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ECONOMIC DEVELOPMENT TRENDS

The Covid-19 pandemic has significantly affected economic development on a global scale, including in Latvia. GDP in Latvia decreased by 2.2% in 2020. Thanks to the large-scale support measures of the government and European Union funds, as well as the improvement of the epidemiological situation, in 2021, Latvia's economy began to recover, and GDP increased by 4.1 percent.

When Russia invaded Ukraine on February 24, 2022, the geopolitical situation and economic development prospects worsened. Energy and food prices have risen significantly, adding to inflationary pressures at a time when the cost of living around the world was already rising rapidly in the recovery from the pandemic. War also affects the global economy by disrupting raw material supply chains.

In Q1 of 2022, the effects of the war were not yet fully felt in Latvia. Compared to Q1 of 2022, the economy grew by 5.6%. The rise was influenced by the low base at the beginning of 2021 and the gradual lifting of Covid-19 restrictions. However, already in Q2 of 2020, GDP growth rates declined to 2.9 percent on an annual basis.

It is anticipated that in Q3 and Q4 of 2022, economic growth rates will be much slower than in the first half of the year. As a consequence of the war, growth will be hindered, inflationary pressure will increase. The Ministry of Economy forecasts that in 2022, due to geopolitical factors, economic growth will decline by at least 3 percentage points, compared to the forecast before the Russian invasion of Ukraine. However, growth in 2022 will remain positive and can reach 2.6% on an annual basis. However, in 2023 the growth rates will be much more moderate.

Key Economic Development Indicators

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022f | 2023f |
|---|------|------|------|------|------|-------|-------|
| Gross domestic product, at current prices, billion euro | 27.0 | 29.2 | 30.7 | 30.3 | 33.7 | 39.4 | 42.1 |
| <i>Changes against the previous year, as per cent</i> | | | | | | | |
| Gross domestic product | 3.3 | 4.0 | 2.6 | -2.2 | 4.1 | 2.6 | 0.6 |
| Private consumption | 2.9 | 3.0 | 0.2 | -4.6 | 8.2 | 6.7 | 0.3 |
| Public consumption | 3.3 | 1.7 | 3.9 | 2.4 | 4.4 | 1.8 | 1.8 |
| Gross fixed capital formation | 11.4 | 11.7 | 6.9 | -2.6 | 2.9 | 0.2 | -0.6 |
| Exports | 6.4 | 4.4 | 2.1 | -0.3 | 5.9 | 7.2 | 1.9 |
| Imports | 8.6 | 6.3 | 3.1 | -0.3 | 15.3 | 9.0 | 1.6 |
| Consumer prices | 2.9 | 2.5 | 2.8 | 0.2 | 3.3 | 16.9 | 7.6 |
| <i>as per cent</i> | | | | | | | |
| Changes in the number of employed | 0.2 | 1.6 | 0.1 | -1.9 | -3.2 | 1.7 | -0.1 |
| Employment rate | 62.9 | 64.5 | 65.0 | 64.2 | 62.5 | 63.7 | 63.7 |
| Unemployment rate | 8.7 | 7.4 | 6.3 | 8.1 | 7.6 | 6.8 | 6.7 |
| <i>as per cent of GDP</i> | | | | | | | |
| General government balance | -0.8 | -0.8 | -0.6 | -4.3 | -7.0 | -7.0 | -3.4 |
| General government debt | 38.9 | 37.0 | 36.5 | 43.2 | 43.6 | 42.0 | 43.0 |
| Net exports | -0.6 | -0.7 | -0.7 | 1.0 | -3.4 | -5.5 | -4.5 |

f-forecast

After the Covid-19 crisis, a significant contribution to economic growth provides household consumption. In 2021, private consumption increased by 8.2%; and in the first half of 2022 – by 12.4%. The growth was facilitated by the increase in the average wage, the decrease in unemployment, and the gradual lifting of restrictions on the spread of Covid-19. However, in the second half of the year, domestic consumption will slow down or even fall slightly due to high inflation.

Support measures implemented by the government to mitigate the negative impact of Covid-19, which are largely financed at the expense of increasing the state budget deficit, maintained a positive increase in state consumption both in 2020 and 2021. It continued to grow in the first half of 2022 as well – by 1.6 percent.

Investment growth remains moderate. In 2020, due to the Covid-19 crisis, it decreased by 2.6%. However, in 2021, due to the increase in investments in machinery and equipment, as well as in intellectual property products, it rose by 2.9 percent.

Despite the great uncertainty due to geopolitical tension, in the first half of 2022, investments grew by 1.4% year-on-year. Investments in buildings and structures decreased by 11.4% due to the rapidly rising costs. At the same time, investments in machinery, equipment, and vehicles increased by 11.4% and in intellectual property products by 21.5%. It is anticipated that in the following quarters, geopolitical tension, and the rapid increase in costs will hinder investments. Nevertheless, investments will be facilitated by a significant influx of EU funds into the Latvian economy.

Exports of goods provide a significant contribution to the growth. In both 2020 and 2021, the export of goods increased. In 2021, compared to 2019, it increased by 12.2%. In 2021, the exports of wood and its products, mineral products, and iron and steel products had the largest positive impact on growth. In the first half of 2022, the export of goods continued to grow – by 7.7% on an annual basis.

After a significant decline in services exports at the start of the Covid-19 pandemic, they are recovering rapidly. In 2020, the export of services decreased by 15.9%. The decline was largely influenced by the fall in the export of the aviation and tourism services sectors affected by the Covid-19 restrictions, as well as the decline in the export of transit services. In 2021, the situation stabilized, and the exports of services increased by 7.3%. On the other hand, in the first half of 2022, the export of services increased by 22.9% compared to the first half of 2021, which was most significantly affected by the increase in the export of transport services, computer services.

In the recovery from the Covid-19 crisis, the imports of goods and services has also increased rapidly. In 2021, it increased by 15.3%. However, in the first half of 2022 it rose by 14.2 percent.

From 2011 to 2021, a low current account deficit of the balance of payments was observed, thus indicating the external sustainability of the Latvian economy. In the first half of 2022, the current account had a deficit of 8.6% of GDP. In the following years, despite the geopolitical uncertainty, it is expected that the current account will have a small deficit, without threatening the external balance of the Latvian economy.

Development trends vary across sectors. Although GDP in 2021 slightly exceeded the pre-crisis level of 2019, economic activity in several sectors was well below this level. Thus, compared to the pre-crisis period, accommodation and food services were down by 36.8%; the arts, entertainment, and recreation by – 32.5%; transportation and storage – by 12.2%; agriculture and forestry – by 11.2%; and construction – by 16.3%. On the other hand, the largest increases during this period were observed in the health care, public administration, and financial services sectors, as well as in the energy sector. Also, growth was observed in the manufacturing.

With the lifting of Covid-19 restrictions, rapid growth rates were observed in the first half of 2022 in the sectors that were most severely affected by the pandemic. On an annual basis, in the first half of the year, the increase in the accommodation and food service activities reached 79.3%; in the arts, entertainment, and recreation sector – 31.2%. Also, a rapid increase (+8.6%) in the commercial services sector, as well as in the ICT sector (by 12.4%) was observed. The average growth rates of the national economy were also exceeded by the largest manufacturing sub-sectors – in the first half of the year, agriculture and forestry increased by 5%; and manufacturing rose by 6.9 percent.

In the first half of the year, a decline was observed in some sectors of the economy. As a result of the sanctions imposed by the EU, the turnover of goods with the markets of Russia and Belarus has decreased. Therefore, the wholesale sector decreased by 1.3%. The rapid increase in costs has caused the planned construction projects to be revised or extended their deadlines – the volumes of the construction in the first half of the year were 12.4% lower than a year ago. The fall in the first half of the year was also observed in the mining industry and energy sector.

The Covid-19 pandemic has caused significant changes in the fiscal policy implemented thus far. In 2020, the *general exception clause of the Stability and Growth Pact (SGP)* was activated in the EU, allowing EU countries to increase the general government budget deficit in 2020-2022 to the extent necessary to mitigate the economic damage caused by the pandemic. Considering the Russia-Ukraine war and all the consequences related to it, the SGP general exception clause will also be valid in 2023. As a result of the Covid-19 pandemic, the budget deficit in Latvia increased to 4.3% of GDP in 2020, or 1.3 billion euro. However, in 2021 – up to 7.0% of GDP, or 2.4 billion euro. The Covid-19 crisis is gradually coming to an end; consequently, the amount of support is decreasing and the Saeima approved the 2022 budget with a deficit of 4.8% of GDP, or 1.6 billion euro. However, the budget deficit could be higher due to the war in Ukraine.

Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest in the EU. The outbreak of Covid-19 led to the need to provide a significant amount of funding to mitigate the impact of the crisis caused by Covid-19. In 2021, the amount of national debt increased to 43.6% of GDP, or 14.7 billion euro. As nominal GDP growth is relatively rapid in the face of high inflation, debt is expected to stabilize relative to GDP in the coming years.

The Covid-19 pandemic and subsequent restrictions had a significant impact on global demand, resulting in lower prices. Also, in 2020 deflation was observed in most months and the average annual inflation was only 0.2%. In 2021, as the pace of vaccination increased and Covid-19 restrictions eased, global demand increased rapidly.

However, supply (mainly due to supply chains) was unable to adapt as quickly, leading to higher prices for raw materials, especially energy resources and food, prevalent in the second half of 2021.

In 2022, Russia's invasion of Ukraine and the subsequent sanctions caused an additional impact on price growth, resulting in a shortage of energy and production raw materials, which in turn increases the price level in the world, have caused an additional impact on the price increase. Latvia's inflation rate is one of the highest in the EU – in September 2022, it reached 22.2%, while the annual average inflation was 13.7%. As energy prices rise and the heating season begins, inflation will continue to increase. The Ministry of Economy forecasts that in 2022 the average annual inflation could reach 16.9%. At the end of 2022 and the beginning of 2023, inflation rates should start to decrease.

The labour market is gradually recovering from the shock of the Covid-19 pandemic; however, the structural effects of the crisis remain. The number of employees and the level of employment are still significantly lower than in 2019. In Q2 of 2022, the number of employees was by more than 20 thousand (i.e., 2.3%) less than Q2 of 2019. The crisis has affected the economic activity of the population, which, along with demographic processes, narrows the supply of labour in the labour market and increases the risks of labour shortage. A high proportion of long-term job seekers remains, which, together with regional labour market disproportions, may create risks of structural unemployment in the coming years, as well as aggravate the problem of labour availability. In Q2 of 2022, 885.2 thousand were employed of population aged 15-74. Compared to Q2 of 2021, the number of employed people has grown by 2.7% or 23.6 thousand, which has been the most significant quarterly increase in employment since 2013. The increase in the number of employed persons is still largely determined by the low base effect – the number of employed persons decreased significantly during the Covid-19 crisis, and with the return of economic activities in the national economy, the demand for labour also gradually increases.

Since the middle of 2020, the trend of decreasing unemployment rates has been maintained. In Q2 of 2022, the unemployment rate was 6.6%, i.e., by 1.3 percentage points lower than in Q2 of 2021. Overall, in Q2 of 2022, there were 62.8 thousand job seekers (population aged 15-74), which is 14.4% (10.6 thousand) less than Q2 of 2021.

Considering the worsening of the geopolitical situation, it is anticipated that the situation in the labour market in the second half of 2022 will be tentative. The resilience of

Latvia's economy against external shocks has significantly strengthened in previous years, especially in the financial sector, so the direct impact of sanctions and the narrowing of the export market on the Latvian labour market is expected to be limited. The labour market will continue to be supported by the recovery of sectors from the Covid-19 pandemic crisis, as well as the construction of state infrastructure facilities, other types of state investments, and economic recovery support measures.

The monthly average gross wage continues to increase rapidly. In Q2 of 2022, compared to the corresponding period last year, it increased by 8.3% – rising to 1,362 euros per month. It should be noted that significant wage growth in Latvia has already been observed in previous years – the average wage growth over the last 5 years has been close to 7% per year. However, in contrast to what was observed in previous years, the net salary in the first two quarters of 2022, considering the rise in consumer prices, has declined, which indicates a decrease in the purchasing power of salaried employees. This trend is expected to continue in the short term whilst the rapid rise in inflation continues.

At the same time, upward pressure on wages will continue to be maintained both by the process of wage convergence closer to the wage level of the economically developed countries of the EU, and by the growing shortage of qualified labour – the narrowing of the labour market, which makes it necessary for entrepreneurs to think more actively not only about how to attract new specialists but also how to keep the existing ones, incl. reviewing rates of pay.

The further development of the economy in the medium term depends on the situation in the external environment and the progress of reforms. The largest risk to Latvia's growth is related to the development of the global economy, especially stopping the expansion of the Covid-19 epidemic and the geopolitical situation. The future development of the EU's common economic space is also important. Latvia's economic advantages in the medium term will mainly be 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 support programs and improvements in the business environment.

The competitive advantage of Latvia's economy is based on technological factors, improvement of production efficiency and innovations, to a lesser extent on cheap labour and low resource prices. In the medium term, Latvia's growth rates can reach 4-5% growth per year. As the war in Ukraine and the Covid-19 pandemic drag on, the pace of economic recovery could be slower.

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WORLD ECONOMIC OUTLOOK

The **world** economy is paying a high price for Russia's war of aggression against Ukraine. With the impact of the Covid-19 pandemic still lingering, the war is holding back growth and putting additional pressure on prices, mainly food and energy. It is predicted that the global GDP will grow by 3% in 2022. In 2023, however, growth will slow down to 2.2 percent.

Gross Domestic Product
as per cent

| | 2021 | 2022f | 2023f |
|-----------|------|-------|-------|
| World | 5.8 | 3.0 | 2.2 |
| G20 | 6.2 | 2.8 | 2.2 |
| Euro area | 5.2 | 3.1 | 0.3 |
| US | 5.7 | 1.5 | 0.5 |
| Germany | 2.6 | 1.2 | -0.7 |
| China | 8.1 | 3.2 | 4.7 |

Source: OECD Economic Outlook, Interim Report September 2022;
f – forecast

Growth in **China** is forecast to slow to 3.2% in 2022, given the isolation imposed by the Covid-19 pandemic and the weakness of the real estate market; however, policy support could help growth recover in 2023. It is expected that the **Indian** economy will grow by 6.9% in 2022. On the other hand, in 2023, economic growth will slow down to 5.7%, which still could be assessed as rapid growth, considering the weak development of the global economy.

The **US** started implementing restrictive monetary policy earlier than other major developed economies. Therefore, inflation may have peaked. GDP is expected to grow by 1.5% and 0.5% in 2022 and 2023, respectively.

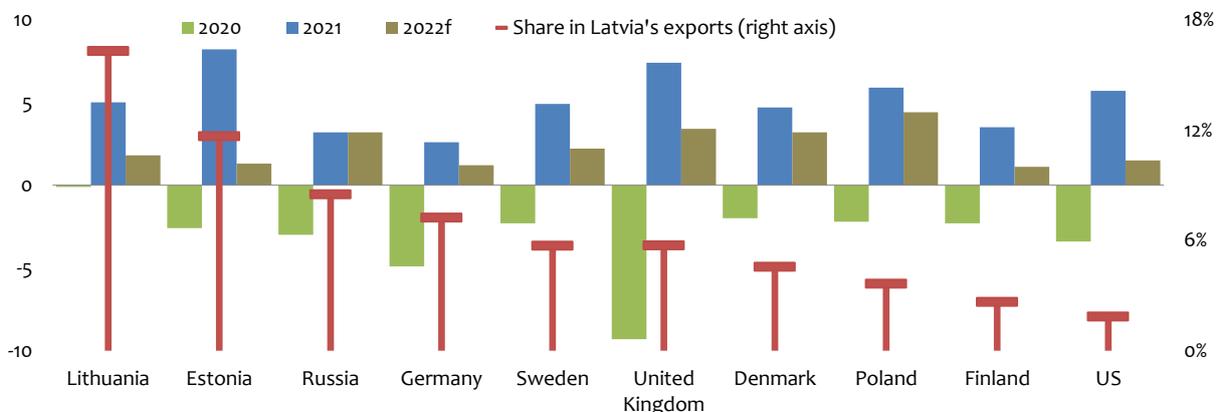
In **Europe**, energy prices have risen sharply. Russia's gradual reduction of gas flows to Europe in 2022 has forced European economies to buy more gas in the liquefied natural gas (LNG) markets, thus raising gas prices. In Europe, inflation could be more difficult to reduce than expected due to tight labour markets and expectations.

GDP in the **United Kingdom** is expected to grow by 3.4% in 2022. On the other hand, in 2023, it is predicted that the GDP will remain at the level of 2022.

It is expected that in 2022 the GDP in **Germany** will increase by 1.2%; however, in 2023 it will decrease by 0.7%. Uncertainty, tighter financing conditions, higher cost pressures from input prices and wages, and supply-side constraints will weigh on investment. It is predicted that GDP in **Sweden** will reach 2.2% in 2022, while in 2023 the pace of GDP growth will slow down to 1%. Private consumption will remain weak as households face the dual challenge of high inflation and rising interest rates, especially on mortgage loans. **Estonia's** GDP will grow by 1.3% and 1.8% in 2022 and 2023, respectively. In the first half of the year, private consumption remained strong, despite the rapid increase in prices. It is predicted that in 2022 and 2023, **Lithuania's** GDP will grow by 1.8% and 1.6%. Economic activity will be slowed down by weaker export dynamics (especially to Ukraine, Russia, Belarus).

Growth of Latvia's Largest Trade Partners

GDP changes against the corresponding period last year, as per cent – left axis; share as per cent in 2021 – right axis

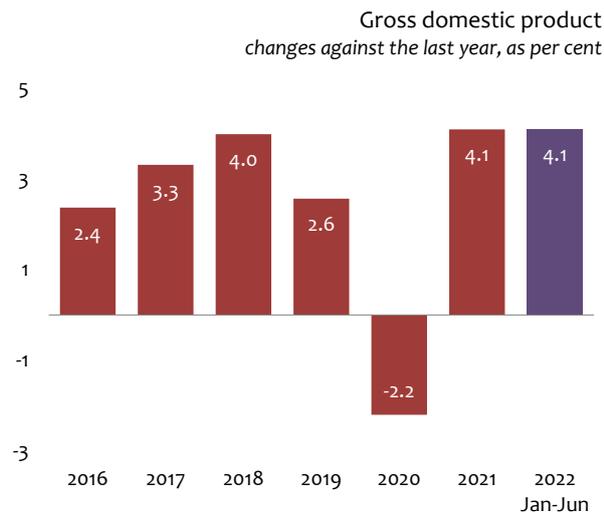


Source: CSB, OECD; f – forecast

2022 | 2 GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

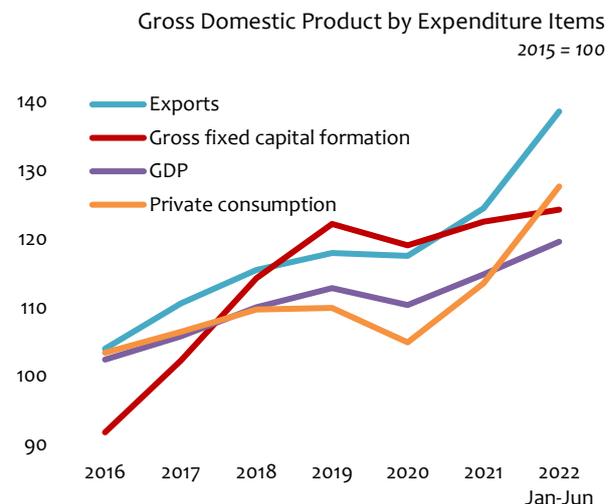
GROSS DOMESTIC PRODUCT

Economic growth will endure in 2022. In the first half of 2022, GDP grew by 4.1%, i.e., a slightly more moderate increase than in the first half of the previous year.

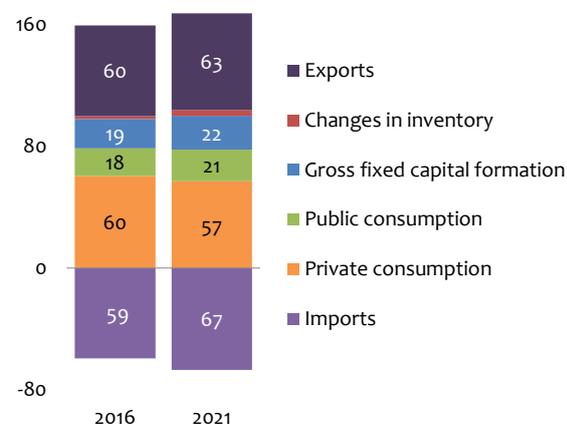


The economic development in the first half of 2022 was affected by the low base and the gradual lifting of Covid-19 restrictions. Rapid growth was observed in Q1 of 2022. However, in Q2 of 2022, GDP grew more moderately due to the great geopolitical uncertainty, the rapid rise in the prices of energy resources, and the disruption of raw material supply chains.

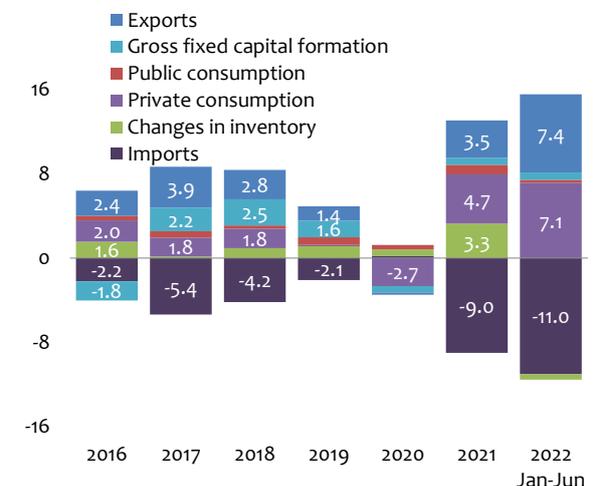
rapidly; while exports of goods grew more moderately due to the high base effect. Although a significant rise in consumer prices has been observed, private consumption grew very rapidly. The increase was facilitated by the rise in the average wage, the decrease in unemployment, and the completely lifted restrictions. Despite the great uncertainty, a slight increase in investment was observed. Investment in buildings and structures decreased due to rapid rise in costs, while investment in machinery, equipment, and vehicles and intellectual property products increased. Government consumption also continued to grow, albeit more moderately than in previous years.



Gross Domestic Product from Expenditure Approach % of GDP



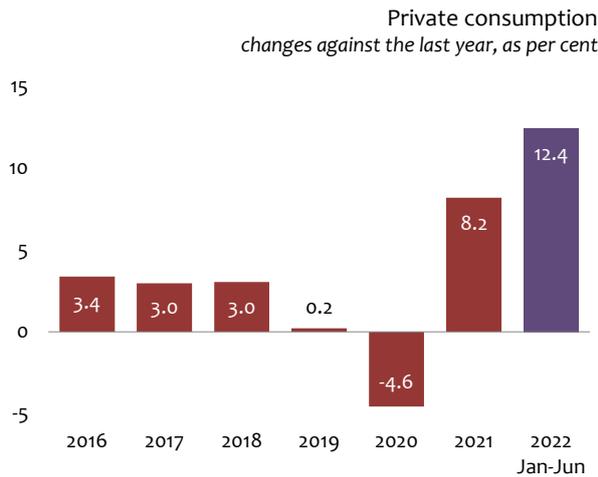
Gross Domestic Product by Expenditure Items contribution to growth as percentage points



The largest impact yielded the increase in exports and private consumption. Exports of services grew more

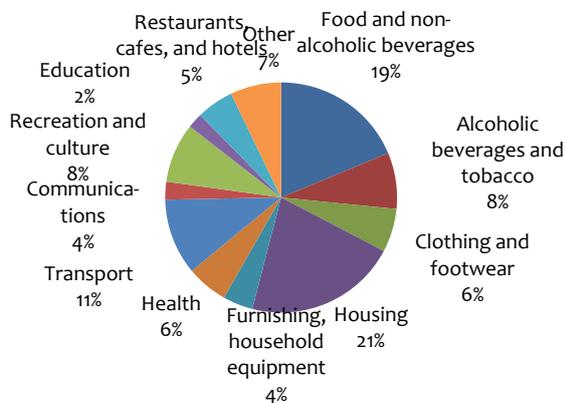
CONSUMPTION

Private consumption is growing rapidly. From 2015 to 2019, private consumption increased by 2.3% on average per year. However, in 2020, private consumption declined sharply due to Covid-19 restrictions. As the economy recovered, in 2021 and in the first half of 2022, a sharp rise in private consumption, driven by both the easing of Covid-19 restrictions and the rise in average wages and government support measures, was observed.



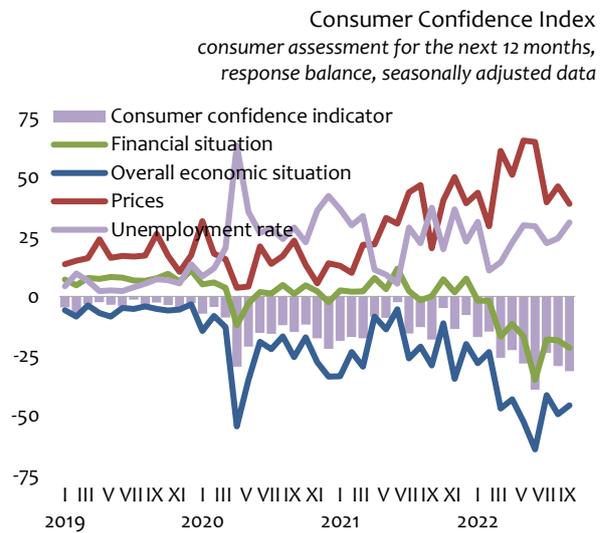
In the structure of household consumption, the majority is made up of expenses for housing. In 2021, compared to the last year, expenses increased in all consumption groups, except for alcohol and tobacco. In connection with the spread of Covid-19, a significant increase in health expenses was observed. On the other hand, with the gradual easing of Covid-19 restrictions, expenses increased more rapidly for clothing and shoes, restaurants and hotels, transport, housing, and recreation and culture.

