



Ministry of Economics  
Republic of Latvia

# MACROECONOMIC REVIEW OF LATVIA

April 2020

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Central Statistical Bureau of Latvia

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## ECONOMIC DEVELOPMENT TRENDS

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

In 2017-2018, economic growth rate accelerated. GDP growth reached 3.8% and 4.3%, respectively. Accelerated economic growth was facilitated by improvements in the external environment, increased absorption of EU structural funds, and rising employment and wages.

**In 2019, economic growth moderated. GDP increased by 2.2%.** The slight economic slowdown was driven by both internal factors (investments from EU funds have peaked, developments in the financial sector, etc.) and external factors (review of global trade tensions, Brexit, slower growth in other EU countries).

**In 2020, Latvia's economic prospects are highly uncertain.** The COVID-19 epidemic has a very significant impact on

the global and Latvian economy, but the magnitude of the impact is unclear. As late as the end of February 2020, various international organizations predicted a V-type scenario as the baseline scenario (i.e. a sharp but short-term downturn followed by a rapid recovery). At present, however, a U-type scenario looks more plausible, which would imply that the downturn phase will last longer, at least six months, but an even longer downturn caused by COVID 19 cannot be ruled out. According to the Ministry of Economics, the total impact of the COVID-19 epidemic on GDP could be between 4 and 8 percentage points, compared to the forecast at the beginning of 2020. **Thus, GDP in 2020 could decline by as much as 6%, compared to 2019.** However, if the effect of the virus in the world will be longer than half a year, then the negative impact on the Latvian economy will be even greater and the economy risks falling into an even deeper recession.

## Key Economic Development Indicators

	2014	2015	2016	2017	2018	2019
Gross domestic product, at current prices, billion euro	23.7	24.4	25.1	26.8	29.1	30.5
<i>changes as per cent</i>						
Gross domestic product	1.9	3.3	1.8	3.8	4.3	2.2
Private consumption	1.1	2.5	1.5	3.1	4.2	2.9
Public consumption	2.1	3.0	2.9	3.2	4.0	2.6
Gross fixed capital formation	-0.3	-1.2	-8.2	11.3	15.8	3.1
Exports	6.5	2.9	4.0	6.4	4.0	2.0
Imports	3.0	1.7	3.8	8.4	6.4	2.3
Consumer prices	0.6	0.2	0.1	2.9	2.5	2.8
<i>as per cent</i>						
Changes in the number of employed	-1.0	1.3	-0.3	0.2	1.6	0.0
Employment rate	59.1	60.8	61.6	62.9	64.5	65.0
Unemployment rate	10.8	9.9	9.6	8.7	7.4	6.5
<i>as per cent of GDP</i>						
General government balance	-1.4	-1.4	0.1	-0.5	-0.7	-0.5
General government debt	40.9	36.7	40.3	38.6	36.4	36.0
Net exports	-2.0	-0.9	1.0	0.2	-0.2	0.1

f – forecast

In recent years, a rapid rise in investments has significantly contributed to economic growth. In 2018, investments increased by 15.8%. Along with the EU fund investment volume peak in the current period, the pace of investment growth has declined. In 2019, investments increased only by 3.1%. In 2019, investments in dwellings and buildings increased by 2.8%, whilst investments in machinery and equipment and vehicles grew by 2%. On the other hand, investments in intellectual property products experienced a higher growth in 2019 – by 11.6 per cent.

A major driver of growth has been private consumption. Along with a rise in employment and wages, private consumption in 2018 increased by 4.2%, representing the largest growth since 2014. In 2019, private consumption growth (2.7%) remained relatively high. In 2019, public consumption increased by 2.5 per cent.

**Exports of goods and services also continue to grow. However, growth is slowing.** In 2018 and 2019, exports increased by 4% and 2%, respectively. In 2019, exports of services grew faster (by 5.7%), while exports of goods

grew by only 0.4%. The increase in exports of services was mainly due to income from road transport, information and communication services, and other commercial services. In turn, the largest contribution to the growth of exports of goods was made by the export of wood and wood products, electrical appliances and equipment, as well as the increase in the value of exports of cereals, alcoholic and non-alcoholic beverages and pharmaceutical products. The development of exports in 2019 was negatively affected by the export of machinery and equipment.

Since 2011, Latvia has experienced a low current account deficit, thus indicating the external sustainability of the Latvian economy. In 2019, the current account deficit of 0.5% of GDP was observed. It is anticipated that in the coming years the current account will remain with a small deficit, not comprising the external sustainability of Latvia's economy.

**In 2019, the most significant contribution to economic growth was provided by the trade sector (an increase of 4.1%),** which was facilitated by the growth of both retail and wholesale volumes. Rapid growth in 2019 was also observed in the agricultural and forestry sector (by 12.8%), which was largely influenced by the high grain yield. Also, in 2019, catering services (by 11.2%), computer programming and consulting (by 9.1%) services, and commercial services (by 6.5%) experienced accelerated growth.

**In 2019, manufacturing increased by 2.1%.** At the same time, trends in industry sub-sectors are very different. In the largest sector - wood processing, production volumes in 2019 remained at the level of 2018. The industry was affected by both the British withdrawal process from the EU and the sharp fall in production prices due to the spread of spruce bark beetles in Europe. In 2019, production volumes decreased in the food industry, construction materials and furniture production. At the same time, stable growth in 2019 continued in the metal processing, electronics, as well as electrical equipment manufacturing sectors.

**In 2019, growth in the construction sector was 2.9%,** which was significantly slower than in the previous two years, as the amount of the EU fund investments in 2019 remained at the level of 2018. Also, in 2019, private investor projects were not as large as in previous years. In 2019, a decrease was observed in the financial sector, transport services (both the volumes of transported cargo and transport-related activities related to their servicing decreased). Also, the production volumes in the energy sector declined.

**The COVID-19 epidemic will significantly affect the development of Latvia's economy in 2020.** The main channels of influence on the Latvian economy in March 2020 were restrictions on international transport, reduction of travel flows, losses to companies accrued due to quarantine and self-isolation of employees, a decrease in

demand in export markets, delays in raw material supply chains, a decline in demand for domestic services, etc.

Overall, the impact on the Latvian economy and its individual sectors in 2020 will largely depend on the spread of the COVID-19 epidemic, the extent and duration of the restrictions imposed to combat it, and the effectiveness of government support measures imposed.

**The value added of the sectors most affected by the coronavirus is almost 800 million EUR, which represents 2.9% of GDP,** incl. accommodation (0.6%), passenger air transport (0.5%), travel agency, and tour operator reservation services (0.2%). The Covid-19 epidemic will also adversely affect other sectors. Manufacturing will be affected by both the decline in demand in export markets and delays in supply chains.

**In the Latvian economy, the large pre-crisis macroeconomic disproportions have been eliminated and the economic vulnerability risks to internal and external shocks – reduced.** Latvia has successfully managed to maintain low government debt, budget and balance of payments close to balance. Although inflation has risen steadily, it has been based on several supply-side factors.

In 2019, average inflation reached 2.8%, which was slightly higher than in 2018. The rise in prices for services had a significant impact on the consumer price level. In 2020, average annual inflation is expected to be significantly lower than in 2019, which will be mainly determined by the negative impact of the COVID-19 epidemic on economic development.

Since 2011, when Latvia returned to economic growth, significant improvements in the fiscal position have been achieved. In recent years, the budget has had a small deficit. According to the assessment, in 2019 the budget had a deficit of about 0.5% of GDP. The general government budget deficit in 2020 is planned at 0.3% of GDP. However, the COVID-19 epidemic could significantly increase the deficit.

After the global financial crisis at the end of 2008 and early 2009, the monetary indicators of Latvia have gradually stabilized – the quality of the loan portfolio has improved, and the banking sector operates profitably. Significant steps have been taken to strengthen the capital of credit institutions. Although resident deposits continue to increase, lending remains subdued. Also, entrepreneurs are cautious to take up new credit commitments. Significant changes in the banking system related to servicing the deposits of non-residents are being implemented.

**The increase in economic activity positively affects the situation in the labour market – the high unemployment rate, primarily caused by the financial crisis, is declining.** In 2019, the number of employed increased moderately - by 0.1% or approximately 0.6 thousand, compared to 2018, which has been the slowest growth in the number of employed since 2016. The slight increase can mainly be

attributed to the slowdown in economic activity. The rise in employment is also affected by demographic trends – the decline of working population.

In 2019, the unemployment rate decreased to 6.3%, thus approaching the pre-crisis 2007 unemployment rate. The rapid decline in unemployment, however, is still hampered by the high proportion of long-term unemployed, which accounts for more than 2/5 of the total number of employed. The decline in unemployment is further hindered by the regional disparities – in Riga the level of unemployment is almost twice as low as in Latgale region, thus significantly amplifying the risks of structural unemployment in the context of low labour mobility.

In 2019, the employment rate increased to 65%, thus continuing to correct the previously set highs for the third year in a row. Considering the negative demographic trends, the involvement of various economically inactive groups in the labour market will become increasingly important in maintaining the labour supply at the current level.

**Wage growth has remained above 7% per year over the last three years.** In 2019, the average gross salary continued to grow and reached EUR 1,076 (an increase of 7.2%, compared to 2018).

**The impact of the COVID-19 epidemic on the labour market will largely depend on how long the restrictions associated with the spread of the coronavirus last.** The longer restrictions remain, the higher the risk of job losses and rising unemployment. The impact on the labour

market is on average slower - with a lag of 2-3 months. As the situation continues to deteriorate and restrictions persist for a longer period, the number of employees may decrease by 5% in 2020. In 2020, the unemployment rate on average could rise to 10% (99 thousand jobseekers).

**Further economic development heavily relies on the situation in the external environment and the implementation of reforms.** The development of Latvia's economy will closely be linked to export opportunities. Thus, the largest risk to economic growth is related to the development trends in the global economy, especially the cessation of the expansion of the COVID-19 epidemic. The further development of the EU's common economic space is also important. Latvia's economic competitiveness in the medium term will be mainly based on the achieved macroeconomic stability, as a result of which Latvia's credit ratings have improved, as well as on the efficiency of the planned EU structural fund support programs and improvements in the business environment.

The accelerated growth scenario assumes that the growth in the largest Latvian export markets will be sustained, the competitiveness of Latvia's economy will mostly rely on technological factors, such as improved production efficiency and increased innovation; however, the reliance on cheap labour force and low resource prices will be subdued. In the medium term, Latvia's growth rates could reach 4-5% annually. However, in the weak growth scenario, Latvia's economic growth rates may be much slower as growth in the EU would weaken and geopolitical conditions would not significantly improve.

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## WORLD ECONOMIC OUTLOOK

The global economic outlook is currently highly uncertain. The COVID-19 epidemic is having a major impact on the world economy, but the magnitude of the impact is unclear. As late as the end of February, various international organizations predicted a V-type scenario for the baseline scenario (i.e. a sharp but short-lived downturn followed by a rapid recovery). At present, a U-type scenario looks more plausible, which would mean that the downturn phase will last longer, at least six months, but an even longer downturn caused by COVID 19 cannot be ruled out.

GDP Growth Rate  
as per cent

	2019	2020p	2021p
World	2.9	2.4	3.3
G20	3.1	2.7	3.5
Euro Area	1.2	0.8	1.2
USA	2.3	1.9	2.1
Russia	1.0	1.2	1.3

Source: OECD Interim Economic Outlook Forecasts, March 2020;  
f – forecast

In 2019, GDP growth in China reached 6.1%. In 2020, China's growth forecasts have been significantly reduced. At the beginning of March 2020, the OECD predicted that GDP growth in 2020 will fall slightly below 5%. In 2021, GDP could grow to 6.5%. Similar economic prospects are projected for economies closely related to China, including Japan, Korea, Australia and Indonesia.

The OECD predicted in early March 2020 that the impact of the coronavirus outbreak on other economies that are

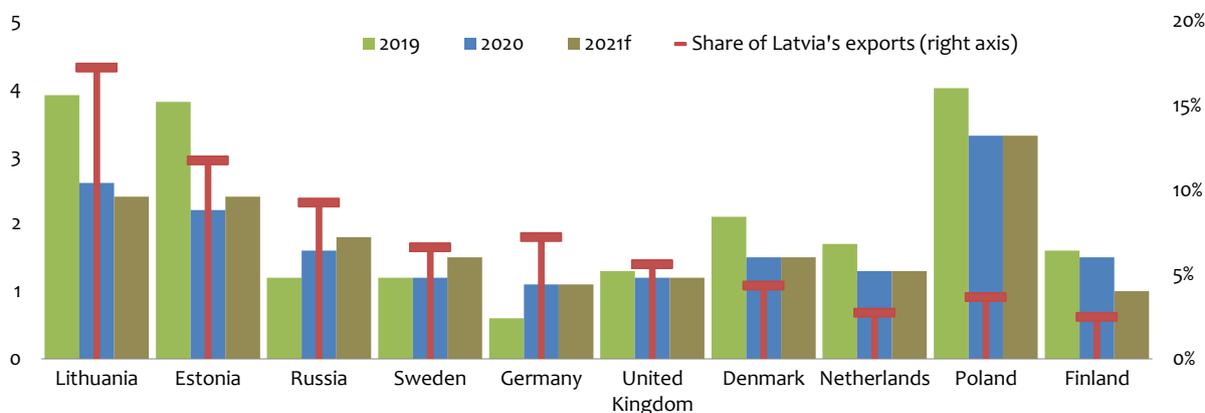
less integrated with China, especially the US and Canada, will not be significant, although declining confidence, supply chain disruptions and weaker external demand will dampen growth prospects. However, given the COVID-19 outbreak in the second half of March, the economic impact could be much larger than initially projected. In 2019, US economic growth reached 2.4 percent.

In 2019, the GDP growth of the Eurozone reached 1.2%. The economic growth in the Eurozone in 2020, as elsewhere in the world, is expected to be significantly affected by the COVID-19 epidemic.

In 2019, the United Kingdom GDP reached 1.3% (European Commission, 2020). In the United Kingdom, private consumption and expansionary fiscal policies are expected to remain the main drivers of growth.

In 2019, GDP growth in Germany slowed to 0.6%, mainly due to weaker export growth and a continued decline in manufacturing. Growth was mainly driven by strong domestic demand. Private consumption also rose sharply, as employment levels and wage growth remained high. Sweden's real GDP growth in 2019 reached 1.2%. Sweden's economic growth in 2019 has become relatively weak due to a significant decline in domestic demand. Also, investment in housing fell significantly after a significant increase in 2018. GDP growth in Estonia in 2019 reached 3.8%. Economic growth in 2019 was mainly facilitated by increased investments of companies and households, as well as exports. In 2019, Lithuania's real GDP grew by 3.9%. Strong domestic demand and exports helped maintain the high growth rate in 2019 for the third year in a row.

Growth of Latvia's Largest Trade Partners  
changes and share as per cent

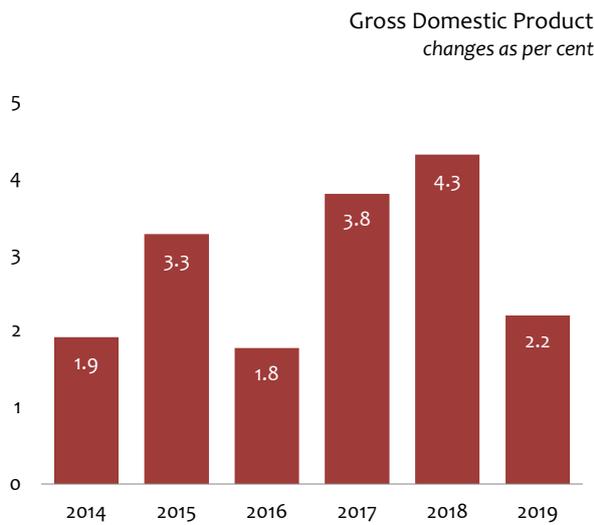


Source: CSB, IMF World Economic Outlook Database, October 2019  
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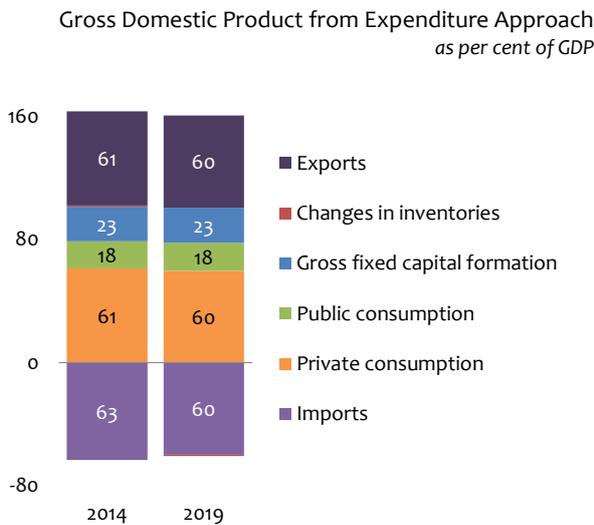
# 2020 | 1 GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

## GROSS DOMESTIC PRODUCT

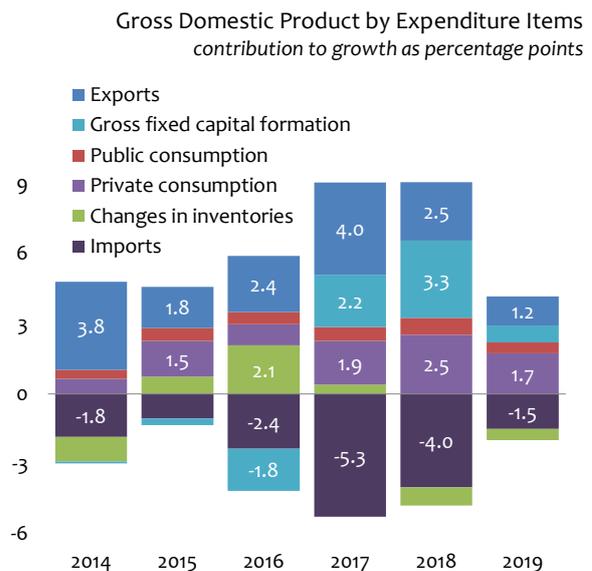
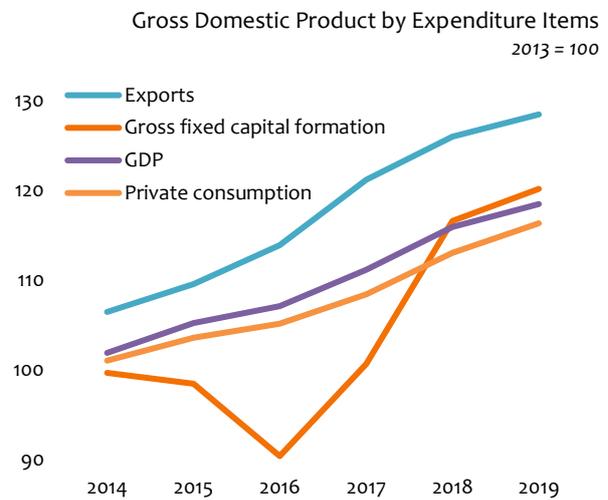
In 2019, GDP growth has moderated. In 2019, GDP grew by 2.2%, which was the slowest growth in the last three years.



In 2019, the slowdown in growth was determined by both internal factors (developments in the financial sector, changes in port management, investments of the EU funds reached a maximum, etc.) and external factors (review of global trade relations, Brexit, slower growth in EU countries).

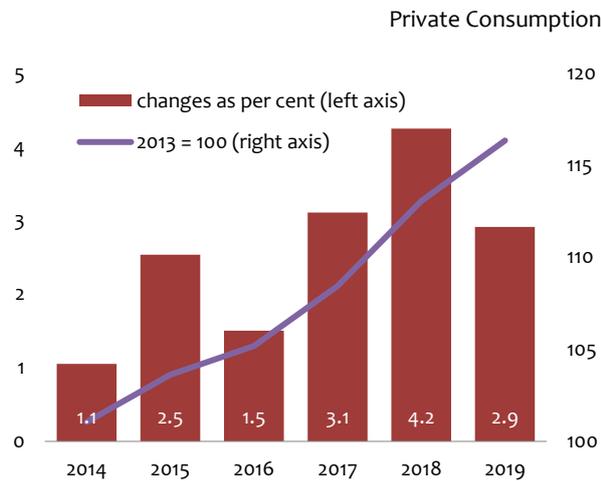


In 2019, a moderate growth in exports was observed. Exports of services grew faster, while exports of goods grew very moderately. Although at a slower pace, private consumption, supported by strong wage growth, continued to grow, but labour market improvements were modest. After a sharp increase in 2017 and 2018, investment growth moderated in 2019. Public consumption also increased at a slower pace than in previous years.



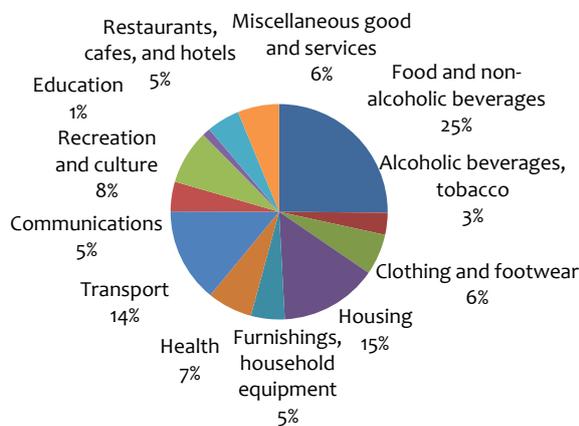
CONSUMPTION

Private consumption continues to increase. From 2014 to 2019, private consumption on average rose by 2.6% annually, mainly stimulated by rising employment and wages. Although wages have increase rapidly, the slower growth in 2019 was determined by more moderate improvements in the labour market - the number of employed increased by only 0.1 per cent.

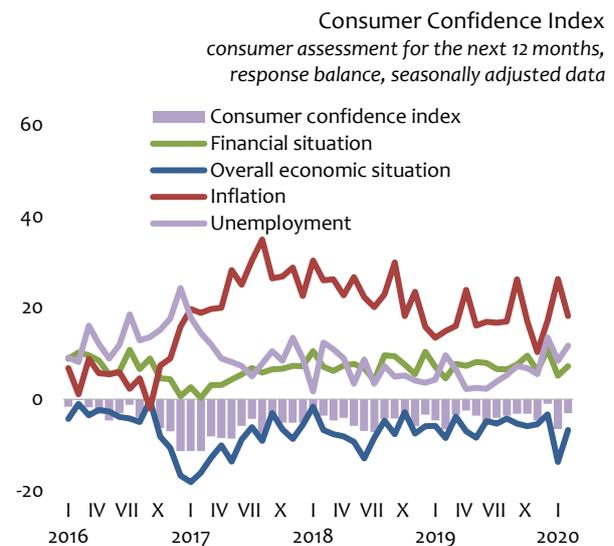


Expenditures on food and non-alcoholic beverages account for the majority of household consumption. In 2019, spending on food and non-alcoholic beverages, compared to 2018, increased only by 0.9%. Spending on housing, the second largest consumer spending group, rose slightly – by 2%. The largest increase was observed for transport expenditure, the third largest expenditure group, where expenditures rose by 9.6%. This was mainly due to higher expenditure on the operation of personal vehicles and the purchase of cars. The fourth priority in household spending is on recreation and culture, where spending increased by 6.9 percent.

Structure of Household Expenditures 2019, as per cent

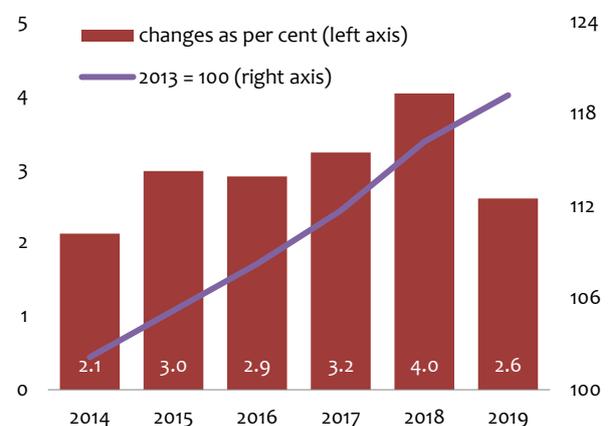


Overall, in 2019, consumer confidence improved. Slightly more positively have been evaluated the family financial situation and the perceived overall economic situation in the country. Similarly, inflation and unemployment expectations have declined. In comparison to 2018, the largest improvements were observed regarding inflation expectations. Also, unemployment expectations, albeit more moderately, improved. The assessment of overall economic situation in the country has continued to improve. However, compared to last year, the assessment of the family's financial situation has remained essentially the same.



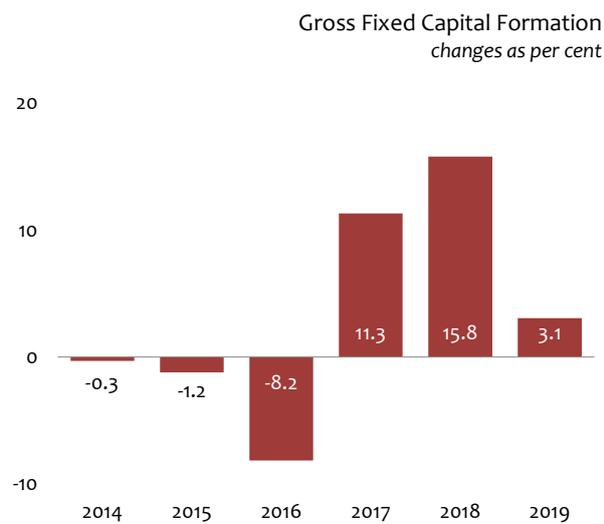
Public consumption gradually increases. Since 2014, along with an increase in budget revenues, public consumption has risen more rapidly. Between 2014-2019, public consumption has increased by 3.0% annually. In 2018, the largest increase since 2016 was observed. Also, in 2019 public consumption continues to increase; however, the growth has moderated.

