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ECONOMIC DEVELOPMENT TRENDS

After the recovery from the Covid-19 crisis, the economy started to grow again in 2021. The large-scale support measures of the government and EU funds, as well as the improvement of the epidemiological situation, contributed to the recovery of Latvia's economy, and GDP grew by 4.1% in 2021.

After Russia's invasion of Ukraine, economic growth in Latvia slowed down to 2% in 2022. The economic development in 2022 was significantly affected by supply chain disruptions caused by the war, the rise in inflation caused by energy and food prices, as well as the decrease in global demand. In the first half of 2022, the consequences of the war were not yet fully felt. The economy grew by 3.9%, compared to the first half of 2021. The rise was influenced by the low base at the beginning of 2021 and the gradual lifting of Covid-19 restrictions. However, in the 2nd half of the year, annual growth decreased to 0.3%, as the balance of exports and imports worsened, and private consumption and investment growth rates decreased.

It is anticipated that geopolitical uncertainty and high prices will continue to affect economic development in 2023 as well. Most likely, very moderate economic growth rates will be observed in the first half of 2023. The Ministry of Economics forecasts that, in 2023, the GDP will remain close to the 2022 levels, if no significant changes in the existing geopolitical situation take place.

Key Economic Development Indicators

	2018	2019	2020	2021	2022	2023f
Gross domestic product, at current prices, billion euro	29.2	30.7	30.3	33.6	39.1	42.8
Changes against the previous year, as per cent						
Gross domestic product	4.0	2.6	-2.2	4.1	2.0	0.8
Private consumption	3.0	0.2	-4.6	8.1	8.1	1.3
Public consumption	1.7	3.9	2.4	4.4	2.8	1.2
Gross fixed capital formation	11.7	6.9	-2.6	2.9	0.7	1.0
Exports	4.4	2.1	-0.3	5.9	9.1	2.2
Imports	6.3	3.1	-0.3	15.3	11.6	2.8
Consumer prices	2.5	2.8	0.2	3.3	17.3	9.8
as per cent						
Changes in the number of employed	1.6	0.1	-1.9	-3.2	2.6	-0.1
Employment rate	64.5	65.0	64.2	62.5	63.9	64.0
Unemployment rate	7.4	6.3	8.1	7.6	6.9	6.7
as per cent of GDP						
General government balance	-0.8	-0.6	-4.3	-7.0	-4.7	-4.2
General government debt	37.0	36.5	42.0	43.6	42.0	43.0
Net exports	-0.7	-0.7	1.0	-3.4	-5.9	-6.6

f-forecast

The rate of price growth is exceeding the wage growth, negatively affecting the purchasing power of the population. However, due to the base effect of the restrictions of the Covid-19 pandemic and the improvement of the situation in the labour market, the dynamics of household consumption remained positive. In 2022, private consumption increased by 8.1%.

Public consumption continues to grow largely at the expense of the government budget deficit in order to finance the support measures implemented by the government to mitigate the negative effects of Covid-19 and the consequences of the war in Ukraine. In 2022, public consumption increased by 2.8%.

Geopolitical uncertainty affects investment. In 2022, investments in gross fixed capital formation increased by only 0.7%. Investments in buildings and structures decreased by 11% due to the rapid increase in costs. At the same time, investments in machinery and equipment increased by 9% and in intellectual property products - by 21.2%.

Despite the geopolitical situation, the net flows of FDI attracted to Latvia continue to increase. In 2022, the net flows of FDI attracted to Latvia constituted 3.7% of GDP, while the accumulated FDI at the end of 2022 reached almost 22 billion euro, i.e. 60% of GDP.

Exports play a vital role in ensuring growth. Export volumes of goods and services increased by 9.1% in 2022. Considering the lifting of the restrictions of the Covid-19 pandemic, the exports of services is rapidly recovering, which was 20% higher in 2022 than a year ago. In 2022, the exports of transport services, computer services, and other economic activity services grew rapidly. The exports of goods increased by 5.6% in 2022. The main export goods were wood and wood products, electrical appliances and electrical equipment. In 2022, import volumes increased faster than exports (by 11.6%) and the export-import balance in actual prices was negative 5.9% of GDP.

In 2022, the current account deficit increased to 6.4% of GDP, which was most significantly affected by the deterioration of the goods trade balance due to the increase in energy prices. The current account is expected to improve slightly in the coming years.

Development trends are highly variant across sectors. Rapid growth rates in 2022 remain in the sectors that were most severely affected by the restrictions of the Covid-19 pandemic. The accommodation and food service activities grew by 57.5%; the arts, entertainment, and recreation sector – by 16.5%; and other commercial services – by 15.2%. A stable increase (by 14%) in the ICT sector in 2022 was also observed. In 2022, the agriculture and forestry sector increased by 7%.

Despite the increase in costs, disruptions in supply chains and great uncertainty, in 2022, positive growth remained in the manufacturing sector (+2.7%). In wood processing and the food industry, output volumes were slightly behind the 2021 level. At the same time, positive trends in the manufacture of electrical equipment, non-metallic minerals, furniture, and metal products was observed. In certain sectors, the volumes of production and services decreased in 2022. Due to the rapid rise in prices and the decrease in consumption, the decrease was in the electricity, gas supply, and heat supply sector (by 14.3%). Similarly, due to the rapid increase in costs, the decline in the construction industry endured (by 11.3%). As a result of the EU sanctions, the turnover of goods with the markets of Russia and Belarus has decreased, affecting the trade sector, which decreased by 6.3% in 2022.

The Covid-19 pandemic has caused significant changes in the fiscal policy implemented so 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 (1.3 billion euros) in 2020. However, in 2021, it reached 7% of GDP or 2.4 billion euros. According to the assessment of the Ministry of Finance, the budget deficit of the general government in 2022 was 4.7% of GDP. The Saeima has approved the budget deficit for 2023 in the amount of 1.8 billion euros or 4.2% of GDP.

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 government debt increased to 43.6% of GDP, or 14.7 billion euro. According to the assessment of the Ministry of Finance, in 2022, the government debt was 42% of GDP. As nominal GDP growth is fast in the context of high inflation, debt is expected to stabilize relative to GDP in the coming years.

The banking sector has been able to maintain stability despite the economic turmoil caused by the Covid-19 pandemic and geopolitical tensions. The banking sector is profitable. However, credit development is still considered weak, especially business lending.

Inflation in 2022 was most significantly affected by the rise in world prices for energy resources and food. In December 2022, consumer prices in Latvia were 20.8% higher than a year ago, while the annual average inflation rose to 17.3%. In December, food prices had increased by 29.3%, electricity, gas and solid fuel - by 63.9%, and fuel - by 17.9%.

In 2023, consumer prices will stabilize. The main influence on price changes will still be related to fluctuations in the prices of energy resources and food in the world, and their secondary effect on the prices of industrial goods and services will also be observed. Considering the geopolitical tension and the base effect of inflation dynamics, in 2023, the average annual inflation is expected to be within 9%.

Despite the economic turmoil, the labour market remains stable. The number of employed in Latvia increased by 2.6% in 2022. On an annual basis, this has been the most rapid increase in the number of employed since 2007, which was partly determined by the recovery of the labour market from the Covid-19 pandemic, as well as the ever-expanding employment of Ukrainian civilians in Latvia. Along with the increase in employment, the unemployment rate continues to decrease. It decreased to 6.9% in 2022 (compared to 2021 – by 0.7 percentage points).

However, despite significant improvements in the labour market, the number of employed is still significantly behind the pre-pandemic level - in Q4 of 2022, the number of employed was 22.5 thousand (or 2.5%) less than in Q4 of 2019.

Despite the tense geopolitical situation, as well as the expected slowdown in economic growth, the labour market will not deteriorate significantly in 2023, as the demand for labour is still high. The Ministry of Economics forecasts that the overall unemployment rate could decrease to an average of 6.7% in 2023, while the number of employed would remain close to the 2022 level.

The monthly average gross wage continued to increase in 2022, albeit its growth rate was lower than the rate of inflation, causing a decrease in purchasing power. The average net wage was 1,006 euros, or 7.1% higher than in 2021. On the other hand, considering the increase in consumer prices, the net salary decreased by 8.7% in 2022, which indicates a rapid decline in the purchasing power of employees. This trend is expected to continue in the short term until the rapid rise in inflation endures.

At the same time, positive 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 increasing 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 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 basically 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 drags on, the pace of economic recovery could be slower.

2023 | 1 WORLD ECONOMIC OUTLOOK

The world economy is paying a high price for Russia's unprovoked, unjustified, and illegal 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. In 2023 and 2024, global GDP (excluding the EU) is forecast to grow by 3.0% and 3.3% (EC).

Gross Domestic Product

as per cent

	2022	2023f	2024f
World (excl. EU)	3.1	3.0	3.3
Euro Area	3.5	0.9	1.5
USA	2.1	1.0	1.6
China	3.0	5.0	4.7
Germany	1.8	0.2	1.3

Source: European Commission Economic Forecast (Winter 2023)
f – forecast

China's economy grew by 3% in 2022. In 2023 and 2024, it is forecast that China's GDP will grow by 5% and 4.7%, respectively (EC). However, China's economy remains burdened by high corporate and municipal debt, declining demographics, and disruptions in the real estate sector. India's economy grew by 6.8% in 2022. On the other hand, in 2023 and 2024, it is forecast that GDP will grow by 6.1% and 6.8%, respectively (IMF).

In 2022, US GDP grew by 2.1%. Currently, high-frequency indicators of economic activity indicate a decrease in the manufacturing, service and construction sectors. In 2023 and 2024, it is forecast that GDP will grow by 1% and 1.6%, respectively (EC).

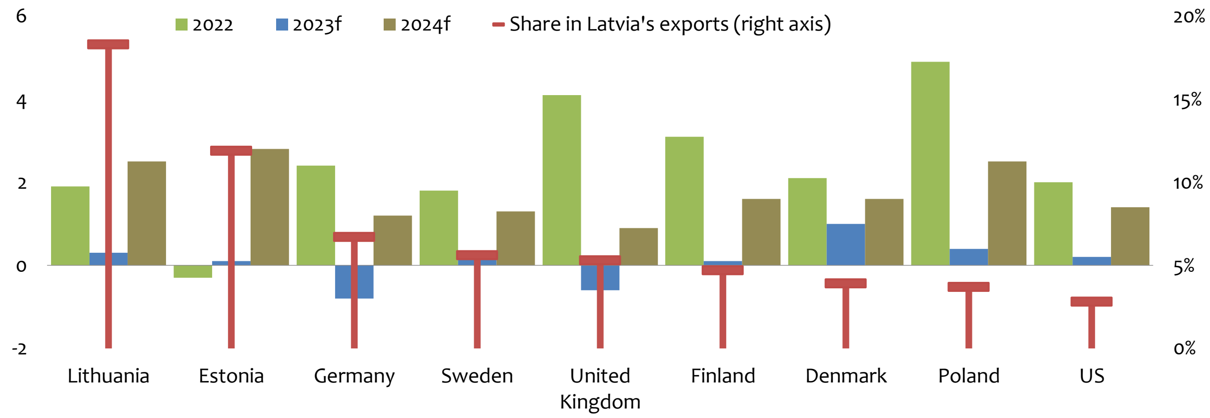
Several positive trends have been observed in the EU economy since autumn. The average price of the European TTF gas benchmark has fallen below pre-war levels, driven by a sharp decline in gas consumption and continued diversification of supply sources. Despite the energy shock and the record-high inflation caused by it, in 2022 the GDP in the eurozone grew by 3.5%. In 2023 and 2024, GDP is forecast to grow by 0.9% and 1.5%, respectively (EC).

In the United Kingdom, GDP grew by 4.1% in 2022. It is anticipated that in 2023 GDP will decrease by 0.6%, while in 2024 GDP will increase by 0.9% (IMF).

In 2022, GDP in Germany grew by 1.8% (EC). The reduction of inflation caused by energy prices, adaptation to the diversification of supply chains, as well as stable corporate finances will contribute to the gradual recovery of investments in early 2023. It is forecast that in 2023 and 2024 GDP will grow by 0.2% and 1.3%, respectively. In 2022, GDP in Sweden reached 2.4% (EC). In the first half of 2023, weaker growth will remain, the volumes of the construction industry will be significantly affected by high construction costs. It is forecast that GDP in 2023 will decrease by 0.8% and increase by 1.2% in 2024. In 2022, Estonia's GDP decreased by 0.3%. Despite the decline in private consumption, the labour market remained strong. It is forecast that in 2023 and 2024, GDP will grow by 0.1% and 2.8%, respectively (EC). In 2022, Lithuania's GDP grew by 1.9%. In 2023 and 2024, economic activity is expected to be weakened by geopolitical uncertainty and a decrease in private consumption, with GDP growing by 0.3% and 2.5%, respectively (EC).

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 2022 – right axis



Source: CSB, EC (2023), IMF (2023); f – forecast

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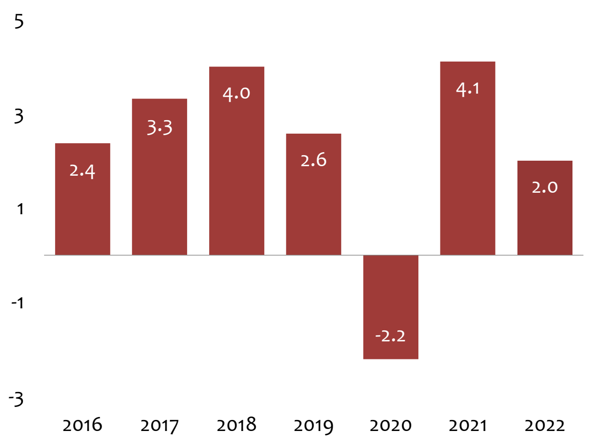
GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

GROSS DOMESTIC PRODUCT

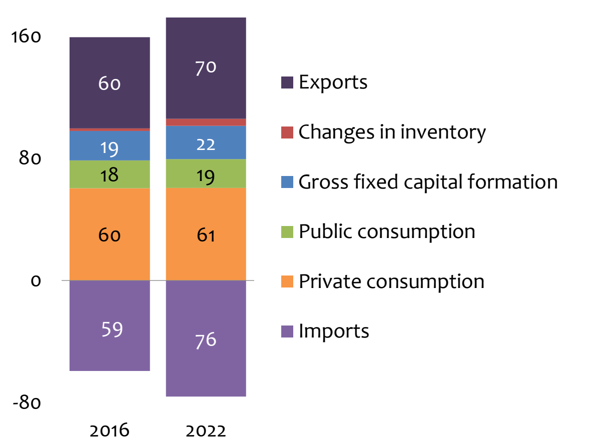
In 2022, GDP grew by 2%, i.e., the lowest growth since 2014, excl. the drop of 2020 due to Covid-19 pandemic.

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



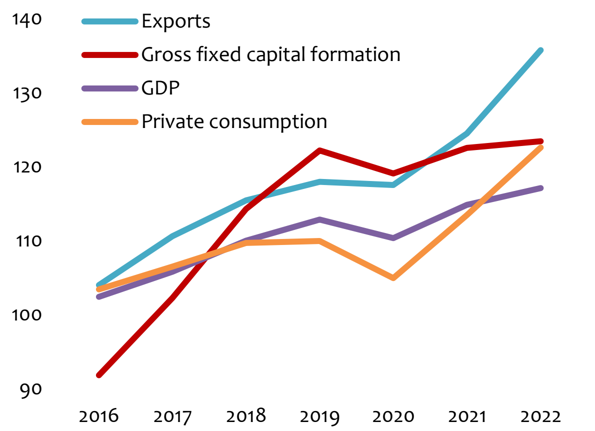
Economic development in the first half of 2022 was affected by the low base at the beginning of 2021 and the gradual lifting of Covid-19 restrictions, albeit uncertainty in the geopolitical situation due to the Russian invasion of Ukraine, which affected raw material supply chains, and sharply rising energy and food prices slowed economic growth rates in the second half of the year.

Gross Domestic Product from Expenditure Approach
% of GDP

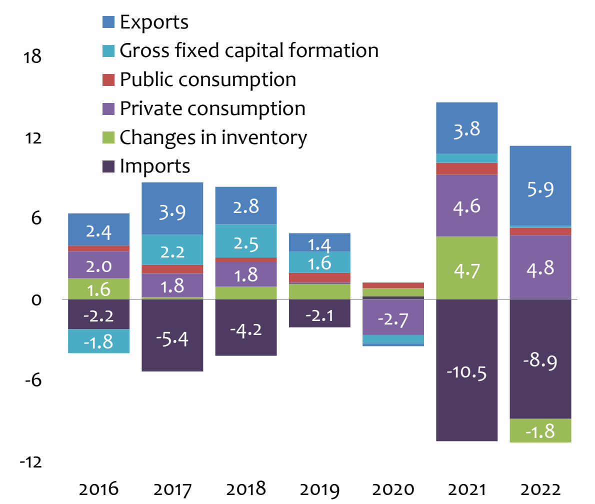


The largest impact yielded the increase in exports and private consumption. Exports of services grew faster, while exports of goods grew more moderately due to the high base effect. Although a significant rise in consumer prices was observed, private consumption grew very rapidly. The increase was facilitated by both the improvement of the situation on the labour market and the completely lifted restrictions on the spread of Covid-19. Despite the great uncertainty, moderate growth remained in investments. Investment in buildings and structures decreased due to rapid cost growth, while investment in machinery, equipment and vehicles and intellectual property products increased. Government consumption also continued to grow, albeit more moderately than the previous year.

Gross Domestic Product by Expenditure Items
2015 = 100



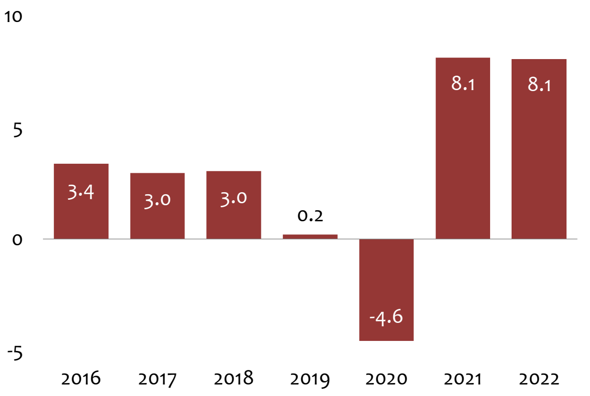
Gross Domestic Product by Expenditure Items
contribution to growth as percentage points



CONSUMPTION

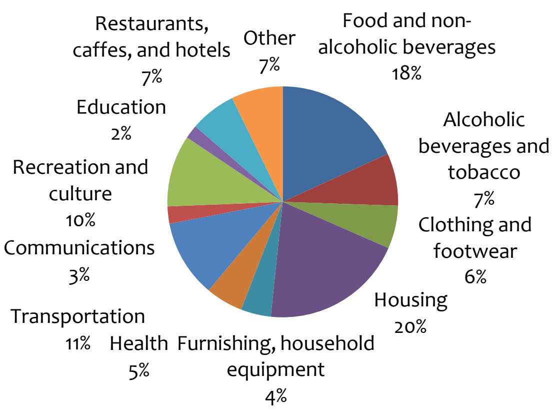
Private consumption is growing rapidly. As the economy recovered, a rapid increase in private consumption was observed in 2021. Although price growth outpaced wage growth, negatively affecting the purchasing power of citizens, due to the base effect of Covid-19 restrictions and the improvement of the situation on the labour market, household consumption continued to rise rapidly in 2022.

Private consumption
changes against the last year, as per cent



In the structure of household consumption, the majority is made up of expenses for housing. In 2022, the lifting of restrictions related to reducing the spread of Covid-19 contributed to a rapid increase in spending on recreation and culture, as well as restaurants and hotels. A slight increase in household expenses for transportation, while the volume of expenses for food practically did not change. Rapidly rising prices for energy resources have encouraged households to save and housing-related expenses fell sharply. The decrease was also influenced by warmer weather at the beginning of the heating season.

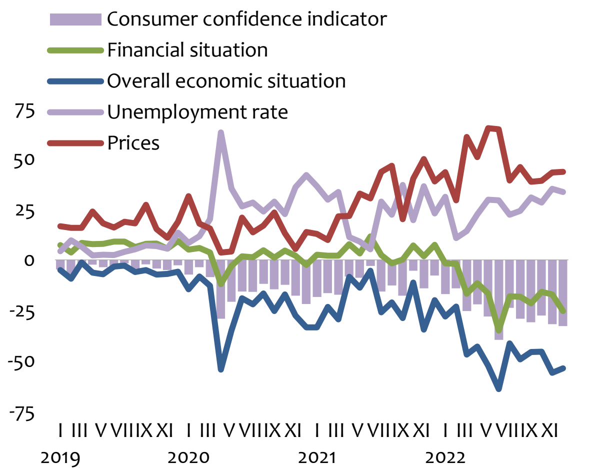
Structure of Household Expenditures
2020, as per cent



In 2022, consumer confidence has remained significantly more pessimistic. After Russia's invasion of Ukraine, consumer confidence began to deteriorate in March, a trend exacerbated by rising inflation.

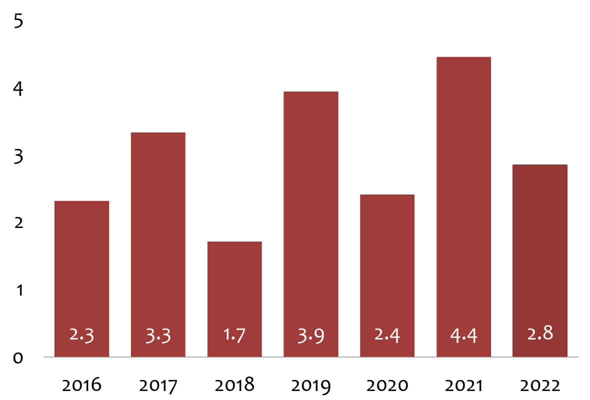
In Q2 of 2022, a decline in all the main items of the confidence indicator was observed. The most pessimistic assessment of future prospects was reached in June 2022. The assessment of the financial situation and the general economic situation fell to the lowest level since the financial crisis in 2009, while 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 optimism increased in Q3 of 2022, which was weakened by increased heating bills at the end of the year.

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



Public consumption continues to grow. Support measures implemented by the government to mitigate the negative impact of Covid-19 and the rapid rise in energy prices maintained a positive increase in public consumption.

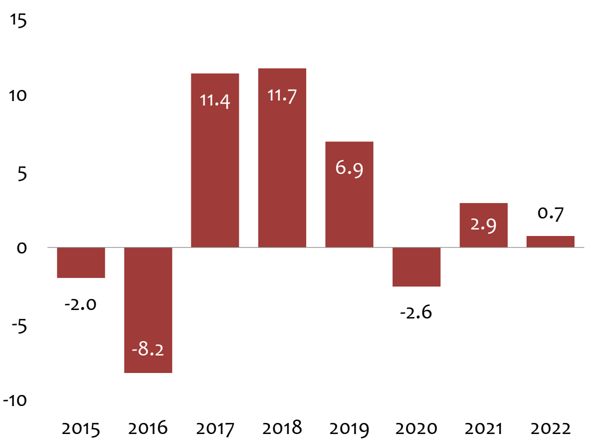
Public Consumption
changes against the last year, as per cent



INVESTMENT

Investment activities have slowed down significantly since 2020. In the last three years, the gross fixed capital increased by 0.4% on average per year, which is much more moderate than before the Covid-19 pandemic in 2017-2019 (increased by 10% on average per year).

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



Under the influence of the shock caused by the Covid pandemic, in 2020, gross fixed capital formation decreased by 2.6%. As the economy stabilized, investment volumes also increased. In 2021, gross fixed capital formation were 2.9% higher than a year ago.