Structure of Household Expenditures 2020, as per cent



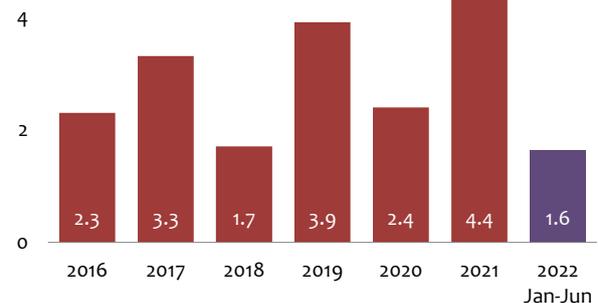
In 2022, consumer sentiment has remained significantly more pessimistic. Following the Russian invasion of Ukraine, consumer confidence experienced a sharp decline, exacerbated by rising inflation.

Due to the above-mentioned factors, in the first half of 2022, the deterioration of the confidence indicator was observed. The most pessimistic assessment was reached in June 2022. Both the assessment of the financial situation and the general economic situation fell to the lowest level since the financial crisis in 2009, while the level of inflation expectations reached the pre-crisis level of 2007. Consumers did not expect major shocks in the labour market, with unemployment expectations remaining at the previous year's level. Consumer sentiment has started to improve in the 3rd quarter; however, future prospects are assessed rather cautiously.



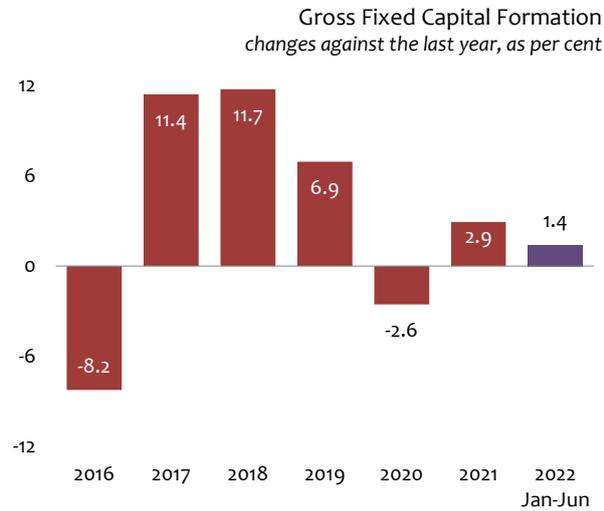
Public consumption continues to grow. Since 2014, as budget revenues increase, public consumption has also risen. From 2015 to 2021, the public consumption increased by 3%. In the first half of 2022, public consumption continued to grow moderately.

Public Consumption changes against the last year, as per cent



INVESTMENT

Due to the Covid-19 pandemic, the dynamics of investments weakened. From 2017-2019, investment volumes grew by an average of 10% annually. A large part of public investments constitute investments financed by the EU. As the absorption of EU structural funds approached the final phase, investment activities declined.



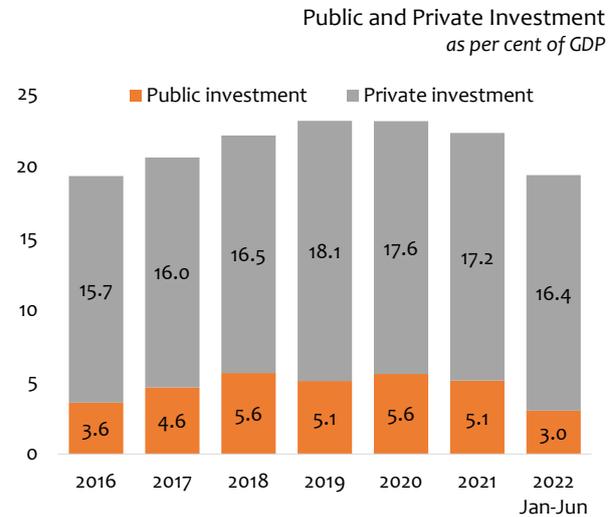
In 2020, investments decreased by 2.6%; however, in 2021, investments exceeded the level of the last year by 2.9%. Also, at the beginning of 2022, the growth of investments remains moderate. In the first half of 2022, compared to the corresponding period last year, expenses in the total fixed capital formation increased by 1.4 percent.

Private investment is increasing, albeit its level is low. Between 2017 and 2019 (before the Covid-19 crisis), private investments grew by 8.4% on average annually and accounted for almost 17% of GDP. Due to the impact of the Covid-19 crisis, the volume of private investments decreased by 5.3% in 2020. The lifting of pandemic restrictions had a positive effect on the dynamics of private investment; however, it is almost half as moderate as before the Covid-19 crisis. In 2021, compared to the previous year, they increased by 4.7%. In the first half of 2022, they were 4.2% larger than a year ago.

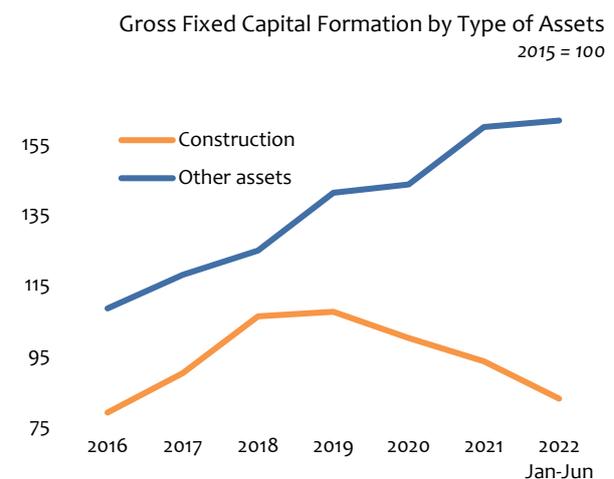
From a long-term perspective, private investment is low, largely affected by weak credit, low demand, and high uncertainty. The impact of these factors on investments was significantly intensified by the Covid-19 crisis.

Public investments in Latvia are at a relatively high level. Public investments constitute almost 1/5 of the total investments in the national economy of Latvia and their dynamics is largely related to the cyclical nature of EU structural funds. In the period from 2017 to 2019, public investments grew by 16% on average per year. As EU funding reached its peak, the amount of public investment decreased significantly in 2019. Despite the Covid-19 crisis,

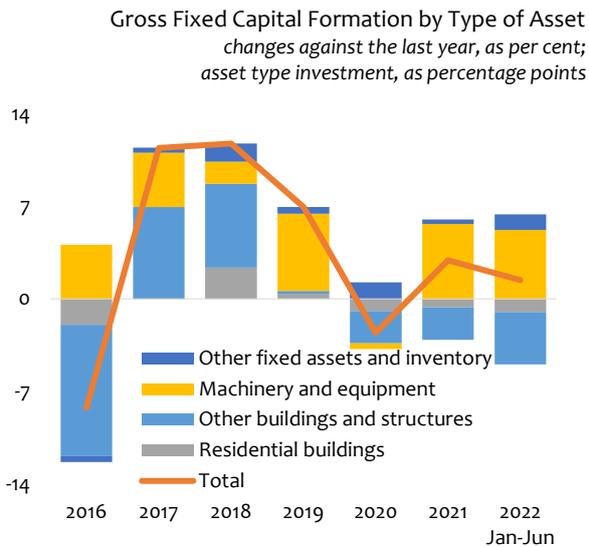
public investments increased by 7.2% in 2020. On the other hand, in 2021 and the first half of 2022 investments declined by 2.8% and 11%, respectively.



Investments in construction assets have been declining since 2020. Investments in buildings and constructions in the last three years before the Covid-19 crisis accounted for almost 45% of the expenses for the formation of the total fixed capital. As a result of the crisis, in 2020, investments in construction assets (at constant prices) decreased by 6.9%; however, in 2021 they were 6.5% lower than a year ago. Also, in 2022, investments in these assets continue to decline. In the first half of 2022, investments in engineering structures and buildings decreased by 11.5%; in housing – by 10.8%, which was largely influenced by the increase in construction costs.

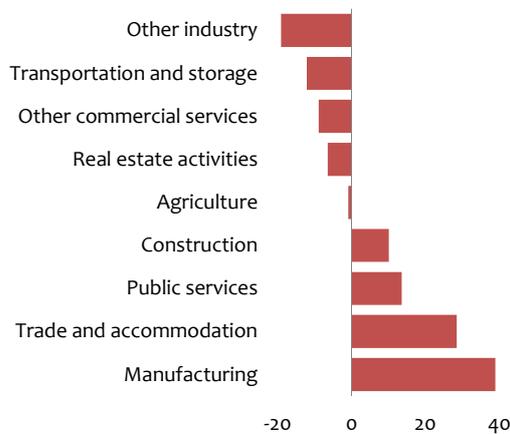


From 2017-2019, investments in machinery and technological equipment (excl. vehicles) did not exceed 40% of investments and their dynamics were slower than in other asset classes. In 2020, investments in machinery and equipment remained at the last year's level.



In 2021, investment in machinery and equipment increased by 12.9%. Also, in the first half of 2022, investments in machinery and equipment continued to grow, exceeding the level of the previous year by 11.4%. The increase in investment was largely driven by investments in vehicles, information and communication technology equipment.

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



* – calculated using quarterly data, at current prices

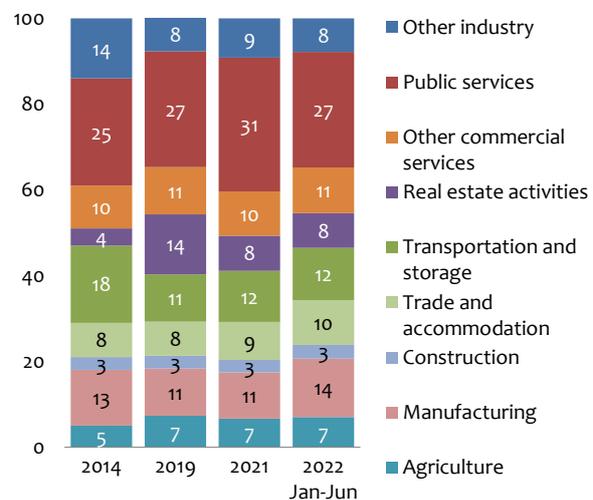
Investments in intellectual property products are increasing every year. In the last two years (2020-2021), they averaged 2.2% of GDP, which is higher than in the pre-Covid-19 pandemic period. The positive investment dynamics remained in 2022 as well. In the first half of 2022, investments in intellectual property products increased by 21.5% and reached 2.3% of GDP.

Gross capital investments in tangible fixed assets in the goods production sectors in the first half of 2022, compared to the corresponding period of the previous year, increased by 7.5%. Capital investments in service industries increased more moderately – by 3.4%.

The largest contribution provided the increase of investments in the manufacturing (by 39%), in the trade sector (by 28.8%), as well as in public service sectors (by 13.6%). The largest decrease in investment in tangible assets was in the energy sector, transportation and storage, and the education sector, which were 24.2%, 12.1%, and 28.2% lower than a year ago, respectively.

The results of the survey of managers of industrial companies show that the most important factor promoting investment is the rise in demand. On the other hand, the results of the survey of the European Investment Bank (EIB) reveal that in the long term the largest obstacles to investments are the uncertainty about the future and the lack of qualified labour force. Availability of finance is also of great importance in stimulating investments.

Gross capital investment structure
by sectors, as per cent*

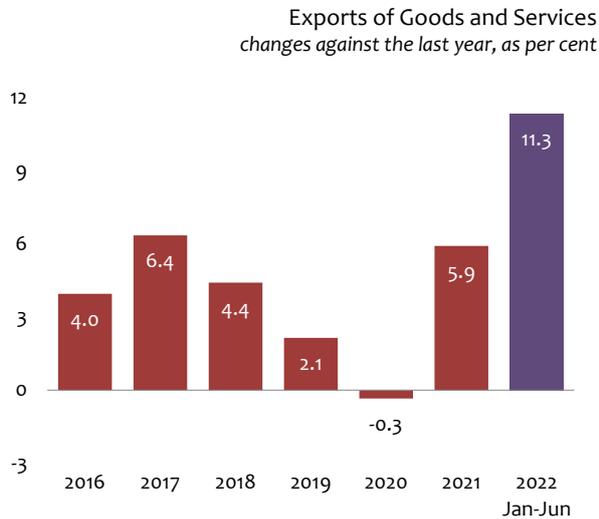


* Gross capital investment in tangible assets
(calculated using quarterly data)

The dynamics of investments will be greatly affected by uncertainty about geopolitical developments, inflation and measures to curb it, as well as the risks of the spread of Covid-19. Increasing the loan portfolio, which has been at a low level for a long time, will be of great importance. However, rising interest rates and inflation can become significant obstacles. The positive dynamics of investment will be influenced by EU funding, which is an important stimulus for increasing the level of investment. Investment activities will be stimulated by the start of the implementation of the Rail Baltica project. A large contribution in the increase of investment activities will ensure the projects financed within the framework of the RRF. It should be noted that investments in construction assets will be significantly limited by the rising cost of construction materials and their shortage. Also, the war in Ukraine increases uncertainty about geopolitical developments and may make private investors and lenders take a cautious position regarding investment plans and investment project financing.

EXPORTS

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



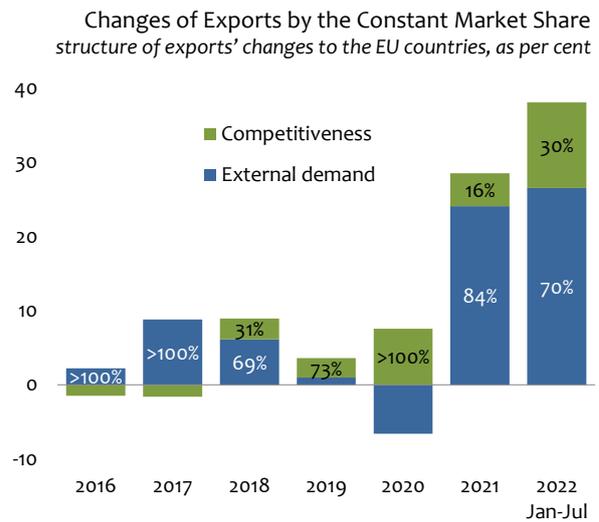
In 2020, the export volumes of goods and services decreased, mainly due to the Covid-19 pandemic. In 2021, thanks to rapid external demand and partly due to the base effect, export growth started to grow again.

In the first half of 2022, as external demand increased, export volumes continued to grow rapidly. Export growth was similar in both Q1 and Q2 of 2022.

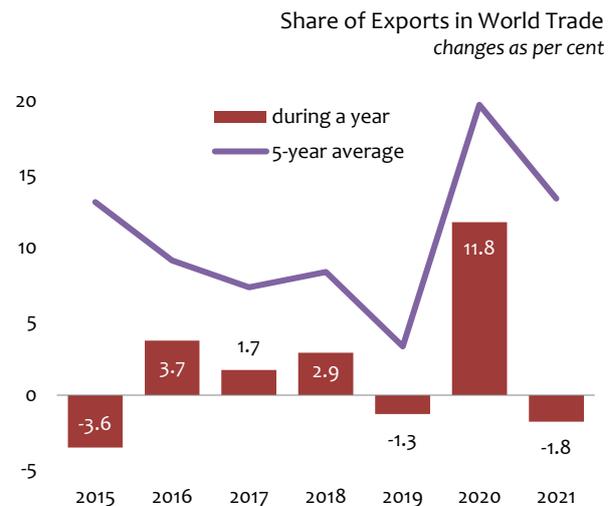


In 2015-2018, export growth was mainly determined by external demand, while the role of price competitiveness in export growth was smaller or even negative. In 2019, export growth was promoted by the competitiveness

effect associated with the successful acquisition of new markets. In 2020, under the influence of the spread of Covid-19, external demand declined rapidly, which was almost completely compensated by the increase in competitiveness in certain sectors. Both in 2021 and in January-July 2022, export growth was promoted by both a rapid increase in external demand and competitiveness.

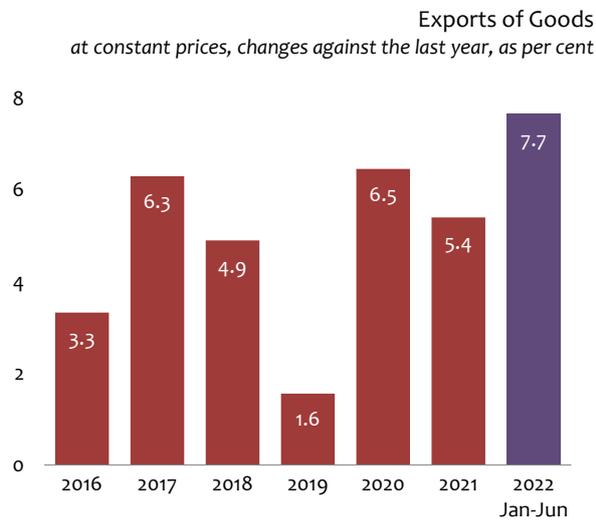


Since 2017, the share of Latvia's exports in the world market has increased, excluding the years 2019 and 2021, when Latvia's export growth rates were lower than the world average. On the other hand, in 2020, due to the impact of the Covid-19 pandemic crisis, the share of Latvia's exports in world markets exceeded the previous year's level by 11.8%. This shows that Latvia remains competitive, despite the rapid increase in labour costs.

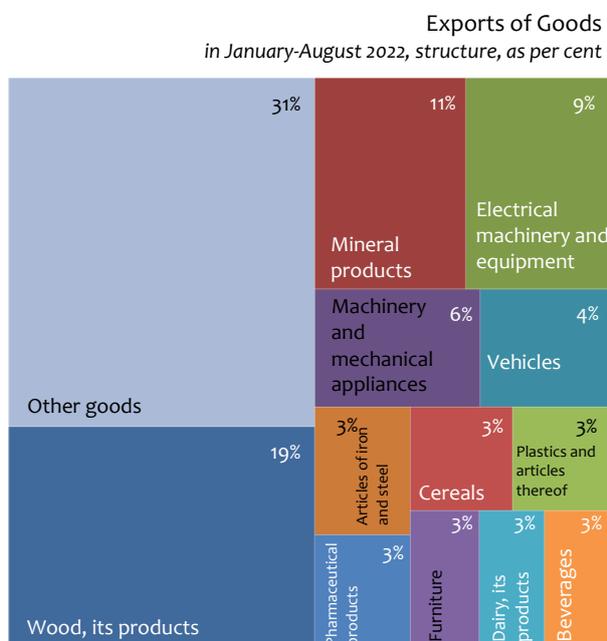


Exports of Goods

In recent years, the share of goods exports has been about $\frac{3}{4}$ of Latvia's total exports. As the export of goods have grown more rapidly, its share in the total export is increasing. In the first half of 2022, the export of goods made up 76% of the total export value.

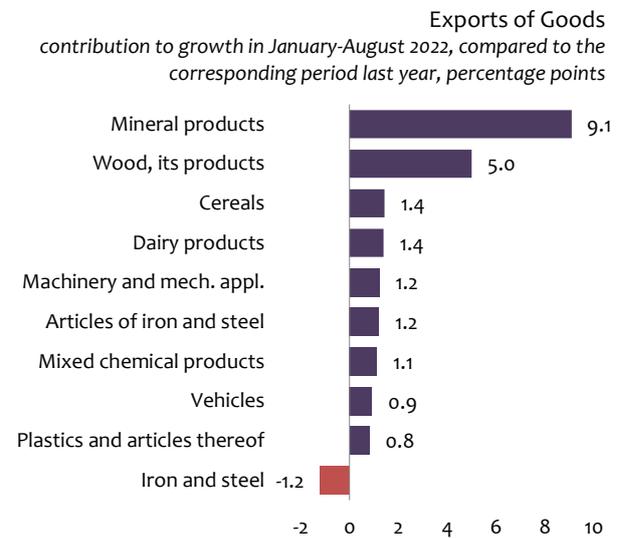


In 2020-2021, the growth of export of goods was relatively rapid. In 2021, at constant prices, it increased by 5.4%. While export prices significantly increased, the increase in actual prices was more rapid – by 23.7%.



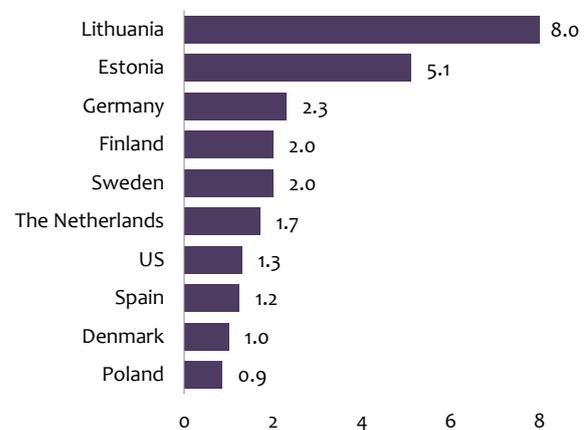
In 2021, the growth of export of goods was significantly facilitated by the increase in the export value of wood and its products, mineral products, as well as iron and steel. In January-August 2022, the export of goods in actual prices

increased by 31.2%. The export value of mineral products and wood and its products increased significantly.



In January-August 2022, the export of goods to all main partner countries increased. It grew more slowly to the CIS countries, but more rapidly in the EU and other countries.

Exports of Goods by Country
contribution to growth in January-August 2022, compared to the corresponding period last year, changes as per cent



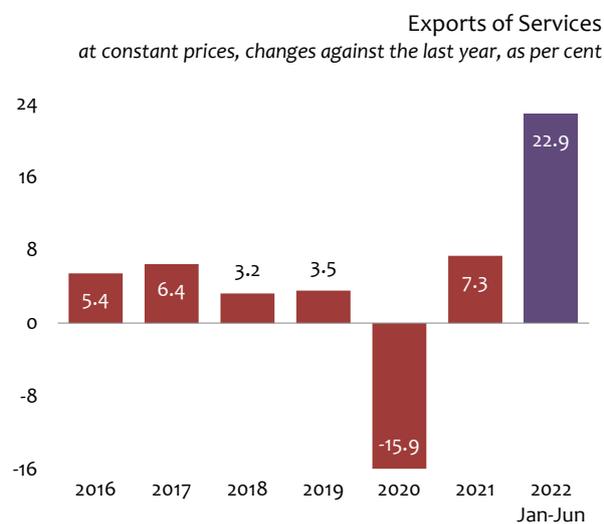
In January-August 2022, the largest export partner countries of Latvian goods were Lithuania, Estonia, Germany, the United Kingdom, Sweden, Russia, Denmark and Poland, accounting for 64% of exported goods.

In January-August 2022, the main export goods to EU countries were wood, its products, mineral products, and electrical machinery and equipment. Alcoholic beverages, machinery, and pharmaceuticals accounted for a large part of exports to the CIS countries. However, the largest export groups to other countries were wood and its products, cereals, and electrical devices and equipment.

Exports of Services

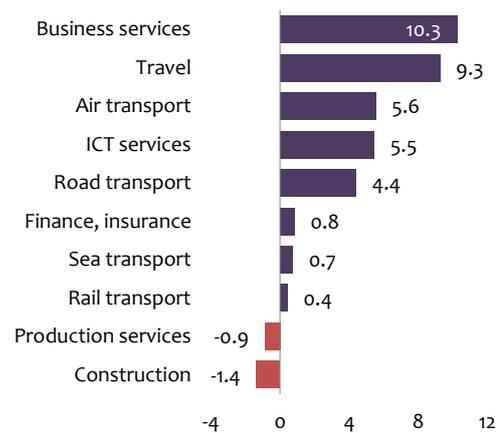
Until the pandemic, Latvia's export of services grew more rapidly than the export of goods every year on average. A large contribution to export growth was made by several service items – transport services, travel, ICT, and trade brokerage services. However, since 2016, the share of the exports of financial services has decreased.

Due to the spread of Covid-19, from Q2 of 2020 to Q1 of 2021, the export of services significantly decreased. Accordingly, in the next three quarters, the export of services increased significantly, partly due to the base effect. Overall, in 2021, the export of services in actual prices was by 10.4%, and in the first half of 2022 – by 35% higher than a year ago. However, considering price changes, exports of services grew more moderately at constant prices.

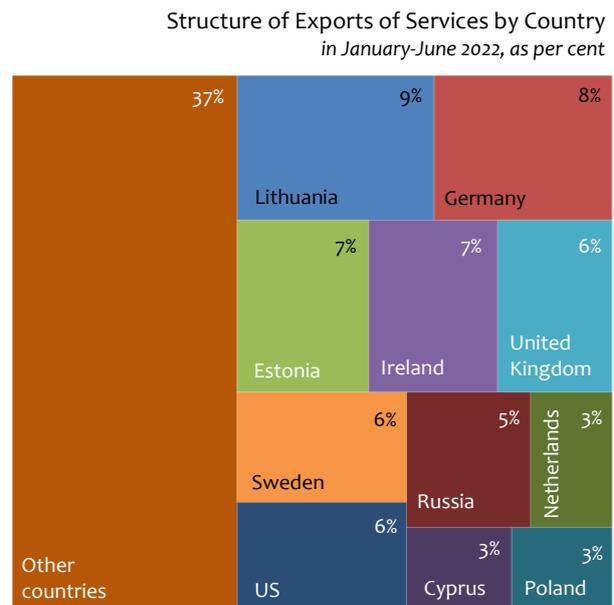
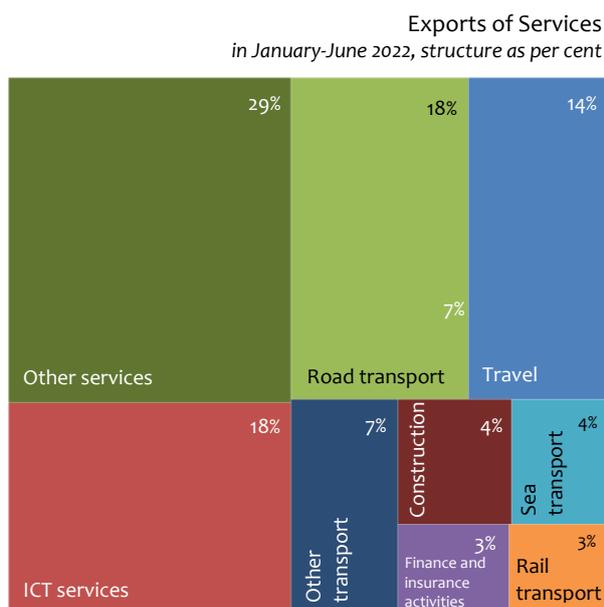


In the first half of 2022, the largest contribution to the increase in the exports of services provided transportation services and economic activity services. However, it should be noted that the export of transport services was slightly lower than in the first half of 2019. Exports of travel and ICT services also increased. On the other hand, a decrease was observed in the export of construction services.

