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## ECONOMIC DEVELOPMENT

In Latvia, stable economic growth that exceeds the EU average resumes. From 2011-2018, GDP on average increased by 3.5% annually.

In 2017-2018, economic growth rate accelerated. GDP grew by 3.8% and 4.6%, respectively. Accelerated economic growth was facilitated by improvements in the external environment, increased absorption of EU structural funds, and rising employment and wages.

In 2019, economic growth has become more moderate. In the first half of the year, GDP grew by 2.3%. The slight economic slowdown was driven by both internal factors (e.g. increased use of EU investment funds, developments

in the financial sector) and external factors (e.g. review of global trade tensions, Brexit, slower growth in other EU countries). It is anticipated that the above-mentioned global factors will also affect Latvia's economic growth in the second half of 2019 and 2020, negatively impacting Latvia's export capacity. At the same time, positive development trends are expected to be observed in commercial services and other internal demand-oriented sectors of the economy.

According to the forecasts by the Ministry of Economics, GDP growth in 2019 could reach 2.5%.

## Key Economic Development Indicators

	2012	2013	2014	2015	2016	2017	2018	2019f
GDP, at current prices, billion euro	21.9	22.8	23.7	24.4	25.1	26.8	29.2	30.7
<i>changes as per cent</i>								
GDP	4.1	2.3	1.9	3.3	1.8	3.8	4.6	2.5
Private consumption	3.6	5.7	1.1	2.5	1.5	3.1	4.2	2.9
Public consumption	0.4	1.2	2.1	3.0	2.9	3.2	4.0	2.5
Gross fixed capital formation	16.1	-5.9	-0.3	-1.2	-8.2	11.3	15.8	4.6
Exports	9.8	1.1	6.5	2.9	4.0	6.4	4.0	0.6
Imports	5.4	0.4	3.0	1.7	3.8	8.4	6.4	3.8
Consumer prices	2.3	0.0	0.6	0.2	0.1	2.9	2.5	2.9
<i>as per cent</i>								
Employment changes	1.6	2.1	-1.0*	1.3	-0.3	0.2	1.6	0.0
Employment rate	56.1	58.2	59.1	60.8	61.6	62.9	64.5	64.9
Unemployment rate	15.0	11.9	10.8	9.9	9.6	8.7	7.4	6.5
<i>as per cent of GDP</i>								
General government budget balance	-1.2	-1.2	-1.4	-1.4	0.1	-0.5	-0.7	-0.5
General government debt	41.6	39.4	40.9	36.7	40.3	38.6	36.4	36.0
Net exports	-4.4	-3.5	-2.0	-0.9	1.0	0.2	-0.9	-0.2

f – forecast

\* Since 2014, changes have taken place in the methodology of the Labour Force Survey. The quarterly average population of private households (formerly population at the beginning of the year) is used for quarterly data.

In recent years, a rapid rise in investments has significantly contributed to economic growth. In 2017 and 2018, investments increased by 11.3% and 15.8%, respectively. Along with EU fund investment volume peak in the current period, the pace of investment growth has declined. In the first half of 2019, investments increased by 4.9%.

**A major driver of growth has been private consumption.**

Along with a rise in employment and wages, private consumption increased by 4.2%, representing the largest growth since 2014. In the first half of 2019, private consumption growth (2.7%) remained relatively high. In 2018 and during the first half of 2019, public consumption increased by 4% and 2.4%, respectively.

Although growth rates gradually slow down, exports of goods and services still experience steady growth. In 2018 and during the first half of 2019, exports increased by 4% and 0.6%, respectively. In the first half of 2019, exports of cereal products, electrical appliances and equipment, and pharmaceutical products significantly contributed to the development of exports. However, exports were negatively affected by the decline of production volumes for machinery and appliances, iron and steel, and petroleum products.

In the first half of 2019, exports of services grew by 5.4%. The increase was mainly facilitated by income from tourism and exports of ICT services.

Since 2011, Latvia has experienced a low current account deficit, thus indicating the external sustainability of the Latvian economy. In 2018, the current account deficit of EUR 283 million (1% of GDP) was observed. In 2019, however, a current account surplus of 1.1% of GDP was reached. It is anticipated that in the coming years the current account will remain with a small deficit, not comprising the external sustainability of the Latvian economy.

In 2018, the largest contribution to economic growth provided construction, ICT, transportation and storage, trade and commercial services sectors. In the first half of 2019, the largest growth was observed in agriculture, forestry, and fishery, ICT services, accommodation and catering, and other internal demand-oriented sectors of the economy.

Increased business competitiveness and positive demand dynamics in major export markets have significantly contributed to growth in manufacturing. In 2017, a rapid increase (by 6.9%) in manufacturing volumes was observed. In 2018 and during the first half of 2019, growth in manufacturing slightly slowed down. In recent years, the largest contribution to growth has been provided by wood processing. The production of electrical equipment and motor vehicles and trailers also significantly contributed to economic growth.

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

In 2018 and 2019, average inflation reached 2.5% and 3%, respectively. The level of consumer prices to a large extent was determined by the price increase for services. Inflation was also affected by the rise in world prices for oil and food. It is anticipated that average annual inflation in 2019 will be slightly higher.

Since 2011, when Latvia returned to economic growth, significant improvements in the fiscal position have been achieved. In recent years, the budget has had a small deficit. In 2018, a deficit of 0.7% of GDP was observed. The government budget for 2019 was adopted by the Saeima with a deficit of 0.5% of GDP. In 2019, a fiscal margin of 0.1% of GDP was also anticipated.

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 trade and construction. In the first half of 2019, the number of employed increased only by 0.1%. The slight increase can mainly be attributed to the slowdown in economic activity. The rise in employment is also affected by demographic trends – the decline of working population.

The employment rate continues to increase. In 2018, it reached 64.5% of the population aged 15-74 (by 1.6% percentage points higher level than in 2017). Similarly, in the first half of 2019, increased population activity was observed. Considering the negative demographic trends, the involvement of different economically inactive groups in the labour market will play a crucial role in sustaining the current labour force supply.

In 2018, the unemployment rate declined to 7.4%, thus getting closer to the historically lowest unemployment rates in 2006/2007. In 2019, the unemployment rate continues to decline. In August, the unemployment rate reached 6.3% (compared to 6.9% in August 2018). The rapid decline in unemployment, however, is still hampered by the high proportion of long-term unemployed, which accounts for more than 2/5 of the total number of employed. The decline in unemployment is further hindered by the regional disparities – in Riga the level of unemployment is almost twice as low as in Latgale region, thus significantly amplifying the risks of structural unemployment in the context of low labour mobility.

Since 2010, as the economic situation stabilized, wage growth has resumed. Wage growth over the past four years has remained above 5% annually. In 2018, average gross wage increased by 8.4%. However, in the first half of 2019, average wage growth reached EUR 1 060 (representing a 7.8% increase since the corresponding period from the last year).

It is anticipated that strong demand-side pressure in the labour market will prevail, resulting in a small increase in the level of employment. At the same time, negative demographic trends and labour market regional disparities will affect the labour market.

**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 trends in 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 programmes, 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.

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## WORLD ECONOMIC OUTLOOK

According to the International Monetary Fund (IMF) forecasts for October 2019, global economic growth in 2019 and 2020 will reach 3% and 3.4%, respectively. In 2019, economic growth is projected to be at its lowest level since global financial crisis, and has been revised down by 0.3 percentage points, compared to the April 2019 forecast. IMF has also lowered its growth forecast for 2020 by 0.2 percentage points.

GDP Growth Rate  
as per cent

	2017	2018	2019f	2020f
World	3.8	3.6	3.0	3.4
European Union	2.4	1.8	1.5	1.6
USA	2.2	2.9	2.4	2.1
Russia	1.6	2.3	1.1	1.9
Asia	6.5	6.4	5.9	6.0

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

The decline in global growth rates can largely be attributed to the increased uncertainty in terms of trade (especially tensions between the U.S. and China), geopolitics, and several structural factors such as low productivity growth and population ageing in developed countries.

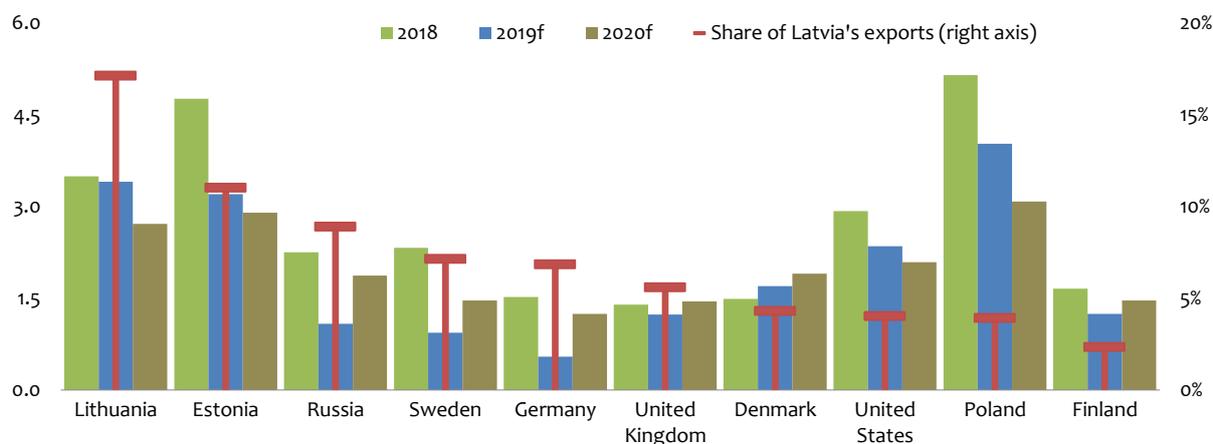
A modest recovery of the global economy is forecast in 2020, reflecting improvements in a number of developing

markets in Latin America, the Middle East, and Europe. The recovery, unlike the synchronized slowdown in 2019, however, will not be wide-ranging and remain volatile.

In 2020, economic growth is expected to moderate in the U.S., Eurozone, China, and Japan, which together account for nearly half of global GDP.

Forecasted economic slowdown in Eurozone is related to weaker growth in global trade and growing uncertainty in trade policy. Also, internal factors (e.g. declining car production volumes, escalating social tensions, etc.) have also significantly influenced economic outlook. However, the prospects for the economic development in Eurozone remain stable. In 2019 and 2020, Eurozone GDP is expected to grow by 1.2% and 1.4, respectively (in the EU: by 1.5% and 1.6%). Improvements in the labour market, low financing costs, and expansive fiscal policies will continue to stimulate economic growth, albeit at a more moderate pace.

In 2019, economic growth in the U.S. is projected to reach 2.4%. Along with the reduction of fiscal stimulus measures, slightly more moderate GDP growth of 2.1% is anticipated in 2020. Stable situation in the labour market and favourable financial conditions will continue to foster private consumption of households. On the other hand, the changes in tariffs will lead to an increase in business costs, reducing companies' investment and export volumes.

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

Source: CSB, IMF World Economic Outlook Database, October 2019  
f – forecast

In 2019 and 2020, GDP growth in Asia is expected to reach 5.9% and 6.0%, respectively. In China, policies will stimulate economic activity, thereby alleviating negative external shocks. In 2019 and 2020, economic growth in China is projected to be between 6.1% and 5.8%, respectively. India's economy is also expected to experience high growth rates of 6.1% and 7% in 2019 and 2020, respectively.

In 2019 and 2020, economic growth in Russia is anticipated to reach 1.1% and 1.9%, respectively. Currently, structural reforms (e.g. strengthening of

competitiveness, improvements in the public procurement system, labour market reforms) in Russia are necessary to boost economic growth. Ukraine's economy faces risks related to lower steel prices and possible decline in Russian natural gas transit flows. At the same time, Belarus remains under pressure to repay the country's external debt, which will likely reflect less favourable oil import conditions, thus adversely affecting economic activity (United Nations, 2019).

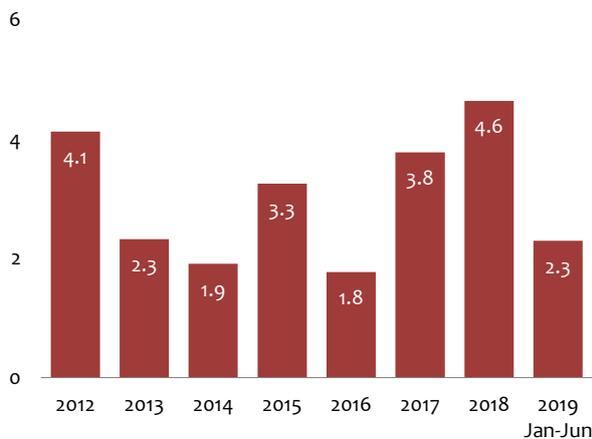
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## GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

### GROSS DOMESTIC PRODUCT

In 2018, GDP increased by 4.6%, reflecting the largest growth in the past seven years. In the first half of 2019, however, a slightly more moderate growth was observed.

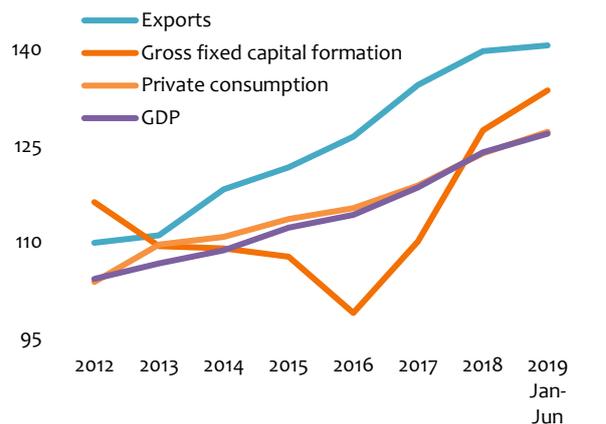
Gross Domestic Product changes as per cent



Latvia's economy is also affected by various processes in the external environment – the review of global trade tensions, uncertainty about the outcome of Brexit, and declining growth in other EU countries.

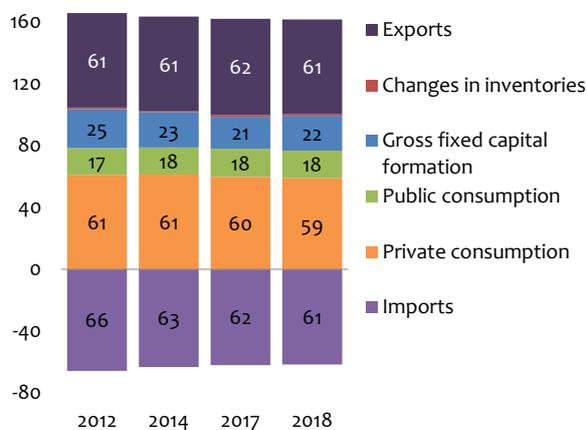
In the first half of 2019, a moderate growth in exports was observed. The increase in exports of services slightly outpaced the growth in exports of goods. Private consumption is also growing steadily, encouraged primarily by the labour market situation and the rise in wages. However, the growth in public consumption, in comparison to the previous years, has slightly declined.

Gross Domestic Product by Expenditure Items 2011 = 100

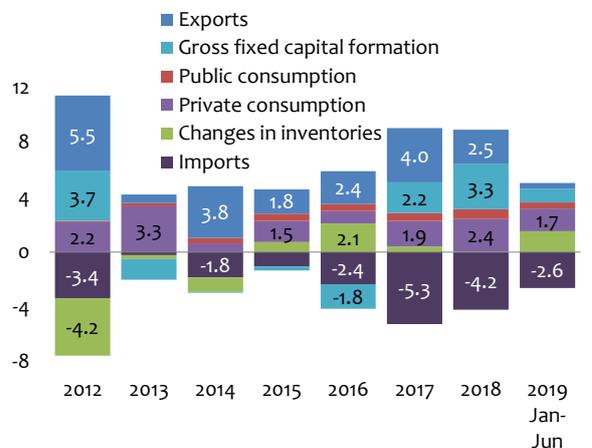


In the first half of 2019, the slowdown in economic activity was mainly driven by the decline in construction, which, in turn, affected the aggregate level of investments. EU fund investments have peaked, and no further growth this year can be anticipated.

Gross Domestic Product from Expenditure Approach % of GDP



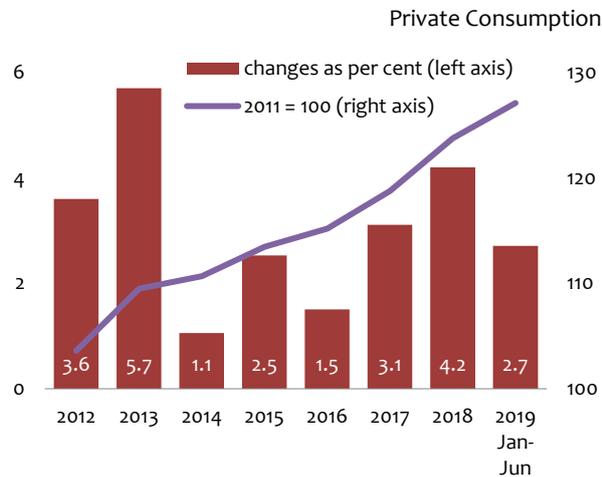
Gross Domestic Product by Expenditure Items contribution to growth as percentage points



CONSUMPTION

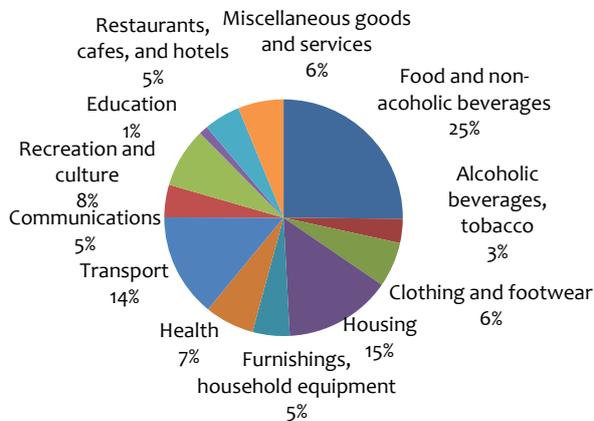
Private consumption continues to steadily increase.

Between 2012-2018, private consumption, mainly driven by the rise in employment and wages, increased by 3.1% annually. Also, in the first half of 2019, private consumption continues to grow.



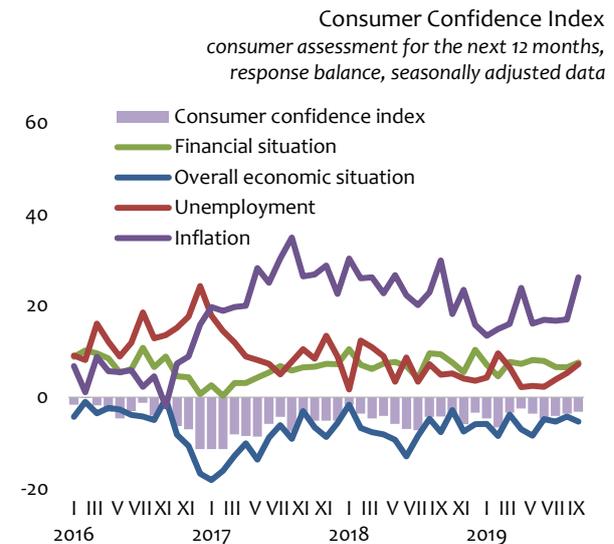
Expenditures on food and non-alcoholic beverages account for the majority of household consumption. In 2018, spending on food and non-alcoholic beverages, in comparison to the last year, increased by 6%. Spending on housing, the second largest consumer spending group, rose slightly – by 2%. The third largest share of household consumption was devoted to transport, wherein a 4% rise in expenditure was observed. It was mainly facilitated by an increase in spending on the operation of vehicles and the purchase of cars. The largest growth in consumption was observed for recreation and culture (the 4<sup>th</sup> largest expenditure category) – by 12%.

Structure of Household Expenditures 2018, per cent



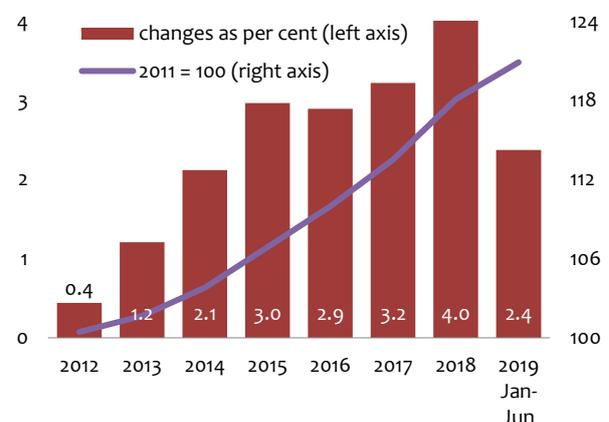
In 2019, consumer confidence continues to improve.

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



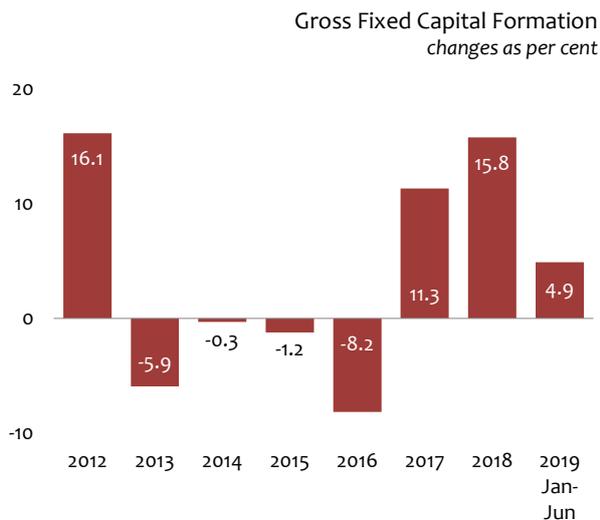
Public consumption gradually increases. Since 2014, along with an increase in budget revenues, public consumption has risen more rapidly. Between 2012-2018, public consumption has increased by 2.4% annually. In 2018, the largest increase since 2016 was observed. Also, in 2019 public consumption continues to increase; however, the growth has moderated.

Public Consumption



## INVESTMENT

In recent years, investment (gross fixed capital formation) has increased significantly. Since 2017, the period of weak investment growth has been overcome. In 2017 and 2018, investment grew by 11.3% and 15.8% (a growth rate significantly above the EU average), respectively. In 2019, investment activities also remained relatively high. In the first half of 2019, investment in Latvia's economy was by 4.9% higher than a year ago. The increase was mainly driven by large investment volumes in construction assets.

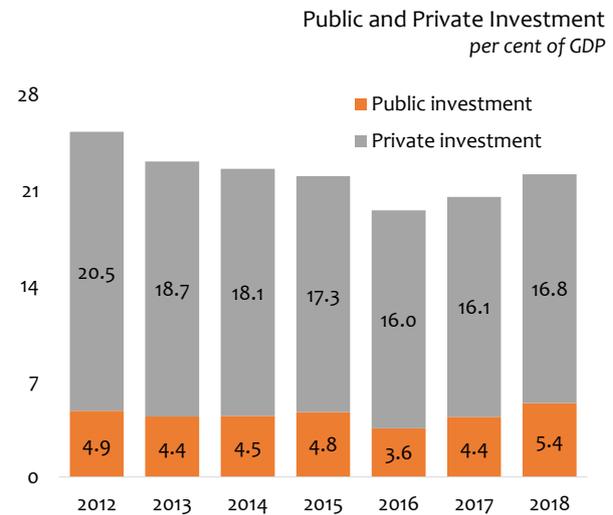


Aggregate investment levels have also peaked, reaching 22.5% of GDP in 2018. However, it still remains lower than the pre-crisis level.

