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Republic of Latvia

MACROECONOMIC REVIEW OF LATVIA

April 2018

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Central Statistical Bureau of Latvia

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ECONOMIC POLICY

In 2017, Latvia experienced a remarkably high growth rate, the highest over the last 6 years, of 4.5%. Stable growth was also observed in exports, investments, and both private and public consumption. Currently, export volumes have reached the historically highest levels. Overall, current positive trends in exports have highly encouraged the development of export-oriented sectors, such as agriculture, forestry, and transport.

According to the estimates of the Ministry of Economics, both positive trends in the external environment and continuing acquisitions of EU structural funds will effectively stimulate GDP growth rate, which could reach 4.2% in 2018. The current GDP growth rate estimates of the 1st quarter show an annual increase of 4.0%, which also is an indicator of economic stability.

To maintain the GDP growth rate of at least 4–5% also in the medium-term, systematic work on the targets set in the government declaration must be continued. The stimulation of exports, investments, and boosting of productivity and human resources are the key priorities.

To achieve the targets, the Ministry of Economics, along with its social partners and colleagues from other ministries, has begun work on a sustainable economic development model in which exports would be the main driving force of economic development. To accomplish that, Latvia must successfully compete in both domestic and international markets. Latvia also needs to improve its competitiveness in attracting foreign capital, thus significantly boosting productivity.

As the development of the sustainable model is largely affected by reforms in the education system and changes in the labour market, preparation and adjustment to structural changes is very important. The initiated reforms in the education system must be continued. Key priorities, however, should be the strengthening of exact and nature sciences in basic and secondary education and the development of adult education.

To coordinate cooperation in planning, development, implementation, and monitoring of labour market reforms and thus reducing disproportion in the labour market, an Employment Council of three ministers from the Ministry of Economics, the Ministry of Education and Science, and the Ministry of Welfare has been created. The ministers have already agreed to supplement priority reforms with the creation and implementation of life-long learning system in the workplace and the development of efficient, modern, and high-quality general education. Another key priority is to increase the number of students in Science and Technology, Engineering, and Mathematics (STEM).

To address the current labour market supply and demand mismatches, crucial is the involvement of employers in both the creation and provision of the labour supply and the improvement of skills and employment of young people.

Work on the planned development of EU fund support programmes has almost been completed, which opens up the opportunity to invest EUR 4.4 billion in Latvia's development. The increase of financial flow in research and development, the attraction of private investments, and the activation of cooperation between research institutions and entrepreneurs are among the most important objectives of EU funding. Significant investments are also planned in the improvements of information and communication technologies and transport infrastructure, which directly contribute to economic productivity and serve as a basis for the creation of new, well-paid jobs and the overall improvement of life quality.

In the new planning period, EUR 868.6 million are available for targeted investments in modernization and industrialization of Latvian economy. Significant increase in EU funding is also planned to facilitate energy efficiency. Specifically, it is planned to invest more than EUR 377.3 million in energy efficiency improvements in apartment buildings, public, and industrial buildings. The following activities of the EU funds were continued or initiated: Introduction of New Products into Manufacturing (support for the purchase of equipment), Promotion of International Competitiveness (national stands, incl., acquisition of external markets (participation in exhibitions)), Training of Employees, Competence Centres, Business Incubators, Insulation of Apartment Buildings. Also, the support to businesses will be continued and expanded in the form of financial instruments (guarantee programmes, loan programmes, risk capital instruments, incl., acceleration funds).

At the beginning of 2017, new regulations and special support programmes for unique, modern, and fast-growing Latvian technology companies have been approved. The developed programmes have already gained an international approval. The Ministry of Economics has signed a Memorandum of Understanding with Latvian Startup Association "Startin.LV"; regular communication with ecosystem representatives currently takes place.

Our ambition is to make Latvia the No. 1 startup choice in Baltics. The Law on Support to Startups and risk capital funding serve as a basis for the development of such companies. Additionally, to address the needs of

entrepreneurs, specific support programmes are currently being introduced.

Improvement of the business environment is one of the key priorities of the Ministry of Economics. Targeted reforms and close cooperation with Latvian entrepreneurs have allowed to achieve very good results. In the World Bank's Doing Business 2018 research Latvia has been ranked 19th among 190 countries and 8th among the EU countries.

On 15 March 2017, the Cabinet of Ministers approved a Plan for Improvement of the Business Environment developed by the Ministry of Economics. The ambition of the Ministry of Economics is to create an excellent business environment and to move towards an innovative economic model. Thus, the Ministry of Economics have identified five directions of action for further work on the improvement of the business environment: the strengthening of the rule of law, the development of customer-oriented public administration, the industrial digitalization (Industry 4.0) and the digitalization of public services, the openness of the business environment, and the competitiveness of the taxation system.

Demonstrating determination to implement a number of measures for industrial support and to make significant investments in modernization of industry, thus boosting the industry's international competitiveness, on 25 April 2018 the Ministry of Economics and representatives of industrial sectors signed a Memorandum of Understanding on the Development of Latvian Industry.

Work on the improvement of national innovation system is still in the progress. To encourage private sector investments in research and development (R&D) and motivate companies to invest in innovations, several support programmes are currently being implemented. The main support instruments encourage enterprises and research sectors to initiate and implement common projects. The commercialization of research projects within the promotion of wider technological transfer processes, incl., the capacity strengthening of Latvian Investment and Development Agency, forming it as an innovation and technology agency. At the same time, activities designed to motivate general public and engage it in innovation and business activities are currently carried out. We have engaged in active work to establish cooperation mechanisms with state-owned companies and identify existing and future R&D investments in these companies. These activities are closely related to the efforts made to achieve purposeful improvements in Latvia's rating in the European Innovation Scoreboard.

On 24 May 2017, the Cabinet of Ministers approved State Tax Policy Guidelines for 2018–2021, introducing a new corporate income tax system from 2018 – a 0% rate for reinvested profit, which would allow companies to build capital reserves and invest them in further development.

Improvements to the micro-enterprise tax regime aimed at supporting new and small enterprises in low-wage sectors should also be mentioned. So far, it has served as an incentive to start a new business, reduce the shadow economy, and simplify tax payments. Meanwhile, to address the issue of social contributions to employees, employees of a micro-enterprise have been assigned the right to voluntarily join the national social insurance system.

When developing the regulatory framework for the tax system, it is of major importance to create simple and inexpensive way to pay and administer taxes. The lower the administrative burden on entrepreneurs, the cheaper the service can be provided by the State.

To improve and simplify construction processes, extensive work, including the provided support for fully electronic construction process documentation, has already been completed. In the summer of 2017, work on the development of the Building Information System (BIS) was started. It is expected that the system will be available to users from 1 July 2018. Within the framework of the project, a number of imperfections in the supervision of construction works, the management of construction companies and specialists will be improved by developing BIS as a common information system for building and construction processes.

On 31 May 2016, the Memorandum on cooperation between the members of the Cabinet of Ministers and representatives of the construction industry was signed. In the Memorandum, the parties came to the agreement that during the next three years the size of the shadow economy in the construction industry should be reduced by at least half. To achieve the objectives set in the Memorandum, representatives of the construction industry employers, together with representatives of trade unions, have agreed on the terms of general agreement and have started the signing process. At the same time, Saeima has adopted amendments to the Law on Taxes and Fees, and the electronic working time registration in the construction sector has been introduced since 1 October 2017.

Construction sector has taken a major step towards the development of social dialogue, and its initiative and the results achieved will serve as an example for other sectors as well.

To reduce bureaucratic obstacles and facilitate the construction process, on 22 June 2017 Saeima adopted amendments to the Construction Law. The amendments stipulate simplified procedures for making changes to the project documentation, also during execution of works, as well as derogations from the technical rules for harmonization.

To facilitate the purchase of housing for young families, the total funding of the support programme has reached EUR 16.9 million, providing guarantees of EUR 55 million. Over the three years, the programme has helped more

than 8 thousand families and 11 530 children to obtain housing of suitable size and quality. The programme has a significant impact on the mortgage market – 30% of all housing purchases have occurred with the help of a mortgage, of which housing guarantee programme was used in 47% cases in 2017.

Currently, the work on the development of a sustainable support model is carried out. The objective of the model is to provide citizens with high-quality and affordable housing in different regions of Latvia, while ensuring that housing expenditure does not exceed 30% of the household income. Now the lack of apartments for rent is one of the main factors hindering the creation of new jobs in regions outside Riga. At the same time, it is necessary to take into account the interests of both lessors and tenants via introduction of legal framework, which would ensure prompt and convenient procedures for dispute settlement.

Significant activities, which will allow to boost the competitiveness of Latvian enterprises, have been implemented in the energy sector. A decision to change financing model of mandatory procurement component (MPC), which would allow to reduce MPC costs of manufacturers has been made. Also, a long-term solution to provide state support for merchants, who produce electricity from renewable energy sources and high-efficiency cogeneration, was developed and harmonised with the European Commission.

On 3 April 2017, Latvian natural gas market was opened, thus facilitating increase in the competition between natural gas traders; the number whereof has grown to 35 traders. The management and storage of natural gas were separated from the historical natural gas monopoly "Latvijas Gāze" AS – the activities are currently performed by "Conexus Baltic Grid" AS, and the distribution system is now managed by the "Gasol" AS. At the same time, within

the framework of the regional gas coordination group, the work is continued on the development of common natural gas market in the Baltic region. Over the next three years, it is planned to complete the work on linking Baltic and Finland markets, establishing an interconnection between Estonia and Finland, connecting Baltic and European networks, establishing interconnections between Lithuania and Poland, and strengthening the role of Inčukalns underground gas storage in the region.

In addition to improving the legislative conditions of the Latvian energy market, active work on the development of electricity infrastructure, aimed at strengthening national energy security and diversification of energy paths and sources, currently takes place.

The main objective in the energy sector until 2020 is to increase the security of energy supply in Latvia, provide competitive energy prices to consumers, and facilitate the sustainability of the Latvian energy market.

To achieve the goals, the Ministry of Economics actively engages in dialogue with entrepreneurs, non-governmental organizations, and other representatives of the community.



Arvils Ašeradens,
Deputy Prime Minister,
Minister of Economics

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DEVELOPMENT TRENDS IN ECONOMY

In Latvia, stable economic growth has now resumed. Currently, the growth rates exceed the EU average levels. From 2011 to 2017, GDP on average grew by 3.5% annually. In 2017, GDP exceeded the pre-crisis level of 2007 by 0.8%.

In 2017, the growth rate accelerated; GDP rose by 4.5%, which has been the sharpest growth rate over the last six

years. Such growth in 2017 was mainly facilitated by the improvement of situation in external environment, more intense acquisition of EU structural funds, and the rise in employment and wages.

Statistical data show that accelerated economic growth also continues at the beginning of 2018. **In the 1st quarter of 2018, GDP increased by 4.3%.**

Latvia: Key Figures of Economic Development

	2012	2013	2014	2015	2016	2017	2018f
Gross domestic product, at current prices, billion euro	21.9	22.8	23.6	24.3	24.9	26.9	28.8
<i>changes as per cent</i>							
Gross Domestic Product	4.0	2.4	1.9	3.0	2.2	4.5	4.2
Private consumption	2.9	5.3	1.2	2.7	3.4	5.1	5.1
Public consumption	0.3	1.6	1.9	1.9	2.7	4.1	3.7
Gross fixed capital formation	14.4	-6.0	0.1	-0.5	-15.0	16.0	17.7
Exports	9.8	1.1	6.0	3.0	4.1	4.8	4.5
Imports	5.4	0.4	1.2	2.1	4.5	9.5	6.7
Consumer Prices	2.3	0.0	0.6	0.2	0.1	2.9	2.5
<i>per cent</i>							
Changes in employment (15-74 years of age, % compared to the previous year)	1.6	2.1	-1.0*	1.3	-0.3	0.2	0.4
Employment rate	56.1	58.2	59.1	60.8	61.6	62.9	64.3
Unemployment rate (job seekers, % of the economically active population, 15-74 years of age)	15.0	11.9	10.8	9.9	9.6	8.7	8.0
<i>per cent of GDP</i>							
General government budget balance	-1.2	-1.2	-1.5	-1.4	0.1	-0.5	-1.0
General government debt	41.2	39.0	40.9	36.8	40.5	40.1	38
Export-import balance	-4.4	-3.5	-1.4	-0.5	0.9	-1.3	-1.3

f – forecast

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

In 2017, private consumption increased by 5.1%, which was due to the sharp increase in wages. Public consumption also grew faster than in previous years – by 4.1%.

Along with the increase of economic activity in the largest Latvian markets for goods, exports also continue to grow. In 2017, exports rose by 4.8%. In fact, export volumes have now reached yet unprecedentedly high levels. The rise in the domestic demand, however, has greatly contributed to the import growth, which was 9.5% in 2017.

Since 2011, Latvia maintains a low current account deficit in its balance of payments, which indicates that Latvian economy is externally balanced. In 2017, the current account had a small deficit constituting EUR 204 million or 0.8% of GDP. It is expected that investment flows will increase, and the current account will show a small deficit

also in the upcoming years. However, the external balance of the Latvian economy will not be threatened.

After a decrease over the last two years, in 2017 rapid growth in gross fixed capital formation (which increased by 16%) was observed. Foreign direct investment flows in Latvia increased as well, amounting to EUR 640 million or 2.4% of GDP in 2017.

The sharp growth in manufacturing facilitated by both the rise in competitiveness of businesses and the current dynamics of demand in the largest export markets is a very positive trend to note. In 2017, manufacturing output went up by 8%. Although the rise was observed in all largest manufacturing sectors, the fastest growth occurred in the manufacture of electronic and optical products. However, the manufacture of fabricated metal products and food products mostly contributed to the industry's

accelerated growth. However, the output growth of the largest manufacturing sector – wood processing – was moderate in this period.

Investment rise had a significant impact on construction sector – in 2017, output in the construction industry rose by 19.4%. The rise was encouraged by both active acquisition of EU structural funds and private investments, including the construction of offices and commercial buildings.

In 2017, significant growth was observed in transportation and storage (of 7.3%), which was mainly influenced by the growing share of freight transportation and the increasing number of passengers in airports and ports. Similarly, a sharp rise was also observed in other industry. Mining and quarrying, electricity, gas supply, and heat and water supply sectors experienced a total rise of 7.2%. Noticeable increase was recorded in information and communication sector, which was mostly facilitated by the sharp upturn in computer programming and other information service activities. Sharp growth was also registered in trade (of 5.2%), accommodation and food service activities (of 4.3%). The value added in Agriculture, Forestry and Fishing industries grew by 1.9%. Financial and insurance services was the only sector that experienced a downturn in 2017 (of 16.6%), which was mainly because of the decline in non-resident business in Latvia.

Due to the current positive market conjuncture – economic growth in the European Union (EU), which is the largest Latvian export market, and the available EU structural funds – **rapid growth will also continue in 2018**. According to the estimates of the Ministry of Economics GDP growth could reach 4.2%.

In 2018, the sharpest increase is expected in manufacturing and construction. Due to the favourable situation in external environment, stable growth currently persists in chemical industry, manufacture of electrical and optical equipment, manufacture of machinery and equipment, and manufacture of motor vehicles. Due to the rise in private consumption, steady increase also continues in retail sales and commercial services. Along with the growing budget expenditures, the amount of public services provided will also increase.

The macroeconomic disproportions of the “fat years” have been eliminated; the risks of economic vulnerability to internal and external shocks reduced - Latvia maintains a low public debt, the government budget and the country's balance of payments are currently well-balanced. Inflation, although rising, is still based on supply-side factors.

In 2017, Latvia experienced one of the highest consumer price rises over the recent years – the average annual inflation grew by 2.9%. In 2017, the price level was influenced by the rise of world food and oil prices. Services had a significant impact on consumer prices as well.

At the beginning of 2018, the price increase has been the same as in the corresponding period of previous year. In 2018, the average annual inflation is expected to be similar to that registered in 2017. It will be affected by various supply-side factors associated with the tax increases. Demand-side factors, such as an increase in economic activities and growth in wages will also significantly affect inflation. At the same time, inflation still will largely depend on the world oil and food price fluctuations.

Since 2011, when Latvia returned to growth, significant fiscal position improvements have been achieved. For the first time since 1998, the general government budget (according to the methodology of the European System of Accounts) had a surplus constituting 0.1% of GDP in 2016. In 2017, however, a small budget deficit of EUR 131.1 million or 0.5% of GDP was observed. In 2017, the deficit was lower than projected in the Budget Law, in which it was set at 1.1% of GDP. The smaller deficit can be explained by higher tax revenues, smaller contributions to the EU budget, and lower expenditures on social benefits than planned.

The medium-term budget framework foresees that the general government budget deficit will constitute 1% of GDP in 2018, 0.9% in 2019, and 0.4% in 2020. In both 2018 and 2020, the fiscal general reserve is planned for 0.1% of GDP.

After the financial market turmoil at the end of 2008 and the beginning of 2009, Latvia's monetary indicators stabilized gradually – the quality of credit portfolio improved, and crediting became more stable. Important steps have been taken to strengthen the capital of credit institutions. Compared to the previous period, the number of new loans granted to companies increased significantly. Although the number of deposits, on the contrary, decreased in 2017, it was mainly due to the decline in non-resident deposits.

The increase in economic activity positively affects the labour market: the high unemployment caused by the crisis is decreasing, and the employment rate is growing.

At the same time, some population groups, especially people with lower educational attainment level and qualification, the elderly, and the youth, experience smaller improvements of the situation.

In 2017, the number of employed reached 894.8 thousand and was by 0.2% or 1.5 thousand higher than in 2016. Mainly due to the growth of construction industry, greater demand for labour was observed in the second half of the year.

In 2017, the employment rate among population aged 15–74 reached 62.9% – an increase of 1.3 percentage points over the year. However, the growth in the employment rate during the recent years can mainly be attributed to the fact that the number of population of working age have been declining relatively faster than the number of employed people.

In 2017, unemployment kept declining and, compared to 2016, the annual average unemployment rate fell to 8.7%, decreasing by 0.9 percentage points. Also, the registered unemployment rate continues to gradually decrease, and at the end of December 2017 it reached 6.8%.

Improvements in the labour market are hampered by regional disparities and low labour mobility. For example, the registered unemployment rate in Latgale region is almost four times higher than in Riga region, where it is close to the natural level. In addition, four fifths of all new job vacancies are within Riga region. Structural problems are also aggravated by the relatively high share of long-term unemployed persons – still more than one fourth of registered unemployed persons are seeking job for more than a year.

With the economic situation stabilizing, since the end of 2010 the growth of wages has resumed. During the period from 2011 to 2017, average gross wages have increased by 40%. Moreover, the rise has become sharper over the recent years. In 2017, the average monthly gross wages rose by 7.9%.

It is expected that an intense demand-side pressure in the labour market will also prevail in 2018, which could result in a small increase in the number of employed persons. At the same time, labour market still will be affected by the negative demographic trends and regional disparities. In the light of this, the situation with labour availability will become even more difficult in the nearest future and will have significant impact on the wage growth and labour

costs. The average gross wages are expected to exceed EUR 1 000 in 2018 (EUR 926 in 2017). In 2018, the unemployment rate on average could fall to 8%.

Further development of the economy depends on the situation in the external environment and the progress of reforms. Further development of the Latvian economy still will be closely related to export opportunities. Thus, the greatest risk for Latvian growth is related to the development of global economy. Further development of the EU's common market is also of vital significance. The economic benefits of Latvia in the medium term will mainly be based on the achieved macroeconomic stability, which has resulted in improvement of Latvia's credit ratings, as well as on the effectiveness of the planned support programmes of the EU structural funds and improvements in the business environment.

A scenario of more rapid economic growth anticipates renewal of growth in the main Latvian export markets, basing competitive advantage on technological factors and improvements to production efficiency and innovations rather than advantaging from inexpensive labour and low resource prices. In the medium-term, Latvia's growth rates could reach 4–5% annually. A weaker growth scenario, in turn, estimates that, along with the weakening of growth in the Europe and no improvements in geopolitical situation, economic growth in Latvia could be much slower.

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DEVELOPMENT OF THE WORLD ECONOMY

Global economic growth continues to improve. In the second half of 2017, the economic development of most developed countries, in fact, was faster than projected. Similar trends were also observed in the largest developing countries. At the end of 2017, indicators of global trade rose sharply, which was mostly facilitated by stable growth in investments, especially within the group of developed countries, and rising production output in Asia. Industry confidence shows signs of steady demand. Stable growth is also expected to persist in 2018–2019.

Growth of Gross Domestic Product
changes as per cent

	2016	2017	2018f	2019f
World	3.2	3.8	3.9	3.9
European Union	2.0	2.7	2.5	2.1
USA	1.5	2.3	2.7	2.5
CIS	0.4	2.2	2.2	2.1
Asia	6.4	6.5	6.5	6.6

Source: IMF World Economic Outlook Database
f – forecast

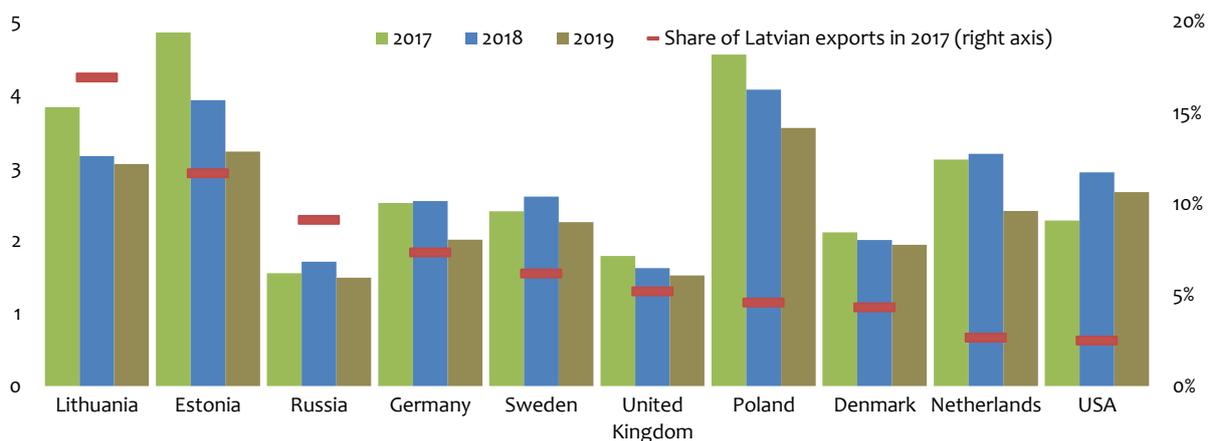
demand stabilized, boosting the confidence of businesses and consumers and improving the situation in the labour market. It is expected that the economic development of the EU will remain stable. The number of occupied posts will increase, which, in turn, stimulates higher private consumption levels. Favourable investment conditions will also prevail and internal and external demand will strengthen.

In 2017, the economic activity of the USA also improved. It was based on several factors – favourable financial markets, low dollar exchange rates, growth of energy sector and strong external demand. It is also expected that current tax reform will accelerate USA growth in the nearest future by stimulating investment and household expenditure.

Economies of CIS countries, including Russia, although still recovering from the recession, have shown growth in 2017. The growth was facilitated by relatively stable oil prices, more favourable financial conditions, and increased confidence levels. However, further development will be hindered by oil prices, negative demographic situation, and other structural obstacles.

In 2017, global growth and rise in sales contributed to the economic development of the EU. Also, the internal

Economic Development of Latvian partner Countries
GDP growth rates as per cent



Source: CSB, IMF World Economic Outlook Database

Asian region is still the leader in the global growth. Growth is facilitated by stimulant economic reforms, especially government investments. Growth of the region also in future will be driven by stable domestic demand and increasing external demand.

In the nearest future, the main risks of global development are fairly balanced, but in the medium term – negative. As the most important risk stricter financing requirements are mentioned. The risk of economic development in the EU is still related to the UK withdrawal from the EU.

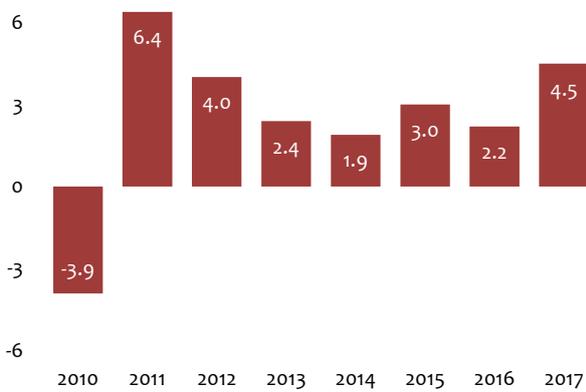
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GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

GROSS DOMESTIC PRODUCT

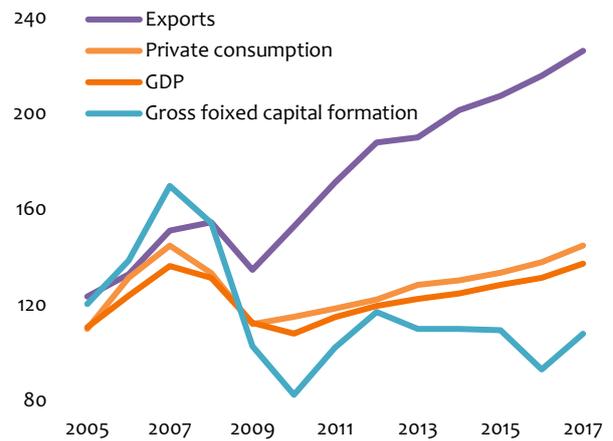
In 2017, GDP rose by 4.5%, which was the sharpest rise since 2012.