Exports of Services
contribution to growth in January-June 2022, changes as per cent



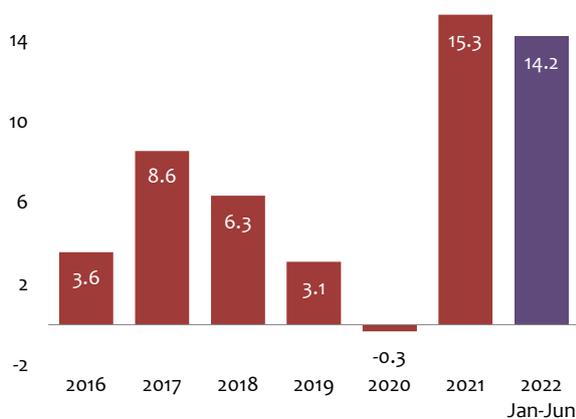
In the export of services by group of countries, an increasing proportion is made up of exports to EU countries. A considerable part is made up of the export of services to the CIS countries, which is mostly related to transit services. It should be noted that the share of service exports to the CIS countries has a decreasing trend in recent years.



IMPORTS

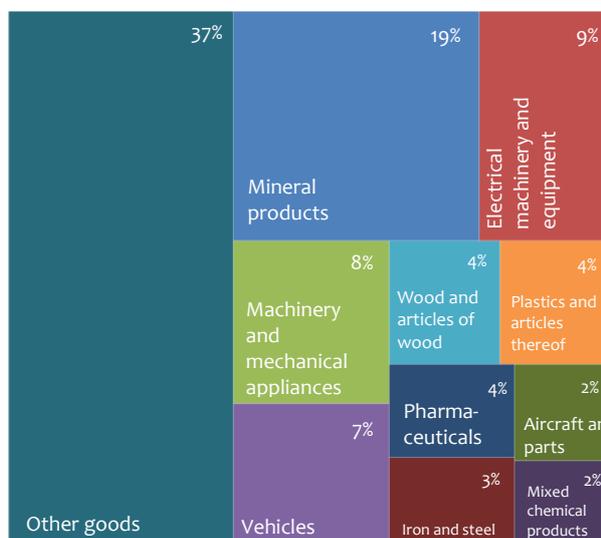
In recent years, the volumes of imports of goods and services have developed similarly to exports. Since 2017, the imports of services have traditionally grown more rapidly than imports of goods. In 2020, due to the impact of Covid-19, the import of services decreased significantly, while the import of goods increased slightly. In 2021, the import of both goods and services increased significantly. **In the first half of 2022, import growth endured, with services growing more rapidly.**

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



In January-August 2022, the imports of goods increased more rapidly in actual prices than in constant prices – by 35.9% due to price increases. A large part of the increase in the import of goods was due to the increase in the value of the imports of mineral products. Imports of electrical appliances and equipment, land vehicles, and various chemical products also increased.

Structure of Imports of Goods
in January-August 2022, as per cent



The main import partner countries of Latvian goods are Lithuania, Estonia, Germany, Poland, Russia, China, the Netherlands, and Finland. The value of imports from these countries in January-August 2022 made up 2/3 of Latvian goods imports.

In January-August 2022, the main groups of imported goods from EU countries were mineral products, mechanisms, vehicles and electrical appliances. Mineral products, wood and its products, and iron and steel accounted for a large part of the imports from the CIS countries. It should be noted that 90% of imports from CIS countries are imports from Russia and Belarus.

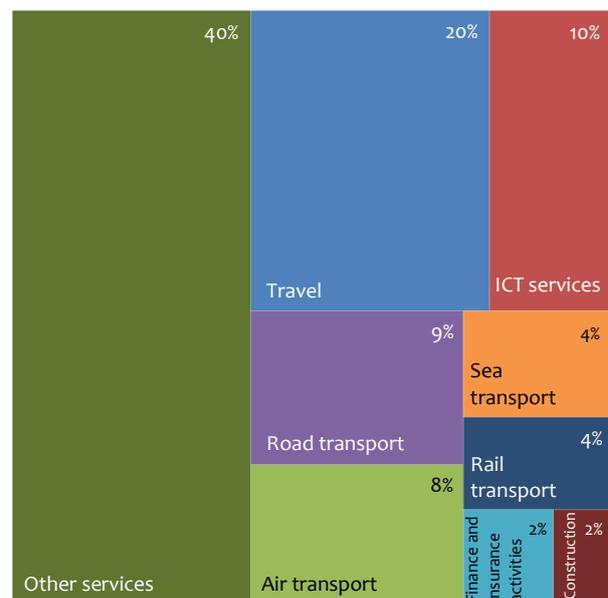
In the import structure, after the final use of goods, since 2019, the share of capital goods and consumer goods has slightly decreased, respectively – the share of intermediate consumption goods has increased.

Latvia's import of services in 2017-2019 developed dynamically, similarly to the export of services. During this period, imports of services grew by 8.5% (in actual prices).

In 2020, due to the spread of Covid-19, the import of services in actual prices decreased by 9.2%. The decrease in the imports of travel and transport services, especially air transport, had a major impact on the decrease.

In 2021, partly due to the base effect, the imports of services increased by 24.9%. **The rapid increase in the imports of services continued in the first half of 2022 – by 37.5%.** It was significantly facilitated by the increase in the value of imports of travel, transport and business services. Imports of ICT services also increased. On the other hand, the import of financial services decreased slightly.

Structure of Imports of Services
in January-June 2022, as per cent



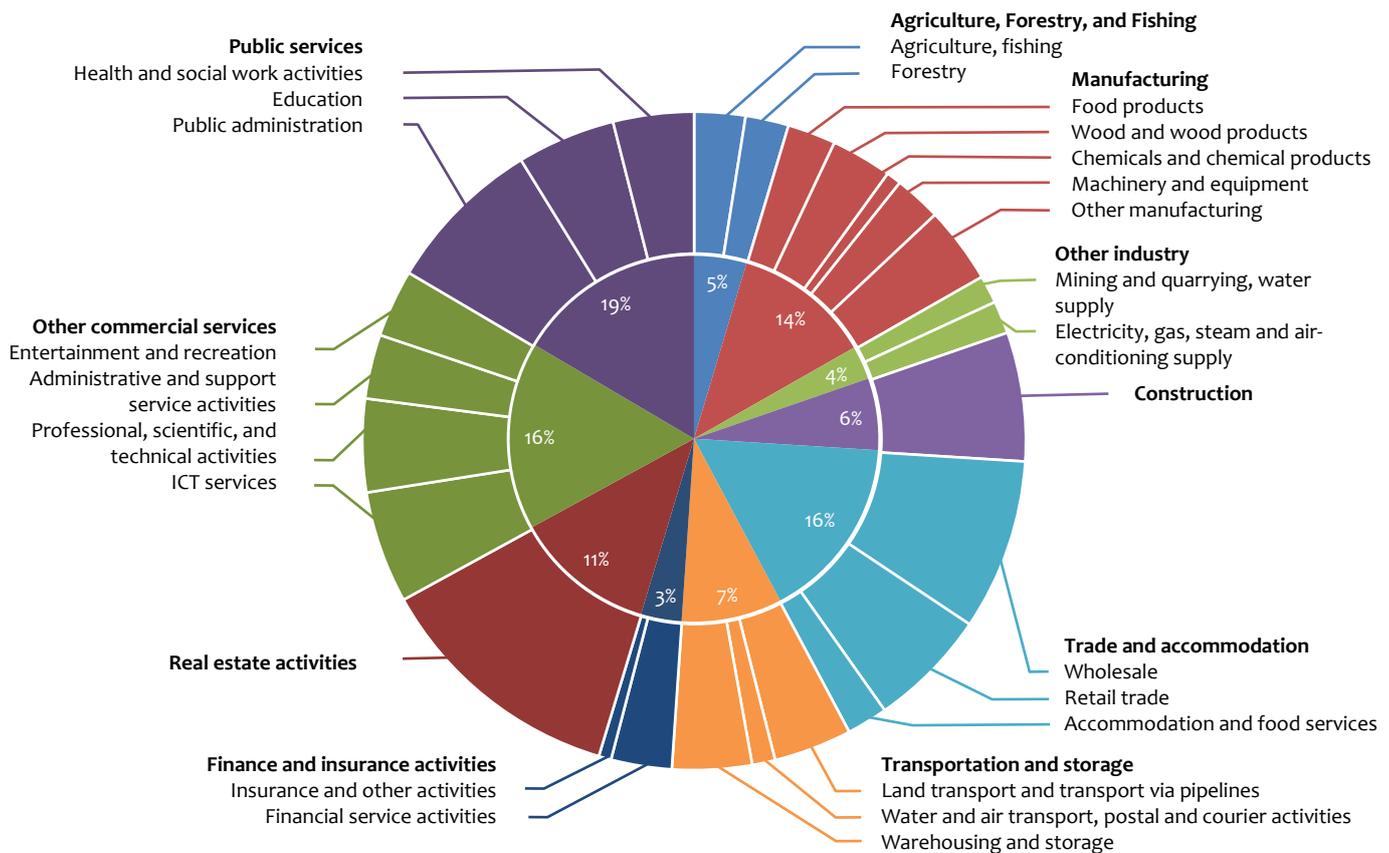
2022 | 2 SECTORAL DEVELOPMENT

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 2010, the share of these sectors reached 33.1% of the total value added. However, in 2021, the share of these sectors reached 28.7%. In 2010, tradable sectors (i.e., agriculture, forestry, and fishing, manufacturing, and construction) constituted 27.6% of the total value added. In 2021, it slightly declined to 27.3%. In 2021, compared to 2010, the share has increased in construction, commercial services and public services. However, a decline in other industry, transportation, trade and accommodation has been observed.

In 2015-2019, growth was observed in all sectors, except for electricity, gas, steam, and air conditioning supply, and

finance and insurance activities. Growth in trade and manufacturing had the largest impact on growth. However, in 2020, the Covid-19 crisis had negatively affected practically all sectors of the economy. Growth was observed only in agriculture, forestry, and fishing, construction, and public services. The largest decline was recorded in transport, accommodation and food service activities, the arts, entertainment, and recreation. As the economy recovered, in 2021, growth was observed in manufacturing and other industry, trade, transportation, financial activities, information and communication, and public services. In the first half of 2022, growth was observed in all sectors, except for construction, other industry, and trade. The largest impact yielded the increase in volumes in manufacturing.

Structure of Value Added
2021*, as per cent



* calculations by the Ministry of Economics

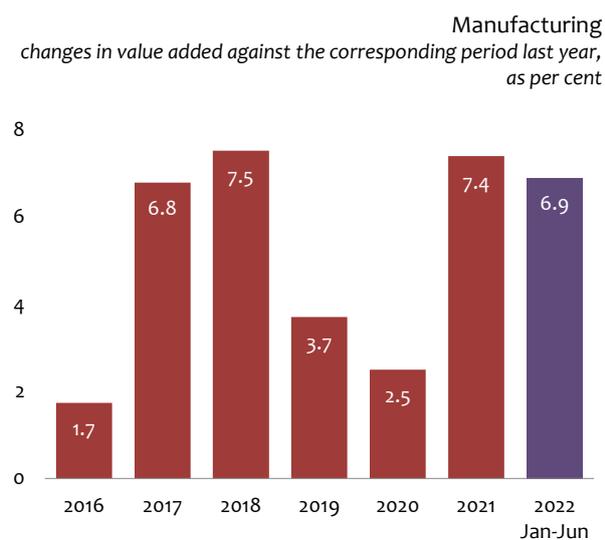
Development of Sectors
changes against the last year, as per cent

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 Jan-Jun |
|---|------------|------------|------------|------------|-------------|------------|-----------------|
| Gross domestic product | 2.4 | 3.3 | 4.0 | 2.6 | -2.2 | 4.1 | 4.1 |
| Agriculture, forestry, and fishing | -4.3 | 1.9 | -3.6 | 24.7 | 0.7 | -11.7 | 5.0 |
| Mining and quarrying | -2.8 | 9.1 | 9.1 | -5.2 | 8.3 | 5.0 | 2.1 |
| Manufacturing | 1.7 | 6.8 | 7.5 | 3.7 | 2.5 | 7.4 | 6.9 |
| Manufacture of food products | 1.8 | 5.2 | -2.9 | -0.7 | -1.7 | 1.3 | 2.6 |
| Light industry | 2.1 | 7.6 | -0.8 | -2.6 | -9.5 | 11.8 | 6.8 |
| Manufacture of wood and articles of wood | 8.0 | 2.1 | 4.5 | 0.0 | 4.5 | 3.7 | 3.4 |
| Manufacture of paper and paper products | 3.6 | 4.5 | -3.7 | 5.7 | 4.7 | 14.0 | 10.2 |
| Manufacture of chemicals and chemical products | 10.7 | 11.4 | 7.0 | 3.9 | -1.8 | 14.8 | 14.9 |
| Manufacture of non-metallic mineral products | 11.6 | 11.1 | 1.3 | -2.1 | -1.4 | 4.4 | 12.1 |
| Manufacture of basic metals | 5.4 | 12.0 | 3.6 | 13.5 | -5.6 | 5.8 | 28.6 |
| Manufacture of computer, electronic and optical products | 12.6 | 15.8 | 12.1 | 11.3 | 12.1 | 5.7 | -7.1 |
| Manufacture of machinery and equipment | 8.5 | 21.5 | 7.0 | -1.9 | -2.7 | 24.1 | -3.2 |
| Manufacture of motor vehicles | -2.9 | 22.8 | 7.3 | -7.7 | -15.3 | 17.7 | 23.0 |
| Other manufacturing | 0.8 | 4.3 | -1.8 | 2.8 | -14.2 | 11.8 | 4.4 |
| Electricity, gas, steam, and air-conditioning supply | 17.5 | -1.9 | -38.8 | 2.6 | 27.7 | 3.1 | -16.1 |
| Construction | -9.6 | 14.7 | 12.4 | 1.3 | -7.2 | -9.8 | -12.4 |
| Construction of buildings | -11.1 | 22.4 | 25.6 | 7.8 | 0.9 | -10.5 | -8.5 |
| Civil engineering | -25.7 | 30.0 | 11.6 | 1.0 | -1.5 | -5.0 | -16.5 |
| Trade | 4.5 | 2.6 | 3.9 | 6.2 | 1.4 | 8.0 | -1.3 |
| Retail trade | 2.3 | 4.3 | 3.8 | 2.3 | 1.5 | 2.5 | 7.2 |
| Transportation and storage | 1.7 | 6.6 | 3.8 | 3.5 | -20.2 | 9.9 | 2.3 |
| Freight rail transport | -14.1 | -8.4 | 12.5 | -15.8 | -42.3 | -9.5 | 17.8 |
| Cargo handling | -9.3 | -2.0 | 6.9 | -5.7 | -27.9 | -7.2 | 15.3 |
| Freight transport by road | 1.3 | 7.0 | 12.8 | -3.8 | 2.6 | 7.8 | -1.1 |
| Accommodation and food service activities | 4.4 | 9.3 | 7.6 | -3.9 | -33.7 | -4.6 | 79.3 |
| Information and communication services | 5.0 | 8.7 | 9.6 | 4.4 | 1.1 | 7.2 | 12.4 |
| Finance and insurance activities | -0.2 | -17.7 | -2.4 | -12.1 | -0.5 | 18.8 | 1.9 |
| Real estate activities | 1.6 | -1.6 | 2.3 | -3.6 | -1.1 | -1.7 | 0.7 |
| Other service activities | 3.9 | 4.6 | 2.7 | 0.4 | 0.8 | 1.4 | 15.8 |
| Public administration and defence; compulsory social security | 1.4 | 3.7 | 2.7 | 3.4 | 2.8 | 2.8 | 1.4 |
| Education | 1.2 | 4.4 | 3.1 | 2.8 | 2.7 | 3.1 | 3.7 |
| Health and social work activities | 1.2 | 4.4 | 9.3 | 9.6 | 4.3 | 25.2 | 6.2 |
| Arts, entertainment, and recreation | 5.0 | 5.1 | 6.1 | 2.8 | -30.2 | -3.3 | 31.2 |

MANUFACTURING

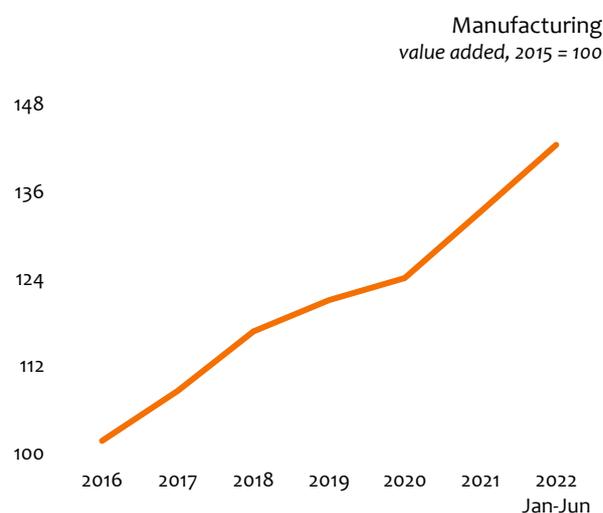
The development of manufacturing is promoted by the improvement of the competitiveness of Latvian producers, as well as the dynamics of demand in the largest export markets. Production volumes increased particularly rapidly in 2017 and 2018, albeit more moderately in 2019.

Due to the impact of the Covid-19 crisis, the growth of the manufacturing slowed down in 2020. Nevertheless, production volumes were 2.5% higher than a year ago.



In 2021, rapid growth resumed in the manufacturing. Also, similar rates will be maintained in 2022. In January-August 2022, the growth of manufacturing was influenced by increases in the production volumes of metals, non-metallic minerals, finished metal products, and beverages.

In 2022, the turnover of manufacturing in actual prices is also growing rapidly. In January-August 2022, the volume of production realized in the domestic market as well as through exports grew similarly.

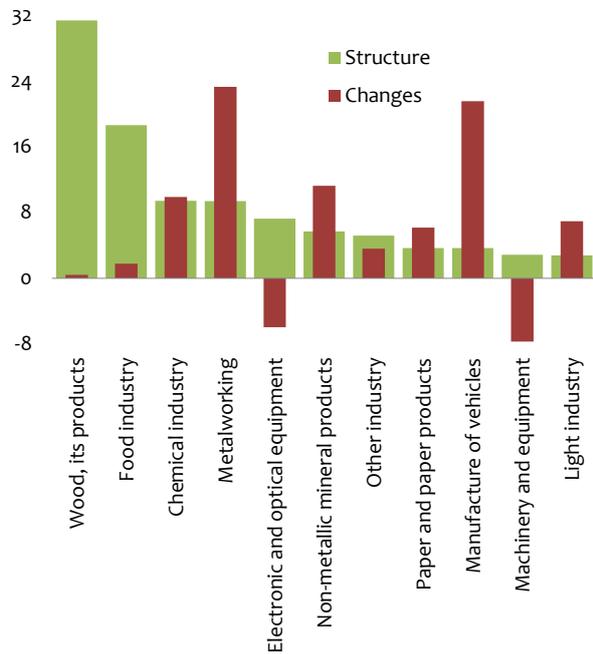


In 2018 and 2019, the number of occupied posts in manufacturing did not change significantly. In 2020, the number of occupied posts in manufacturing increased by 6.8 thousand, while in 2021 it increased by 5 thousand; however, in the first half of 2022, it slightly decreased – by 0.6 thousand. During the year, the increase in the number of occupied posts was observed in the manufacture of electrical and optical equipment, metalworking. However, it decreased in food and light industry, and woodworking.

Structure of Manufacturing and Development Trends by Field
as per cent

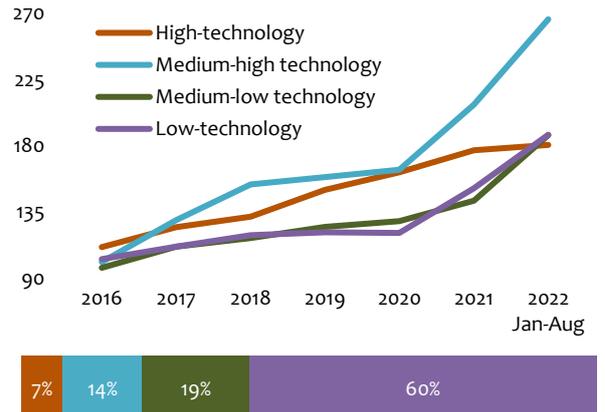
| | Structure in 2021 | | | Changes in production volumes | | | |
|--|-------------------|----------------|------------------------|-------------------------------|-------------|------------|--------------|
| | Output | Occupied posts | Exports in total sales | 2019 | 2020 | 2021 | 2022 Jan-Aug |
| Manufacturing | 100 | 100 | 67.5 | 2.1 | -0.9 | 7.5 | 4.7 |
| Food industry | 18.6 | 19.0 | 40.4 | -0.7 | -1.7 | 1.3 | 1.8 |
| Light industry | 2.9 | 8.1 | 82.6 | -2.6 | -9.5 | 11.8 | 6.9 |
| Manufacture of wood and wood products | 31.1 | 20.4 | 71.3 | 0.0 | 4.5 | 3.7 | 0.4 |
| Manufacture of paper and paper products | 3.7 | 4.5 | 67.2 | 5.7 | 4.7 | 14.0 | 6.2 |
| Manufacture of chemicals and chemical products | 9.4 | 7.6 | 75.7 | 3.9 | -1.8 | 14.8 | 9.9 |
| Manufacture of non-metallic mineral products | 5.0 | 5.2 | 51.1 | -2.1 | -1.4 | 4.4 | 11.3 |
| Manufacture of basic metals | 9.1 | 10.8 | 65.4 | 13.5 | -5.6 | 5.8 | 23.3 |
| Manufacture of electronic products | 8.5 | 5.3 | 88.6 | 11.3 | 12.1 | 5.7 | -5.9 |
| Manufacture of machinery and equipment | 2.9 | 3.3 | 91.9 | -1.9 | -2.7 | 24.1 | -7.7 |
| Manufacture of motor vehicles | 3.4 | 3.5 | 92.7 | -7.7 | -15.3 | 17.7 | 21.6 |
| Other manufacturing | 5.4 | 12.3 | 73.1 | 2.8 | -14.2 | 11.8 | 3.6 |

Growth of Manufacturing structure and changes in January-August 2022, compared to the corresponding period last year, as per cent



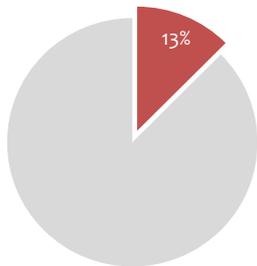
Stable demand in the EU enables manufacturing companies to maintain positive growth rates. However, the further development will be adversely affected by the Russian-Belarusian war in Ukraine. As a result, existing raw material supply chains will be disrupted and companies will be affected by rising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

Manufacturing Volume Index and Structure by Levels of Technology
2015 = 100, structure in 2021, as per cent

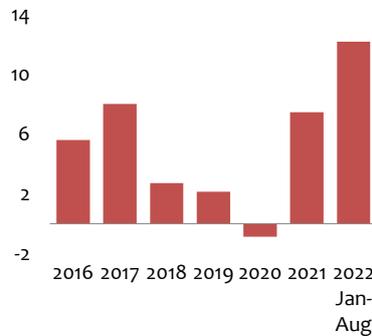


Main Indicators of Manufacturing¹

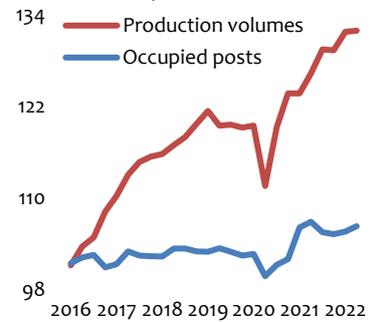
Share in total value added in January-August 2021, as per cent



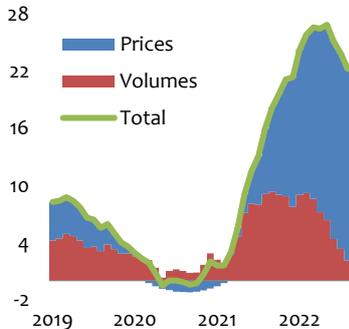
Changes in production volumes as per cent



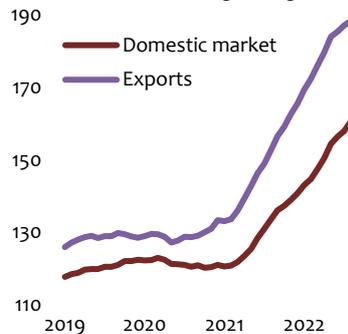
Production volumes and occupied posts Q4 2015 = 100



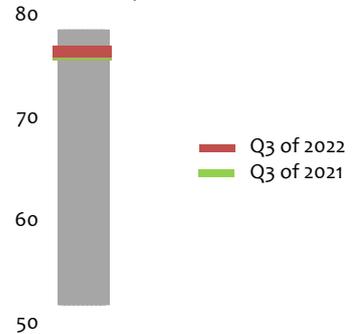
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average



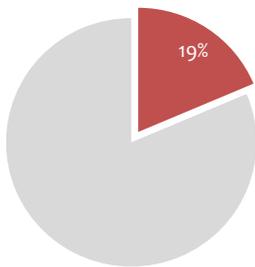
Capacity utilization rate Historically highest/ lowest level, as per cent



