Ministry of Economics
Republic of Latvia

ECONOMIC DEVELOPMENT OF OF LATVIA

RIGA 2024

ISSN 2661-5118

Ministry of Economics

ECONOMIC DEVELOPMENT OF LATVIA

RIGA 2024

Comments, questions or suggestions are welcome:

To the Ministry of Economics

Brīvības iela 55, Riga, LV-1519

Phone 371-67013100

Fax 371-67280882

E-mail: macro@em.gov.lv

Website: https://www.em.gov.lv

Report prepared by: O. Barānovs (editor, 1., 6.5.), T. Buls (2.), I. Šnīdere (3.1., 3.2., 4.1., 4.3., 4.4., 4.6., 4.7., 4.8., 4.9., 6.1.), J. Ušpelis (3.2., 4.5., 6.4., 6.6.), I. Skribāne (3.3., 6.2., 6.3., 6.7.), E. Gergelevičs (3.4., 4.2.), L. Kurpniece (4.2., 7.1., 7.2.), N. Ozols (5., 7.), L. Neiders (6.8., 6.9.), I. Leonova, I. Kudeikins (8.1.), A. Zimele (8.2., 11.), L. Anspoka (8.2.), S. Zakse (8.2., 10., 12.3., 12.4.), Č. Gržibovskis (6.10., 9.1.), J. Reinsone (9.2.), D. Butāne, A. Paegle, J. Nalivaiko, M. Jansons (10.), E. Pētersone, I. Irbe, A. Bekasova, I. Lore (10., 12.1.), F. Bikaunieks, A. Belte (10., 12.3.), R. Supe (11.), K. Cine, S. Zandere, (12.1.), I. Baltābola (12.1., 12.3.), A. Zambžetskis (12.2.), D. Klinsone, R. Zaremba, A. Jaunzeme (12.3.), V. Zinkevičs (12.4.), R. Supe (12.5.), G. Sproģis, A. Lazarevs, I. Biukšāne (13.), R. Lastovska, N. Balinskis (14.), M. Lūka-Ruskulova, I. Vjatere Meinarte, I. Šīrava (15.), L. Stauvere, K. Riekstiņa, S. Buša, M. Blašķe, A. Latišenko, S. Dombrovska-Latišenko, J. Bulāns, B. Januma (16.), I. Eglītis, P. Celma (17.)

All figures and data, unless indicated otherwise, have been obtained from the Central Statistical Bureau of the Republic of Latvia. The data of the European Union have been obtained from *Eurostat*. The data of the Bank of Latvia and the Financial and Capital Market Commission have been used in the description of balance of payments and the bank and monetary indicators of Latvia. The data of the Treasury have been used in the description of financial indicators.

ISSN 2661-5061

OPENING STATEMENT

Experts of the Ministry of Economics have prepared the current Report on the Economic Development of Latvia 2024. The report assesses the economic situation, as well as forecasts the prospects of economic development.

In 2024, economic development continued to be affected by the geopolitical situation and uncertainty, and the slow recovery of the export target market. In Q1-Q3 of this year, the gross domestic product (GDP) was 0.5% lower than a year before. Private and public consumption rose, while exports, imports and investment fell. Experts of the Ministry of Economics forecast that, in 2024, the economy will generally be close to the previous year's level.

In 2025, economic activity will return to growth at a slightly faster pace of 2.6%. According to forecasts by international organisations, the global economic environment will improve slightly in 2025, supporting a recovery in Latvian export activities. Lower interest rates will also improve the situation in the euro area, including Latvia, helping to boost consumption, the real estate market and construction. Increased inflows of EU Funds will also significantly impact the Latvian economy, as will the reforms to strengthen competitiveness, including lower labour taxes and other factors.

We have a clear vision of Latvia's future economic model and an understanding of the steps needed to accelerate growth. We have developed and submitted to the Parliament and for public consultation a new comprehensive growth strategy for Latvia, its key elements being increasing the productivity and export capacity of Latvian companies, major reforms in human capital development, innovation and latest technologies, and national excellence in the green economy, renewable energy and bio-economy. The growth strategy aims to double the country's GDP from 40.3 billion euro today to 83 billion euro in 2035 within ten years. This will be achieved by significantly increasing the productivity of Latvian companies – from 60% of the EU average in 2023 to the EU average in 2035.

To achieve the set goals, substantial support is provided to increase productivity, digitisation, energy efficiency, export capacity, and competitiveness of our entrepreneurs. The funds intended for increasing business competitiveness will be channelled towards creating industrial zones, new jobs with high added value, raising high added value investment, transforming the economy, and supporting export capacity.

11 EU funding programmes have been approved for a total funding of 371.05 million euro, including financial instruments (start-up and productivity loans, guarantees, venture capital investments) and grant programmes. Access to finance for SMEs has been significantly facilitated – ALTUM has reduced collateral requirements for loans up to 100 thousand euro, as well as the rate has been reduced to 3% (period over 12 months) or 4% (period up to 12 months) for start-up and SME loans.

Work continues on coordinating 9 other EU Fund programmes for new product development, job support, sectoral training, energy efficiency support, innovation loans and port infrastructure of 649.58 million euro, which will consecutively be made available after the Recovery Fund or after the reallocation of EU funds.

The activity of the Investment Fund (Altum loans with a capital discount for export-capable large projects) also continues with 282.56 million euro currently available. The objective of the Investment Fund is to stimulate an influx of new investments to expand entrepreneurship by stimulating entrepreneurs to make new investments and thus create a value-added chain throughout the economy.

The work of the Coordination Council for Large and Strategically Important Investment Projects has been activated, clarifying its composition, functions and tasks. Around 80 topical investment projects have taken shape. For a company to initiate a review of the complications or challenges of its investment project by the Coordination Council, a representative of the company should contact the Council secretariat, providing as specific information as possible on the identified problems that make the implementation of the investment project in Latvia difficult and, if possible, what inter-institutional solutions should be provided to solve these problems or mitigate their impact.

18 Latvia's external economic representations abroad continued to work in 2024 to support Latvian companies in increasing exports. Entrepreneurs are also offered services of the Enterprise Europe Network – help in searching for international partners, preparing market information, consulting on legislation and business aspects, access to finance, etc. It should be noted that the Investment and Development Agency of Latvia has developed a national platform for business development business.gov.lv, which provides information and the possibility to apply for services provided by the agency and for different state aid programmes. Moreover, the platform is also expanded with services provided to entrepreneurs by other state institutions.

A new European Union funding instrument will be available for the development of dual-use new products and technologies in defence and security, with a total public funding of more than 32 million euro. Support will be available for the development of innovative products or technologies, as well as for increasing R&D expenditure in the business sector and promoting cooperation between the business and research sectors.

The objectives set out in the National Industrial Policy Guidelines 2021-2027 provide for building a new economic model based on knowledge and innovation, focusing on strengthening innovation capacity, improving the quality of the institutional environment and increasing business dynamism. Start-ups play an important role in the overall innovation "ecosystem" providing an inflow of innovative business ideas and contributing to a faster shift in the economic paradigm towards the knowledge economy.

The Latvian start-up "ecosystem" consists of at least 626 start-ups, of which more than half are active in information and communication, and more than 20% in manufacturing and professional, scientific and technical activities. One of the priority tasks of the Ministry of Economics is not only to strengthen cooperation with representatives of the start-up environment and organisations representing them but also to create an environment supporting entrepreneurship through a joint strategy in which start-ups can form and develop their innovation thereby creating preconditions for the growth of the Latvian economy. In support of the organisations representing the Latvian start-up environment, the state reinforced its clear position regarding the role of the start-up "ecosystem" in the development of the national economy and continued working on both local and international level to promote the image of Latvia as a country favourable to start-ups and attracting investment.

In 2024, the Ministry of Economics launched Latvia's first long-term national research programme Innovation Fund – Long-Term Research Programme. It aims to develop new knowledge, products and technology solutions in the long term in the areas of the Smart Specialisation Strategy approved by Latvia. The programme will be implemented in cooperation with the Latvian Council of Science in several phases until 2032. The Ministry of Economics currently has 18 million euro available with the possibility of increasing the funding for the next three phases.

Investment in the development of the digital transformation of businesses is one of the priorities for promoting productive business. To achieve these objectives, companies have access to support for digitisation of business processes, improvement of digital skills, development of new products and services, as well as testing and purchasing of technological equipment. Development Finance Institution ALTUM has so far approved projects worth a total of 31 million euro under the enterprise digitalisation programme co-financed by the European Union's Recovery Fund, which has supported 51 projects so far. Companies use the programme funding both to buy automated production equipment and to digitise processes.

The Ministry of Economics is planning to invest 194.15 million euro in digital transformation support programmes. Two European Digital Innovation Hubs (EDIH) have been approved to help entrepreneurs identify their needs in digital transformation. They will provide consultations, mentoring, technological services, first and second digital maturity test, digital development roadmap and report development services.

A favourable business environment is one of the most important elements for increasing the competitiveness of the national economy. The better business conditions a state is able to create, the higher investments flow into the national economy, subsequently leading to new jobs and better welfare of people. For further improvement of the business environment, we have envisaged a more effective process of identifying and administering the necessary measures by developing closer feedback with economic operators and by allowing for continuous follow-up to the progress made in the implementation of the measures.

On 2 April 2024, the Cabinet of Ministers approved an action plan to reduce administrative burdens in real estate development processes. The plan includes almost 60 measures to improve local-level spatial development planning, land survey, construction process, cadastral survey, environmental impact assessment and deforestation. The implementation of the plan will be an important step towards reducing bureaucracy in Latvia, promoting the growth of the real estate development and construction sectors and attracting investment. To reduce the shadow economy, electronic working time registration systems will also be introduced at smaller construction sites.

The Ministry of Economics also continues to improve the construction information system, and a convenient platform for efficient management and operational supervision of structures, including residential houses, has been established. Over the last few years, several complex measures have been implemented in cooperation with the construction industry contributing to a significant improvement in the competitiveness of the industry. To promote the growth of the construction sector, a draft Latvian Construction Sector Strategy 2025-2030 has been developed, which is a medium-term planning document reflecting the strengths, weaknesses, development opportunities and threats of the sector, which are the decisive factors for defining strategic objectives and implementing specific activities. The objective of the strategy by 2030 is a competitive and sustainable development oriented construction sector that provides high-quality, safe and efficient construction services to society, creating a long-term modern living environment for current and future generations.

The provision of a fair competitive environment is also considered to be an essential element in promoting competitiveness in the country. A pressing topic in the competition policy is to keep supervising that companies do not breach the law and act fairly, as well as fostering equal and non-discriminating competition between public persons (for example, state or local government capital companies) and the private sector. The authorisations of the Competition Council have been extended and it will also monitor the application of the Digital Markets Act and the Foreign Subsidies Regulation in Latvia and support the European Commission in its investigative activities. Amendments to the Competition Law are being forwarded to the Saeima for adoption. They envisage granting the Competition Council a new function to provide methodological support to public commissioning authorities in recovering losses incurred in procurement due to infringements of competition law by market players.

