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ECONOMIC DEVELOPMENT TRENDS

In Latvia, stable economic growth rate that exceeds the current EU average continues. From 2011-2018, GDP, on average, increased by 3.6% annually.

In 2017-2018, economic growth accelerated. GDP growth rate increased to 4.6% and 4.8%, respectively. Accelerated economic activity was facilitated by improvements in the labour market, more intense acquisition of EU structural funds, and an increase in employment and wages.

The largest contribution to economic growth in 2018 yielded household consumption and investment growth. Along with an increase in employment and wages, private consumption in 2018 increased by 4.5%. It was the largest increase since 2014. In recent years, public consumption has also risen quite steadily. In 2018, public consumption grew by 4.0%.

After a decline in 2013-2016, investment growth has accelerated. In 2017 and 2018, investments increased by 13.1% and 16.4%, respectively. The increase was mainly facilitated by the intense acquisition of EU structural fund projects and private investments in various construction projects. A relatively rapid increase in investments in machinery and equipment (11% in 2018) was observed. Foreign direct investment (FDi) in Latvia has also increased. In 2017, it amounted to EUR 650 million (2.4% of GDP). However, in 2018 it reached EUR 744 million (2.5% of GDP).

Indicators of Economic Development

	2012	2013	2014	2015	2016	2017	2018	2019p
GDP, at current prices, billion euro	21.9	22.8	23.6	24.3	25.0	27.0	29.5	31.6
changes as per cent								
Gross Domestic Product	4.0	2.4	1.9	3.0	2.1	4.6	4.8	3.5
Private consumption	3.1	5.1	1.4	2.5	1.4	4.1	4.5	4.0
Public consumption	0.3	1.6	1.9	1.9	3.9	4.1	4.0	3.0
Gross fixed capital formation	14.4	-6.0	0.1	-0.5	-8.4	13.1	16.4	6.2
Exports	9.8	1.1	6.0	3.1	4.4	6.2	1.8	2.2
Imports	5.4	0.4	1.2	2.1	4.4	8.9	5.1	3.6
Consumer prices	2.3	0.0	0.6	0.2	0.1	2.9	2.5	2.7
as per cent								
Employment changes	1.6	2.1	-1.0*	1.3	-0.3	0.2	1.6	0.9
Employment rate	56.1	58.2	59.1	60.8	61.6	62.9	64.5	65.3
Unemployment rate	15.0	11.9	10.8	9.9	9.6	8.7	7.4	6.8
as per cent of GDP								
General government budget balance	-1.2	-1.2	-1.5	-1.4	0.1	-0.6	-1.0e	-0.5
General government debt	41.2	39.0	40.9	36.8	40.3	40.0	36.0e	34.5
Net exports	-4.4	-3.5	-1.4	-0.5	1.2	0.1	-0.6	-0.7

f – forecast, e – estimation

* as of 2014, changes have been made to the labour force survey methodology. The quarterly average number of people living in private households (previously – population at the beginning of the year) is used to generalize the quarterly data.

Exports of goods and services, which at current prices in 2018 reached EUR 17.4 billion, continue to grow. However, growth rates have slightly declined. In 2018, exports grew by 1.8% and exports of goods increased by 1.5%. Exports of wood and its articles constituted the largest share of the total export volume. Exports of machinery and equipment, iron and steel products, and vehicles also significantly increased. Exports to the EU countries grew at a slightly faster pace; however, exports to CIS and other countries were more moderate.

In 2018, exports of services increased by 2.7%. The increase was mainly facilitated by the income from tourism and ICT sectors.

Since 2011, low current account deficit (a sign of the external balance of Latvian economy) has been observed. In 2018, the current account deficit reached EUR 283 million (1% of GDP). Also, in the coming years it is expected that investment flows will continue to increase, and the current account remain with a small deficit, which will not threaten the external balance of Latvian economy.

In 2018, the fastest growing sector was construction, which grew by 21.9% and accounted for almost 1/3 of total economic growth in Latvia. A significant increase was also observed in information and communication services (13%), transportation and storage (5.3%), and trade and other commercial services.

Enhanced competitiveness of entrepreneurs and demand dynamics in major export markets contributed to the growth in manufacturing. In 2017, the sector experienced a particularly large growth rate of 8%. However, in 2018, a more moderate growth was observed. The largest growing sub-sector was wood processing. A significant growth was also observed in the manufacture of electrical equipment and the manufacture of motor vehicles, trailers, and semi-trailers. Year 2018 was not successful for the manufacture of food products, the second largest sub-sector of manufacturing, the manufacture of beverages, the manufacture of paper and paper products, and printing.

In 2019, economic development will strongly be influenced by the uncertainties in the external environment – the impact of *trade wars* on the global economy, the outcome of Brexit, and slower growth in EU countries, etc. In 2019, investment growth will continue to rely on the EU structural fund projects; however, further growth in investments will slightly be held down due to the caution of entrepreneurs in the context of growing uncertainty in the external environment and the prudent bank lending policies. Growth in private consumption will be facilitated by improvements in the labour market – stable employment and rising wages. According to the Ministry of Economics, GDP growth rate in 2019 could reach 3.5%.

In the Latvian economy, the large pre-crisis macroeconomic disproportions have been eliminated, and the economic vulnerability risks to internal and external shocks reduced. Low public debt, budget and the balance of payments balanced. Inflation, although rising, is mainly based on several supply-side factors.

In 2018, the average inflation rate was 2.5%. The level of consumer prices was significantly affected by the rise in prices for services. The increase in world prices for oil also influenced the level of consumer prices. In 2019, the average annual inflation is expected to be slightly higher than in 2018. The increase will mostly be facilitated by several supply-side factors, such as tax and tariff increases, and by the demand side - increased economic activity and rising wages. At the same time, inflation will still largely depend on overall fluctuations in world food and oil prices.

Since 2011, when Latvia returned to economic growth, significant improvements in the fiscal position have been achieved. In recent years, there has been small budget deficit. In 2018, it amounted to about 1% of GDP. The State Budget for 2019 was adopted by parliament on April 3, 2019. A budget deficit of 0.5% of GDP and a fiscal security reserve of 0.1% of GDP are projected for 2019.

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

The increase in economic activity positively affects the situation in the labour market – the high unemployment rate, primarily caused by the financial crisis, is declining. The number of employed in 2018 amounted to 909.4 thousand, and was by 1.6%, or 15 thousand, higher than in 2017. The rise has mainly been facilitated by the growing demand for labour in construction. Also, a significant increase in employment in 2018 was observed in trade.

Along with an increase in the number of employed, the employment rate also continues to rise. The employment rate in 2018 increased to 64.5% of the population aged 15-74, which was by 1.6 percentage points higher than in 2017.

The growth in employment has largely been driven by an increase in economic activity. It should be noted that the working age population continues to shrink, which in turn affects the labour supply. Thus, the involvement of different economically inactive groups of population in the labour market is crucial to maintain the labour supply at the existing level.

In 2018, unemployment rate declined to 7.4%, thus getting closer to the historically lowest unemployment rates in 2006/2007. The rapid decline in unemployment, however, is still hampered by the high proportion of long-term unemployed, which accounts for more than 2/5 of the total number of employed. The decline in unemployment is further hindered by the regional unemployment gap – in the Riga region the level of unemployment is almost twice as low as in the Latgale region, which significantly increases the risks of structural unemployment in the context of low labour mobility.

Since 2010, as the economic situation gradually stabilizes, wage growth has resumed. Wage growth over the past four years has remained above 5% annually. The average gross wage in 2018 rose by 8.4%, reaching EUR 1,004.

It is expected that strong demand-side pressure in the labour market will remain, and it will be reflected in a small increase in the level of employment. At the same time, negative demographic trends and labour market regional disparities will continue to affect labour market.

It is anticipated that the number of employed in 2019 will continue to increase; however, the growth, compared to 2018, will be slightly subdued. Overall, in 2019 the number of employed could increase by 0.9%, and the unemployment rate could drop below 6.8%

Further economic development heavily relies on the situation in the external environment and the implementation of reforms. The development of Latvian economy will closely be linked to export opportunities. Thus, the largest risk to economic growth is related to the development of the global economy. The further development of the EU's common space is of vital significance. The economic advantages of Latvia in the medium term will mainly be based on the achieved macroeconomic stability, which has resulted in improved credit ratings of Latvia, the efficient acquisition of EU structural fund programms, and overall improvements in the business environment.

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

2019 | 1 WORLD ECONOMIC OUTLOOK

The global economy is slowing down after a long and rapid growth in recent years. Economic activity in several developed countries, especially in the Eurozone and Japan, was weaker than previously anticipated. The signs of the economic downturn are increasingly evident in China. At the same time, economic growth rates in the US and India remained stable.

GDP Growth Rate
as per cent

	2017	2018	2019p	2020p
World	3.8	3.6	3.3	3.6
European Union	2.4	1.8	1.6	1.7
USA	2.2	2.9	2.3	1.9
CIS	2.4	2.8	2.2	2.3
Asia	6.5	6.4	6.3	6.3

Source: *IMF World Economic Outlook Database, April 2019; f – forecast*

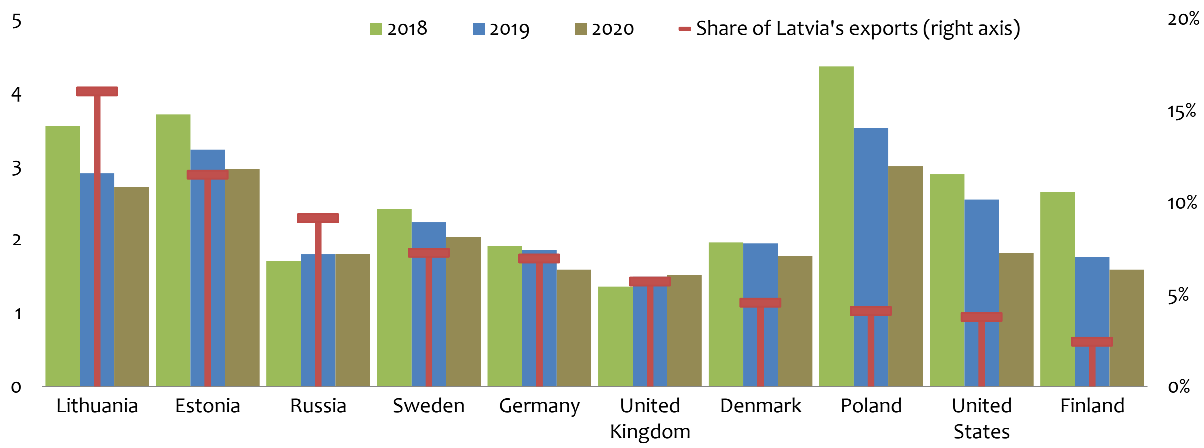
World GDP (excluding the EU) is estimated to have increased by 3.6% in 2018. However, the outlook for economic growth in 2019 and 2020 remains broadly unchanged – global GDP is expected to grow by 3.3-3.6% in the next two years.

The decline of growth rates in the Euro area can largely be attributed to decreased external support, including subdued global trade growth and higher uncertainty about trade policy. Also, several internal factors are linked to the decline in growth rates.

It is anticipated that the US economy will continue to grow rapidly in 2019. The growth will mainly be facilitated by improvements in the labour market, growing confidence, and various fiscal incentives. However, it is expected that the political situation in the congress, which led to the suspension of the government and state institutions for a whole month, will have a negative impact on consumer sentiment and growth at the beginning of the year. In 2020, the economic growth will slow down due to reduced macroeconomic policy support.

In China, however, recent data confirm a decline in economic growth. The uncertainty about the outcome of trade negotiations between China and the US and the effectiveness of domestic policy incentives that will affect short-term growth prospects are of vital significance. China's economic growth will continue to slow down – private consumption will decline, export growth is expected to weaken, and the real estate sector will experience a downturn.

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



Source: CSP, *IMF World Economic Outlook Database, April 2019*

The fall in oil prices since 2018 have worsened the growth prospects of oil exporters, including Russia and OPEC.

High political uncertainty is the main risk of global growth in the near future. The risk of economic development in the EU remains linked to the Brexit process.

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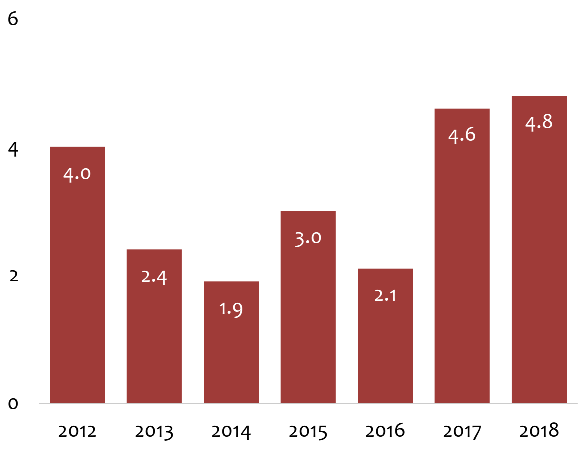
GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

GROSS DOMESTIC PRODUCT

In 2018, GDP increased by 4.8%, which has been the largest increase in the last seven years.

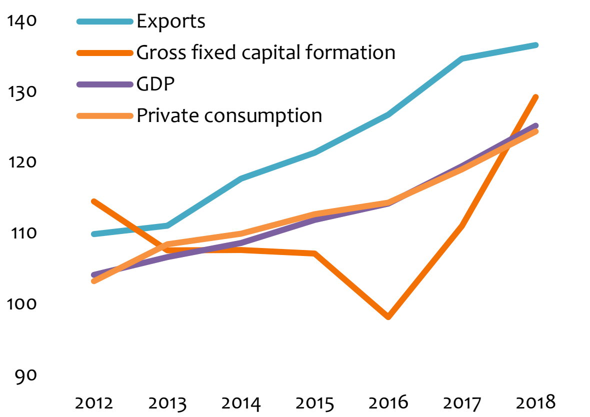
Gross Domestic Product
changes as per cent



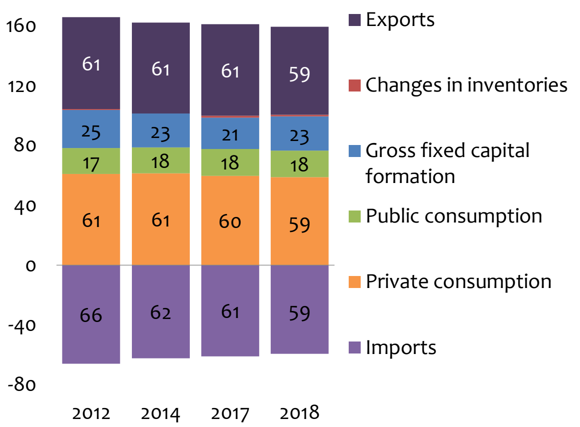
Accelerated growth in 2018 to a large extent can be attributed to favourable situation in the EU, start of new structural fund resource programms, and increasing employment and wages. At the same time, stable growth in investments, private and public consumption was observed.

In 2018, export volumes (growth rate lower by 1.8% than a year ago) kept rising. Exports of goods experienced a larger growth rate than exports of services. In addition, more rapid growth in exports was observed in the first half of the year. During the second half of the year, however, export volumes slightly declined. Also, rise in private consumption was mainly facilitated by improvements in the labor market. Similarly, public consumption increased. After a decline in the previous years rapid growth in 2017 and 2018 was observed in investments.

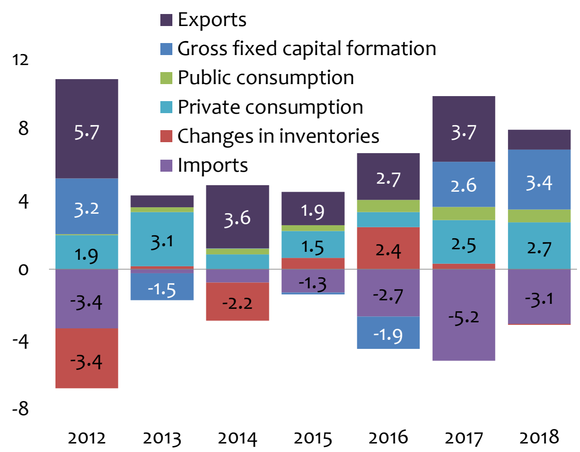
Gross Domestic Product by Expenditure Items
2011 = 100



Gross Domestic Product from the Expenditure Approach
per cent of GDP



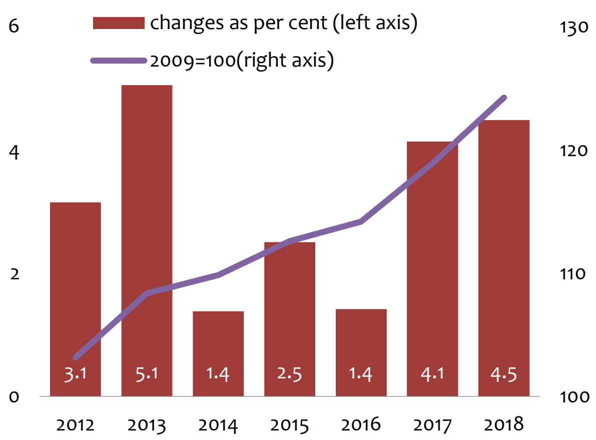
Gross Domestic Product by Expenditure Items
contribution to growth as percentage points



CONSUMPTION

Private consumption has been growing steadily. From 2011-2018, private consumption on average increased by 3.2% annually. The increase was mainly facilitated by rising wages.

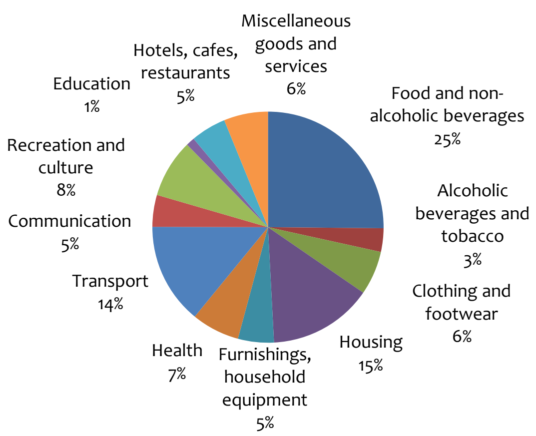
Private Consumption



Household expenditures have peaked. The largest share of household consumption (25%) is devoted to food and non-alcoholic beverages. In 2018, compared to 2017, expenditures for food and non-alcoholic beverages increased by 6%. Also, a small increase was observed in expenditures for housing – by 2%, constituting it the second largest expenditure group. The third largest share of household consumption was devoted to tranport (growth by 4%). The growth was mainly facilitated by an increase in expenditures for private transportation vehicle exploitation and automobile purchases. However, the largest expenditure increase was observed in recreation and culture – by 12%, comprising the fourth largest expenditure category.

Structure of Household Expenditures

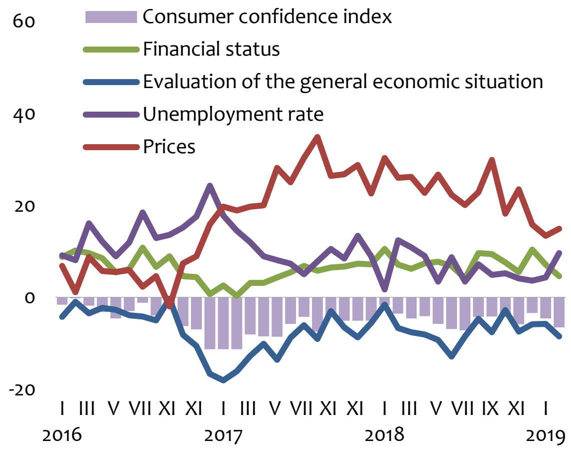
2018, per cent



In 2018, consumer confidence improved. Financial situation was evaluated positively, inflation expectations declined, and unemployment expectations remained the same as in the previous year. In early 2019, consumer confidence, compared to 2018, declined. The most pessimistic assessment was for the overall economic situation in the country, as well as significantly increased unemployment expectations. The assesment of the familys's financial situation also deteriorated slightly. Meanwhile, inflation expectations among consumers declined broadly.

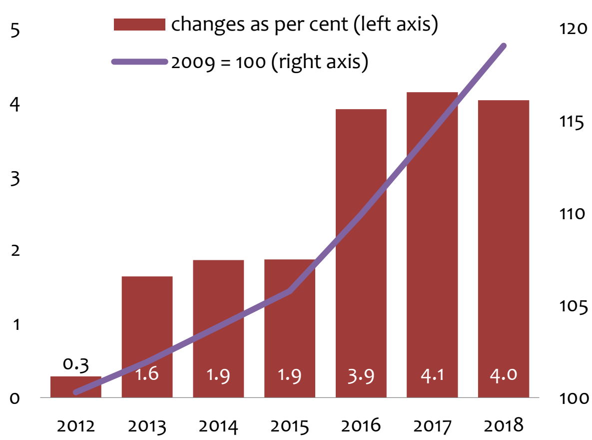
Consumer Confidence Indicator

consumers' measurement over the next 12 months, response balance, seasonally adjusted data



After a significant decline during the financial crisis, public consumption continues to steadily increase. Since 2013, along with an increase in budget revenues, growth in public consumption has accelerated. Overall, from 2011-2018 public consumption on average increased by 2.5% annually. In 2017, the largest growth since 2006 was observed.

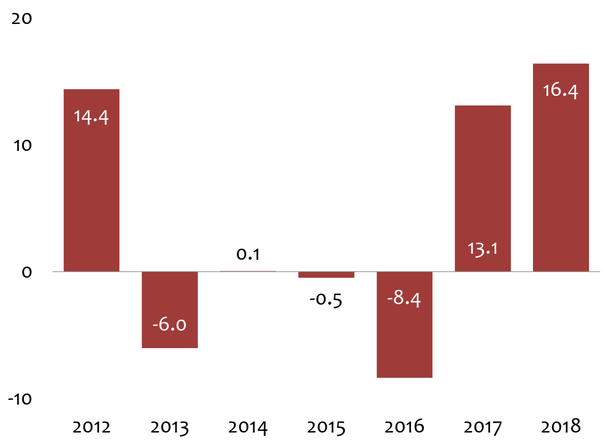
Public Consumption



INVESTMENT

Since 2017, the increase in investment (gross fixed capital formation) has been one of the largest in the EU. The increase in investment activities shows that the period of investment stagnation has been overcome. In 2018, rapid growth in investments was observed. Compared to 2017, investment in Latvia's economy was 16.4% higher and represented 22.8% of GDP. The increase was mainly driven by substantial investments in construction assets. However, the investment level still remains lower than before the financial crisis.

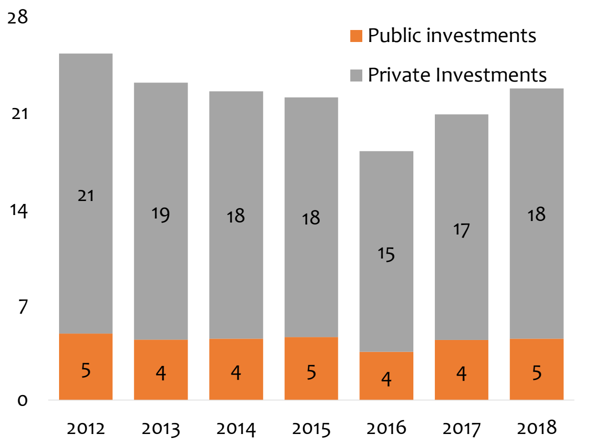
Gross Fixed Capital Formation
changes as per cent



The relatively low investment volume is mainly related with the slow recovery of private investments in the post-crisis period. From 2011-2016, private investments on average amounted to 17.7% of GDP, which is by almost 11 percentage points lower level than in rapid growth years. The low level and weak dynamics in this period mainly were determined by weak crediting, low demand, relatively high private sector debt level, and, most importantly, the uncertainty in the external environment. In recent years, private investment dynamics have been positive. In 2017 and 2018, private investments grew by 9% and 14.6%, respectively. In the face of subdued lending, significant support for private investments is provided with the EU structural fund co-financing. The EU structural funds are very important source for public investments.