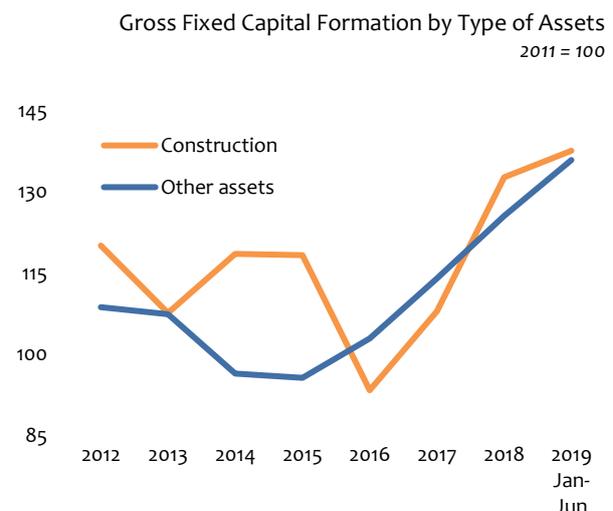
The relatively low level of investment can mainly be attributed to the lacklustre recovery of private investment. Private investment during the post-crisis period (2010-2018) on average constituted 17.6% of GDP (i.e. almost 11 percentage points lower than during the years of rapid economic development). Low level and moderate dynamics were mainly driven by weak lending, low demand, relatively high levels of private sector indebtedness, and economic and political uncertainty in the external environment. In recent years, the dynamics of private investment have improved. In 2018 and during the first quarter of 2019, private investment increased by 13.6% and 5.3%, respectively. Private investment growth was facilitated through co-financing of the EU structural funds.

In Latvia, public investment remains at a high level. In recent years, public investment constitutes 1/5 of total investment in the Latvian economy, and its dynamics largely rely on the cyclical dynamics of the absorption of EU structural funds. Since 2017, along with the recovery of EU structural funds, public investment has increased on average by 33.5% annually. In the first quarter of 2019,

public investment exceeded the previous year's level by 23%. In Latvia, the share of public investment is one of the highest amongst EU member states. According to Eurostat, public investment in EU-28 on average constituted 2.8% GDP in 2018. However, in Latvia it reached 5.4% of GDP.

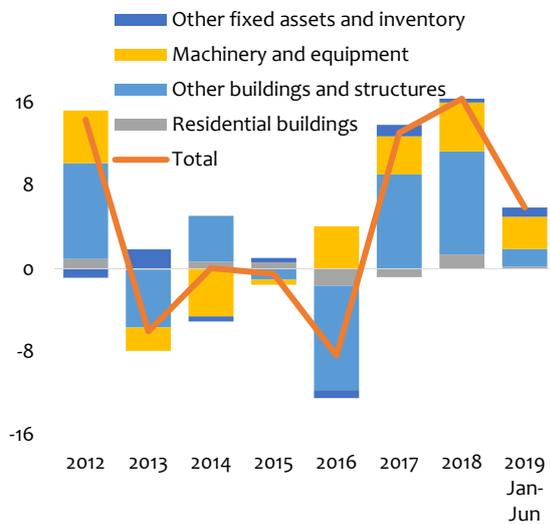


Since 2007, the structure of investment assets has changed. During the economic recession, investment volumes declined in all asset classes. The largest downturn was observed in construction. However, the drop in investment in machinery and equipment was slightly more moderate. Investment in intellectual property remained essentially unchanged, constituting on average 1% of GDP (including investment in R&D of 0.6% of GDP) for several years.



**Investment volumes in construction assets rose relatively faster.** In the first half of 2019, investment growth in construction assets was by 3.7% higher, compared to the corresponding period last year, and its share of total investment volume reached almost 52%. Higher proportion of investment was devoted to engineering structures and buildings. However, investment in housing during the first half of 2019 represented 22% (in 2018 – 18%) of investment in construction assets. Investment in machinery and equipment was by 77.9% higher than a year ago. Meanwhile, investment volumes in vehicles declined by 8.1%. Investment growth in intellectual property products (an increase of 11.6%), compared to the last year, also rose at a higher rate.

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



**In the first half of 2019, non-financial investment more rapidly increased in services sector.** Investment volumes were by nearly 26% larger than a year ago. Meanwhile, investment volumes in goods sector increased by 18%.

Investment growth in the public administration (33% increase) and real estate operations (54% increase) constituted the largest share of total investment growth. Investment in manufacturing was nearly 45% higher than a year ago. However, investment volumes in energy sector and construction have declined.

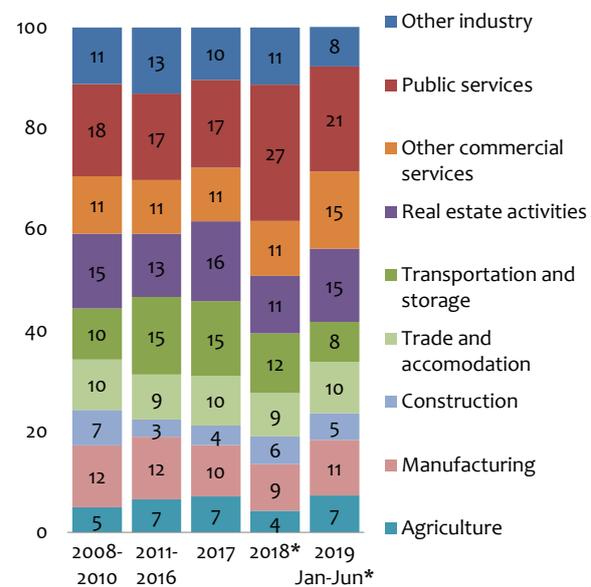
The survey results of top executives and managers in the industry reveal that the demand remains the most significant factor for investment decisions. In recent years, the role of finance accessibility has increased. In 2019, financial conditions (also technical factors such as technological developments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

**Non-financial Investment Dynamics**  
changes in Jan-Jun 2019, %\*



\* – calculated using quarterly data

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

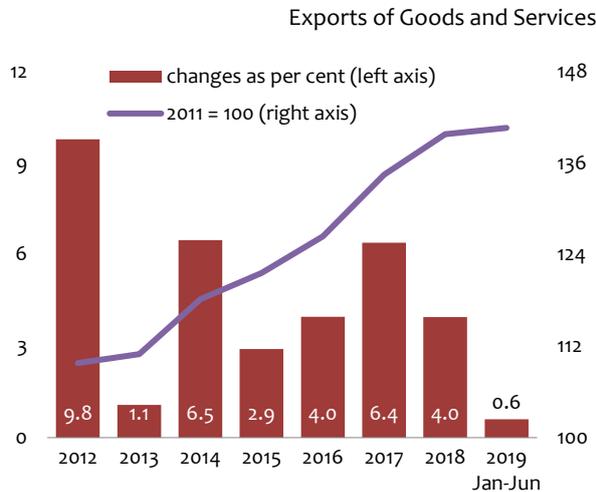


\* – calculated using quarterly data

**Investment dynamics may moderate in the upcoming years.** Amid uncertainties in the external environment and low levels of lending, investment dynamics may weaken. Investments will also be affected by the cessation of EU structural funds and declining external demand. At the same time, the limited supply of workforce and high production capacity may provide stimulus to investment.

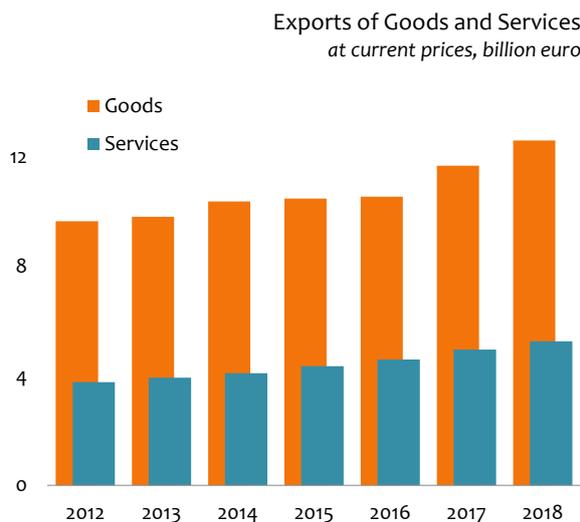
## EXPORTS

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



In 2018, exports of goods and services increased steadily. The growth was mainly facilitated by economic development in Lithuania and Estonia, stable demand in the most important export markets (other EU countries), and the stabilization of economic situation in Russia and other CIS countries.

In the first half of 2019, export growth, in comparison with the corresponding period last year, was more moderate. The decline in growth was driven by weaker growth rates amongst major trading partners.

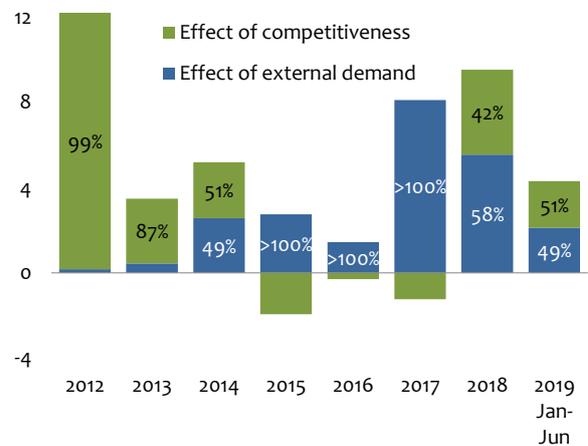


Between 2014-2017, export growth was mainly driven by external demand. The role of price competitiveness, however, was lower or even negative. Since 2018, external

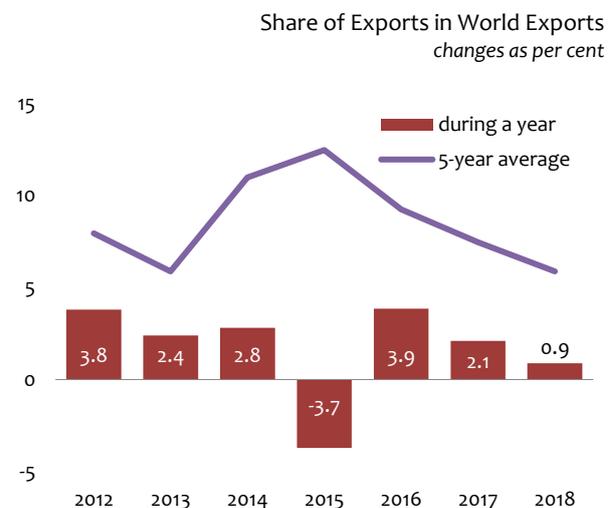
demand (especially for wood products due to the expected Brexit) increasingly affects export growth.

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

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

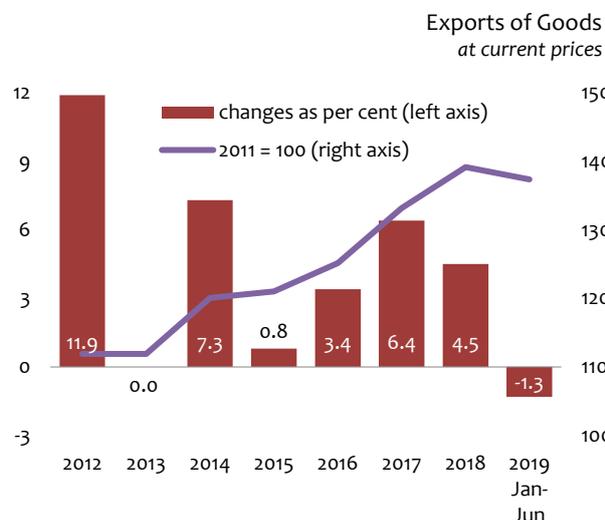


Latvia's share of exports in the global market is increasing, indicating that Latvia's entrepreneurs remain competitive despite rapidly rising labour costs.



## Exports of Goods

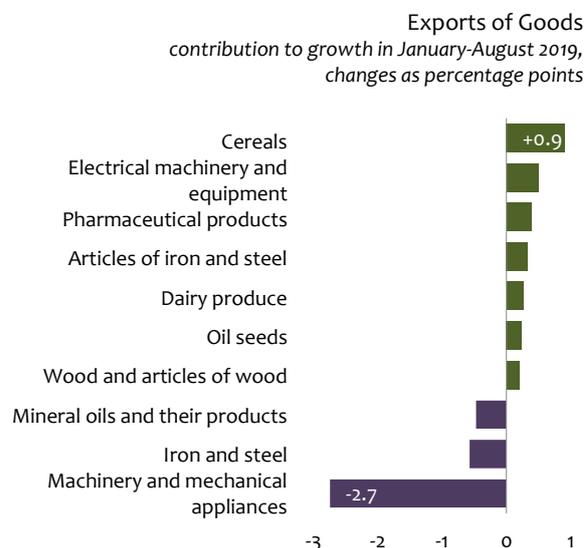
Exports of goods have remained stable, constituting around 70% of total Latvia's exports. Also, its share has not changed significantly in recent years.



### In 2018, exports of goods developed dynamically

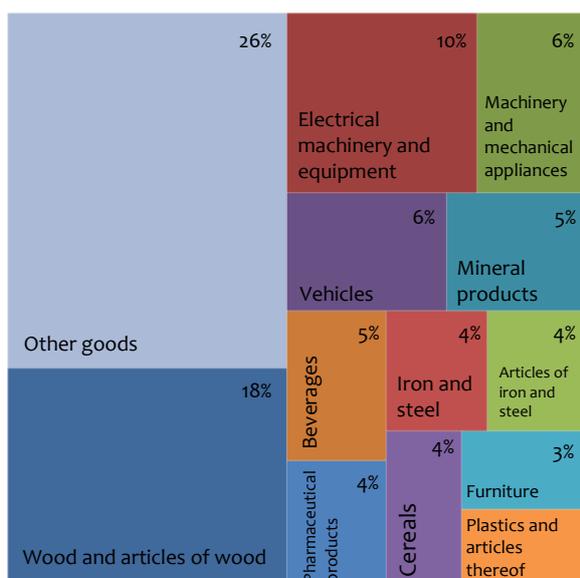
(compared to 2017, an increase of 9.4% at current prices was observed). The growth was mainly facilitated by the export of wood and articles of wood, electrical machinery and equipment, and basic metals and its products. Exports slightly faster increased to EU countries. However, a more moderate export growth was observed to CIS countries.

equipment, and pharmaceutical products. On the other hand, export development was negatively affected by the decline in export volumes of machinery and mechanical appliances, iron and steel, and mineral products.



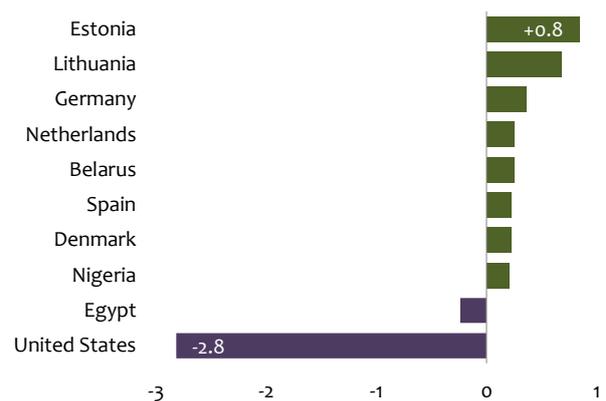
In January-August 2019, the largest exports partners were Lithuania, Estonia, Russia, Germany, Sweden, UK, Denmark, and Poland. Exports to these countries constituted approximately 2/3 of all exports of goods.

Exports of Goods January-August 2019, structure as per cent



However, in January-August 2019, export growth was only 0.4%. The largest contribution to export growth provided the increase in exports of cereals, electrical machinery and

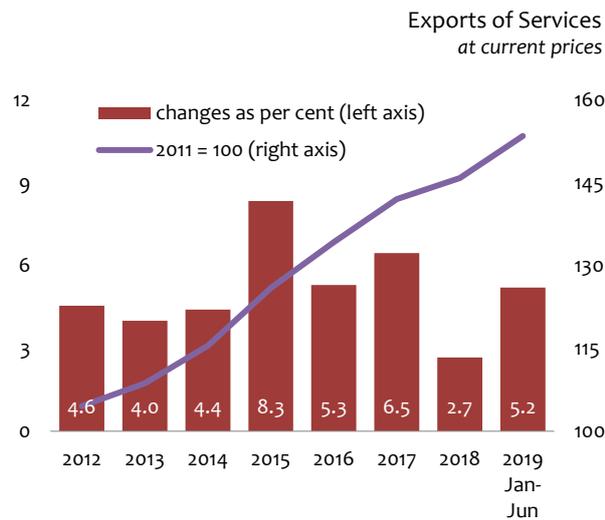
Exports by Country contribution to growth in January-August 2019, changes as percentage points



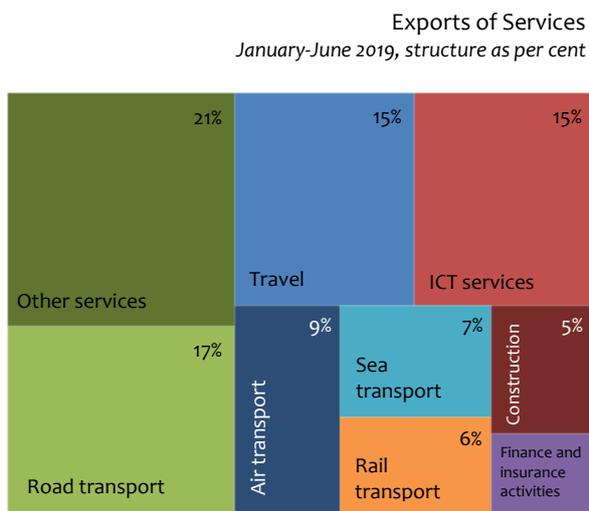
In January-August 2019, the main export product groups to EU countries were wood and articles of wood, electrical machinery and equipment, and vehicles. The largest share of exports to CIS countries comprised of alcoholic beverages, machinery and mechanical appliances, pharmaceutical products, and electrical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

## Exports of Services

Since 2011, exports of services have increased at a higher rate than exports of goods. Transport services, ICT, trade, and travel services provide a major contribution to export growth. However, the share of finance and insurance activities in exports is declining. In 2018 and during January-June 2019, a significant growth was observed in exports of services of 6.1% and 7.1%, respectively.



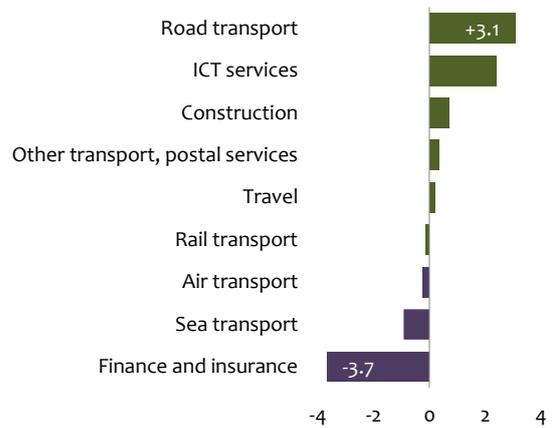
In January-June 2019, export volumes in trade and road transport services increased at a higher rate. Similarly, growth was observed in ICT, construction, and travel services. However, export volumes declined in finance and insurance activities, sea and air transport services.



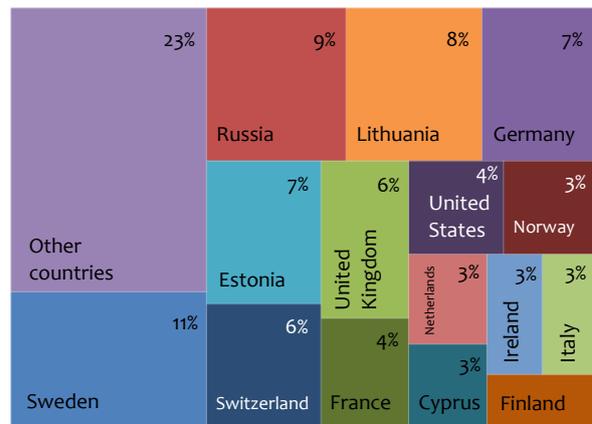
Each year the share of exports of services to EU countries has increased. In 2011, the share of exports to the EU amounted to 49%. In the first half of 2019, however, it has risen to 67%. Exports of services to CIS countries (mainly transit services) still comprise a significant share of total export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

to CIS countries have slightly declined from 17% in 2014 to 12% in the first half of 2019.

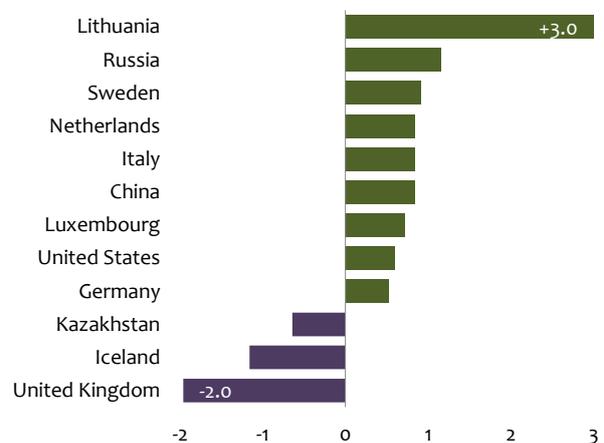
Exports of Services contribution to growth in January-August 2019, changes as percentage points



Structure of Exports of Services by Country January-June 2019, structure as per cent



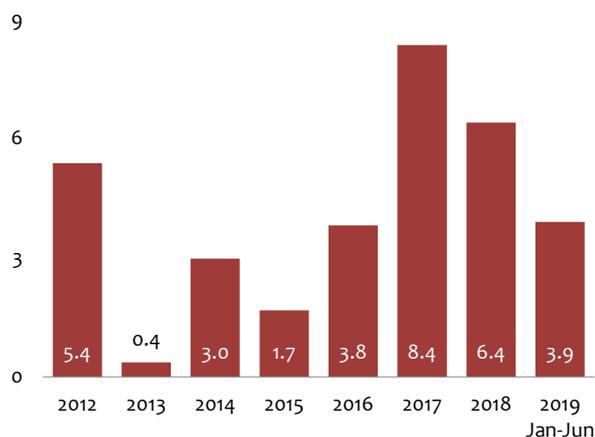
Exports of Services by Country January-August 2019, changes as percentage points



## IMPORTS

In recent years, imports of goods and services have steadily increased. In 2017, imports of goods grew at a higher rate than imports of services.

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

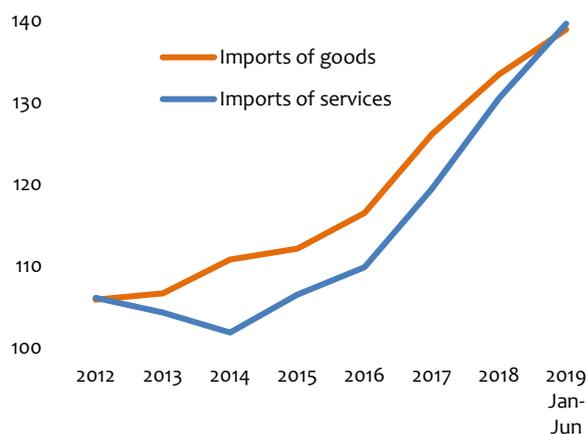


### In 2018, rapid growth in imports of goods continued.

Imports at current prices increased by 11.4%. The increase was mainly facilitated by volume growth in electrical machinery and equipment, iron and steel, wood and articles of wood, and mineral products. In January-August 2018, imports increased more moderately – by 1%. The growth in imports was mainly driven by an increase in the value of aircrafts and parts thereof, pharmaceutical products, and fertilisers. However, a decline in the value of imports was observed in electrical machinery and equipment, mineral products, and iron and steel.

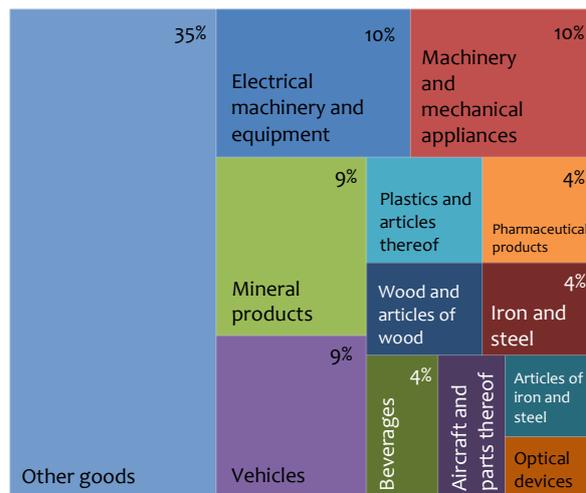
The main Latvia's imports of goods partner countries are Lithuania, Germany, Poland, Estonia, Russia, Finland, and the Netherlands. In January-August 2019, their production volumes amounted to more than 60% of Latvia's total imports of goods.