Gross Domestic Product changes as per cent



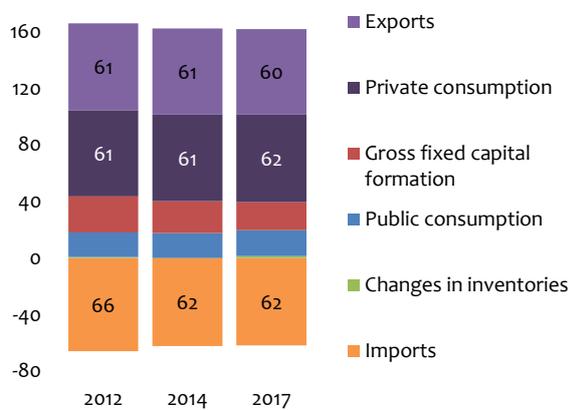
Export volumes were mostly influenced by the rise in the external demand. Currently, export volumes have reached the historically highest levels. Improvements in the labour market can also be observed. The increase in private income has stimulated private consumption. Public consumption, however, has increased more rapidly than in the previous years. Following a decrease recorded in the last two years, accelerated investment growth was observed in 2017.

Gross Domestic Product by Expenditure Items
2004 = 100

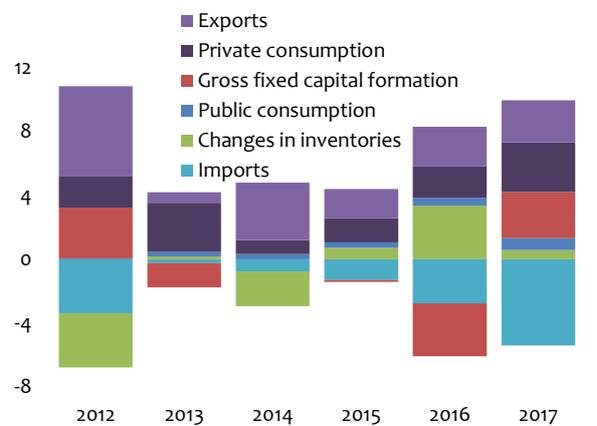


The acceleration of growth in 2017 was facilitated by the improvement of the situation in the external environment, more intensive acquisition of EU structural funds, and increase in both employment and wages. In 2017, exports and private and public consumption rose steadily.

Gross Domestic Product from the Expenditure Approach
per cent of GDP

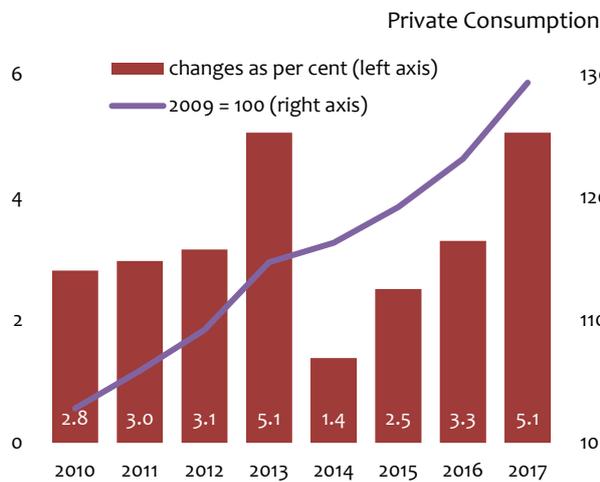


Gross Domestic Product by Expenditure Items contribution to growth as percentage points

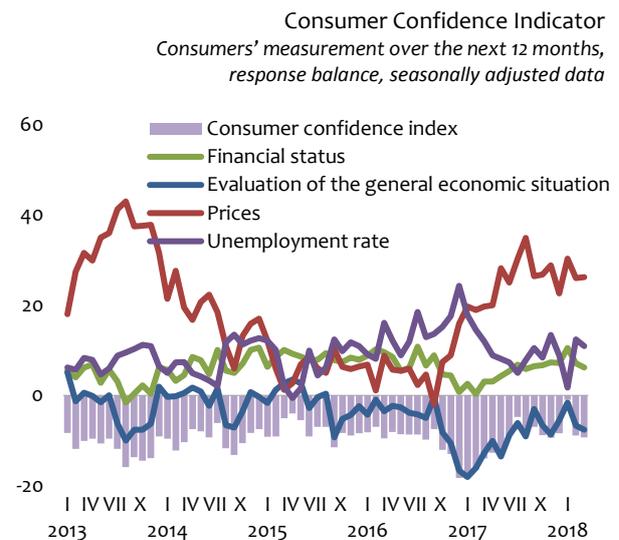


PRIVATE AND PUBLIC CONSUMPTION

Private consumption continues to steadily grow. From 2011 to 2017, private consumption on average grew by 3.4% annually, which was mainly because of a significant rise in wages.

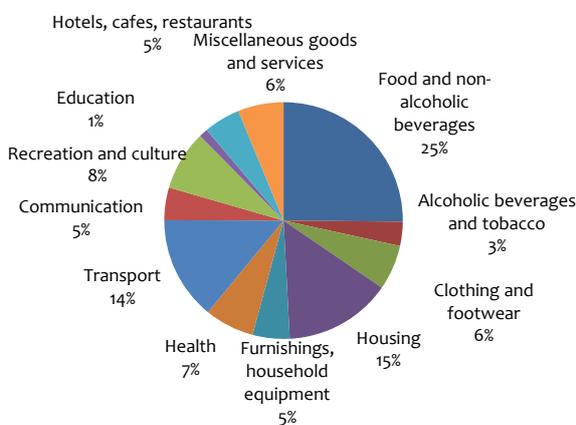


The positive consumer sentiment has grown over the year; inflation expectations has remained, compensated by lower unemployment and improvement of financial situation. Since the end of 2016, the consumer sentiment is gradually improving. Optimism about the financial situation in family and the overall situation in the country is growing. Unemployment expectations are decreasing, However, since the end of 2016 the inflation expectations are growing. Such attitude can be explained by recent price rises and relatively low inflation rates for the last few years.



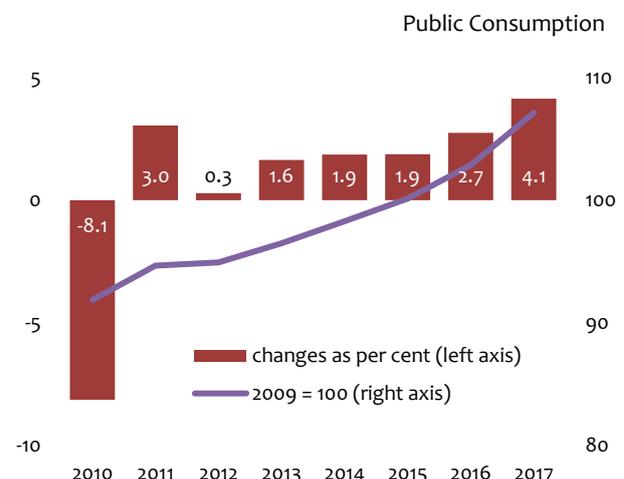
Household expenditure – the highest recorded over the last 10 years. The largest share of household consumption consists of expenditure on food. In 2017, compared to the year before, expenditure on food remained at the level recorded in the previous year. No changes were registered also in expenditure on housing and utilities that together constitute the second largest part of consumption expenditure. The third priority in household expenditure is given to expenditure on transport that had a rise of 7%. It was mainly facilitated by the increase in expenditure on the operation of personal transport equipment and the purchase of cars. However, a sharper rise – of 13% – was observed in expenditure on recreation and culture, which was the fourth largest consumption group.

Structure of Household Expenditure 2017*, per cent



* evaluation by Ministry of Economics

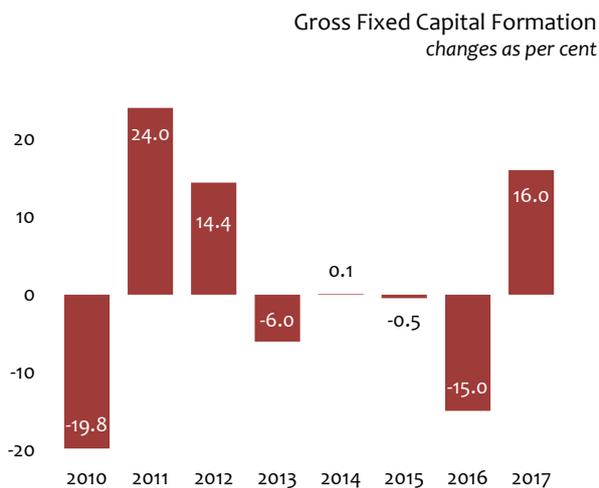
Following the sharp decline during the crisis, the public consumption in recent years has been steadily growing. As a result of increased budget revenues, public consumption has been rising faster since 2014. However, despite the gradual increase, public consumption still lags behind the pre-crisis level. From 2011 to 2017, public consumption in total went up by 1.9%. In 2017, the sharpest rise since 2006 was observed.



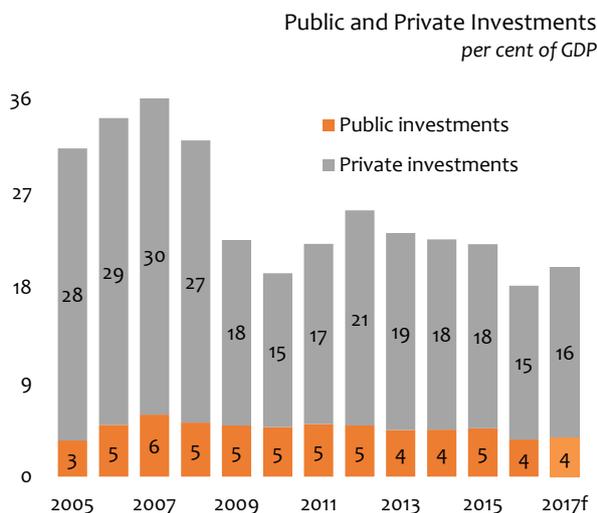
GROSS FIXED CAPITAL FORMATION

After a long period of weak investment dynamics, the gross fixed capital formation have started to steadily grow; however, the level still remains lower than before the crisis.

The increase in the investment activities indicates that investment stagnation period of almost five years has been overcome. In 2017, gross fixed capital formation was 16% higher and constituted almost 20% of GDP.



Since the end of 2016, investments (in fixed capital formation) in Latvian economy are growing faster than on average in the EU, however, the level is still lower than before crisis.



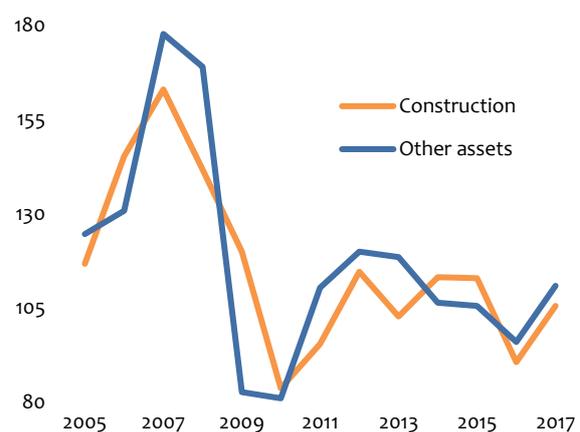
f - forecast

The relatively low investment level is mainly related to the sharp decline in private investment during the crisis and the slow recovery afterwards. From 2011 to 2016, private investment on average constituted 17.7% of GDP, which was almost by 11 percentage points lower than during the

years of rapid growth. The low level and weak growth during the period was mainly a consequence of poor crediting, low demand, relatively high levels of indebtedness in private sector, and uncertainty of economic and political situation in the external environment. In 2017, private investment grew by 17%; however, the level is still almost twice lower than during the pre-crisis period. Under the conditions of weak crediting, state provides significant support to private investments from the EU structural funds. EU structural funds are also an important source of public investment financing.

Since 2011, public investment in Latvia remains at high level. In recent years, public investment constitutes one fifth of the total investment in the Latvian economy, and its dynamics are relatively stable. An exception is Year 2016, when public investment was by 20.3% lower than in 2015. This was mainly because of the temporary cessation of EU structural fund transfers due to the cyclical nature of EU structural fund acquisition. Along with the restoration of the EU structural fund financing, public investment increased and in 2017 it was by 12.5% higher than a year ago. It should be noted that the share of public investment in the total investment in Latvia is one of the highest among the EU Member States – according to Eurostat, public investment in the EU-15 on average accounts for 2.8% of GDP (4.5% in Latvia).

Gross Fixed Capital Formation by Types of Assets
2004 = 100

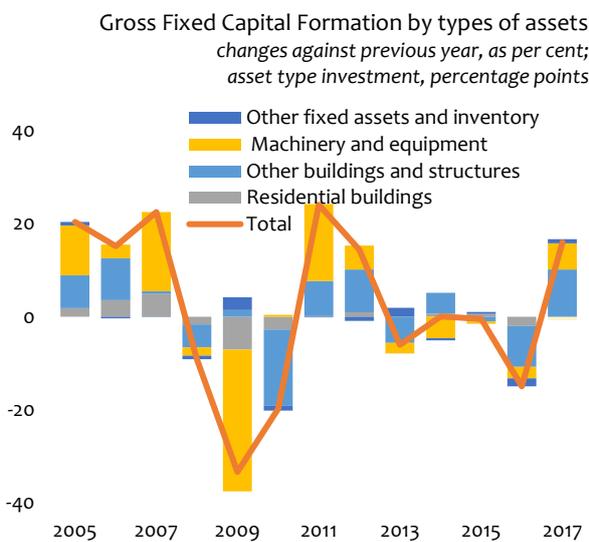


Structure of investment assets has changed since 2007.

During the economic recession, the investment volumes decreased for all types of assets. The largest drop in investment was due to the downturn in the investment volumes in the construction industry, which fell by 10.8 percentage points of GDP (from 2007 to 2016). In addition, the decline of investment in machinery and equipment was slightly lower – constituting a

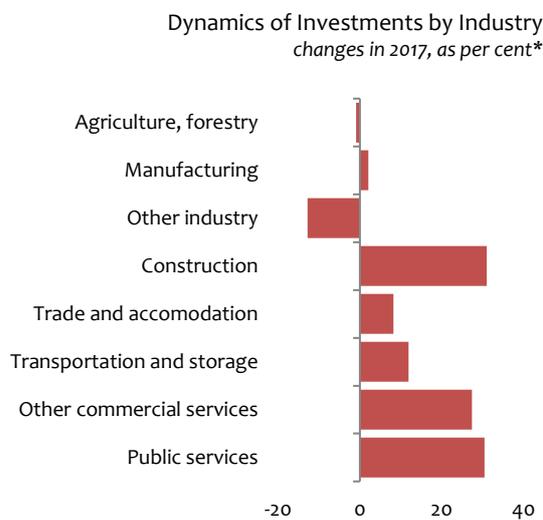
7.2 percentage point decrease. Investment in intellectual property assets, however, almost did not change, staying low for several years – on average at 1% of GDP, of which investments in R&D stayed at 0.6% of GDP.

In 2017, investment dynamics were positive for all types of assets. Investments in construction assets rose by 16.4%, compared to the previous year, and their share in total investments reached 54.1%, of which investments in housing comprised 9.3% (19.8% in 2007). Compared to the year before, businesses invested 13.7% more in machinery and equipment (of which 50.3% in vehicles). Investment in these assets comprised 37.4% of total investment. Significant investment was also made in products of intellectual property – in 2017, they were almost by 25% higher than a year ago.



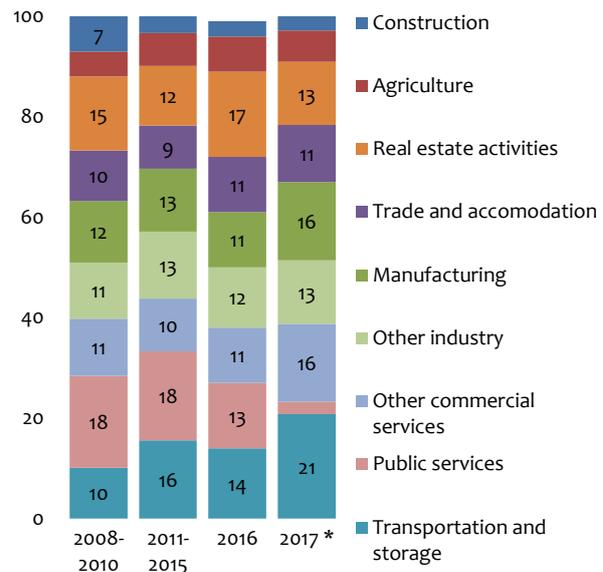
In 2017, investment activities grew in almost all sectors.

The estimates of investment volumes in breakdown by sector, quarterly data show that, compared to 2016, 22% more were invested in services sectors than in 2017.



* – calculated by using quarterly data

Non-financial Investment Structure by sector, as per cent



* – calculated by using quarterly data

Investments in public services (up by 30.5%) and real estate activities (up by 111%) yielded the greatest contribution. Compared to the previous year, investment level in production sectors was by 3.2% lower, which was mostly influenced by lower investment dynamics in mining and quarrying and energy sector. Investment in manufacturing rose by 2%.

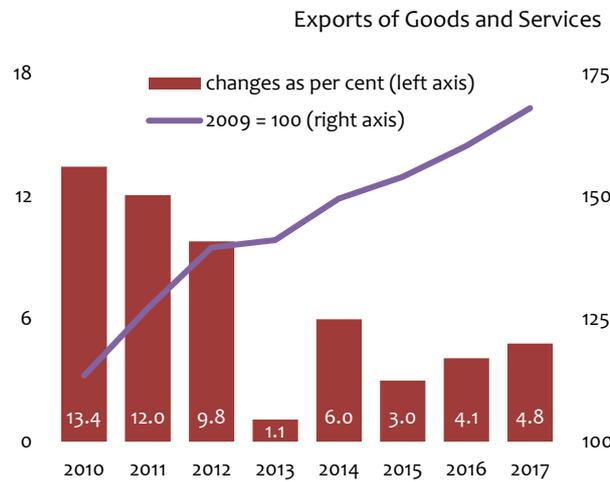
The results of the survey of industrial enterprise managers show that the increase in demand is the most important factor facilitating investment. In recent years, the role of financial accessibility in stimulating investment has increased as well. In 2017, the financial situation, which can be viewed as an equivalent to technical factors, such as technological development, availability of qualified labour, etc., is perceived to be a significant factor encouraging investment.

Sharp investment growth is expected in the next few years.

Higher investment activities are positively influenced by the growing external and internal demand, better availability of EU structural funds, increased crediting, etc. In future, also limited supply of labour will serve as a major stimulus for investment. If investment in environment will remain favourable and high production capacity will take place, positive investment dynamics can be expected in future.

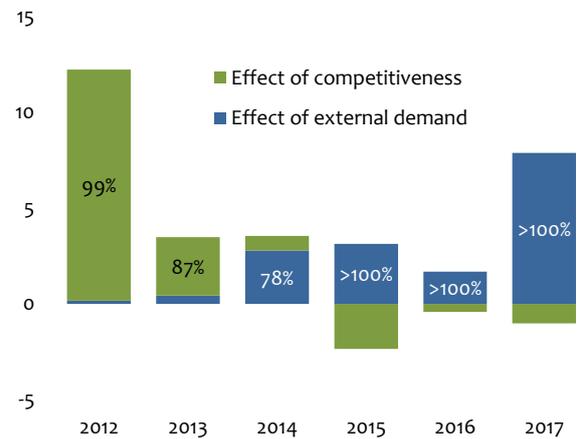
EXPORTS

Since 2010 exports have been growing, and still remain the main driving force of economic development. The growth of exports is closely related to the external demand and the economic development of Latvia's main partner countries.



From 2014, export growth has been primarily driven by the external demand, while the role of price competitiveness in the growth of exports is steadily decreasing. Over the period of rapid economic growth, some of the largest export groups of goods (e.g., wood and products of wood and cork, base metals) dominated in the growth of exports of goods. During the crisis, export volumes fell in all commodity groups; however, the most notable decline was observed in the largest export groups, which resulted in the improvement of diversification index. During the post-crisis period, as the growth resumed, the growth of exports by product group have become more similar, which leads to a higher level of exports diversification. In recent years, the export diversification indicator in Latvia meets the EU-15 average.

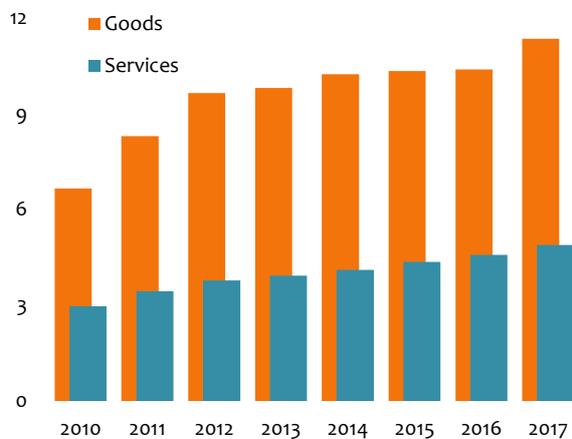
Changes of Exports by the Constant Market Share structure of exports' changes to the EU countries, as per cent



In 2017, exports of goods and services kept rising. Exports were positively affected by both faster economic growth rates in Lithuania and Estonia and steady demand in the most important export market – EU countries. The stabilization of economic situation in Russia and other CIS countries also contributed to positive export dynamics in Latvia.

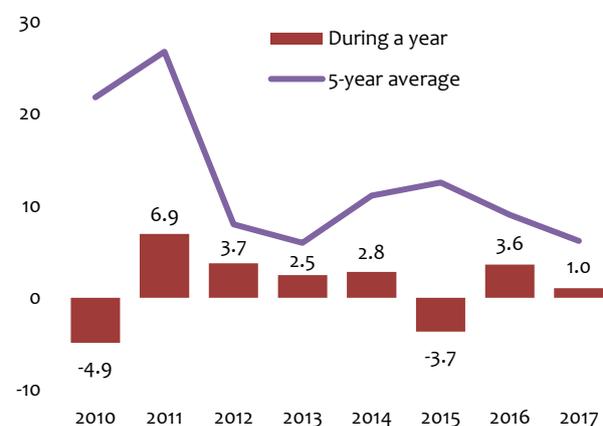
It is expected that, as the external demand will remain stable in 2018, export earnings will similarly continue to increase.

Exports of Goods and Services current prices, billion euro



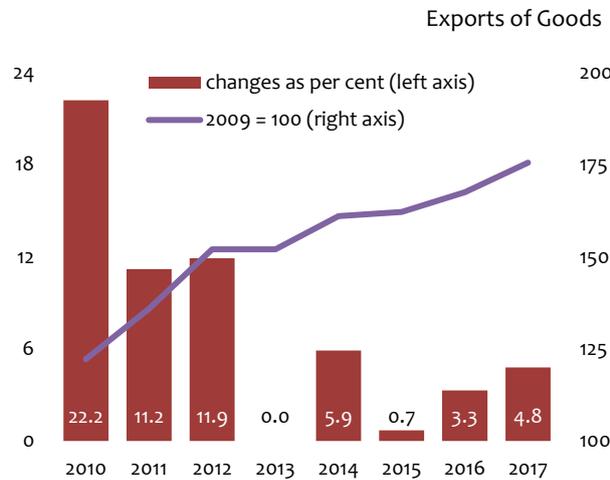
Latvia's share of exports in the global market are increasing, which shows that Latvian businesses maintain their competitiveness and enter new markets.

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

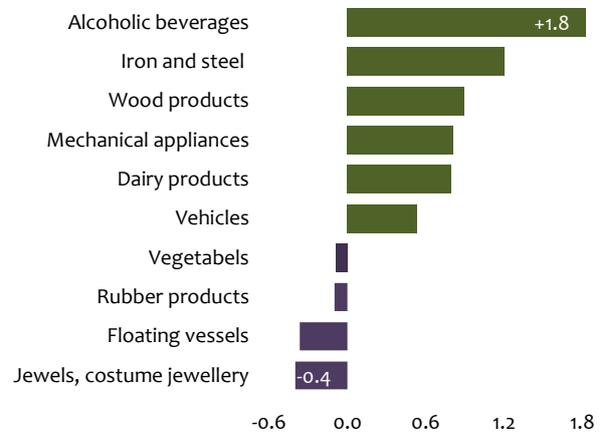


Exports of Goods

Exports of goods constitutes approximately 70% of Latvia's total exports, and this share has not changed significantly over the last years.



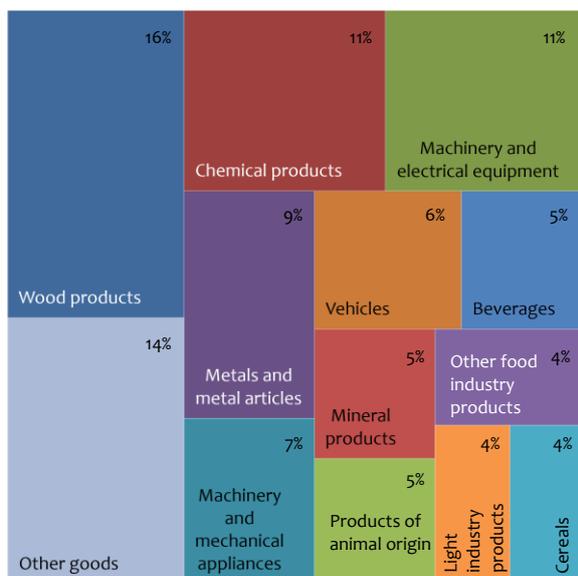
Exports of Goods contribution to growth in 2017, as percentage points



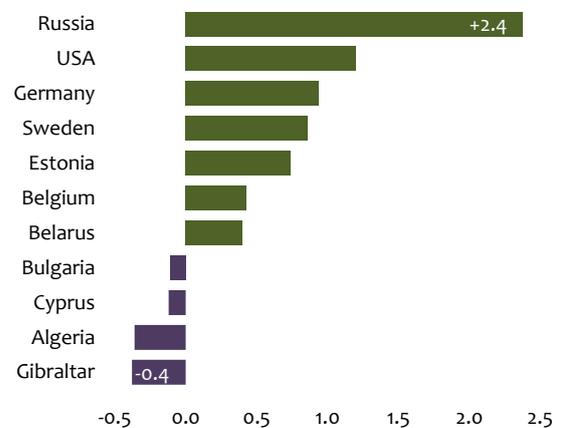
In 2017, Lithuania, Estonia, Russia, Germany, Sweden, United Kingdom, and Poland were the main export partners of Latvia. Out of all goods exported, more than 60% were exported to these countries.