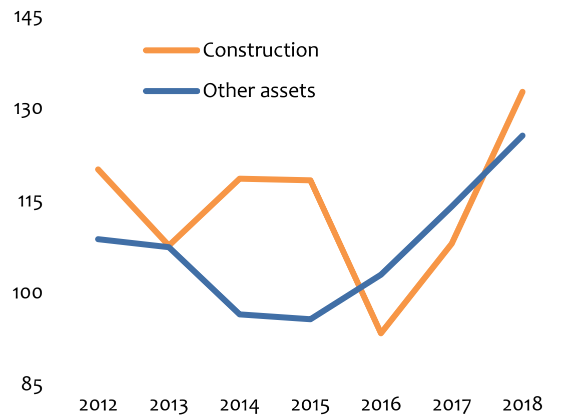
Public investments in Latvia remain at a high level. In recent years, public investments constituted 1/5 of total investments in Latvia's economy and their dynamics have remained relatively stable, except for 2016, when public investment declined by 20.3% annually. The decline can mainly be explained by the cesssation of the EU structural fund transfers – a consequence of their cyclicality. According to preliminary data in 2018, public investment exceeded the previous year's level by 20%. Latvia's share of public investment in total investment is one of the highest among EU Member States. According to *Eurostat* figures in 2018, in the EU-28 countries, public investment on average amounted to 2.8% of GDP (nearly 5% in Latvia).

Public and Private Investment
per cent of GDP



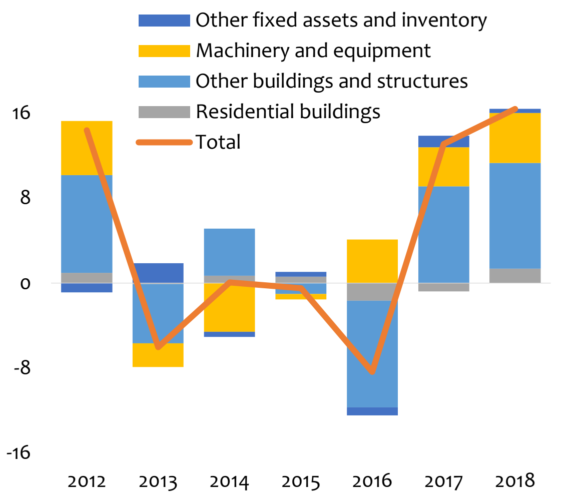
Since 2007, the structure of investment actives has changed. During the recession, the volume of investments decreased in all actives. The largest fall in investments were observed in construction. Moreover, drop in investments for machinery and equipment was slightly lower. Investments in intellectual property remained practically unchanged, constituting 1% of GDP (including R&D at 0.6% of GDP).

Gross Fixed Capital Formation by Types of Assets
2004 = 100



Investment growth in construction assets has been more rapid. In 2018, investments in construction assets increased by 22.9%, and their share in total investments amounted to almost 52% (the largest growth in engineering structures and buildings). Investments in housing represent almost 22.8% of investments in construction assets (35.4% in 2007). In machinery and equipment entrepreneurs invested 24.7% more than a year ago, while investment volumes in vehicles decreased by 15.2%. More moderate than in the past year, there is also an increase in investment in intellectual property products.

Gross Fixed Capital Formation by types of assets
changes as per cent; asset type investment, percentage points

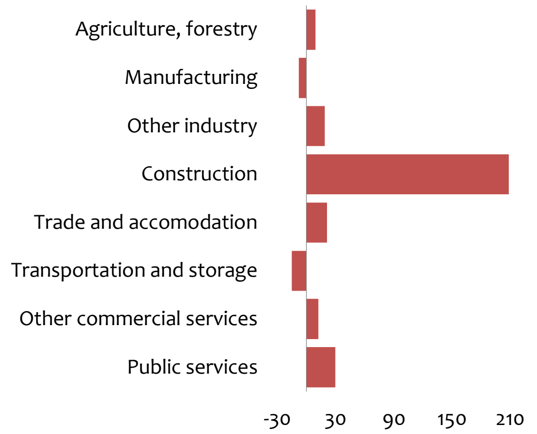


In 2018, investments grew in goods production sectors more than in services sectors. In goods production sectors investments grew by 20%, while in services sectors by 17%.

The largest contribution to the investment growth provided construction (growth by 208%) real estate activities (growth of 39.4%). However, investments in manufacturing declined by 8%.

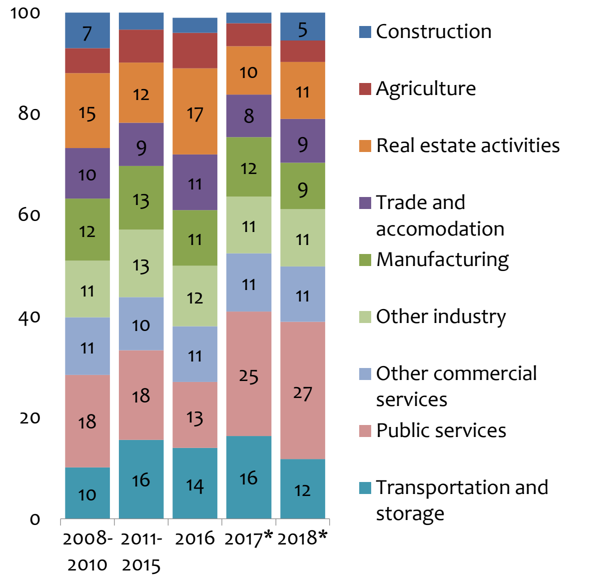
Surveys with managers of industrial companies suggest that the main investment motivating factor is the demand. In recent years, an important factor for increasing investments has been the accessibility of finance. In 2018, the financial conditions are considered as investment motivating, which is equivalent to technical factors such as technological development and accessibility of qualified labor.

Dynamics of Investments by Industry*
changes in 2017, as per cent



* – calculated by using quarterly data

Non-financial Investment Structure by Sectors
*as per cent**



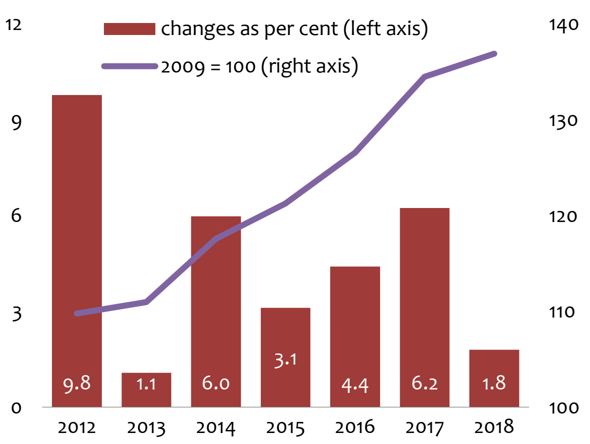
* – calculated by using quarterly data

In the next years rapid growth in investments is expected to continue. The process of investing is positively activated by accessibility of the EU structural funds as well as by growing external and internal demand, increase in lending volumes and other factors. Also, the limited supply of labor will become a strong incentive for increased investments. Amid the favourable outlook for investments and the high production workload, growth in investments is expected to remain high.

EXPORTS

Exports, one of the main drivers of economic development, are increasing. The growth is closely linked to the external demand dynamics and the economic development of the main trading partners.

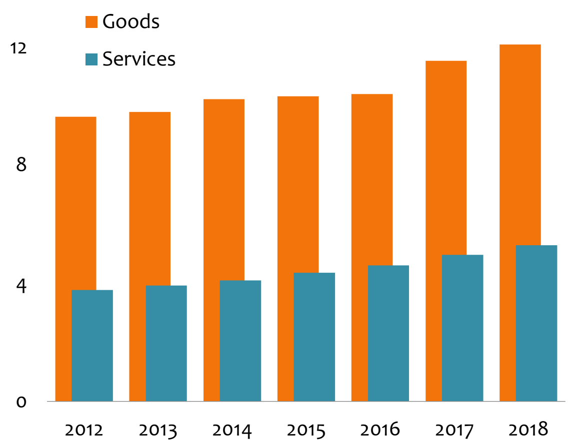
Exports of Goods and Services



In 2018, exports of goods and services increased; however, the growth has slightly slowed down. The growth was stimulated by accelerated economic growth in Lithuania and Estonia, stable demand in the main export markets – the EU countries, and growing economic stability in Russia and other CIS countries.

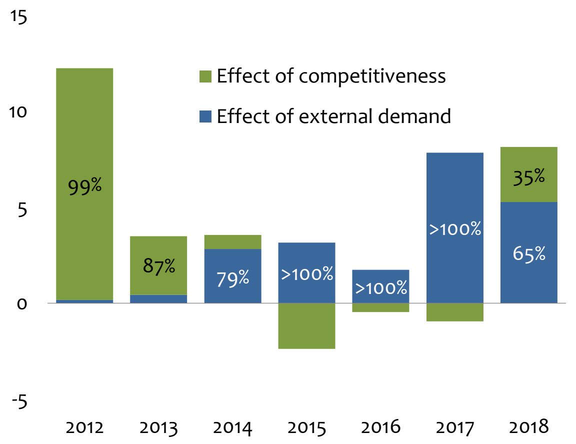
It is expected that in 2019 exports will grow steadily due to slower growth trends in the main partner countries.

Exports of Goods and Services
current prices, billion euro



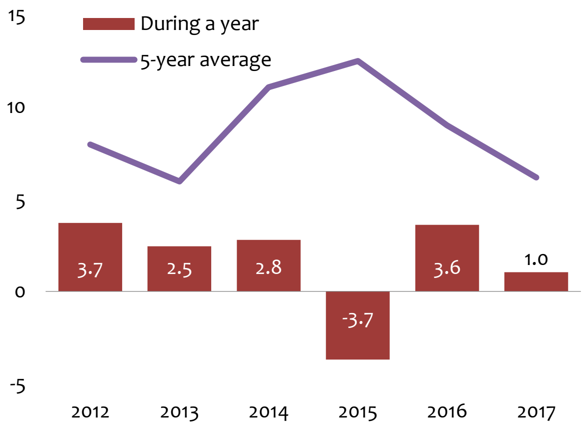
Since 2014, the increase in exports has mainly been determined by external demand, and the relationship of competitiveness in prices has smaller affect on the export increase. In the years of rapid growth, the increase in exports was mainly led by few large production goods, for example, wood and its products, and metals. During the crisis, export volumes decreased in all goods categories. However, the largest decrease for goods was observed in the main export categories. After the crisis, as Latvia returned to economic growth, increase in volumes of exports by groups of products have been similar, which determines higher diversification level. In Latvia, during the last years the diversification measure coincides with the EU-15 average.

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



The export share of Latvia in the world market increases, which means that entrepreneurs of Latvia remain huge competitiveness and enters in new markets.

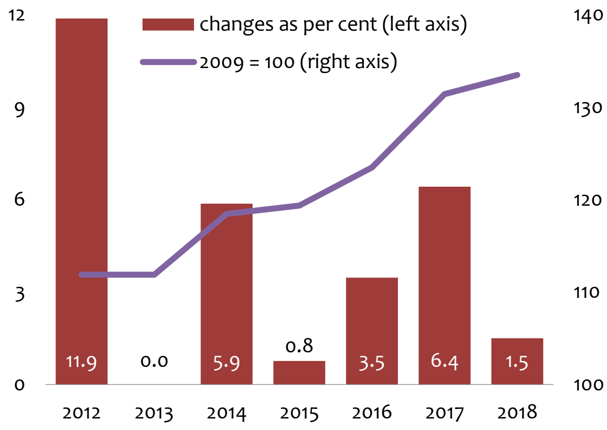
Market Share of Latvian Exports in the Global Exports
changes as per cent



Exports of Goods

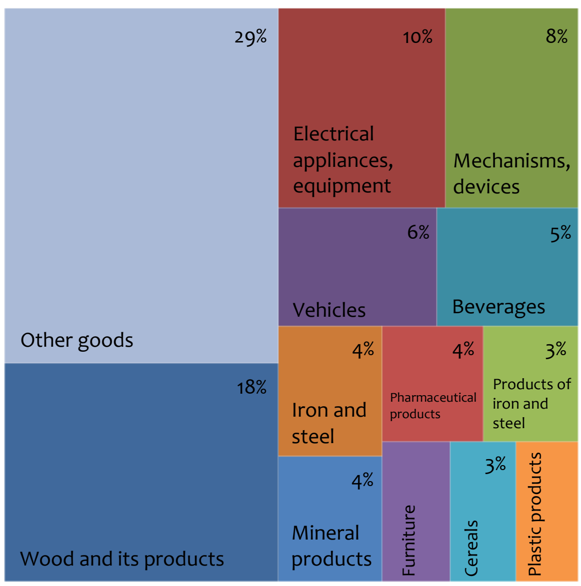
Exports of goods constitute around 70% of total Latvian exports and its share in the last years has not changed.

Exports of Goods



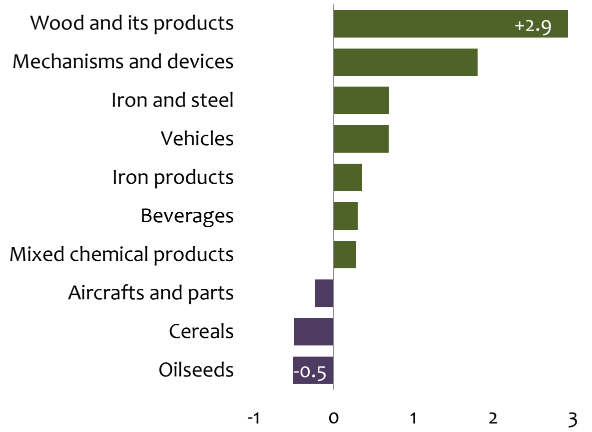
In 2018, exports of goods developed dynamically. Comparing with 2017, exports in current prices increased by 7.4%. The increase was mainly driven by development in export of wood and its products, basic metals and its products, as well as mechanisms, devices. However, negative development trends were observed for exports of cereal crops and oilseed. Export to EU countries increased a bit faster, but slower to CIS and other countries.

Exports of goods
2018, %



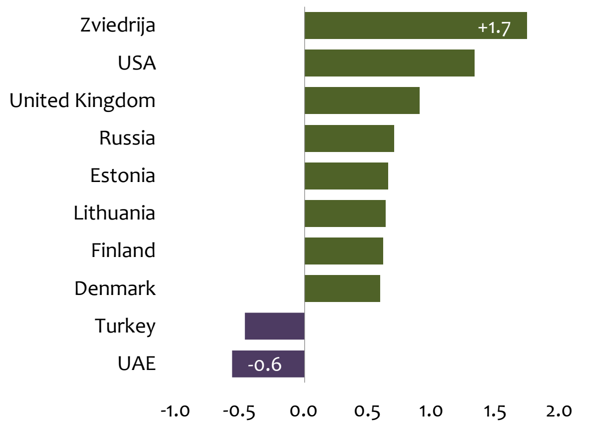
From January until February 2019, exports of goods increased a bit compared to the respective period a year before. In the first two months of 2018, exports of goods were by 0.2% higher than in January and February of 2018. Similarly as in 2018, exports of wood and its products contributed to the export development. Exports to EU countries increased more rapidly during this period. The growth, however, was slightly slower to CIS countries. Significantly export volumes declined to the rest of the countries.

Exports of Goods
contribution to growth in 2018, as percentage points



In 2018, the largest Latvian partner countries in export of goods were Lithuania, Estonia, Russia, Sweden, Germany, Great Britain, Denmark, and Polish. Exports to these countries comprised 60% of total exports.

Exports by Countries
contribution to growth in 2018, as percentage points

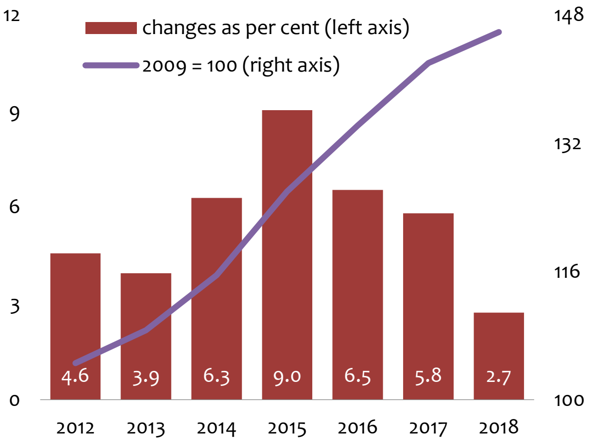


To EU countries in 2018 the main groups of goods for exports were wood and its products, mechanisms, devices, and vehicles. To CIS countries – alcoholic beverages, mechanisms, devices, and pharmaceutical products. However, to other countries in this period the largest export groups were mechanism, devices, wood and its products, and electrical appliances, equipment.

Exports of services

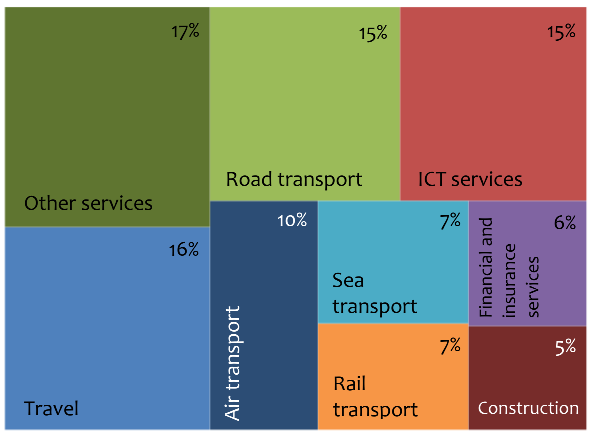
Since 2011, exports of services has experienced a larger growth than exports of goods. The largest contribution to growth was provided by transportation services. Also, significant increase has been observed among the exports of construction and ICT services. However, financial and insurance service activities have experienced a decline.

Exports of Services



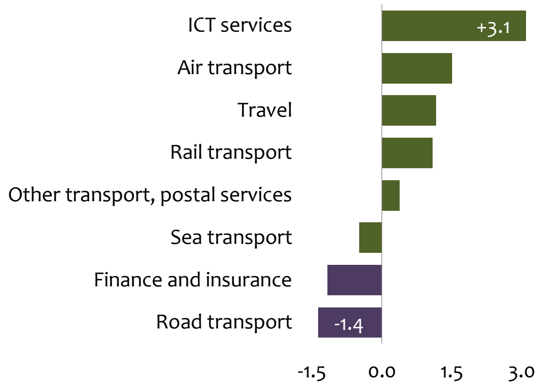
In 2018, in exports of services stable growth was observed. ICT services sector grew rapidly. Also, air transport, travel, and rail transport increased quite significantly. A decrease, however, was observed in road transport and financial and insurance activities.

Structure of Exports of Services
2018, as per cent

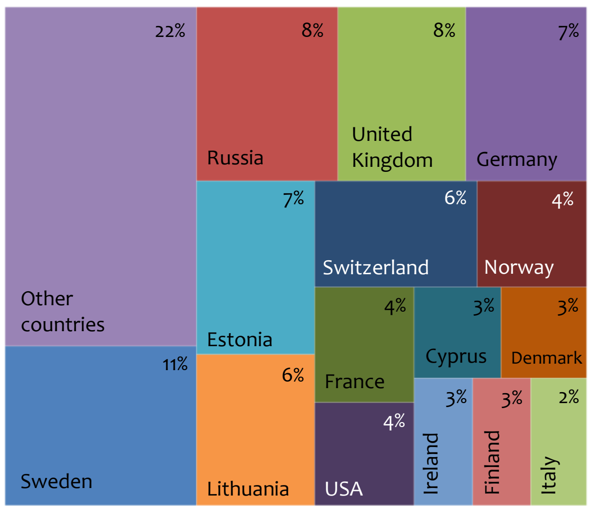


The share exports of services to EU countries have increased from 49% in 2011 up to 66% 2018. A large share of exports, mainly transit services, are exported to CIS countries. However, the exports of services to CIS countries has decreased from 17% in 2014 to 12% in 2018.

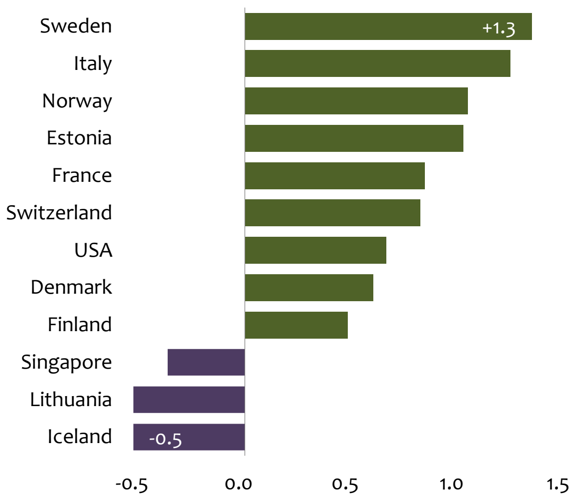
Exports of Services
contribution to growth in 2018, as percentage points



Structure of Exports of Services by Countries
2018, as per cent



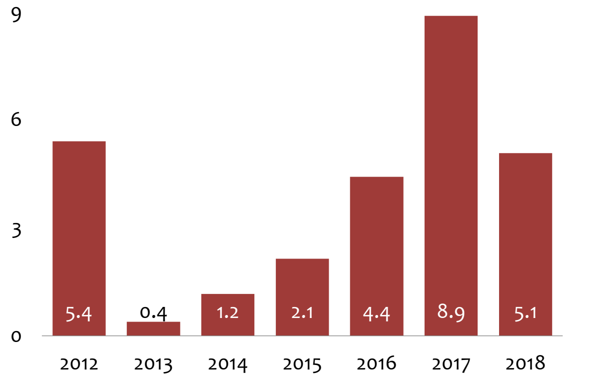
Exports of Services by Country
contribution to growth in 2018, as percentage points



IMPORTS

After a large decrease during the financial crisis, imports in recent years have increased rapidly. Successful was year 2017, when it increased by 8.9%. Imports of good has increased at a slightly higher rate than imports of services.

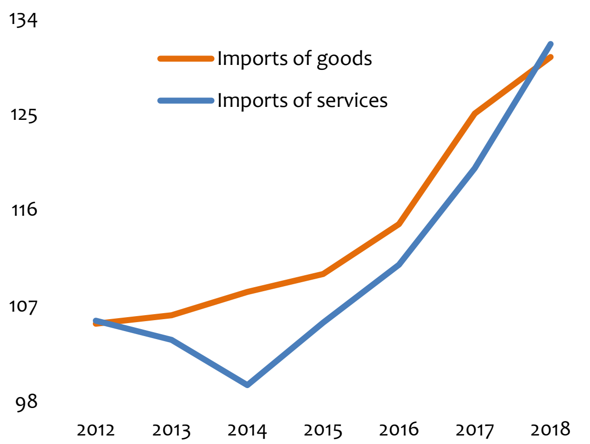
Imports of Goods and Services
changes as per cent



In 2018, imports of goods continued to increase. Compared to 2017, in 2018 imports in actual prices increased by 10.3%. The increase was mainly driven by the growth in machinery and mechanical appliances, iron and steel, wood and its products, and mineral products. It was also influenced positively by other import groups.

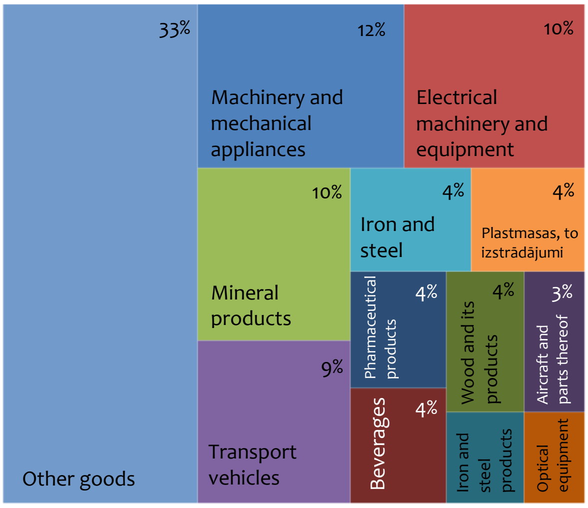
Main Latvian import partner countries are Lithuania, Germany, Poland, Estonia, Russia, Canada, and Finland. Together those countries form 60% of total imports of goods in Latvia.

