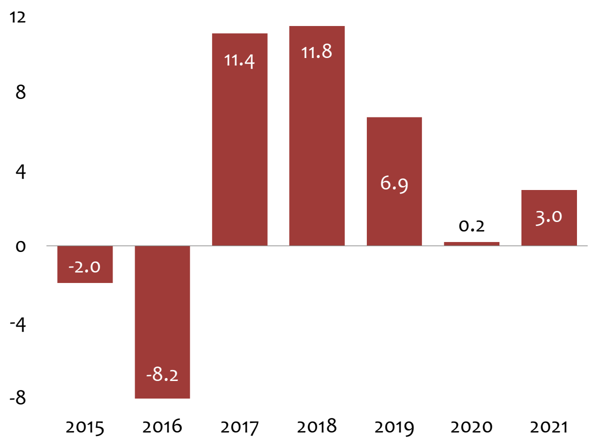
Public Consumption
changes against the last year, as per cent



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.

Gross Fixed Capital Formation
changes against the last year, as per cent



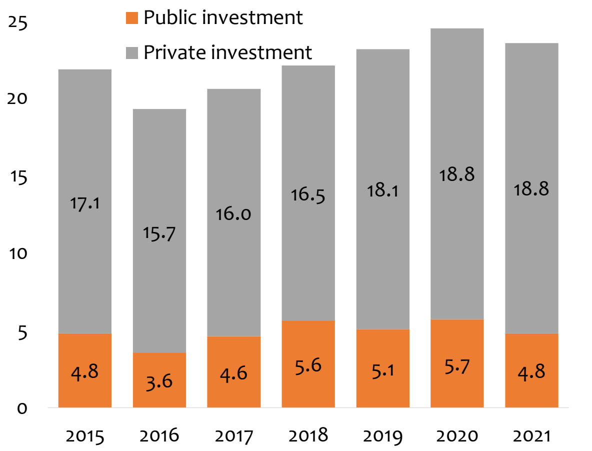
Due to the Covid-19 pandemic, investment activity was lacklustre. In 2020, compared to 2019, the amount of investments increased by only 0.2%. Nevertheless, it was one of the highest growth rates in the EU countries. In 2021, investment activities began to grow gradually and were 2.9% higher than a year ago.

Private investment is rising; however, it remains at a low level. After the global financial crisis 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%. However, in 2021, private sector investments were 7.1% 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.

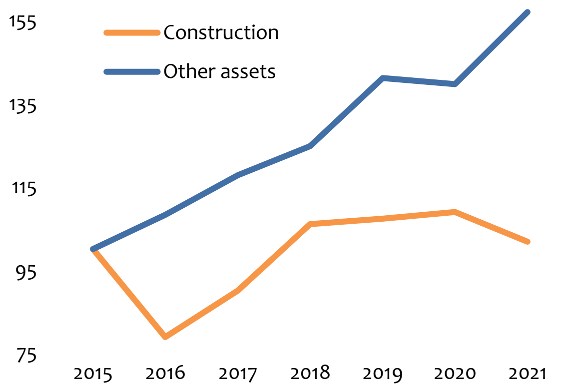
Public investment in Latvia is relatively high. Public investment accounts for almost 1/5 of the total investment in the Latvian economy and its dynamics are largely related to the cyclical nature of the absorption of EU structural funds. Between 2017-2019, public investment increased on average by 16% annually. In 2019, with EU funds reaching its peak, public investment declined significantly and was 8% lower than a year ago. Despite the Covid-19 crisis, in 2020, public investment increased by almost 7%. However, in 2021, it decreased and were almost 10.5% less than a year ago.

Public and Private Investment
as per cent of GDP



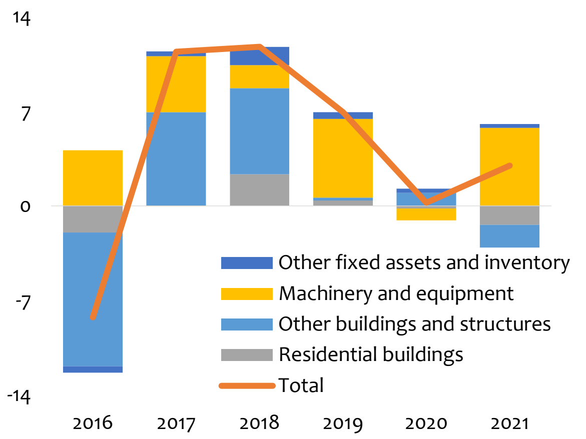
Most of investments has been made in construction assets. These are mainly investments in buildings and structures, which in the last three years accounted for almost 45% of total gross fixed capital formation expenditure. In 2020, investments in construction assets (at constant prices) increased by 1.5%. However, in 2021, investment in construction assets was 6.5% lower than a year ago, due to a decrease in investment in civil engineering and buildings (by 4.2%) and investment in housing (by 14.6%).

Gross Fixed Capital Formation by Type of Assets
2015 = 100



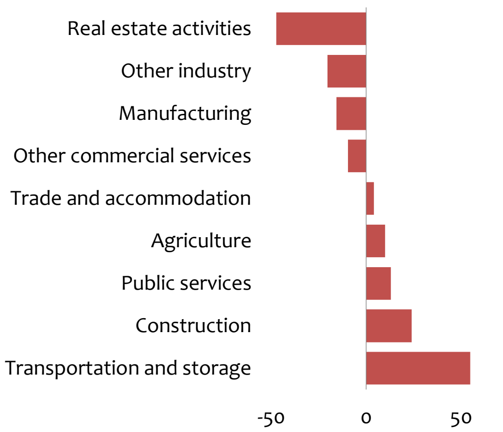
Between 2017-2019, investments in machinery and technological equipment (excl. vehicles) did not exceed 40% of total investment and their dynamics were lower than in other asset classes. In 2020, entrepreneurs invested in machinery and equipment by 2.8% more than a year ago. However, the volume of investments in vehicles declined significantly – by 22.3%.

Gross Fixed Capital Formation by Type of Asset
changes against the last year, as per cent; asset type investment, as percentage points



In 2021, investments in machinery and equipment increased by 13.7%. The increase in these assets was largely driven by investment in vehicles (by 23.4%) and in information and communication technology equipment, i.e., the equipment required to provide remote work.

Non-financial Investment Dynamics
*in 2021, changes against the last year, as per cent**



* – calculated using quarterly data, at current prices

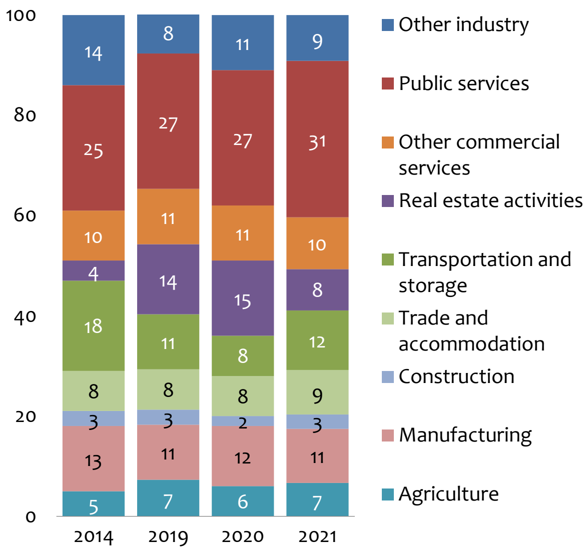
Investment in intellectual property products averaged 1.7% of GDP over the last three years before the Covid-19 crisis. In 2020, investment in intellectual property products rose by 2.8%. Positive investment dynamics have been also observed in 2021 - investment in intellectual property products rose by 17.8%, reaching 2.1% of GDP.

In 2021, compared to the previous year, capital investment in property, plant, and equipment in the goods production sector was almost 9.7% lower. However, in the services sector capital investment remained at the previous year's level.

The largest declines were observed in investment in manufacturing (by 15.6%), energy and heat supply sector (by 20.4%), and real estate (by 22.8%). This was partly offset by the increase in capital investment in tangible assets in the transportation and storage and health care sectors, which was 12.9% and 7.5% higher than a year ago, 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**



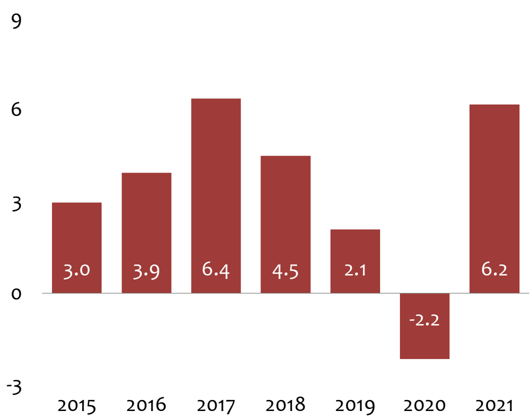
* Gross capital investment in tangible assets (calculated using quarterly data)

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. However, it should be noted that investment in construction assets will be significantly hampered by the increase in the price of construction materials and their shortage. Also, the war in Ukraine increases uncertainty regarding geopolitical developments and may force private investors and lenders to take a cautious stance on investment plans and investment project financing

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.

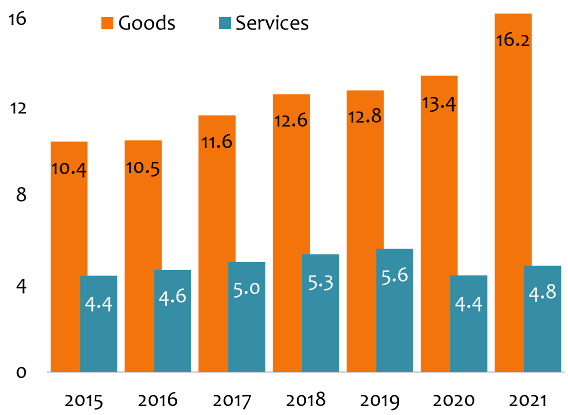
Exports of Goods and Services
changes against the last year, as per cent



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.

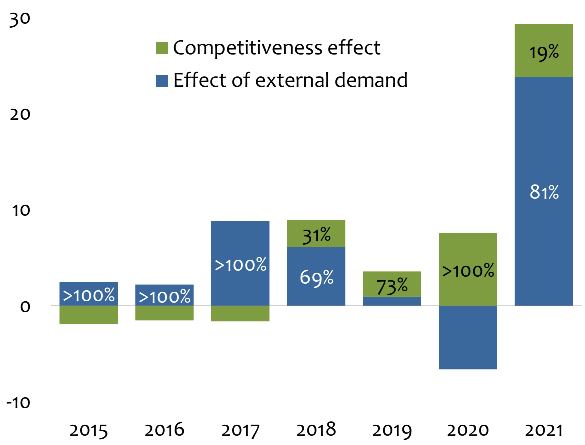
In 2021, due to rapid external demand, and partly due to the base effect, exports resumed growth. In Q1 of 2021, export volumes were slightly lower than a year ago. In Q2 of 2021, exports grew rapidly - by 15.5%. However, in the second half of the year, it rose slightly more moderately.

Exports of Goods and Services
at current prices, billion euro



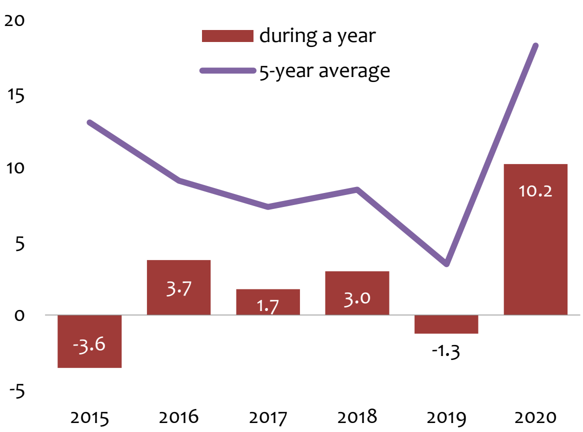
Between 2015-2018, export growth was mainly driven by external demand. The role of price competitiveness was negligible. On the other hand, in 2019, the growth of exports was more influenced by the competitiveness effect, which is related to the successful acquisition of new markets. However, in 2020, due to the spread of Covid-19, external demand is rapidly declining, which is partially offset by the increase in competitiveness in certain sectors. However, in 2021, the growth of exports is ensured by a rapid increase in external demand and competitiveness.

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.

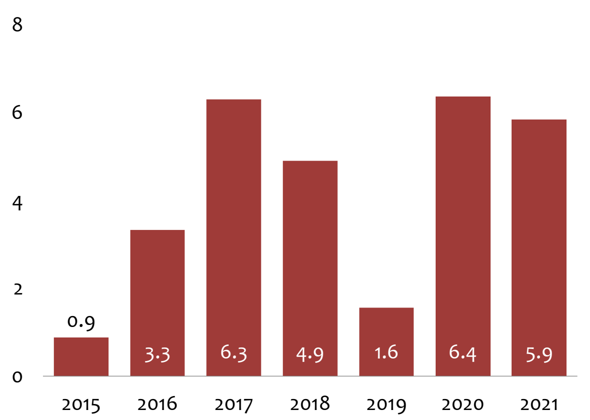
Share of Exports in World Trade
changes as per cent



Exports of Goods

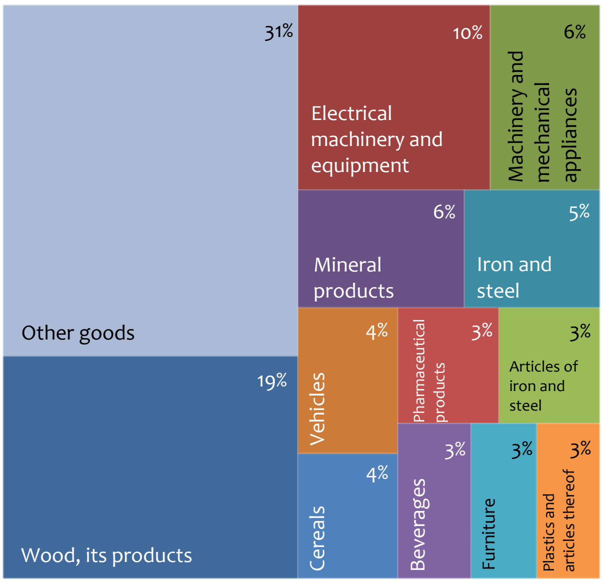
Exports of goods have remained stable, constituting around 70% of total Latvia's exports. It should be noted that in 2020, with exports of goods growing rapidly and exports of services declining, the share of goods in total exports increased slightly. In 2021, exports of goods accounted for 77% of the total export value.

Exports of Goods
at constant prices, changes against the last year, as per cent



In 2020-2021, the growth of exports of goods was relatively rapid. In 2021, at constant prices, it increased by 5.9%. Nevertheless, with a significant increase in export prices, the increase in actual prices was even more rapid – by 18.2%.

Exports of Goods
in 2021, structure, as per cent

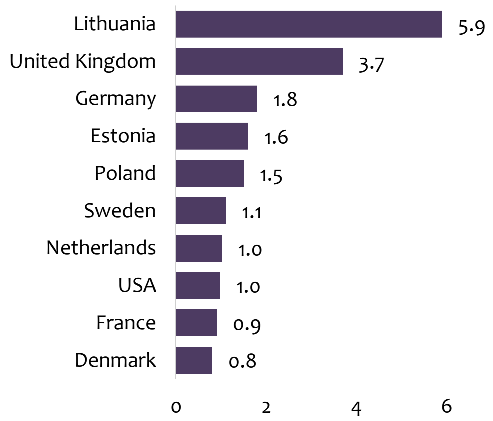


In 2021, the growth of exports of goods was significantly facilitated by the increase in the value of exports of wood and wood products, mineral products, as well as iron and steel. In January 2022, exports of goods increased by 29.6%. The most significantly increasing export product groups were the same as in 2021.

Exports of Goods
contribution to growth in 2021, compared to the corresponding period last year, percentage points

In 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 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, the United Kingdom, Germany, Russia, Sweden, Denmark, and Poland. Latvia exported 2/3 of all goods to these countries.

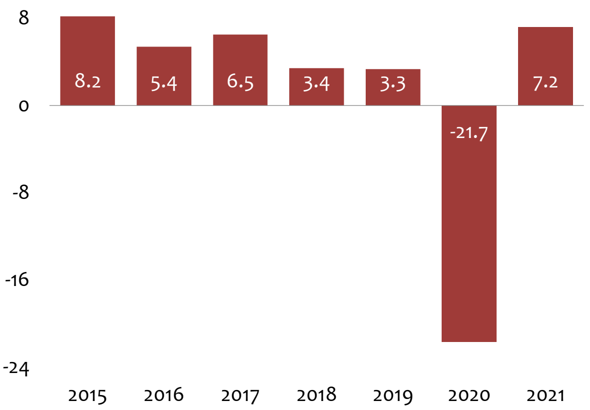
In 2021, the main export groups to the EU countries were wood and wood products and electrical appliances. Alcoholic beverages, electrical appliances, machinery and equipment, and pharmaceutical products accounted for a large share of exports to the CIS countries. The largest export groups to other countries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

Exports of Services

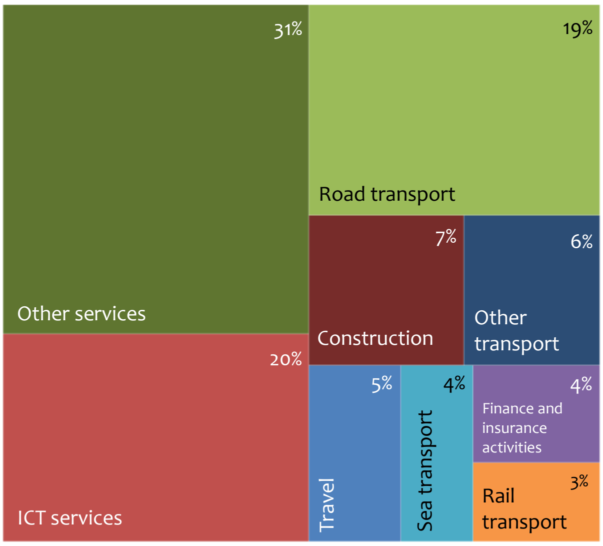
Until the pandemic, on average, Latvia's exports of services increased more rapidly than exports of goods. Transport services, ICT, trade intermediation, and travel services provide a major contribution to export growth. However, since 2016, the share of finance and insurance activities in exports is declining.

Due to the spread of Covid-19, from Q2 of 2020 until Q1 of 2021, the export of services declined significantly. Accordingly, exports of services increased significantly over the next three quarters, partly due to the base effect. Overall, in 2021, exports of services at current prices were 10.1% higher than a year ago. However, exports of services grew more moderately at constant prices due to price changes.

Exports of Services
at constant prices, changes against the last year, as per cent

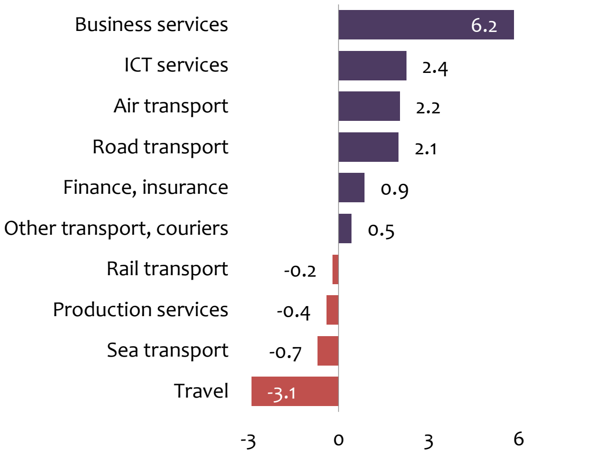


Exports of Services
2021, structure as per cent



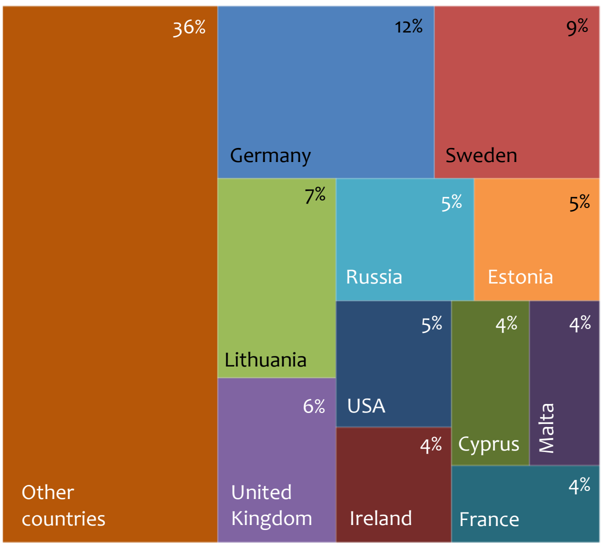
In 2021, the largest contribution to the growth of exports of services yielded the exports of business services. Exports of transport services, especially road transport, also increased significantly. However, it should be noted that exports of transport services were 26% lower than in 2019. Exports of ICT services also increased. Nevertheless, exports of travel services continued to decline.