Public Consumption



INVESTMENT

After two years of rapid growth, investment dynamics have moderated. In 2017 and 2018, expenditure on total fixed capital formation increased by 11.3% and 15.8%, respectively, which was much faster growth than in most EU Member States. At the beginning of 2019, investment growth remained relatively high; however, as the absorption of the EU structural funds has nearly peaked, the growth rate of investment activities has become more and more moderate. Overall, in 2019, investments in the Latvia's economy were 3.1% higher than a year ago.



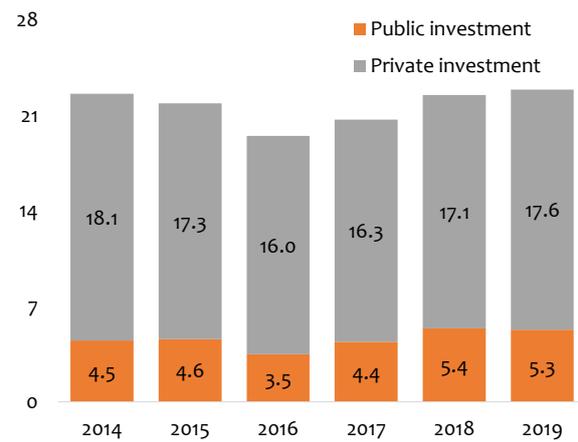
Both public and private investment grew at a slower pace than in the previous year. However, despite the slowdown in growth, investment grew faster than GDP, reaching 22.9% of GDP in 2019 (22.6% of GDP in 2018).

Private investment grew, albeit at a more moderate pace than a year ago. The recovery of private investment after the crisis was long-lasting. Since 2017, positive dynamics, albeit volatile, have been observed. Private investment in 2017 and 2018 increased by 6.7% and 11.6%, respectively. However, in 2019, the growth rate of private investment was almost three times slower than a year ago - it increased by 4.4% and accounted for 17.6% of GDP, which is lower than in the years of economic expansion. The low level and moderate dynamics are mainly influenced by weak lending, moderately growing demand, and the uncertainty of the economic and political situation in the external environment. Investment financing was mainly provided by entrepreneurs' own funds. Significant support for private investment is also granted by the state with co-financing from the EU structural funds.

In Latvia, public investment remains at a high level. In recent years, public investment constitutes 1/5 of total investment in the Latvian economy, and its dynamics largely rely on the cyclical nature of the absorption of EU

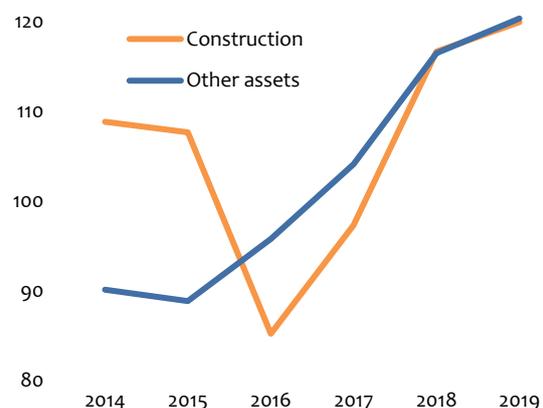
structural funds. Since 2017, along with the recovery of EU structural funds, public investment has increased on average by 33.5% annually. As EU structural funds reached its peak, public investment growth slowed. In 2019, government expenditure on fixed capital formation did not exceed the previous year's level, accounting for almost 1/5 of the total investment in the Latvian economy.

Public and Private Investment as per cent of GDP

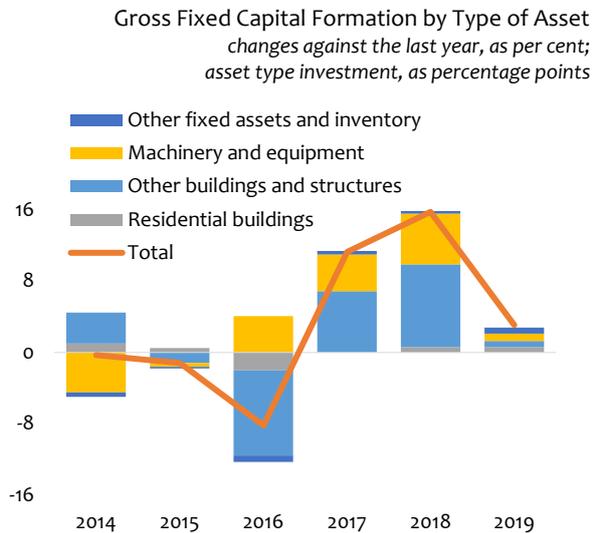


The largest share of investments has been made in construction. Primarily these constituted investments in buildings and structures, which during the last three years accounted for 43.1% of total fixed capital formation expenditure. Investments in housing comprised 10% of total investments. However, investments in machinery and equipment has been slower to recover from the crisis than other asset classes, not exceed 30% in the total investment structure. Investment in intellectual property products remained at an average level of 1.6% of GDP (including investment in R&D - 0.6% of GDP).

Gross Fixed Capital Formation by Type of Assets 2013 = 100



In 2019, investments in construction assets rose by 2.8%, and their share in total investments reached 54.8%. Investments in housing increased by 7.8%, while investments in engineering structures and buildings grew at a much slower pace - by 1.7% (in 2018 - by 23%). Entrepreneurs invested 3.1% more in machinery and equipment than a year ago, whilst investment in vehicles decreased by 1.6%. However, investments in intellectual property products experienced a faster increase of 11.6%.

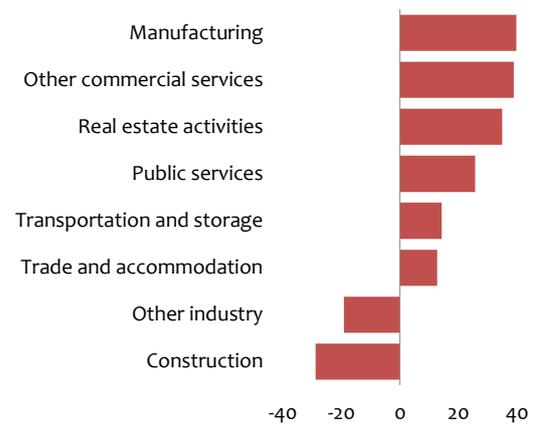


In the first half of 2019, non-financial investment more rapidly increased in services sector. Investment volumes were by nearly 26% larger than a year ago. Meanwhile, investment volumes in goods sector increased by 9.8%.

Investment growth in the public administration (33% increase) and real estate operations (54% increase) constituted the largest share of total investment growth. Investment in manufacturing was nearly 40% higher than a year ago. However, investment volumes in energy sector and construction have declined.

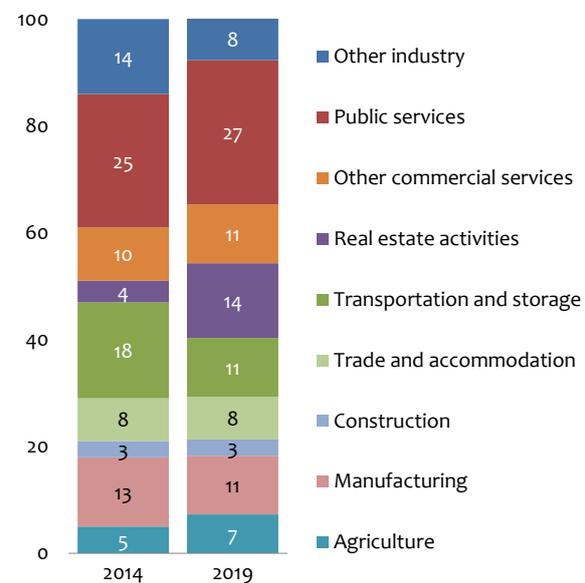
The survey results of top executives and managers in the industry reveal that the demand remains the most significant factor for investment decisions. In recent years, the role of finance accessibility has increased. In 2019, financial conditions (also technical factors such as technological developments and access to skilled labour, etc.) are deemed highly important in fostering investment.

**Non-financial Investment Dynamics**  
2019\*, changes as per cent



\* – calculated using quarterly data

**Non-financial Investment Structure**  
by sectors, as per cent

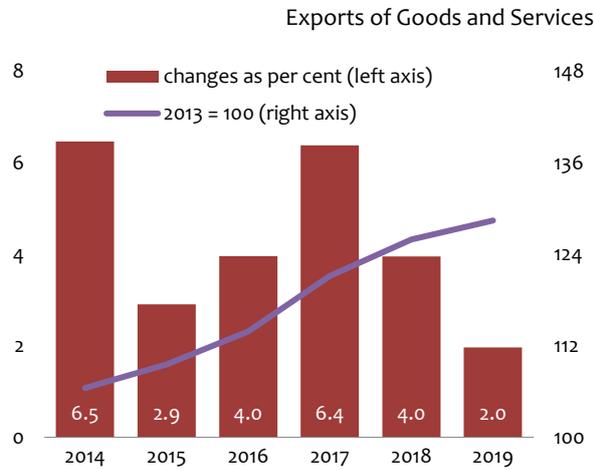


\* – calculated using quarterly data

**Investment dynamics may moderate in the upcoming years.** Amid uncertainties in the external environment and low levels of lending, investment dynamics may weaken. Investments will also be affected by the cessation of EU structural funds and declining external demand. It is anticipated that investment activities will pick up along with the launch of the *Rail Baltica* project.

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.



In 2019, exports of goods and services, albeit more moderately than in the previous year, increased steadily. The growth was mainly facilitated by economic development in Lithuania and Estonia and the stabilization of economic situation in Russia and other CIS countries.

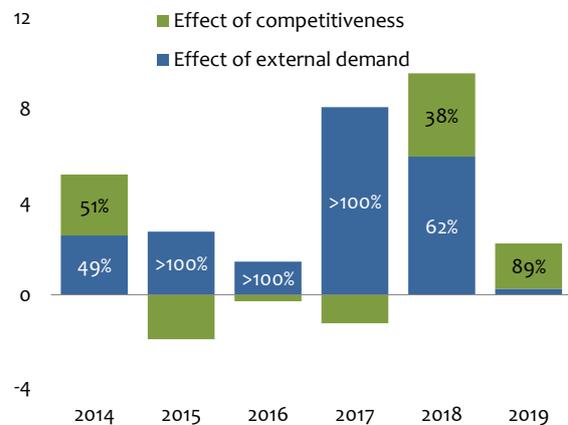


Between 2014-2018, export growth was mainly driven by external demand. The role of price competitiveness, however, was lower or even negative. On the other hand, in 2019, the growth of exports was more influenced by the competitiveness effect, which is related to the successful acquisition of new markets.

During years of rapid economic development, a few large exports of goods categories (e.g. wood and its products,

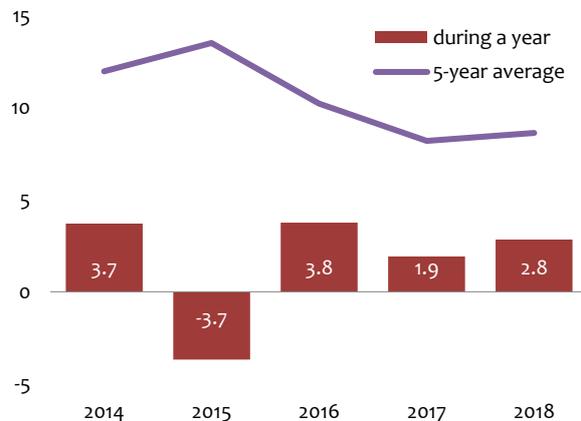
metals) constituted a considerable share of total exports. Amidst the crisis, export volumes declined across all export classes; however, the most substantial downturn was observed for the largest exports of goods categories. In the aftermath of crisis, as the economic growth resumed, exports of goods volume growth across product classes has become more similar, implying a higher degree of diversification for exports. In recent years, the export diversification rate of Latvia corresponds to the EU-15 average.

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



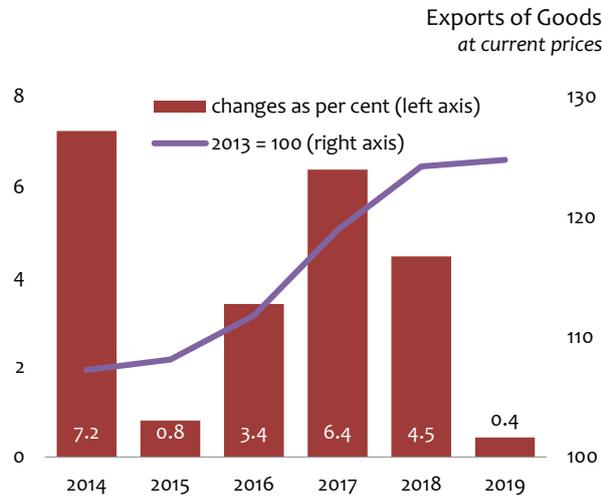
Latvia's share of exports in the global market is increasing, indicating that Latvia's entrepreneurs remain competitive despite rapidly rising labour costs.

Share of Exports in World Exports changes as per cent

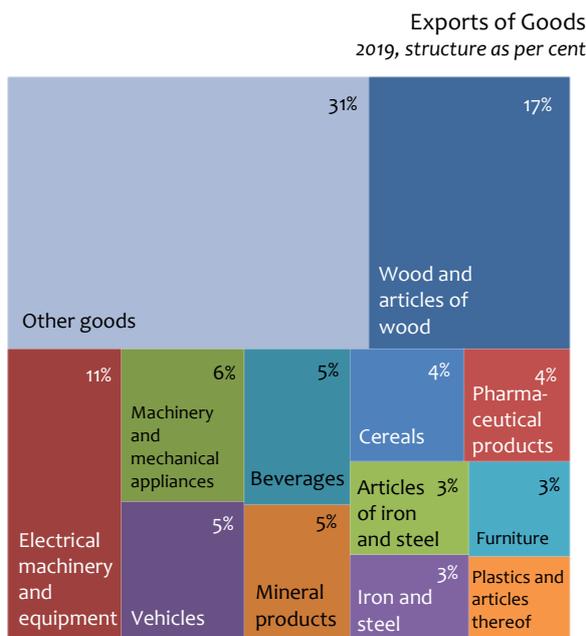


## Exports of Goods

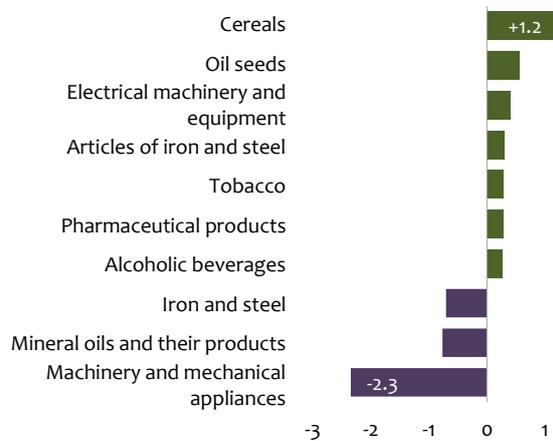
Exports of goods have remained stable, constituting around 70% of total Latvia's exports. Also, its share has not changed significantly in recent years.



In 2019, exports of goods increased moderately (compared to 2018, an increase of 0.2% at current prices and 0.4% at constant prices was observed). The growth was primarily driven by the development of exports of cereals, oilseeds and machinery and mechanical appliances. In turn, the development of exports was negatively affected by the reductions in exports of electrical machinery and equipment, refined petroleum products, iron and steel, as well as wood and articles of wood.

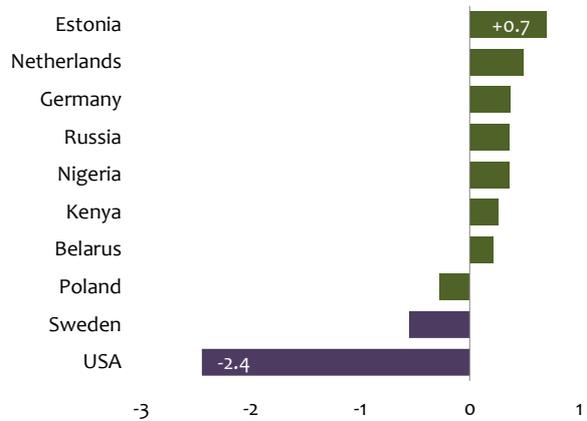


Exports of Goods contribution to growth in 2019, changes as percentage points



In 2019, the largest exports partners were Lithuania, Estonia, Russia, Germany, Sweden, UK, Denmark, and Poland. Exports to these countries constituted approximately 2/3 of all exports of goods.

Exports by Country contribution to growth in 2019, changes as percentage points

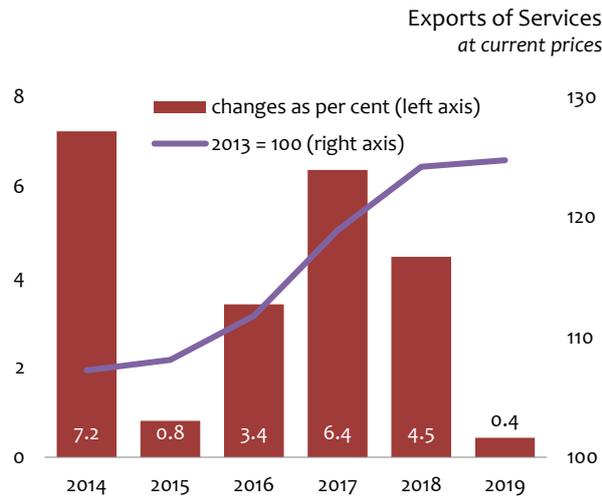


In 2019, the main export product groups to EU countries were wood and articles of wood, electrical machinery and equipment, and vehicles. The largest share of exports to CIS countries comprised of alcoholic beverages, pharmaceutical products, electrical machinery and equipment, and machinery and mechanical appliances. However, the largest export groups to other countries were wood and articles of wood, cereals, and electrical machinery and equipment.

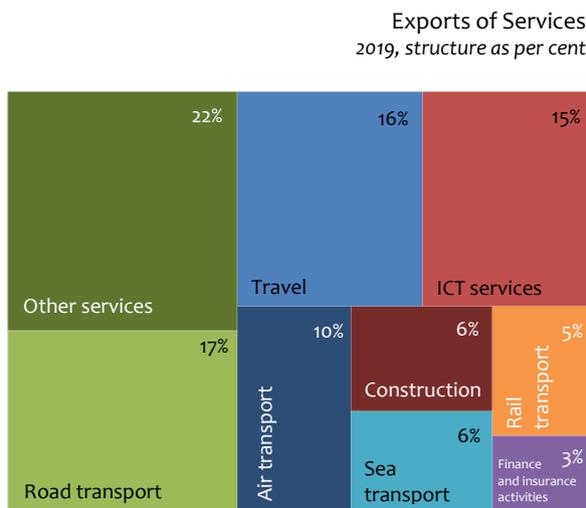
## Exports of Services

Since 2013, exports of services have increased at a higher rate than exports of goods. Transport services, ICT, trade intermediation, and travel services provide a major contribution to export growth. However, the share of finance and insurance activities in exports is declining.

In 2019, a stable growth of 5.7% in exports of services was observed.

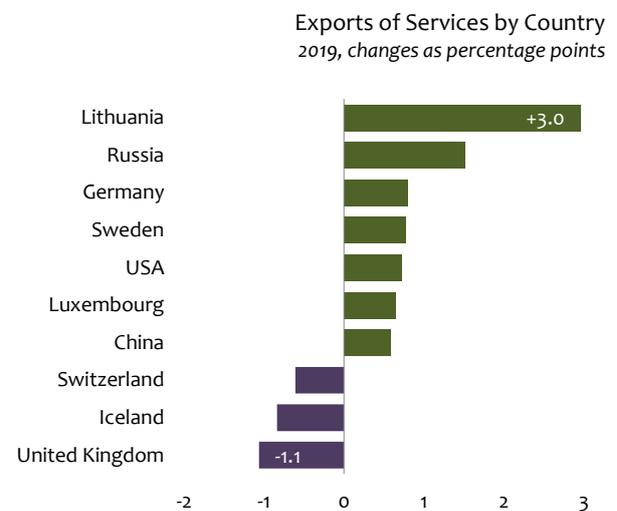
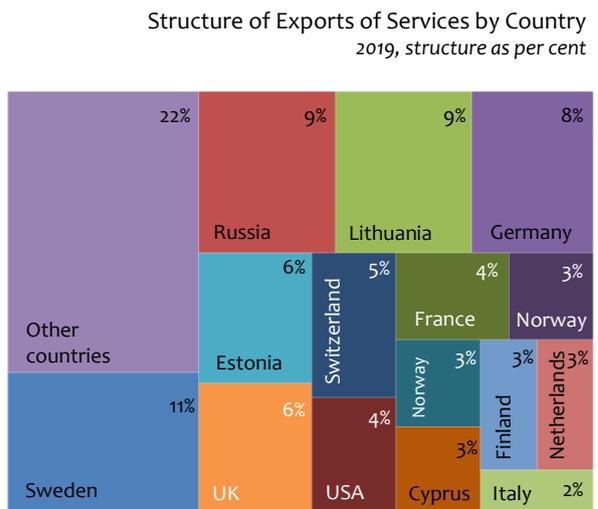
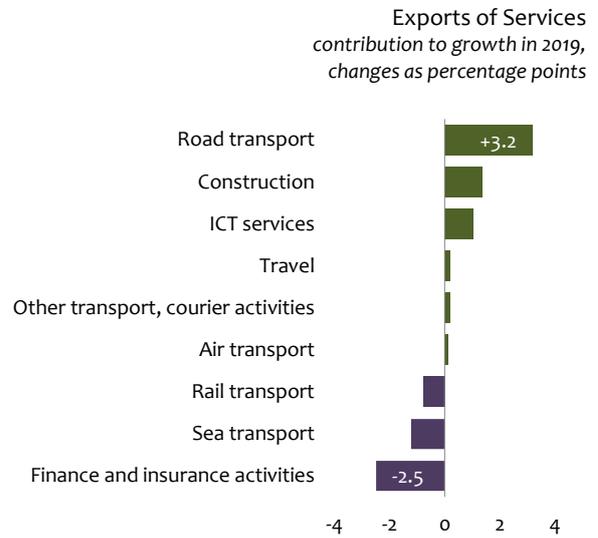


In 2019, export volumes in trade intermediation and road transport services increased at a higher rate. Similarly, growth was observed in ICT, construction, and travel services. However, export volumes declined in finance and insurance activities, sea and air transport services.



Each year the share of exports of services to EU countries has increased. In 2011, the share of exports to the EU amounted to 49%. In 2019, however, it has risen to 67%. Exports of services to CIS countries (mainly transit services) still comprise a significant share of total export volume. It

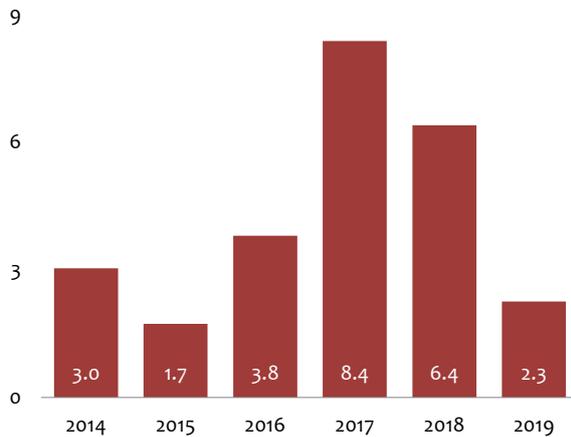
should be noted that exports of services to CIS countries have slightly declined from 17% in 2014 to 13% in 2019.



## IMPORTS

In recent years, imports of goods and services experience a similar growth as exports. In 2017-2018, imports of goods increased at a higher rate than imports of services.

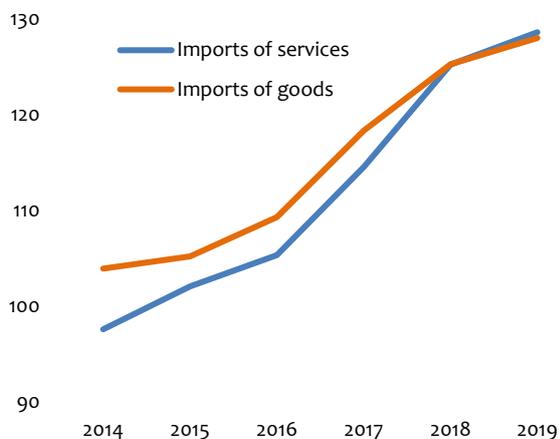
**Imports of Goods and Services**  
comparable price, changes as per cent



Although imports of goods observed an increase at constant prices in 2019, at current prices they decreased by 0.3%. Growth in imports of goods was primarily driven by the rise in imports of aircraft and their parts, electrical machinery and equipment, and pharmaceutical products. However, imports of machinery and equipment, refined petroleum products, and iron and steel declined.

The main Latvia's imports of goods partner countries are Lithuania, Germany, Poland, Estonia, Russia, Finland, and the Netherlands. In 2019, their production volumes amounted to more than 60% of Latvia's total imports of goods.

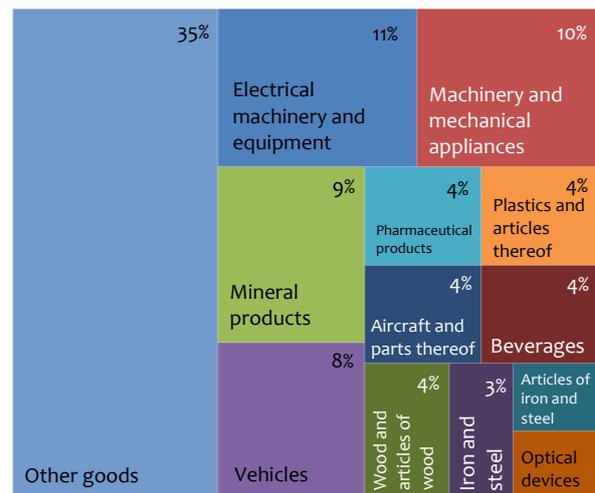
**Imports of Goods and Services**  
2013 = 100



Since 2012, the import structure by the end use of goods has not significantly changed. Due to a decline in the value

of fuel imports, the share of intermediate consumption goods has slightly declined. Similarly, the share of fuel in intermediate consumption has decreased from 34% in 2012 to 20% in 2019. The drop to a large extent can be explained by declining world prices for oil.