Imports of Goods and Services
2011 = 100



From the final use of imported goods, the structure of imports has not changed substantially since 2012. A slight decline in intermediate consumption has been noticed, which was due to fuel import value decrease. Its share in intermediate consumption has dropped from 34% in 2012 to 20% in 2018 due to significant drop in world oil price.

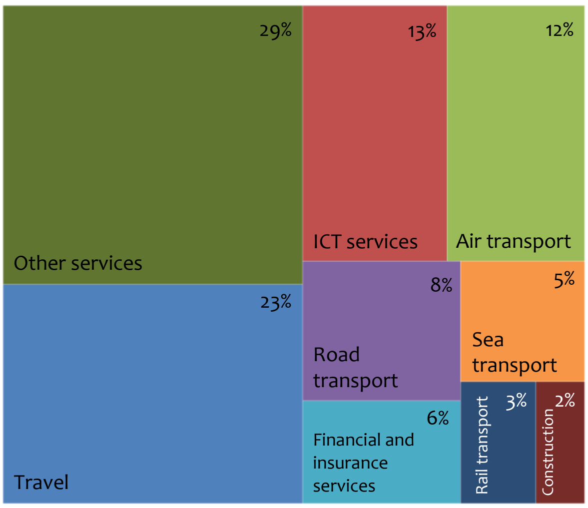
Structure of Imports of Goods
2018, as per cent



Imports of services in Latvia after the crisis period has developed dynamically, but slightly slower than export of services. A decrease in value of imports was noticed from 2013-2014, which was mainly due to significant price adjustments.

In 2018, imports of services in actual prices increased by 9.8%. A large contribution in the increase had the transportation services, ICT services, and imports of business services. However, imports of financial services declined.

Structure of Imports of Services
2018, as per cent

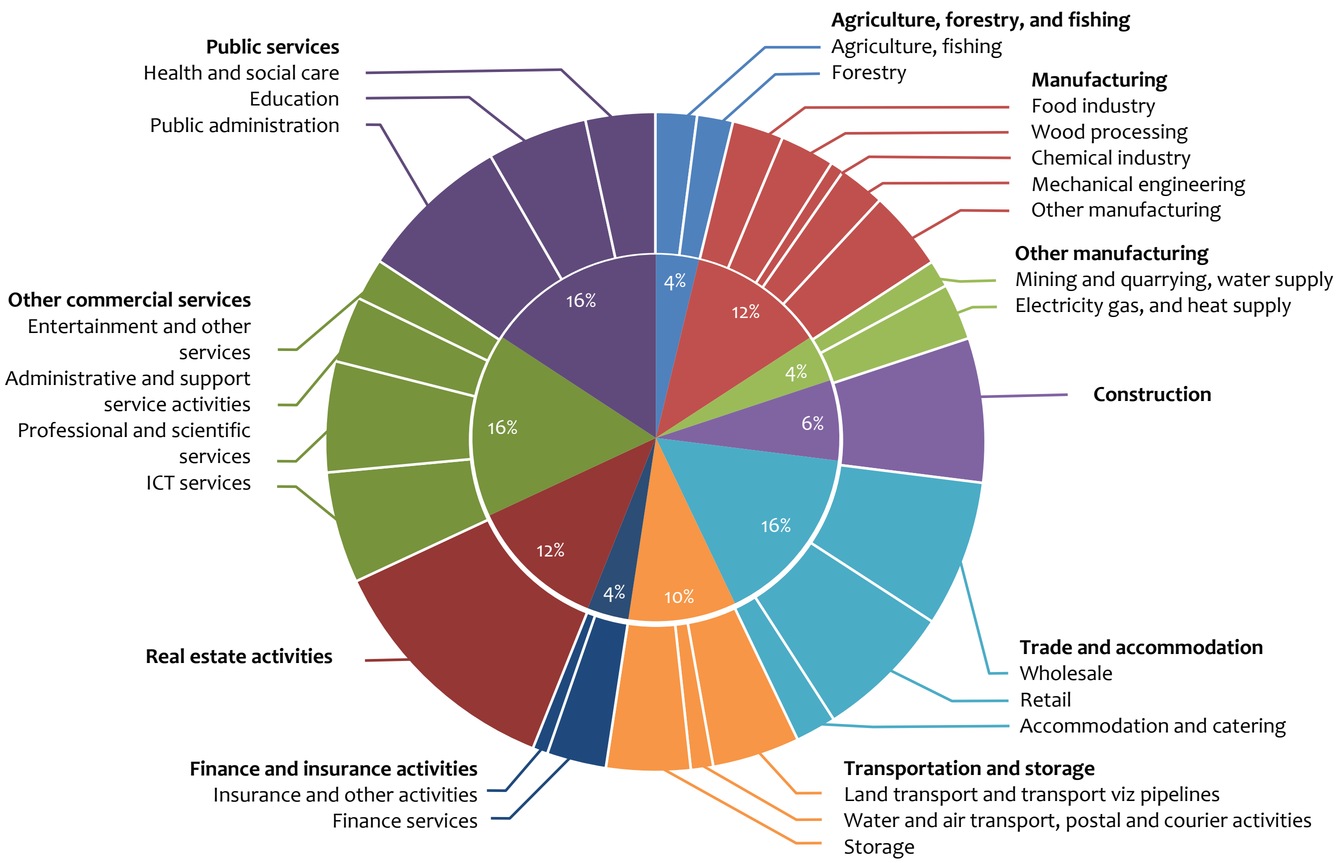


2019 | 1

CONTRIBUTION OF SECTORS

During the global financial crisis, as labour costs declined, the competitiveness of Latvian producers improved, which significantly stimulated export growth and hence the development of tradable sectors. The structure of the economy changed. In 2008, tradable sectors (agriculture, forestry, manufacturing, and transportation and storage) constituted 26% of the total value added. However, in 2010, the share for these sectors reached 33%. In 2018, it slightly declined to 29.4%. In fact, the share has dropped in practically all sectors, except construction and commercial services. However, the share of public services has remained practically unchanged. In 2014-2016, the growth continued in all sectors, except construction. On the other hand, in 2017 and 2018 the largest growth was observed in construction.

Structure of the Value Added
2018, as per cent*



* calculations by the Ministry of Economics

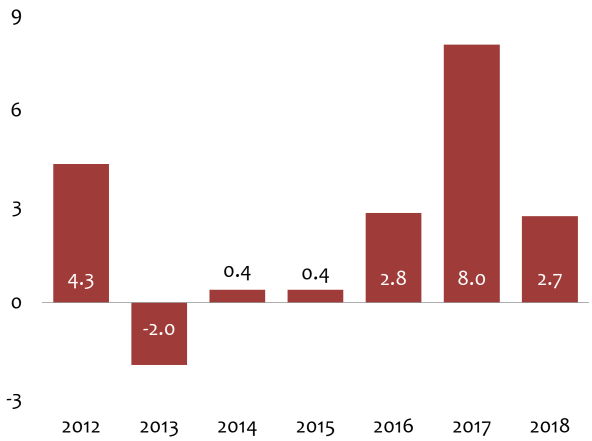
Development of Sectors
changes against the corresponding period of previous year, as per cent

	2014	2015	2016	2017	2018
Gross Domestic Product	**1.9**	**3.0**	**2.1**	**4.6**	**4.8**
Agriculture	0.2	12.5	-9.8	1.9	3.4
Mining	-9.8	6.7	-3.6	18.0	3.7
Manufacture	0.4	0.4	2.8	8.0	2.7
Food industry	0.1	-4.6	1.8	5.2	-2.9
Light industry	-13.6	-13.2	2.1	7.6	-0.8
Wood processing	6.9	7.1	8.0	2.1	4.5
Manufacture of paper and paper products; printing	-0.6	0.0	3.6	4.5	-3.7
Chemical industry	-2.6	-4.1	10.7	11.4	7.0
Manufacture of non-metallic mineral products	1.2	-9.8	11.6	11.1	1.3
Manufacture of basic metals	-10.5	34.8	5.4	12.0	3.6
Manufacture of electrical and optical equipment	32.3	16.7	12.6	15.8	12.1
Manufacture of machinery and equipment	2.4	7.9	8.5	21.5	7.0
Manufacture of motor vehicles	-15.2	3.5	-2.9	22.8	7.3
Other manufacturing	-12.0	3.5	0.8	4.3	-1.8
Electricity and gas supply	-14.3	22.6	18.0	7.3	-2.7
Construction	5.4	-1.8	-14.7	19.4	21.9
Construction of buildings	33.6	-6.2	-2.2	11.8	45.9
Civil engineering structures	-10.4	5.2	-33.3	30.4	21.1
Trade	5.3	7.3	2.7	5.3	2.1
Retail	3.5	4.9	2.3	4.3	3.8
Transportation and storage	1.3	-7.7	6.1	7.5	5.3
Freight traffic	2.2	-2.4	-14.1	-8.4	12.5
Cargo loaded and unloaded at ports	5.2	-6.2	-9.3	-2.0	6.9
Freight traffic	2.7	0.5	1.3	7.0	12.8
Accommodation and catering services	3.6	6.0	1.3	4.3	5.1
ICT services	-2.4	2.1	5.1	6.4	13.0
Finance and insurance activities	11.6	4.8	3.2	-18.9	-7.3
Real estate activities	1.4	1.4	0.2	0.5	2.9
Other commercial services	-5.7	5.9	1.2	6.3	3.0
Public administration and defence; obligatory social insurance	1.5	0.5	5.5	3.6	3.2
Education	4.1	0.7	0.6	5.6	2.1
Health and social care	6.8	5.5	1.4	5.6	5.0
Art, entertainment, and recreation	1.1	-3.7	5.0	8.5	4.9

MANUFACTURING

The development of manufacturing is mainly facilitated by the improvement of the competitiveness of Latvian producers and the demand dynamics in the largest export markets. In 2017, the output of manufacturing increased rapidly.

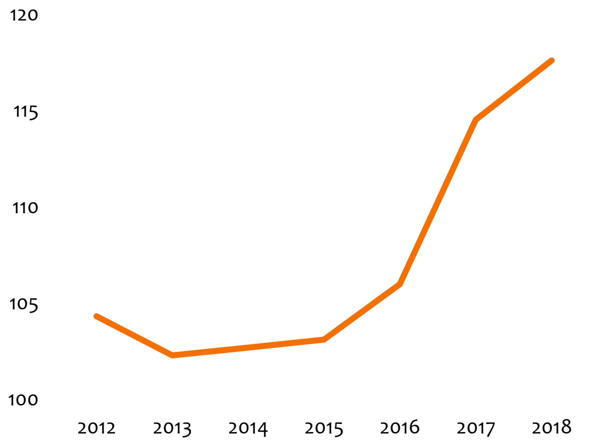
Manufacturing
growth, as per cent



In 2018, moderate growth in manufacturing was observed. The largest contribution to the growth in manufacturing yielded its largest sub-sector – wood processing. A significant growth was also observed in the manufacture of electrical equipment and the manufacture of motor vehicles, trailers, and semi-trailers. Year 2018 was not especially successful for the manufacture of food products, the second largest sub-sector of manufacturing, the manufacture of beverages, the manufacture of paper and paper products, and printing.

In 2018, manufacturing turnover at current prices grew faster than output. Domestic sales volumes increased relatively faster; however, the growth in export volumes was more moderate.

Manufacturing
2011 = 100

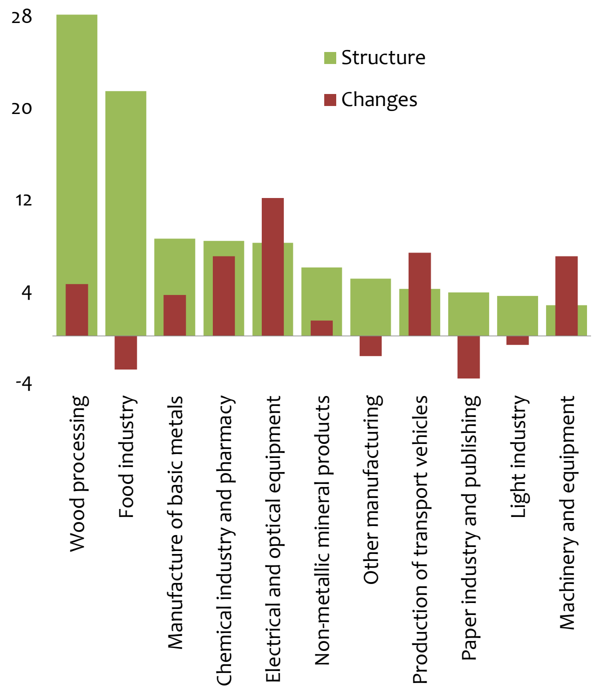


In 2018, the number of occupied posts continued to grow in manufacturing. The largest increase was observed in the manufacture of electrical and optical equipment, the manufacture of machinery and equipment. However, a decline was observed in food industry.

Structure of Manufacturing and Development Trends by field
as per cent

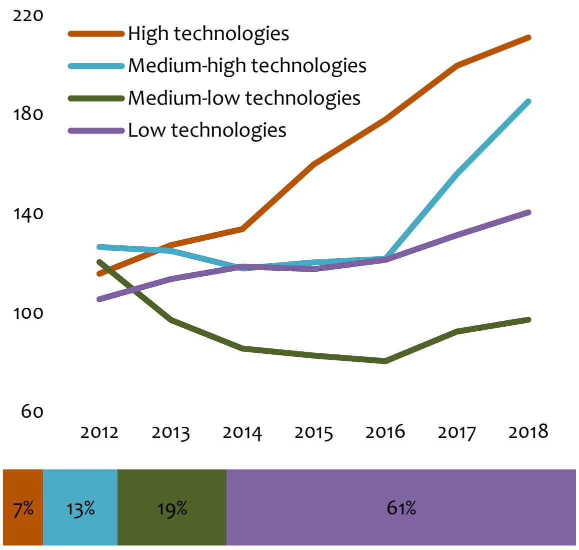
	Structure in 2018			Changes in production volumes				
	Output	Occupied posts	Share of exports in the sales	2015	2016	2017	2018	2019 Jan-Feb
Manufacturing	**100**	**100**	**65.4**	**4.3**	**5.6**	**8.0**	**2.7**	**4.7**
Manufacture of food products	21.5	19.6	35.0	-4.6	1.8	5.2	-2.9	0.3
Light industry	3.5	10.0	84.1	-13.2	2.1	7.6	-0.8	-6.8
Wood processing	28.2	20.2	71.3	7.1	8.0	2.1	4.5	7.1
Manufacture of paper and paper products; printing	3.8	4.3	64.7	0.0	3.6	4.5	-3.7	5.4
Chemistry and pharmacy	8.3	7.2	76.8	-4.1	10.7	11.4	7.0	5.8
Manufacture of non-metallic mineral products	6.0	4.9	52.4	-9.8	11.6	11.1	1.3	-2.6
Manufacture of basic metals	8.5	10.1	68.5	34.8	5.4	12.0	3.6	11.7
Manufacture of electronic products	8.2	4.7	90.5	16.7	12.6	15.8	12.1	14.6
Manufacture of machinery and equipment	2.7	3.5	88.4	7.9	8.5	21.5	7.0	22.2
Manufacture of motor vehicles	4.1	3.4	91.7	3.5	-2.9	22.8	7.3	-2.5
Other manufacturing	5.0	12.1	66.4	3.5	0.8	4.3	-1.8	0.2

Growth of Manufacturing
structure and changes in 2018, as per cent



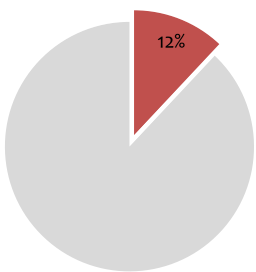
In 2019, a similar growth rate to 2018 in manufacturing will be observed. More rapid growth in manufacturing will be constrained by uncertainties in the external environment, which might considerably limit the potential of export opportunities.

Manufacturing Volume Index and Structure by Levels of Technology
2011 = 100; structure in 2018, as per cent

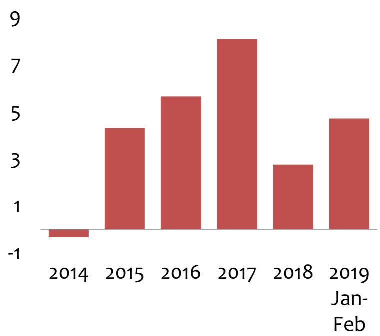


Main Indicators in Manufacturing

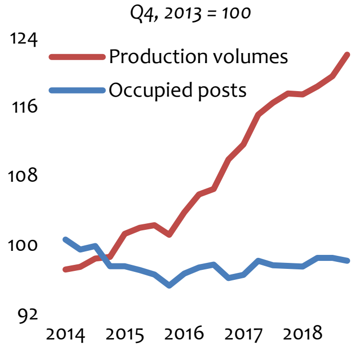
The share of the sector in national economy
2018, as per cent



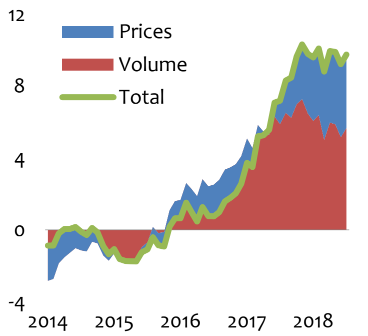
Changes in production volumes
as per cent



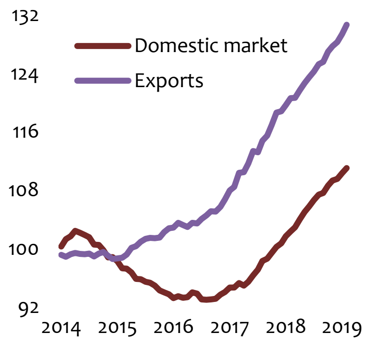
Production volumes and occupied posts
Q4, 2013 = 100



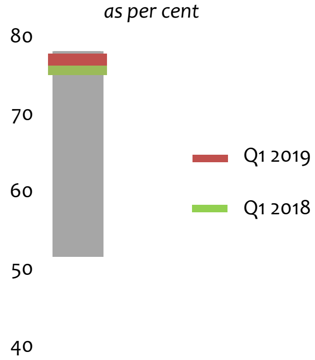
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

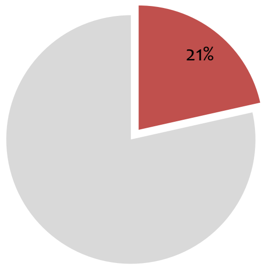


Capacity utilization rate
Historically highest and lowest levels, as per cent

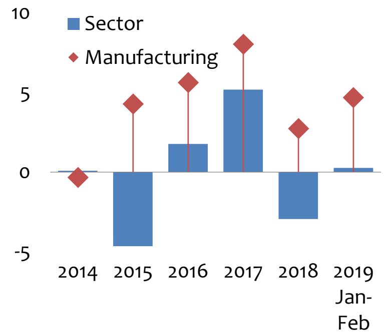


Manufacture of Food Products and Beverages

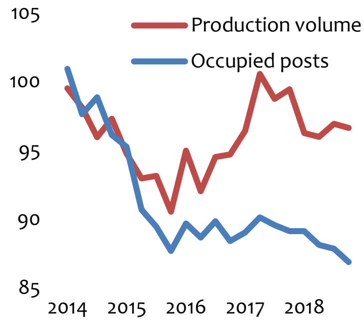
The share of the sector in national economy
2018, as per cent



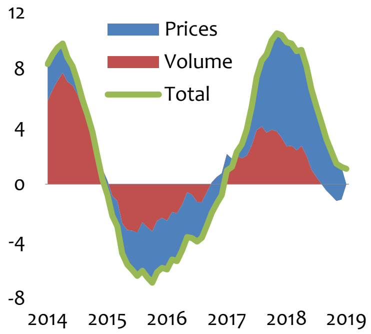
Changes in production volumes
as per cent



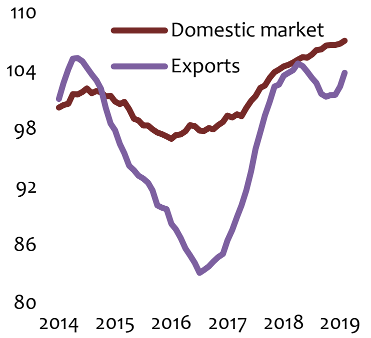
Production volumes and occupied posts
Q4, 2013 = 100



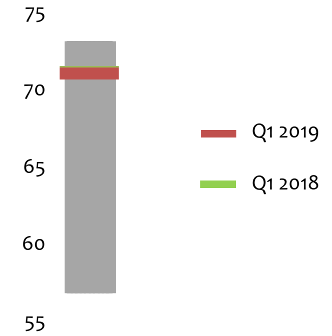
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

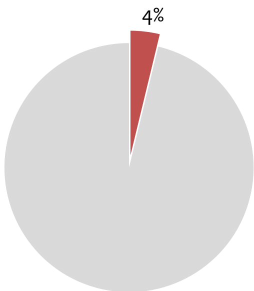


Capacity utilization rate
Historically highest and lowest levels, as per cent

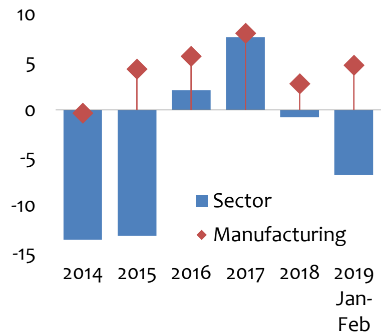


Light Industry

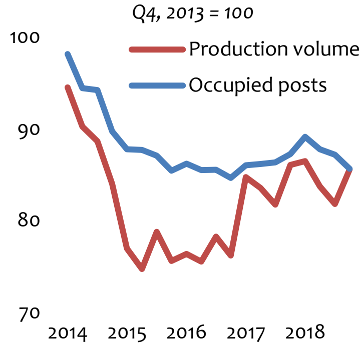
The share of the sector in national economy
2018, as per cent



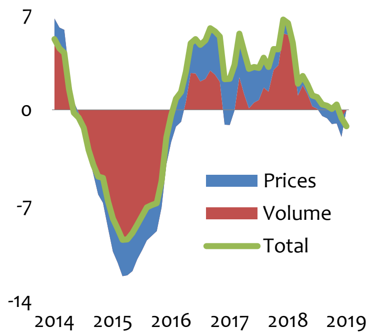
Changes in production volumes
as per cent



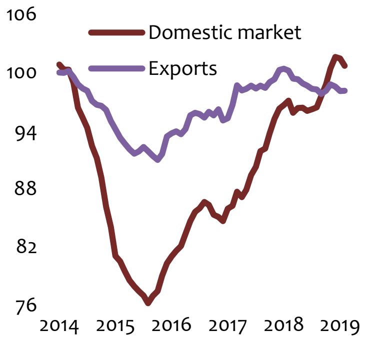
Production volumes and occupied posts
Q4, 2013 = 100



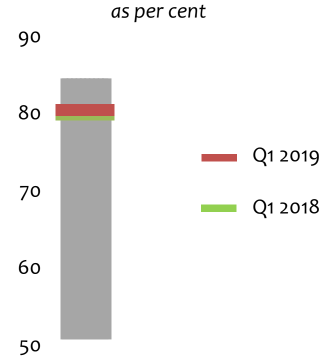
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

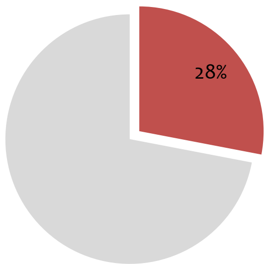


Capacity utilization rate
Historically highest and lowest levels, as per cent

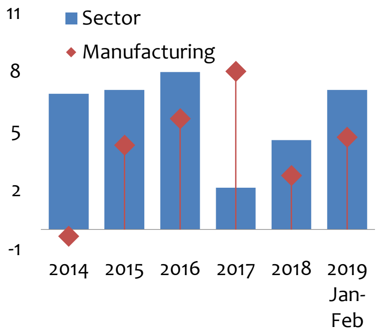


Wood Processing

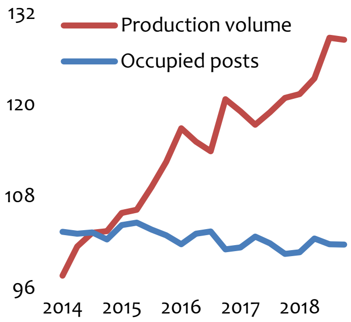
The share of the sector in national economy
2018, as per cent