**Imports of Goods and Services**  
2011 = 100



Since 2012, the import structure by the end use of goods has not significantly changed. Due to a decline in the value of fuel imports, the share of intermediate consumption goods has slightly declined. Similarly, the share of fuel in intermediate consumption has decreased from 34% in 2012 to 20% in 2018. The drop to a large extent can be explained by declining world prices for oil.

**Structure of Imports of Goods**  
January-August 2019, structure as per cent

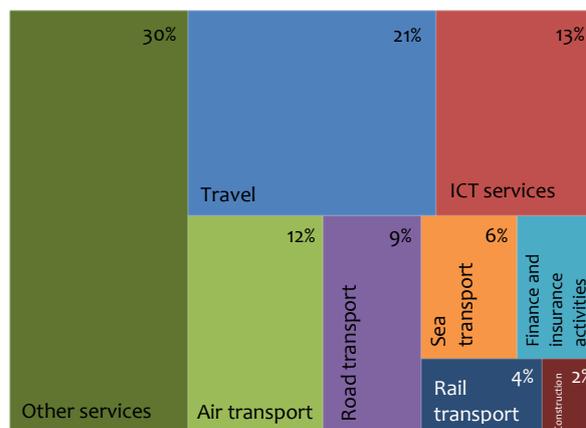


In recent years, imports of services have grown at a relatively higher rate than imports of goods. Between 2015-2018, imports of services increased by 8.9% annually.

### In January-June 2019, imports of services at current prices grew by 8.2%.

In the first half of 2019, imports of trade and ICT services, road transport, and air transport significantly increased. However, a decline was observed in finance and insurance activities.

**Structure of Imports of Services**  
January-June 2019, structure as per cent



2019 | 2

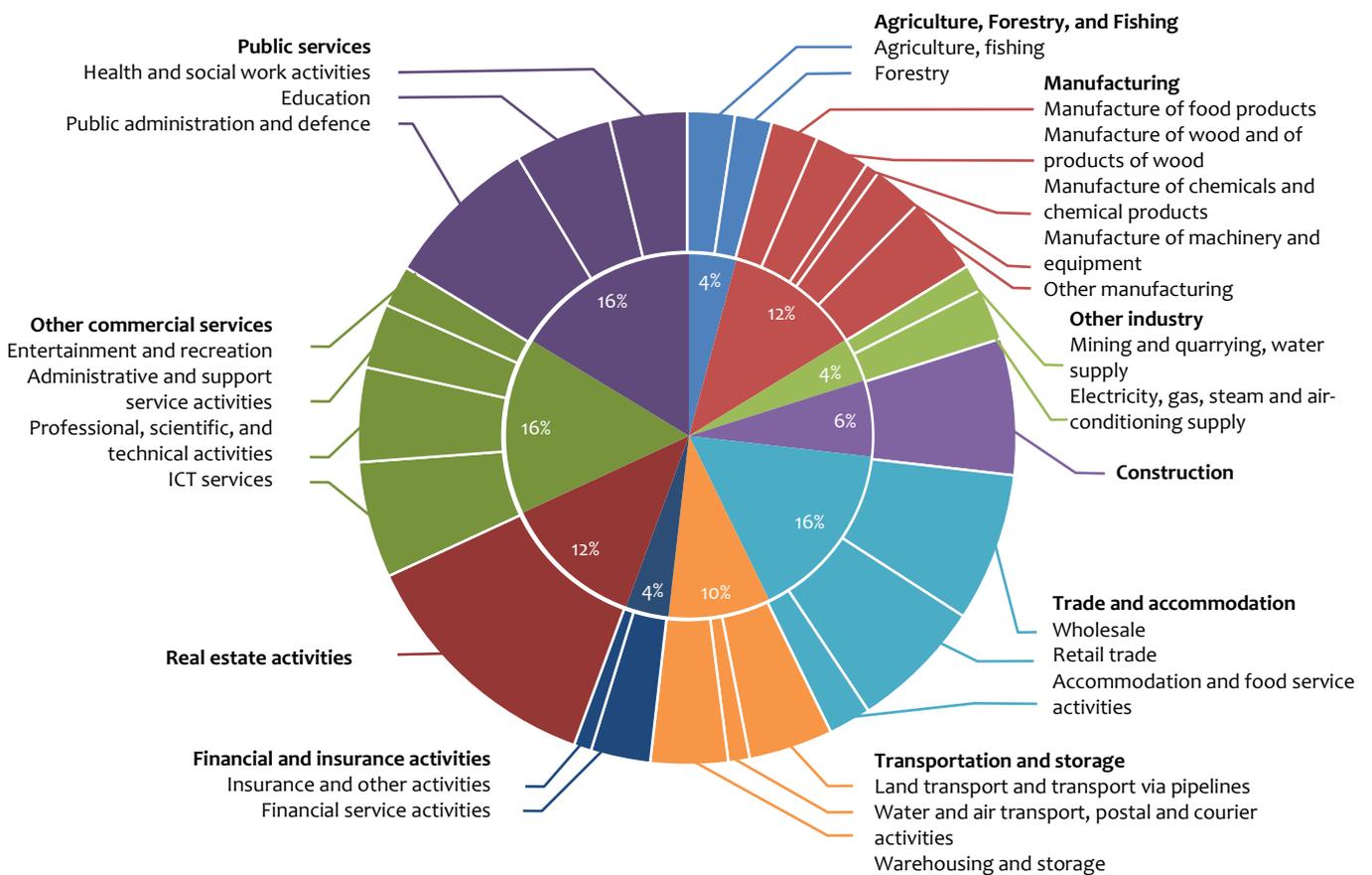
# SECTOR DEVELOPMENT

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 26.4% of the total value added. However, in 2010, the share for these sectors reached 33.2%. In 2018, it slightly declined to 28.7%. 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 and transport. Nonetheless, in 2017 and 2018, the largest growth was observed specifically in construction and transport.

In 2018, goods accounted for 27% and services for 73% of total value added.

Structure of Value Added  
2018\*, as per cent



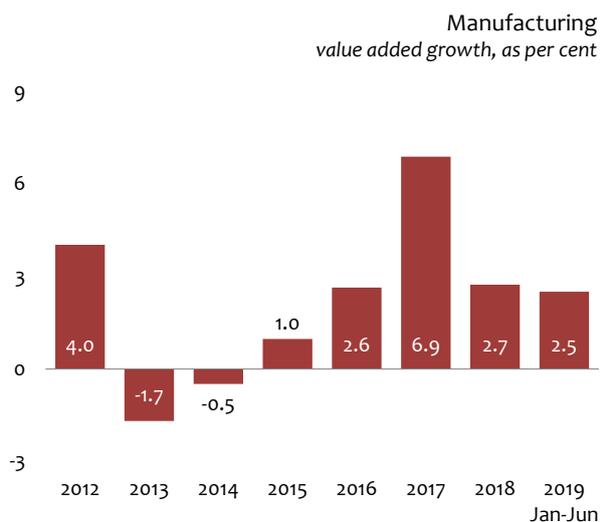
\* calculations by the Ministry of Economics

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

	2015	2016	2017	2018	2019 Jan-Jun
<b>Gross domestic product</b>	<b>3.3</b>	<b>1.8</b>	<b>3.8</b>	<b>4.6</b>	<b>2.3</b>
Agriculture, forestry, and fishing	12.6	-10.5	5.1	2.1	10.2
Mining and quarrying	11.5	-4.4	11.2	3.7	4.7
Manufacturing	1.0	2.6	6.9	2.7	2.5
Manufacture of food products	-4.6	1.8	5.2	-2.9	-1.3
Light industry	-13.2	2.1	7.6	-0.8	-1.3
Manufacture of wood and of products of wood	7.1	8.0	2.1	4.5	2.3
Manufacture of paper and paper products	0.0	3.6	4.5	-3.7	4.4
Manufacture of chemicals and chemical products	-4.1	10.7	11.4	7.0	-0.1
Manufacture of non-metallic mineral products	-9.8	11.6	11.1	1.3	-6.4
Manufacture of basic metals	34.8	5.4	12.0	3.6	12.3
Manufacture of computer, electronic and optical products	16.7	12.6	15.8	12.1	11.5
Manufacture of machinery and equipment	7.9	8.5	21.5	7.0	5.2
Manufacture of motor vehicles	3.5	-2.9	22.8	7.3	0.2
Other manufacturing	3.5	0.8	4.3	-1.8	3.7
Electricity, gas, steam, and air-conditioning supply	22.9	17.9	-1.8	-2.7	-12.8
Construction	-2.4	-14.9	14.3	17.6	2.0
Construction of buildings	-8.2	-11.1	22.4	25.6	4.7
Civil engineering	0.4	-25.7	30.0	11.6	-3.3
Trade	7.4	2.9	2.3	1.8	4.6
Retail trade	4.9	2.3	4.3	3.8	3.4
Transportation and storage	-7.8	6.2	7.5	4.7	-1.2
Freight rail transport	-2.4	-14.1	-8.4	12.5	-7.9
Cargo handling	-6.2	-9.3	-2.0	6.9	-0.2
Freight transport by road	0.5	1.3	7.0	12.8	-4.2
Accommodation and food service activities	6.0	1.5	9.4	5.2	7.0
Information and communication services	1.9	5.4	8.7	12.8	3.1
Finance and insurance activities	7.2	0.4	-17.6	1.0	-0.9
Real estate activities	1.5	0.5	-0.5	2.6	0.2
Other service activities	6.2	1.0	5.6	2.7	5.9
Public administration and defence; compulsory social security	1.5	2.7	3.5	3.2	2.1
Education	2.1	0.7	5.1	2.1	2.2
Health and social work activities	5.8	1.0	8.5	5.1	9.1
Arts, entertainment, and recreation	-4.2	5.0	6.7	4.8	6.0

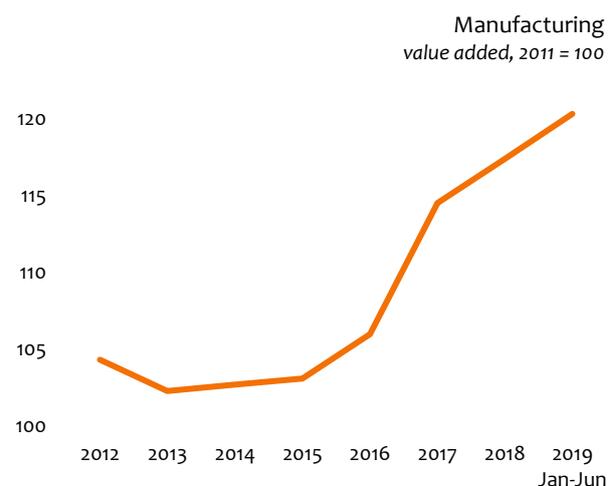
## MANUFACTURING

The development of manufacturing is driven by improvements in the competitiveness of producers in Latvia and the favourable demand dynamics in major export markets. In 2017, a rapid growth in production volumes was observed. In 2018, the growth rate, however, slightly moderated. The growth was positively affected by the largest sub-sector – manufacture of wood and its products. At the same time, the second largest sub-sector (manufacture of food products) slightly declined.



products, machinery and equipment, and the manufacture of chemicals and chemical products. In January-August 2019, however, production volumes declined in the manufacture of food products, non-metallic mineral products, and the manufacture of motor vehicles.

In January-August 2019, turnover in manufacturing at current prices increased at a higher rate than output volumes. During the period, a similar increase in production volumes both in domestic and external markets has been observed.

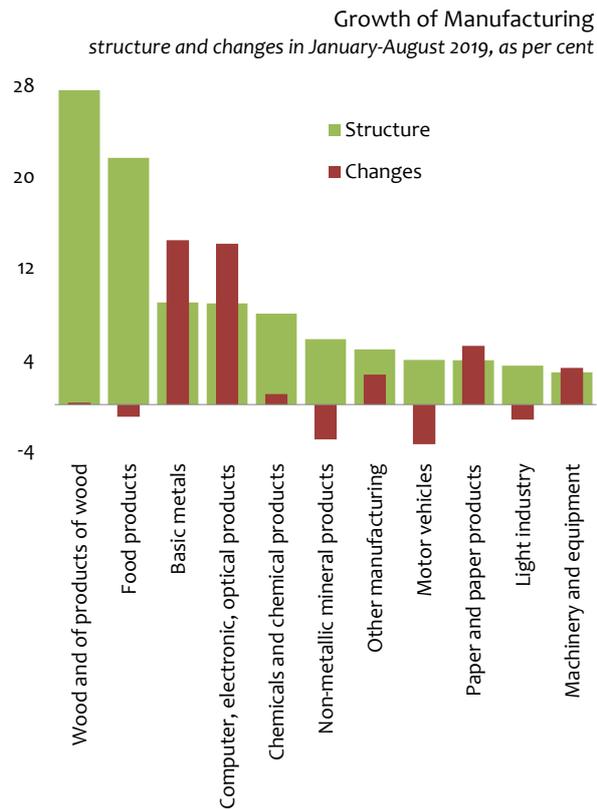


In January-August 2019, a relatively moderate growth in manufacturing was observed. The growth was mainly driven by positive developments in the manufacture of basic metals and the manufacture of computer, electronic, and optical products. Similarly, production volumes increased in the manufacture of paper and paper

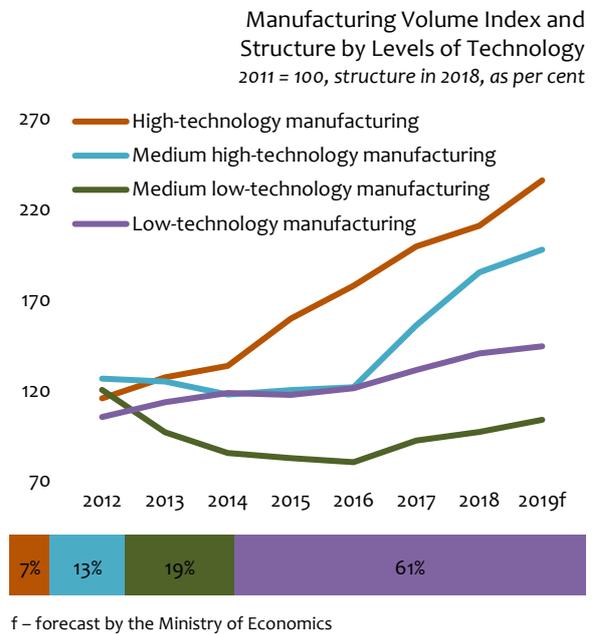
products. In 2018 and during the first half of 2019, the number of occupied posts continued to increase. In January-June 2019, the largest increase was observed in the manufacture of non-metallic mineral products. However, a decline in occupied posts was recorded in light industry and in the manufacture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

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

	Structure in 2018			Changes in production volumes				
	Output	Occupied posts	Exports in total sales	2015	2016	2017	2018	2019 Jan-Aug
<b>Manufacturing</b>	<b>100</b>	<b>100</b>	<b>65.4</b>	<b>4.3</b>	<b>5.6</b>	<b>8.0</b>	<b>2.7</b>	<b>2.3</b>
Manufacture of food products	21.5	19.6	35.0	-4.6	1.8	5.2	-2.9	-1.1
Light industry	3.5	10.0	84.1	-13.2	2.1	7.6	-0.8	-1.3
Manufacture of wood and of products of wood	28.2	20.2	71.3	7.1	8.0	2.1	4.5	0.2
Manufacture of paper and paper products	3.8	4.3	64.7	0.0	3.6	4.5	-3.7	5.2
Manufacture of chemicals and chemical products	8.3	7.2	76.8	-4.1	10.7	11.4	7.0	0.9
Manufacture of non-metallic mineral products	6.0	4.9	52.4	-9.8	11.6	11.1	1.3	-3.1
Manufacture of basic metals	8.5	10.1	68.5	34.8	5.4	12.0	3.6	14.5
Manufacture of computer, electronic, and optical products	8.2	4.7	90.5	16.7	12.6	15.8	12.1	14.2
Manufacture of machinery and equipment	2.7	3.5	88.4	7.9	8.5	21.5	7.0	3.2
Manufacture of motor vehicles	4.1	3.4	91.7	3.5	-2.9	22.8	7.3	-3.5
Other manufacturing	5.0	12.1	66.4	3.5	0.8	4.3	-1.8	2.6

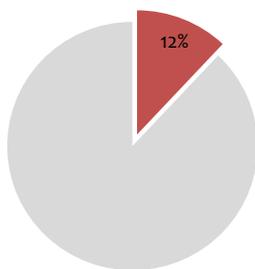


In 2019, it is anticipated that similar growth in manufacturing will prevail. Accelerated growth in manufacturing will be constrained by uncertainties in the external environment, which will not provide significant export expansion opportunities.

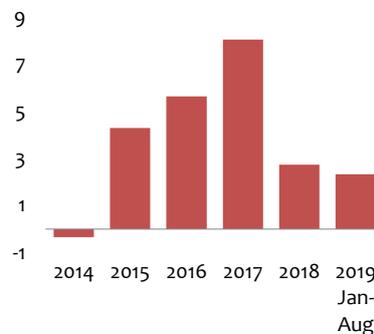


### Main Indicators in Manufacturing<sup>1</sup>

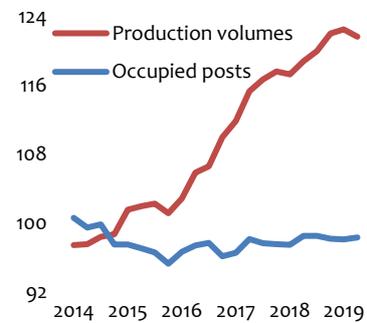
Share in total value added 2018, as per cent



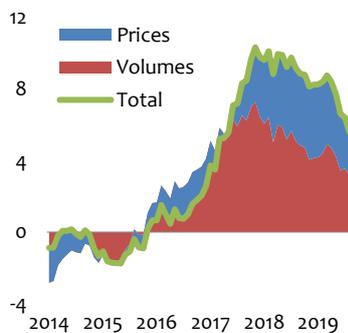
Changes in production volumes as per cent



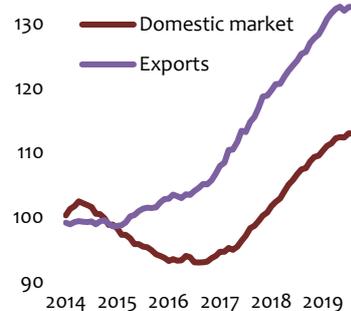
Production volumes and occupied posts Q4 2013 = 100



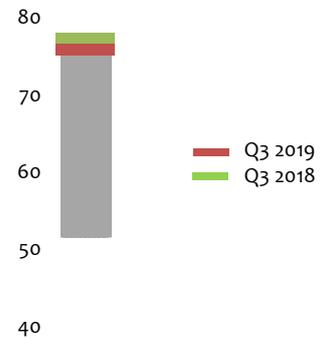
Changes in production sales 12-month moving average



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



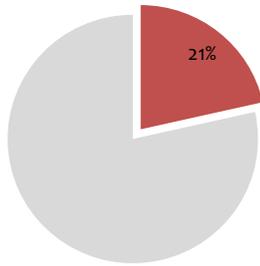
Capacity utilization rate Historically highest/lowest level, as per cent



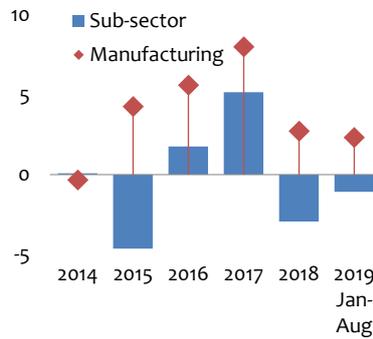
<sup>1</sup>Sales data available until August 2019; data on occupied posts available until Q2 2019

Manufacture of food products and beverages

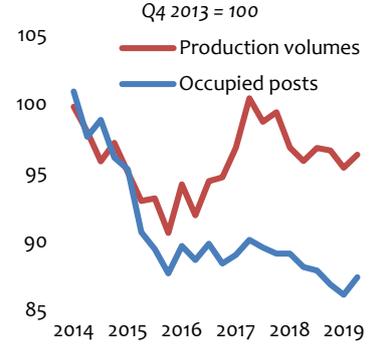
Share in total manufacturing 2018, as per cent



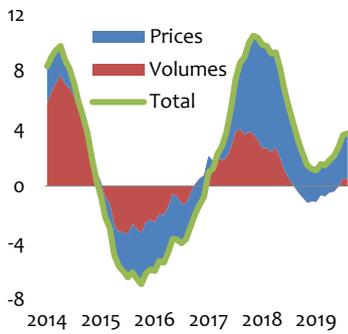
Changes in production volumes as per cent



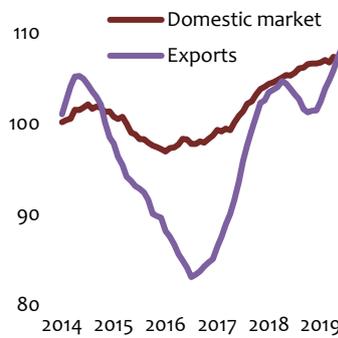
Production volumes and occupied posts Q4 2013 = 100



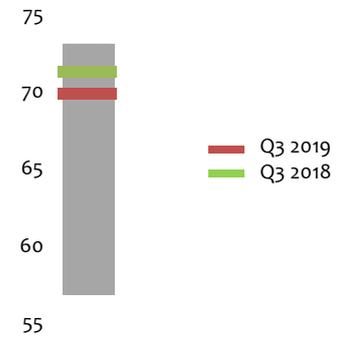
Changes in production sales 12-month moving average



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

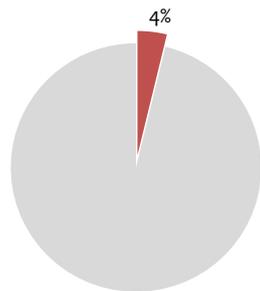


Capacity utilization rate Historically highest/lowest level, as per cent

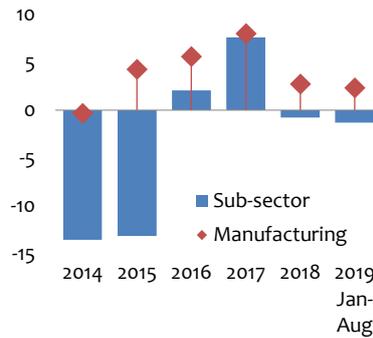


Light industry

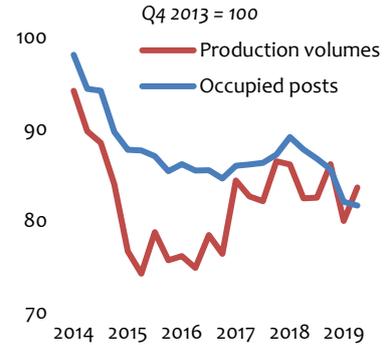
Share in total manufacturing 2018, as per cent



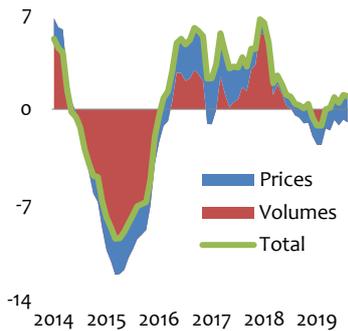
Changes in production volumes as per cent



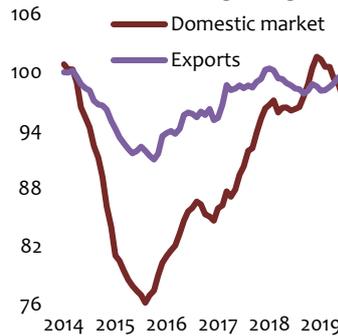
Production volumes and occupied posts Q4 2013 = 100



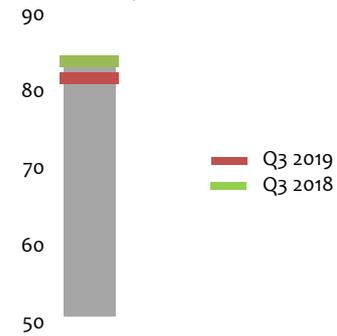
Changes in production sales 12-month moving average



