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MACROECONOMIC REVIEW OF LATVIA

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2018 | 2

TABLE OF CONTENTS

DEVELOPMENT TRENDS IN ECONOMY	4
DEVELOPMENT OF THE WORLD ECONOMY	7
GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND	8
GROSS DOMESTIC PRODUCTS	8
PRIVATE AND PUBLIC CONSUMPTION	9
GROSS FIXED CAPITAL FORMATION	10
EXPORTS	12
IMPORTS	15
CONTRIBUTION OF SECTORS.....	16
MANUFACTURING.....	18
AGRICULTURE, FORESTRY, AND FISHING.....	25
OTHER MANUFACTURING.....	25
CONSTRUCTION	26
TRADE, ACCOMMODATION, AND CATERING.....	27
TRANSPORTATION AND STORAGE.....	28
COMMERCIAL SERVICES	29
PUBLIC SERVICES	29
LABOUR MARKET	30
EMPLOYMENT AND UNEMPLOYMENT.....	30
WAGES AND SALARIES	33
ECONOMICAL STABILITY AND COMPETITIVENESS	34
PRICES.....	34
BALANCE OF PAYMENTS	36
FOREIGN DIRECT INVESTMENT	37
MONETARY INDICATORS	38
GENERAL BUDGET AND GOVERNMENT DEBT	39
BUDGET REVENUES AND EXPENDITURES	40
PRODUCTIVITY AND COMPETITIVENESS	41
EARLY ALERT MECHANISM	42
INTERNATIONAL RANKING OF LATVIA	43

2018 | 2

DEVELOPMENT TRENDS IN ECONOMY

In Latvia stable economic growth, which currently exceeds the EU average level, has resumed. From 2011-2017, GDP on average increased by 3.5% annually. In 2017, GDP exceeded the 2007 pre-crisis level by 0.7 percentage points.

In 2017, GDP growth rate accelerated. GDP increased by 4.6%, which has been the largest increase over the last 6

years. The accelerated growth in 2017 was affected by the improvement of the situation in the external environment, more intense acquisition of EU structural funds, and the increase in employment and wages.

According to statistical data, **at the beginning of 2018 rapid economic growth persists.** In the first half of 2018, GDP grew by 4.7%.

Main indicators of economic development

	2012	2013	2014	2015	2016	2017	2018f
Gross domestic product, at current price, billion euros	21.9	22.8	23.6	24.3	25.0	27.0	28.8
<i>changes over the previous year, per cent</i>							
Gross Domestic Product	4.0	2.4	1.9	3.0	2.1	4.6	4.2
Private consumption	3.1	5.1	1.4	2.5	1.4	4.1	5.1
Public consumption	0.3	1.6	1.9	1.9	3.9	4.1	3.7
Gross fixed capital formation	14.4	-6.0	0.1	-0.5	-8.4	13.1	17.7
Exports	9.8	1.1	6.0	3.1	4.4	6.2	4.5
Imports	5.4	0.4	1.2	2.1	4.4	8.9	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	1.6	2.1	-1.0*	1.3	-0.3	0.2	0.4
Employment	56.1	58.2	59.1	60.8	61.6	62.9	64.3
Unemployment	15.0	11.9	10.8	9.9	9.6	8.7	8.0
<i>per cent, as a share of GDP</i>							
General government sector balance	-1.2	-1.2	-1.8	-1.4	0.1	-0.5	-1.0
General government debt	41.2	39.0	40.9	36.8	40.3	40.0	38.0
Export-import balance	-4.4	-3.5	-1.4	-0.5	0.9	-2.2	-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

Private consumption in 2017 increased by 4.1%. However, in the first half of 2018, private consumption, which was mainly driven by rapid wage increase, grew by 4.4%. Also, public consumption grew more rapidly than in previous years. In 2017 and during the first half of 2018, public consumption increased by 4.1%.

Along with an accelerated economic activity in the largest Latvian good markets, exports continue to increase. In 2017, exports grew by 6.2%. In the first half of 2018, however, they rose by 3.8%. Export volumes have currently reached the historically highest level so far.

In the first half of 2018, exports of goods increased by 5.1%, while exports of services grew by only 0.9%. The increase of exports of goods was mainly determined by the development of machinery, equipment and electrical equipment, wood and wood products, and agricultural and food products. Export volumes rapidly grew to CIS countries. However, slightly slower growth of exports was observed to EU countries. Also, export volumes

significantly increased to other countries, for example, the United States.

Since 2011 in Latvia a low balance of payments current account deficit can be observed, which is an indicator of the external balance of Latvia's economy. In 2017, the current account deficit was 191 million euros, or 0.7% of GDP. Also, in the next few years it is expected that the financial flows will increase, and the current account will remain with a small deficit, not threatening the external balance of the Latvian economy.

After a decline over the last 2 years, in 2017 a rapid growth of investments, which increased by 13.1%, was observed. Also, during the first half of 2018 investments continued to increase. Investments, mainly driven by substantial investments in construction assets, grew by 17.1%. Foreign direct investments, which in 2017 amounted to 640 million euros, or 2.4% of GDP, have also increased.

The increase in competitiveness of entrepreneurs and the demand dynamics in the largest Latvian export markets

foster economic growth in manufacturing. In 2017, manufacturing grew by 8%. Moreover, the growth was observed in all manufacturing sub-sectors. The largest contribution to the overall growth in manufacturing ensured 2 sub-sectors: the manufacture of fabricated metal products and the manufacture of food products.

In the first half of 2018, a more moderate growth in manufacturing (3.4%) can be observed. The sharpest growth was recorded in the manufacture of machinery and equipment and the manufacture of electrical equipment. A significant increase was also observed in the manufacture of non-metallic mineral products, chemical products, and basic metal products. A decline, however, occurred in the manufacture of food products, light metal products, and the production of paper, printing.

In 2017, transportation and storage, which was mainly driven by the increasing freight traffic by road and the growing number of passengers in airports and ports, grew by 7.5%. In the first half of 2018, however, transportation and storage increased only by 0.8%.

Continued growth can be observed in trade, accommodation and catering, which in 2017 and during the first half of 2018 increased by 5.2% and 3.5%, respectively. However, the added value in agriculture and forestry in 2017 and during the first half of 2018 grew by 1.9% and 7.8%, respectively.

In 2017, the only industry that experienced a decline was finance and insurance, which fell by 18.9%. The decline can mainly be explained by the decrease of non-resident business volume in Latvia. In the first half of 2018, influenced by the same above-mentioned factors, the industry continued to decline, experiencing a drop of 14.6%.

Considering the favourable conjuncture, i. e., the economic growth in EU countries, which is the largest Latvian export market, and the available EU structural funds, also in the second half of 2018 accelerated economic growth will prevail. According to the estimates of the Ministry of Economics, in 2018 GDP growth could reach 4.2%.

The large macroeconomic disproportions during the rapid growth of the Latvian economy have been eliminated and economic vulnerability risks against internal and external shocks reduced. Currently, Latvia has a low government debt, balanced budget and balance of payments. Inflation rate, although rising, is mostly determined by supply side factors.

In 2017, average annual inflation was 2.9%. During the first eight months of 2018, inflation rate was higher than in the corresponding period last year. In August, average annual inflation was 2.4%. It was mainly influenced by several demand side factors related to increased taxes and the supply side, which was affected by increased economic activity and the rise in wages. At the same time, inflation

remains highly dependent on the fluctuations in world prices of oil and food.

Since 2011, when economic growth in Latvia resumed, significant improvements in the fiscal position have been achieved. In 2017, there was a small budget deficit of 131.1 million euros, or 0.5% of GDP. The deficit was smaller than projected in the Law on Budget and Financial Management, where it was fixed at 1.1% of GDP. The lower budget deficit can be explained by higher tax revenues, smaller contributions to the EU budget, and lower than planned expenditures on social benefits.

The medium-term budget framework anticipates that the general government budget deficit in 2018, 2019, and 2020 will be 1%, 0.9%, and 0.4% of GDP, respectively. In 2018, the same as in 2020, a fiscal reserve of 0.1% of GDP has been determined.

After the global financial crisis, at the end of 2008 and at the beginning of 2009, monetary indicators of Latvia gradually started to stabilize - the quality of the loan portfolio improved, and lending stabilized. Significant steps have been taken to strengthen the capital of credit institutions. Currently, the number of new loans issued to companies are increasing. Although in 2017 and during the first half of 2018 the amount of deposits declined, it was mainly related to the fall of non-resident deposits.

The increased economic activity positively affects the situation in the labour market – the high unemployment level declines. At the same time, separate groups of people, especially individuals with low level of education and qualification, young and elderly people, experience smaller improvements of the situation in the labour market.

The total number of employees in 2017 was 894.8 thousand, and it was by 0.2%, or 1.5 thousand, more than in 2016. In the first half of 2018, the number of employees also continue to increase.

In 2017, the employment rate amongst the population aged 15-74 reached 62.9%, and during the year it had increased by 1.3 percentage points. In recent years, the increase in the level of employment has mainly been determined by the relatively faster declining working population compared to relatively slower decreasing number of employees.

Unemployment rate continues to decline. In 2017, it dropped to 8.7%. Compared to 2016, it decreased by 0.9 percentage points. However, in the first half of 2018, unemployment level was 7.9%. Also, the level of registered unemployment continues to gradually decline. At the end of August 2018, it reached 6.3%. Improvements in the labour market are hampered by regional disparities and low labour mobility.

Since the end of 2010, as the economic situation stabilized, wage growth has resumed. From 2011-2017, the average gross wage has increased by 40%. In the last

years, its growth rates continue to accelerate. In 2017, the average gross wage increased by 7.9%. In the 2nd quarter of 2018, in comparison with the corresponding period last year, the average monthly gross wage grew by 8.4%, or EUR 78, reaching EUR 1004 for a full-time job.

It is expected that a strong demand-side pressure in the labour market, which could result in an increase in the number of employees, will also persist in future. At the same time, the labour market will continue to be affected by the negative demographic trends and regional disparities.

The further economic development is dependent on the situation in the external environment and the implementation of reforms. The further economic development of the Latvian economy still will closely be linked to export opportunities. Thus, the greatest risk of growth in Latvia is related to global economic development trends. Especially important is the further development of the EU's common economic space. The

economic advantages of Latvia in the medium-term will mainly be based on the achieved macroeconomic stability, because of which Latvia's credit ratings have improved, the effectiveness of the planned EU structural fund support programs, and improvements in the business environment.

The accelerated economic growth scenario forecasts that growth will persist in the largest Latvian export markets. Also, the competitive advantage of the Latvian economy will mostly be based on technological factors, improved production efficiency, and innovations; however, to a lesser extent - on cheap labour force and low resource prices. In the medium-term, Latvia's growth rates could reach 4-5% per annum. According to the conservative growth scenario, along with weak economic growth and unimproved geopolitical situation in the EU, the growth of the Latvian economy can be much slower.

2018 | 2

DEVELOPMENT OF THE WORLD ECONOMY

The global economy continues to grow. In the first half of 2018, in some developed countries the economic growth was slightly lower than at the end of 2017. Also, it is anticipated, due to the introduction of several trading conditions, that in the largest developed countries GDP growth rates in 2018 and 2019 will be lower than in 2017. However, in developing countries, the economic growth will be affected by geopolitical tensions and rising oil prices. Nevertheless, it is expected that the overall growth of the global economy in 2018 and 2019 will be similar to 2017. Overall, in 2018 and 2019, stable economic growth will persist in the main Latvia's trading partner countries.

Gross World Product
changes as per cent

	2016	2017	2018f	2019f
World	3,2	3,7	3,7	3,7
European Union	2,0	2,7	2,2	2,0
United States	1,5	2,2	2,9	2,5
CIS	0,4	2,1	2,3	2,4
Asia	6,5	6,5	6,5	6,3

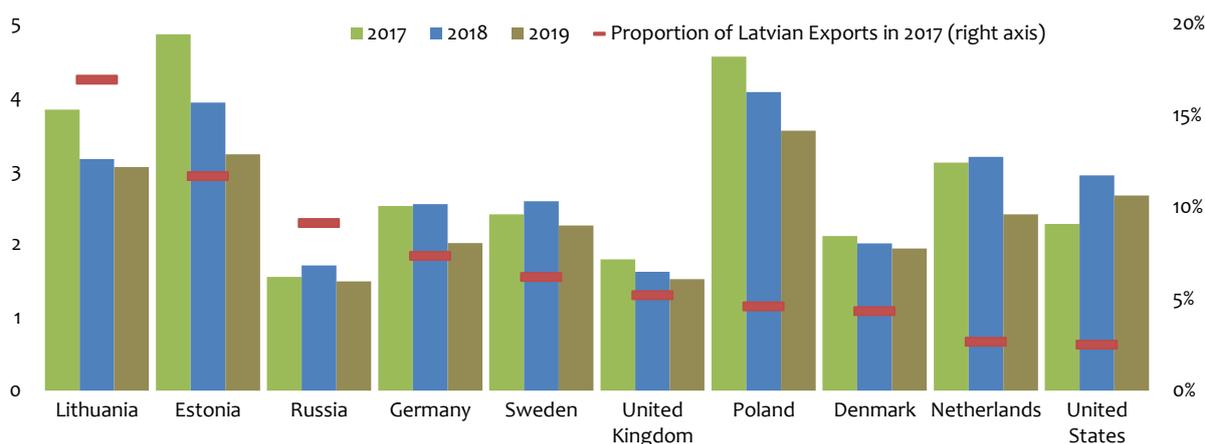
Source: IMF World Economic Outlook Database, October 2018;
f – forecast

The slowdown of the EU growth at the beginning of 2018 was influenced by several temporary factors. Also, the confidence indicators were low, and the overall economic activity was affected by trade tensions. In some Member States political uncertainty increased. Oil prices also rose, thus curbing overall economic activity. Although a solid foundation for EU economic growth remains, risks, related to the development of global trade policy in the short- and medium-term, have increased.

A steady growth in the US economy can be observed. It is mainly determined by the improvements in the labour market, the growing confidence, and the various fiscal stimulus. At the same time, cyclical fiscal policy poses threats, and, as the US current account deficit grows, the protectionism tendencies could be further strengthened. Protective measures, currently implemented by the US, most likely will show up in the business confidence indicators and investments.

CIS countries, including Russia, are recovering from the recession. In 2017, CIS countries started to show signs of economic growth, which was mainly stimulated by the growing oil prices and domestic demand. In 2018 and 2019, the economic growth in the region will persist. Meanwhile, the growth rate will be moderate.

Growth of the Largest Trading Partners of Latvia
changes as per cent



Source: CSB, IMF World Economic Outlook Database, October 2018

Asia remains the leader in global growth. The economic growth of China slightly slowed down due to the weaker external demand and more stringent financial conditions (interest rates). It is anticipated that in 2019 the economic growth of China will be negatively affected by trade tariffs. In other countries of the region the growth rates in 2018

and 2019 will remain stable. Of the most important risks to the future growth of the region are rising oil prices and stringent financial conditions. The most major risk, however, to the future global growth is the high political uncertainty. The risk of the EU's economic development is still highly linked to the Brexit.

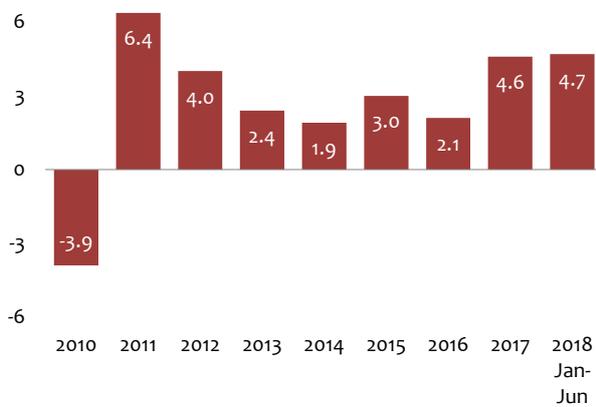
2018 | 2

GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

GROSS DOMESTIC PRODUCTS

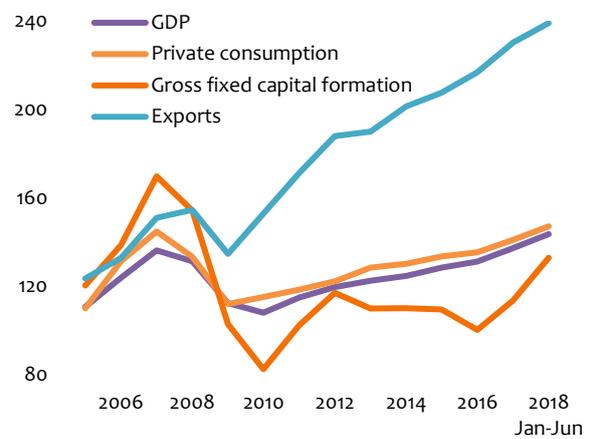
In 2017 GDP increased by 4.6%, which has been the steepest increase since 2012. Also, in the first half of 2018 the increasing trend remains.

Gross Domestic Product changes as per cent



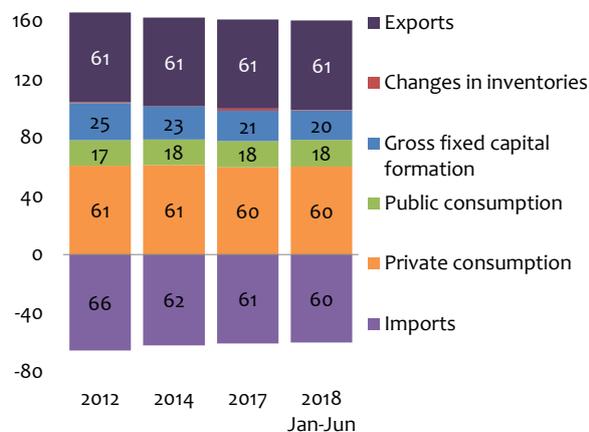
Export volume was influenced by increase in external consumption, which is why it reached the highest level till now. However, improvements in the labor market and increase in the wages were both due to increase in private consumption. Faster than in previous years also went up the government's consumption. In the same period from drop in previous years investments recovered steeply.

Gross Domestic Product by Expenditure Items 2004 = 100

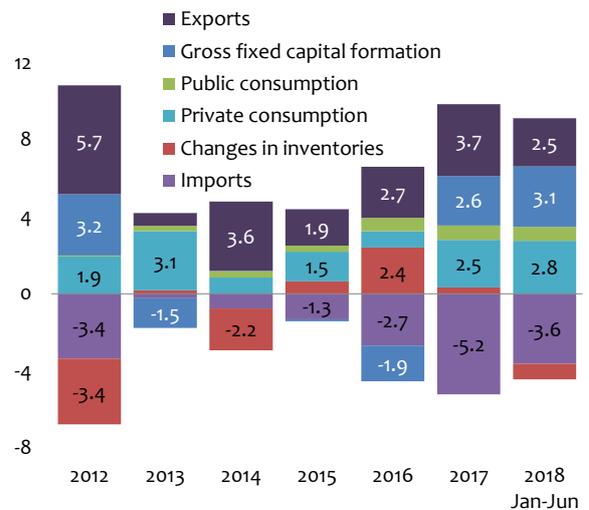


Accelerating growth in 2017 and first half of 2018 was due to better situation in external environment, more intense EU structural fund mastering, employment and salary increase. At the same time a stable growth could be seen in exports, private and governmental consumption.

Gross Domestic Product from the Expenditure Approach per cent of GDP

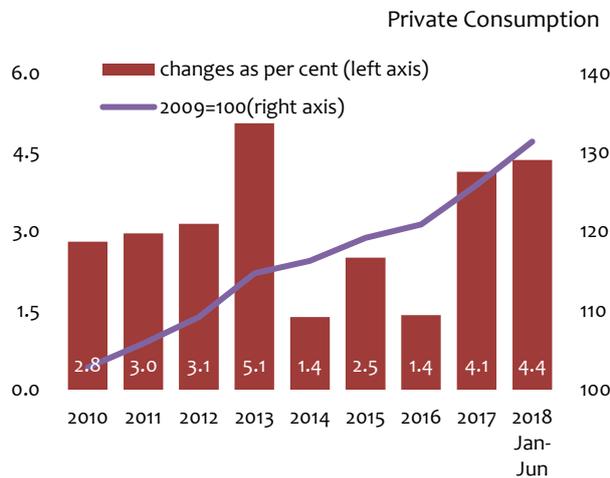


Gross Domestic Product by Expenditure Items contribution to growth as percentage points

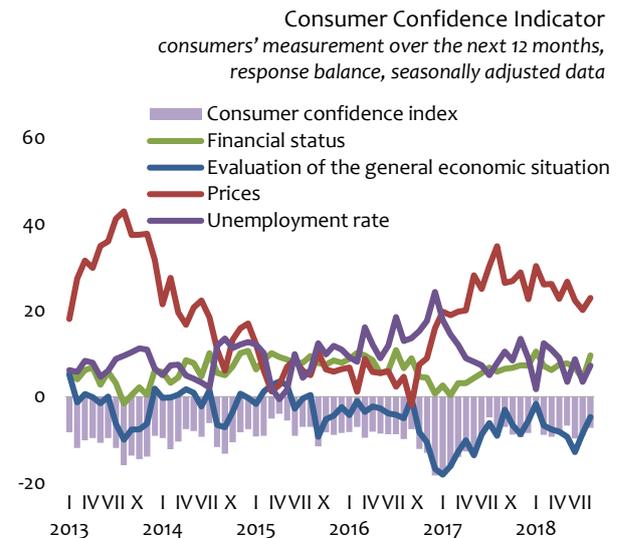


PRIVATE AND PUBLIC CONSUMPTION

Private consumption keeps stable growth. From 2011 till 2017 private consumption increased by 2,9% at average a year, which was mainly due to meaningful increase in wages. Furthermore, in the first half of 2018 it keeps increasing.



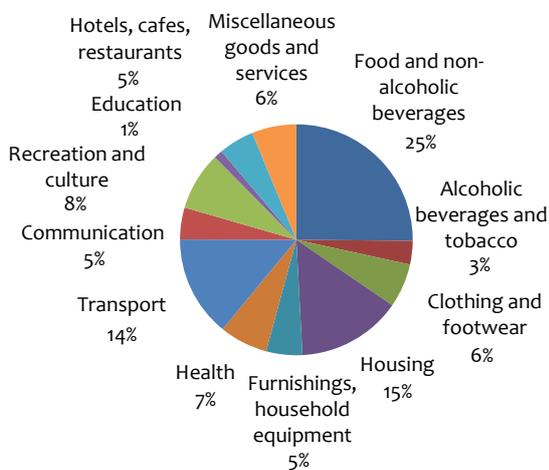
Consumers mood in 2018 improves. More positively is evaluated financial status, lowers inflation expectations. However, unemployment expectations are the same as before year. Since end of 2016 consumer's state of mind steadily improves: increases optimism about family's financial situation, as well as about overall situation in country. Inflation expectations since end of 2017 lowers due to slower price increase and huge inflation year before.



Household expenditures – biggest in last 10 years. Biggest part of the household expenditures are expenditures for food. The volume in 2017 has not changed from 2016. The same trend is for expenditures for housing and utilities, which both together makes the second largest group. Third priority in household expenditures is for transport costs, where an increase of 7% has been noticed. It was mainly influenced by increase in costs of personal transport exploitation and purchasing. However, expenditures for leisure and culture increased by 13%, which is the fourth largest expenditure group.

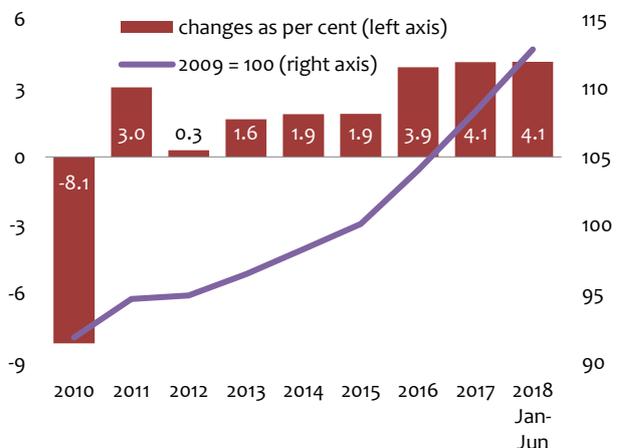
Country's expenditure after a huge drop during crisis time, in the last years slowly recovers. With increasing budget revenues since 2014 states consumption increases faster. Overall from 2011 till 2017 country's consumption at average a year increased by 2,4%. In 2017 was observed steepest growth since 2006. In the first half of 2018 it keeps growing.