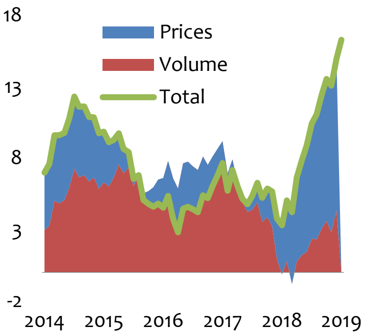
Changes in production volumes
as per cent



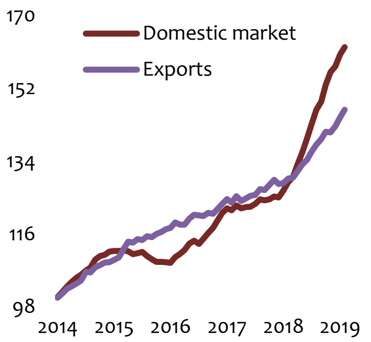
Production volumes and occupied posts
Q4, 2013 = 100



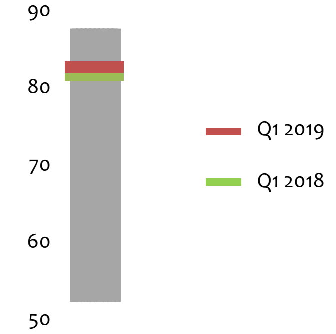
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

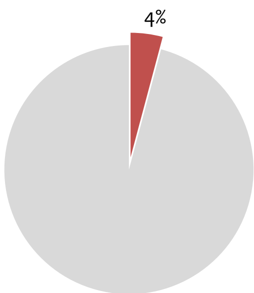


Capacity utilization rate
Historically highest and lowest levels, as per cent

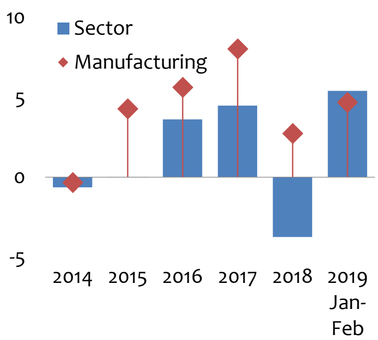


Manufacture of Paper and Paper Products; Printing

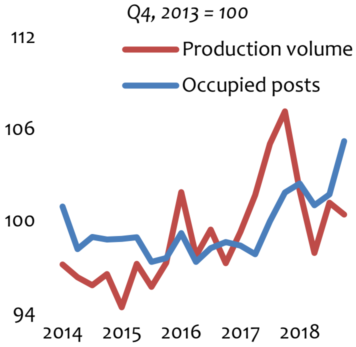
The share of the sector in national economy
2018, as per cent



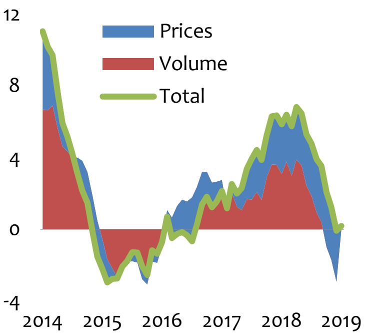
Changes in production volumes
as per cent



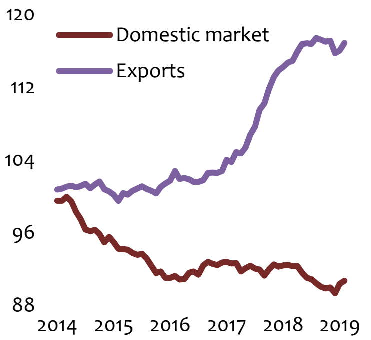
Production volumes and occupied posts
Q4, 2013 = 100



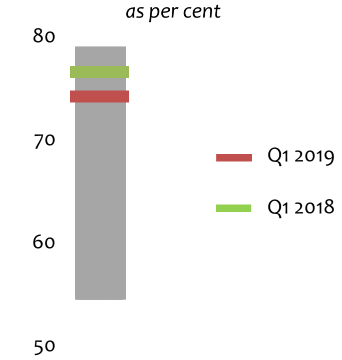
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

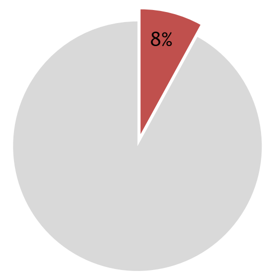


Capacity utilization rate
Historically highest and lowest levels, as per cent

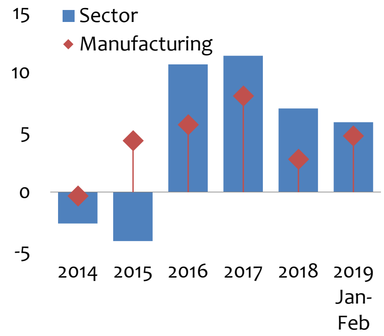


Chemical Industry

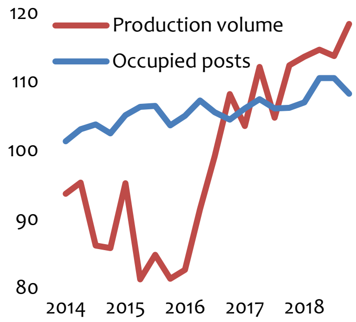
The share of the sector in national economy
2018, as per cent



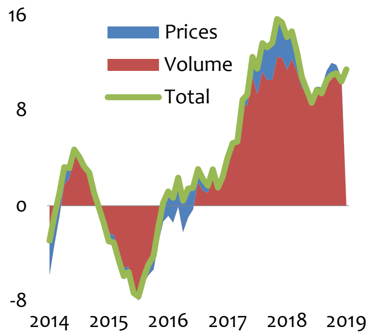
Changes in production volumes
as per cent



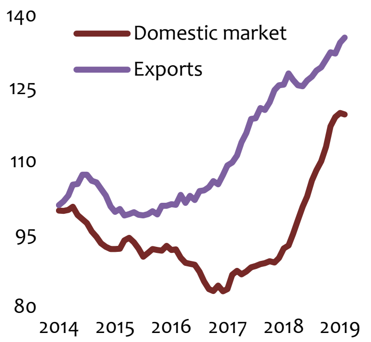
Production volumes and occupied posts
Q4, 2013 = 100



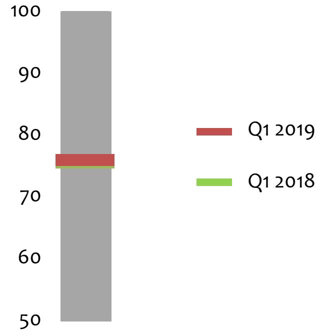
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

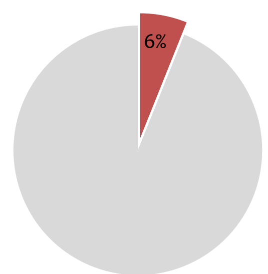


Capacity utilization rate
Historically highest and lowest levels, as per cent

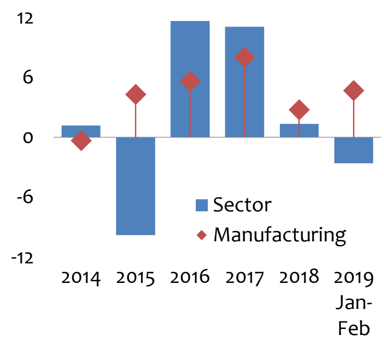


Manufacture of Non-metallic Mineral Products

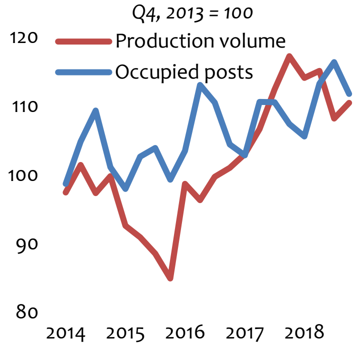
The share of the sector in national economy
2018, as per cent



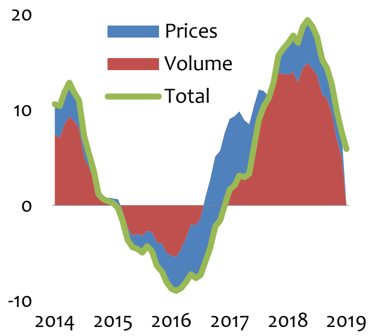
Changes in production volumes
as per cent



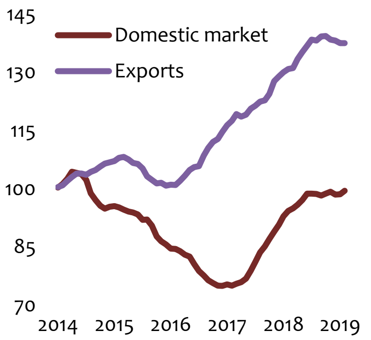
Production volumes and occupied posts
Q4, 2013 = 100



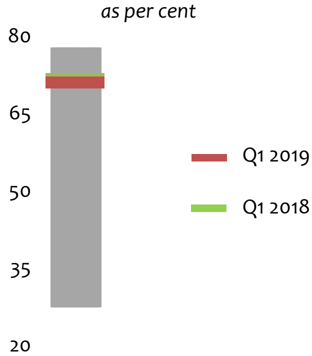
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

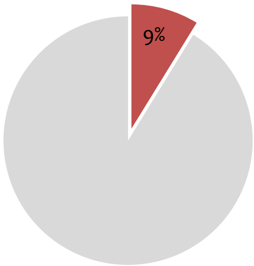


Capacity utilization rate
Historically highest and lowest levels, as per cent

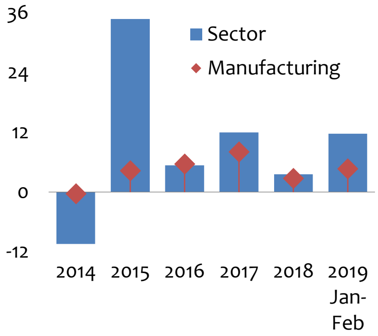


Manufacture of Basic Metals and Metal Products

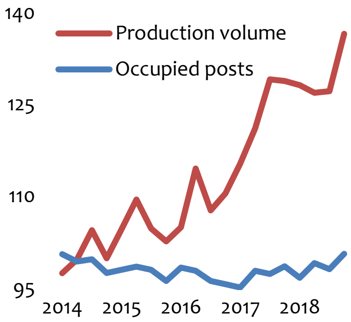
The share of the sector in national economy
2018, as per cent



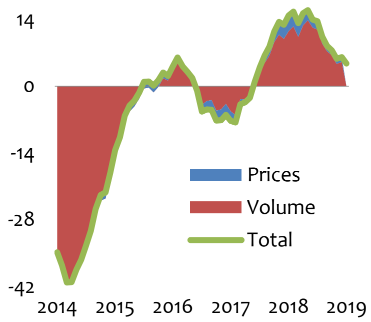
Changes in production volumes
as per cent



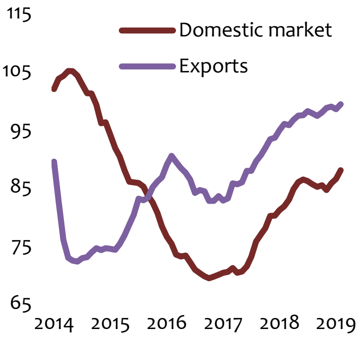
Production volumes and occupied posts
Q4, 2013 = 100



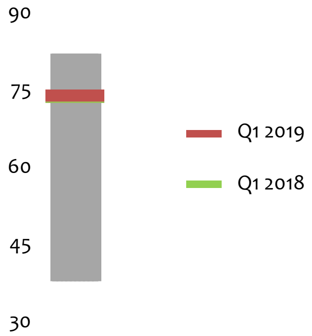
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

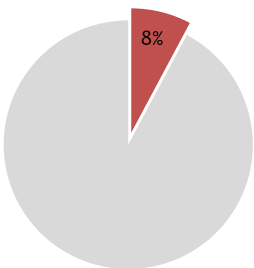


Capacity utilization rate
Historically highest and lowest levels, as per cent

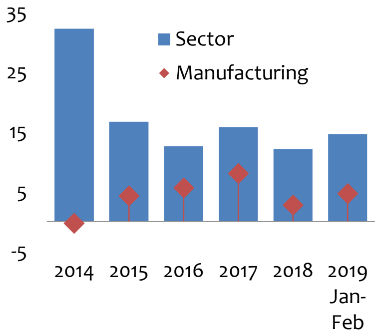


Manufacture of Electrical and Optical Equipment

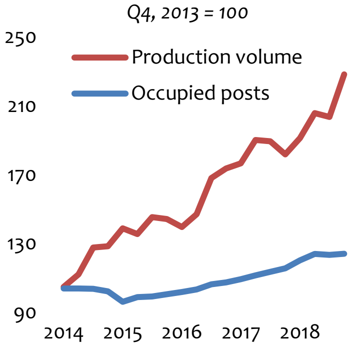
The share of the sector in national economy
2018, as per cent



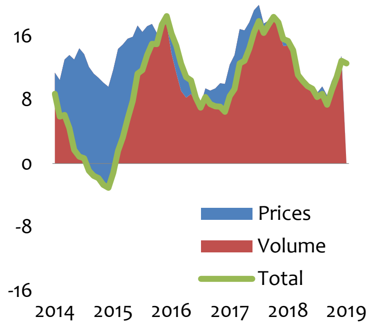
Changes in production volumes
as per cent



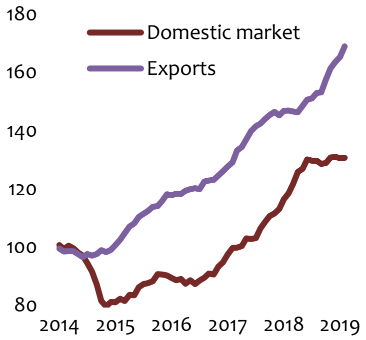
Production volumes and occupied posts
Q4, 2013 = 100



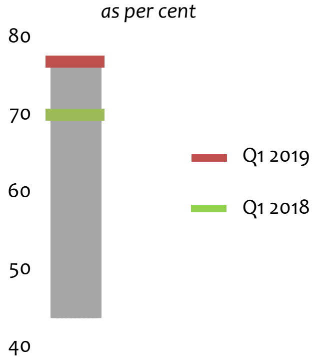
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

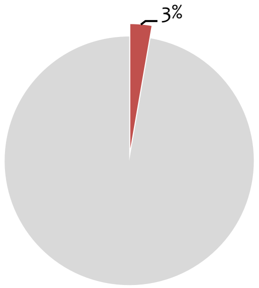


Capacity utilization rate
Historically highest and lowest levels, as per cent

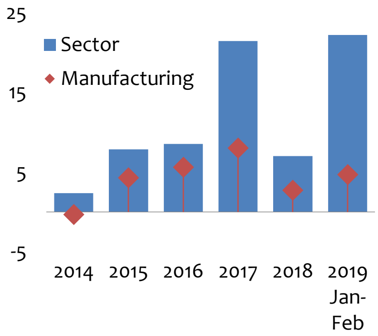


Manufacture of Machinery and Equipment

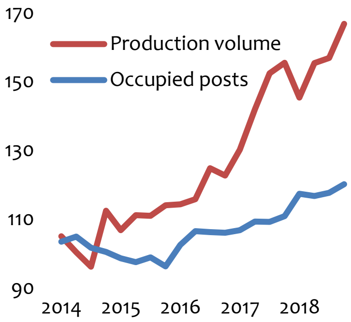
The share of the sector in national economy
2018, as per cent



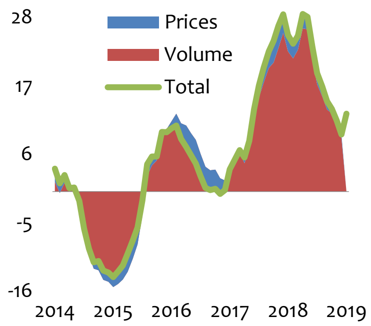
Changes in production volumes
as per cent



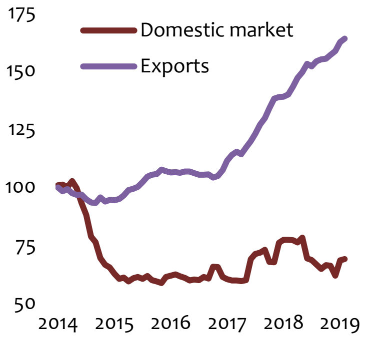
Production volumes and occupied posts
Q4, 2013 = 100



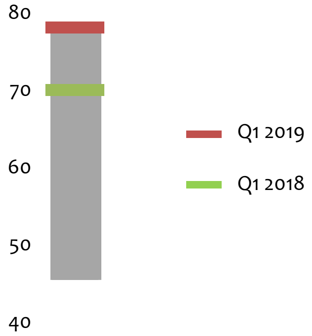
Changes in the sales of production
12-month moving average



Sales of production
12-month moving average, Dec 2013 = 100

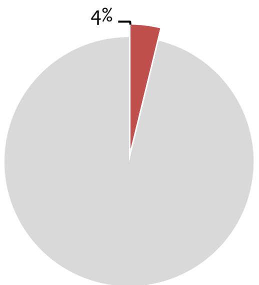


Capacity utilization rate
Historically highest and lowest levels, as per cent

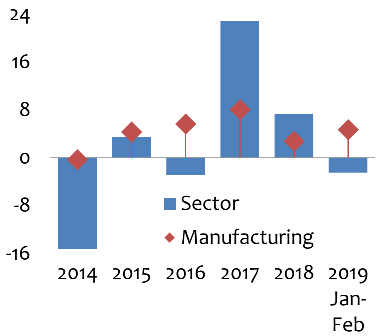


Manufacture of Motor Vehicles

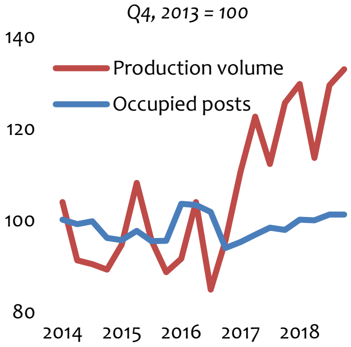
The share of the sector in national economy
2018, as per cent



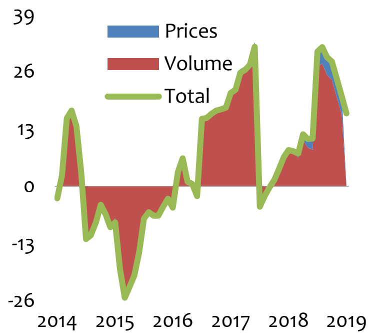
Changes in production volumes
as per cent



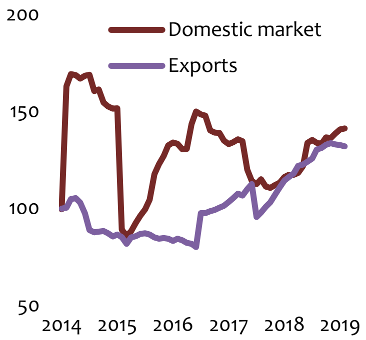
Production volumes and occupied posts
Q4, 2013 = 100



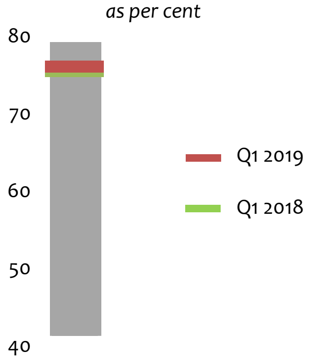
Changes in the sales of production
12-month moving average



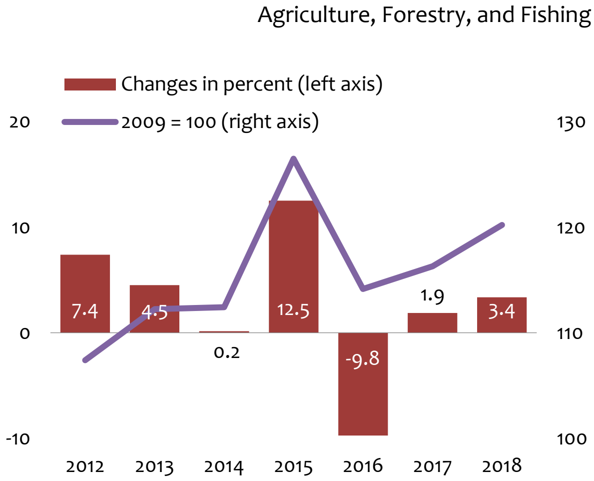
Sales of production
12-month moving average, Dec 2013 = 100



Capacity utilization rate
Historically highest and lowest levels, as per cent

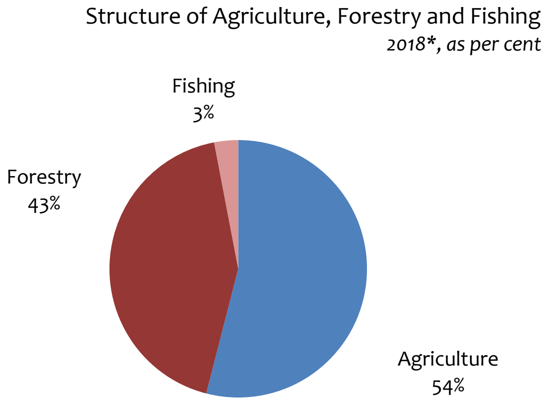


AGRICULTURE, FORESTRY, AND FISHING



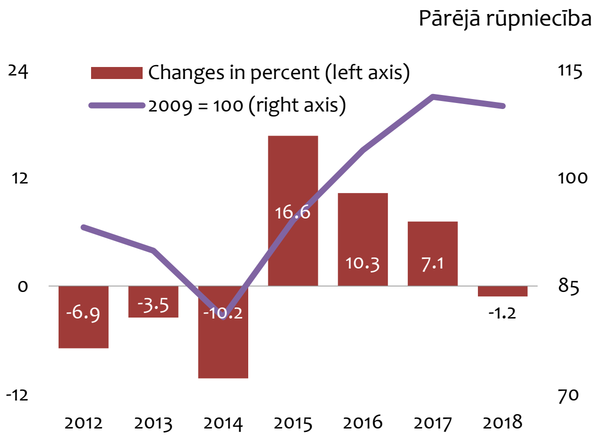
Agriculture and forestry comprise a very large share of the sector. The sector is highly dependent on the weather conditions. Thus, a volatile growth of the sector can be observed. After a rapid growth in 2015, when growth was determined by a record harvest of grain, the output volumes of the sector subsequently decreased. Due to unfavourable weather conditions, which significantly affected crop production and forestry, only a minor growth in 2017 was observed.

In 2018, more rapid growth in the sector due to favourable weather conditions and increased growth in forestry was observed. The number of employed in the sector is gradually decreasing. However, the number of occupied posts increase, and has currently exceeded the pre-crisis level. The number of occupied posts rise due to the increase in the number of paid jobs. However, the fall in the number of employed is a result of declining number of self-employed. This signals that in the sector hired labour force is increasingly used.