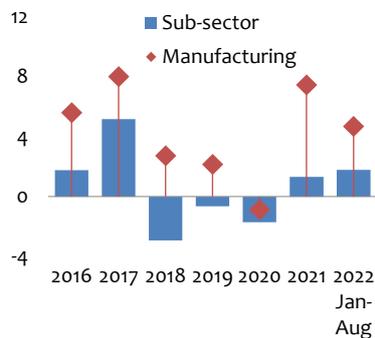
¹ data on sales of products until August 2022

Manufacture of food products and beverages

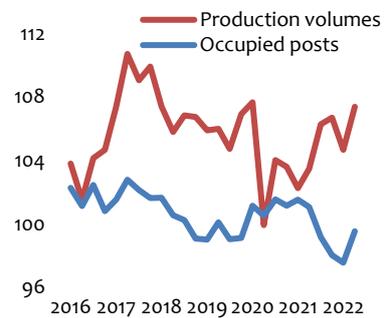
Share of manufacturing 2021, as per cent



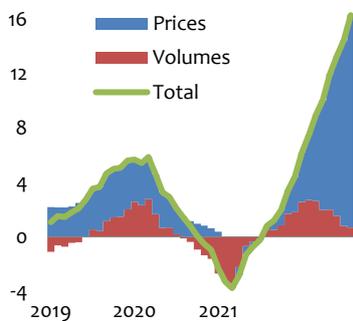
Changes in production volumes as per cent



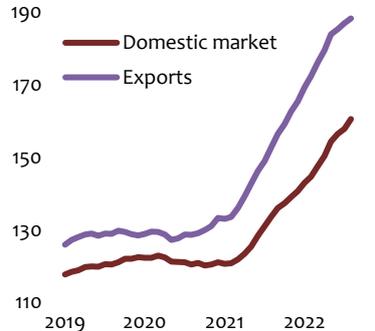
Production volumes and occupied posts Q4 2015 = 100



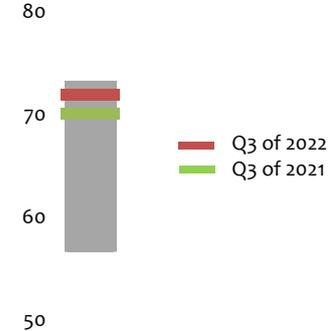
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

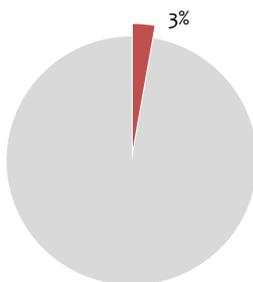


Capacity utilization rate Historically highest/ lowest level, as per cent

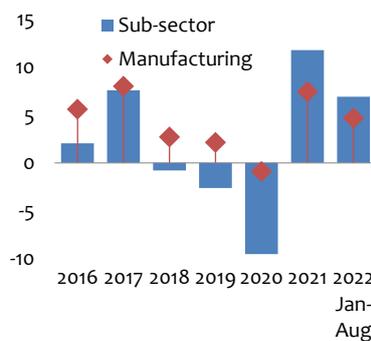


Light Industry

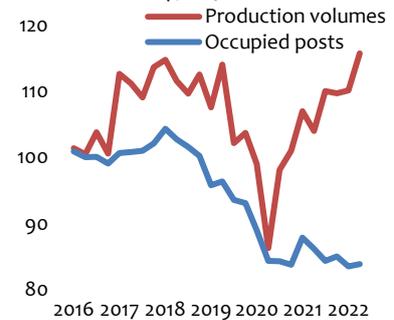
Share of manufacturing 2021, as per cent



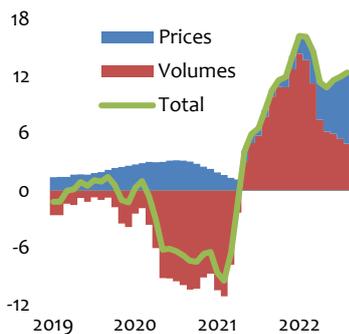
Changes in production volumes as per cent



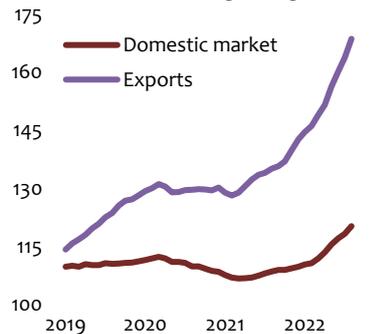
Production volumes and occupied posts Q4 2015 = 100



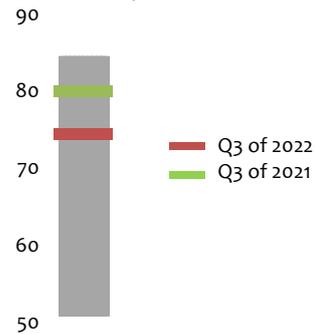
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

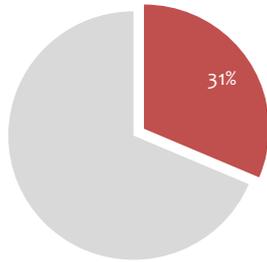


Capacity utilization rate Historically highest/ lowest level, as per cent

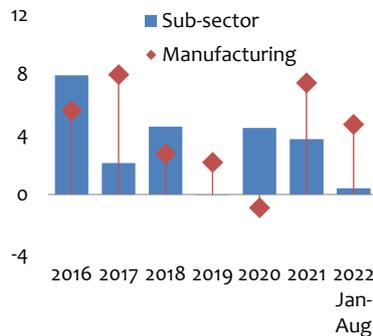


Manufacture of wood and wood products

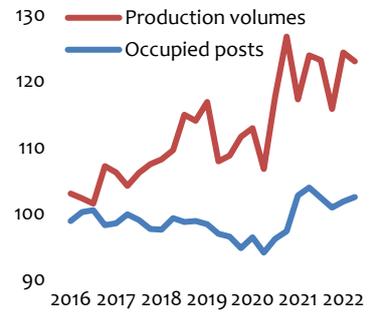
Share in total value added in January-August 2021, as per cent



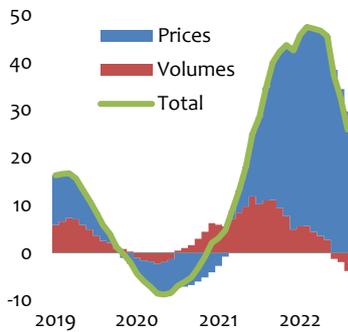
Changes in production volumes as per cent



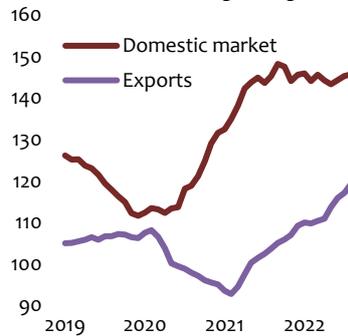
Production volumes and occupied posts Q4 2015 = 100



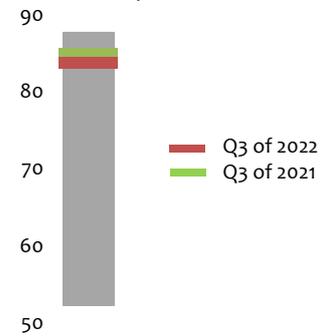
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

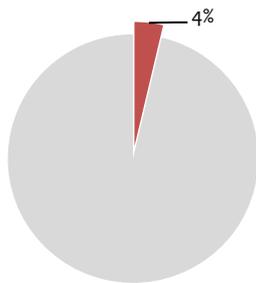


Capacity utilization rate Historically highest/ lowest level, as per cent

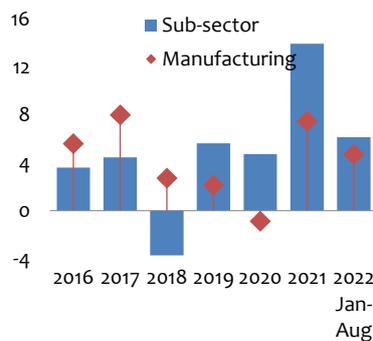


Manufacture of paper and paper products

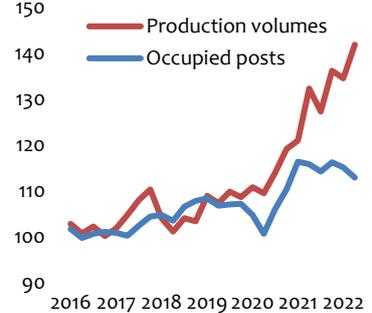
Share in total value added in January-August 2021, as per cent



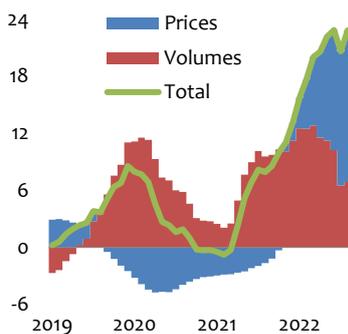
Changes in production volumes as per cent



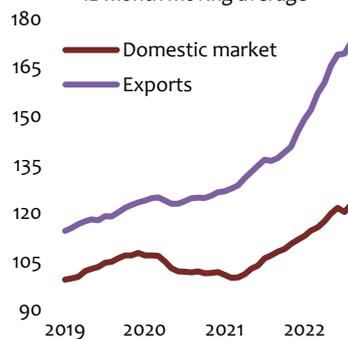
Production volumes and occupied posts Q4 2015 = 100



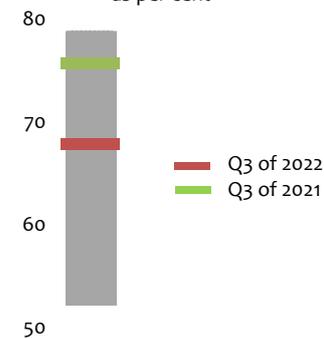
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

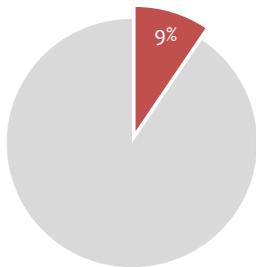


Capacity utilization rate Historically highest/ lowest level, as per cent

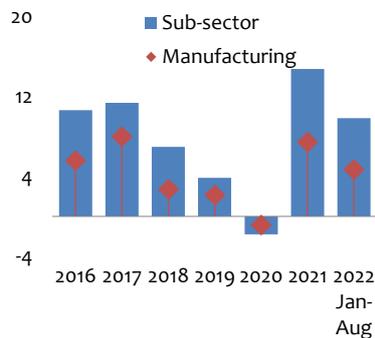


Manufacture of chemicals and chemical products

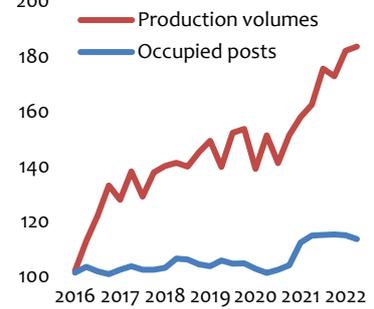
Share in total value added in January-August 2021, as per cent



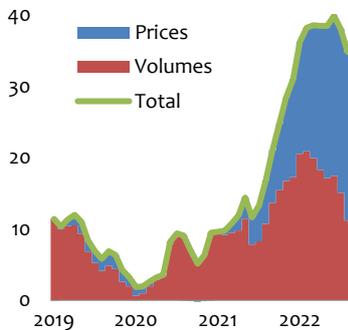
Changes in production volumes as per cent



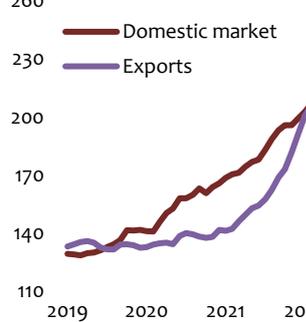
Production volumes and occupied posts Q4 2015 = 100



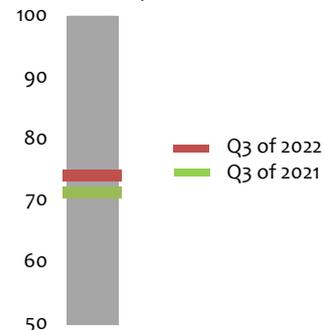
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

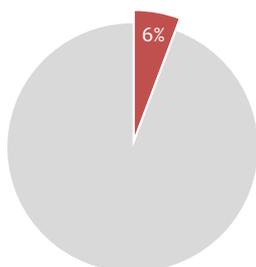


Capacity utilization rate Historically highest/ lowest level, as per cent

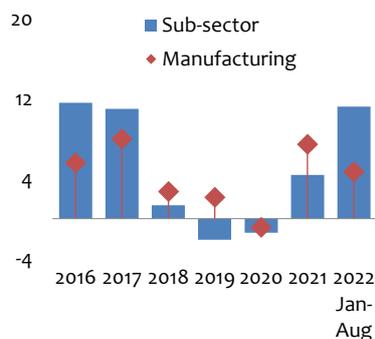


Manufacture of non-metallic mineral products

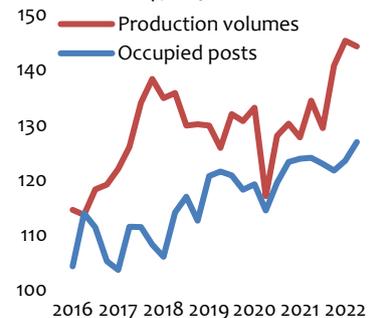
Share in total value added in January-August 2021, as per cent



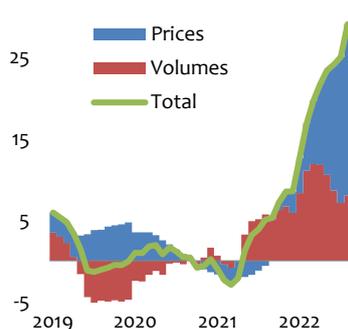
Changes in production volumes as per cent



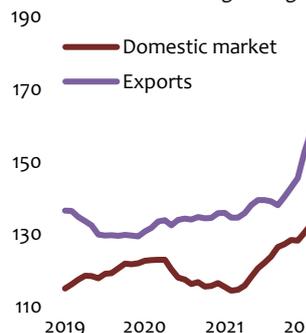
Production volumes and occupied posts Q4 2015 = 100



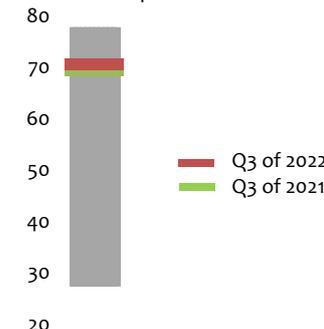
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

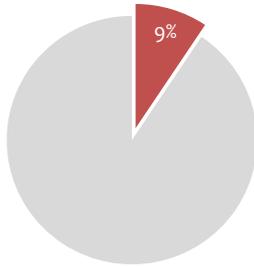


Capacity utilization rate Historically highest/ lowest level, as per cent

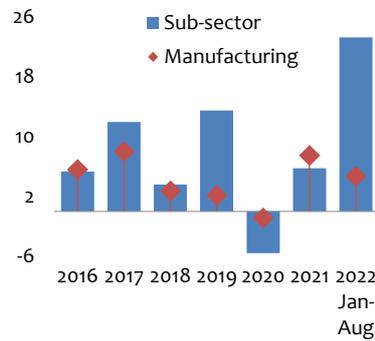


Manufacture of basic metals and fabricated metal products

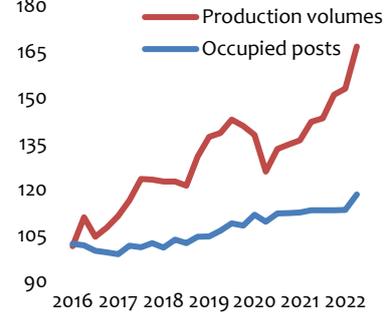
Share in total value added in January-August 2021, as per cent



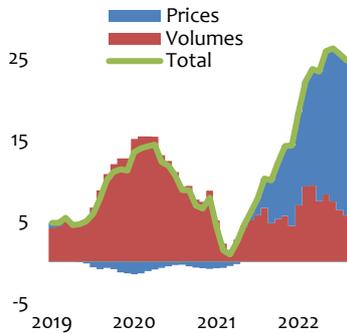
Changes in production volumes as per cent



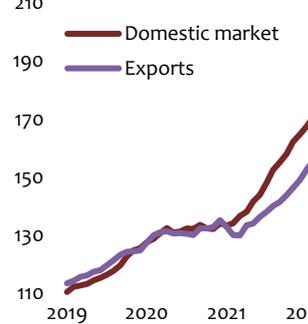
Production volumes and occupied posts Q4 2015 = 100



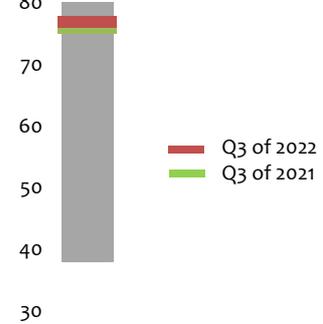
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

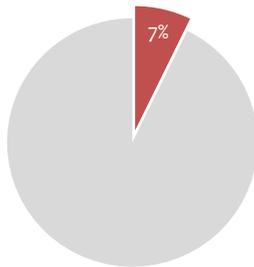


Capacity utilization rate Historically highest/ lowest level, as per cent

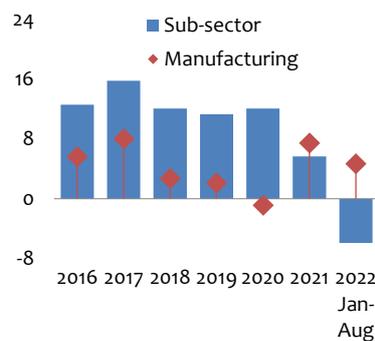


Manufacture of electronic and optical products

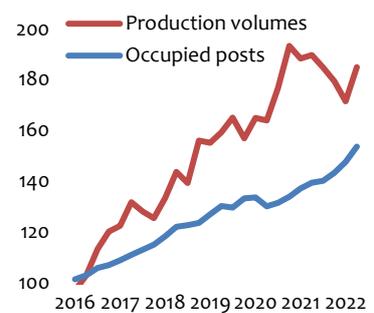
Share in total value added in January-August 2021, as per cent



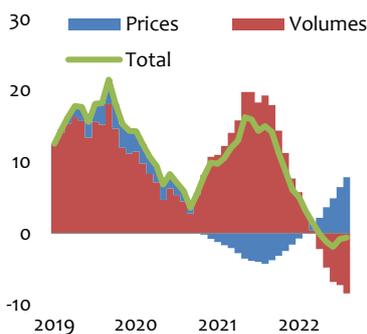
Changes in production volumes as per cent



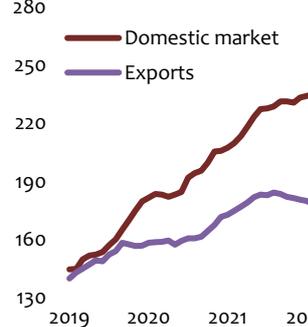
Production volumes and occupied posts Q4 2015 = 100



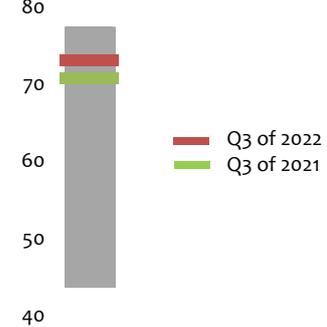
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

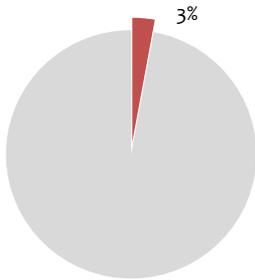


Capacity utilization rate Historically highest/ lowest level, as per cent

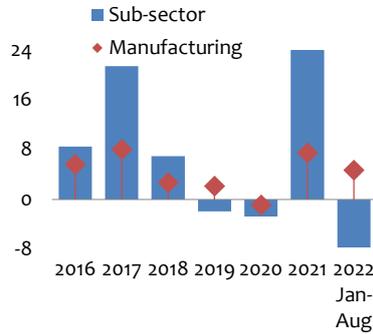


Manufacture of machinery and equipment

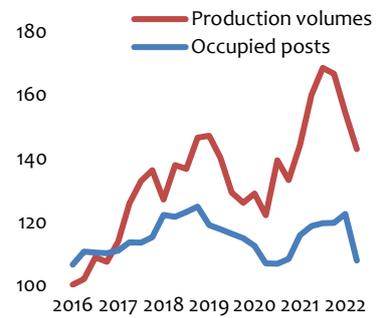
Share in total value added in January-August 2021, as per cent



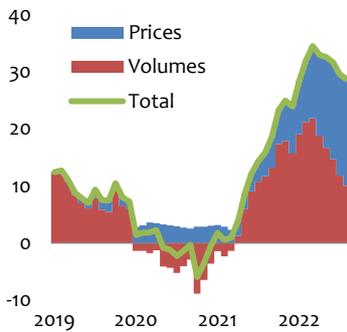
Changes in production volumes as per cent



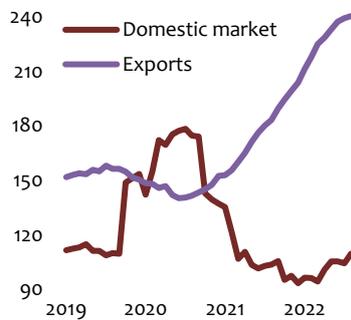
Production volumes and occupied posts Q4 2015 = 100



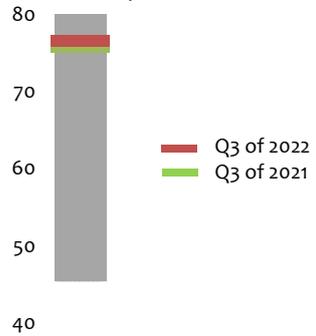
Changes in sales of production 12-month moving average



Production sales December 2018 = 100, 12-month moving average

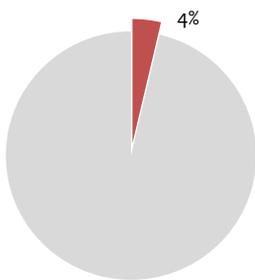


Capacity utilization rate Historically highest/ lowest level, as per cent

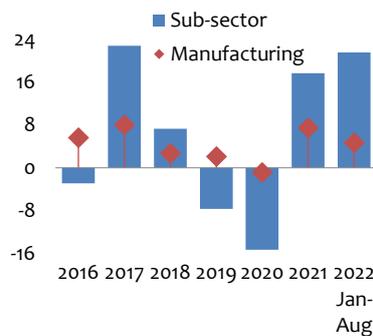


Manufacture of motor vehicles

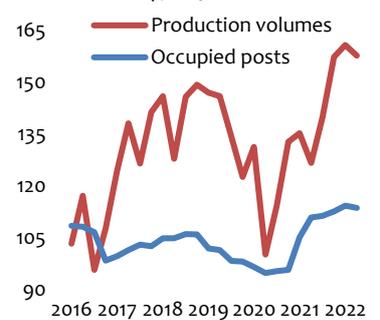
Share in total value added in January-August 2021, as per cent



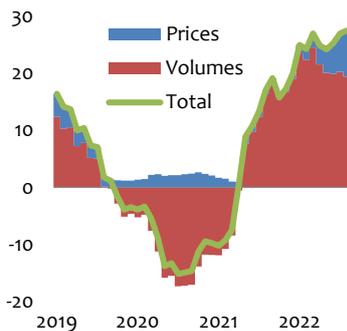
Changes in production volumes as per cent



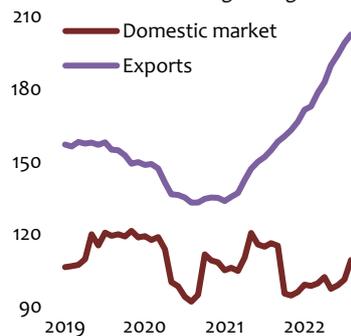
Production volumes and occupied posts Q4 2015 = 100



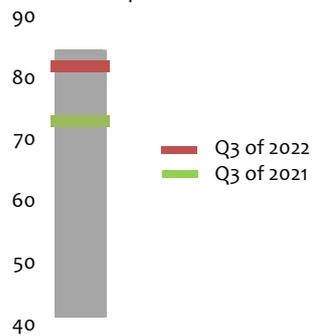
Changes in sales of production 12-month moving average



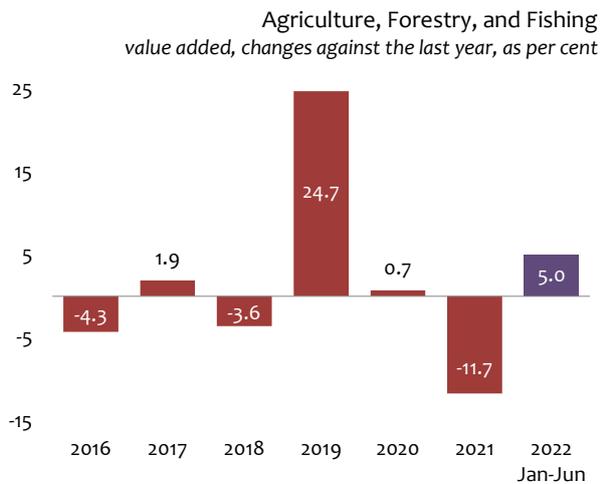
Production sales December 2018 = 100, 12-month moving average



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



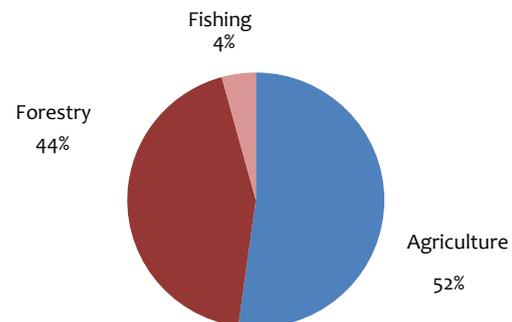
AGRICULTURE, FORESTRY, AND FISHING



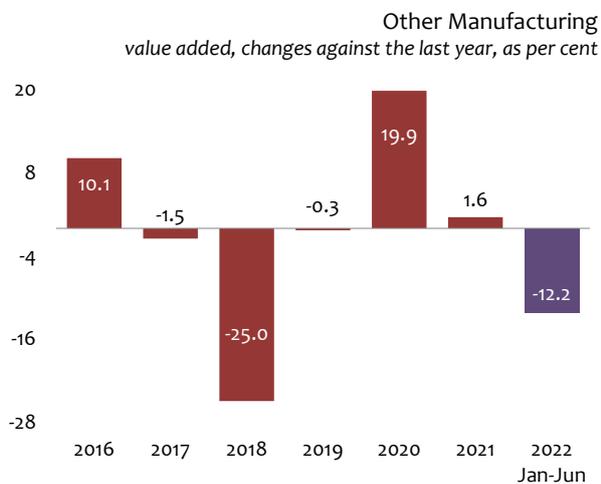
animal husbandry and fisheries production volumes increased moderately. In recent years, the number of employed and occupied posts slowly increased. However, in 2020, under the influence of Covid-19, the number of occupied posts decreased in agriculture and forestry; nevertheless, it increased in fishing. In 2021 and the first half of 2022, the number of occupied posts decreased in all subsectors.