Structure of Household Expenditure 2017*, per cent



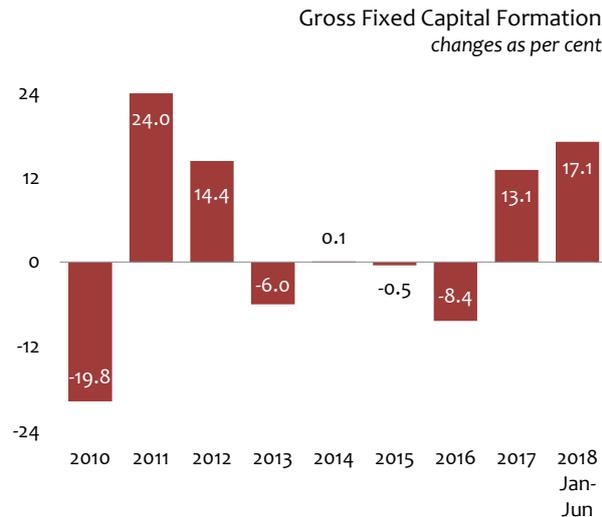
* evaluation by Ministry of Economics

Public Consumption



GROSS FIXED CAPITAL FORMATION

Since 2017 the growth of investments (gross fixed capital formation) is one of the sharpest in EU countries. More investing activities shows that the stagnation period is over. In 2017 investments in equity was 13.1% higher in volumes and was almost 20.9% of GDP. Also, in 2018 investments keeps growing. In the first half of this year they were by 17.1% higher than previous year, which was due to voluminous investment in construction assets.

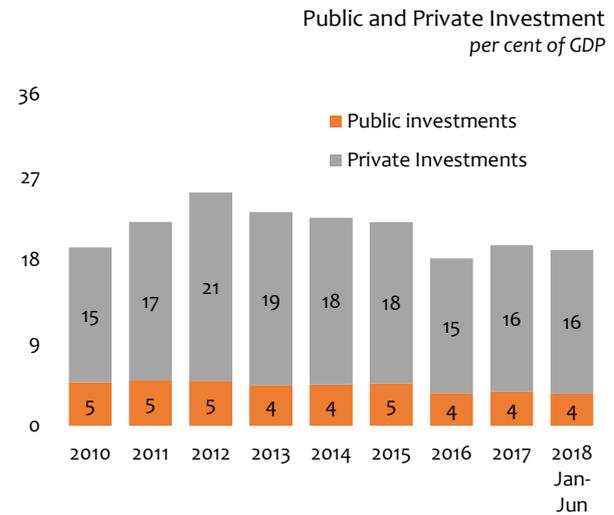


Relatively small investments are mainly related with the slow recovery of private investments in after crisis period.

In period from 2011 till 2016 private investments made at average 17.7% of GDP, which is by almost by 11 percentage points lower level than in rapid growth years. The low level and weak dynamics in this period mainly were determined by weak crediting, low demand, relatively high private sector debt level, as well as the uncertainty in external economic and political situations. In 2017 and 2018 first quarter comparing with previous year's corresponding period private investments grow by 17.3% and 16.4% respectively. In case of weak crediting country provides significant support for private investments with the EU Structural Funds co-financing. The EU Structural Funds are very important source for public investments.

Public investments in Latvia remains at high level. In the last few years public investments make up 1/5 of total investments in Latvia's national economy and their dynamics is relatively stable, except for 2016, when they were by 20.3% lower than in 2015. This was mainly due to the stop in transfers of EU Structural Fund, which was a result of their acquiring cyclicity. Together with removal of the EU Structural Funds public investments increased and in 2017 were by 11% higher than before a year. However, in the first quarter of 2018 comparing with previous year's respective period public investment volume increased by 36%. Public investment share of total

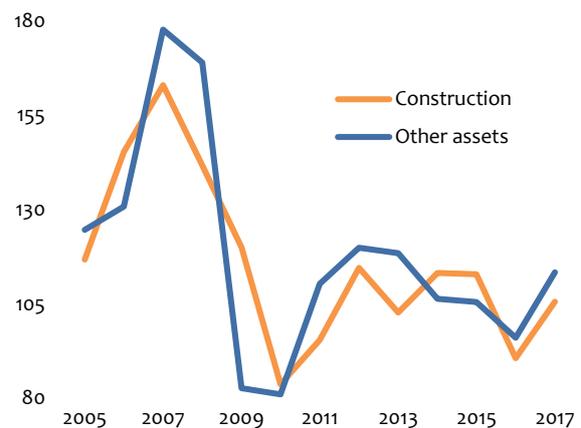
investment volume in Latvia is one of the highest between EU countries, according to Eurostat data. In 2017 in EU-28 countries public investments were 2.8% of GDP (In Latvia they were 4%).



Since 2007 the structure of investment actives has changed. In recession years the volume of investments decreased in all actives. Biggest fall in investments were related to construction. Moreover, drop in investments for machinery and equipment was a bit smaller. Investments in intellectual property remained the same as already few years at average 1% of GDP level (including R&D at 0.6% of GDP)

Gross Fixed Capital Formation by Types of Assets

2004 = 100

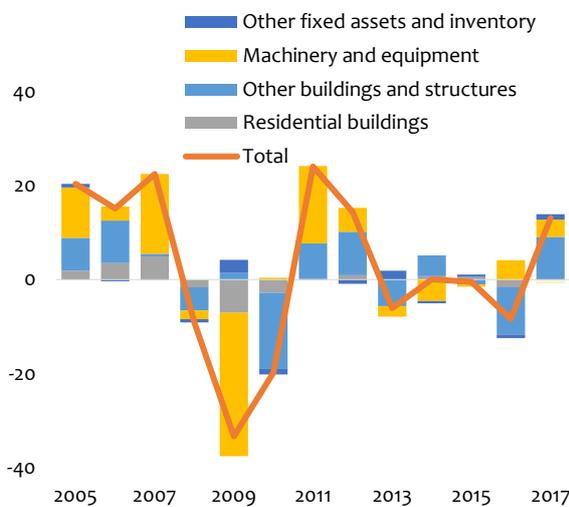


In 2017, comparing with previous year's respective period, investments in dwellings, other buildings and structures increased by 17.5% and in machines and equipment by 8.2% (including vehicles – by 35.8%). Investments in

intellectual property products in 2017 was by almost 25% higher than year before.

In 2018 increased investments in construction assets, while for machines and equipment overall the volume of investment remained the same as previous year. In the first half of this year, in construction assets already invested by 37% more than before year, and their share is being almost 53% of total investments, including investments in dwellings 23.2%, which were 19.8% in 2007. In machinery and equipment entrepreneurs invest by 5.7% more than before year, which is mainly due to drop by 2.3% in investments in vehicles. Also, in the intellectual property investments decreased by 11.8%.

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

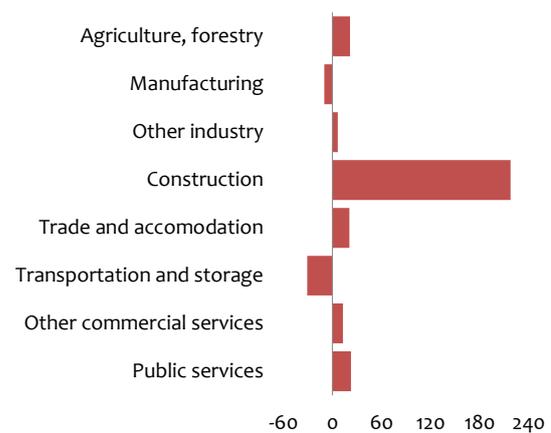


In the first half of 2018 investments grown in goods production sectors more than in service sectors. In goods production services they invested by 20% more than before year, while, in service sectors by 9.4%.

Biggest contribution for growth in investments was for construction industry (growth by 218%) and for operation with real estate (growth of 63.1%). However, investments in manufacturing sector was by 10% lower in overall than before year.

Surveys with managers of industrial companies suggest that the main investment motivating factor is growth of demand. In the last years important factor for increasing investments is the accessibility of finances. Also, in 2018 the financial conditions are considered as investment motivating factor, which is like technical factors, for example, technological development, accessibility of qualified labor and other.

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

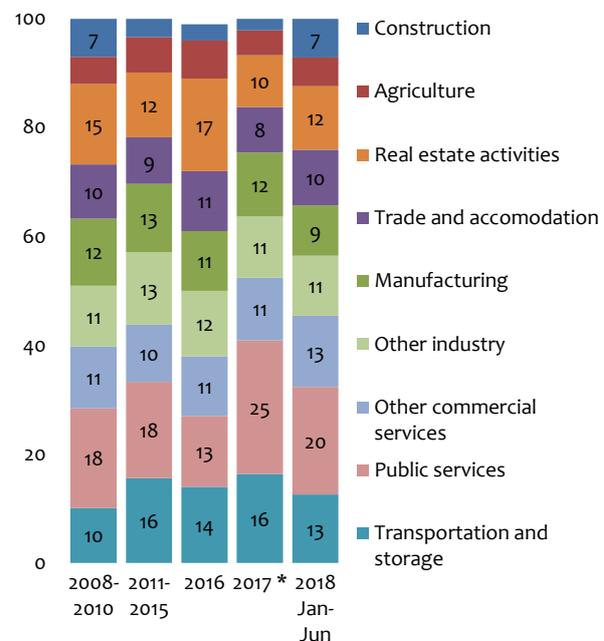


* – calculated by using quarterly data

In the next years steep growth in investments is expected.

The process of investing is positively activated by accessibility of the EU Structural Funds as well as by growing external and internal demand, increase in lending volumes and other. Also, the limited supply of labor will become as strong stimulus for investments. Remaining the environment for investments favorable, as well as considering the high production workload, increase in the investments is expected.

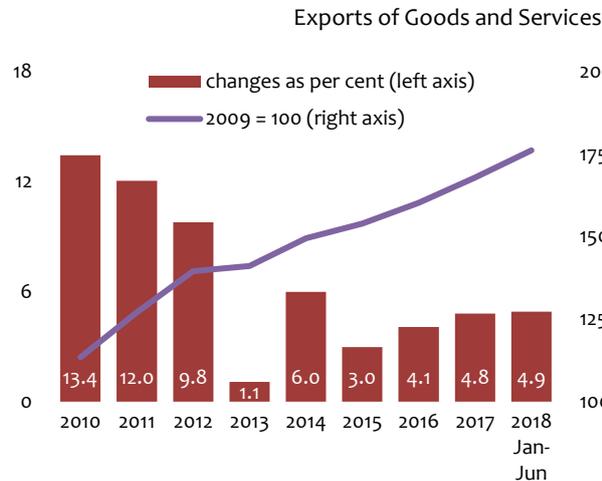
Non-financial Investment Structure by Sectors as per cent*



* – calculated by using quarterly data

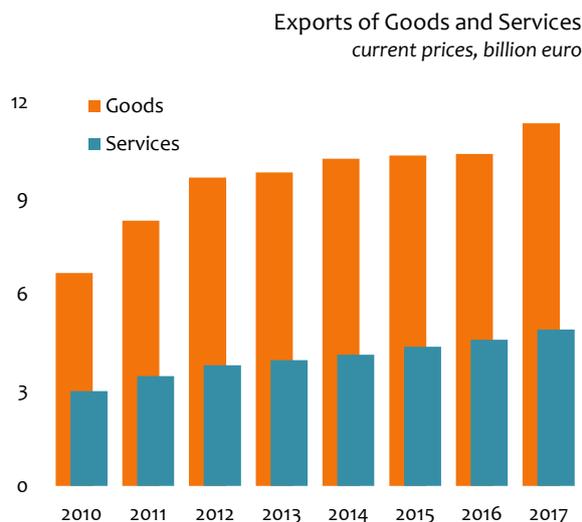
EXPORTS

Exports are rising, and it is one of the most drivers for national economy. Its growth is closely related with external demand and main partner countries' growth.



In the first half of 2018 exports of goods and services keeps growing. It was positively affected by steeper economic growth in Lithuania and Estonia, by stable demand in the main export market – the EU countries, and by economic stability recovering in Russia and other CIS countries.

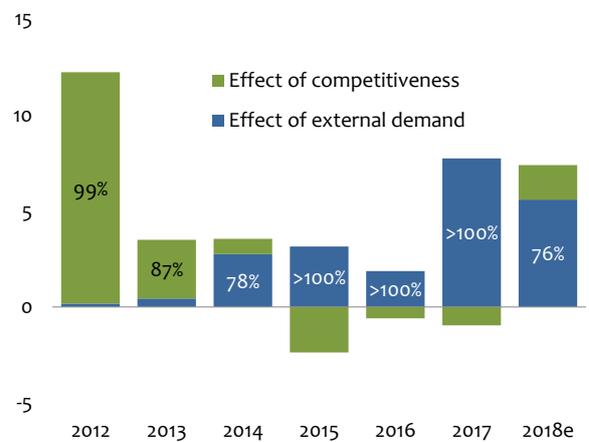
It is expected that in the second half of 2018 with the same stable external demand incomes from export will keep rising.



Since 2014 the increase in export is mainly determined by external demand and the relationship of competitiveness in prices has smaller affect on the export increase. In the

years of rapid growth, the increase in export was mainly led by few biggest production goods, for example, wood and its products, and metals. During the crisis export volumes decreased in all groups of goods, but faster decreased the hugest export group volumes, which determined the improvement in diversification measure. However, after the crisis, with resuming growth increase in volumes of exports by groups of products are quit the same, which determines higher diversification level. In Latvia during the last years the diversification measure coincides with EU-15 average level.

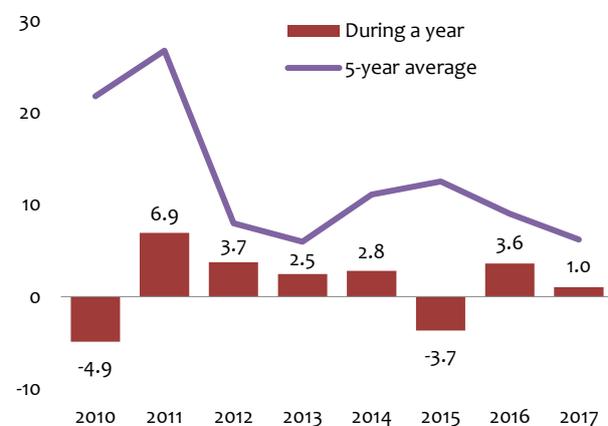
Changes of Exports by the Constant Market Share structure of exports' changes to the EU countries, as per cent



e – Evaluation by Ministry of Economics

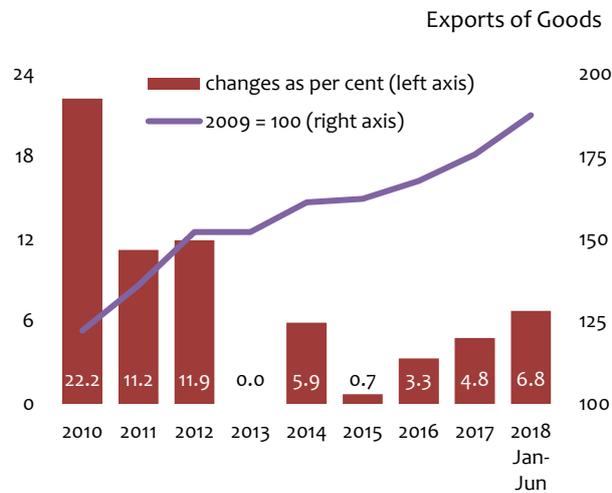
The export share of Latvia increases in the world market, which means that entrepreneurs of Latvia remains huge competitiveness and enters in new markets.

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

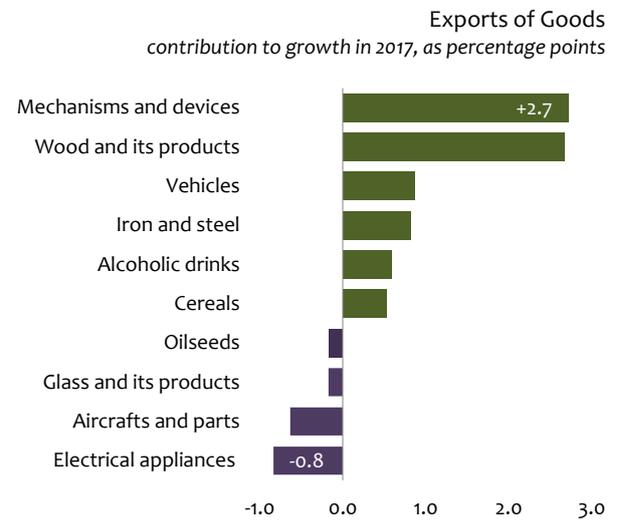


Exports of Goods

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



period, export of goods increased by 9.5%. Increase was mainly driven by development of exports in such sectors like mechanisms, equipment and electrotechnics, wood and its products, as well as in agriculture and food production.

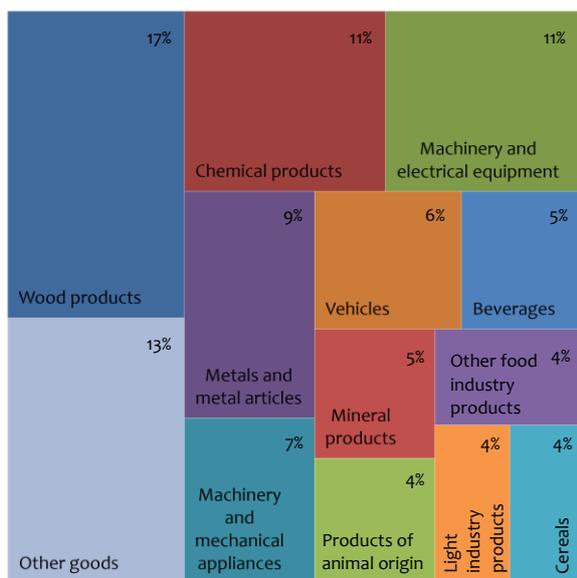


In 2017 exports of goods developed dynamically.

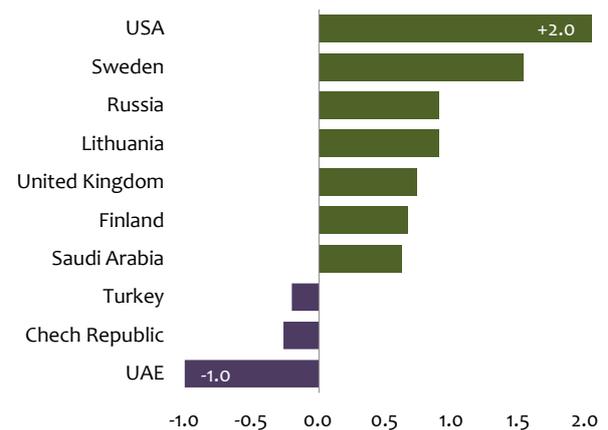
Comparing with 2016, exports in current prices increased by 11%. Increase was mainly driven by development in export of food production, simple metallics and its products, as well as mechanisms, equipment and electrotechnics. Export to EU countries increased a bit slower, but much faster to CIS and other countries.

This year biggest Latvian partner countries in export of goods are Lithuania, Estonia, Russia, Sweden, Germany, Great Britain, Denmark and Polish. To these countries Latvia exports more than 60% from all goods.

Structure of Exports of Goods 2017, as per cent



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



In 2018 the exports of goods keep increasing rapidly. In the first seven months, comparing with 2017 respective

In the first 7-month of 2018 main groups of goods for export were wood and its products, mechanisms and equipment. Significant share of exports to CIS countries is made by alcoholic drinks, mechanisms and equipment and pharmacy products. To other countries in this period biggest export groups were mechanisms and equipment, wood and its products.

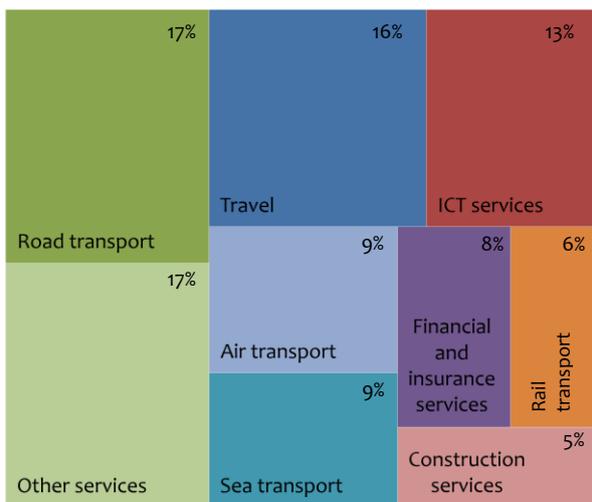
Exports of Services

Since 2011 export of services develops faster than export of goods. Largest contribution as always gives the export of transportation. Also, every year increases the export of construction as well as export of information and communication technologies (ICT). However, in the total export of services decreases the share of financial and insurance service exports.



In the first half of 2018, a small increase was discovered in export of services. Faster increased the ICT services. Also, need to point out meaningful increase in export of services in air transport, travel and construction services. But export of car and sea transportation services decreased.

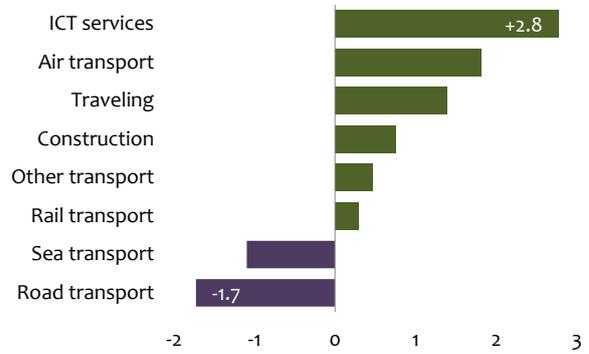
Structure of Exports of Services 2017, as per cent



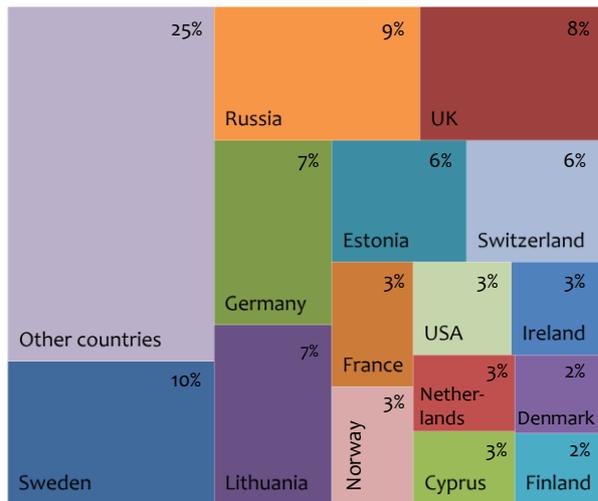
From 49% in 2011 till 65% in 2017 the export of services increases to EU countries. Mainly related with transportation services a meaningful share is exported to

CIS countries. However, it has decreased from 17% in 2014 till 13% in 2017.

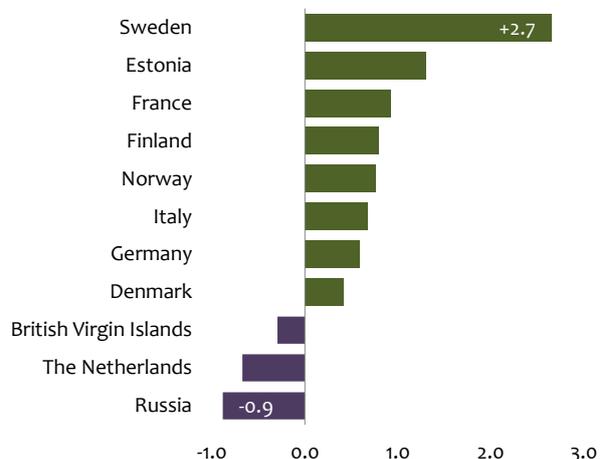
Exports of Services contribution to growth in 2017, as percentage points



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

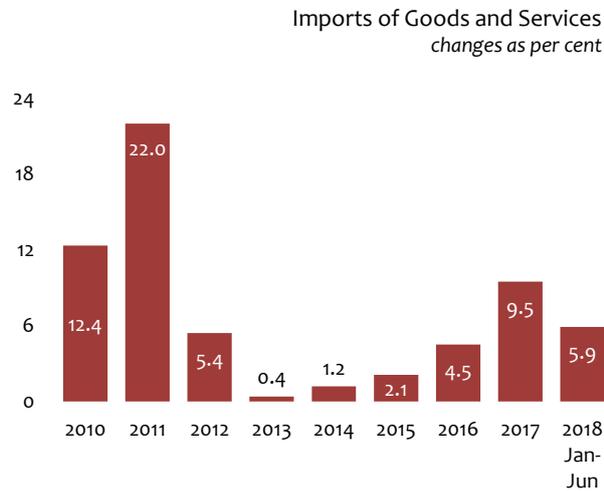


Exports of Services by Country contribution to growth in 2017, as percentage points



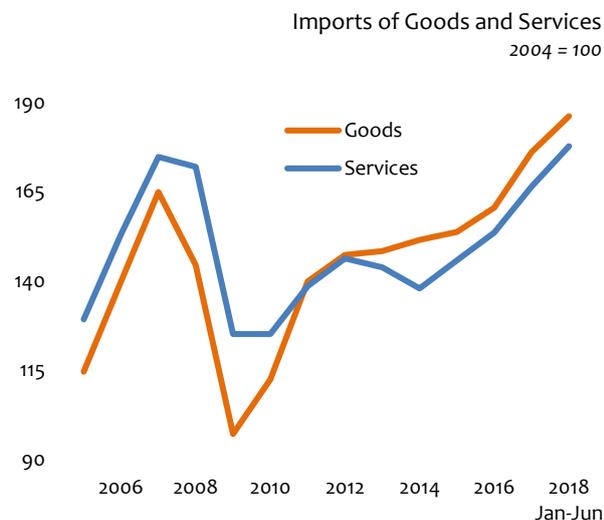
IMPORTS

After huge decrease in crisis period import has increased in the last years rapidly. Successful was year 2017, when it increased by 9.5%. Comparing import of goods and import of services, then import of goods increased faster.