In 2017, exports of goods developed quite dynamically. Compared to 2016, exports of goods at current prices rose by 10%. The growth was mainly influenced by the development of exports of food products, basic metals and metal articles, machinery and equipment, and electrical equipment. The value of exports of other goods rose as well. In 2017, a significant increase was observed for exports to CIS countries, followed by smaller growth in exports to EU countries. Exports to other countries went up as well.

Structure of Exports of Goods 2017, as per cent



Exports by Countries contribution to growth in 2017, as percentage points

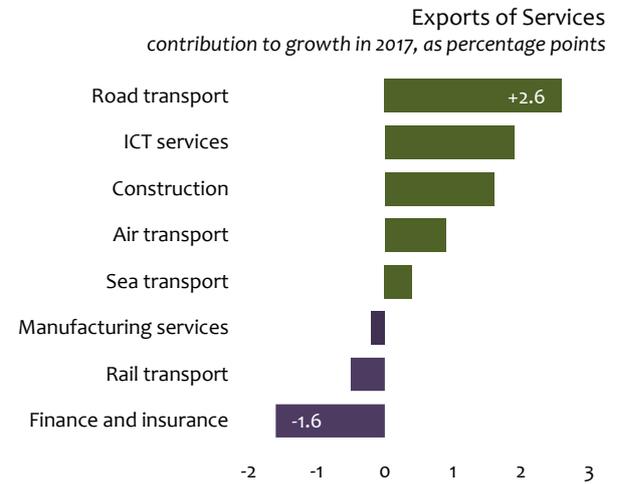
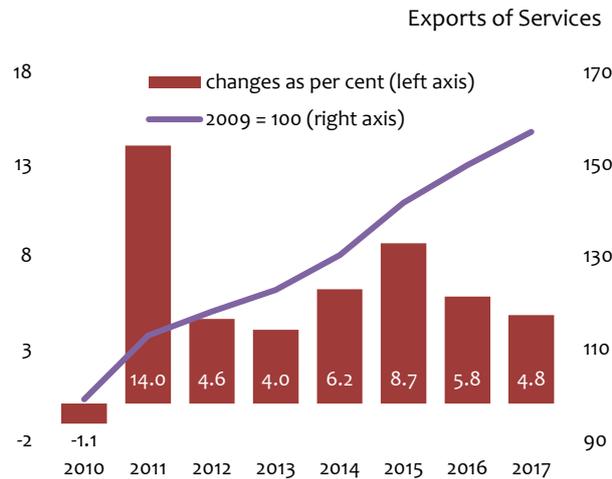


Similar trends in the export development were observed also at the beginning of 2018. During the first two months of the year, exports at current prices grew by 14.8%. This was significantly affected by the upturn in exports of machinery and equipment, wood and products of wood and cork, and cereals. In 2017, relatively faster export volumes increased to CIS countries. However, more moderate growth in exports to EU countries was observed. Exports to other countries also went up significantly.

Exports of Services

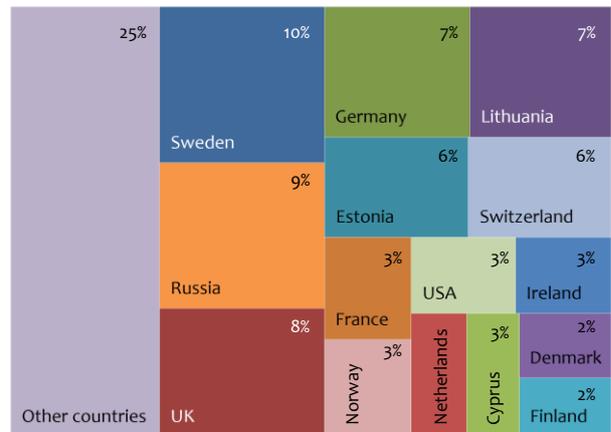
Since 2011 Latvian exports of services have grown more rapidly than the exports of goods. Exports of transport services traditionally have the greatest impact on the growth of exports. Similarly, the share of exports of construction and ICT services have been increasing every year. However, the share of exports of financial and insurance services have decreased.

2017. Considerable part consists of exports of services to the CIS countries, which is mainly related to the transit services. It should be noted that exports of services to the CIS countries have decreased slightly in recent years – from 17% in 2014 to 13% in 2017.

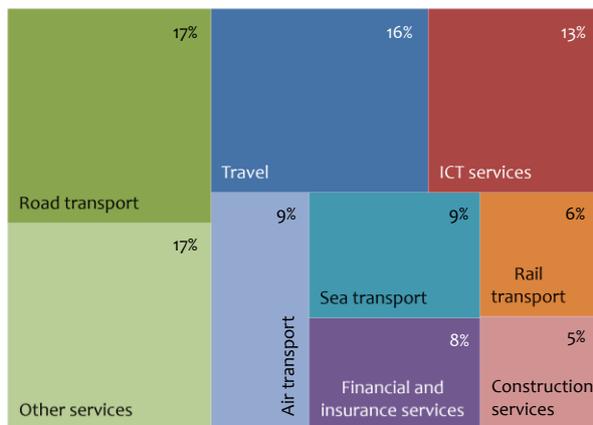


In 2017, exports of services experienced a similar growth as in recent years. A significant upturn was recorded in construction and ICT services. Also, a considerable increase in road and transportation services was observed. Along with the slight drop in rail transportation, the volumes of other transport services remained unchanged in the second half of 2017. However, the exports of financial and insurance services decreased.

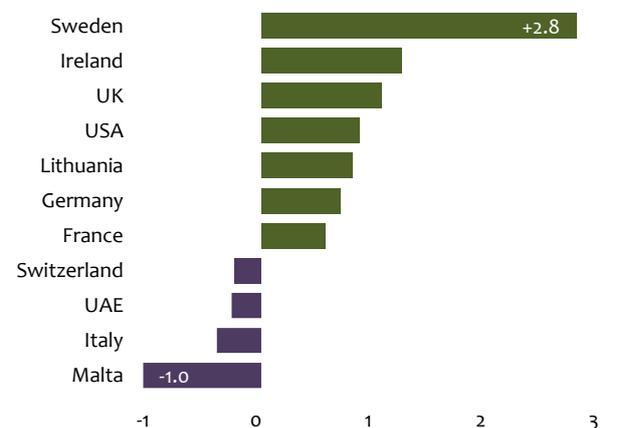
Structure of Exports of Services by Countries 2017, as per cent



Structure of Exports of Services 2017, as per cent



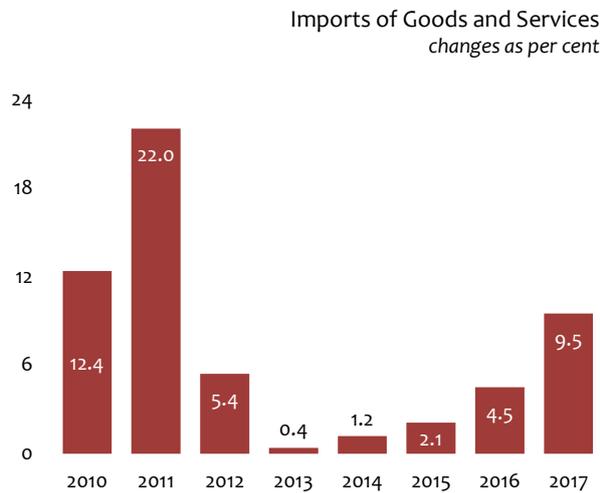
Exports of Services by Country contribution to growth in 2017, as percentage points



In respect to the exports of services in breakdown by country group, increasingly larger share is formed by exports to EU countries – from 49% in 2011 to 64% in

IMPORTS

After a dramatic decline during the crisis, imports of goods and services have now been rising steadily over the past few years. Year 2017 was especially important for the growth of imports, because imports rose by 9.5%. In addition, imports of goods increased slightly faster than that of services.



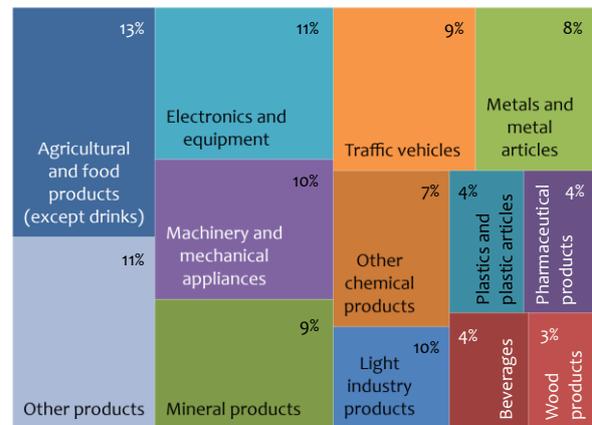
The structure of imports by the final use of goods has not changed significantly since 2012. However, the share of intermediate goods has slightly declined, which can mainly be attributed to the decrease in the value of fuel imported. The fuel share in the intermediate products group has declined from 31% in 2012 to 19% in 2017, which can be explained by the significant drop in the world oil prices.

In 2017, imports of machinery and equipment, mineral products, alcoholic beverages, plastics and plastic articles significantly contributed to the overall import growth.

Other import groups also positively affected the growth of imports. However, imports of precious or semi-precious stones and imitation jewellery decreased.



**Structure of Imports of Goods
2017, as per cent**

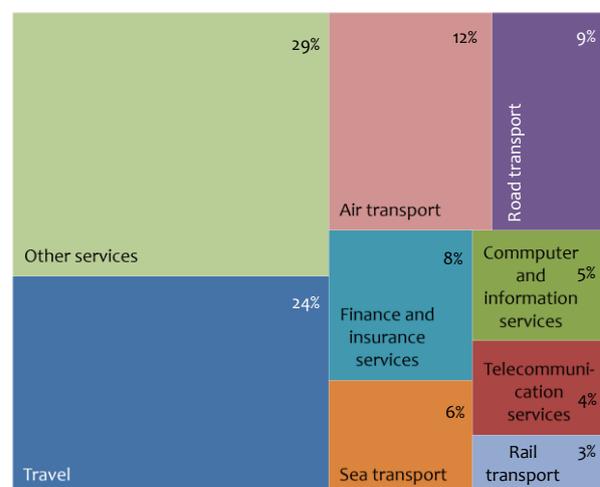


Lithuania, Germany, Poland, Estonia, Russia, and Finland are the main import partners of Latvia. Altogether, products from these countries account for more than a half of total Latvian imports of goods.

Latvia's imports of services during the post-crisis period are developing dynamically, but slightly slower than exports of services. The decrease in the value of imports was observed in 2013–2014, which was mainly influenced by the significant price adjustments.

In 2017, imports of goods at current prices rose by 8.7%. Imports of transport services, computer and information services, as well as financial and insurance services significantly contributed to the overall import growth. The decline, however, was observed in the imports of telecommunication services.

**Structure of Imports of Services
2017, as per cent**

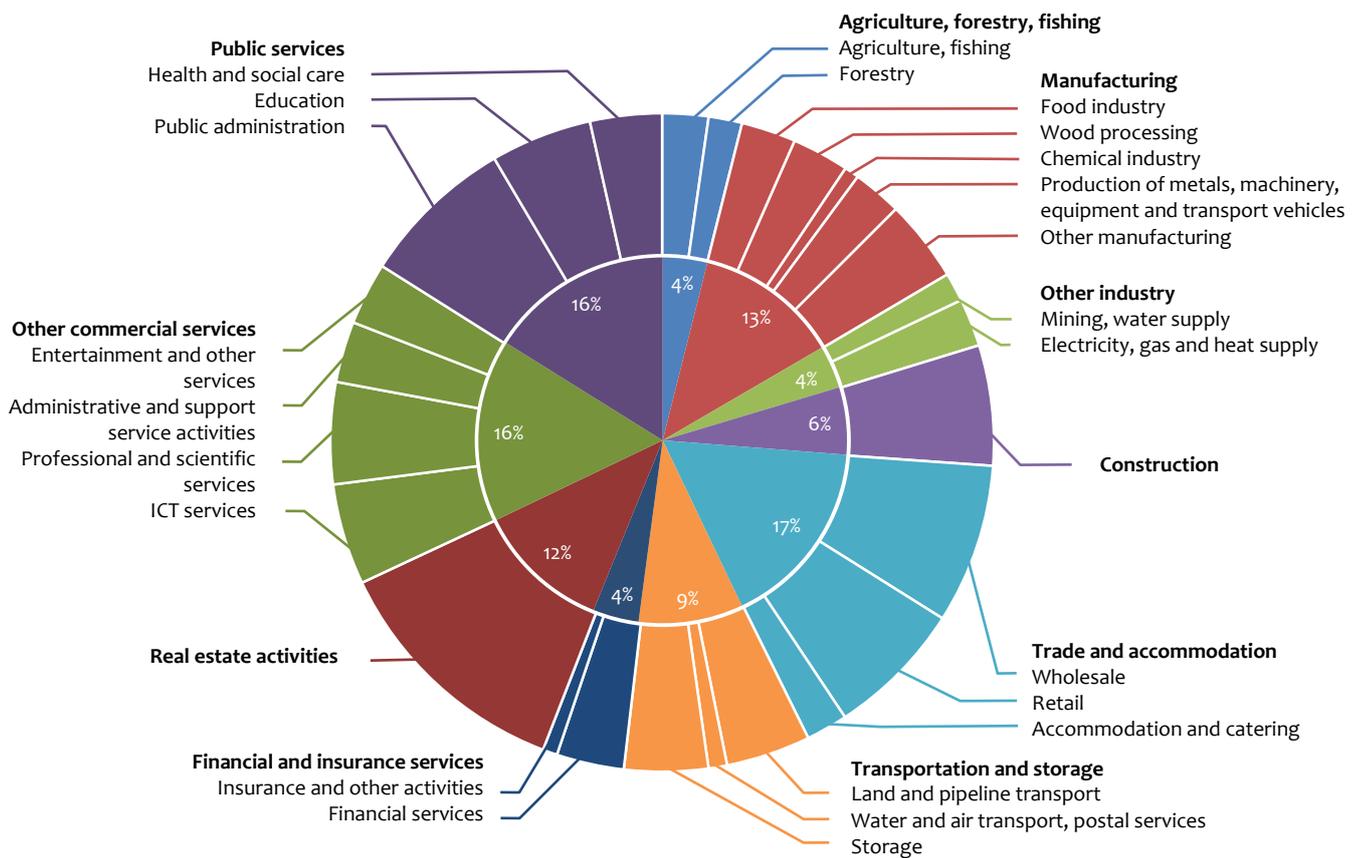


2018 | 1 CONTRIBUTION OF SECTORS

During the crisis, as labour costs fell, the competitiveness of Latvian producers improved, which served as a basis for the export rise and, therefore, also for the development of tradable sectors. The structure of the national economy changed. In 2008, tradable sectors alone (agriculture, forestry, manufacturing and transport services) comprised only 26% of the total value added, while in 2010 their share reached 33%. In 2017, the share of these sectors has fallen slightly, constituting 29.5% of the total value added.

Compared to 2010, in 2017 the share dropped in all but construction and business service sectors. The share of public services, in turn, has remained practically unchanged. In 2014–2016, the growth continued in all sectors, except for the construction industry. In 2017, however, the rise in construction output had the greatest impact on growth.

Structure of the Economy 2017, as per cent*



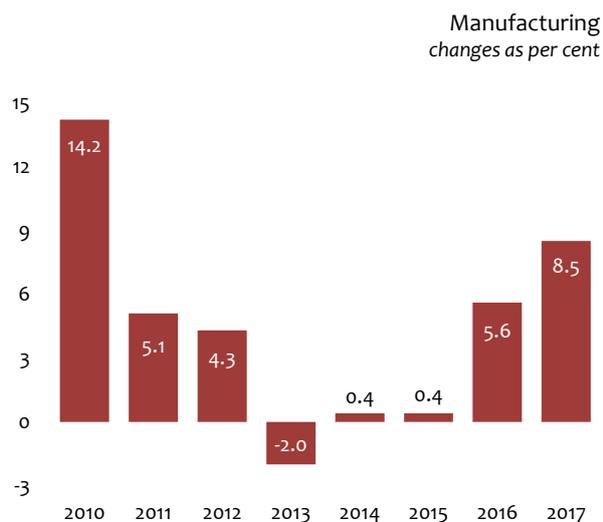
* calculations by Ministry of Economics

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

	2014	2015	2016	2017	2017			
					I	II	III	IV
Gross Domestic Product	1.9	3.0	2.2	4.5	4.1	4.0	5.8	4.2
Agriculture, forestry, fishing	0.2	12.5	-0.6	1.9	2.9	2.8	0.1	2.5
Mining and quarrying	-9.8	6.7	0.8	18.1	18.5	16.0	22.1	15.4
Manufacturing	0.4	0.4	5.6	8.0	10.3	7.1	8.4	6.9
Food and beverage industry	0.1	-4.6	1.8	5.2	3.8	8.1	4.2	4.5
Light industry	-13.6	-13.2	2.1	7.6	12.1	5.6	2.1	10.8
Wood processing	6.9	7.1	8.0	2.1	5.4	0.1	3.5	-0.5
Paper industry and publishing	-0.6	0.0	3.6	4.5	2.2	1.5	4.7	9.1
Chemical industry	-2.6	-4.1	10.7	11.4	20.7	17.2	7.0	4.7
Other non-metallic mineral products	1.2	-9.8	11.6	11.1	9.2	8.9	9.8	15.8
Metals and metal articles	-10.5	34.8	5.4	12.0	9.6	3.9	19.4	16.9
Electrical and optical equipment	32.3	16.7	12.6	15.8	31.4	25.7	11.7	3.5
Machinery and equipment	2.4	7.9	8.5	21.5	14.4	22.2	21.4	25.8
Motor vehicles	-15.2	3.5	-2.9	22.8	24.4	14.6	30.3	27.8
Other production industries	-12.0	3.5	0.8	4.3	10.7	-3.8	8.7	3.0
Electricity and gas supply	-14.3	22.6	7.2	8.2	15.2	8.8	18.9	-4.1
Construction	5.4	-1.8	-17.9	19.4	8.4	15.9	25.0	21.0
Building Construction	33.6	-6.2	-2.2	11.8	10.0	7.8	12.7	14.9
Engineering structures	-10.4	5.2	-33.3	30.4	4.2	28.1	39.6	29.3
Trade	5.3	7.3	3.3	5.2	4.4	5.0	2.7	9.0
Retail trade	3.5	4.9	2.3	4.3	2.6	3.8	5.0	5.8
Transportation and storage	1.3	-7.7	0.5	7.3	10.2	4.1	9.5	5.6
Freight traffic by rail	2.2	-2.4	-14.1	-8.4	8.1	-7.0	-12.1	-22.7
Cargo loaded and unloaded at ports	5.2	-6.2	-9.3	-2.0	8.7	5.1	-3.1	-17.6
Freight traffic by road	2.7	0.5	1.3	7.0	22.1	1.2	3.4	7.3
Accommodation and catering services	3.6	6.0	8.4	4.3	4.3	6.8	2.9	3.4
Information and communication services	-2.4	2.1	4.1	6.1	5.1	7.1	5.7	6.6
Financial and insurance services	11.6	4.8	3.1	-16.6	-14.5	-12.6	-13.3	-25.4
Real estate activities	1.4	1.4	0.2	0.3	0.5	-0.1	3.0	-2.4
Other commercial services	-5.7	5.9	3.1	6.0	4.9	4.2	6.2	8.5
Public administration and defence; compulsory social insurance	1.5	0.5	3.9	3.6	3.1	4.4	4.2	3.0
Education	4.1	0.7	0.7	5.5	5.3	7.2	6.5	3.6
Human health and social work activities	6.8	5.5	2.5	5.6	5.8	5.0	5.5	6.3
Art, entertainment and recreation	1.1	-3.7	3.2	8.4	7.9	7.5	9.7	8.6

MANUFACTURING

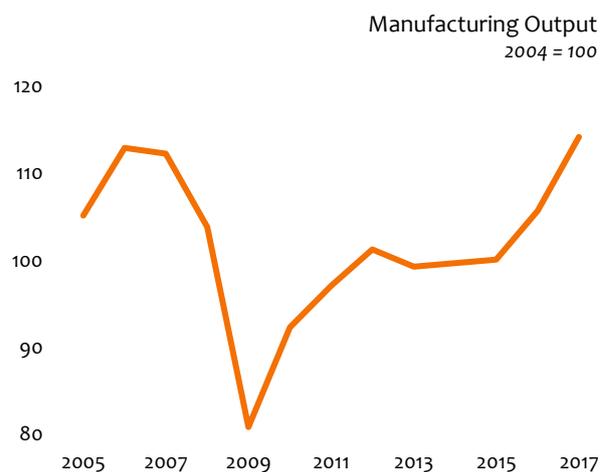
As Latvia has returned to economic growth after the crisis, the growth rates of the manufacturing have been considerably faster than the overall economic development. Manufacturing, in fact, has become one of the main driving forces of economic growth. The development of manufacturing is mainly facilitated by the improvement of the competitiveness of Latvian manufacturers and positive demand dynamics in the largest export markets.



In 2017, as the external environment improved, manufacturing experienced the largest growth in recent years. In 2017, a rise was recorded in all sub-sectors, especially in manufacture of basic metals and metal articles and food industry. Other sub-sectors, such as the production of transport vehicles, the production of electrical and optical equipment; as well as the production

of non-metallic mineral products also greatly contributed to the overall industry's growth.

In 2017, manufacturing turnover at current prices increased slightly faster than its output (by 9.5%). The volume of products sold in the domestic market rose moderately. A sharper rise, however, was observed in the volume of exported products.



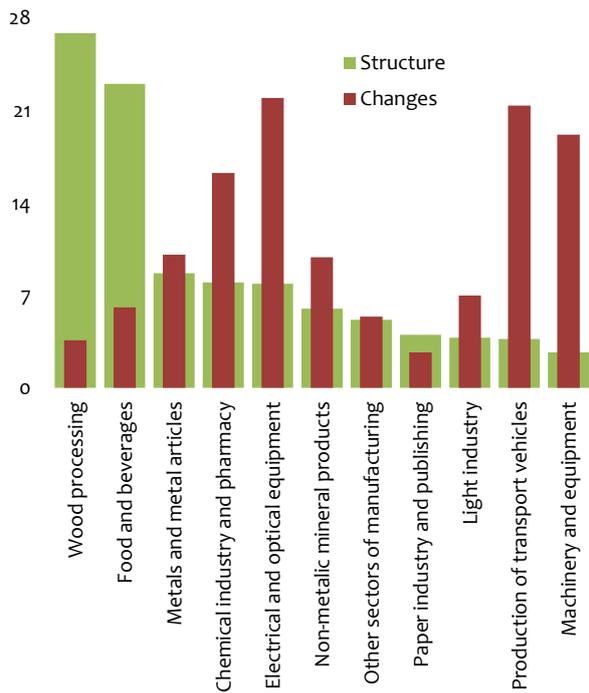
Over the Q1 of 2018, manufacturing continued to grow. A sharper rise was recorded in the production of non-metallic mineral products, chemical industry, and the production of metals and metal articles.

In 2014-2015, the number of occupied posts in the manufacturing fell, while in 2016-2017 the demand for labour slightly increased. In 2017, a number of new jobs arose in the manufacture of electrical and optical equipment. A decrease, in turn, was observed in wood processing and in the production of transport vehicles.

Manufacturing Structure and Development Trends by Field as per cent

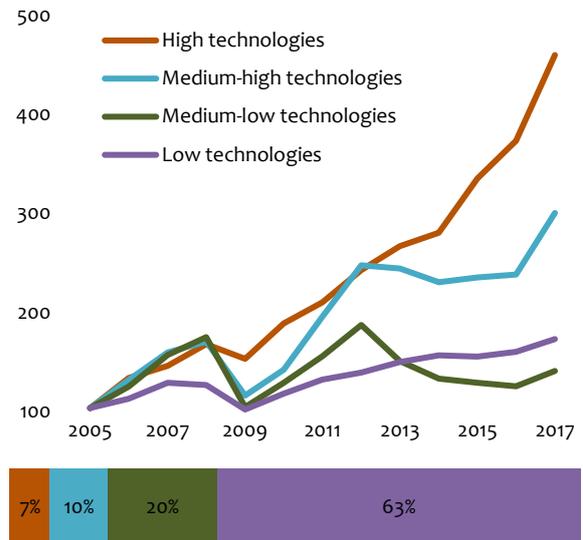
	Structure in 2017			Changes in production volume			
	Output	Occupied posts	Share of exports in sales	2015	2016	2017	2018 Jan-Mar
Manufacturing	100	100	65,5	4,3	5,6	8,0	2,4
Food and beverage industry	23,0	20,1	35,8	-4,6	1,8	5,2	-1,8
Light industry	3,8	9,9	85,0	-13,2	2,1	7,6	-1,8
Wood processing	26,5	20,4	73,8	7,1	8,0	2,1	-0,3
Paper industry and publishing	4,2	4,1	63,5	0,0	3,6	4,5	0,1
Chemical industry and pharmacy	8,0	7,0	80,6	-4,1	10,7	11,4	8,4
Production of non-metallic mineral products	6,1	4,8	52,7	-9,8	11,6	11,1	11,8
Production of metals and metal articles	8,8	10,0	68,7	34,8	5,4	12,0	7,4
Electrical and optical equipment	7,8	4,4	90,8	16,7	12,6	15,8	4,4
Machinery and equipment	2,7	3,2	84,4	7,9	8,5	21,5	11,3
Production of transport vehicles	3,8	3,3	91,8	3,5	-2,9	22,8	12,1
Other sectors of manufacturing	5,4	12,7	61,6	3,5	0,8	4,3	-0,7

Growth of Manufacturing 2017, as per cent



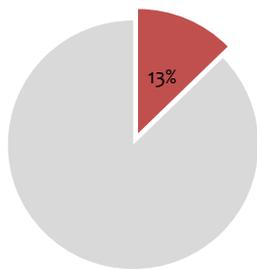
In 2017, as producer prices returned to growth, the turnover in the manufacturing industry rose quite rapidly. Faster growth in sales was registered in some sub-sectors that managed to attain higher growth rates. The turnover of exported products grew rapidly. Sales in the domestic market, however, increased moderately.