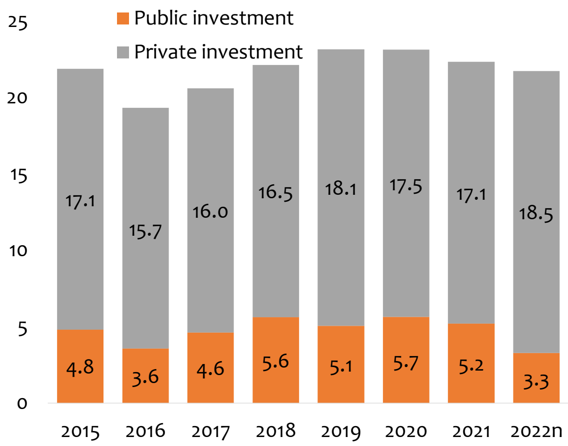
The war in Ukraine has exacerbated the situation and increased uncertainty, which is reflected in the dynamics of investment activities. In 2022, investments grew by only 0.7% and accounted for 21.7% of GDP.

Private investment is sensitive to external and internal shocks. In 2020, the amount of private sector investments decreased by 5.3%. However, in 2021, their volume increased again and exceeded the 2021 level by almost 4.6%. The positive, albeit much slower dynamics remained in 2022 - the volume of private investments was only 0.7% higher than a year earlier.

From a longer-term perspective, private investment remains low, largely affected by weak credit, low demand and high uncertainty. The negative impact of these factors was significantly intensified by the crisis caused by Covid-19 and the war in Ukraine.

Public investment 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 state investment in 2019 significantly decreased and was 8% lower than the year before. Although we experienced the Covid-19 crisis, public investment increased by 9% in 2020. On the other hand, in 2021 and 2022 (assessed at constant prices) they decreased by 2.4% and 35%, respectively.

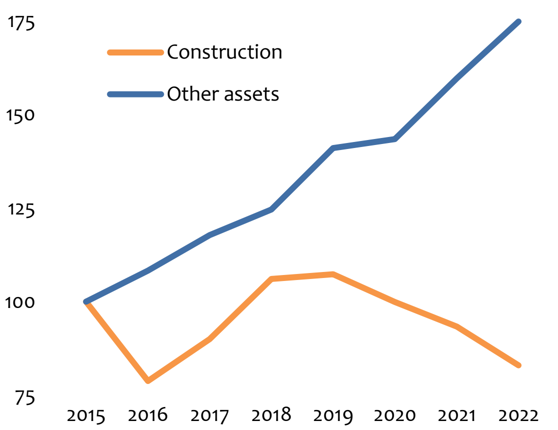
Public and Private Investment
as per cent of GDP



e – estimate

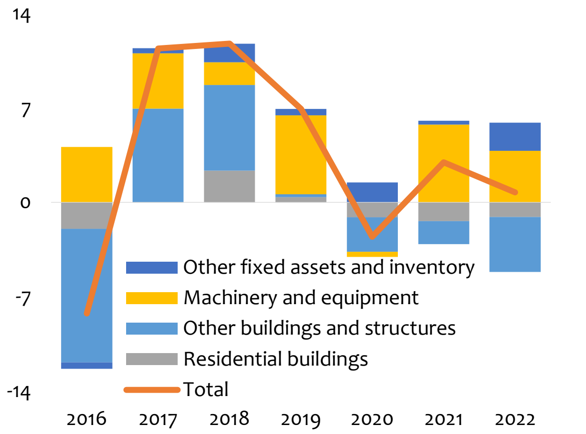
Investments in construction assets make up the majority of the total investment volume. These are mainly investments in buildings and structures, which in the last three years before the Covid-19 crisis accounted for almost 45% of the gross fixed capital formation. Since 2020, investments in construction assets (estimated at constant prices) have been declining. In 2020 and 2021, they were respectively 6.9% and 6.5% lower than a year ago. On the other hand, in 2022, investments in construction assets decreased by 11%, which was determined by a decrease in investments in engineering structures and buildings - by 11%; and investments in housing decreased by 11.1%.

Gross Fixed Capital Formation by Type of Assets
2015 = 100



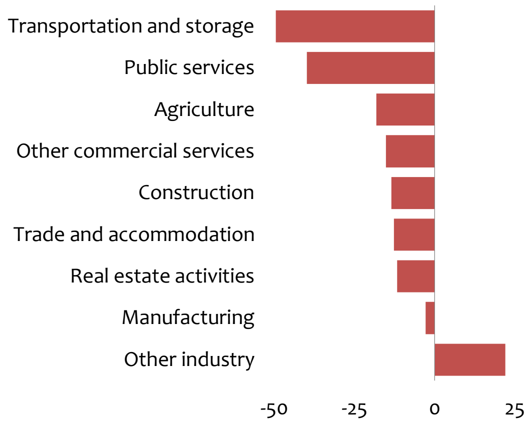
Investments in machinery and technological equipment (excluding vehicles) in 2017-2019 did not exceed 40% of total investments and their dynamics were slower than in other assets. In 2021, 12.9% more was invested in machines and equipment than a year ago. Also, in 2022, such investments continued to grow, exceeding the previous year's level by 9%.

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



The increase in investments in recent years was largely determined by investments in vehicles, as well as in information and communication technology equipment, which is necessary equipment for remote work.

Non-financial Investment Dynamics
*in 2022, changes against the last year, as per cent**



* – calculated using quarterly data, at current prices

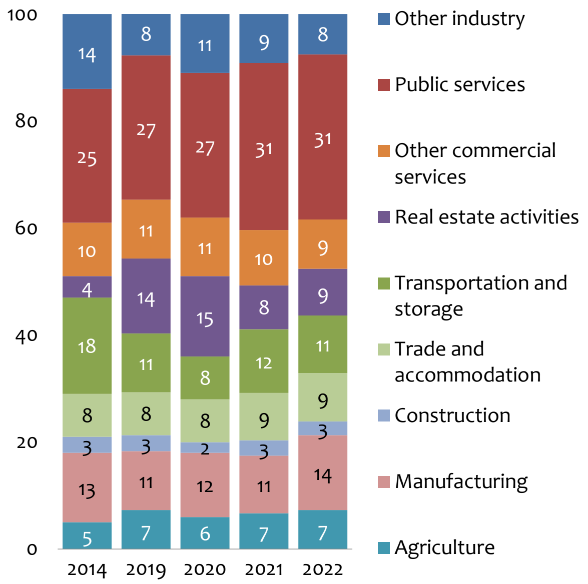
Investments in intellectual property assets make up approximately 7% of total investments. They are characterized by resilience in the years of economic recession and in general a growing dynamic is observed. Since 2020, investments in these assets have increased by an average of 15.4% annually. In 2022, intellectual property products were invested by 21.2% more than a year earlier and accounted for 2.4% of GDP.

Capital investments in tangible fixed assets in goods production sectors in 2022, compared to the previous year (assessed in actual prices), were almost 17.3% higher in volume. On the other hand, capital investments in service sectors increased by 6.9 percent.

The largest contribution yielded the increase in investments in the manufacturing sector (by 42.8%), in the agricultural sector (by 20.3%), and the real estate transactions (by 16.9%). However, capital investments in the education sector, as well as in the utilities sector, were 30.1% and 24.9% lower than a year ago.

Surveys conducted by the European Investment Bank (EIB) show that in the field of investment, Latvian entrepreneurs consider the lack of qualified personnel and the uncertainty of the future to be the most significant long-term obstacles. Investments are also limited by the cost of energy resources and gaps in business regulation.

Gross capital investment structure
*by sectors, as per cent**



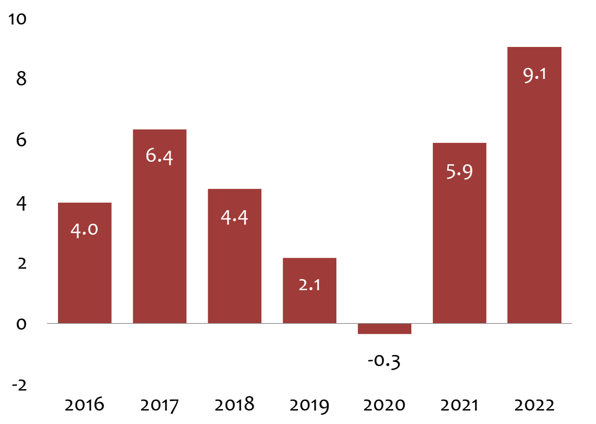
* Gross capital investment in tangible assets (calculated using quarterly data)

The dynamics of investments will continue to be affected by the uncertainty of the international environment. The investment dynamics will be positively influenced by EU funding, which is an important incentive to increase the investment level. It is expected that the Rail Baltica project and several other projects, which are expected to be financed within the framework of the Recovery and Resilience Facility, will make a significant contribution to the increase of investment activities. Increasing the credit portfolio is also of vital importance. However, it should be noted that in the coming years, investments will be significantly limited by both the rapid rise in inflation and the increase in the cost of lending, as the ECB implements the restrictive monetary policy.

EXPORTS

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

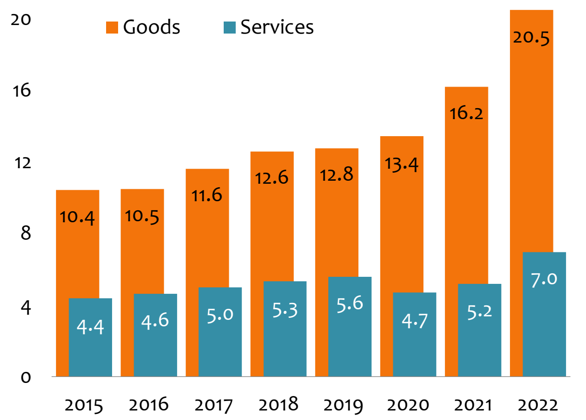
Exports of Goods and Services
changes against the last year, as per cent



In 2020, 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.

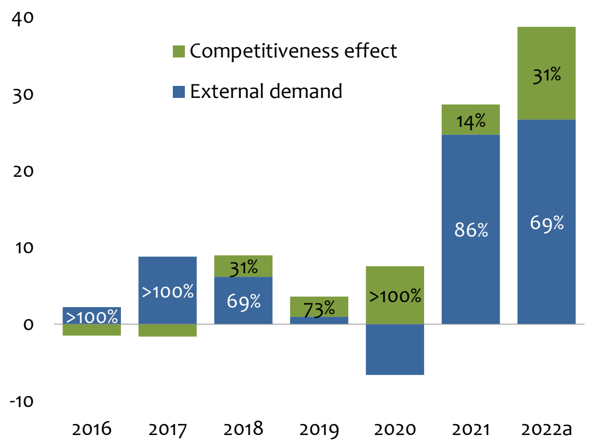
In 2022, as external demand grew, export volumes continued to grow rapidly. Export growth was equally fast in the Q1-Q3 of 2022, while it slowed down a bit in the last quarter of the year.

Exports of Goods and Services
at current prices, billion euro



In 2016-2018, 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. In both 2021 and 2022, the growth of exports was promoted by a rapid increase in external demand, as well as competitiveness.

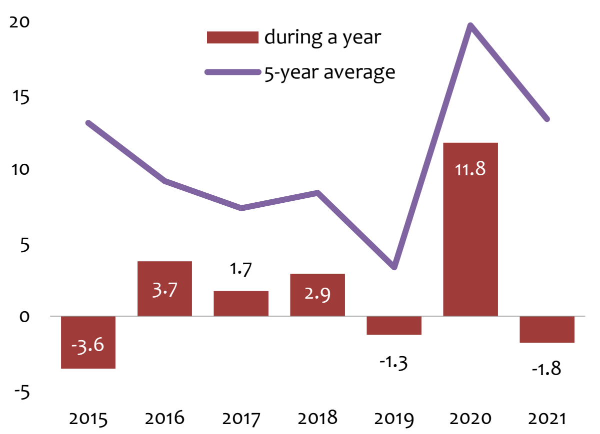
Changes of Exports by the Constant Market Share
structure of exports' changes to the EU countries, as per cent



a – assessment of the Ministry of Economics

Since 2016, the share of Latvia's exports in the world market has been increasing, excluding the years 2019 and 2021, when Latvian export growth rates were lower than the world average. This reveals that Latvia remains competitive, despite the rapid increase in labour costs.

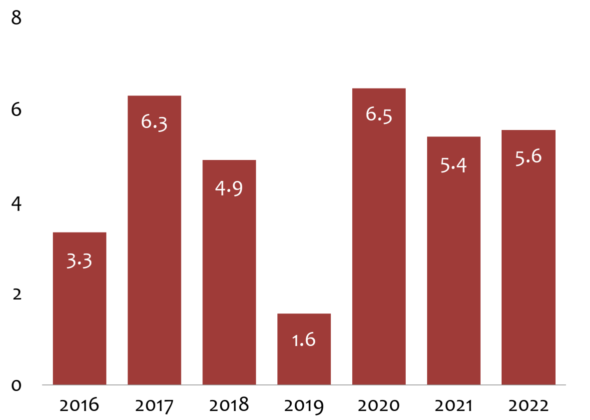
Share of Exports in World Trade
changes as per cent



Exports of Goods

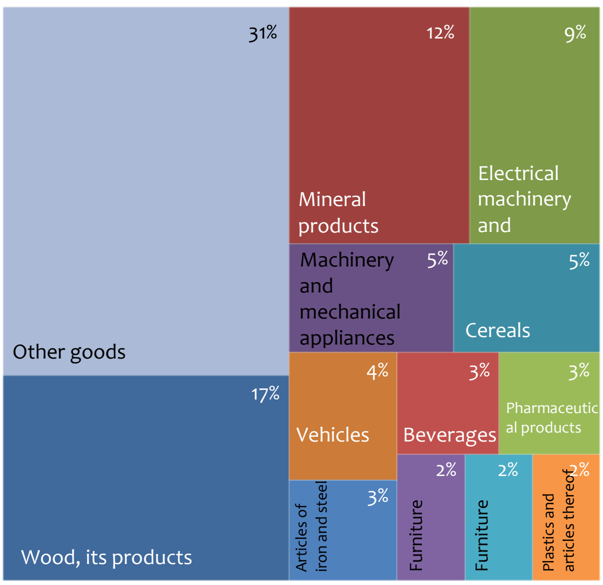
The proportion of goods exports has not changed significantly since 2020 and constitute approximately 3/4 of Latvia's total exports.

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



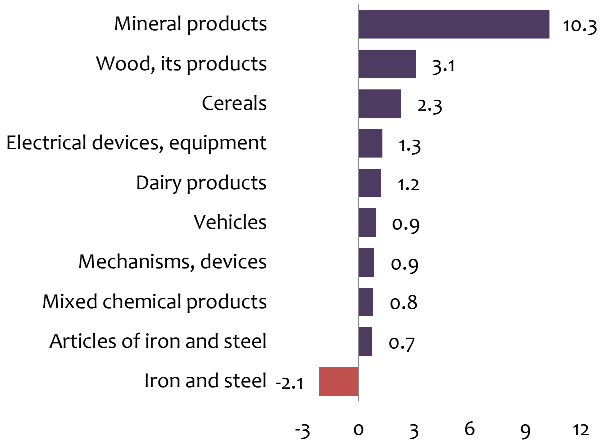
In 2020-2022, the growth of export of goods was relatively rapid. In 2022, at constant prices, exports increased by 5.6%. While export prices significantly rose, the increase in actual prices was even more rapid - by 29.7%.

Exports of Goods
in 2022, structure, as per cent



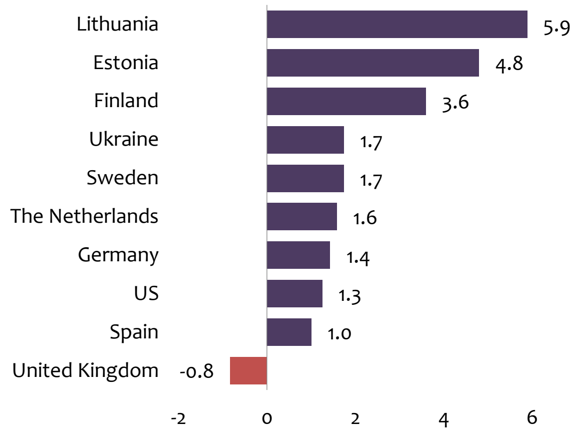
In 2022, the growth of exports of goods was significantly facilitated by the increase in the export value of mineral products, wood and its products, as well as cereals. In January 2023, the exports of goods in actual prices increased by 8.9%. Exports of electrical appliances and equipment, cereals and beverages grew rapidly.

Exports of Goods
contribution to growth in 2022, compared to the corresponding period last year, percentage points



In 2022, the exports of goods increased to almost all main partner countries. It grew rapidly to the EU and other countries (excl. the EU and the CIS). It also increased slightly to the CIS (due to the rise in export prices).

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



The largest Latvia's export partner countries in 2022 were Lithuania, Estonia, Germany, Russia, Sweden, the United Kingdom, Finland, Denmark, the Netherlands, and Poland. Latvia exported almost 70% of goods to these countries.

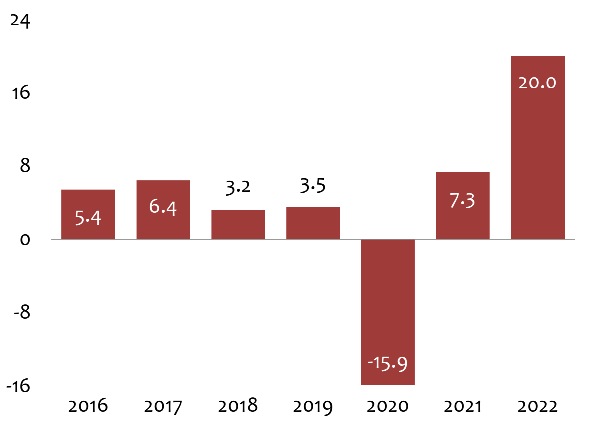
In 2022, the main export goods to EU countries were mineral products, wood and its products, and electrical devices and equipment. Alcoholic beverages, pharmaceutical products and mechanisms and devices accounted for a large part of exports to the CIS countries. To other countries the largest export groups were wood and its products (United Kingdom), cereals, as well as electrical devices and equipment.

Exports of Services

In 2016-2021, Latvia's export of services grew at a similar pace as the export of goods. The exception was 2020, when the export of services significantly decreased due to the imposed Covid-19 restrictions. In 2021, the exports of services started to grow again, and in 2022 its pace significantly exceeded the growth of the exports of goods.

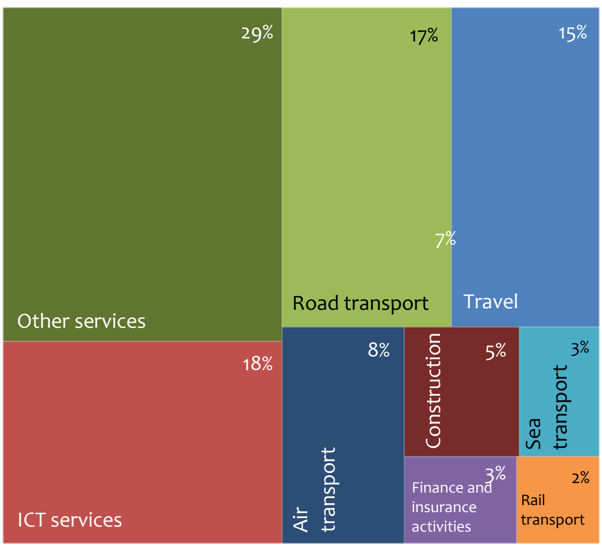
In 2022, the export of services in actual prices increased by 34.8%. A large contribution to its growth was made by several service items – transport services, trade brokerage services, travel and ICT services. The exports of services grew faster in the first three quarters of 2022, albeit more moderately in the 4th quarter.

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

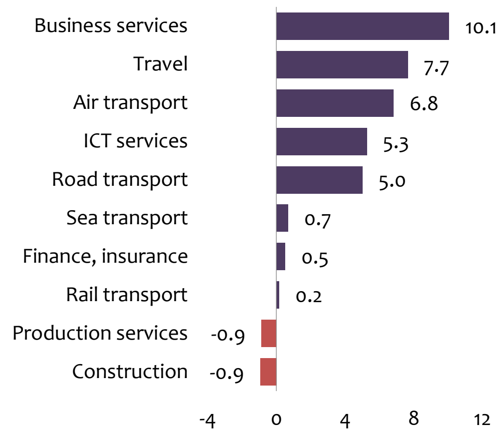


The export of services will also grow in 2023. In January, it was 30.7% (in actual prices) higher than a year ago.

Exports of Goods
in 2022, structure, as per cent



Exports of Goods
contribution to growth in 2022, compared to the corresponding period last year, percentage points

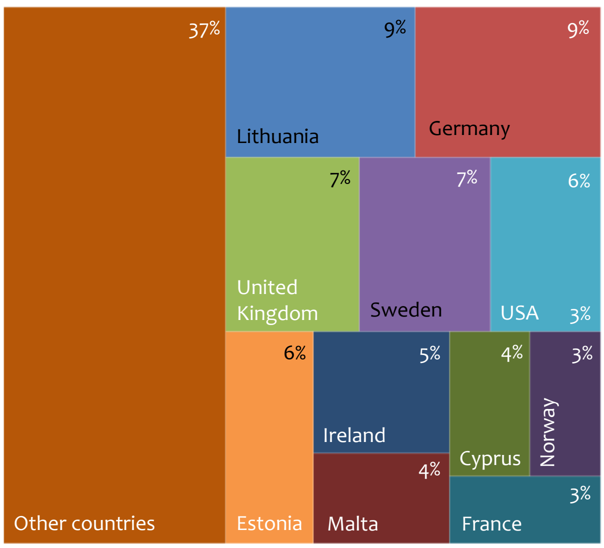


An increasing proportion of exports of services go to EU countries. In 2019, it made up 61%, and in 2022 - 65% of all service exports. The export of services to Lithuania, Estonia, Ireland, Malta and Cyprus increased significantly, albeit it decreased to Germany and Slovenia.

Exports to the CIS countries, which are mostly related to transit services and their development, make up an increasingly smaller share of service exports. It should be noted that the share of service exports to CIS countries has decreased from 12% in 2019 to 4% in 2022.

With the exception of the EU and the CIS, the exports of services are developing dynamically. In 2022, it grew faster in the United Kingdom, the United States and Norway, while it decreased in Hong Kong.

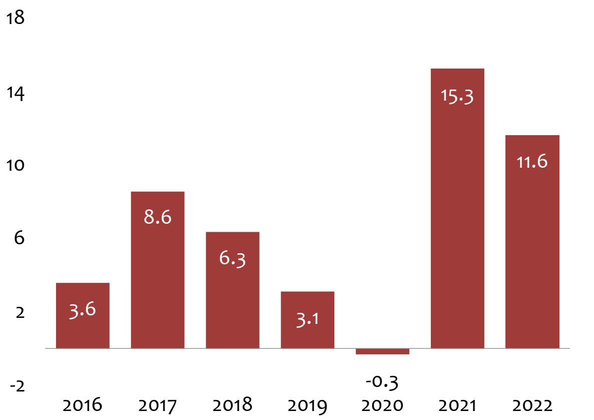
Exports of Goods by Country
contribution to growth in 2022, compared to the corresponding period last year, changes as per cent



IMPORTS

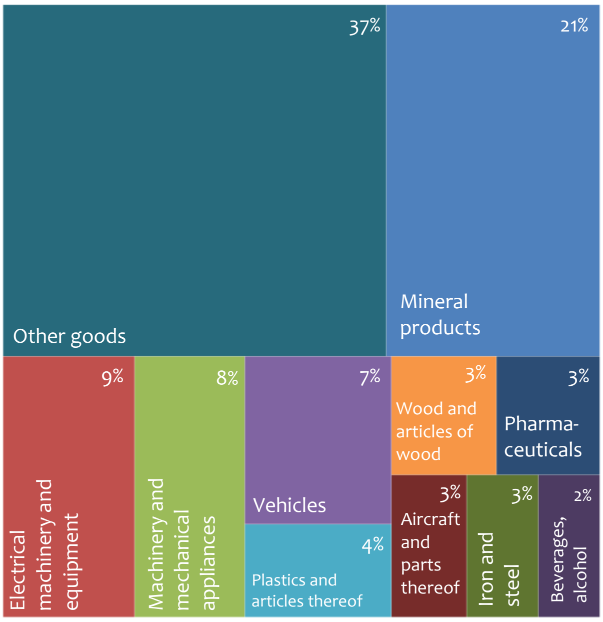
Until 2019, import and export growth was similar. In 2020, due to the Covid-19, the imports of services decreased significantly, while the imports of goods increased slightly. In 2021, the imports increased significantly. In 2022, services imports grew more rapidly than goods imports.