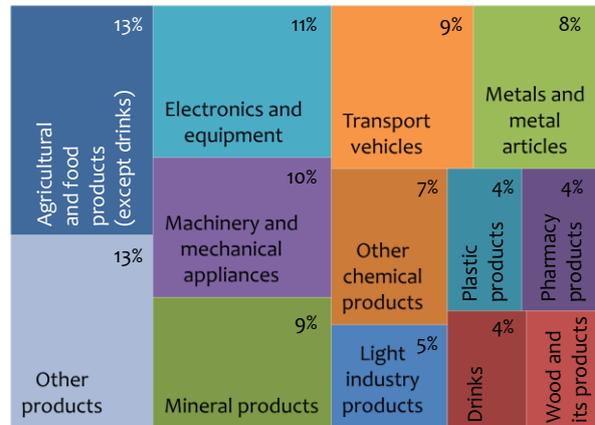


From end use of imported goods, the structure of them has not changed. A little drop in intermediate consumption is noticed, which was due to fuel import value decrease. Its share in intermediate consumption has dropped from 31% in 2012 to 19% in 2017 due to significant drop in world oil price.

From January till July in 2018 import of goods keeps rising. In current prices it increased by 9.1% comparing with the relevant period of 2017. It was mainly motivated by mechanism and equipment, iron and steel, wood and its products, as well as transport vehicle import growth. It was also influenced positively by other import groups. However, value of import of oil products dropped.



Structure of Imports of Goods 2017, as per cent

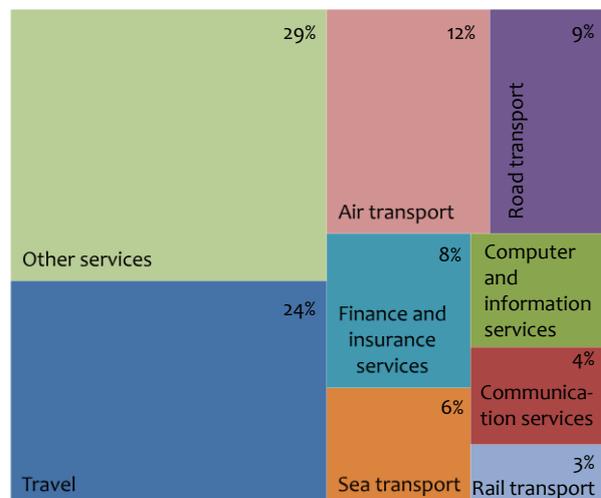


Main Latvian import partner countries are Lithuania, Germany, Poland, Estonia, Russia and Sweden. Together those countries form more than half of total import of goods in Latvia.

The import of services in Latvia in after crisis period develops dynamically, but slower than export of services. Decrease in value of imports was noticed from 2013 till 2014, which was mainly due to significant price adjustments.

In first half of 2018 import of services in current prices increased by 8.5%. Huge contribution in this increase had the transportation services, computer and information service as well as other economic service import. However, decreased the imports of financial services.

Structure of Imports of Services 2017, as per cent

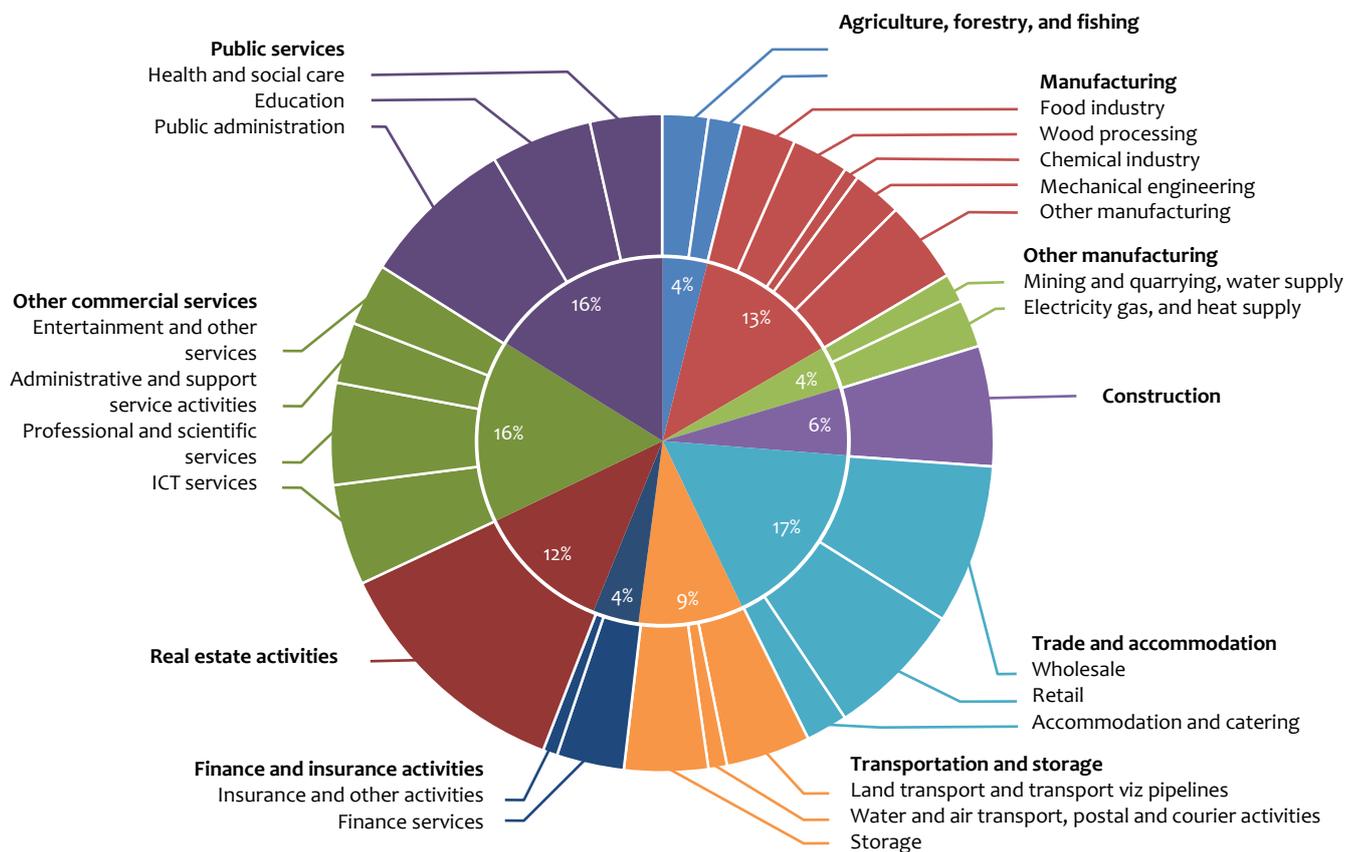


2018 | 2 CONTRIBUTION OF SECTORS

During the financial crisis, as labour costs declined, the competitiveness of Latvian producers improved. It was the basis for the growth of exports and, consequently, the development of tradable sectors. The structure of the economy changed. In 2008, tradable sectors (agriculture, forestry, industry, and transport) constituted only 26% of the total value added. In 2010, however, the share of the tradable sectors reached 33%. In 2017, the share of these sectors slightly decreased, and constituted 29.5% of the

total value added. Last year, compared to 2010, the share of construction and commercial services increased. The proportion of all other sectors, in turn, declined. However, the share of public services has remained unchanged. From 2014-2016, the growth was observed in all sectors, except construction. In 2017, the growth of construction had the greatest impact on the overall economic development.

Structure of the value added
2017, as per cent



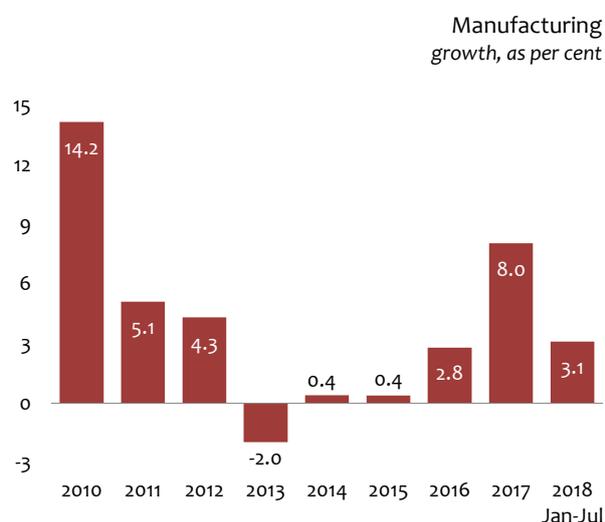
* - calculations by the Ministry of Economics

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

	2014	2015	2016	2017	2018 Jan-Jun
Gross Domestic Product	1.9	3.0	2.1	4.6	4.7
Agriculture	0.2	12.5	-9.8	1.9	7.8
Mining	-9.8	6.7	3.6	18.0	1.7
Manufacture	0.4	0.4	2.8	8.0	3.4
Food industry	0.1	-4.6	1.8	5.2	-2.6
Light industry	-13.6	-13.2	2.1	7.6	-0.7
Wood processing	6.9	7.1	8.0	2.1	3.3
Manufacture of paper and paper products; printing	-0.6	0.0	3.6	4.5	-0.8
Chemical industry	-2.6	-4.1	10.7	11.4	6.5
Manufacture of non-metallic mineral products	1.2	-9.8	11.6	11.1	10.3
Manufacture of basic metals	-10.5	34.8	5.4	12.0	6.6
Manufacture of electrical and optical equipment	32.3	16.7	12.6	15.8	8.4
Manufacture of machinery and equipment	2.4	7.9	8.5	21.5	11.1
Manufacture of motor vehicles	-15.2	3.5	-2.9	22.8	5.3
Other manufacturing	-12.0	3.5	0.8	4.3	1.2
Electricity and gas supply	-14.3	22.6	18.0	7.3	0.3
Construction	5.4	-1.8	-14.7	19.4	33.1
Construction of buildings	33.6	-6.2	-2.2	11.8	45.9
Civil engineering structures	-10.4	5.2	-33.3	30.4	21.1
Trade	5.3	7.3	2.7	5.3	3.2
Retail	3.5	4.9	2.3	4.3	5.3
Transportation and storage	1.3	-7.7	6.1	7.5	0.8
Freight traffic	2.2	-2.4	-14.1	-8.4	-2.3
Cargo loaded and unloaded at ports	5.2	-6.2	-9.3	-2.0	-4.6
Freight traffic	2.7	0.5	1.3	7.0	13.6
Accommodation and catering services	3.6	6.0	1.3	4.3	6.8
ICT services	-2.4	2.1	5.1	6.4	10.9
Finance and insurance activities	11.6	4.8	3.1	-16.6	-13.6
Real estate activities	1.4	1.4	0.2	0.5	3.2
Other commercial services	-5.7	5.9	1.2	6.3	3.3
Public administration and defence; obligatory social insurance	1.5	0.5	5.5	3.6	3.1
Education	4.1	0.7	0.6	5.6	1.8
Health and social care	6.8	5.5	1.4	5.6	5.0
Art, entertainment, and recreation	1.1	-3.7	5.0	8.5	4.6

MANUFACTURING

The development of manufacturing is facilitated by the improvement of the competitiveness of Latvian manufacturers and the demand dynamics in the largest export markets. In 2017, an especially rapid growth in manufacturing was observed.



In January-July 2018, moderate growth of manufacturing was observed. The fastest growth in production volumes occurred in the manufacture of machinery and equipment and electrical equipment. Also, significantly increased the manufacture of non-metallic mineral products, chemical industry, and the manufacture of basic metals. A decline, however, was observed in the manufacture of food products, light industry, and in the manufacture of paper and paper products; printing.

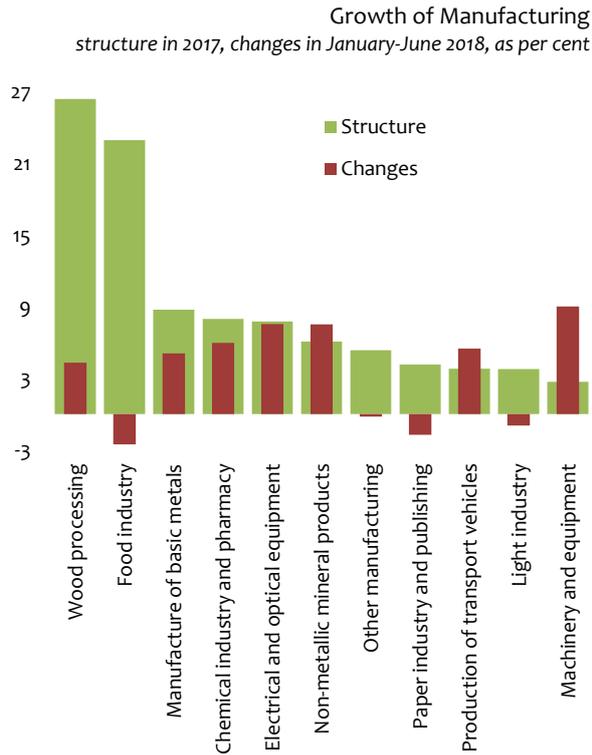
In January-July 2018, manufacturing turnover at current prices grows faster than the output. In the local market the volumes of realized production increase rapidly; however, the volumes of exported production rise only moderately.



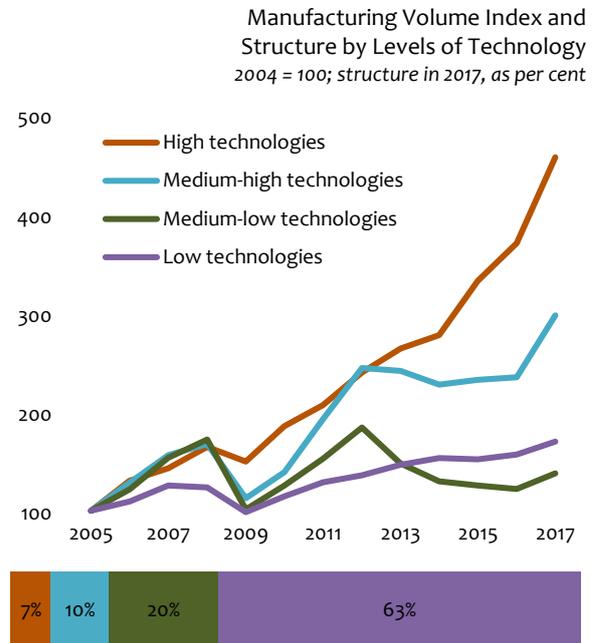
In 2018, the number of occupied posts continue to grow in manufacturing. In the first half of 2018, the number of occupied posts most rapidly increased in the manufacture of electrical and optical equipment, the manufacture of machinery and equipment, and light industry. However, a decline in the number of occupied posts was observed in the manufacture of food products

Structure of Manufacturing and Development Trends by field as per cent

	Structure in 2017			Changes in production volumes			
	Output	Occupied posts	Share of exports in the sales	2015	2016	2017	2018 Jan-Jul
Manufacturing	100	100	65.5	4.3	5.6	8.0	3.1
Manufacture of food products	23.0	20.1	35.8	-4.6	1.8	5.2	-2.5
Light industry	3.8	9.9	85.0	-13.2	2.1	7.6	-1.0
Wood processing	26.5	20.4	73.8	7.1	8.0	2.1	4.3
Manufacture of paper and paper products; printing	4.2	4.1	63.5	0.0	3.6	4.5	-1.7
Chemistry and pharmacy	8.0	7.0	80.6	-4.1	10.7	11.4	6.0
Manufacture of non-metallic mineral products	6.1	4.8	52.7	-9.8	11.6	11.1	7.5
Manufacture of basic metals	8.8	10.0	68.7	34.8	5.4	12.0	5.1
Manufacture of electronic products	7.8	4.4	90.8	16.7	12.6	15.8	7.6
Manufacture of machinery and equipment	2.7	3.2	84.4	7.9	8.5	21.5	9.1
Manufacture of motor vehicles	3.8	3.3	91.8	3.5	-2.9	22.8	5.5
Other manufacturing	5.4	12.7	61.6	3.5	0.8	4.3	-0.2

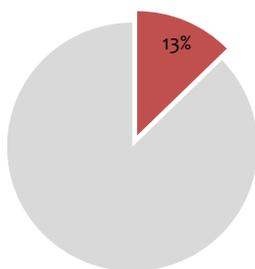


After a relatively rapid increase in producer prices in 2017-2018, the turnover of manufacturing has increased. The turnover of exported products grew relatively faster; however, the volumes of realized production domestically increased moderately.

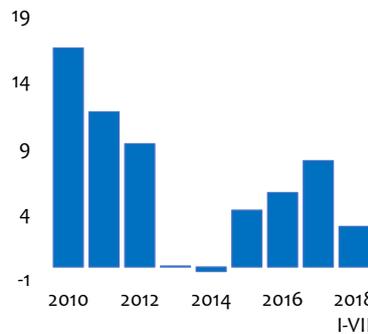


Main Indicators in Manufacturing

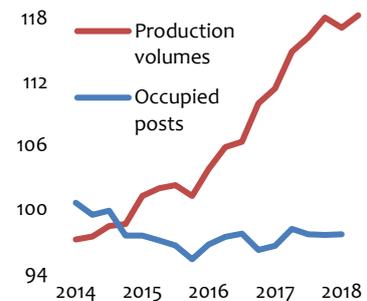
The share of the sector in national economy 2017, as per cent



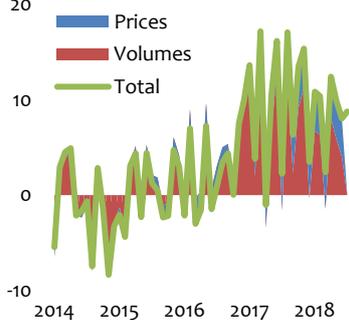
Changes in production volumes as per cent



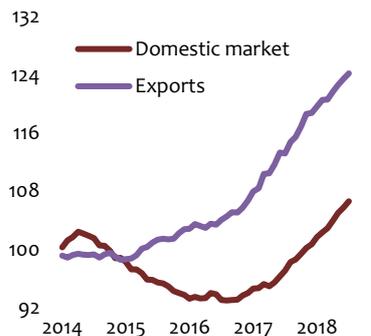
Production volumes and occupied posts Q4, 2013 = 100



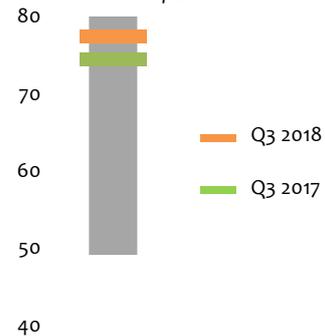
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

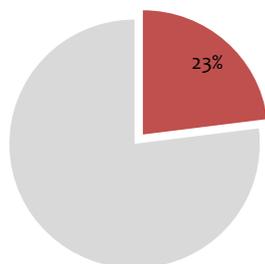


Capacity utilization rate Historically highest and lowest levels, as per cent

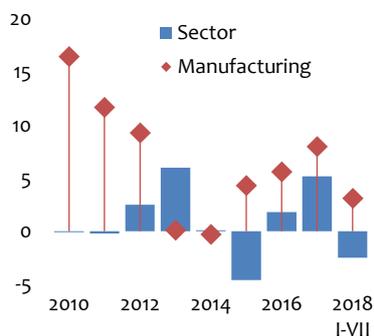


Manufacture of Food Products and Beverages

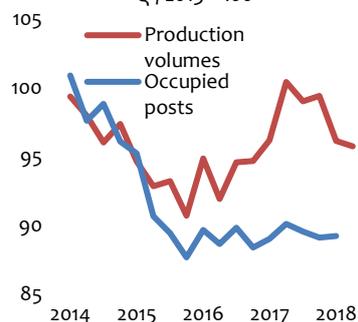
The share of the sector in national economy 2017, as per cent



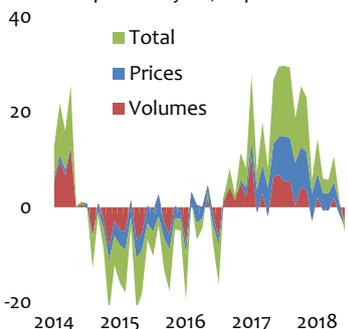
Changes in production volumes as per cent



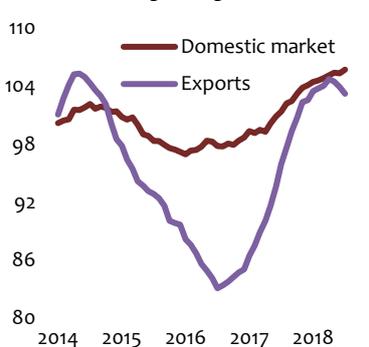
Production volumes and occupied posts Q4 2013 = 100



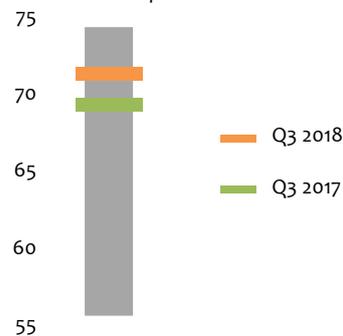
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

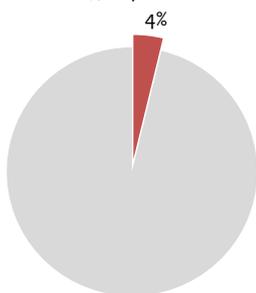


Capacity utilization rate Historically highest and lowest levels, as per cent

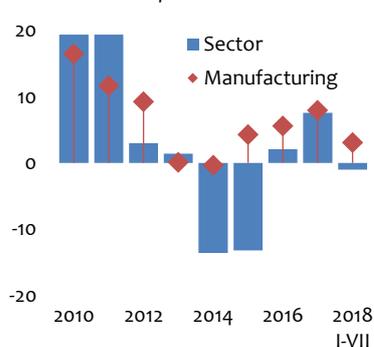


Light Industry

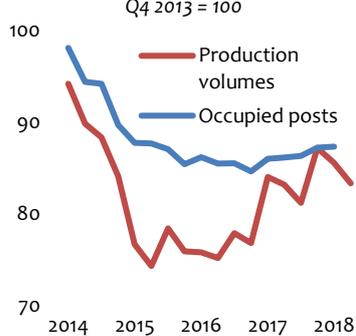
The share of the sector in national economy 2017, as per cent



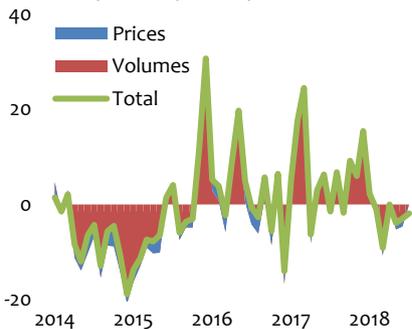
Changes in production volumes as per cent