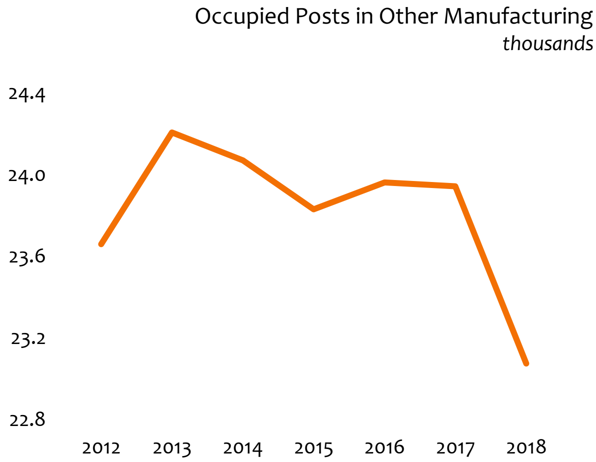


* – Estimate by the Ministry of Economics

OTHER MANUFACTURING



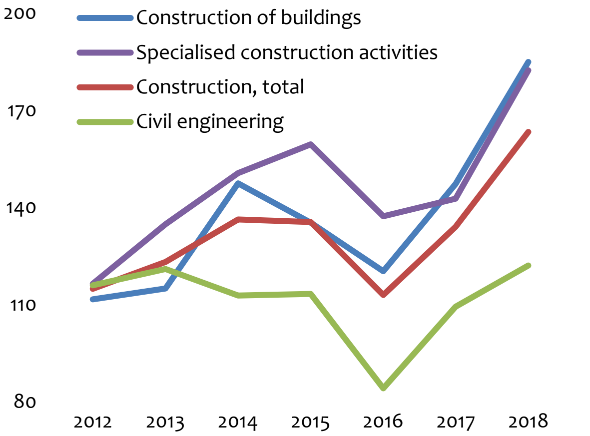
Other manufacturing (mining and quarrying, water supply, electricity, gas, and heat supply) dominate electricity and gas supply. In 2015-2017, rapid growth in other industry can be observed. Considering that the winter months of 2016-2017 were considerably colder, the amount of electricity and heat consumed rised. In 2017, the share of mining industry, driven by a significant increase in peat extraction, also increased. In 2018, however, the volume of other manufacturing declined due to warm weather conditions. The number of occupied posts continue to decline in water supply, waste management, and electricity and gas supply sectors.



CONSTRUCTION

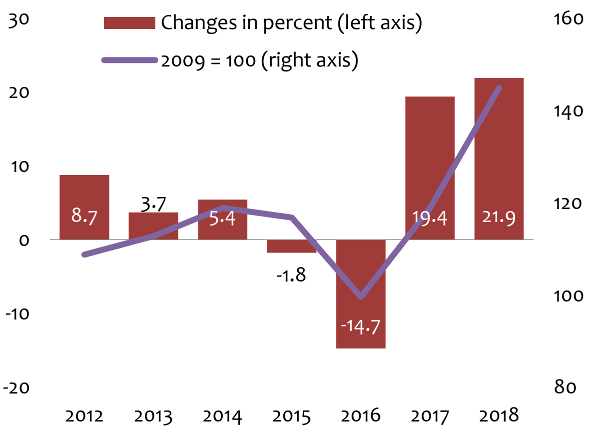
Development of the Construction Industry

2011 = 100



Construction is developing rapidly for the second consecutive year. The driving forces behind the development of the sector to a large extent are the implementation of EU structural fund projects and private investments. In 2018, construction volumes increased in all major construction sub-sectors. The fastest growth, however, was observed in building and specialized construction. Construction of both residential and non-residential buildings increased. The growth in non-residential buildings was driven by the construction of office buildings, wholesale, and retail buildings. The construction of engineering structures was largest amongst the construction of roads, streets, airfield runaways and tracks, trunk pipelines, mains, and power lines.

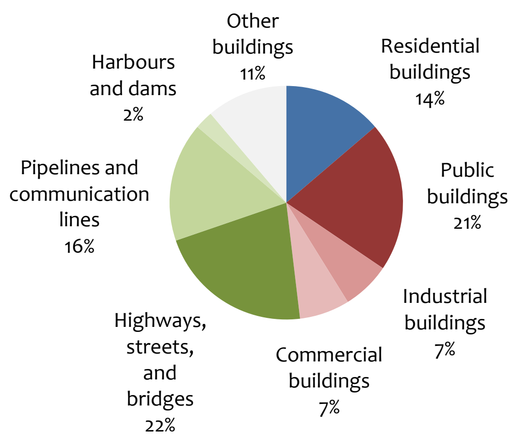
Construction



It is expected that in the near future the growth rates of the sector might slightly slow down. If the intensity of implementation of EU structural fund projects and private investments will remain high, the growth rates will stay relatively modest.

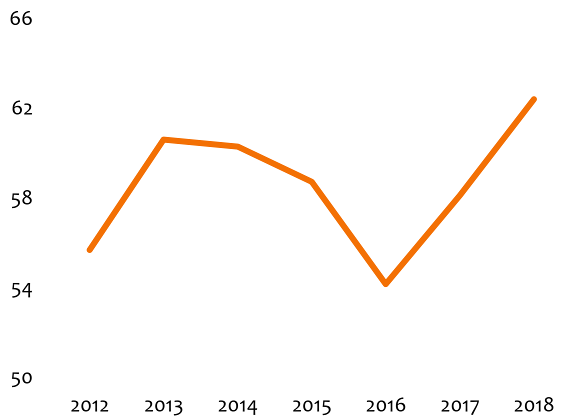
Structure of Construction Industry

2018, as per cent



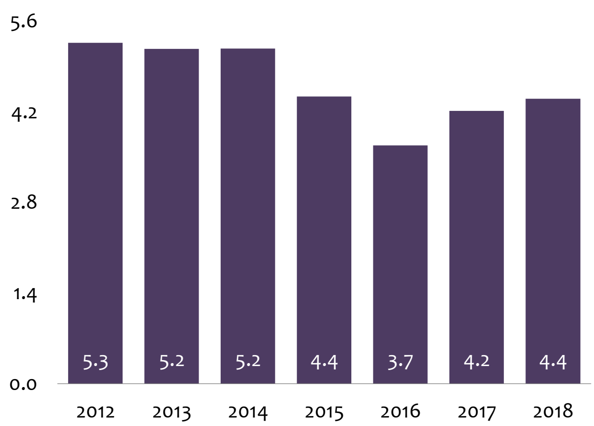
Occupied Posts in Construction

thousands



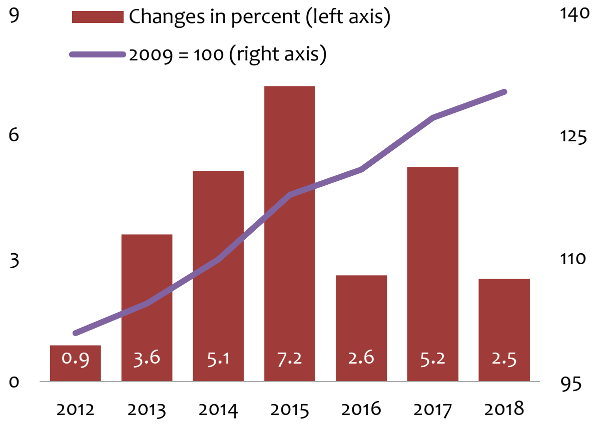
Number of Building Permits Granted

thousands



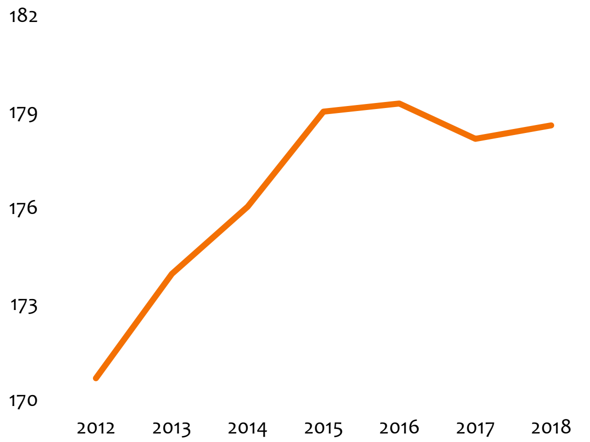
TRADE, ACCOMMODATION, AND CATERING

Trade, Accommodation, and Catering

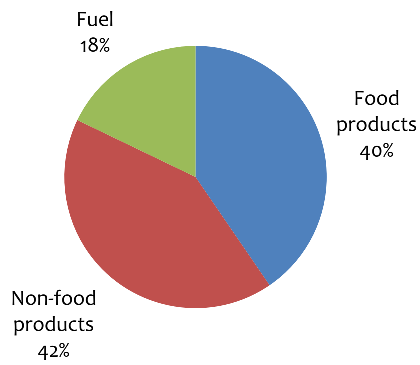


Trade, accommodation, and catering service volumes continue to increase. The trade sector is positively affected by the growth in private consumption, increasing wages, and improvements in the labour market. In 2017, it increased by 2.1%. In 2018, retail trade turnover grew by 3.8%. The largest growth was observed in the retail sales of food products. However, the wholesale trade turnover in 2018 remained close to the previous year's level. Accommodation and catering sector is positively affected by the development of the tourism sector. In 2018, the sub-sector grew by 5.1%. The largest share of occupied posts remains in trade; however, its share has recently started to decline – in turn, occupied posts now grow faster in trade and catering.

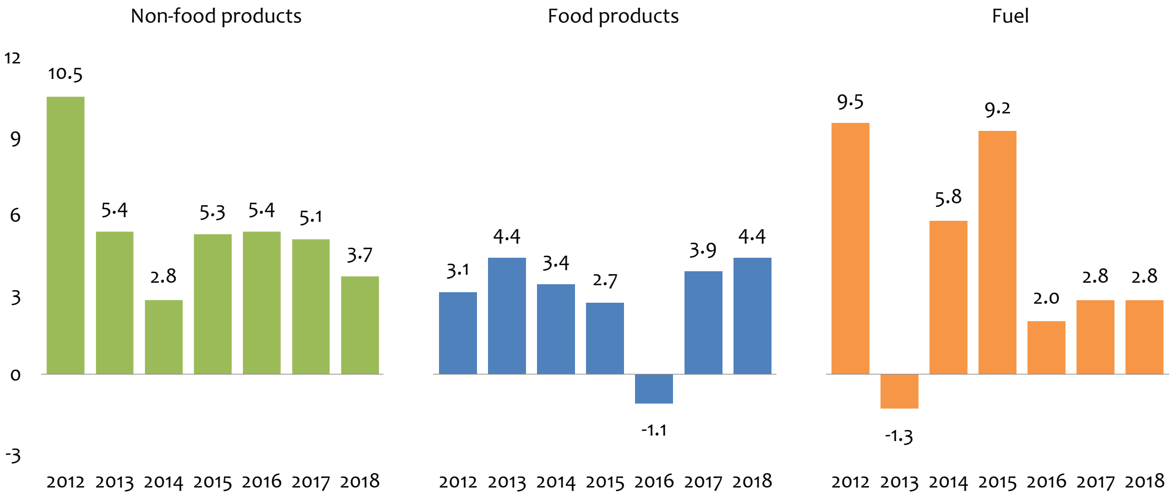
Occupied Posts in Trade, Accommodation, and Catering
thousands



Structure of Retail Trade Turnover
2018, as per cent

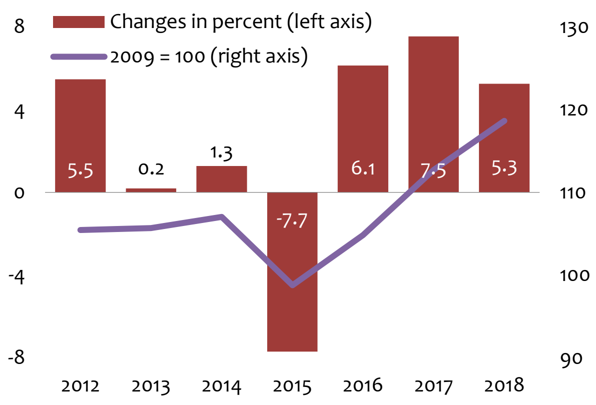


Retail Trade Turnover
changes in percent



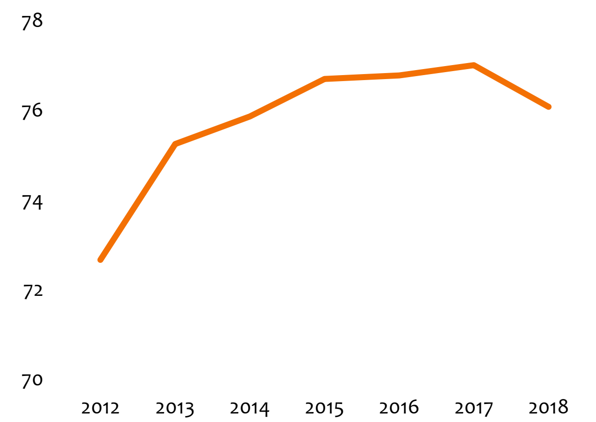
TRANSPORTATION AND STORAGE

Transportation and storage

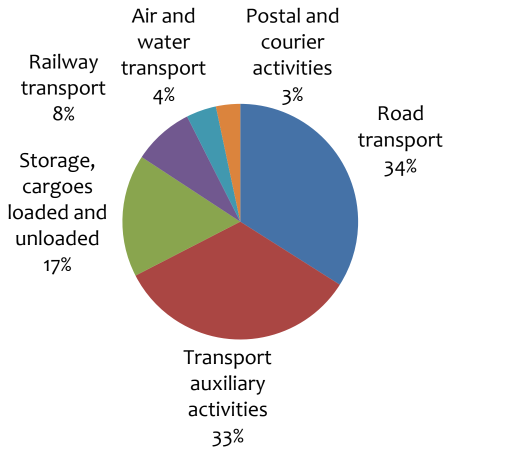


Transportation and storage is closely linked to international transport. After a sharp increase in the post-crisis period, the sector grew only by 1% on average over the period 2012-2017. The minor growth can mainly be attributed to the decline in transit freight traffic, mainly due to Russian transport policy and increasing competition. Since the end of the 1990s, Russia has set itself the target of developing its own transport infrastructure, thus ensuring its independence from transit countries. Despite the decline in transit freight by rail and at ports, the growth in recent years has been driven by road transport and the increase in the number of passegers at airports and seaports. In 2018, both passenger and freight transport increased for all modes of transportation. Passenger transport increased by 15%, freight traffic rose by 5%, postal and courier activities – by 18%, and transport auxiliary activities – by 2 per cent.

Occupied Posts in Transportation and Storage
thousands

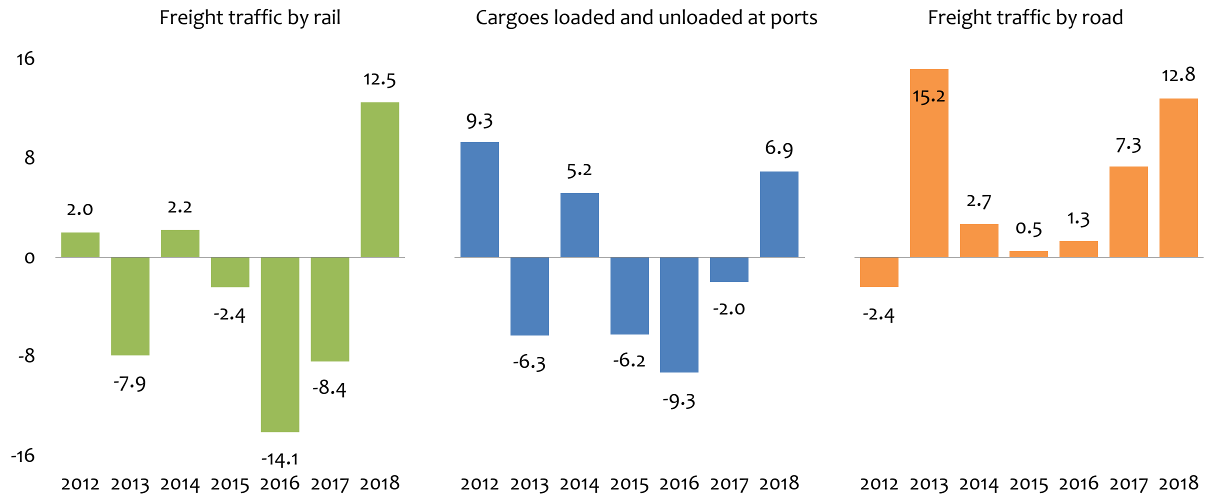


Structure of Transportation and Storage
2018, as per cent*



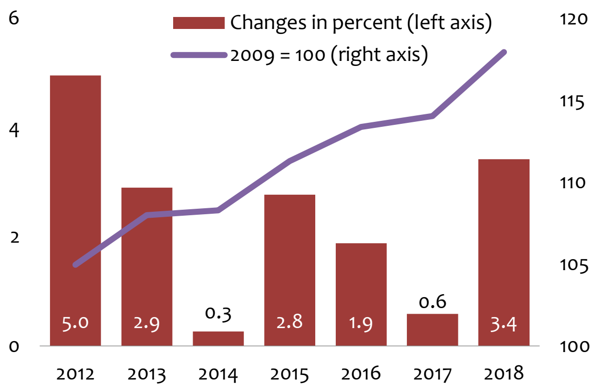
* – Estimate by the Ministry of Economics

Freight Traffic
changes as per cent



COMMERCIAL SERVICES

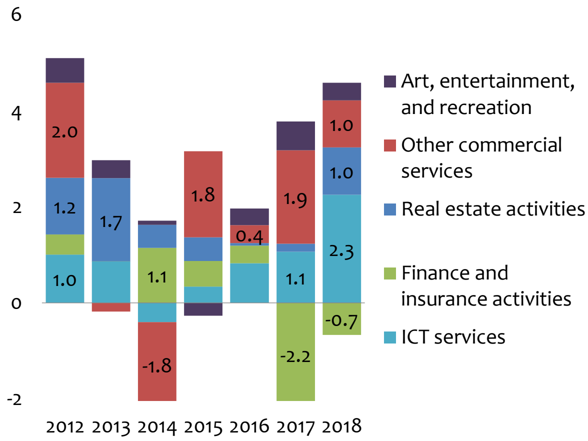
Commercial services



In the commercial services structure (ICT services, finance and insurance activities, real estate activites, professional, scientific, and technical services, administrative and support service activites, art, entertainment, and recreation) dominate real estate activities. In 2018, the volumes of services in these sectors grew faster than in 2017. The increase was mainly facilitated by the growth in the ICT sector. A significant growth was also observed in real estate activities, professional, scientific, and technical services, and administrative and support service activites.

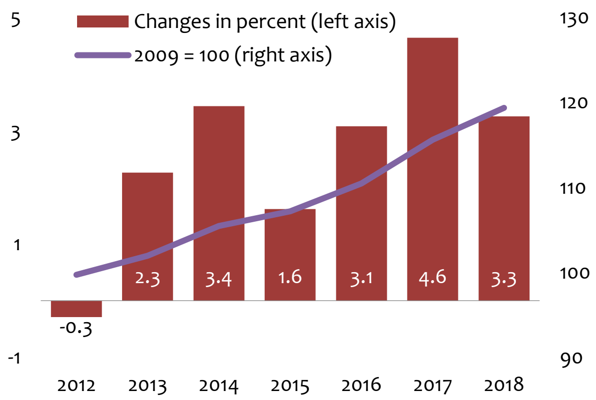
However, a decline was recorded in finance and insurance activities, which to a large extent was driven by the decrease in the non-resident business volume in Latvia, bank mergers and acquisitions, and the decline in the number of employed. The largest share of occupied posts can be observed in professional, scientific, and technical services, administrative and support service activities, and ICT services, where the number of occupied posts has increased most rapidly in recent years.

Contribution of Commercial Services Sectors
percentage points



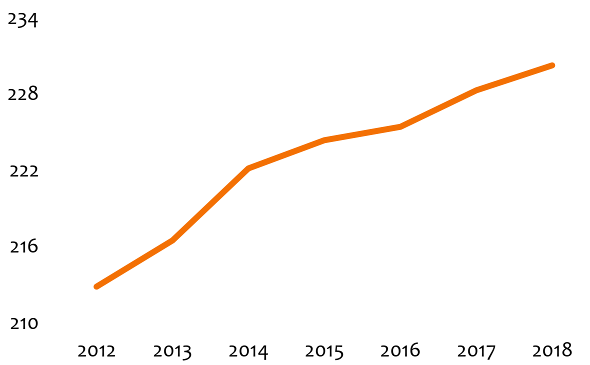
PUBLIC SERVICES

Public services



In the public services structure (public administration and defence, education, health and social care) dominate public administration and defence. Along with an increased government spending, public services sectors have experienced steady growth since 2013. In 2017, the largest growth since 2006 was observed. Also, in 2018, the sector continued to rapidly grow. In recent years, increased public consumption has been directed to defence, health, and education. The largest share of occupied posts is in education; however, the shares are quite similar in public administration and health and social care. The largest growth in occupied posts in recent years can be observed in health and social care. Moderate growth, on the other hand, can be recorded in public administration. However, a decline in occupied posts in 2018 was observed in education.

Occupied Posts in Public Services
thousands



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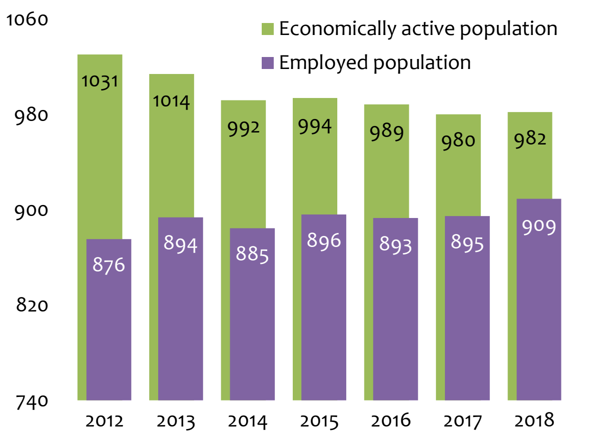
LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

As economic activity increases, the labour market situation continues to improve. A Major driver of the labour market in 2018 was the growth of occupied posts in the construction sector. At the same time, demand incentives continued to be shadowed by demographic trends. The decline in the working-age population has a negative impact on potential labour supply, which continues to lead to a sharp fall in unemployment. The average unemployment rate fell to 7.4% in 2018, the lowest rate in the last decade. In view of this, it has become increasingly difficult for companies to find the specialists they need, which is also reflected in the rapidly growing number of job vacancies in the labour market. The number of vacancies registered in 2018 has increased by more than 40%.

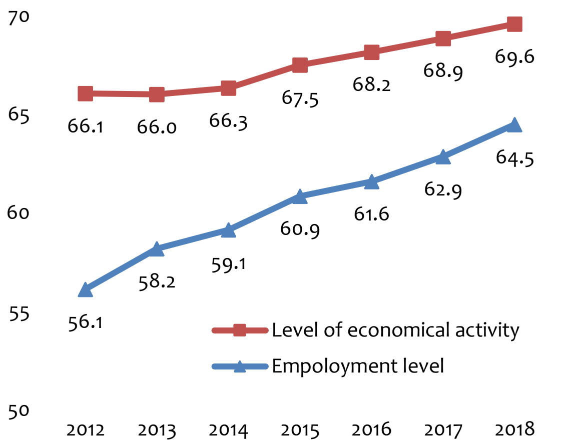
Number of Employed and Economically Active Population
aged 15-74, thousands



Economic growth positively impacts the employment as well as the dynamics of number of economically active employees. In 2018, the number of employed increased by 1.6% or 15 thsd, which was the largest growth in the last five years. Similarly, rapid growth has been observed in number of occupied posts – by 1.1% or 9.5 thsd. In 2018, the number of employed in construction sector increased by 18.2% or 11.5 thsd, which is around 80% from total growth in economy employed. In 2018, 909.4 thousand people from 15-74 years age were employed.

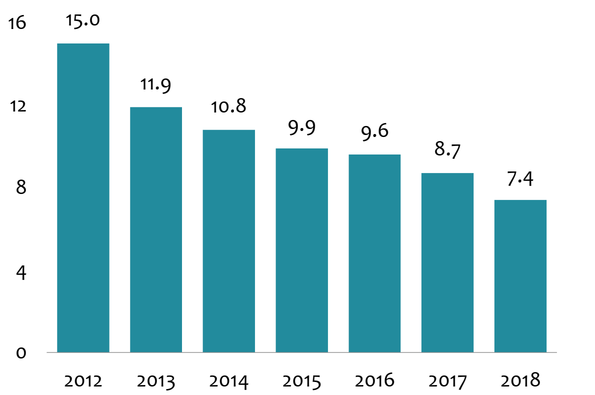
The number of employed is still under the pre-crisis level, although the share of the population in 2018 was 2.9 percentage points higher than in 2007. The employment rate reached 64.5% in 2018, which has been the historically highest in Latvia so far.