Exports of Services
contribution to growth in 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.

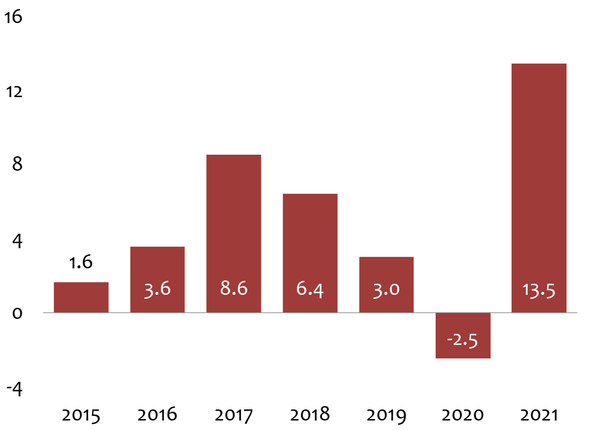
Structure of Exports of Services by Country
in 2021, as per cent



IMPORTS

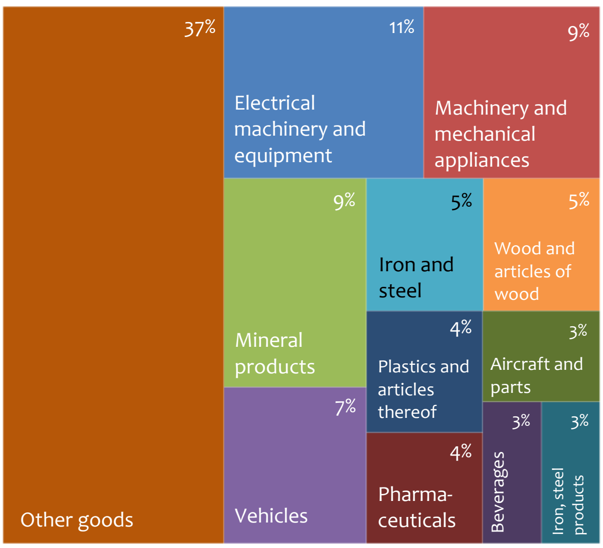
In recent years, imports of goods and services experience a similar growth as exports. Since 2017, imports of goods increased at a higher rate than imports of services. However, in 2020, under the influence of Covid-19, imports of services decreased significantly, while imports of goods essentially remained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

Imports of Goods and Services
at constant prices, changes against the last year, as per cent



In 2021, due to the increase in prices, the value of imports of goods at current prices grew more rapidly than at constant prices - by 28.4%. In Q1 and Q2 of 2021, imports of goods increased significantly. A large part of the increase can be attributed to the rise in imports of mineral products, iron and steel, aircraft and their parts, wood and its products, and machinery and equipment. However, imports of beverages and tobacco declined.

Structure of Imports of Goods
in 2021, as per cent



In January 2022, imports of goods increased by 35.8%. It was significantly affected by the rise in the value of imports of mineral products, chemical products, and metals and metal products.

Latvia's main imports of goods partner countries are Lithuania, Germany, Poland, Russia, Estonia, China, the Netherlands, and Finland. In 2021, Latvia imported 2/3 of all goods from these countries.

In 2021, the main groups of imported goods from the EU were machinery, electrical appliances, vehicles, and mineral products. Mineral products, iron and steel, wood, its products accounted for a large share of imports from the CIS countries. It should be noted that 90% of imports from the CIS countries are from Russia and Belarus.

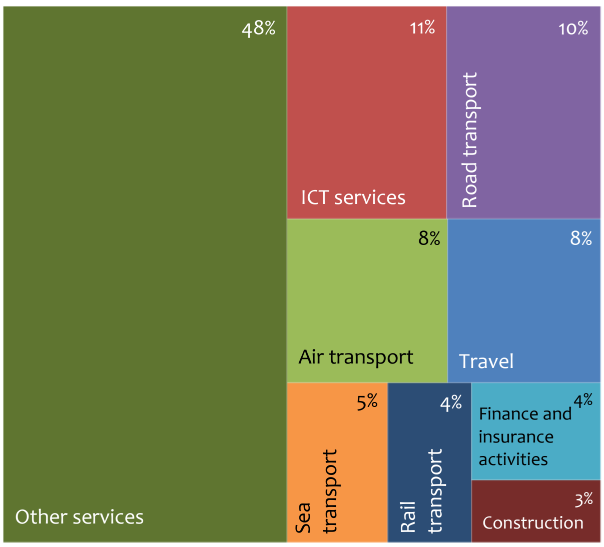
In the structure of imports, after the end use of goods, the share of capital goods and consumer goods has slightly decreased since 2019. Consequently, the share of intermediate goods has increased.

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 a fall in imports of travel and transport services, especially air transport.

In 2021, partly due to the base effect, imports of services increased by 20.5%. This was significantly driven by an increase in the value of imports of business services. Imports of transport and ICT services also increased. However, imports of financial services and travel declined.

Structure of Imports of Services
in 2021, as per cent



2022 | 1

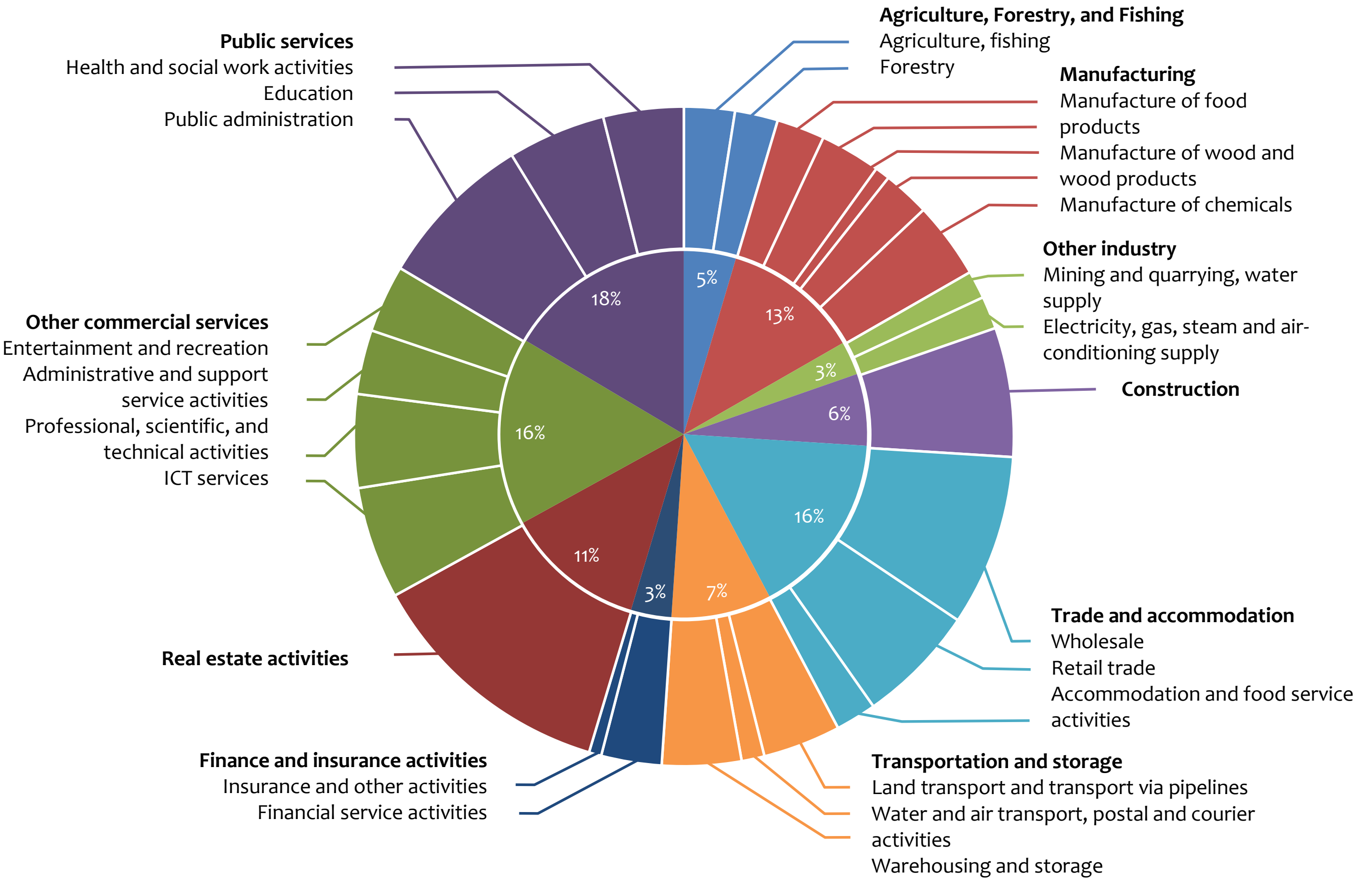
SECTORL DEVELOPMENT

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 2021, the share of these sectors reached 28.3%. In 2010, tradable sectors (i.e., agriculture, forestry, and fishing, manufacturing, and construction) constituted 27.6% of the total value added. In 2021, it slightly declined to 27.2%. In 2021, compared to 2010, the share has increased in construction, commercial services and public services. However, a decline in other industry, transportation, trade and accommodation has been observed.

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. As the economy recovered, in 2021, growth was observed in manufacturing and other industry, trade, transportation, financial activities, information and communication, and public services.

Structure of Value Added

2021, as per cent*



* calculations by the Ministry of Economics

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

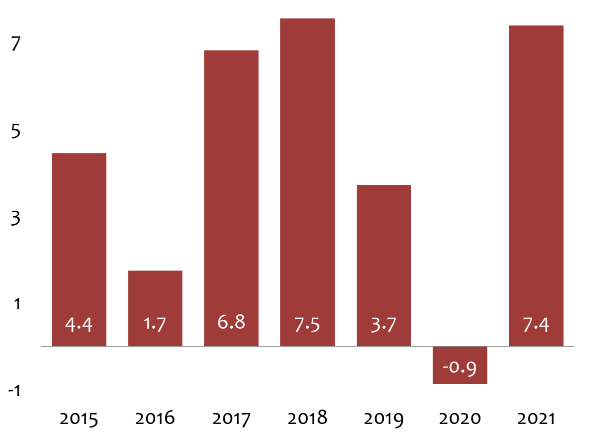
	2015	2016	2017	2018	2019	2020	2021
Gross domestic product	**3.9**	**2.4**	**3.3**	**4.0**	**2.5**	**-3.8**	**4.7**
Agriculture, forestry, and fishing	2.7	-4.3	1.9	-3.6	19.8	0.8	-6.8
Mining and quarrying	14.8	-2.8	9.1	9.1	-5.2	8.8	5.0
Manufacturing	4.4	1.7	6.8	7.5	3.7	-0.9	7.4
Manufacture of food products	-4.6	1.8	5.2	-2.9	-0.7	-1.7	1.3
Light industry	-13.2	2.1	7.6	-0.8	-2.6	-9.5	11.8
Manufacture of wood and articles of wood	7.1	8.0	2.1	4.5	0.0	4.5	3.7
Manufacture of paper and paper products	0.0	3.6	4.5	-3.7	5.7	4.7	14.0
Manufacture of chemicals and chemical products	-4.1	10.7	11.4	7.0	3.9	-1.8	14.8
Manufacture of non-metallic mineral products	-9.8	11.6	11.1	1.3	-2.1	-1.4	4.4
Manufacture of basic metals	34.8	5.4	12.0	3.6	13.5	-5.6	5.8
Manufacture of computer, electronic and optical products	16.7	12.6	15.8	12.1	11.3	12.1	5.7
Manufacture of machinery and equipment	7.9	8.5	21.5	7.0	-1.9	-2.7	24.1
Manufacture of motor vehicles	3.5	-2.9	22.8	7.3	-7.7	-15.3	17.7
Other manufacturing	3.5	0.8	4.3	-1.8	2.8	-14.2	11.8
Electricity, gas, steam, and air-conditioning supply	22.1	17.5	-1.9	-38.8	2.6	-6.0	3.3
Construction	-0.4	-9.6	14.7	12.4	1.3	0.1	-6.1
Construction of buildings	-1.6	-9.5	11.7	16.1	9.3	0.9	-10.5
Civil engineering	-0.5	-15.9	26.6	6.5	-10.6	-1.5	-5.0
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	2.5
Transportation and storage	1.2	1.7	6.6	3.8	3.5	-14.6	5.9
Freight rail transport	-2.4	-14.1	-8.4	12.5	-15.8	-42.3	-9.5
Cargo handling	-6.2	-9.3	-2.0	6.9	-5.7	-28.0	-7.2
Freight transport by road	0.5	1.3	7.0	12.8	-3.8	2.6	7.8
Accommodation and food service activities	8.9	4.4	9.3	7.6	-3.9	-42.0	-5.2
Information and communication services	2.3	5.0	8.7	9.6	4.4	-7.0	10.9
Finance and insurance activities	13.3	-0.2	-17.7	-2.4	-9.6	-2.0	19.8
Real estate activities	-2.4	1.6	-1.6	2.3	-3.6	-0.6	-1.7
Other service activities	1.9	3.9	4.6	2.7	0.6	-3.7	2.6
Public administration and defence; compulsory social security	2.4	1.5	3.8	2.8	3.6	1.5	2.9
Education	3.2	1.1	4.3	3.0	2.7	0.8	3.0
Health and social work activities	5.2	1.2	4.4	9.3	9.6	2.4	24.8
Arts, entertainment, and recreation	8.2	5.0	5.1	6.1	2.8	-28.6	-3.3

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.

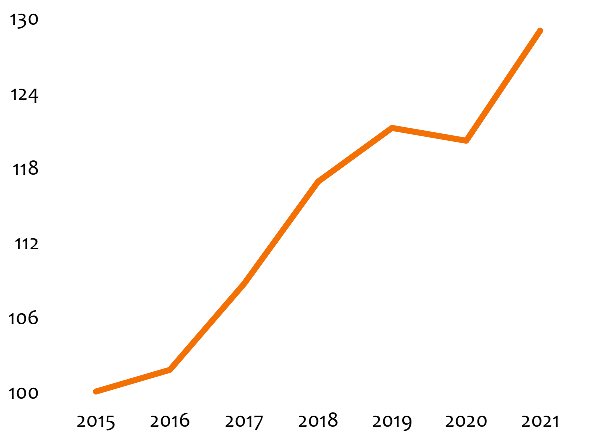
Manufacturing
changes in value added against the corresponding period last year, as per cent



In 2021, a rapid growth in manufacturing can be observed. Manufacturing production volumes exceeded last year's level by 7.5%. The growth of the sector was significantly influenced by the growth of the chemical industry, wood processing, electrical and machinery and equipment production. In January 2022, the volumes of manufacturing were 12.2% higher than a year ago.

In 2021, the turnover of manufacturing at current prices also increased by 21.4%. The volumes of products sold on the domestic market grew more moderately. Nevertheless, the volumes of exported products grew more rapidly. Also, in January 2022, sales of industrial products continued to grow.

Manufacturing
value added, 2015 = 100



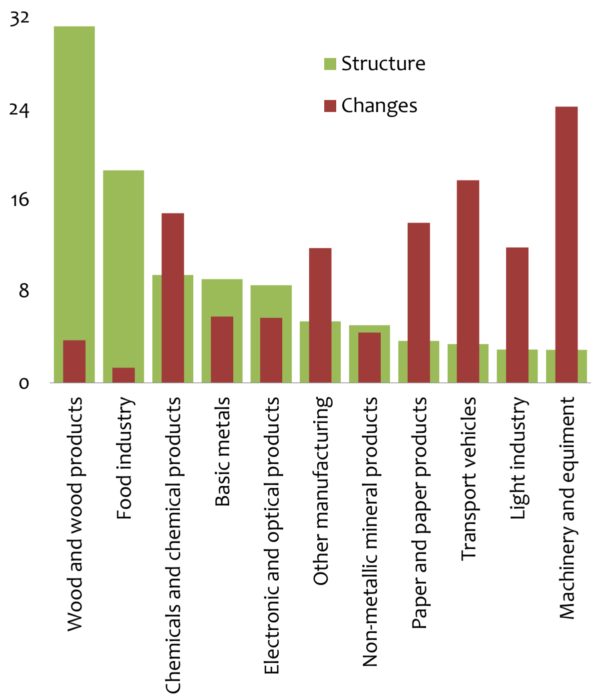
In 2018 and 2019, the number of occupied posts in manufacturing remained essentially unchanged. However, in 2020, the number of occupied posts in manufacturing decreased by 6.8 thousand. However, in 2021, it increased by 5 thousand. Significant growth during the year was observed in wood processing, chemical industry, and the manufacture of vehicles.

Structure of Manufacturing and Development Trends by Field
as per cent

	Structure in 2021			Changes in production volumes			
	Output	Occupied posts	Exports in total sales	2019	2020	2021	2022 Jan
Manufacturing	**100**	**100**	**67,5**	**2,1**	**-0,9**	**7,5**	**12,2**
Food industry	18,6	19,0	40,4	-0,7	-1,7	1,3	2,7
Light industry	2,9	8,1	82,6	-2,6	-9,5	11,8	7,6
Manufacture of wood and wood products	31,1	20,4	71,3	0,0	4,5	3,7	1,2
Manufacture of paper and paper products	3,7	4,5	67,2	5,7	4,7	14,0	16,4
Manufacture of chemicals and chemical products	9,4	7,6	75,7	3,9	-1,8	14,8	37,7
Manufacture of non-metallic mineral products	5,0	5,2	51,1	-2,1	-1,4	4,4	28,7
Manufacture of basic metals	9,1	10,8	65,4	13,5	-5,6	5,8	33,9
Manufacture of electronic products	8,5	5,3	88,6	11,3	12,1	5,7	-7,9
Manufacture of machinery and equipment	2,9	3,3	91,9	-1,9	-2,7	24,1	15,0
Manufacture of motor vehicles	3,4	3,5	92,7	-7,7	-15,3	17,7	26,6
Other manufacturing	5,4	12,3	73,1	2,8	-14,2	11,8	16,2

Growth of Manufacturing

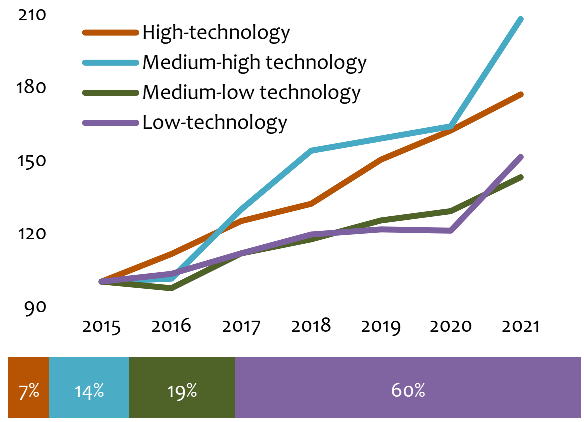
structure and changes in 2021, compared to the corresponding period last year, as per cent



Stable demand in the EU enables manufacturing companies to maintain positive growth rates. However, the further development will be adversely affected by the Russian-Belarusian war in Ukraine. As a result, existing raw material supply chains will be disrupted and companies will be affected by rising global prices for goods, including energy. Companies that were related to their markets have to look for new supply opportunities and new outlets.