To improve bank competition and reduce mortgage rates a regulatory framework for consumer mortgage remortgaging to another credit service provider has been developed. On 15 February 2024, the Saeima adopted in final reading amendments to four laws that lowered the barriers to remortgaging and made it easier for consumers to remortgage, making the remortgaging process cheaper, simpler and faster.

The Digital Services Act, which came into force in 2024, aims to make the online environment safer, more predictable and more trustworthy for all its users. To implement it, the Consumer Rights Protection Centre has been designated as the digital services coordinator, which will monitor Latvian online platforms and other intermediary service providers to reduce the appearance and distribution of illegal content online.

On 20 March 2024, amendments to the Law On Uniformity of Measurements entered into force, introducing a new form of metrological control into Latvian legislation, namely, statistical verification, which will streamline processes and save almost 120 million euro over eight years.

To prevent Latvian citizens from overpaying for basic necessities and to prevent differential pricing between domestic and imported food products, the Ministry of Economics has developed proposals to reduce food prices and continues working on the necessary amendments to the law.

The Ministry of Economics actively continues working on the Human Capital Development Action Plan 2024-2027. In close cooperation with businesses, this will provide both a more accurate picture of employers' and employees' needs and more effective interaction in the field of human capital development. Medium- and long-term labour market forecasts have been updated, covering sectoral employment needs by occupations and education up to 2040. The forecasts are based on the target economic growth scenario and corresponding demographic forecasts and take into account current global economic development processes, geopolitical challenges and trends in artificial intelligence.

A new adult education governance model has also been developed to create a more targeted, data-driven and prioritised publicly funded adult education offer coordinated with business organisations to meet the current and future workforce needs of the economy. The new governance model will help to educate and reskill people to meet the needs of employers and the most in-demand occupations of the future, thus helping to reduce unemployment and avoid a situation where there are both too many vacancies and high unemployment because people's skills do not match the needs of employers. The new model will be introduced gradually, but a pilot project was already implemented in 2024.

Activity in the construction of low-rent housing in the regions has started – 5 projects for the construction of 374 dwellings in Valmiera, Bauska, Jelgava, Tukums and Ventspils have already been approved under the support programme, and several more projects are under assessment and development.

On 21 January 2024, the Cabinet of Ministers approved a report prepared by the Ministry of Economics on the implementation of the state aid programme for major international events. A major event is an event of an international scale that takes place in Latvia and is organised, delegated or partnered by a global or European scale organisation, the event is widely covered in the media and has a significant impact on the Latvian economy (international visibility and competitiveness, etc.) and attracts a significant number of foreign visitors and participants staying in Latvian tourist accommodations. On 21 January, the Government also decided to support the organisation of two major events – the 2024 World Rally Championship and the 2025 European Basketball Championship Men's Finals.

A new model for the management of the national petroleum product safety stocks was introduced in 2024, which provides for a gradual acquisition of 100% of the safety stocks by 31 December 2028. The new model is expected to save the state more than 500 million euro over the next ten years.

Latvia is moving towards the development of a hydrogen industry. Latvia has great potential to produce hydrogen and its derivatives using renewable energy sources. This is an essential step towards achieving our goal of making the Latvian economy more productive and export-capable. Although the hydrogen economy is still in its infancy, we can already foresee that Latvian companies could become major players in the field of hydrogen at the European level. The Ministry of Economics is currently developing a National Zero Emission Technology Strategy, which will promote both the production and export of green hydrogen and its chemical compounds, as well as support for port infrastructure and other production related to the hydrogen ecosystem.

Programmes are currently being implemented to support energy efficiency with the main task to limit an increase in final consumption of primary energy sources and energy and to ensure a reduction in energy consumption. The Ministry of Economics is planning to invest 275 million euro to support energy efficiency in the coming years.

The energy sector has grown rapidly in recent years, accounting for almost a third of global investment, and this is an indication of the huge potential of the energy sector. The "wave of investment" in this industry is a unique opportunity for

Latvia to establish itself as a leading player in the global energy landscape. Hydrogen is a good example of how technologies that are in the process of growth can provide an opportunity for Latvia. The Latvian Investment and Development Agency's development of the ELWIND offshore wind project in cooperation with Estonia demonstrates the joint work and commitment of two European Union countries to renewable energy sources, in particular offshore wind energy.

To achieve the objectives set, the Ministry of Economics is actively creating a dialogue with entrepreneurs, non-governmental organisations, and other members of the community.

In this Report you will find information on the most important economic and social indicators of Latvia, development of industries and the external economic environment, the government's economic policy, and the main instruments of its implementation.

Not all the issues discussed in the Report were assessed by the Cabinet of Ministers, therefore, part of judgments on economic development of Latvia and suggestions for further action reflect only the opinion of the experts of the Ministry of Economics.

I would like to express my gratitude to the authors of the Report!

Viktors Valainis,

Minister of Economics

December 2024

TABLE OF CONTENTS

ABBREVIATIONS, MEASUREMENT UNITS, AND SYMBOLS

Abbreviations

Altum	Joint Stock Company "Development Finance Institution Altum"
RRF	Recovery and Resilience Facility
UN	United Nations
JSC	Joint Stock Company
USA	United States of America
FICIL	Foreign Investors Council in Latvia
FDI	Foreign Direct Investment
BIM	Building Information Modelling
BIS	Building Information System
AMR	Alert Mechanism Report
CSB	Central Statistical Bureau
DESI	Digital Economy and Society Index
ECB	European Central Bank
EDIH	European Digital Innovation Hub
EEA	European Economic Area
EC	European Commission
MoE	Ministry of Economics
ERDF	European Regional Development Fund
EU	European Union
EU-14	European Union Member States before the enlargement in 2004
EU-27	European Union Member States after the withdrawal of the United Kingdom on 1 February 2020
EU-28	European Union Member States and United Kingdom
ESF	European Social Fund
EUR	*euro*
Eurostat	Statistical Office of the European Union
MoF	Ministry of Finance
GCI	Global Competitiveness Index
GWh	Gigawatt-Hour
GDP	gross domestic product
ICT	information and communication technologies
IMI	Internal Market Information System
MoES	Ministry of Education and Science
CF	Cohesion Fund

CC	Competition Council
kWh	Kilowatt-Hour
LIAA	Investment and Development Agency of Latvia
MoW	Ministry of Welfare
CM	Cabinet of Ministers
MIP	Macroeconomic Imbalances Procedure
Mtoe	megaton oil equivalent
SMM	Small and Medium-Sized Merchants
SME	small and medium-sized enterprises
MWh	Megawatt-Hour
NDP	National Development Plan of Latvia
NATO	North Atlantic Treaty Organization
NRP	National Reform Programme
SEA	State Employment Agency
CIS	Commonwealth of Independent States
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
OPEC+	Countries of the Organization of the Petroleum Exporting Countries (OPEC) and 10 more oil-producing countries
R&D	research and development
CPI	Consumer Price Index
PJ	Petajoule
PPS	Purchasing Power Standard
CRPC	Consumer Rights Protection Centre
RIS3	National/regional research and innovation strategies for smart specialisation
LLC	Limited Liability Company
SOLVIT	EU Internal Market Problem Solving System
STEM	science, technology, engineering, and mathematics
IMF	International Monetary Fund
MoJ	Ministry of Justice
TRIS	Technical Regulations Information System
CIT	Corporate Income Tax
ULC	unit labour costs of products
MoEPRD	Ministry of Environmental Protection and Regional Development
MoA	Ministry of Agriculture

Country Abbreviations

AT	Austria	HU	Hungary
BE	Belgium	IE	Ireland
BG	Bulgaria	IT	Italy
CZ	Czech Republic	LT	Lithuania
CY	Cyprus	LU	Luxembourg
DE	Germany	LV	Latvia
DK	Denmark	MT	Malta
EE	Estonia	NL	Netherlands
EL	Greece	PL	Poland
ES	Spain	PT	Portugal
EU	European Union	RO	Romania
FI	Finland	SE	Sweden
FR	France	SI	Slovenia
HR	Croatia	SK	Slovakia

PART I. ECONOMIC DEVELOPMENT TRENDS

1. ECONOMIC DEVELOPMENT TRENDS – OVERVIEW

Stable economic growth in Latvia with rates exceeding the EU average continued until the COVID-19 pandemic. From 2013 to 2019, GDP grew by 2.7% per year on average. The COVID-19 pandemic has had a significant impact on economic development on a global scale and also in Latvia. GDP shrank by 3.5% in Latvia in 2020. The extensive government and EU funds support measures, as well as the improvement of the epidemiological situation in 2021, contributed to the recovery of Latvia's economy, and GDP grew by 6.9%.

After the rapid recovery of the economy from the crisis of the COVID-19 pandemic in 2021, growth in Latvia slowed to 1.8% in 2022. The economic development in 2022 was significantly influenced by the disruptions in supply chains caused by Russia's invasion of Ukraine, the rise in inflation caused by the cost of energy and food, as well as the decline in global demand.

In 2023, economic development continued to be affected by the geopolitical situation and uncertainty, high prices and growing bank interest rates. GDP has grown by 1.7%. In 2023, private consumption, exports and imports fell, while public consumption and investment rose.

In Q1-Q3 2024, the economy was stagnant due to the unfavourable external environment even though inflation rates stabilised. GDP decreased by 0.5% in Q1-Q3 of the year compared to the corresponding period of 2023. Private and public consumption rose, while exports, imports and investment fell.

The Ministry of Economics forecasts that, in 2024, the economy will generally be close to the previous year's level, while in 2025 economic activity will increase. The acceleration in economic growth will be supported by an improving global economic environment, a projected decline in interest rates in the euro area, an increase in EU Fund inflows and other factors.

Table 1.1

Latvia: Key Figures of Economic Development

	2018	2019	2020	2021	2022	2023	2024f	2025f
Gross domestic product (at current prices, billion euro)	28,2	29,6	29,2	32,3	36,1	39,1	39,7	41,2
changes as per cent								
Gross domestic product	4,3	0,7	-3,5	6,9	1,8	1,7	-0,2	2,6
Private consumption	3,6	-0,1	-4,8	8,1	5,1	-1,0	0,8	2,1
Public consumption	1,9	5,6	3,9	3,7	2,4	7,0	8,0	3,4
Gross fixed capital formation	11,5	1,3	-2,4	6,8	-1,6	9,9	-5,6	2,7
Export	4,4	-0,6	-0,3	9,1	11,4	-4,7	-0,6	3,1
Import	6,3	2,0	-1,1	15,1	9,9	-2,0	-1,2	3,0
Consumer prices	2,5	2,8	0,2	3,3	17,3	8,9	1,2	1,8
as a percentage in relation to the GDP, unless indicated otherwise								
General government sector balance	-1,4	-0,2	-4,1	-7,2	-4,9	-2,4	-2,6*	-2,9*
General government debt	38,3	37,9	44,0	45,9	44,4	45,0	45,8*	47,0*
Export-import balance	-0,5	-0,2	1,4	-3,2	-4,9	-3,7	-3,0	-2,8
Changes in the number of the employed (15-74 years of age, % compared to the previous year)	1,6	0,1	-1,9	-3,2	2,6	-0,2	-0,2	0,3
Employment rate	64,5	65,0	64,2	62,5	63,9	64,2	64,3	65,0
Unemployment rate (unemployed, % of the economically active population, 15-74 years of age)	7,4	6,3	8,1	7,6	6,9	6,5	6,9	6,4
Average gross wage changes (% compared to the previous period)	8,4	7,2	6,2	11,8	7,5	11,9	9,9	7,8

f – forecast, *MoF evaluation

Private consumption has resumed its growth as the purchasing power of the population has improved. The dynamics of real income had a negative impact on household consumption in 2023, especially in the second half of the year. In contrast to the strong growth of private consumption in 2022, it declined by 1% in 2023. As the population's purchasing power improved, private consumption increased by 0.6% in Q1-Q3 2024 compared to the corresponding period of the previous year.