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

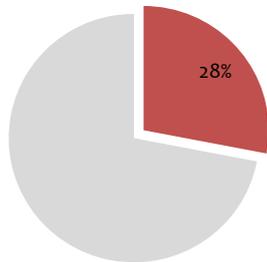


Capacity utilization rate Historically highest/lowest level, as per cent

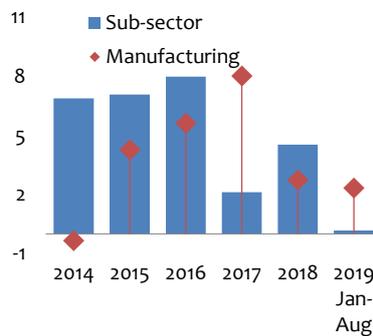


Manufacture of wood and of products of wood

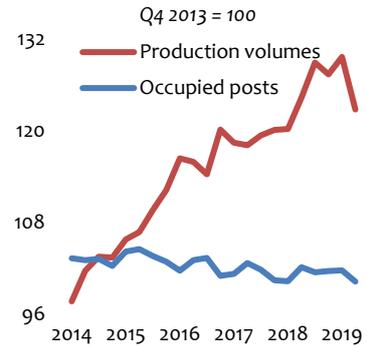
Share in total manufacturing 2018, as per cent



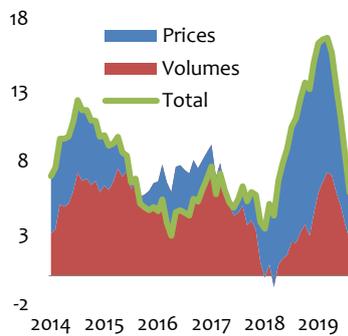
Changes in production volumes as per cent



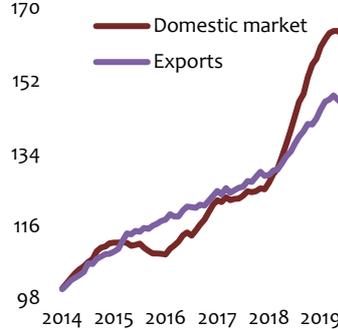
Production volumes and occupied posts Q4 2013 = 100



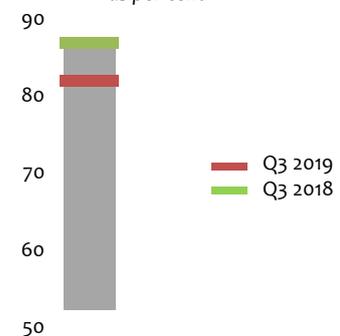
Changes in production sales 12-month moving average



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

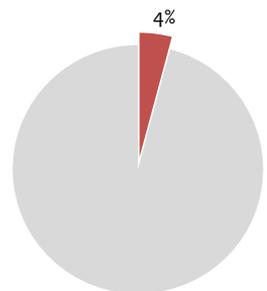


Capacity utilization rate Historically highest/lowest level, as per cent

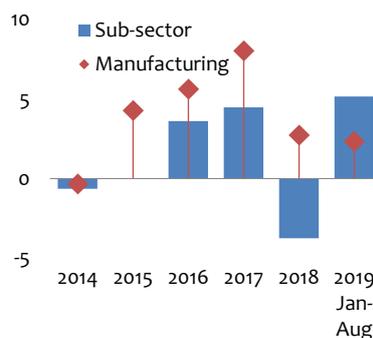


Manufacture of paper and paper products

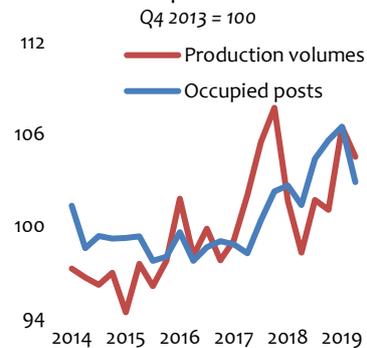
Share in total manufacturing 2018, as per cent



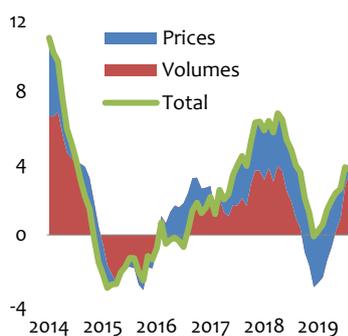
Changes in production volumes as per cent



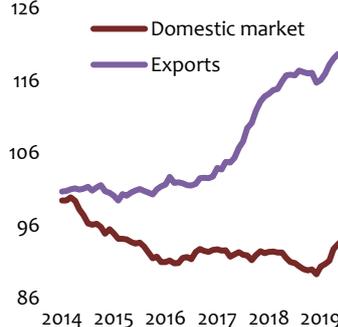
Production volumes and occupied posts Q4 2013 = 100



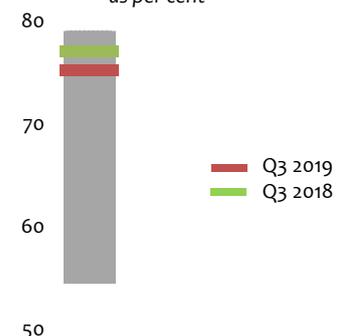
Changes in production sales 12-month moving average



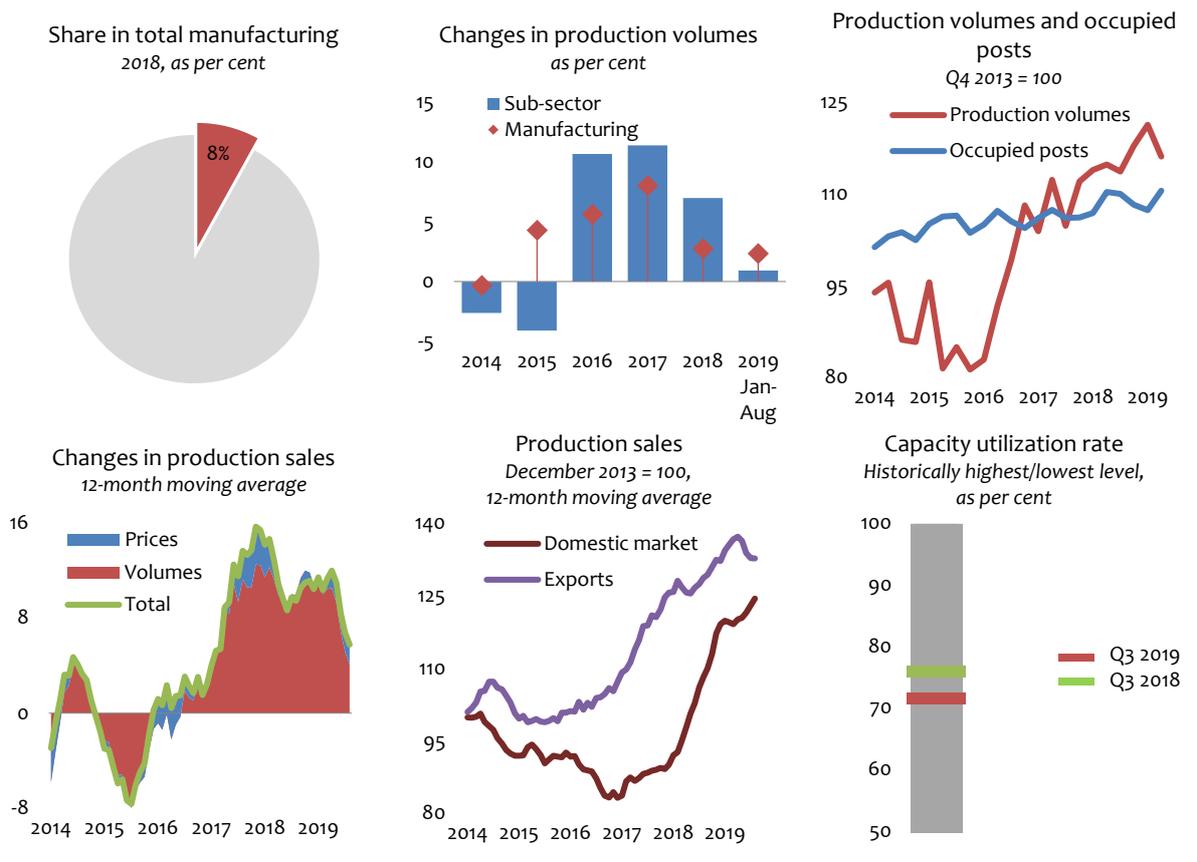
Production sales December 2013 = 100, 12-month moving average



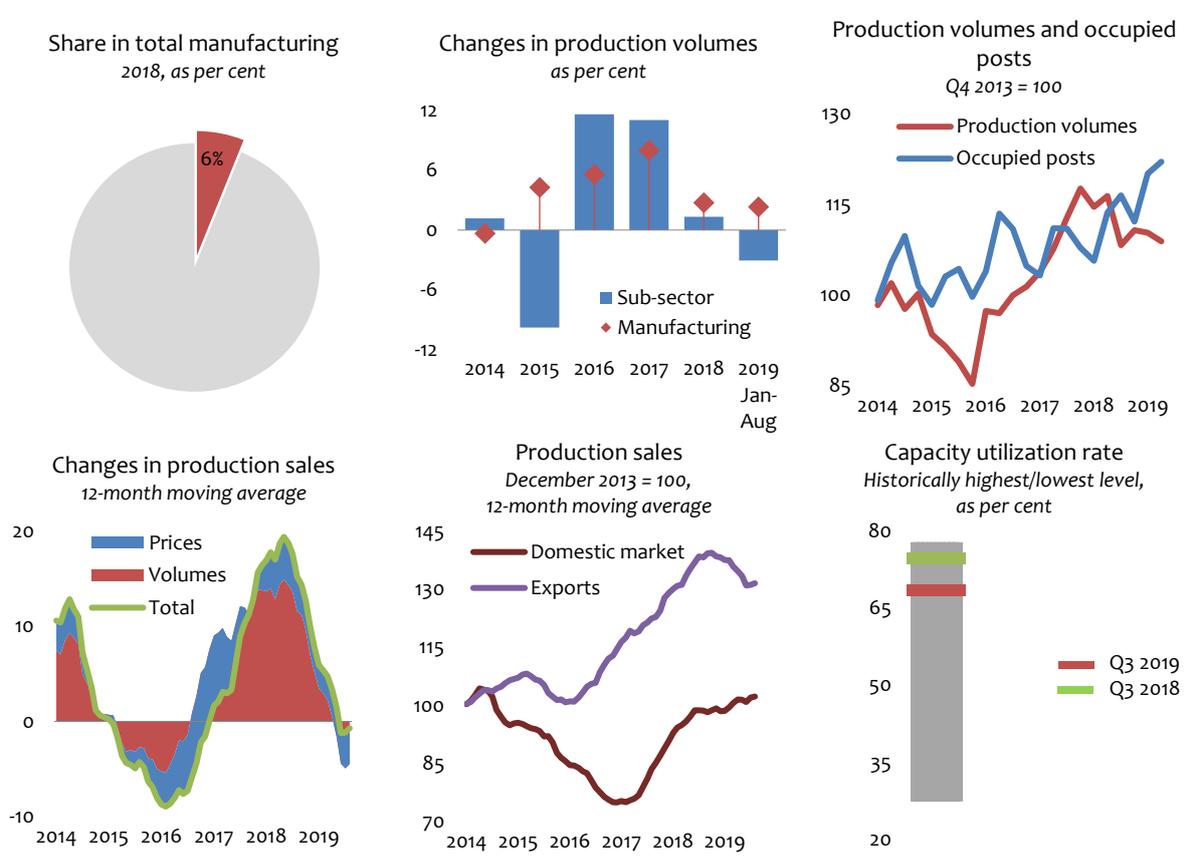
Capacity utilization rate Historically highest/lowest level, as per cent



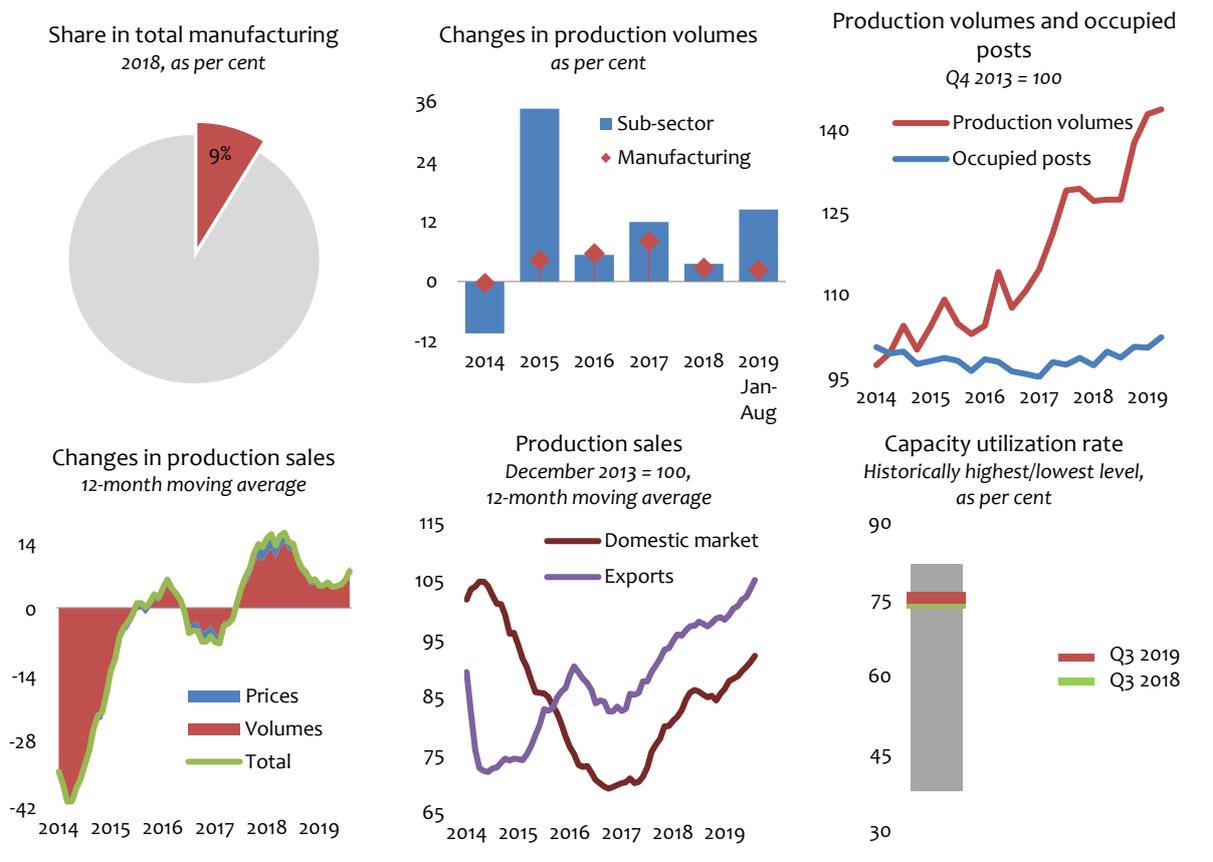
Manufacture of chemicals and chemical products



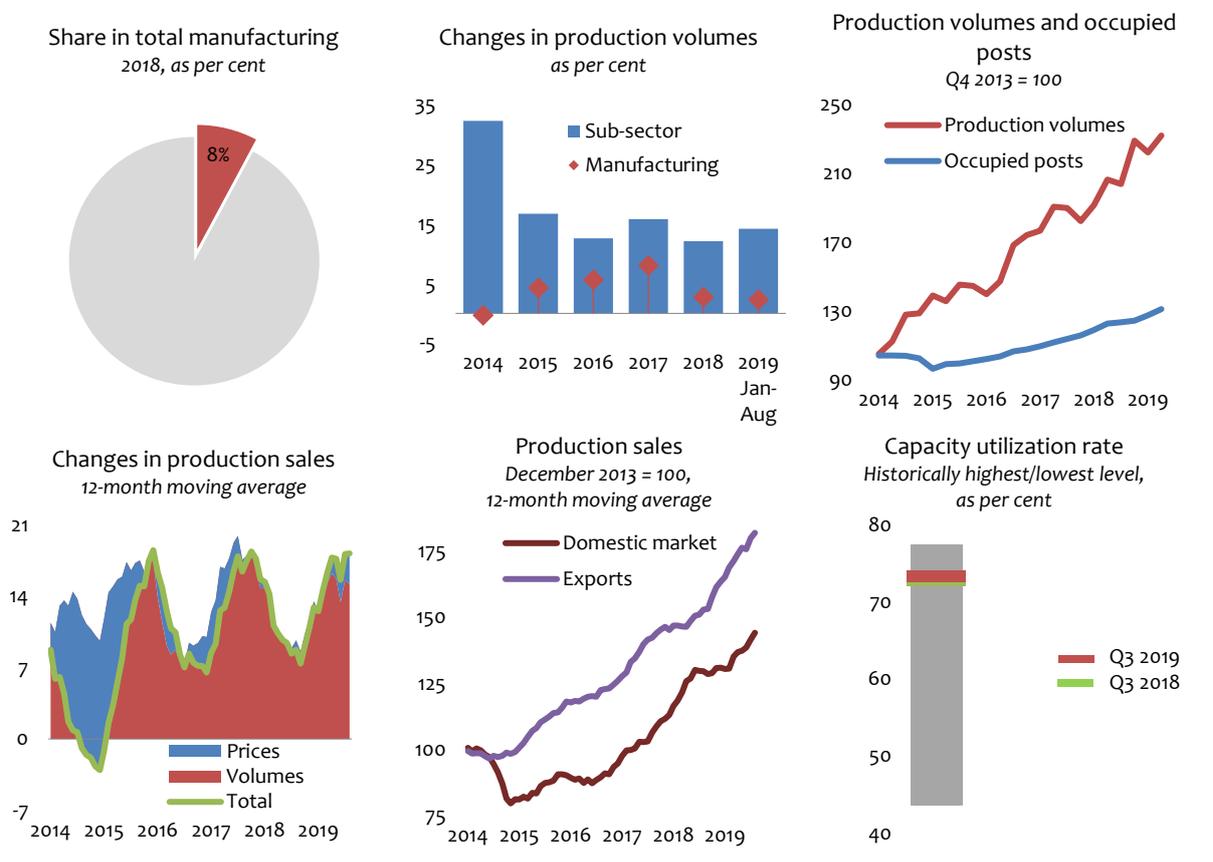
Manufacture of non-metallic mineral products



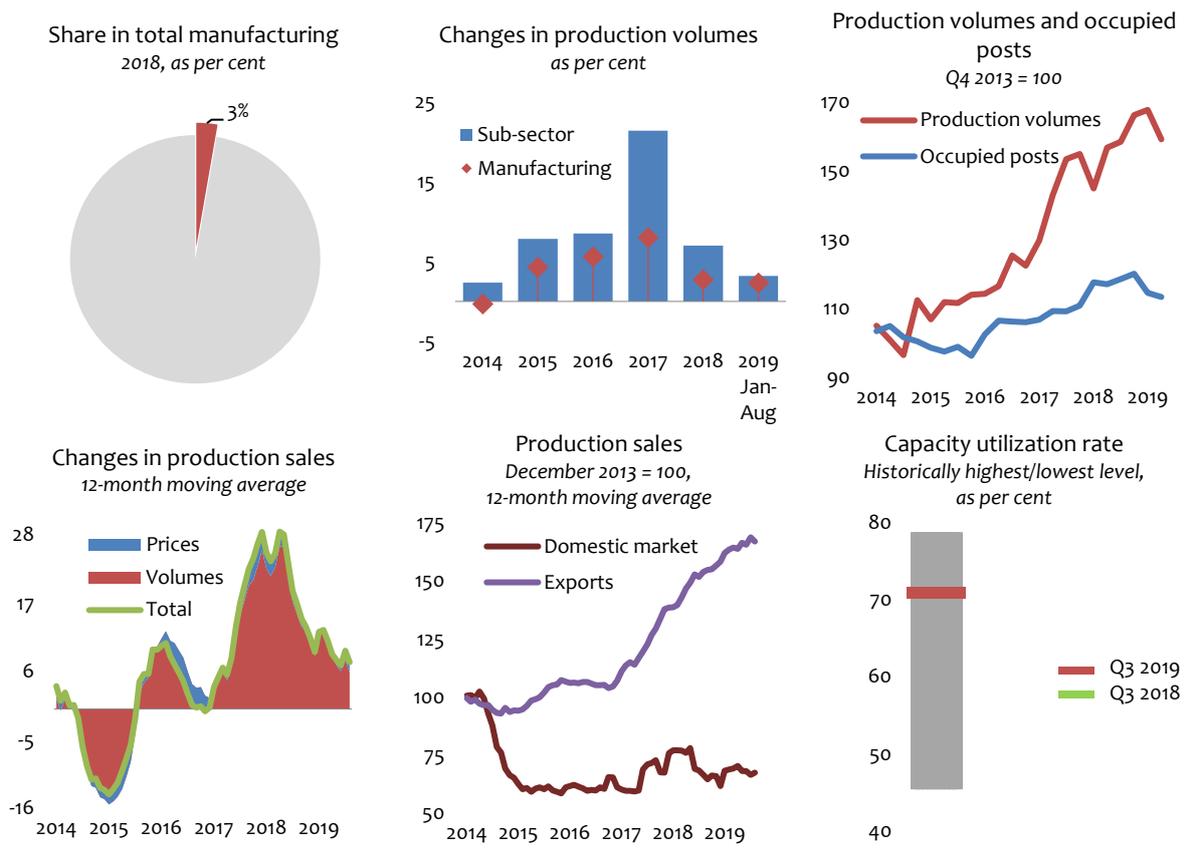
Manufacture of basic metals and fabricated metal products



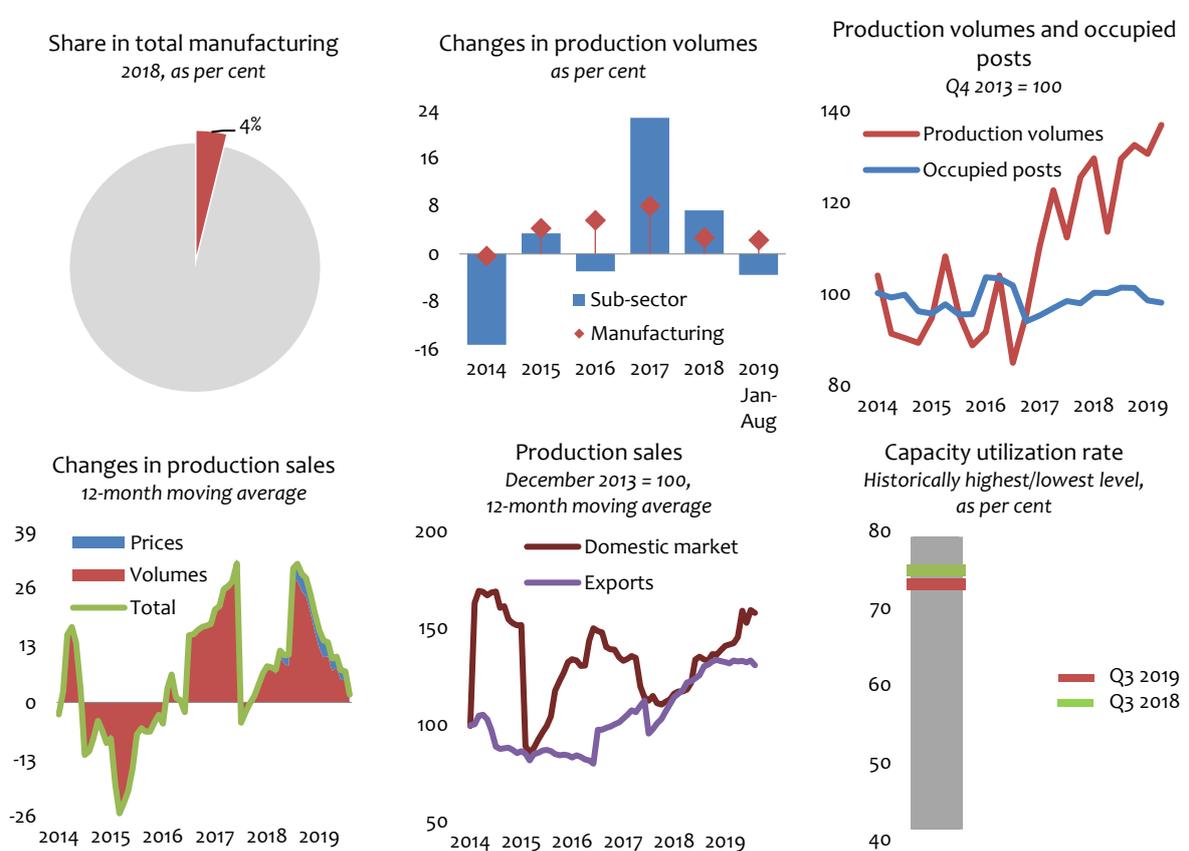
Manufacture of computer, electronic, and optical products



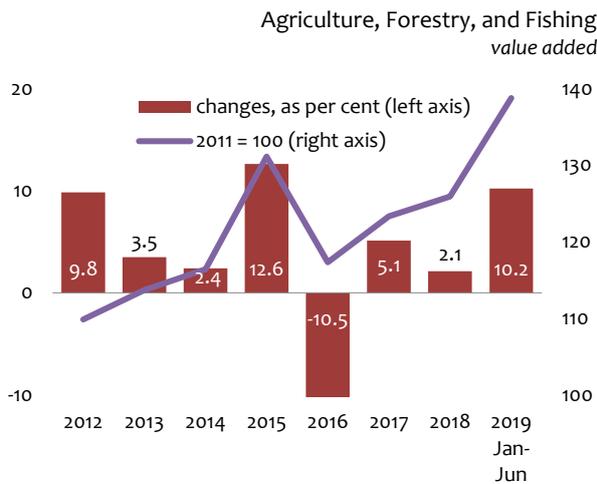
Manufacture of machinery and equipment



Manufacture of motor vehicles



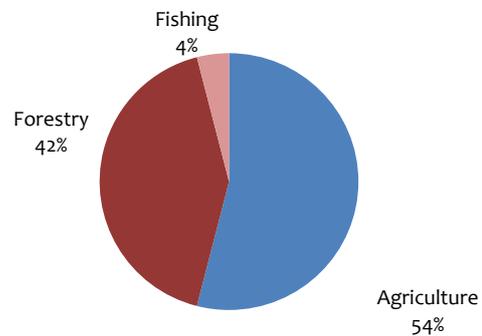
AGRICULTURE, FORESTRY, AND FISHING



In 2018, the sector's growth was largely driven by accelerated growth in forestry, which compensated muted growth in agriculture due to a prolonged drought that affected cereal and vegetable yields. The number of employed is on a decline. However, the number of occupied posts within the sector has recently increased, also exceeding 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.