Manufacturing Volume Index and Structure by Levels of Technology 2004 = 100; structure in 2017, as per cent

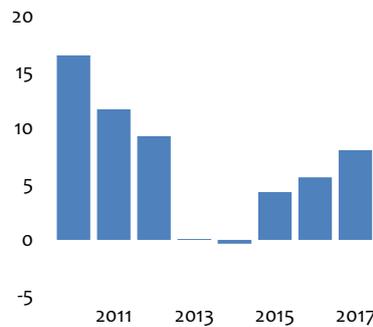


Indicators Characterising Manufacturing

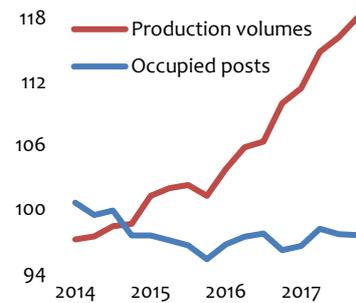
The share of the sector in national economy 2017, as per cent



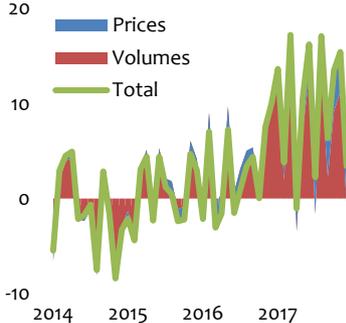
Changes in production volumes as per cent



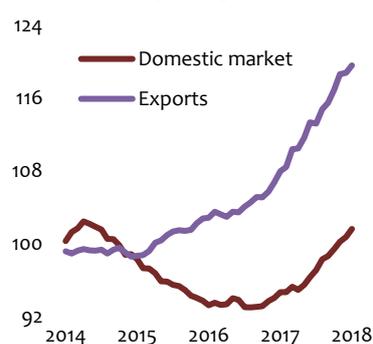
Production volumes and occupied posts Q4 2013 = 100



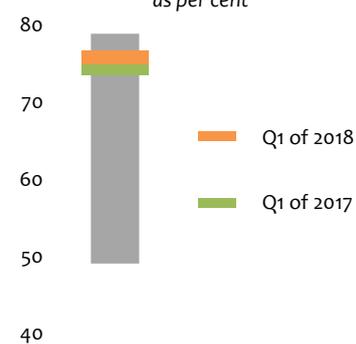
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

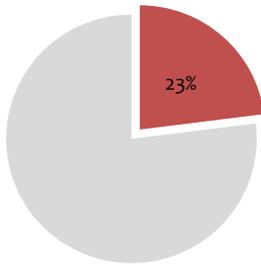


Capacity utilization rate Historically highest and lowest levels, as per cent

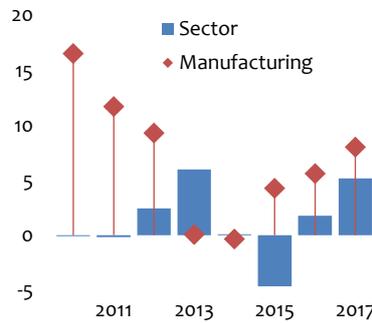


Manufacturing of food products and beverages

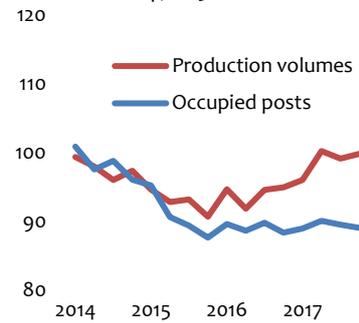
The share of the sector in manufacturing 2017, as per cent



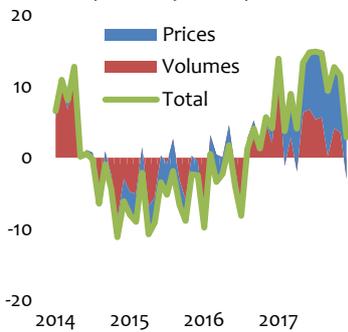
Changes in production volumes as per cent



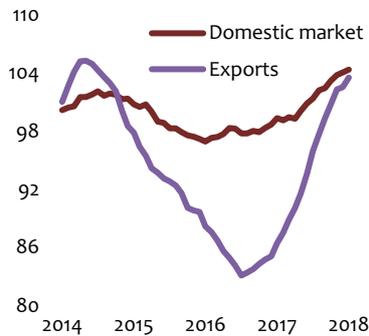
Production volumes and occupied posts Q4 2013 = 100



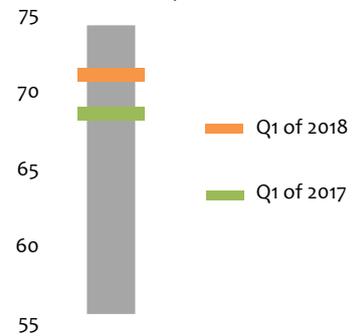
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

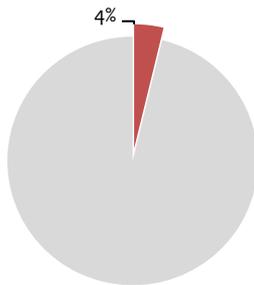


Capacity utilization rate Historically highest and lowest level, as per cent

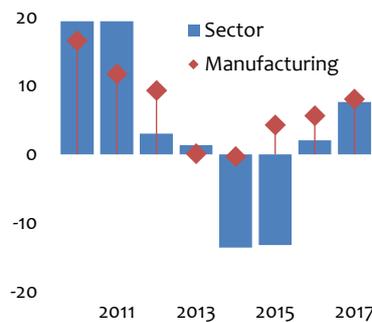


Light industry

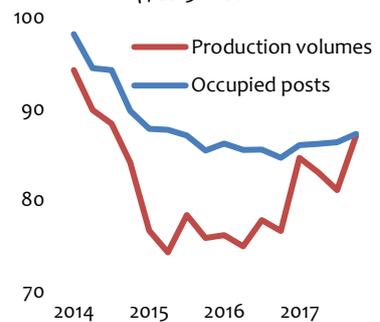
The share of the sector in manufacturing 2017, as per cent



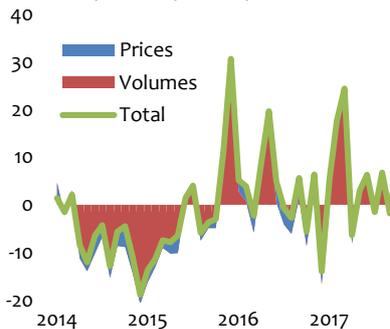
Changes in production volumes as per cent



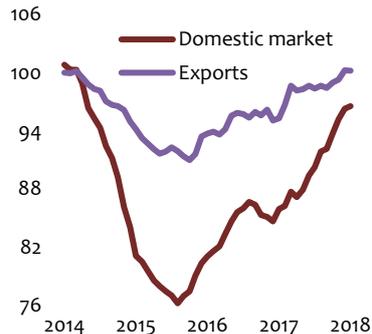
Production volumes and occupied posts Q4 2013 = 100



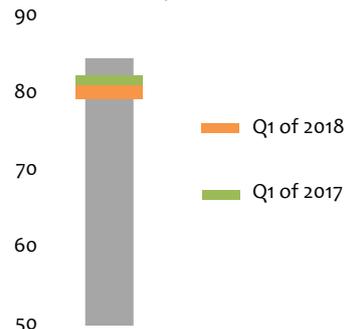
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

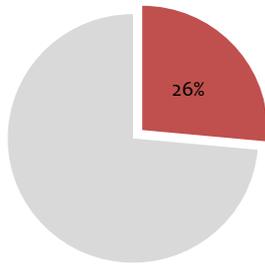


Capacity utilization rate Historically highest and lowest level, as per cent

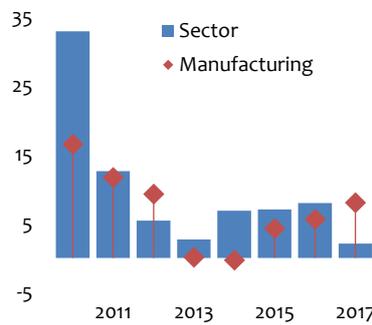


Wood processing

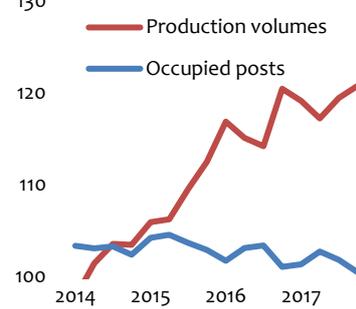
The share of the sector in manufacturing 2017, as per cent



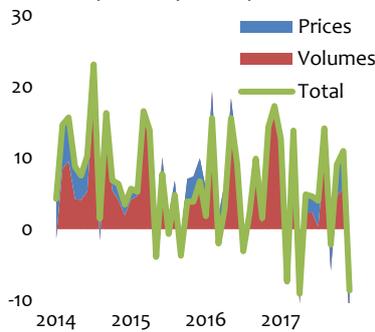
Changes in production volumes as per cent



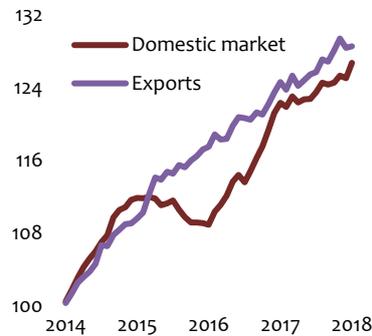
Production volumes and occupied posts Q4 2013 = 100



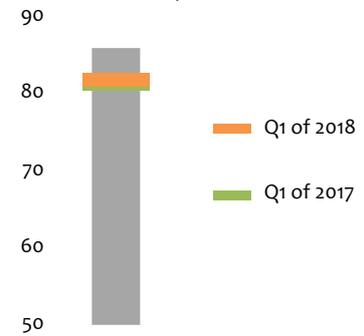
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

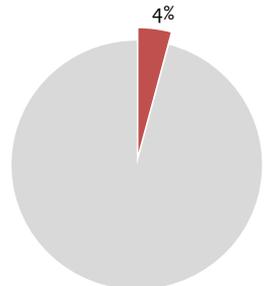


Capacity utilization rate Historically highest and lowest level, as per cent

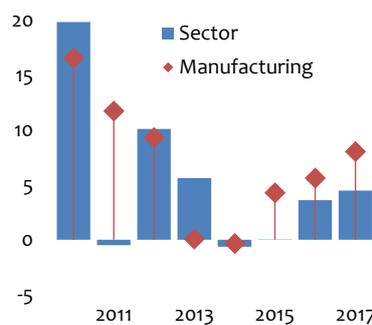


Manufacture of paper and paper products, publishing

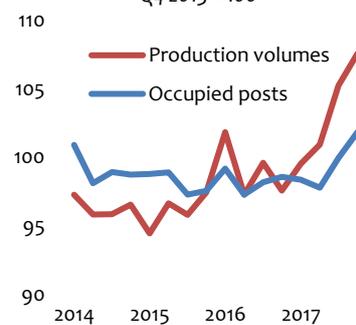
The share of the sector in manufacturing 2017, as per cent



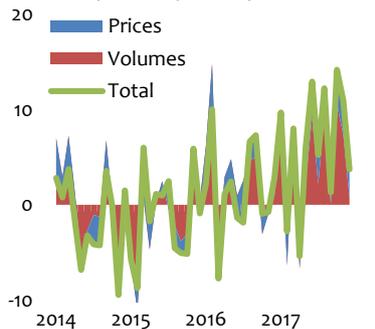
Changes in production volumes as per cent



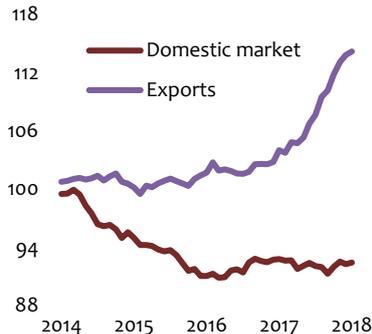
Production volumes and occupied posts Q4 2013 = 100



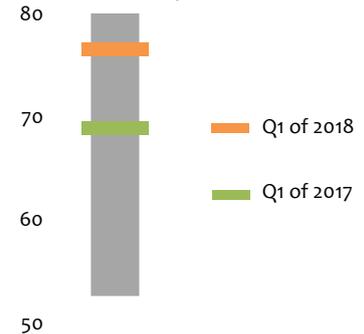
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

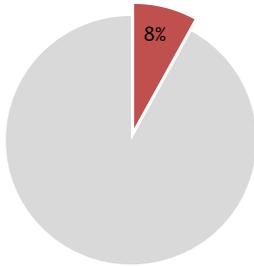


Capacity utilization rate Historically highest and lowest level, as per cent

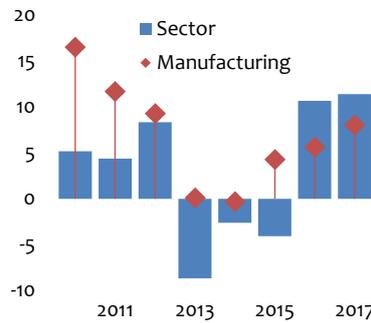


Manufacture of chemicals and chemical products

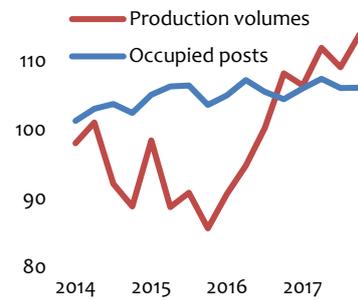
The share of the sector in manufacturing 2017, as per cent



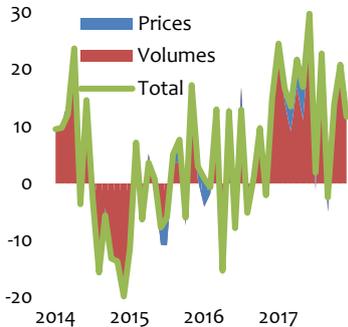
Changes in production volumes as per cent



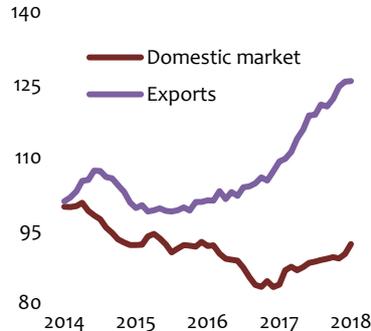
Production volumes and occupied posts Q4 2013 = 100



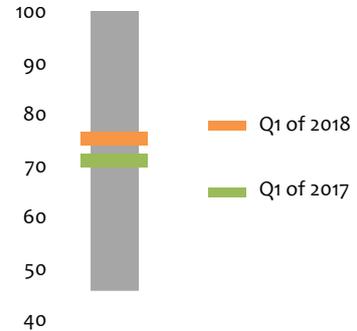
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

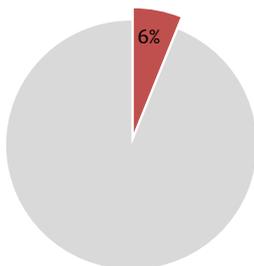


Capacity utilization rate Historically highest and lowest level, as per cent

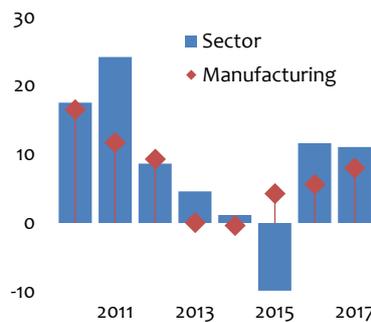


Manufacture of non-metallic mineral products

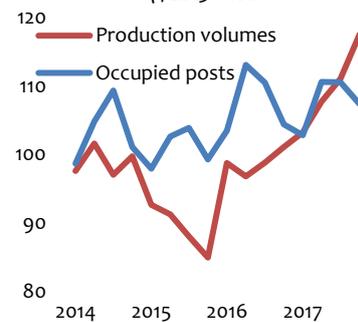
The share of the sector in manufacturing 2017, as per cent



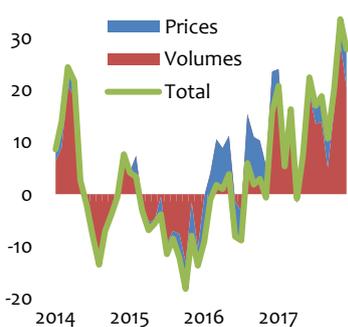
Changes in production volumes as per cent



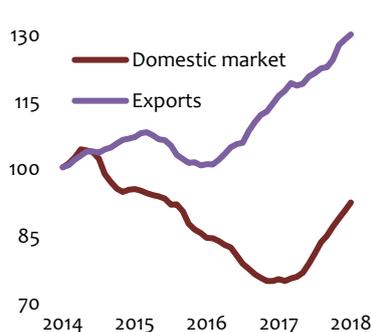
Production volumes and occupied posts Q4 2013 = 100



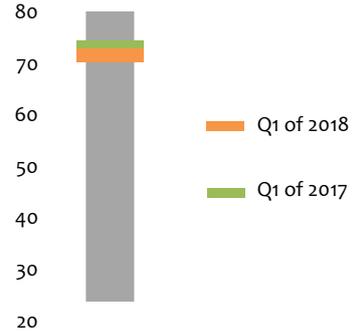
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

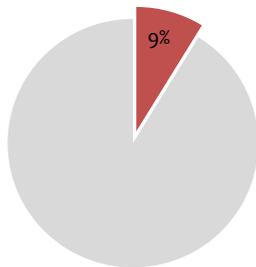


Capacity utilization rate Historically highest and lowest level, as per cent

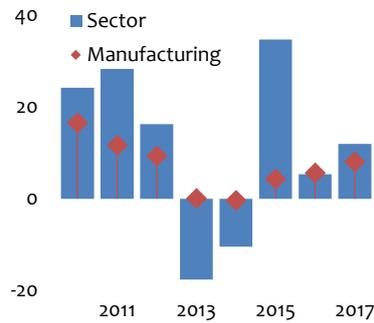


Manufacture of basic metals and fabricated metal products

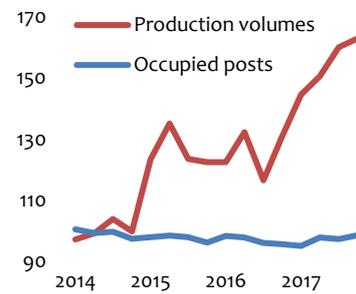
The share of the sector in manufacturing 2017, as per cent



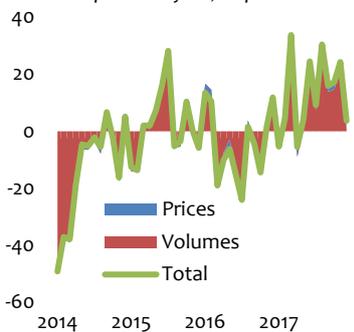
Changes in production volumes as per cent



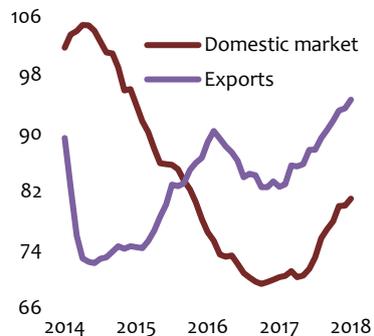
Production volumes and occupied posts Q4 2013 = 100



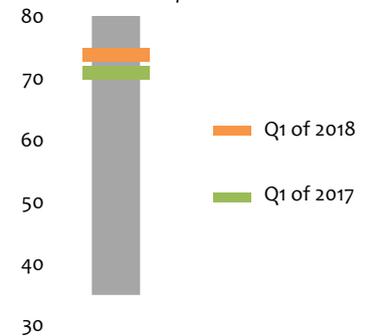
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

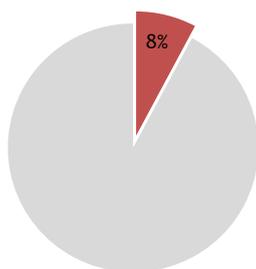


Capacity utilization rate Historically highest and lowest level, as per cent

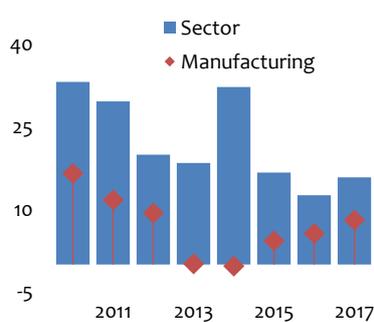


Manufacture of computer, electronic and optical products

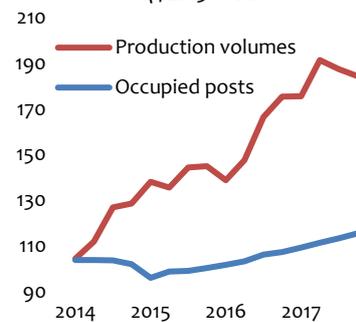
The share of the sector in manufacturing 2017, as per cent



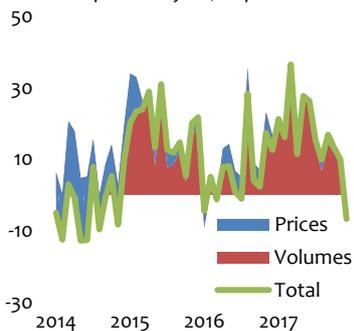
Changes in production volumes as per cent



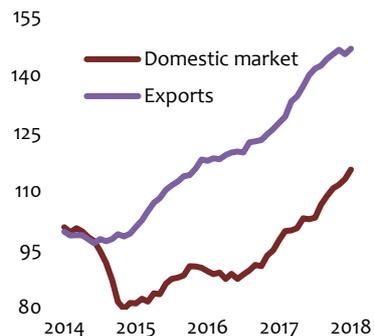
Production volumes and occupied posts Q4 2013 = 100



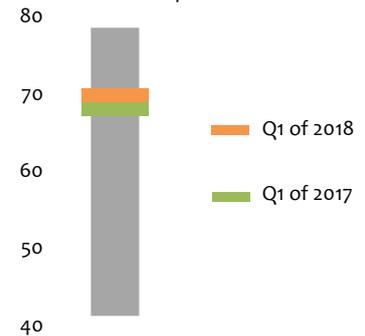
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

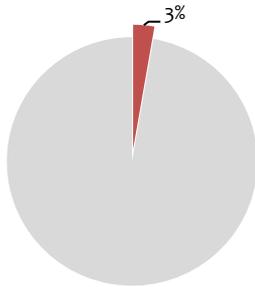


Capacity utilization rate Historically highest and lowest level, as per cent

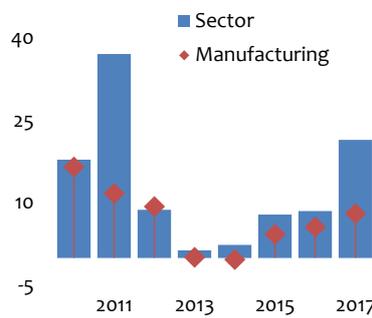


Manufacture of machinery and equipment

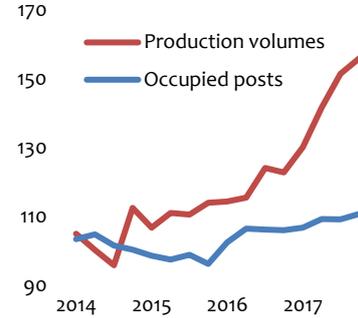
The share of the sector in manufacturing 2017, as per cent



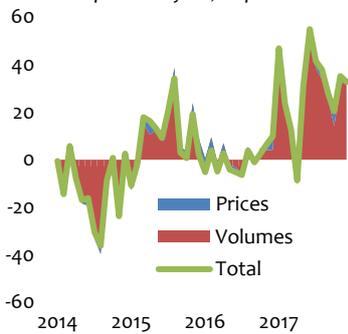
Changes in production volumes as per cent



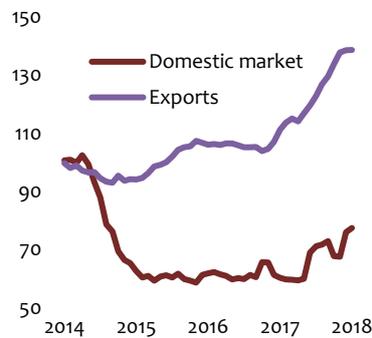
Production volumes and occupied posts Q4 2013 = 100



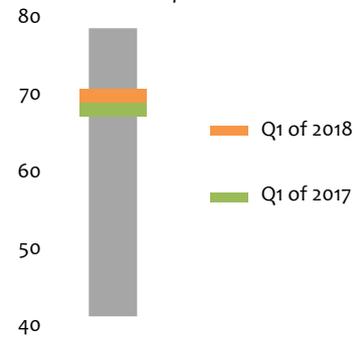
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