Public consumption continues to grow largely at the expense of the government deficit so that government priority measures can be financed. Public consumption grew by 7% in 2023. It increased by 8.2% in Q1-Q3 2024 compared to the corresponding period of the previous year.

Investment dynamics are volatile. Due to the increase in financing of EU funds, investments in gross fixed capital formation were 9.9% higher in 2023 than a year before. In Q1-Q3 2024 compared to the corresponding period in the previous year, investment shrank by 6.1% significantly affected by weakening private investment. Net flows of FDI attracted in Latvia continue to increase. In 2023, net FDI inflows into Latvia accounted for 2.8% of GDP. In 2024, they continued to grow. FDI reached 658 million euro or 2.3% of GDP in Q1-Q3 2024. Investments were mainly made in professional, scientific and technical activities and financial and insurance activities. The biggest investors were from Sweden, Estonia and Denmark.

The situation in the external environment adversely affects foreign trade. Export volumes of goods and services decreased by 4.7% in 2023, but in Q1-Q3 2024 they were 2.1% lower than a year before. Services exports saw the largest drop (5.1%) in the first three quarters of the year. Export volumes of goods decreased by 2.1% in the three quarters. The main export goods were agricultural products and food products, wood and wood products, mechanisms, devices and electrical equipment, chemical industry goods. Import volumes in the first three quarters of the year were also lower than a year ago. Imports fell by 3.2% in the first three quarters of this year. The current account deficit has been on a declining trend in recent years. In 2024, the negative current account balance continued to decline and stood at 3.2% of GDP in the three quarters. The current account will continue to improve in the coming years.

Development trends across sectors vary considerably. In 2023, the total value added increased by 2.5%, but in Q1-Q3 2024 it was 0.9% lower compared to the same period of the previous year. The overall decline has continued in producing sectors, largely due to weak export opportunities, as well as in several services sectors.

Manufacturing decreased by 4.7% in Q1-Q3 2024 compared to the corresponding period of the previous year. The decline in manufacturing was mainly due to declines in wood processing, manufacture of fabricated metal products, manufacture of chemicals and chemical products and manufacture of other non-metallic mineral products. On the other hand, positive trends were observed in manufacture of food products, manufacture of electrical and optical equipment, manufacture of machinery and equipment.

The drop in volumes in transportation and storage (by 8.5%) was affected by land transportation and warehousing and support activities for transportation. The trade sector grew by 2.3% in Q1-Q3 2024.

In Q1-Q3 2024, compared to the previous year, a decline was also observed in the ICT sector (1.6%), education (5.6%) and real estate activities (2.9%).

After a sharp increase in 2023, the construction sector experienced a 5.6% drop in production volumes in Q1-Q3 2024. Agriculture and forestry saw an increase of 1.7% and other industry – 6.5%. Positive growth rates also persist in human health and social work activities (+17.0%) and public administration and defence (+1.2%).

The COVID-19 pandemic has led to significant changes in the fiscal policy that has been implemented so far. In 2020, the general escape clause of the *Stability and Growth Pact* (SGP) was activated in the EU, enabling EU countries to increase their general government deficits to the extent necessary to mitigate the economic harm caused by the pandemic. Given the Russia-Ukraine war and all the related consequences, the general exception clause of the SGP also remained in force in 2023. In 2024, the application of EU fiscal rules resumed, ending the effect of the EU's general escape clause.

Under the influence of the COVID-19 pandemic, the budget deficit in Latvia increased considerably in 2020 – 2022 and exceeded 4% of GDP. The general government budget deficit in 2023 amounted to 0.9 billion euro or 2.3% of GDP. According to the MoF forecasts, the budget deficit could be 2.6% of GDP in 2024. The Saeima submitted a budget with a deficit of 2.9% of GDP for 2025.

Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest in the EU. Government debt increased to 45.9% of GDP or 14.8 billion euro in 2021. Since the nominal GDP increase under high inflation conditions is rapid, then its ratio to GDP in 2022 reduced to 44.4% but increased to 16 billion euro in nominal terms. The public debt was 17.6 billion euro or 45% of GDP in 2023. In 2024, general government debt is projected at 45.8% of GDP and in 2025 – 47% of GDP. The debt provision of 60% of GDP defined in the *Fiscal Discipline Law* is expected to be observed in the medium term.

The banking sector has been able to remain stable, despite the economic turmoil caused by the COVID-19 pandemic and the geopolitical tension. The banking sector is operating with profit. However, the development of lending is still evaluated as weak, in particular lending to businesses. Meanwhile, positive trends are observed in lending to households. Deposit volumes continue to rise.

Inflation is mostly affected by the rise in global prices of energy and food. In December 2022, consumer prices were 20.8% higher than a year before, but the annual average inflation increased to 17.3%. In December, food prices increased by 29.3%, prices of electricity, gas and solid fuel – by 63.9% and prices of fuel – by 17.9%. In 2023, consumer prices stabilised and were shrinking every month compared to the corresponding month of the previous year – from 21.5% at the beginning of 2023 to 0.6% in December, but given the base effect of inflation dynamics, the average annual inflation in 2023 remained high – 8.9%.

In the eleven months of 2024, the rise of prices was faster than in the corresponding period of the year before. In November 2024, compared to December of the previous year, consumer prices rose by 3.0%. The average annual inflation in November was 1.0%. The increase in prices of food and services had the biggest effect on the level of average consumer prices. Price decreases were observed for home-related energy sources – heat, electricity, natural gas and solid fuel.

Overall, average annual inflation in 2024 will be significantly lower than in 2023 and is expected to be within 1.2%. The main impact on price changes still continues to be linked to the fluctuations in global prices for energy and food and will be determined by global development. At the same time, inflation in Latvia will be affected by different supply-side factors related to the increase of taxes and tariffs, as well as the demand side promoted by the increase in wages.

Despite the economic turmoil, the labour market remains stable because the demand for labour remains high. In 2023, the employment rate increased by 0.3 percentage points – to 64.2%. The unemployment rate in 2023 was 6.5%, down 0.4 percentage points from a year before. However, in 2023, the number of employed people fell by 0.2% or 2 thousand employees compared to 2022. The decrease in employment was largely influenced both by the slowdown of the economic growth rate and by the factors of the labour market supply side – the decrease of the working-age population, as well as the decrease of the total labour supply.

Given the still high uncertainty in external markets as well as the tense geopolitical situation, labour market activities generally slightly decreased in Q1-Q3 2024. Compared to the respective period a year before, the unemployment rate in Q3 2024 was 64.2%, down 0.5 percentage points from Q3 2023. The unemployment rate in Q3 2024 was 6.7%, up 0.2 percentage points from a year before. However, in Q3 2024, the number of employed people fell by 1.2% or 10.8 thousand employees compared to the respective period of 2023. The decrease in employment was largely influenced both by the slowdown of the economic growth rate and the decrease in the working-age employed population.

The situation in the labour market will continue to be influenced by supply-side factors, taking into account the negative demographic background, as well as the reduction in the total labour supply, thus keeping unemployment at a low level. Overall, the unemployment rate in 2024 could reach 6.9%, while the number of employees will reduced by 0.2%.

The monthly average gross wage continues to grow; however, its growth rates were lower than the inflation growth rate compared to the corresponding period from Q1 2022 to Q1 2023, causing a deterioration in purchasing capacity. Real wages have resumed rising since Q2 2023. The net average wage in 2023 (calculated using the employment taxes applicable in the workplace) was 1,119 euro or 72.9% of gross wage, and it increased by 11.3% during the year, outpacing the rise in consumption prices. The increase in real net wage, taking account of inflation, was 2.2%.

The net average wage in Q3 2024 (calculated using the employment taxes applicable in the workplace) was 1,231 euro or 72.3% of gross wage, and it increased by 9.4% during the year. The increase in real net wage, taking account of inflation, was 8.3%.

At the same time, positive impact on wages will continue to be maintained both by the process of wage convergence closer to the wage level of the economically developed countries of the EU, and by the growing shortage of qualified labour – the narrowing of the labour market, which makes it necessary for entrepreneurs to think more actively not only about how to attract new specialists, but also how to keep the existing ones, including through a review of wage rates.

Further economic development in the medium term depends on the situation in the external environment and progress in reforms. The highest risk to the growth of Latvia is related to global economic development, particularly the geopolitical situation. Further development of the EU's total economic space is similarly important. In the medium term, the economic advantages of Latvia are mainly based on the achieved macroeconomic stability, as a result of which Latvia's credit ratings have improved, as well as on the efficiency of planned aid programmes of the EU funds and the improvements in the business environment. If the war in Ukraine endures, the pace of economic recovery might be slower.

If the advantages of Latvian economic competitiveness are mainly based on technological factors, improvement of production efficiency, and innovation, and to a lesser extent on low-paid labour and low resource prices, Latvia's growth rates could potentially reach 4-5% per year in the medium term.

2. GLOBAL ECONOMIC DEVELOPMENT

The global economy is facing growing challenges. The war of aggression started by Russia causes untold suffering and destruction in Ukraine and has significant global consequences. The escalating conflict in the Middle East has so far had a limited impact on the EU economy, but there are growing risks of global disruptions to oil and gas supplies. Meanwhile, a slow innovation process and weak business dynamics in EU manufacturing sectors continue to pose challenges. These factors, combined with the introduction of tighter financial conditions, contributed to stagnation in the EU from the end of 2022 to 2023. Labour markets have remained resilient. However, there are uncertainties about the extent to which the EU economy will be able to maintain its return to growth in the increasingly unfavourable and uncertain environment. The EC forecasts global growth of 3.2% in 2024 and 3.3% in 2025.