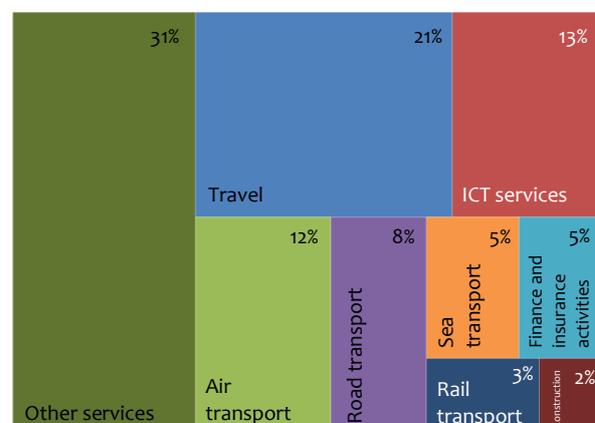
**Structure of Imports of Goods**  
2019, structure as per cent



In recent years, imports of services have grown at a relatively higher rate than imports of goods. Between 2017-2019, imports of services increased by 6.9% annually.

In 2019, imports of services at current prices grew by 8.2%. Imports of trade intermediation services, ICT services, air transport and road transport services, significantly contributed to the growth of imports of services. Imports of telecommunications and financial services, on the other hand, declined.

**Structure of Imports of Services**  
2019, structure as per cent



2020 | 1

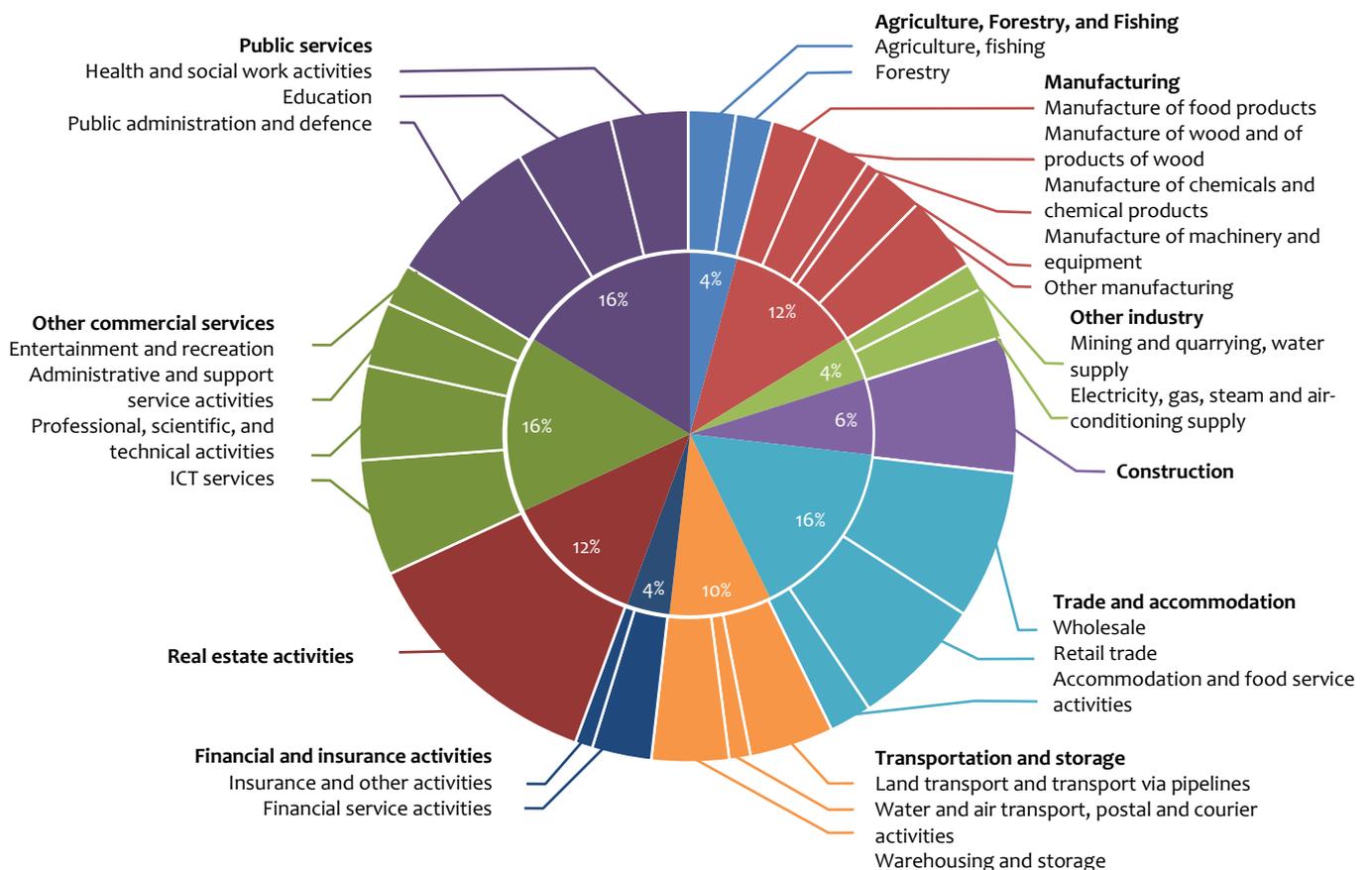
# SECTORAL DEVELOPMENT

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 2008, tradable sectors (agriculture, forestry, manufacturing, and transportation and storage) constituted 26.4% of the total value added. However, in 2010, the share for these sectors reached 33.2%. In 2019, it slightly declined to 27.7%. In 2019, compared to 2010, the

share has dropped in practically all sectors, except construction, commercial services, and public service sectors. In 2014-2016, the growth continued in all sectors, except construction and transport, while in 2017 and 2019, the increase in construction volumes had one of the largest effects on growth.

In 2019, goods accounted for 27% and services for 73% of total value added.

Structure of Value Added  
2019\*, as per cent



\* calculations by the Ministry of Economics

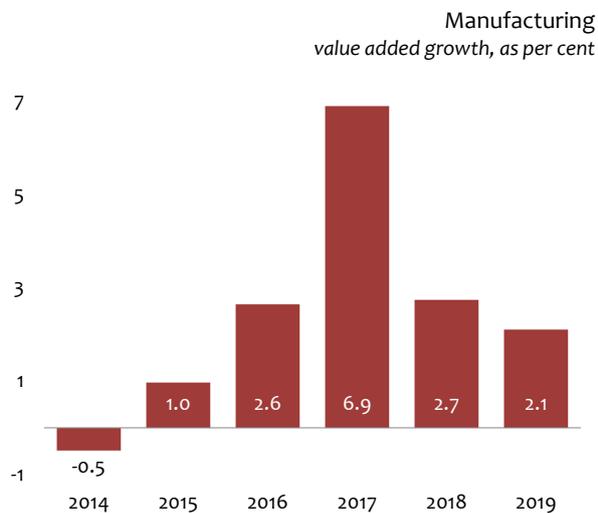
Development of Sectors  
changes against the corresponding period last year, as per cent

	2014	2015	2016	2017	2018	2019
<b>Gross domestic product</b>	<b>1.9</b>	<b>3.3</b>	<b>1.8</b>	<b>3.8</b>	<b>4.3</b>	<b>2.2</b>
Agriculture, forestry, and fishing	2.4	12.6	-10.5	5.1	2.0	12.8
Mining and quarrying	-10.6	11.5	-4.4	11.2	3.7	-4.6
Manufacturing	-0.5	1.0	2.6	6.9	2.7	2.1
Manufacture of food products	0.1	-4.6	1.8	5.2	-2.9	-0.7
Light industry	-13.6	-13.2	2.1	7.6	-0.8	-2.6
Manufacture of wood and articles of wood	6.9	7.1	8.0	2.1	4.5	0.0
Manufacture of paper and paper products	-0.6	0.0	3.6	4.5	-3.7	5.7
Manufacture of chemicals and chemical products	-2.6	-4.1	10.7	11.4	7.0	3.9
Manufacture of non-metallic mineral products	1.2	-9.8	11.6	11.1	1.3	-2.1
Manufacture of basic metals	-10.5	34.8	5.4	12.0	3.6	13.5
Manufacture of computer, electronic and optical products	32.3	16.7	12.6	15.8	12.1	11.3
Manufacture of machinery and equipment	2.4	7.9	8.5	21.5	7.0	-1.9
Manufacture of motor vehicles	-15.2	3.5	-2.9	22.8	7.3	-7.7
Other manufacturing	-12.0	3.5	0.8	4.3	-1.8	2.8
Electricity, gas, steam, and air-conditioning supply	-14.3	22.9	17.9	-1.8	-12.7	-4.5
Construction	6.0	-2.4	-14.9	14.3	17.6	2.9
Construction of buildings	28.2	-8.2	-11.1	22.4	25.6	7.8
Civil engineering	-6.8	0.4	-25.7	30.0	11.6	1.0
Trade	4.9	7.4	2.9	2.3	1.8	4.1
Retail trade	3.5	4.9	2.3	4.3	3.8	2.4
Transportation and storage	1.3	-7.8	6.2	7.5	4.6	-4.0
Freight rail transport	2.2	-2.4	-14.1	-8.4	12.5	-15.8
Cargo handling	5.2	-6.2	-9.3	-2.0	6.9	-5.7
Freight transport by road	2.7	0.5	1.3	7.0	12.8	-3.8
Accommodation and food service activities	3.5	6.0	1.5	9.4	5.2	8.0
Information and communication services	-2.9	1.9	5.4	8.7	12.8	2.0
Finance and insurance activities	11.5	7.2	0.4	-17.6	-2.0	-8.8
Real estate activities	1.7	1.5	0.5	-0.5	2.6	1.4
Other service activities	-4.3	6.2	1.0	5.6	2.7	6.5
Public administration and defence; compulsory social security	2.3	1.5	2.7	3.5	3.2	1.9
Education	2.6	2.1	0.7	5.1	2.0	2.8
Health and social work activities	7.0	5.8	1.0	8.5	5.1	9.5
Arts, entertainment, and recreation	0.9	-4.2	5.0	6.7	4.8	5.8

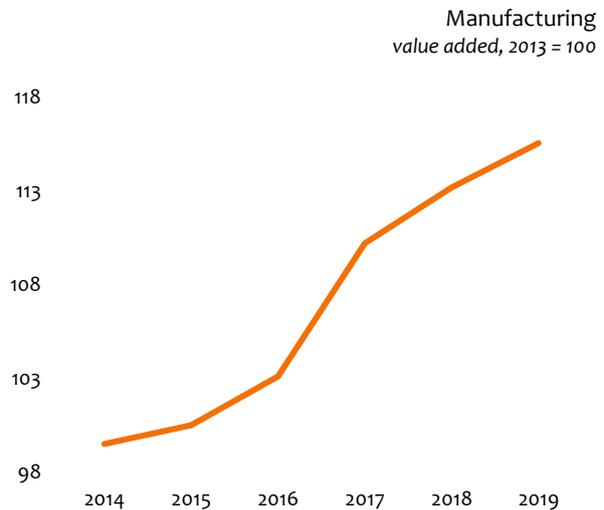
## MANUFACTURING

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

In 2019, the growth in manufacturing was positively influenced by manufacture of basic metals and manufacture of computer, electrical and optical equipment. The production volumes of the largest sub-sector (i.e., wood products and articles of wood) experienced a similar growth than a year ago. At the same time, the second largest sub-sector (i.e., manufacture of food products) slightly declined.



In 2019, turnover in manufacturing at current prices increased at a higher rate than output volumes. During the period, production volumes domestically increased more rapidly, whilst exported production volumes remained moderate.

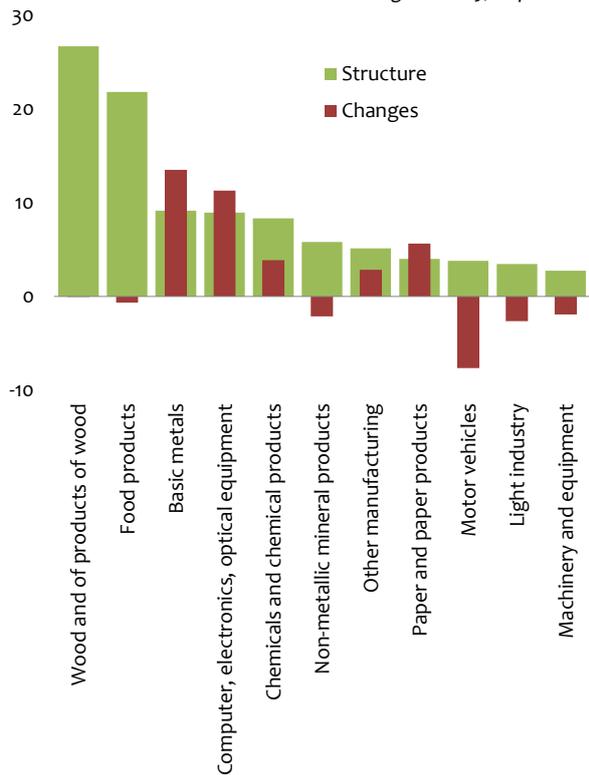


In 2018 and 2019, the number of occupied posts continued to increase. In 2019, the largest increase was observed in the manufacture of non-metallic mineral products and manufacture of basic metals. However, a decline in occupied posts was recorded in light industry and in the manufacture of food products.

**Structure of Manufacturing and Development Trends by Field as per cent**

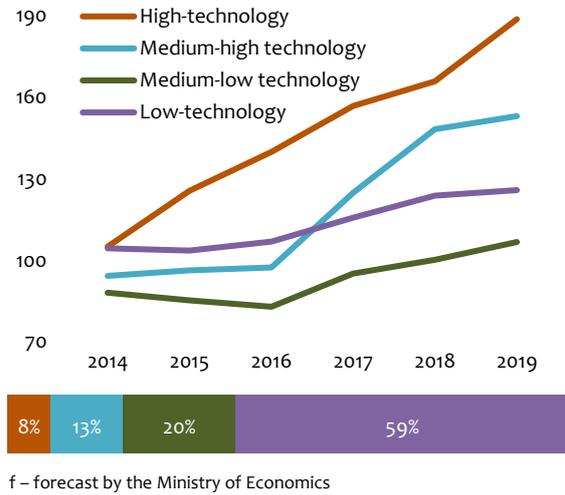
	Structure in 2019			Changes in production volumes			
	Output	Occupied posts	Exports in total sales	2017	2018	2019	2020 Jan
<b>Manufacturing</b>	<b>100</b>	<b>100</b>	<b>64.9</b>	<b>8.0</b>	<b>2.7</b>	<b>2.1</b>	<b>-3.6</b>
Manufacture of food products	21.8	19.4	37.6	5.2	-2.9	-0.7	2.4
Light industry	3.7	9.2	85.8	7.6	-0.8	-2.6	1.9
Manufacture of wood and of products of wood	26.7	19.8	70.9	2.1	4.5	0.0	-10.7
Manufacture of paper and paper products	4.0	4.3	64.3	4.5	-3.7	5.7	-0.4
Manufacture of chemicals and chemical products	8.3	7.1	75.2	11.4	7.0	3.9	-15.8
Manufacture of non-metallic mineral products	5.8	5.2	49.4	11.1	1.3	-2.1	7.7
Manufacture of basic metals	9.2	10.6	67.5	12.0	3.6	13.5	10.4
Manufacture of computer, electronic and optical products	8.9	5.0	89.8	15.8	12.1	11.3	11.4
Manufacture of machinery and equipment	2.7	3.3	83.5	21.5	7.0	-1.9	-19.1
Manufacture of motor vehicles	3.8	3.2	90.2	22.8	7.3	-7.7	-8.9
Other manufacturing	5.1	12.6	62.5	4.3	-1.8	2.8	-8.7

**Growth of Manufacturing structure and changes in 2019, as per cent**



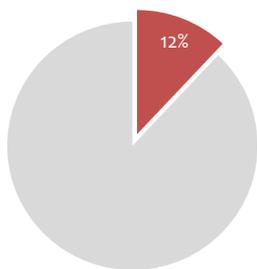
In 2020, the growth of the manufacturing will be constrained by the uncertainty of the situation in the global economy, especially the expansions of COVID-19 epidemic, which does not allow to anticipate the expansion of export opportunities.

**Manufacturing Volume Index and Structure by Levels of Technology 2013 = 100, structure in 2019, as per cent**

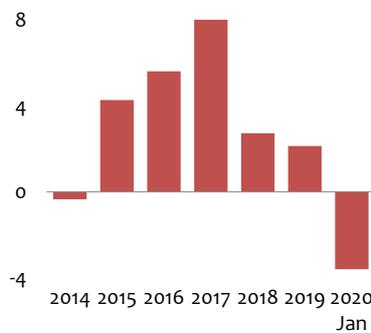


**Main Indicators in Manufacturing<sup>1</sup>**

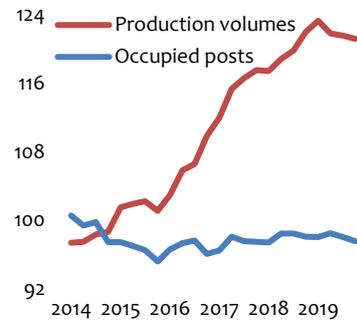
**Share in total value added 2019, as per cent**



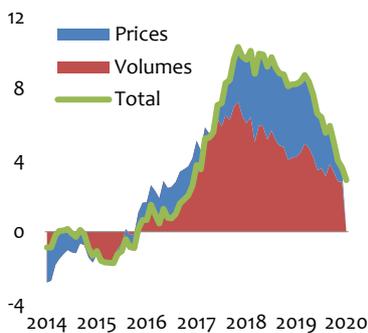
**Changes in production volumes as per cent**



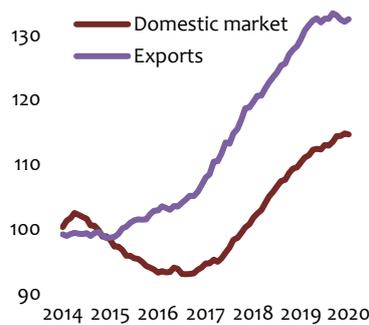
**Production volumes and occupied posts Q4 2013 = 100**



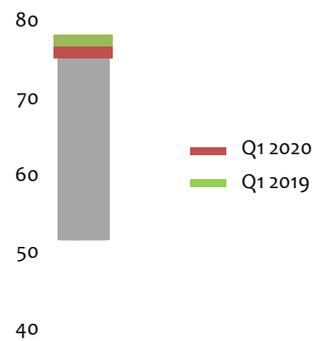
**Changes in sales of production 12-month moving average**



**Production sales December 2013 = 100, 12-month moving average**



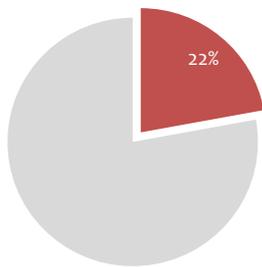
**Capacity utilization rate Historically highest/lowest level, as per cent**



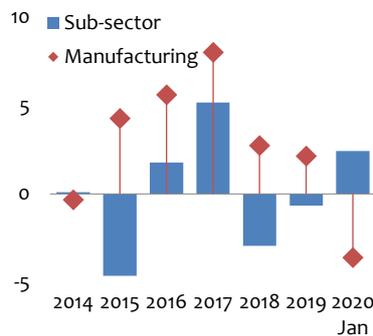
<sup>1</sup>Sales data available until January 2020

Manufacture of food products and beverages

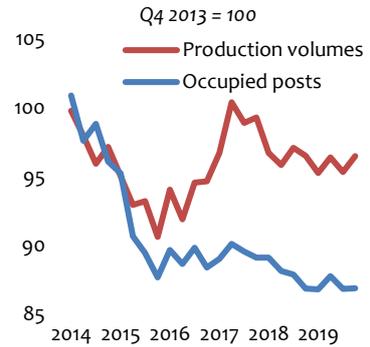
Share in total manufacturing 2019, as per cent



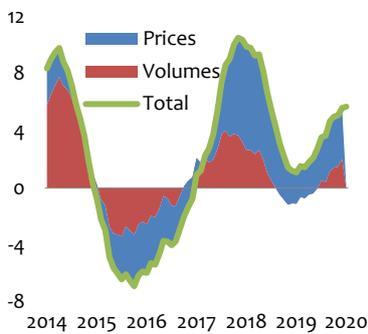
Changes in production volumes as per cent



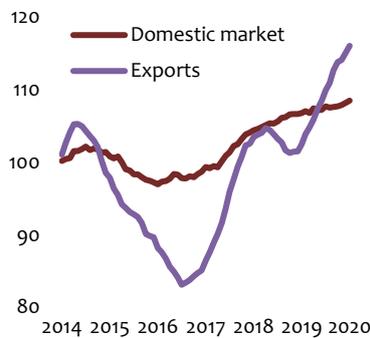
Production volumes and occupied posts



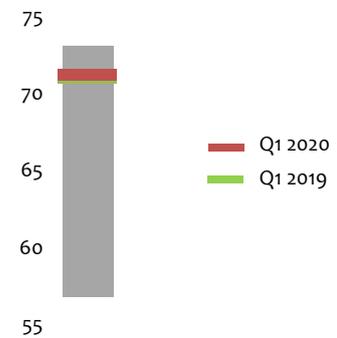
Changes in sales of production 12-month moving average



Production sales December 2013 = 100, 12-month moving average

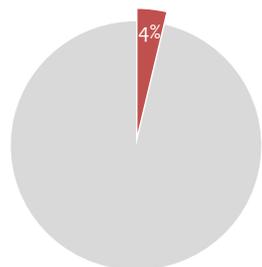


Capacity utilization rate Historically highest/lowest level, as per cent

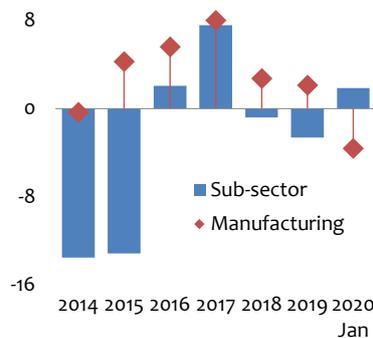


Light industry

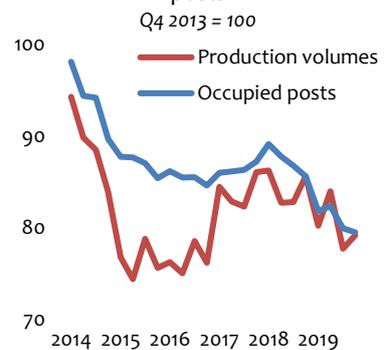
Share in total manufacturing 2019, as per cent



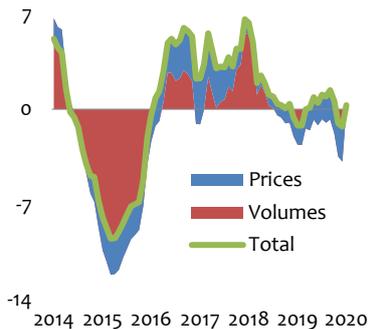
Changes in production volumes as per cent



Production volumes and occupied posts



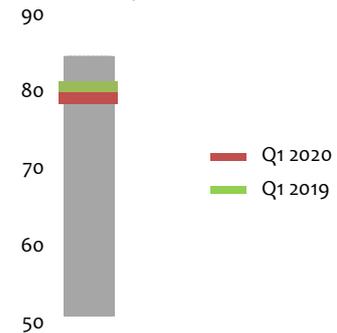
Changes in sales of production 12-month moving average



Production sales December 2013 = 100, 12-month moving average

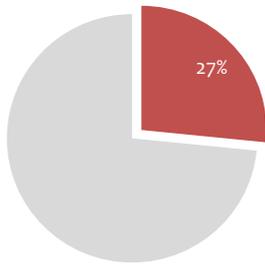


Capacity utilization rate Historically highest/lowest level, as per cent

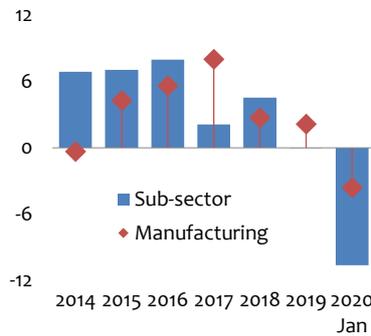


Manufacture of wood and articles of wood

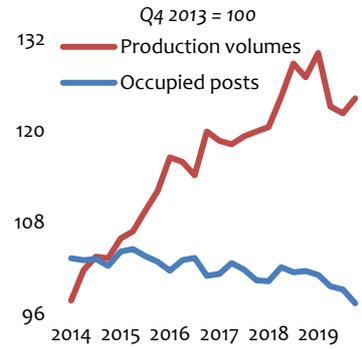
Share in total manufacturing 2019, as per cent



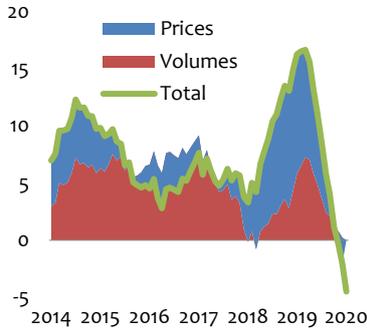
Changes in production volumes as per cent