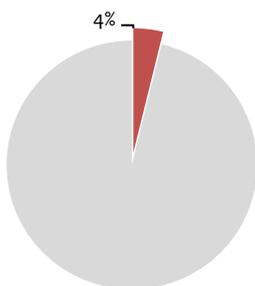


Capacity utilization rate Historically highest and lowest level, as per cent

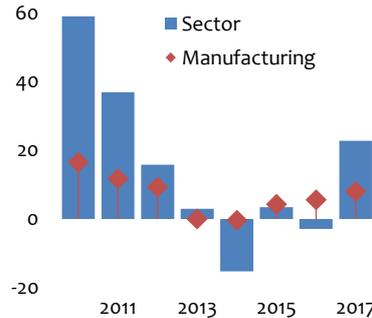


Manufacture of motor vehicles

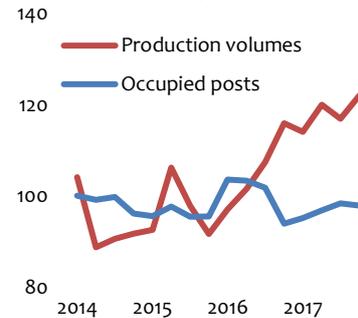
The share of the sector in manufacturing 2017, as per cent



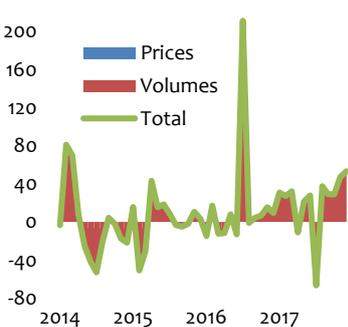
Changes in production volumes as per cent



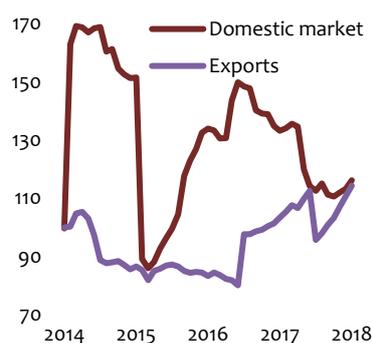
Production volumes and occupied posts Q4 2013 = 100



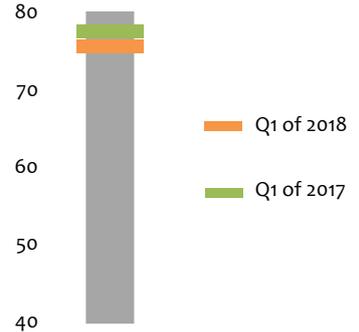
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



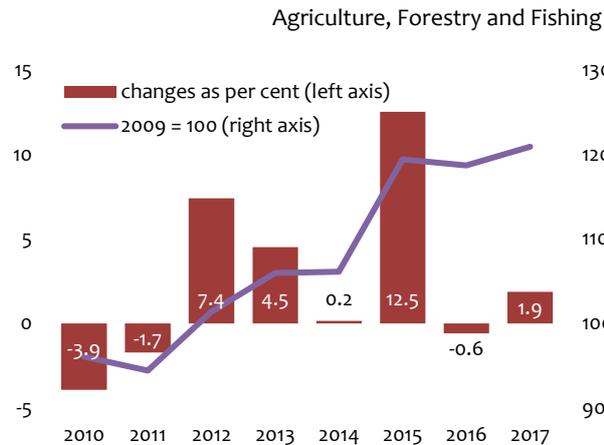
Sales of production 12-month moving average, Dec 2013 = 100



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



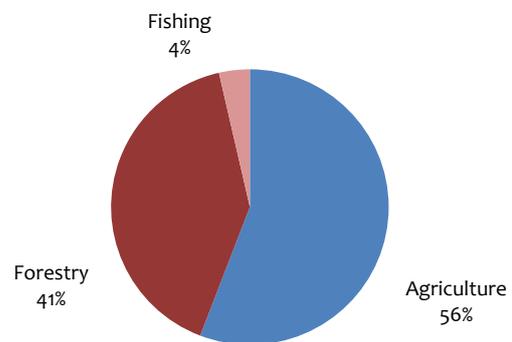
AGRICULTURE, FORESTRY AND FISHING



The number of employed persons has significantly declined in recent years within the sector. At the same time, the number of occupied posts has increased and currently it exceeds the pre-crisis level. The outcome can be explained by different data registration systems. The number of occupied posts is growing due to the increase in the number of salaried posts. However, the number of employed is decreasing due to the drop in the number of self-employed persons, which indicates that the sector is increasingly using salaried labour.

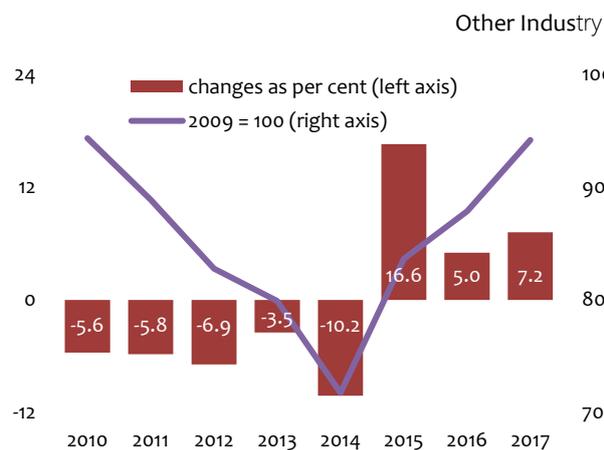
Agriculture and forestry prevail in the sector. Productivity in the sector is closely related to weather conditions; thus, the overall growth of the sector is frequently fluctuating. Following the significant increase in the agricultural sector in 2015, which was mainly driven by an unprecedentedly high grain yield, the sector output fell in 2016. However, in 2017, due to the unfavourable weather conditions negatively affecting the crop production and forestry, only a slight increase was observed.

Structure of Agriculture, Forestry and Fishing Industry 2017*, as per cent



* – evaluation by Ministry of Economics

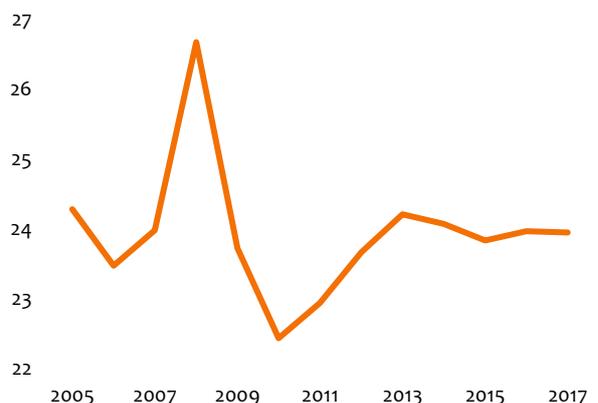
OTHER INDUSTRY



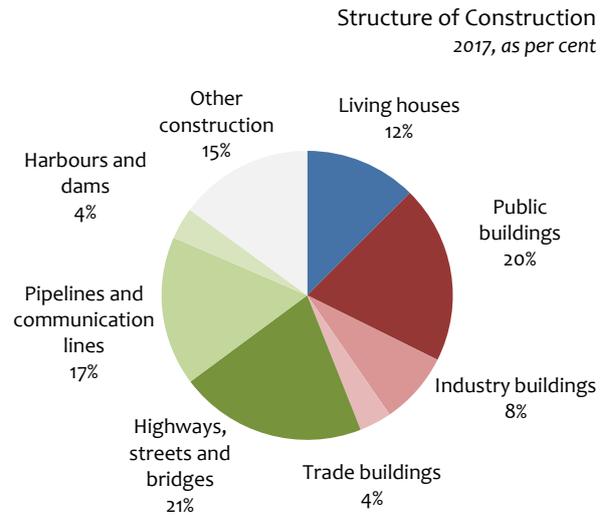
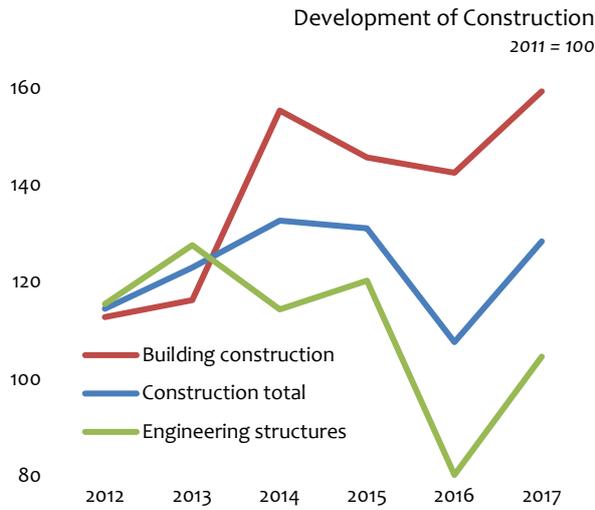
weather conditions having direct influence on the volume of electricity and heat produced. Knowing that 2016–2017 weather in winter months was significantly colder, the volume of electricity and heat consumed rose. The number of occupied posts in all sectors has increased since the crisis, while over the past years the number of posts in mining and quarrying as well as electricity and gas supply is declining.

Other industry (mining and quarrying, electricity and gas supply, water supply; sewerage, waste management and remediation activities) are mainly dominated by electricity and gas supply sector. The share of mining and quarrying has been growing steadily over the past few years, which is because of the increase in extraction of peat. The dynamics of electricity and gas supply are related to the

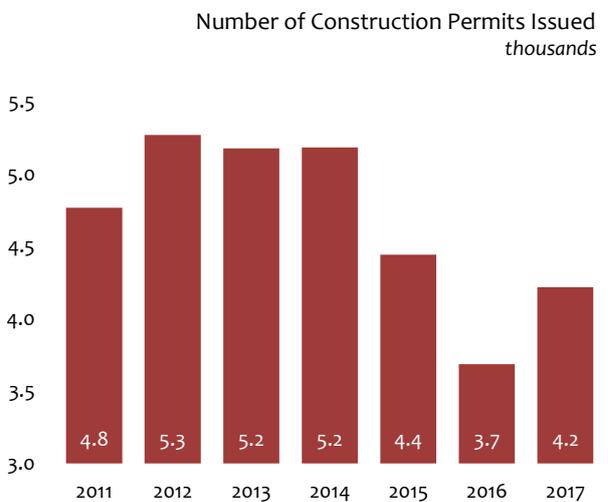
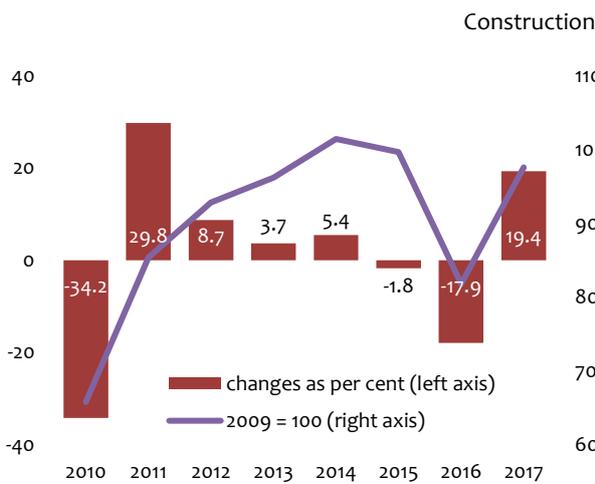
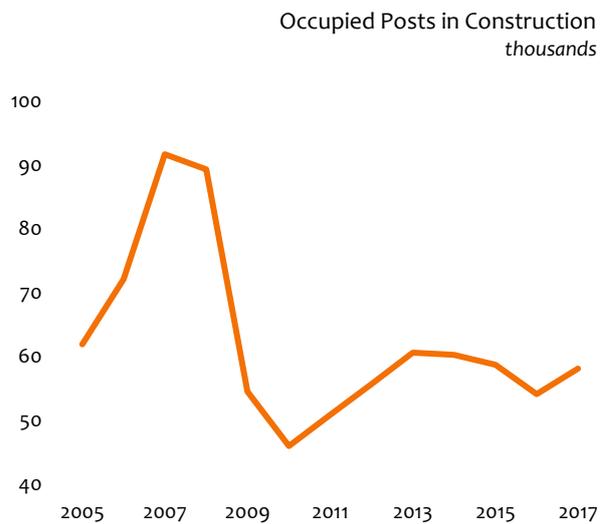
Occupied Posts in Other Industry thousands



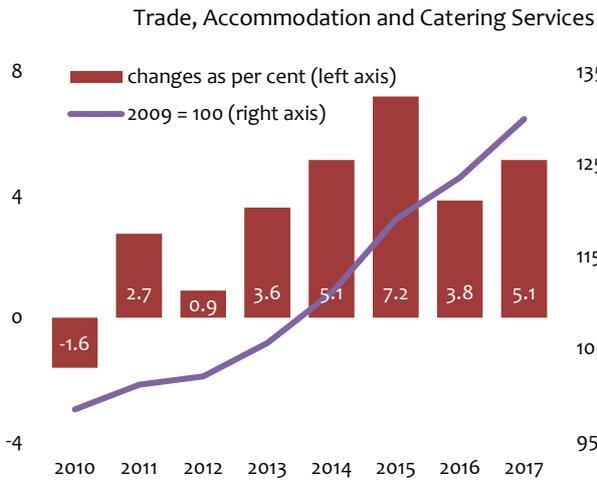
CONSTRUCTION



Development of construction sector to a large extent is related to public orders and EU structural fund projects. In 2017, after a two-year recess the growth in construction industry resumed. It was largely influenced by both the initiation and implementation of EU structural fund projects, which have positive impact on the sector. The sector growth was also facilitated by private investment. In 2017, construction output increase was recorded in construction of buildings and construction of civil engineering works. A higher growth rate, however, was observed in the construction of civil engineering works. Considering the acquisition of EU structural fund projects and implementation of large infrastructure projects, it is expected that construction of civil engineering works will continue to grow over the upcoming years.

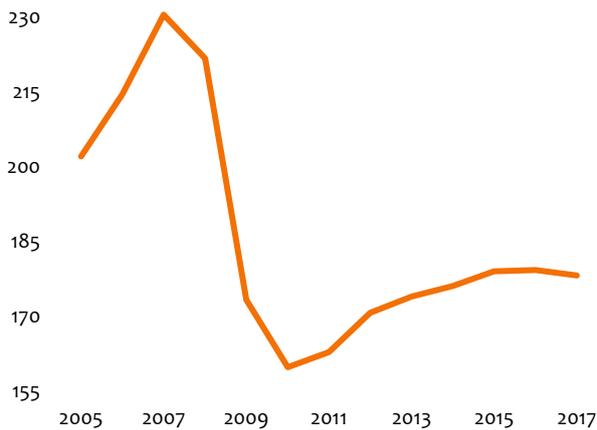


TRADE, ACCOMMODATION AND CATERING SERVICES

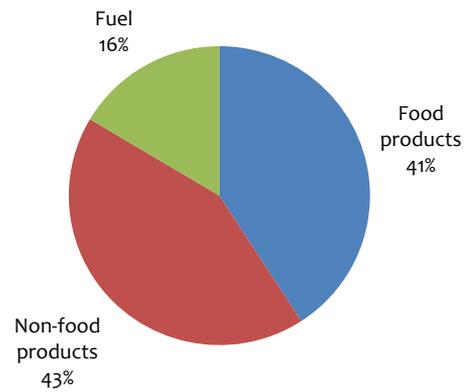


The volume of services provided in trade, accommodation and catering sectors continue to increase. Trade sector is positively influenced by the rise in private consumption and wages and the overall improvement of the situation in the labour market. In 2017, the sector grew by 5.2%. Also, in 2017, retail trade turnover went up by 4.3%. The sharpest increase was observed in the retail trade of non-food products. Along with an increase in the foreign trade turnover, wholesale turnover also experienced growth. In 2017, wholesale turnover rose significantly by 11.3%. Accommodation and food service industry is positively affected by the development of tourism sector. In 2017, the sector output grew by 4.3%, which was mostly facilitated by sharper increase in public catering service output volumes. The largest share of occupied posts can be observed in the trade sector. However, as the number of jobs in the accommodation and food service sector is currently growing, the share has slightly declined in recent years.

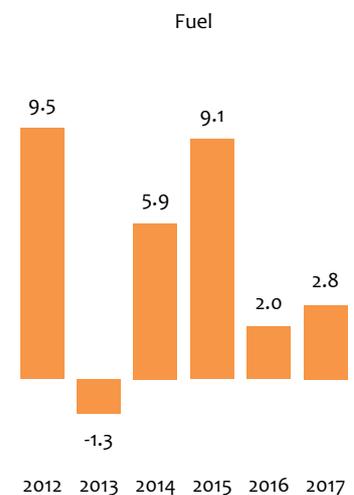
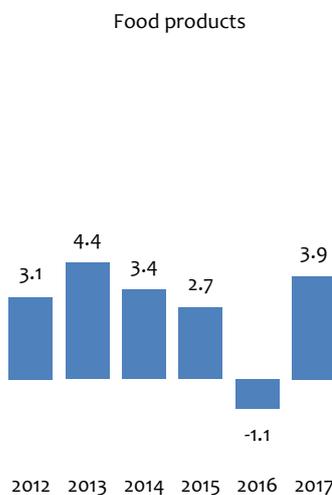
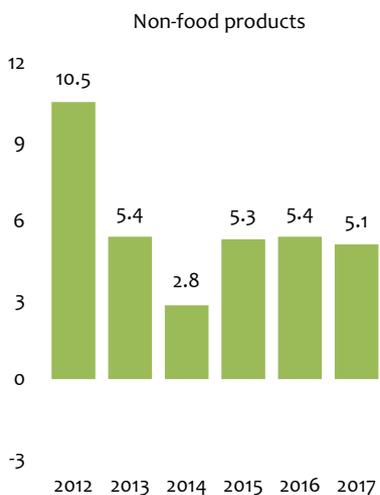
Occupied posts in Trade, Accommodation and Catering Services thousands



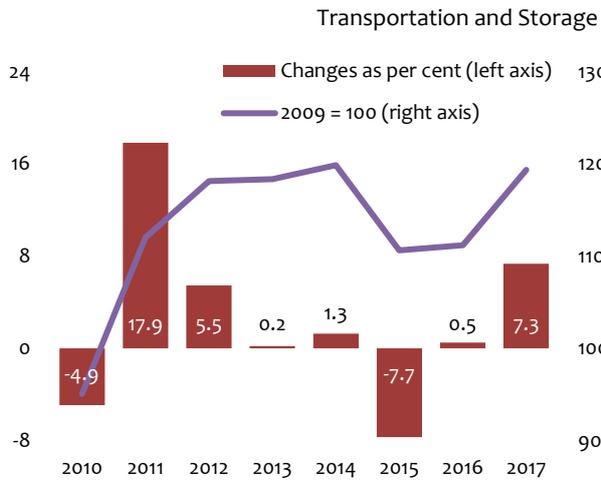
Retail Trade Turnover Structure 2017, as per cent



Retail Turnover changes as per cent

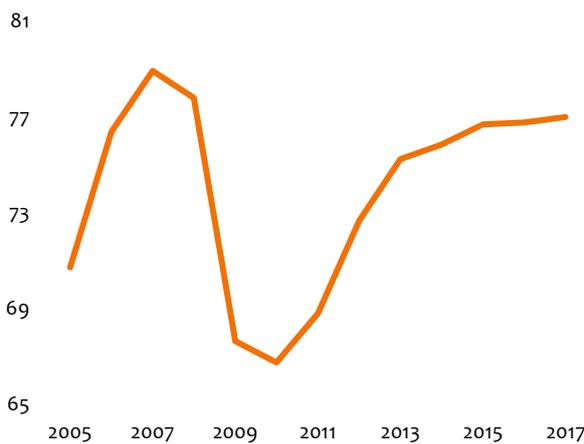


TRANSPORTATION AND STORAGE

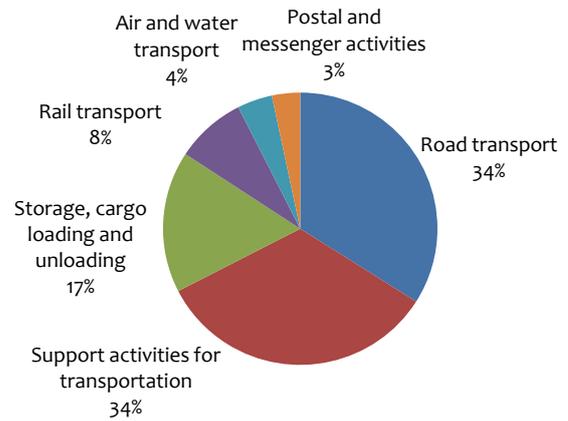


Transportation and storage is closely related to international transport. From 2012 to 2017, the sector grew only by 1%. The lacklustre growth can mostly be explained by the decline of transit freight transport, which was primarily a result of rising competition and Russian transport policies. Since the end of the 1990s, Russia has set an objective to develop its transport infrastructure so as to ensure its independence from transit countries. In 2017, despite the drop-in transit freights carried by rail and sea, the growth of the sector was influenced by the rise in road freight transport and the increase in the number of passengers at airports and ports. Passenger transport increased by 8%, storage and other transportation support activities by 10%, postal and courier activities by 14%, and freight transport by 2%.

Occupied posts in Transportation and Storage thousands



Structure of Transportation and Storage Industry 2017, as per cent



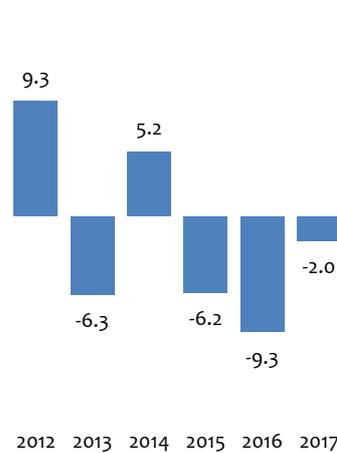
* – evaluation by Ministry of Economics

Freight Traffic changes as per cent

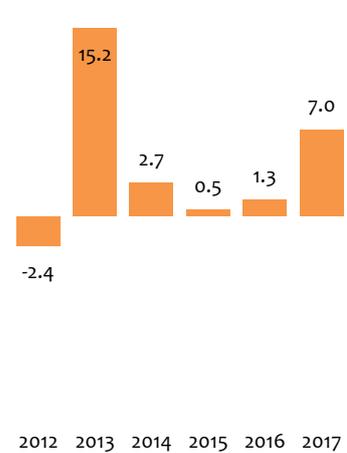
Freight traffic by rail



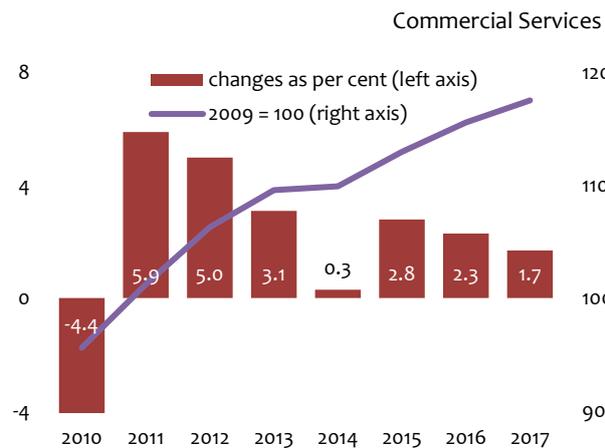
Cargoes loaded and unloaded at ports



Freight traffic by road



COMMERCIAL SERVICES

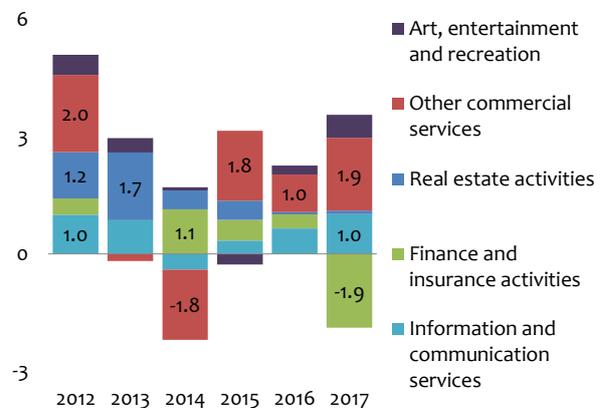


insurance services, which was mainly caused by the reduction in volume of non-resident businesses in Latvia, merging of banks, and the decrease in the number of employed persons. A steep growth was recorded in arts, entertainment and recreation.

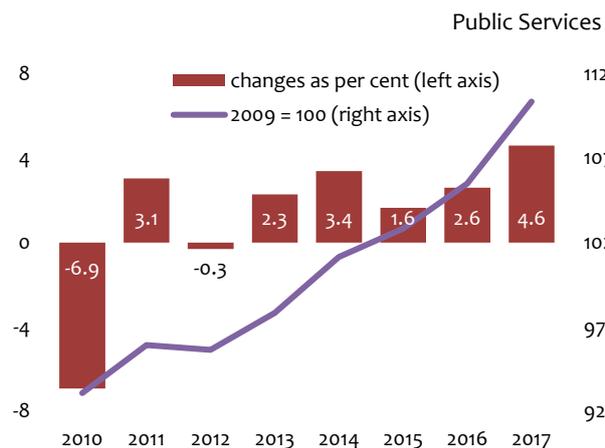
Currently, the largest share of occupied posts is in professional, scientific, and technical activities, administrative and support service activities, and information and communication service fields. In addition, the sharpest increase in the occupied posts in recent years has been recorded specifically in these sectors.

Among all commercial services (information and communication, financial and insurance services, real estate activities, professional, scientific and technical activities, administrative and support service activities, arts, entertainment and recreation) dominate real estate activities. In 2017, the volume of services provided in commercial service industry grew slower than in 2016. The growth was driven by the increase in professional, scientific, and technical activities, administrative and service activities, and information and communication services. However, a sharp decline was observed in financial and

Contribution to Growth of Commercial Services by Fields as percentage points



PUBLIC SERVICES



the sharpest rise since 2006 was observed. Currently, the largest share of occupied posts applies to education. However, the number of posts in public administration and human health activities remains unchanged. In recent years, the sharpest rise in the number of occupied posts can be observed in human health activities. Posts in public administration and education has not changed.