Manufacturing Volume Index and Structure by Levels of Technology

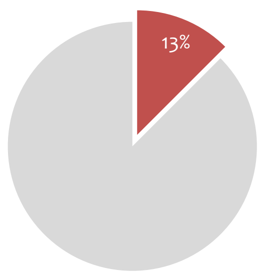
2015 = 100, structure in 2021, as per cent



Main Indicators of Manufacturing [1]

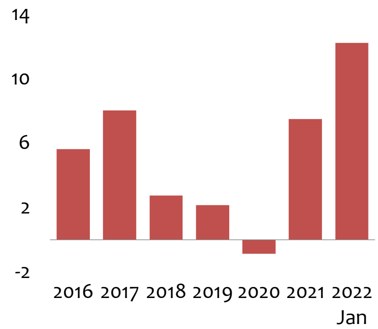
Share in total value added

2021, as per cent



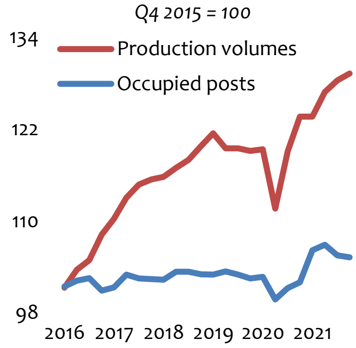
Changes in production volumes

as per cent



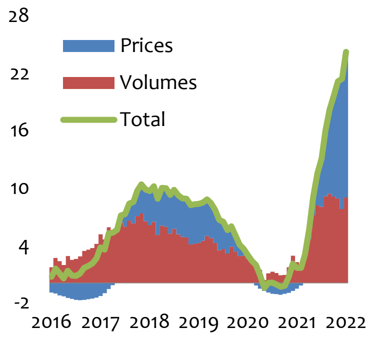
Production volumes and occupied posts

Q4 2015 = 100



Changes in sales of production

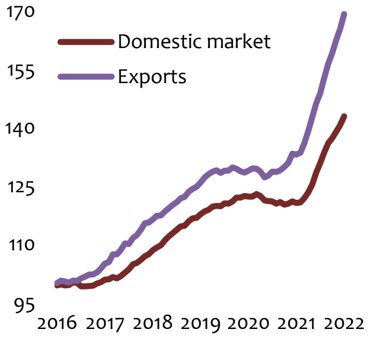
12-month moving average



Production sales

December 2015 = 100,

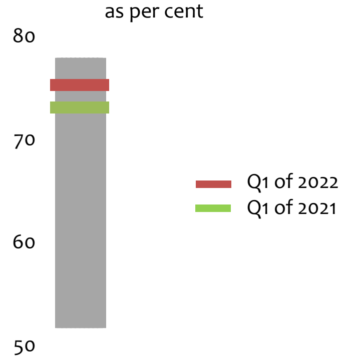
12-month moving average



Capacity utilization rate

Historically highest/ lowest level,

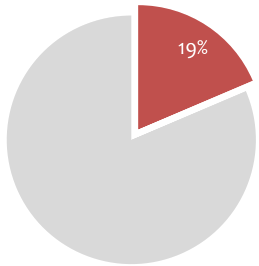
as per cent



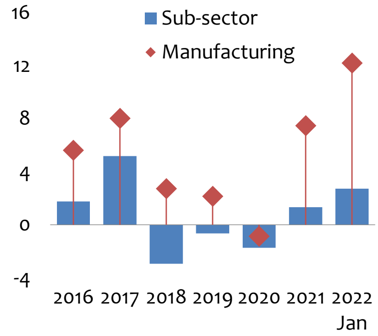
[1] data on sales of products until January 2022

Manufacture of food products and beverages

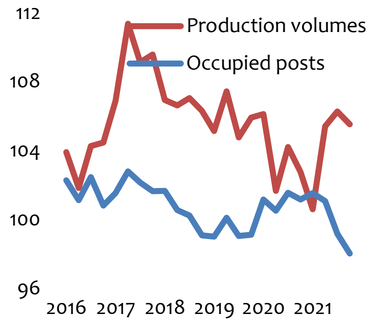
Share of manufacturing
2021, as per cent



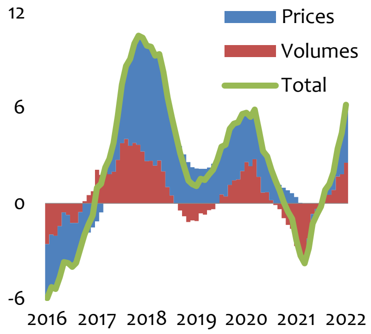
Changes in production volumes
as per cent



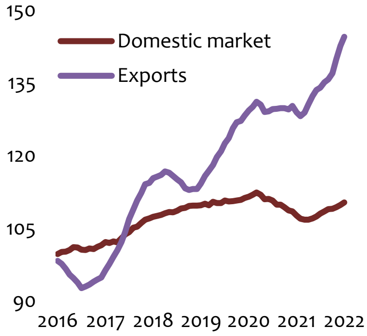
Production volumes and occupied posts
Q4 2015 = 100



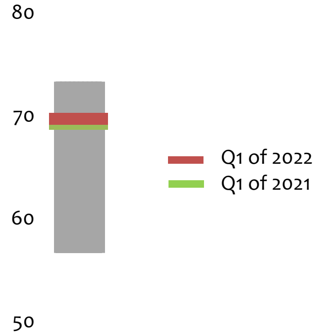
Changes in sales of production
12-month moving average



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

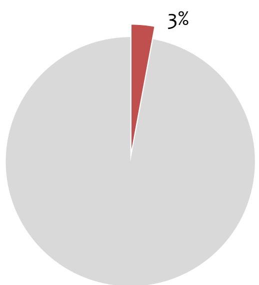


Capacity utilization rate
Historically highest/ lowest level, as per cent

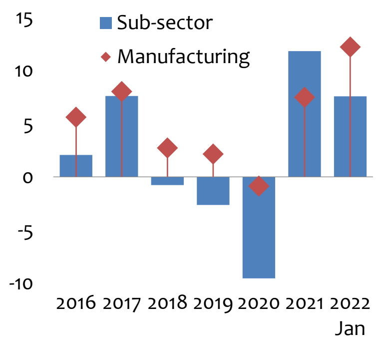


Light Industry

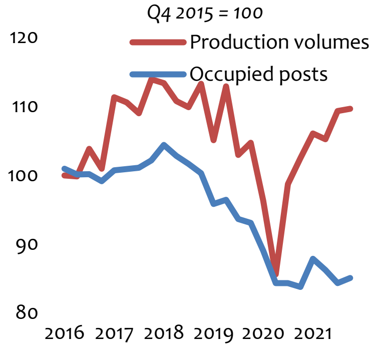
Share of manufacturing
2021, as per cent



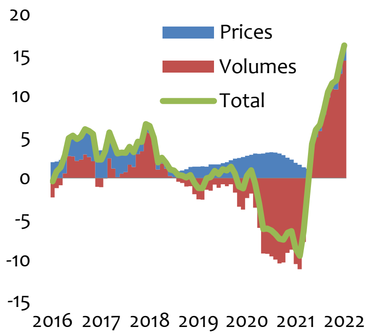
Changes in production volumes
as per cent



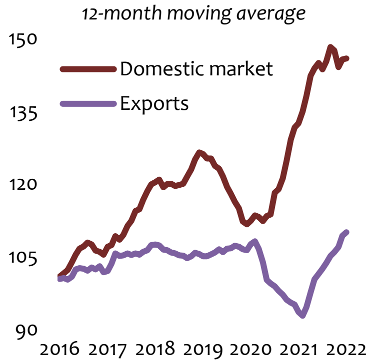
Production volumes and occupied posts
Q4 2015 = 100



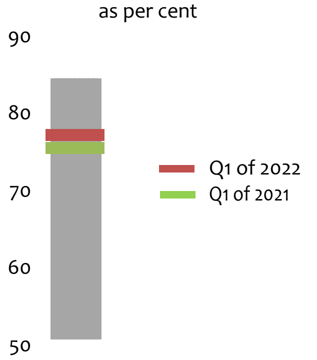
Changes in sales of production
12-month moving average



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

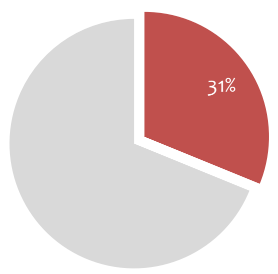


Capacity utilization rate
Historically highest/ lowest level, as per cent

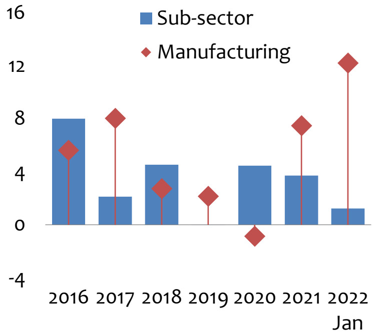


Manufacture of wood and wood products

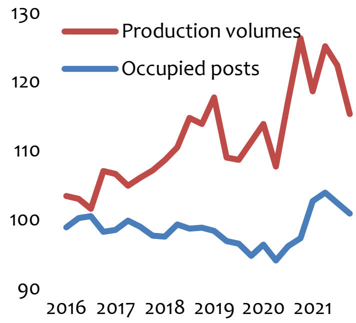
Share of manufacturing
2021, as per cent



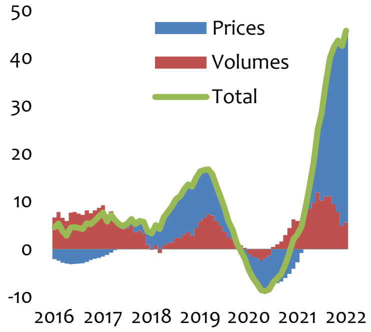
Changes in production volumes
as per cent



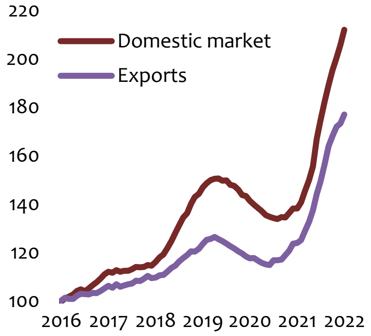
Production volumes and occupied posts
Q4 2015 = 100



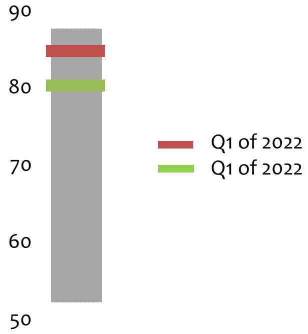
Changes in sales of production
12-month moving average



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

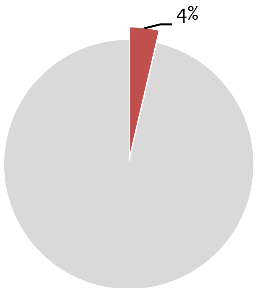


Capacity utilization rate
Historically highest/ lowest level,
as per cent

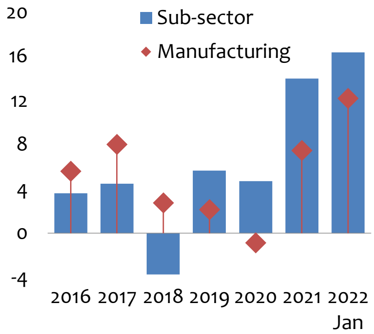


Manufacture of paper and paper products

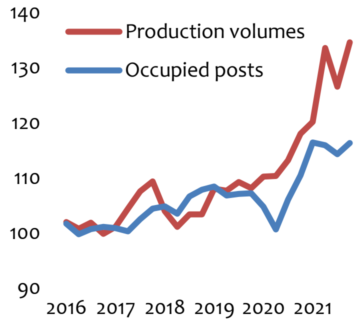
Share of manufacturing
2021, as per cent



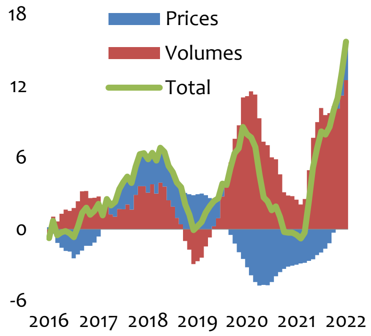
Changes in production volumes
as per cent



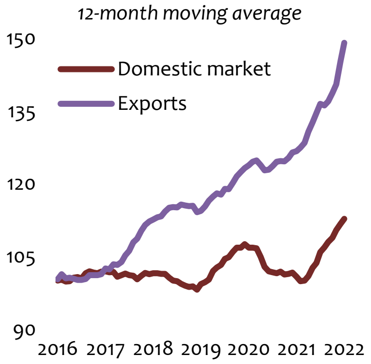
Production volumes and occupied posts
Q4 2015 = 100



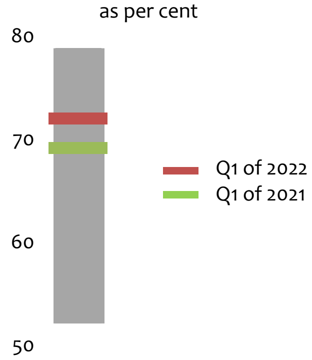
Changes in sales of production
12-month moving average



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

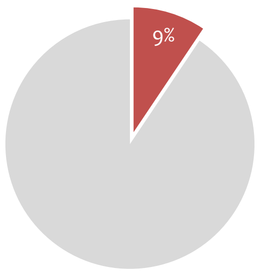


Capacity utilization rate
Historically highest/ lowest level,
as per cent

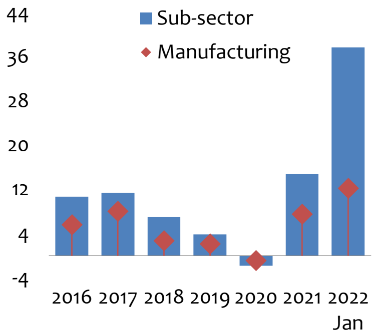


Manufacture of chemicals and chemical products

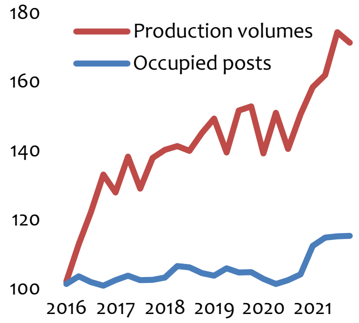
Share of manufacturing
2021, as per cent



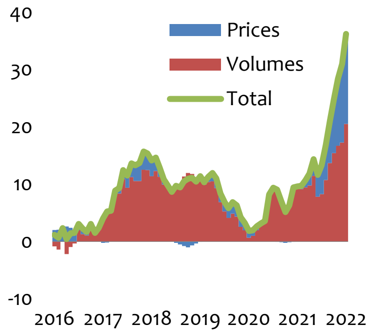
Changes in production volumes
as per cent



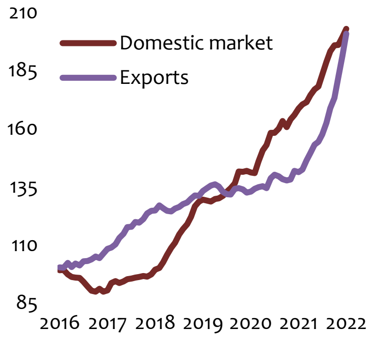
Production volumes and occupied posts
Q4 2015 = 100



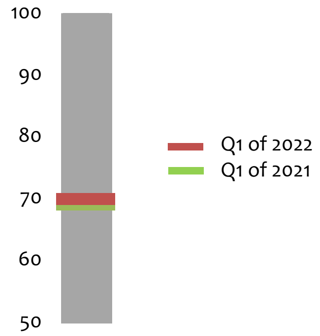
Changes in sales of production
12-month moving average



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

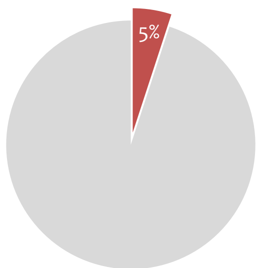


Capacity utilization rate
Historically highest/ lowest level,
as per cent

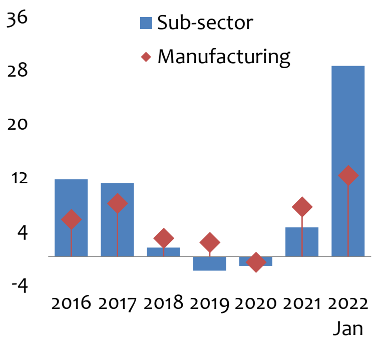


Manufacture of non-metallic mineral products

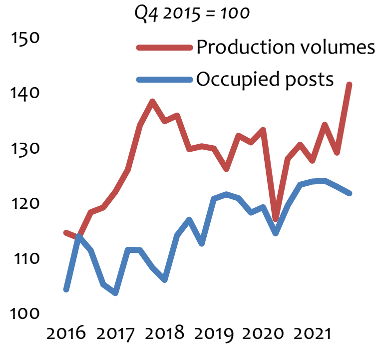
Share of manufacturing
2021, as per cent



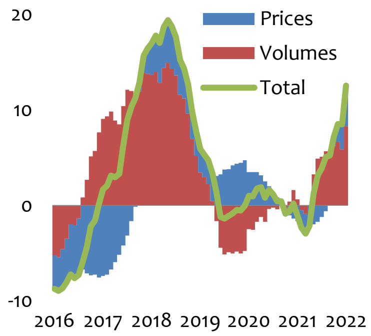
Changes in production volumes
as per cent



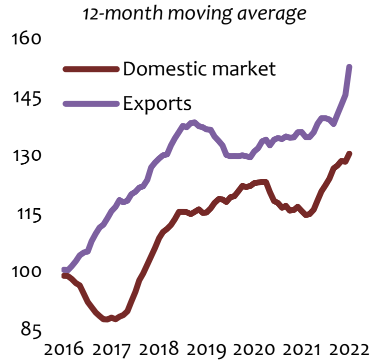
Production volumes and occupied posts
Q4 2015 = 100



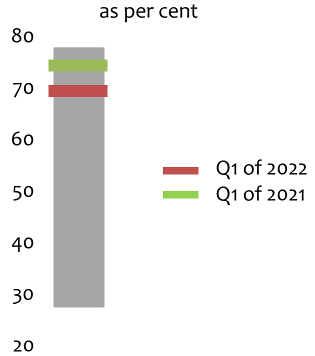
Changes in sales of production
12-month moving average



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

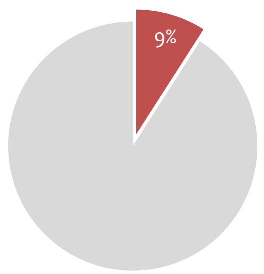


Capacity utilization rate
Historically highest/ lowest level,
as per cent

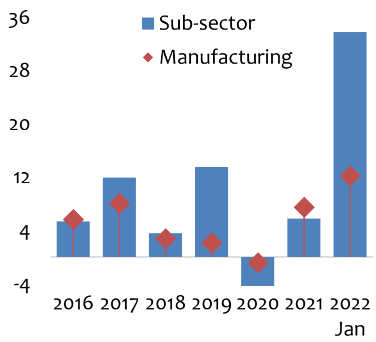


Manufacture of basic metals and fabricated metal products

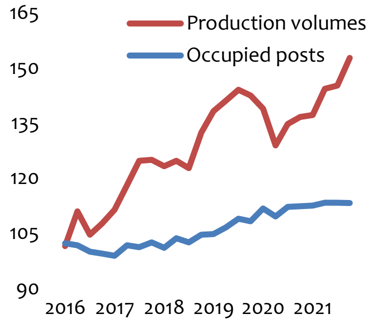
Share of manufacturing
2021, as per cent



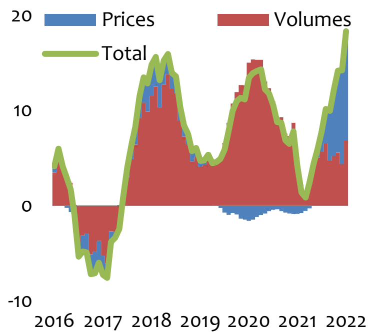
Changes in production volumes
as per cent



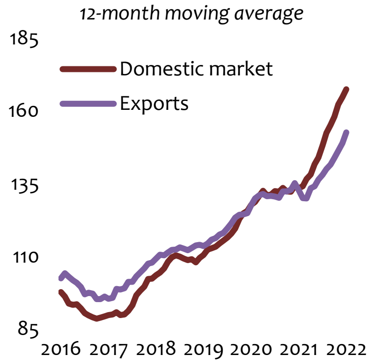
Production volumes and occupied posts
Q4 2015 = 100



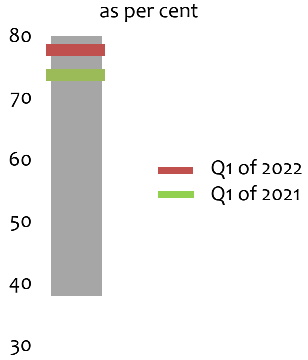
Changes in sales of production
12-month moving average