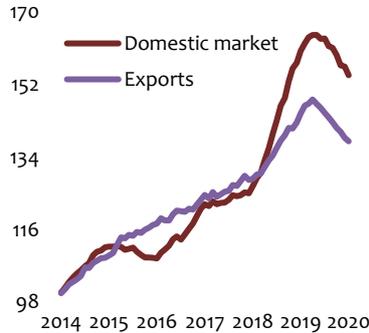
Production volumes and occupied posts



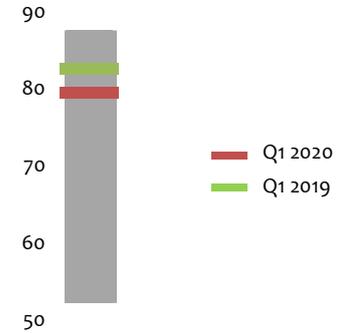
Changes in sales of production 12-month moving average



Production sales December 2013 = 100, 12-month moving average

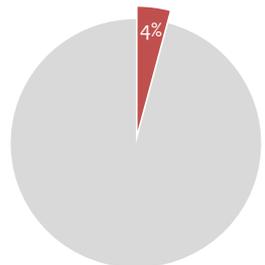


Capacity utilization rate Historically highest/lowest level, as per cent

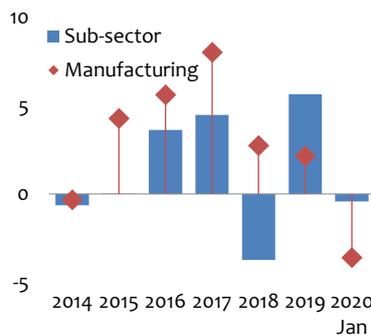


Manufacture of paper and paper products

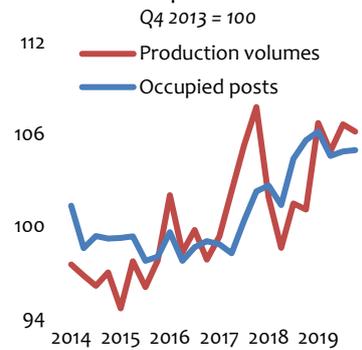
Share in total manufacturing 2019, as per cent



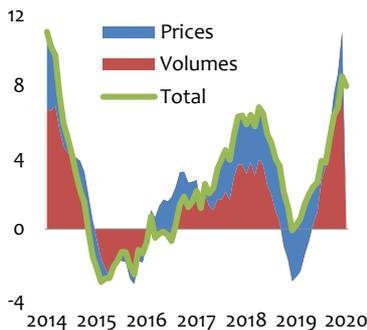
Changes in production volumes as per cent



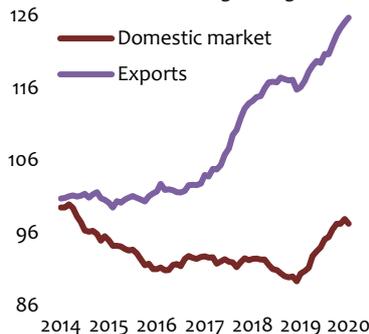
Production volumes and occupied posts



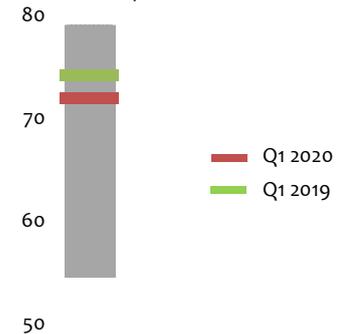
Changes in sales of production 12-month moving average



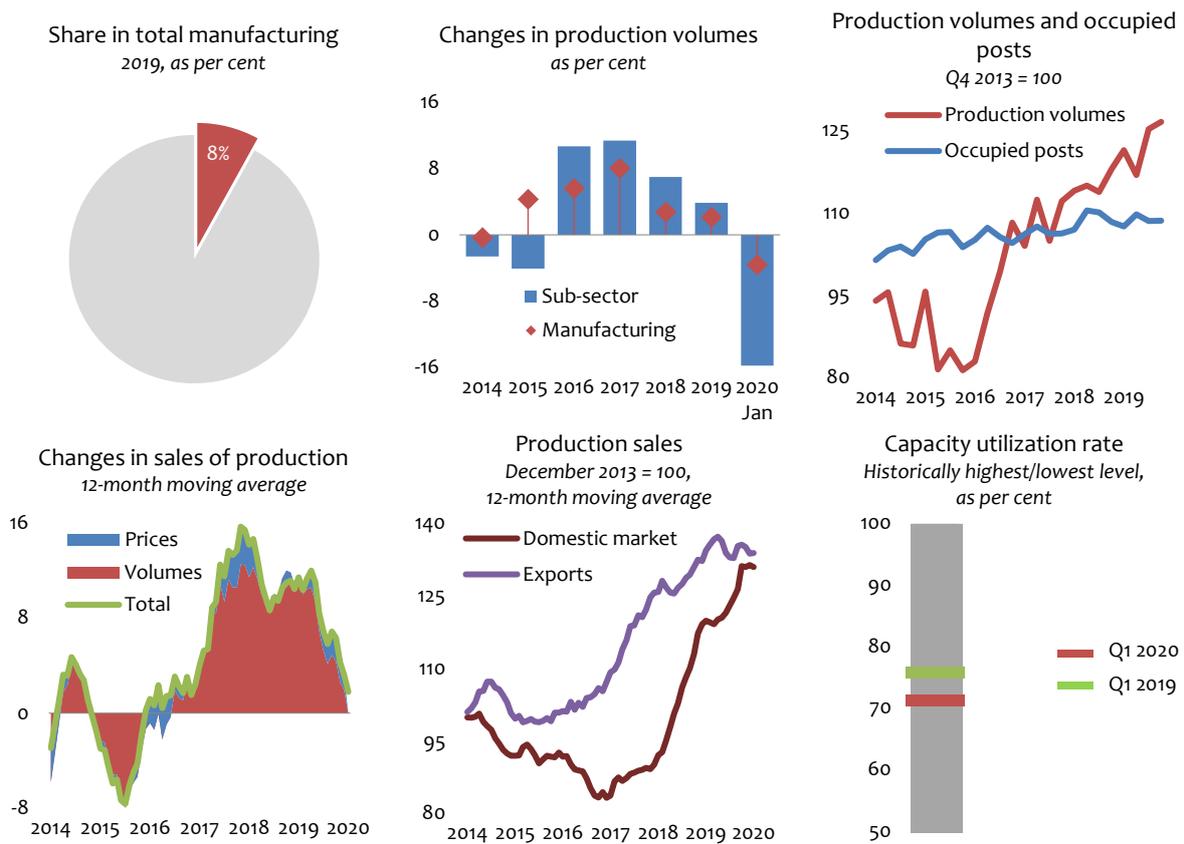
Production sales December 2013 = 100, 12-month moving average



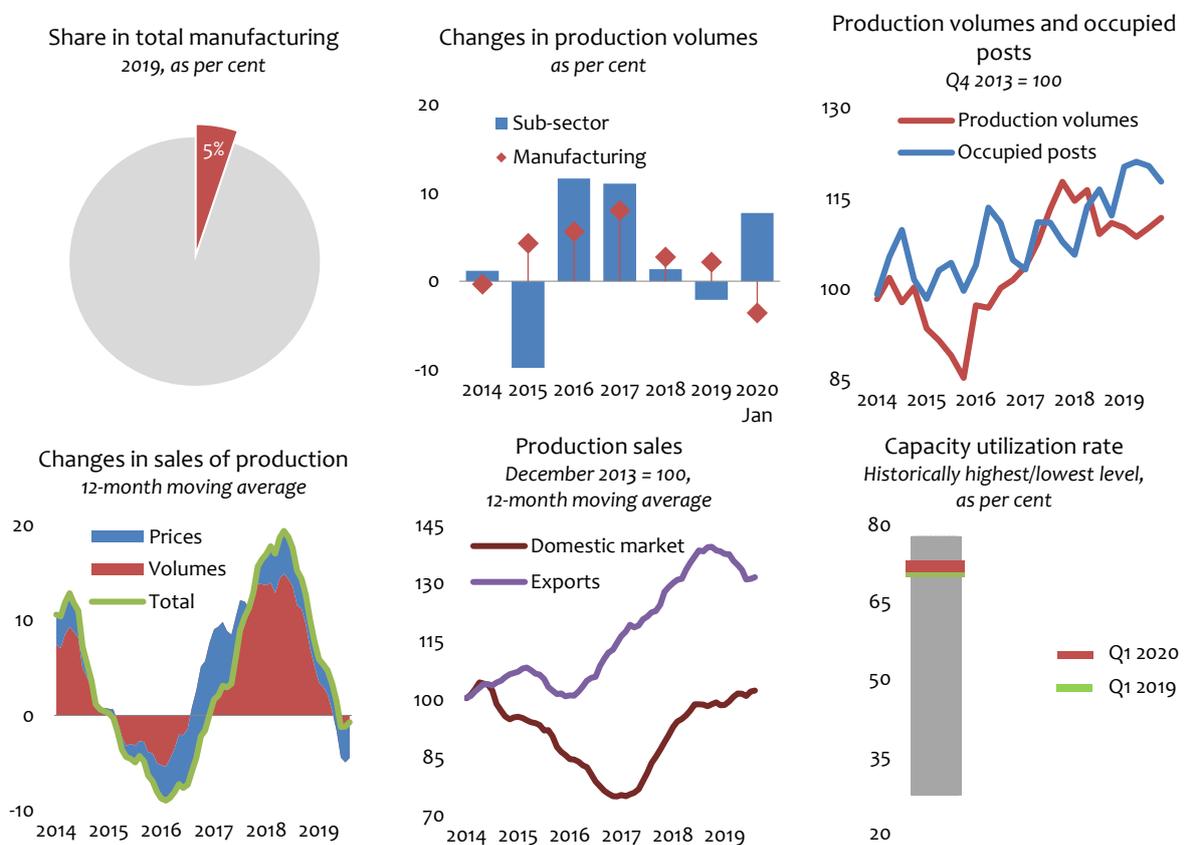
Capacity utilization rate Historically highest/lowest level, as per cent



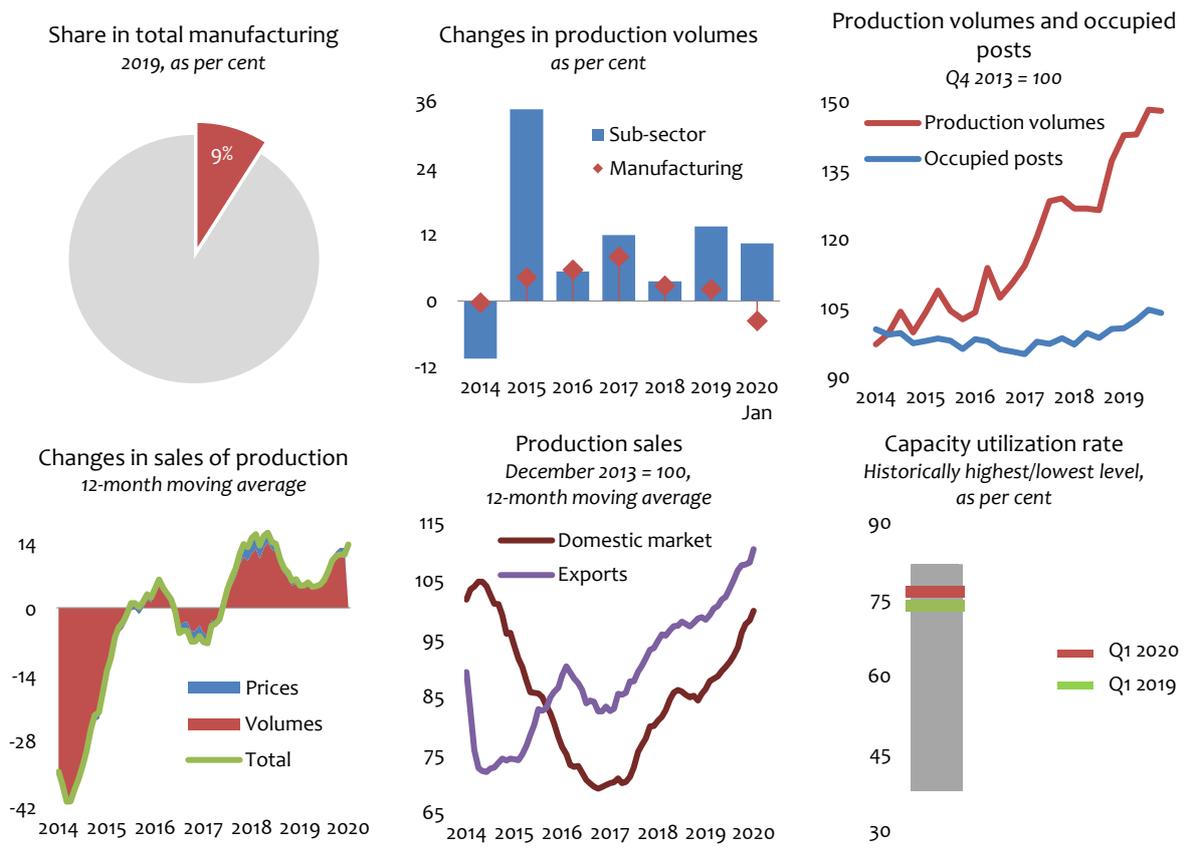
Manufacture of chemicals and chemical products



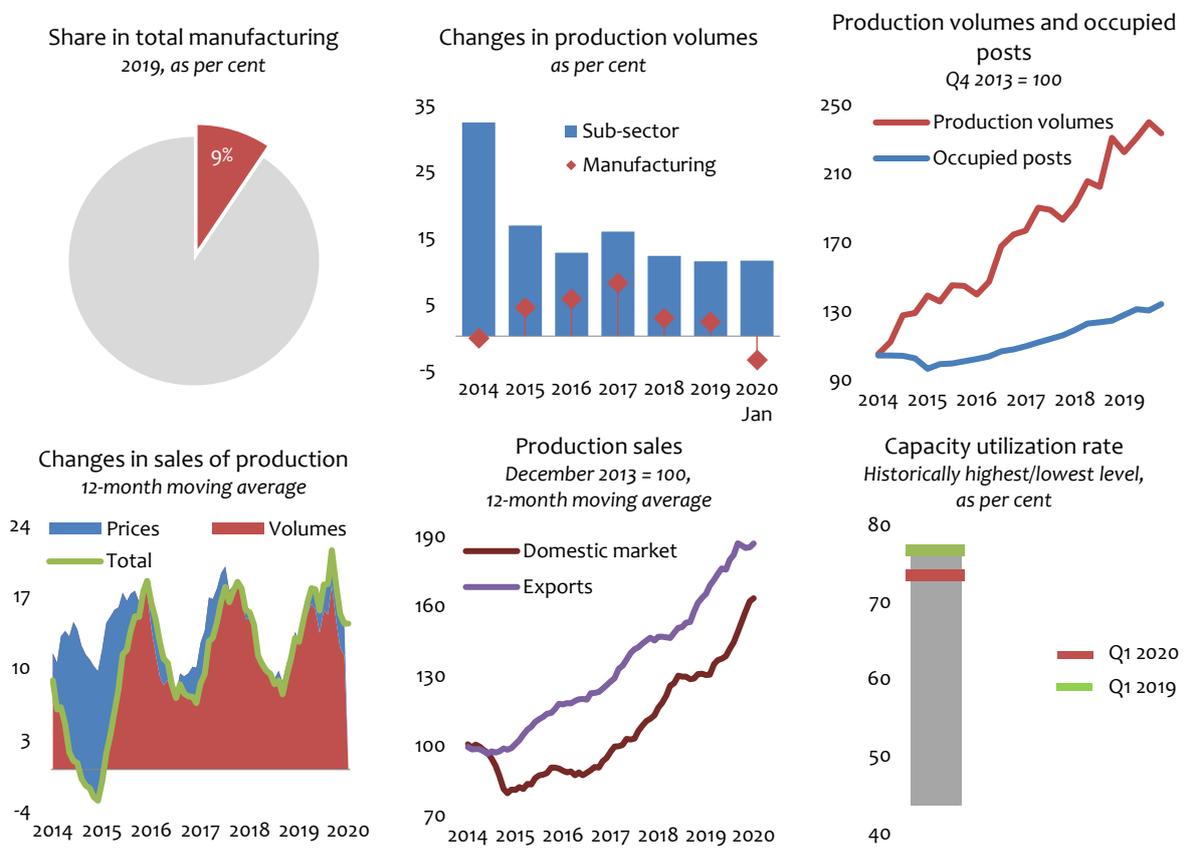
Manufacture of non-metallic mineral products



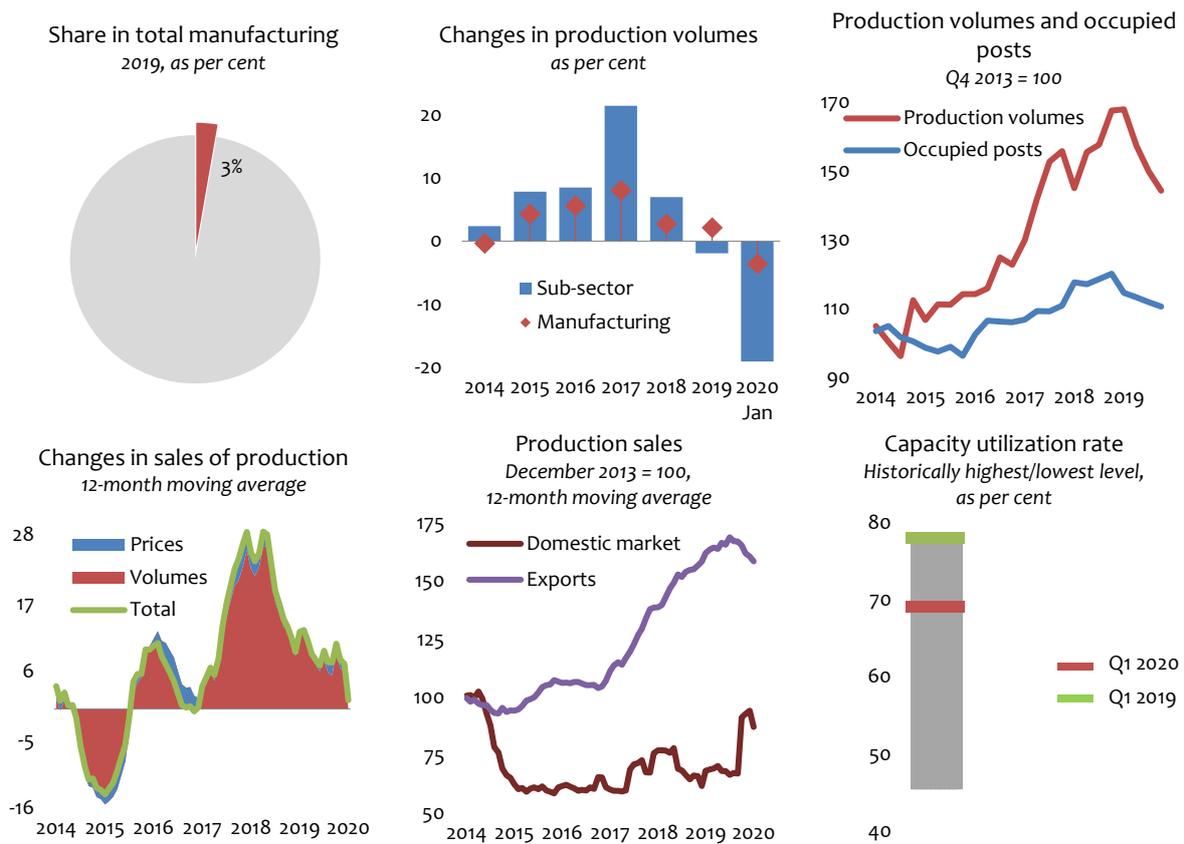
Manufacture of basic metals and fabricated metal products



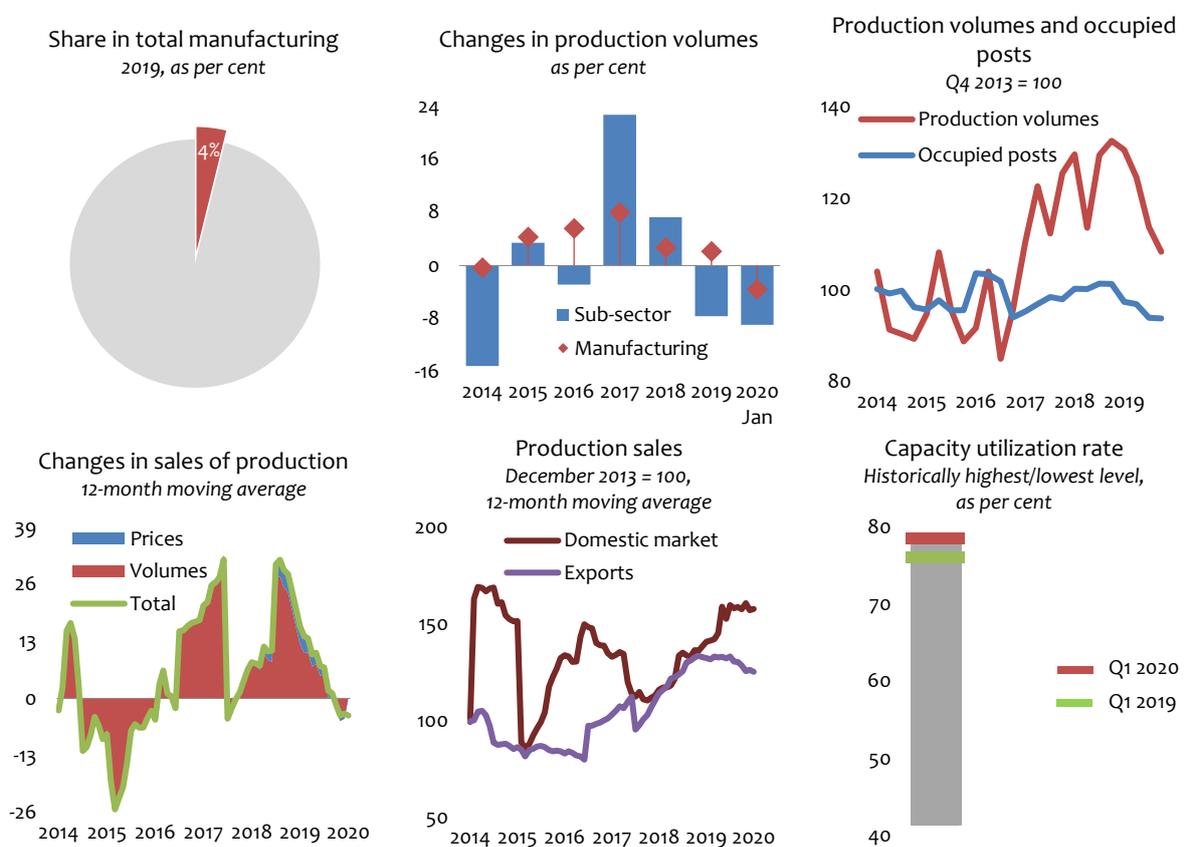
Manufacture of computer, electronic, and optical products



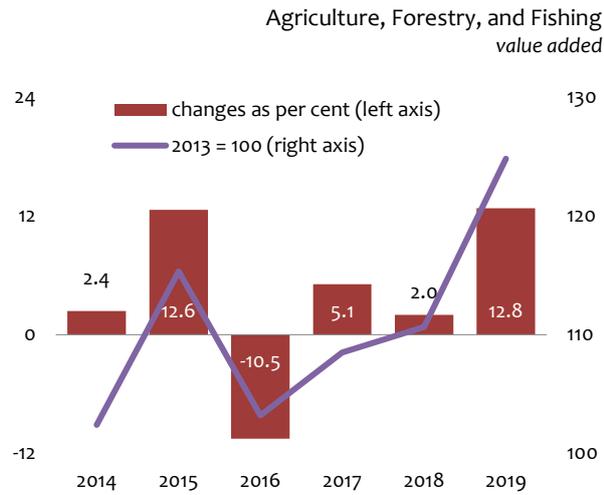
Manufacture of machinery and equipment



Manufacture of motor vehicles

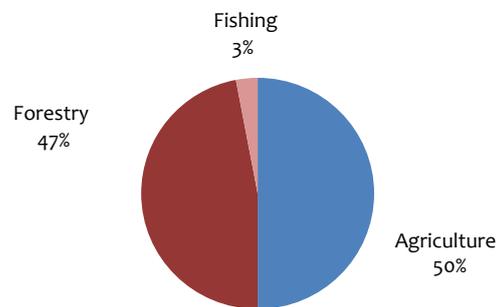


AGRICULTURE, FORESTRY, AND FISHING



Overall, in 2018, a moderate growth was observed, which was mainly determined by the growth in the forestry sector. However, in 2019, production volumes significantly increased due to favourable weather conditions and the rapid growth of the crop production sector. Both the number of employed and the number of occupied posts has been gradually growing, currently exceeding the pre-crisis level. Occupied posts, however, are growing at a higher rate, which implies that the sector is increasingly using paid labour.