Number of Occupied Posts in Public Service Industry thousands



Public administration and defence take the dominant share in the public services (public administration and defence, education, human health and social work activities). Along with an increase in public expenditure, public services have grown steadily since 2013. In 2017,

2018 | 1

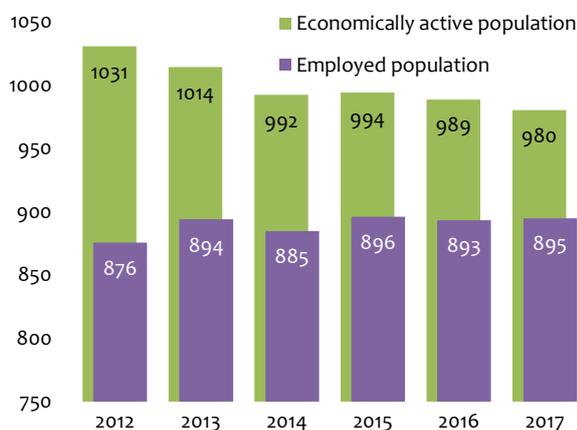
LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

Situation in the labour market keeps improving – unemployment is declining, and employment rates consequently continue to rise. At the same time, the increase in the number of employed persons is hampered by the demographic trends and regional differences. In previous years, labour market trends were mainly determined by supply-side factors. However, in 2017, as activities in the construction sector resumed, growing pressure in the labour market was exerted by the demand side. Meanwhile, the declining number of labour force was still largely compensated by higher economic activity.

Despite the increase in economic activity, in 2017 demand for labour grew slower – the number of occupied posts increased by only 0.9%. However, the number of employed persons rose by 0.2% or 1.9 thousand. Faster growth in the demand for labour was observed in the second half of the year, mainly due to the growth of construction industry's output. In 2017, 895 thousand people aged 15–74 in Latvia were employed.

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

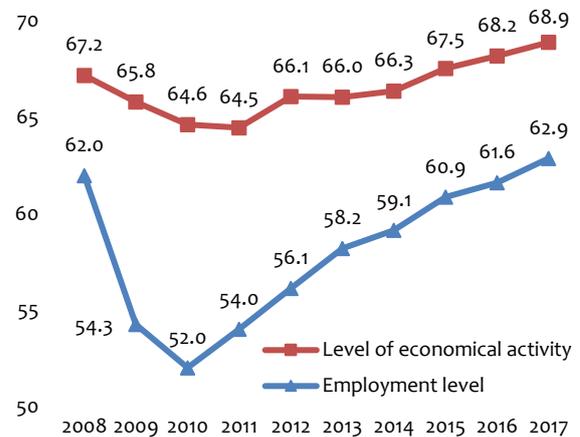


Economic volumes have now returned to the pre-crisis levels. The growth has mostly been driven by the rise in productivity and to a lesser degree by the increase in the number of employed persons.

The low-base effect in the labour market has disappeared and moved closer to its saturation point, which, together with the decline of working-age population, hinders employment growth.

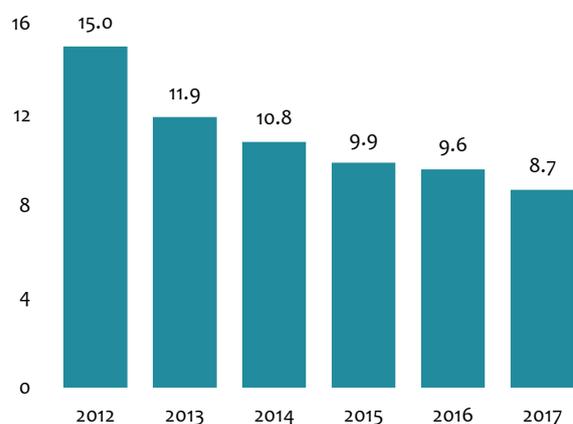
Although in absolute terms the number of employed persons is smaller than before crisis, in 2017 the employment rate was by 0.9 percentage points higher than in 2008, reaching the historically highest level of 62.9%. The increase in the employment rate can mainly be attributed to the fact that the working-age population is declining relatively faster than the number of employed persons. In 2017, compared to 2016, the population aged 15–74 fell by almost 27 thousand or 1.9%.

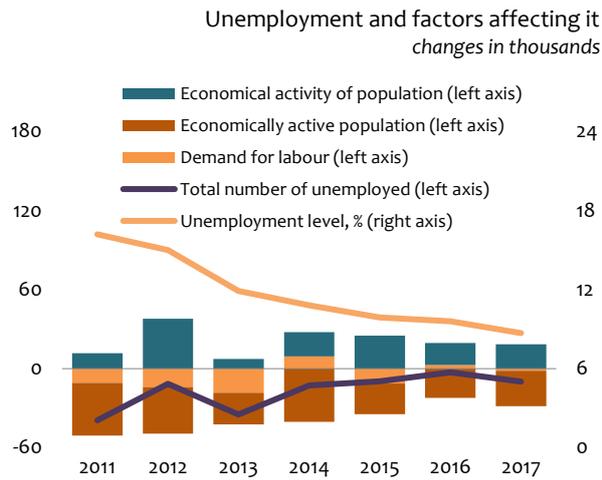
Level of Participation and Employment Rates aged 15-74, as per cent



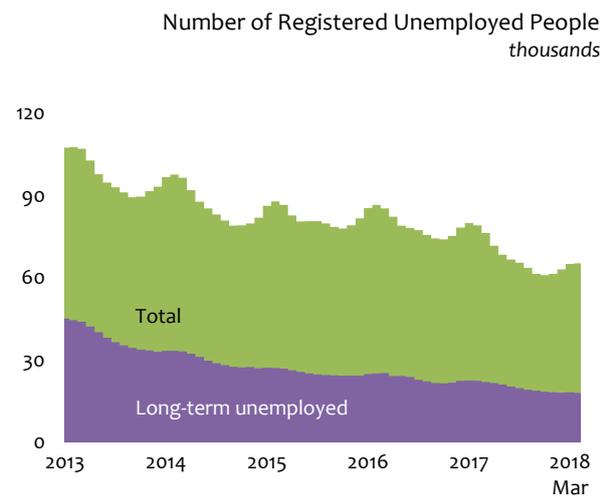
In 2017, the unemployment rate dropped to 8.7%, which is by 0.9 percentage points less than in 2016. In 2017, 85.4 thousand people were unemployed, which is by 9.9 thousand less than in 2016.

Unemployment Rate aged 15-74, as per cent



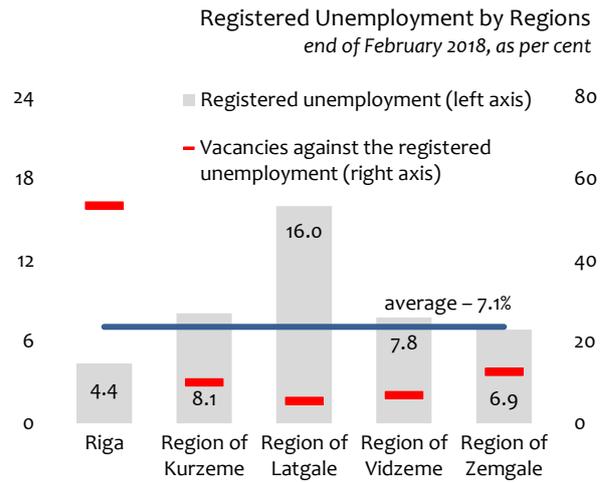


The decrease of unemployment can mainly be explained by the demographic trends – the decline of the working-age population and the overall changes in the age structure of population.



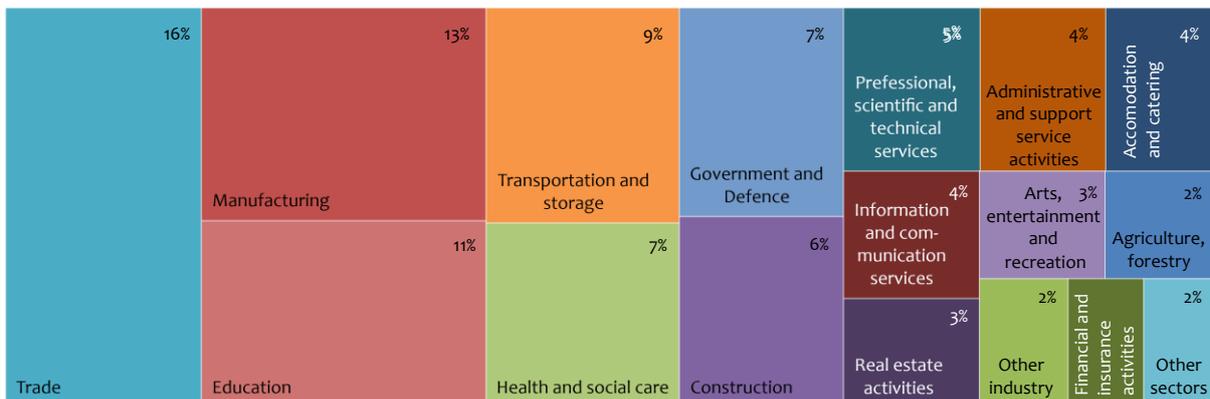
Although the uneven regional distribution of labour resources and job vacancies is currently one of the most

visible structural labour market risks, it is not the only one. Risks are also caused by the relatively high share of long-term unemployed persons – still more than one fourth of them are seeking job for more than a year. It should be taken into account that high long-term unemployment can lead to an increase in the structural unemployment, i.e., the longer people are unemployed, the greater risk of losing their job skills and knowledge. Furthermore, as individuals may lack certain skills and knowledge required in the labour market, a risk that some of the unemployed people in future may experience problems finding a job that would suit their skills prevail.



In 2017, the sharpest rise in occupied posts was recorded in construction and ICT services. In 2017, almost two thirds of the rise in the number of occupied posts was formed by two sectors – construction and ICT services. Last year, the number of occupied posts in construction rose by almost 4 thousand or 7.3%. At the end of 2017, the number of occupied posts in this sector reached almost 59 thousand. An increase in the demand for labour force in the construction was largely influenced by the rise in the industry’s output, which, after the renewal of flows from the EU funds, has resumed to growth.

Structure of Occupied Posts by Sector 2017, as per cent



A significant increase in the demand for labour force was also observed in ICT services where the number of occupied posts rose by 1.6 thousand in 2017. The number mainly increased due to the growth in the demand for labour force in computer programming and information technology services.

At the same time, the most significant decrease in the demand for labour force was recorded in retail trade and personal service activities.

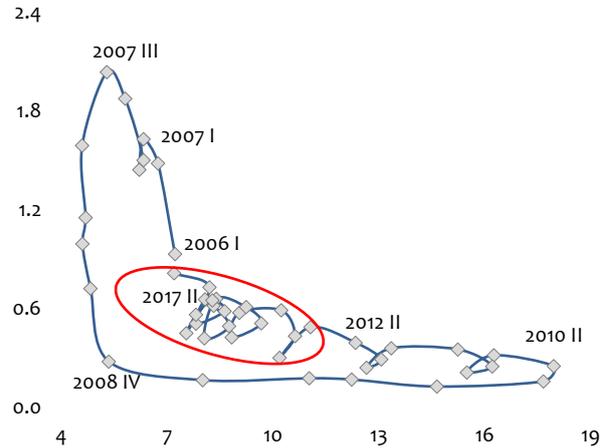
A sharp rise in the number of occupied posts was still observed in private sector. After the drop of 30% during the crisis, the number of jobs in private sector increased by almost one quarter from 2010 to 2017.

At the same time, a relatively slow growth in the number of occupied posts was recorded in public sector where the number grew only by 1.3% from 2010 to 2017. A sharper rise in the number of occupied posts in public sector was observed in 2014, when it increased by 1.5%, compared to 2013.

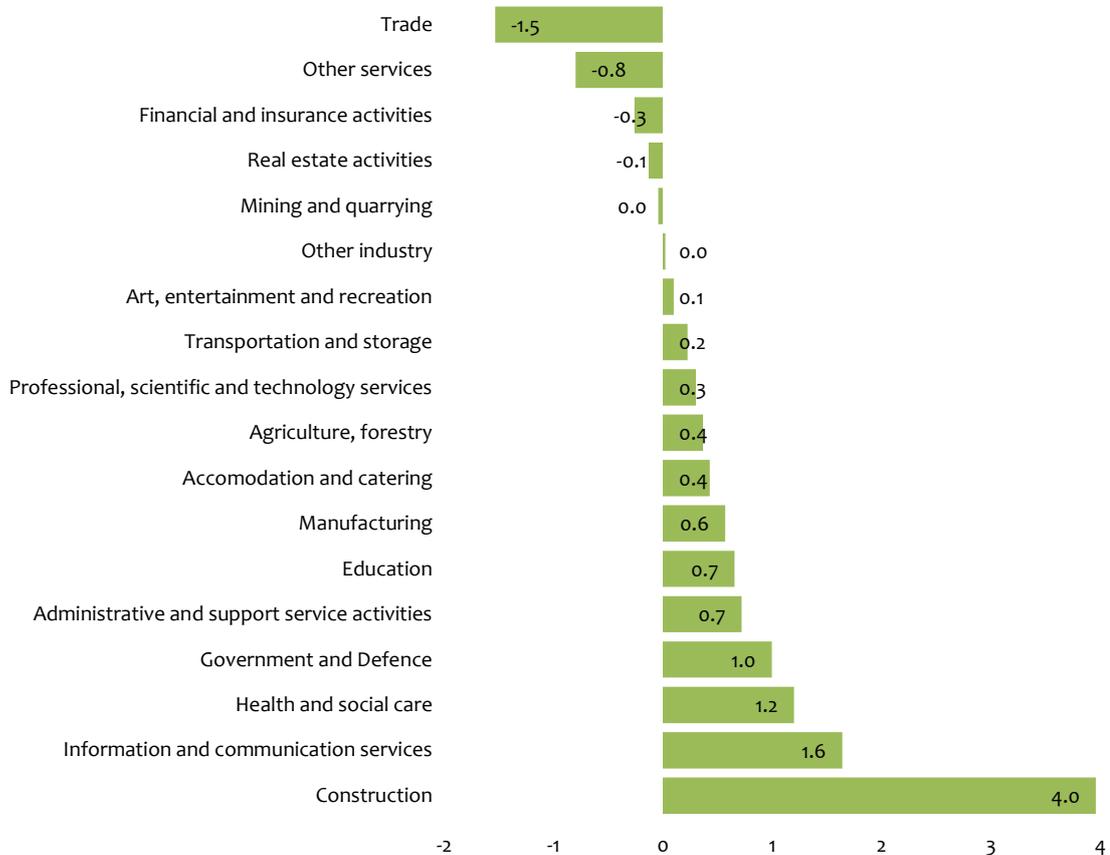
The deviation of the Beveridge curve to the right could mainly be explained by the regional differences in the national labour market and low labour mobility. For example, the registered unemployment rate in Latgale

region is still more than three times higher than in Riga region, where it is close to the natural level. At the same time, new job opportunities mostly lie in Riga region, which, in fact, offers more than four fifths of the total vacancies.

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



Changes in Occupied posts by Industries
2017, changes in thousands

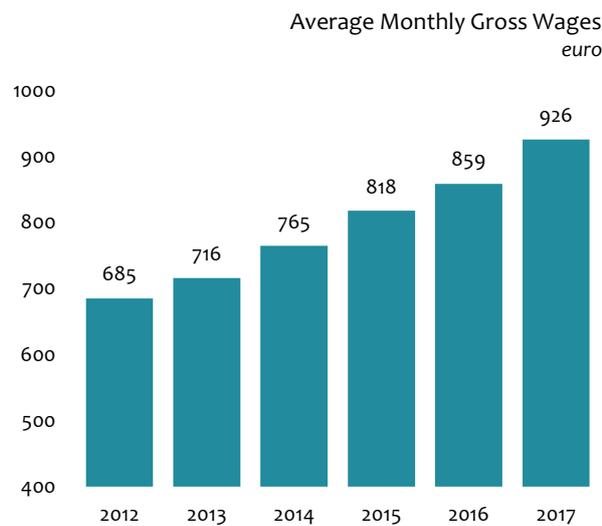


WAGES

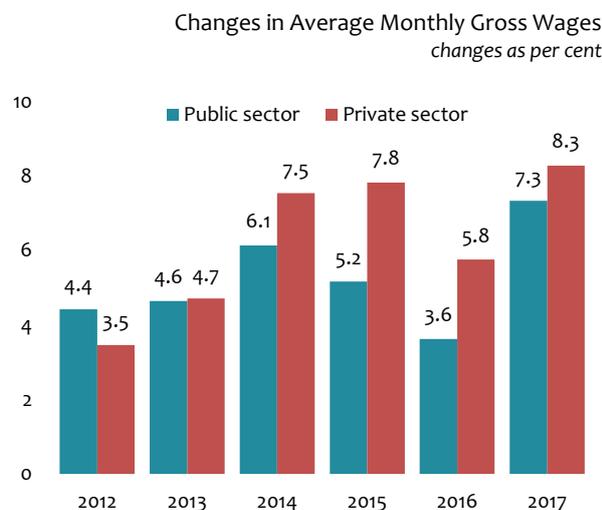
Since the end of 2010, the growth of wages has resumed. Although unemployment still remains relatively high, a shortage of labour, which puts pressure on wages, in the most economically active regions can be observed.

In recent years, the average gross wages have climbed rapidly, rising by 7.8% in 2017 and reaching EUR 926.

Since 2010, annual wages have risen in both private and public sector. In 2017, a sharper increase of 8.3% in wages was recorded in private sector. In public sector, however, earnings grew by 7.4%. Compared to the pre-crisis level in 2008, wages have grown by 35.8%.



Along with a rise in nominal wages, real wages gradually increased as well. In 2013–2016, a sharper increase in real wages was observed. The growth can mostly be explained by the nominal wage increase and moderate changes in consumer prices. In 2017, real wages grew slower – by 4%.



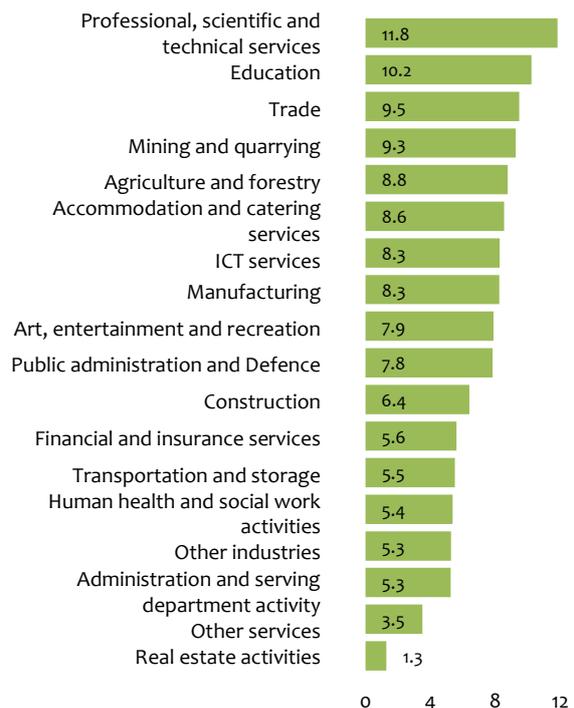
Distribution of Employed by Gross Wages
as per cent of total number of employed



In recent years, the share of persons receiving minimum wage has gradually declined. Also, the number of employees, who receive wages of more than EUR 1 000 a month, has increased. In 2017, the share of people receiving EUR 1 000 or more amounted to one fourth of the total number of employees.

In 2017, wages grew in all sectors of national economy. However, different dynamics between sectors were observed. A sharp rise was recorded in service sectors, such as trade, accommodation and catering, where the average gross wage previously has been relatively low.

Changes in Gross Wages by Industry
2017, as per cent



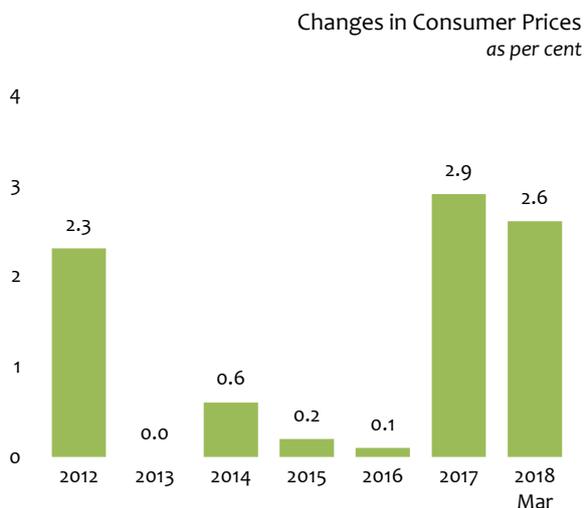
2018 | 1

ECONOMIC STABILITY AND COMPETITIVENESS

PRICES

In 2017, one of the highest price rises of the past years was registered. Consumer prices grew by 2.2%, but the annual average inflation constituted 2.9%. In 2017, the consumer price level was essentially determined by the rise in prices of food and oil on the world markets. Also, the price rises in the service sector significantly influenced the average level of consumer prices.

During the first three months of 2018, the price increase coincides with that recorded in the same period a year ago. Consumer prices rose by 1.5%. In March 2018, compared to the corresponding period last year, consumer prices grew by 2.2%. The annual average inflation in March was 2.6%.



Key factors influencing consumer prices in 2017:

(1) the price rises of food, primarily for the products of milk, butter, meat, and eggs, significantly impacted the average level of consumer prices. World food prices, however, did not change. A rise was registered in prices of meat and cereals. Conversely, a reduction in prices of sugar, vegetable oils, and milk products was observed.

(2) the rise of service prices – the fastest growth was recorded in compulsory civil liability insurance of owners of motor vehicle (OCTA) (due to record high losses of insurers last year), catering, health, recreation and culture services.

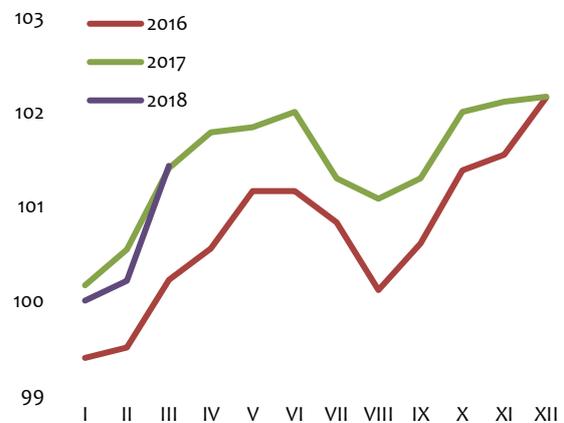
(3) the rise in prices of fuels for transport; Since July 2018, the global oil prices, after a decline in the first half of the year, have gradually started to increase. Overall, oil prices on average increased by 20% annually. The increase in oil prices was stimulated by the maintained limitations in oil

production and the growth in the oil demand due to both geopolitical events and natural disasters.

(4) the rise in prices for heat energy and gas due to the increase in natural gas prices; the growth in tobacco product prices due to a higher excise tax rate.

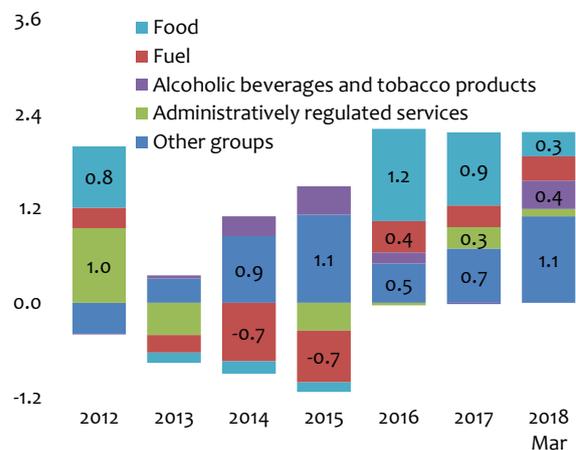
(5) the decline in prices of alcoholic beverages.

Consumer Price Index
December of previous year = 100



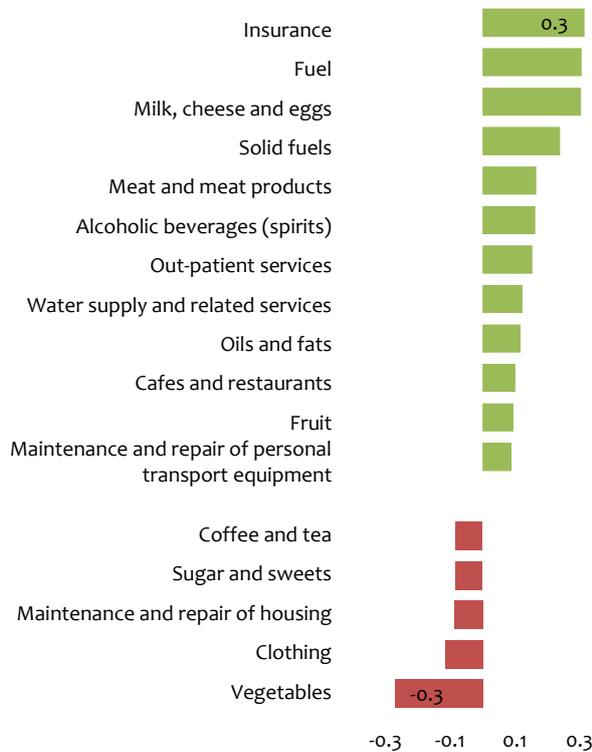
During the first three months of 2018, the rise in prices for alcoholic beverages and fuels for transport due to a higher excise tax, as well as prices of goods and services related to housing had the greatest upward effect on the average price level. A significant increase was recorded also in prices of leisure and culture, outpatient services. However, food prices decreased.