Table 2.1

GDP Growth Rate
year-on-year changes, as per cent

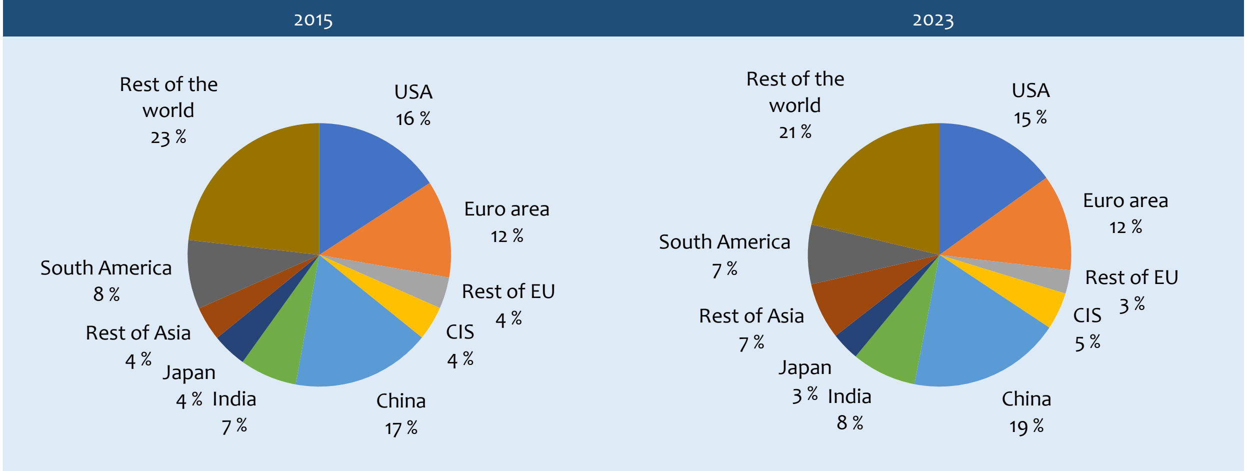
	2021	2022	2023	2024f	2025f
World, including:	**6.5**	**3.4**	**3.2**	**3.2**	**3.3**
USA	6.1	2.5	2.9	2.7	2.1
United Kingdom	8.6	4.8	0.3	1.0	1.4
EU, including:	6.3	3.5	0.4	0.9	1.5
Euro area	6.3	3.5	0.4	0.8	1.3
Japan	2.7	1.2	1.7	0.2	1.2
China	8.5	3.0	5.2	4.9	4.6

Source: EC *European Economic Forecast, Autumn 2024*
f – forecast

Rapid GDP growth in 2024 in the United States is largely driven by strong domestic demand. However, growth rates are expected to moderate in 2025 as the labour market cools and fiscal policies become slightly tighter, and GDP will grow by 2.1%. Inflation has declined and is close to the target, allowing the Federal Reserve System to make its first interest rate reduction since the COVID-19 pandemic. Risks to the growth outlook are balanced, but uncertainty remains elevated, especially regarding the policies of the new administration following the presidential elections in November.

Figure 2.1

Breakdown of the Total Global GDP by Countries and Groups of Countries
by purchasing capacity parity, share in the global total, as per cent



Source: International Monetary Fund (IMF)

China's economic outlook for 2024 points to growing difficulties fuelled by weak domestic confidence, slow wage growth and a protracted real estate crisis hampering growth. Despite recent policy measures, including a substantial monetary and fiscal support package, their full impact remains unclear. In the future, structural challenges are likely to continue to constrain growth, although stronger policy support in the short term could help growth to recover. The EC forecasts that China's economic growth will reach 4.9% in 2024, slowing slightly to 4.6% in 2025.

Table 2.2

Main Macroeconomic Indicators of the EU Member States
as per cent

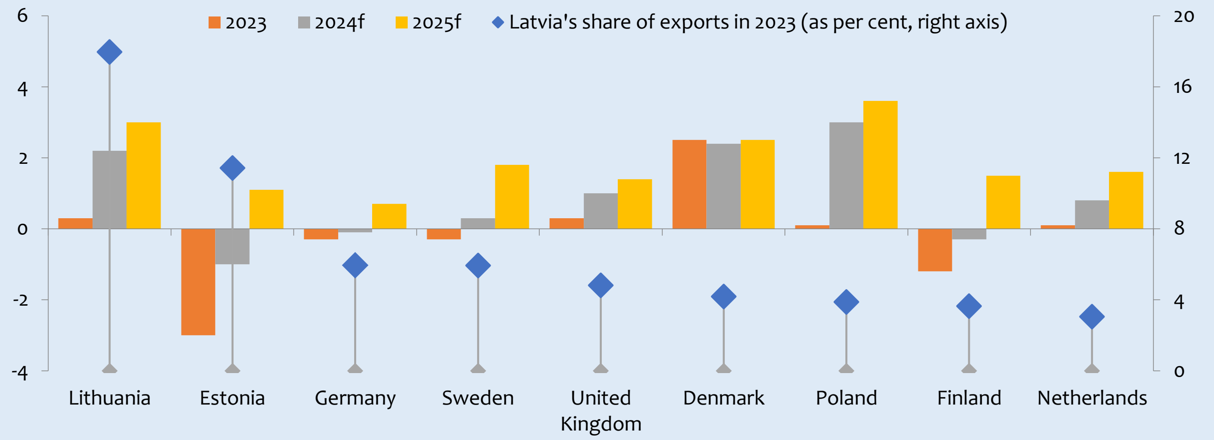
	Real GDP			Inflation			Unemployment rate		
	2023	2024f	2025f	2023	2024f	2025f	2023	2024f	2025f
EU	**0.4**	**0.9**	**1.5**	**6.4**	**2.6**	**2.4**	**6.1**	**6.1**	**5.9**
Austria	-1.0	-0.6	1.0	7.7	2.9	2.1	5.1	5.3	5.3
Belgium	1.3	1.1	1.2	2.3	4.4	2.9	5.5	5.6	5.7
Bulgaria	1.9	2.4	2.9	8.6	2.5	2.3	4.3	4.3	4.0
Czech Republic	-0.1	1.0	2.4	12.0	2.7	2.4	2.6	2.6	2.7
Denmark	2.5	2.4	2.5	3.4	1.3	1.9	5.1	5.8	5.8
France	0.9	1.1	0.8	5.7	2.4	1.9	7.3	7.4	7.5
Greece	2.3	2.1	2.3	4.2	3.0	2.4	11.1	10.4	9.8
Croatia	3.3	3.6	3.3	8.4	4.0	3.4	6.1	5.1	4.7
Estonia	-3.0	-1.0	1.1	9.1	3.6	3.6	6.4	7.5	7.7
Italy	0.7	0.7	1.0	5.9	1.1	1.9	7.7	6.8	6.3
Ireland	-5.5	-0.5	4.0	5.2	1.4	1.9	4.3	4.4	4.4
Cyprus	2.6	3.6	2.8	3.9	2.2	2.1	5.8	4.9	4.7
Latvia	1.7	0.0	1.0	9.1	1.2	2.2	6.5	6.7	6.7
Lithuania	0.3	2.2	3.0	8.7	0.9	1.7	6.9	7.5	7.0
Luxembourg	-1.1	1.2	2.3	2.9	2.3	2.4	5.2	6.0	6.0
Malta	7.5	5.0	4.3	5.6	2.5	2.2	3.5	3.2	3.1
Netherlands	0.1	0.8	1.6	4.1	3.2	2.4	3.6	3.7	3.8
Poland	0.1	3.0	3.6	10.9	3.8	4.7	2.8	2.9	2.8
Portugal	2.5	1.7	1.9	5.3	2.6	2.1	6.5	6.4	6.3
Romania	2.4	1.4	2.5	9.7	5.5	3.9	5.6	5.5	5.5
Slovakia	1.4	2.2	2.3	11.0	3.1	5.1	5.8	5.5	5.3
Slovenia	2.1	1.4	2.5	7.2	2.1	3.2	3.7	3.5	3.6
Finland	-1.2	-0.3	1.5	4.3	1.0	2.0	7.2	8.2	7.9
Spain	2.7	3.0	2.3	3.4	2.8	2.2	12.2	11.5	11.0
Hungary	-0.9	0.6	1.8	17.0	3.8	3.6	4.1	4.5	4.3
Germany	-0.3	-0.1	0.7	6.0	2.4	2.1	3.1	3.3	3.3
Sweden	-0.3	0.3	1.8	5.9	1.9	1.5	7.7	8.5	8.4
United Kingdom	0.3	1.0	1.4	6.8	3.1	2.4	4.0	4.3	4.2

Source: EC – *European Economic Forecast. Autumn 2024*
f – forecast

Economic activity in Japan in 2024 is projected to remain weak, reflecting weak domestic demand in the first half of the year. Growth is likely to accelerate in the coming years, as strong wage growth fuels a recovery in private consumption. Japan's GDP is projected to grow by 0.2% in 2024 and 1.2% in 2025. Consumer price inflation is expected to fall below the central bank's 2% target in 2025 and remain moderate thereafter.

Figure 2.2

Economic Development of the Main Partner Countries of Latvia
annual real GDP growth, as per cent



Source: CSB, EC – European Economic Forecast, Autumn 2024
f – forecast

The euro area economy is expected to grow 0.8% in 2024, while growth rates will increase to 1.3% in 2025.

Germany's economic activity is projected to decline by 0.1% in 2024. High uncertainty continues to have a negative impact on consumption and investment, while trade prospects have deteriorated as global demand for industrial goods has declined. Domestic demand is expected to increase further, supported by rising real wages. This could boost GDP growth to 0.7% in 2025 and 1.3% in 2026. The government budget deficit is likely to decrease, while the government debt ratio will stabilise.

After slow growth in 2024 with GDP growing by 0.3%, the economy of Sweden is projected to recover in 2025 and continue to grow in 2026. GDP is expected to increase by 1.8% in 2025. Easing of financial conditions and falling inflation will boost real income and domestic demand. Inflation is expected to reach its lowest level in 2025 and remain just below 2% in 2026. The labour market will recover gradually. Public finances will improve. The government debt-to-GDP ratio is likely to remain stable.

The economy of the United Kingdom grew faster than expected in the first half of 2024 recovering from a slight technical recession at the end of 2023. However, growth is likely to slow in the second half of the year as the foundations of economic activity remain weak and private consumption and investment remain low. Fiscal policies are expected to keep becoming tighter, while further easing of monetary policies could contribute to a recovery in domestic demand in 2025 and 2026. GDP is projected to grow gradually, reaching 1.4% in 2025, although improvements in trade and investment will be moderate.

After unexpectedly strong GDP growth in the first half of 2024, economic activity in Russia is expected to slow and weaken further. Inflation, which has been rising for most of 2024, is expected to start gradually easing thanks to tight monetary policies. Recently introduced tax increases will boost revenues outside the energy sector, helping to contain the budget deficit despite high war-related expenditures. Public debt is likely to increase only slightly.

Despite continued and intensified attacks on critical infrastructure, the economy of Ukraine has so far shown remarkable resilience. Growth is facilitated by renewed export opportunities, high defence expenditure and rising household consumption, and is projected to reach 3.5% in 2024 and 2.8% in 2025. Due to increased hostilities, reconstruction work is not expected to start until 2026. Inflation is expected to rise to 9.2% in 2025, driven by rising energy costs and wage increases, however, it could decline in 2026 as the supply-side pressure eases. The continued increase in expenditure is likely to keep the government budget deficit at elevated levels.

In the last years, Baltic States have been experiencing the fastest rates of increase in prices, especially food and energy prices, among EU Member States.