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

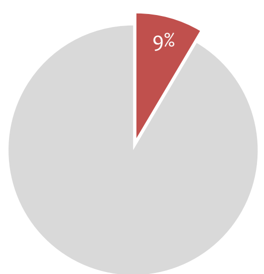


Capacity utilization rate
Historically highest/ lowest level,
as per cent

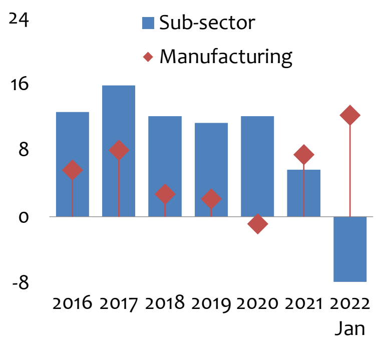


Manufacture of electronic and optical products

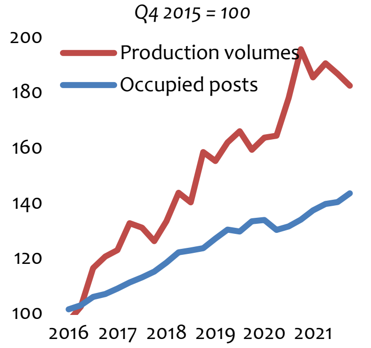
Share of manufacturing
2021, as per cent



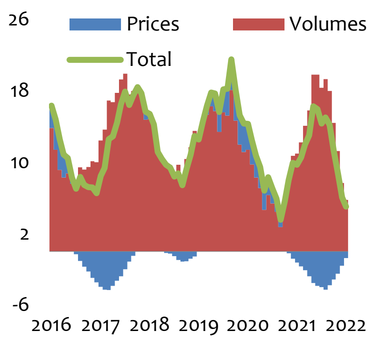
Changes in production volumes
as per cent



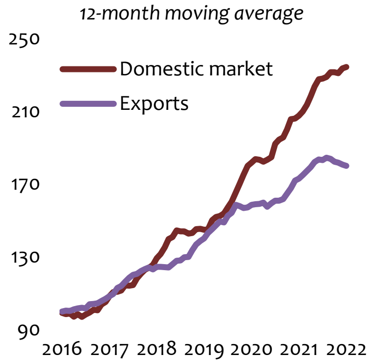
Production volumes and occupied posts
Q4 2015 = 100



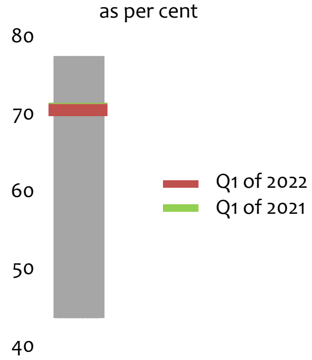
Changes in sales of production
12-month moving average



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

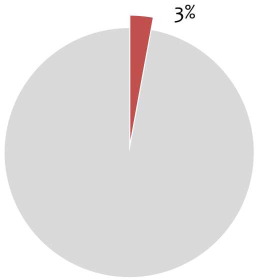


Capacity utilization rate
Historically highest/ lowest level,
as per cent

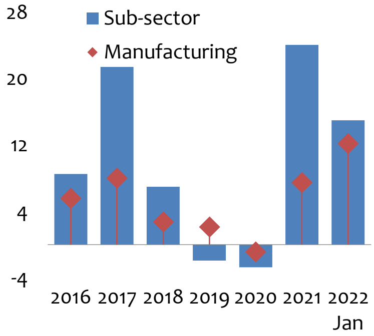


Manufacture of machinery and equipment

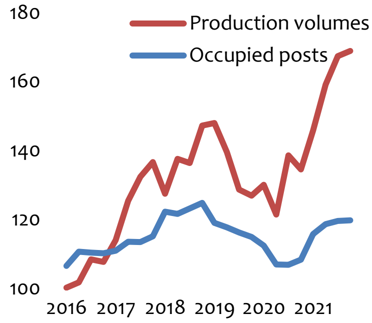
Share of manufacturing
2021, as per cent



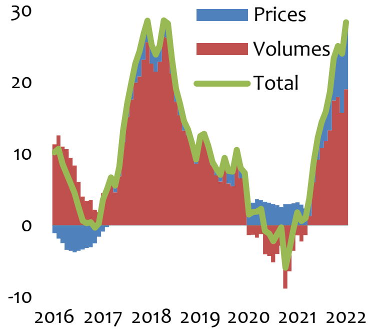
Changes in production volumes
as per cent



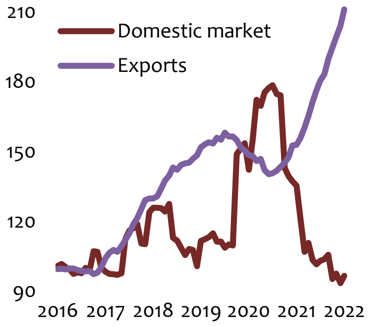
Production volumes and occupied posts
Q4 2015 = 100



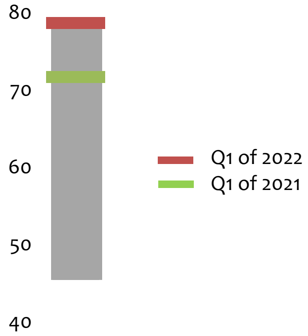
Changes in sales of production
12-month moving average



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

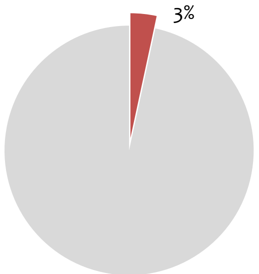


Capacity utilization rate
Historically highest/ lowest level,
as per cent

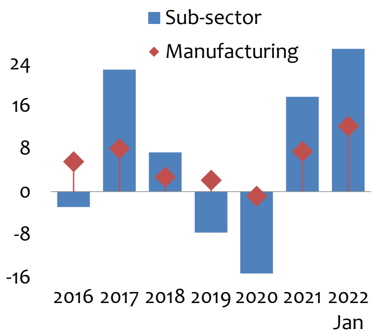


Manufacture of motor vehicles

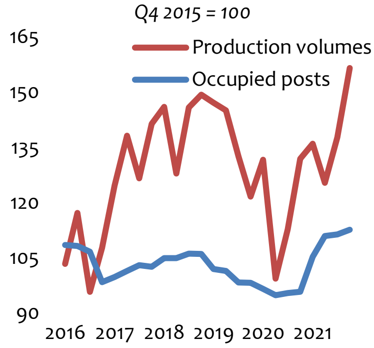
Share of manufacturing
2021, as per cent



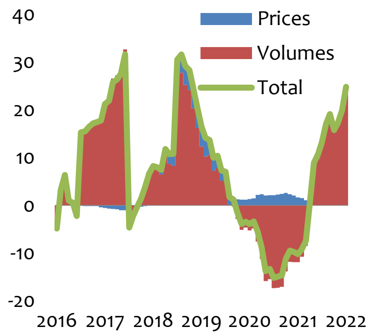
Changes in production volumes
as per cent



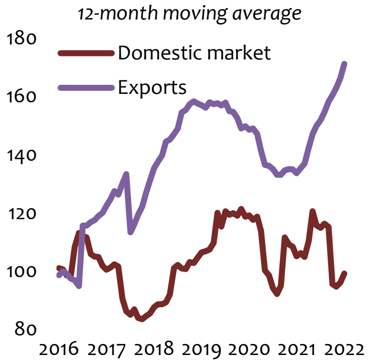
Production volumes and occupied posts
Q4 2015 = 100



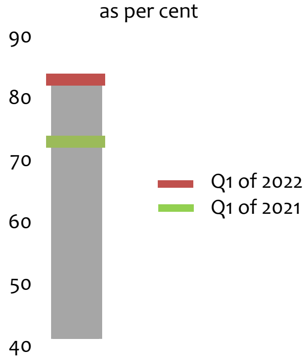
Changes in sales of production
12-month moving average



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

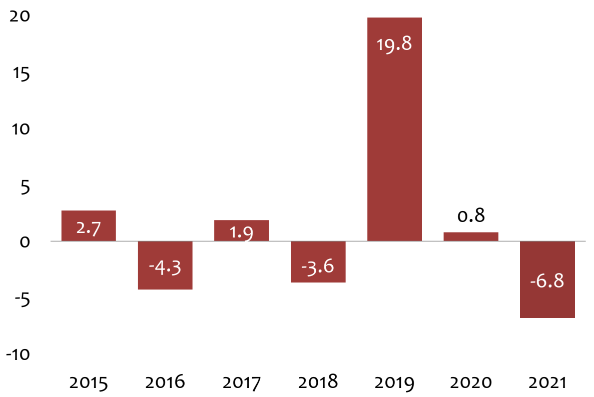


Capacity utilization rate
Historically highest/ lowest level,
as per cent



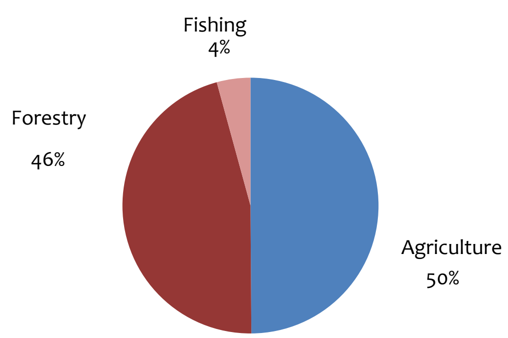
AGRICULTURE, FORESTRY, AND FISHING

Agriculture, Forestry, and Fishing
value added, changes against the last year, as per cent



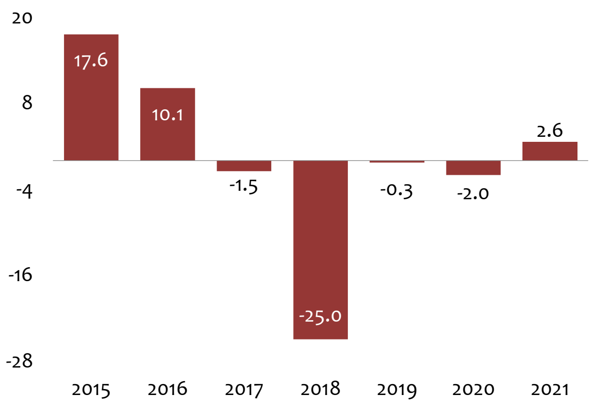
Agriculture and forestry provide the largest contribution to growth within the sector. The economic activity of the sector is closely tied to weather conditions. Thus, volatile growth within the sector can be observed. In 2020, the sector volumes increased slightly. Production volumes increased in crop and livestock production. However, production volumes decreased in forestry and logging and fishing. In 2021, in general, the sector volumes decreased rapidly. Production volumes declined in all three sub-sectors. A significant decrease was observed in the crop sector due to unfavorable weather conditions, which significantly reduced the yield of all cereals. In recent years, the sector has seen a slow increase in both employment and occupied posts. However, in 2020, under the influence of Covid-19, a decline in employment due to a sharp fall in the forestry was observed. In 2021, the number of occupied posts decreased in all sub-sectors.

Structure of Agriculture, Forestry, and Fishing
2021, as per cent



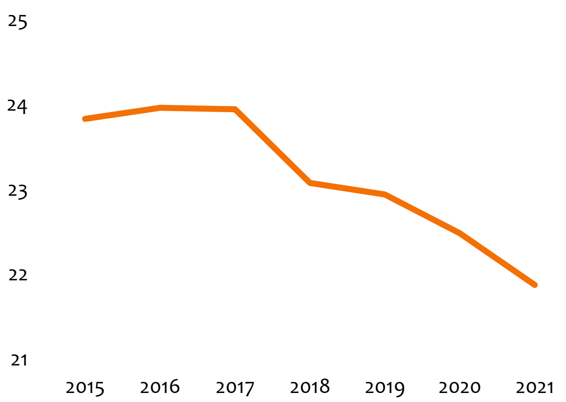
OTHER MANUFACTURING

Other Manufacturing
value added, changes against the last year, as per cent



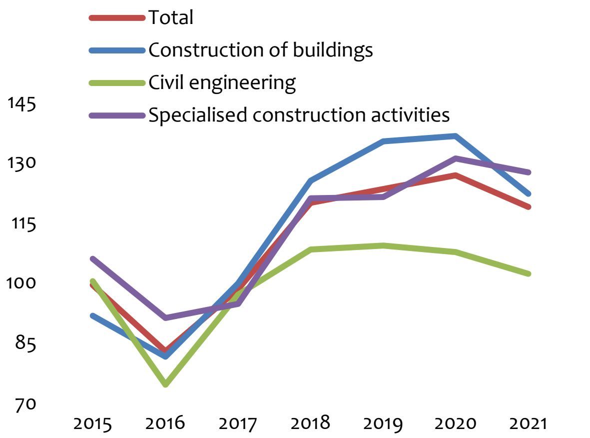
The largest share of added value in other manufacturing (incl. mining and quarrying, electricity, gas, steam, and air-conditioning supply, water supply, and waste management) provide electricity and gas supply sub-sectors. In 2017-2020, the volumes of other manufacturing decreased, primarily determined by the decline in the electricity and gas supply due to warm weather conditions. In 2021, the volumes of other manufacturing grew moderately. Cold weather conditions at the beginning of the year and at the end 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 sector. In recent years, the number of occupied posts has increased in mining and quarrying and water supply and waste management sectors, with a particularly sharp increase in 2021. However, a sharp decline in other sub-sectors has been observed.

Occupied Posts in Other Manufacturing
in thousands

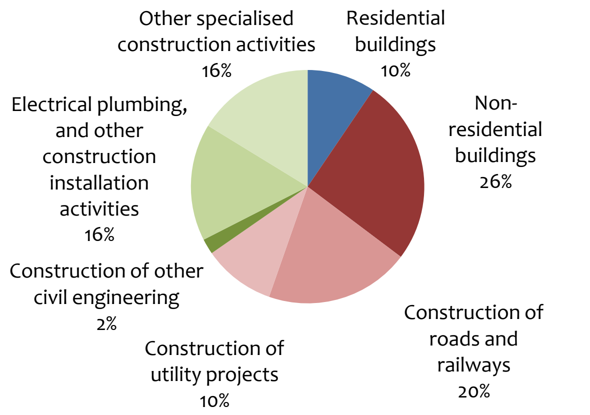


CONSTRUCTION

Development of Construction
2014 = 100



Structure of Construction
in 2021, as per cent

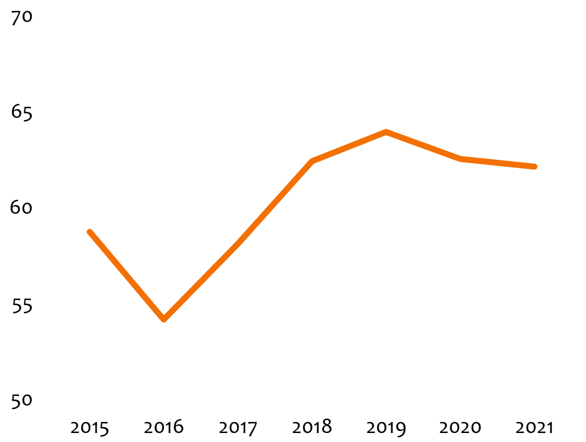


In 2021, activities in construction declined. Construction output decreased by 6.2%. A decline was observed in almost all quarters of the year, with the exception of a slight increase in the second quarter.

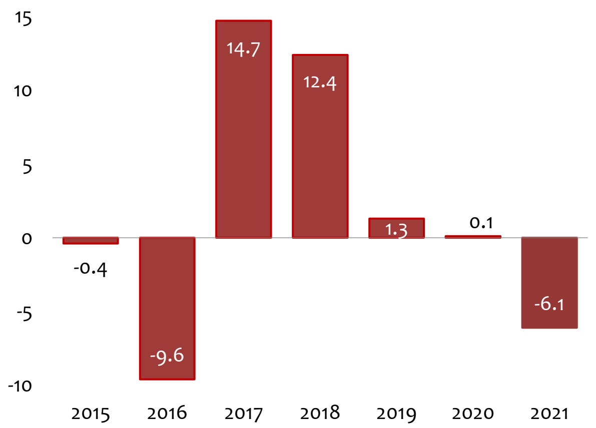
The decline in the first quarter can largely be attributed to the base effect (the unusually warm winter of 2020, which is favorable for construction). In the 2nd half of 2021, a decline in demand has been observed due to the global rise in construction costs, especially with increasing wood and metal prices. As a result, both activities in the implementation of existing projects and the launch of new projects slowed down. Decrease is observed in all main construction groups, with the sharpest decline in building construction output.

In 2021, compared to 2020, the number of building permits issued increased. Overall, 4,972 building permits were issued, which is 3.2% more than in the previous year.

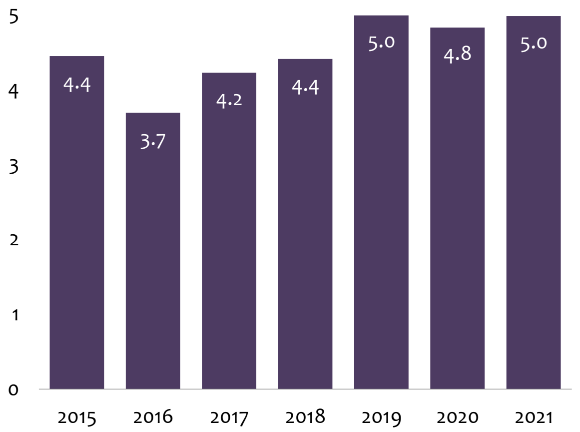
Occupied Posts in Construction
in thousands



Construction
value added, changes against the last year, as per cent

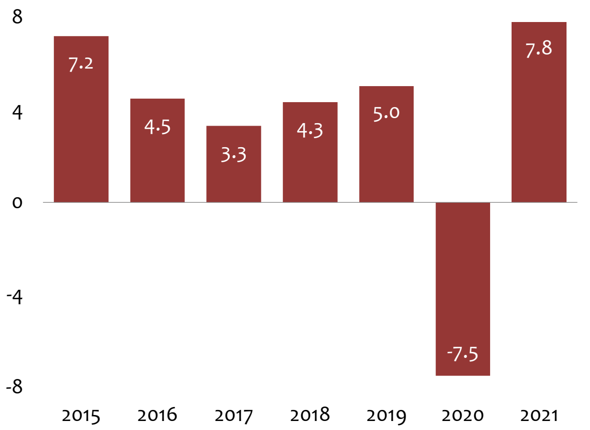


Building Permits Granted
in thousands



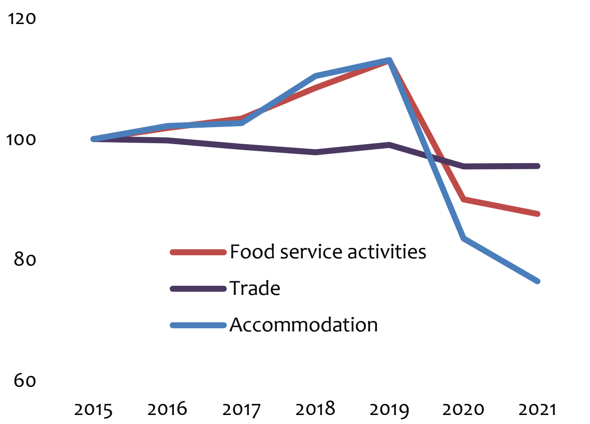
TRADE, ACCOMMODATION, AND FOOD SERVICE ACTIVITIES

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

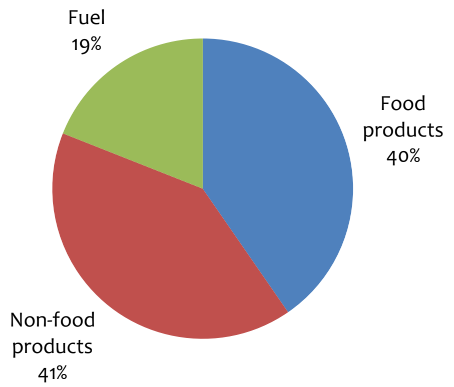


In 2021, the volume of services provided in the trade, accommodation and food service activities increased. The trade has been positively affected by the easing of restrictions on Covid-19. In 2021, it increased by 8.9%. In 2021, compared to 2020, the growth of retail trade turnover was slightly higher and increased by 2.5%. Retail trade turnover in food remained essentially unchanged. Nevertheless, despite trade restrictions, non-food and fuel trade grew rapidly. The turnover of the wholesale trade sector at current prices increased by 28.4%. Although the growth of the accommodation and food service activities was very rapid in the second and fourth quarters of 2021, it should be noted that these sectors are recovering from a very deep recession and are still significantly lagging behind the pre-crisis level. In 2021, the industry volumes decreased by 5.2%. The largest share of occupied posts remains in trade. In 2021, under the influence of Covid-19, the decline in the number of occupied posts continued in the accommodation and food service activities. However, in trade occupied posts increased.