Consumer Prices of Goods and Services
contribution to 12-month changes in March of 2018, as per cent

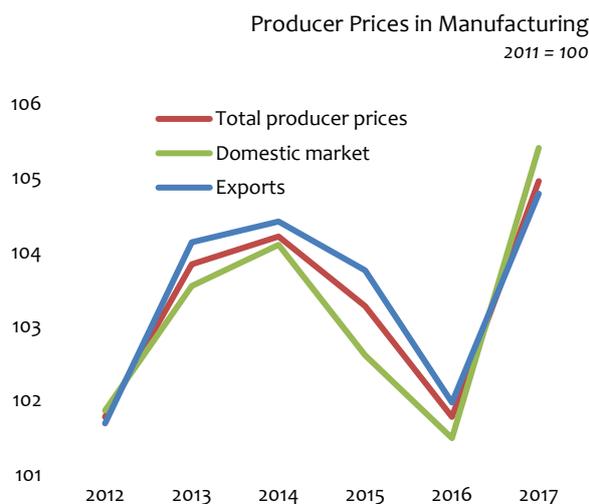


In 2018, the average annual inflation is expected to remain similar to that registered in 2017. It will be affected by tax increases, a higher economic activity and the rise in wages. At the same time, inflation will still largely depend on world oil and food price fluctuations.

Largest Consumer Price Changes of Goods and Services contribution to 12-month changes in March 2018, percentage points



Producer prices grew significantly in 2017. Producer prices rose by 2.6%, and the volume of goods sold on both the domestic market and exported abroad grew equally fast.



In 2017, producer prices in manufacturing experienced the sharpest rise since 2011. Producer prices in manufacturing went up by 3.1%. The producer prices of goods sold on the domestic market and prices of exported products grew by 3.8% and 2.7%, respectively.

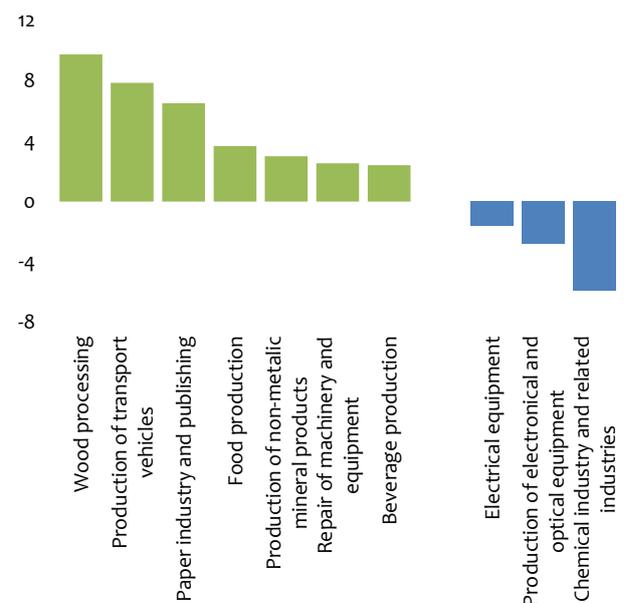
The most notable price increase was recorded in the manufacture of food products and wood processing. However, the manufacture of computer, electronic and optical products experienced a downward effect.

In 2018, producer prices in manufacturing continued to rise rapidly. During the first three months of 2018, producer prices in manufacturing grew by 1.5%. In January-March, the producer prices of goods sold on the domestic market and the prices of exported products grew by 1.7% and 1.3%, respectively.

During the first three months, the most notable price rise was recorded in wood processing. However, the production of food products had the greatest downward impact on producer prices.

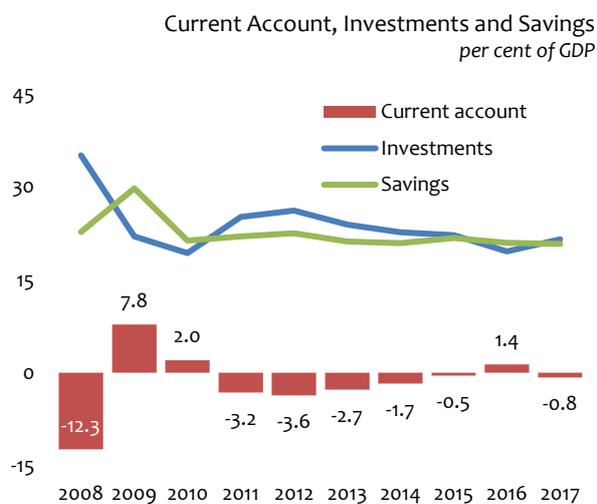
In 2018, the rise in producer prices in the manufacturing sector will remain similar to that recorded in 2017. The level of producer prices is largely influenced by the fluctuations in producer prices of exported products, which are mainly caused by the dynamics of world raw material prices. It should be noted that in 2017 and at the beginning of 2018, world energy and raw material prices increased. At the same time, prices of products sold on the domestic market are also influenced by higher growth rates.

Changes in Producer Prices of the Manufacturing at March of 2018 against previous years relevant period, as per cent

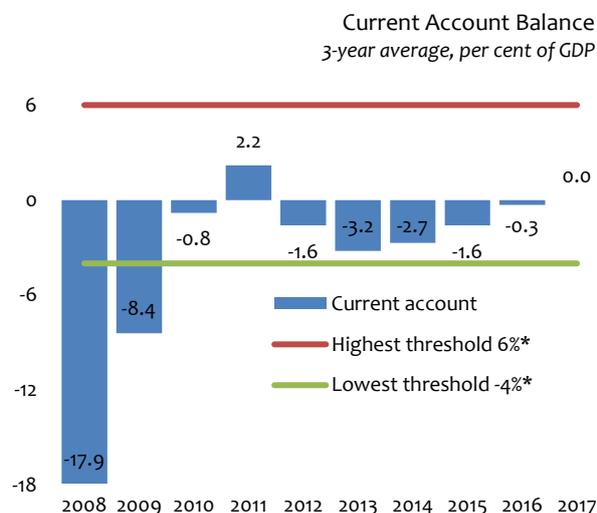


BALANCE OF PAYMENTS

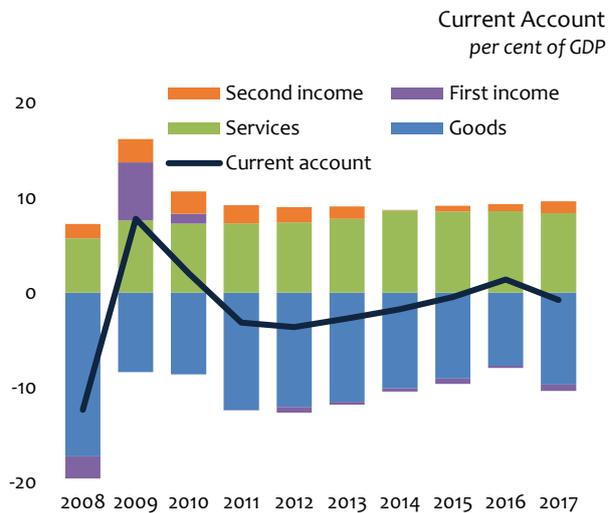
In the last three years, the current account is close to the balance, and the annual fluctuations thereof are rather insignificant. The annual average current account constitutes 0.05% of GDP. It is a level below the indicative threshold set by the EC Early Alert System and is considered to be sustainable. Since 2013, the current account balance deficit has been gradually decreasing. In 2016, it had a surplus of 1.4% of GDP. In 2017, the current account balance experienced a small deficit of 0.8% of GDP. A moderate deficit of the current account balance indicates to the balance between national savings and domestic investment.



The situation in the current account of the balance of payments strongly depends on the foreign trade balance. A foreign trade deficit is quite characteristic in Latvia. During the years of accelerated economic growth, it reached 22.8% of GDP in 2007. However, during the recession, the foreign trade deficit decreased due to the cyclical adjustment and the significant drop in imports.



During the last three years, the foreign trade deficit constituted on average 8.8% of GDP. In 2017, it reached 9.7% of GDP and was by almost 2 percentage points higher than a year ago, which was because of the faster growth in imports than in exports.



The service balance is positive, constituting on average 8.5% of GDP over the last three years and covering almost 90% of the foreign trade deficit. In 2017, exports and imports of services at current prices were higher than a year ago by 6.9% and 8.7%, respectively. The service balance reached a surplus of 8.4% of GDP (8.6% of GDP in 2016). The decline in the surplus of service balance was largely influenced by the rise in imports of financial services.

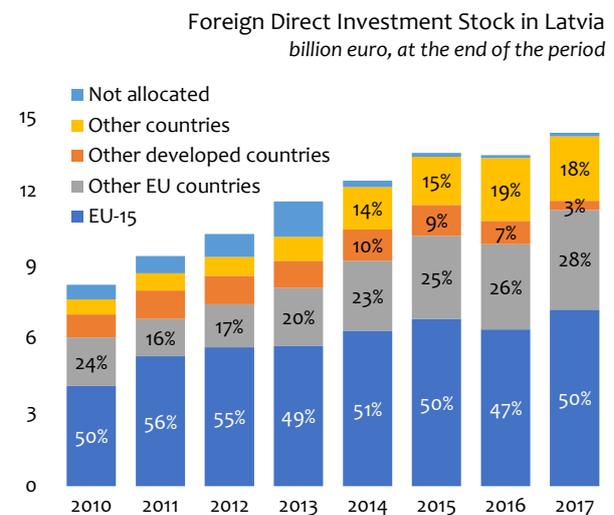
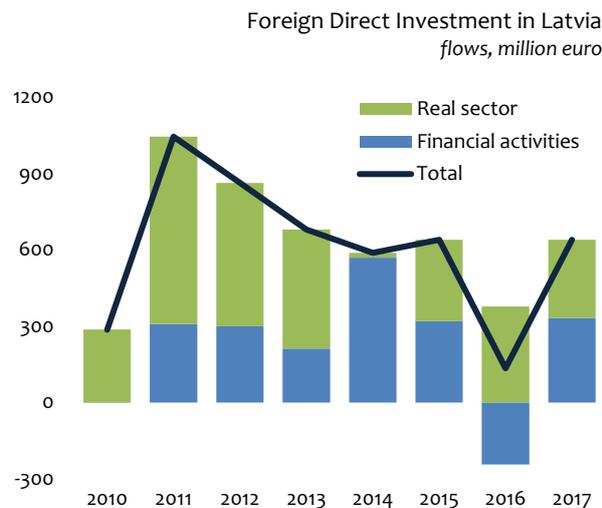
Changes in income and capital account are mainly related to the changes in activities for the acquisition of EU structural funds. Over the last three years, the surplus of the capital account balance on average accounted for 1.5% of GDP. In 2017, the surplus was 0.8% of GDP.

In recent years, the situation of the financial account balance was mainly determined by the stabilization measures of the financial sector, public debt restructuring activities of the Bank of Latvia made within the framework of extended asset purchase programme, and the reduction in non-resident deposits in Latvian credit institutions. In 2017, assets of the financial account in general grew less than liabilities, and the balance of financial account (without reserve assets) was negative, amounting to 0.8% of GDP.

FOREIGN DIRECT INVESTMENT

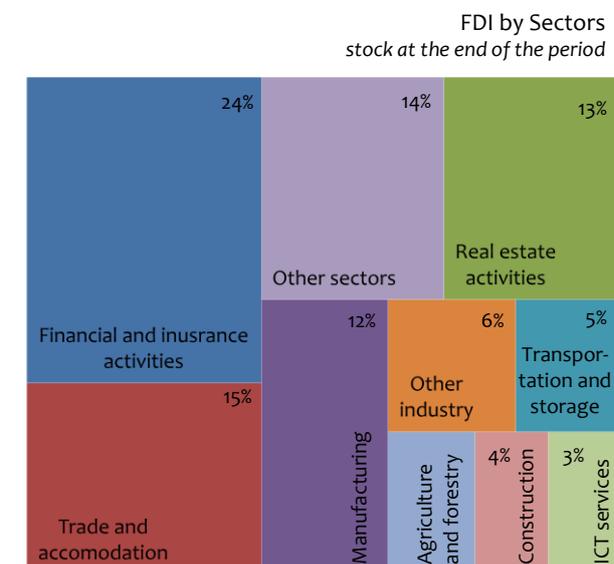
Foreign direct investment (FDI) flows to the Latvian economy have recently been increasing; however, FDI still remains lower than before financial crisis. During the past three years, the volume of FDI attracted in Latvia was almost 3.5 times lower than at the times of rapid economic growth, on average accounting for 2% of GDP annually. The decline of FDI can mainly be attributed to the current instability in the world economy, the rising geopolitical risks and the unpredictability of the political processes. In 2017, compared to 2016, the volume of FDI substantially increased, amounting to 2.4% of GDP.

At the end of 2017, the FDI accumulated in the Latvian economy reached EUR 14.4 billion (53.5% of GDP). Over the year, it grew by 6.8%. Currently, Sweden is the largest investor in Latvian economy. At the end of 2017, investments of Swedish entrepreneurs accounted for 19.2% of the total FDI accumulated; mainly those were investments in financial intermediation. Large investments were also made by the Netherlands, Cyprus, Germany, Norway, Russia, Estonia, Lithuania, Denmark, and Luxembourg. At the end of 2017, the investments of these countries constituted almost 76% of the total FDI accumulated in the Latvian economy.



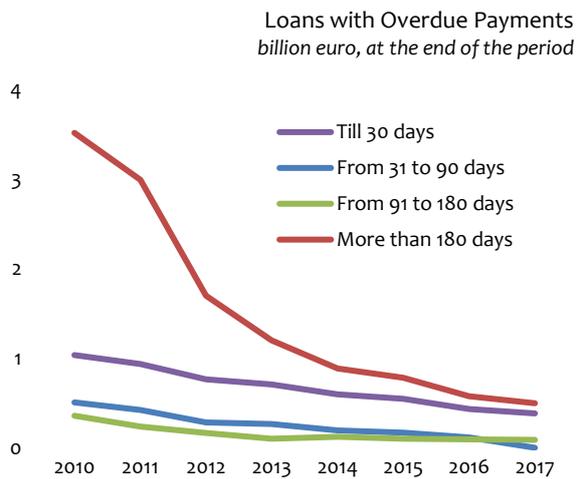
In 2017, the intensity of FDI flows grew also in other Baltic States. In 2017, the net FDI inflows attracted in the Baltic States amounted to EUR 2 063 million, which is almost six times more than a year ago. Latvia attracted 34.3% of all FDI in the Baltic States, 37.3% and 28.3% in Estonia and Lithuania, respectively.

Currently, the largest share of the accumulated FDI by sectors are in the financial and insurance activities, trade, real estate, and manufacturing industries, accounting for 24.3%, 14.4%, 13.3%, and 12% of total investments, respectively.

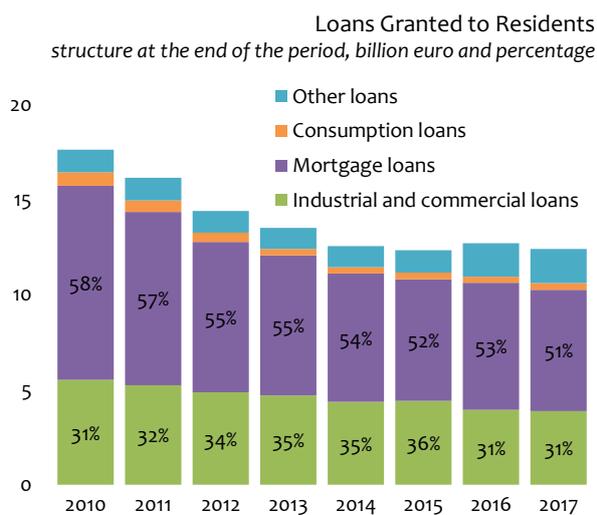


MONETARY INDICATORS

After the financial market turmoil at the end of 2008 and the beginning of 2009, Latvia's monetary indicators gradually started to stabilize – the quality of the credit portfolio improved, and crediting stabilized. Important steps have been taken to strengthen the capital of crediting institutions.

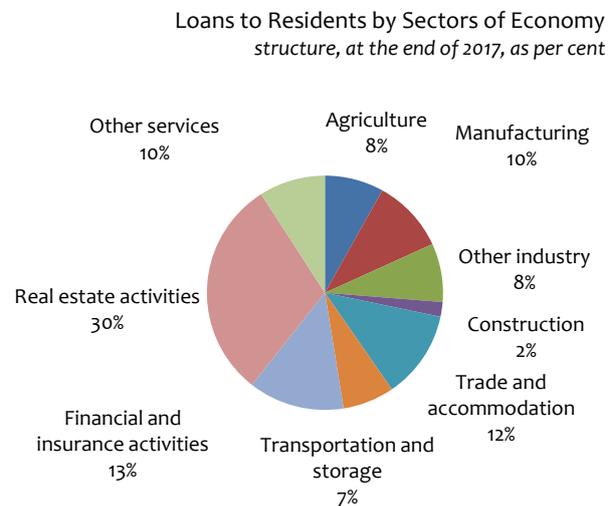


Although the total loan portfolio of banks in the 4th quarter of 2017 was by 2.3% lower than in the 4th quarter of 2016, the number of loans issued to companies is currently increasing. In the 4th quarter of 2017, the number of new loans granted to companies was by 43% larger than in the corresponding period of 2016. Business crediting, however, is largely influenced by the availability of the EU co-financing.



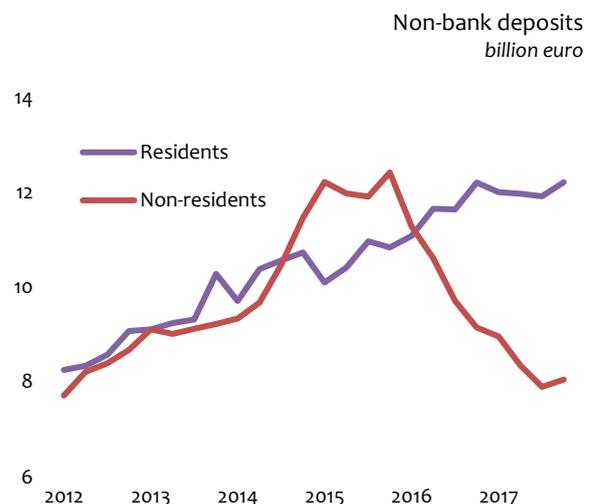
At the end of 2017, the largest share of credits was granted to real estate activities (30% of all loans), financial

and insurance services (13%), trade and accommodation (12%), and manufacturing (10%).



After a long period of decline, interest rates on loans granted to non-financial corporations are now gradually increasing. In February 2018, the rates of long-term loans amounted to 2.39%. However, the rates of short-term loans were 2.84%.

In 2017, the volume of deposits decreased, which was mainly due to the decline in non-resident deposits. After a prolonged increase over several years, non-resident deposits have been decreasing since the beginning of 2015. In the 4th quarter of 2017, non-resident deposits were by 12% lower than a year ago and amounted to 12.8% of all deposits. Banks working with non-resident deposits are subject to higher requirements on liquidity and capital adequacy. It is expected that in 2018 non-resident deposits will continue to decrease.



GENERAL BUDGET AND GOVERNMENT DEBT

Since 2011, when Latvia returned to growth, significant fiscal position improvements were achieved. In line with the European System of Accounts, general government deficit was reduced from 9.1% of GDP in 2009 to approximately 1–1.5% of GDP in 2012–2015. In 2016, for the first time since 1998 Latvia experienced a budget surplus of 0.1%. In 2017, the budget had a small deficit of EUR 131.1 million or 0.5% of GDP. Also, the budget deficit was registered in both central government and local government budgets. The budget surplus, however, was recorded in Social Insurance Fund.

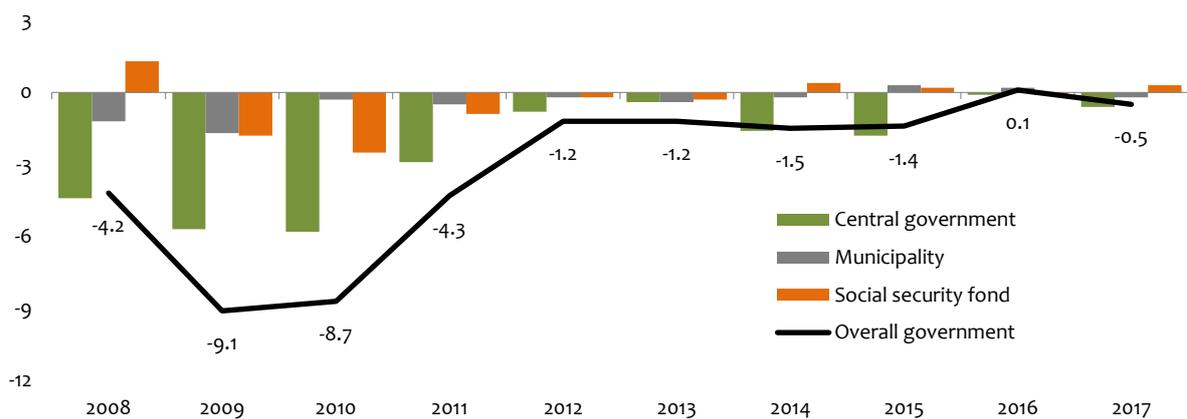
In 2017, the deficit was lower than projected in the Budget Law, in which it was set at 1.1% of GDP. A lower deficit might be related to higher tax revenues, smaller contributions to the EU budget, and decreased expenditures on social benefits.

A medium-term budgetary framework prognosticates that the general government budget deficit will be 1% of GDP in 2018, 0.9% in 2019, and 0.4% in 2020. In years 2018 and 2020, a fiscal margin of 0.1% of GDP is planned.

General Government Budget

	2013	2014	2015	2016	2017
Revenues					
billion euro	8.3	8.6	9.0	9.3	10.1
% of GDP	36.6	36.6	36.9	37.2	36.5
Expenditures					
billion euro	8.6	9.0	9.3	9.3	10.2
% of GDP	37.7	38.1	38.2	37.1	38.0
Balance					
billion euro	-0.3	-0.4	-0.3	0.02	-0.1
% of GDP	-1.2	-1.5	-1.4	0.1	-0.5

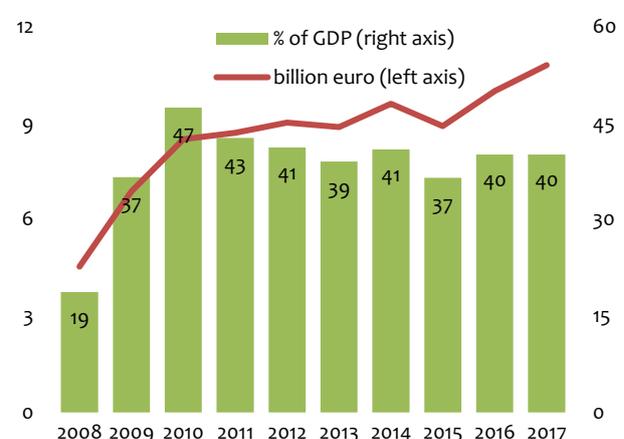
General Government Budget Balance by Sub-Sectors
per cent of GDP



The level of the central government debt in Latvia is one of the lowest in the EU. Until 2017, the general government debt in Latvia grew moderately. Thereupon, to finance state financial obligations, the general government debt has increased sharply, reaching EUR 8.4 billion or 46.8% of GDP at the end of 2010. Since the end of 2011, a tendency for the general government debt to decline can be observed. In 2017, it amounted to EUR 10.8 billion or 40.1% of GDP.

Timely borrowing measures taken in line with the medium-term strategy and continuation of sustainable fiscal policy allows to refinance the current central government debt obligations with favourable conditions on rates and terms, as well as to reduce and stabilize the general government debt at a sustainable level in long-term, while complying with the general government debt criterion set by the Maastricht Treaty.

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

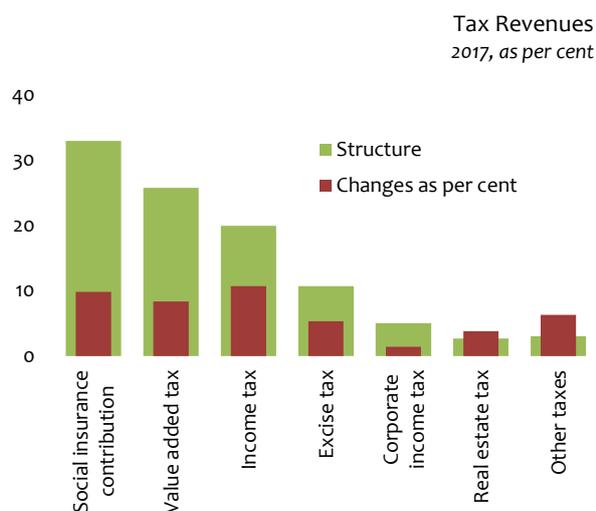


BUDGET REVENUES AND EXPENDITURES

Rise in the tax revenues exceed the rate of economic growth. Although in 2017 economic growth was relatively fast, revenue growth was even higher.

In 2017, general government consolidated budget revenues amounted to EUR 9 624 million, which is by 6.1% more than a year ago. During the period, the total tax revenues rose by 8.5%.

Employment tax revenues currently account for approximately half of all the tax revenues. The increase in budget revenues was facilitated by the rise in employment, wages, salaries, and minimum wage.



In 2017, the consumption tax revenues grew by 7.9%. The most significant contribution within the consumption tax group was made by the revenues from the value added tax.