Lithuania's economy is expected to continue to grow, supported by a strong increase in private consumption and active services exports. GDP growth is estimated at 2.2% in 2024 and 3% in 2025 driven by resumed investment and strong consumption. Inflation will reduce substantially in 2024, mainly due to falling energy and unprocessed food prices. Inflation is expected to rise to 1.7% in 2025 and 1.6% in 2026, as service prices and other components return to their normal levels. The government budget deficit is likely to increase gradually, while the government debt-to-GDP ratio will remain stable.

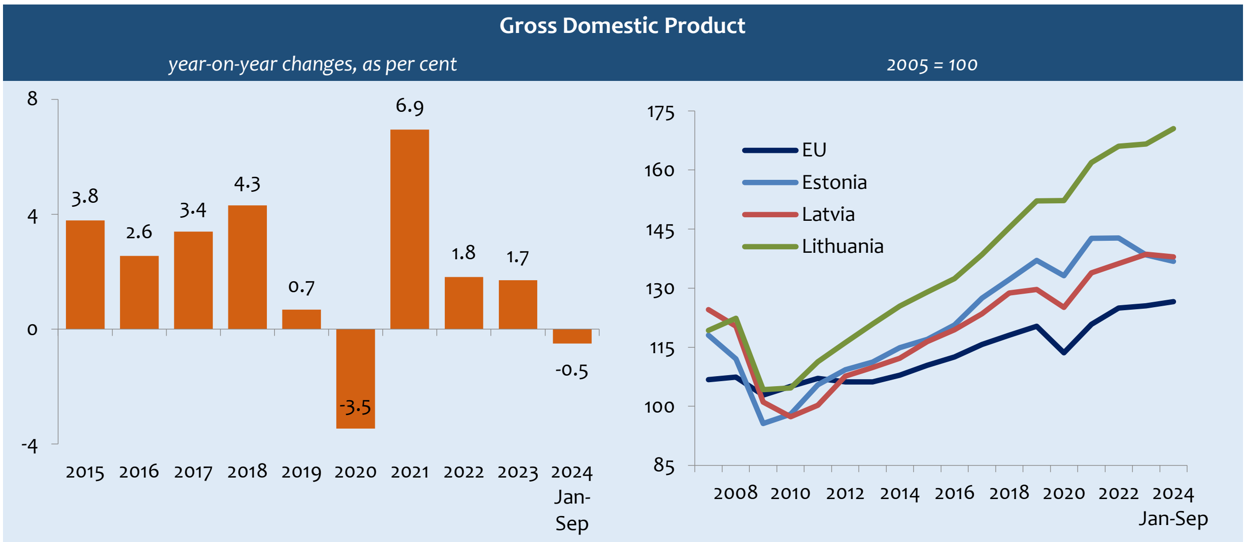
Estonia's economy is expected to remain in recession in 2024 driven by weak domestic demand. In 2025, a number of tax increases will constrain private consumption despite higher wages and lower household debt servicing costs. Exports are recovering slowly, but investment activity is likely to remain low as capacity is underutilised. GDP is expected to grow by 1.1% in 2025 and 2.6% in 2026. Inflation, driven by tax increases, is projected at 3.6% in 2025 and 2.4% in 2026.

3. GROSS DOMESTIC PRODUCT AND AGGREGATE DEMAND

3.1. DYNAMICS AND STRUCTURE

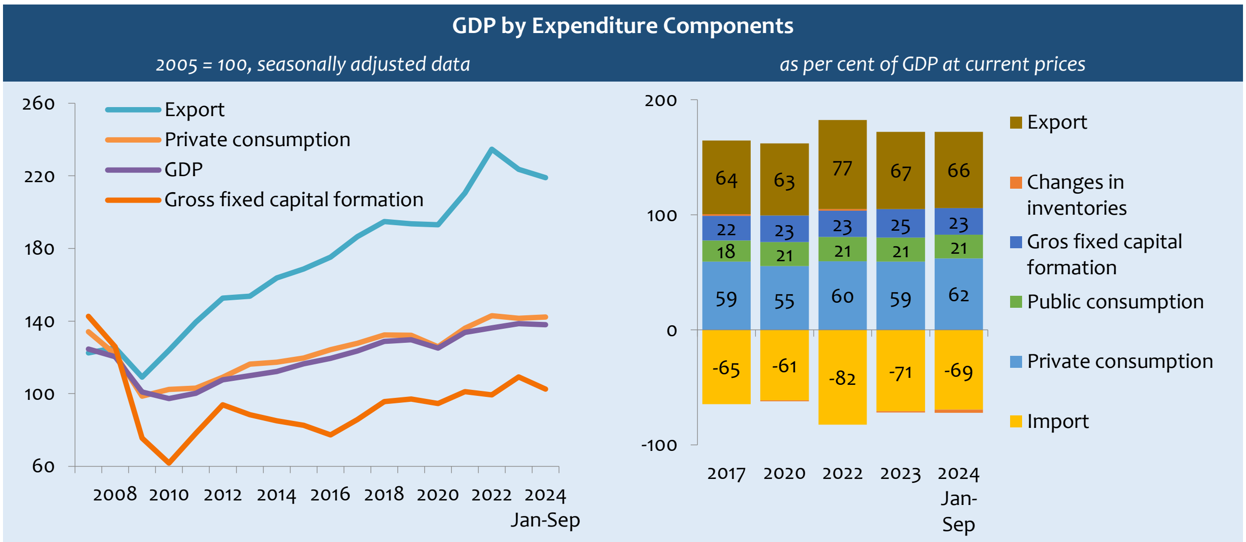
From 2015 to 2019, GDP grew by 2.9% per year on average. In 2015, Latvia's economy grew rapidly, boosted by rapid growth in private consumption and exports, despite the tense geopolitical situation in the region. Growth was weaker in 2016 due to the drop in investments and delayed implementation of the EU's new structural funds programme.

Figure 3.1



Growth became more rapid in 2017-2018 fostered by the improvement of the situation in the EU, the commencement of a new structural funds programme, increase in wages and employment. In this period, exports, investments, private and public consumption were growing stably. The deceleration of economic development in 2019 was underpinned by both internal factors (the investments from EU funds have reached their maximum, developments in the financial sector, changes in port management), and external factors (revision of global trade relations, Brexit, slower growth in the EU countries).

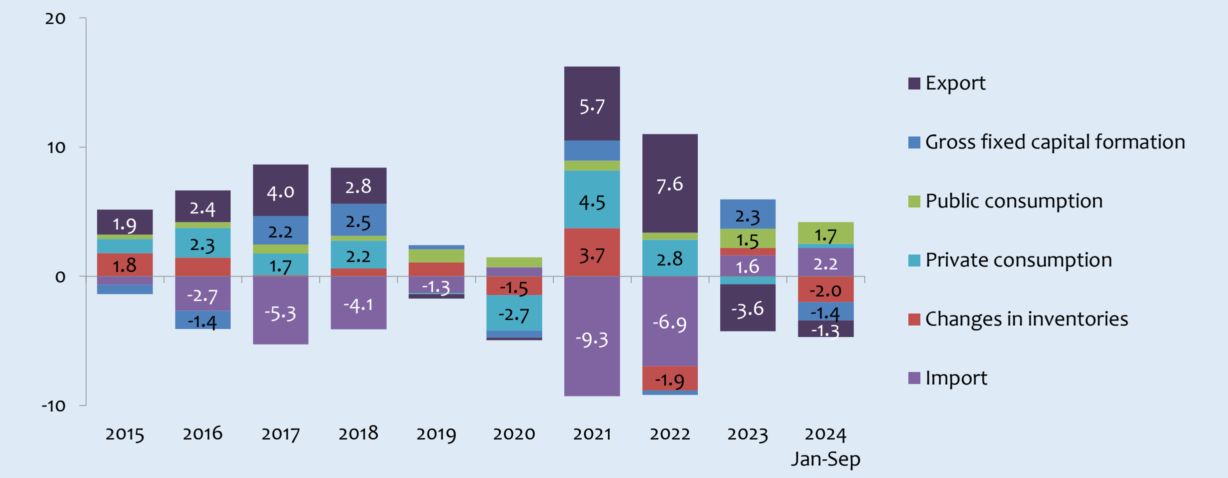
Figure 3.2



Economic development in 2020 was mainly dependent on the negative effects of the COVID-19 crisis, which was the only time when GDP dropped since the financial crisis. Economic development in 2021 was still affected by the COVID-19 pandemic and measures to restrict it, but very rapid growth was observed in the economy in the middle of the year largely due to the base effect. The significant impact was from the increase in exports fostered by the favourable atmosphere in Latvia's largest export markets and the rise in private consumption. After the rapid recovery of the economy from the crisis of the COVID-19 pandemic in 2021, growth in Latvia slowed in 2022. The economic development in 2022 was significantly influenced by the disruptions in supply chains caused by Russia's invasion of Ukraine, the rise in inflation caused by the cost of energy and food, as well as the decline in global demand.

Figure 3.3

Contribution of Expenditure Components to GDP Changes
as percentage points



In 2023, economic development continued to be affected by the geopolitical situation and uncertainty, high prices and growing bank interest rates. The biggest impact came from the decline in exports and private consumption. The unfavourable external environment affected the Latvian export market, while the decreasing real income of the population negatively affected household consumption. In contrast, the biggest increasing impact came from investment growth, with the most rapid investment increases in housing, buildings and structures underpinned by the growth of the construction sector. Government consumption also rose sharply.

In 2024, the economic situation was stagnant due to the unfavourable external environment, although inflation rates stabilised. GDP was 0.5% lower in Q1-Q3 2024 than a year before. The main growth-diminishing effects came from falling exports and investment, while the growth-boosting effects came from rising government consumption. The unfavourable situation in the external environment and weak demand in the main target markets affected Latvia's export performance. High uncertainty, weak lending and low demand have also contributed to a sharp decline in investment, especially private investment. Private consumption is gradually rising, positively influenced by real income growth. Prices are also stabilising, but remain high, especially for food and services, which is holding back private consumption growth.

From 2015 to 2023, among the Baltic states, Lithuania experienced the fastest growth, averaging 3.2% annually, while Latvia and Estonia grew by 2.4% and 2.1% respectively.