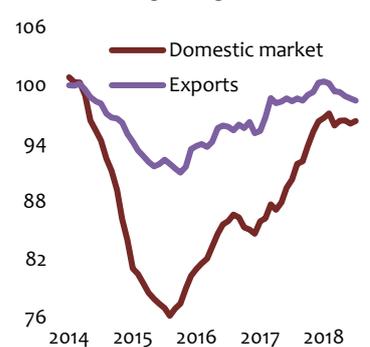
Production volumes and occupied posts Q4 2013 = 100



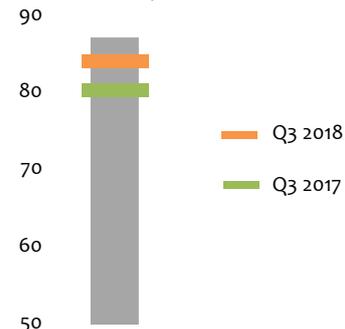
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

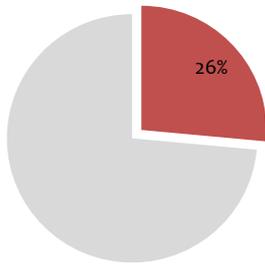


Capacity utilization rate Historically highest and lowest levels, as per cent

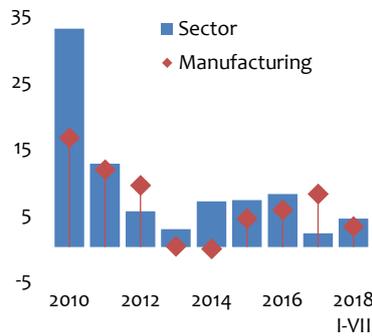


Wood Processing

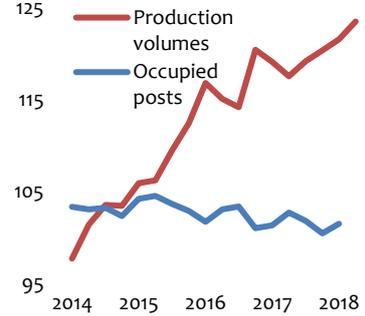
The share of the sector in national economy 2017, as per cent



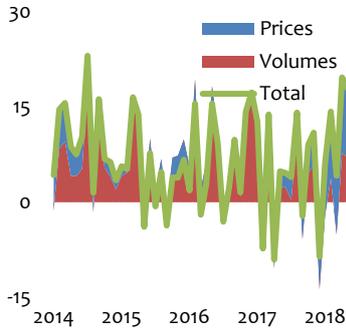
Changes in production volumes as per cent



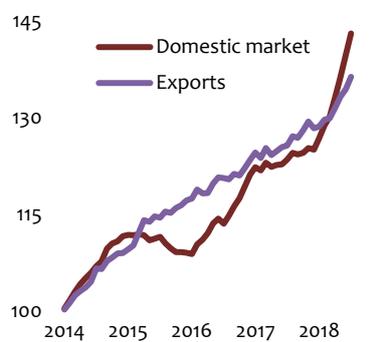
Production volumes and occupied posts Q4 2013 = 100



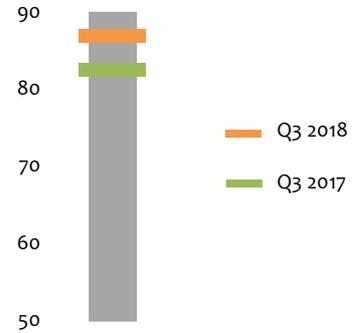
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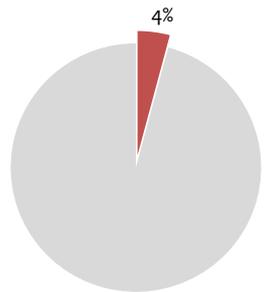


Capacity utilization rate Historically highest and lowest levels, as per cent

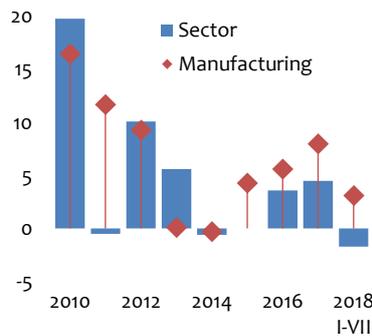


Manufacture of Paper and Paper Products; Printing

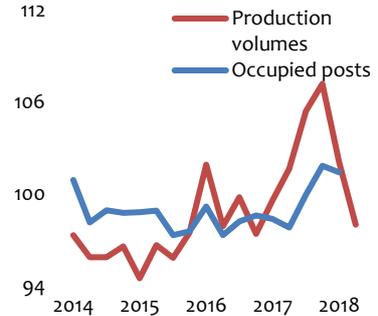
The share of the sector in national economy 2017, as per cent



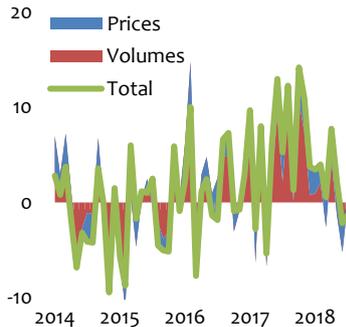
Changes in production volumes as per cent



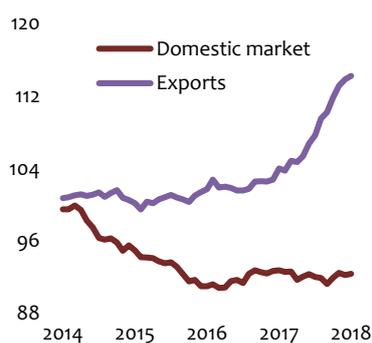
Production volumes and occupied posts Q4 2013 = 100



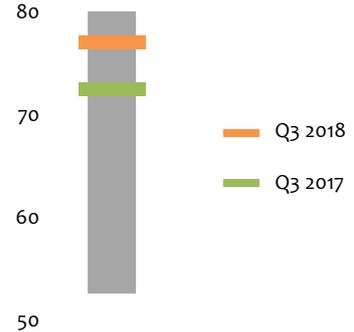
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

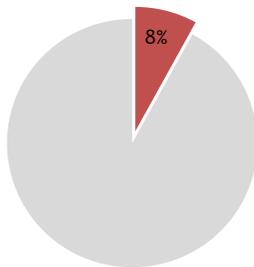


Capacity utilization rate Historically highest and lowest levels, as per cent

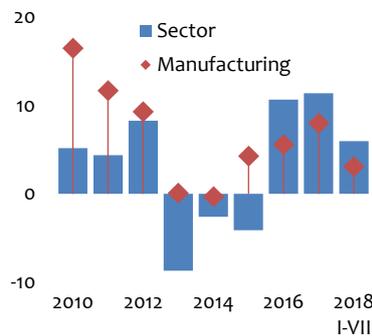


Chemical Industry

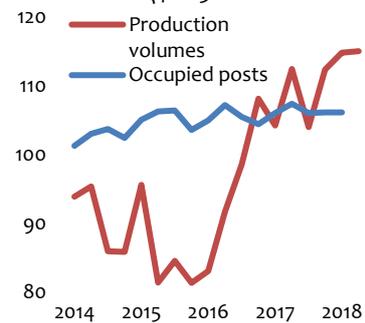
The share of the sector in national economy 2017, as per cent



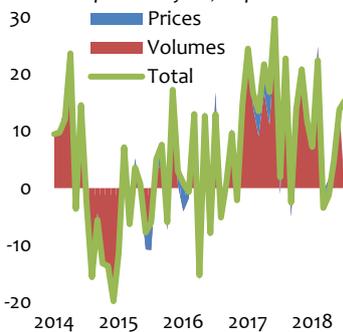
Changes in production volumes as per cent



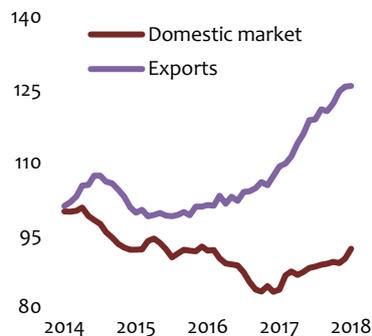
Production volumes and occupied posts Q4 2013 = 100



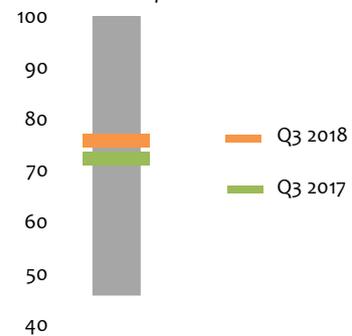
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

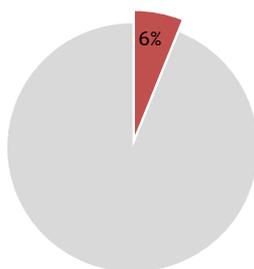


Capacity utilization rate Historically highest and lowest levels, as per cent

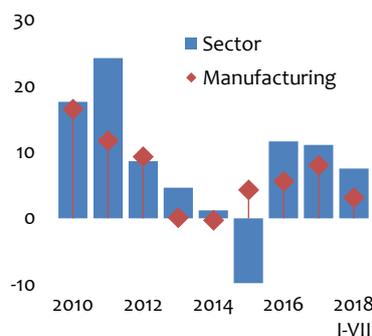


Manufacture of Non-metallic Mineral Products

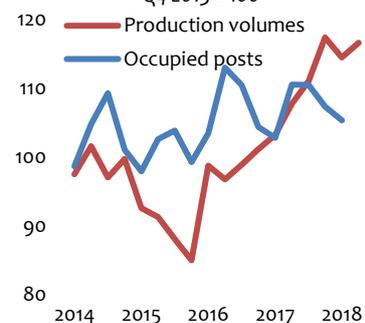
The share of the sector in national economy 2017, as per cent



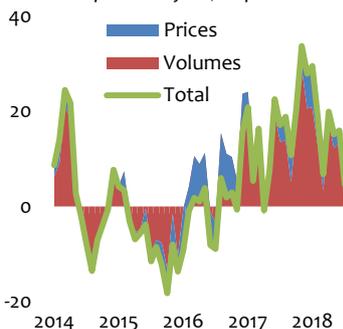
Changes in production volumes as per cent



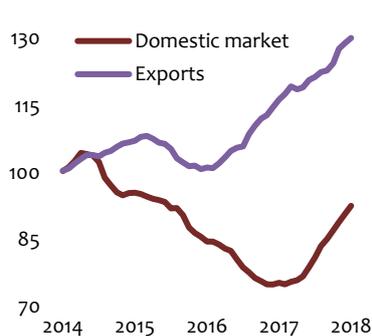
Production volumes and occupied posts Q4 2013 = 100



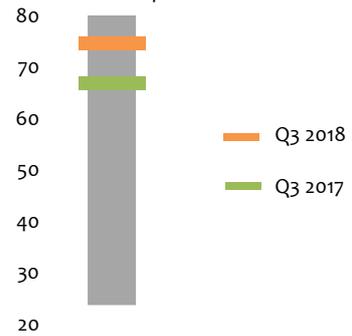
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

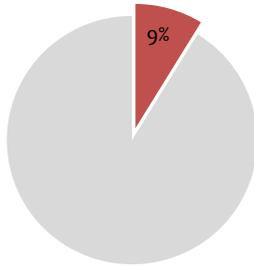


Capacity utilization rate Historically highest and lowest levels, as per cent

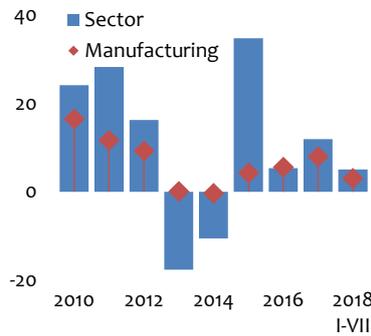


Manufacture of Basic Metals and Metal Products

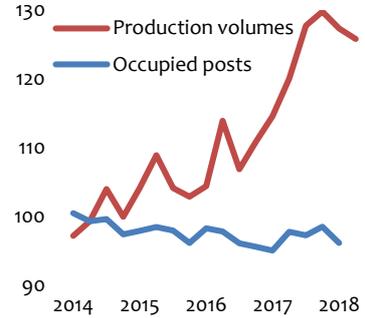
The share of the sector in national economy 2017, as per cent



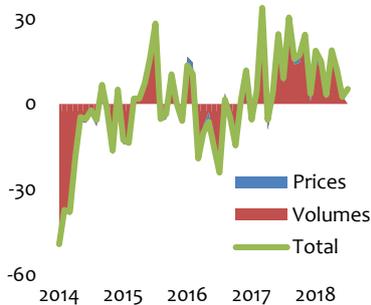
Changes in production volumes as per cent



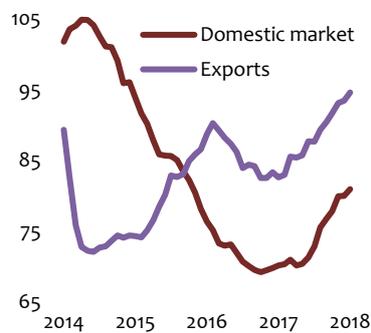
Production volumes and occupied posts Q4 2013 = 100



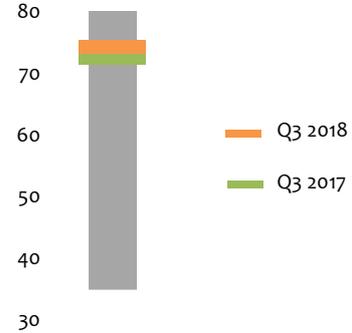
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

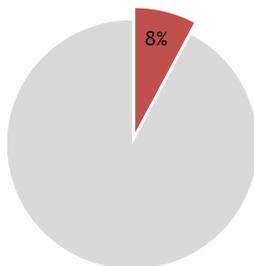


Capacity utilization rate Historically highest and lowest levels, as per cent

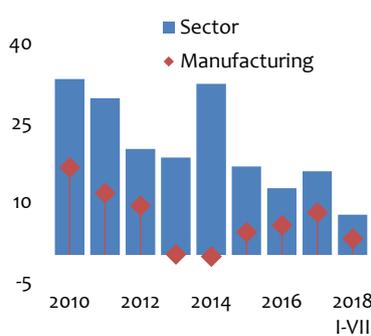


Manufacture of Electrical and Optical Equipment

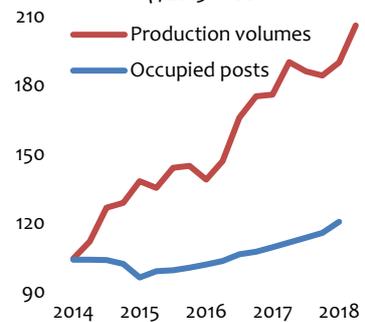
The share of the sector in national economy 2017, as per cent



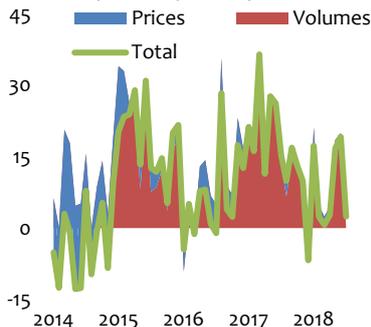
Changes in production volumes as per cent



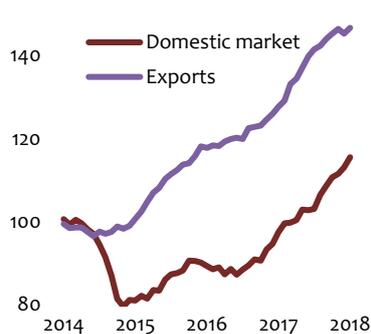
Production volumes and occupied posts Q4 2013 = 100



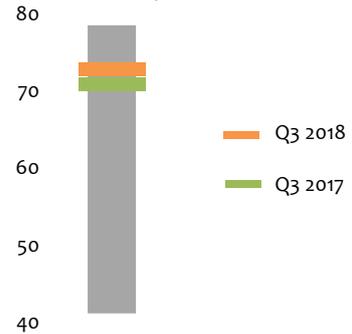
Changes in the sales of production compared to the corresponding period of the previous year, as per cent



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

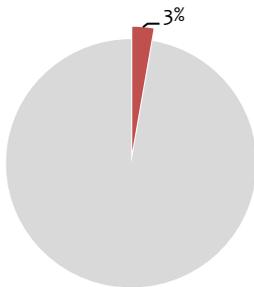


Capacity utilization rate Historically highest and lowest levels, as per cent

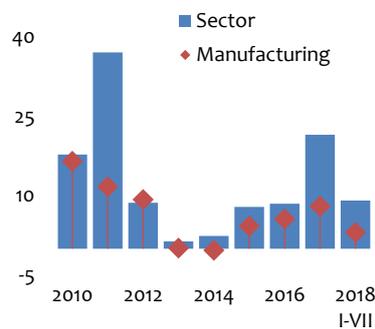


Manufacture of Machinery and Equipment

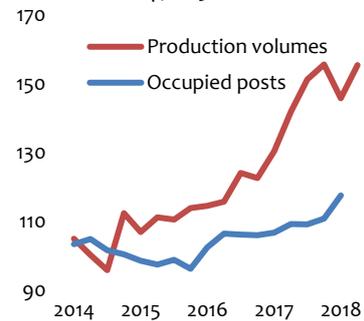
The share of the sector in national economy 2017, as per cent



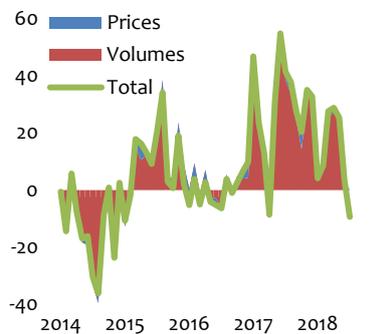
Changes in production volumes as per cent



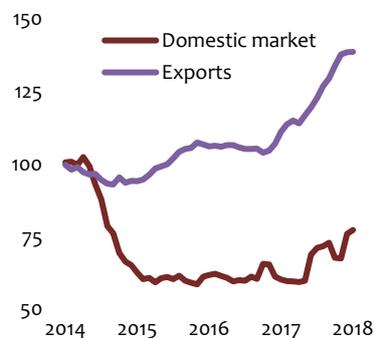
Production volumes and occupied posts Q4 2013 = 100



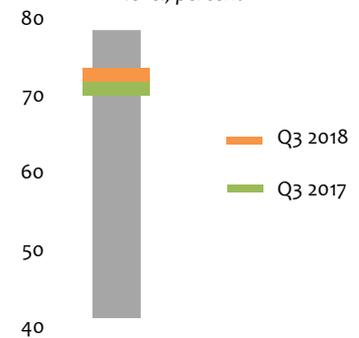
Realization of products, changes against the corresponding period last year



Realization of products Dec 2013 = 100, 12-month moving average

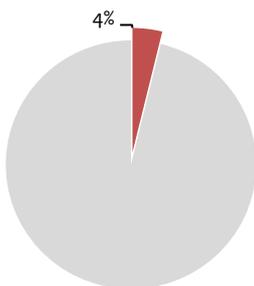


Capacity utilization rate The historically highest and the lowest level, percent

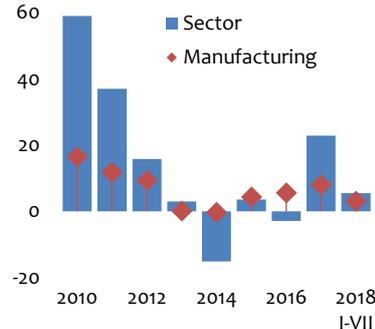


Manufacture of Motor Vehicles

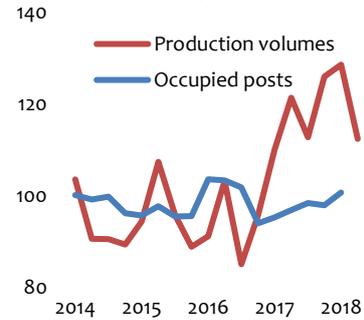
The share of the sector in national economy 2017, as per cent



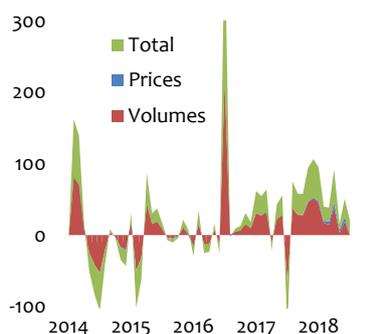
Changes in production volumes as per cent



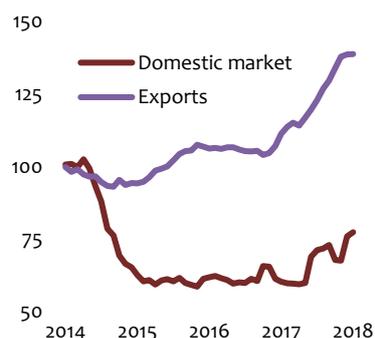
Production volumes and occupied posts Q4 2013 = 100



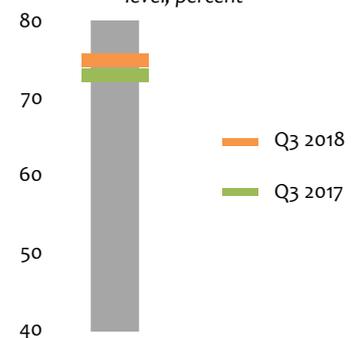
Realization of products, changes against the corresponding period last year



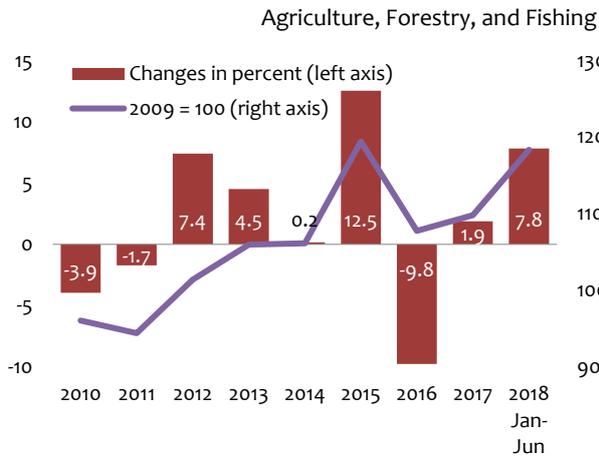
Realization of products Dec 2013 = 100, 12-month moving average



Capacity utilization rate The historically highest and the lowest level, percent



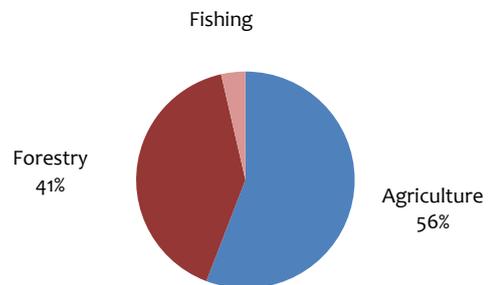
AGRICULTURE, FORESTRY, AND FISHING



In the first half of 2018, the production volumes of the sector due to favorable weather conditions rapidly increased. In the sector, the number of employees significantly declines; however, the number of occupied posts continue to increase, and has currently surpassed the pre-crisis level. This can be explained using different data tracking systems. The number of occupied posts increase due to rising wages. However, as the number of self-employed rises, the number of employees declines. This, in turn, means that the sector is increasingly using hired labour force.

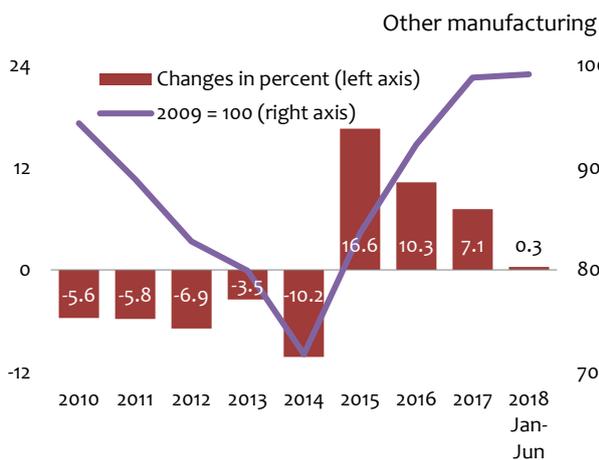
The largest growth can be observed in agriculture and forestry. The activity of the sector is highly dependent on the weather conditions. Thus, the growth of the sector is subject to certain fluctuations. After the substantial growth of agriculture in 2015, which was largely driven by record-high grain yields, in 2016 its production volumes declined. In 2017, however, due to unfavorable weather conditions, which mostly affected the crop production and forestry, the sector experienced only a slight increase in the production volumes.