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



In 2022, due to the increase in prices, the value of goods imports in actual prices increased much faster than in constant prices - by 35.8%. A large part of the increase in the imports of goods provided mineral products. Imports of vehicles, electrical appliances and equipment, mechanisms and devices and various chemical products also increased.

Structure of Imports of Goods
in 2022, as per cent



In January 2023, the imports of goods increased by 14.5%, compared to January 2022.

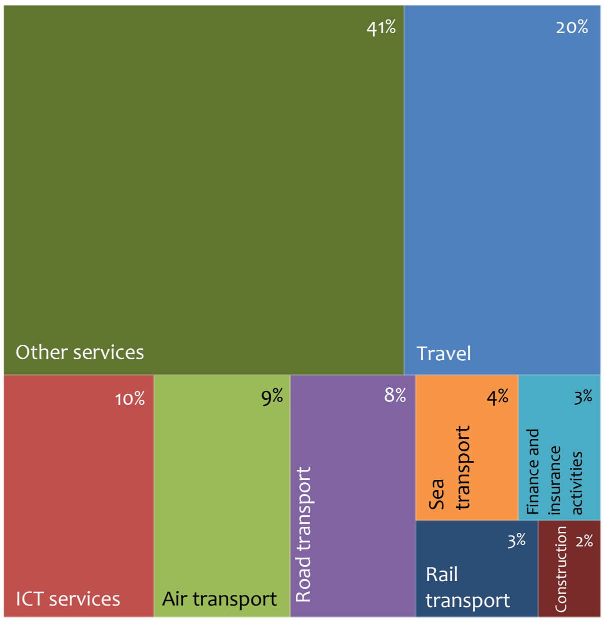
The main Latvia's import partner countries are Lithuania, Estonia, Germany, Poland, Russia, the Netherlands, China, and Finland. The value of imports to the countries in 2022 made up 71% of total imports. In 2022, the share of imports from Lithuania and Estonia increased significantly, albeit declined from Russia and Belarus.

In 2022, the main groups of imported goods from EU countries were mineral products, mechanisms, vehicles and electrical appliances. Mineral products, wood, iron and steel accounted for a large part of the imports from the CIS. Also, 95% of imports from the CIS countries are imports from Russia and Belarus, and 3% from Kazakhstan.

Latvia's imports of services developed dynamically in 2017-2019, albeit in 2020, due to the Covid-19, the imports of services decreased significantly. In 2021, the imports of services returned to growth. A rapid increase in the imports of services was observed in 2022, due to the increase in the value of economic activities, transport services and travel. Imports of ICT services also increased.

EU countries constitute 2/3 of the services import structure. In 2022, imports from Lithuania, Estonia, the USA, Ireland and Germany increased faster, while imports from Russia and Belarus decreased.

Structure of Imports of Services
in 2022, as per cent



In January 2023, the imports of services increased by 28.4%, compared to January 2022.

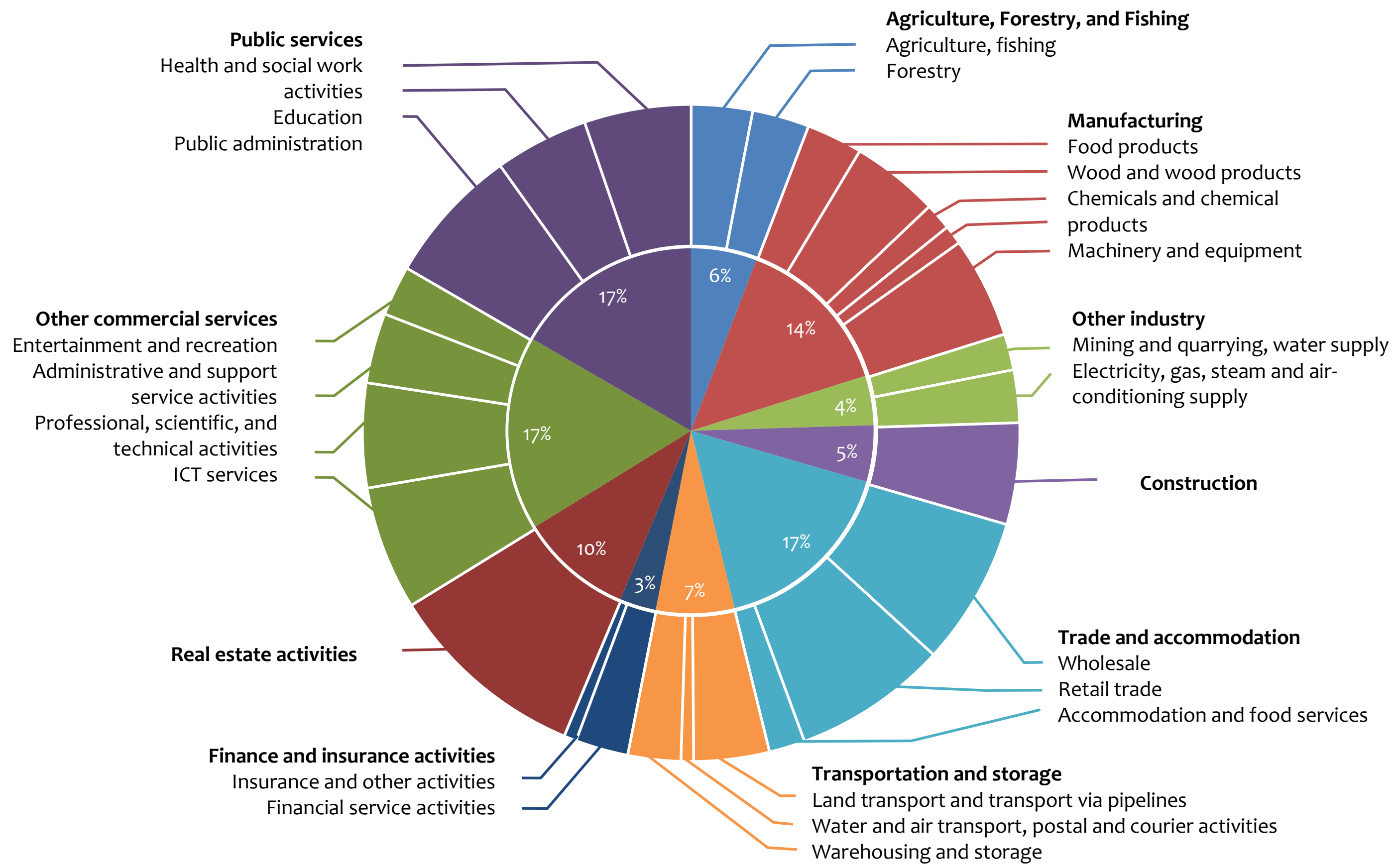
2023 | 1

SECTORAL DEVELOPMENT

In 2009-2010, as labour costs declined, the competitiveness of Latvian producers improved, which significantly stimulated export growth and hence the development of tradable sectors. The structure of the economy changed. In 2010, the share of these sectors reached 33.1% of the total value added. However, in 2022, the share of these sectors reached 31.4%. In 2010, tradable sectors (i.e., agriculture, forestry, and fishing, manufacturing, and construction) constituted 27.6% of the total value added. In 2022, it reached to 29.5%. In 2022, compared to 2010, the share in the structure of the national economy has increased in agriculture, forestry, and fishing, manufacturing, commercial services and public services sectors, albeit decreased in transportation, other industry, and trade.

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 2022, growth was observed in all sectors, except for construction, other industry, trade and financial activities. The largest impact provided the increase in volumes in the activities of administrative and service services.

Structure of Value Added
2022, as per cent*



* calculations by the Ministry of Economics

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

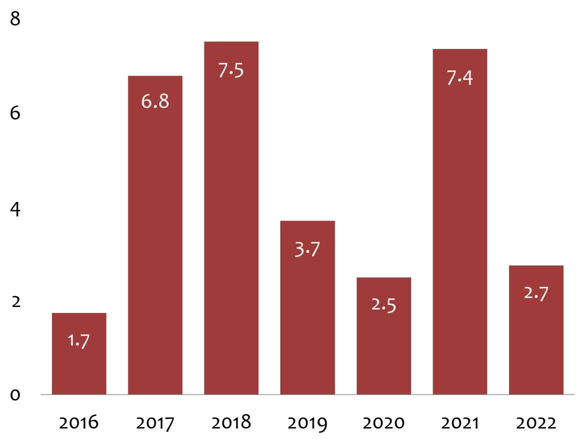
	2016	2017	2018	2019	2020	2021	2022
Gross domestic product	**2.4**	**3.3**	**4.0**	**2.6**	**-2.2**	**4.1**	**2.0**
Agriculture, forestry, and fishing	-4.3	1.9	-3.6	24.7	0.7	-8.9	7.0
Mining and quarrying	-2.8	9.1	9.1	-5.2	8.3	5.0	-0.5
Manufacturing	1.7	6.8	7.5	3.7	2.5	7.4	2.7
Manufacture of food products	1.8	5.2	-2.9	-0.7	-1.7	1.3	1.3
Light industry	2.1	7.6	-0.8	-2.6	-9.5	11.8	5.1
Manufacture of wood and articles of wood	8.0	2.1	4.5	0.0	4.5	3.7	-1.0
Manufacture of paper and paper products	3.6	4.5	-3.7	5.7	4.7	14.0	-2.7
Manufacture of chemicals and chemical products	10.7	11.4	7.0	3.9	-1.8	14.8	4.1
Manufacture of non-metallic mineral products	11.6	11.1	1.3	-2.1	-1.4	4.4	5.4
Manufacture of basic metals	5.4	12.0	3.6	13.5	-5.6	5.8	16.1
Manufacture of computer, electronic and optical products	12.6	15.8	12.1	11.3	12.1	5.7	3.5
Manufacture of machinery and equipment	8.5	21.5	7.0	-1.9	-2.7	24.1	-12.3
Manufacture of motor vehicles	-2.9	22.8	7.3	-7.7	-15.3	17.7	19.5
Other manufacturing	0.8	4.3	-1.8	2.8	-14.2	11.8	3.8
Electricity, gas, steam, and air-conditioning supply	17.5	-1.9	-38.8	2.6	27.7	3.1	-14.3
Construction	-9.6	14.7	12.4	1.3	-7.2	-9.8	-11.3
Construction of buildings	-11.1	22.4	25.6	7.8	0.9	-10.5	-9.8
Civil engineering	-25.7	30.0	11.6	1.0	-1.5	-5.0	-13.1
Trade	4.5	2.6	3.9	6.2	1.4	8.0	-6.3
Retail trade	2.3	4.3	3.8	2.3	1.5	2.5	4.3
Transportation and storage	1.7	6.6	3.8	3.5	-20.2	9.0	2.3
Freight rail transport	-14.1	-8.4	12.5	-15.8	-42.3	-9.5	-2.1
Cargo handling	-9.3	-2.0	6.9	-5.7	-27.9	-7.2	15.2
Freight transport by road	1.3	7.0	12.8	-3.8	2.6	7.8	-0.8
Accommodation and food service activities	4.4	9.3	7.6	-3.9	-33.7	-4.7	57.5
Information and communication services	5.0	8.7	9.6	4.4	1.1	7.1	14.0
Finance and insurance activities	-0.2	-17.7	-2.4	-12.1	-0.5	17.9	-3.1
Real estate activities	1.6	-1.6	2.3	-3.6	-1.1	-1.6	1.6
Other service activities	3.9	4.6	2.7	0.4	0.8	1.2	15.2
Public administration and defence; compulsory social security	1.4	3.7	2.7	3.4	2.8	2.8	3.6
Education	1.2	4.4	3.1	2.8	2.7	3.1	4.3
Health and social work activities	1.2	4.4	9.3	9.6	4.3	25.2	0.7
Arts, entertainment, and recreation	5.0	5.1	6.1	2.8	-30.2	-3.4	26.6

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.

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

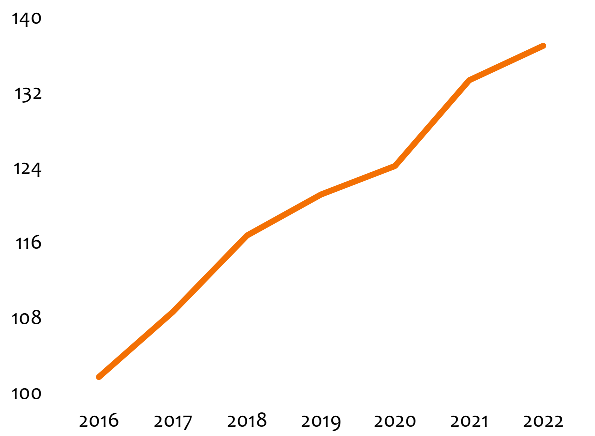


In 2021, rapid growth resumed in the manufacturing. High growth of the sector remained in the first half of 2022.The growth of the sector was facilitated by increases in the production volumes of metalworking, vehicle production, and chemical industry. However, the volumes of machinery and equipment and woodworking decreased.

In January 2023, the production volumes of the manufacturing were 3.5% lower than a year ago.

In 2022, the turnover of the manufacturing grew rapidly in actual prices. The volume of production sold on the domestic market grew faster, and the volume of exported production – moderately.

Manufacturing
value added, 2015 = 100

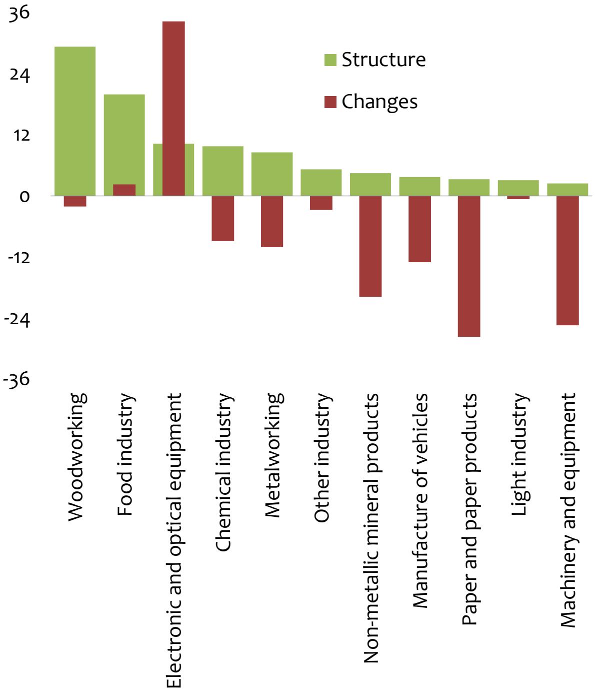


In 2018-2019, the number of occupied posts in the manufacturing did not change significantly. In 2020, the number of occupied posts decreased by 6.8 thousand. In 2021 it increased by 5 thousand, albeit in 2022 it decreased slightly - by 0.6 thousand. During the year, the increase in the number of occupied posts was observed in the electrical and optical equipment manufacturing and metalworking sub-sectors, while it decreased in food and light industry, and woodworking.

Structure of Manufacturing and Development Trends by Field
as per cent

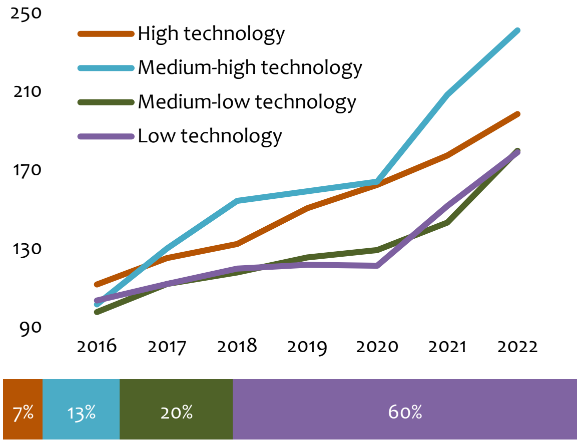
	Structure in 2021			Changes in production volumes				
	Output	Occupied posts	Exports in total sales	2019	2020	2021	2022	2023 Jan
Manufacturing	**100**	**100**	**67.1**	**2.1**	**-0.9**	**7.5**	**2.7**	**-3.5**
Food industry	19.3	18.7	42.3	-0.7	-1.7	1.3	1.3	2.3
Light industry	2.8	8.0	88.1	-2.6	-9.5	11.8	5.1	-0.6
Manufacture of wood and wood products	30.2	20.4	65.8	0.0	4.5	3.7	-1.0	-2.1
Manufacture of paper and paper products	3.7	4.4	64.7	5.7	4.7	14.0	-2.7	-27.7
Manufacture of chemicals and chemical products	9.2	7.5	80.1	3.9	-1.8	14.8	4.1	-8.9
Manufacture of non-metallic mineral products	5.7	5.3	60.2	-2.1	-1.4	4.4	5.4	-19.8
Manufacture of basic metals	9.2	11.2	69.4	13.5	-5.6	5.8	16.1	-10.0
Manufacture of electronic products	7.9	5.7	87.5	11.3	12.1	5.7	3.5	34.3
Manufacture of machinery and equipment	2.8	3.1	89.7	-1.9	-2.7	24.1	-12.3	-25.4
Manufacture of motor vehicles	3.8	3.6	94.3	-7.7	-15.3	17.7	19.5	-13.0
Other manufacturing	5.4	12.1	64.9	2.8	-14.2	11.8	3.8	-2.8

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



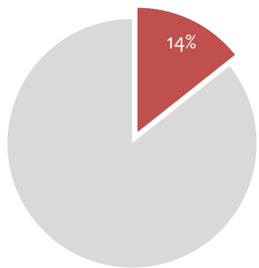
Stable demand in the largest market for Latvian goods in the EU preserves opportunities for the growth of the manufacturing. However, the further development of the sector continues to be negatively affected by the war in Ukraine, as the existing supply chains of raw materials are disrupted, and companies are also negatively affected by the global increase in prices for goods, including energy resources. Companies that were connected to the markets of these countries must continue to look for new markets.

Manufacturing Volume Index and Structure by Levels of Technology
2015 = 100, structure in 2022, as per cent

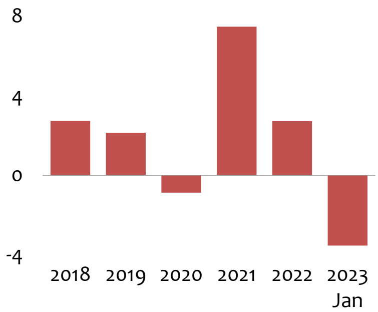


Main Indicators of Manufacturing[1]

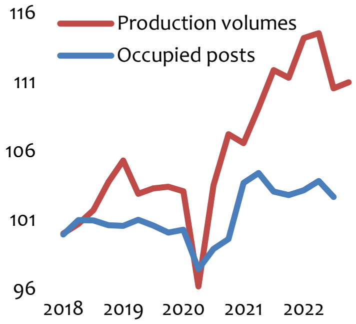
Share in total value added
in 2022, as per cent



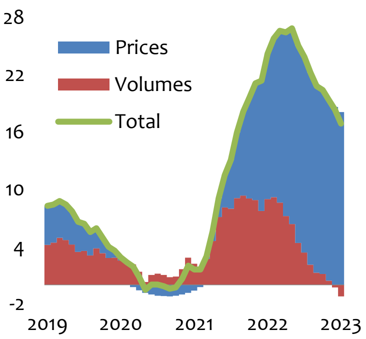
Changes in production volumes
as per cent



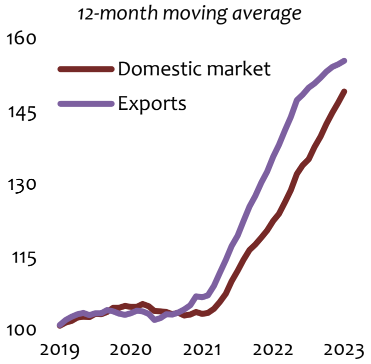
Production volumes and occupied posts
Q4 2017 = 100



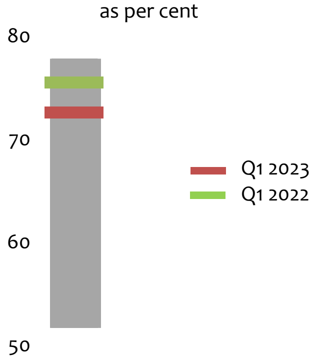
Changes in sales of production
12-month moving average



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



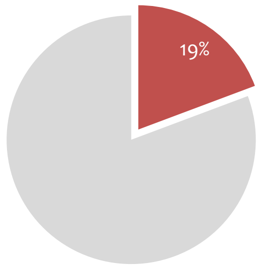
Capacity utilization rate
Historically highest/ lowest level,
as per cent



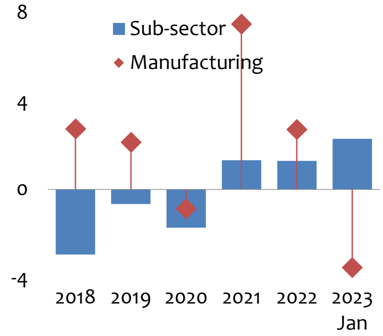
[1] data on sales of products until January 2023

Manufacture of food products and beverages

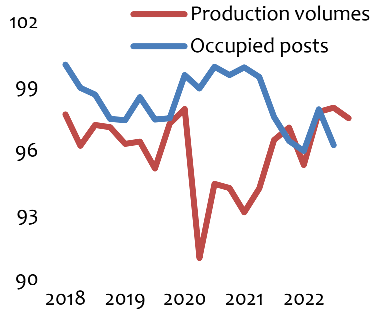
Share in total value added
in 2022, as per cent



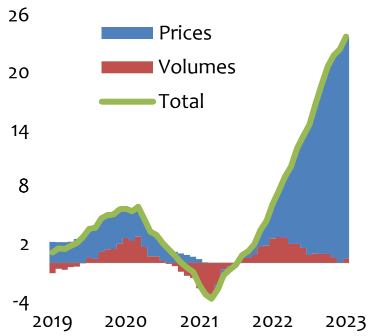
Changes in production volumes
as per cent



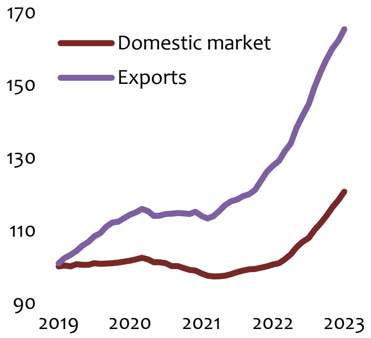
Production volumes and occupied posts
Q4 2017 = 100



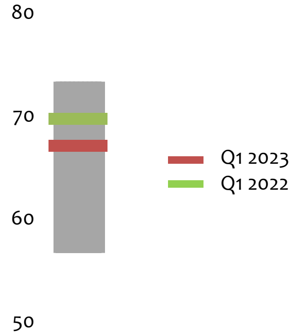
Changes in sales of production
12-month moving average



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

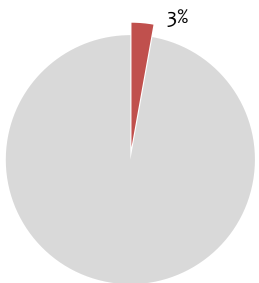


Capacity utilization rate
Historically highest/ lowest level,
as per cent

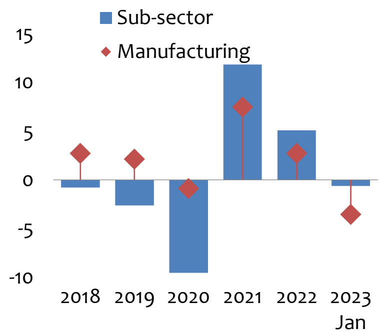


Light Industry

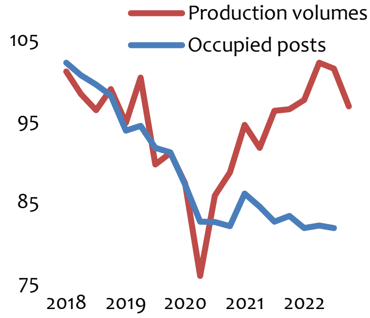
Share in total value added
in 2022, as per cent