Table 3.1

GDP by Expenditure Components
year-on-year changes, as per cent

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024 Jan-Sep
GDP	**3.8**	**2.6**	**3.4**	**4.3**	**0.7**	**-3.5**	**6.9**	**1.8**	**1.7**	**-0.5**
Private consumption	1.8	3.9	2.8	3.6	-0.1	-4.8	8.1	5.1	-1.0	0.6
Public consumption	1.8	2.5	3.8	1.9	5.6	3.9	3.7	2.4	7.0	8.2
Gross fixed capital formation	-3.0	-6.3	11.0	11.5	1.3	-2.4	6.8	-1.6	9.9	-6.1
Export	3.1	3.9	6.5	4.4	-0.6	-0.3	9.1	11.4	-4.7	-2,1
Import	1.0	4.2	8.6	6.3	2.0	-1.1	15.1	9.9	-2.0	-3.2

3.2. CONSUMPTION

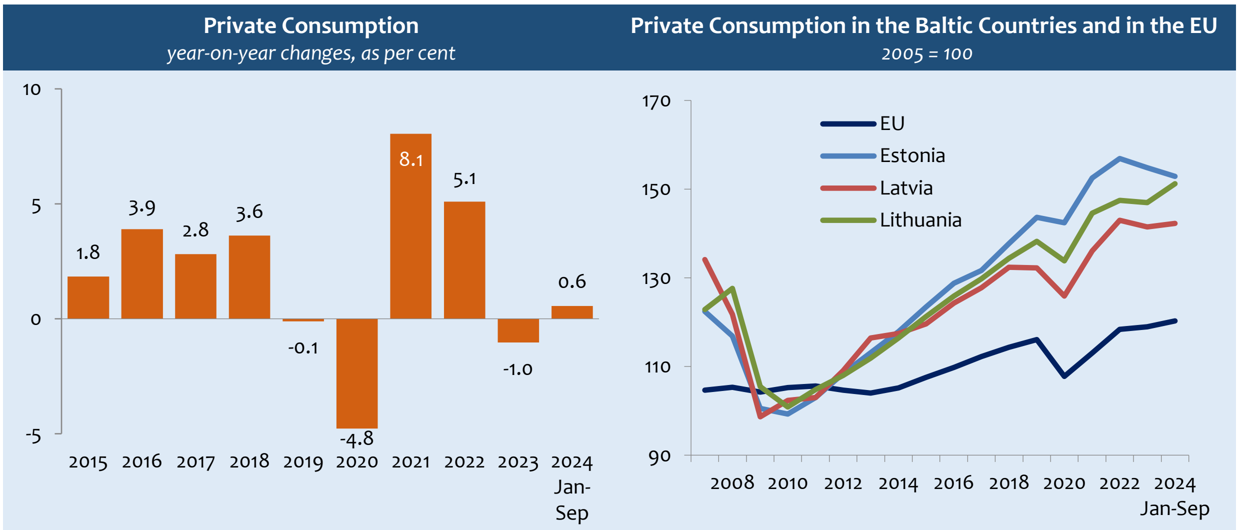
The increase in private consumption volumes, as well as overall economic growth, has been moderate since 2014. From 2014 to 2019, private consumption increased by an average of 2.1% annually. The increase was fostered by growth in wages, but the rise in employment was slow. In 2020, private consumption declined sharply due to the restrictions caused by the COVID-19 pandemic. As economics recovered, a rapid increase in private consumption was observed in 2021 and 2022 fostered by both the gradual lifting of COVID-19 restrictions and the increase in average wages, decrease in unemployment, and government support measures.

In 2023, household consumption was affected by the high level of prices, as well as rising interest rates. The fall in real income had a negative impact on people's purchasing power. The sharper decline in private consumption was offset by government support to compensate for high energy prices, faster pension indexation in August 2022, as well as savings made by citizens during the COVID-19 crisis.

Despite improving purchasing power and stabilising prices, they remain high, especially for food and services, which is holding back faster private consumption growth in 2024. The population has adapted to cheaper and smaller purchases and the sentiment to spend more remains cautious. Private consumption grew very moderately in Q1 and Q2 2024, but more rapidly in Q3 compared to the respective period of the previous year. Overall, private consumption increased by 0.6% in the three quarters of 2024 compared to the corresponding period of 2023.

Since 2015, Latvia has been having the slowest increase in private consumption in comparison with other Baltic countries.

Figure 3.4



In the structure of household consumption, most of the expenditure is on food, expenditure on housing is the second largest consumption group, while transport expenditure is the third priority. Within 10 years, the share of expenditure related to food, alcoholic beverages and tobacco, clothing and footwear, housing, transport and education has decreased in the structure of household consumption expenditure, while the share of expenditure related to housing equipment (furniture, household appliances and maintenance), health, communication, recreation and culture, restaurants, cafes and hotels, as well as insurance and financial services has increased.

High energy and food prices encouraged households to continue saving in 2023, which led to a sharp reduction in both housing-related expenditure (rent, maintenance and repairs, water, electricity, gas and solid fuel) by 9.5% and food expenditure by 3.2%, which also had the largest diminishing impact. Expenditure on health, housing equipment, alcoholic beverages and tobacco saw a more moderate decrease. The biggest boost came from household expenditure on transport, which increased by 6.1%. There were also significant effects from increases in expenditure on clothing and footwear (4.3%), information and communication (5.7%), as well as increases in expenditure on restaurant and hotel services (3.7%), partly due to the low base effect of the COVID-19 restrictions in early 2022.

In 2023, compared to 2013, household consumption expenditure increased in all groups of consumption expenditure, except education and insurance and financial services. Meanwhile, spending on transport, food, clothing and footwear, recreation and culture was the biggest consumer expenditure, which also led to an increase in overall costs.

Consumer sentiment generally improved between 2010 and 2019, despite being negative. The most optimistic sentiment level over the past five years had been reached in July 2019, when the rate was -1.7 points. Such an improvement in the sentiment has been largely fostered by rapid economic growth in recent years. Latvian consumers were generally more optimistic, and consumer confidence has been higher than the EU average since mid-2011. The confidence level was more pessimistic in 2017-2018 when Latvia's indicator slipped below the EU average. After an improvement in 2019, pessimistic trends prevailed in the following years, which have been overcome during January-October 2024.

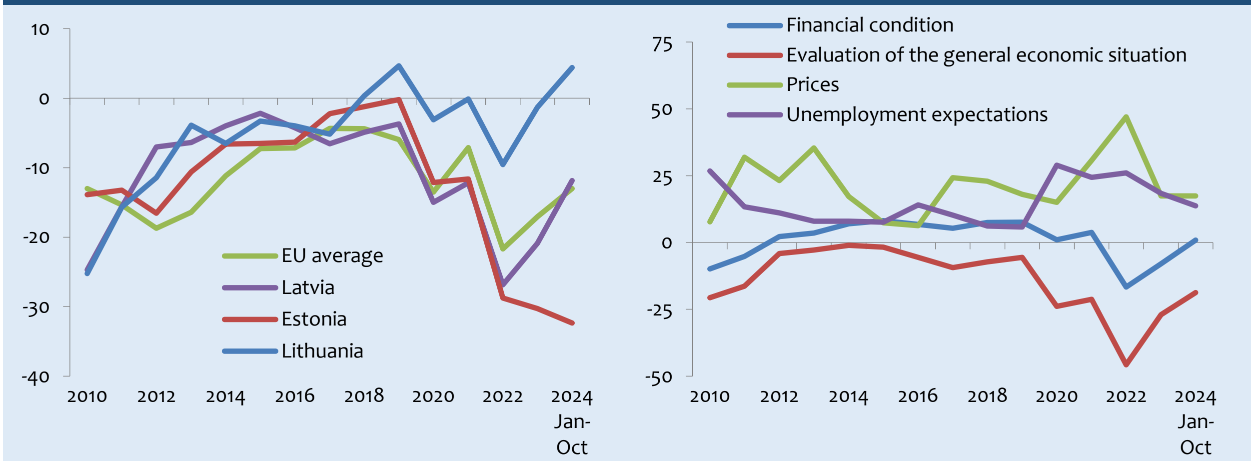
As a result of the COVID-19 pandemic, the consumer confidence indicator experienced a sharp decrease in the spring of 2020. As the epidemiological situation improved and restrictions eased, in 2021, consumer sentiment broadly improved, but in the second half of the year, optimism was tempered by growing uncertainty and concerns about the development of the spread of COVID-19, as well as price growth trends.

Figure 3.5

Consumer Confidence Indicator*

response balance, seasonally adjusted data

Consumer confidence in the Baltic countries and in the EU | Consumer evaluation for the upcoming 12 months



* Consumer confidence indicator is calculated as the average of response balance to 4 questions – about the financial situation, the general economic situation, unemployment assessment and savings in the next 12 months.

Russia's invasion of Ukraine has severely impacted consumer confidence in 2022, and this trend was exacerbated by inflation. The confidence indicator fell to its lowest level since 2010. Consumer sentiment improved quite substantially in 2023, as the inflation pressure eased and wages rose.

Consumer confidence in 2024 is stable, showing a gradual slight improvement. The main items have not changed dramatically over the 10 months. The only item that has seen a sharper change is inflation expectations, which rose and remained at their highest level since June. In low inflation conditions, this can be explained by rising service prices and still high food prices.

Consumers' assessment of the financial situation of the family in the future has largely stabilised since 2012 and was generally positive during the year. Optimism has been growing on average since mid-2017, continuing until April 2020. While overall the financial prospects of families were viewed positively in 2020 and 2021, this indicator deteriorated in those years. However, in 2022, following Russia's invasion of Ukraine, a sharp decline followed. The indicator has been improving since 2023. In 2024, the positive trend continues showing a positive performance over the 10-month period.

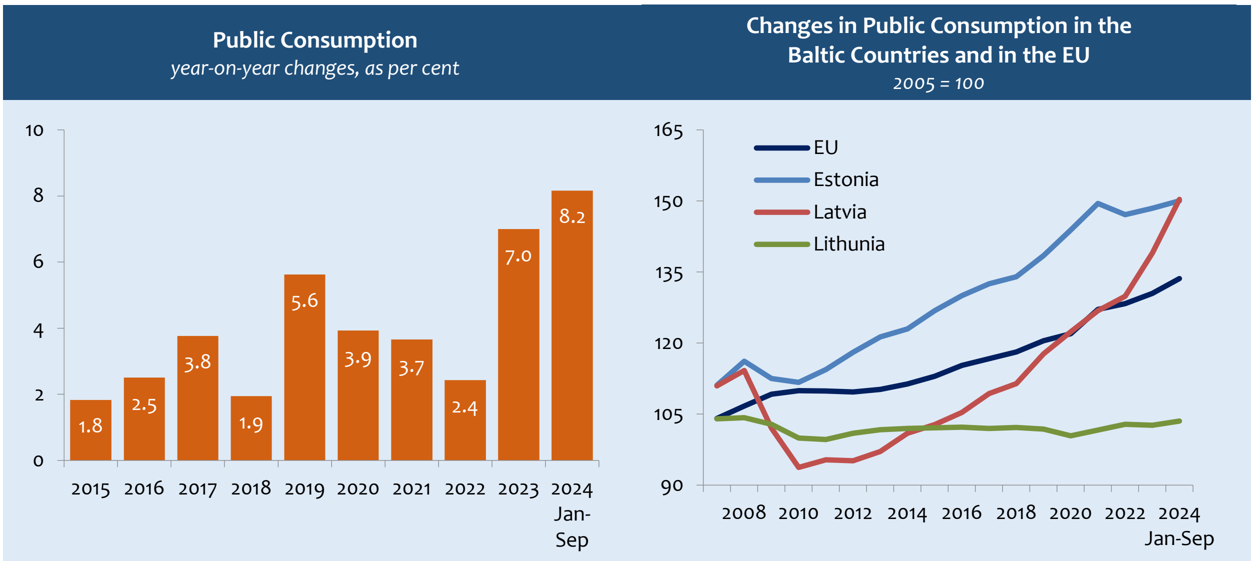
The assessment of the overall situation in the country, which has tended to improve since 2010, is essentially similar to the assessment of the financial situation of the family. A rapid increase has been observed until 2012, and in 2012 consumer confidence stabilised at the same time sticking to the ascending trend. The emergency announced in early 2020 drastically reduced consumer optimism. It continued to ease throughout the year and into 2021 as well. A particularly sharp decline was experienced in 2022. Similarly, this indicator for the assessment of the family's financial situation tends to increase since 2023. It should be noted that the prospects of the country's economic situation are evaluated much more critically than the future of the financial condition of the family.