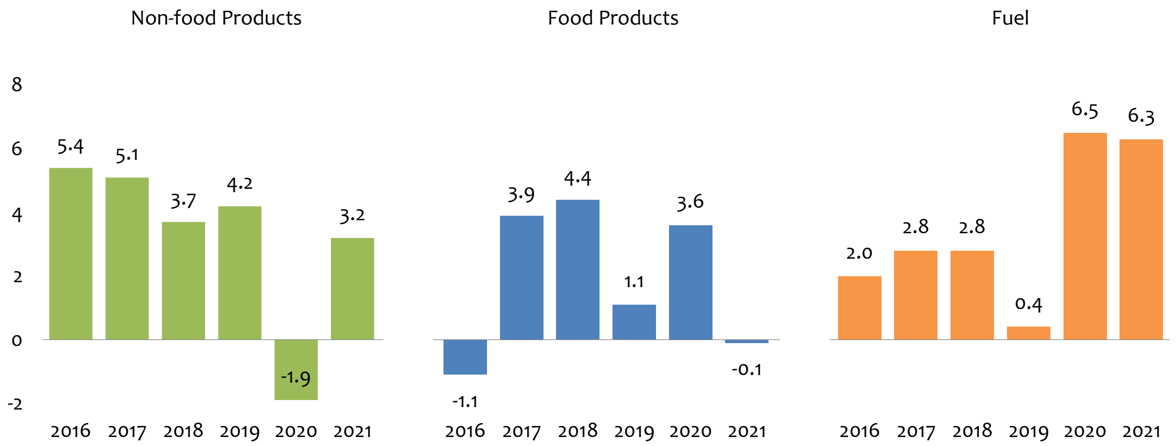
Occupied Posts in Trade, Accommodation, and Food Service Activities
2015 = 100



Structure of Retail Turnover
2021, as per cent

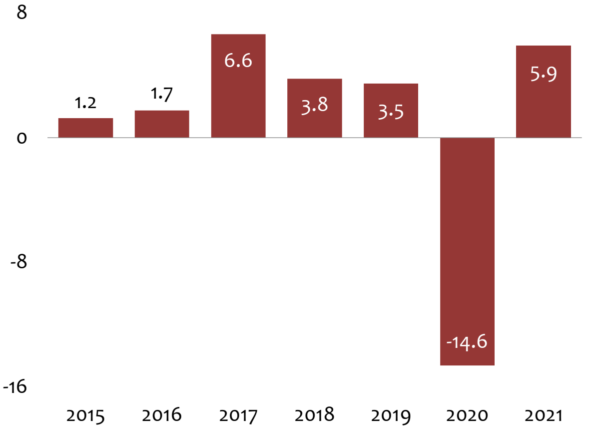


Retail Turnover
changes against the last year, as per cent



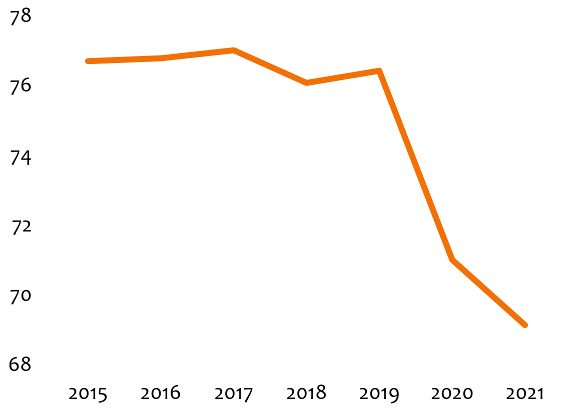
TRANSPORTATION AND STORAGE

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

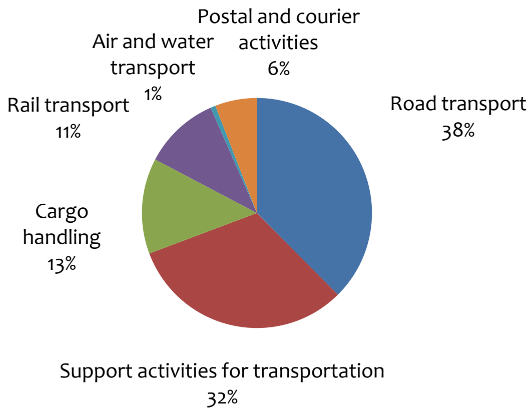


The transportation and storage sector is closely linked to international transportation. In 2020, the sector volumes declined sharply due to Covid-19 restrictions. With the improvement of the epidemiological situation and the lifting of the introduced restrictions, in 2021, the volumes of the sector increased. The volumes of freight transport by rail and at ports decreased. However, the volumes of freight transport by road increased sharply, which was determined by the increase in the volume of freight transport both domestically and internationally. In 2021, under the influence of Covid-19, passenger transportation at ports and land transportation declined by 46.5% and 16.6%, respectively. On the other hand, an increase was observed in air transport - by 17%. Nevertheless, the number of passengers lagged significantly behind the pre-crisis volume in 2019.

Occupied Posts in Transportation and Storage
in thousands

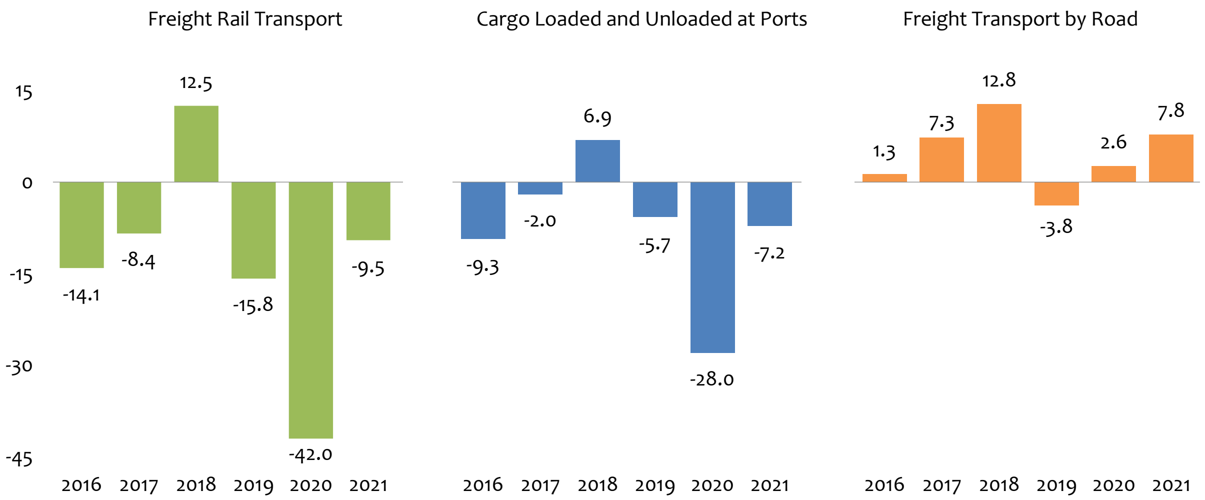


Structure of Transportation and Storage
2021, as per cent*



* – forecast by the Ministry of Economics

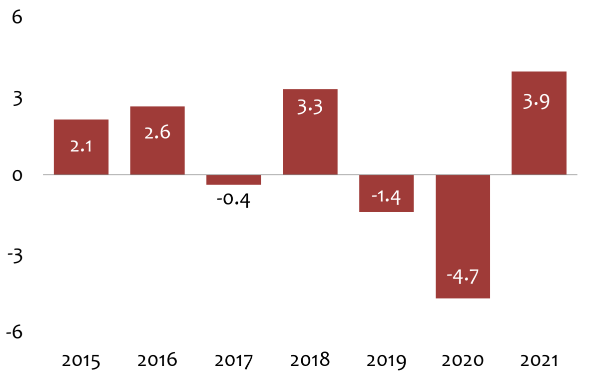
Freight Traffic
changes against the last year, as per cent



COMMERCIAL SERVICES

Commercial Services

value added, changes against the last year, as per cent

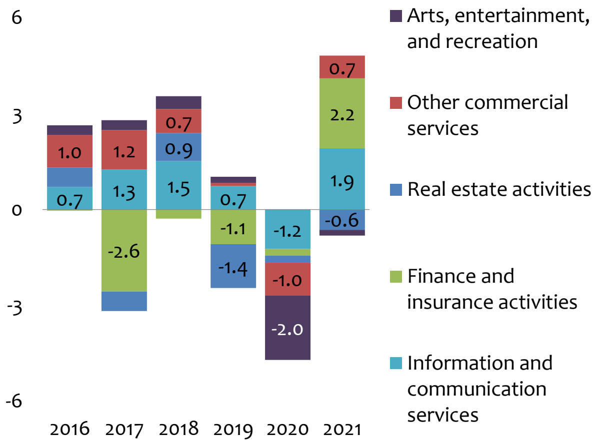


The largest share of added value in commercial services (incl. information and communication services, financial and insurance activities, real estate activities, professional, scientific, and technical services, administrative and support service activities, arts, entertainment, and recreation) provide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

The largest contribution to growth of services was observed in financial and insurance activities and information and communication services. Volumes, on the other hand, continued to decline in the arts, entertainment, and recreation and real estate activities. The largest share of occupied posts was observed in professional, scientific, and technical services, administrative and support service activities, and information and communication services. In 2021, the number of occupied posts increased only in the sectors of information and communication and professional, scientific, and technical services.

Contribution of Commercial Services

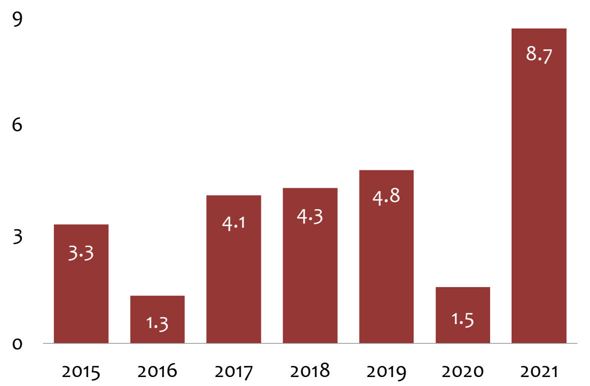
changes as per cent



PUBLIC SERVICES

Public Services

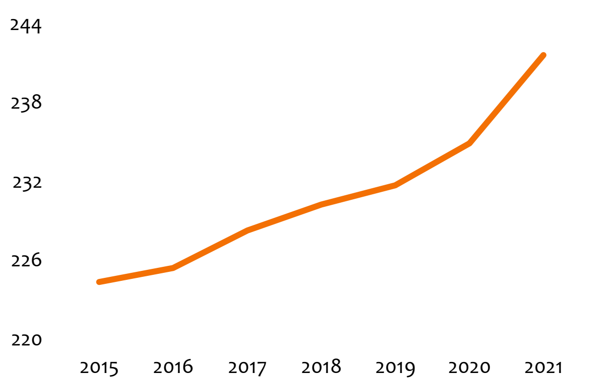
value added, changes against the last year, as per cent



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 moderately. However, in 2021, the volumes of total services increased sharply, which was determined by the increase in volumes for health and social care - by 24.8%. The volumes of public administration and defence rose by 2.9%. Also, the volumes of education services increased by 3.0%. The largest share of occupied posts remains in education. In recent years, the most rapid increase in occupied posts has been in healthcare. In 2021, the number of occupied posts also increased in public administration. However, in education the number of occupied posts declined.

Occupied Posts in Public Services

in thousands



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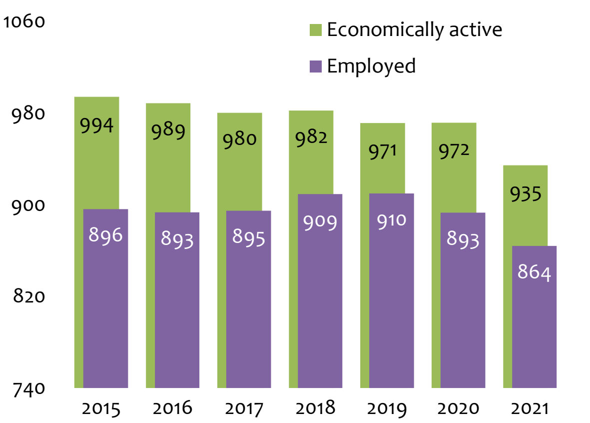
LABOUR MARKET

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 labour shortage.

Employed and Economically Active
aged 15-74, in thousands



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 3.2% (i.e., almost 29 thousand), compared to the corresponding period last year, representing the largest decrease since 2010.

Although the overall negative effects of Covid-19 on employment have been absorbed by the state aid measures, which have partially preserved both jobs and incomes during the emergency period, however the impact has widened on the labour market because of the lingering of the crisis.

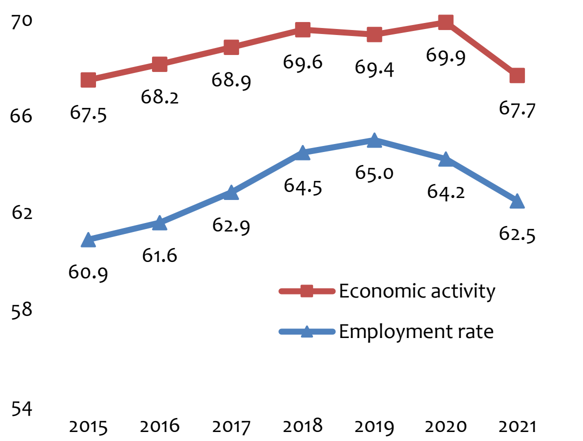
From March 2020 to January 2022, according to seasonally adjusted data, the number of employed persons aged 15-74 in Latvia has decreased by 49.3 thousand, thus each month of the crisis has brought an average of 2.1 thousand reduction in employment.

At the same time, as the economy adjusts to new conditions and the impact of the pandemic shock on the labour market diminishes, **employment has stabilized and gradually returned to growth since April 2021.** In March 2021, the decline in the number of employees reached its historically lowest point. However, the increase in the demand for seasonal labour in the period from April-September 2021 increased by a total of 30.1 thousand.

With the tightening of restrictions on the spread of Covid-19 infection in October 2021 and the decrease in seasonal labour demand, a slight decrease in the number of employees was observed at the end of the 2021. According to seasonally adjusted data the number of employees from October to December 2021decreased by 9.5 thousand. Nevertheless, the general employment trend remained positive and with the easing of restrictions in January 2022, employment rose again. According to seasonally adjusted data, in January 2022, compared to December 2021, the number of employees increased by 3.8 thousand (0.4%).

Overall, in 2021 around 864.2 thousand people aged 15-74 were in employment, which accounts 62.5% of the total population in private households aged 15-74. The annual employment rate in 2021 decreased by 1.7 percentage points, lagging the pre-crisis level (2019) by 2.5 percentage points.

Employment and Economic Activity
aged 15-74, as per cent

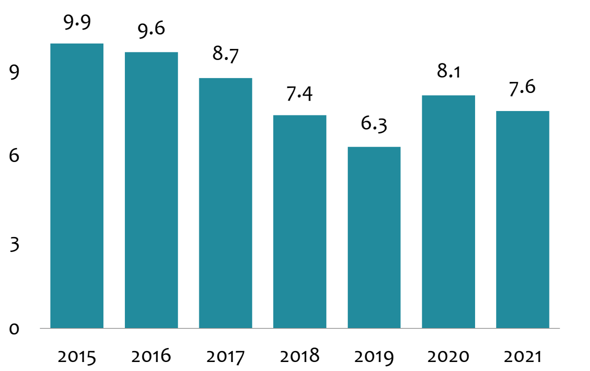


The employment rate in the most economically active age groups in Latvia remained significantly lower than in neighbouring countries. In 2021, the share of employees in the age group from 15 to 64 of the total population in Latvia was 69.9%. However, in Estonia and Lithuania it reached 74% and 72.5.%, respectively.

The Covid-19 crisis has affected both the demand and supply side of the labour market. Although the growth of economic activity of the population was still observed in 2020, since Q4 of 2020, the participation of the population in the labour market has been gradually declining. In 2021 the level of economic activity of the population aged 15 to 74 years was by 2.2% lower than 2020.

The declining labour participation in labour market was the key driver of unemployment decrease in 2021. It should be noted that unemployment rates have been steadily declining since mid-2020 and unemployment has approached pre-crisis levels. In January 2022, compared to January 2020, the unemployment rate among the economically active population aged 15-74 reached 7.5%, which is only 0.3 percentage points higher than in January 2020 (7.3%). In January 2022, the number of jobseekers was about 1% (0.7 thousand) lower.

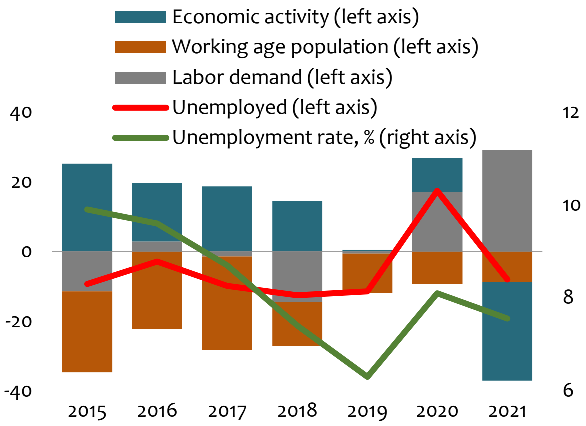
Unemployment Rate
aged 15-74, as per cent



Overall, in 2021, the average unemployment rate declined to 7.6%. However, the number of job seekers reached 70.6 thousand of population aged 15-74, which is by 10.3% (8.1 thousand) less than in 2020. At the same time, in 2021, the unemployment rate in Latvia remained on average higher than in Lithuania (7.1%) and Estonia (6.2%). In addition to the decline in the economic activity of the population, **a significant impact on unemployment rates continues to be maintained by demographic processes** - the decline in the working age population, which has a negative impact on the total labour supply (the number of economically active population).

In 2021, compared to 2020, the number of economically active population aged 15-74, decreased by 37.1 thousand (by 3.8%), thus reaching 934.6 thousand and falling to the historically lowest level.

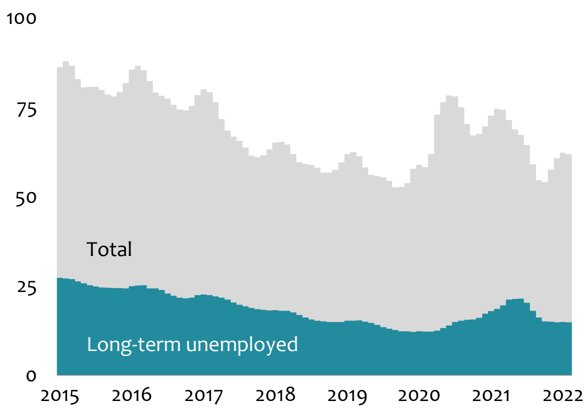
Unemployment Rate and Its Determinants
changes against the last year, in thousands



Given the gradual decline in labour supply, in addition to overcoming the effects of the crisis and promoting employment, **the shortage of skilled labour has become an increasingly significant problem, especially in the most rapidly growing sectors.**

The prolongation of the crisis and the reduction in the number of job vacancies in the labour market have generally reduced the chances of the unemployed returning to work quickly, which has contributed to rising long-term unemployment. At the end of February 2022, approximately 14.8 thousand registered jobseekers (24% of all registered jobseekers) were unemployed for more than a year. Although the overall share of long-term jobseekers has been gradually declining since July 2022, it is still significantly higher than before the Covid-19 crisis.