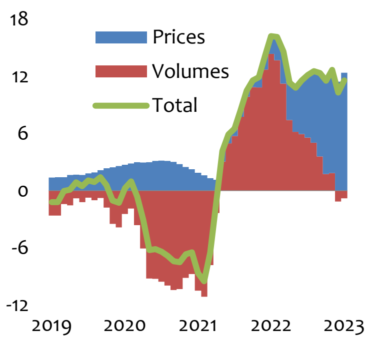
Changes in production volumes
as per cent



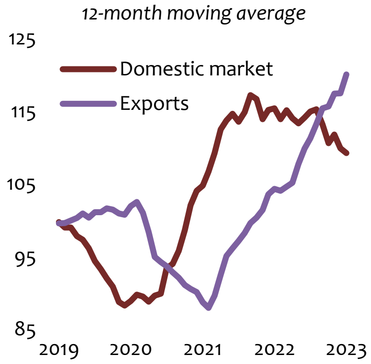
Production volumes and occupied posts
Q4 2017 = 100



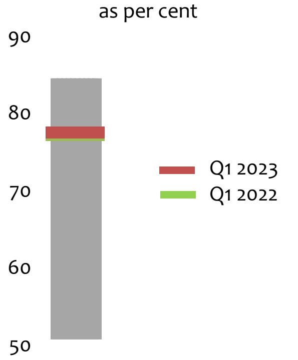
Changes in sales of production
12-month moving average



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

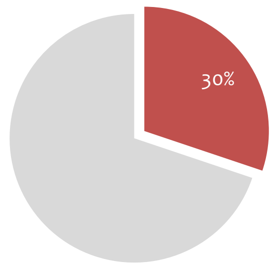


Capacity utilization rate
Historically highest/ lowest level,
as per cent

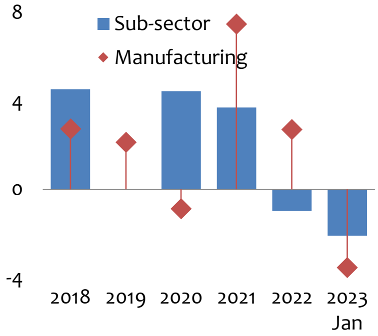


Manufacture of wood and wood products

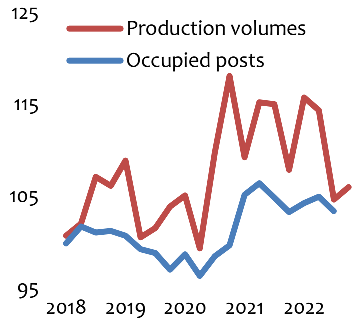
Share in total value added
in 2022, as per cent



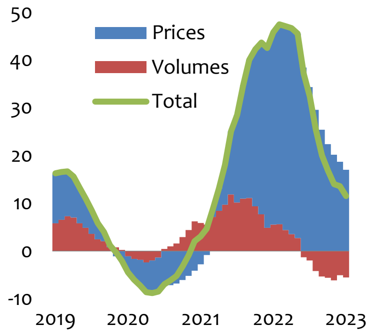
Changes in production volumes
as per cent



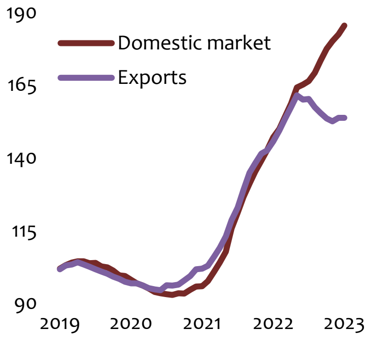
Production volumes and occupied posts
Q4 2017 = 100



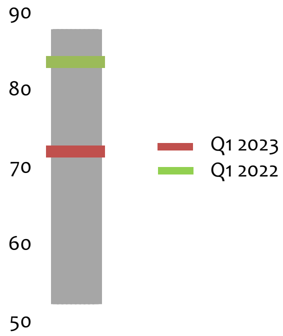
Changes in sales of production
12-month moving average



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

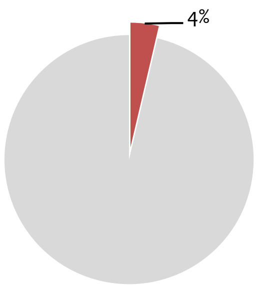


Capacity utilization rate
Historically highest/ lowest level,
as per cent

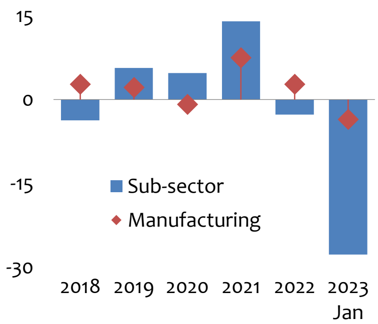


Manufacture of paper and paper products

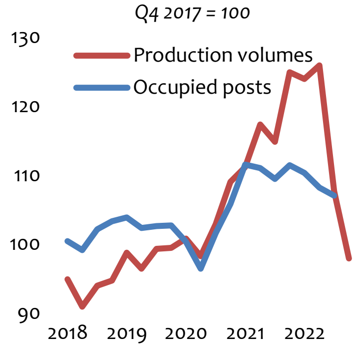
Share in total value added
in 2022, as per cent



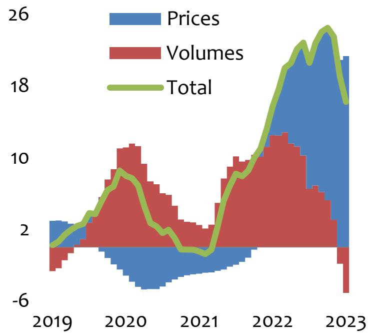
Changes in production volumes
as per cent



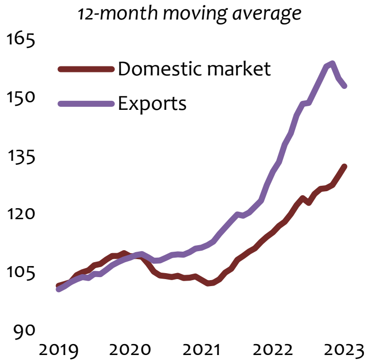
Production volumes and occupied posts
Q4 2017 = 100



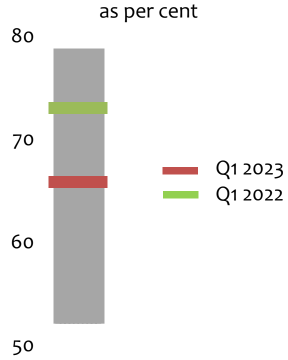
Changes in sales of production
12-month moving average



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

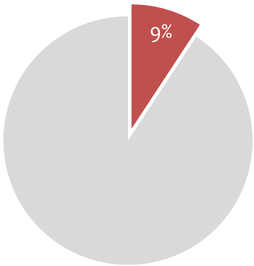


Capacity utilization rate
Historically highest/ lowest level,
as per cent

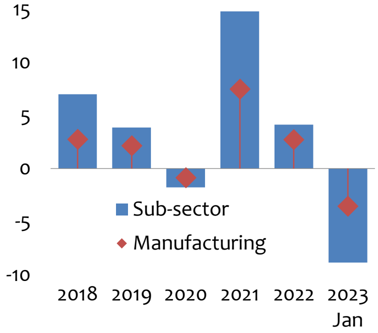


Manufacture of chemicals and chemical products

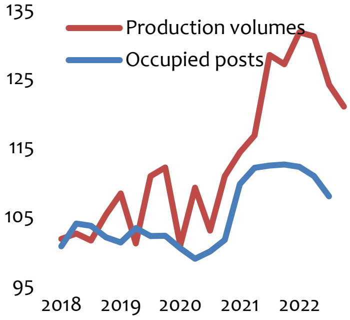
Share in total value added
in 2022, as per cent



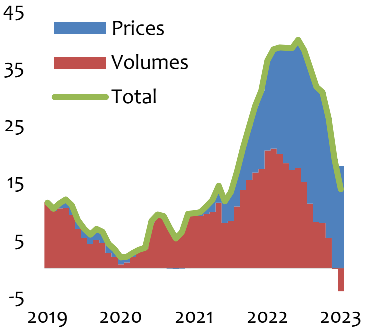
Changes in production volumes
as per cent



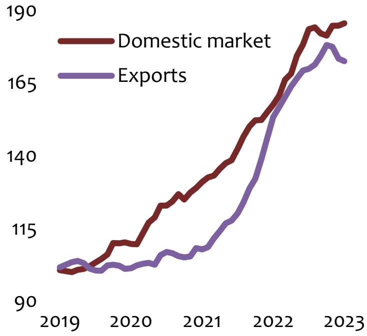
Production volumes and occupied posts
Q4 2017 = 100



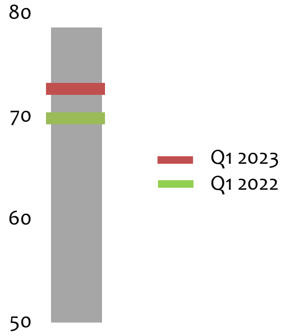
Changes in sales of production
12-month moving average



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

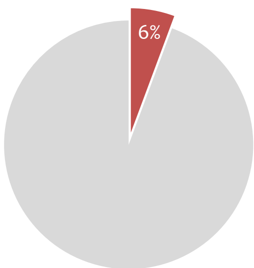


Capacity utilization rate
Historically highest/ lowest level,
as per cent

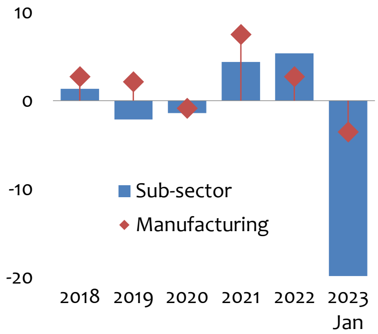


Manufacture of non-metallic mineral products

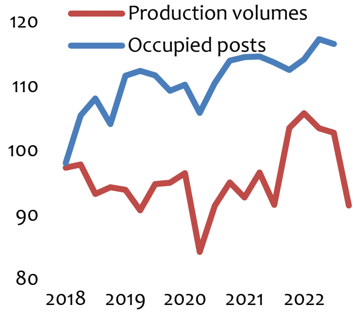
Share in total value added
in 2022, as per cent



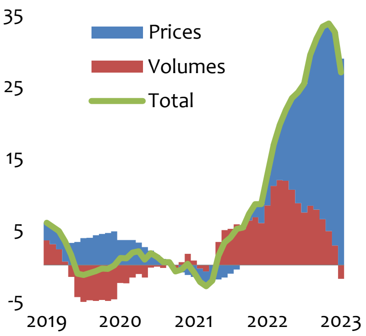
Changes in production volumes
as per cent



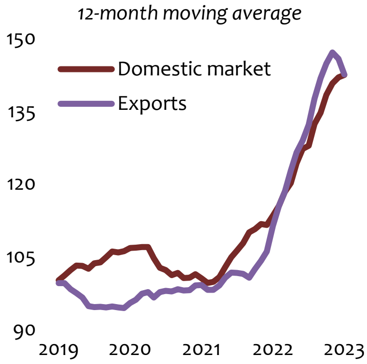
Production volumes and occupied posts
Q4 2017 = 100



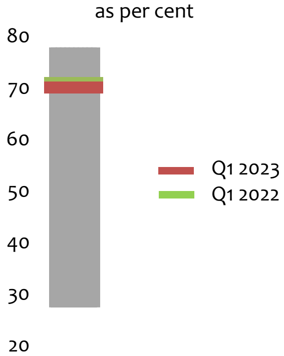
Changes in sales of production
12-month moving average



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

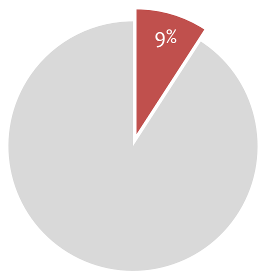


Capacity utilization rate
Historically highest/ lowest level,
as per cent

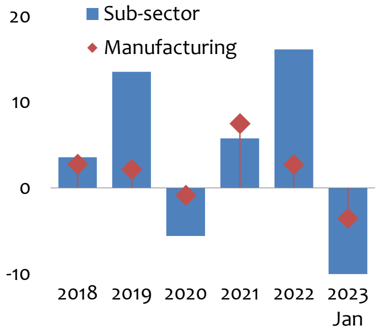


Manufacture of basic metals and fabricated metal products

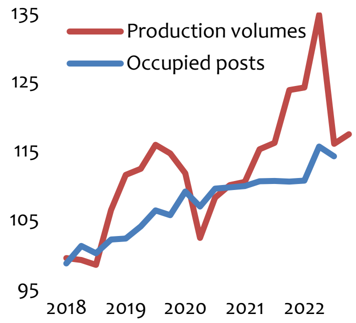
Share in total value added
in 2022, as per cent



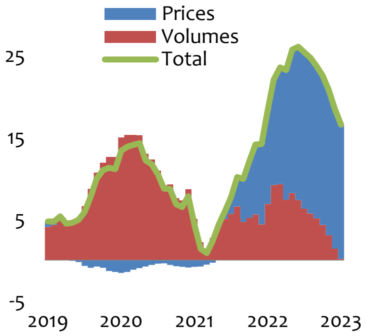
Changes in production volumes
as per cent



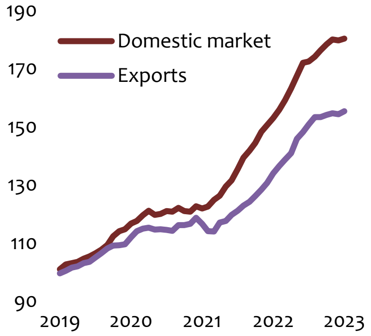
Production volumes and occupied posts
Q4 2017 = 100



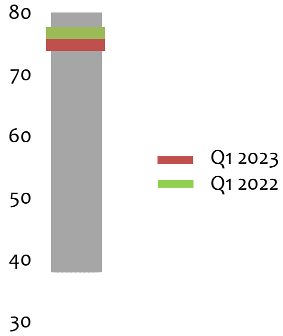
Changes in sales of production
12-month moving average



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

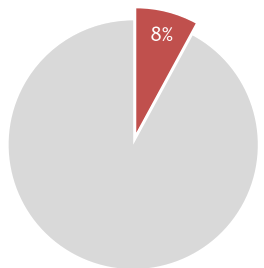


Capacity utilization rate
Historically highest/ lowest level, as per cent

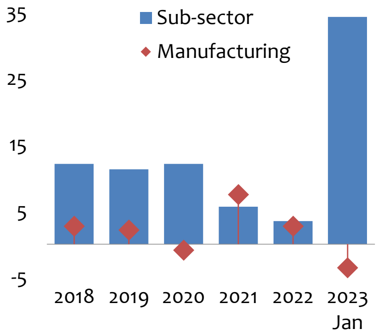


Manufacture of electronic and optical products

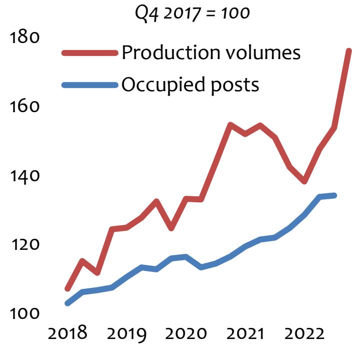
Share in total value added
in 2022, as per cent



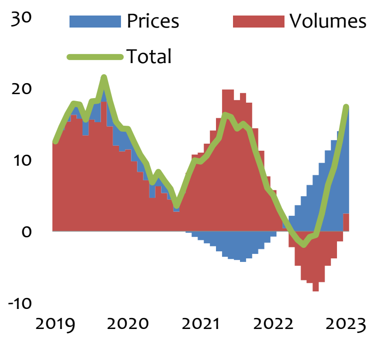
Changes in production volumes
as per cent



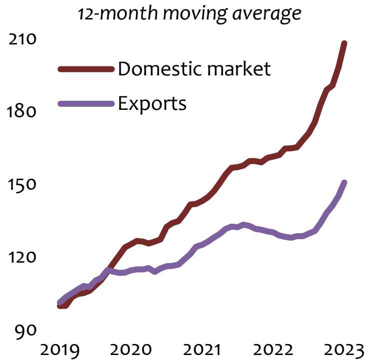
Production volumes and occupied posts
Q4 2017 = 100



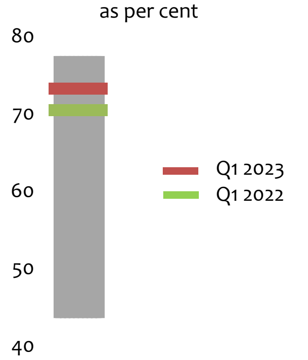
Changes in sales of production
12-month moving average



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

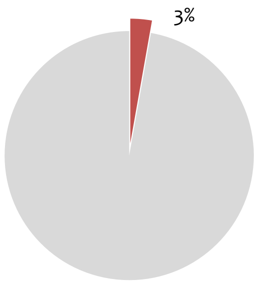


Capacity utilization rate
Historically highest/ lowest level, as per cent

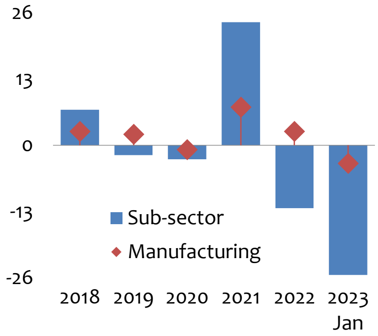


Manufacture of machinery and equipment

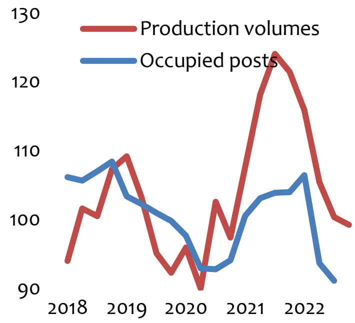
Share in total value added
in 2022, as per cent



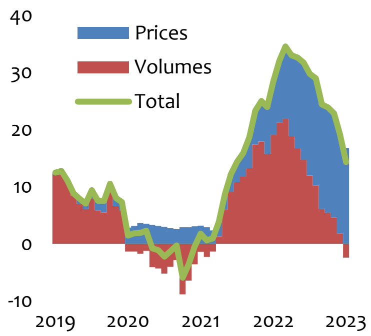
Changes in production volumes
as per cent



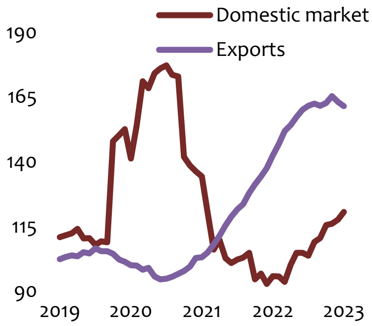
Production volumes and occupied posts
Q4 2017 = 100



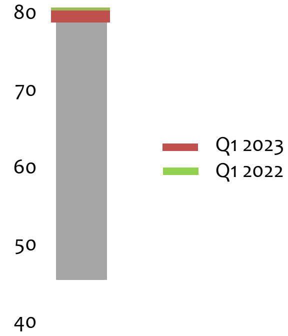
Changes in sales of production
12-month moving average



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

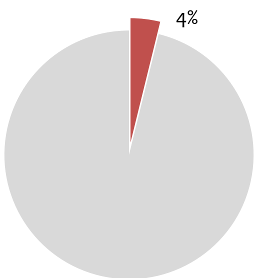


Capacity utilization rate
Historically highest/ lowest level,
as per cent

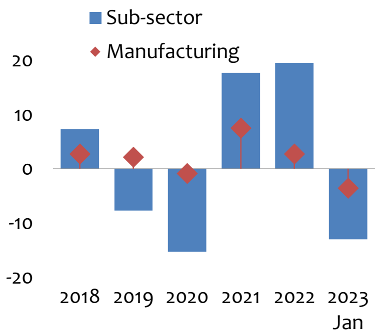


Manufacture of motor vehicles

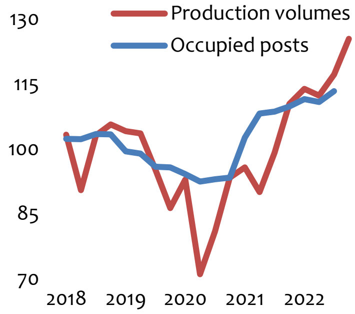
Share in total value added
in 2022, as per cent



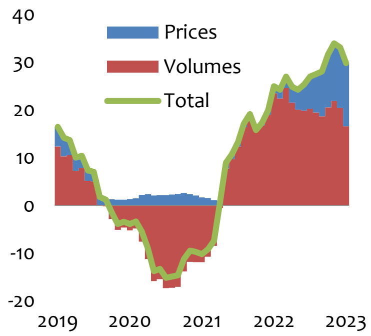
Changes in production volumes
as per cent



Production volumes and occupied posts
Q4 2017 = 100

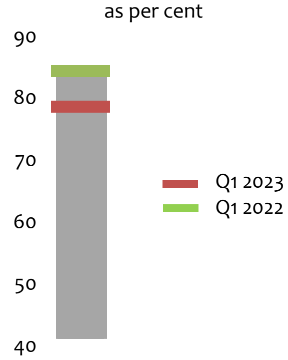


Changes in sales of production
12-month moving average



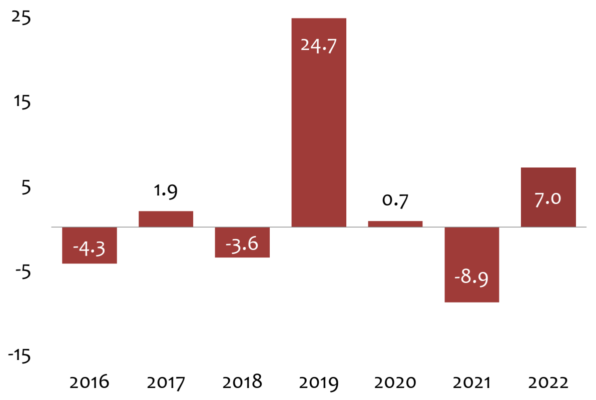
Production sales
December 2018 = 100,
12-month moving average

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



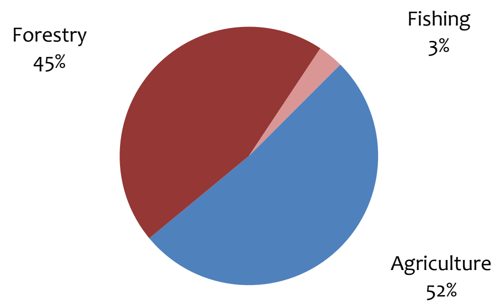
AGRICULTURE, FORESTRY, AND FISHING

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



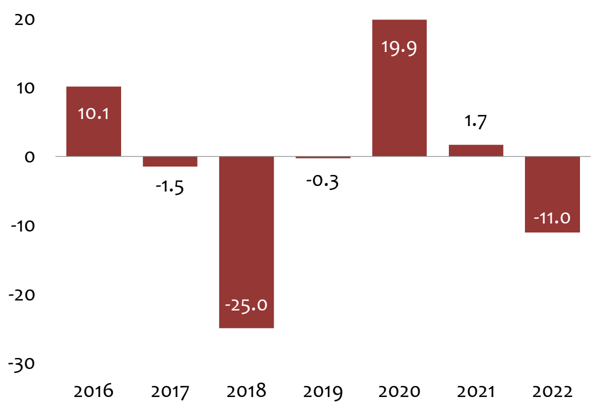
Agriculture and forestry provide the largest contribution to growth within the sector. The activity of the sector is closely related to the weather conditions; therefore, the sector experiences fluctuating growth. After a sharp decline in 2021, in 2022, production volumes increased rapidly, which was facilitated by the increase in production volumes in crop and livestock farming and forestry, albeit a decrease was observed in fishing. In general, the number of employed and occupied posts slowly increased in the sector in recent years until the pandemic. However, in 2020, under the influence of Covid-19, the number of occupied posts decreased in agriculture and forestry, albeit increased in fishing. In 2021, occupied posts decreased in all subsectors. In 2022, they decreased only in agriculture.