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



* – Estimate by the Ministry of Economics

OTHER MANUFACTURING

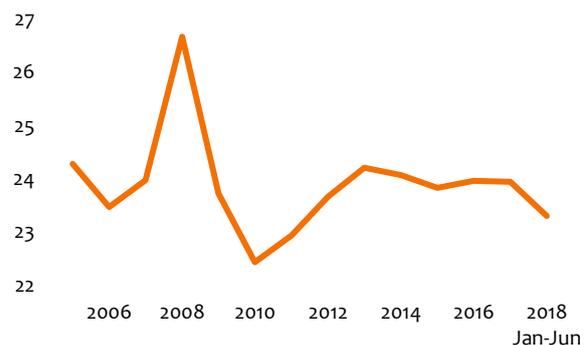


volume dynamics of electricity and gas supply sectors are closely linked to weather conditions. The winter months 2016-2017 in Latvia were considerably colder; therefore, the amount of electricity and heat consumed increased.

Since the global financial crisis, the number of occupied posts in all sub-sectors of other manufacturing has increased. However, in the last years, the number of occupied posts has declined in mining, electricity, and gas supply sectors.

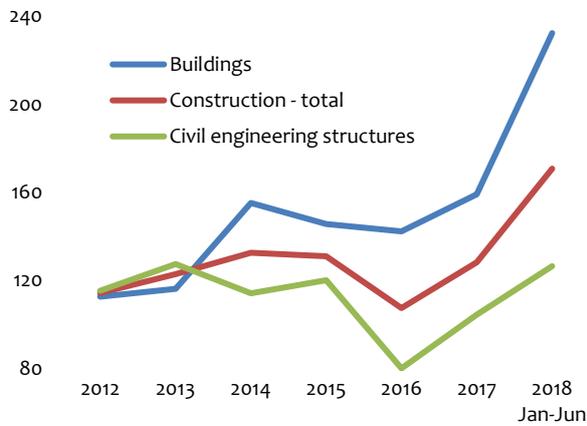
In the sectoral structure of other manufacturing (mining, electricity, gas supply, heat supply and conditioning, water supply, and waste management) the largest contribution yield electricity and gas supply sectors. In recent years, share of mining sector continues to increase gradually. The growth of the sector can mainly be explained by the volume rise in the extraction of peat. The production

Occupied Posts in Other Manufacturing thousands

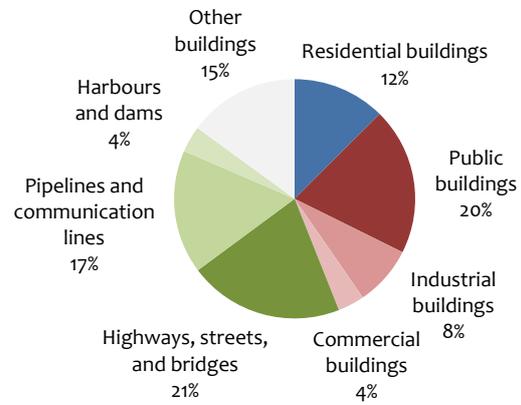


CONSTRUCTION

Development of the Construction Industry
2011 = 100



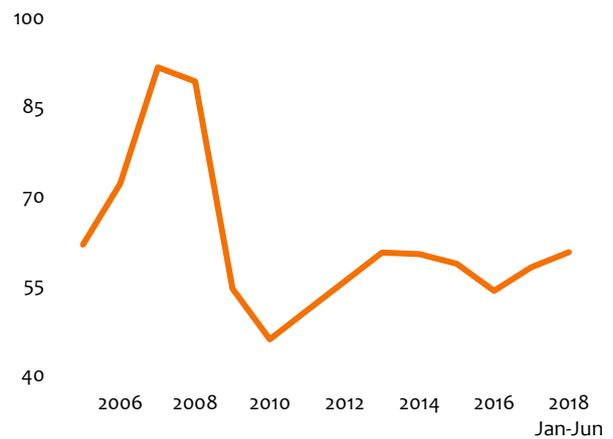
Structure of Construction Industry
2017, as per cent



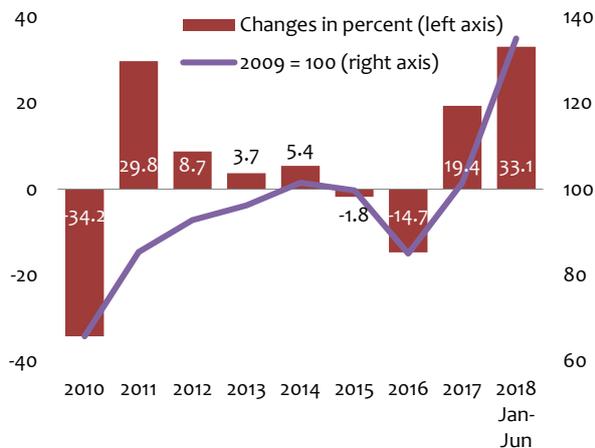
The development of the construction industry to a large extent is linked with public procurements and the EU structural fund projects. In 2017, after a two-year recess, the growth of the construction industry resumed. The growth was mostly stimulated by the initiation and implementation of the EU structural fund projects and private investments.

In 2018, the production volumes continue to rise for both buildings and civil engineering structures. The largest growth, however, is currently observed in the construction of buildings. As the EU structural fund projects and large-scale infrastructure projects will be implemented, it is anticipated that the construction volumes of civil engineering structures will continue to rise also in the upcoming years.

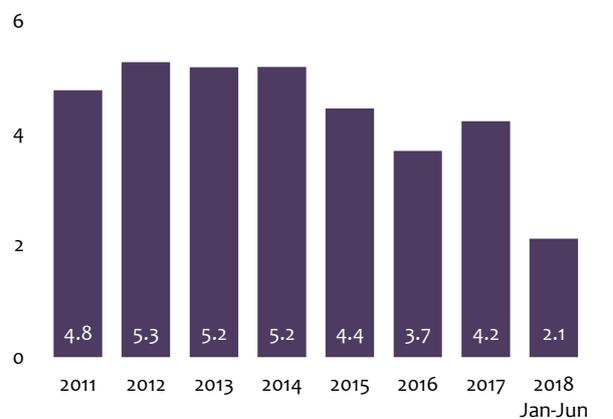
Occupied Posts in Construction
thousands



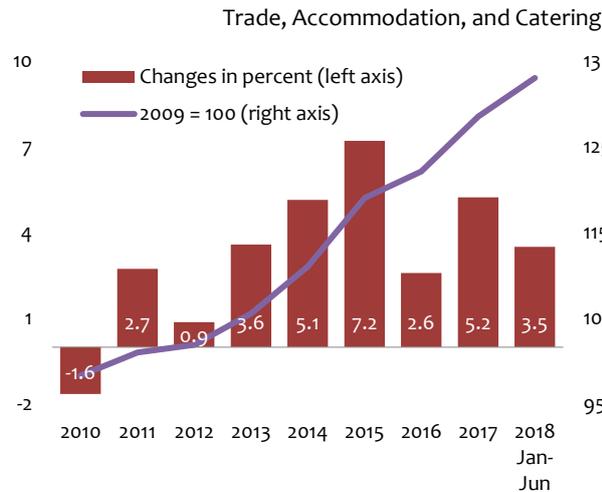
Construction



Number of Building Permits Granted
thousands



TRADE, ACCOMMODATION, AND CATERING

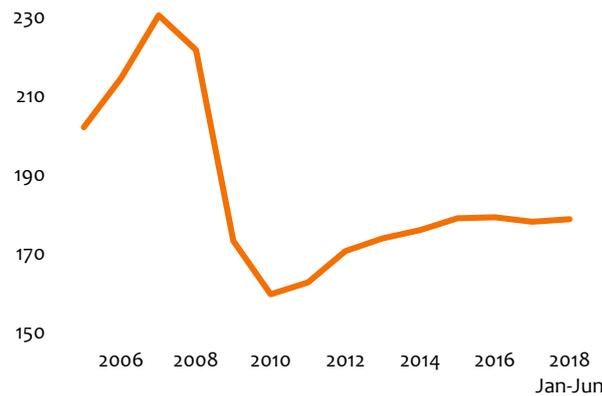


The volumes of services provided in trade, accommodation, and catering continue to increase. Trade industry is positively affected by the rise in private consumption, wage increase, and improvements in the labour market. In the first half of 2018, trade industry grew by 3.2%. In the first seven months of 2018, retail trade turnover increased by 5.1%. The sharpest growth was observed in the sales volumes of automotive fuel. However, wholesale turnover, in comparison with the corresponding period last year, in the first half of 2018 remained practically unchanged.

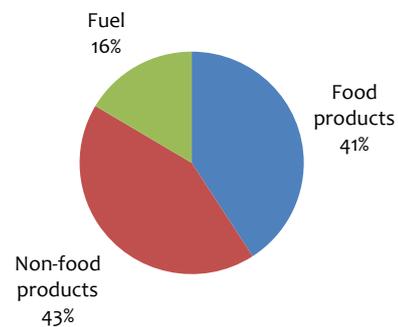
Accommodation and catering sector, in turn, is positively affected by the development of tourism industry. In the first half of 2018, the production volumes of the sector increased by 6.8%.

Currently, the largest share of occupied posts remains in trade industry. However, in recent years, this share has been steadily declining, and the number of occupied posts, in turn, has increased in accommodation and catering sector.

Occupied Posts in Trade, Accommodation, and Catering thousands



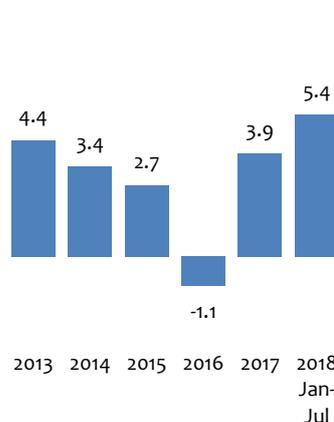
Structure of Retail Trade Turnover 2017, as per cent



Non-food products

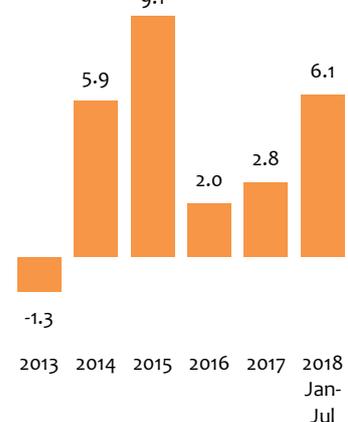


Food products

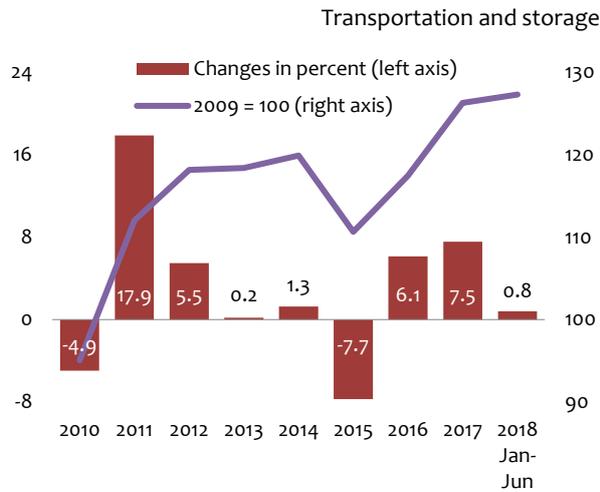


Retail Trade Turnover changes in percent

Automotive fuel



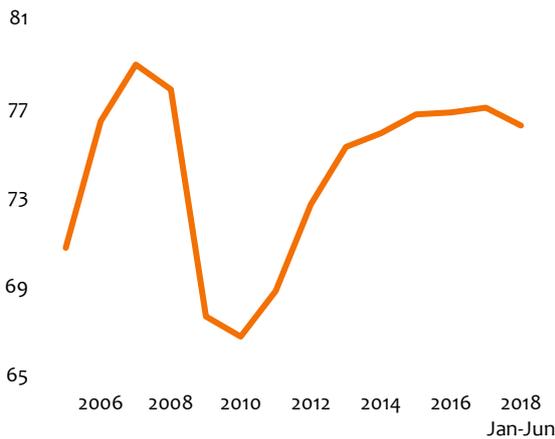
TRANSPORTATION AND STORAGE



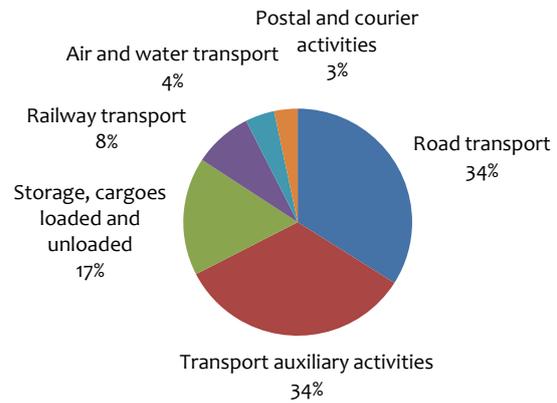
Transportation and storage is closely linked to international freight traffic. From 2012-2017, the industry grew only by 1%. The slight increase can be explained by the decline of goods in transit, which, in turn, was a result of Russia’s transport policy and the increasing competition. Since the end of 1990s, Russia has aspired to develop its own transport infrastructure, thus ensuring its independence from transit countries.

In the first half of 2018, the growth of the industry was determined by the increased passenger traffic in the airport and ports. Passenger traffic and postal and courier activities increased by 14% and 24%, respectively. However, storage and transport auxiliary activities and freight traffic declined by 3% and 1.5%, respectively.

Occupied Posts in Transportation and Storage
thousands



Structure of Transportation and Storage
2017, as per cent



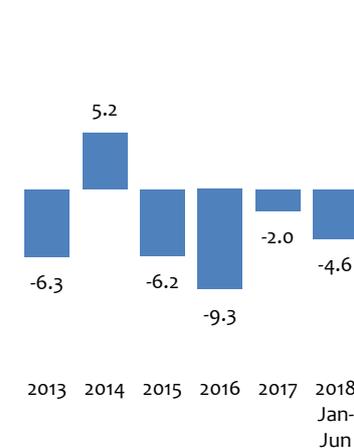
* – Estimate by the Ministry of Economics

Freight Traffic changes as per cent

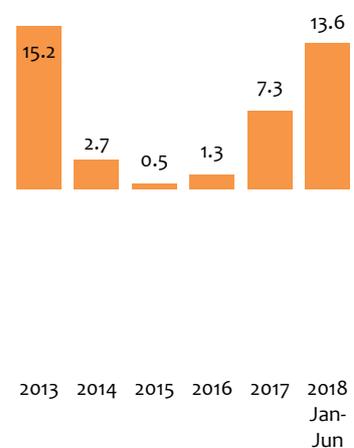
Freight traffic by rail



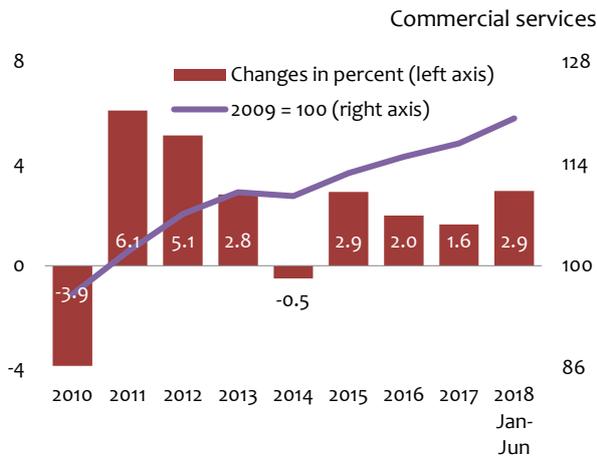
Cargoes loaded and unloaded at ports



Freight traffic by road



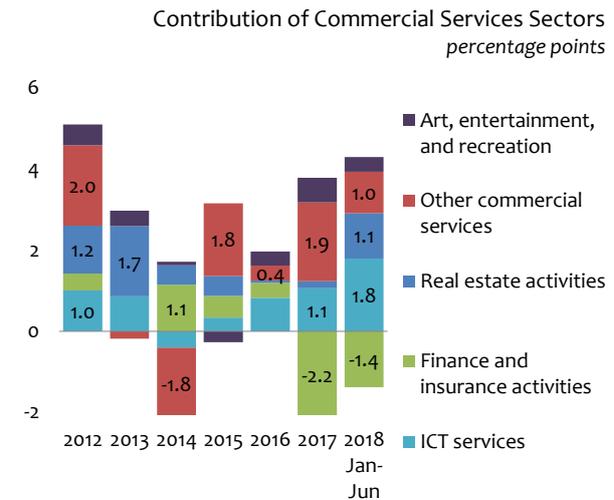
COMMERCIAL SERVICES



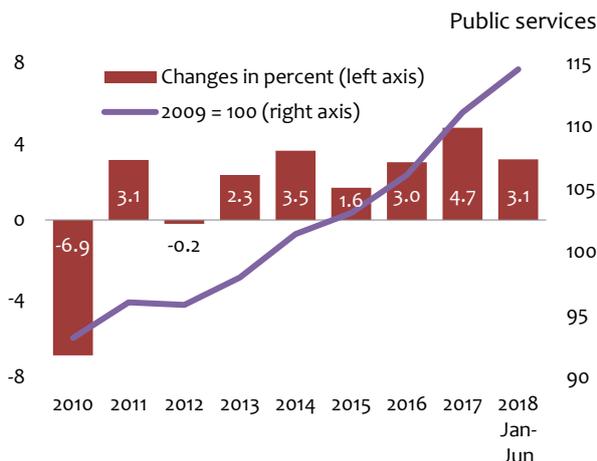
activities. However, the volumes continued to decline in finance and insurance industry. The downward trend could mainly be attributed to the decline of non-resident business volumes in Latvia, mergers of banks, and the decrease in the number of employees.

Currently, the largest share of occupied posts remains in professional, scientific, and technical services, administrative and support service activities, and ICT sectors. Also, the largest increase in the number of occupied posts has been observed in these sectors.

The largest share in commercial services (ICT services, financial and insurance activities, real estate activities, professional, scientific, and technical services, administrative and support service activities, art, entertainment, and recreation) form real estate activities. In the first half of 2018, the volumes of services experienced a larger growth than in the corresponding period last year. The increase was mainly determined by the growth of ICT services, professional, scientific, and technical services, and administrative and support service

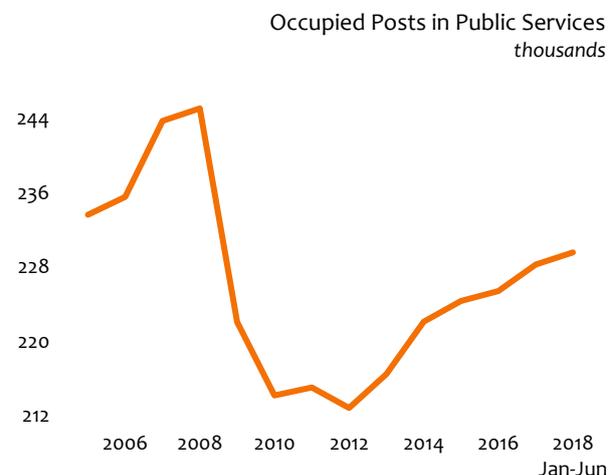


PUBLIC SERVICES



largest growth since 2006 was experienced. The largest share of occupied posts remains in education. However, in public administration and health and social care sectors the share of occupied posts is similar. The sharpest rise in the number of occupied posts in recent years can be observed in health and social care. The increase in public administration and education, in turn, has remained stable.

The largest growth in commercial services sectoral structure (public administration and defence, education, health and social care) was observed in public administration and defence. Since 2013, along with an increase in public expenditure, a stable growth has been observed in commercial services sub-sectors. In 2017, the



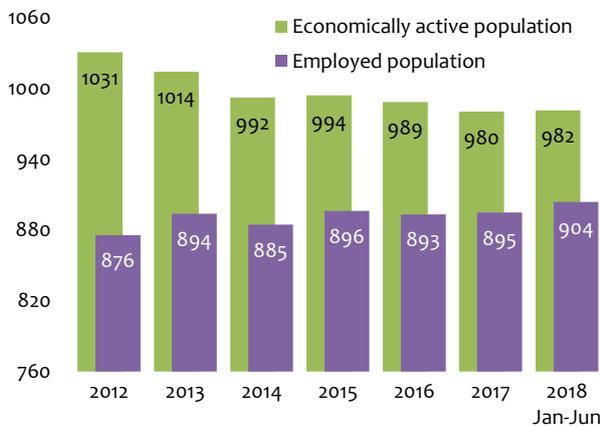
2018 | 2 LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

In 2018 unemployment keeps dropping, but average gross salary in the 2 quarter is over exceeded 1000-euro border. Strong incentive on labor market demand remained from the side of construction industry. As well significant work place increase is seen in ICT services. In the same time, despite the negative demographical aspect, increase in economical activeness positively affects labor supply dynamics.

Increase in economical activeness pushes labor demand up. Taken work places by number in first half of 2018 increased by 1.2%, but number of employed – by 1.9% or 16,7 thous. if compared with corresponding period of 2017, which is the steepest labor demand increase from middle of 2015. Increase of work places was mainly driven by increase in labor demand in construction industry. Overall in first half of 2018 903,8 thous. were employed in age range from 15 till 74.

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

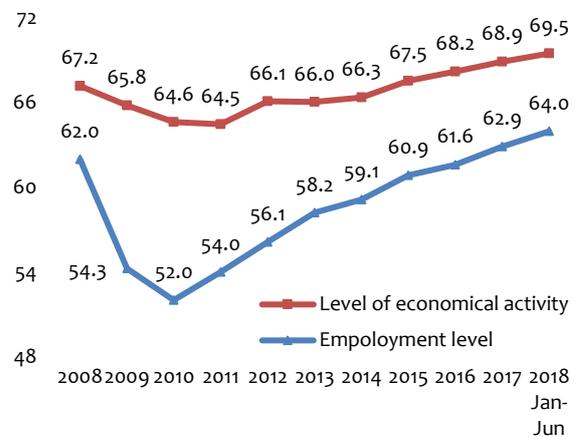


At the same time the number of employed is still lower than before crisis level, even though proportion of employed in the population in the first half of 2018 was by 3.7 percentage points higher than in first half of 2007. Employment level in 2017 has reached historically highest mark – 62.9%, which points at the fact that low basis effect in labor market has disappeared and further inhabitant engagement in employment will become more complicated.

The most important limitation for increase in employed is the negative demographical situation. Increase in

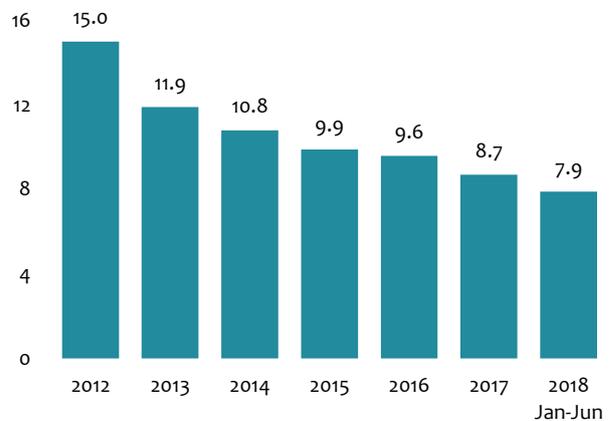
employment level mainly is driven by decrease in the number of workable people versus the dynamics of employed. In the first half of 2018 the number of people in age range from 15 till 74 was by almost 15.4 thous. or 1.1% smaller than before year.

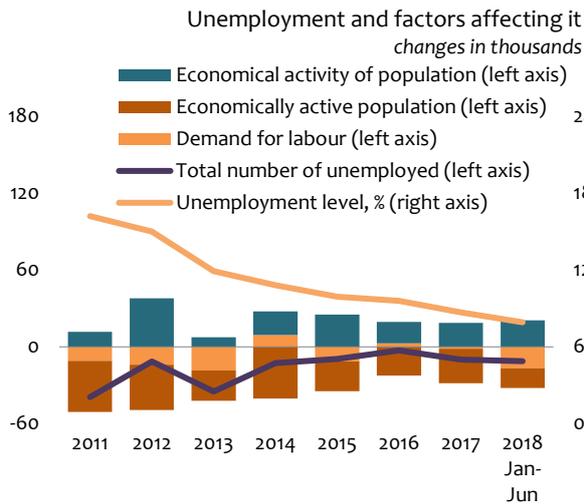
Level of Participation and Employment Rates aged 15-74, as per cent



In 2018 first half **unemployment level decreased** till 7.9%, which was by 1.2 percentage points smaller than in first half of 2017. Overall in first half of 2018 in search of job was 77.7 thous. people, which was by 11.3 thous. less than in 2017 relevant period.