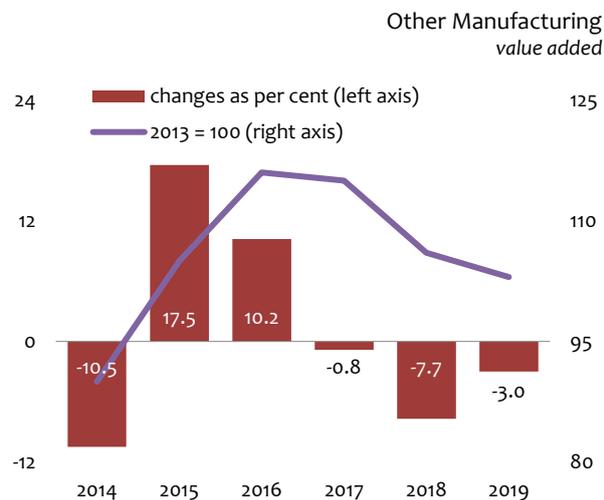
Structure of Agriculture, Forestry, and Fishing 2019, structure as per cent



\*- forecast by the Ministry of Economics

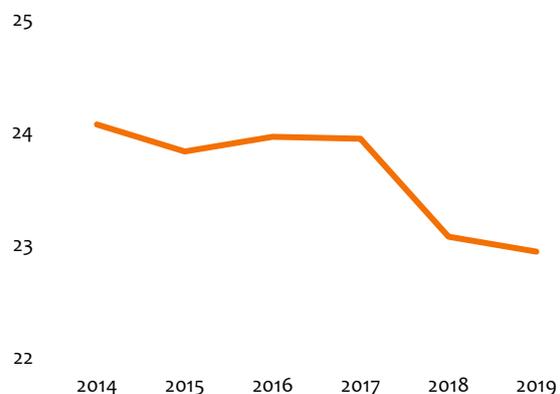
Agriculture and forestry provide the largest contribution to growth within the sector. The economic activity of the sector is closely tied to weather conditions. Thus, volatile growth within the sector can be observed. After a significant decline in the agricultural sector in 2016, in 2017, despite adverse weather conditions, the second highest average yield in Latvia's history was achieved.

OTHER MANUFACTURING



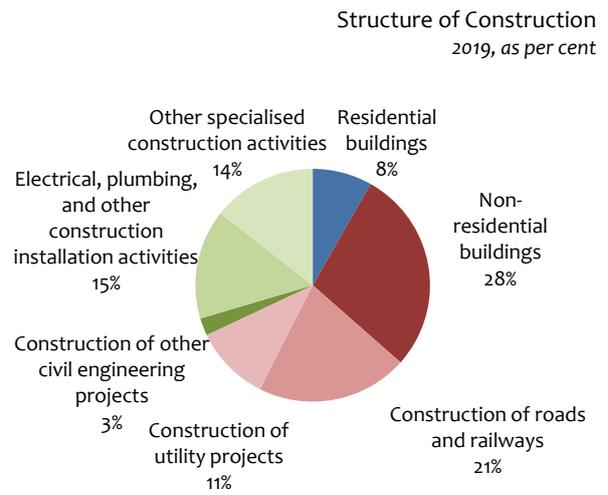
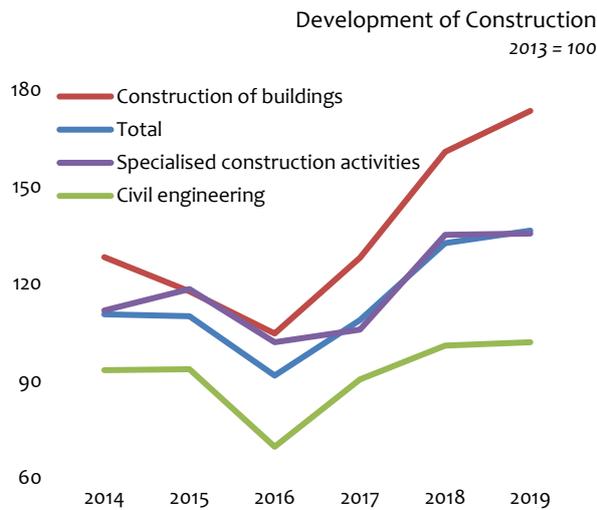
consumption during significantly colder winter months increased. In 2017-2019, however, production volumes in other manufacturing declined due to a downturn in electricity and gas supply, as sub-sectors were adversely affected by warm weather conditions. A decline in occupied posts can be observed in electricity, gas, steam, and air-conditioning supply sub-sectors.

Occupied Posts in Other Manufacturing in thousands



The largest share of added value in other manufacturing (incl. mining and quarrying, electricity, gas, steam, and air-conditioning supply, water supply, and waste management) provide electricity and gas supply sub-sectors. In 2015-2016, other manufacturing experienced a sharp increase, as electricity and thermal energy

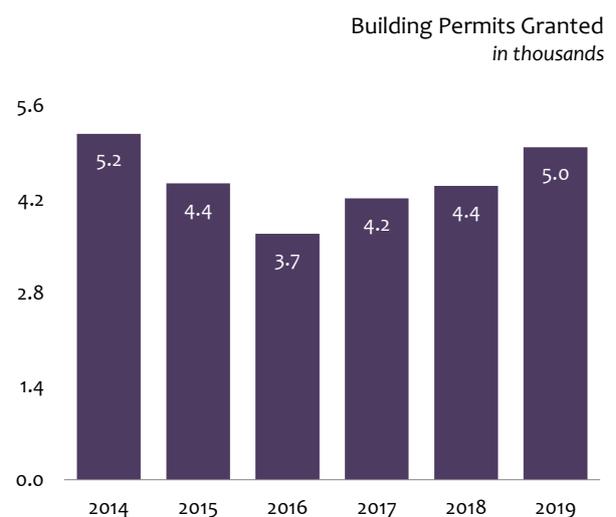
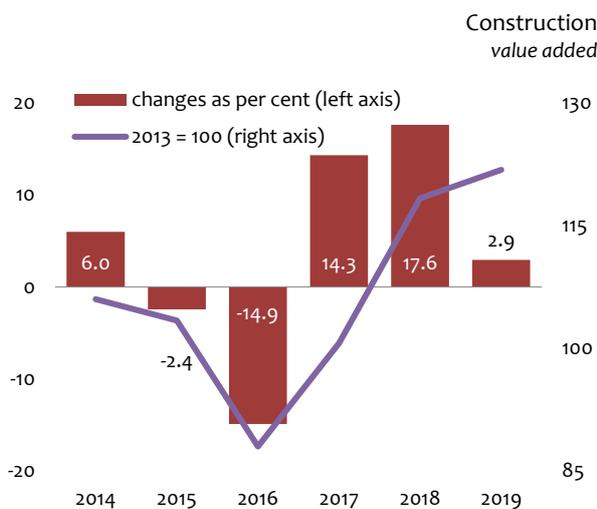
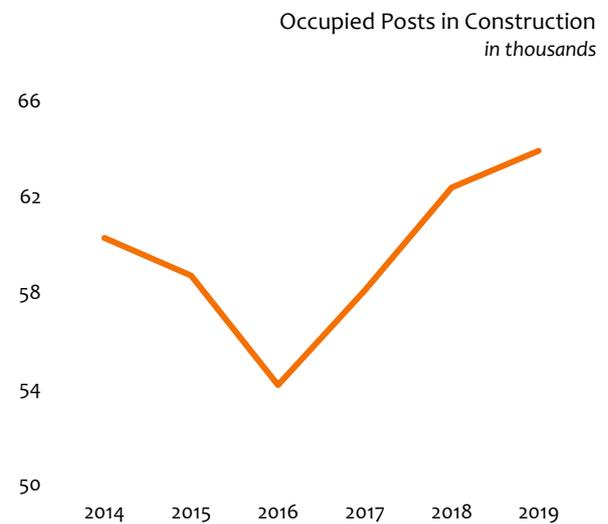
CONSTRUCTION



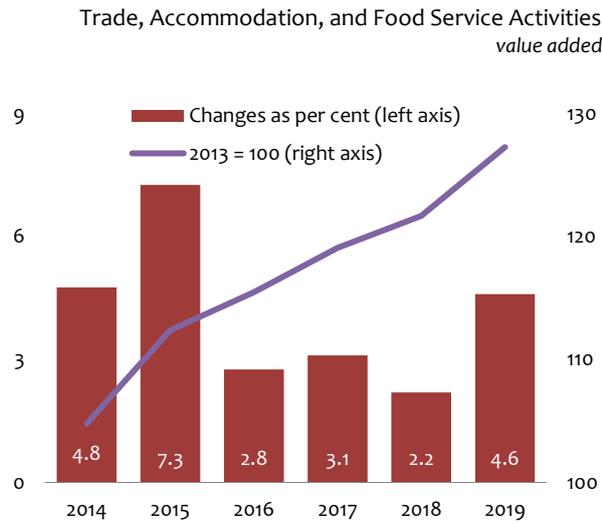
Although the volume of construction output in 2019 continued to increase for the third consecutive year, the growth was relatively meager. In 2019, construction grew by 2.9%, compared to 2018.

The base effect (i.e., the high growth rates achieved in the previous years) is one of the explanations of subdued growth within the sector. The development of construction is influenced by the completion of large construction projects and peaked investment flows of the EU structural funds.

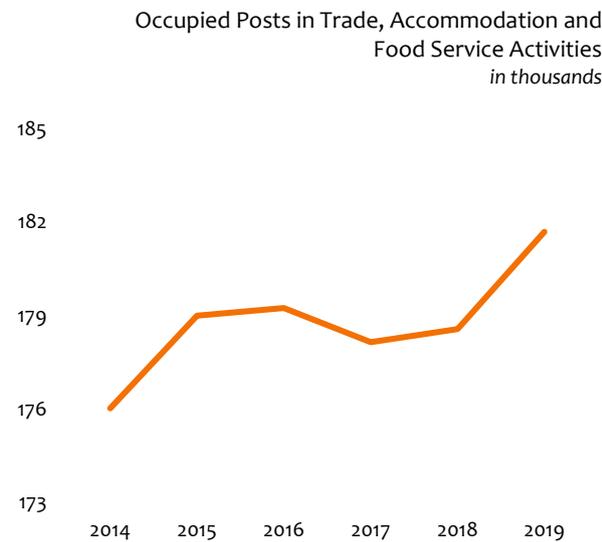
In 2019, construction volumes increased in all its sub-sectors. The most significant contribution to growth provided the construction of buildings, where construction volumes picked up by 7.8%. However, both civil engineering and specialized construction activities experienced a subdued economic growth.



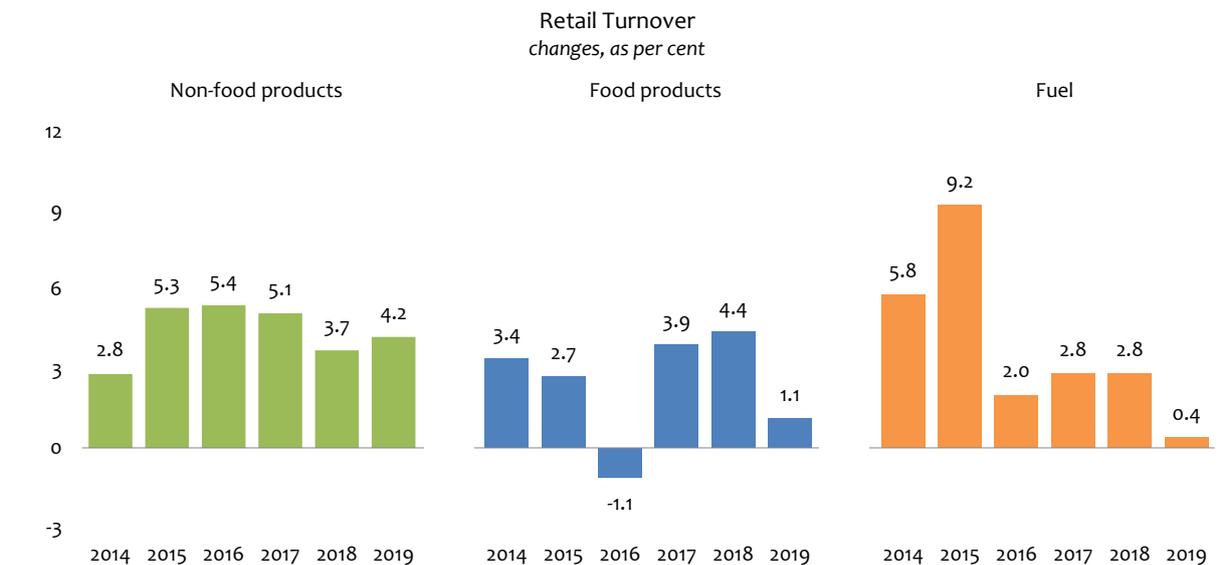
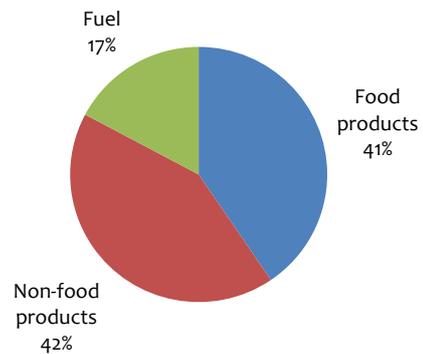
TRADE, ACCOMMODATION, AND FOOD SERVICE ACTIVITIES



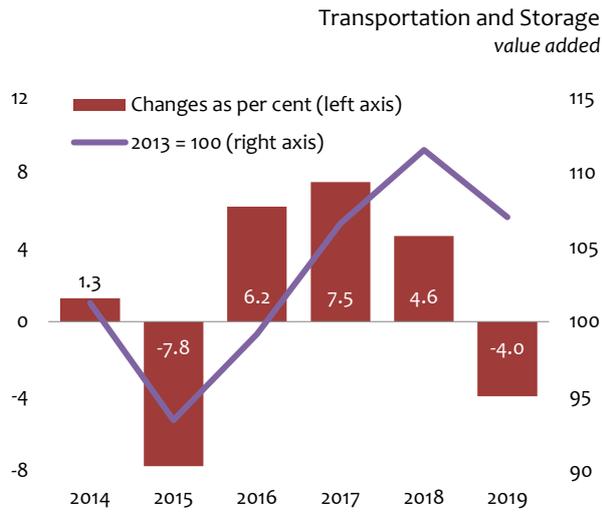
The volume of services provided by trade, accommodation, and food services continue to increase. The sector is positively affected by the rise in private consumption, increase in wages, and improvements in the labour market. In 2019, an increase of 4.1% was observed. In 2019, retail sales turnover increased by 2.4%. The largest rise in sales was observed for non-food products. In turn, the turnover of wholesale sector at current prices in 2019 increased by 4%. Accommodation and food services activities are positively affected by the development of tourism. In 2019, sector volumes increased by 8%. The largest share of occupied posts remains in trade, but in recent years it has been declining as occupied posts in accommodation and food service activities have grown faster.



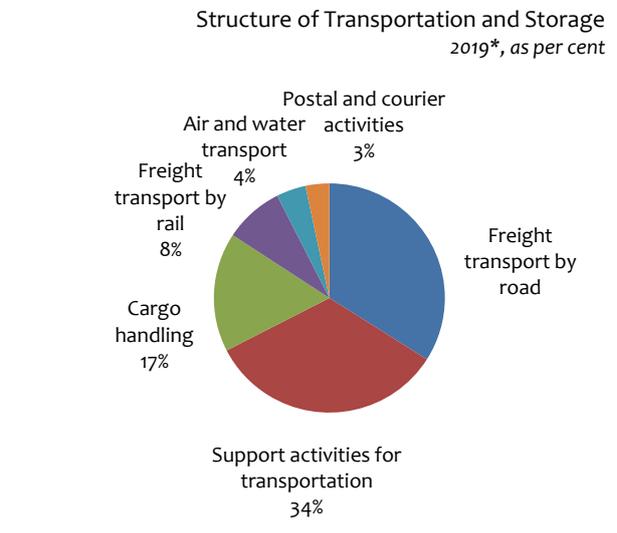
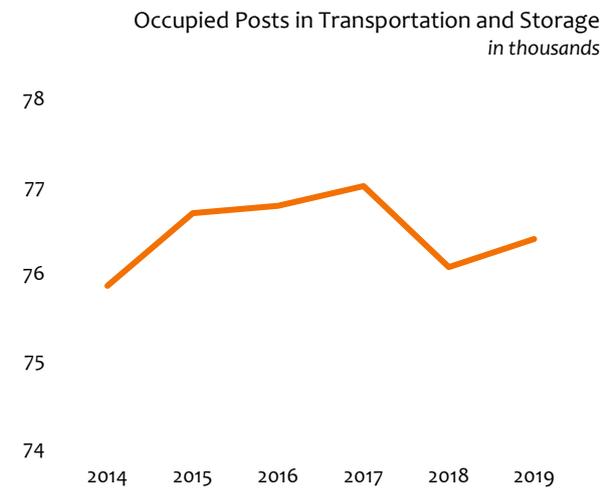
Structure of Retail Turnover 2019, as per cent



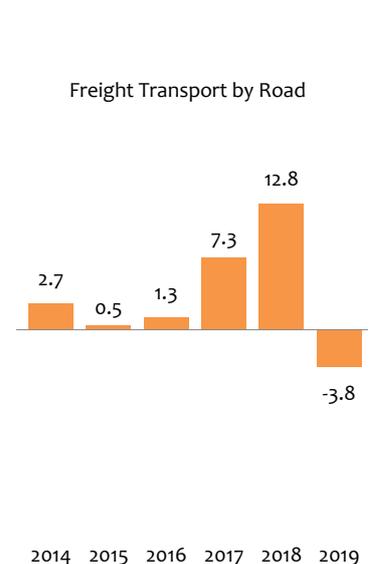
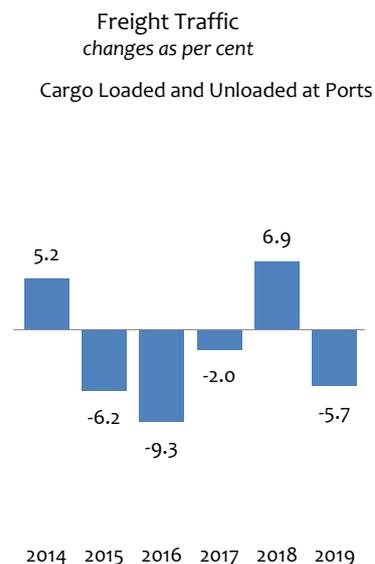
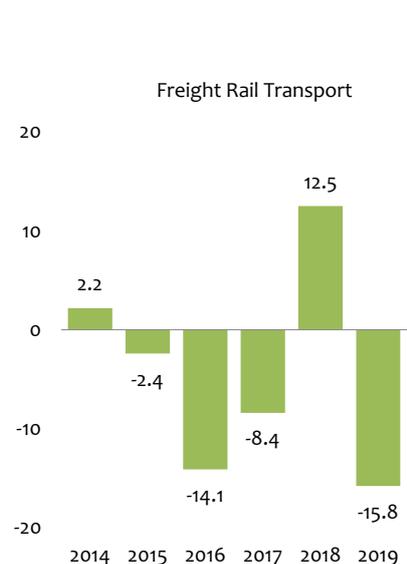
TRANSPORTATION AND STORAGE



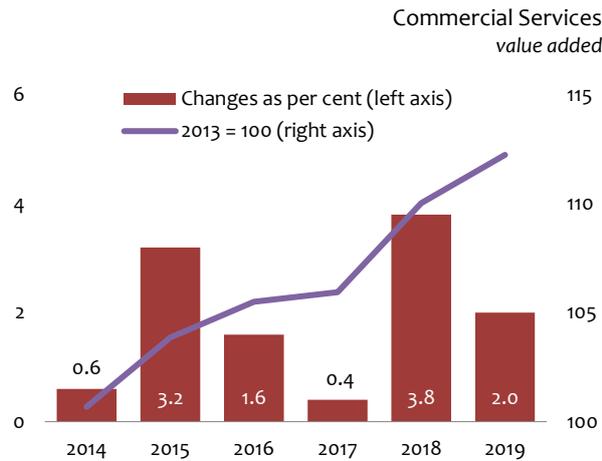
Transportation and storage is closely linked to international transportation. Between 2014-2019, the sector's volumes increased only by 1.1% annually, reflecting a decline in freight transport caused by Russia's transport policies and increased competition. Since the end of the 1990s, Russia has aimed at developing its own transport infrastructure, thus ensuring its independence from transit countries. Despite the decline in transit freight by rail and at ports, the growth in recent years has been driven by road transport and the increase in the number of passengers at airports and seaports. In 2019, a downturn in the sector was determined by a decline in freight transport and support activities for transportation. Freight transport decreased in all modes of transport, while passenger transport increased by 7%, postal and courier activities – by 18 per cent.



\* – forecast by the Ministry of Economics

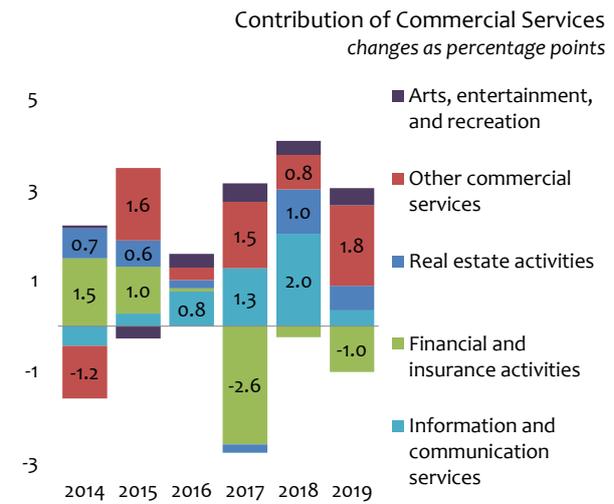


COMMERCIAL SERVICES

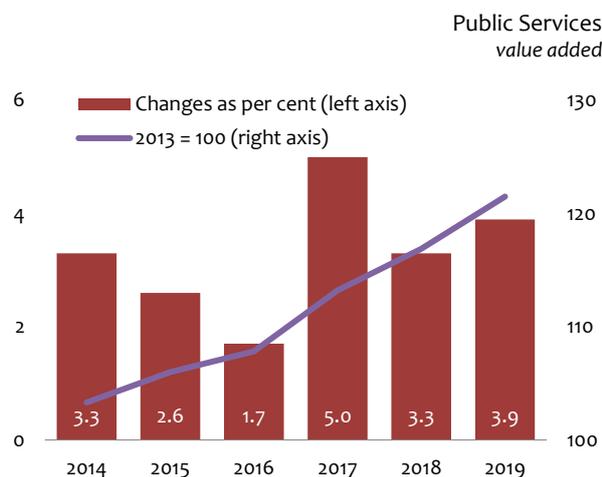


recreation sectors had a small upward effect. However, a decline was recorded in financial and insurance activities. Downturn to a large extent can be attributed to the decline of non-resident deposits, bank mergers and acquisitions, and declining number of employed. The largest share of occupied posts remains in professional, scientific, and technical services, administrative and support service activities, and ICT services, where the largest growth in occupied posts in recent years has been observed.

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 2019, service volume increase in professional, scientific, and technical services and administrative and support service activities provided the largest contribution to the growth. Also, the increase in real estate activities, information and communication services and the arts, entertainment and

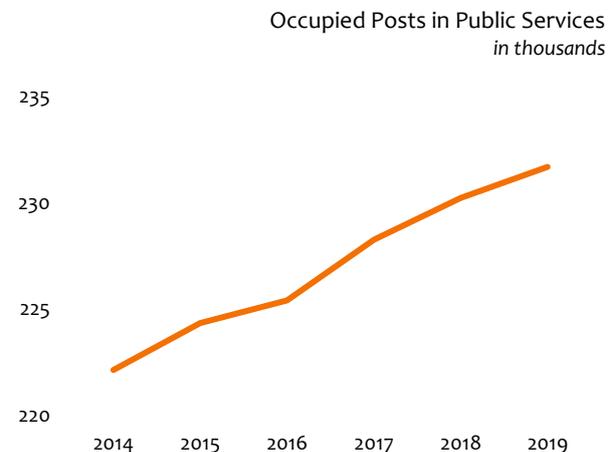


PUBLIC SERVICES



rapidly. In recent years, public spending on defence, health, and education has increased significantly. The largest share of occupied posts remains in education. However, the shares of occupied posts are quite similar in public administration and social work activities. In recent years, the largest rise in occupied posts has been observed in health care. Also in 2019, there was an increase in occupied posts in health care. However, the number of occupied posts declined in public administration.

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. Since 2013, along with an increase in government spending, a steady growth in public services has been observed. In 2017, the largest growth since 2006 was recorded. Also, in 2019, the sector continued to grow



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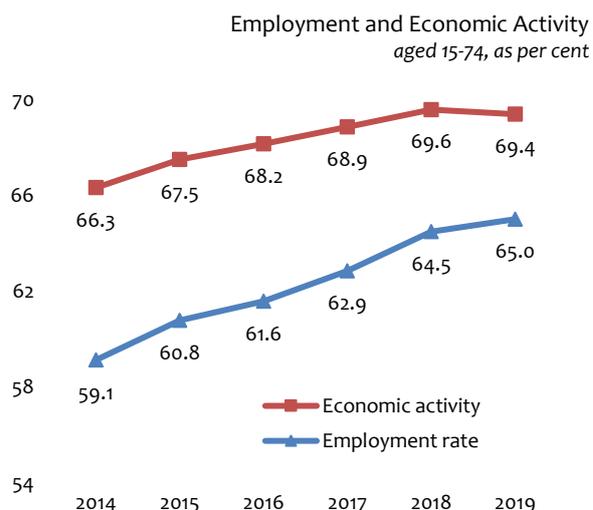
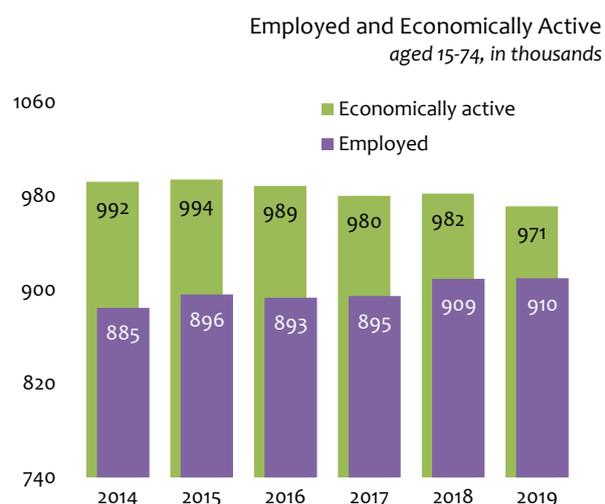
# LABOUR MARKET

## EMPLOYMENT AND UNEMPLOYMENT

In 2019, a major driver of the labour market activity was the development of domestic demand-oriented sectors. An increase in occupied posts was observed in construction and trade. At the same time, demographic processes are increasingly affecting developments in the labour market. The decline in working-age population reduces labour supply, thus adversely affecting free labour force reserves. In 2019, unemployment rate declined to 6.3%, reaching the lowest rate in the last decade. At the end of February 2020, the number of registered vacancies in State Employment Agency was by 23% higher than a year ago.

differences between the increase in the number of occupied posts and the number of employed in normal working time units. If the number of occupied posts in 2019 increased on average by 1.0%, then the average number of employed in normal working hours increased by only 0.7%. As a result, increasingly more people are employed in several jobs at the same time, and the number of part-time jobs in the labour market is increasing.