Structure of Agriculture, Forestry, and Fishing
2022, as per cent



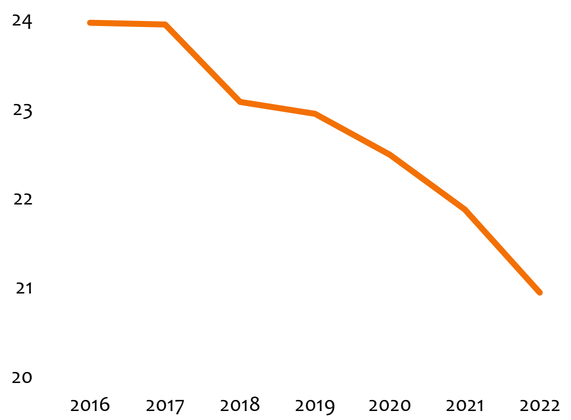
OTHER MANUFACTURING

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



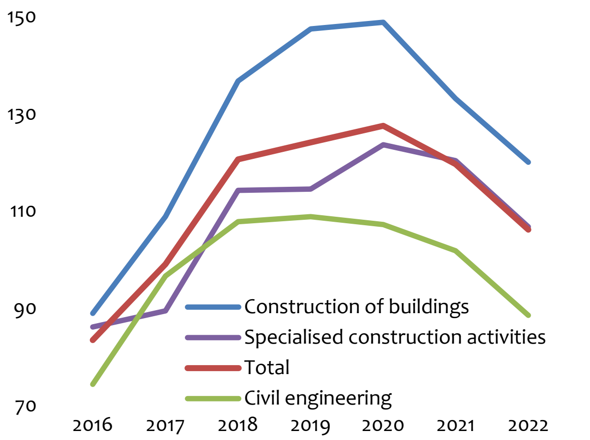
The largest share of added value in other manufacturing (incl. mining and quarrying, electricity, gas, steam, and air-conditioning supply, water supply, and waste management) provide electricity and gas supply sub-sectors. In 2022, the volumes of the rest of the industrial sectors saw a rapid decline. The largest impact yielded the drop in volumes in the electricity, gas supply, heating and air conditioning sector, due to the cessation of natural gas supplies from Russia. In addition, due to the increase in the price of natural gas, its consumption decreased. A slight decline was also observed in the volumes of the mining and quarrying, which was determined by a larger decrease in volumes in the development of gravel and sand quarries than the increase in peat extraction and processing. The number of occupied posts has been increasing in the mining industry in recent years, albeit it is declined rapidly in other sectors.

Occupied Posts in Other Manufacturing
in thousands

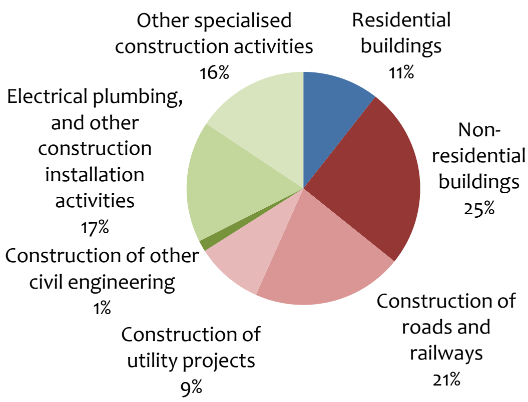


CONSTRUCTION

Development of Construction
2015 = 100



Structure of Construction
in 2022, as per cent

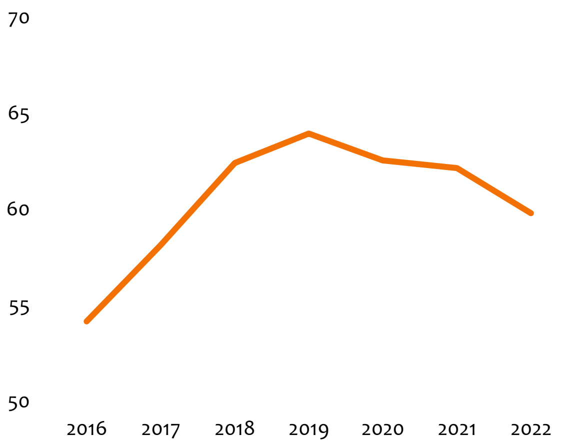


In 2022, the volume of construction decreased by 11.3%. In all quarters of 2022, a decline in the secor, as investments in construction slowed down, was observed. Already in 2021, the sector was negatively affected by the global cost increase caused by Covid-19, especially with a significant increase in the prices of wood and metals. In 2022, the pressure on construction costs was intensified by Russia's invasion of Ukraine, as a result of which the availability of certain building materials significantly increased, as well as energy resources becoming more expensive.

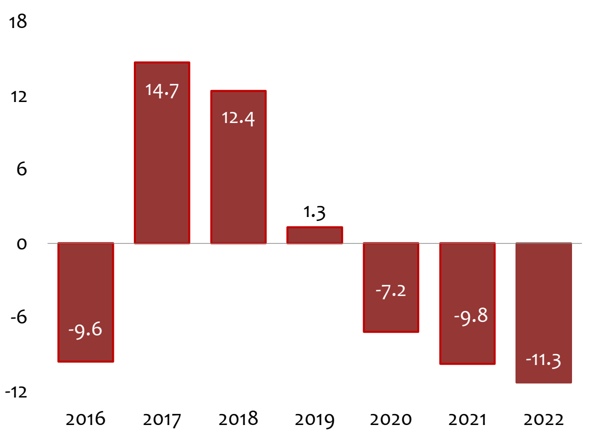
A decline was observed in all the main construction groups. The construction of buildings in 2022 decreased the least - by 9.8%. The other main groups: civil engineering and specialized construction activities, decreased by 13.1% and 11.3%, respectively.

In 2022, 4,784 building permits were issued, which was 3.8% less than the previous year. The rate of reduction of the expected floor space in building permits was more rapid – i.e., by 28.6%.

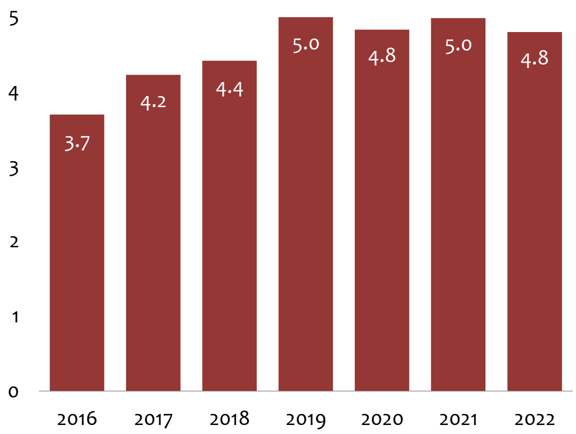
Occupied Posts in Construction
in thousands



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

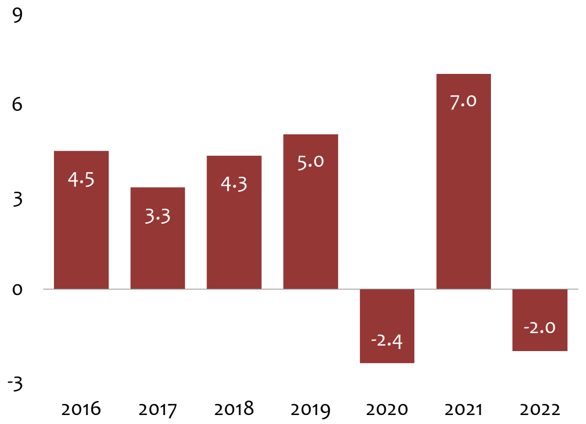


Building Permits Granted
in thousands



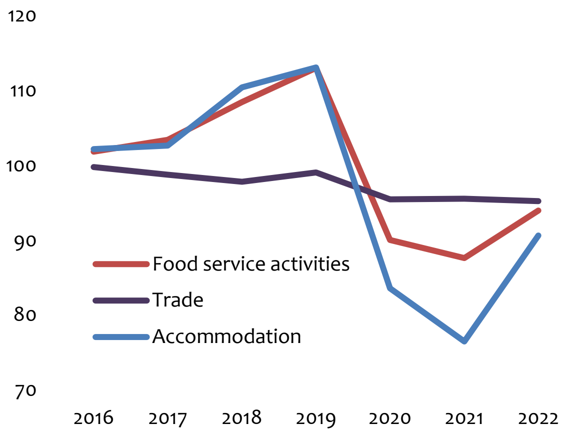
TRADE, ACCOMMODATION, AND FOOD SERVICE ACTIVITIES

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

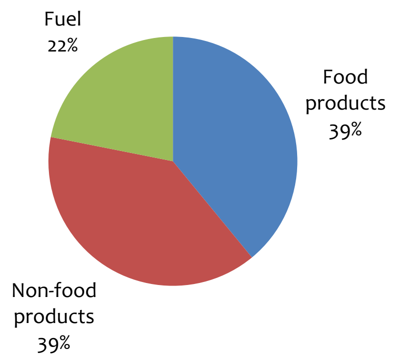


In 2022, the volumes of services provided in the trade, accommodation, and food service activities decreased. The trade sector was negatively affected by the decrease in the turnover of goods with the markets of Russia and Belarus due to the sanctions imposed by the EU, as a result of which the wholesale volumes decreased sharply (by 6.3%). On the other hand, the retail turnover in 2022 increased rapidly – by 4.3% due to the lifting of the restrictions of Covid-19. The turnover of non-food retail sales grew the most rapidly. For fuel it grew more moderately, albeit for food it remained practically unchanged. The growth of the accommodation and food service sectors in 2022 was very rapid (by 57.5%). However, it should be noted that these sectors are recovering from a very deep recession and are still slightly behind the pre-crisis level. At the same time, the number of occupied posts also increased rapidly in the accommodation and food service activities, albeit slightly decreased in trade. The largest share of occupied posts remains in trade.

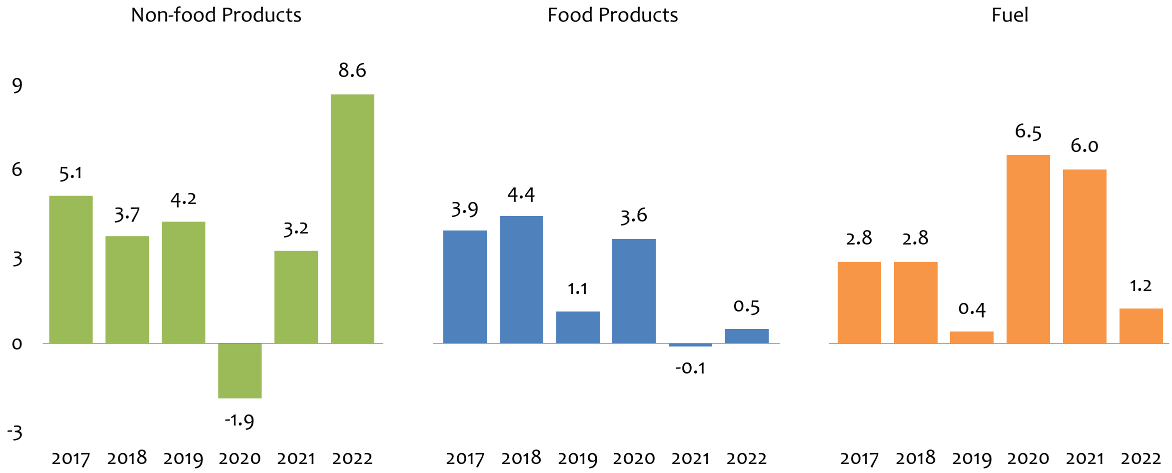
Occupied Posts in Trade, Accommodation, and Food Service Activities
2015 = 100



Structure of Retail Turnover
2022, as per cent

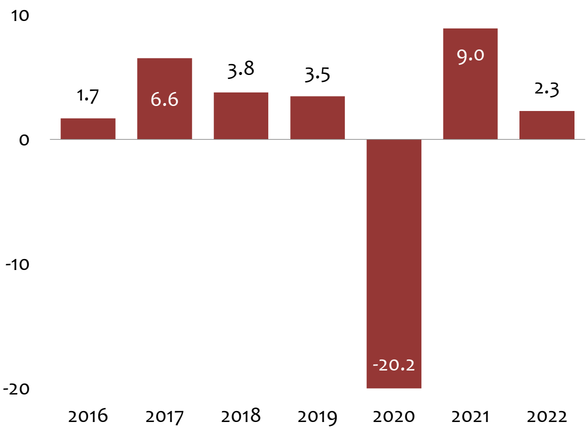


Retail Turnover
changes against the last year, as per cent



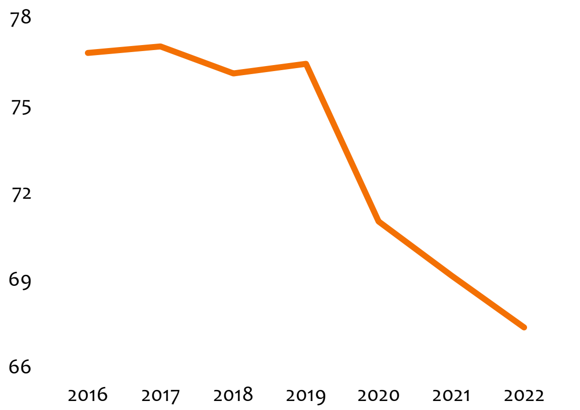
TRANSPORTATION AND STORAGE

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

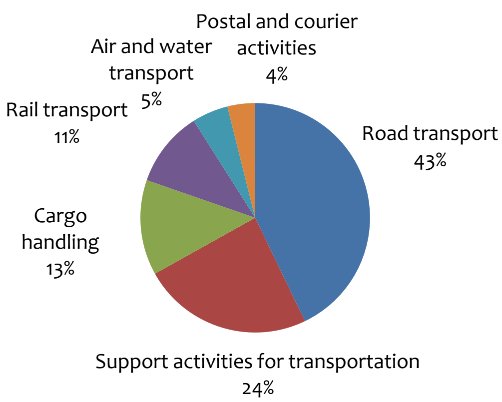


The transportation and storage sector is closely linked to international transportation. In 2021, as the epidemiological situation improved and the introduced restrictions were lifted, the volume of the sector grew rapidly. In 2022, the volumes of the sector continued to increase moderately. A rapid increase in the volume of transported cargo was observed in the ports, while the volume of railway cargo decreased slightly, as it decreased both in domestic and international transport, and the volume of road transport cargo, 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 Covid-19 restrictions, increased rapidly in 2022 - by 48.8% and in land transportation - by 28%. On the other hand, the number of passengers in air transportation increased more than twice, compared to 2021.

Occupied Posts in Transportation and Storage
in thousands



Structure of Transportation and Storage
2022, as per cent*



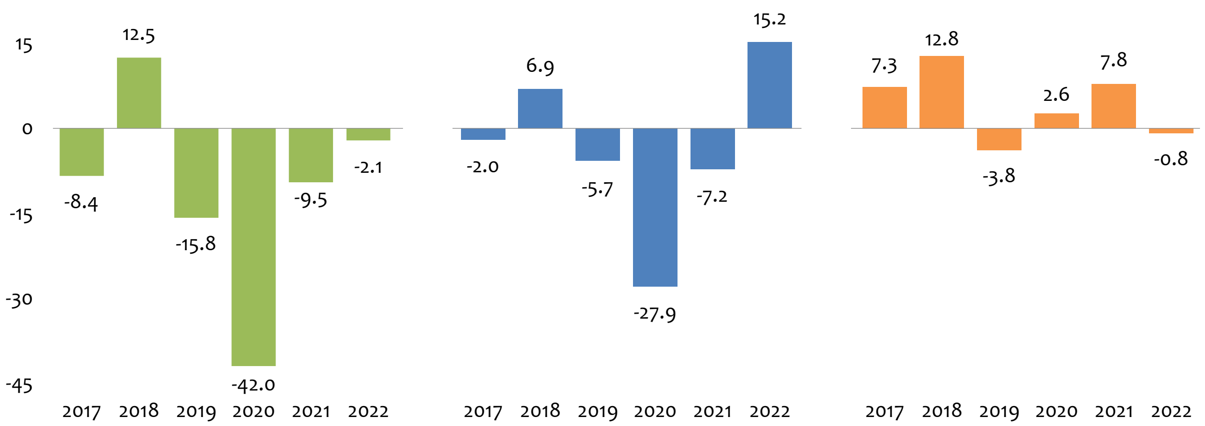
* – forecast by the Ministry of Economics

Freight Traffic
changes against the last year, as per cent

Freight Rail Transport

Cargo Loaded and Unloaded at Ports

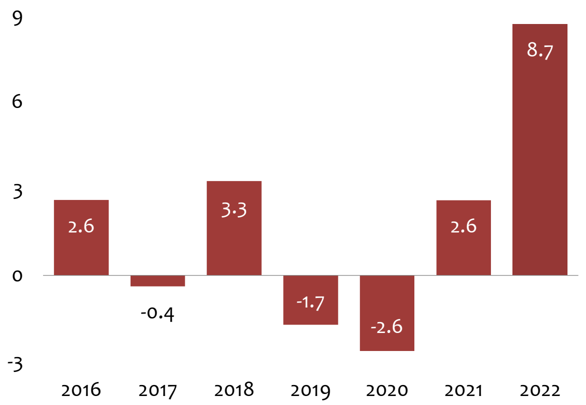
Freight Transport by Road



COMMERCIAL SERVICES

Commercial Services

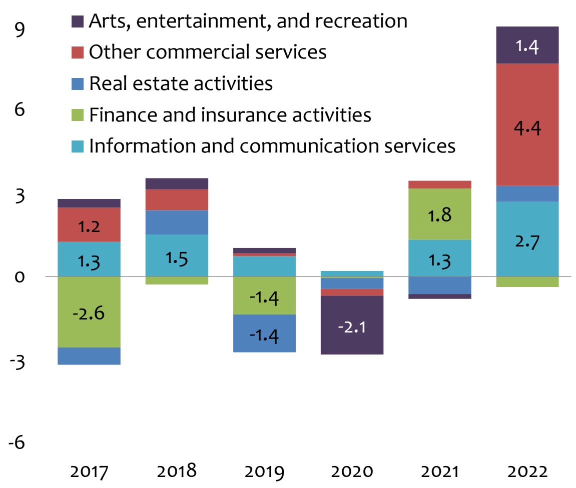
value added, changes against the last year, as per cent



The largest share of added value in commercial services (incl. information and communication services, financial and insurance activities, real estate activities, professional, scientific, and technical services, administrative and support service activities, arts, entertainment, and recreation) provide real estate activities. In 2021, recovering from the Covid-19 crisis, the volumes of commercial services increased. In 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; in 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 2022, the number of occupied posts increased in information and communication services, financial and insurance and administrative and support services activities.

Contribution of Commercial Services

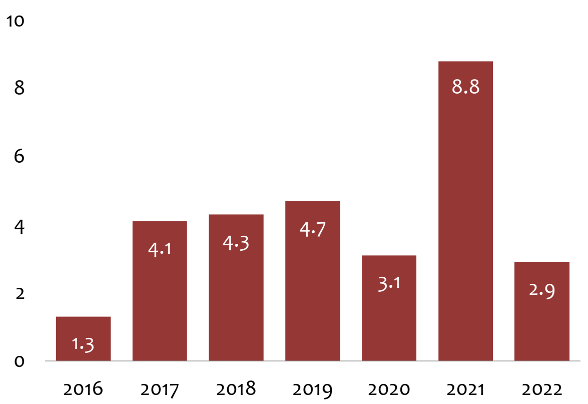
changes as per cent



PUBLIC SERVICES

Public Services

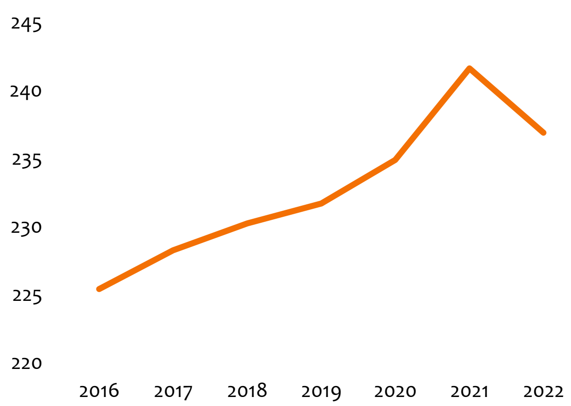
value added, changes against the last year, as per cent



The largest share of value added in public services (incl. public administration and defence, education, health and social work activities) provide public administration and defence. In 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. On the other hand, in 2022, the volumes increased more rapidly in education - by 4.3%. The volumes of state administration and defence services increased by 3.6%, while the growth in health and social care was very moderate - by 0.7%. The largest proportion of occupied posts remains in education. In 2022, the number of occupied posts increased only in the health and social care sector. The most rapid decline in occupied posts was observed in education.

Occupied Posts in Public Services

in thousands



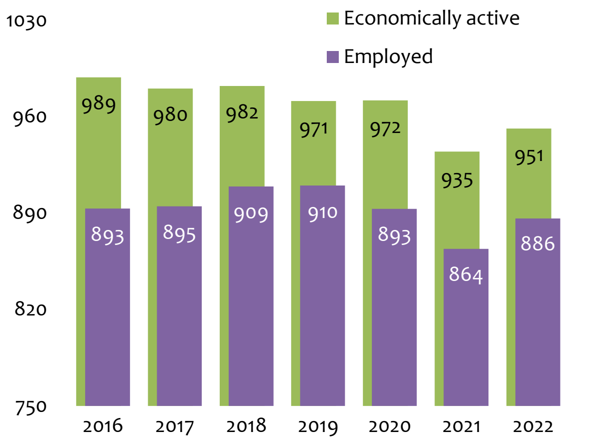
2023 | 1

LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

Along with the increase in economic activity, a rise in the number of employed persons can be observed. Also, taking into account the increase in labour market activity, unemployment also continues to fall steadily and the lack of labour is becoming more and more noticeable, as indicated by the gradual return of unemployment indicators to the pre-pandemic (2019) level, and the increase in the number of vacancies and workload. At the same time, the negative impact of the supply side on the lack of labour has been slightly reduced by the influx of refugees from the Ukrainian war in Latvia, which has generally increased the number of the working population in the country.

Employed and Economically Active
aged 15-74, in thousands



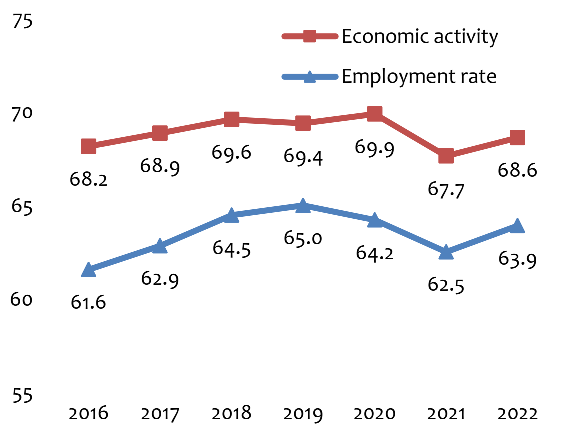
Despite the increase in employment, the overall labour demand remains constrained, as indicated by the decrease in the total number of occupied posts. With increasing pressure from the labour supply side, both in terms of the availability of human resources and in terms of wages, it is increasingly difficult for employers to create new jobs and attract employees.

Since April 2021, the population's employment has been increasing. In Q4 of 2022, the number of employed increased by 3.1% or 26.4 thousand, compared to Q4 of 2021. However, in 2022, it increased by 2.6% (22.2 thousand), compared to 2021. On an annual basis, this has been the fastest increase in the number of employed since 2007, which is partly determined by both the recovery of the labour market from the Covid-19 crisis (low base effect) and the increasingly widespread employment of Ukrainian refugees.