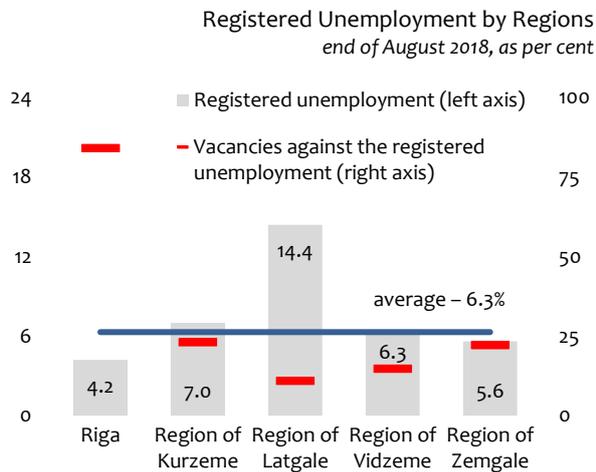
Unemployment Rate aged 15-74, as per cent





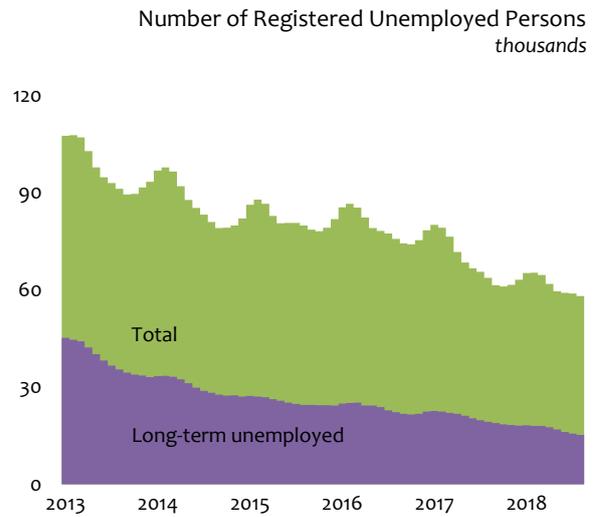
Unemployment drop in first half of 2018 mainly was driven by the increasing labor demand, in result more and more job seekers were involved in employment. In addition to demand factors also relevant for unemployment dynamics was the demographical tendencies – drop in number of workable people and changes in populations age structure.

Even though unemployment level in last six years has dropped more than by half, it is still higher than in neighboring countries: in Estonia unemployment in second quarter 2018 was 5.1%, but Lithuania – 5.9%. Unemployment steeper drop still is delayed by regional differences – unemployment level in region of Latgale is still more than three times higher than in Riga.



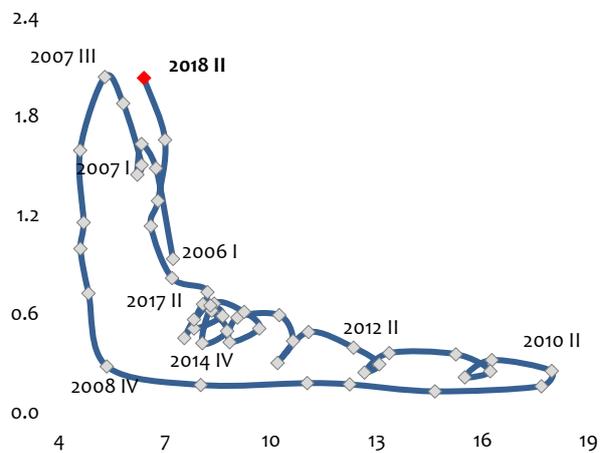
Even though the current uneven distribution of labor and vacancies is one of the seen labor market structural risks, it is not the only one. Risks exists also due to huge share of longterm jobless people – still more than 1/4 from registered job seekers are without job more than year. Need to consider that big lonterm unemployment may create structural unemployment increase, in other words, if people are long time without job, they might lose their

skills and speciality. Also, there is a risk that people will be not able to find a job in near future which would correlate with their skills, because it might not overlap with market demand.



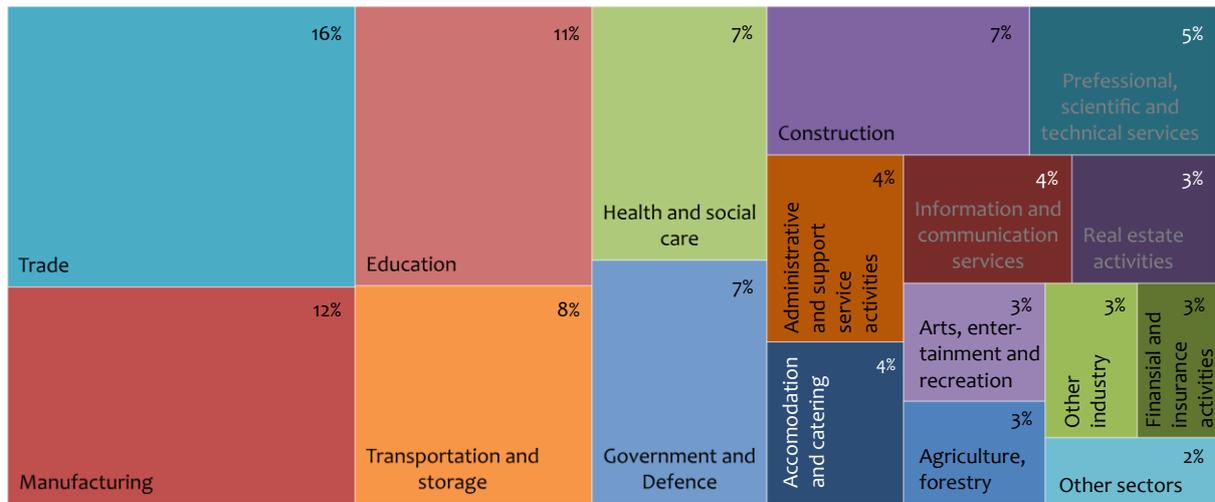
Should be noted that on labor market structural problems point out also Beveridge curve shift to the right – despite the increase in number of vacancies, job seekers share in labor market remains high.

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



Steepest increase in workplaces is seen in construction industry and ICT services. More than 2/3 from total taken workplace increase in 2018 first part provided two industries – construction and ICT services. Taken number of workplaces in construction increased by 6.4% in first half of 2018, comparing with first part of 2017. In second quarter of 2018 the number of taken workplaces in this industry reached 63.3 thousand.

Structure of Occupied Posts by Sector
2017, as per cent



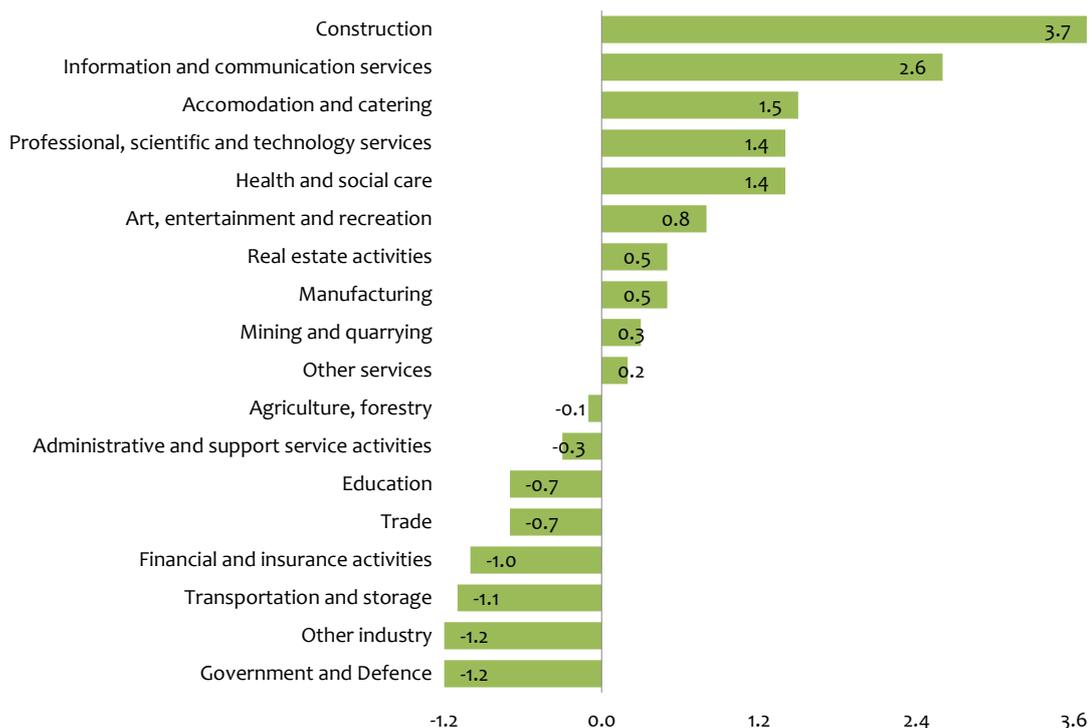
Also, important employment demand increase is seen in ICT services, where number of taken workplaces in 2018 second quarter has risen by 2.6 thousand. Mainly this number have been increasing due to upward sloping labor demand in computer programming and information technology services.

At the same time biggest decrease in the taken workplaces has been in government and other manufacturing industries.

Number of workplaces keeps increasing in private sector. After decrease in crisis period by 30% from 2010 number of workplaces in private sector has increased by almost one fourth.

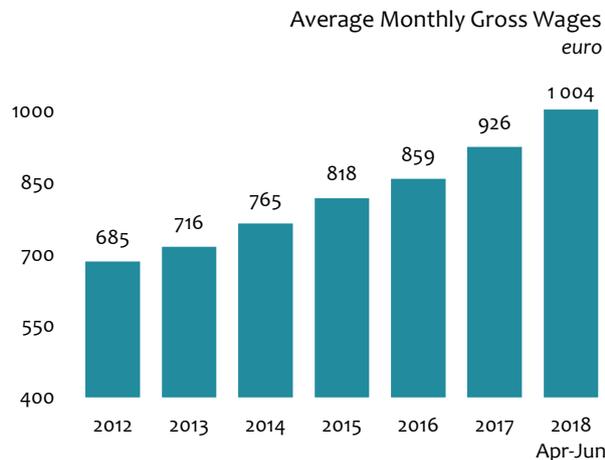
At the same time, comparatively slow workplace increase has been in public sector, where occupied posts in this period have went up by only 2%. Steeper increase in public sector was in 2014, when it increased by 1.5% comparing with 2013.

Changes in Occupied posts by Industries
2017, changes in thousands

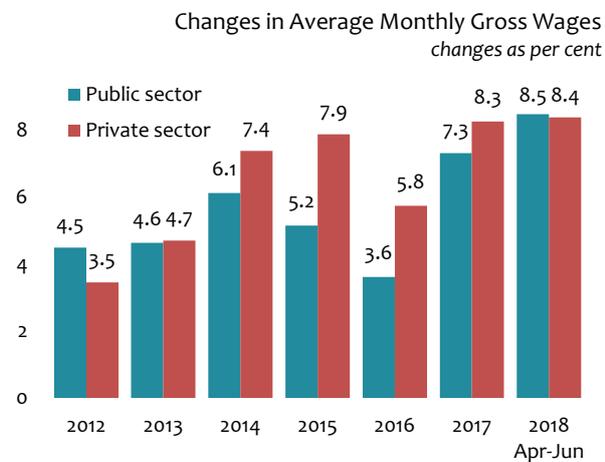


WAGES AND SALARIES

Together with recovery of activity in labor market from end of 2010 the increase in salaries has come back. Although unemployment remains comparatively high, in economically active regions more and more sensible is the lack of working hands, what keeps pressure on the wages.



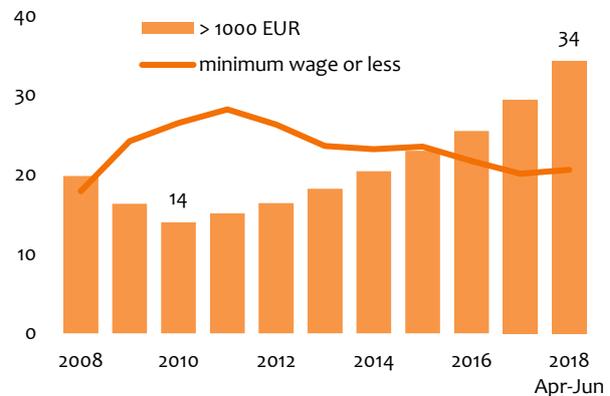
Working wage increase in last four years remains above 5% a year. Average gross salary in first half of 2018 increased by 8.6% in the second quarter exceeding 1000-euro benchmark.



Since 2010 wage has risen in private as well as in public sector. At the same time increase in private sector in the last years has been much steeper. It is largely correlated with the different dynamics of labour demand across different sectors. In private sector number of occupied jobs from 2011 has risen by almost 17%, but in public sector – just by 1.2%.

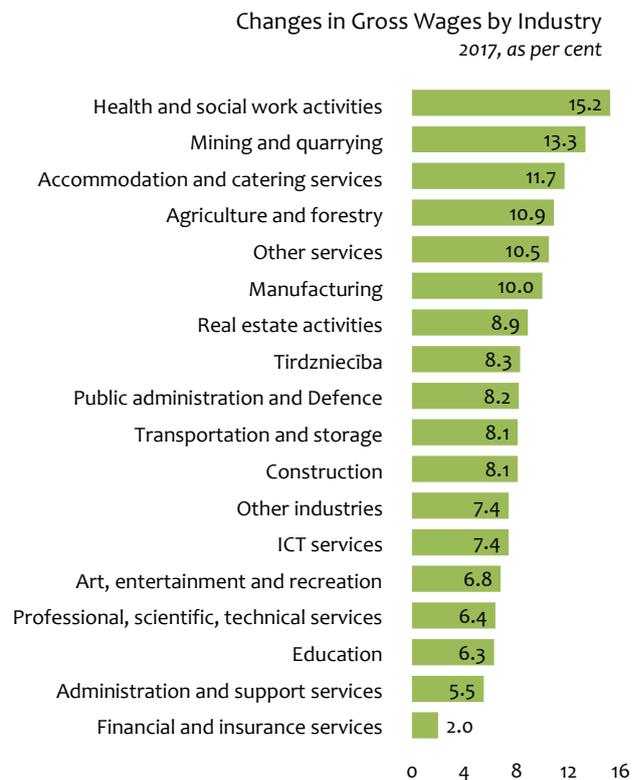
In 2018 year's, budget more than 90 million euro were redirected for salary increase for medical staff. Therefore, in this in health and social care field in 2018 second quarter, comparing with second quarter of 2017, average gross salary increased by more than 15%.

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



In the last years gradually decreases the number of people who gets minimal salary. In the same time increases number of employees who get salary higher than 1000 euro a month. In second quarter of 2018 there was around 1/3 of all employed with such salary.

In second quarter this year salary increased in all key sectors of the economy, but they had different dynamics. Steepest salary increase was observed in health and social work activities, which was followed by mining industry and accommodation and catering industry. Slowest wage increase was seen in finance sector – in second quarter of 2018 the increase was only by 2%.



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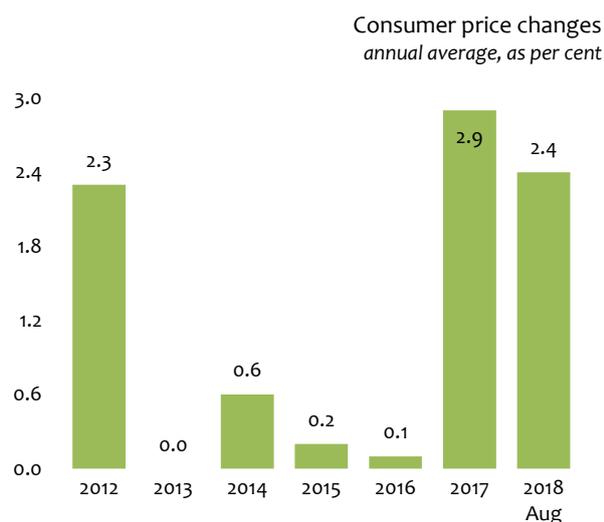
2018 | 2

ECONOMICAL STABILITY AND COMPETITIVENESS

PRICES

In 2017, one of the highest price increases in recent years was observed. Consumer prices rose by 2.2% and annual average inflation increased by 2.9%. Consumer price level was mainly affected by rising world prices for food and oil. The price increase for services also significantly impacted the overall consumer price level.

In the first eight months of 2018, the price increase was higher than in the corresponding period last year. In August 2018, consumer prices, in comparison with December 2017, increased by 1.7%. When compared to August 2017, consumer prices rose by 2.8%. Average annual inflation in August was 2.4%.

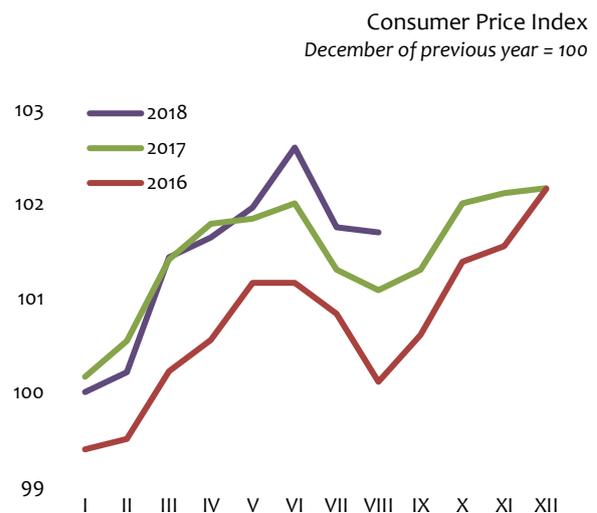


(3) the price increase for alcoholic beverages due to increased excise tax rate;

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

(5) the price decline for food (mostly for vegetables, which in part was influenced by the reduction of VAT since January 1, 2017. World prices for food decreased by 1%. Prices declined for sugar, vegetable oils, and meat; however, an increase was observed for dairy products and cereals;

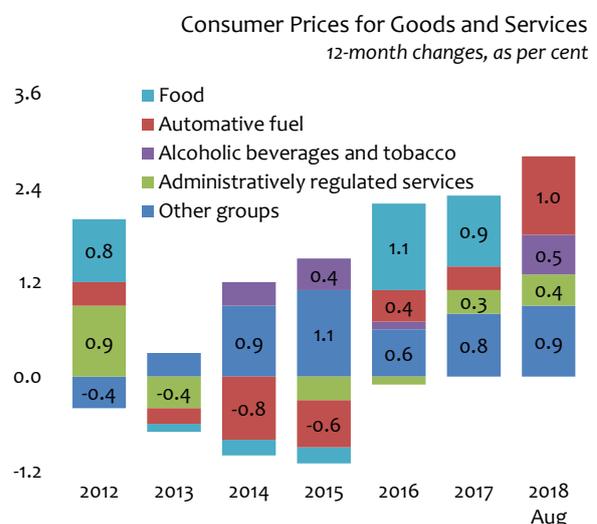
(6) the fall in prices for clothing and footwear.



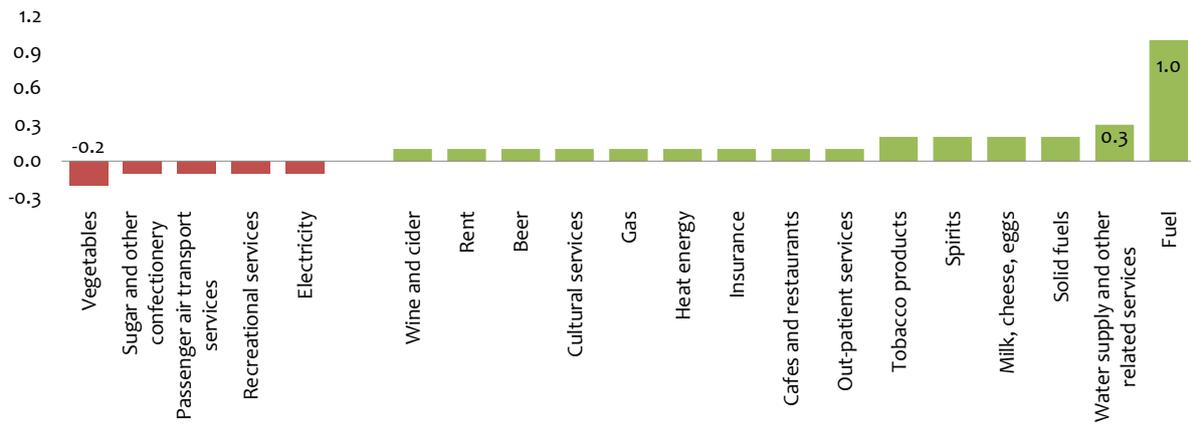
The main factors affecting the price level in the first eight months of 2018:

(1) the greatest impact on the average consumer price level was caused by the price increase for services – the largest price rise was observed for housing-related services (rent, water supply, and waste collection (due to the increase of natural resources tax rate)), catering, health and social care, and recreation and culture;

(2) the price rise for automotive fuel, excise tax increase, and rising world prices for oil. Overall, world prices for oil in the first eight months of 2018 on average increased by 12.5%. This increase can mainly be explained by the preservation of oil production limits and the increased demand for oil due to several geopolitical events and growing trade tensions;



Goods and Services with The Largest Impact on Consumer Price Changes
12-month changes, August 2018, percentage points



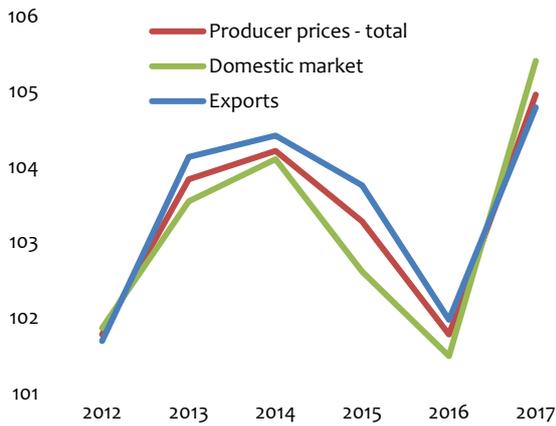
Overall, the average annual inflation will remain similar to the level observed in 2017. Inflation rate was affected by several supply-side factors mainly related to the increase in taxes. Also, it was influenced by the demand-side, which, in turn, was stimulated by an increased overall activity and the rise in wages. At the same time, inflation to a large extent is highly dependant on the fluctuations of world prices for oil and food.

In 2017, producer prices experienced a significant increase. In fact, the largest growth since 2011 was observed for producer prices in manufacturing.

In the first seven months, the most significant impact on consumer price increase had wood processing. However, the largest downward effect on consumer prices had the manufacture of electrical equipment.

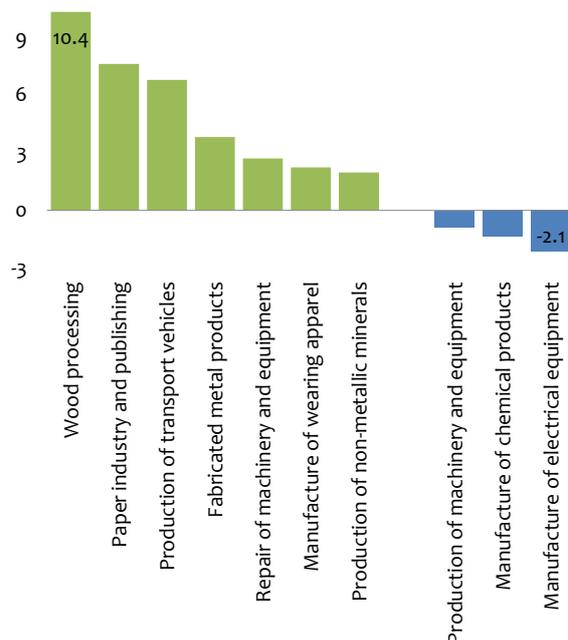
In 2018, producer prices in manufacturing are expected to increase similarly as in 2017. Producer price level to a large extent will be influenced by the fluctuations of producer prices for specifically exported products, which, in turn, are driven by the dynamics of world commodity prices. It should be noted that in the first half of 2017 and 2018 world energy and commodity prices increased. At the same time, the growth of producer prices in domestic market is affected by the increased overall economic activity.