In 2019, employment is on the rise. Overall, in 2019, the employment rate increased to 65%, which was by 0.5 percentage points higher than in 2018. Therefore, the employment rate remained at the historically highest level.



The slowdown in economic growth is affecting the dynamics of employment. With the slowdown in economic activity, the increase in the number of employed in 2019 has essentially ceased. Overall, in 2019, the number of employed increased by merely 0.1% or 0.6 thousand, compared to 2018.

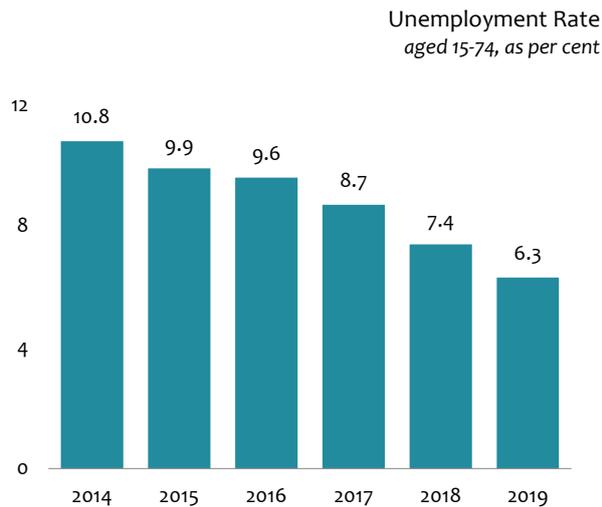
Economic activity has reached its highest level so far, currently remaining close to its potential. Thus, further improvements can only be achieved by addressing structural imbalances – in particular, regional labour market differences and skills mismatches.

It should be noted that along with a decline in economic activity in the economy, the stagnation of the number of employed has long been influenced by negative demographic trends. The decrease in the working age population and changes in the age structure significantly limit the entry of new workers into the labour market, which ultimately also affects the dynamics of the total number of employed.

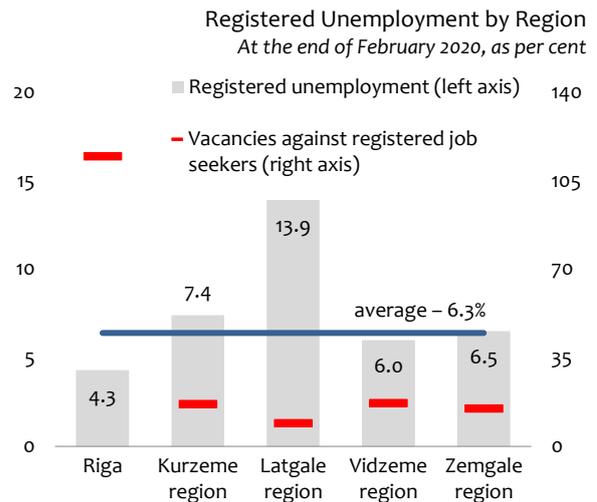
In 2019, economic activity declined by 0.3 percentage points, compared to 2018, reaching 69.4% amongst population aged 15-74. Overall, economically active population declined by 10.9 thousand, descending to 971.3 thousand.

Also, increasingly more labour needs are outweighed by productivity gains. Thus, fewer employees are needed to perform certain jobs. This is further illustrated by the

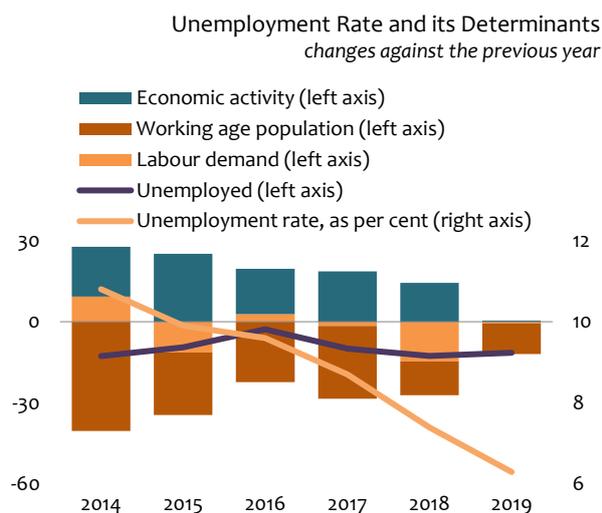
The most significant constraints to the increase in the number of employed and economically active population pose negative demographic trends. In 2019, population aged 15-74 declined by 11.3 thousand or 0.8%, compared to 2018.



In 2019, unemployment rate declined to 6.3%, thus closely approaching the level of year 2007. Overall, in 2019, the number of unemployed decreased by 61.3 thousand (by 11.5 thousand less than a year ago).

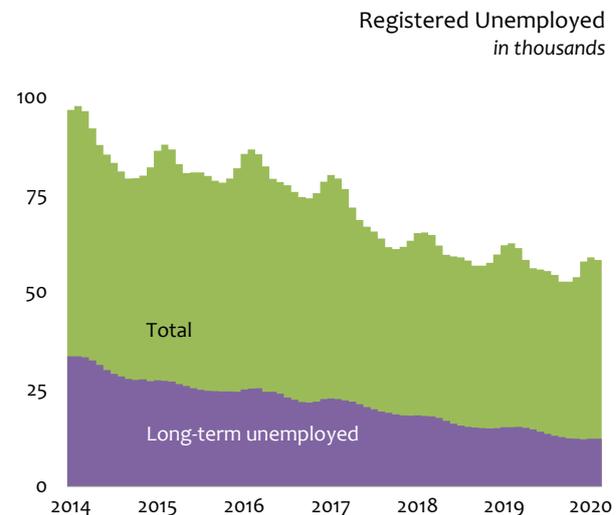


Also, significant risks are posed by the relatively high share of long-term unemployed – nearly 1/4 of registered job seekers are currently unemployed for more than a year.



Overall, in 2019, the unemployment rate in Latvia was about 0.4 percentage points lower than in the EU27 (on average 6.7%), but it remained significantly higher than in Estonia (4.4%). In Lithuania, the unemployment rate in 2019 increased by 0.1 percentage points, compared to 2018, reaching 6.3% annually.

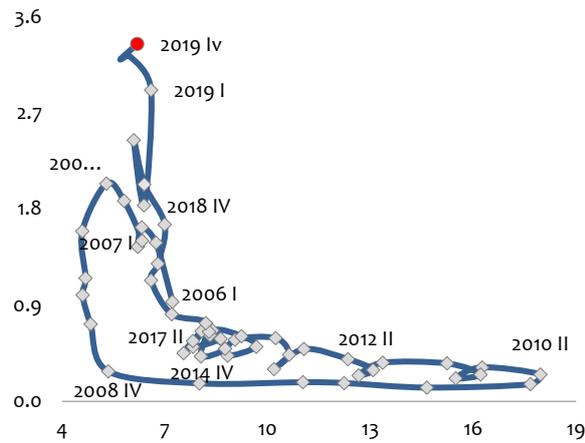
**The decline in unemployment continues to be hampered by regional labour market differences** – the unemployment rate in Latgale region is more than 3 times higher than in Riga. Coupled with low labour force mobility, it poses high risks of structural unemployment.



A large share of long-term unemployed can lead to an increase in structural unemployment – the longer these people remain unemployed, the higher the risks of losing the necessary skills required for the job.

Structural problems in the labour market are further illustrated by the right shift of the Beveridge curve – despite the increase in vacancies, the share of job seekers in the labour market has remained high. It should be noted that the number of registered vacancies at the end of February 2020 was 33% higher than a year ago. At the same time, registered unemployment rate has declined only by 0.4%.

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



The largest increase in occupied posts can be observed in domestic demand-oriented sectors. In 2019, about 2/3 of the total increase in occupied posts was ensured by domestic demand-oriented sectors, half of which were provided by trade and construction.

During the last year, the number of occupied posts in construction increased by 1.5 thousand or approximately 2.4%. In 2019, the number of occupied posts reached approximately 64 thousand.

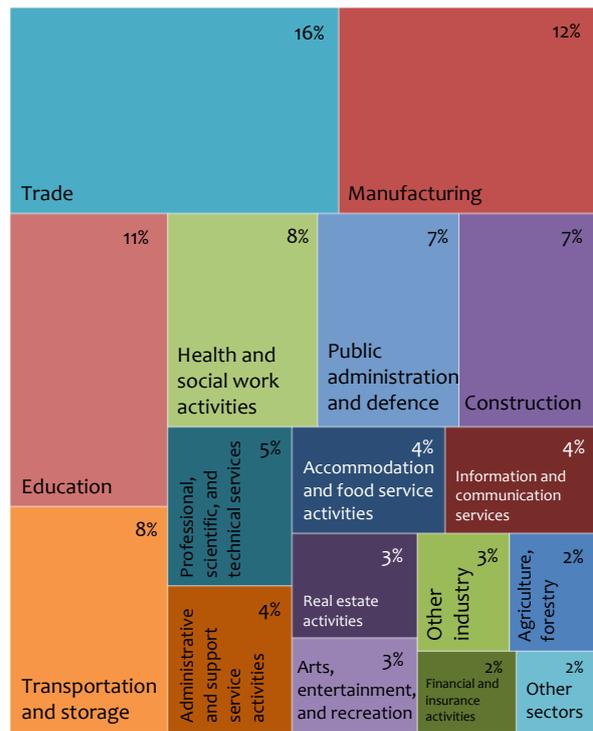
Similarly, a significant increase in labour demand can be observed in trade, where the number of occupied posts during the corresponding period increased by 1.8 thousand.

The largest increase in occupied posts can still be observed in the private sector – in 2019, the number of

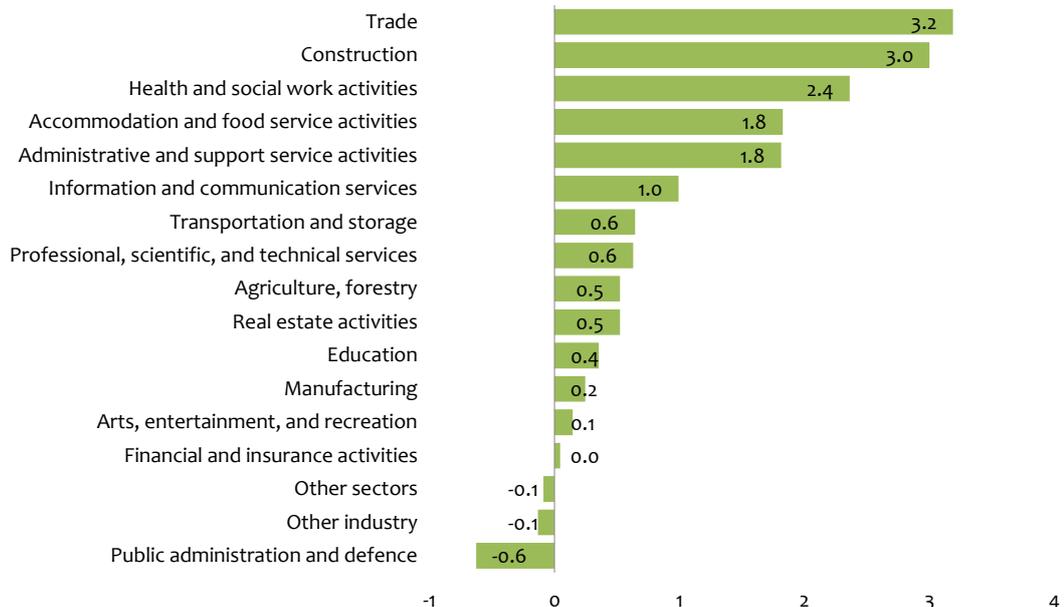
occupied posts rose by 9.7 thousand. It should be noted that after nearly a 30% job cut during the crisis, the number of occupied posts has returned to the pre-crisis level of 2006.

A decline in occupied posts can be observed in the public sector. In 2019, the number of occupied posts decreased by 700.

**Occupied Posts by Sector structure in 2019, as per cent**

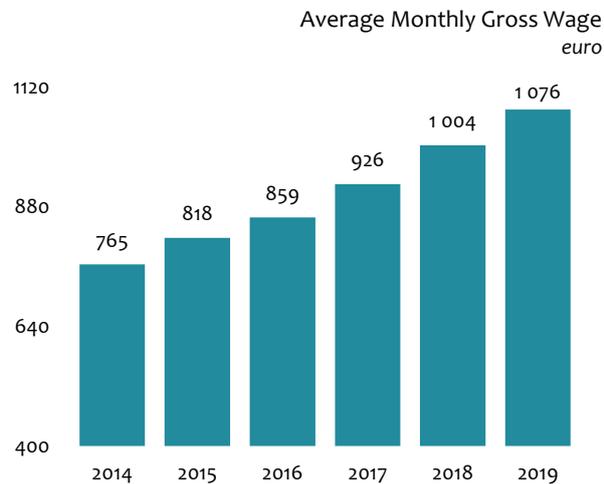


**Changes in Occupied Posts 2019 compared to 2018, in thousands**

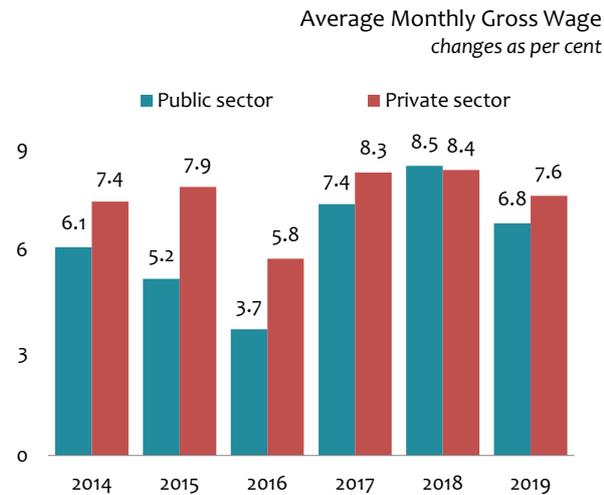


## WAGES AND SALARIES

Since 2010, along with the recovery in the labour market, wage increases have resumed. At the same time, rising demand for labour and declining working-age population increasingly impact labour availability and put continuous pressure on wages.

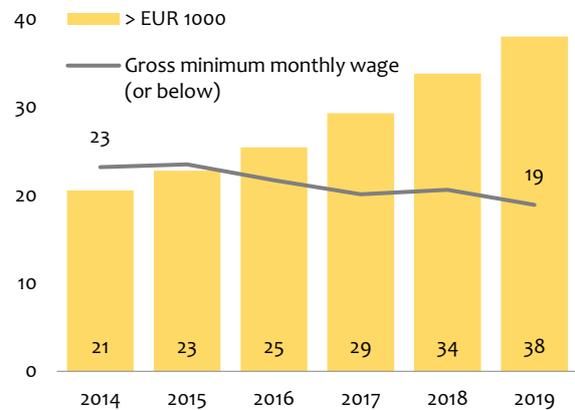


Over the last four years, wage growth on average has increased by 5% annually. In 2019, average gross wage increased by 7.8%, compared to 2018, reaching EUR 1,076.

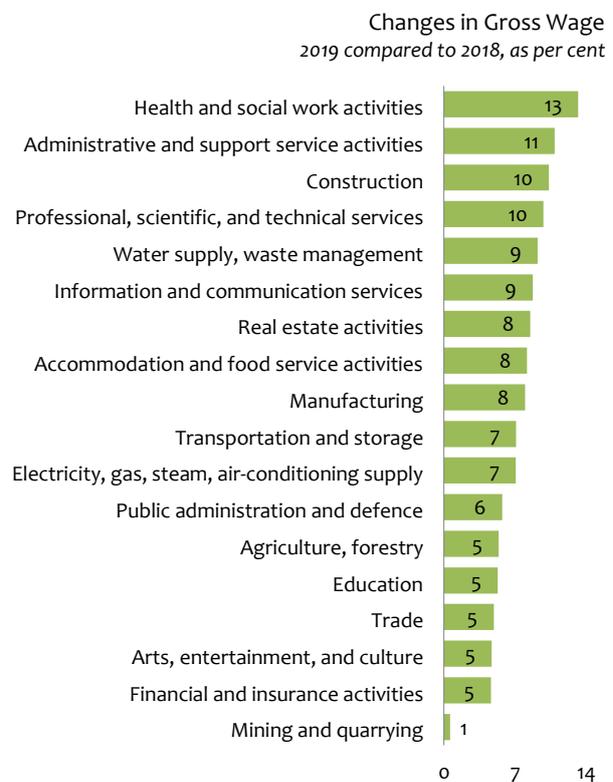


Since 2010, wage growth has been observed in both public and private sector. However, wages in private sector increased at a higher rate than in public sector. This can largely be attributed to the different labour demand dynamics across sectors in the economy. Since 2011, the number of occupied posts in the private sector has increased by 20.2%. However, an increase of only 1.3% has been observed in the public sector.

**Employee Gross Wage**  
as per cent of total number of employed



In 2019, wages grew in all major sectors of the economy. The largest wage increase was observed in health care and social work activities. In 2019, the average gross wage growth in the sector reached 13.2%. At the same time, lower wage growth was observed in mining and quarrying, other services (including activities of community, political and other organizations, repair of personal and household goods, dry cleaning, hairdressing, beauty care, funeral and other services) and finance and insurance activities. Remuneration in financial and insurance activities remains almost twice the national average.



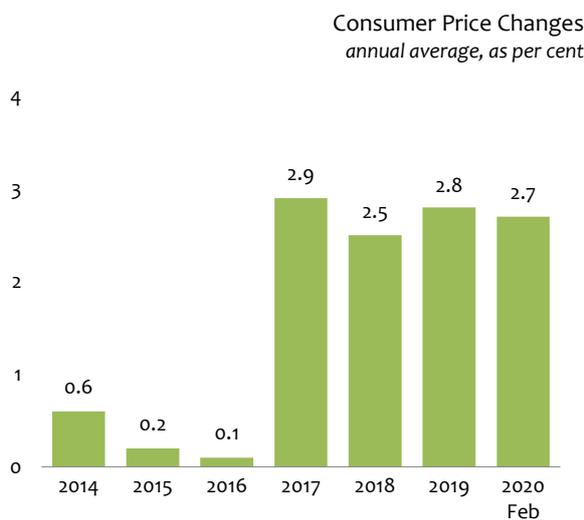
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# ECONOMIC STABILITY AND COMPETITIVENESS

## PRICES

In 2019, one of the largest price increases in recent years was observed. Consumer prices rose by 2.3%, but annual inflation rate was 2.8%. Rising prices for services and world price trends had a significant impact on consumer price levels.

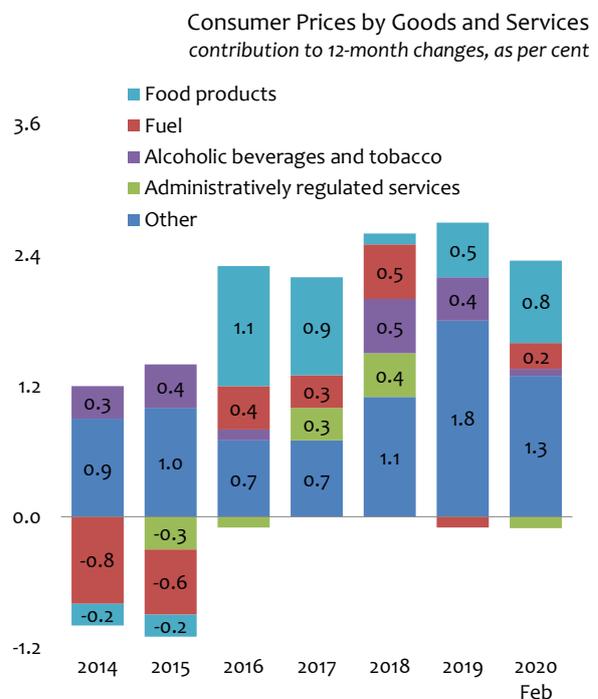
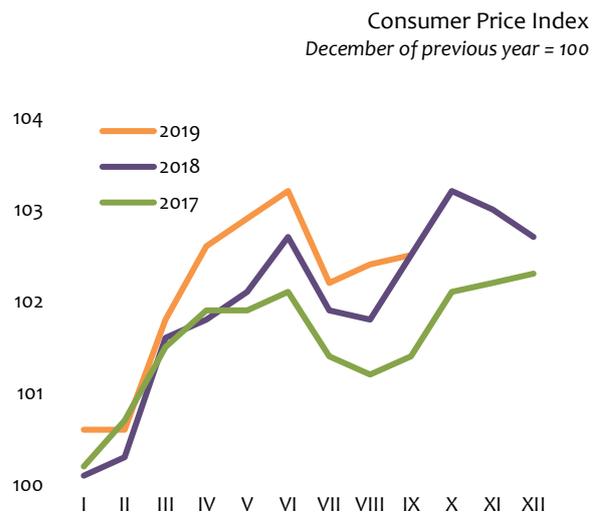
In the first two months of 2020, price dynamics have remained similar to the corresponding period of the previous year. In February 2020, compared to December 2019, consumer prices increased by 0.5%. Compared to February 2019, consumer prices increased by 2.3%. In February 2020, average annual inflation was 2.7 per cent.



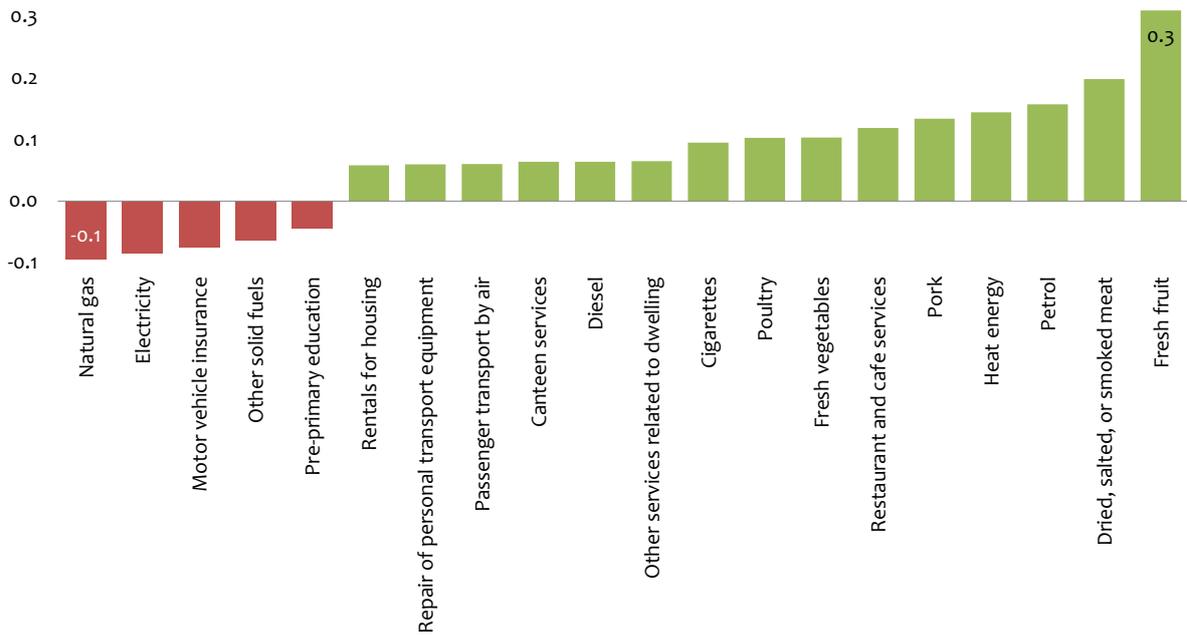
### Key factors affecting overall price level in 2019:

- (1) price increase for services – the largest impact was on price increases for catering, out-patient, recreation and cultural services, as well as for waste collection (due to the increase in the tax on natural resources for waste disposal);
- (2) rising food prices affected by pick up in world food prices. The largest upward effect had the rise in prices for meat, fresh fruit, bread and cereals. World food prices rose by 12.5% (an increase was observed in all major food groups except cereals);
- (3) an increase in prices for alcoholic beverages and tobacco products due to the rise in excise duty. The largest price increase was observed for beer and cigarettes;

(4) an increase in prices for electricity and heat (due to a tariff increase), which in turn was partially offset by a fall in natural gas prices due to a tariff reduction.



Consumer Price Changes by Goods and Services  
September 2019, contribution to 12-month changes, as percentage points

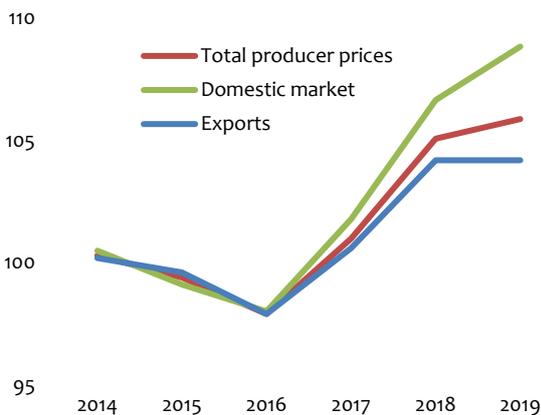


Overall, in 2020, the average annual inflation will be lower than in 2019. It will be primarily determined by the impact of the Covid-19 pandemic on the development of the global economy, as well as the associated fluctuations in world prices. Supply and demand shocks will work contrariwise and asynchronously, so inflation will be volatile.