Unemployment expectations of consumers have been generally falling since 2010, although fluctuations were observed and stuck to the descending trend. However, since 2016 these expectations resumed growth reaching the highest level (24.3 points) by the end of 2016. Since the middle of 2017, unemployment expectations have been generally declining, which is largely related also to the overall decline in the unemployment rate and an increase in employment. Unfortunately, in 2020, unemployment expectations of consumers grew rapidly, reaching 63.1 points, the highest level since 2010. Consumers then regained confidence in their job prospects in 2021, but the Russian invasion of Ukraine in 2022 worsened this. The favourable labour situation and rising wages have led to an increasingly positive outlook since 2023, and unemployment expectations are generally falling.

Inflation expectations were rising sharply until April 2011. Since the middle of 2011, inflation expectations have been cyclical and this was the consumers' way of responding to different changes, however, they have been generally declining. Since the middle of 2013, the drop has been very rapid reaching the level of -2.3 points in September 2016, the lowest since 2011. At the end of 2016, inflation expectations started to pick up again, a trend that persisted until mid-2017. Since the end of 2017, inflation expectations have moderately reduced, largely under the influence of a slower rise in prices and high inflation in the previous years. The COVID-19 pandemic did not significantly influence inflation expectations in 2020. Consumer concerns about price increases rose significantly in 2021, further boosted by Russia's invasion of Ukraine in 2022, and the highest rate of inflation expectations was reached in May and June. In 2023, as price growth reduces, the inflation expectations indicator is also shrinking, except for June, affected by the planned increase in electricity distribution tariffs. The indicator declined in early 2024 but has increased since June and remains at the level of the previous year during the 10-month period.

The volume of public consumption or public services has grown at the fastest pace since 2015 as budget revenues increased. Overall, from 2015 to 2023, public consumption was growing by an average of 3.6% per year.

Figure 3.6



The government support measures to mitigate the negative effects of the COVID-19 crisis maintained a positive increase in public consumption in 2020 and 2021. In 2022 and 2023, support measures implemented by the state to compensate for the rapid increase in energy prices for households and enterprises contributed to the increase in public consumption.

In recent years, public consumption has kept growing largely at the expense of the government deficit so that government priority measures can be financed. Budget expenditure has been growing rapidly in recent years to increase public defence capacity and ensure public defence funding of 2-2.5% of GDP (3.5% of GDP in 2025). To promote a sustainable and balanced country's economic development, deferred CIT for enterprise profits was introduced, the tax burden of the labour force was reduced and an increase of funding for defence, health, education, energy and road maintenance was primarily ensured within the scope of the state budget possibilities.

Since 2015, Latvia has been having the most rapid increase in public consumption in comparison with other Baltic countries.

3.3. INVESTMENT

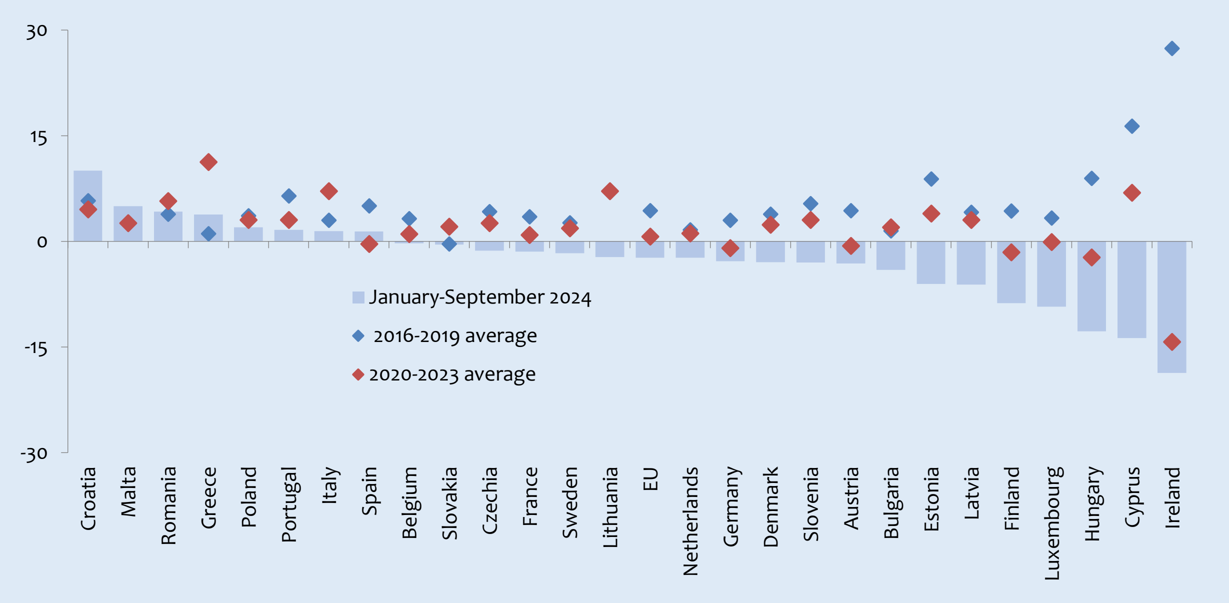
Investment activities in the Latvian economy are still very volatile, significantly affected by changes in the geopolitical situation, availability of financing and production resources, as well as other external and internal factors.

In the last four years (2020-2023), expenditure on total fixed capital formation increased by an annual average of 3.0%, more moderate than before the COVID-19 pandemic in 2016-2019, when growth averaged 4.1% per year.

In 2020, investment activities declined significantly due to the COVID-19 pandemic. Sensing the uncertainty about the possibility of combatting the pandemic soon, in 2020, expenditure on fixed capital formation fell by 2.4%, and this was the worst indicator in the Baltic States. However, as the economy stabilised after the shock caused by the COVID-19 pandemic, investment volumes increased by 6.8% in 2021.

Figure 3.7

Changes in Investment Volumes in the EU countries
changes as per cent



The war in Ukraine has increased uncertainty, but its impact on investment dynamics has been rather limited, with investment falling by 1.6% in 2022. Investment activity was limited by the increase in construction prices and delays in the absorption of EU-funded programmes. Moreover, in 2023, investment activities were growing rapidly and were 9.9% higher than a year ago.

Overall, from 2020 to 2023, investment in the national economy of Latvia amounted to 23.5% of GDP, slightly higher than the average indicator of the three years before the pandemic, but still lower than before the global financial crisis.

In 2024, investment dynamics are on a downward trend. In January-September of the year, expenditure on total fixed capital formation decreased by 6.1% year-on-year, significantly affected by weakening private investment.

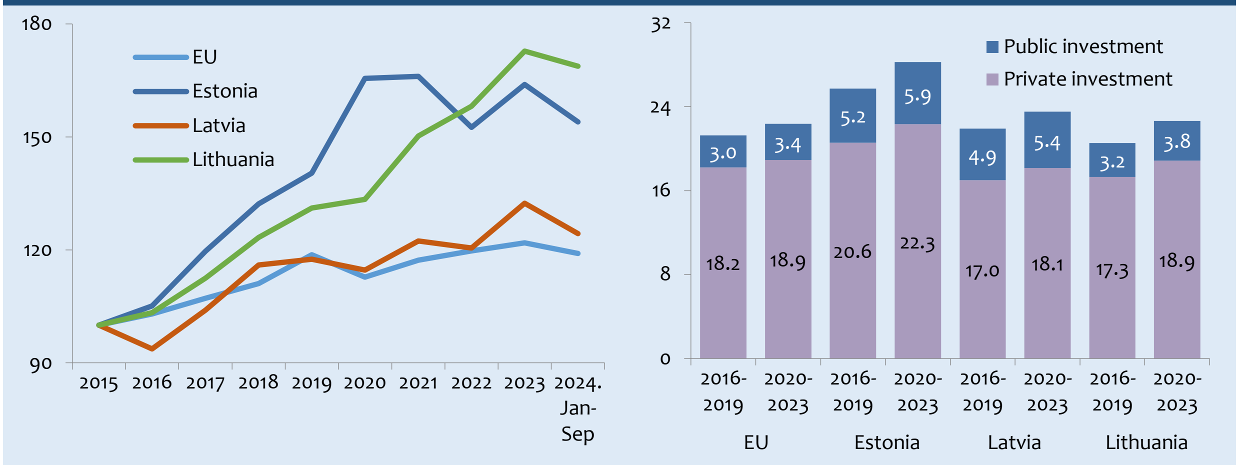
The high uncertainty associated with the geopolitical situation and the further development of the global economy, uncertainty about the course of the Russian war in Ukraine, weak lending, as well as the deterioration of financing conditions due to the monetary policy implemented by the European Central Bank (ECB) have reduced the incentive of the private sector to invest.

Private investments have been growing by 3% per year on average in the last four years (2020-2023), almost 1.1 percentage points more moderately than before the COVID-19 pandemic (2016-2019). Measures to combat the COVID-19 pandemic limited overall economic activity and discouraged previously planned investments. In 2020, the private sector investment volume fell by 6.5%, compared to the previous year. However, in the years that followed, private sector investments grew by an average of 6.4% annually. Private investment dynamics were negative in 2024. In January-September of this year, their volume (at constant prices) was 5.2% lower than a year before.

Figure 3.8

Increase in Investments in the Baltic Countries and in the EU
2015 = 100

Investment Level in the Baltic Countries and in the EU
as per cent of GDP



Although since 2021 the dynamics of private investment have been generally on an upward trend, their level is still lower than before the global financial crisis and also lower than in most EU countries, including Lithuania and Estonia. This is largely affected by weak lending, which has been very low for a long time.

According to the data of the Bank of Latvia, the balance of loans to non-financial corporations and households in 2023 accounted for 28.5% of GDP, which is well below the level before the global financial crisis and one of the lowest in the EU. Compared to 2022, it shrank by 2.1 percentage points. It should be noted that lending is gradually growing in 2024 as interest rates gradually fall and overall sentiment improves. In Q1-Q3 of this year, outstanding loans issued to non-financial corporations increased by 3.7%, while those to households rose by 5.4%. The domestic credit portfolio reached 29.5% of GDP in October 2024.