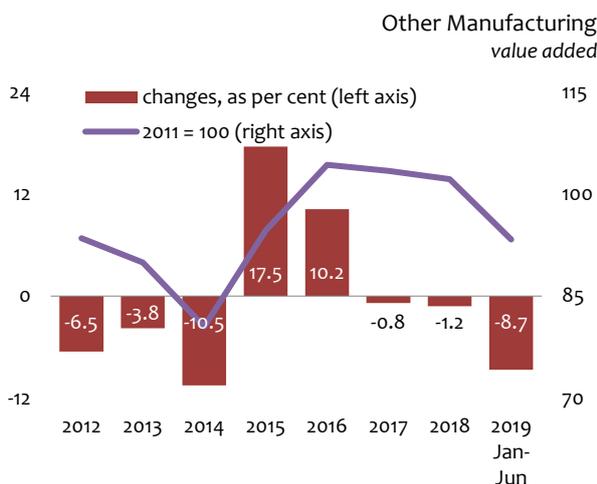
Agriculture and forestry provide the largest contribution to growth within the sector. The economic activity of the sector is closely tied to weather conditions. Thus, volatile growth within the sector can be observed. After a significant increase in production volumes in agriculture, which was mainly facilitated by record high grain yields, a decline was observed in 2016. However, in 2017, despite adverse weather conditions, the second highest average yield in Latvia's history was achieved.

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



\*- forecast by the Ministry of Economics

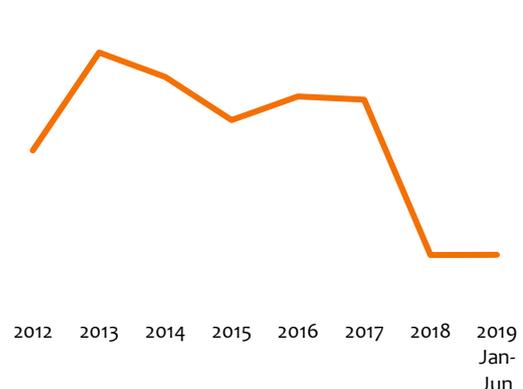
OTHER MANUFACTURING



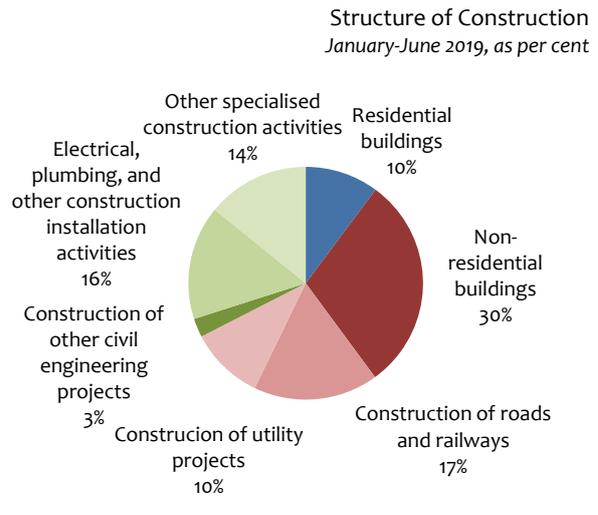
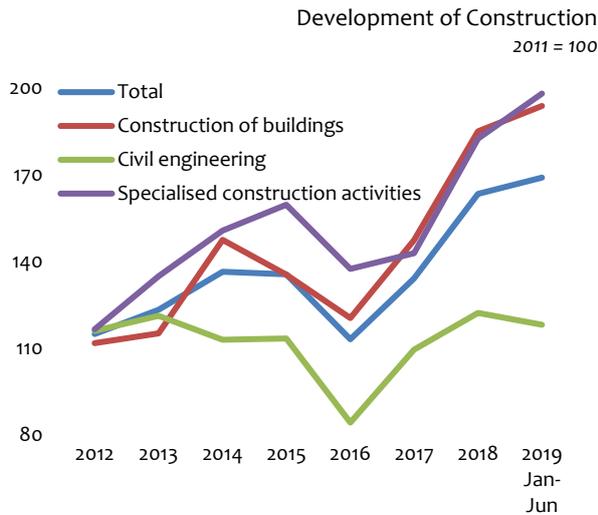
increased. In 2017-2018, however, production volumes in other manufacturing declined due to a downturn in electricity and gas supply, as sub-sectors were adversely affected by warm weather conditions. In the first half of 2019, a decline in production volumes continued – still negatively affected by warm weather conditions. Currently, a decline in occupied posts can be observed in electricity, gas, steam, and air-conditioning supply.

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

Occupied Posts in Other Manufacturing in thousands



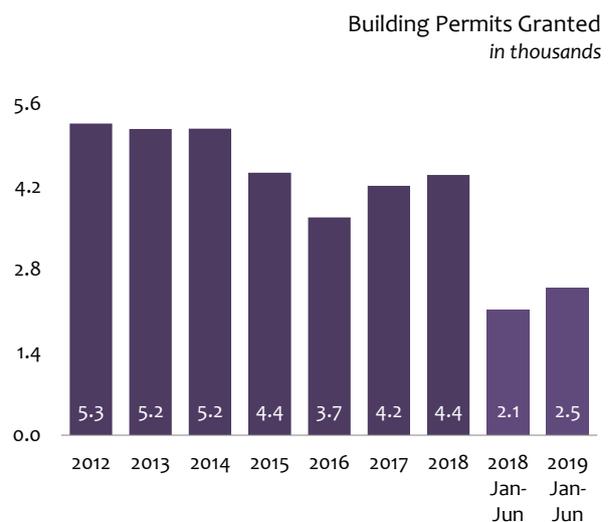
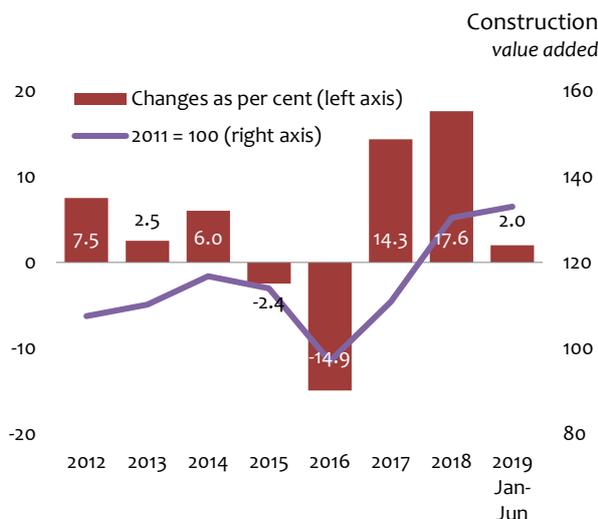
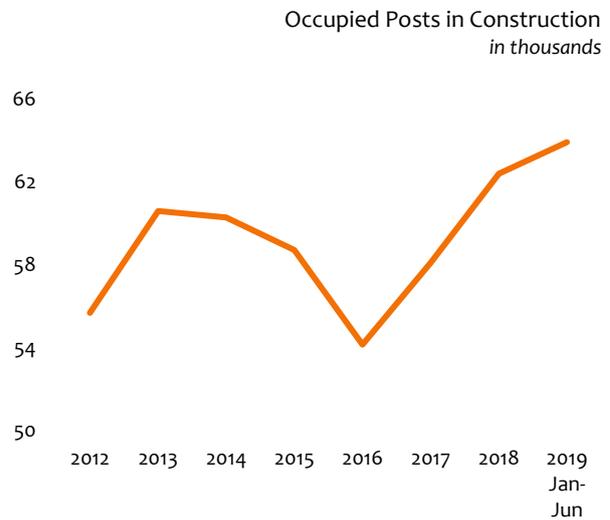
CONSTRUCTION



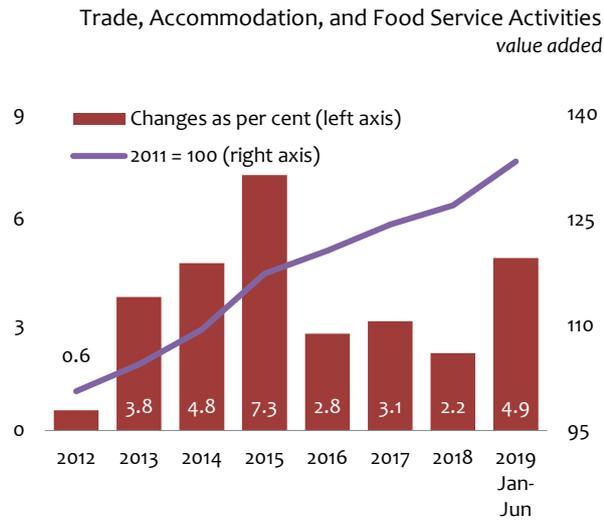
During the past two years, construction experienced very high growth rates. However, production volumes in 2019 indicate that growth has slightly subdued. In the first half of 2019, production volumes increased by 2%, compared to the corresponding period last year.

The base effect (the high growth rates achieved in the previous years) is one of the explanations of subdued growth in the first half of 2019. In addition, the development of construction is constrained by the completion of large construction projects and reached investment peak of the EU structural funds.

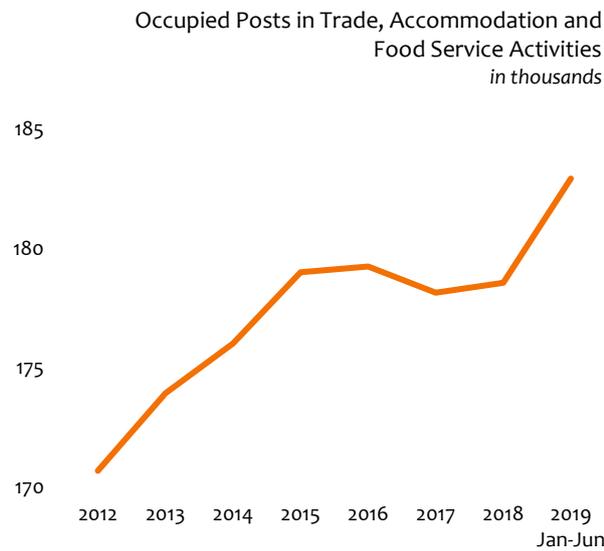
In the first half of 2019, the relatively minor increase was provided by the construction of buildings and specialised construction activities. However, a decline was observed in civil engineering.



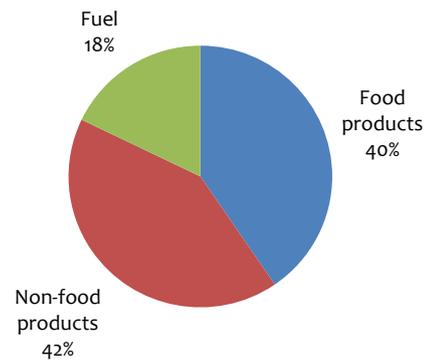
TRADE, ACCOMMODATION, AND FOOD SERVICE ACTIVITIES



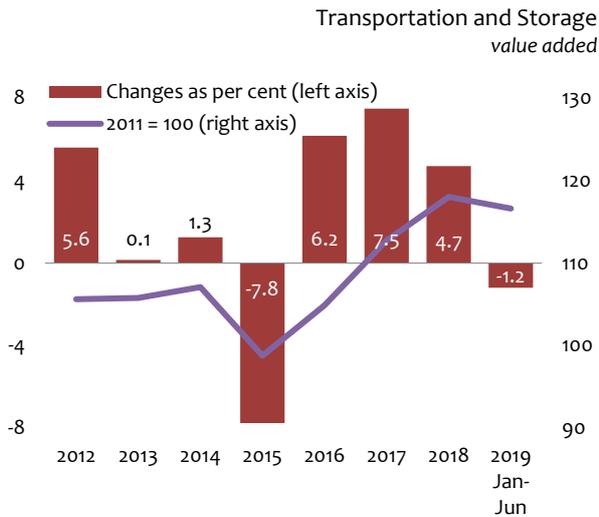
The volume of services provided by trade, accommodation, and food services continue to increase. The sector is positively affected by the rise in private consumption, increase in wages, and improvements in the labour market. In the first half of 2019, an increase of 4.6% was observed. In January-August 2019, retail sales turnover increased by 3.1%. The largest rise in sales was observed for non-food products. Also, in the first half of 2019, turnover of wholesale increased by 8.1%. Accommodation and food services activities were positively affected by the development of tourism. In the first half of 2019, service volumes increased by 7%. The largest share of occupied posts remains in trade. However, a decline in recent years has been observed in accommodation and food service activities.



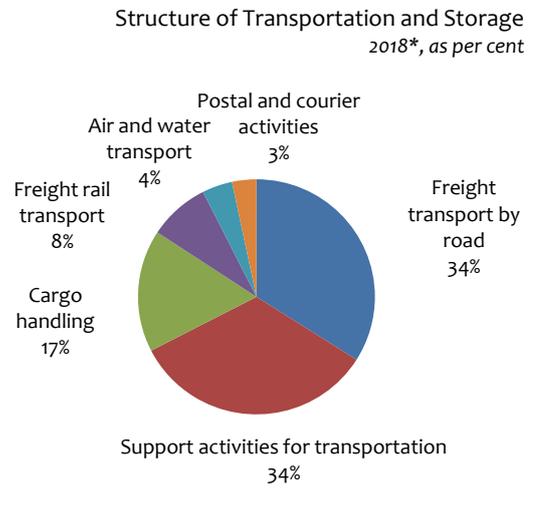
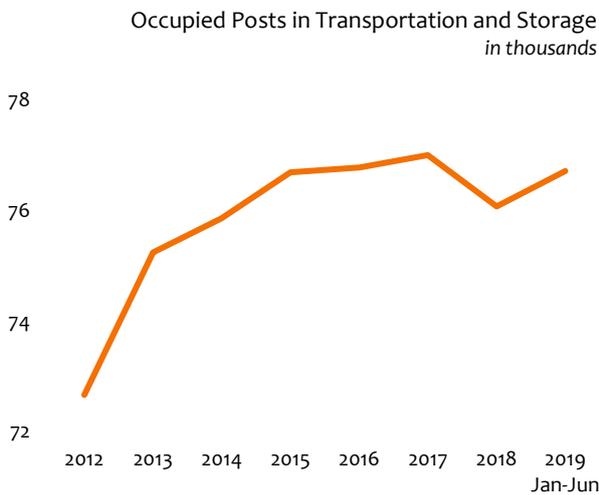
Structure of Retail Turnover 2018, as per cent



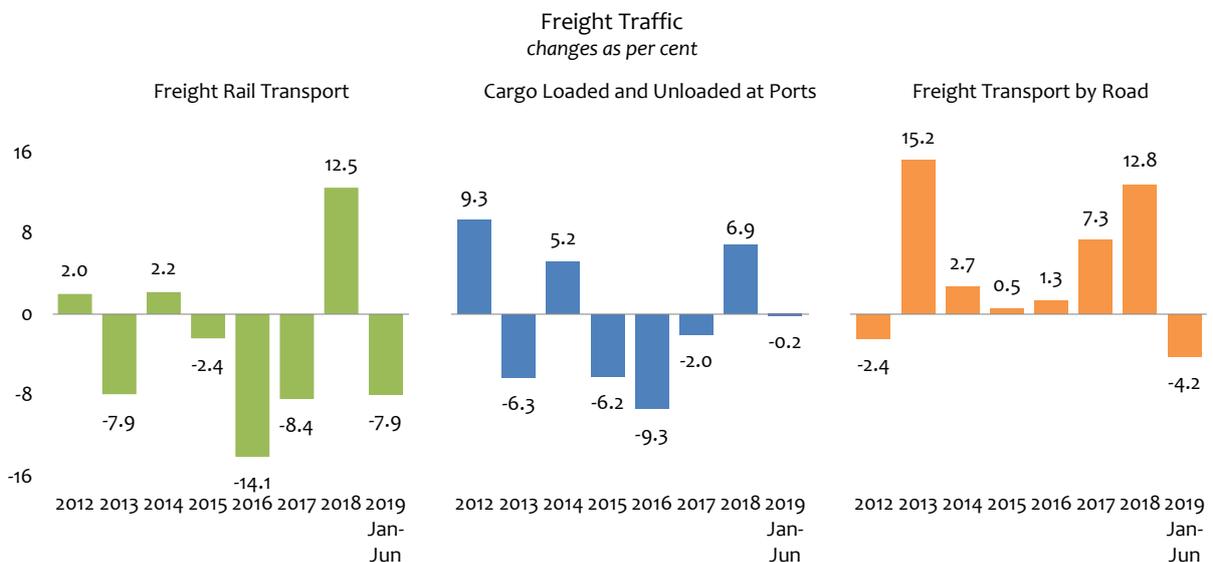
TRANSPORTATION AND STORAGE



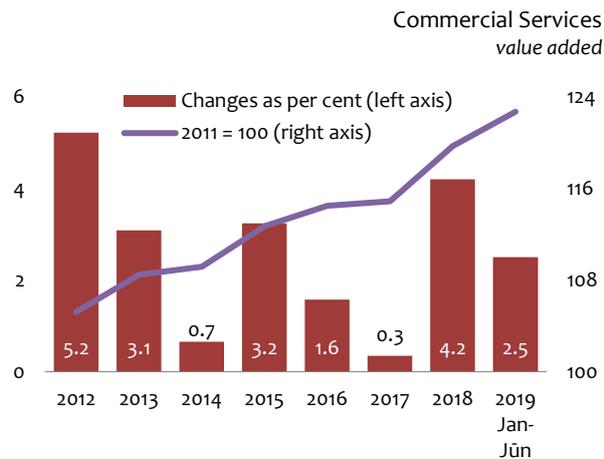
Transportation and storage is closely linked to international transportation. Between 2012-2017, the sector's volumes increased only by 2% annually, reflecting a decline in freight transport caused by Russia's transport policies and increased competition. Since the end of the 1990s, Russia has set itself 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 passengers at airports and seaports. In 2018, freight transport increased. However, in the first half of 2019, a decline in all modes of transport was observed. In the first half of 2019, passenger transport and postal and courier activities increased by 3% and 24%, respectively. However, support activities for transportation declined by 2 percentage points.



\* – forecast by the Ministry of Economics

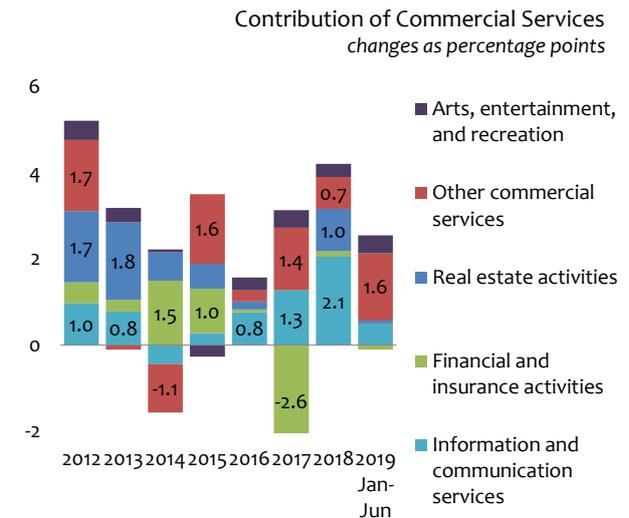


## COMMERCIAL SERVICES

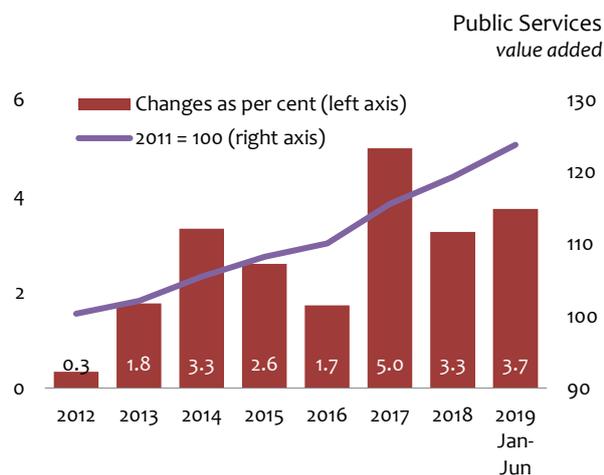


The largest share of added value in commercial services (incl. information and communication services, financial and insurance activities, real estate activities, professional, scientific, and technical services, administrative and support service activities, arts, entertainment, and recreation) provide real estate activities. In the first half of 2019, service volumes in professional, scientific, and technical services and administrative and support service activities increased at a higher rate, compared to the corresponding period last year. Similarly, an increase in volumes was observed in ICT services and arts,

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

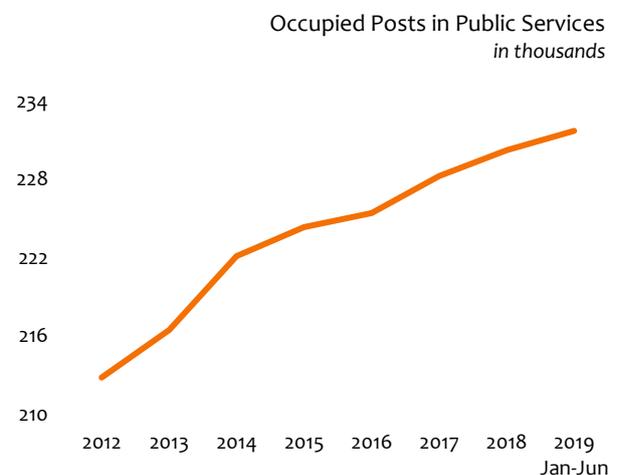


## PUBLIC SERVICES



The largest share of value added in public services (incl. public administration and defence, education, health and social work activities) provide public administration and defence. Since 2013, along with an increase in government spending, steady growth in public services has been observed. In 2017, the largest growth since 2016 was recorded. Also, in the first half of 2019, the sector continued to experience high growth. In recent years,

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

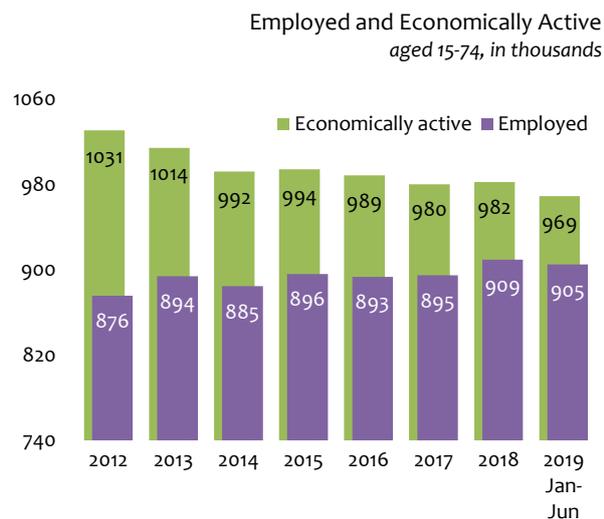


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## LABOUR MARKET

## EMPLOYMENT AND UNEMPLOYMENT

**Despite the economic slowdown, activity in the labour market remains high.** In the first half of 2019, a major driver of economic growth was the development of domestic demand-oriented sectors. An increase in occupied posts was observed in construction and trade. At the same time, demographic processes are increasingly affecting developments in the labour market. The decline in working-age population reduces labour supply, thus adversely affecting free labour force reserves. In the first half of 2019, unemployment rate declined to 6.6% (the lowest rate in the last decade). At the end of August 2019, the number of registered vacancies in State Employment Agency were by 36% higher than a year ago.