Producer Prices in Manufacturing
2011 = 100



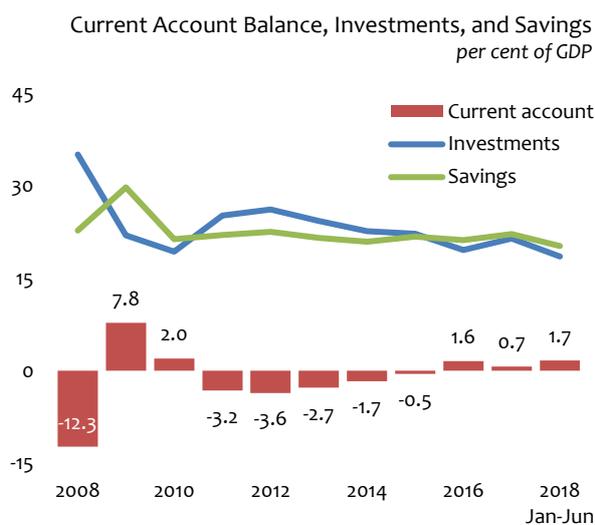
In 2018, a rapid growth of producer prices can be observed. In the first seven months of 2018, the price increase has been larger than in 2017. In the first seven months of 2018, producer prices in manufacturing increased by 3%. Overall, in January-July, producer prices in domestic market grew by 2.8%. However, producer prices for the exported production increased by 3.1%.

The Largest Producer Price Changes in Manufacturing Sub-sectors at July 2018 against the corresponding period of previous year, as per cent

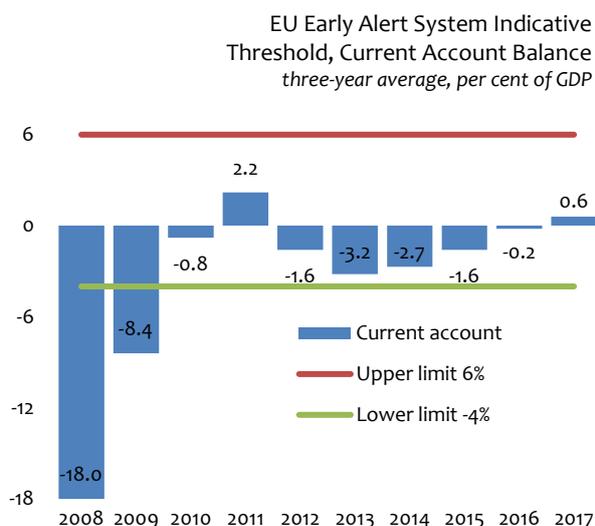


BALANCE OF PAYMENTS

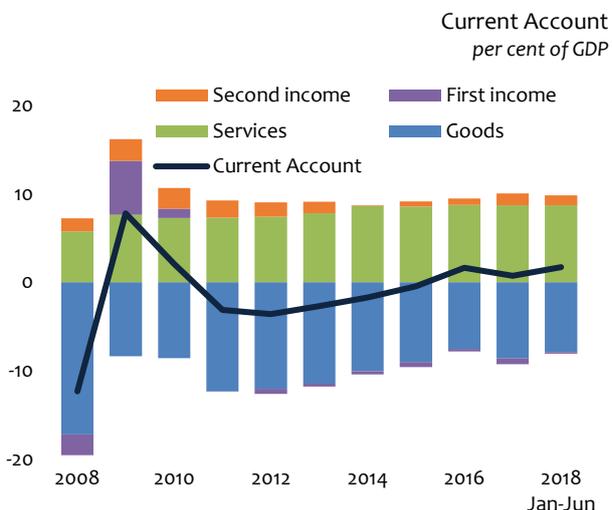
Since 2016, the current account is close to the balance. In the last three years (2015-2017), the current account has on average had an annual surplus of 0.6% of GDP. Since 2010, the current account balance is below the indicative threshold set by the EU Early Alert System and thus is considered to be sustainable. In 2017, the current account surplus was 0.7% of GDP. However, in the first half of 2018, the surplus reached 1.7% of GDP, which is an indicator of larger savings and balanced domestic investments.



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



In the last three years, the foreign trade deficit on average was 8.4% of GDP. In 2017, it reached 8.6% of GDP. However, in the first half of 2018, it amounted to 7.9% of GDP and was by almost 1.5 percentage points lower than a year ago.



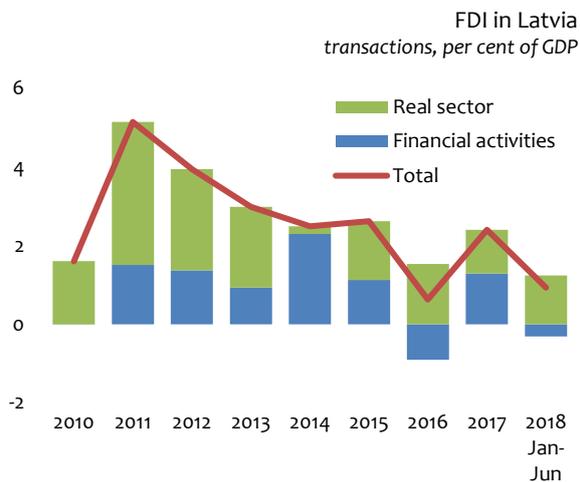
Currently, the service balance is positive – in the last three years, it has on average been 8.6% of GDP, and by almost 90% has covered the foreign trade deficit. In the first half of 2018, exports and imports of services at current prices were by 6.1% and 8.5% higher than a year ago. The balance of services surplus reached 8.7% of GDP (in the first half of 2017, it amounted to 9.1% of GDP). The decrease in the balance of services surplus to a large extent was influenced by the increase in imports of transport services.

Changes in income and capital account are closely related with the changes in the EU structural fund utilization activities. In the last three years, the capital account surplus on average amounted to 1.5% of GDP. In 2017, the surplus was 0.8% of GDP. However, in the first half of 2018, the capital account showed only a small surplus of 0.1% of GDP.

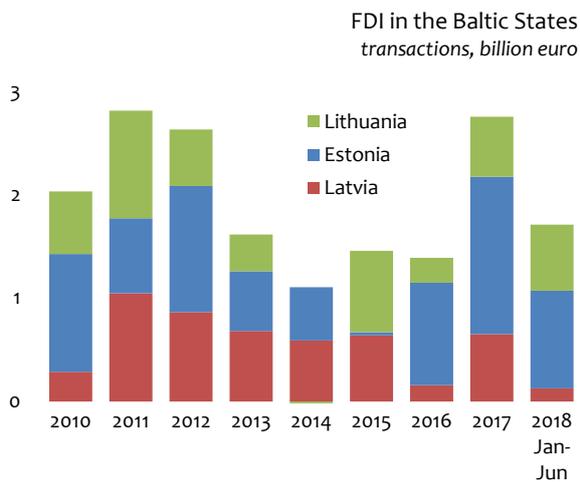
In recent years, the status of financial account balance was mainly influenced by the public sector, particularly by financial sector stabilization measures and the Bank of Latvia's restructuring of public debt under the extended asset acquisition program. Fluctuations in the financial account balance were also affected by the decline of non-resident deposits in Latvian credit institutions. In 2017, the assets of the financial account increased less than the total liabilities. Thus, the financial account balance (without reserve assets) was a negative 2% of GDP. However, in the first half of 2018, the financial account balance was a positive 7.1% of GDP.

FOREIGN DIRECT INVESTMENT

FDI flows in the Latvian economy continue to increase; however, remain below the pre-crisis level. In the last three years (2015-2017), the attracted foreign direct investment in Latvia has been lower than in the years of rapid economic development, which mostly can be explained by the instability in the world economy, growing geopolitical risks, and increased political uncertainty.



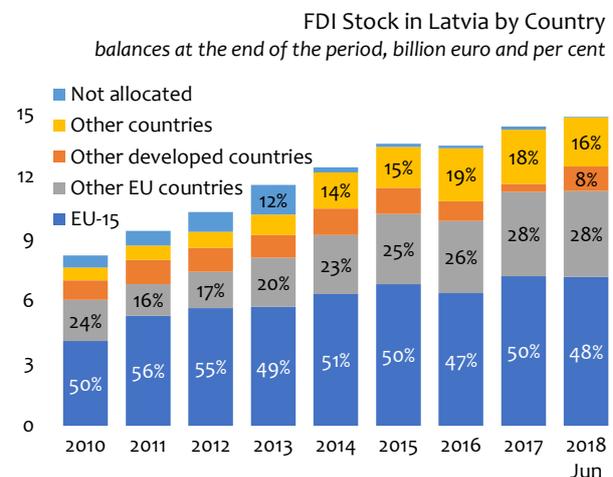
In 2017, compared to 2016, the volume of attracted FDI significantly increased, reaching 2.4% of GDP. In the Baltic States, total net FDI inflow in 2017 was 2,063 million euros, which, in fact, by almost 3 times exceeds the total net inflow a year ago. Latvia attracted 34.3% of the total FDI in the Baltic States. However, Estonia and Lithuania attracted 37.3% and 28.3% of FDI, respectively.



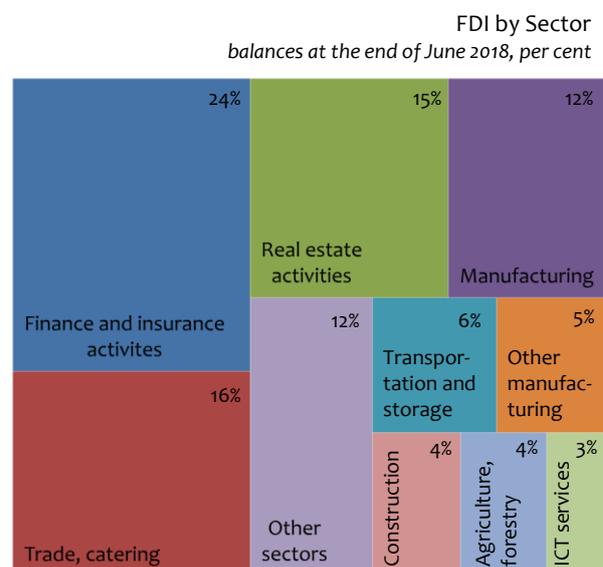
In 2018, the attracted foreign direct investment flows are quite volatile. In the first quarter of 2018, FDI inflow in the Latvian economy reached 105 million euros, maintaining the average quarterly investment level of the previous period. However, in the second quarter of 2018, FDI inflow amounted to only 23 million euros (almost by 6 times lower than in the corresponding period last year). Overall,

the volume of attracted FDI in the first half of 2018 is two times lower than a year ago.

At the end of June 2018, the accumulated FDI in the Latvian economy amounted to 14.8 billion euros (54.5 % of GDP). During the year, the accumulated FDI increased by 5.2%. Currently, the largest investor in the Latvian economy is Sweden. At the end of June 2018, Swedish entrepreneurs' investments accounted for 19.2% of the total accumulated FDI in Latvia. Mostly these include investments in financial intermediation. Investors from the Netherlands, Cyprus, Germany, Norway, Russia, Estonia, Lithuania, Denmark, and Luxembourg also form large share of the total accumulated FDI in Latvia. At the end of June 2018, these country investments accounted for almost 80% of the total accumulated FDI in Latvia.

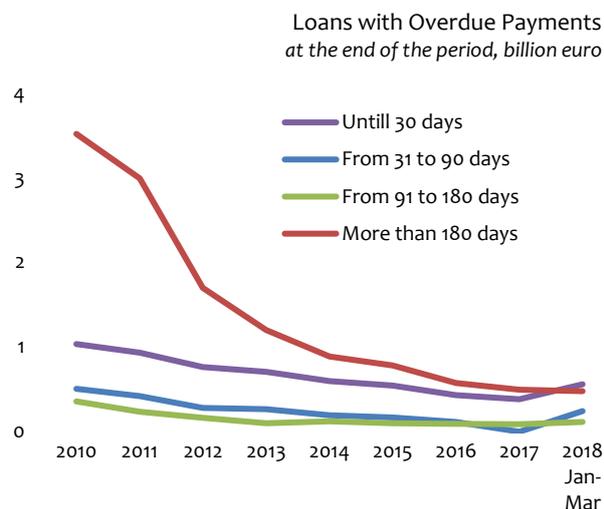


In the sectoral structure, the share of accumulated FDI is higher for investments in financial intermediation (24% of total accumulated FDI), trade (16%), real estate activities (15%), and manufacturing (12%).

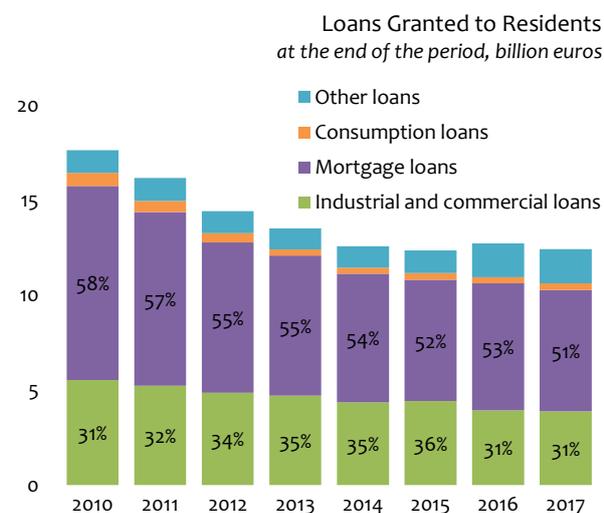


MONETARY INDICATORS

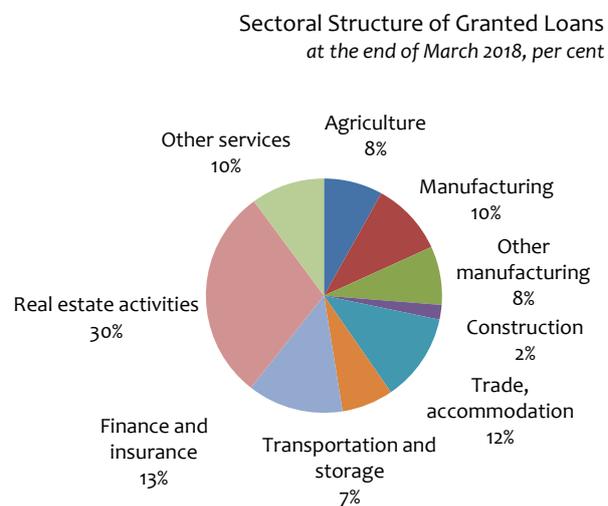
After the 2008 global financial crisis, the monetary indicators of Latvia gradually started to stabilize. In recent years, lending has become moderate. Positive trends in lending to companies can be observed. Significant steps have been taken to strengthen the capital of credit institutions.



Although the total loan portfolio of the banks in the first quarter of 2018 continued to shrink, the volumes of new loans granted to companies increased and positive trends were also observed in household lending. In the first quarter of 2018, the volumes of new loans issued to companies were by 35% higher than in the corresponding period last year. Lending to companies to a large extent is affected by the availability of the EU structural funds. The volumes of new loans issued to households in the first quarter of 2018 increased by 5.6%, when compared to the corresponding period last year.

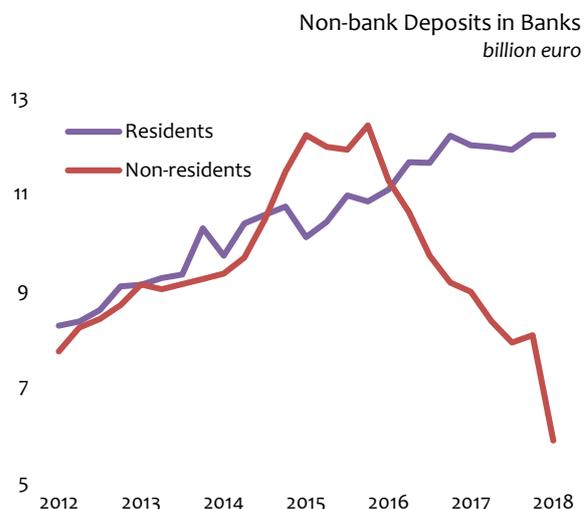


In the first quarter of 2018, the largest share of credits was granted to real estate activities (30% of all the loans granted), finance and insurance activities (13%), trade and catering (12%), and manufacturing (10%).



Since 2016, the interest rates on loans granted to non-financial corporations in euro (outstanding amounts) are relatively stable – in July 2018 for long-term loans the interest rates slightly declined and reached 2.28%. However, for short-term loans the interest rates increased to 2.93%.

In 2018, the volumes of deposits continue to decline. The decline can mainly be explained by the decrease of non-resident deposits. In the first quarter of 2018, the volumes of non-resident deposits were by 1/3 lower than a year ago and constituted 32% of all the deposits (for a comparison, in the first quarter of 2016 the share was 50%). Banks working with non-resident deposits are subject to higher claims on liquidity and capital adequacy.



GENERAL BUDGET AND GOVERNMENT DEBT

Since 2011, when Latvia returned to economic growth, significant improvements in the fiscal position have been achieved. The general government budget deficit in accordance with the European System of Accounts has been reduced from 9.1% of GDP in 2009 to approximately 1-1.8% of GDP in 2012-2015. In 2016, for the first time since 1998, the budget had a surplus of 0.1% of GDP. In 2017, however, a small budget deficit of 148.2 million euros, or 0.5% of GDP, was observed. A budget deficit in 2016 was in both central and local government budgets. A surplus was obtained in the 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.

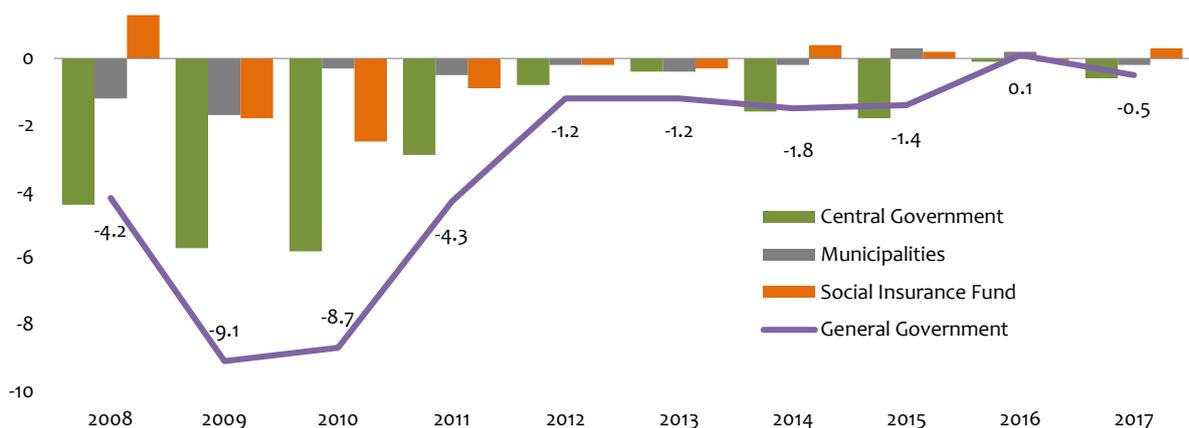
A medium-term budgetary framework estimates that the general government budget deficit in 2018, 2019, and

2020 will be 1%, 0.9%, and 0.4% of GDP, respectively. In 2018 and 2020, a fiscal margin of 0.1% of GDP is planned. In the first quarter of 2018, the general government budget surplus was 260 million euros, or 4.1% of GDP, which is significantly more than in the corresponding period last year.

General Government Budget

	2013	2014	2015	2016	2017
Revenues, bln euro	8,3	8,6	9,0	9,3	10,1
% of GDP	36,6	36,6	36,9	37,0	37,2
Expenditures, bln euro	8,6	9,1	9,3	9,3	10,2
% of GDP	37,7	38,4	38,2	37,01	37,7
Balance, bln euro	-0,3	-0,4	-0,3	0,02	-0,1
% of GDP	-1,2	-1,8	-1,4	0,1	-0,5

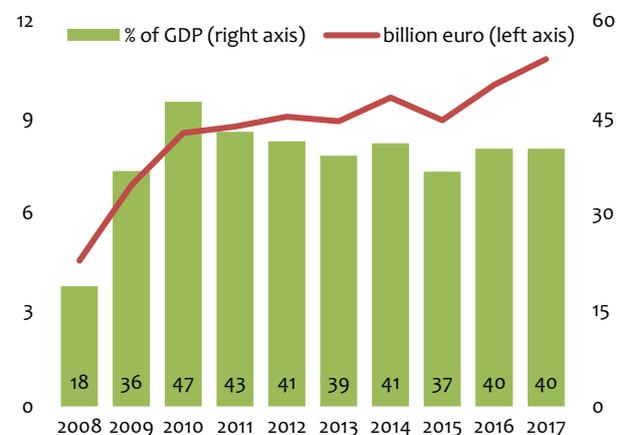
General Government Budget Balance by Sub-sector
per cent of GDP



General government debt in Latvia is one of the lowest in the EU. Until 2007, general government debt in Latvia increased moderately. Since 2008, however, to finance state financial obligations, general government debt has risen more rapidly, thus at the end of 2010 reaching 10.8 billion euro, or 40.1% of GDP. Since the end of 2011, general government debt has gradually started to decline. In the first half of 2018, general government debt slightly fell and constituted 9.8 billion euro.

By executing timely borrowing measures in accordance with the medium-term strategy, and continuing to implement sustainable fiscal policies, current central government debt obligations, based on favourable borrowing conditions, can be successfully refinanced. Also, a long-term reduction and stabilization of the general government debt at a sustainable level, thus respecting the general government debt criterion set by the Maastricht Treaty, can be achieved.

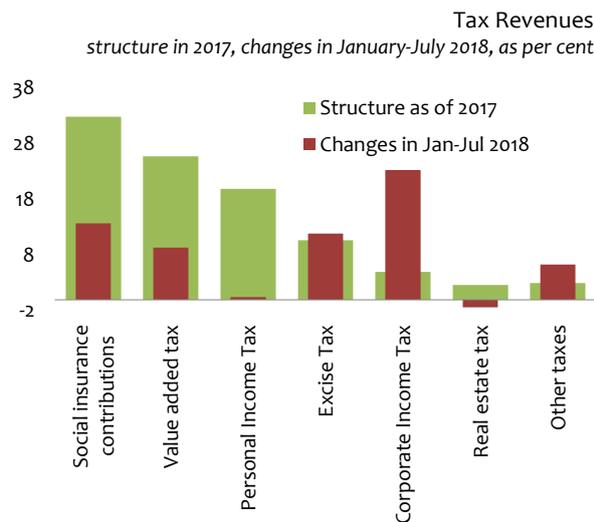
General Government Consolidated Gross Debt
by nominal value at the end of the year



BUDGET REVENUES AND EXPENDITURES

The increase in tax revenues exceeds the economic growth rate. Although the economic growth in Jan-Jul 2018 has accelerated rapidly, the rise in tax revenues has been even higher.

In the first seven months of 2018, consolidated general government budget revenues amounted to 6,498 million euro, which is by 15.7% more than a year ago.



Employment taxes constitute approximately half of the total tax revenues. The increase in budget revenues was mainly facilitated by higher employment and the rise in wages and the minimum wage.

Consolidated General Government Budget

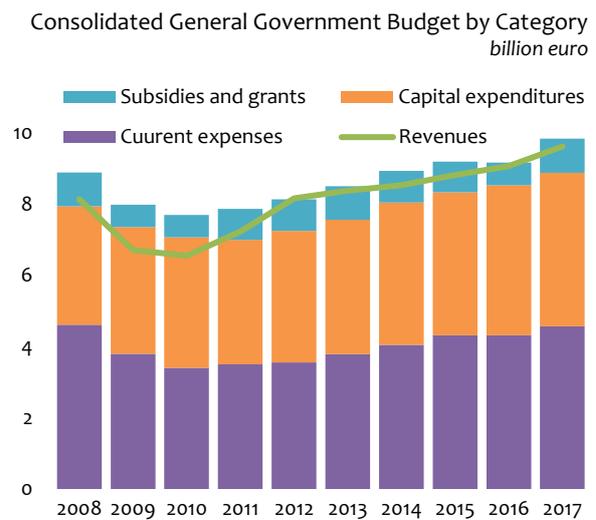
	billion euro		changes as per cent	
	2016	2017	2018 Jan-Jul	2018 Jan-Jul
Revenues, including:	9.1	9.6	6.5	15.7
Indirect taxes, including:	2.9	3.1	1.9	11.8
Value added tax	2.0	2.2	1.3	11.3
Excise tax	0.9	0.9	0.6	12.4
Personal income tax and real estate tax, including:	2.2	2.4	1.4	2.3
Corporate income tax	0.4	0.4	0.3	13.2
Personal income tax	1.5	1.7	0.9	0.3
Social insurance contributions	2.5	2.8	1.8	14.0
Other taxes	0.2	0.3	0.1	0.3
Other revenues	1.2	1.1	1.2	54.6
Expenditures	9.2	9.8	5.8	9.4

In 2018, capital tax revenues are growing moderately. Real estate tax revenues have declined by 1.2%. However,

corporate income tax revenues, in comparison with the corresponding period last year, have increased by 13.2%.