Agriculture and forestry provide the largest contribution to growth within the sector. The activity of the sector is closely related to the weather conditions; therefore, the sector experiences fluctuating growth. After a sharp decline in 2021, production volumes increased in the first half of 2022 in all sub-sectors. A more rapid increase was observed in crop production, forestry and logging, while in

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



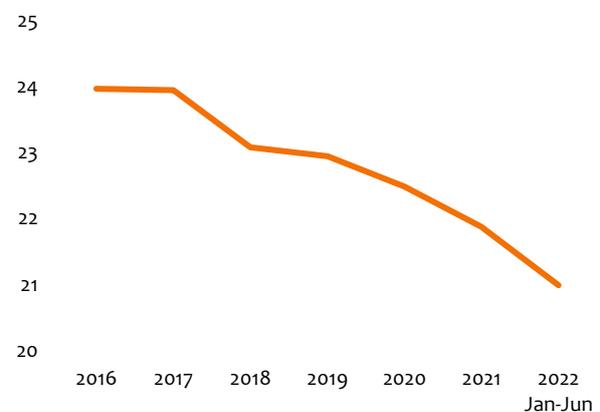
OTHER MANUFACTURING



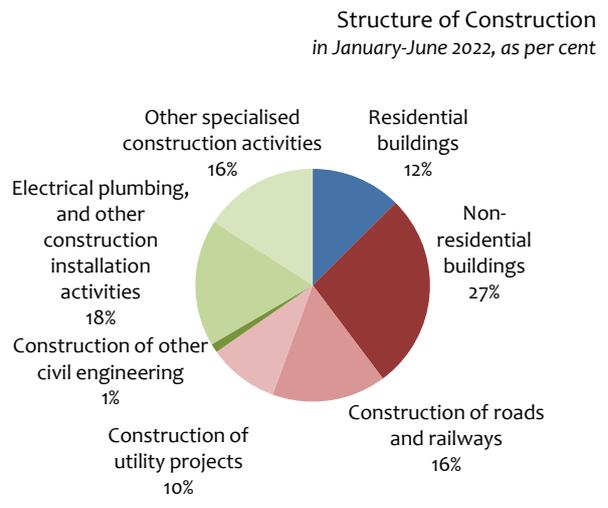
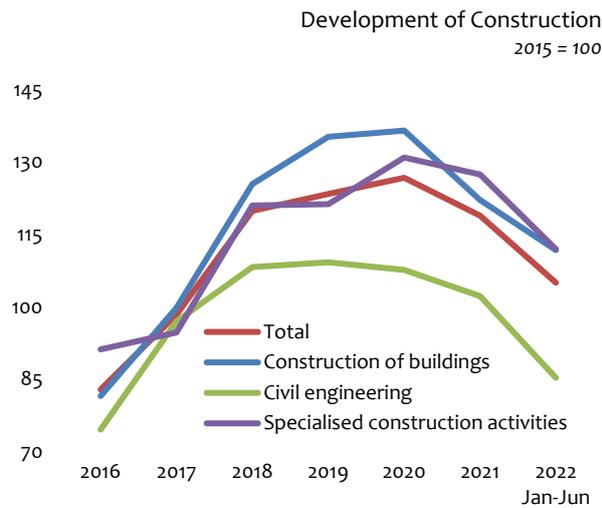
consumers. This is related to the cessation of natural gas supplies from Russia due to its invasion of Ukraine and also to the drop in consumption due to high natural gas prices. On the other hand, the favourable weather conditions at the beginning of the year contributed to the growth of the volumes of the mining and quarrying sectors. In recent years, the number of occupied posts has been increasing in the mining; however, it has been decreasing rapidly in other industrial sectors.

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 the first half of 2022, the volumes of the rest of the industrial sectors showed a sharp decline. The largest impact provided the decline in volumes in the electricity, gas supply, heating and air conditioning sector, which was determined by the low volumes of electricity produced in cogeneration plants and reduced gas supplies to

Occupied Posts in Other Manufacturing in thousands



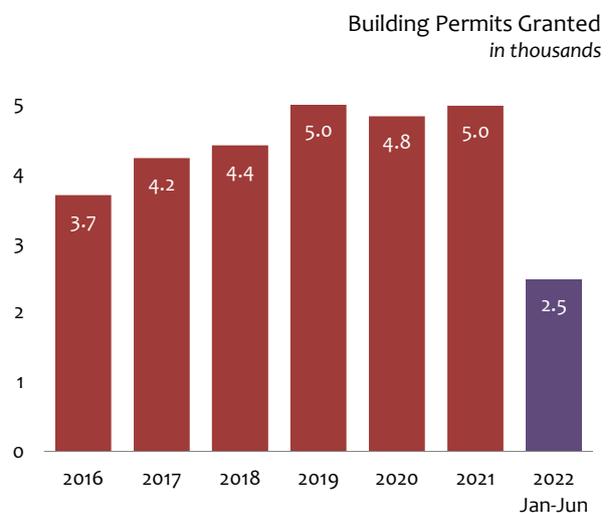
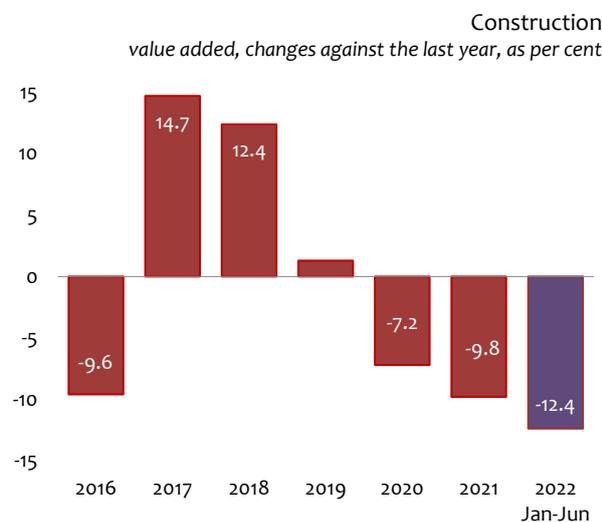
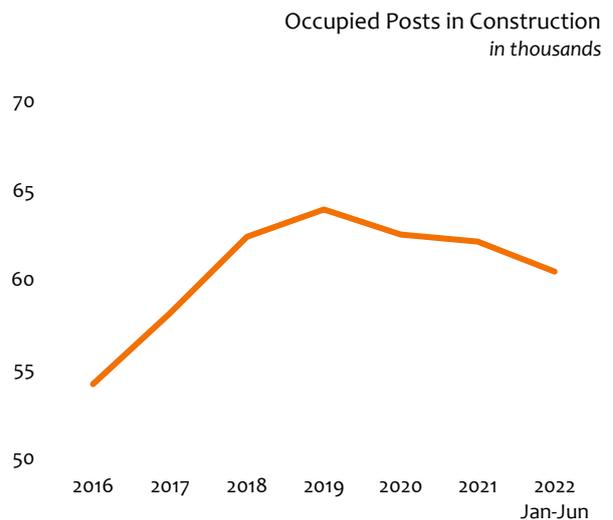
CONSTRUCTION



In the first half of 2022, compared to the corresponding period last year, construction production volumes continued to decrease by 11.7%. The rapid rise in prices is causing a decline in construction for the fourth consecutive quarter.

The decline can be observed in all main categories of construction. Building construction has been affected to a lesser extent, the rate of decrease in the first half of 2022 was 8.5%, compared to the corresponding period of 2021. This was mainly due to the decline in the construction of non-residential buildings. The other main categories of construction: engineering construction and specialized construction works, decreased more rapidly. In the first half of 2022, they declined by 16.5% and 12.2%, respectively.

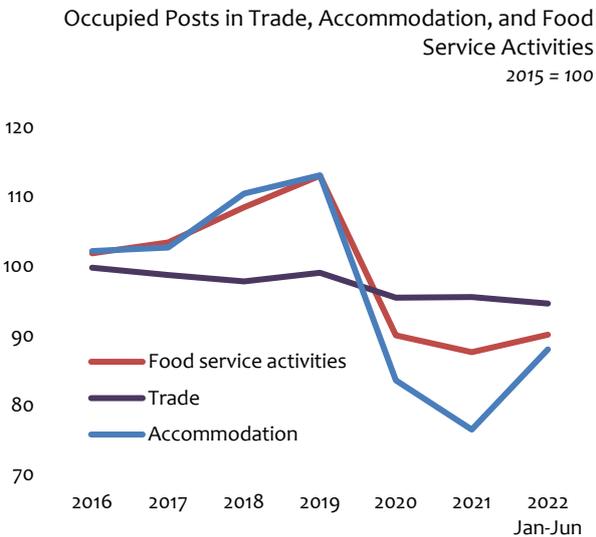
The number of building permits issued in the first half of 2022 was 2 473, remaining at the level of the corresponding period of the previous year. In contrast, the estimated area was 9% less during this period.



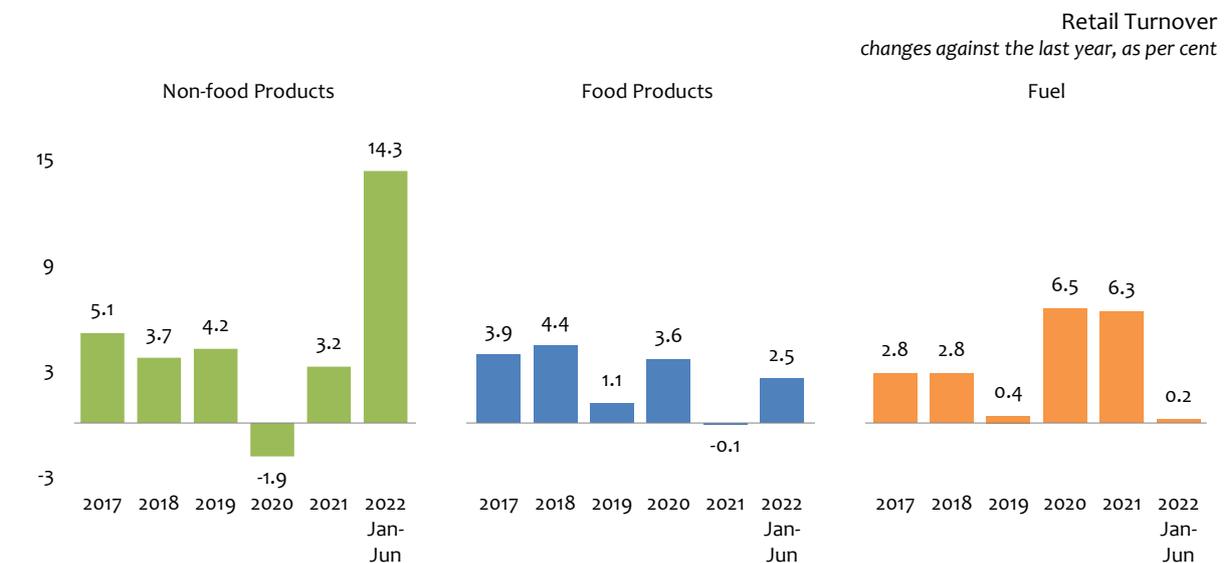
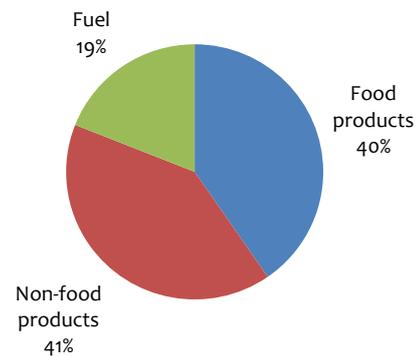
TRADE, ACCOMMODATION, AND FOOD SERVICE ACTIVITIES



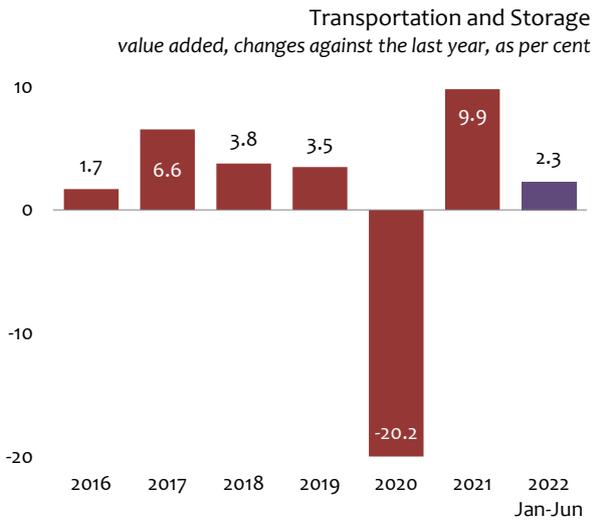
The volumes of services provided in the trade, accommodation, and food service activities are increasing. In the first half of 2022, the trade sector was negatively affected by the decline in the turnover of goods with the markets of Russia and Belarus. Therefore, the wholesale volumes decreased sharply in Q2 of 2022. Overall, trade volumes decreased by 1.3%. In the first half of 2022, the turnover of retail sales increased very rapidly – by 7.2% due to the lifting of restrictions due to Covid-19. The turnover of non-food retail sales grew most rapidly. It increased more moderately for food, albeit remained unchanged for fuel. In the first half of 2022, the growth of the accommodation and food service was rapid (by 79.3%). It should be considered that these sectors are recovering from a very deep recession and still lag behind the pre-crisis level. Also, the number of occupied posts also increased rapidly in the accommodation and food service activities. A slight decrease was observed in trade. The largest share of occupied posts remains in trade.



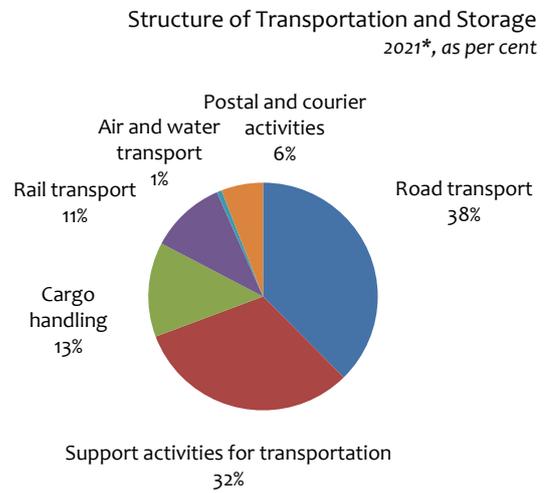
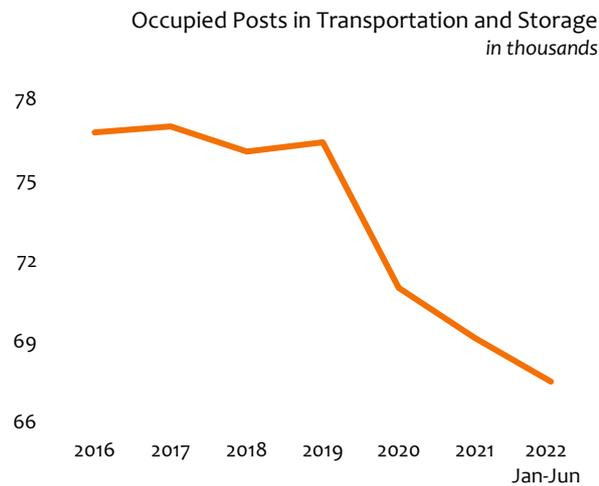
Structure of Retail Turnover
2021, as per cent



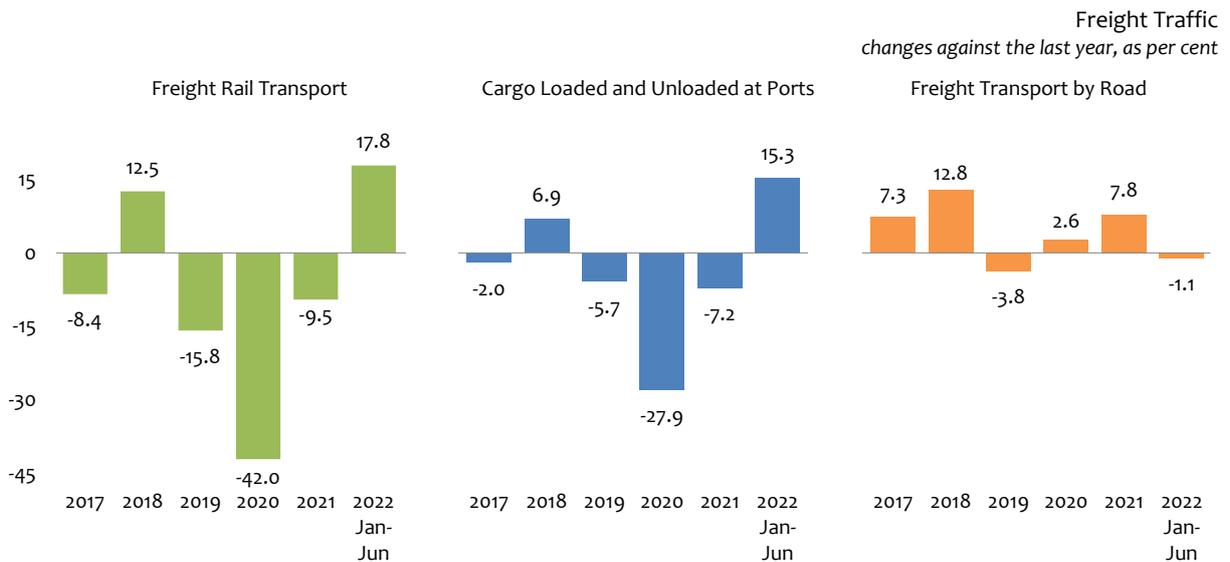
TRANSPORTATION AND STORAGE



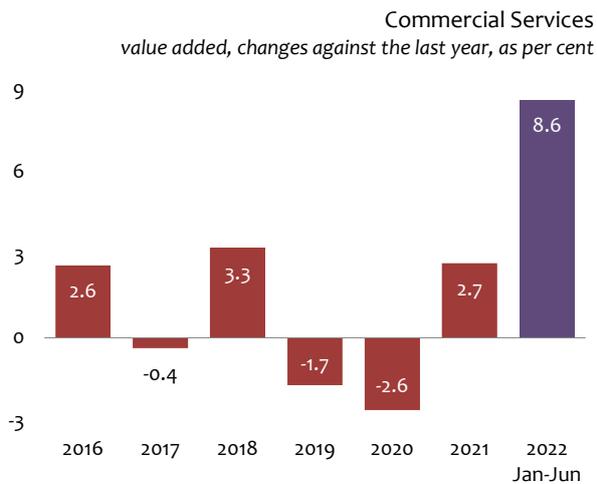
The transportation and storage sector is closely linked to international transportation. As the epidemiological situation improved and the introduced restrictions were lifted, the volume of the sector grew rapidly in 2021. In the first half of 2022, the volumes of the sector continued to increase. A rapid increase in the volume of transported cargo was observed in railways and ports, while the volume of road transport cargo decreased slightly, which was determined by a sharp drop in the volume of cargo transported in international transport. Passenger transportation, with the resumption of flow after the lifting of the Covid-19 restrictions, increased rapidly in the first half of 2022 in ports – by 65.8%; and in land transportation – by 33.3%. On the other hand, the number of passengers in air transportation increased more than five times, compared to the first half of 2021.



* – forecast by the Ministry of Economics

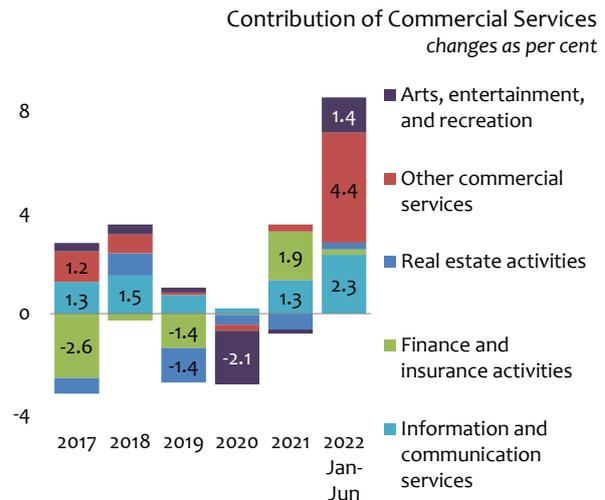


COMMERCIAL SERVICES

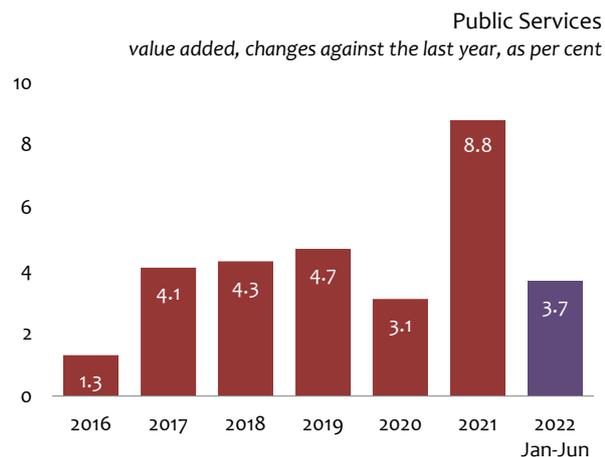


The largest share of added value in commercial services (incl. information and communication services, financial and insurance activities, real estate activities, professional, scientific, and technical services, administrative and support service activities, arts, entertainment, and recreation) provide real estate activities. In 2021, recovering from the Covid-19 crisis, the volumes of commercial services increased. In the first half of 2022, a rapid increase in volumes can be observed. The largest impact yielded the increase in the volume of services in professional, scientific and technical services, the operation

of administrative and service services, in information and communication services, and in the arts, entertainment, and recreation. The largest proportion of occupied posts is in information and communication services, professional, scientific and technical services, and administrative and service services. In the first half of 2022, the number of occupied posts increased only in the activities of finance and insurance and administrative and support service activities.

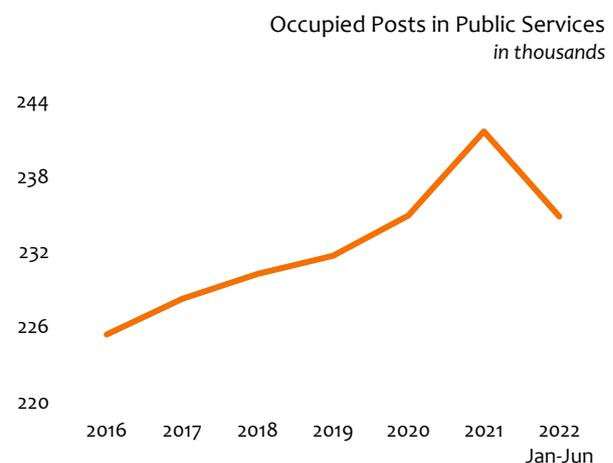


PUBLIC SERVICES



The largest share of value added in public services (incl. public administration and defence, education, health and social work activities) provide public administration and defence. In 2021, a rapid increase in the total volumes of services, which was determined by the increase in volumes for health and social care, was observed. Also, in the first half of 2022, the volumes for health and social care grew

more rapidly – by 6.2%. Also, the volumes of state administration and defence grew by 1.4%; and the volumes of education services – by 3.7%. The largest proportion of occupied posts was observed in education. After the rapid increase in last years, in the first half of 2022, the number of occupied posts declined in all sectors. The largest decline was observed in education.

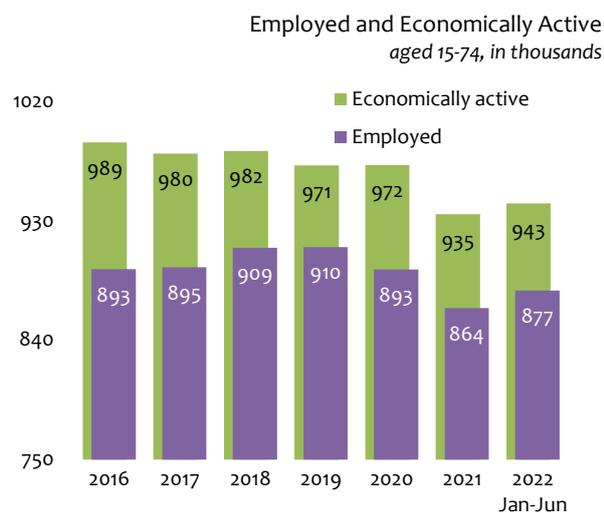


2022 | 2

LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

Along with the increase in economic activities, since April 2021, employment has started to rise again, and unemployment continues to fall. Also, along with the increase in labour demand, the shortage of labour is becoming increasingly noticeable, as evidenced by the return of unemployment indicators to the pre-crisis (2019) level, as well as the increase in the number of vacancies and the number of employed. The Covid-19 crisis has generally had a negative impact on the population's economic activity, which, along with demographic processes, narrows the supply of labour on the labour market and increases the risks of labour shortages.



At the same time, despite the increase in employment, the overall demand for labour remains limited, which is also indicated by the decrease in the total number of occupied posts. With increasing pressure from the supply side, both in terms of the availability of human resources and in terms of wages, it is increasingly difficult for employers to create new jobs and attract employees to them.