Overall, in Q4 of 2022, 890.6 thousand residents were employed (64% of all residents aged 15-74). In 2022, the number of employed persons increased to 886.2 thousand, and the employment rate - to 63.9%, which is 1.4 percentage points higher than in 2021.

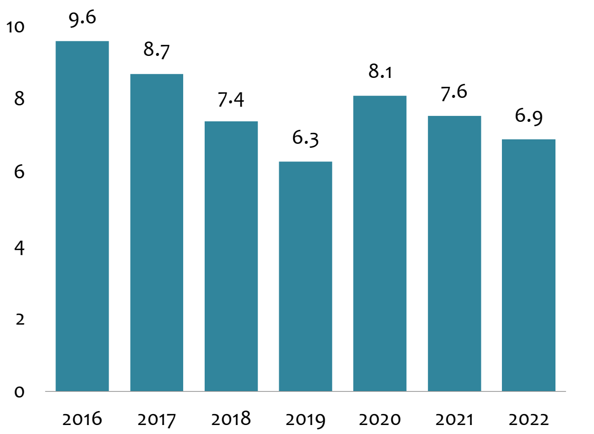
However, the number of employed persons still significantly lag behind the pre-pandemic level (in Q4 of 2022, the number of employed persons was 22.5 thousand or 2.5% less, compared to Q4 of 2019) and in general, the development of the labour market in recent years has been relatively uneven. In many sectors directly affected by the Covid-19 crisis, the number of employees in 2022 was still significantly lower than in 2019 - in the arts, entertainment, and recreation sector by approximately 22%; in accommodation and food service activities - by 17%; and in the transportation and storage sector - by 11%. At the same time, the number of people employed in information and communication services increased by approximately 2/3. It should be noted that such drastic changes in labour demand significantly increase the risks of labour market imbalances - exacerbating labour shortages in the most rapidly growing sectors on the one hand, and increasing the risks of structural unemployment on the other hand.

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



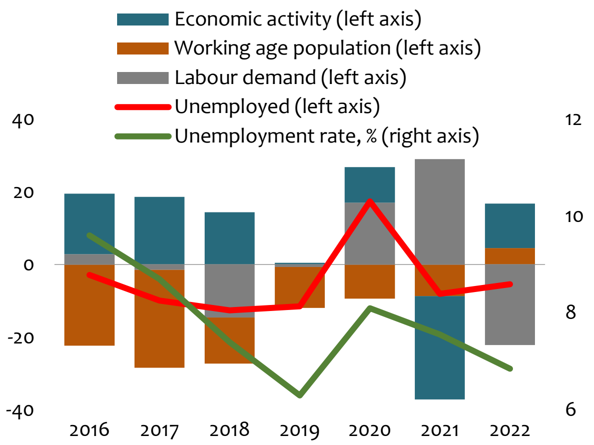
The recovery of activities in the labour market generally has a positive effect on the supply side of the labour market as well. The level of economic activity of the population increased to 68.5% in Q4 of 2022, which was 0.9 percentage points higher than in Q4 of 2021, thus contributing to the increase in the total labour supply. In Q4 of 2022, the number of economically active population aged 15-74 increased to 954.1 thousand, which was by 23.4 thousand or 2.5% higher than a year ago.

Unemployment Rate
aged 15-74, as per cent



Along with the increase in the population's economic activity, the dynamics of the number of economically active population in Q4 of 2022 has also been favourably affected by the increase in the working age population - in Q4 of 2022, it increased by approximately 14.6 thousand, compared to Q4 of 2021.

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



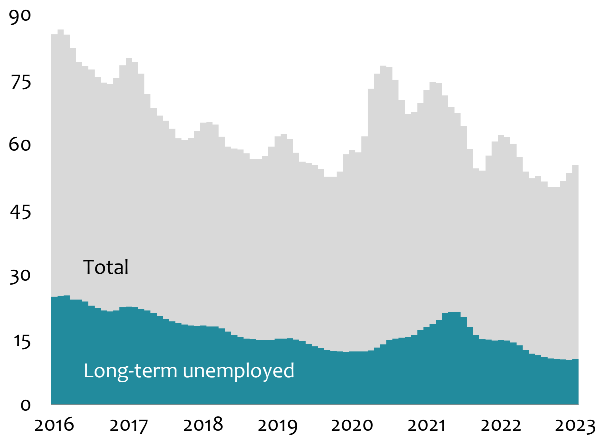
*In the first half of 2022; changes, compared to the first half of 2021.

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 by both a smaller working age population (compared to 2019) and the lower level of population participation in the labour market, which in general still continues to maintain negative pressure on the labour market on the supply side, and as the demand for labour increased, **the shortage of qualified labour emerged as a more significant problem, especially in the most rapidly growing economic sectors.**

Along with the increase in employment, unemployment rates continue to decrease. In Q4 of 2022, the unemployment rate decreased to 6.7%, which was 0.4 percentage points lower than in Q4 of 2021 (7.1%). In 2022, the unemployment rate decreased to 6.9% (a decrease of 0.7 percentage points, compared to 2021). Overall, in Q4 of 2022, there were 63.5 thousand job seekers (population aged 15-74), which is 4.5% (i.e., 3 thousand) less than Q4 of 2021.

Positive trends can also be observed in the dynamics of the long-term unemployed. From the middle of 2021, both the number of long-term unemployed and their share in the total number of jobseekers gradually declined. In the period from the end of December 2021 to the end of December 2022, the number of registered long-term unemployed decreased by more than 30%, or 4.6 thousand. In general, at the end of December 2022, there were approximately 10.3 thousand unemployed for more than a year, constituting approximately 19% of all registered unemployed.

Registered Unemployed
in thousands

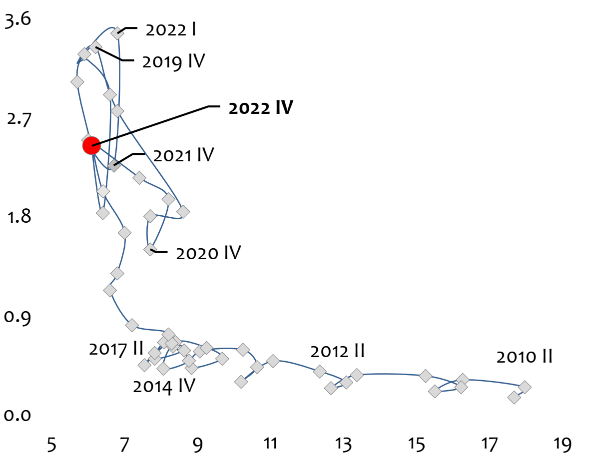


At the same time, despite the decrease in unemployment, still a high risk that some of the existing unemployed might have problems finding a job matching their skills in the coming years remains, since the full recovery in the sectors where the most jobs were lost in the past years could be long-lasting. However, in the sectors where new ones were created job opportunities, previously learned skills may not be in demand. It should also be taken into account that being out of work for a long time creates risks of structural unemployment, i.e., the longer a person is unemployed, the greater the risk of losing previous work skills and abilities, as well as the more difficult it is to adapt to new labour market requirements.

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 labourintensive 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, qualification improvement and retraining measures continue to play a vital role in overcoming structural changes in the labour market.

Beveridge Curve

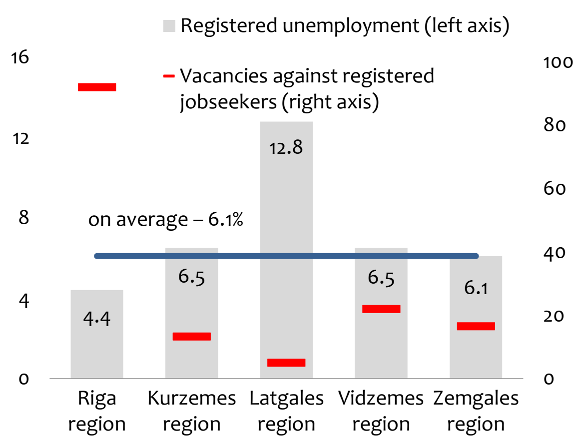
by quarters as per cent; horizontal axis – unemployment rate; vertical axis – vacancies against the economically active population



Also, structural problems may deepen regional differences in the labour market, which may hinder labour market recovery in the future. Although the regional disproportions 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.

Registered Unemployment by Region

at the end of 2022, as per cent



Even though the situation in the Latvian labour market gradually improved, it should be noted that improvements remained slower than in the neighbouring countries. The employment rate in Latvia in Q4 of 2022 was 5.6 percentage points lower than in Estonia (69.6%), and 1.3 percentage points lower than in Lithuania (65.3%). Likewise, in Q4 of 2022, the unemployment rate in Latvia remained on average 1.3 percentage points higher than in Estonia (5.4%), and 0.3 percentage points higher than in Lithuania (6.4%).

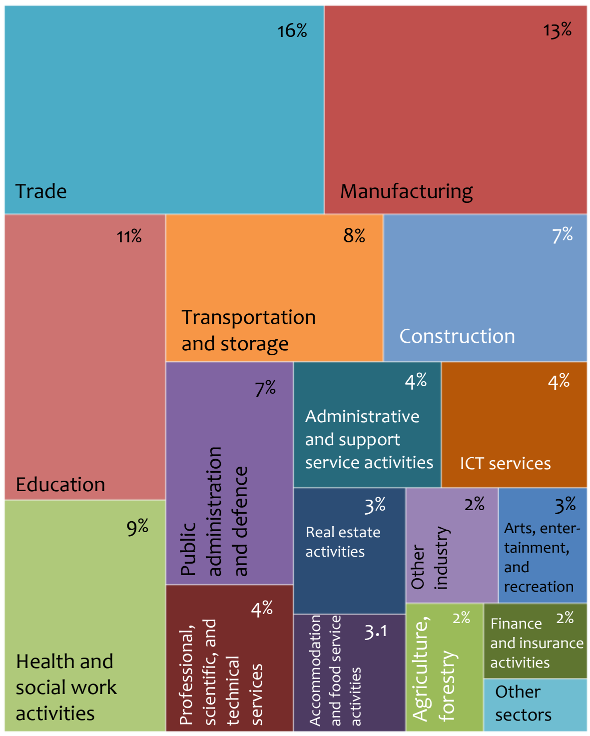
Despite the increase in population employment, the total number of occupied posts in 2022 decreased to 887.7 thousand – a decrease of 4.9 thousand jobs, or 0.6%, compared to 2021.

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 increased, 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 number of occupied posts declines, the number of employed people continues to grow, considering the rise in the labour capacity per workplace.

In 2022, the number of occupied posts for employees in basic work increased by 7.1 thousand or 1.2%, compared to 2021, reaching a total of 618.9 thousand occupied posts. On the other hand, the average number of employees in normal working time units increased by 26.5 thousand or 3.7%. In 2022, it reached a total of 737.8 thousand employee.

Occupied Posts by Sector

structure in 2022, as per cent



In 2022, the largest increase in occupied posts was observed in accommodation and food service activities, the health and social care sector, and the administrative and support service activities. The rapid growth of jobs in accommodation and catering services, as well as in the administrative and support service activities, has been largely facilitated by the low base effect in the sectors after the Covid-19 pandemic, and despite the gradual recovery of the sectors, the number of occupied posts is still significantly lower than it was before Covid-19 crisis in 2019. In 2022, the number of occupied posts in the accommodation and food service activities increased by 17% or approximately 6.3 thousand, compared to 2019. However, in the administrative and support service activities - by approximately 2.2 thousand.

Considering the decrease in construction volumes, the most significant decrease in the number of occupied posts at the end of 2022 was observed in the construction sector, as well as in related fields. Overall, the number of occupied posts in construction decreased by 2.3 thousand (or 3.8%) on an annual basis where almost 2/3 of the total decrease was determined by the decline of jobs in specialized construction works.

Also, compared to 2021, a significant decrease in the number of occupied posts can be observed in the education sector - a decrease of 2.2 thousand (2.2%); in the transportation services - a decrease of 1.8 thousand (2.6%), in the professional, scientific, and technical services - a decrease of 1.1 thousand (2.7%).

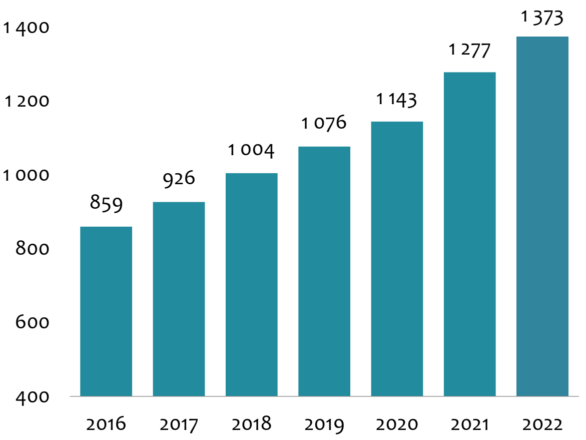
Changes in Occupied Posts

in 2022, compared to the corresponding period last year, in thousands

WAGES AND SALARIES

Considering the return of activities in the labour market, as well as the growing pressure on the supply side of the labour market, the average wage in the economy continues to rise. The average monthly gross wage in 2022 increased by a total of 7.5% compared to 2021, rising to 1,373 euros. At the same time, in Q4 of 2022, the annual average wage increase reached 8%, while the average gross wage increased to 1,443 euros. It should be noted that already in 2021, the increase in the average gross wage amounted to almost 12%, which was the most rapid wage increase in the last 13 years. Thus, the total wage increase over the past 2 years exceeds 1/5.

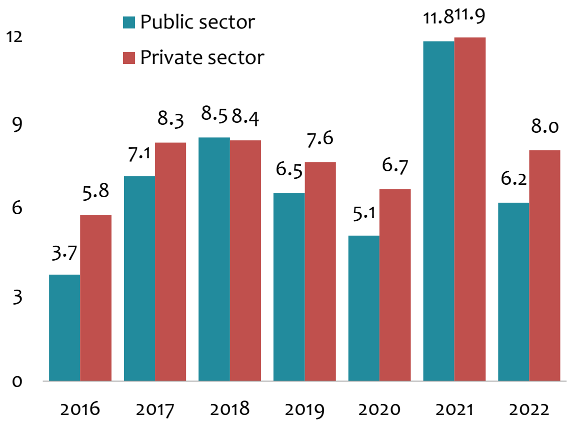
Average Monthly Gross Wage
euro



The increase in the average gross wage in 2021 was significantly affected by the increase in the minimum wage rate by 16.3% - to 500 euros from 430 euros in 2020, as well as a decrease in the proportion of lower-paid jobs, for example, a decrease in jobs in sectors such as accommodation and food service activities, transportation services, as well as in the administrative and support service activities. On the other hand, in 2022, the increase in wages was largely determined by both the acute labour shortage and the growing inflationary pressure. It should be noted that under the influence of inflation, for the first time since 2010, Latvia has seen a decrease in real wages on an annual basis. The real wage in 2022 decreased by an average of 8.7%, compared to 2021.

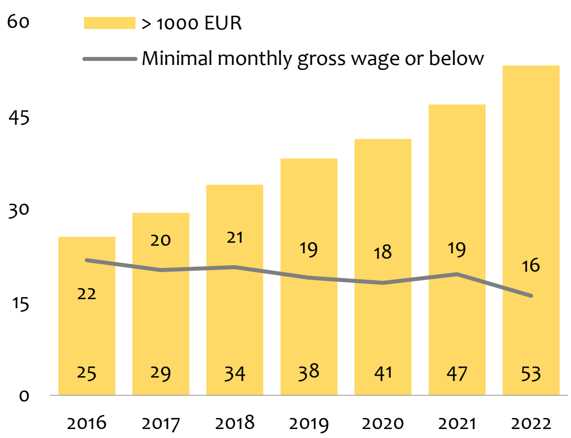
In 2022, wages have grown for both private and public sector workers. Compared to 2021, the average gross wage in the public sector (excluding foundations, associations, funds, and their commercial companies) increased by 6.2% (to an average of 1,373 euros), and in the private sector - by 8% (to an average of 1,375 euros). On the other hand, in Q4 of 2022, the average wage for employees in the public sector increased by an average of 4.9% (up to 1,451 euros), and in the private sector by 9.3% (up to 1,441 euros). In general, the growth of wages in the private sector over the last 4 years has remained faster than for those working in the public sector. In 2022, the average gross wage in the private sector on an annual basis exceeded the average gross wage in the public sector for the first time in the last 2 decades.

Average Monthly Gross Wage
changes as per cent



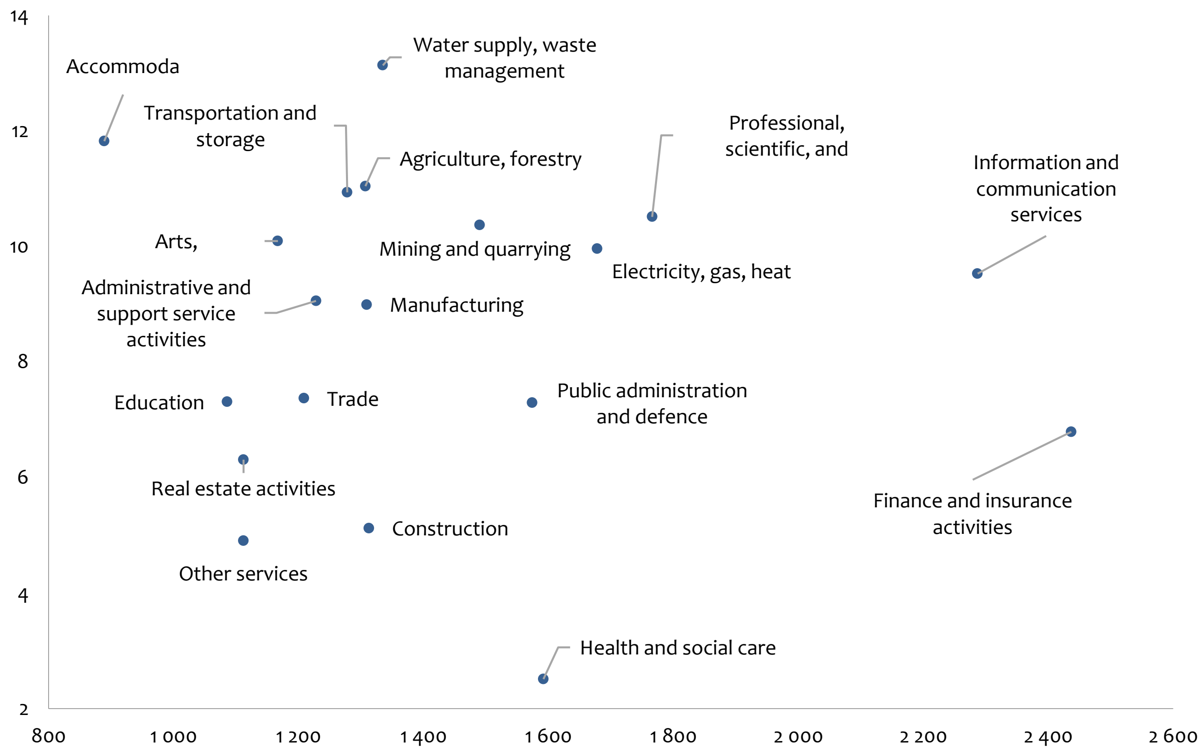
Overall, the downward trend in the proportion of low-paid employees remained stable, as evidenced by the ever-increasing trend in the proportion of employees receiving a wage above 1,000 euros per month. In 2022, more than half (53%) of all employees had a gross wage exceeding 1,000 euros.

Employee Gross Wage
as per cent of total number employed



Gross wages in economic sectors

in 2022; horizontal axis – average gross wage, euro; vertical axis – average gross wage changes, compared to 2021, as per cent



In 2022, wage growth was observed in all sectors of the economy. The most significant wage increase was in water supply and waste management - compared to 2021, the average gross wage increased by 13.1%, as well as in the accommodation and food service activities (an increase of 11.8%), where the average wage has so far been significantly lower than average in the economy.

At the same time, wages have grown more slowly in the health and social care sector (the average gross wage in 2022 increased by 2.5%, compared to 2021), which is largely explained by the reduction of bonuses in the sector, which were common during the Covid-19 pandemic. However, despite slower wage growth in 2022, health and social care still maintained the second fastest wage increase, compared to the pre-pandemic period - wages in health and social care increased by approximately 44%.

The highest wage level in 2022 remained in the financial services sector - the average monthly gross wage reached 2,437 euros, while the lowest wage was observed in the accommodation and food service activities - an average of 889 euros per month.

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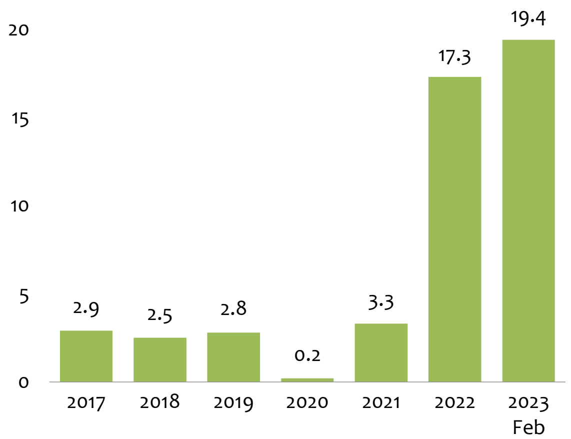
ECONOMIC STABILITY AND COMPETITIVENESS

PRICES

In 2022, a very rapid rise in prices was observed. Consumer prices increased by 20.8%, while the annual average inflation was 17.3%. A significant impact on the level of consumer prices yielded the increase in world prices for energy resources and food, which was intensified by Russia's invasion of Ukraine.

In the two months of 2023, prices continued to rise. In February 2023, compared to December 2022, consumer prices increased by 1.1%, which was the fastest increase in January-February since 2011, excluding the price increase observed in this period in 2022. It continued to be affected by high world prices and the unstable geopolitical situation. Compared to February 2022, consumer prices increased by 20.3%. Annual average inflation in February was 19.4%.

Consumer Price Changes
annual average, as per cent



The key factors affecting prices in 2022:

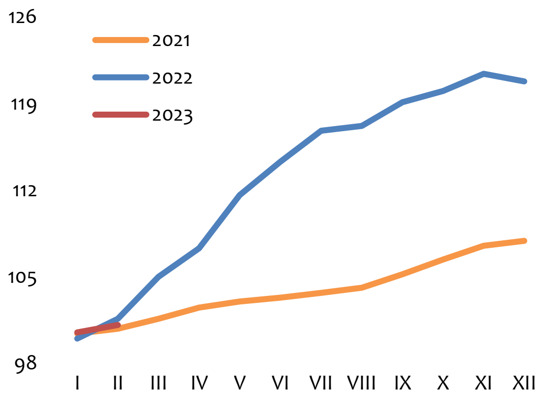
(1) the largest impact on the consumer price level was the rise in food prices, affected by the rapid increase in world food prices since the middle of 2020. The largest impact provided the rise in prices for bread and cereals, dairy products, and meat;

(2) the increase in prices of energy resources related to housing (electricity, natural gas, solid fuel and thermal energy), which was determined by the increase in world prices for natural gas and oil;

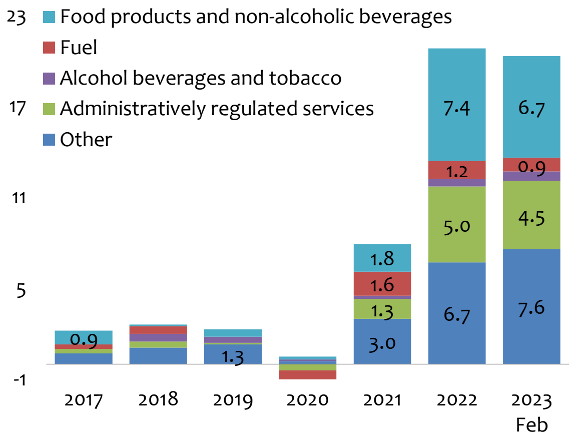
(3) price increase for services - the largest impact provided the rise in the price of housing-related services, catering, ambulatory, recreational and cultural services, price increase for maintenance and repair of personal vehicles, motor vehicle insurance, and mobile phone services;

(4) the increase in fuel prices due to the rise in world oil prices, which was particularly sharp in the first half of the year. This was driven by sanctions against Russia, rising demand and limited production.