Employment and economic activity
aged 15-74, as per cent



The increase in employment has been driven largely by an increase in the economic activity of the population, driven by both increases in wages and job opportunities. It should be noted that the population of working age is still shrinking, which also affects the number of working arms available. In view of this, the involvement of different economically inactive groups in the labour market is of great importance to keep the labour supply at the current level. The number of economically active population increased by 1.9 thsd in 2018, while the economic activity of the population increased by 0.7 percentage points (to 69.6%).

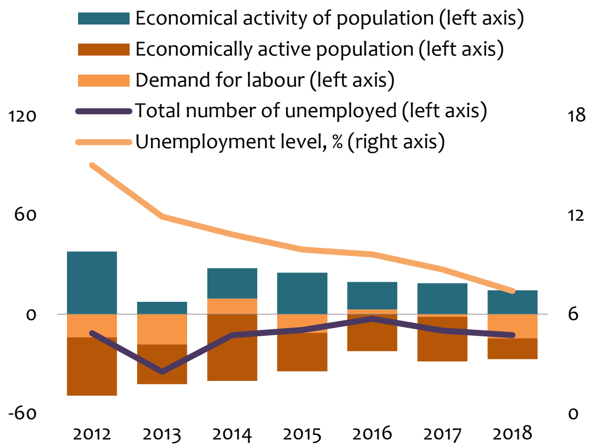
Unemployment Rate
aged 15-74, as per cent



The most significant constraint on the increasing numbers of employed and economically active population is the adverse demographic situation. The population in the age group 15-74 decreased by 12.5 thousand, or 0.9%, last year, compared to 2017.

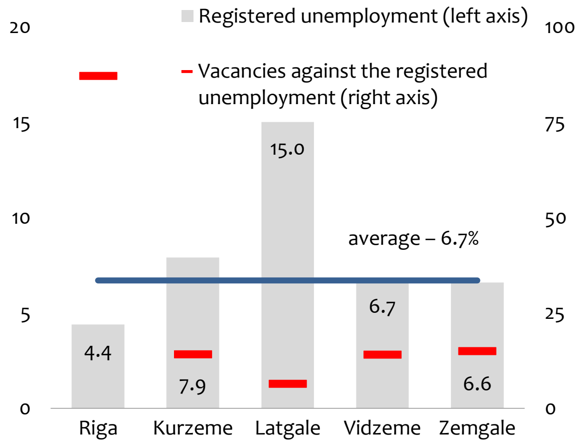
Along with an increase in employment, unemployment continues to decline. Adverse demographic trends as well as increased labour demand have a great impact on labour access in the labour market. The unemployment rate declined to an average of 7.4% in 2018, but was 6.9% in the last quarter of 2018, getting closer to the level of 2006/2007. Overall, the number of unemployed decreased to 72.8 thousand in 2018, almost 13 thousand less than a year earlier.

Bezdarbs un to ietekmējošiem faktori
izmaiņas tūkstošos pret iepriekšējo gadu



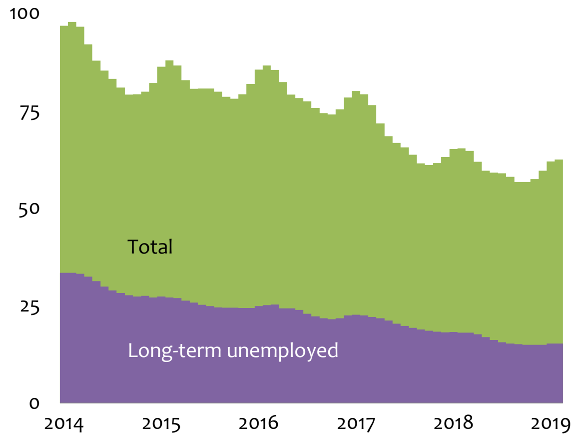
The unemployment rate decline in 2018 was mainly driven by the increasing labor demand. As a result, more job seekers were involved in employment. In addition to demand factors, demographic trends are also very crucial – a decline in the number of working people and changes in the population age structure.

Registered Unemployment by Regions
end of January 2019, as per cent



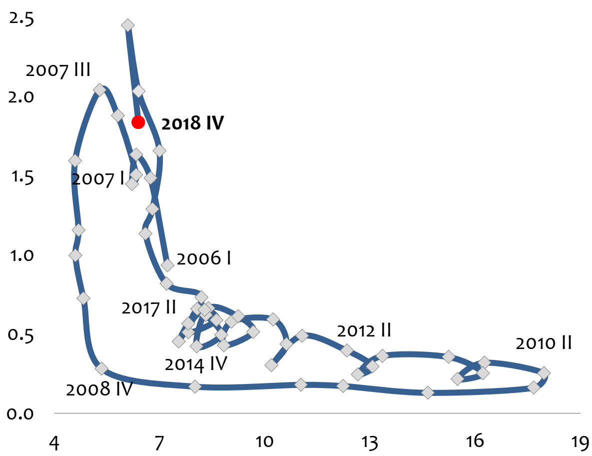
Unemployment in Latvia remains significantly higher than in neighbouring countries. In Estonia, the unemployment rate was 5.4% in 2018 and 6.2% in Lithuania. The decline in unemployment is to be hampered by regional labour market disparities – the unemployment rate in Latgale is more than 3 times higher than in the Riga region, which, along with the low geographical mobility of the labour force, increases the risks of structural unemployment.

Number of Registered Unemployed Persons
thousands



The relatively high proportion of long-term unemployed people also poses risks: around ¼ of registered job seekers remain unemployed for more than a year.

Beveridge Curve
by quarters, as per cent
vertical axis – number of vacancies per economically active person; horizontal axis – unemployment level



High long-term unemployment can lead to an increase in structural unemployment, namely the longer these people are unemployed, the higher the risk of losing their skills. Moreover, there is a risk that some of the unemployed people in the future may have problems finding jobs that match their skills, because they may not match what the market demands.

Structural problems in the labour market are also indicated by the shift of the Beveridge curve to the right – despite the increase in vacancies, the share of job sekers in the labour market remained high. The number of registered vacancies was up 42% at the end of 2018, higher than a year ago. At the same time, the registered unemployment rate has decreased by only 0.4 percentage points over the period considered.

The largest increase in workplaces was observed in construction and ICT services. More than 2/3 from total occupied posts in 2018 was provided by two sectors – construction and ICT services. The number of workplaces in construction increased by 7.4% in 2018. The number of workplaces in construction in 2018 reached 62.4 thousand.

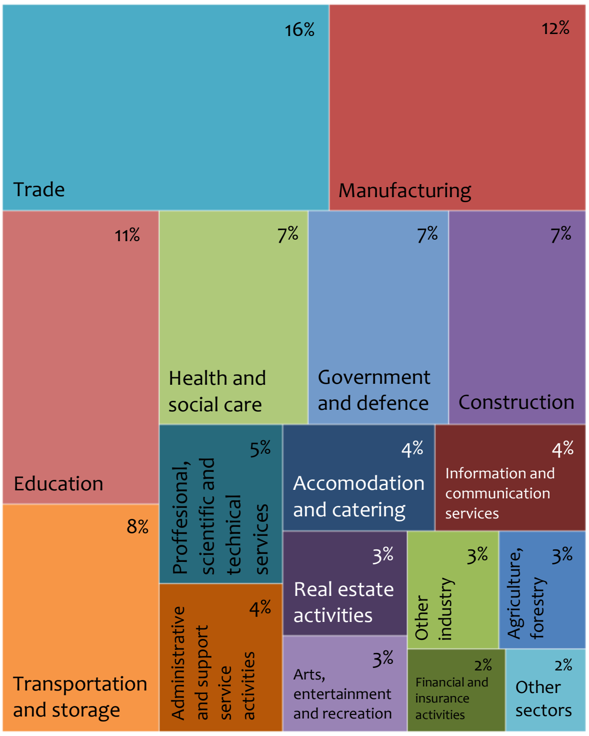
Similarly, a significant increase in labour demand was observed in ITC services, where the number of jobs occupied increased by 2.3 thousand in 2018. The number of occupied posts increased due to increased labour demand in computer programming, professional, scientific, and technical services.

The largest decline in the number of occupied posts was in the commercial sector – by around 1300 jobs or 0.9%, while the most significant job cuts were in financial and insurance services – by over 800 jobs or 4.6 per cent.

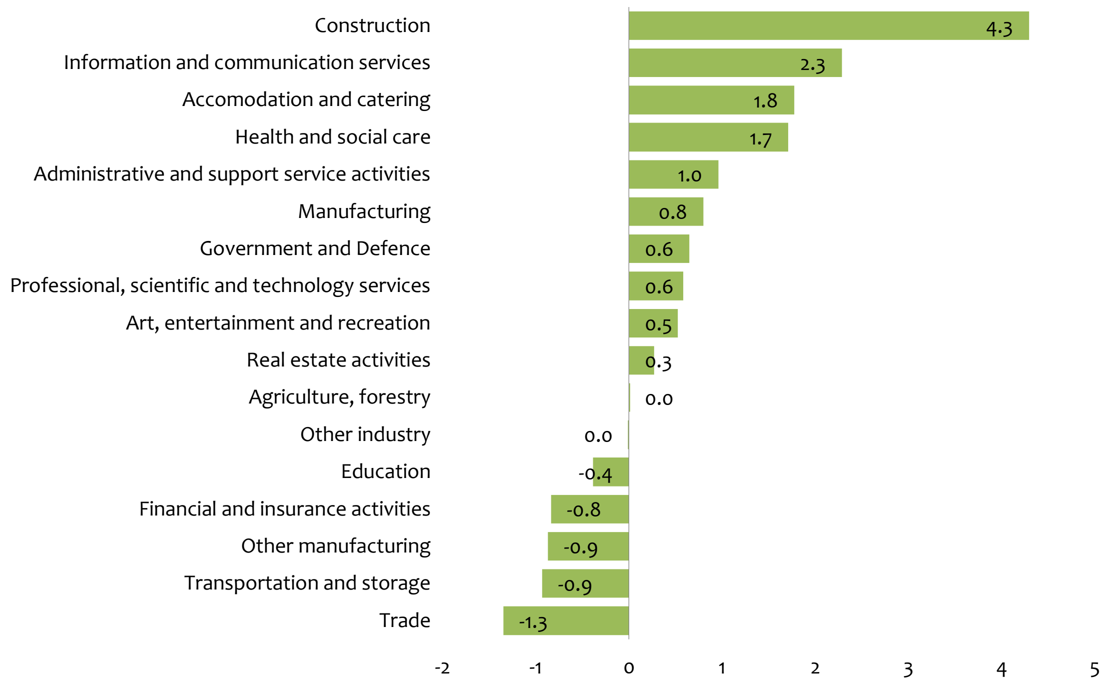
The number of occupied posts continue to increase in private sector. After a decrease in the crisis period by 30%, from 2010 the number of occupied posts in private sector has increased by almost one fourth.

At the same time, relatively slow increase in occupied posts has been observed in public sector, where occupied posts in the period have went up by only 0.3%. A larger increase in public sector was in 2014, when it grew by 1.5%, compared to 2013.

Structure of Occupied Posts by Sector
2018, as per cent



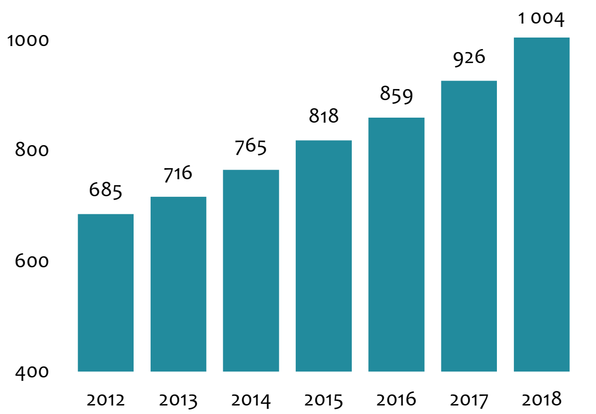
Changes in Occupied posts by Industries
2018, changes in thousands



WAGES AND SALARIES

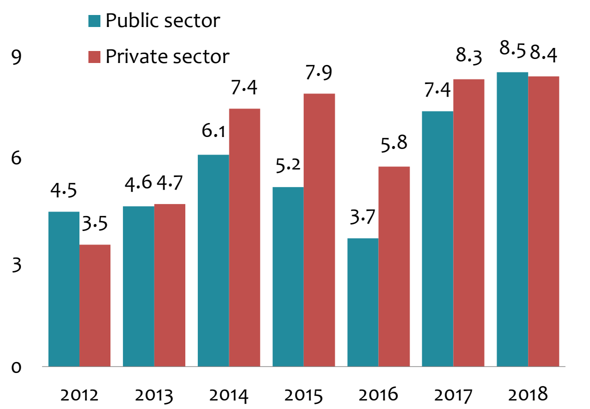
Along with several improvements in the labor market from the end of 2010, wages have increased. Although unemployment remains relatively high, in economically active regions more and more sensible is the lack of working hands, which keeps pressure on the wages.

Average Monthly Gross Wages
euro



Wage increase in the last four years remains above 5% annually. Average gross wage in 2018 increased by 8.4%, reaching 1 004 euro.

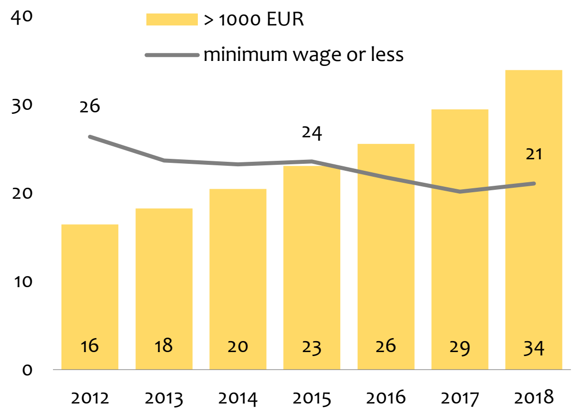
Changes in Average Monthly Gross Wages
changes as per cent



Since 2010, wages have risen in private and public sector. At the same time, increase in private sector in the last years has been significantly larger. It is largely correlated with the different dynamics of labour demand across different sectors. In private sector number of occupied posts from 2011 has risen by more than 18%, but in public sector – just by 1.6 per cent.

In 2018, more than 90 million euro of the budget was redirected to increase wages for medical staff, which was reflected in the overall wage rise in the sector. The average bruto salary increase was almost 16%.

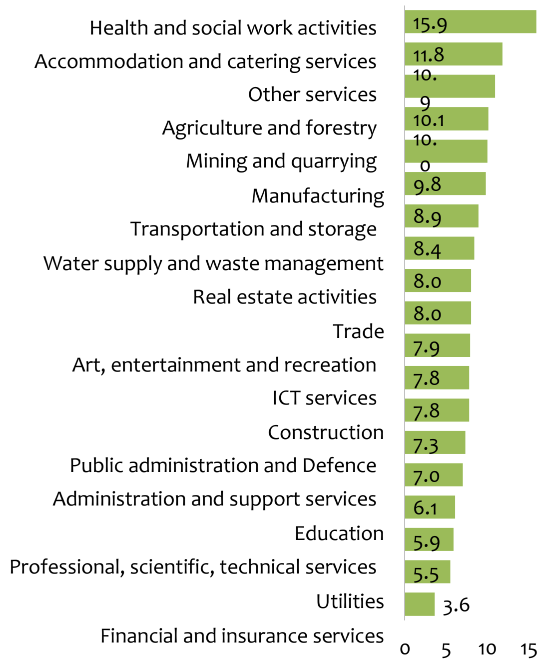
Distribution of Employed by Gross Wages
as per cent of total number of employed



In recent years, the number of people, who receive minimal salary, have slighlt declined. At the same time, the number of employees who receive a salary larger than EUR 1000 a month has increased. In 2018, around 1/3 of all employed with received a salary larget than EUR 1000.

In 2018, salary increased in all key sectors of the economy, but different dynamics, however, was observed. The largest salary increase was observed in health and social care activities. A lackluster wage increase was observed in finance sector – in 2018 the increase was only 3.6%. Despite the low increase, the average salary in the sector was almost two times larger than the average in the economy.

Changes in Gross Wages by Industry
2018, as per cent



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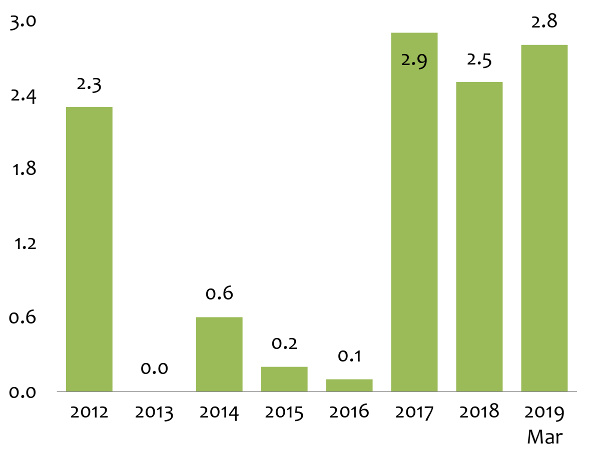
ECONOMICAL STABILITY AND COMPETITIVENESS

PRICES

In 2017, one of the largest price increases in recent years was observed. Consumer prices rose by 2.6% and annual average inflation was 2.5%. Consumer price level was mainly affected by rising world prices for oil and increase in price of services.

In the first two month of 2019, the price increase was larger than in the corresponding period last year. Consumer prices in 2019 February, compared with 2018 December, increased by 0.5%. When compared to February 2018, consumer prices rose by 2.9%. Average annual inflation in February was 2.7%.

Consumer price changes
annual average, as per cent



The main factors affecting the price level in 2018:

(1) price increase for services – the largest price rise was observed for housing-related services (rent, watter supply, and waste collection (due to the increase of natural resources tax rate)), catering, health and social care, and recreation and culture;

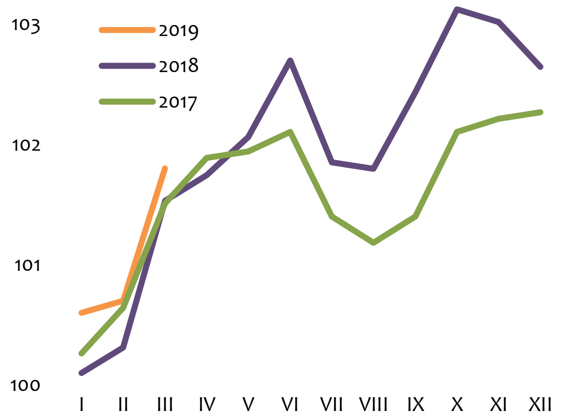
(2) price rise for automative fuel, excise tax increase, and rising world prices for oil. Overall, world prices for oil in 2018 on average increased by 30%. This increase can mainly be explained by the preservation of oil production limits and the increased demand for oil due to several geopolitical events and growing trade tensions;

(3) price increase for alcoholic beverages due to rise in excise tax;

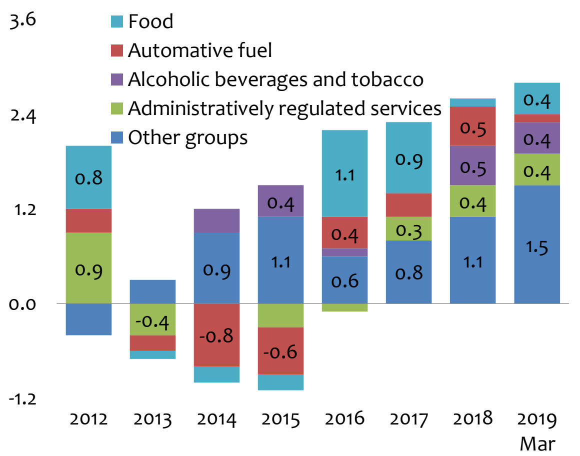
(4) price rise for gas (due to increased price for natural gas) and solid fuels; however, the price declined for electricity due to the changed mandatory procurement component (MPC);

(5) price decline for food due to the reduction of VAT and dynamics of food prices around the world. Bread and cereals had the largest increasing effect, while sugar and fruit - declining. Global food prices fell 4%. They declined in all major food groups excluding cereals.

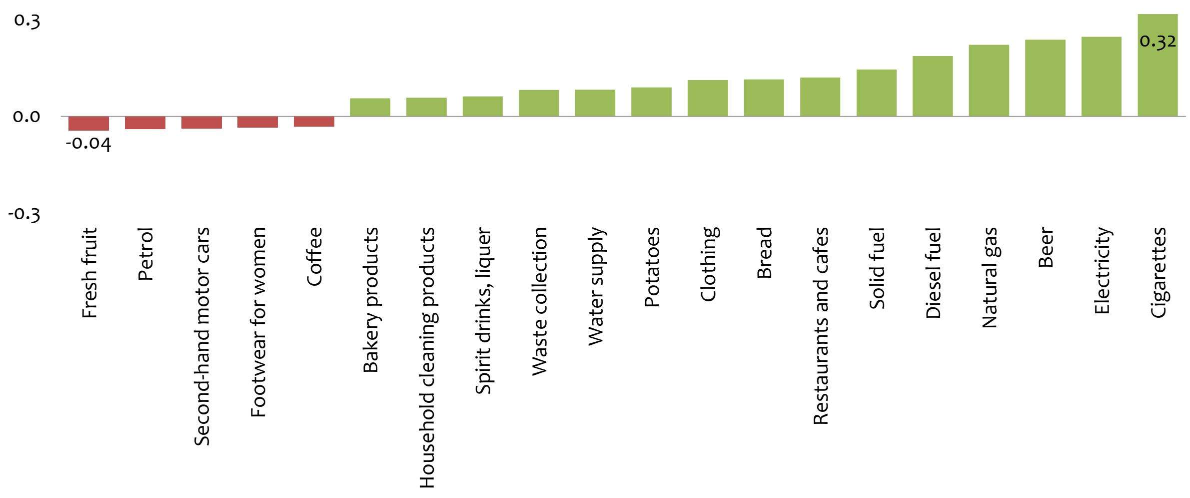
Consumer Price Index
December of previous year = 100



Consumer Prices for Goods and Services
12-month changes, as per cent



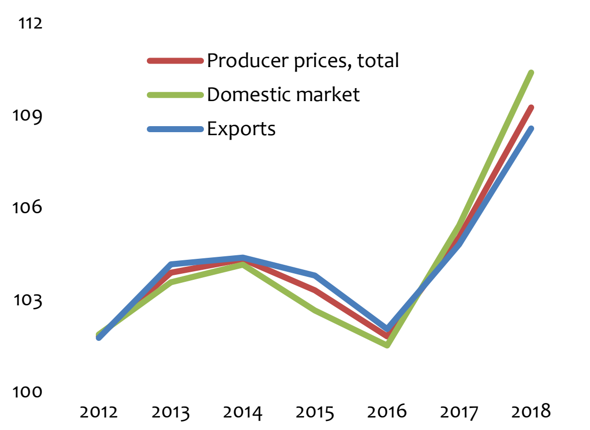
Goods and Services with The Largest Impact on Consumer Price Changes
12-month changes, March 2019, percentage points



Overall, the average annual inflation in 2019 might be a bit higher than observed in 2018. It will continue to be influenced by a variety of supply-side factors in terms of tax and tariff increases, as well as by the demand side, driven by increases in economic activity and pay increases. At the same time, inflation will still depend heavily on fluctuations in global oil and food prices.

Producer prices continued to rise sharply in 2018, with producer prices in the manufacturing industry experiencing the largest rise since 2011 in 2018.

Producer Prices in Manufacturing
2011 = 100

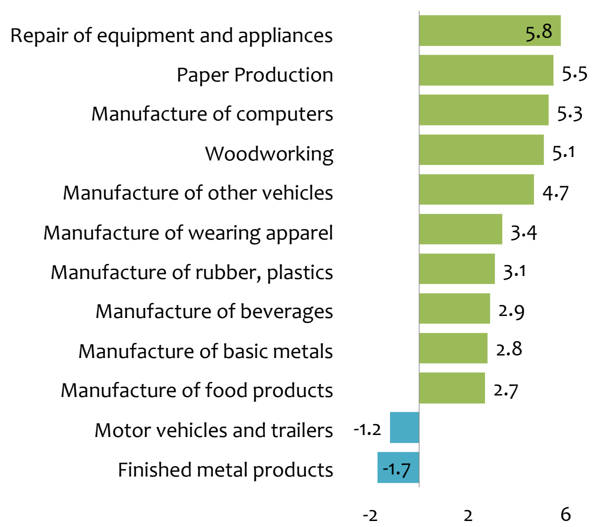


In 2018, producer prices in manufacturing grew more rapidly for domestically marketed products, affected by domestic demand and increased growth rates. The most important price increases were in woodworking, but the smallest effect was in the production of electrical equipment.