Along with the increase in economic activities, since April 2021, the employment has also started to grow. In the first half of 2022, compared to the corresponding period last year, the number of employees has increased by 19.8 thousand or 2.3%. However, in Q2 of 2022, it reached 23.6 thousand (2.7% annual increase), which has been the most significant quarterly increase in employment since 2013.

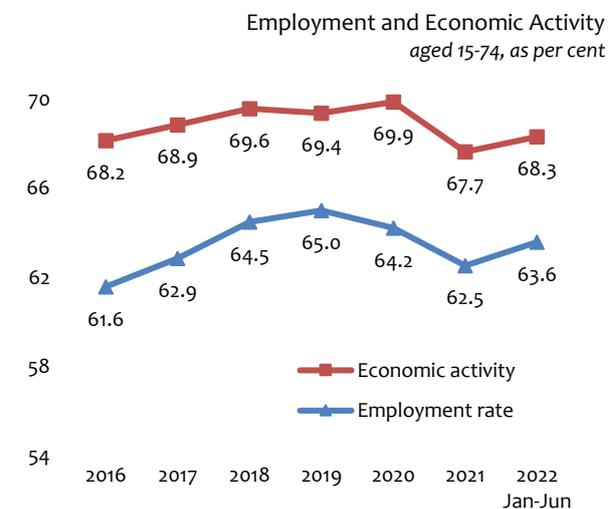
Employment growth is still largely driven by the low base effect. It should be noted that in 2021 the number of employed reached its lowest level since 2011 (in 2021, there

were 864 thousand employed population). As economic activity in the national economy rebound, the demand for labour is also gradually increasing.

Despite the rapid increase in employment, the number of employed still lags behind the level of the 2019 (before the Covid-19 crisis). In Q2 of 2022, the number of employees was by more than 20 thousand (or 2.3%) less, compared to Q2 of 2019.

Overall, in Q2 of 2022, 885.2 thousand population aged 15-74 were employed (i.e., 64% of residents in private households). The annual employment rate of the population increased by 1.7 percentage points; however, it lags behind the 2019 level by 0.7 percentage points.

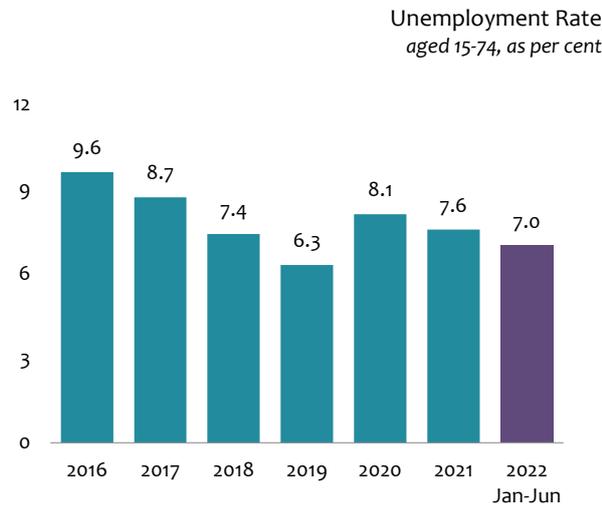
It should be noted that the employment level in Latvia in Q2 of 2022 remained significantly lower than in the neighbouring countries – in Estonia, the proportion of employed population in this period was 68.8% of the total population aged 15-74; while in Lithuania – 66.9 percent.



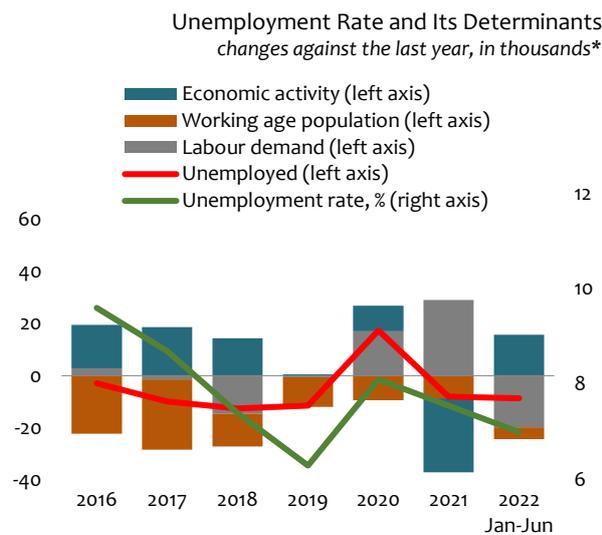
Along with the improvements in the epidemiological situation and the recovery of the labour market, the economic activity of the population, or participation rate, has also increased. In Q2 of 2022, the level of economic activity of the population increased to 68.5%, which is 0.9 percentage points higher than a year ago.

Considering the increase in economic activity of the population, the number of economically active population has also increased in Q2 of 2022. During this period, the

number of economically active population aged 15-74 increased by almost 13 thousand (or 1.4%) and reached 948 thousand. It should be noted that along with the increase in economic activity of the population, the dynamics of the number of economically active population in Q2 of 2022 was also favourably affected by the improvement of demographic trends – i.e., the number of the population aged 15-74 increased by approximately 0.9 thousand, compared to Q2 of 2021.



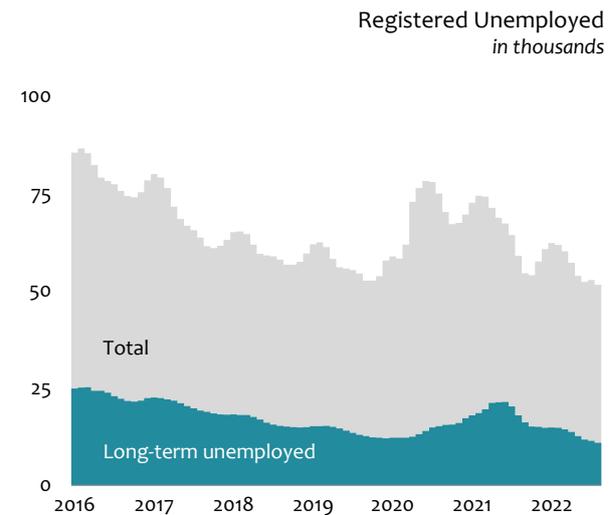
At the same time, it should be noted that the number of economically active population is still lagging behind the level of 2019, which is affected both by the lower number of economically active population and the lower level of population participation in the labour market. It continues to maintain negative pressure on the labour market supply, and as the demand for labour increased, the shortage of qualified labour became a more significant problem, especially in the rapidly growing sectors.



*In the first half of 2022, compared to the corresponding period last year.

Since the middle of 2020, the trend of decreasing unemployment remained. In the first half of 2022, the unemployment rate decreased to an average of 7%, while it fell to 6.6% Q2 of 2022, which was 1.3 percentage points lower than a year ago (7.9%). Overall, in Q2 of 2022, there were 62.8 thousand job seekers, which is 14.4% (or 10.6 thousand) less than in Q2 of 2021. In Q2 of 2022, the unemployment rate in Latvia remained higher than in Lithuania (5.3%) and Estonia (5.8%).

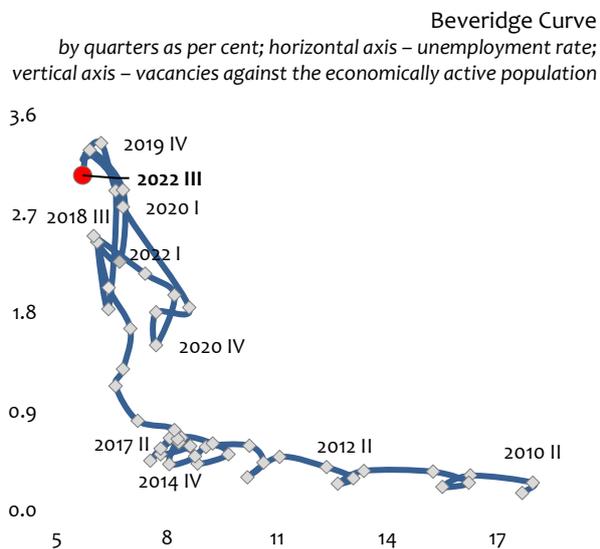
Along with improvements in the labour market, positive trends can also be observed in the dynamics of the long-term unemployed. Both the number of long-term unemployed and their share in the total number of jobseekers have been gradually decreasing since the middle of 2021. It should be noted that the number of long-term unemployed registered during the year decreased by almost 2/5, or approximately 7 thousand, which indicates an even more pronounced depletion of labour reserves, determined by the increase in labour shortage in the most rapidly growing industries. At the end of August 2022, there were approximately 11 thousand unemployed (for more than a year) registered jobseekers, or approximately 21% of all registered unemployed.



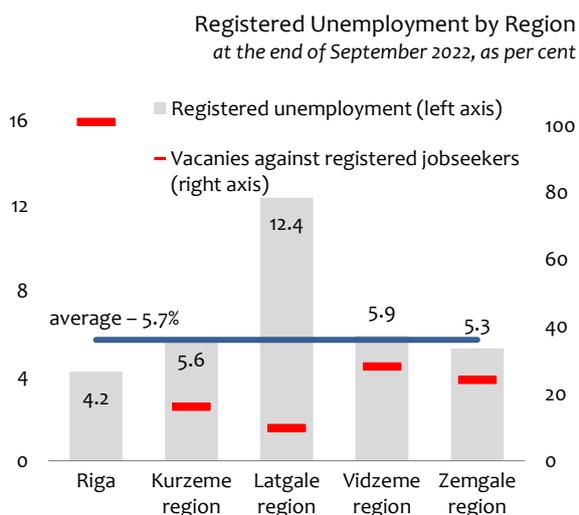
At the same time, despite the decrease in unemployment, still a high risk that some of the existing unemployed could have problems finding a job that matches their skills in the coming years exists. Also, as the full recovery in the sectors directly affected by the Covid-19 crisis could be long, and in the sectors where job opportunities could arise, previously learned skills may not be in demand. It should be noted that high long-term unemployment can lead to an increase in structural unemployment, i.e., the longer these people are unemployed, the greater the risk of losing their previous work skills and abilities, and the more difficult it becomes to adapt to new labour market needs.

It should be noted that the Covid-19 pandemic crisis has generally accelerated the structural changes in labour demand, accelerating the automation of jobs in labour-intensive sectors – mainly by reducing the demand for

low- and medium-skilled labour without professional skills, while increasing the share of higher-skilled jobs, especially in information and communication services. Therefore, measures to increase the qualifications and retrain the workforce are essential support for overcoming structural changes in the labour market.



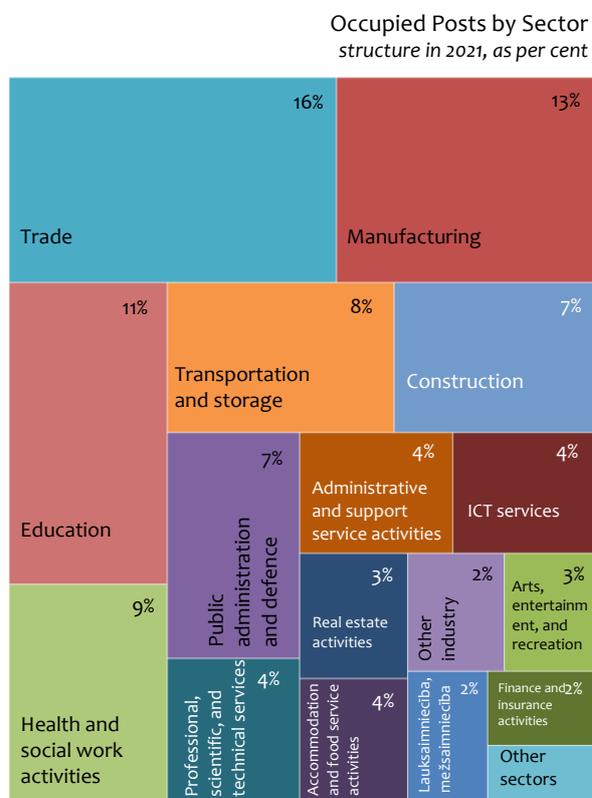
Also, structural problems may deepen regional differences in the labour market, which may hinder labour market recovery in the future. Although the regional disparities of the labour market have somewhat levelled out during the crisis, the unemployment rate in the Latgale region is still more than twice as high as the average in the country, albeit almost 3 times higher than in the Riga region, which, together with the low geographical mobility of the workforce, increases the risks of structural unemployment.



At the end of Q2 of 2022, compared to Q2 of 2021, despite the increase in population employment, the number of occupied posts decreased by 17.9 thousand, or 2%, thus accounting for 893.5 thousand occupied posts.

At the same time, it should be noted that the number of occupied posts where employees are employed in the main job has increased, as well as the average number of employees in normal working time units has risen, which generally indicates a tendency to decrease both the number of part-time jobs and the number of employees employed in several jobs at the same time. Therefore, although the total number of occupied posts declines, the number of employed continues to rise, considering the increase in the labour capacity per one job.

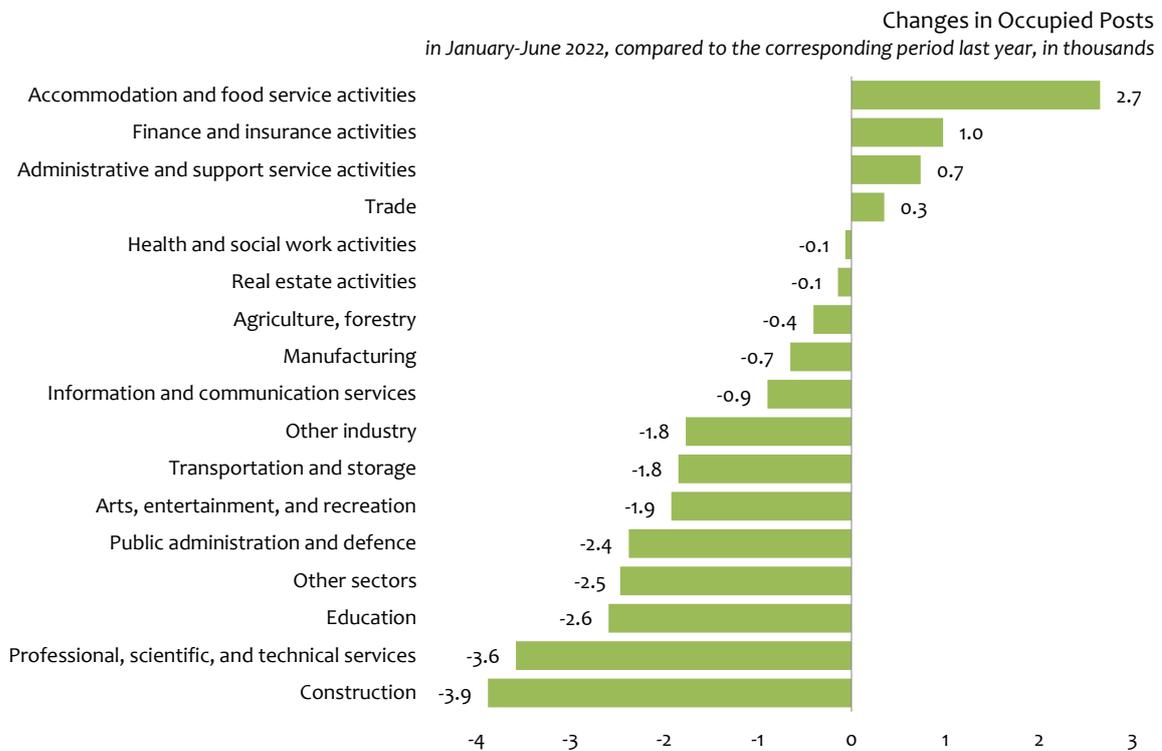
In Q2 of 2022, compared to Q2 of 2021, the number of occupied posts with employees in the main job increased by 15.5 thousand or 2.5%, reaching a total of 625 thousand. On the other hand, the average number of employees in normal working time units increased by more than 22 thousand or 3.1% in the corresponding period of time, reaching a total of 742.6 thousand.



In Q2 of 2022, the most significant increase in the number of occupied posts was observed in the sectors most affected by the Covid-19 crisis – in accommodation and food service activities, administrative and service services, and trade. Also, a significant increase in occupied posts in financial services has been observed. However, despite the gradual recovery of the sectors, it should be noted that the number of occupied posts is still significantly lower than before the Covid-19 crisis in 2019. In Q2 of 2022, the number of occupied posts in the accommodation and food service activities was still by 17% (or approximately 6.5 thousand) lower, compared to Q2 of 2019.

At the same time, considering the decrease in construction volumes, the most significant decline in the number of occupied posts in Q2 of 2022 was observed in the construction, and the sectors related to it. Overall, the number of occupied posts in construction fell by 3.9 thousand or 5.9%, where approximately half of the decline was determined by the decrease of occupied posts in specialized construction works.

Also, in Q2 of 2022, compared to Q2 of 2021, a significant decrease in the number of occupied posts can be observed in the professional and scientific-technical services – a decrease of 3.6 thousand or 8.5%. More than 2/5 of the total job losses in the sector were caused by job losses in advertising and market research services, and almost 1/5 in architecture and engineering services.

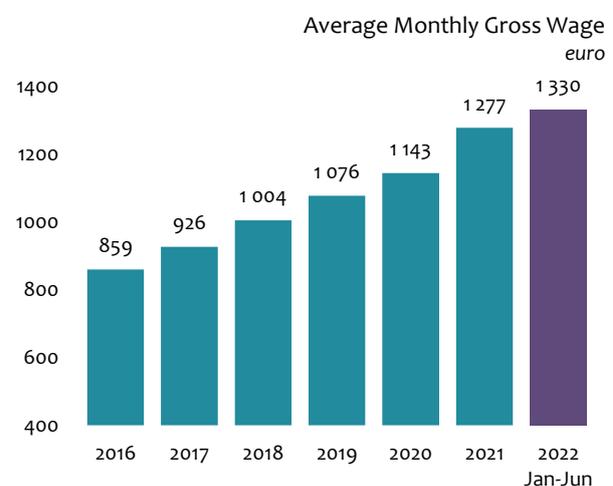


WAGES AND SALARIES

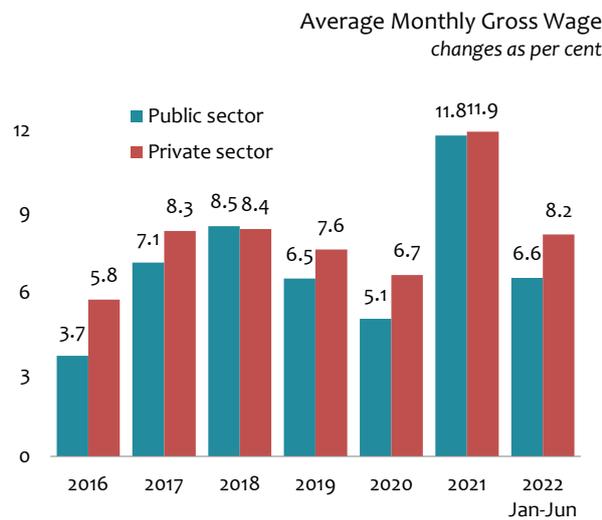
Considering the return of activities in the labour market, as well as the increasing pressure on the supply side, the average wage in the economy continues to grow at a rapid pace. In the first half of 2022, compared to the corresponding period last year, the average gross salary increased by an average of 7.7%. At the same time, in Q2 of 2022, the average annual wage increase reached 8.4%. The average gross wage increased to 1,362 euros. It should be noted that in 2021 the increase in the average gross wage reached almost 12%, representing the most rapid increase in the last 13 years. Therefore, the total wage increase in the past 2 years exceeds 1/5.

In 2021, the increase in the average wage was significantly affected by the rise in the minimum wage rate by 16.3% – to 500 euros from 430 euros in 2020, as well as a decline in the proportion of lower-paid jobs, e.g., a decrease in occupied posts in sectors such as accommodation and food service activities, transport services, and the administrative and support service activities. However, in 2022, the increase in wages will largely continue to be determined by the acute labour shortage and the

increasing inflationary pressure. It should be noted that due to inflation, for the first time since 2011, a decrease in real wages has been observed in Latvia. In Q1 of 2022, real wages decreased by an average of 2.7% compared to the corresponding period last year. In Q2 of 2022, it declined by 7.6 percent.



Overall, in the first half of 2022, wages have grown for both private and public sector workers. Compared to the first half of 2021, the average gross salary in the public sector increased by 6.6% (to an average of 1,333 euros), and in the private sector – by 8.2% (to an average of 1,332 euros). On the other hand, in Q2 of 2022, the average wage for employees in the public sector increased by an average of 7% (up to 1,380 euros), and in the private sector by 9.1% (up to 1,358 euros).



Overall, a declining trend of the share of low-paid employees, which is evidenced by an increasing trend in the share of employees receiving a salary above 1,000 euros per month, has been observed. In the first half of 2022, more than half of all employees had a gross wage exceeding 1,000 euros.

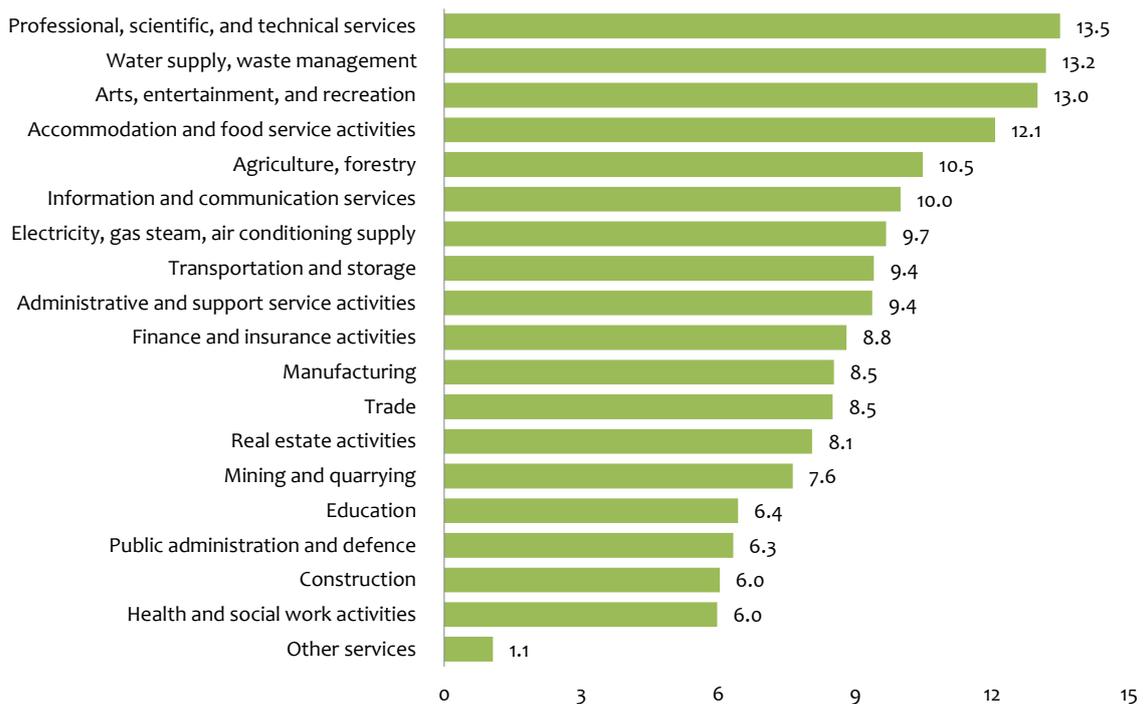
Employee Gross Wage as per cent of total number employed



In the first half of 2022, wage growth was observed in all sectors of the economy. The most significant wage increase was in the professional and scientific services – by 13.5%. Also, growth was observed in such sectors as water supply and waste management, the arts, entertainment and recreation, and accommodation and food service activities, where the average salary has so far been significantly lower than the national average.

The highest salary level in the first half of 2022 remained in the financial services sector – the average monthly gross wage was 2,494 euros, while the lowest wage was in the accommodation and food service activities – an average of 836 euros per month.

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



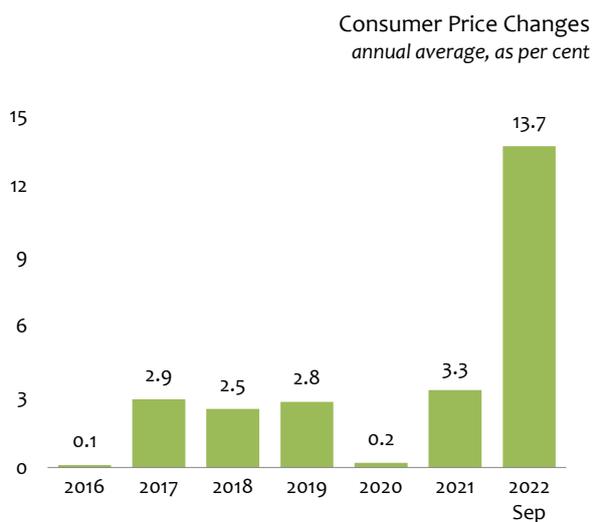
2022 | 2

ECONOMIC STABILITY AND COMPETITIVENESS

PRICES

In 2021, a rapid rise in prices was observed. Consumer prices rose by 7.9%, while annual average inflation was 3.3%. A significant impact on the level of consumer prices provided the increase in global prices as the economy recovered after the Covid-19 crisis.