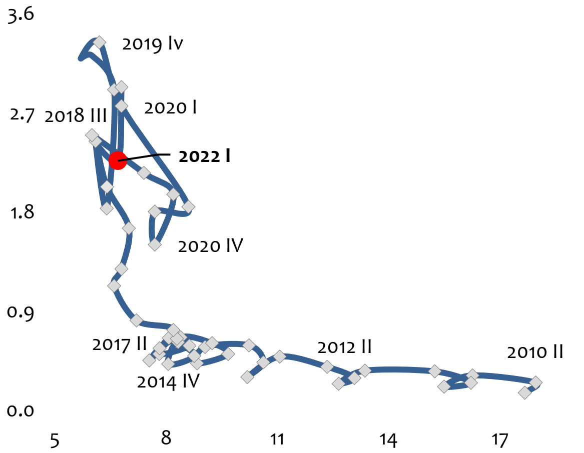
Registered Unemployed
in thousands



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 are unemployed, the greater the risk of losing their previous skills and abilities, and the more difficult it may become to adapt to new labour market needs. Also, as recovery in sectors directly affected by the Covid-19 crisis may be slow, a risk that some of the unemployed may have difficulty finding a job that matches their skills in the future persists. In addition, in sectors that could provide new jobs in the future previously acquired skills may not be in demand.

Beveridge Curve

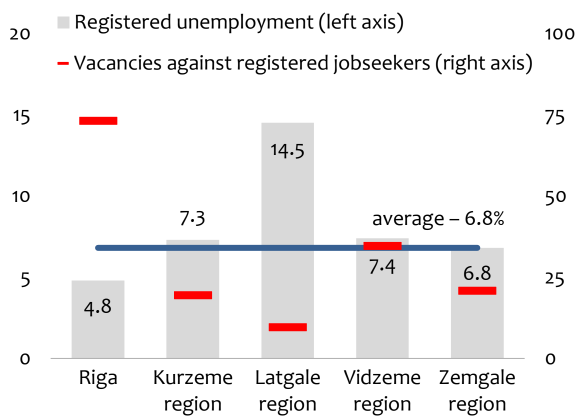
by quarters as per cent; horizontal axis – unemployment rate; vertical axis – vacancies against the economically active population



The Covid-19 pandemic has generally accelerated structural change in labour demand, advancing job automation in labour intensive sectors - mainly by reducing the demand for low- and medium-skilled unskilled labour, while increasing the share of higher-skilled jobs, especially in information and communication services. Consequently, measures to upgrade and retrain the workforce are essential to help overcome structural changes in the labour market.

Registered Unemployment by Region

at the end of February 2022, as per cent



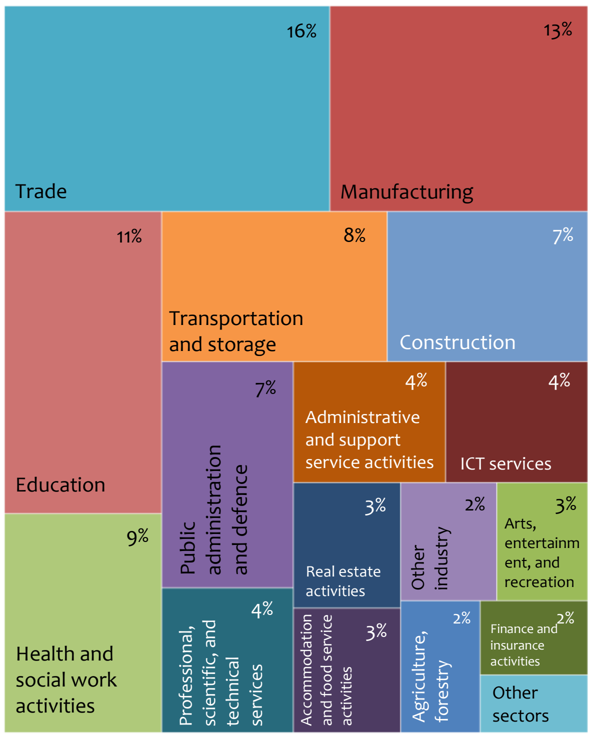
Structural problems may also exacerbate regional labour market disparities, which may hamper future recovery. Although regional labour market disparities have levelled off during the crisis, the unemployment rate in Latgale region is still more than twice as high as the Latvian average. Also, it remains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

With the increase in economic activity, the number of occupied posts is gradually increasing. Overall, in 2021, compared to 2020, the number of occupied posts increased by 0.4% or 3.4 thousand, thus increasing to 892.6 thousand occupied posts annually.

The most significant job growth was observed in manufacturing, healthcare, and information and communication services. In 2021, the number of occupied posts in manufacturing increased by almost 5 000 (4.5%). The number of occupied posts in health and social care increased by more than 3 800 (5.3%). However, in information and communication services occupied posts increased by approximately 2 600 (7.3%).

Occupied Posts by Sector

structure in 2021, as per cent



In 2021, the most significant increase in the number of occupied posts was observed in the private sector, which contributed to an increase of 3 300 occupied posts (constituting about 96% of the total increase).

Similarly, as in whole in 2021, also compared to the pre-crisis period (2019), the largest increase in occupied posts was observed in health and social work, information and communication services, and manufacturing.

In 2021, the most significant decline in labour demand was observed in the transport services sector, administrative and support service activities, as well as accommodation and food service activities. At the same time, the accommodation and food service activities lags behind the pre-crisis level most significantly in terms of the number of occupied posts, which in the past two years has declined by a nearly ¼ or 24.4%, amounting to 8 thousand occupied posts.

Changes in Occupied Posts

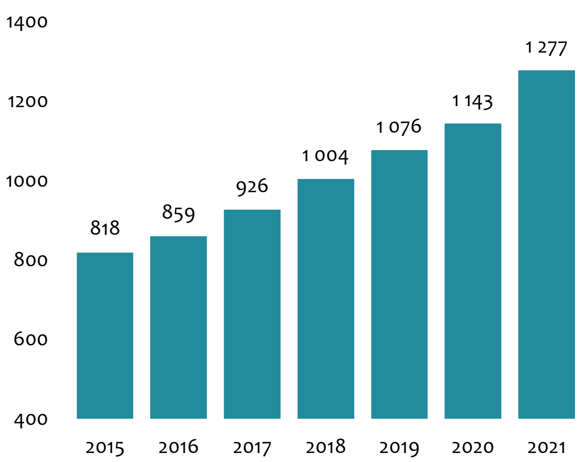
in 2021, compared to the corresponding period last year, in thousands

WAGES AND SALARIES

With the return of economic activity, the average wage is growing rapidly. In 2021, the average monthly gross salary increased by 11.7% - rising to an average of 1 277 euros per month, which has been the most rapid growth of the average salary in the last 13 years.

Average Monthly Gross Wage

euro



In 2021, the increase in the average wage was significantly influenced by the rise of the minimum wage rate by 16.3% - to 500 euros from 430 euros in 2020, as well as the decrease in the share of lower paid jobs in the labour market, especially considering the significant reduction in administration and support services, where wages have so far been significantly lower than the national average.

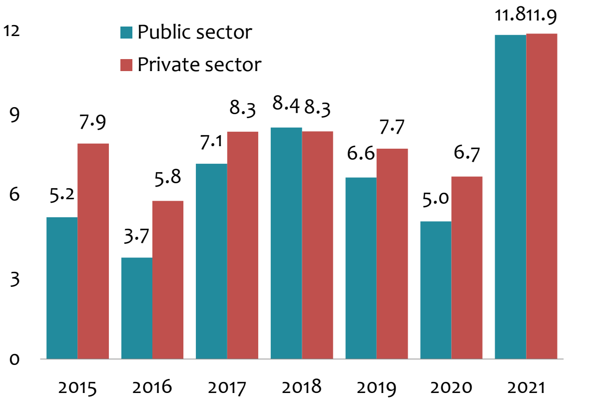
Wage growth in the health sector has also had a significant impact on wage growth, given the work-related bonuses paid during the Covid-19 pandemic.

In recent years, a significant increase in wages has been observed - the average increase in wages over the last 5 years has been close to 7% per year. Consequently, the process of wage convergence closer to the level of wages in the economically developed countries of the EU has improved; and the growing shortage of skilled labour – i.e., the narrowing of the labour market, which makes it necessary for entrepreneurs to think more actively not only about attracting new specialists, but also keep existing ones, incl. reviewing wage rates.

In 2021, wages have grown equally expeditious in both the private and public sectors. Compared to 2020, the average gross salary in the public sector increased by 11.8% (to an average of 1,287 euros). However, in the private sector it rose by 11.9% (to an average of 1 273 euros). More rapid wage growth in the public sector has been largely driven by revised wage rates in the education and health care.

Since 2010, wages have risen in both the private and public sectors. From 2011 to 2021, the number of occupied posts in the private sector has increased by 23.2%. Meanwhile, in the public sector it rose by 0.7%.

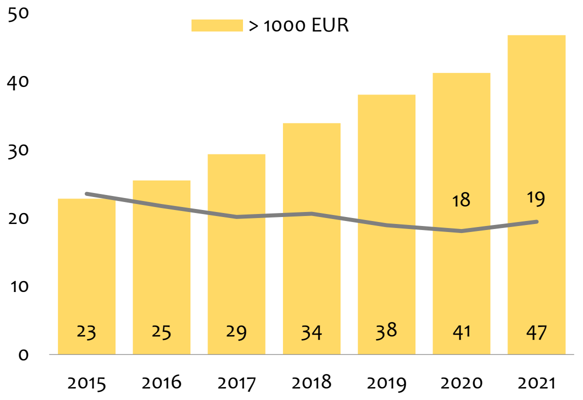
Average Monthly Gross Wage
changes as per cent



Overall, the share of low-paid employees declined, as evidenced by the growing trend in the share of employees earning over 1 000 euro per month. In 2021, the gross salary of almost half of all employees was over 1 000 euro.

In 2021, an increase in wages was observed in all sectors of the economy. The largest increase in wages and salaries was observed in health and social work – by more than 28%, and in professional and scientific services – by 18.1%.

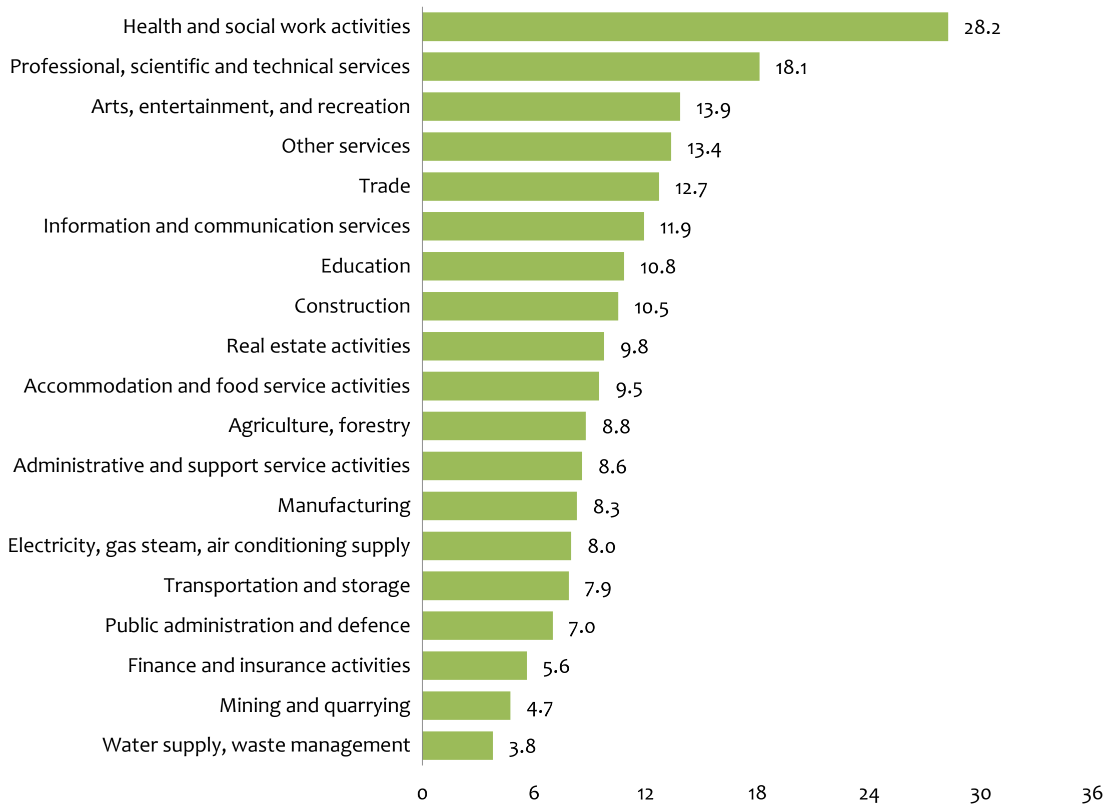
Employee Gross Wage
as per cent of total number employed



Wages continue to lag behind in the sectors most affected by the crisis. Although since 2019 the level of wages has increased in almost all sectors, the growth of wages in the accommodation and food service activities, and transport services has been one of the slowest. It should be noted that in 2021 the lowest average wage was still observed in accommodation and food service activities, reaching an average of 795 euros per month.

Meanwhile, in 2021, the highest level of remuneration still remained in the financial services sector - the average gross monthly wage reached 2 282 euros.

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



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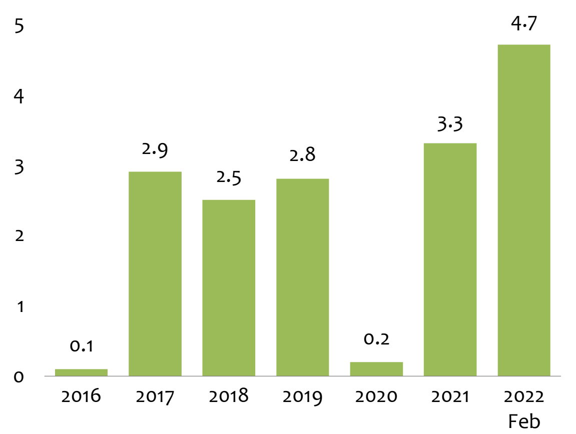
ECONOMIC STABILITY AND COMPETITIVENESS

PRICES

In 2021, a sharp rise in prices was observed. Consumer prices rose by 7.9%, while average annual inflation was 3.3%. The rise in world prices following the Covid-19 crisis had a significant impact on consumer price levels.

In the two months of 2022, prices continued to rise sharply. In February 2022, compared to December 2021, consumer prices increased by 1.6%, representing the most rapid increase in January-February since 2011. The increase was determined by the rise in world prices for energy resources and food. Compared to February 2021, consumer prices increased by 8.7%. In February 2022, the average annual inflation was 4.7 percent.

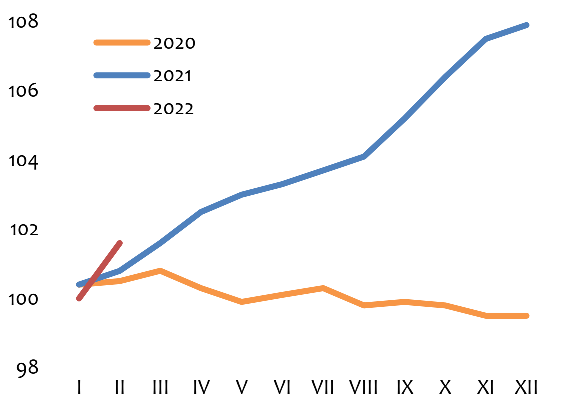
Consumer Price Changes
annual average, as per cent



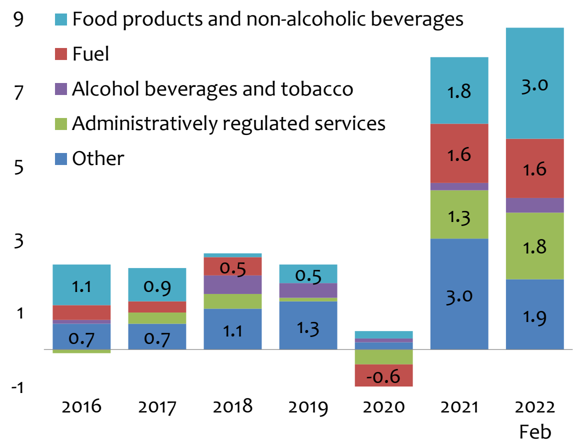
Key factors influencing prices in 2021:

(1) the largest impact on the average consumer price level over the year yielded the rise in prices for electricity, gas, and other fuels, driven by rising world prices for natural gas and oil, as well as rising demand;
(2) rising food prices, driven by soaring global food prices. The largest impact provided the rise in prices for dairy products, bread, and cereals, fresh vegetables and potatoes. World food prices rose by 28% on average over the year. Prices increased in all major food groups, with vegetable oils and sugar growing the most rapidly and dairy products and meat growing more moderately;
(3) rising fuel prices due to rising world oil prices. Overall, oil prices rose by almost 50% during the year, driven by strong demand growth and limited production;
(4) rise in prices for services: The rise in prices for outpatient, leisure and cultural services and catering had the largest impact;
(5) the increase in prices for alcoholic beverages and tobacco products due to the increase in the rate of excise duty;
(6) rising prices for clothing and footwear due to easing of measures restricting the spread of Covid-19.

Consumer Price Index
December of the previous year = 100



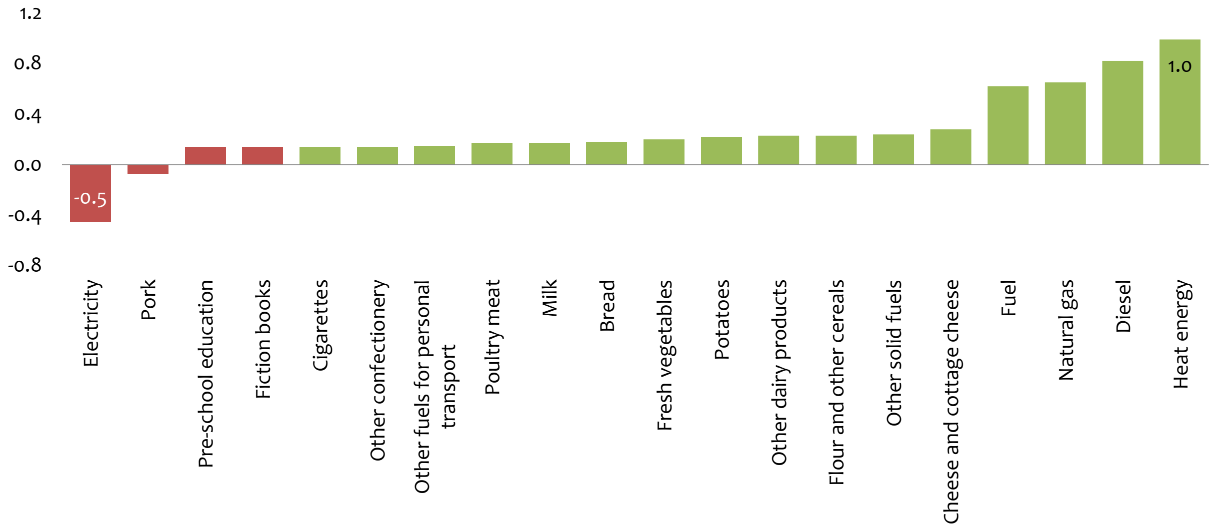
Consumer Prices by Goods and Services
contribution to 12-month changes, as per cent



Overall, in 2022, the average annual inflation will be significantly higher than in 2021. Price changes are anticipated to significantly exceed the level of seasonal fluctuations in the coming months. The main impact on price developments will continue to be related to rising world prices for energy and food, which will be largely affected by geopolitical tensions in the region due to Russia's aggression in Ukraine. Their second-round effects on the prices of industrial goods and services are also forecast.

Consumer Price Changes by Goods and Services

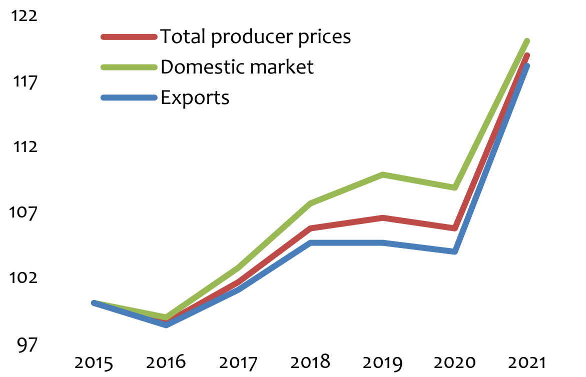
February 2022, contribution to 12-month changes, as per cent



In 2021, there was a very sharp rise in producer prices in the manufacturing.