In 2019, there was a significantly slower increases in producer prices in the manufacturing industry. In the two months of 2019, producer prices in the manufacturing industry remained stable, compared to December 2018.

In 2019, producer prices of the manufacturing industry increased more slowly than in 2018. The level of producer prices is largely influenced by the price volatility of exported products, which are based on the dynamics of world raw material prices. It should be noted that at the end of 2018 world energy and raw material prices experienced a fall. At the same time, the increase in producer prices will continue to be influenced by the growth rates for domestic products.

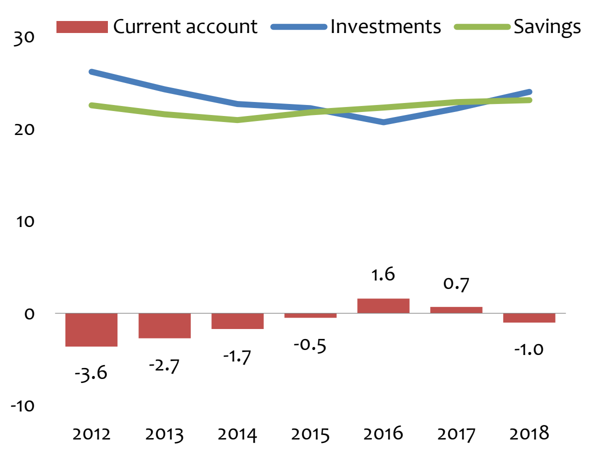
The Largest Producer Price Changes
in Manufacturing Sub-sectors at February 2019
against the corresponding period of previous year, as per cent



BALANCE OF PAYMENTS

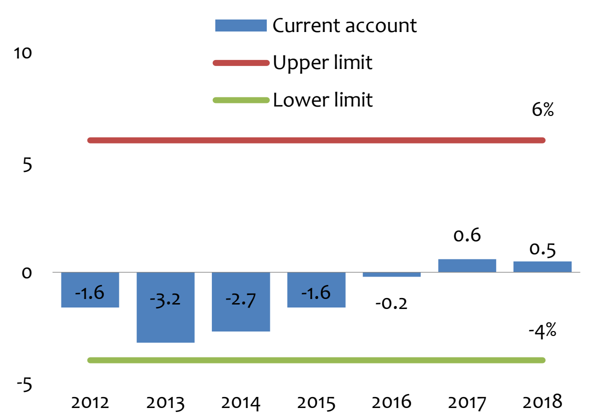
The current account of the balance of payments is close to the balance. From 2010-2018, on average, the current account had a small deficit of 0.9% of GDP, showing a balance between stocks and domestic investment. The annual fluctuation of the current account is very minor. In 2018, the current account deficit was 1% of GDP. This does not exceed the indicative thresholds set out in the EU Alert Mechanism and is considered to be sustainable.

Current Account Balance, Investments, and Savings
per cent of GDP



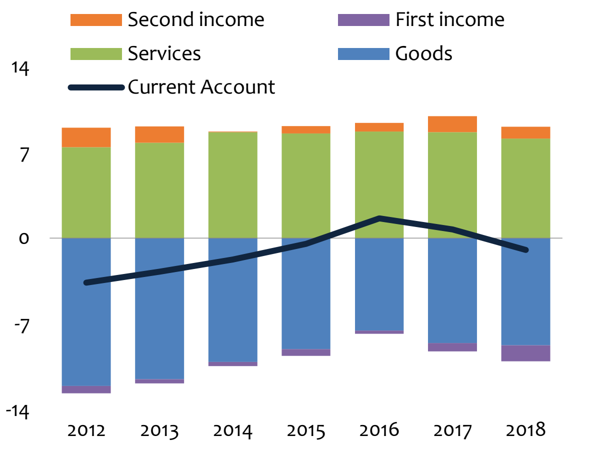
The fluctuations in the current account balance are mainly determined by the foreign trade balance. In Latvia, foreign trade deficit prevails. For example, in 2007, it reached 22.8% of GDP. However, during the recession, the foreign trade deficit decreased due to the cyclical adjustment and the significant drop in imports.

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



In the last three years, the foreign trade deficit on average was 8.3% of GDP. In 2018, it reached 8.7% of GDP and was by almost 0.2 percentage points higher than a year ago. The increase in trade deficits was largely driven by an increase in imports of goods, with increased domestic investment and household consumption.

Current Account
per cent of GDP



Currently, the service balance is positive – in the last three years, it has on average been 8.5% of GDP, and has almost covered the foreign trade deficit. In 2018, exports and imports of services at current prices were by 6.4% and 9.8% higher than a year ago. The balance of services surplus reached 8.1% of GDP (in 2017, it amounted to 8.6% of GDP). The decrease in the balance of services surplus to a large extent was influenced by the increase in imports of transport services, computer and information services, as well as increase in imported services of other economic activities.

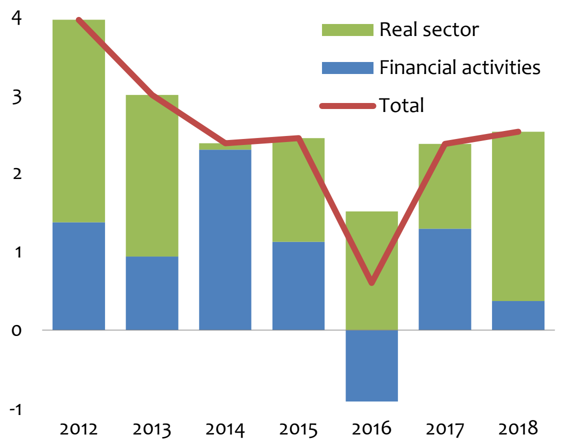
Changes in income and capital accounts are mainly related to changes in the absorption activities of EU funds. The capital account balance surplus averaged 1.2% of GDP over the last three years, including in 2018 the capital account surplus reached 1.8% of GDP and was almost 1 percentage point higher than a year ago.

The state of the balance sheet of the financial account was mainly affected by the public sector in recent years, e.g., financial sector stabilization measures, public sector debt restructuring measures within the framework of the Bank of Latvia's extended asset purchase programme. The fluctuations in the financial account were also affected by the decrease in deposits of non-residents in Latvian credit institutions. In 2018, financial account assets in general decreased less than liabilities, and financial account balances (without reserve assets) were positive – 0.6% of GDP.

FOREIGN DIRECT INVESTMENT

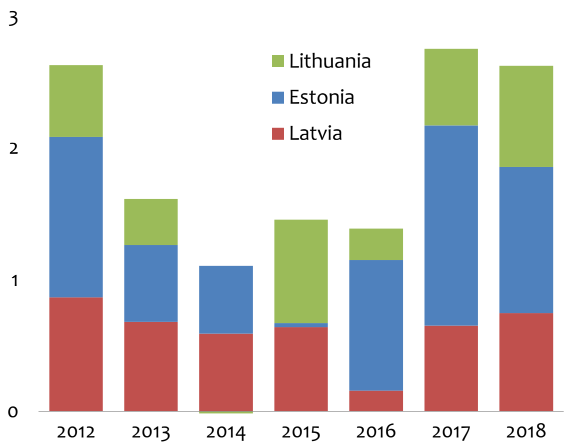
FDI flows in the Latvian economy continue to increase; however, FDI remain below the pre-crisis level. It can be explained by the instability in the world economy and growing geopolitical risks.

FDI in Latvia
flows, % of GDP



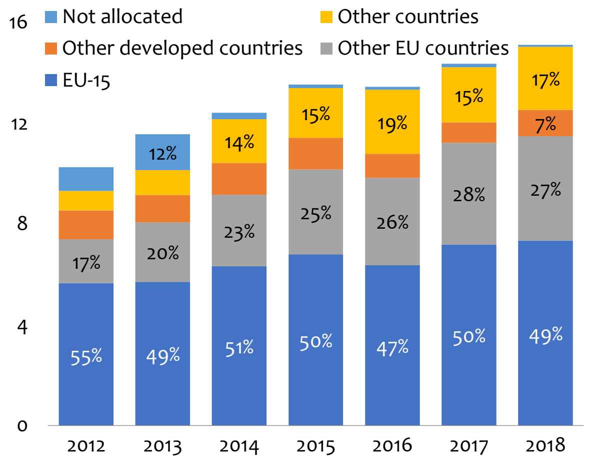
In 2018, the volume of FDI in Latvia increased by 16.3%, compared to the previous year, and reached a level of 2.5% of GDP. Significant FDI flows were carried out in real estate, commercial, and manufacturing sectors. FDI flows in financial intermediation declined. Total net flows of FDI in the Baltic States in 2018 amounted to 2.5 billion euros, almost 5% less than a year ago. Latvia attracted 28.4% of all FDI in the Baltic States, Estonia – 42.3% and Lithuania – 29.3 per cent.

FDI in the Baltic States
flows, billion euro



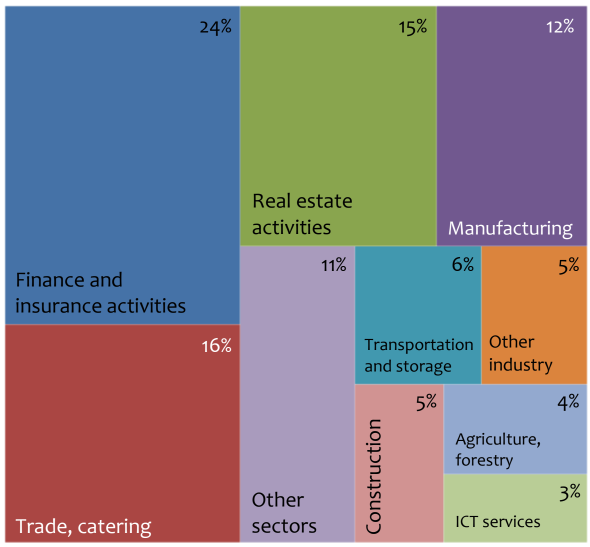
At the end of June 2018, the accumulated FDI in the Latvian economy amounted to 15.1 billion euros (51.2 % of GDP). During the year, the accumulated FDI increased by 5.2%. Currently, the largest investor in the Latvian economy is Sweden. At the end of 2018, Swedish entrepreneurs' investments accounted for 17.5% of the total accumulated FDI in Latvia. Mostly these include investments in financial intermediation. Investors from the Netherlands, Cyprus, Germany, Norway, Russia, Estonia, Lithuania, Denmark, and Luxembourg also form large share of the total accumulated FDI in Latvia. At the end of 2018, these country investments accounted for almost 80% of the total accumulated FDI in Latvia.

FDI Stock in Latvia by Country
balances at the end of the period, billion euro and per cent



In the sectoral structure, the share of accumulated FDI is higher for investments in financial intermediation (24% of total accumulated FDI), trade (16%), real estate activities (15%), and manufacturing (12%).

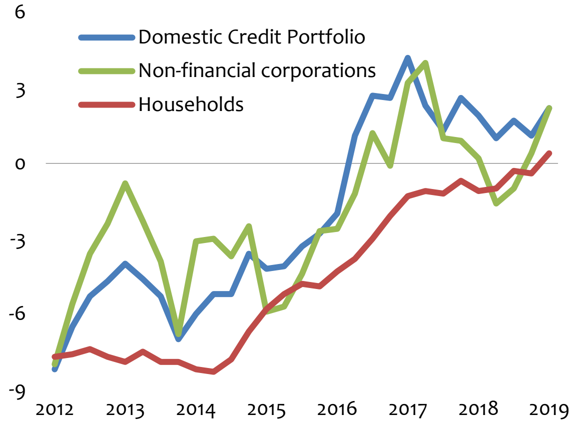
ĀTI pa nozarēm
atlikumi 2018.gada beigās



MONETARY INDICATORS

Following the turmoil of the financial market at the end of 2008 and early 2009, Latvia's monetary indicators are gradually stabilizing. Lending has moderated in recent years.

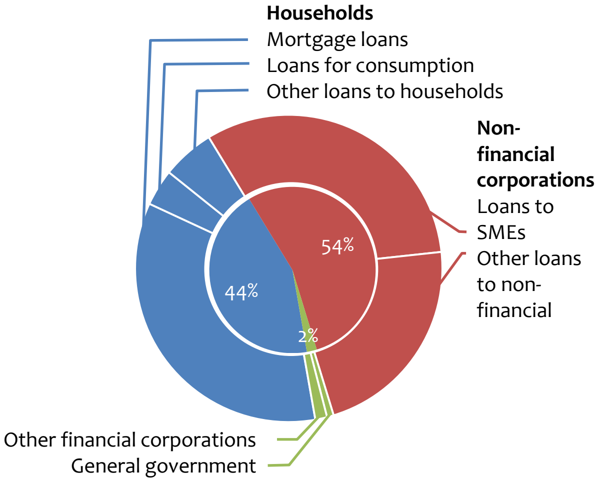
Dynamics of domestic credit balances*
as per cent



* – excluding one-off effects due to structural changes in the banking sector
Source: Bank of Latvia

The domestic credit portfolio is still developing slowly. In December 2018, compared to December 2017, domestic credit portfolio grew by only 1.6%. The credit portfolio of private non-financial corporations increased by 0.9%. Corporate lending is largely affected by the availability of co-finnacing from EU funds. There is also no significant change in household lending (0.1% increase in December 2018).

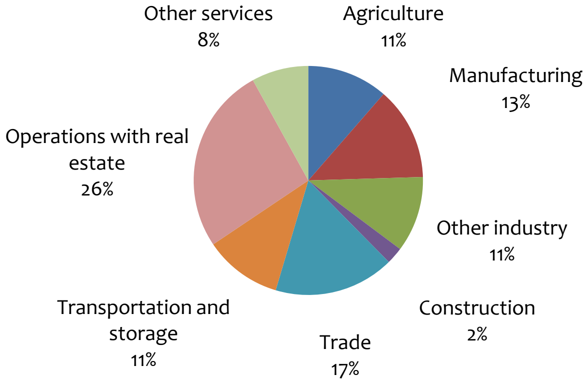
Loan portfolio of resident non-bank clients
at the end of 2018, as per cent



Source: FCMC

By sectors of the economy, at the end of 2018 the most credits were in real estate operations (26% of total loans), in the area of trade and accomodation (17%) and in the manufacturing (10%).

Sectoral Structure of Granted Loans
at the end of 2018, as per cent

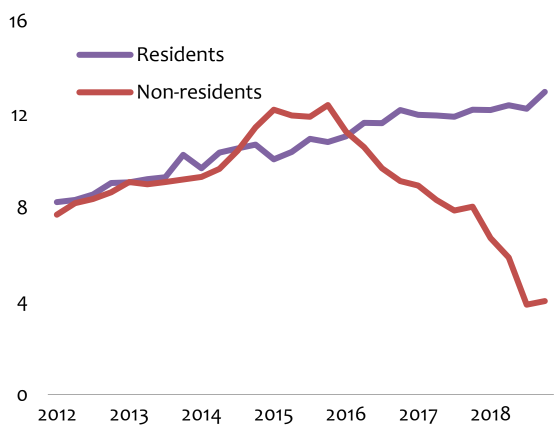


Source: FCMC

Since 2016, the interest rates on loans granted to non-financial corporations in euro (outstanding amounts) are relatively stable – in December 2018 for long-term loans the interest rates reached 2.24%. However, for short-term loans the interest rates increased to 2.79 per cent.

In 2018, the volumes of deposits continue to decline. The decline can mainly be explained by the decrease of non-resident deposits. In the fourth quarter of 2018, the volumes of non-resident deposits were by 70% lower than in 2015 and constituted 24% of all the nonbank deposits (for a comparison, in the fourth quarter of 2015 the share was 53%). Banks working with non-resident deposits are subject to higher claims on liquidity and capital adequacy.

Non-bank Deposits in Banks
billion euro



Source: FCMC

GENERAL BUDGET AND GOVERNMENT DEBT

Since 2011, when Latvia returned to economic growth, significant improvements in the fiscal position have been achieved. The general government budget deficit in accordance with the European System of Accounts has been reduced from 9.1% of GDP in 2009 to approximately 1.2-1.5% of GDP in 2013-2015. In 2016, for the first time since 1998, the budget had a surplus of 0.1% of GDP. In 2017, however, a small budget deficit of 155.7 million euros, or 0.6% of GDP, was observed.

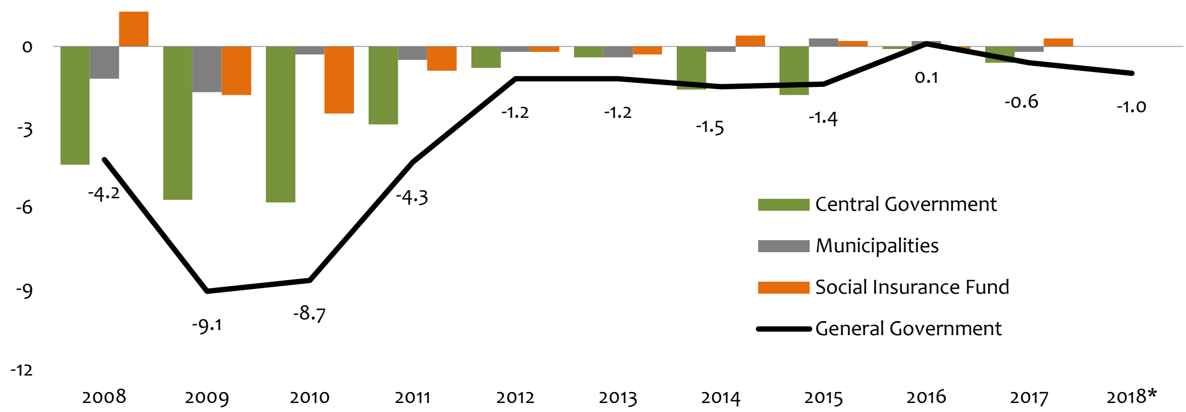
According to estimations by Ministry of Economics, in 2018 the government budget deficit was as planned – around 1 per cent.

In accordance to Cabinet of Ministers approved budget plan for 2019, the government deficit is planned to be reduced to 0.5% of GDP. In 2019, a fiscal margin of 0.1% of GDP is planned.

General Government Budget

	2013	2014	2015	2016	2017
Revenues, bln euro	8.3	8.6	9.0	9.3	10.1
% of GDP	36.6	36.6	36.9	37.0	37.2
Expenditures, bln euro	8.6	9.0	9.3	9.3	10.2
% of GDP	37.7	38.1	38.2	37.0	37.7
Balance, bln euro	-0.3	-0.4	-0.3	0.02	-0.1
% of GDP	-1.2	-1.5	-1.4	0.1	-0.6

General Government Budget Balance by Sub-sector
as per cent of GDP

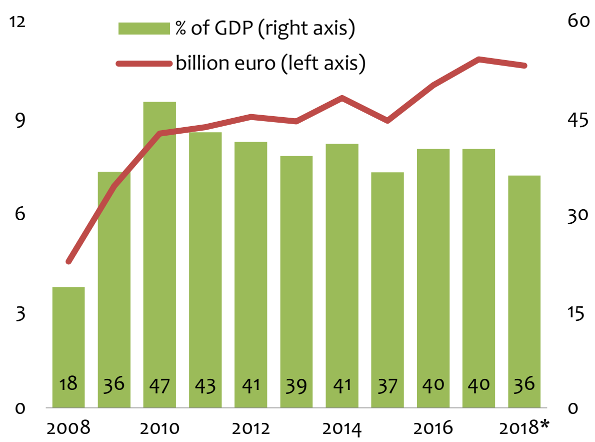


* estimation of Ministry of Economics

General government debt in Latvia is one of the lowest in the EU. Until 2007, general government debt in Latvia increased moderately. Since 2008, however, to finance state financial obligations, general government debt has risen more rapidly, thus at the end of 2010 reaching 8.4 billion euro, or 46.8% of GDP. Since the end of 2011, general government debt has gradually started to decline. According to measurement of Ministry of Economics it was 36% of GDP.

By timely applying borrowing events in line with the medium-term strategy and by pursuing a sustainable fiscal policy, it is possible, on rates and maturity-friendly terms, to refinance current central government debt obligations, and to achieve a long-term reduction and stabilisation of general government debt levels at sustainable level, with a strong respect for the Maastricht Treaty – the benchmark for the size of government debt.

General Government Consolidated Gross Debt
by nominal value at the end of the year



* estimation of Ministry of Economics

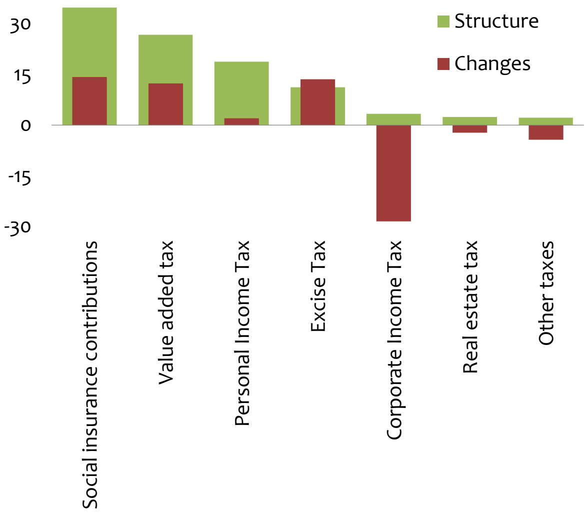
BUDGET REVENUES AND EXPENDITURES

In 2018, revenues and expenses of the state's consolidated budget are rising sharply. Compared to 2017, revenues increased by 13.1% and amounted to EUR 10.9 billion. Revenue from both consumption tax and resources and employment taxes increased.

Increase in employment tax revenues was driven by increased employment and wages, as well as by higher minimum wage. Employment taxes represent a little over half of all tax revenue.

Tax Revenues

Structure and changes in 2018, as per cent



Capital-tax revenue declined in 2018. Real estate tax revenue decreased by 2.2%, while corporate income tax revenue decreased by 28.6%, compared to 2017.

Consolidated General Government Budget

	billion euro			changes as per cent
	2016	2017	2018	2018
Revenues, including:	9.1	9.6	10.9	13.1
Indirect taxes, including:	7.8	8.5	9.2	8.2
Value added tax	2.5	2.8	3.2	14.3
Excise tax	2.0	2.2	2.5	12.3
Personal income tax and real estate tax, including	1.1	1.1	1.2	2.0
Corporate income tax	0.4	0.4	0.3	-28.6
Personal income tax	0.9	0.9	1.0	13.5
Social insurance contributions	0.2	0.2	0.2	-2.2
Other taxes	0.3	0.3	0.3	-9.5
Other revenues	1.2	1.1	1.7	55.1
Expenditures	9.2	9.8	11.1	12.7

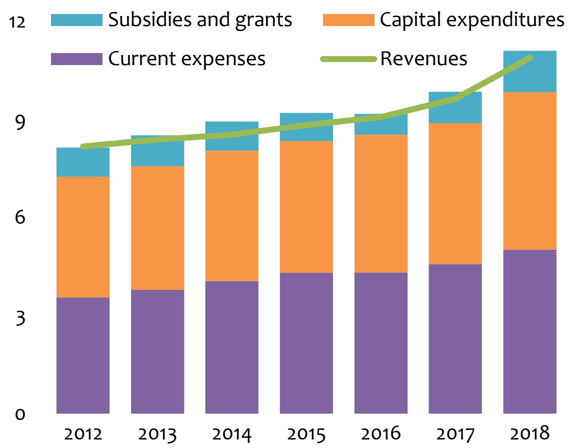
Indirect tax revenue also increased by 12.7% in 2018. The most significant contribution to this group was for revenue from value added tax.

The general government's budget expenditure in 2018 amounted to EUR 11.1 billion, which is 12.7% more than in 2017.