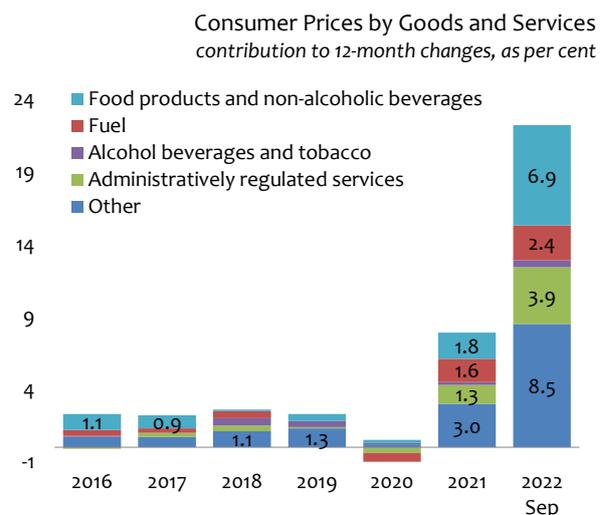
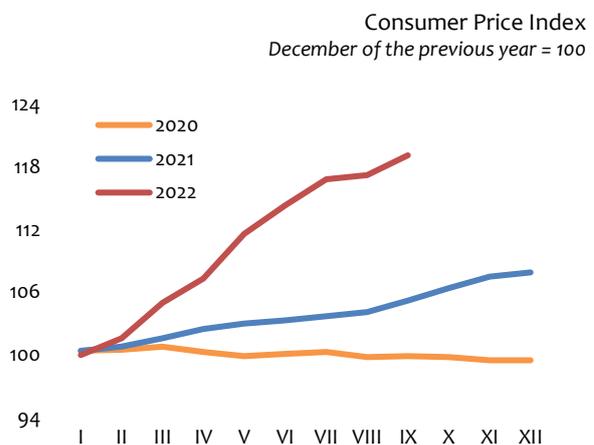
In January-September 2022, prices continued to rise rapidly. In September 2022, compared to December 2021, consumer prices increased by 19.1%, which was the most rapid increase in January-September since 1994. It was determined by the rise in world prices for energy resources and food, which is also exacerbated by Russia's invasion of Ukraine. Compared to September 2021, consumer prices increased by 22.2%. Annual average inflation in September 2022 was 13.7 percent.



The main factors affecting prices in January-September 2022:

- (1) the largest impact on the average level of consumer prices yielded the increase in the prices of energy resources related to housing (electricity, natural gas, solid fuel and heat energy), which was determined by the increase in the world prices of natural gas and oil;
- (2) the increase in food prices, which was affected by the rapid rise in world food prices in the second half of 2021 and at the beginning of this year. The largest impact provided the increase in prices for bread and cereals, dairy products, and meat. World food prices have been declining since April 2022, increasing by 2% in January-September 2022. Prices increased for

- vegetable oils, cereals, and dairy products; however, prices decreased for sugar and meat;
- (3) rise in fuel prices due to rise in world oil prices. Overall, oil prices rose by 20% in the first nine months of 2022, driven by increased demand and limited production;
 - (4) price increase for services – the largest impact yielded the price increase for catering and ambulatory services, recreation and culture, road transport insurance, and waste collection.

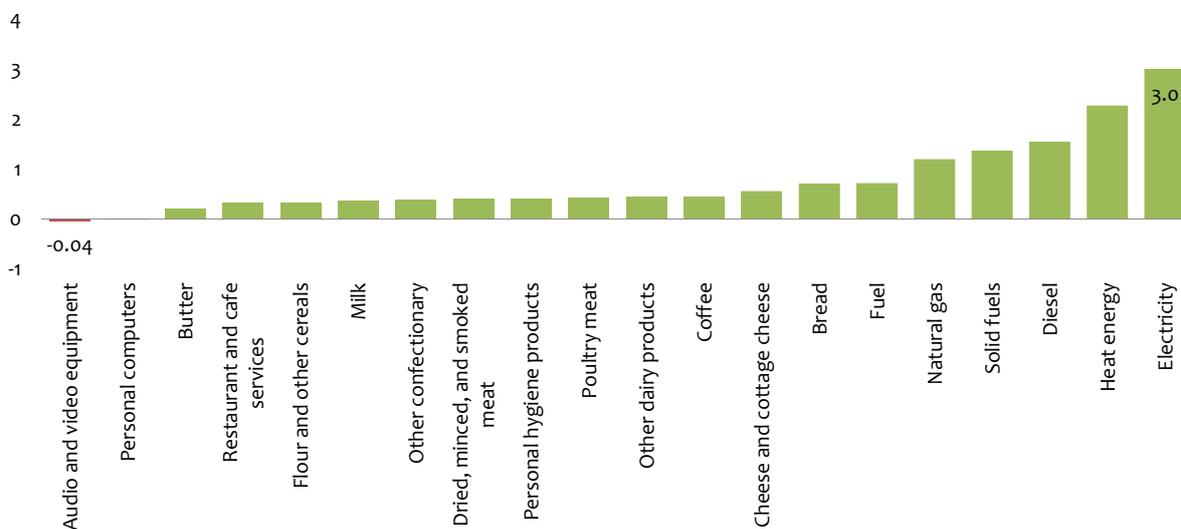


Overall, the average annual inflation in 2022 will be significantly higher than that observed in 2021. It is anticipated that in the coming months, price changes will continue to exceed the level of seasonal fluctuations.

Nevertheless, the price increase might not be as rapid as it was observed in previous months. It is forecast that

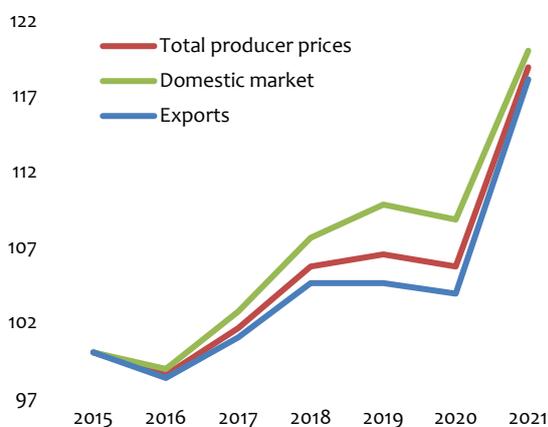
in 2022, the overall average annual inflation could reach 16.9 percent.

Consumer Price Changes by Goods and Services
September 2022, contribution to 12-month changes, as per cent



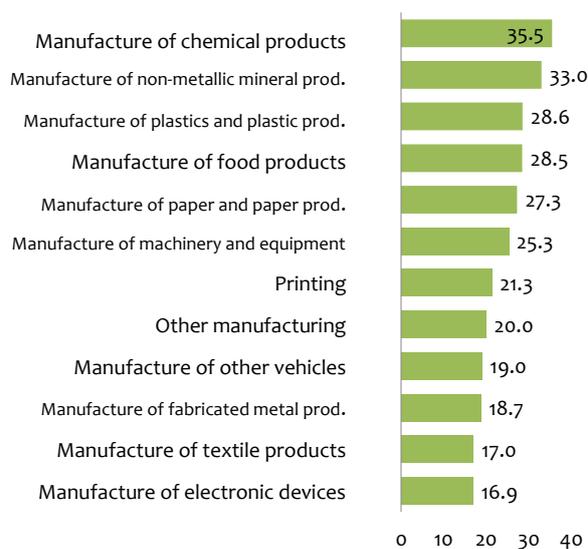
In 2021, a very rapid rise in producer prices was observed in manufacturing.

Producer Prices in Manufacturing
2015 = 100



It should be noted that the global energy and raw material prices are currently falling, which could slightly reduce the rate of increase in producer prices. However, limited supplies of raw materials in connection with the imposed sanctions on Russia and Belarus will have a significant impact on producer prices. Nevertheless, the growth rates for the production sold domestically have not declined, which is mainly affected by the high prices of energy resources and raw materials, such as raw food, wood, etc. Also, the dynamics of producer prices for production sold on the domestic market will be affected by growth rates, which could slow down in the second half of the year.

The Most Rapid Producer Price Changes in Manufacturing
in August 2022
against the corresponding period last year, as per cent



In 2022, the rapid increase in producer prices in manufacturing will continue. In January-August 2022, prices rose by 15.8%. Prices for products sold domestically increased by 22.9%, and for exported products – by 12.1%.

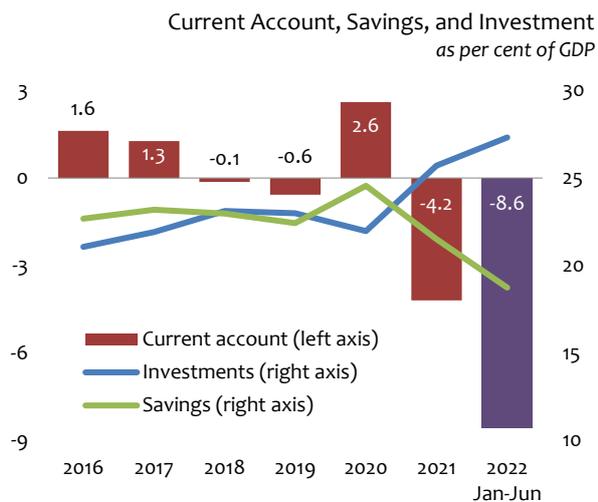
In January-August 2022, producer prices in manufacturing increased in all sub-sectors. The most influential price increase was in woodworking, food products, fabricated metal products, and non-metallic minerals.

In 2022, the prices of the producers of manufacturing will increase rapidly. The level of producer prices is largely influenced by the price fluctuations of exported products, determined by the dynamics of global raw material prices.

BALANCE OF PAYMENTS

External shocks have increased current account fluctuations. Between 2015-2019, the current account balance was on average positive (0.3% of GDP), with a moderate downward trend and relatively small fluctuations.

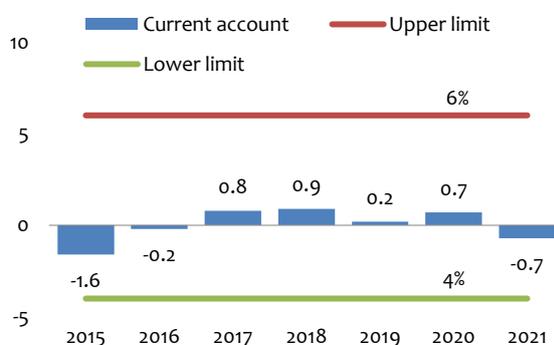
Restrictions introduced to combat the pandemic, as well as geopolitical events, unevenly affected cross-border flows of goods, services, and income, reflected in significant adjustments to the current account.



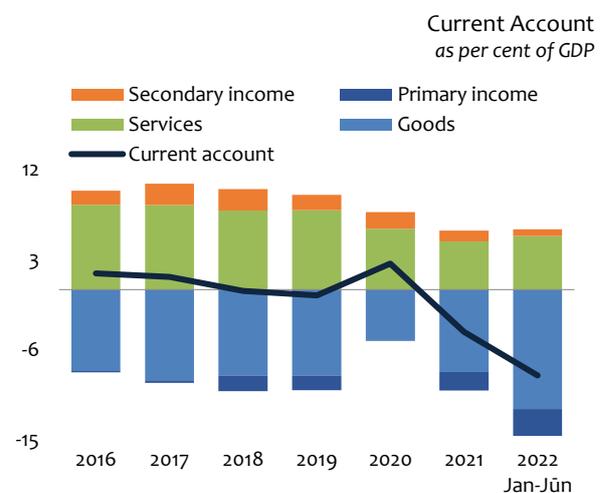
In 2020, compared to 2019, the current account balance improved, reaching a surplus of 2.6% of GDP. However, in 2021 it was already in deficit – at the level of 4.2% of GDP. In the first half of 2022, the current account deficit increased to the level of 8.6% of GDP.

Despite the increase in the current account deficit, it does not yet exceed the indicative thresholds set by the EU alert mechanism.

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



In recent years, a weakening of foreign trade flows has been observed. This was mainly influenced by the uncertainty of the external environment and the decrease in external demand. Measures to limit the spread of the Covid-19 pandemic also had a strong negative impact on trade intensity. In 2020, the foreign trade deficit reached the level of 5.1% of GDP. In 2021, the goods trade deficit increased to 8.2% of GDP, which was determined by a more rapid increase in the volume of imports than in exports. Also, in the first half of 2022, compared to the corresponding period last year, the export dynamics were more moderate than import dynamics, i.e., 32.6% and 36.5%. The trade deficit increased to 11.9% of GDP.



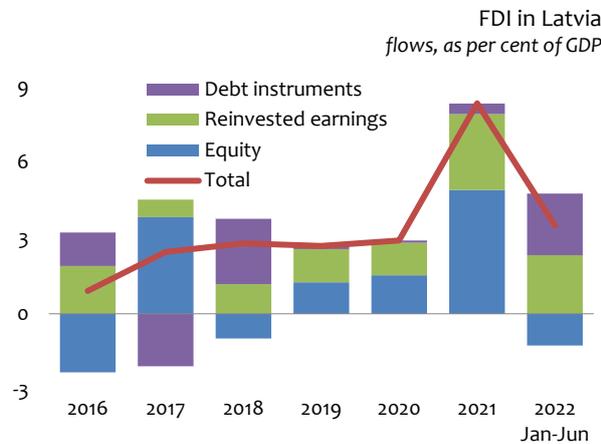
Cross-border trade in services is more affected by external shocks than trade in goods. Although the balance of services is positive and almost completely covers the foreign trade deficit, it has been shrinking every year. In 2020, the balance was 6.1% of GDP (in 2019 – 7.9%), which was mainly affected by movement restrictions. In 2021, the imports of services grew almost 2 times more rapidly than exports, which determined the decline of the service balance surplus to 4.8% of GDP. In the first half of 2022, export growth was more rapid than a year ago, albeit still more moderate than imports, and the positive balance of services reached 5.4% of GDP.

The changes in the income and capital account are mainly related to the absorption activities of EU funds. In the first half of 2022, the surplus of the capital account reached 1% of GDP.

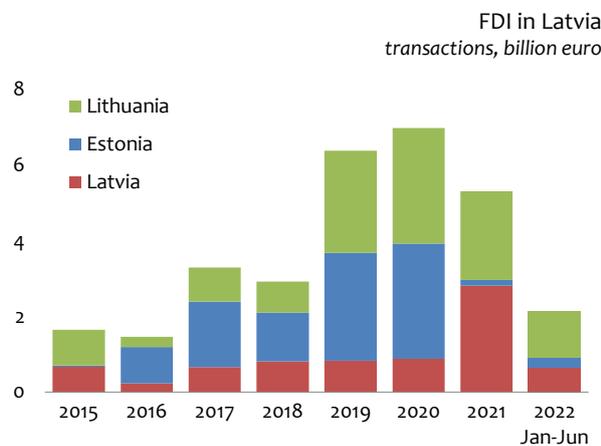
The state of the financial account balance in recent years was largely determined by financial sector stabilization measures, public sector debt restructuring, the Bank of Latvia's measures within the extended asset purchase program. In the first half of 2022, financial account assets grew more moderately than liabilities, and the financial account balance (with reserve assets) was -3.6% of GDP.

FOREIGN DIRECT INVESTMENT

The intensity of foreign direct investment (FDI) flows in recent years was affected by the restrictions on the spread of the Covid-19 pandemic, as well as instability in the world economy.



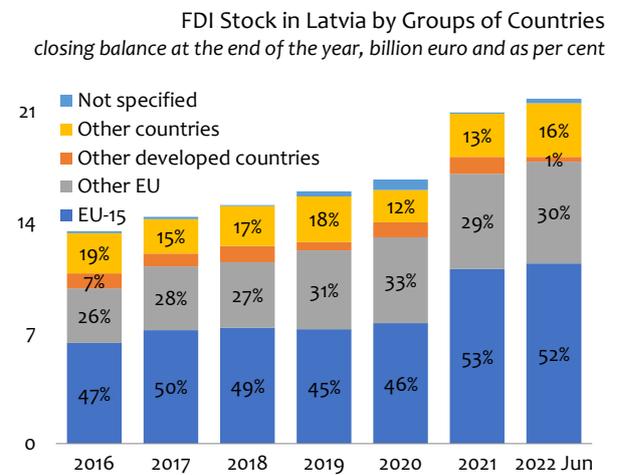
The cross-border flows of direct investments in the Baltic States were more moderate at the beginning of 2022 than a year ago. In the first half of 2022, the Baltic countries attracted a total of almost 2.2 billion euro (3.3% of GDP), which is a half less than a year ago. The largest volume of FDI transactions was in the Lithuanian economy (57.3% of FDI). The share of Latvia and Estonia in the total volume of FDI transactions was 29.6 and 13.1 percent, respectively.



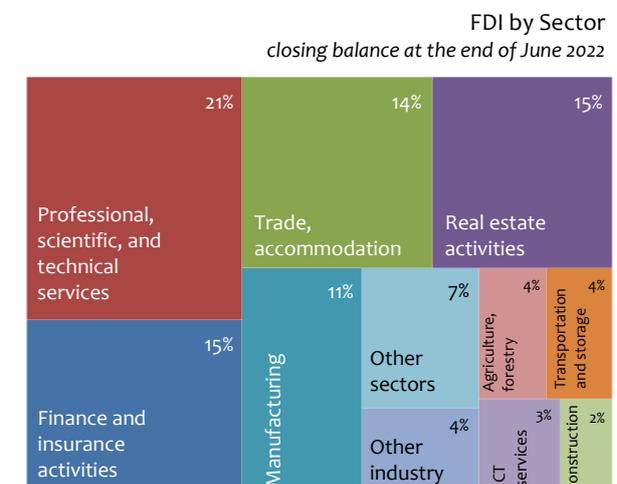
In the first half of 2022, the net flows of FDI attracted to Latvia constituted 3.5% of GDP. From 2017 to 2020, FDI flows averaged 2.7% of GDP. In 2021, the volume of FDI transactions increased significantly, reaching 2,809 million euros (8.4% of GDP), which was determined by the Swedish company Swedbank AB's ambitious investments in the equity capital of companies registered in Latvia. In the first half of 2022, FDI transactions were almost 1.5 times lower than a year ago. This was largely due to the negative flow of investment in corporate equity in response to EU sanctions against Russia. The outflow of

foreign capital was offset by non-resident investments in the form of reinvested earnings and transferable instruments.

Accumulated FDI in the Latvian economy at the end of June 2022 reached almost 22 billion euro, i.e. 60% of GDP, increasing by 24% during the year. Sweden is the largest investor in Latvia's economy. At the end of June 2021, the accumulated investments of its entrepreneurs made up 27.5% of the total FDI, which is twice as much as a year ago. Also, large investments have been made by the entrepreneurs from Estonia, Russia, Lithuania, Germany, Cyprus, and the Netherlands. The investments of these countries in the Latvian economy at the end of June 2022 made up 73% of the total accumulated FDI in Latvia.

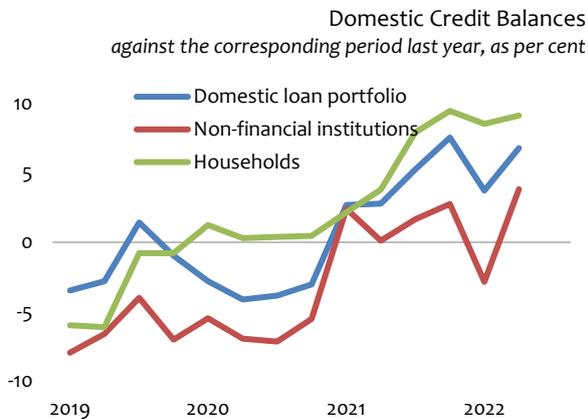


The structure of the accumulated FDI sectors has changed. This was determined by large-scale investments in the professional, scientific, and technical services, and its share in the total amount of FDI accumulated at the end of June 2022 increased to 20.8%. Investments in financial intermediation make up 15% of all FDI. Also, trade (14.4%), real estate transactions (14.8%), and manufacturing (11.3%) constitute a large share of FDI.



MONETARY INDICATORS

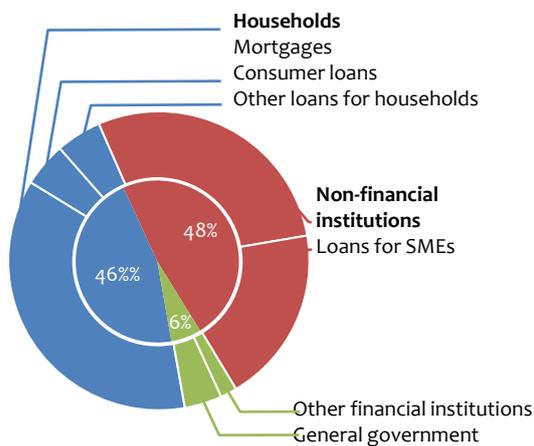
The financial sector remains stable. The volumes of deposits continue to grow; however, activity in lending is still moderate, business lending can be assessed as weak.



Source: FCMC

At the end of June 2022, the credit portfolio of non-bank customers was 15.1 billion euro. The loan portfolio of domestic customers grew by 6.8% annually. The credit portfolio of non-financial corporations rose by 3.8%; however, lending to small and medium-sized enterprises is still negative. The most rapid rise in lending was observed in the household sector – the loan portfolio grew by 9.1%.

Lending Portfolio of Non-Financial Institutions by Sector
at the end of June 2022, as per cent



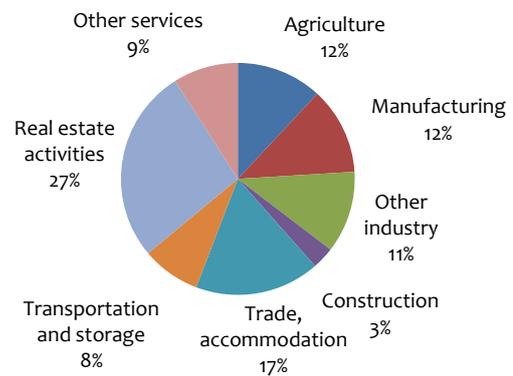
Source: FCMC

The distribution of loans by sector has not changed significantly – at the end of September 2022, the most loans were issued in real estate activities (28% of total loans) and to companies in the agriculture, forestry, and fishery (12%).

According to the data of the Bank of Latvia, the interest rates (balances) of long-term loans issued to non-financial companies in euro have not changed significantly

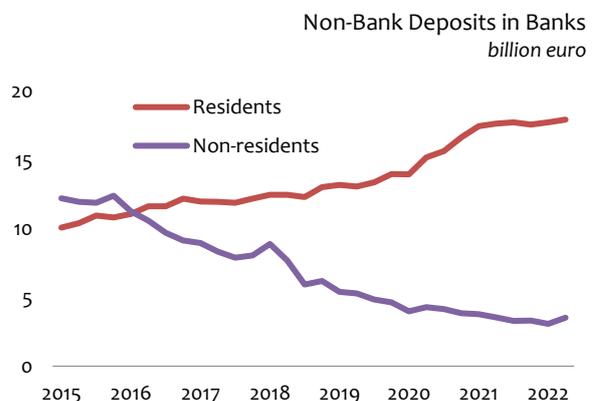
since 2016. In August 2022, for long-term loans, interest rate was 2.57%; for short-term loans – 2.39%. Fluctuations in the interest rates of long-term loans issued to households for the purchase of housing are minimal and were 2.52% in August 2022. Also, short-term loan interest rates decreased slightly and were 3.33%. Considering the September decision of the ECB Council on raising the base interest rates at the end of 2022 and in 2023, an increase in interest rates is anticipated.

Lending Portfolio of Non-Financial Institutions by Sector
at the end of June 2022, as per cent



Source: FCMC

At the end of June 2022, the amount of deposits increased to 21.5 billion euro, which was 1.2% more than a year ago. A more rapid increase in deposits started in Q2 of 2020, which coincides with the initial stage of the Covid-19 crisis, when residents were more cautious in their spending and tried more to build savings. Along with the increase in citizens' spending, the growth rates of deposits have significantly weakened since 2021. Of the total amount of deposits, 16% are foreign deposits (for comparison at the end of June 2015 – 54% of all deposits), which continues to shrink. At the end of June 2022, the volumes were 0.4% lower than a year ago. Domestic deposits increased by 1.6% in this period and accounted for 84% of total deposits at the end of June 2022.



Source: FCMC

BUDGET AND GOVERNMENT DEBT

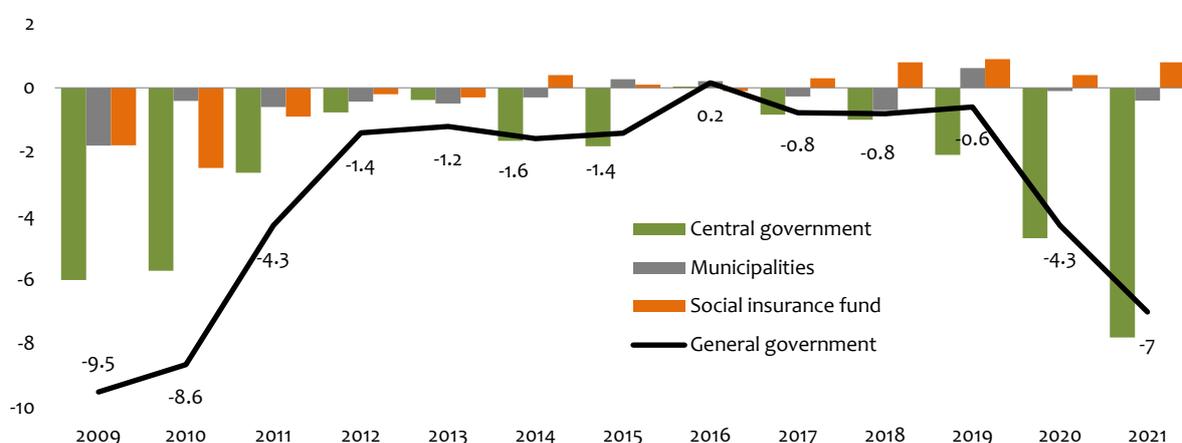
The Covid-19 pandemic has led to significant changes in policy. In 2020, the general exemption clause of the Stability and Growth Pact was activated in the EU, allowing EU countries to increase the general government budget deficit in 2020-2022 to the extent necessary to reduce the economic damage caused by the pandemic. Considering the Russia-Ukraine war and all the consequences related to it, the SGP general exception clause will also be valid in 2023. As a result of the Covid-19 pandemic, the budget deficit in Latvia increased to 4.3% of GDP in 2020, or 1.3 billion euro. However, in 2021 – up to 7.0% of GDP or 2.4 billion euro. The Covid-19 crisis is gradually coming to an end; therefore, the amount of support is declining and the Saeima approved the 2022 budget with a deficit of

4.8% (or 1.6 billion) of GDP. However, the budget deficit could be higher due to the war in Ukraine.