**The number of occupied posts is on the rise, and employment rate is close to its potential.** In the first half of 2019, increase in the number of employed has essentially ceased. In the first quarter of 2019, an increase of 0.6% in the number of employed was observed. However, during the second quarter of 2019, already a decline of 0.4% was recorded.

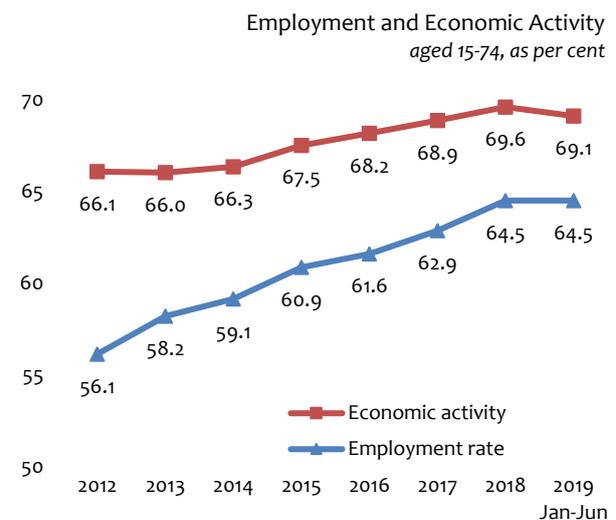
In the first half of 2019, the number of occupied posts increased by 1.7%, compared to the corresponding period last year. In the first and second quarter of 2019, the number of occupied posts increased by 1.9% and 1.5%, respectively.

The number of employed has long been adversely affected by negative demographic trends. It should be noted that the decline in working-age population and changes in the age structure significantly restrict the

involvement of new workers in the labour market, which ultimately will affect total employment dynamics.

Also, increasingly more labour needs are outweighed by productivity gains. Thus, fewer employees are needed to perform certain jobs. This is further illustrated by the differences between the increase in the number of occupied posts and the number of employed in normal working time units. In the second quarter of 2019, the number of occupied posts rose by 1.5%. However, the number of employed in normal working time units increased only by 0.4%. Thus, people are increasingly employed at several jobs. Also, the number of part-time jobs has increased.

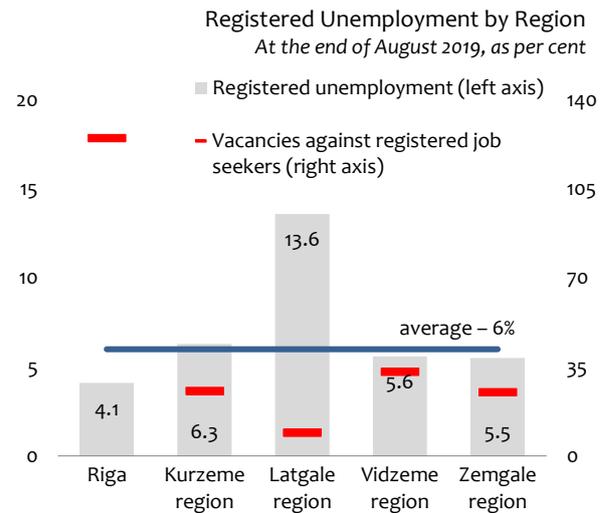
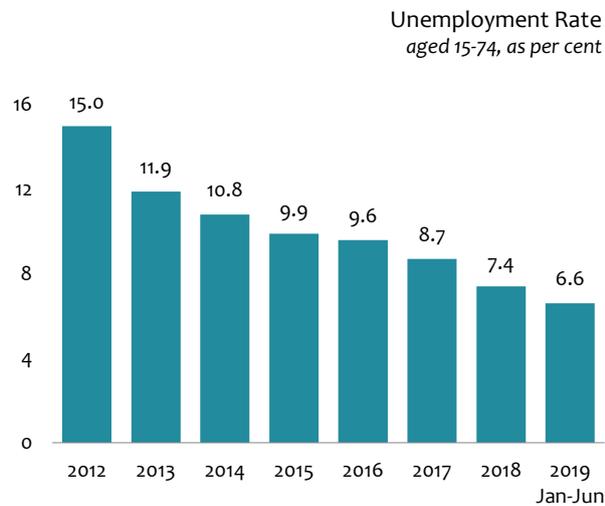
Employment continues to increase. In the second quarter of 2019, employment rate reached 64.7% (the historically highest level).



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

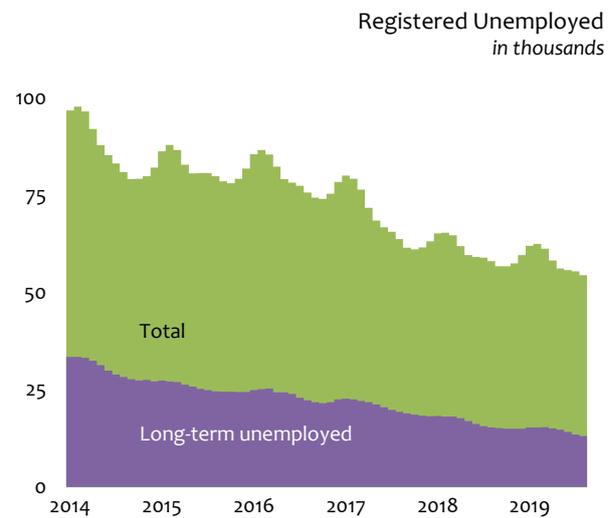
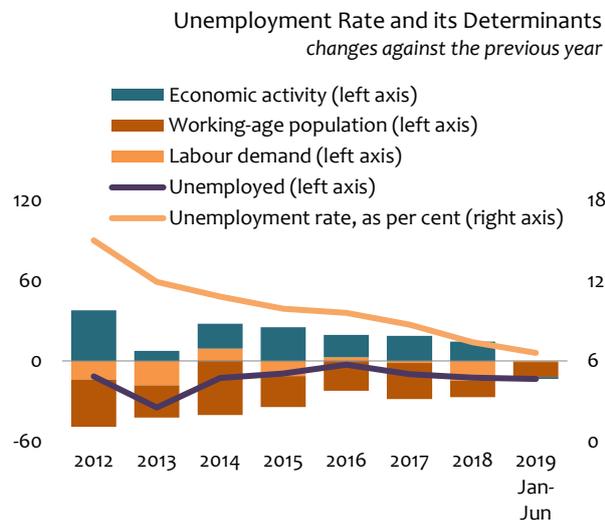
In the first half of 2019, economic activity declined by 0.3 percentage points, in comparison with the corresponding period last year, reaching 69.1% amongst population aged 15-74. Overall, economically active population declined by 12.7 thousand, descending to 968.9 thousand.

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



Also, significant risks are posed by the relatively high share of long-term unemployed – nearly ¼ of registered job seekers are currently unemployed for more than a year.

In the first half of 2019, unemployment rate declined to 6.6% (6.4% in Q2 of 2019), thus closely approaching year 2006/2007 level. Also, the number of unemployed decreased by 64.3 thousand (by 13.5 thousand less than a year ago) in the first half of 2019.



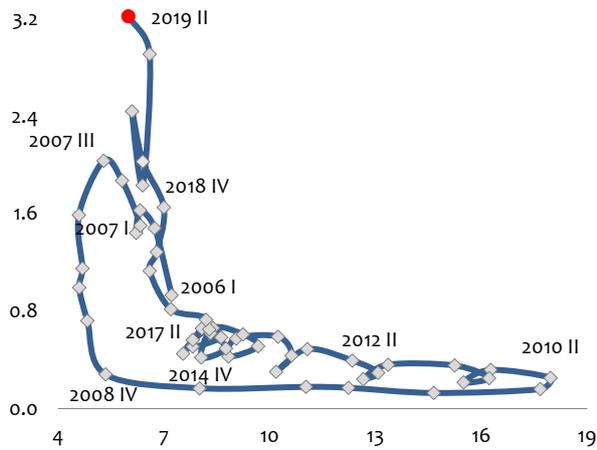
A large share of long-term unemployed can lead to an increase in structural unemployment – the longer these people remain unemployed, the higher the risks of losing the necessary skills required for the job.

Structural problems in the labour market are further illustrated by the right shift of the Beveridge curve – despite the increase in vacancies, the share of job seekers in the labour market has remained high. It should be noted that the number of registered vacancies at the end of August 2019 was 36% higher than a year ago. At the same time, registered unemployment rate has declined only by 0.4% in the corresponding period.

In Latvia, unemployment rate remained higher than in other Baltic countries – in the second quarter of 2019, unemployment rate in Estonia and Lithuania reached 5.1% and 6.2%, respectively.

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

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



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

During the last year, the number of occupied posts in construction increased by 3 thousand or approximately 5%. In the first half of 2019, the number of occupied posts on average increased by 64 thousand.

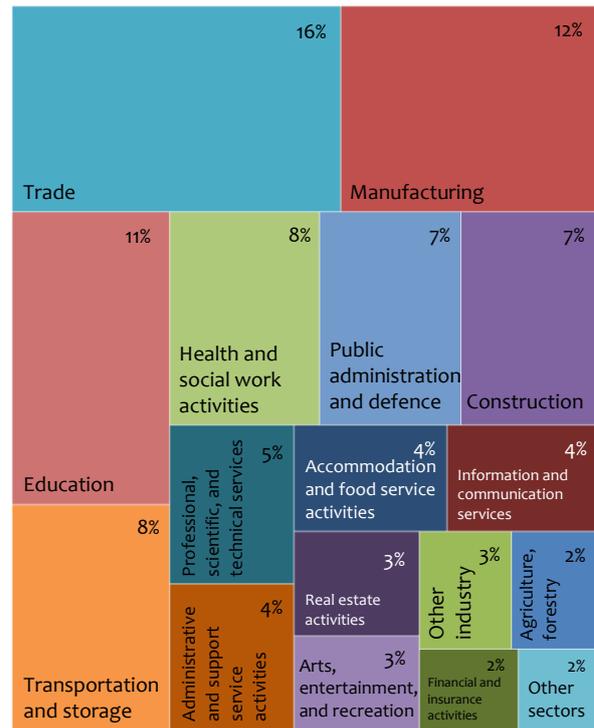
Similarly, a significant increase in labour demand can be observed in trade, where the number of occupied posts increased by 3.2 thousand during the corresponding period.

The largest decline in occupied posts (of 600 or 1%) was observed in public administration.

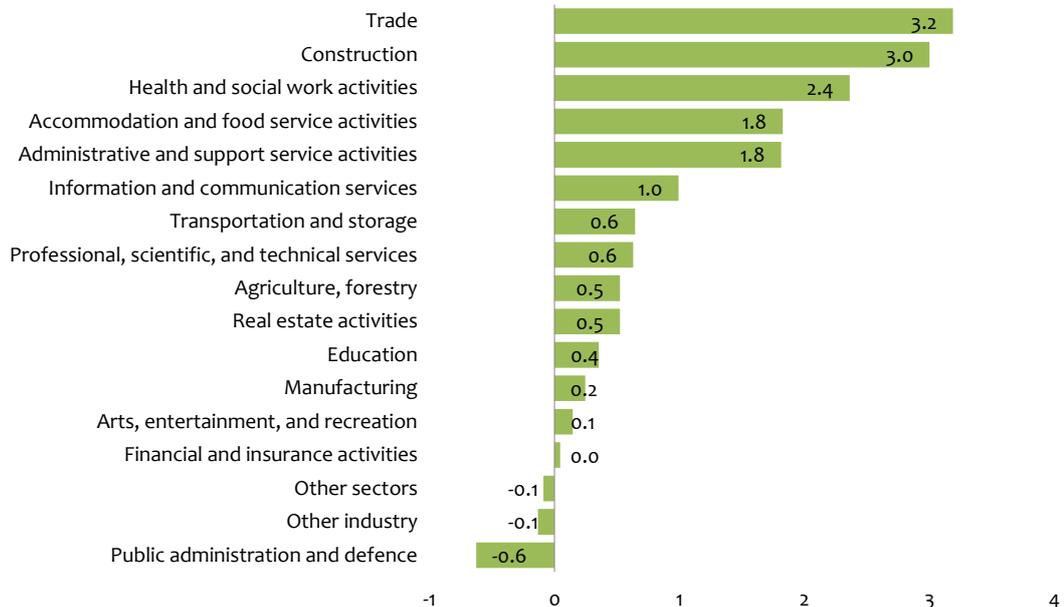
The largest increase in occupied posts still can be observed in the private sector – in the first half of 2019, the number of occupied posts rose by 16.1 thousand. It should be noted that after nearly a 30% job cut during the crisis, the number of occupied posts has returned to the pre-crisis level of year 2006.

A decline in occupied posts can be observed in public sector. In the first half of 2019, the number of occupied posts decreased by 650.

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

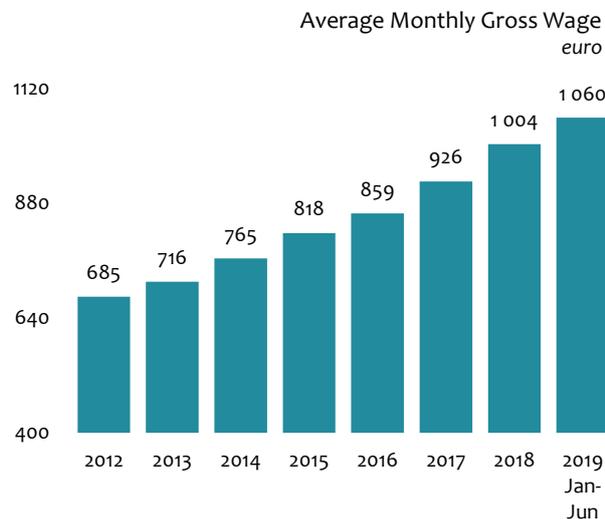


**Changes in Occupied Posts**  
Q1 2019 in comparison to Q1 2018, in thousands

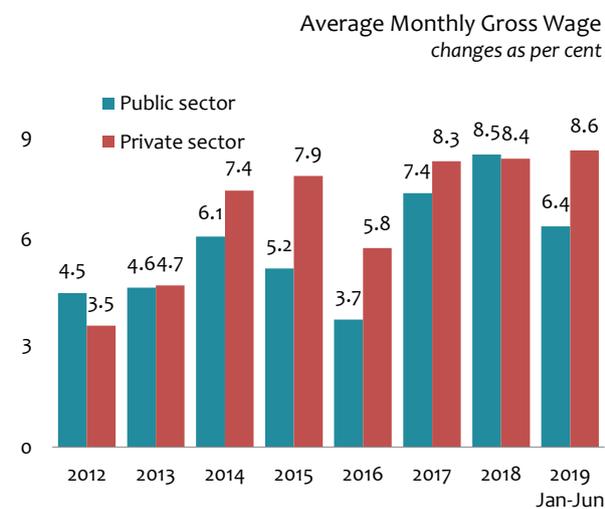


## WAGES AND SALARIES

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

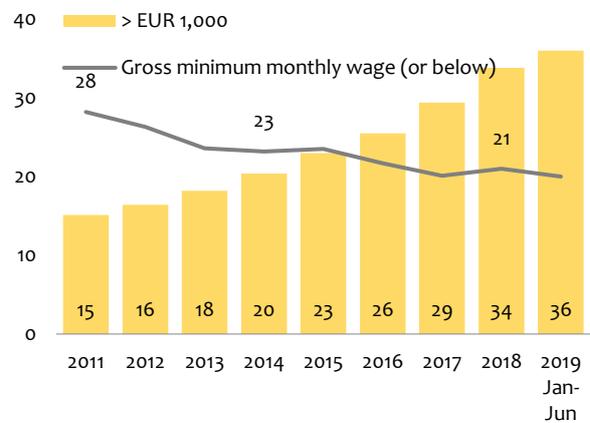


Over the last four years, wage growth on average has increased by 5% annually. In the first half of 2019, average gross wage increased by 7.8%, compared to the corresponding period last year, reaching EUR 1,060.



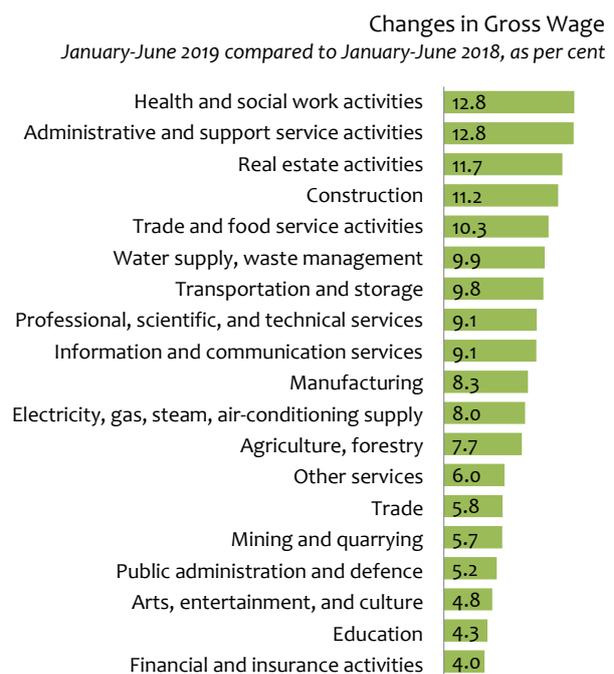
Since 2010, wage growth has been observed in both public and private sector. However, wages in private sector increased at a higher rate than in public sector. This can largely be attributed to the different labour demand dynamics across sectors in the economy. Since 2011, the number of occupied posts in private sector has increased by 22.1%. However, an increase of only 1.5% has been observed in the public sector.

Employee Gross Wage as per cent of total number of employed



In recent years, the share of employees receiving a minimum wage has slightly declined. At the same time, the share of employees with gross monthly wage of EUR 1 000 (or above) has increased. In the first half of 2019, 36% of employees received at least EUR 1 000 wage.

In the first half of 2019, wages grew in all major sectors of the economy. The largest wage increase was observed in health care and social work activities. In the first half of 2019, average gross wage growth in the sector reached 13.4%. At the same time, the lowest wage growth (by 3.5%) was observed in financial and insurance service activities. Despite the relatively minor increase, wages in financial and insurance activities still remain nearly twice as high as average in the economy.



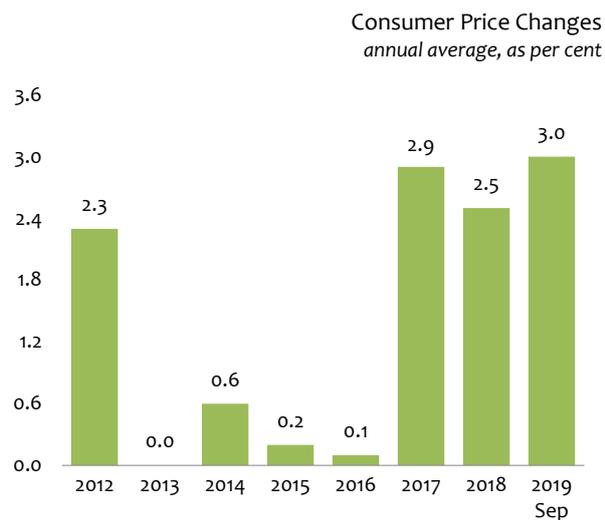
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## ECONOMIC STABILITY AND COMPETITIVENESS

### PRICES

In 2018, one of the largest price increases in recent years was observed. Consumer prices and annual inflation rose by 2.6% and 2.5%, respectively. Price increase for services significantly affected the overall level of consumer prices. Also, consumer price level was influenced by the rise in world prices for oil.

In January-September 2019, price dynamics have remained similar to the corresponding period last year. In September 2019, consumer prices increased by 2.4%, in comparison to December 2018. However, compared to September 2018, prices rose by 2.6%. In September 2019, average annual inflation reached 3%.

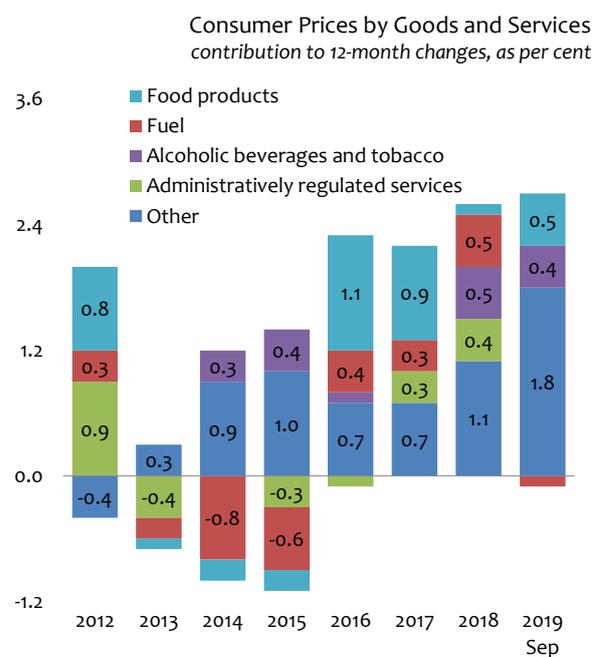
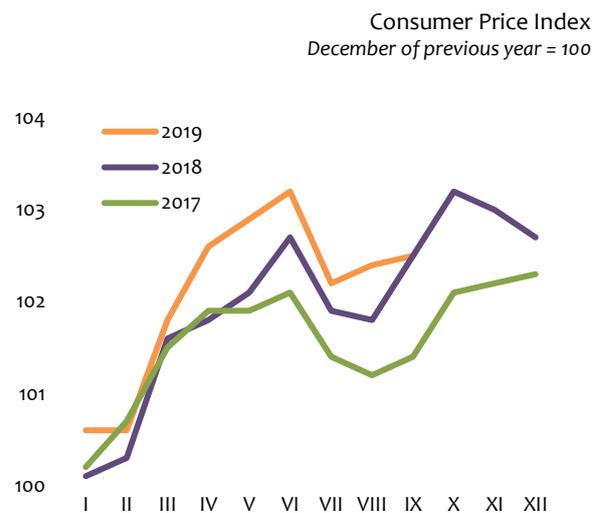


#### Key factors affecting overall price level in January-September 2019:

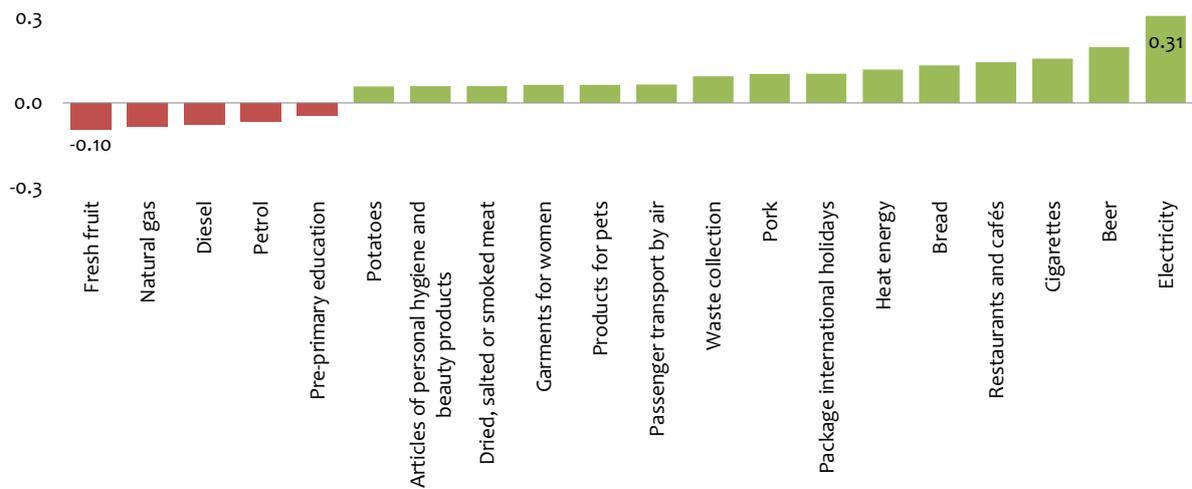
- (1) price increase for services – recreation, food service activities, telecommunications and ambulatory services, and housing related services (e.g. rent and waste collection (due to increase in natural resources tax));
- (2) price increases for alcoholic beverages and tobacco due to increased excise duty;
- (3) price increase for electricity and heat (due to the rise in tariffs); however, slightly offset by the fall in prices for natural gas due to the reduction in tariffs;
- (4) price increase for food products, as global food prices picked up. The largest price increase was observed for

meat, potatoes, and bread. World prices for food products rose by 5%. The upturn was observed across all major food product groups, excluding cereals and sugar.