Consumer Price Index
December of the previous year = 100

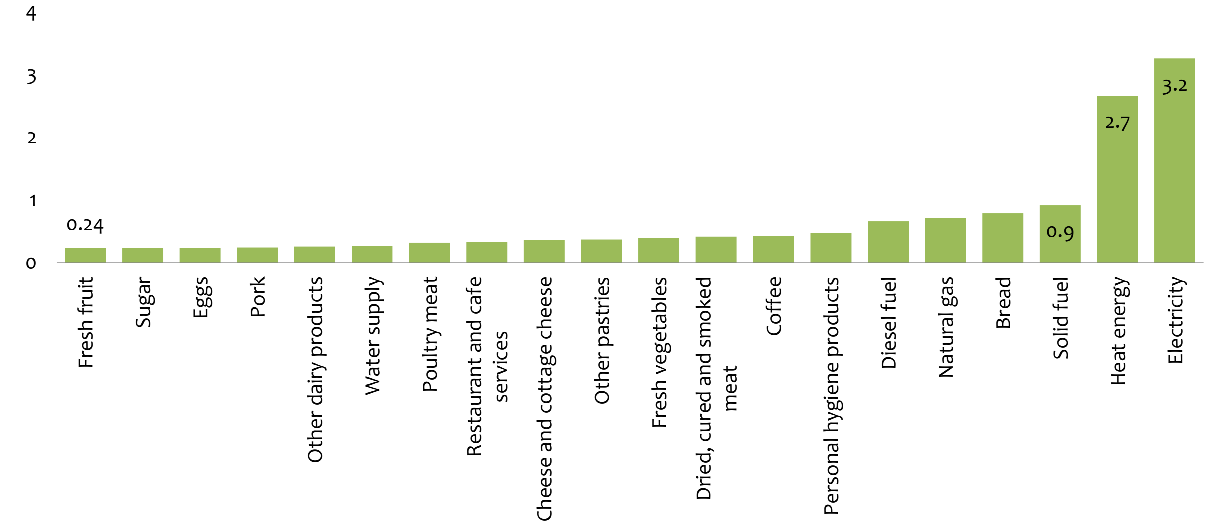


Consumer Prices by Goods and Services
contribution to 12-month changes, as per cent



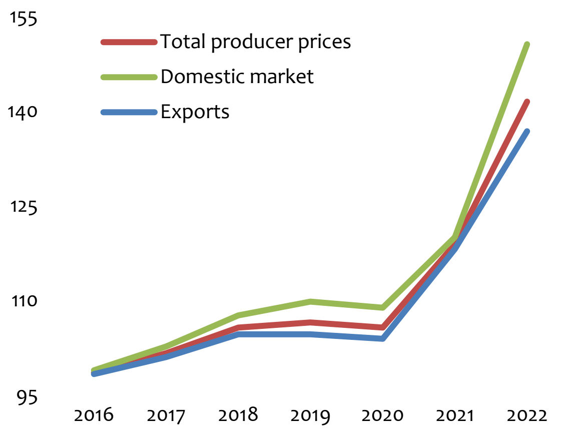
Overall, the average annual inflation in 2023 will be lower than in 2022. The main influence on price changes will continue to be related to energy resource and food price fluctuations in the world, and their secondary influence on the prices of industrial goods and services will also be observed. Considering the uncertain geopolitical situation and the base effect of inflation dynamics, in 2023 the average annual inflation is expected to be within 9%.

Consumer Price Changes by Goods and Services
February 2023, contribution to 12-month changes, as per cent



In 2022, under the influence of the energy crisis, a very rapid rise in producer prices in manufacturing endured.

Producer Prices in Manufacturing
2015 = 100

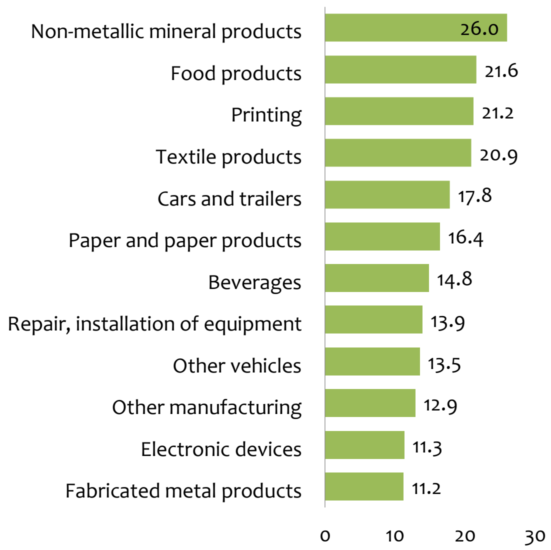


In 2022, producer prices in the manufacturing sector increased by 19.1%. Prices for products sold on the domestic market increased by 25.5%, and for exported products - by 15.9%. Producer prices rose in all manufacturing sectors. The largest price increase was in woodworking, the manufacture of food products, non-metallic mineral products, and fabricated metal products.

At the beginning of 2023, producer prices in the manufacturing sector will decrease. In January-February 2023, producer prices in the manufacturing sector decreased by 1%, which was mainly determined by the drop in prices in woodworking.

In 2023, the prices of the manufacturers will increase more moderately, or may even decrease. The level of producer prices is largely influenced by the price fluctuations of exported products, which are basically determined by the dynamics of global raw material prices. It should be noted that global energy and raw material prices have been falling in recent months, which could reduce producer price increase. Limited supplies of raw materials in connection with the imposed sanctions on Russia and Belarus for aggression in Ukraine will still have a significant impact on producer prices. Also, the rates of price growth for products sold on the domestic market have been decreasing in recent months, mainly affected by the drop in the prices of energy resources and raw materials both in the world and in the domestic market, such as raw food, wood, etc. Also, the dynamics of producer prices will be affected by the production sold on the domestic market, which will be moderate in the first half of the year.

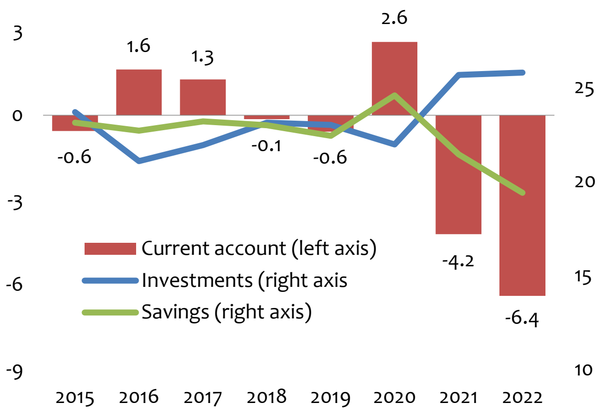
The Most Rapid Producer Price Changes in Manufacturing in February 2023
against the corresponding period last year, as per cent



BALANCE OF PAYMENTS

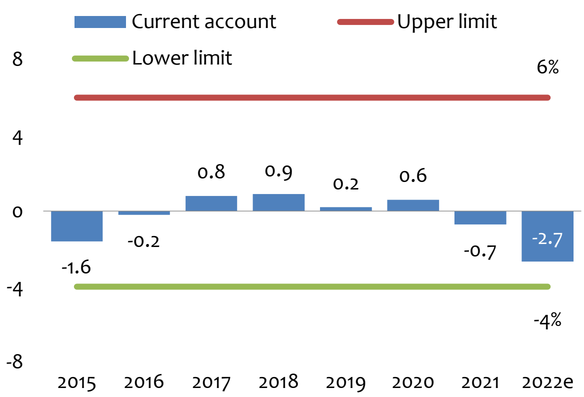
Fluctuations in the current account have increased since 2020 under the influence of external shocks. In 2020, amid the rapid decline in global trade, the current account balance significantly improved, forming a surplus of 2.6% of GDP. As economic activities and domestic demand grew, the current account balance in 2021 was -4.2% of GDP. It continued to deteriorate in 2022, with the deficit increasing to 6.4% of GDP, affected by changes in the geopolitical environment after Russia's invasion of Ukraine.

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



Despite the increase in the current account deficit of the balance of payments, it does not exceed the indicative thresholds set by the EU warning mechanism and can be assessed as sustainable. However, it should be noted that if the downward trends of the current account remain, the risks of external imbalances increase.

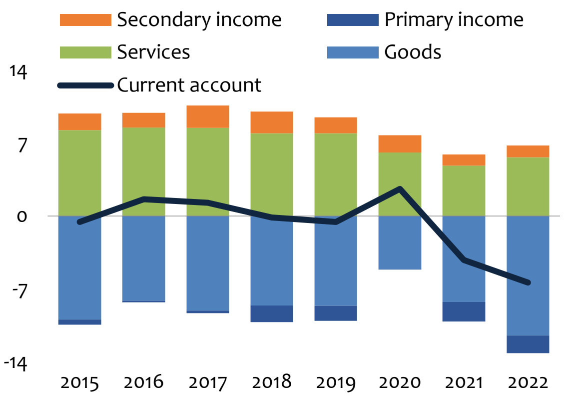
EU Alert System Indicative Threshold and Current Account
three-year average, as per cent of GDP



In recent years, there has been a weakening of foreign trade flows. Its main cause was the economic shock caused first by the Covid-19 pandemic, then by the Russian invasion of Ukraine, which increased the uncertainty of the external environment. In 2021, the value of goods exports was 20.5% higher than a year ago, albeit the value of imports increased faster than exports - by almost 26.5% and the trade deficit reached 8.2% of GDP.

In 2022, the dynamics of exports was more moderate than imports. The increase in the price of energy resources and the need to change the supply sources significantly increased the value of imports. As exports continued to grow more slowly than imports and price increases weighed more heavily on the prices of imported products, the trade deficit widened to 11.5% of GDP.

Current Account
as per cent of GDP



Cross-border trade in services is affected more strongly by the Covid-19 shock than trade in goods. Although the partial lifting of pandemic restrictions contributed to the growth of export and import of services, in 2021, the surplus of the balance of services continued to shrink, reaching 4.8% of GDP. In 2022, the imports of services in actual prices was 34.2% higher than a year ago, while exports increased by 34.8%, and the balance of services surplus increased to 5.7% of GDP. In the last three years (2020-2022), the positive balance of services covered the deficit of foreign trade in goods by almost 66%, which is less than in the years before the Covid-19 pandemic.

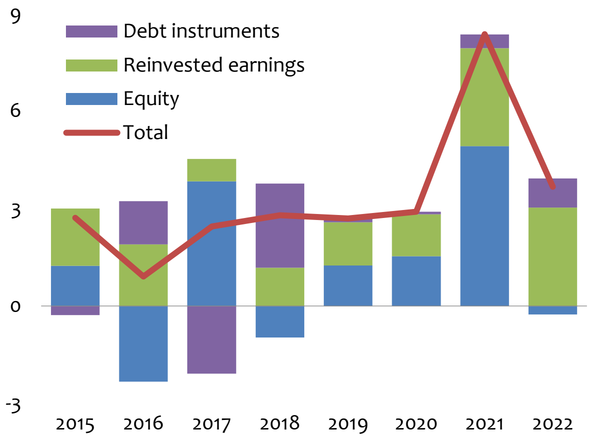
Changes in the income and capital account are mainly related to the appropriation of EU funds. The surplus of the capital account balance in 2022 was 1.1% of GDP.

The state of the financial account balance in recent years was determined by financial sector stabilization measures, public sector debt restructuring, the Bank of Latvia's measures within the extended asset purchase program, as well as the implementation of the restrictive monetary policy of the European Central Bank to combat inflation. In 2022, financial account assets grew more moderately than liabilities and the financial account balance (with reserve assets) was -1.9% of GDP. The state of the balance of payments accounts in the near future will be determined by the impact of sanctions against Russia on cross-border flows and Latvia's economy as a whole.

FOREIGN DIRECT INVESTMENT

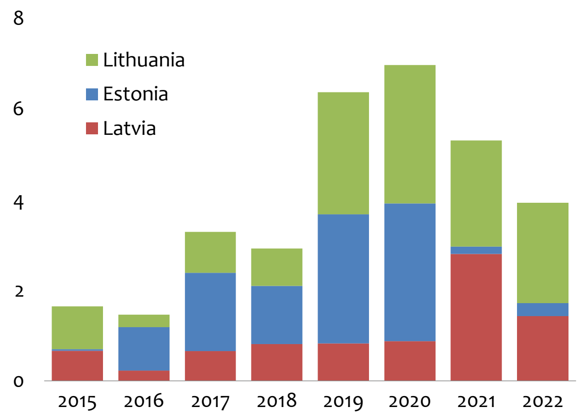
The intensity of foreign direct investment (FDI) flows is moderate. Restrictions on the spread of the Covid-19 pandemic, as well as instability in the global economy, are a significant obstacle to cross-border investment flows.

FDI in Latvia
flows, as per cent of GDP



The cross-border flows of direct investments in the Baltic States were more moderate in 2022 than a year ago. FDI reached 2.8% of GDP, as most of the FDI flows were in the Estonian economy. In 2022, the FDI net flows attracted in the Baltic States were almost 3.9 billion euro. Nearly 36% of the total volume of FDI transactions was in the Latvian economy. The share of Estonia and Lithuania in the volume of FDI transactions was 7.5% and 56.2%.

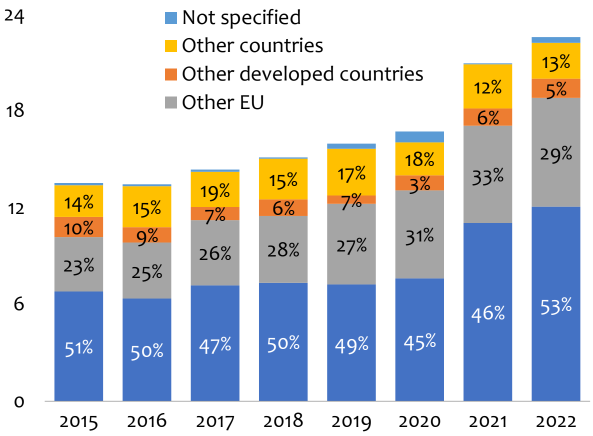
FDI in Latvia
transactions, billion euro



In 2022, the volume of FDI transactions was half that of a year ago and accounted for 3.7% of GDP. 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 investment in the form of reinvested profits and debt instruments. The income of foreign direct investors increased by 19.5%. Most of them were reinvested.

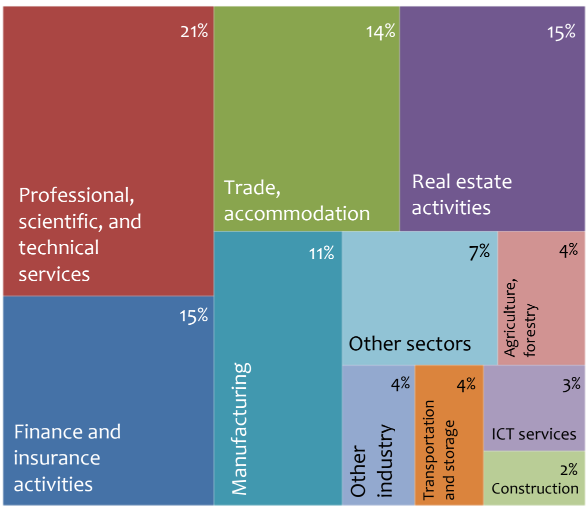
Accumulated FDI in the Latvian economy at the end of 2022 reached almost 22.6 billion euro, i.e. 57.8% of GDP. In 2022, they increased by 6.4%. The geopolitical structure of accumulated FDI is relatively stable. It is dominated by EU entrepreneur's investments, which at the end of 2022 made up 81.7% of the accumulated FDI. Sweden is the largest investor in Latvia's economy. The investments of its entrepreneurs have grown 2.3 times since 2020 and at the end of 2022 made up 28.5% of the accumulated FDI. Investments from Estonia, Lithuania, Russia, the Netherlands, Cyprus, and Germany are also large.

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



The structure of the accumulated FDI across sectors has changed. Thanks to large-scale investments in the professional, scientific, and technical services, its share in the accumulated FDI at the end of 2022 increased to 21%. Significant investments have been made in financial intermediation (15.2% of all FDI), trade (13.3%), real estate activities (14.4%), and manufacturing (12.1%).

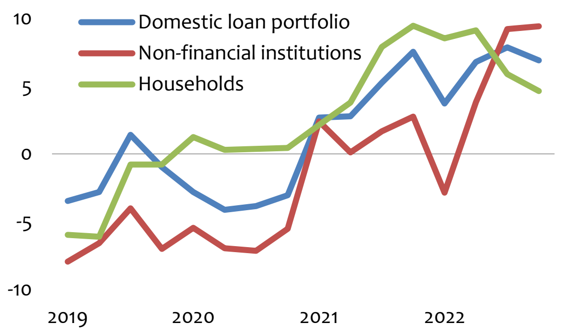
FDI by Sector
closing balance at the end of 2022



MONETARY INDICATORS

The banking sector remains strong. The volumes of deposits continue to grow, albeit activity in lending is still moderate, and business lending can be assessed as weak.

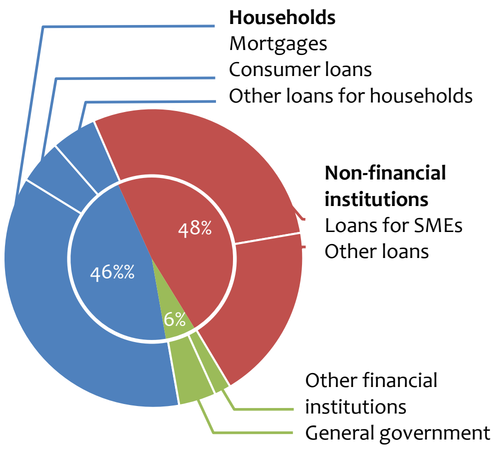
Domestic Credit Balances
against the corresponding period last year, as per cent



Source: FCMC

The total credit portfolio of banks at the end of 2022 was 15.7 billion euro. 13.1 billion euro was issued to domestic non-bank clients. The increase during the year was 6.9%. The credit portfolio of non-financial corporations grew by 9.4%, but lending to small and medium-sized enterprises developed more slowly. The growth rate of lending to households was also slower, during the year – 4.6%.

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

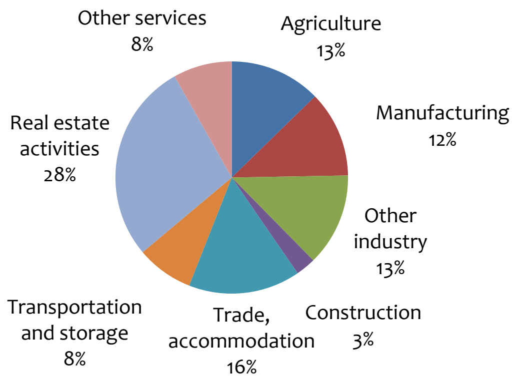


Source: Bank of Latvia

By the distribution of loans by sector, at the end of 2022, 28% of total company loans in the real estate activities. Wholesale and retail trade and agriculture, forestry, and fishing constituted 13% of loans, respectively.

The interest rates (for balances) of long-term loans issued in Euros were without significant changes since 2016. In Q4 of 2022, a rapid rise in credit interest rates, which was caused by the ECB's decisions on raising base interest rates to limit inflation, was observed. At the end of 2022, interest rates for non-financial companies for long-term loans were 3.93%, and for short-term loans - 3.94%. Meanwhile, long-term interest rates for household loans for home purchase were 3.73%, and short-term interest rates reached 4.73%.

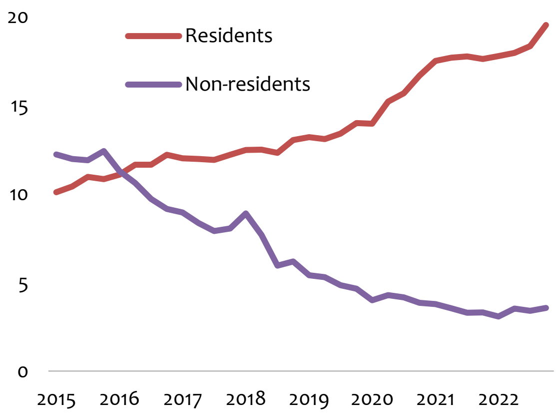
Lending Portfolio of Non-Financial Institutions by Sector
at the end of January-June 2022, as per cent



Source: Bank of Latvia

Total deposits increased to 23.1 billion euro at the end of 2022, exceeding the 2021 indicator by 10.4%. A more rapid increase in deposits started with 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. The growth trend endured in 2022 as well. During this time, domestic deposits grew by 10.9%, and foreign deposits - by 7.8%. The share of domestic deposits was 85% and is gradually increasing. The proportion of foreign deposits was 15% of the total volume of deposits. For comparison, in 2015, their share exceeded half of all deposits.

Non-Bank Deposits in Banks
billion euro



Source: Bank of Latvia

BUDGET AND GOVERNMENT DEBT

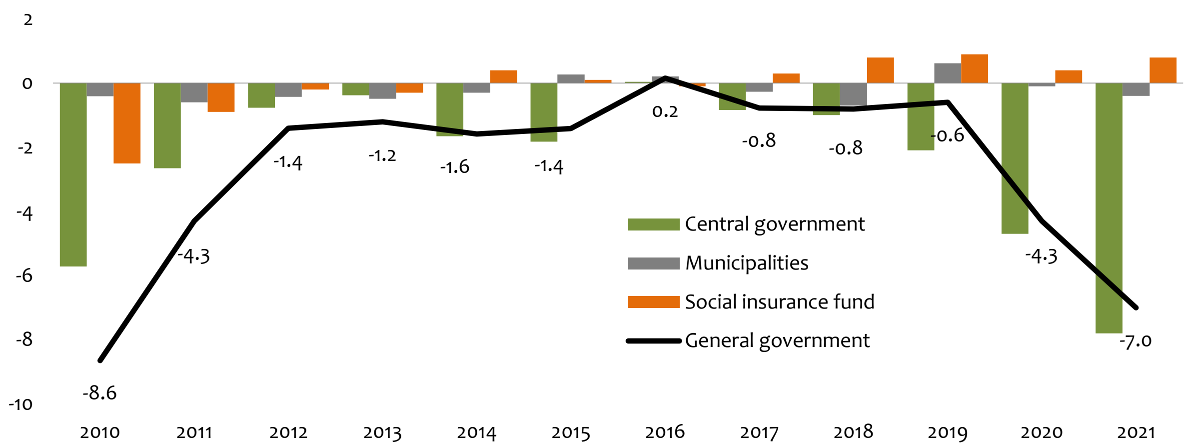
The Covid-19 pandemic has caused significant changes in the policies implemented so far. In 2020, the "General Exception Clause of the Stability and Growth Pact (SGP)" was activated in the EU, allowing EU countries to increase the general government budget deficit in 2020-2022 to the extent necessary 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 euros. However, in 2021 - up to 7% of GDP or 2.4 billion euros. According to the assessment of the Ministry of Finance, the budget deficit of the general government in 2022 was 4.7% of GDP. The Saeima has approved a budget deficit for 2023 of 1.8 billion euros or 4.2% of GDP.