General Government Budget

| | 2017 | 2018 | 2019 | 2020 | 2021 |
|------------------------|-------|-------|-------|------|-------|
| Revenues, bln euro | 10.2 | 11.2 | 11.5 | 11.5 | 12.5 |
| % of GDP | 37.9 | 38.5 | 37.6 | 37.8 | 37.0 |
| Expenditures, bln euro | 10.4 | 11.5 | 11.7 | 12.7 | 14.8 |
| % of GDP | 38.7 | 39.4 | 38.2 | 42.2 | 44.0 |
| Net, bln euro | -0.21 | -0.24 | -0.17 | 1.32 | -2.35 |
| % of GDP | -0.8 | -0.8 | -0.6 | -4.3 | -7.0 |

General Government Budget Balance by Sector as per cent of GDP



Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest amongst the EU. The outbreak of Covid-19 led to the need to provide a significant amount of funding to mitigate the impact of the crisis caused by Covid-19. In 2020, the amount of national debt increased to 42.0% of GDP, or 12.7 billion euro. In 2021, it continued to increase to 43.6% of GDP or 14.7 billion euro.

According to the operational data of the State Treasury, the national debt in Q2 of 2022 made up 43.7% of the forecast GDP. As nominal GDP growth is rapid in the face of high inflation, debt is expected to stabilize relative to GDP in the coming years.

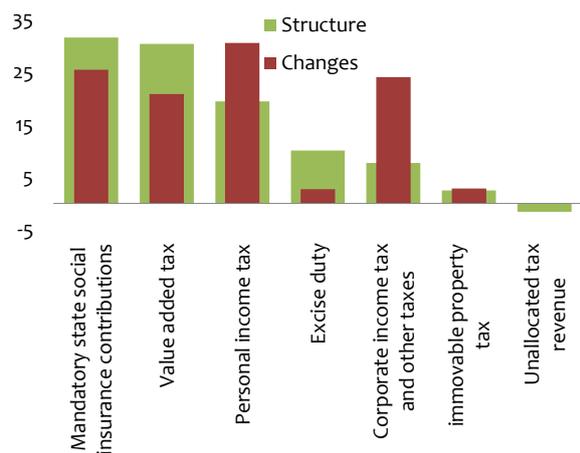
General Government Consolidated Gross Debt nominal value at the year end



BUDGET REVENUES AND EXPENDITURES

Since 2011, the revenue of the state consolidated budget has been increasing. Due to the Covid-19 crisis, budget revenues only slightly decreased in 2020. As the economy recovers from the shock, positive dynamics have been restored. Budget revenues in the 8 months of 2022 were 12.5% higher than in the corresponding period last year.

Tax Revenues structure and changes in January-August 2022 compared to the last year, as per cent



In January-August 2022, an increase across revenue tax groups can be observed. The favourable labour market situation and wage growth are reflected in the strongly positive dynamics of employment taxes. Income from personal income tax in this period was 30.6% higher than a year ago, while income from state social insurance contributions – by 25.4 percent.

Consolidated General Government Budget

| | billion euro | | | Changes as per cent |
|--|--------------|------|--------------|---------------------|
| | 2020 | 2021 | 2022 Jan-Aug | 2022 Jan-Aug |
| Revenues: | 11.3 | 12.6 | 9.2 | 10.9 |
| Tax revenues: | 9.0 | 10.0 | 7.4 | 14.6 |
| Mandatory State Social Insurance Contributions | 2.8 | 3.0 | 2.3 | 25.4 |
| Value added tax | 2.5 | 2.8 | 2.2 | 20.8 |
| Personal Income Tax | 1.8 | 1.9 | 1.4 | 30.6 |
| Corporate Income Tax | 0.2 | 0.3 | 0.3 | 21.6 |
| Excise Duty | 1.1 | 1.1 | 0.7 | 2.7 |
| Immovable Property Tax | 0.2 | 0.2 | 0.2 | 2.9 |
| Other taxes | 0.3 | 0.4 | 0.3 | 26.3 |
| Other revenues | 2.3 | 2.5 | 1.9 | 9.0 |
| Expenditures | 12.5 | 14.4 | 9.2 | 1.5 |

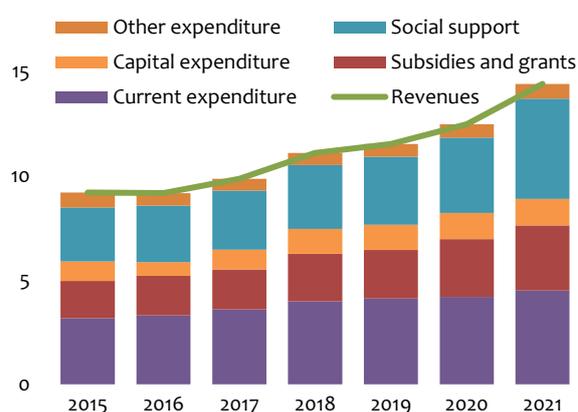
In 2022, consumption tax revenues were affected by both the increase in economic activity and the general increase

in prices. Revenues from value added tax increased by 20.8%; while from excise duty – by 2.7%.

Growth can also be observed for corporate income tax revenue. In January-August 2022, the corporate income tax revenues were 21.6% higher than a year ago.

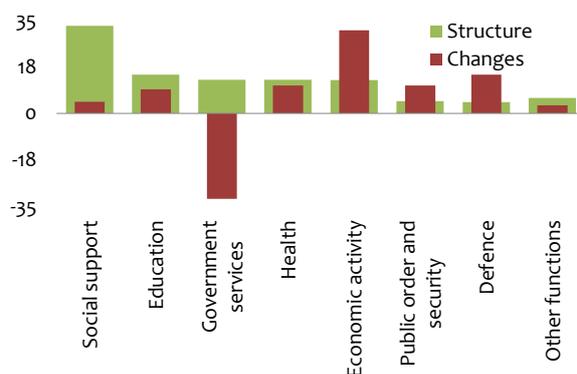
In January-August 2022, compared to the corresponding period last year, the expenses of the state consolidated budget increased by 1.5%. The dynamics of budget expenditure items was determined by the transfer of funds to support measures for Covid-19, to compensate the prices of energy resources, as well as to support Ukraine. Expenditures for subsidies and grants grew most rapidly – by 27.6%, while current expenses – by 10%. Also, capital expenditures and social support expenditures decreased by 5.4% and 16.2%, respectively.

Consolidated General Government Budget Expenditures billion euro



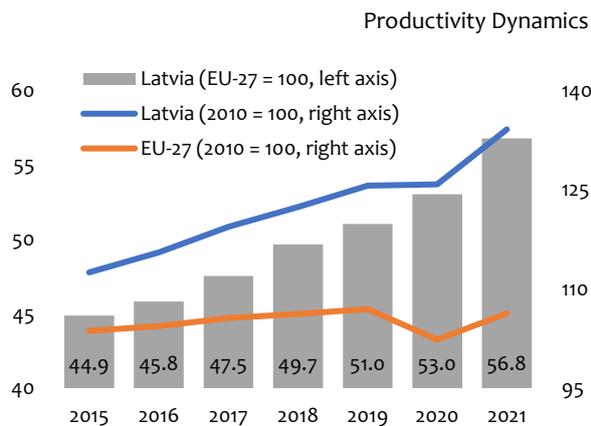
From budget expenditures by functional categories, in January-August 2022, expenditures increased more rapidly in economic activity, defence, health, and public order and security.

Consolidated General Government Budget Expenditures by Functions structure and changes in January-August 2022, as per cent



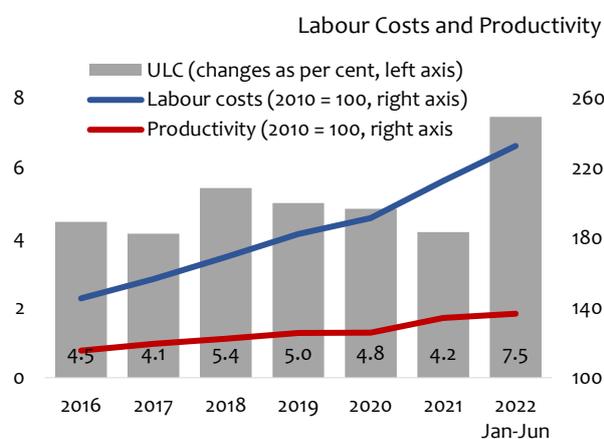
PRODUCTIVITY AND COMPETITIVENESS

Productivity dynamics in recent years were determined by adjustments in the product and labour markets in response to measures to contain the Covid-19 pandemic. In 2020, productivity remained at the level of the previous year. In 2021, as restrictions eased and economic activities resumed, productivity increased by 6.6%. In the first half of 2022, it rose by 1.8%. GDP per capita in the national economy of Latvia as a whole reached 56.8% (74.8% according to PPS) of the average EU level. Since 2016, the productivity gap with the EU average level (according to PPS) has decreased by almost 9 percentage points.

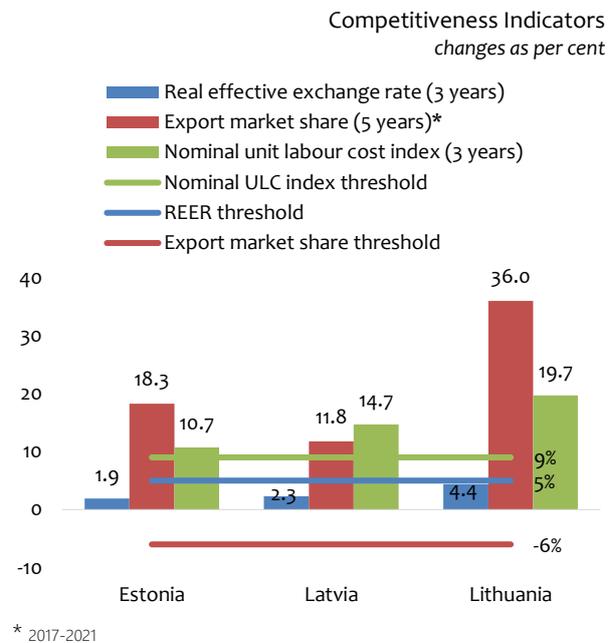


Labour costs continue to rise. In the first wave of the pandemic, due to the reduction of economic activities, the dynamics of labour costs slowed down a little. However, with productivity remaining at the last year's level, nominal labour costs (ULC) per unit of output increased by 4.8%.

In 2021, labour costs continued to grow rapidly, exceeding the 2020 level by 11%. However, it did not put significant pressure on unit labour costs due to productivity gains. In 2021, ULC increased by only 4.2%. In the first half of 2022, labour costs increased almost five times more rapidly than productivity, which determined the rise of ULC by 7.5%.



A rapid increase in nominal ULC can be observed in Baltic countries. In 2021, compared to 2018, the nominal ULC in Latvia rose by 14.7%; in Estonia – by 10.7%; and Lithuania – by 19.7%, i.e., more rapidly than the EU average (6.2%). The threshold set by the EU Alert Mechanism (MIP) has been exceeded in the Baltic States (9%).



The real effective exchange rate (REER) is rising. Consumer Price Index (CPI)-based REER against 42 trading partner countries increased by 2.3% in the last three years (2018-2021), which is less than the threshold set by MIP.

Despite the negative trend of cost competitiveness, the long-term dynamics of Latvia's export market share is improving. In the last five years (2017-2021), Latvia's export share in world markets increased by 11.8%, which was largely influenced by the positive changes in the goods export market in 2020. Between 2017-2021, Latvia's share in the goods export market increased by 19.7%. The market share of the export of services decreased in the world – by 5.2%. It was mainly determined by the negative dynamics of the market share since 2019 due to the restrictions on the spread of the pandemic.

Productivity growth is a key determinant of competitiveness. Although Latvia's export share in world markets is growing, the risks of reducing competitiveness remain high. The crisis caused by Covid-19 has widened the gap between productivity and labour costs. Productivity dynamics are positive, albeit labour costs are growing more rapidly. A sustained increase in productivity will largely be determined by structural changes in the Latvian economy in the direction of higher value-added activities and knowledge-intensive industries.

EU ALERT MECHANISM

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

The Alert Mechanism Report for 2022 did not identify Latvia amongst those 12 EU Member States, where macroeconomic imbalances were present, and further in-depth study – required. In the list of indicators (see table), in 2020 and 2021, Latvia had 3 and 4 indicators that exceeded the established thresholds, respectively.

Changes in the real effective exchange rate exceeded the threshold, as in 2020 it was affected by the depreciation of the Russian ruble by about 20%. The nominal unit labour cost index exceeded the threshold as wages continued to rise. This was driven by both skills shortages and Covid-19-related job losses, mostly in the low-wage sectors. The net international investment position, on the other hand,

continued to improve. In 2020, it no longer exceeded the threshold. Latvia's negative net international investment position is affected by government debt and foreign direct investment, which poses a low risk of a sudden outflow of capital and an increase in servicing costs.

Private sector debt levels remained stable, albeit lending to the corporate sector was limited. The financial sector is stable and well capitalized. However, profitability deteriorated significantly in 2020.

The nominal labour unit cost index also exceeded the threshold in 2021, as the pursuit of wage levels towards the EU average continues. The increase in real housing prices in 2021 exceeded the threshold. Unemployment and employment indicators fluctuated according to the waves of Covid-19 morbidity. Therefore, the 3-year average in 2021 revealed a deterioration of both the level of the economically active workforce and the level of youth unemployment.

List of Indicators for the Macroeconomic Imbalances Procedure for Latvia

| | Robežvērtības | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|--|------------------------|-------|-------|-------|-------|-------|-------|
| External imbalances and competitiveness | | | | | | | |
| Current account (% of GDP, 3-year average) | -4%/6% | -0.2 | 0.8 | 0.9 | 0.2 | 0.7 | -0.7 |
| Net international investment position (% of GDP) | -35% | -54.3 | -51.5 | -45.4 | -40.4 | -35.1 | -28.1 |
| Real effective exchange rate – 42 partner countries, HICP deflator (% changes over the last 3 years) | ±5%* & ±11% | 4.8 | 1.7 | 5.1 | 3.8 | 5.9 | 2.3 |
| Export market share – % of world export (% changes over the last 5 years) | -6% | 9.1 | 7.3 | 8.4 | 3.3 | 17.5 | 11.8 |
| Nominal unit labour costs index (% changes over the last 3 years) | 9%* & 12% | 14.9 | 14.2 | 14.7 | 15.3 | 16.1 | 14.7 |
| Internal imbalances | | | | | | | |
| House price index (% annual changes) | 6% | 7.2 | 5.3 | 6.3 | 5.8 | 2.7 | 7.2 |
| Private sector credit flow (% of GDP, consolidated) | 14% | 2.5 | 2.8 | -0.2 | 1.1 | -1.9 | 0.9 |
| Private sector debt (% of GDP, consolidated) | 133% | 78.3 | 75.7 | 69.8 | 66.2 | 64.7 | 58.1 |
| General government debt (% of GDP) | 60% | 40.4 | 39.0 | 37.1 | 36.7 | 43.3 | 44.8 |
| Unemployment rate (3-year average) | 10% | 10.2 | 9.4 | 8.6 | 7.5 | 7.3 | 7.3 |
| Financial sector liabilities (% annual changes) | 16.5% | 4.7 | 6.2 | -3.5 | 4.6 | 10.8 | 13.2 |
| Employment indicators | | | | | | | |
| Economically active population – % of population aged 15-64 (% over the last 3 years) | -0.2 percentage points | 2.4 | 2.5 | 1.9 | 1.1 | 1.1 | -1.8 |
| Long-term unemployment rate – % economically active population (% changes over the last three years) | 0.5 percentage points | -1.9 | -1.5 | -1.5 | -1.7 | -1.2 | -1.1 |
| Youth unemployment rate – % of economically active population (% over the last 3 years) | 2 percentage points | -5.7 | -2.6 | -4.1 | -4.8 | -2.1 | 2.6 |

* – Euro area countries.

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

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

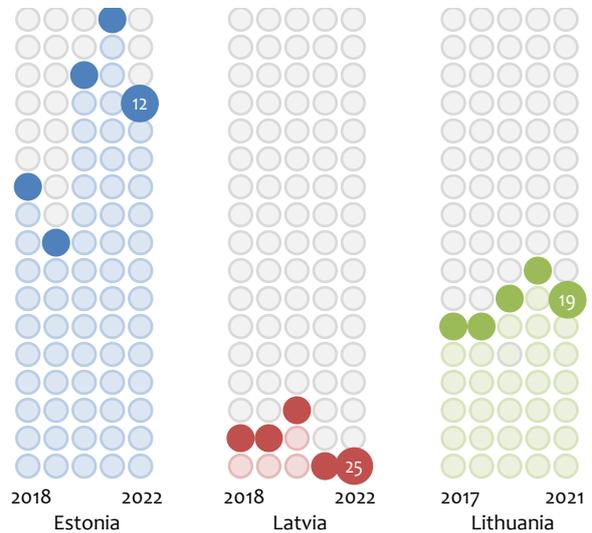
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LATVIA IN INTERNATIONAL RANKINGS

The ratings made by the International Institute for Management Development, the World Intellectual Property Organization, the European Commission, and other organizations describe Latvia as a country that is relatively stable and resistant to various external shocks, as well as containing development potential. The progress shown in recent years has not allowed to maintain the achieved places in several rankings.

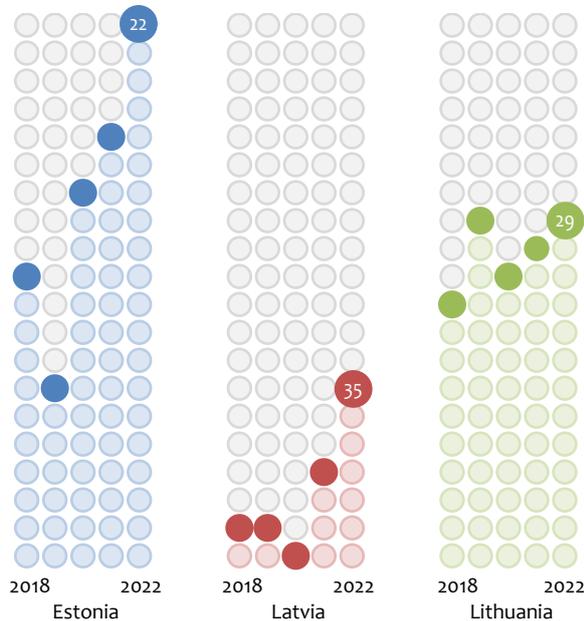
In the **Global Competitiveness Ranking 2022** (Global Competitiveness Ranking 2022), published annually by the International Institute for Management Development (IMD), Latvia is ranked 35th among 63 countries, improving its position by 3 positions. Progress during has been achieved due to the stability of the government, the growth of investments in the economy, the growth of exports, and the growth of investments by companies in research and development. Progress has been hampered by rising energy prices, which have led to high consumer price inflation, and worsening employment figures.

Baltic Countries in the European Innovation Scoreboard*



Source: European Commission, European Innovation Scoreboard 2022
* since 2020 excluding the UK.

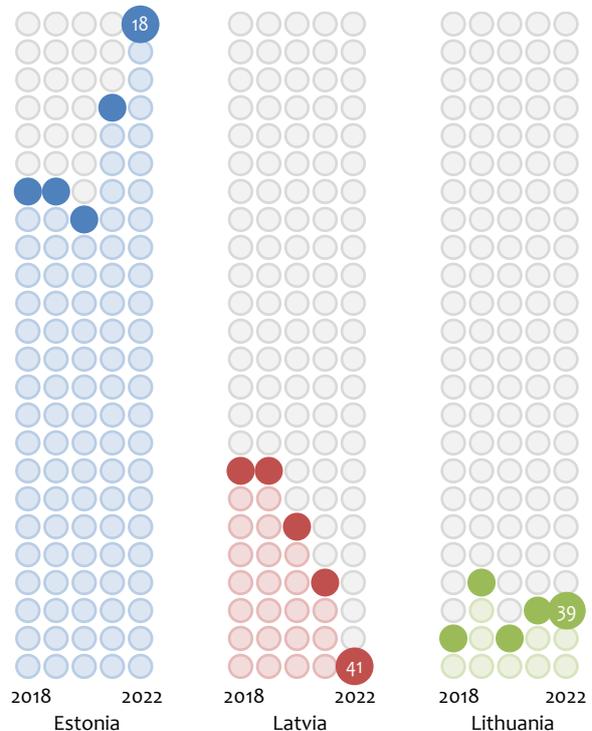
Baltic Countries in Global Competitiveness Ranking



Source: IMD, World Competitiveness Ranking 2022

In the **Global Innovation Index 2022** prepared by the World Intellectual Property Organization (WIPO), Latvia is ranked 38th among the 132 surveyed countries.

Baltic Countries in Global Innovation Index

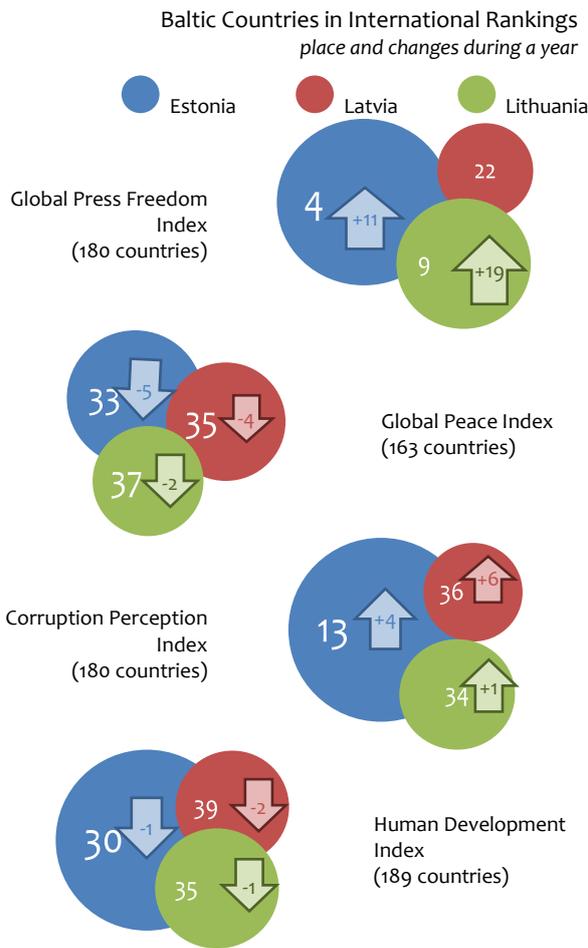


Source: Cornell University, INSEAD, WIPO, Global Innovation Index 2022: What is the future of innovation-driven growth?

In the **European Innovation Scoreboard 2022** published annually by the European Commission, Latvia ranks 25th among 27 EU countries, and ranks in the group of modest innovator countries. The report notes that the overall business environment is favourable and the potential for innovation is high; however, no large companies invest in research and development.

The strengths of Latvia have been highlighted: the ratio of students to teachers in secondary education institutions, the proportion of those with secondary education enrolled in universities, the use of ICT, ecological efficiency, the proportion of employed women with scientific degrees, gross domestic expenditure on research and development financed from abroad, high-tech exports, exports of cultural and creative services, number of national feature films, share of printing and other media industries, exports of goods of creative industries.

In the **World Press Freedom Index** created by the international press and freedom of expression organization "Reporters without Borders", Latvia took 22nd place in 2022 (180 countries surveyed), maintaining its 2021 place.



Source: Reporters Without Borders, 2022 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2022; Transparency International, Corruption Perceptions Index 2021; United Nations Development Programme, Human Development Report 2021/2022.

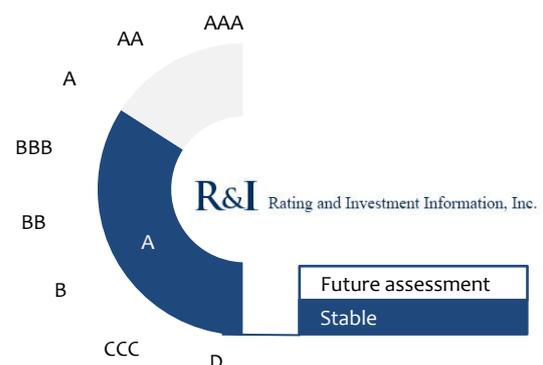
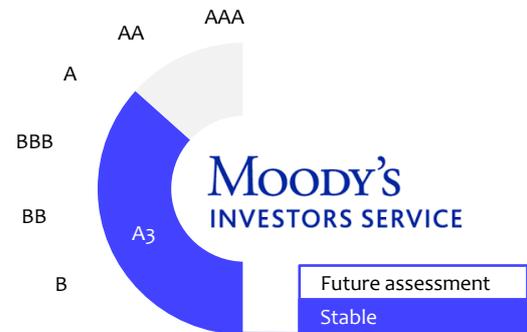
In the **Global Peace Index** created by the Institute of Economics and Peace, Latvia took 35th place (163 countries) in 2022. Latvia has worsened its position by 4 places, as it has increased spending on defence and is located next to countries involved in war.

In the **Corruption Perception Index** created by the international anti-corruption organization Transparency

International, Latvia took 36th place in 2021 (180 surveyed countries), improving its position by 6 places.

In the **Human Development Index** created by the United Nations Development Program (UNDP), Latvia took 39th place in 2022 (189 countries), declining by 2 positions.

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



Source: State Treasury

In February 2020, the international rating agency *S&P Global Ratings* raised Latvia's credit rating from "A" to "A+", which marks the historically highest credit rating for Latvia. In the latest assessment in June 2022, the agency confirmed that Latvia still meets the "A+" level and a stable future rating. The other rating agencies have also not changed their assessment of the ratings since the beginning of the Covid-19 pandemic.

The assessment is based on the conclusions that measures to reduce Latvia's energy dependence on Russia, membership in NATO and the European Union, the moderate level of public debt and the creation of an effective national economic policy are sufficient.

Russia's war in Ukraine affects Latvia's export and import indicators; however, inflation reduces the purchasing power of consumers, which has a negative impact on economic growth in 2022. However, the agencies note the ability of the Latvian economy to quickly adapt to external shocks and believe that Latvian companies will be able to direct the majority of exports to other markets, as well as reduce imports from the markets of Russia and Belarus in the near future, thus limiting the risk of a long-term negative impact of the military conflict on the Latvian economy.