- (5) price increase for clothing and footwear.

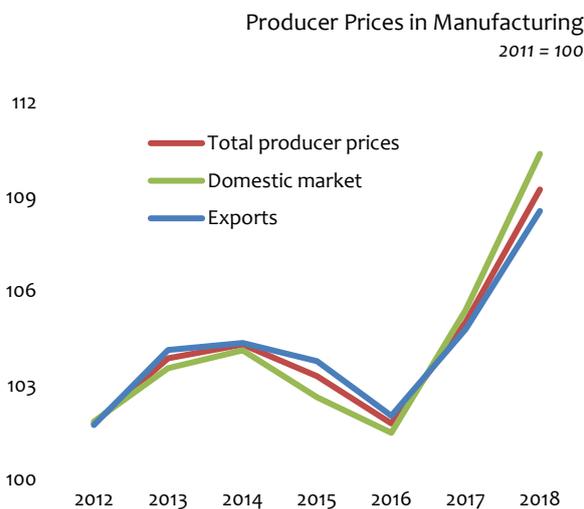


Consumer Price Changes by Goods and Services  
September 2019, contribution to 12-month changes, percentage points



In 2019, it is anticipated that inflation rate will be slightly higher than a year ago, reaching 3%. The increase is mainly driven by various supply-side factors (e.g. tax and tariff increases) and demand-side (e.g. increased economic activity and rise in wages). At the same time, inflation still remains closely dependant on fluctuations of world oil prices.

In 2018, producer prices continued to experience high growth. In fact, the largest increase since 2011 was observed.



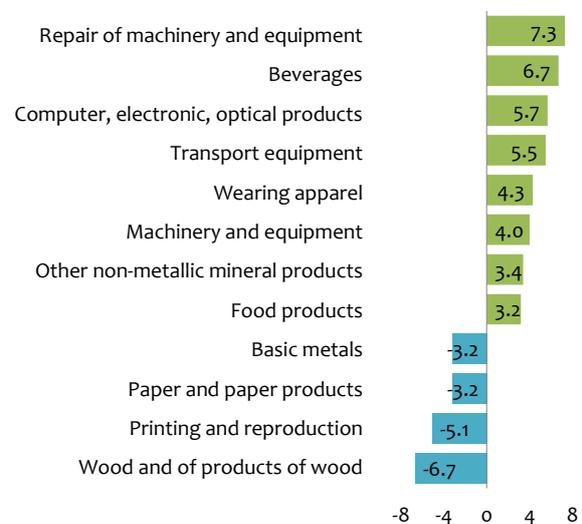
In 2019, a decline in producer prices was observed in manufacturing. In January-September 2019, producer prices in manufacturing decreased by 1%. Overall, in January-September 2019, producer prices in manufacturing for domestically sold products declined by

0.2%. However, prices for exported products decreased by 1.4%.

In January-September 2019, the largest price drop was observed in manufacture of wood and of products of wood. Also, a significant effect on price level had the manufacture of food products.

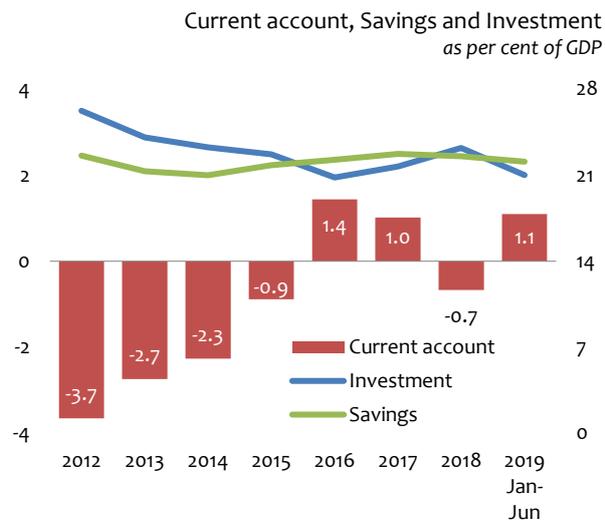
In 2019, producer prices in manufacturing will be lower than in 2018. Producer price level to a large extent is determined by the price volatility of exported products, which, in turn, is dependent on world raw material price dynamics. It should be noted that global energy and raw material prices (after an upturn at the beginning of the year) have fallen in mid-2019. At the same time, the rise in producer prices for domestic products will be facilitated by increased economic activity domestically.

Producer Price Changes in Manufacturing in September 2019 against the corresponding period of previous year, as per cent



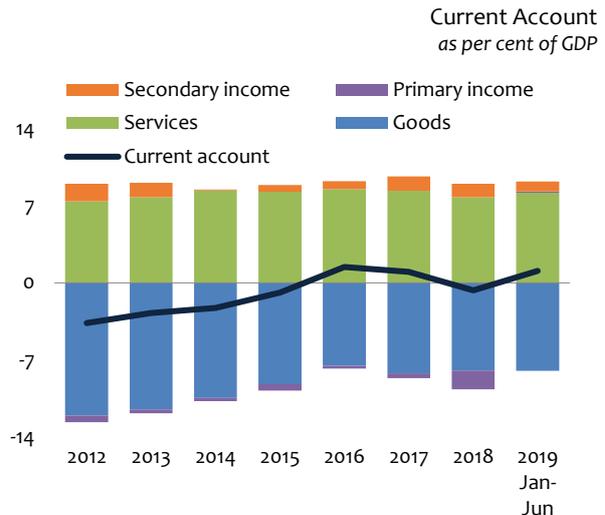
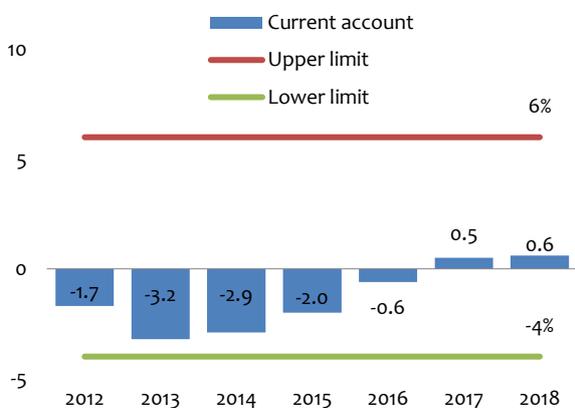
## BALANCE OF PAYMENTS

**Current account remains close to the balance.** In the first half of 2019, current account surplus reached 1.1% of GDP, thus almost doubling, compared to the corresponding period last year. Since 2017, the current account balance has seen a downward trend from a surplus of 1.4% of GDP in 2016 to a deficit of 0.7% of GDP in 2018. However, over the last three years (2016-2018), a current account surplus of 0.6% of GDP on average has been observed. Therefore, the indicative thresholds set by the EU Alarm Mechanism have not been violated, and current account is considered to be sustainable.



**The current account balance is essentially determined by changes in the external trade balance.** Latvia is characterised by an external trade deficit and its relatively high cyclical fluctuations. Over the last three years, external trade deficit on average was 7.9% of GDP. In 2018, it reached 8% of GDP.

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



In the first half of 2019, the external trade deficit reached 8% of GDP – an increase by 1.7 percentage points, compared to the corresponding period last year. The increase in trade deficit was mainly driven by the rise in the value of imported goods (by 4.2%). At the same time, the value of exports of goods remained at the previous year's level.

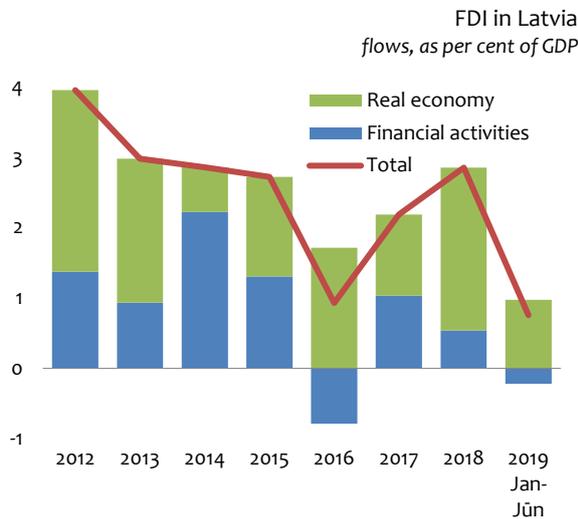
**The balance of services is positive, averaging 8.2% of GDP over the last three years and almost entirely covering the external trade deficit.** In the first half of 2019, exports and imports of services increased by 7.1% and 8.2%, respectively. The surplus of services remained essentially unchanged, compared to the corresponding period last year, constituting 8.2% of GDP. Exports of services are largely stimulated by the growth in transport and information and communication technology services.

**Changes in income and capital accounts can largely be attributed to the variation in the absorption activities of EU funds.** Over the last three years, capital account surplus averaged 1.1% of GDP. In 2018, it increased to 1.8% of GDP. Also, in the first half of 2019, a surplus in capital account (3.4% of GDP) was observed.

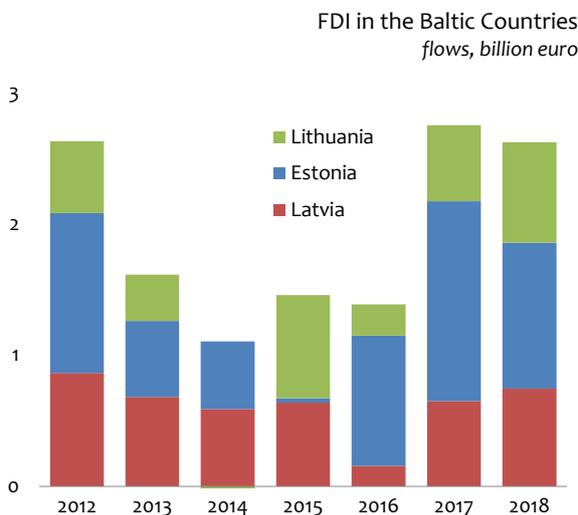
**In recent years, the financial account balance was primarily determined by the public sector (i.e. the financial sector stabilisation measures and other measures adopted by the Bank of Latvia for the restructuring of public debt within the framework of the extended asset purchase programme).** Fluctuations in the financial account were also affected by the decline in deposits of non-residents in credit institutions of Latvia. In the first half of 2019, financial account assets increased and liabilities – declined. The financial account balance (incl. reserve assets) reached a surplus of 6.2% of GDP (in the first half of 2018 – a surplus of 7.8% of GDP).

FOREIGN DIRECT INVESTMENT

Foreign direct investment (FDI) in the Latvian economy continues to increase; however, FDI still remains below the pre-crisis level. This can mainly be attributed to the instability in the global economy and rising geopolitical tensions.

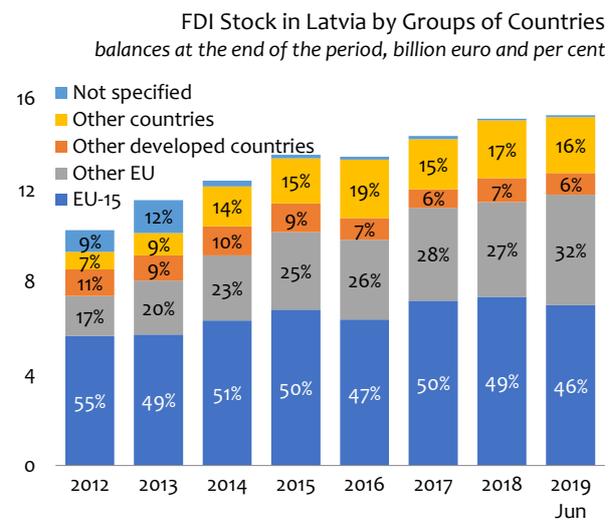


In 2018, the volume of FDI in Latvia, compared to 2017, increased by 42.5%, reaching 2.9% of GDP. The net FDI flows in Baltic countries in 2018 amounted to 3 billion euro (a decline by 6%, compared to the last year). Latvia, Estonia, and Lithuania each attracted 28%, 41.4%, and 30.6% of FDI, respectively.

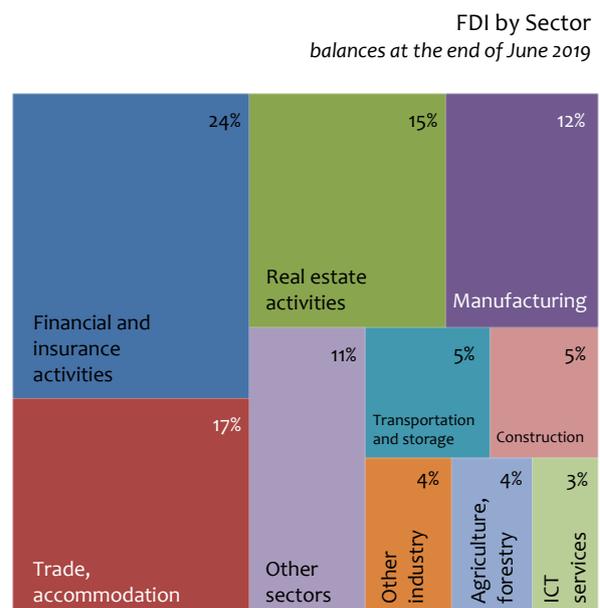


In 2019, FDI flows remain volatile. In the first quarter of 2019, FDI amounted to EUR 172 million (maintaining the average FDI level of the previous year). However, in the second quarter of 2019, FDI net flows were negative (EUR 62.3 million), caused by dividend payouts to foreign investors. Overall, the amount of FDI flows in the first half of 2019 remained at the previous year's level, constituting 0.8% of GDP.

At the end of June 2019, accumulated FDI in Latvia's economy reached EUR 15.3 billion (50.4% of GDP). During the year, an increase of 2.9% was observed. Currently, the largest investor in Latvia's economy is Sweden. At the end of June 2019, accumulated FDI from Sweden (primarily financial intermediation services) amounted to 14.2% of total accumulated FDI in Latvia. Also, significant FDI flows have come from Estonia, Russia, Cyprus, Lithuania, the Netherlands, Germany, Luxembourg, Denmark, Finland, and Norway. At the end of June 2019, the investment volumes of these countries represented nearly 80% of accumulated FDI in the Latvian economy.

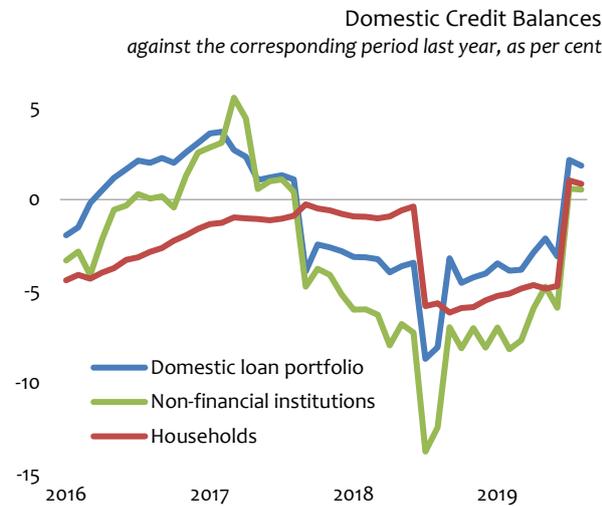


The largest share of accumulated FDI represent investments in financial intermediation services (24% of accumulated FDI), trade (17%), real estate activities (15%), and manufacturing (12%).



MONETARY INDICATORS

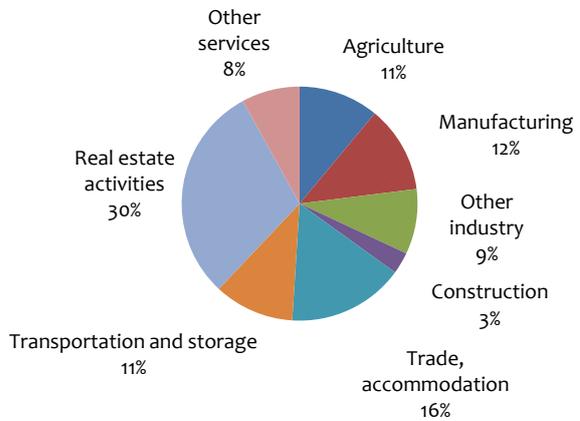
Monetary indicators are gradually stabilising; however, lending remains subdued and deposit volumes continue to decline.



Source: Bank of Latvia

The development of domestic loan portfolio remains moderate. In August 2019, domestic loan portfolio, compared to the corresponding period last year, increased only by 1.8%. Loan portfolio of non-financial institutions grew by 0.5%. Also, no major changes can be observed in the household lending (an increase of 0.9%).

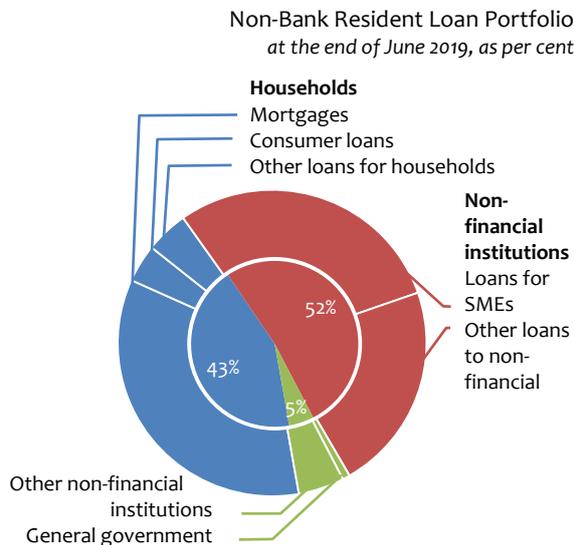
Lending Portfolio of Non-Financial Institutions by Sector at the end of June 2019, as per cent



Source: Financial and Capital Market Commission

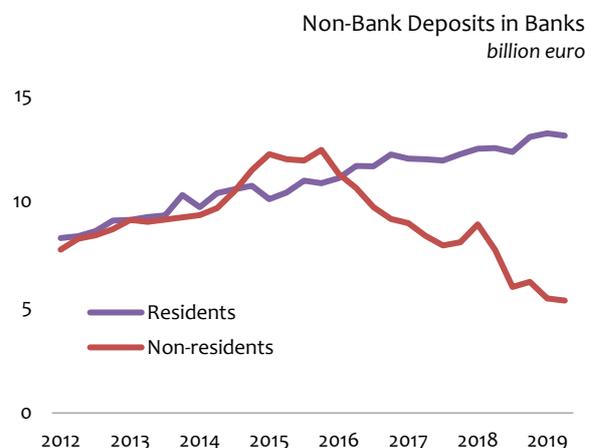
Since 2016, interest rates on loans (in EUR) issued to non-financial institutions have remained relatively stable. However, since 2019, a steady rise in interest rates for both short-term (3.41%) and long-term (2.38%) loans has been observed. Also, interest rates on short-term mortgage loans to households have increased, reaching 4.41% in August 2019 (2.62% in August 2018). Interest rates on long-term loans also have risen slightly; however, their volatility remains low.

In 2019, deposit volumes continue to decline. In the second quarter of 2019, deposits were by 9% lower than in the corresponding period last year. The decline can largely be attributed to decrease in non-resident deposits. In the second quarter of 2019, non-resident deposits were by 1/3 lower than in the corresponding period last year, constituting 29% of total non-bank deposits (in 2015 – 53% of non-bank deposits). At the same time, deposits by non-residents increased by 4/8%. Banks working with non-resident deposits are subject to more stringent liquidity and capital requirements.



Source: Financial and Capital Market Commission

At the end of second quarter of 2019, the largest loan volumes were issued in real estate activities (30% of total loans), trade and accommodation (16%), and manufacturing (12%).



Source: Financial and Capital Market Commission

## BUDGET AND GOVERNMENT DEBT

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

The government budget was adopted by Saeima, anticipating a budget deficit of 0.5% of GDP. In 2019, a fiscal reserve of 0.1% of GDP was approved.

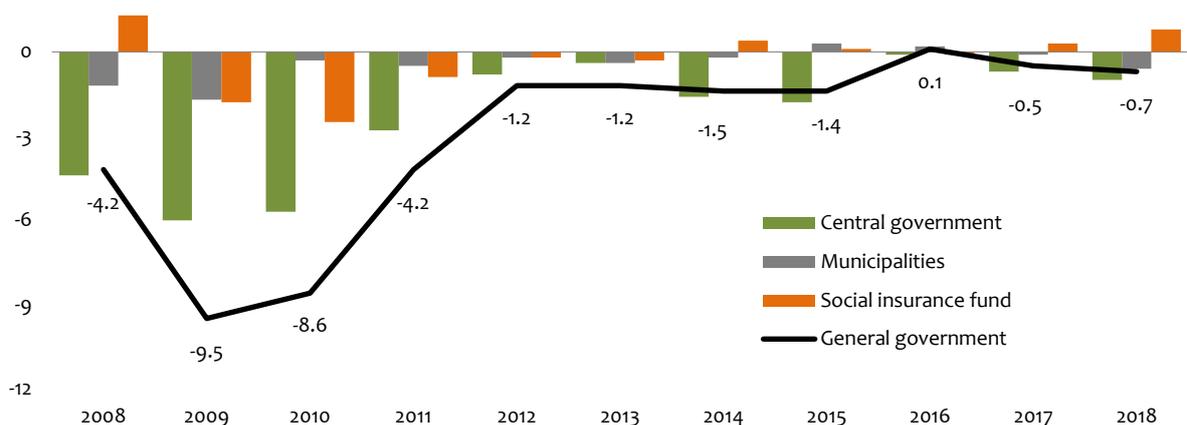
In January-August 2019, according to State Treasury Latvia, the consolidated general budget surplus reached EUR 596.8 million. However, it was by EUR 127.1 million

lower than in the corresponding period a year ago. In 2020, the general government budget deficit is planned at 0.3% of GDP.