General Government Budget

	2018	2019	2020	2021
Revenues, bn euro	11.2	11.5	11.5	12.5
% of GDP	38.5	37.6	37.8	37.0
Expenditures, bn euro	11.5	11.7	12.7	14.8
% of GDP	39.4	38.2	42.2	44.0
Net, bn euro	-0.24	-0.17	1.32	-2.35
% of GDP	-0.8	-0.6	-4.3	-7.0

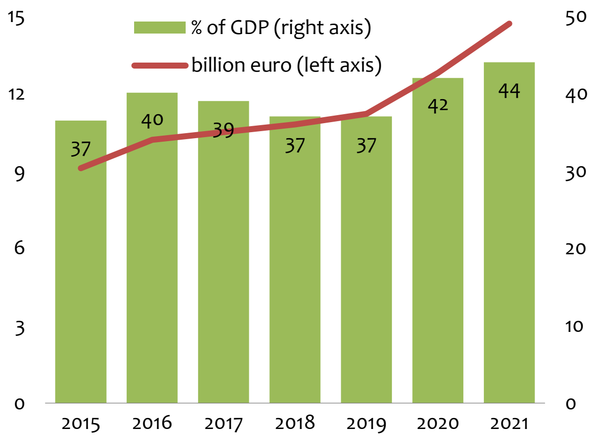
General Government Budget Balance by Sector
as per cent of GDP



Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest 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 2020, the amount of national debt increased to 42% of GDP, or 12.7 billion euros. In 2021, it continued to increase to 43.6% of GDP or 14.7 billion euros.

According to the assessment of the Ministry of Finance in 2022, the national debt was 42% of GDP. As nominal GDP growth is fast 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

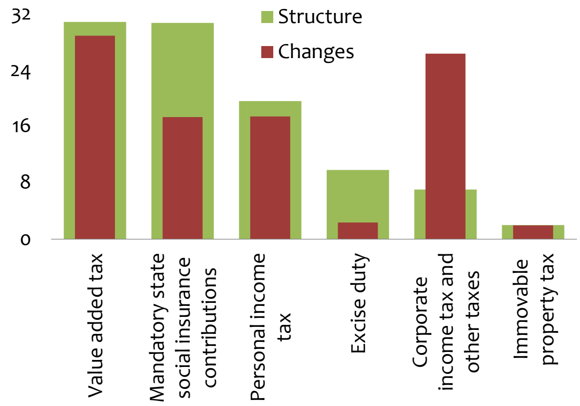


BUDGET REVENUES AND EXPENDITURES

Since 2011, the revenues of the state's consolidated budget have increasing. As a result of the Covid-19 crisis, budget revenues only slightly decreased in 2020. As the economy recovers from this shock, positive dynamics have been restored. Budget revenues increased by 13.7% in 2022.

Tax Revenues

structure and changes in 2022 compared to the last year, as per cent



Revenues increased in all major tax groups in 2022. The favourable labour market situation and wage growth can be seen in the positive dynamics of employment taxes. Income from personal income tax in the reporting period was 17.4% higher than the previous year, while income from state social insurance contributions was 17.3% higher.

Consolidated General Government Budget

	billion euro			Changes %
	2020	2021	2022	2022
Revenues:	11.3	12.5	14.3	13.7
Tax revenues:	9.0	10.0	11.6	15.2
Mandatory State Social Insurance Contributions	2.8	3.0	3.5	17.3
Value added tax	2.5	2.8	3.6	28.8
Personal Income Tax	1.8	1.9	2.3	17.4
Corporate Income Tax	0.2	0.3	0.4	34.7
Excise Duty	1.1	1.1	1.1	2.4
Immovable Property Tax	0.2	0.2	0.2	1.9
Other taxes	0.3	0.7	0.6	-21.4
Other revenues	2.3	2.5	2.8	10.8
Expenditures	12.5	14.4	15.7	9.2

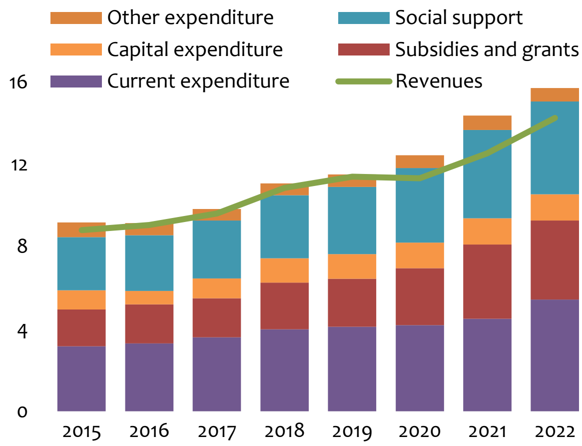
Consumption tax revenues in 2022 were affected by both the increase in economic activity and the general increase in prices. Revenues from value added tax increased by 28.8% during the reporting period, while from excise tax - by 2.4%.

Capital tax revenues also increased, as well as company income tax revenues, which in 2022 were 34.7% higher than a year ago.

The growth rate of state consolidated budget expenditures in 2022 was 9.2%. 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. Current expenses grew the fastest - by 20.9%. Expenditure on subsidies and grants had a more moderate growth rate - by 5.9%; and social support expenditure - by 5.4%. During the reporting period, the increase in capital expenditure was 1%.

Consolidated General Government Budget Expenditures

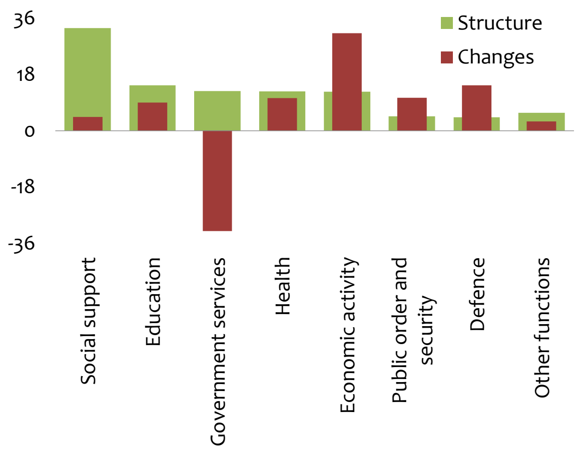
billion euro



In breakdown of budget expenditures by functional categories, it can be seen that in 2022, expenditures increased more rapidly in areas such as economic activity, defence, public order and security, as well as social support.

Consolidated General Government Budget Expenditures by Functions

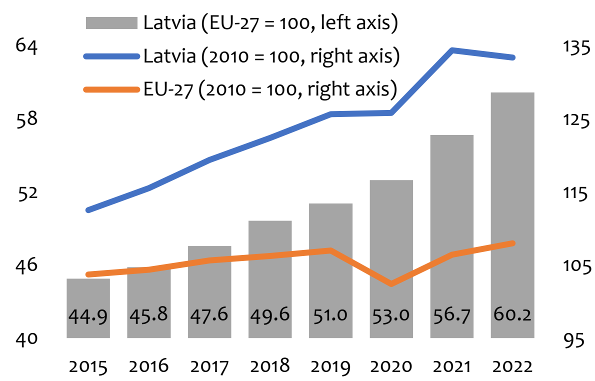
structure and changes in 2022, as per cent



PRODUCTIVITY AND COMPETITIVENESS

Productivity dynamics have been volatile in recent years, driven by adjustments in product and labour markets in response to external shocks. Due to the crisis caused by the Covid-19 pandemic, productivity increased by only 0.1% in 2020. With the recovery of economic activities, in 2021, it increased by 6.8%. In 2022, productivity was 0.7% lower than a year ago and reached 60.2% (75.8% according to PPP) of the average EU level. Since 2012, the productivity gap with the EU average level (according to PPP) has decreased by almost 13 percentage points.

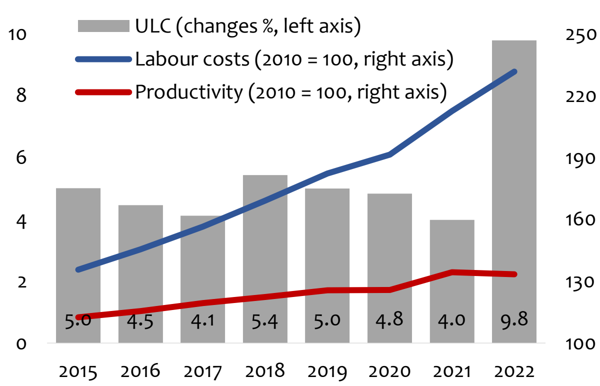
Productivity Dynamics



Labour costs continue to rise. Due to the decrease in economic activities, labour costs in 2020 increased more slowly than a year ago - by 5% (in 2019 - by 7.8%). Although the increase in labour costs was more moderate, it did not compensate for the slow increase in productivity (by 0.1%), and ULC increased by 4.8%.

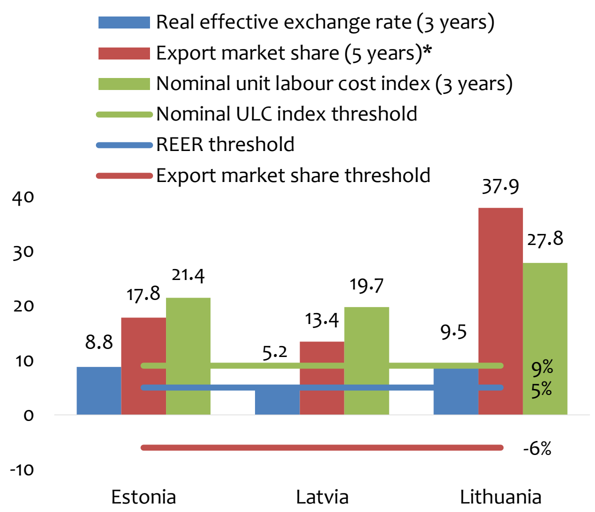
In 2021, labour costs continued to grow rapidly, exceeding the previous year's level by 11%. This did not put significant pressure on unit labour costs as productivity increased at the same time, and ULC increased by only 4%. On the other hand, in 2022, with rapid labour force dynamics remaining (increased by 9%) and productivity decreasing at the same time, labour costs increased by 9.8%, which was the fastest increase in ULC in the last ten years.

Labour Costs and Productivity



A rapid increase in nominal ULC was observed in other Baltic countries as well. In 2022, compared to 2019, the nominal ULC in Latvia increased by 19.7%, in Estonia - by 21.4%, and in Lithuania - by 27.8%, which is much faster than the EU average and this indicator has significantly exceeded the EU alert mechanism (MIP) threshold (9%).

Competitiveness Indicators
changes as per cent



* 2017-2021

The real effective exchange rate (REER) is increasing. Consumer Price Index (CPI)-based REER against 42 trading partner countries increased by 5.2% in the period from 2019 to 2022, which was higher than the MIP threshold.

Despite the negative trend of cost competitiveness generators, the long-term dynamics of Latvia's export market share is improving. On average, in five years (2018-2021), Latvia's export share in world markets increased by 13.3%, which was influenced by the positive changes in the goods export market in 2021. Latvia's share in the goods export market increased by 19.2% in five years (2018-2021). The market share of services exports in the world increased more moderately - by 1.8%, due to the decrease in market share in 2019 and 2020, by 2.9% and 1.1%, due to restrictions on the spread of the pandemic.

Increasing productivity is a key determinant of competitiveness. Although the share of Latvia's exports in world markets is growing, the risks of reducing competitiveness are still very high. The gap between productivity and labour costs has widened. Trends in recent years show that even as economic activity and productivity decline, labour costs continue to rise, so the risk that cost competitiveness will decline is increasing. The persistently positive dynamics of 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.

In the 2023 EU Alert Mechanism report, Latvia is not noted among the 10 EU member states that were found to have macroeconomic imbalances. Unlike other years, 7 new countries, including Latvia, were additionally selected for in-depth analysis in one of the 3 themes (housing market, dynamics of competitiveness, external sustainability and balance), as they are at risk of imbalance.

The compilation of Latvian results reveals that in 2021, four indicators exceeded the indicative thresholds, namely the nominal labour unit cost index, housing price index, changes in the level of the economically active workforce, and changes in the youth unemployment rate.

The report notes that external sustainability risks are contained despite a worsening outlook. Cost competitiveness concerns remain. The increase in nominal unit labour costs slowed down to 4% in 2021, albeit a rapid increase is expected in the future. High inflation puts additional pressure on wage growth, so a worsening economic outlook will reduce productivity growth.

Concern was also caused by the high increase in the nominal prices of housing, which in 2021 was 10.9% and in Q2 of 2022 reached 16.5% on an annual basis. However, mortgage lending is moderate and household debt is low and falling, while the banking sector is stable and well capitalized.

The level of economic activity fell significantly in 2021, ending a nearly decade-long upward trend, albeit it is estimated to have picked up in 2022. Youth unemployment has not improved after the increase in 2020.

List of Indicators for the Macroeconomic Imbalances Procedure for Latvia

Ārējā nelīdzsvarotība un konkurētspēja	Threshold	2016	2017	2018	2019	2020	2021
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	15.2	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 pp	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 pp	-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 pp	-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*

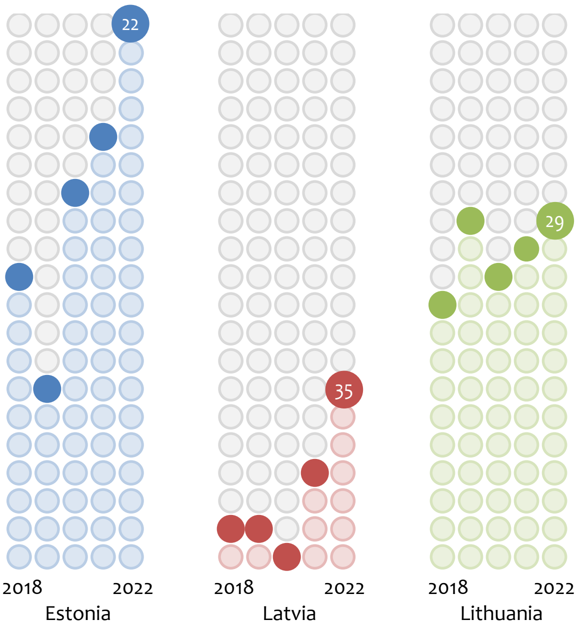
2023 | 1

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.

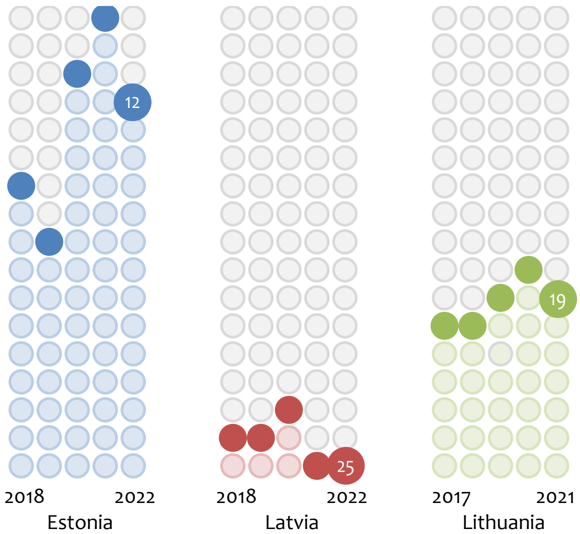
Baltic Countries in Global Competitiveness Ranking



Source: *IMD, World Competitiveness Ranking 2022*

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.

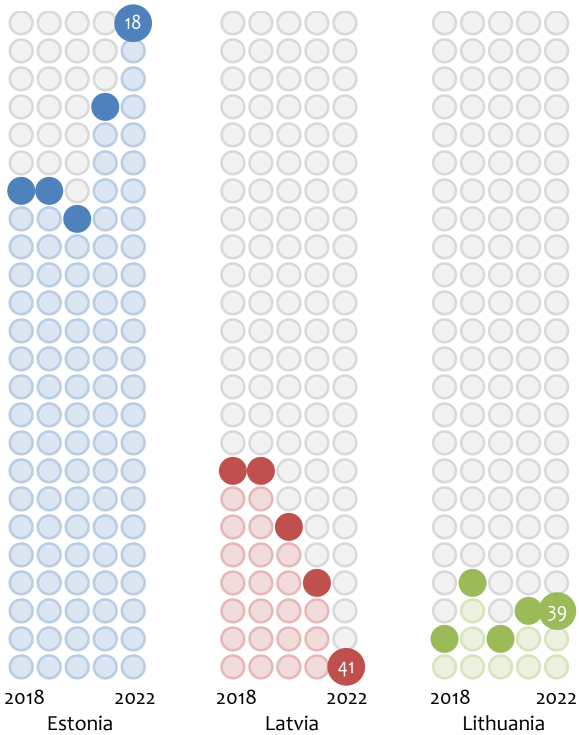
Baltic Countries in the European Innovation Scoreboard *



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

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

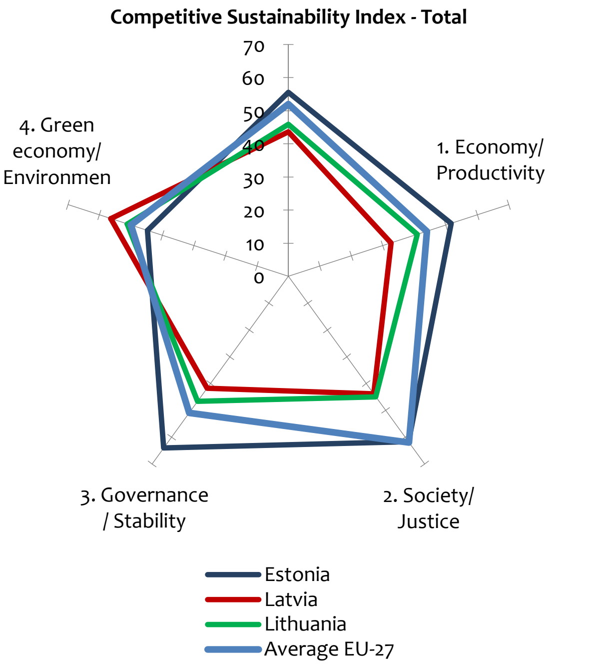


Source: *Cornell University, INSEAD, WIPO, Global Innovation Index 2022: What is the future of innovation-driven growth?*

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 2022 Competitive Sustainability Index developed under the leadership of the Institute of Sustainable Management of the University of Cambridge, which measures competitiveness in connection with the transition to a smart, green, and climate-neutral economy, Latvia is ranked 19th among the 27 EU countries and is in the group of moderately performing countries (Estonia – in 11th place and is included in the group of good performers, Lithuania – in 16th place and is included in the group of moderate performers).

Performance of the Baltic States in the Competitive Sustainability Index and its dimensions
(rating scale from 0-100)

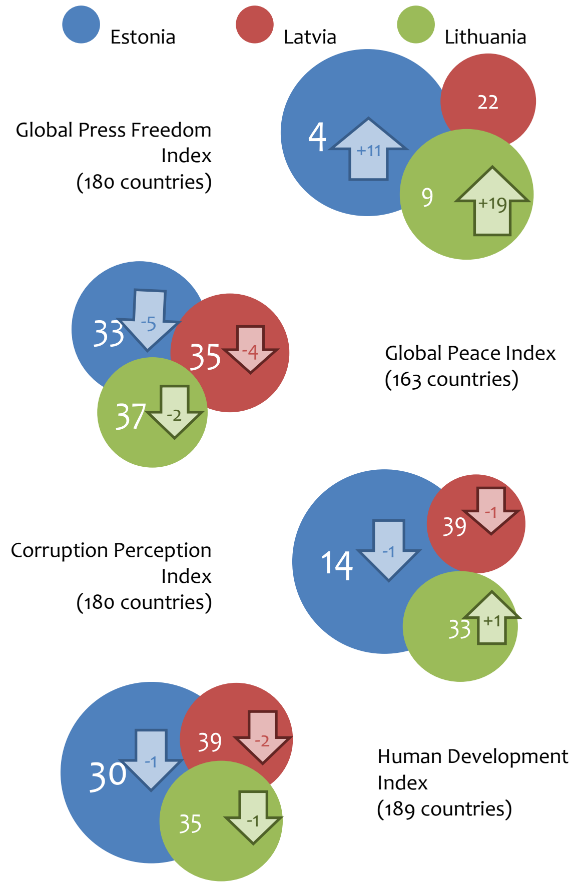


Source: *University of Cambridge Institute for Sustainability Leadership, Competitive sustainability index 2022*

The Competitive Sustainability Index has 4 dimensions, of which Latvia's performance exceeds the EU 27 average in only one dimension - green economy and environment, thanks to preserved biological diversity, good water, forest and wind resources, and their rational use.

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.

Baltic Countries in International Rankings
place and changes during a year



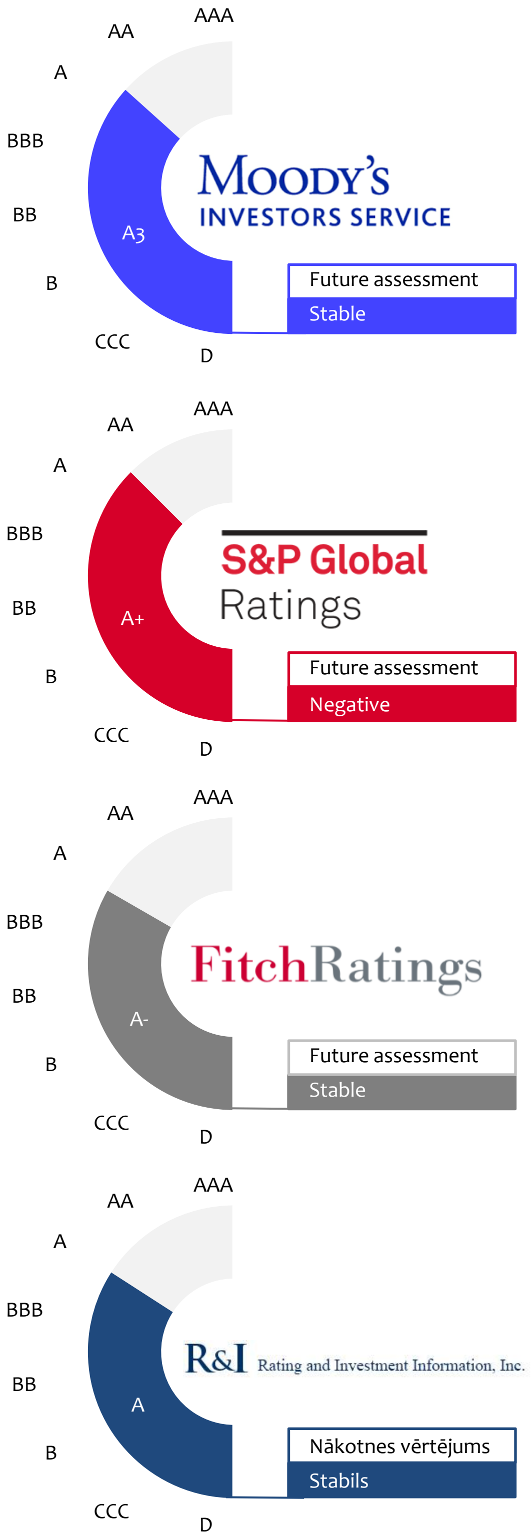
Source: *Reporters Without Borders, 2022 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2022; Transparency International, Corruption Perceptions Index 2022; United Nations Development Programme, Human Development Report 2021/2022.*

In the Global Peace Index created by the Institute of Economics and Peace, Latvia took 35th place in 2022 (surveyed 163 countries). Compared to 2021, Latvia has worsened its position by 4 positions, because 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 39th place in 2022 (out of 180 surveyed countries), decreasing its position by 3 places, compared to 2021.

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, carried out in December 2022, this agency confirmed that Latvia still meets the "A+" level, but lowered the future assessment from stable to negative, justifying it by the impact on the Latvian economy of the prolonged Russian war in Ukraine and high inflation. The other rating agencies have not changed their assessment of the ratings since the beginning of the Covid-19 pandemic.

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

Russia's war in Ukraine affects Latvia's export and import indicators, albeit inflation reduces consumer purchasing power, which had 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. However, prolonged Russian hostilities in Ukraine may increase the growth and competitiveness risks of Latvia as a small and open economy, as well as create direct and indirect costs for the economy and the state budget.

The level of national debt, although it has increased, is still relatively low, and debt servicing costs can be assessed as moderate. The main obstacles to raising the credit rating remain the following: low income level of citizens and long-term demographic challenges. A new factor that may limit the further development of positive ratings, according to the international rating agency *Moody's Investors Service*, is the relatively high debts of state-owned companies.