In 2019, producer prices increased much more slowly than in 2018, producer prices in manufacturing in 2019 rose moderately.

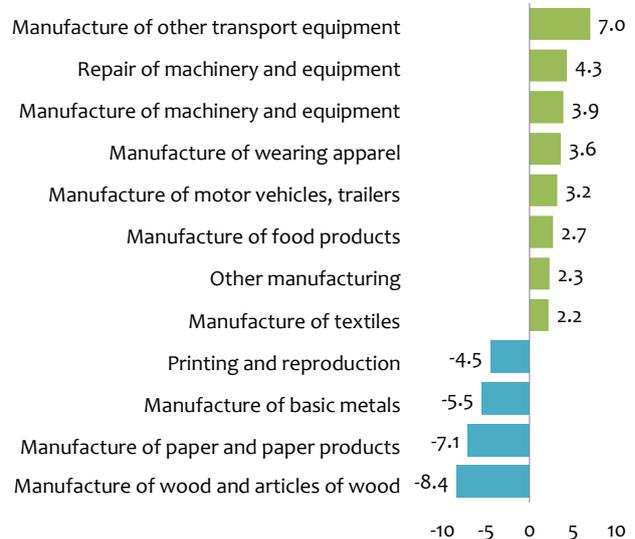
In 2020, it is anticipated that manufacturing producer prices could grow more slowly than in 2019 or even decrease. The level of producer prices is largely influenced by fluctuations in the producer prices of exported products, which are mainly determined by the dynamics of world raw material prices. It should be noted that world energy and raw material prices are currently declining. Fluctuations in the supply and demand of raw materials in the context of the Covid-19 pandemic will also have a significant impact on producer prices. At the same time, the growth of producer prices for products sold on the domestic market will continue to be influenced by economic growth.

Producer Prices in Manufacturing  
2013 = 100



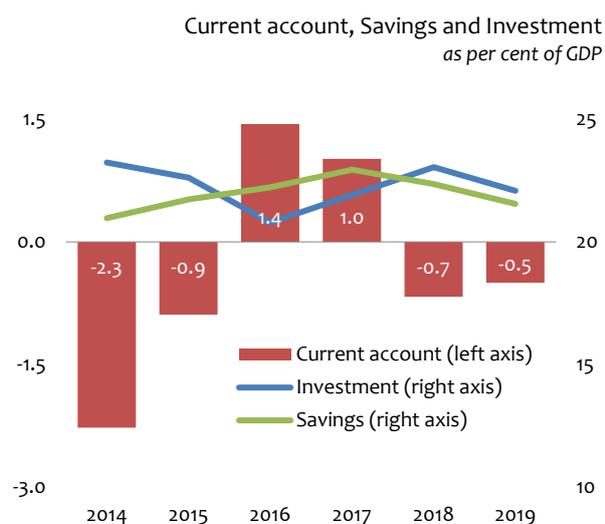
In 2020, producer prices in manufacturing remained practically unchanged. In the two months of 2020, producer prices in manufacturing increased by 0.2% compared to December 2019.

Producer Price Changes in Manufacturing in February 2020  
against the corresponding period of previous year, as per cent



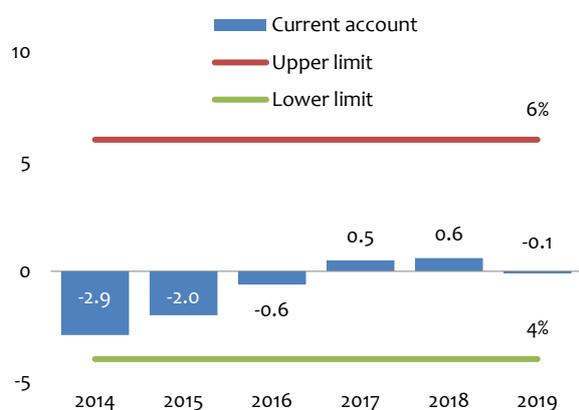
## BALANCE OF PAYMENTS

**Current account remains close to the balance.** In 2019, current account deficit reached 0.5% of GDP, which is lower than a year ago. Since 2017, the current account balance has shown a downward trend from a surplus of 1.4% of GDP in 2016 to a deficit of 0.7% of GDP in 2018. However, over the last three years (2016-2018), the current account does not exceed the indicative thresholds set by the EU Alarm Mechanism, and thus the current account is considered to be sustainable.



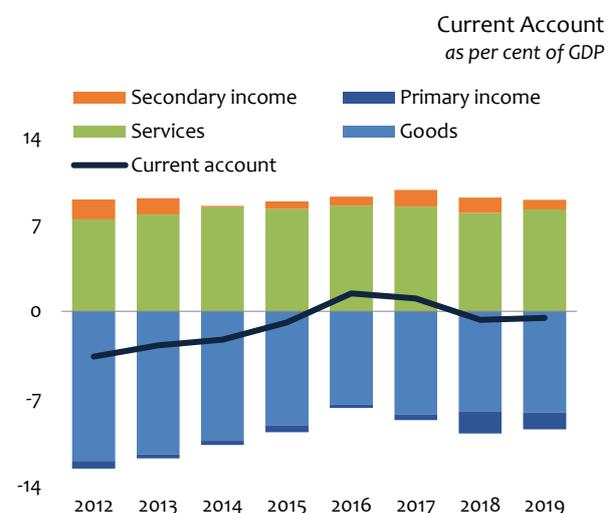
The current account balance is essentially determined by changes in the external trade balance. Latvia is characterised by an external trade deficit. Over the last three years, external trade deficit on average was 8.2% of GDP. In 2019, it reached 8.1% of GDP.

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



Uncertainty in the external environment and weakening external demand are having a negative impact on trade flows, which was reflected in a slowdown in the dynamics of exports and imports of goods. In 2019, the value of

imports of goods increased by 1.1% (in 2018, by 7.5%), while exports of goods exceeded the level of the previous year by only 0.2 per cent.



The balance of services is positive, averaging 8.2% of GDP over the last three years and almost entirely covering the external trade deficit. The dynamics of exports of services have been stable – over the last 5 years, an average increase of 6.5% annually has been observed. In 2019, exports of services at current prices were 6.8% higher than a year ago. Imports of services, on the other hand, grew by 5.2% (i.e., at almost a twice lower rate than in 2018), and the surplus of the services increased, reaching 8.2% of GDP (-7.9% in 2018). Exports of services are largely supported by growth in road transport, information and communication technologies, and other services, offsetting declining exports of financial services.

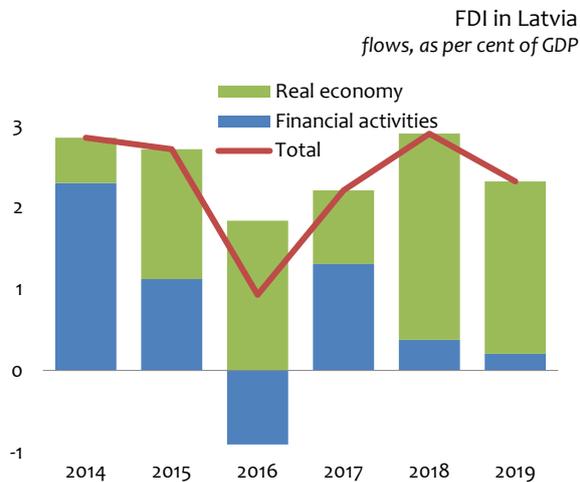
Changes in income and capital accounts can largely be attributed to the variation in the absorption activities of EU funds. Over the last three years, capital account surplus averaged 1.5% of GDP. In 2019, a surplus in capital account of 3.4% of GDP was observed.

In recent years, the financial account balance was primarily determined by the public sector (i.e. the financial sector stabilisation measures and other measures adopted by the Bank of Latvia for the restructuring of public debt within the framework of the extended asset purchase programme). Fluctuations in the financial account were also affected by the decline in deposits of non-residents in credit institutions of Latvia. In 2019, financial account assets decreased to a lesser extent than liabilities, and the financial account balance (with reserve assets) remained positive at the level of 1.5% of GDP.

The global spread of Covid-19 virus has a significant impact on cross-border flows of products, labour, capital, and finance. Therefore, the situation of balance of payments accounts may change significantly in the future.

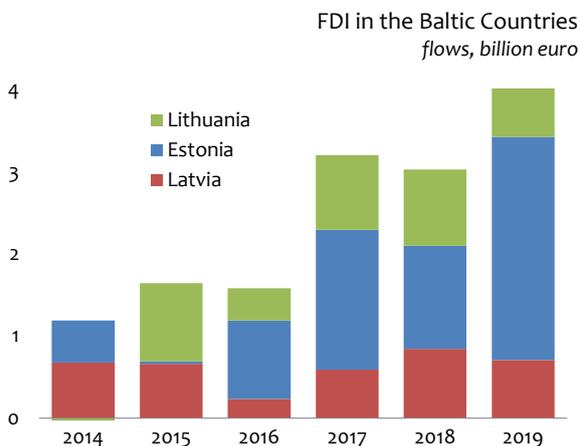
## FOREIGN DIRECT INVESTMENT

The dynamics of foreign direct investment (FDI) flows in Latvia, as well as in other Baltic countries, remain moderate. This can mainly be attributed to the instability in the global economy and rising geopolitical tensions.



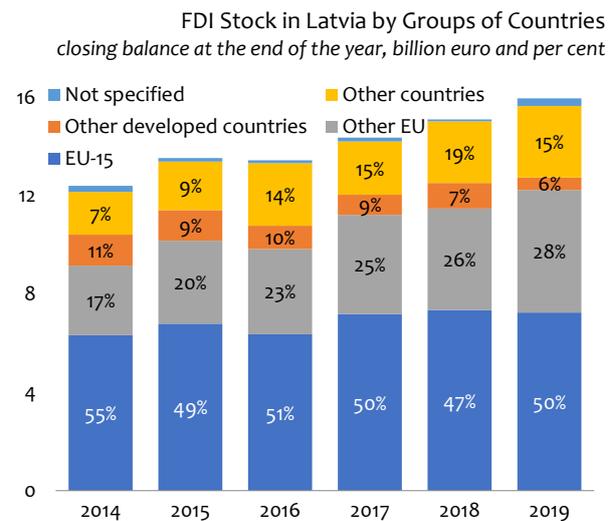
It should be noted that the intensity of cross-border direct investment flows in the world remains more moderate than before the global financial crisis.

Since 2017, the activity of foreign investors in the Baltic countries has increased, reaching the level of almost 3% of GDP, where most of the FDI flows were in the Estonian economy.

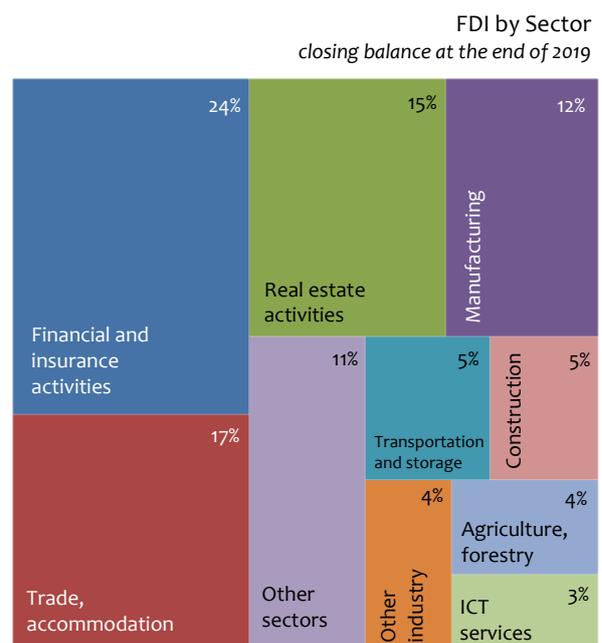


In 2019, FDI flows remain volatile. In the first half of 2019, FDI amounted to EUR 110 million (maintaining the average FDI level of the corresponding period in 2018). However, in the second half of 2019, net FDI flows were significantly higher (EUR 595 million). Fluctuations in FDI flows had a large impact on dividend payments to foreign investors in the second quarter of 2019. In general, the flows of attracted FDI in 2019 were by 16.3% lower than a year ago, accounting for 2.3% of GDP.

At the end of 2019, accumulated FDI in Latvia's economy reached EUR 16.0 billion (52.4% of GDP). During the year, an increase of 5.1% was observed. Currently, the largest investor in Latvia's economy is Sweden. At the end of 2019, accumulated FDI from Sweden (primarily financial intermediation services) amounted to 14.7% of total accumulated FDI in Latvia. Also, significant FDI flows have come from Estonia, Russia, the Netherlands, Cyprus, Lithuania, and Germany. At the end of 2019, the investment volumes of these countries represented nearly 65% of accumulated FDI in the Latvian economy.

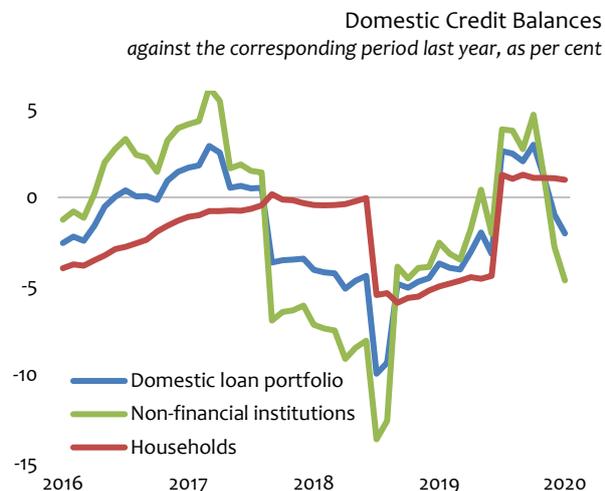


The largest share of accumulated FDI represent investments in financial intermediation services (23% of accumulated FDI), trade (15%), real estate activities (16%), and manufacturing (12%).



MONETARY INDICATORS

Monetary indicators are gradually stabilizing; however, future lending developments may largely be affected by the consequences of the coronavirus.

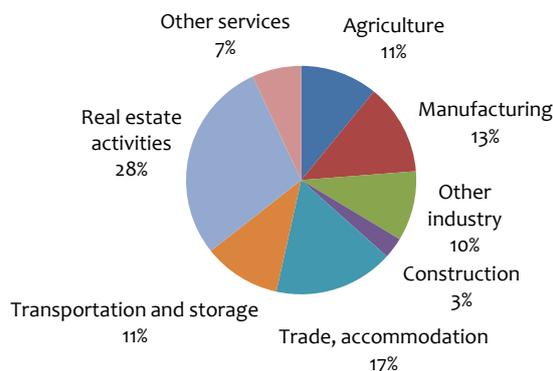


Source: Bank of Latvia

In December 2019, domestic loan portfolio during the year decreased by 1.0%. Loan portfolio of non-financial institutions grew by 2.8%. Also, no major changes can be observed in the household lending (an increase of 1.0%).

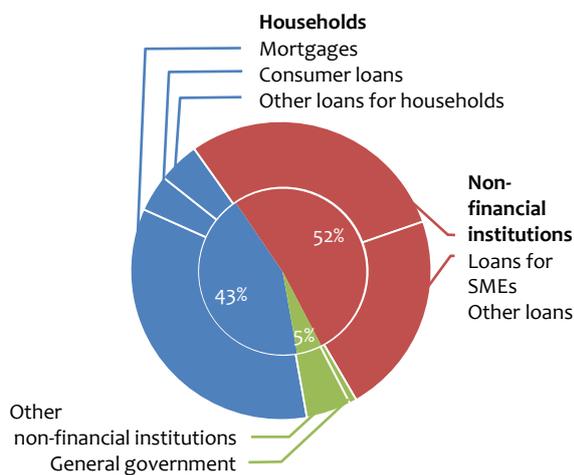
However, since 2019, a steady rise in interest rates has been observed. In January interest rates on long-term and short-term loans were 2.38% and 3.64%, respectively. Also, interest rates on short-term mortgage loans to households have increased more rapidly, reaching 4.41% in January 2020 (2.87% in January 2018). Interest rates on long-term loans also have risen slightly, reaching 2.24%; however, their volatility remains low.

Lending Portfolio of Non-Financial Institutions by Sector at the end of June 2019, as per cent



Source: Financial and Capital Market Commission

Non-Bank Resident Loan Portfolio at the end of 2019, as per cent



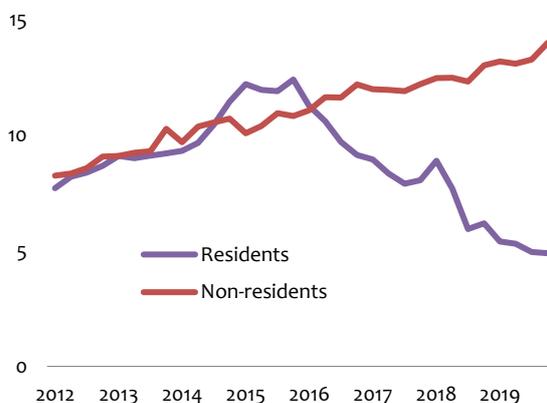
Source: Financial and Capital Market Commission

The breakdown of loans by sector has not significantly changed - at the end of 2019, the largest loan volumes were issued in real estate activities (30% of total loans), trade and accommodation (17%), and manufacturing (12%).

Since 2016, interest rates on loans (in EUR) issued to non-financial institutions have remained relatively stable.

In 2019, deposit volumes continued to decline. At the end of 2019, deposits were by 3% lower than a year ago. The decline can largely be attributed to decrease in non-resident deposits. At the end of 2019, non-resident deposits were by 24.9% lower than a year ago, constituting 1/4 of total non-bank deposits (in 2015 – 53% of non-bank deposits). At the same time, domestic deposits increased by 7.3%. Banks working with non-resident deposits are subject to more stringent liquidity and capital requirements.

Non-Bank Deposits in Banks billion euro



Source: Financial and Capital Market Commission

## BUDGET AND GOVERNMENT DEBT

Since 2011, as Latvia returned to economic growth, significant improvements in the fiscal position have been achieved. The general government budget deficit, in accordance with European System of Accounts (ESA), has been reduced from 9.5% of GDP in 2009 to 1.4% of GDP in 2014-2015. In 2016, for the first time since 1998, a budget surplus of 0.1% was observed. However, in 2017 and 2018, budget was at a small deficit.

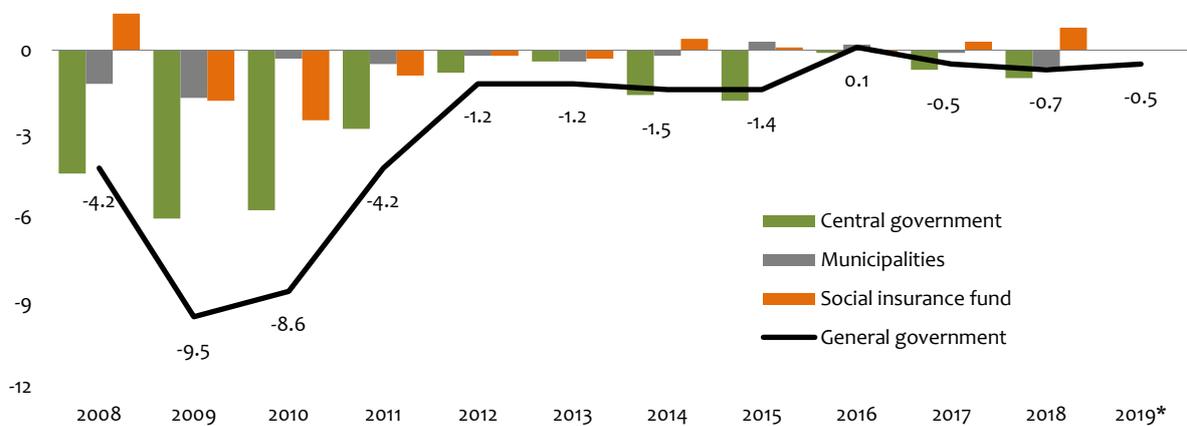
According to the Ministry of Finance, in 2019 the budget had a deficit of approximately 0.5% of GDP. The general government budget deficit in 2020 is planned at 0.3% of

GDP. However, the COVID-19 epidemic could significantly increase the deficit.

General Government Deficit

	2014	2015	2016	2017	2018
Revenues, bn euro	8,6	8,9	9,3	10,0	11,0
% of GDP	36,6	36,6	36,9	37,5	37,8
Expenditures, bn euro	9,0	9,3	9,2	10,2	11,2
% of GDP	38,0	38,0	36,9	38,0	38,5
Net, bn euro	-0,34	-0,33	0,02	-0,14	-0,2
% of GDP	-1,4	-1,4	0,1	-0,5	-0,7

General Government Budget Balance by Sector  
as per cent of GDP



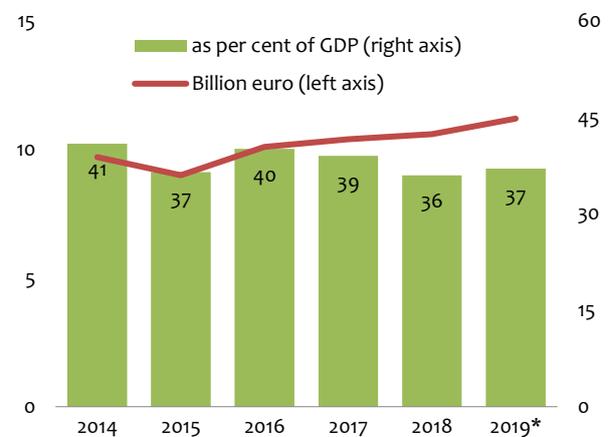
In Latvia, general government debt level remains one of the lowest amongst EU. Until 2007, it increased moderately. To finance state financial obligations, from 2008-2010, however, general government debt increased more rapidly. At the end of 2010, it reached EUR 8.5 billion or 47.3% of GDP. Since the end of 2011, general government debt on average has declined. In 2018, it reached EUR 10.6 billion or 36.4% of GDP.

According to the Treasury of the Republic of Latvia estimate, in 2019, the general government debt to GDP ratio was 36.6%. Due to the COVID-19 epidemic, the amount of public debt in 2020 could increase significantly.

Pursuing timely borrowing measures in line with the medium-term strategy and continuing to implement sustainable fiscal policy (based on favourable interest rate and maturity terms) can help to re-finance current central government debt obligations. Also, it may allow to achieve a long-term reduction and stabilisation of general government debt, thus strongly adhering to the general

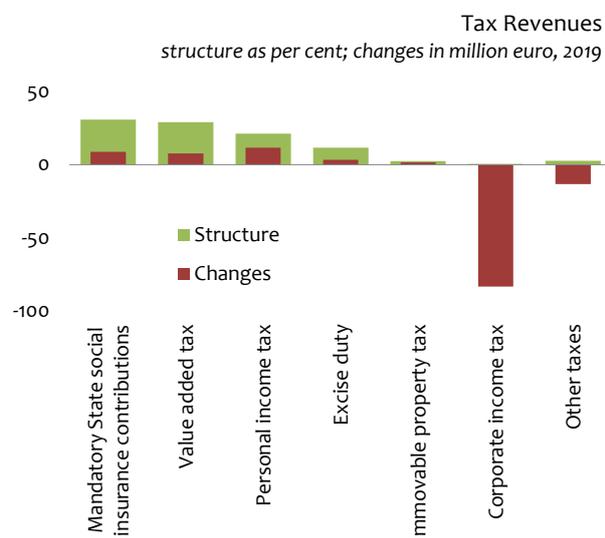
government debt requirements set out in the Maastricht Treaty.

General Government Consolidated Gross Debt  
nominal value at the year end



## BUDGET REVENUES AND EXPENDITURES

Since 2011, general government budget revenues have increased. The rise has mainly been facilitated by income from employment taxes. In 2019, general government budget revenues increased by 4.9%, and reached EUR 11.4 billion.



Revenues from employment taxes – personal income taxes and state social insurance contributions – grey by 11.6% and 8.8%, respectively. The increase was mainly facilitated by higher employment and rise in wages.

Consolidated General Government Budget

	billion euro			Changes as per cent
	2017	2018	2019	2019
Revenues:	9.6	10.9	11.4	4.9
Tax revenues:	8.5	9.2	9.8	4.6
Mandatory State Social Insurance Contributions	2.8	3.2	3.6	8.8
Value added tax	2.2	2.5	2.6	7.8
Personal Income Tax	1.1	1.2	1.3	11.6
Corporate Income Tax	0.4	0.3	0.0	-85.3
Excise Duty	0.9	1.0	1.1	3.4
Immovable Property Tax	0.2	0.2	0.2	1.5
Other taxes	0.3	0.3	0.2	-1.9
Other revenues	1.6	2.2	2.4	6.2
Expenditures	9.8	11.1	11.5	4.0

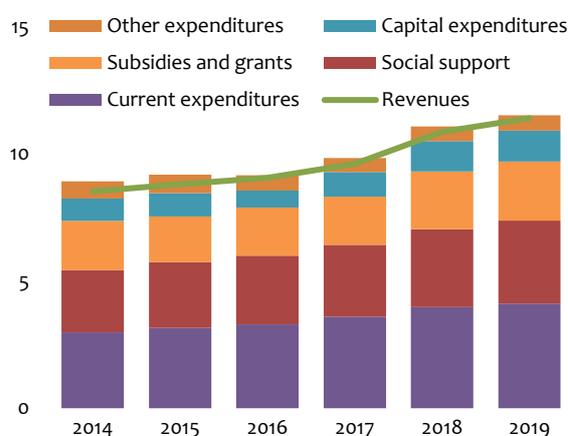
Also, revenues from consumption taxes continue to increase. Income from value added tax and excise duty rose by 7.8% and 3.4%, respectively. However, resource tax revenues have essentially remained at the previous year's level.