General Government Deficit

	2014	2015	2016	2017	2018
Revenues, bn euro	8.6	8.9	9.3	10.0	11.0
as per cent of GDP	36.6	36.6	36.9	37.5	37.8
Expenditures, bn euro	9.0	9.3	9.2	10.2	11.2
as per cent of GDP	38.0	38.0	36.9	38.0	38.5
Net, bn euro	-0.34	-0.33	0.02	-0.14	-0.2
as per cent of GDP	-1.4	-1.4	0.1	-0.5	-0.7

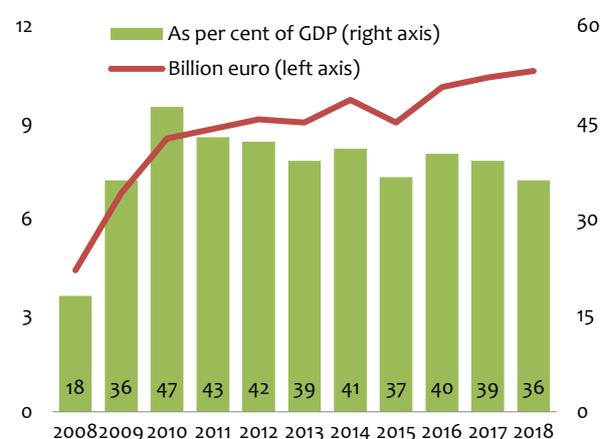
General Government Budget Balance by Sector  
% of GDP



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

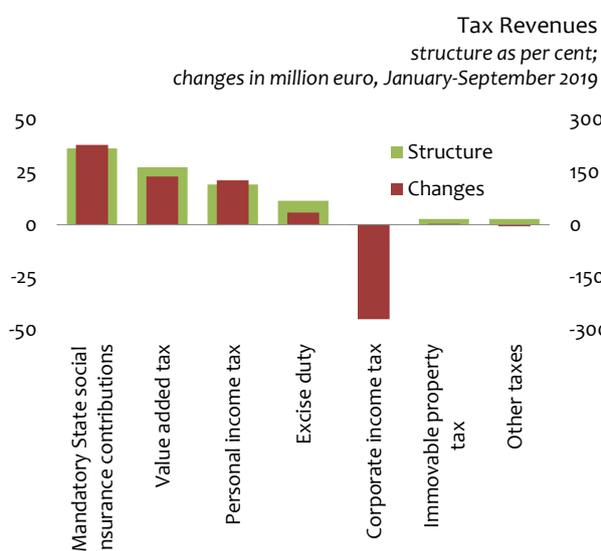
Pursuing timely borrowing measures in line with the medium-term strategy and continuing to implement sustainable fiscal policy (based on favourable interest rate and maturity terms) can help to re-finance current central government debt obligations. Also, it may allow to achieve a long-term reduction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

General Government Consolidated Gross Debt  
nominal value at the year end



## BUDGET REVENUES AND EXPENDITURES

Since 2011, general government budget revenues have increased. The rise has mainly been facilitated by income from employment taxes. In January-September 2019, general government budget revenues increased by 3.1%, compared to the corresponding period last year.



Employment tax revenues and revenues from mandatory state social insurance contributions increased by 10.3% and 9.8%, respectively. The increase was mainly facilitated by higher employment and rise in wages.

### Consolidated General Government Budget

	billion euro			changes as per cent
	2016	2017	2019 Jan-Sep	2019 Jan-Sep
Revenues:	9.6	10.9	8.6	3.1
Tax Revenues:	8.5	9.2	7.1	3.8
Mandatory State Social Insurance Contributions	2.8	3.2	2.6	9.8
Value Added Tax	2.2	2.5	1.9	7.7
Personal Income Tax	1.7	1.7	1.4	10.3
Corporate Income Tax	0.4	0.4	0.0	-92.9
Excise Duty	0.9	1.0	0.8	4.5
Immovable Property Tax	0.2	0.2	0.2	1.7
Other taxes	0.2	0.2	0.2	-2.3
Citi revenues	1.1	1.7	1.6	30.8
Expenditures	9.8	11.1	7.9	5.7

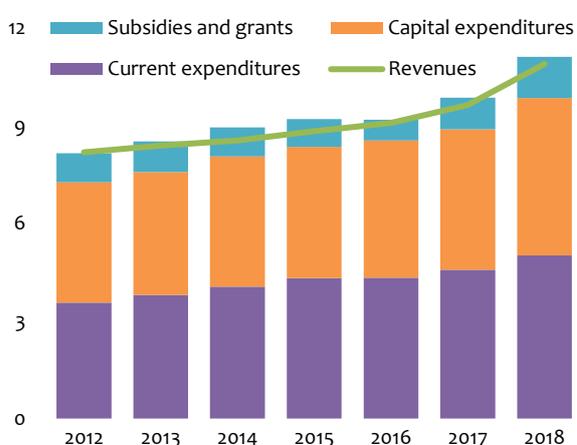
Also, revenues from consumption taxes continue to increase. Income from value added tax and excise duty rose by 7.7% and 4.5%, respectively. However, resource tax revenues have essentially remained at the previous year's level.

On the other hand, capital tax revenues are on a decline, driven by lower corporate income tax revenues (by almost 93%) due to changes introduced (of the tax administration) in the tax reform.

In January-September 2019, consolidated government budget expenditure increased by 5.7%, compared to the corresponding period last year, reaching EUR 7.9 billion.

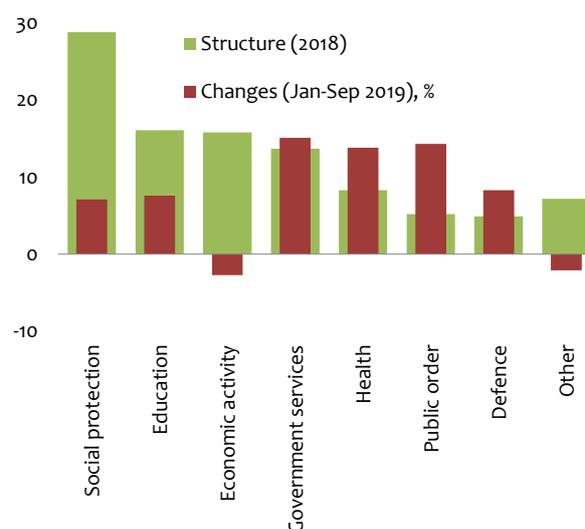
Current expenditures, subsidies and grants, and capital expenditures rose by 6.1%, 4.7%, and 3.4%, respectively.

### Consolidated General Government Budget Expenditures billion euro



An increase in expenditures was observed in general government services and public order. However, expenditures declined in municipal management.

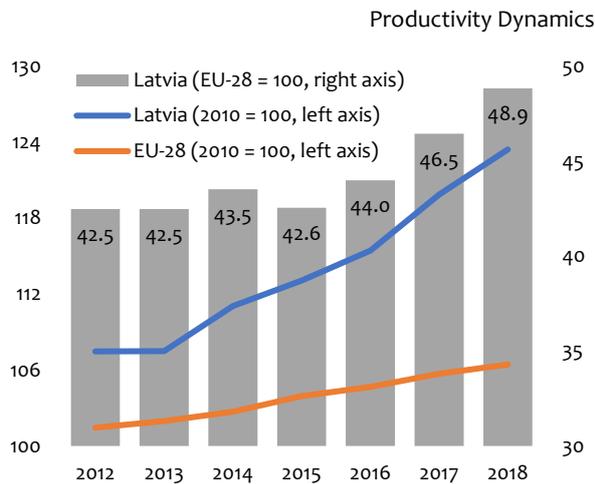
### Consolidated General Government Budget Expenditures by Function structure in 2018, changes January-September 2019, as per cent



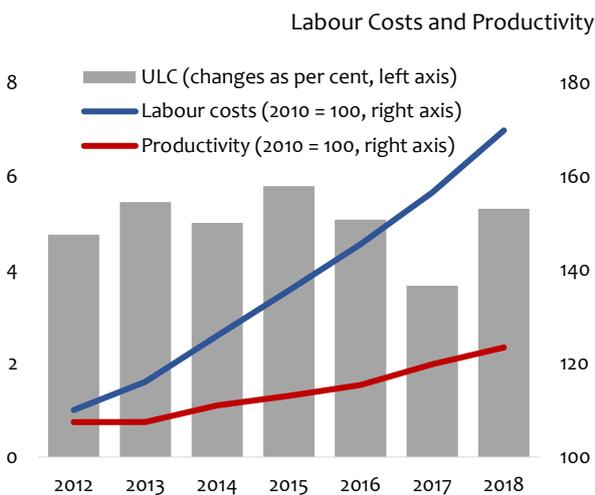
## PRODUCTIVITY AND COMPETITIVENESS

In recent years, productivity dynamics in Latvia on average have increased at a higher rate than the EU average.

Between 2010-2018, the productivity gap with the EU has fallen by nearly 12%. In 2018, GDP per capita (productivity) in Latvia reached 49% (69.3% based on PPP) of the EU average.



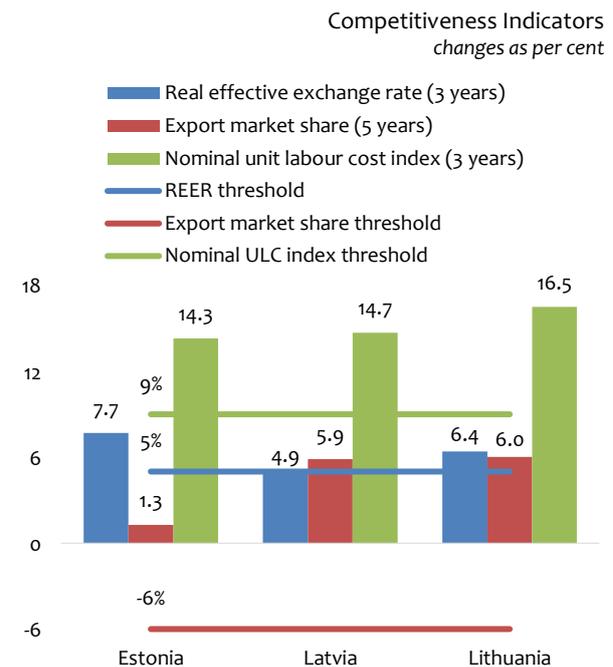
Although Latvia ranks very high based on productivity growth amongst other EU member states, labour costs have risen at a higher rate than productivity, thus undermining the competitiveness of entrepreneurs in Latvia. Also, an increase in nominal unit labour costs (ULC) reflects the increased risks of declining cost competitiveness.



Over the last three years (2016-2018), productivity on average increased by 3%. At the same time, labour costs rose by 7.8% (at 2.5 times higher rate). The strong increase

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

In recent years, a strong increase in nominal unit labour costs can be observed in Baltic countries. Between 2016-2018, nominal ULC in Latvia, Estonia, and Lithuania increased by 14.7%, 14.3%, and 16.5%, respectively (EU average – 0.6%). The indicator exceeds the threshold set by the EU Alert Mechanism.



Despite a large rise in nominal unit labour costs (ULC), Latvia's share in export markets has increased. Between 2014-2018, Latvia's share in world export markets for goods and services increased by 5.9%. Thus, Latvia still maintains its competitiveness in external markets. However, the positive development trends in export markets are becoming more moderate.

Real effective exchange rate (REER) dynamics have been positive. Over the last three years (2016-2018), the consumer price index (CPI)-based REER against 42 trading partners has increased by 4.9% (against Euro Area partner countries by 1.3%). The indicator is close to the threshold set by the EU Alert Mechanism.

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

## EU ALERT MECHANISM

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

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

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

List of Indicators for the Macroeconomic Imbalances Procedure for Latvia

	Threshold	2011	2012	2013	2014	2015	2016	2017	2018
<b>External imbalances and competitiveness</b>									
Current account (% of GDP, 3-year average)	-4%/6%	2.1	-1.7	-3.2	-2.9	-2.0	-0.6	0.5	0.6
Net international investment position (% of GDP)	-35%	-74.8	-67.6	-66.7	-67.2	-64.4	-59.1	-55.8	-48.4
Real effective exchange rate – 42 partner countries, HICP deflator (% changes over the last 3 years)	±5%* & ±11%	-2.4	-8.6	-1.7	0.4	2.5	4.8	1.7	4.9
Export market share – % of world export (% changes over the last 5 years)	-6%	26.5	7.9	5.9	12.0	13.5	10.2	8.2	8.3
Nominal unit labour costs index (% changes over the last 3 years)	9%* & 12%	-20.6	-6.5	8.0	16.0	17.2	16.7	15.2	14.7
<b>Internal imbalances</b>									
House price index (% annual changes)	6%	4.0	-0.2	6.7	4.3	-2.4	7.3	5.6	6.6
Private sector credit flow (% of GDP, consolidated)	14%	-2.4	-5.4	-0.6	-4.4	-0.5	2.3	2.4	-0.2
Private sector debt (% of GDP, consolidated)	133%	115.2	96.8	91.0	82.2	80.4	80.5	76.9	70.3
General government debt (% of GDP)	60%	43.1	41.6	39.4	40.9	36.7	40.2	38.6	36.4
Unemployment rate (3-year average)	10%	17.7	16.9	14.4	12.6	10.9	10.1	9.4	8.6
Financial sector liabilities (% annual changes)	16.5%	-6.2	5.6	5.7	11.4	13.2	4.7	6.2	-3.0
<b>Employment indicators</b>									
Economically active population – % of population aged 15-64 (% over the last 3 years)	-0.2 percentage points	-1.4	0.9	1.0	1.8	1.3	2.3	2.4	2.0
Long-term unemployment rate – % economically active population (% changes over the last three years)	0.5 percentage points	6.9	3.3	-3.1	-4.2	-3.3	-1.7	-1.3	-1.4
Youth unemployment rate – % of economically active population (% over the last 3 years)	2 percentage points	17.4	-4.8	-13.0	-11.4	-12.2	-5.9	-2.6	-4.1

\* – Euro area countries.

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

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

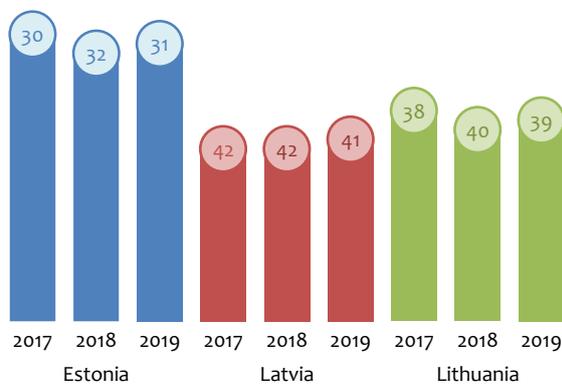
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# LATVIA IN INTERNATIONAL RATINGS

Ratings from the United Nations, the World Bank Group, the World Economic forum, and other organisations described Latvia as a country that makes a lot of reforms to improve its competitiveness by improving e-government, the business environment, ICT infrastructure, and other areas, while providing free press and not militarily endangering other countries of the world. In World Economic Forum report and the **Global Competitiveness Index (GCI 4.0) for 2019** Latvia is ranked 42nd between 140 surveyed countries.

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

Baltic Countries In Global Competitiveness Index 4.0



Source: World Economic Forum, The Global Competitiveness Report 2019

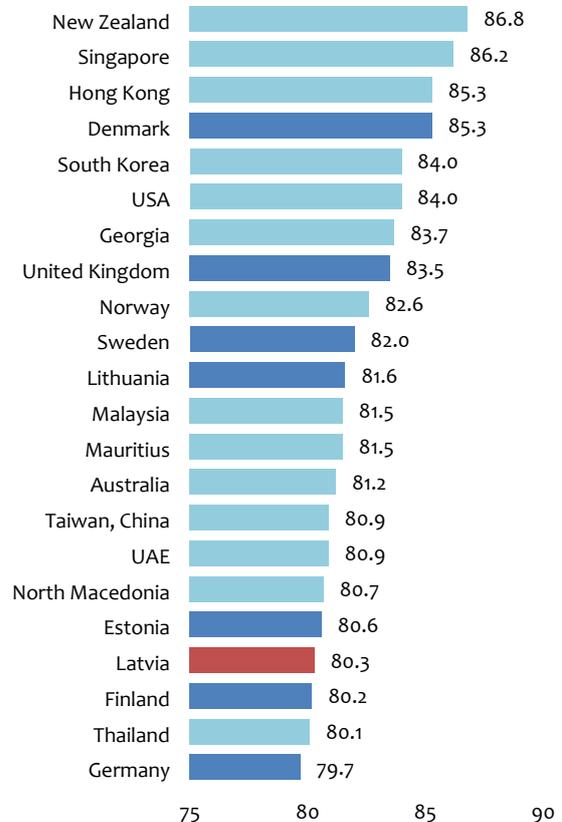
In 2019, Latvia has ranked one place higher, compared to 2018. Improvements can be observed in 8 out of 12 pillars.



Source: World Economic Forum, The Global Competitiveness Report 2019

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

Doing Business 2020 in scale from 0 to 100



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

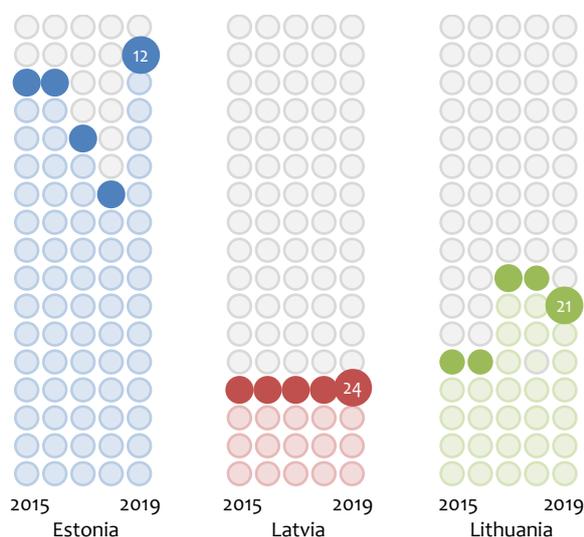
Baltic Country Assessment, *Doing Business* 2020

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

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

In the European Innovation Scoreboard 2019, published annually by the European Commission, Latvia ranks 24<sup>th</sup> among the 28 EU countries, and has been included in the group of moderate innovators for the fourth consecutive year. 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 Countries in the European Innovation Scoreboard 2019

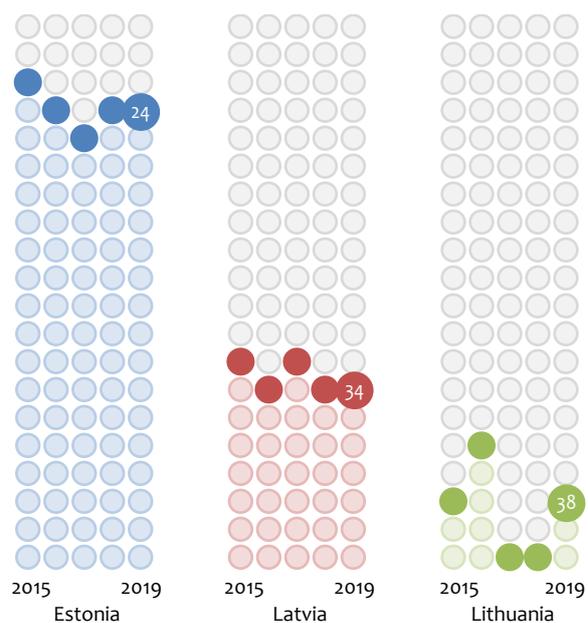


Source: European Commission, *European Innovation Scoreboard* 2019

In turn, in *Global Innovation Index* 2018 Latvia is ranked 34<sup>th</sup> between 129 surveyed countries. As Latvia's strong sides are mentioned the following indicators: pupil-teacher ratio, tertiary enrolment, females employed/ with advanced degrees, ease of getting credit, gross

expenditure on R&D, GDP per capita (based on PPP), and increase in creative outputs.

## Baltic Countries in Global Innovation Index



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

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

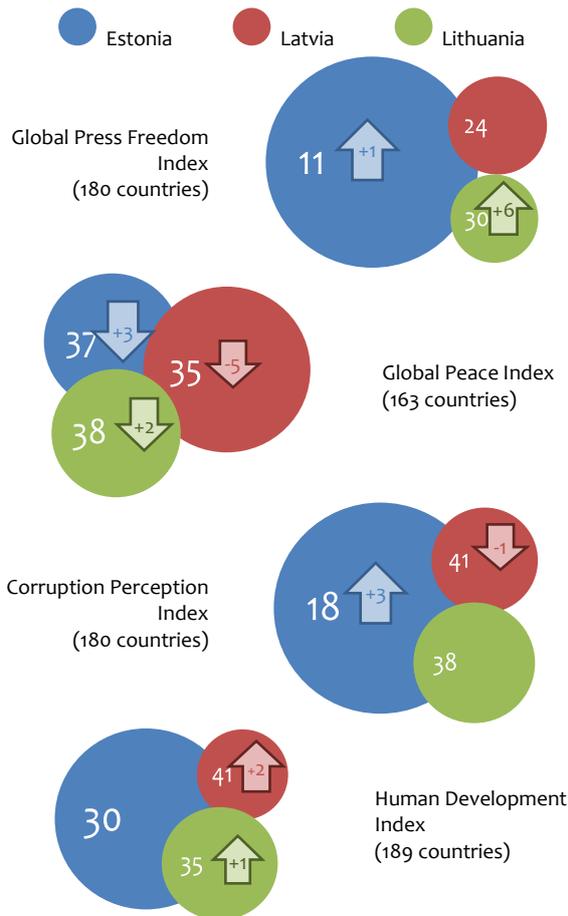
In Global Peace Index (GPI) produced by the Institute for Economics and Peace (IEP) Latvia was ranked 35<sup>th</sup> (amongst 163 countries) in 2019. Compared to 2018, Latvia's position has deteriorated by 5 positions due to increased state defence spending.

In Corruption Perceptions Index 2018 produced by The Global Anti-Corruption Organisation *Transparency International*/Latvia ranked in the 41<sup>st</sup> place (amongst 180 countries). Although index value remained unchanged, a decline by one position, compared to 2017, was observed.

In the Human Development Index (HDI) produced by the United Nations Organization Latvia ranks 41<sup>st</sup> (amongst 189 countries) in 2017, thus achieving by two places higher position than a year ago (in 2016).

factors contributing to Latvia’s credit rating assessment were the fiscal results of previous years and low level of government debt. Latvia’s progress in the prevention of money laundering and financial crime, strengthening the supervision of financial sector, reducing deposits from non-residents, and launching comprehensive financial sector reforms has been assessed. Negative impact can be caused by the outcome of Brexit. However, better fiscal results and the planned reform in sectors such as health, welfare, and education can have positive effects.

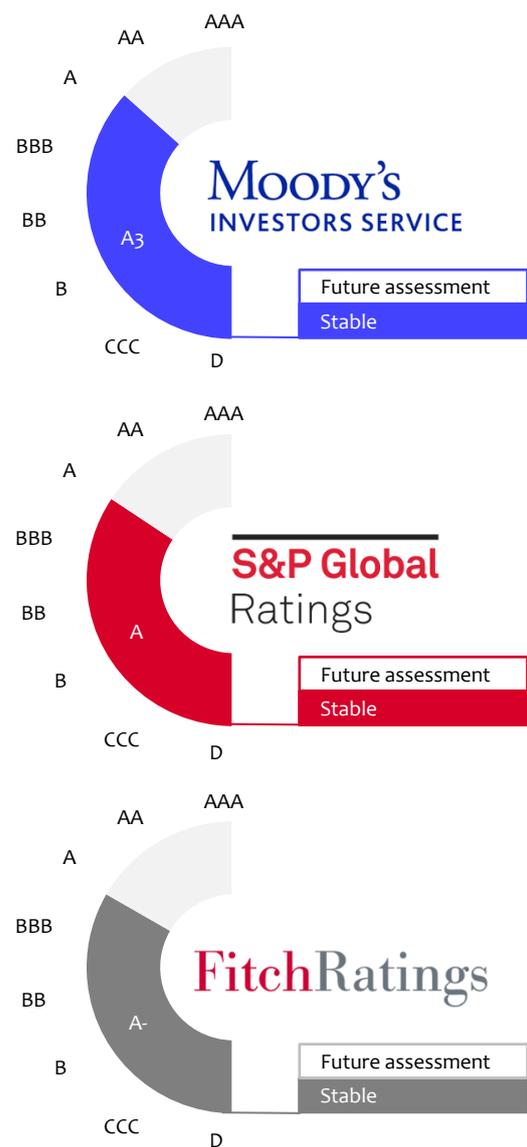
Baltic Countries in International Rankings  
place and changes during a year



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

In 2019, rating agency (*Moody's Investors Service, Fitch Ratings, S&P Global, R&I*) assuring the legitimacy of the previously assigned high credit ratings, noting that the

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



Source: Treasury Republic of Latvia