Producer Prices in Manufacturing

2015 = 100



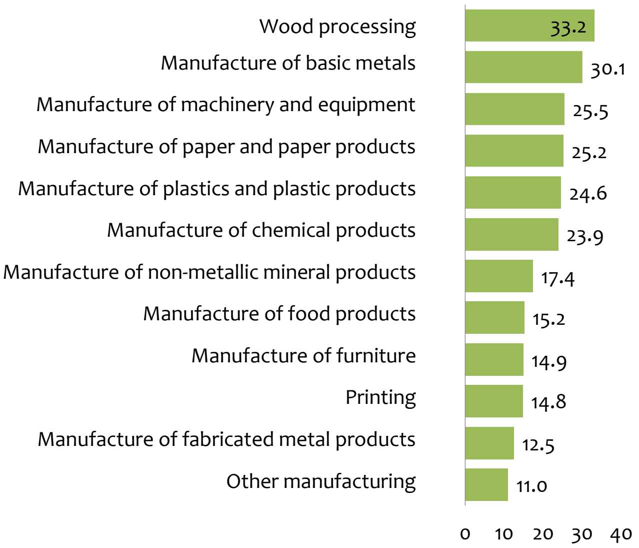
In 2021, producer prices in manufacturing increased by 12.5%. Prices for products sold on the domestic market increased by 10.3%. Prices for exported products rose by 13.7%. The most significant price increases were observed in wood processing, manufacture of chemicals and chemical products, food, and fabricated metal products.

In 2022, the rapid rise in producer prices in the manufacturing is continuing. In the two months of 2022, compared to December 2021, producer prices in manufacturing increased by 2.5%.

In 2022, producer prices in manufacturing will continue to rise rapidly. The level of producer prices is largely influenced by the fluctuations in the producer prices of exported products, which are mainly determined by the dynamics of world raw material prices. It should be noted that world energy and raw material prices are currently rising sharply. Limited supplies of raw materials in connection with the sanctions imposed on Russia and Belarus for aggression in Ukraine will have a significant impact on producer prices. At the same time, the dynamics of producer prices for products sold on the domestic market will continue to be affected by growth rates.

The Most Rapid Producer Price Changes in Manufacturing in February 2021

against the corresponding period last year, as per cent

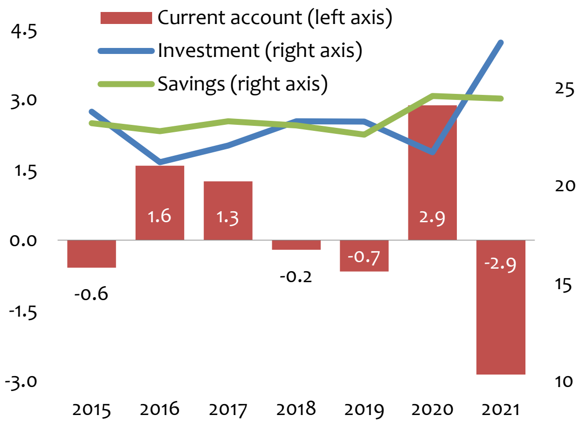


BALANCE OF PAYMENTS

External shocks have increased current account fluctuations. Between 2015-2019, on average, the current account balance was positive with a moderate downward trend. In 2016, a surplus of 1.6% of GDP was observed. However, in 2019 it reached a deficit of 0.7% of GDP.

Restrictions imposed to combat the pandemic had an uneven impact on cross-border flows of goods, services and income, reflected in significant current account adjustments.

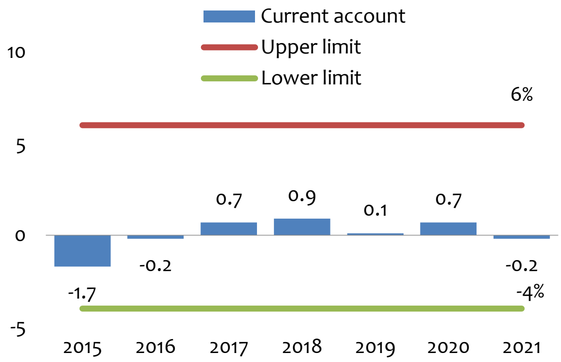
Current Account, Savings, and Investment
as per cent of GDP



In 2020, compared to 2019, the current account balance improved, reaching a surplus of 2.9% of GDP. However, in 2021 it fell into a deficit of 2.9% of GDP.

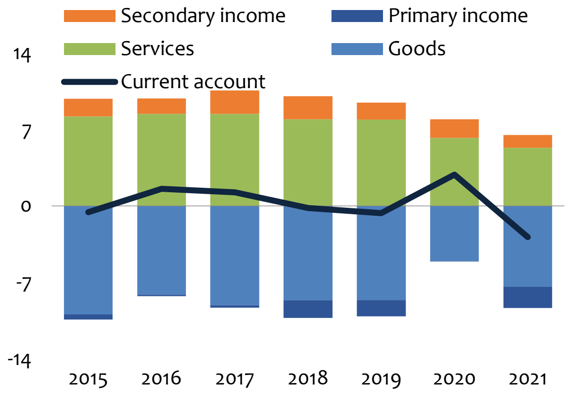
Despite the widening current account deficit, it does not exceed the indicative thresholds set by the EU alert mechanism and is considered sustainable.

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, the foreign trade deficit reached the level of 5.1% of GDP, which was determined by the decrease in import volumes, while the positive dynamics of exports remained. In 2021, compared to 2020, the value of exports of goods at current prices increased by 20.9%. Also, the value of imports increased by 25.2%. Consequently, the trade deficit increased to 7.4% of GDP.

Current Account
as per cent of GDP



Cross-border trade in services is more strongly affected by the Covid-19 shock than trade in goods. Although the services balance is positive and almost completely covers the foreign trade deficit, in 2020, the balance shrank to 6.2% of GDP (8% in 2019). The decline in cross-border flows of services was largely driven by restrictions on movement and the population's caution about leisure and business travel, which led to a decline in the value of travel, air, and road transport services. In 2021, imports of services at current prices were 20.5% higher in value than a year ago. At the same time, exports increased by merely 10.1%. Therefore, the surplus of the services balance decreased to 5.3% of GDP.

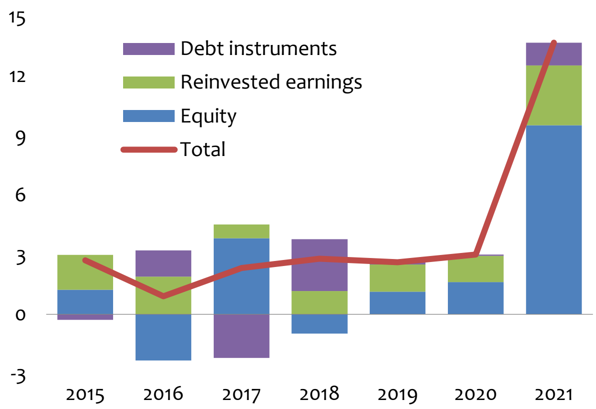
Changes in the income and capital account are mainly related to the absorption activities of EU funds. In 2021, the surplus of the capital account balance was 1.4% of GDP.

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 2021, financial account assets grew more moderately than liabilities and the financial account balance (with reserve assets) was -1.8% of GDP. The position of the balance of payments accounts in the near future will be determined by the impact of the imposed sanctions on Russia on cross-border flows and the Latvian economy as a whole.

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.

FDI in Latvia
flows, as per cent of GDP



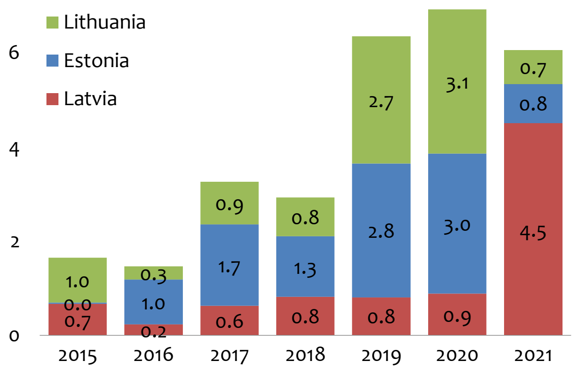
In the Baltic States, cross-border direct investment flows in 2021 were more moderate than a year ago.

In 2020, FDI inflows in the Baltic States reached 6.6% of GDP, with the majority of FDI flows in Estonia.

In 2021, the total net inflow of FDI in the Baltic States reached almost 6.1 billion euros. Almost 74% of the total volume of FDI transactions was in the Latvian economy. Estonia and Lithuania accounted for 14% and 12% of FDI transactions, respectively.

FDI in Latvia

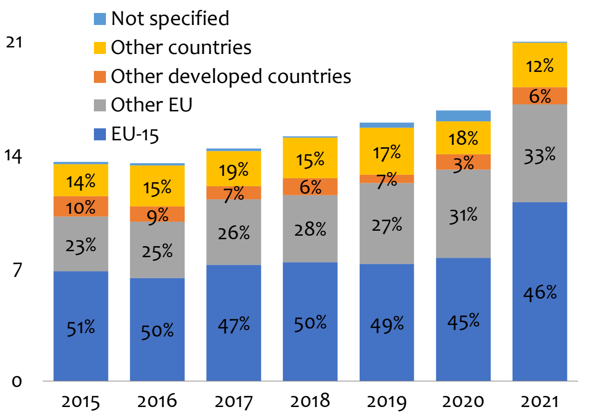
flows, as per cent of GDP



In 2021, the volume of FDI transactions increased significantly, reaching 4 502 million euro. This was mainly due to the large investments of the Swedish company Swedbank AB in the equity of companies registered in Latvia in Q4 of 2021. In 2021, the reinvested earnings of foreign investors also exceeded the level of the previous year almost 3 times. Overall, in 2021, the net inflows of FDI attracted were almost 5 times higher than a year ago and accounted for 13.7% of GDP.

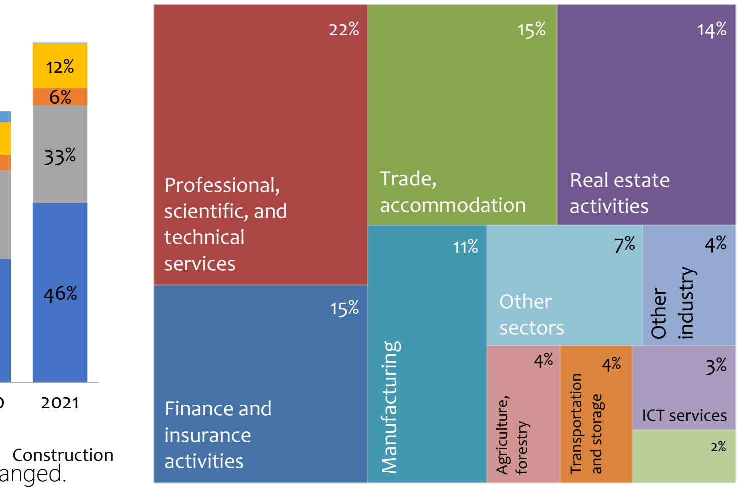
At the end of 2021, the accumulated FDI in the Latvian economy reached almost 21 billion euro, i.e. 64% of GDP. During the year, the accumulated FDI increased by 25.3%. The largest investor in the Latvian economy is Sweden. Since 2020, the accumulated investments of its entrepreneurs have doubled. At the end of 2021, investments from Sweden accounted for 28.8% of the total accumulated FDI. Entrepreneurs from Estonia, Russia, Lithuania, Germany, Cyprus, the Netherlands, Denmark, and Luxembourg also represent a significant part of investment. At the end of 2021, investments of these countries in the Latvian economy accounted for 83% of the total accumulated FDI in Latvia.

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



The structure of accumulated FDI sectors has changed. Owing to large-scale investments in the professional, scientific, and technical services sector, at the end of 2021, its share in the total amount of accumulated FDI increased to 21.6%. Significant investments were also made in financial intermediation services (15.2% of all FDI), trade (14.1%), real estate activities (14.2%), manufacturing (11%).

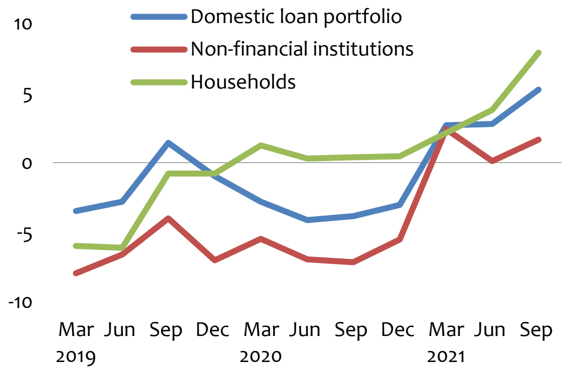
FDI by Sector
closing balance at the end of 2021



MONETARY INDICATORS

Despite the economic impact of the pandemic, the financial sector remains stable. Deposits continue to grow. However, lending activity remains subdued and business lending is weak.

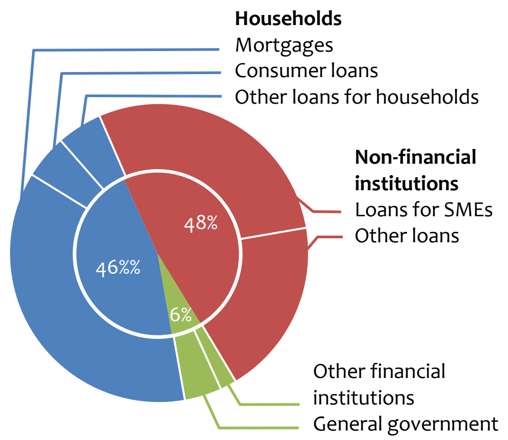
Domestic Credit Balances
against the corresponding period last year, as per cent



Source: FCMC

At the end of September 2021, the total loan portfolio of non-bank customers was 14.5 billion. euro. The loan portfolio of domestic customers grew by 5.2% annually. The loan portfolio of non-financial corporations grew by 1.7%. However, lending to small and medium-sized enterprises remains negative. The situation in household lending is gradually improving, and the household loan portfolio grew by 7.9%.

Lending Portfolio of Non-Financial Institutions by Sector
at the end of September 2021, as per cent

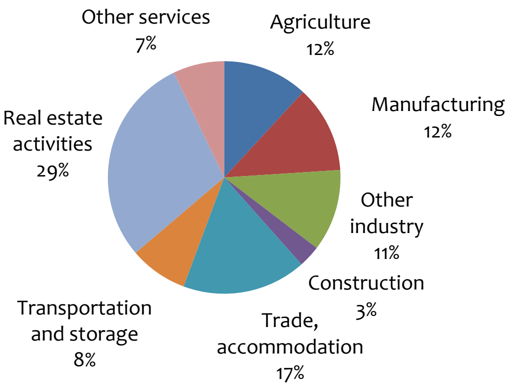


Source: FCMC

The distribution of loans by economic sectors has not changed significantly - at the end of September 2021, most loans were issued in real estate activities (29% of total loans) and trade and accommodation (17%).

Since 2016, interest rates (balances) on long-term loans to non-financial corporations issued in euro have remained essentially unchanged. In September 2021, interest rate was 2.25% for long-term loans. However, it slightly increased to 3.43% for short-term loans. Interest rate fluctuations on long-term loans to households for house purchase remain minor and stood at 2.25% in September 2021. At the same time, short-term interest rates fell slightly, reaching 3.09%.

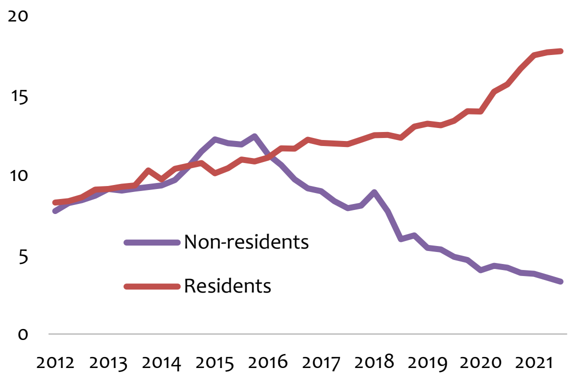
Lending Portfolio of Non-Financial Institutions by Sector
at the end of September 2021, as per cent



Source: FCMC

At the end of September 2021, the amount of deposits increased to 21.1 billion. euro, which was by 6.1% more than a year ago. More rapid growth of deposits began in the Q2 of 2020, along with the outbreak of the Covid-19 pandemic, when people were more cautious in their spending and tried to save more. This trend is declining as population spending increases. Of the total amount of deposits, 16% constitute foreign deposits (compared to 52% of all deposits at the end of September 2015), which continued to shrink and remained 21% lower than a year ago. At the same time, domestic deposits increased by 13%, accounting for 84% of total deposits. Banks dealing with non-resident deposits are subject to higher liquidity and capital adequacy requirements.

Non-Bank Deposits in Banks
billion euro



Source: FCMC

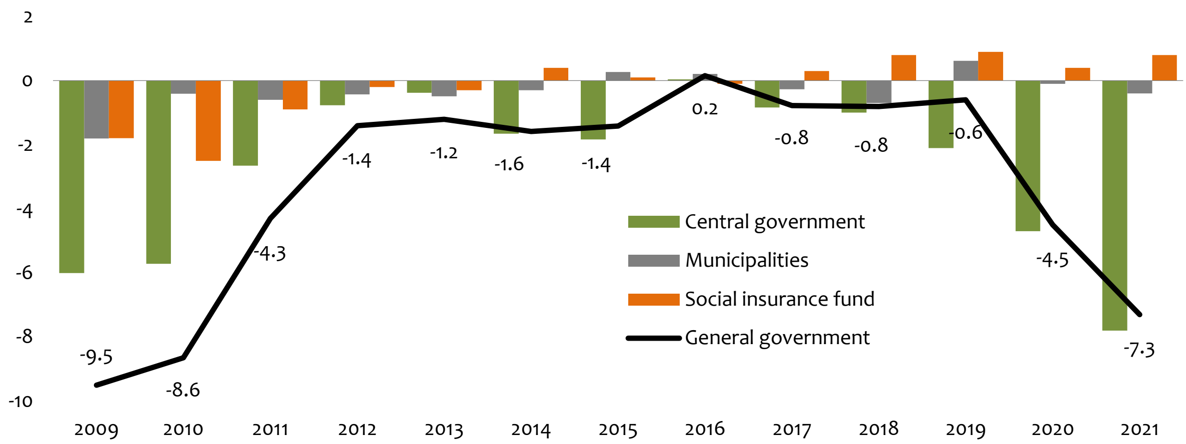
BUDGET AND GOVERNMENT DEBT

The Covid-19 pandemic has led to significant changes in policy. In 2020, the general exemption clause of the Stability and Growth Pact was activated in the EU, allowing EU countries to increase the general government budget deficit in 2020-2022 to the extent necessary to reduce the economic damage caused by the pandemic. Due to the Covid-19 pandemic, in 2020, the budget deficit in Latvia increased to 4.5% of GDP or 1.3 billion euro. However, in 2021, it increased to 7.3% of GDP or 2.4 billion euro. The Covid-19 crisis is gradually ending. Therefore, the amount of support is declining, and the Saeima approved the budget for 2022 with a deficit of 4.8% of GDP (or 1.6 billion euro). However, in view of the Russia-Ukraine war and all its consequences, changes could be made to the budget.

General Government Budget

	2017	2018	2019	2020	2021
Revenues, bln euro	10,2	11,2	11,5	11,4	12,4
% of GDP	37,9	38,5	37,6	38,8	37,6
Expenditures, bln euro	10,4	11,5	11,7	12,7	14,8
% of GDP	38,7	39,4	38,2	43,3	44,9
Net, bln euro	-0,21	-0,25	-0,17	1,32	-2,42
% of GDP	-0,8	-0,8	-0,6	-4,5	-7,3

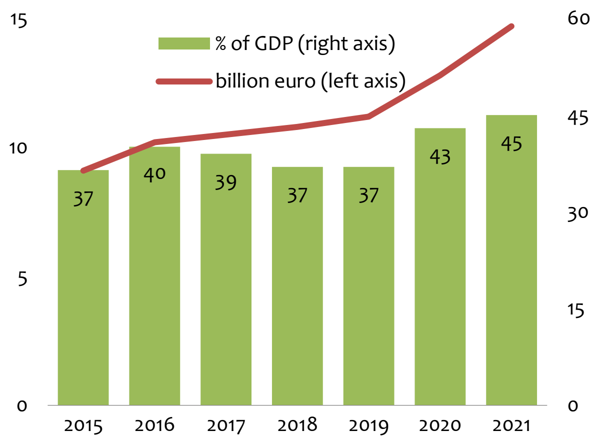
General Government Budget Balance by Sector
as per cent of GDP



Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest amongst the EU. 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 43.3% of GDP or 12.8 billion euro. In 2021, it continued to rise, reaching 44.8% of GDP or 14.7 billion euro.