On the other hand, capital tax revenues are on a decline, driven by lower corporate income tax revenues (by 85.3%) due to changes introduced (of the tax administration) in the tax reform.

In 2019, consolidated government budget expenditure increased by 4.0%, reaching EUR 11.5 billion.

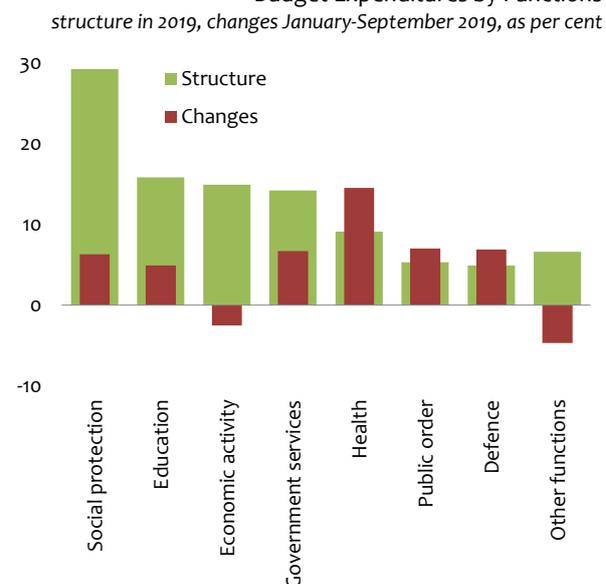
Current expenditures, i.e., subsidies and grants, and capital expenditures, rose by 3.5%, 2.3%, and 1.8%, respectively.

Consolidated General Government Budget Expenditures billion euro



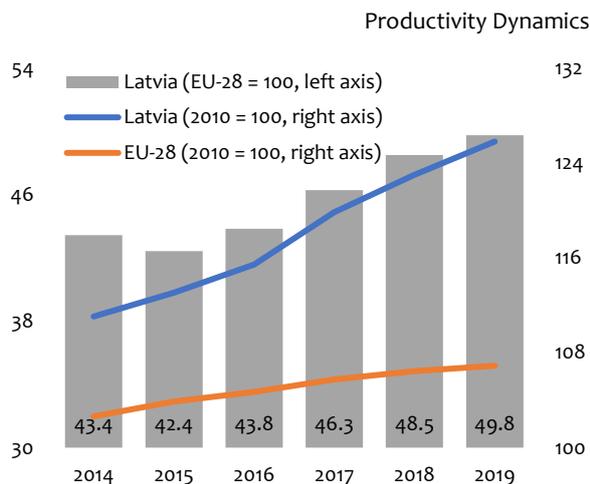
Expenditures for health increased at a higher rate, but it declined for recreation, culture and religion, management of municipal territories and economic activities.

Consolidated General Government Budget Expenditures by Functions

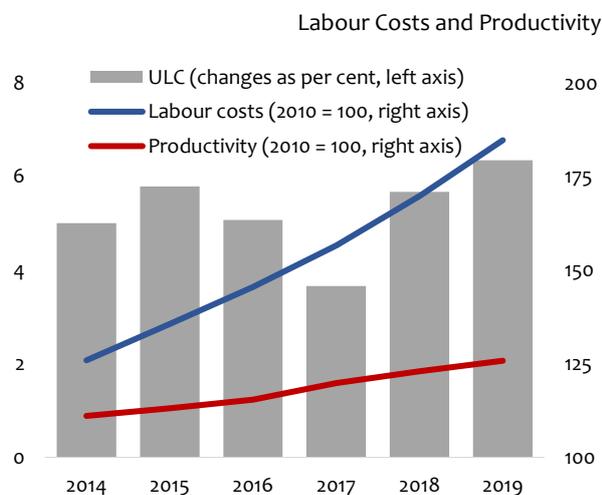


## PRODUCTIVITY AND COMPETITIVENESS

In recent years, productivity dynamics in Latvia on average have increased at a higher rate than the EU average. In 2019, GDP per person employed (productivity) in the Latvian economy reached 49.8% (almost 70% by PPS) of the EU average. From 2010 to 2019, the productivity gap with the EU average level decreased by 12.4 percentage points (during the last three years - by almost 6 percentage points).

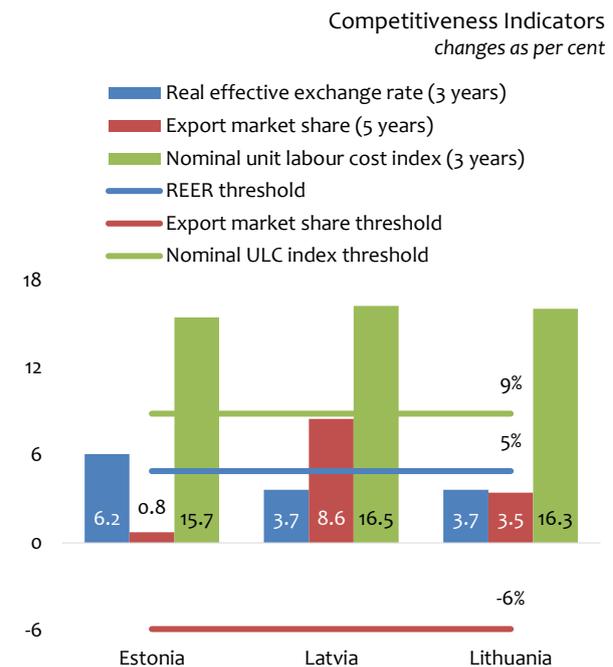


Although Latvia ranks very high based on productivity growth amongst other EU member states, **labour costs have risen at a higher rate than productivity**, thus undermining the competitiveness of entrepreneurs in Latvia. Also, an increase in nominal unit labour costs (ULC) reflects the increased risks of declining cost competitiveness. Over the last three years (2017-2019), productivity has increased on average by 3% annually, whilst labour costs have risen by 7.8%, i.e., almost at a 2.5 higher rate.



The strong increase in labour costs is affected by both wage convergence processes in the integrated EU labour market and rising tension in the domestic labour market.

In recent years, a strong increase in nominal unit labour costs can be observed in Baltic countries. Between 2016-2018, nominal ULC in Latvia, Estonia, and Lithuania increased by 16.5%, 15.7%, and 16.3%, respectively, which is much faster than the EU average (4.1%) and exceeds the EU Alert Mechanism (MIP) threshold (9%).



Despite a large rise in nominal unit labour costs (ULC), **Latvia's share in export markets has increased**. Between 2014-2018, Latvia's share in world export markets for goods and services increased by 8.6%, which is much higher than in other Baltic countries. Thus, Latvia still maintains its competitiveness in external markets. However, the positive development trends in export markets are becoming more moderate.

**Real effective exchange rate (REER) dynamics have been positive**. Over the last three years (2016-2018), the consumer price index (CPI) (based on REER against 42 trading partners) has increased by 3.7% (against Euro Area partner countries by 2.8%). The indicator is close to the threshold set by the EU Alert Mechanism.

The rise in labour costs, which will not be offset by a corresponding increase in productivity, poses threats to profitability and competitiveness in external markets. In addition, long and positive dynamics of ULC increase risks of country's external imbalances.

## 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 2019 did not identify Latvia amongst those 13 EU Member States, where macroeconomic imbalances were present, and further in-depth study – required. However, Latvia violates thresholds set by the Alert Mechanism for some indicators (see the table below). Although improvements in the net international investment position were achieved, as Latvia's external debt to the rest of the world grew more slowly than gross domestic product, the indicator exceeded the

threshold set by the EU Alert Mechanism. Also, nominal unit labour costs index (similarly to Lithuania, Bulgaria, and Estonia) exceeded the threshold. In Latvia, the increase can mainly be attributed to the rise in wages in private non-tradable sectors. Wages have risen at a higher rate than productivity. It is anticipated that wages will continue to increase due to strong demand in the labour market. In addition, the housing price index slightly exceeded the threshold, reflecting the high demand in the housing market. The real effective exchange rate (REER) against 42 trading partners was close to the threshold. However, all employment indicators significantly improved – employment rate has increased, and long-term unemployment and youth unemployment rates have declined.

List of Indicators for the Macroeconomic Imbalances Procedure for Latvia

	Threshold	2014	2015	2016	2017	2018	2019
<b>External imbalances and competitiveness</b>							
Current account (% of GDP, 3-year average)	-4%/6%	-2.9	-2.0	-0.6	0.5	0.6	..
Net international investment position (% of GDP)	-35%	-67.1	-64.1	-59.0	-56.2	-49.0	..
Real effective exchange rate – 42 partner countries, HICP deflator (% changes over the last 3 years)	±5%* & ±11%	0.4	2.5	4.8	1.7	4.9	3.7
Export market share – % of world export (% changes over the last 5 years)	-6%	12.0	13.5	10.2	8.2	8.6	..
Nominal unit labour costs index (% changes over the last 3 years)	9%* & 12%	16.0	17.2	16.7	15.2	15.1	16.5
<b>Internal imbalances</b>							
House price index (% annual changes)	6%	4.3	-2.4	7.4	5.6	6.6	..
Private sector credit flow (% of GDP, consolidated)	14%	-4.4	-0.5	2.3	2.4	-0.2	..
Private sector debt (% of GDP, consolidated)	133%	82.2	80.4	80.5	76.9	70.5	..
General government debt (% of GDP)	60%	40.9	36.7	40.2	38.6	36.4	..
Unemployment rate (3-year average)	10%	12.6	10.9	10.1	9.4	8.6	7.5
Financial sector liabilities (% annual changes)	16.5%	11.4	13.2	4.7	6.2	-3.0	..
<b>Employment indicators</b>							
Economically active population – % of population aged 15-64 (% over the last 3 years)	-0.2 percentage points	1.8	1.3	2.3	2.4	2.0	..
Long-term unemployment rate – % economically active population (% changes over the last three years)	0.5 percentage points	-4.2	-3.3	-1.7	-1.3	-1.4	..
Youth unemployment rate – % of economically active population (% over the last 3 years)	2 percentage points	-11.4	-12.2	-5.9	-2.6	-4.1	-4.9

\* – Euro area countries.

Note: highlighted numbers exceed the thresholds set out in the Early Alert Mechanism Report 2019.

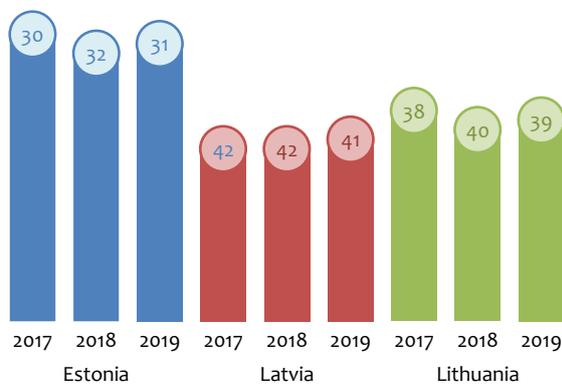
Source: List of Indicators for the Macroeconomic Imbalances Procedure for Latvia, Eurostat

# 2020 | 1 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 by improving e-government, the business environment, ICT infrastructure, and other areas, while providing free press and not militarily endangering other countries of the world. In World Economic Forum report and the **Global Competitiveness Index (GCI 4.0) for 2019** Latvia is ranked 41st between 141 surveyed countries.

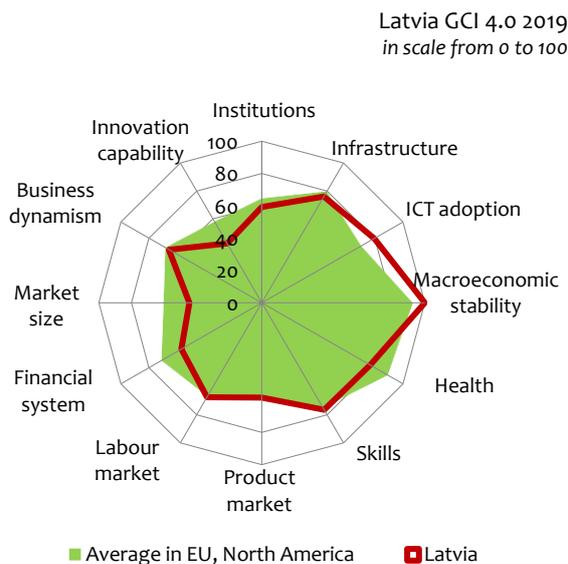
In terms of macroeconomic stability, Latvia ranks 1<sup>st</sup> (along with other 33 countries). Based on well-developed infrastructure and a larger share of internet users, Latvia ranks 15<sup>th</sup> in the ICT adoption index. Latvia also ranks high in skills and labour market indexes – 22<sup>nd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

Baltic Countries In Global Competitiveness Index 4.0



Source: World Economic Forum, The Global Competitiveness Report 2019

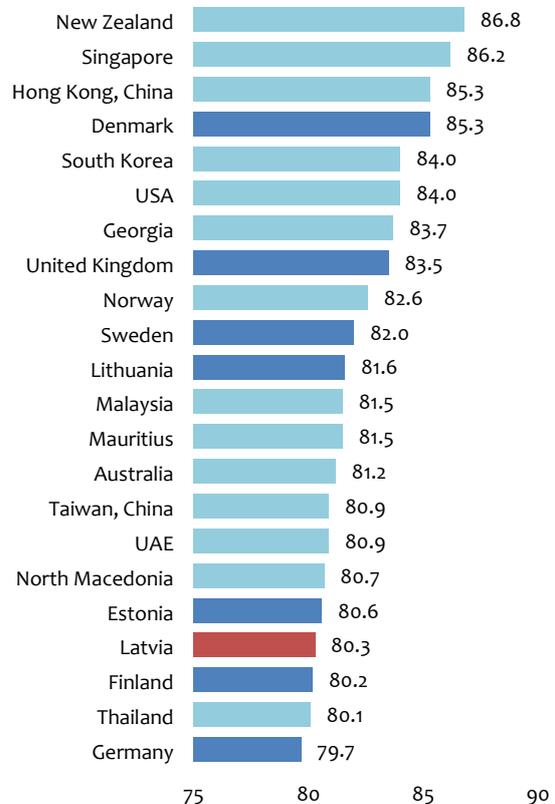
In 2019, Latvia has ranked one place higher, compared to 2018. Improvements can be observed in 8 out of 12 pillars.



Source: World Economic Forum, The Global Competitiveness Report 2019

In the World Bank Group *Doing Business* Latvia ranks 19<sup>th</sup> amongst 190 countries. However, between EU countries Latvia has been ranked in the 6<sup>th</sup> place. Compared to the assessment in 2019, improvements for 2 groups indicators have been achieved. A decline has been observed in one indicator group, and 7 indicator groups have remained the same. Overall, Latvia, compared to 2019, has remained in the same position, ranking 19<sup>th</sup>.

Doing Business 2020 in scale from 0 to 100



Source: Doing Business 2020, International Bank for Reconstruction and Development, The World Bank

Baltic Country Assessment, *Doing Business* 2020

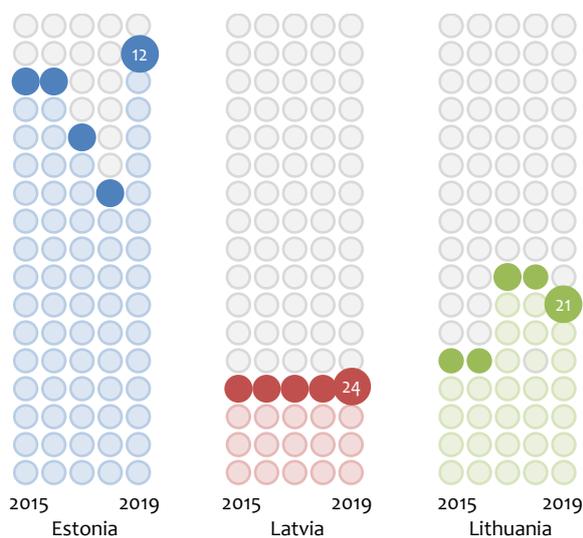
	Latvia			Lithuania		Estonia	
	place	score	changes, compared to <i>Doing Business</i> 2019*	place	score	place	score
<b>Index, total</b>	<b>19</b>	<b>80.3</b>	<b>0</b>	<b>11</b>	<b>81.6</b>	<b>18</b>	<b>80.6</b>
Starting a business	24	94.1	0	34	93.3	14	95.4
Dealing with construction permits	56	73.5	0	10	84.9	19	82.6
Getting electricity	61	82.3	+0.1	15	92.9	53	83.3
Registering property	25	82.3	0	4	93.0	6	91.0
Getting credit	15	85.0	0	48	70.0	48	70.0
Protecting minority investors	45	68.0	0	37	70.0	79	58.0
Paying taxes	16	89.0	-0.7	18	88.8	12	89.9
Trading across borders	28	95.3	0	19	97.8	17	99.9
Enforcing contracts	15	73.5	0	7	78.8	8	76.1
Resolving insolvency	55	59.6	+0.2	89	46.7	54	60.1

\* *Doing Business* 2019 results have been recalculated based on *Doing Business* 2020 methodology  
 Source: *Doing Business* 2020, International Bank for Reconstruction and Development, The World Bank

In the European Innovation Scoreboard 2019, published annually by the European Commission, Latvia ranks 24<sup>th</sup> among the 28 EU countries, and has been included in the group of moderate innovators for the fourth consecutive year. Finance and support, the impact on employment and an innovation-friendly environment are Latvia's strongest dimensions of innovation. However, innovators, research systems and business investment are the weakest dimensions of innovation.

school graduates, compliance with environmental management system standards, ease of obtaining credit, the share of women with higher education, total domestic R&D expenditure financed by foreign, domestic increase in gross domestic product per employee by purchasing power parity, as well as increase in the volume of products of creative industries.

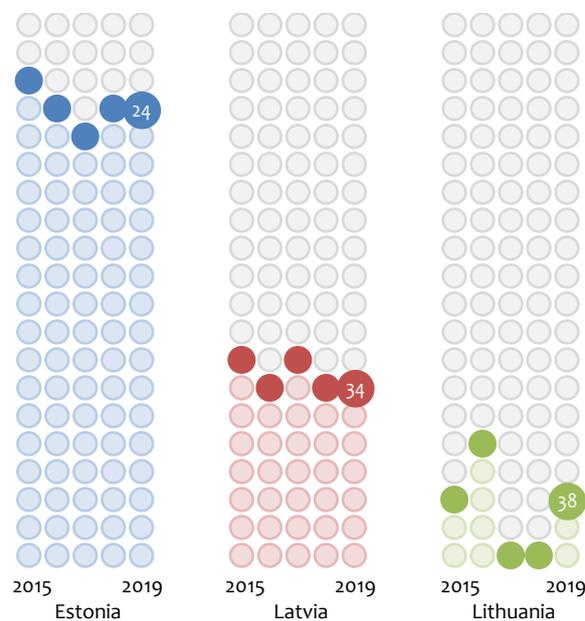
Baltic Countries in the European Innovation Scoreboard 2019



Source: European Commission, *European Innovation Scoreboard* 2019

In turn, in *Global Innovation Index* 2018 Latvia is ranked 34<sup>th</sup> between 129 surveyed countries. The strengths of Latvia are highlighted: the ratio of students and teachers in secondary education institutions, the share of secondary

Baltic Countries in Global Innovation Index



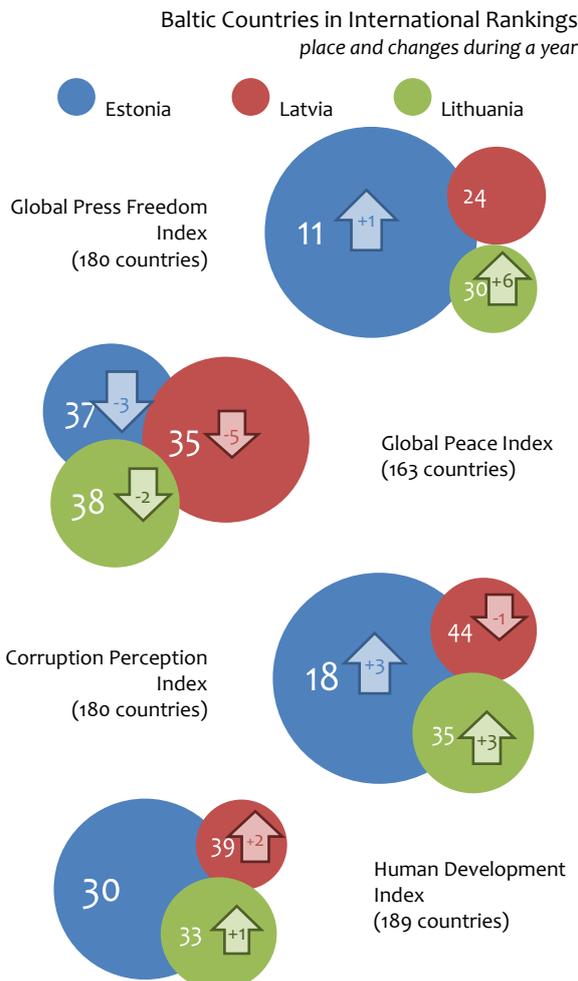
Source: Cornell University, INSEAD, WIPO, *The Global Innovation Index* 2019: *Creating Healthy Lives – The Future of Medical Innovation*

In World Press Freedom Index by Reporters Without Borders (RWB) Latvia ranks 24<sup>th</sup> (amongst 180 countries), maintaining the same position as in 2018.

In Global Peace Index (GPI) produced by the Institute for Economics and Peace (IEP) Latvia was ranked 35<sup>th</sup> (amongst 163 countries) in 2019. Compared to 2018, Latvia's position has deteriorated by 5 positions due to increased state defence spending.

In Corruption Perceptions Index 2019 produced by The Global Anti-Corruption Organisation *Transparency International* Latvia ranked in the 44<sup>th</sup> place (amongst 180 countries), worsening its position by 3 places, compared to 2018.

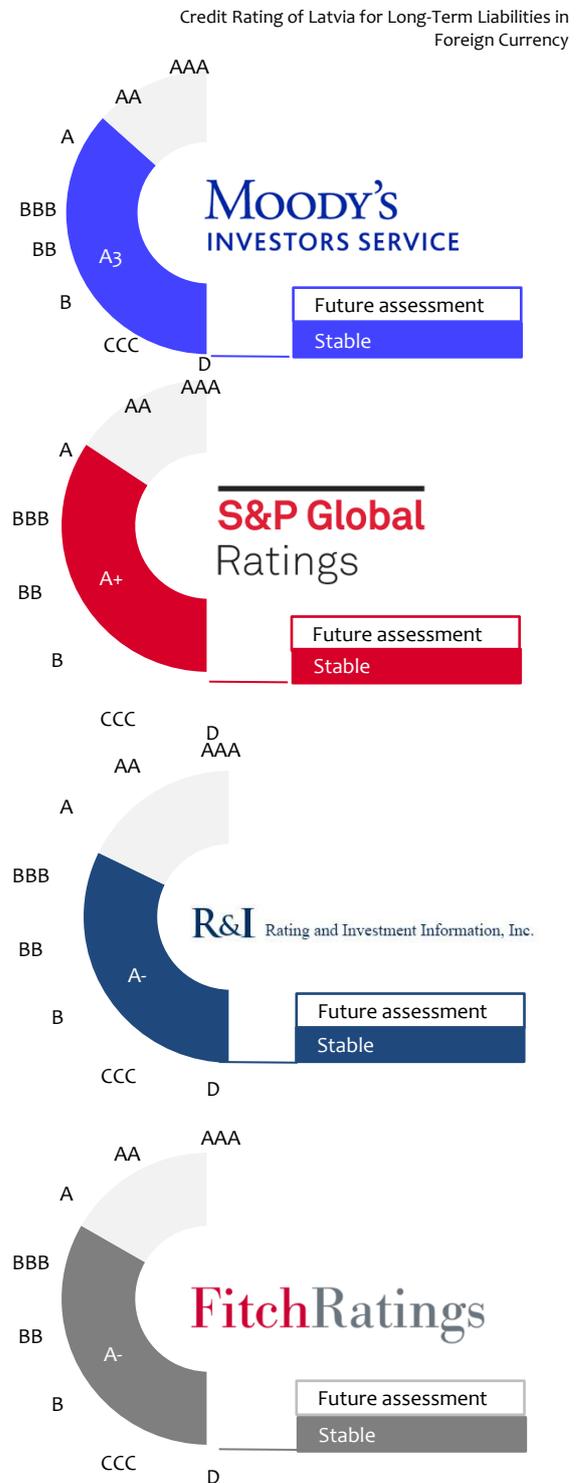
In the Human Development Index (HDI) produced by the United Nations Organization Latvia ranks 39<sup>th</sup> (amongst 189 countries) in 2019, thus achieving by two places higher position than in 2017.



Source: Reporters Without Borders, 2019 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2019; Transparency International, Corruption Perceptions Index 2018; United Nations Development Programme, Human Development Indices and Indicators, 2018 Statistical Update

In 2019, rating agency (*Moody's Investors Service, Fitch Ratings, S&P Global, R&I*) assuring the legitimacy of the previously assigned high credit ratings, noting that the factors contributing to Latvia's credit rating assessment were the fiscal results of previous years and low level of government debt. In February 2020, S&P Global Ratings

upgraded Latvia's credit rating from "A" to "A+", the highest level since 1997, while maintaining a stable outlook. In its assessment, the agency has highlighted two main factors that increase credit ratings: Latvia has a strict fiscal policy that will allow further reduction of public debt, and the vulnerability of the Latvian financial system is limited, as confirmed by the Financial Action Task Force (FATF).



Source: Treasury Republic of Latvia