Budget expenditure in line with economic categories increased in 2018 for subsidies and grants by 12.3% and current expenditure by 9.9%. Capital expenditure increased significantly – by 30.7 per cent.

Consolidated General Government Budget by Category

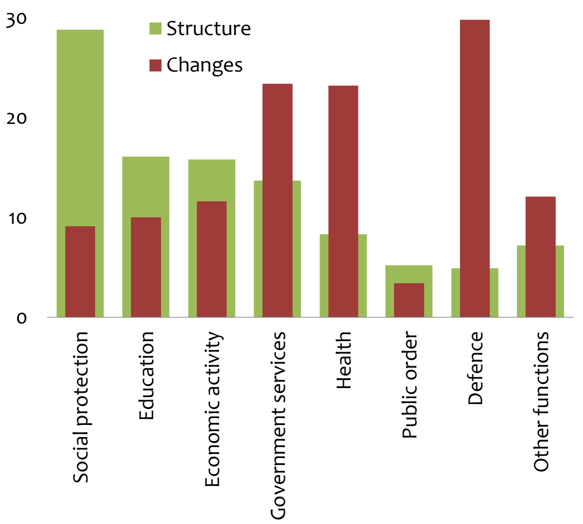
billion euro



Budget expenditure by functional category increased in 2018 in all categories, but more rapidly for defence, general government services and health.

Consolidated General Government Budget Expenditures

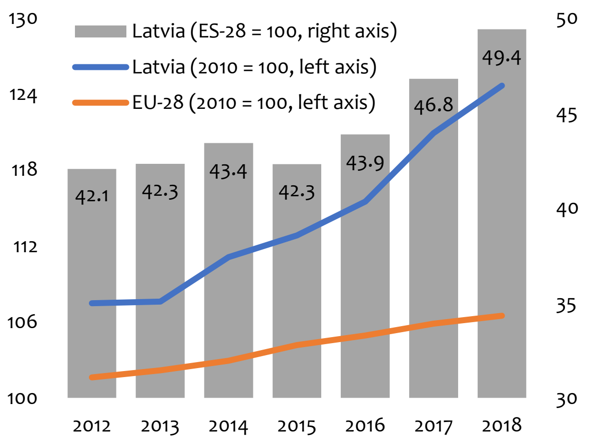
Structure and changes in 2018, as per cent



PRODUCTIVITY AND COMPETITIVENESS

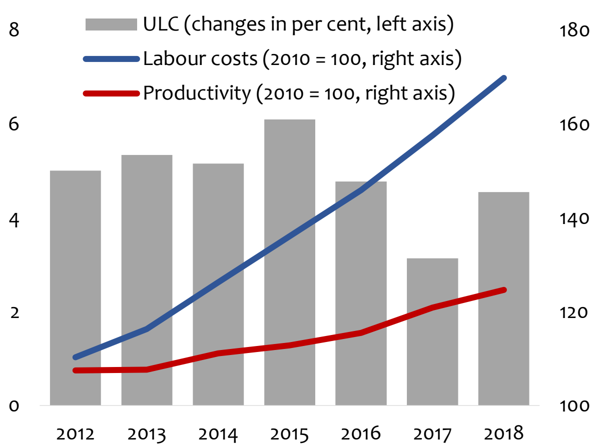
Productivity dynamics in Latvia have been faster than average in the EU in recent years. Over the period 2010-2018, the productivity gap with the EU average fell by nearly 12 percentage points. In 2018, productivity in the Latvia's economy, characterized by GDP per employee, reached 49.4% of the average EU level.

Dynamics of productivity



According to productivity growth rates, Latvia is one of the leading positions in EU Member States, but labour costs have increased more rapidly than productivity, threatening the competitivesness of Latvian entrepreneurs in terms of costs. An increase in nominal unit labour costs (ULC) also reflects the increased risks of reducing cost competitiveness.

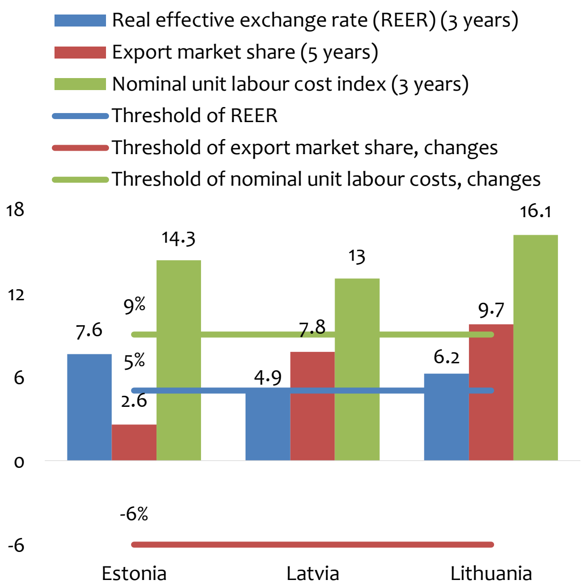
Labour Costs and Dynamics of Productivity



In the last three years (2016-2018), productivity increased by 3.4% on average annually while labour costs increased by 7.7%, i.e. almost 2.5 times faster. A strong increase in labour costs is affected by both wage convergence processes in the integrated EU labour market and by a more tense situation in the domestic labour market.

In recent years, the dynamics of ULC have been particularly strong across the Baltic States. From 2016-2018, nominal ULC in Latvia increased by 13%, in Estonia – by 14.3% and in Lithuania – by 16.1%, which is much larger increase than the average in the EU (0.7%). Thus, the MIP threshold has been exceeded.

Unit Labour Costs, Real Effective Exchange Rate and Export Market Share
as per cent



Despite negative trends in the cost competitiveness indicator (ULC), Latvia's share of exports in the global markets is increasing. Over the period 2013-2017, Latvia's share of exports in the global markets for goods and services increased by 7.8%, which means that Latvia is still maintaining its competitiveness on external markets. However, data on changes in annual market share reveal that positive trends are becoming increasingly moderate.

The real effective exchange rate (REER) dynamics are increasing more rapidly. On the Consumer Price Index (CPI) based REER against 42 trading partner countries increased by 4.9% in the last three years (2016-2018) (including against euro area partner countries – by 1.3%), close to the MIP threshold.

The rise in labor costs, which will not be offset by a corresponding increase in productivity, can put serious pressure on the decline in profit margins to maintain price competitiveness in external markets. In addition, long positive ULC dynamics increases the threat of a country's external imbalance.

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 as soon as possible (through the Alert Mechanism Scoreboard) and correcting macroeconomic imbalances.

The Alert Mechanism Report for 2019 did not identify Latvia among the 13 EU Member States, where macroeconomic imbalances were identified and for whom an in-depth study was needed. However, in the list of indicators (see table) Latvia has two indicators above the thresholds. The indicator of the net international investment position continues to improve as Latvia's external debt to the rest of the world grew more slowly than GDP. The cost index of the nominal unit of labor, for example, in Lithuania, Bulgaria, and Estonia, exceeded the threshold due to continued increases in wages (in Latvia, mainly in the private sector in non-marketable sectors). Wage growth has been faster than productivity growth. Wage growth is expected to continue to be strong due to increased demand in the labor market. The values of two further indicators fluctuate close to the thresholds, the real effective exchange rate calculated for 42 trading partners, and the housing price index, which reflects an increase in demand in the housing market. On the other hand, all employment rates continued to improve, with employment rates increasing, while both long-term unemployment and youth unemployment decreased.

A List of Macroeconomic Indicators of Latvia for The Identification and Prevention of Macroeconomic Imbalances

	Thresholds	2011	2012	2013	2014	2015	2016	2017	2018
External imbalances and competitiveness									
Current account balance (% of GDP, 3-year average)	-4%/6%	2.2	-1.6	-3.2	-2.7	-1.6	-0.2	0.6	0.5
Net international investment position (% of GDP)	-35%	-74.4	-67.2	-66.4	-66.1	-63.5	-58.4	-56.3	-49.1
Real effective exchange rate (REER) – 42 trade partners, HICP deflator (3 year % change)	±5%* & ±11%	-2.4	-8.6	-1.7	0.4	2.5	4.8	1.6	4.9
Export market share –% of world exports (5 year % change)	-6%	26.6	7.9	5.9	11.0	12.5	9.4	7.8	..
Nominal unit labour cost index (3 year % change)	9%* & 12%	-21.0	-6.9	8.1	16.3	17.5	16.9	14.7	13.0
Internal imbalances									
House price index, deflated (1 year % change)	6%	4.1	-0.4	6.5	4.3	-2.4	7.3	5.5	..
Private sector credit flow, consolidated (% of GDP)	14%	-2.0	-2.1	0.9	-11.8	0.7	0.3	0.3	..
Private sector debt, consolidated (% of GDP)	133%	115.3	97.9	92.6	96.2	88.9	88.0	83.5	..
General government gross debt (% of GDP)	60%	42.7	41.2	39.0	40.9	36.8	40.3	40.0	..
Unemployment rate (3-year average)	10%	17.7	16.9	14.4	12.6	10.9	10.1	9.4	8.6
Total financial sector liabilities (1 year % change)	16.5%	-4.1	5.2	5.2	10.4	12.2	5.8	6.1	..
Employment indicators									
Activity rate - % of total population aged 15-64 (3-year change in pp)	-0.2 pp	-1.4	0.9	1.0	1.8	1.3	2.3	2.4	..
Long-term unemployment rate – of active population aged 15-74 (3-year change in pp)	0.5 pp	6.9	3.3	-3.1	-4.2	-3.3	-1.7	-1.3	..
Youth unemployment rate – % of active population aged 15-24 (3-year change in pp)	2 pp	17.4	-4.8	-13.0	-11.4	-12.2	-5.9	-2.6	-4.1

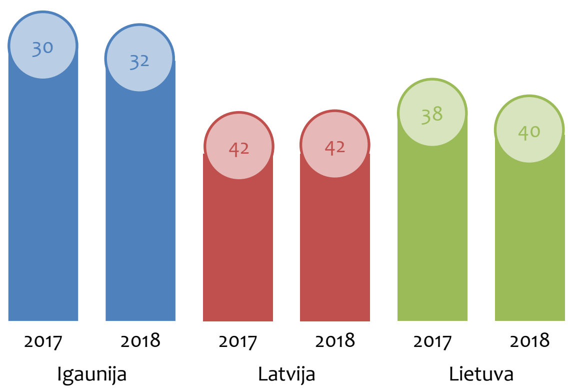
* – Eurozone countries
Note: the highlighted numbers exceed the thresholds set in the Early Warning Mechanism.
Source: Indicators of the MIP procedure, *Eurostat*

2019 | 1

INTERNATIONAL RANKING OF LATVIA

Ratings from the United Nations, the World Bank Group, the World Economic forum, and other organisations described Latvia as a country that makes a lot of reforms to improve its competitiveness by improving e-government, the business environment, ICT infrastructure, etc., while also providing free press and not militarily endangering other countries of the world. In World Economies Forum report in the new Global Competitiveness Index (GCI 4.0) for 2018 Latvia is ranked in place 42 between 140 surveyed countries.

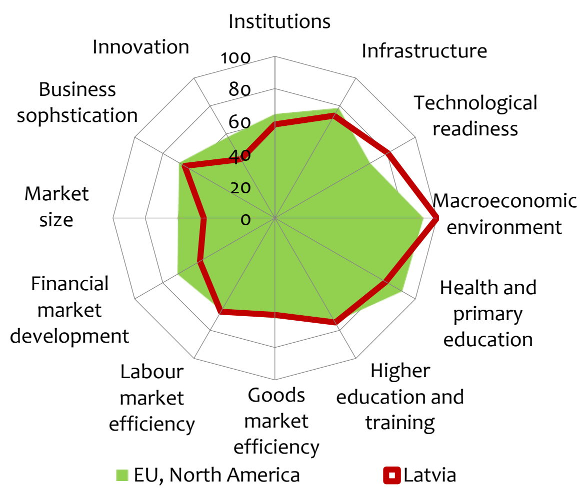
Baltic States in Global Competitiveness Index 4.0



Source: *World Economic Forum, The Global Competitiveness Report 2018*

In 2018, compared to the 2017 result, latvia's place in GCI 4.0 has not changed, but improvements have been observed in 11 out of 12 pillars.

GCI of Latvia 2018 Divided by Pillars
from pillar value: the weakest – 0, thr best - 100

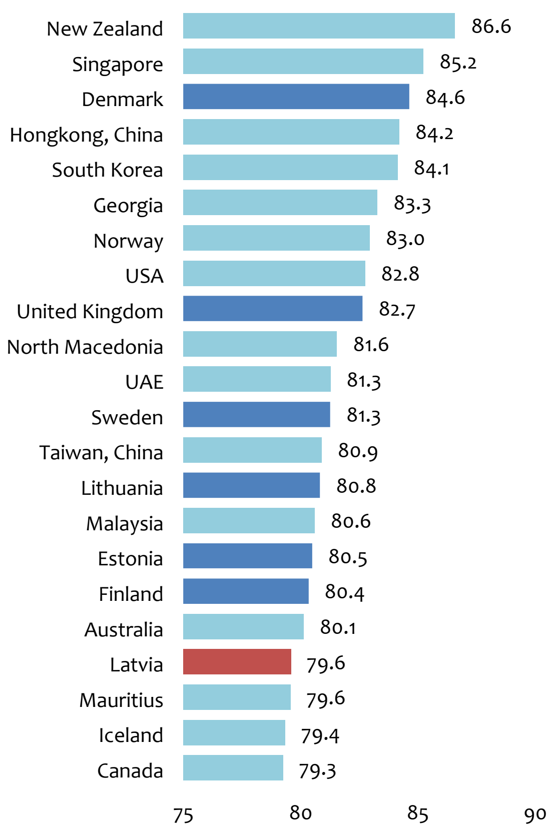


Source: *World Economic Forum, The Global Competitiveness Report 2018*

In the pillar of macroeconomic stability, Latvia is ranked 1st in the same way as another 30 countries. Latvia ranks 11th in the ICT deployment pillar due to good Internet infrastructure and a large share of Internet users. Highly are ranked also skills – 23rd place and the labor market – 29th place. An average performance is for the following pillars: business sophistication – 47th place, infrastructure 47th place, institutions – 49th good market efficiency – 49th innovation – 52nd place. The worst assessment is for the pillars: health and primary education – 76th place, financial market development – 94th place and market size – 94th place.

In the World Bank Group study *Doing Business* between 190 countries Latvia is ranked 19th. When assessing the position among EU countries, Latvia's position in *Doing Business 2019* is one of the highest. Compared to 2018, the values of 8 groups of indicators have improved or remained unchanged, while the results for 2 groups of indicators have deteriorated.

Doing Business 2019 Research Results
Total index: rating 0-100



Source: *Doing Business 2019: Training for Reform, International Bank for Reconstruction and Development, The World Bank*

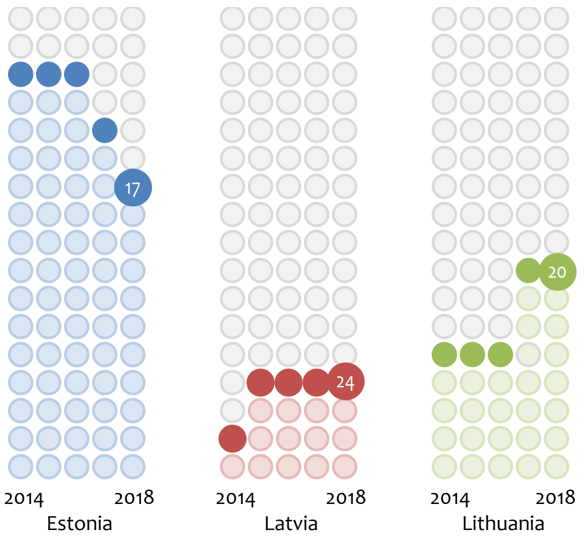
Evaluations for Baltic States by pillars in *Doing Business* 2019 rating

	Latvia			Lithuania		Estonia	
	Rank	*Score*	*Changes in score, compared to Doing Business 2018*	*Rank*	*Score*	*Rank*	*Score*
Total index	**19**	**79.59**	**0.33**	**14**	**80.83**	**16**	**80.50**
Starting a business	24	94.13	0.02	31	93.18	15	95.25
Dealing with construction permits	56	73.46	0.05	7	84.86	14	82.53
Getting electricity	53	82.24	3.19	26	88.43	46	83.26
Registering property	25	81.45	-0.42	3	92.96	6	91.02
Getting credit	12	85.00	0	44	70.00	44	70.00
Protecting minority investors	51	63.33	0	38	66.67	83	56.67
Paying taxes	13	89.74	-0.05	18	88.66	14	89.56
Trading across borders	26	95.26	0	19	97.83	17	99.92
Enforcing contracts	20	71.66	0	7	78.80	13	74.34
Resolving insolvency	54	59.60	0.50	85	46.87	47	62.51

Source: *Doing Business 2019: Training for Reform, International Bank for Reconstruction and Development, The World Bank*

In the European Innovation Scoreboard 2018, published annually by the European Commission, Latvia ranks 24th among the 28 EU countries, and has been included in the group of moderate innovators for the third consecutive year. The relative advantages of the Latvian innovation system are noted: an innovation-friendly environment, finance and support, but the relatively weaker areas are innovators and business investment.

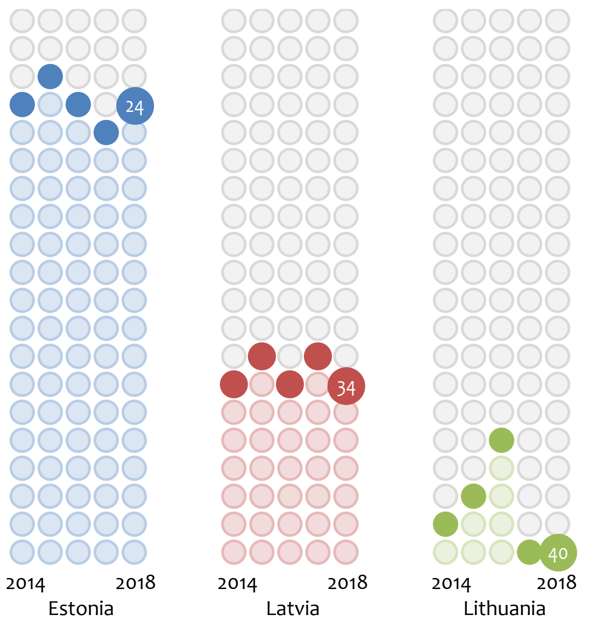
Baltic States in the European Innovation Scoreboard



Source: *European Commission, European Innovation Scoreboard 2018*

In turn, in Global Innovation Index 2018 Latvia is 34th between 126 surveyed countries. As Latvia's strong sides are mentioned further indicators: ease for business to start up, ratio of students and teachers in high school institutions, credit accessibility, share of women with higher education, domestic total expenses for research and development, which is financed by foreigners, gross domestic product increase per worker after purchasing power parity, as well as volume increase in creative industry.

Baltic States in Global Innovation Index



Source: *Cornell University, INSEAD, WIPO, The Global Innovation Index 2018: Energizing the World with Innovation*

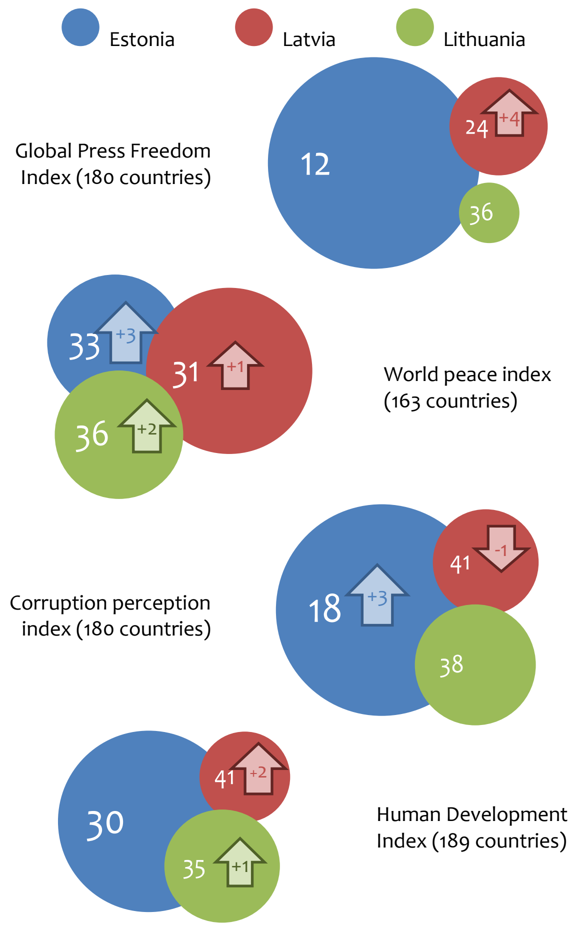
In international press and freedom of speech organization's "Reporters withour borders" created Worldwide press freedom index Latvia is 24th (from 180 countries) by stepping up 4 places from 2017.

Economics and peace institution formated Worlds peace index, where Latvia in 2018 is ranked 31st (from 163 countries), increasing the position by 1 place comparing with adjusted results of 2017.

In Corruption Perception index, made by *Transparency International*, Latvia in 2018 has been ranked 41st (from 180), losing 1 place compared to 2017, although the index value did not change.

In United Nations Development Programme's Human Development Index, which includes life length, reading skills, education level, GDP per capita etc. indicators, Latvia in 2017 is listed as 41st (from 189 countries) stepping up by 2 positions, compared with clarified results of 2016.

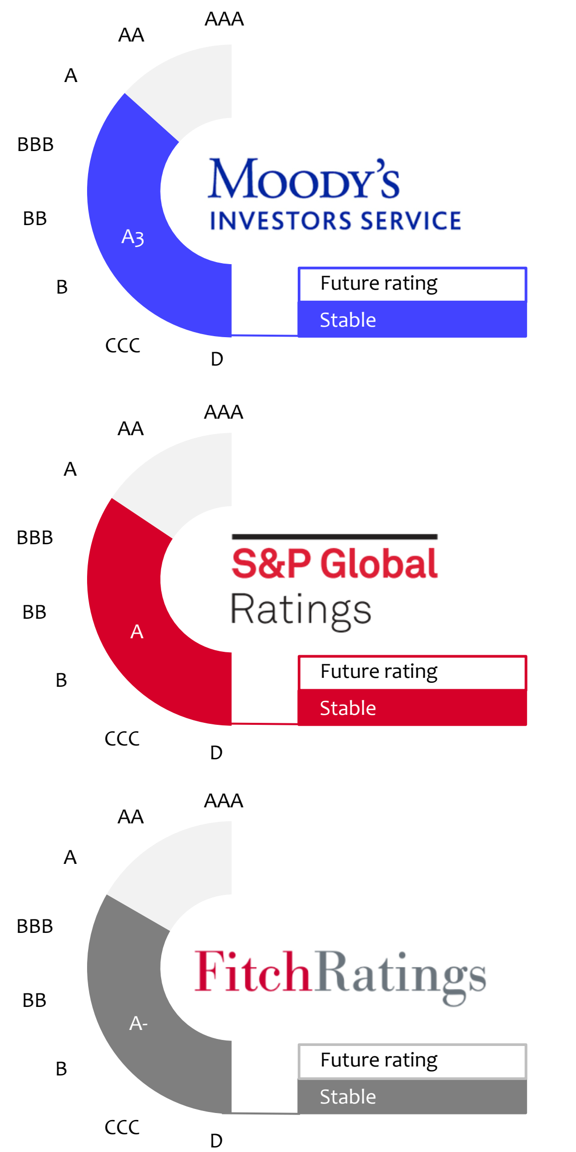
Baltic States in International Ratings
place and changes during a year



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

Rating agencies (*Moody's Investors Service, Fitch Ratings, S&P Global, R&I*) positively appreciate the stability of Latvia's finance system and political situation, strict fiscal policy compliance, and overall economic development, which allows to maintain current credit rating stable. Reduction in non-resident investments in Latvian banking sector has reduced the external risks. Further creditrating improvement would be contributed by steaper government debt decrease, budget revenue increases, and by stable Latvian economy development (without economy overheating).

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



Source: State treasury