As the situation with the fiscal impact of the Covid-19 outbreak stabilizes, the general government debt is expected to decline slightly and stabilize relative to GDP over the medium term from 2023 onwards.

General Government Consolidated Gross Debt nominal value at the year end

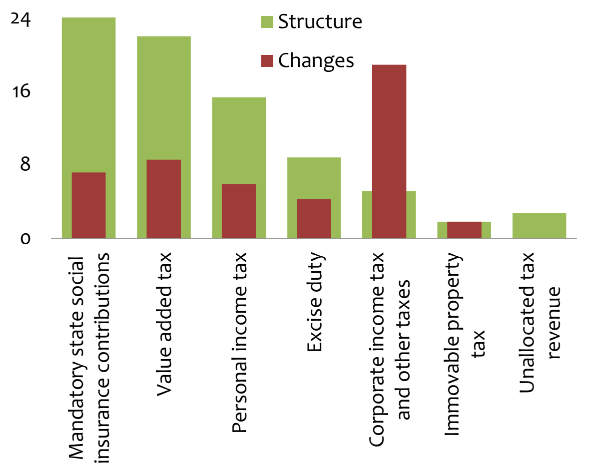


BUDGET REVENUES AND EXPENDITURES

Since 2011, the revenue of the state consolidated budget has been increasing. As a result of the Covid-19 crisis, in 2020, budget revenues decreased slightly. As the economy recovered from this shock, the positive dynamics of budget revenues also resumed in 2021, exceeding the level of 2020 by 10.9%.

Tax Revenues

structure and changes in 2021 compared to the last year, as per cent



In 2021, revenues increased in all tax groups. Employment taxes increased overall following a decline in the previous year due to the Covid-19 pandemic. Revenue from state social insurance contributions increased by 7.1%, while revenue from personal income tax increased by 5.9%.

Consolidated General Government Budget

	Billion euro 2019	2020	2021	Changes as per cent 2021
Revenues:	11.4	11.3	12.6	10.9
Tax revenues:	9.1	9.0	10.0	11.4
Mandatory State Social Insurance Contributions	2.8	2.8	3.0	7.1
Value added tax	2.6	2.5	2.8	8.6
Personal Income Tax	1.9	1.8	1.9	5.9
Corporate Income Tax	0.0	0.2	0.3	35.5
Excise Duty	1.1	1.1	1.1	4.3
Immovable Property Tax	0.2	0.2	0.2	1.8
Other taxes	0.3	0.3	0.4	8.6
Other revenues	2.3	2.3	2.5	9.2
Expenditures	11.5	12.5	14.4	15.6

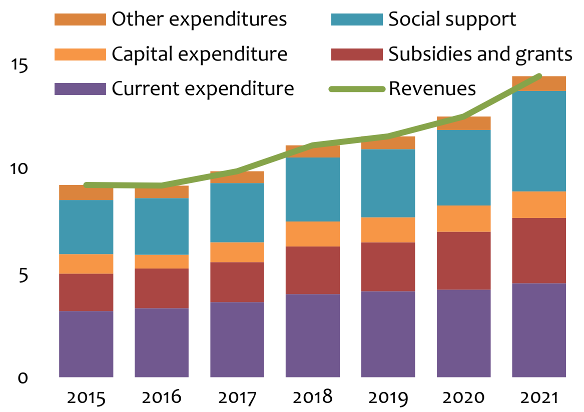
The growth of economic activity has a positive effect on consumption tax revenues. In 2021, revenue from value added tax increased by 8.6%. Also, revenues from excise duty rose by 4.3 percent.

In 2021, capital tax revenues also continued to increase. In this year, the increase in corporate income tax revenue reached 35.5%.

In 2021, compared to 2020, expenditures of the central government consolidated budget increased by 15.6%. This was largely due to the costs incurred in implementing the Covid-19 support measures. It is also reflected in the development of the social support item with an increase of 32.7%. A lower increase can be observed for subsidies and grants, current expenditure, and capital expenditure, which increased by 12.3%, 7.6% and 1.3%, respectively.

Consolidated General Government Budget Expenditures

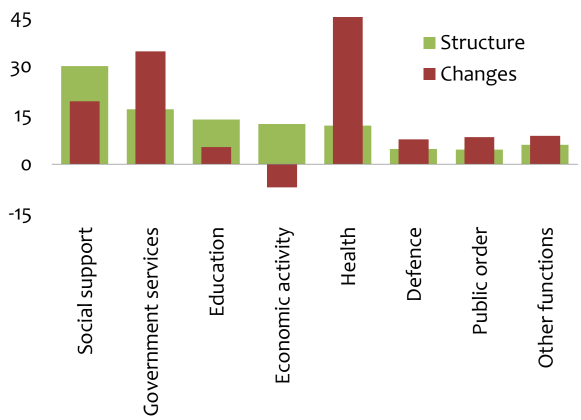
billion euro



The analysis of budget expenditures by functional categories reveals that in 2021 the largest increase in expenditures is in the areas related to the fight against the Covid-19 pandemic and the provision of support to overcome it, such as health, social protection, and general government services.

Consolidated General Government Budget Expenditures by Functions

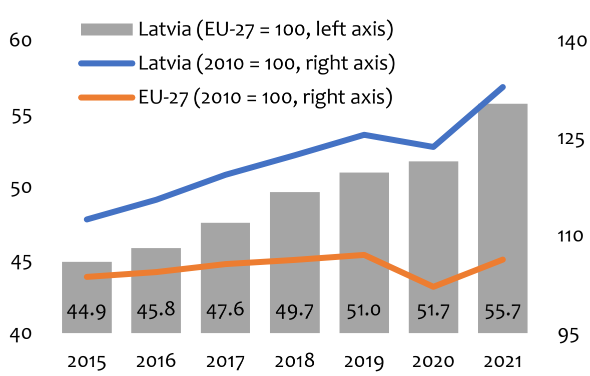
structure and changes in 2021, as per cent



PRODUCTIVITY AND COMPETITIVENESS

In recent years, productivity developments have been driven by adjustments in product and labour markets in response to the Covid-19 pandemic. In 2020, productivity declined by 1.5%. However, in 2021, with the easing of restrictions and the resumption of economic activity, productivity was 7.4% higher than a year ago, and GDP per capita in the Latvian economy reached 55.7% (73.5% after PPS) of the EU average. Since 2010, the productivity gap with the EU average (after PPS) has narrowed by almost 14 percentage points.

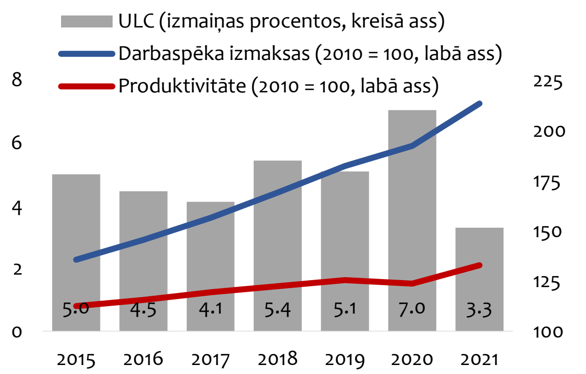
Productivity Dynamics



Labour costs continue to rise. In the first wave of the pandemic, labour costs slowed slightly due to a slowdown in economic activity. In 2020, labour costs increased by 5.5%, as opposed to an increase of 7.8% in 2019. However, more moderate labour cost dynamics did not compensate for the decline in productivity, and unit labour costs (ULC) increased by 7%.

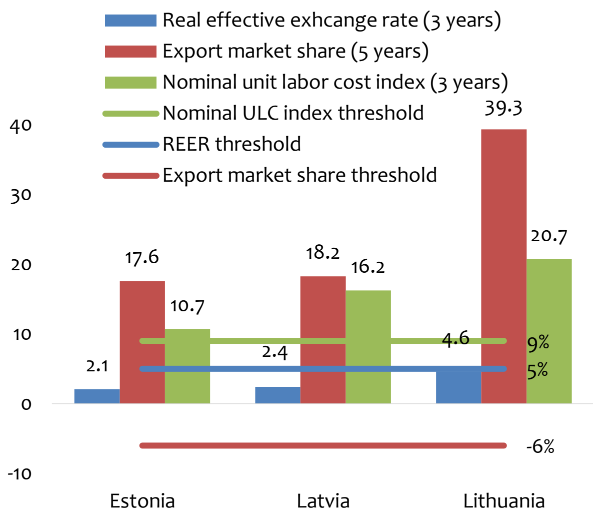
In 2021, labour costs continued to rise sharply and were 11% higher than a year ago. It did not put significant pressure on unit labour costs due to a 7.4% increase in productivity. In 2021, unit labour costs increased by 3.3%.

Labour Costs and Productivity



In recent years, rapid growth of nominal ULC has been observed in other Baltic countries as well. In 2021, compared to 2018, the nominal ULC in Latvia increased by 16.2%; in Estonia - by 10.7%; and in Lithuania - by 20.7%, which is more rapid than the EU average (6.3%). The indicator has exceeded the EU alert mechanism (MIP) threshold (9%).

Competitiveness Indicators
changes as per cent



* 2016-2020

REER dynamics have been positive. Over the past three years (2018-2021) the REER based on the consumer price index (CPI) against 42 trading partners has increased by 4.4%. 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 18.2%, which was largely influenced by the positive changes in 2020. Between 2016-2020, Latvia's share of the goods export market increased by 24.7%. The global market share of services exports grew more moderately, i.e., by 3.4%. It was mainly affected by a decline in market share in 2019 and 2020 (due to pandemic constraints) by 2.9% and 1.2%, 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. The crisis caused by the Covid-19 pandemic has widened the gap between productivity and labour costs. Although the level of productivity in 2021 was higher than in 2019, labour costs will grow more rapidly. The sustained positive dynamics of productivity will be largely determined by structural changes in the Latvian economy towards higher value-added activities and knowledge-intensive industries.

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 2022 did not identify Latvia amongst those 12 EU Member States, where macroeconomic imbalances were present, and further in-depth study – required. In the list of indicators (see table), Latvia had 2 indicators in 2020 that exceeded the specified thresholds.

Changes in the real effective exchange rate exceeded the threshold, as in 2020 it was affected by the depreciation of the Russian ruble by about 20%. The nominal unit labour cost index exceeded the threshold as wages continued to rise. This was driven by both skills shortages and Covid-19-related job losses, mostly in the low-wage sectors. The net international investment position, on the other hand, continued to improve. In 2020, it no longer exceeded the threshold. Latvia's negative net international investment position is affected by government debt and foreign direct investment, which poses a low risk of a sudden outflow of capital and an increase in servicing costs.

In 2020, the growth of real house prices slowed down significantly after several years of dynamic price growth. Private sector debt remained stable, while lending in the corporate sector was limited. The financial sector is stable and well-capitalized; however, profitability deteriorated significantly in 2020. Unemployment rates fluctuate in line with Covid-19 morbidity. Nevertheless, the 3-year average showed a slight decline in 2020.

List of Indicators for the Macroeconomic Imbalances Procedure for Latvia

	Threshold	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	-54.2	-51.4	-45.2	-40.1	-34.7
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	7.3	8.5	3.4	18.2
Nominal unit labour costs index (% changes over the last 3 years)	9%* & 12%	16.7	14.9	14.2	14.7	15.4	18.7
Internal imbalances							
House price index (% annual changes)	6%	-2.8	7.2	5.3	6.3	5.8	2.7
Private sector credit flow (% of GDP, consolidated)	14%	-0.8	2.5	2.7	-0.2	1.1	-1.8
Private sector debt (% of GDP, consolidated)	133%	78.3	78.3	75.6	69.7	66.2	66.7
General government debt (% of GDP)	60%	37.1	40.4	39.0	37.1	36.7	43.2
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	10.8
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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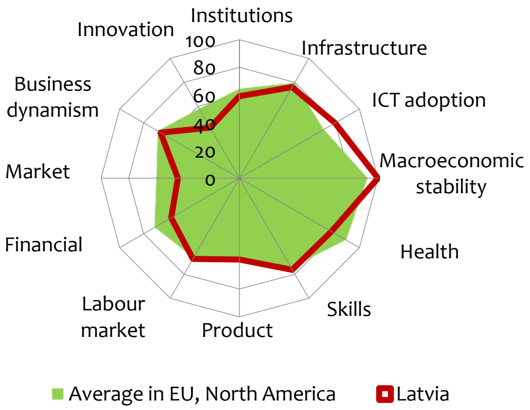
LATVIA IN INTERNATIONAL RANKINGS

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, investments in human resources, ICT infrastructure, and other areas, while providing free press and not militarily endangering other countries.

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

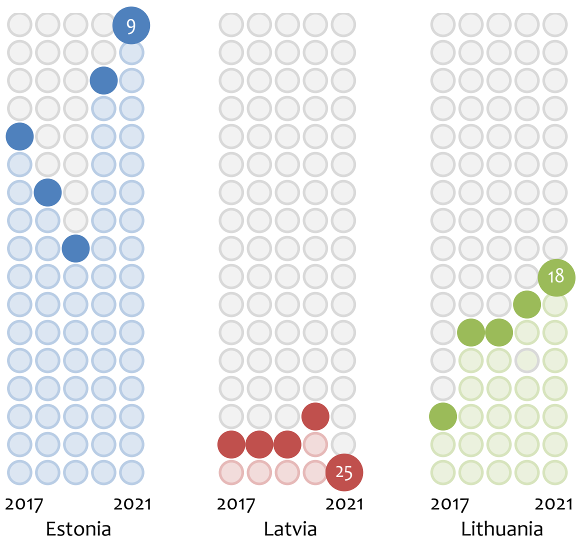


Source: *World Economic Forum, The Global Competitiveness Report 2019*

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.

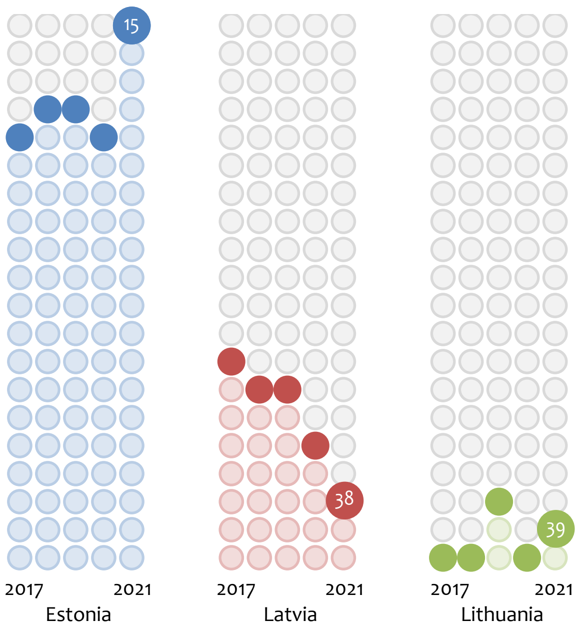
Baltic Countries in the European Innovation Scoreboard*



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

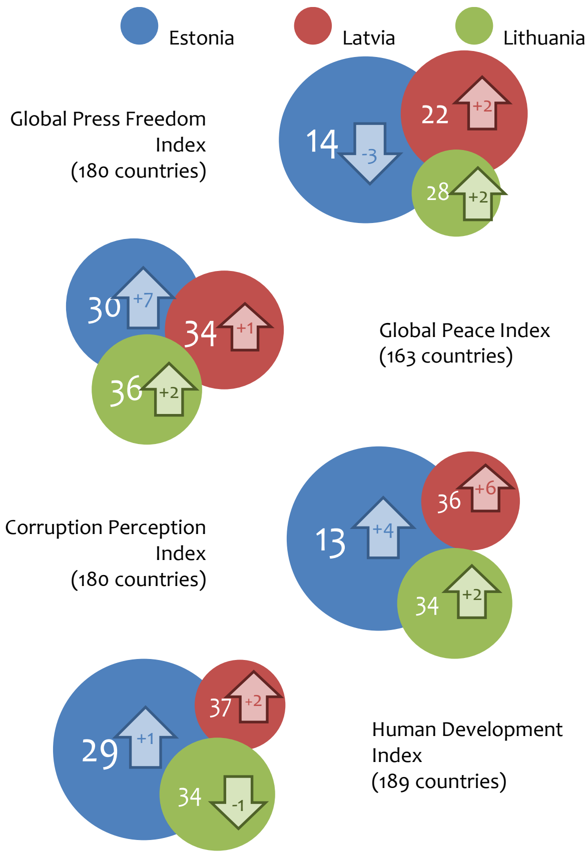


Source: *Cornell University, INSEAD, WIPO, The Global Innovation Index 2021: Tracking Innovation through the COVID-19 Crisis*

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.

Baltic Countries in International Rankings
place and changes during a year



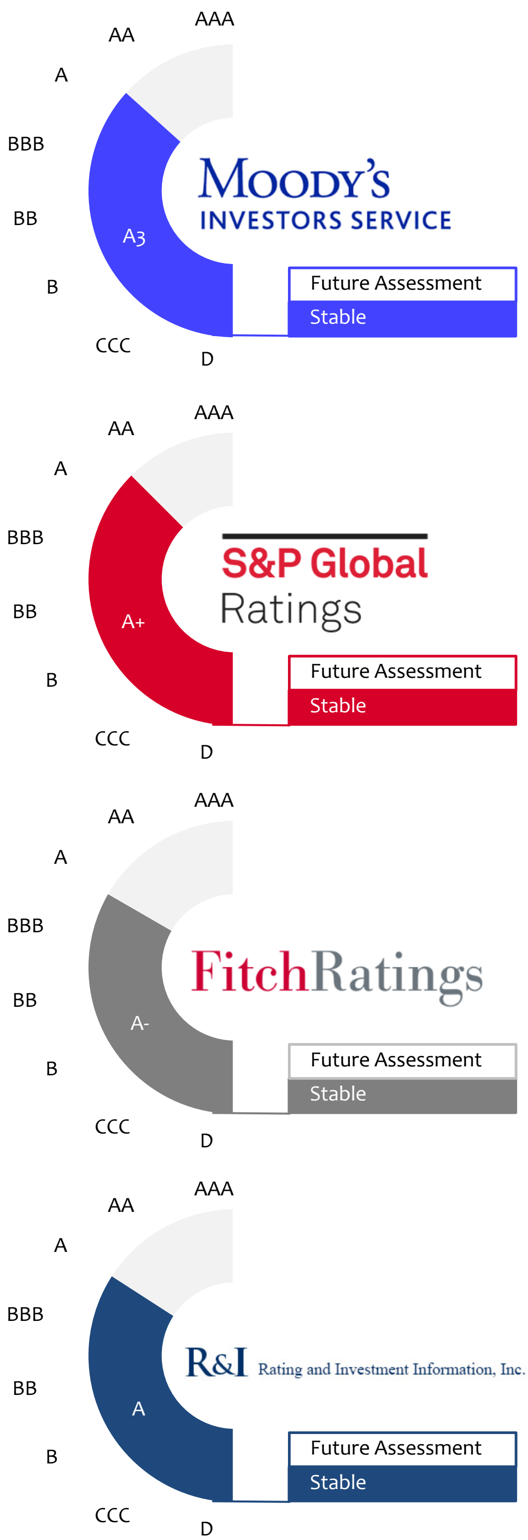
Source: *Reporters Without Borders, 2021 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2021; Transparency International, Corruption Perceptions Index 2020; United Nations Development Programme, Human Development Report 2020.*

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 2021, Latvia ranked 36th in the Corruption Perceptions Index compiled by the international anti-corruption organization Transparency International (out of 180 countries surveyed), improving the position by 6 places, compared to 2020.

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 February 2022, this agency confirmed that Latvia meets the "A +" level and a stable assessment of the future.

Also, other rating agencies have not changed their ratings since the start of the Covid-19 pandemic.

The assessment is based on the conclusion that the Latvian economy has recovered from the turmoil caused by the pandemic and that economic growth is stable, supported by strong domestic demand and government support measures.

The increase in government debt is considered to be moderate and is expected to stabilize in the coming years as the impact of the pandemic diminishes. Economic growth will be boosted by the resources available under the European Recovery and Sustainability Mechanism and the implementation of large-scale investment projects.