In the first seven months of 2018, general government budget expenditures amounted to 6.5 billion euro, which is by 9.7% more than a year ago.

Budget expenditures for subsidies and grants and current expenses have increased by 9.8% and 5.4%, respectively. A sharp rise in capital expenditures by 52.4% was also observed.

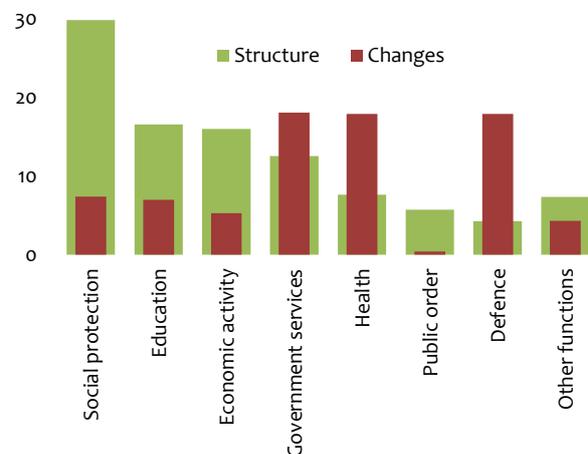


In 2018, indirect tax revenues increased by 11.8%. Value added tax revenues yielded the largest contribution to total tax revenues.

In 2018, budget expenditures significantly increased for education and social protection. Expenditures on environmental protection, however, slightly declined.

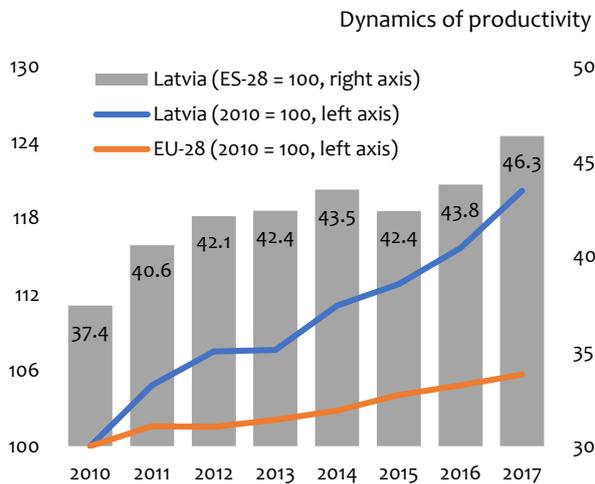
Consolidated General Government Budget Expenditures

structure in 2017, changes in January-July 2018, per cent

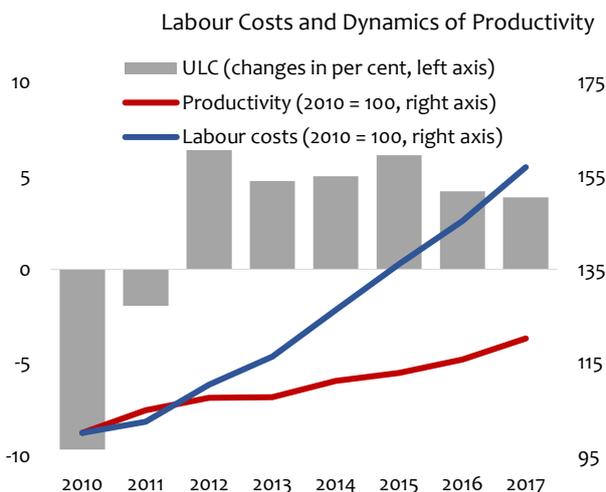


PRODUCTIVITY AND COMPETITIVENESS

In recent years productivity dynamics in Latvia have been more agile than on average in the EU. Since 2010, the productivity gap with the EU average has declined by 9 percentage points. In 2017, productivity measured as GDP per employee, reached 46.3% of the EU average.



Although Latvia has experienced one of the largest productivity growth rates in the EU, **labour costs**, in fact, **have risen more rapidly**, thus threatening the competitiveness of Latvian entrepreneurs in terms of labour costs. Also, the increase in the nominal unit labour cost (ULC) is an indicator of the risks associated with declining cost-competitiveness.

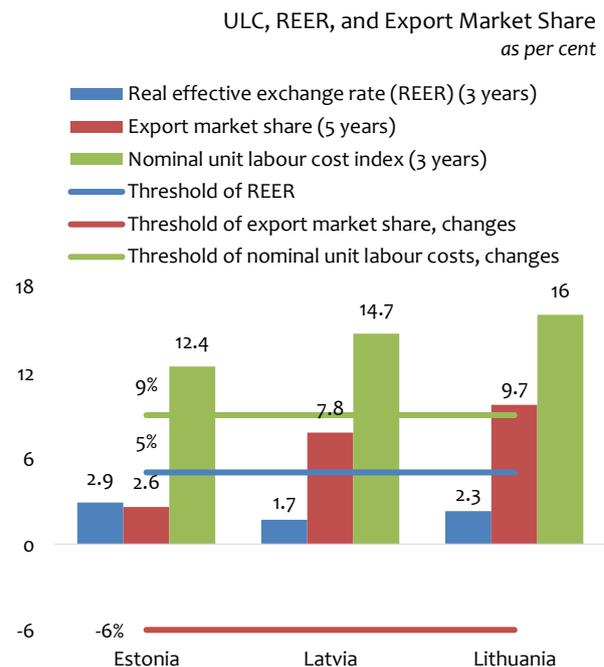


In 2015-2017, productivity on average increased by 2.7% annually. However, labour costs rose by 7.5%, which is by almost three times larger increase.

Similar trends can also be observed in other Baltic countries. In 2015-2017, the nominal unit labour costs in

Latvia, Estonia, and Lithuania, rose by 16.5%, 13.4%, and 14.7%, respectively. It should be noted that the growth of the nominal ULC in the Baltic countries has been one of the largest among the Member States in the EU.

Dynamics of labour costs and productivity reveal that **an increase in economic activity is associated with a rise in the nominal ULC**. One of the most important factors for the increasing nominal ULC is wage growth (wage convergence), which, in turn, is affected by the low competitiveness of Latvia in the open EU labour market.



Latvia still maintains its competitiveness. This is evidenced by the positive dynamics of export market shares. In 2012-2017, Latvia's share of exports in the global goods and services markets has increased by 6.2%.

The rise in the share of exports, along with the rapid increase in labour costs, evidence that wage growth only partially is offset by prices. Also, the real effective exchange rate (REER) dynamics are quite moderate. Over the last three years, the REER (based on CPI) against the 42 major trading partners on average has grown by 4.9%. However, when compared against the Eurozone, the REER has risen by only 0.9%.

At the same time, it should be noted that the increase in labour costs, which will not be offset by a proportionate rise in productivity, could exert a significant downward pressure on the profit margins to maintain the price competitiveness in external markets. In addition, long-lasting positive dynamics of the nominal ULC heighten the threats of external imbalances.

EARLY ALERT MECHANISM

According to the 2011 adopted regulations for monitoring economic and fiscal policies, along with the excessive deficit procedure, the EU also implemented 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", Latvia was not included among the 13 EU Member States, where macroeconomic imbalances were identified, and an in-

depth research required. However, Latvia has not currently met its set targets for three macroeconomic indicators (see the table below). Improvements can be observed in the position of net international investments and unemployment rate. Also, the nominal unit labour cost index, due to wage growth (in Latvia, mostly in non-tradable sectors), similarly as in Lithuania, Estonia, and Bulgaria, has increased, thus exceeding the threshold. Wages, however, have grown more rapidly than productivity.

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

	Thresholds	2010	2011	2012	2013	2014	2015	2016	2017
External imbalances and competitiveness									
Current account balance (% of GDP, 3 year average)	-4%/6%	-0,8	2,2	-1,6	-3,2	-2,7	-1,6	-0,2	0,6
Net international investment position (% of GDP)	-35%	-82,9	-74,4	-67,2	-66,4	-66,1	-63,5	-58,4	-56,3
Real effective exchange rate (REER) – 42 trade partners, HICP deflator (3 year % change)	±5%* & ±11%	6,7	-2,4	-8,6	-1,7	0,4	2,6	4,9	1,7
Export market share – % of world exports (5 year % change)	-6%	21,8	26,7	8,0	5,9	11,0	12,5	9,0	7,8
Nominal unit labour cost index (3 year % change)	9%* & 12%	-2,2	-21,0	-6,9	8,1	16,3	17,5	16,9	14,7
Internal imbalances									
House price index, deflated (1 year % change)	6%	-8,7	4,1	-0,4	6,5	4,3	-2,4	7,3	5,5
Private sector credit flow, consolidated (% of GDP)	14%	2,5	-2,0	-2,1	0,9	-11,8	0,7	0,3	0,3
Private sector debt, consolidated (% of GDP)	133%	134,0	115,3	97,9	92,6	96,2	88,9	88,0	83,5
General government gross debt (% of GDP)	60%	46,8	42,7	41,2	39,0	40,9	36,8	40,3	40,0
Unemployment rate (3 year average)	10%	14,9	17,7	16,9	14,4	12,6	10,9	10,1	9,4
Total financial sector liabilities (1 year % change)	16,5%	-0,3	-4,1	5,2	5,2	10,4	12,2	5,8	6,1
Employment indicators									
Activity rate - % of total population aged 15-64 (3 year change in pp)	-0.2pp	0,4	-1,4	0,9	1,0	1,8	1,3	2,3	2,4
Long-term unemployment rate – of active population aged 15-74 (3 year change in pp)	0.5pp	7,2	6,9	3,3	-3,1	-4,2	-3,3	-1,7	-1,3
Youth unemployment rate – % of active population aged 15-24 (3 year change in pp)	2pp	25,6	17,4	-4,8	-13,0	-11,4	-12,2	-5,9	-2,6

* – Eurozone countries

Note: the highlighted numbers exceed the thresholds set in the Early Warning Mechanism.

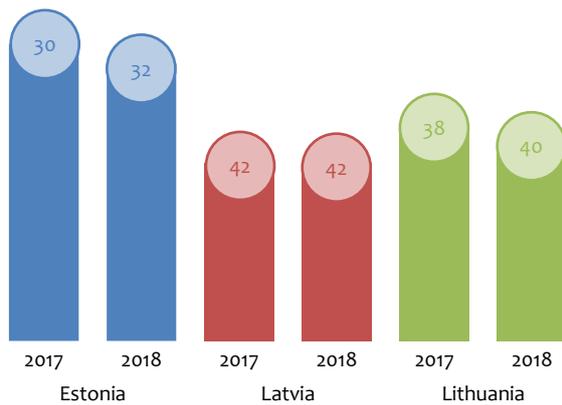
Source: Indicators of the MIP procedure, Eurostat

2018 | 2 INTERNATIONAL RANKING OF LATVIA

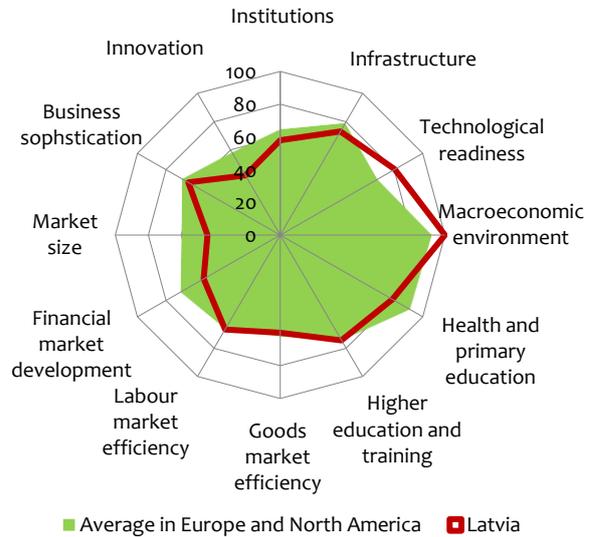
In World Economies Forum report in the new **Global Competitiveness Index (GCI 4.0) for 2018** Latvia is ranked in 42 place between 140 surveyed countries.

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

Baltic States in Global Competitiveness Index 4.0



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



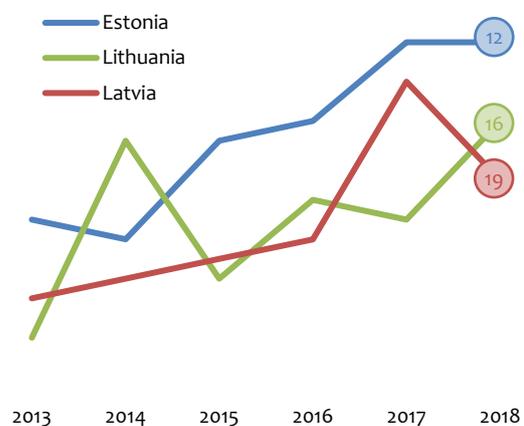
Source: World Economic Forum, *The Global Competitiveness Report 2018*

According to GCI 4.0 methodology in the new index higher weight is given to influence of digital technologies and recalculated is also the index of 2017. In 2018 comparing with 2017 results Latvia remains at the same place in GCI 4.0, but improvements can be seen in 11 out of 12 pillars.

In comparison with previous evaluation period drop is observed in such *Doing Business* index describing pillars like electricity receiving, what is related with *AS Sadales tīkls* investments (increased planned electricity disconnection number) and changes in tariffs, and insolvency solving, what is related with recovery rates indicator deterioration. However, in previous years made improvements in such indicators like starting business, property registration, paying taxes and contract approval has improved the rank of Latvia in for those indicators.

In the pillar of macroeconomical stability Latvia similarly with 30 other countries is ranked in the first place. In ICT introducing pillar Latvia is 11th due to good internet infrastructure and huge number of internet users. At high level is also put the skills – 23th and labor market – 29th. Average performance is for pillars: entrepreneurship dynamism – 47th, infrastructure – 47th, institutions – 49th, market of products – 49th, and innovation abilities – 52nd. However, the worst pillars: health – 76th, financial system – 94th, and market size – 94th.

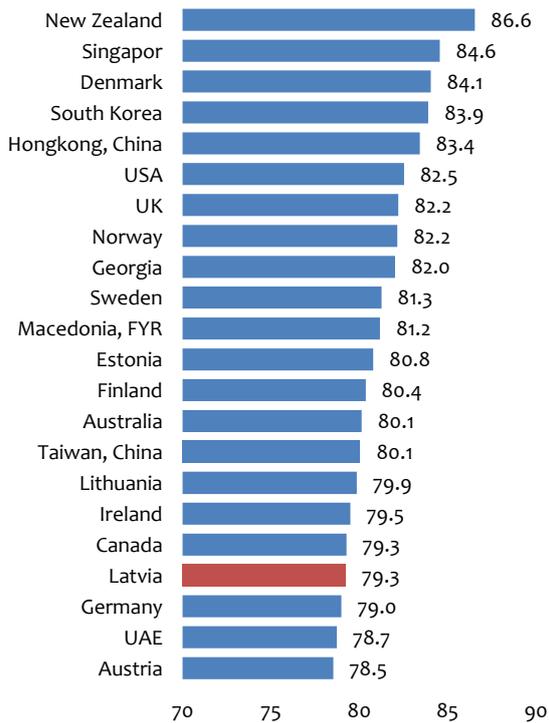
Baltic States in Doing Business Index



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

World Bank Research *Doing Business* is international, comparing business environment rating, which every year measures entrepreneurship regulating administrative procedures and their application in different countries. In competition of 190 countries *Doing Business 2018* report Latvia is ranked 19th, but 14th before a year.

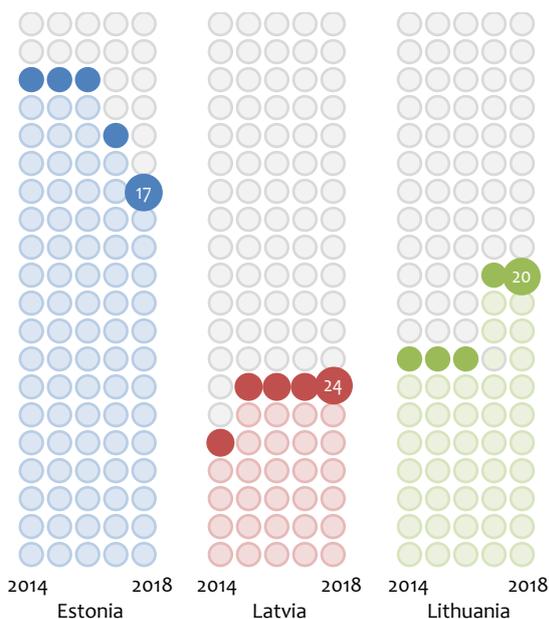
Doing Business 2018
total index: rating 0-100



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

In the European Innovation Scoreboard 2018 Latvia between 28 EU countries is ranked as 24th and third year in a row is included in *moderate innovator* group. As relative advantages for Latvia's innovation systems are mentioned: innovation friendly environment, finances and support. However, disadvantages are innovators and enterprise investments.

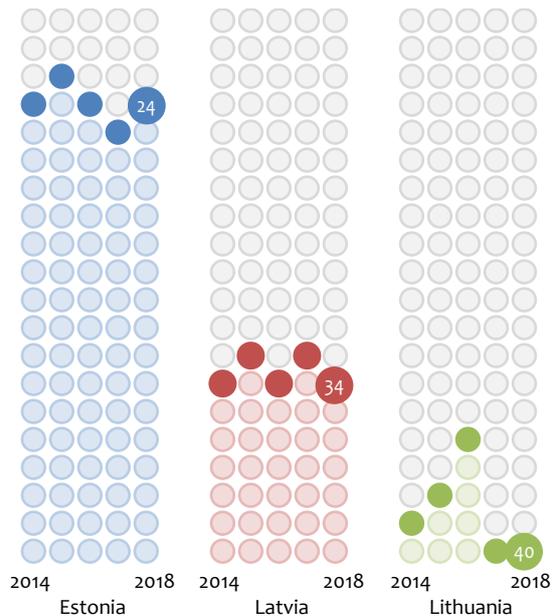
Baltic States in the European Innovation Scoreboard



Source: European Commission, European Innovation Scoreboard 2018

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

Baltic States in Global Innovation Index



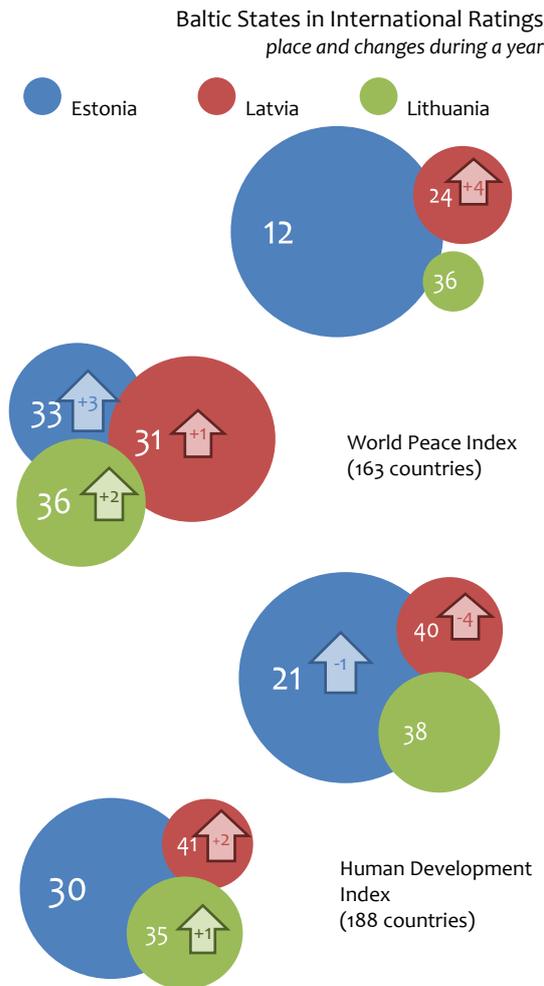
Source: Cornell University, INSEAD, WIPO, The Global Innovation Index 2017: Winning with Global Innovation

In international press and freedom of speech organization's "Reporters without borders" created **Worldwide press freedom index** Latvia is 24th (from 180 countries) by stepping up 4 places from 2017.

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

In **Corruption Perception index**, made by *Transparency International*/Latvia in 2017 were 40th (from 180) by getting back 4 places comparing to 2016. The increase is due to higher index value.

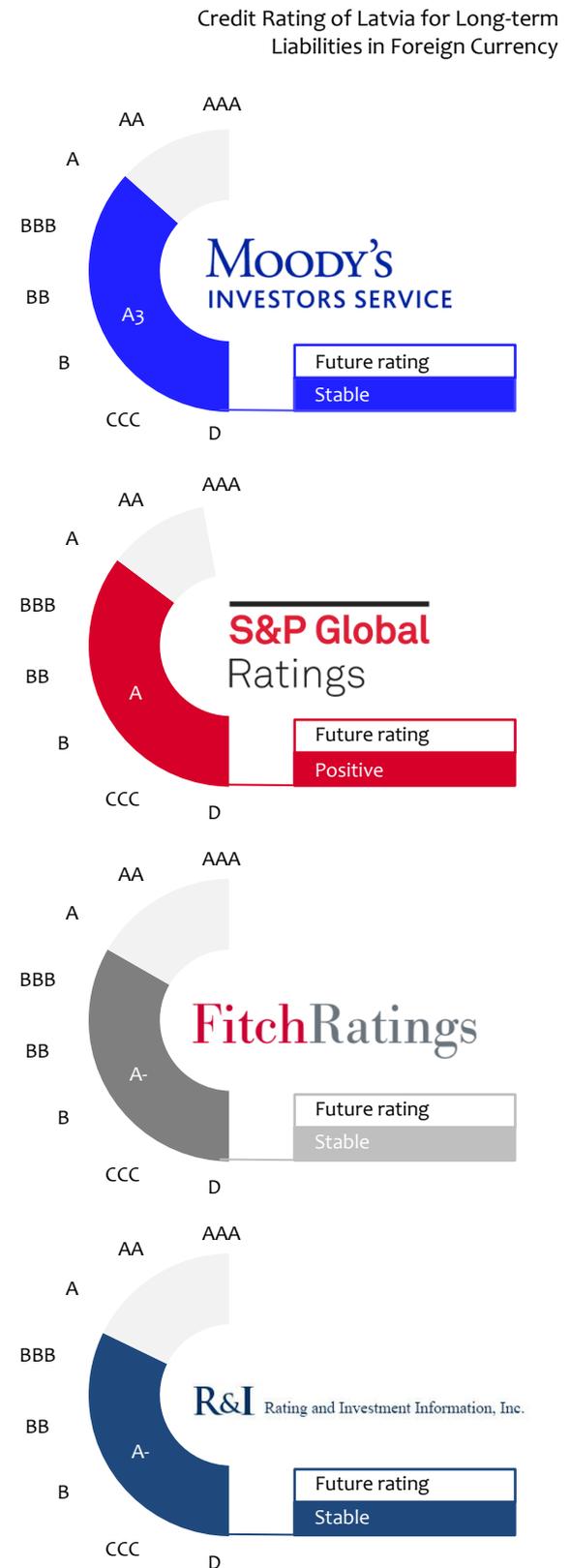
In United Nations Development Programme's **Human Development Index**, which includes life length, reading skills, education level, GDP per capita etc. indicators, Latvia in 2017 is listed as 41st (from 189 countries) stepping up by 2 positions comparing with clarified results of 2016.



Source: Reporters Without Borders, 2018 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2018; Transparency International, Corruption Perceptions Index 2017; United Nations Development Programme, Human Development Indices and Indicators, 2018 Statistical Update

Credit rating of Latvia is determined by following international rating agencies: *Moody's Investors Service*, *Fitch Ratings* and *S&P Global*, as well as rating agency in Japan *R&I*.

Rating agencies positively appreciate stability of Latvia's finance system and political situation, strict fiscal policy compliance, as well as overall economic development, which allows to maintain current credit rating stable. Latvia's credit rating upgrade would be promoted by faster government debt reduction, budget income increases and stable economic growth in Latvia (without overheating of economy). However, credit rating might be reduced, if income level of inhabitants would get worse, fiscal policy would not be considered or if non-resident deposits would decrease stability of financial sector of Latvia.



Source: State treasury