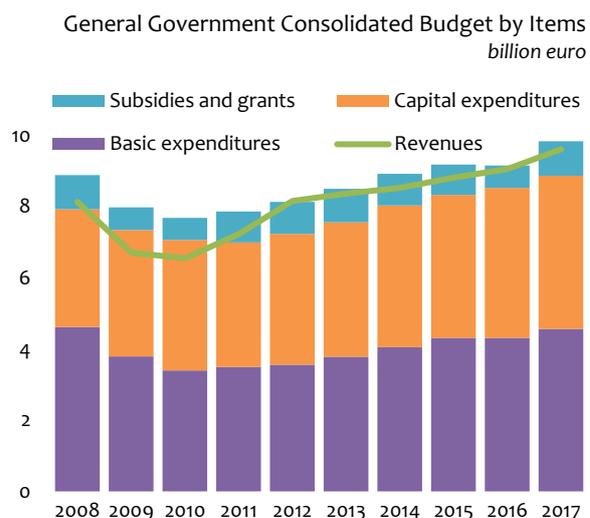
General Government Consolidated Budget

	billions of euro			changes as per cent
	2016	2017	2018 Jan-Mar	2017
Revenues, including:	9.1	9.6	2.5	6.1
Indirect taxes, including:	2.9	3.1	0.8	7.4
Value added tax	2.0	2.2	0.5	8.4
Excise tax	0.9	0.9	0.2	5.3
Income tax and property tax including:	2.2	2.4	0.6	9.7
Corporate income tax	0.4	0.4	0.1	1.4
Personal income tax	1.5	1.7	0.4	10.7
Social insurance contributor	2.5	2.8	0.7	9.8
Other taxes	0.2	0.3	0.1	6.3
Other revenues	1.2	1.1	0.4	-11.5
Expenditure	9.2	9.8	2.3	7.4

In 2017, capital tax revenues grew moderately. However, real estate tax revenues and corporate income tax revenues were by 3.8% and 1.4% higher than in 2016, respectively.

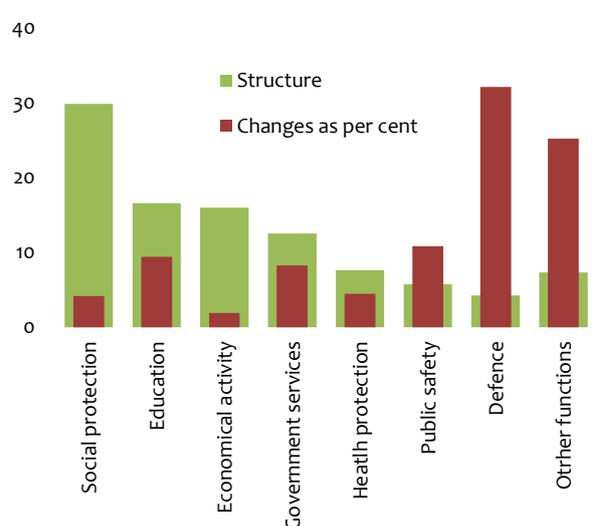
In 2017, general government budget expenditure reached EUR 9.8 billion, which is by 7.4% more than a year ago.

In 2017, budget expenditure for subsidies and grants and current expenditure grew by 2.7% and 6.3%, respectively. A sharp rise in capital expenditure of 52.4% was also observed.



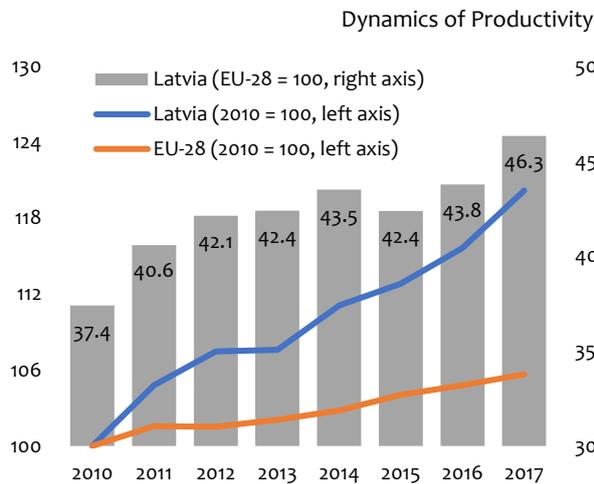
In 2017, budget expenditure by functional category significantly increased for education and social protection. In turn, expenditure on environmental protection slightly declined.

General Government Consolidated Budget Expenditure by Functions 2017, as per cent

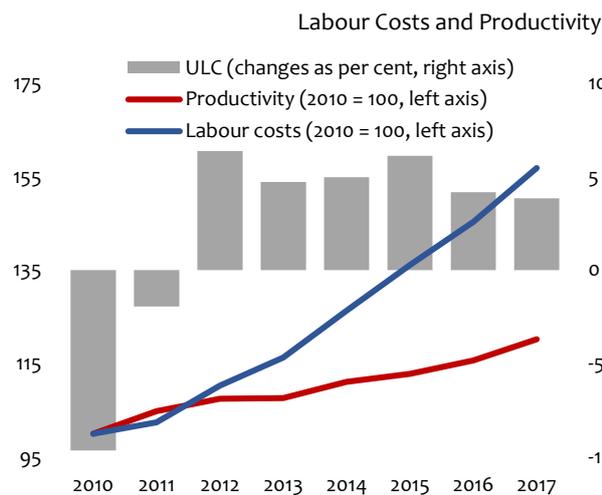


PRODUCTIVITY AND COMPETITIVENESS

In recent years, productivity dynamics of Latvia have been faster than the EU average. As a result, the productivity gap with the EU average has decreased by almost 9% since 2010. In 2017, the productivity in Latvian economy measured by GDP per employee reached 46.3% of the EU average.



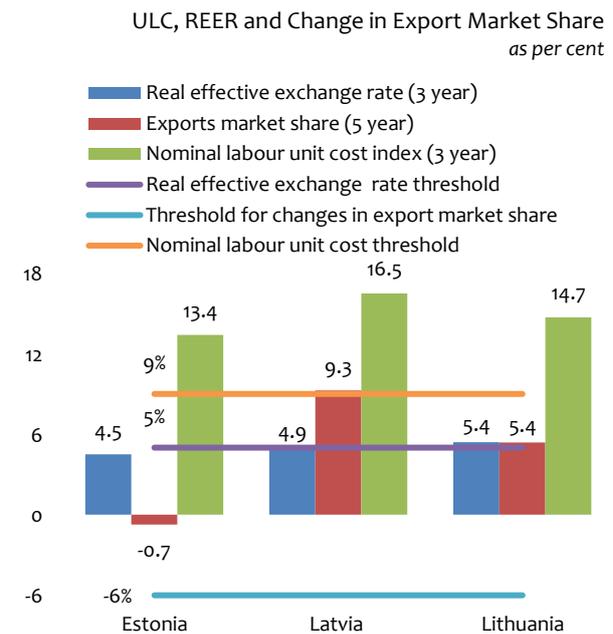
Although Latvia ranks as one of the highest in the EU measured by its productivity growth rates, labour costs have still grown at a faster pace than productivity, thus threatening the competitiveness of Latvian businessmen. The increase in the nominal unit labour cost (ULC) also reveals the growing risks of deteriorated cost competitiveness.



Over the last three years (2015-2017), productivity on average increased by 2.7% annually, while labour costs rose by 7.5%, i.e., almost 3 times faster.

Similar trends can also be observed in all Baltic countries. During the period 2015-2017, the nominal ULC in Latvia grew by 16.5%, while in Estonia and Lithuania it rose by 13.4% and 14.7%, respectively. Baltic countries, in fact, experienced the fastest growth within the EU.

Dynamics of labour costs and productivity reveal that as the economic activity increases, the ULC also continues to grow. In 2017, productivity of the national economy and labour costs increased by 3.9% and 7.9%, respectively, resulting in the growth of ULC by 4%.



Latvia still maintains its competitiveness. The current positive dynamics of export market shares prove the point. During the period from 2012 to 2017, the share of Latvia's exports in the global markets of goods and services grew by 6.2%.

Both the increase in the share of exports and the rapid rise in labour costs means that wage and salary growth is only partly compensated by prices. Also, the real effective exchange rate (REER) dynamics are relatively modest. Compared to 42 major trading partners, the REER (CPI-based) grew by 4.9% over the last three years. However, when compared to euro area partner countries, the rate has decreased by 0.1%.

At the same time, it should be noted that an increase in labour costs, if not offset by a corresponding rise in productivity, could exert significant downward pressure on the profit margin to maintain the price competitiveness in external markets. In addition, long-lasting positive dynamics of ULC increase the threat of external imbalances.

EARLY ALERT MECHANISM

According to the regulations for monitoring economic and fiscal policies adopted in 2011, along with the excessive deficit procedure, EU also created a macroeconomic imbalance procedure aimed at timely identification (with the help of a list of indicators developed by the Early Alert System) and correction of macroeconomic imbalances.

In the "Early Alert Mechanism report 2017" published on 16 November 2016, Latvia was not marked amongst the 13 EU Member States, in which macroeconomic imbalances were identified and an in-depth research was

required. However, Latvia has not currently met its set targets for three macroeconomic indicators (see the table below). Improvements can be observed in both the position of net international investments and unemployment rate. Also, the nominal unit labour cost index, similarly as in Lithuania, Estonia, and Bulgaria, increased and thus exceeded the threshold. The index increase can mainly be attributed to wage growth (mostly in non-tradable sectors), which was larger than the increase in productivity.

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

	Limiting values	2010	2011	2012	2013	2014	2015	2016	2017
External imbalances and competitiveness									
Current account balance (% of GDP, 3-year average indicator)	-4%/6%	-0.8	2.2	-1.6	-3.2	-2.7	-1.6	-0.3	0.0
Net international investment position (% of GDP)	-35%	-82.9	-74.4	-67.2	-66.4	-66.1	-63.9	-58.9	-56.5
Real effective exchange rate – 42 trade partners, SPCI deflator (changes as per cent in 3-year period)	±5%* & ±11%	6.7	-2.4	-8.6	-1.7	0.4	2.6	4.9	1.1
Exports market share -% of total world exports (changes as per cent in 5-year period)	-6%	21.8	26.7	8.0	6.0	11.1	12.5	9.0	6.2
Nominal unit labour cost index (changes as per cent in 3-year period)	9%* & 12%	-2.2	-21.0	-6.9	8.1	16.3	17.5	16.2	14.8
Internal imbalances									
Changes in house prices relative to consumption deflator (changes as per cent year on year)	6%	-8.7	4.1	-0.4	6.5	4.3	-2.4	7.4	5.6
Private sector credit flow (as% of GDP, consolidated)	14%	2.5	-2.0	-2.1	0.9	-11.8	0.7	0.3	-
Debt of private sector (as% of GDP, consolidated)	133%	134.0	115.3	97.9	92.6	96.2	88.9	88.4	-
General government sector debt (as% of GDP)	60%	46.8	42.7	41.2	39.0	40.9	36.8	40.5	40.1
Unemployment rate (3-year average indicator)	10%	14.9	17.7	16.9	14.4	12.6	10.9	10.1	9.4
Changes in total financial sector liabilities (changes as per cent in year)	16.5%	-0.3	-4.1	5.2	5.2	10.4	12.2	5.8	-
New employment indicators									
Economic activity rate –% from all inhabitants, aged 15-64 (changes as per cent in 3-year period)	-0.2 percentage points	0.4	-1.4	0.9	1.0	1.8	1.3	2.3	2.4
Long-term unemployment rate –% of economically active population (changes as per cent in 3-year period)	0.5 percentage points	7.2	6.9	3.3	-3.1	-4.2	-3.3	-1.7	-1.3
Unemployment rate of youth –% of economically active population (changes as per cent in 3-year period)	2 percentage points	25.6	17.4	-4.8	-13.0	-11.4	-12.2	-5.9	-2.6

* – for countries of Eurozone.

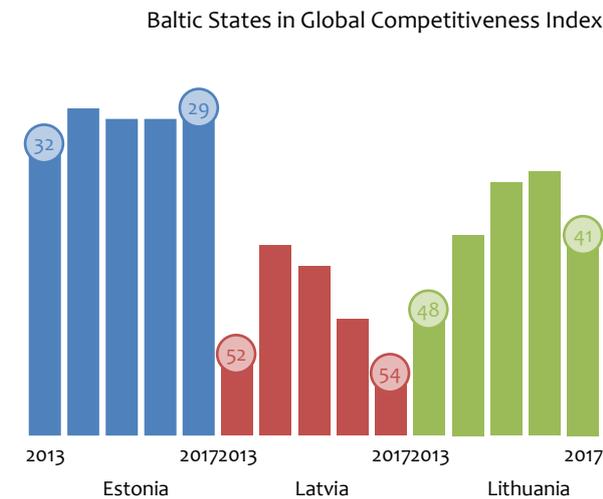
Note: highlighted numbers exceed in Early Alert Mechanism fixed thresholds.

Source: MIP procedure indicators, Eurostat

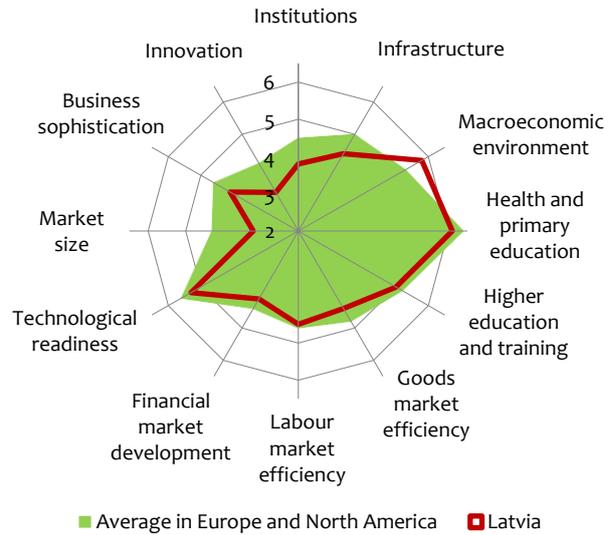
2018 | 1 INTERNATIONAL RANKING OF LATVIA

In the World Economic Forum report 2017-2018 Latvia has been ranked 54th among 137 world economies by the Global Competitiveness Index (GCI).

GCI of Latvia 2017-18 Divided by Pillars from pillar value: the weakest – 1, the best – 7



Source: World Economic Forum, The Global Competitiveness Report 2017-2018

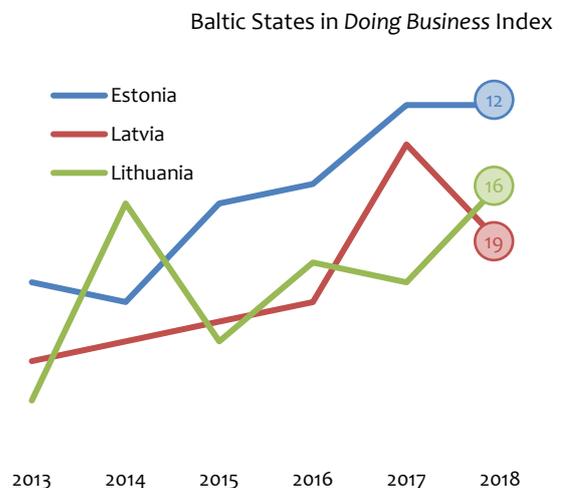


Source: World Economic Forum, The Global Competitiveness Report 2017-2018

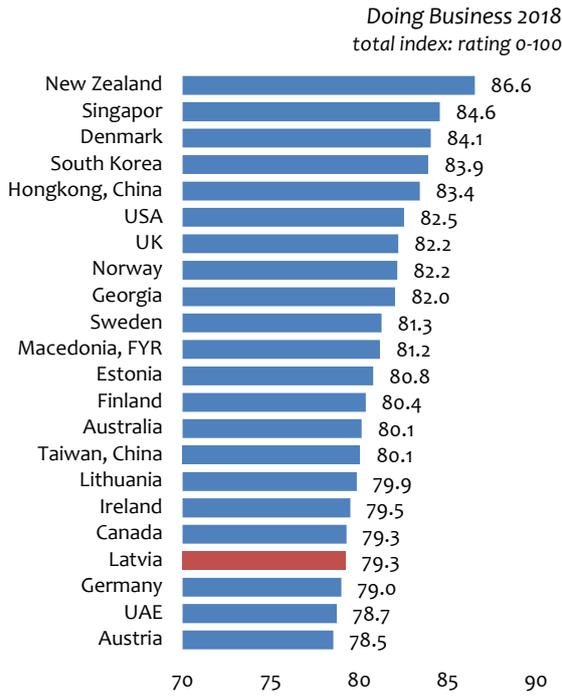
The weakening of Latvia's competitiveness position (reflected in the drop by five places compared to the results of the previous report) was mostly influenced by the mood of the entrepreneurs, who now expressed more critical evaluation of government's work on the new tax reform than a year ago, thus lowering assessment of many institutional indicators. Significant rating drop was also observed in the assessment of innovation potential, which was highly affected by both the weak cooperation between higher education institutions and businesses and relatively low government involvement in technology procurement processes. A slight position decline can also be observed for Latvia in other indicators. However, improvements can be seen in macroeconomic environment and market size indicators.

Compared to the previous assessment period, the decline was observed in such indicators as getting electricity, which is related to AS "Sadales tīkls" investments (the number of planned electricity connections disabled rose), changes in tariffs, and resolving insolvency, which resulted from deterioration of recovery rate indicator. However, previous year improvements in business start-ups, property registration, tax payment, and contract approval indicators have contributed to higher ranks of these indicators.

The World Bank's study Doing Business is an international, comparative business environment rating that annually measures administrative procedures regulating business and their application across the world. This year Latvia ranked 19th among 190 countries. Last year, however, Latvia reached the high 14th place.



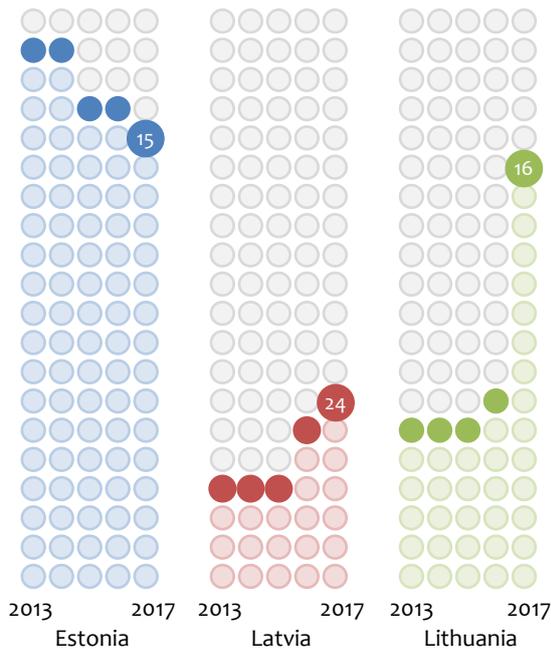
Source: World Bank, Doing Business 2018: Reforming to Create Jobs



Source: World Bank, *Doing Business 2018: Reforming to Create Jobs*

In the European Innovation Scoreboard 2017 published annually by the European Commission, Latvia ranked 24th among 28 EU countries and for the second year in a row has been included in the group of moderate innovators. The relative advantages of Latvian innovation system noted are the following: innovation-friendly environment, human resources, and the influence on employment; while the areas that seek improvement include innovators, attractive research systems, and cooperation.

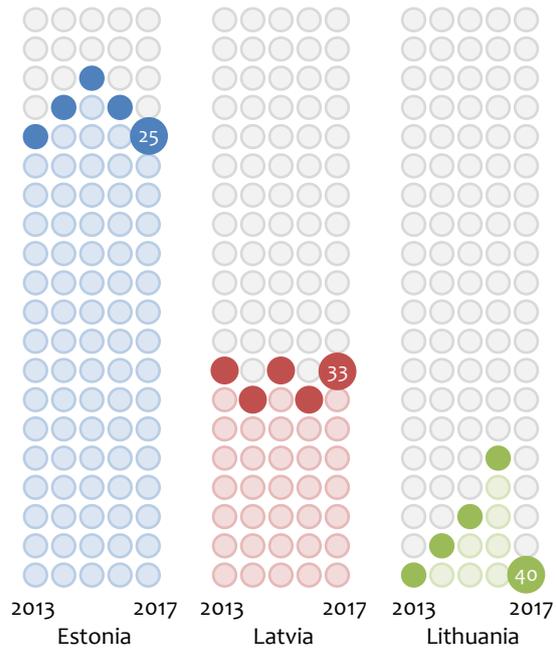
Baltic States in the European Innovation Scoreboard 2017



Source: European Commission, *European Innovation Scoreboard 2017*

In the Global Innovation Index 2017 rating Latvia has climbed to the 33rd place amongst 127 countries surveyed. The rise can mainly be attributed to the improvements in funding for education and growth in creative industry output, as well as good credit opportunities, attraction of foreign gross expenditures on R&D, ratio between students and teachers in secondary education institutions, high number of start-ups, and compliance with environmental management system standards.

Baltic States in Global Innovation Index 2017



Source: Cornell University, INSEAD, WIPO, *The Global Innovation Index 2017: Winning with Global Innovation*

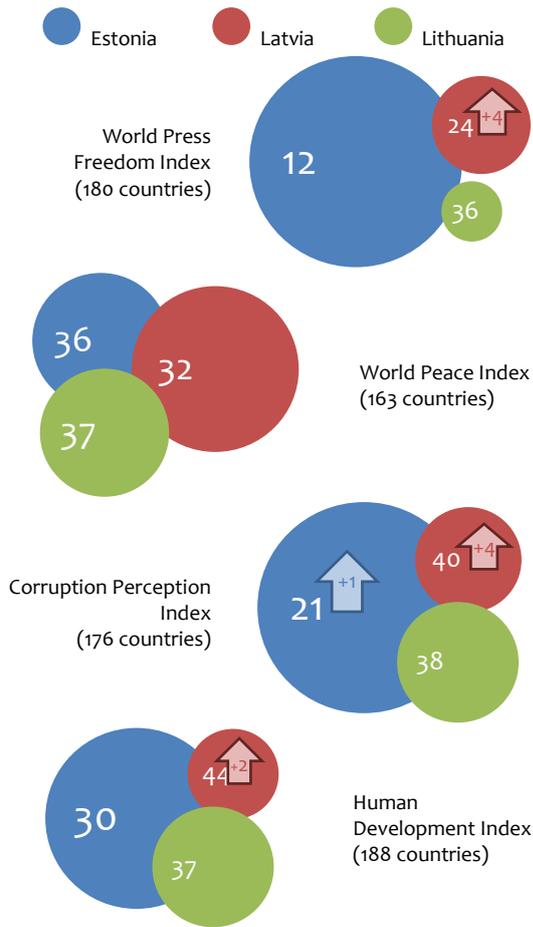
In the 2018 World Press Freedom Index rating created by the international press freedom organization "Reporters Without Borders", Latvia ranked 24th (among 180 countries surveyed), stepping 4 positions up, compared to 2017.

In the World Peace Index 2017 rating developed by the Institute for Economics and Peace, Latvia ranked 32nd (among 163 countries surveyed), similarly to 2016.

In the Corruption Perceptions Index 2017 rating developed by the international anti-corruption organization Transparency International, Latvia ranked 40th (out of the 183 countries surveyed) improving its position by four ranks, compared to 2016.

In the United Nations Development Programme (UNDP) Human Development Index 2016 ranking, which includes life expectancy, reading literacy, educational attainment, GDP per capita, and other indicators, Latvia ranked 44th (among 188 countries surveyed) – up by two positions, compared to 2015.

Baltic States in International Ratings
place and changes during a year

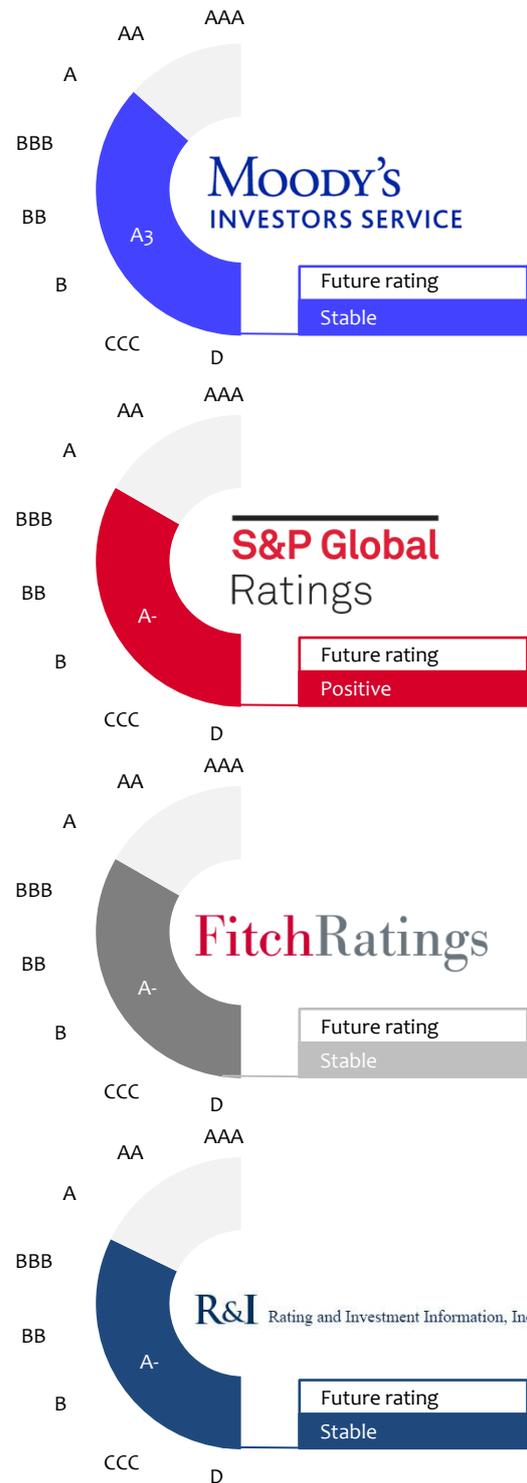


Source: Reporters Without Borders, 2017 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2017; Transparency International, Corruption Perceptions Index 2016; United Nations Development Programme, Human Development Index 2016

Credit rating of Latvia is determined by the following international rating agencies: Moody's Investors Service, Fitch Ratings, Standard & Poor's, and Japanese rating agency R&I.

Rating agencies have positively evaluated the stability of Latvian financial and political systems, Latvia's strict fiscal discipline, as well as the country's overall economic development. Improvement of the credit rating would help to bring income level closer to that in other euro area countries, facilitate improvement of demographic situation, and develop fiscal and external finance areas.

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



Source: State treasury