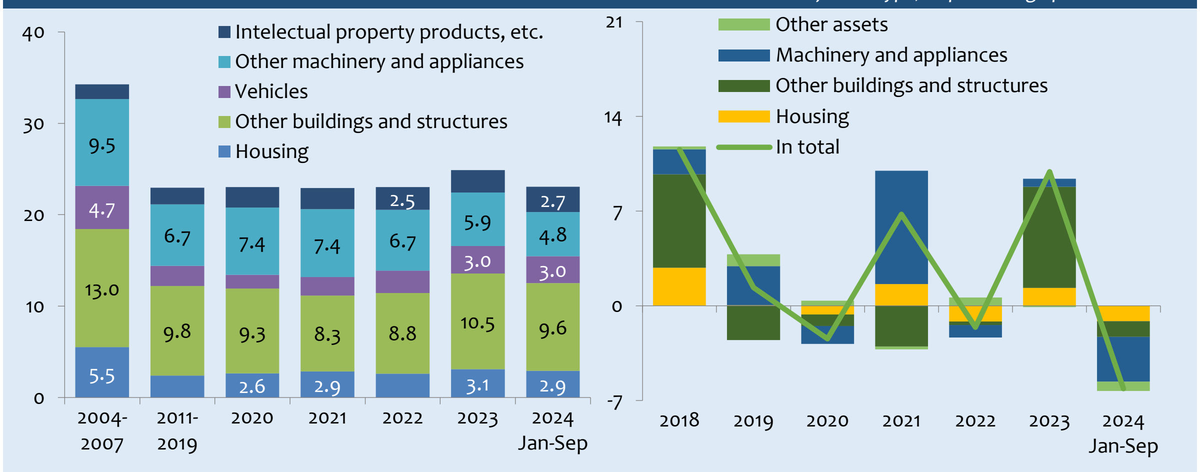
Analysts at the Bank of Latvia note that, despite a moderate increase in the credit portfolio, its size remains small against the background of the overall economy. In addition, the reduction of base interest rates at the September ECB's Governing Council meeting and rising expectations of further reductions will continue to boost the availability of lending at lower borrowing costs.

Figure 3.9

Investment by Asset Type

as per cent of GDP

year-on-year changes, as per cent; contribution of asset type, as percentage points



Public investments in Latvia amount to almost 1/5 of total investments in the Latvian national economy and their dynamics are largely related to the cyclicity of absorption of EU structural funds. From 2016 to 2019, public investments were growing by an average of 4.3% per year (at constant prices). Although we had to experience the COVID-19 crisis, public investment increased by 11.4% in 2020 and 1.7% in 2021. Public investment shrank in 2022 and was 21.5% lower than the year before, while it exceeded the level of the previous year by 26.4% in 2023. Overall, public investment dynamics have been positive over the last four years (2020-2023), growing at an average annual rate of almost 3%, slightly more moderate than in the years before the COVID-19 pandemic. However, in January-September 2024, compared to the corresponding period of the year before, state budget expenditure on total fixed capital formation (at constant prices) was 10% lower.

Investments in construction assets constitute the largest part of the total investment. These mainly are investments in buildings and structures, which accounted for almost 40% of the expenditure on gross fixed capital formation in the last four years (2020-2023). It should be noted that investment in construction assets showed negative dynamics between 2019 and 2022 declining by an average of 2.8% per year and, in 2022, they were 12.4% lower than in 2018. The decline in investment is due to both the end of absorption of the EU Structural Funds in 2019 and the crisis caused by the COVID-19 pandemic in 2020. In 2022, investments in construction assets were significantly constrained by rising construction costs and delays in the absorption of EU-funded programmes. In 2023, investments in construction assets rose sharply and were 19.1% higher than the year before, including a 21.3% increase in investments in civil engineering structures and buildings and an 11.7% increase in investments in dwellings. Rapid investment dynamics are partially explained by the low base effect. Moreover, the positive dynamics were not stable and investment activities in construction assets declined by 4.7% in January-September 2024, including by 3.1% in civil engineering structures and buildings and by 9.8% in dwellings.

Investments into machinery and appliances react sensibly to shocks, their recovery after the crisis is slower than in other assets. This is mainly due to weak lending, relatively high private debt and unfavourable market conditions, as well as low capacity utilisation. In 2020-2023, investments into machinery and appliances accounted for 38.4% of total investments. Moreover, it should be noted that their dynamics were more rapid than in other assets. The impact of the crisis caused by the COVID-19 pandemic on investment in manufacturing machinery and equipment was relatively small. In 2020, investment in these assets fell by 3.4% driven mainly by the lower than a year ago investment in vehicles (by 31.6%). By contrast, in 2021, 21.8% more was invested in machinery and appliances than a year before. However, in 2022 and 2023, investment fluctuations in these assets were overall negligible, remaining on average at the levels of 2021. In January-September 2024, investments in machinery and appliances reduced slightly and were 8.3% lower than a year ago.

Investments in intellectual property assets have accounted for around 10% of total investment in the last four years (2020-2023). They are characterised by stability in the years of economic recession, and moderately growing dynamics are generally observed. Since 2020 (when evaluating at constant prices), investments in these assets increased by 6%, and their levels are higher than before the COVID-19 pandemic. In January-September 2024, 7% less than a year ago was invested in intellectual property products and this investment accounted for 2.6% of GDP.

Table 3.2

Gross Capital Formation
annual average

	1995–2007	2008–2010	2011–2019	2021	2022	2023	2024 Jan-Sep
			real growth				
GDP	**7.4**	**-7.9**	**3.2**	**6.9**	**1.8**	**1.7**	**-0.5**
Gross capital formation	18.1	-25.3	4.4	23.9	-8.7	11.7	-12.8
– gross fixed capital formation	18.4	-22.2	-3.0	6.8	-1.6	9.9	-6.1
			as per cent of GDP				
Gross capital formation	27.9	27.9	24.4	24.7	24.1	24.0	20.2
– gross fixed capital formation	25.2	26.0	23.1	22.9	23.0	24.9	23.1
– changes in inventories	2.6	1.9	1.3	2.8	1.2	-0.9	-2.9

Investments in Latvia's economic sectors are unsustainable, and their volatility is affected by both the cyclicity of the absorption of EU structural funds and the adjustment of private sector investment plans in line with changes in market conditions.

In the last five years (2015-2019) before the COVID-19 crisis the intensity of investment was moderate. Investment volumes increased more rapidly in services sectors – by an average of 3.5% annually, with the largest contribution from extensive investment in real estate activities, public administration, as well as administrative and support service activities. In commodity producing sectors, investments increased slowly – by an average of 0.4% annually. Overall, the investment intensity in the services sectors has been close to historical indicators since 2011, while in the manufacturing sectors it remains at a lower level.

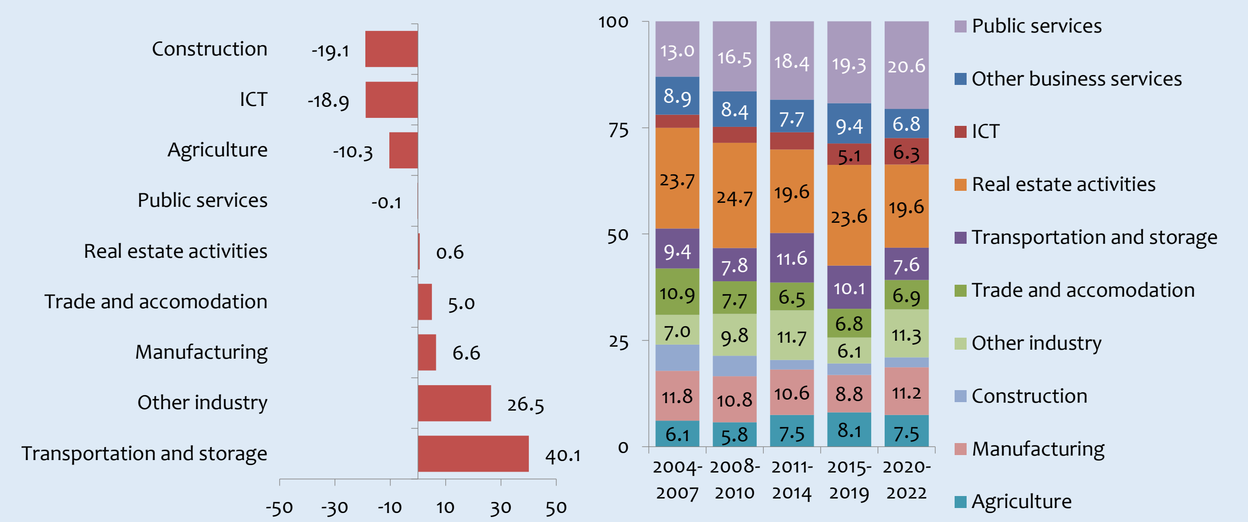
The crisis caused by the Covid-19 pandemic has affected the services sectors the most. In 2020, expenditure on fixed capital formation in the services sectors was 8.1% lower than a year ago. 17% more than in 2019 was invested in the commodity producing sectors, mainly due to the large volume of capital investment in the energy and communal services sectors. In 2021, investments in commodity producing and services sectors increased by almost 8.5% and 6%, respectively, exceeding the level of the previous year. Investments in commodity producing sectors continued to grow (by 12.4%) also in 2022, while investments in the services sectors were 8.2% lower than a year before. It should be noted that, despite the generally unfavourable conditions, investment activity in some sectors from 2020 to 2022 was rather high. There was a significant increase in investment volumes in sectors like manufacturing, energy, transportation and storage. Extensive investments were made in education, health, as well as information and communication. In 2023, investments in information and communication, financial intermediation and real estate transactions increased significantly, while investments in manufacturing were down 1.8% than a year earlier.

According to provisional data, in January-September 2024, overall capital investment in tangible assets (at current prices) in sectors of the Latvian economy increased by almost 4.9%, including by 5.9% in the commodity producing sectors and by 4.3% in the services sectors, thus the commodity producing sectors were growing at a faster rate. The largest increases in capital investments were in the energy sector, transportation and storage, and manufacturing. They account for almost 40% of total capital investment in January-September of this year.

Figure 3.10

Gross Capital Investments by Sectors
*January-September 2024, year-on-year changes, as per cent**

Gross Fixed Capital Formation by Sectors
as per cent



* Calculated using quarterly data, at current prices

Surveys carried out by the European Investment Bank (EIB) show that in the field of investment Latvian entrepreneurs mark as the most significant long-term barriers to investment the shortage of skilled personnel and uncertainty regarding the future. Investments are also limited by the high costs of energy sources and shortcomings in business regulation, as well as access to finance. The share of companies considering access to finance as a major obstacle to investment is among the highest in the EU.

The dynamics of investment will also be further affected by the uncertainty in the international environment. EU funding, which is an important incentive for increasing investment levels, will have a positive impact. Several projects to be funded under the Recovery and Resilience Facility will make a significant contribution to increasing investment activities. Increasing the loan portfolio, which has been low for a long time, also plays an important role. However, it should be noted that in the coming years, investment will be severely constrained by geopolitical uncertainty due to the war in Ukraine, limited availability of labour, and high energy and lending costs.

3.4. EXPORTS AND IMPORTS

Export usually is one of the main factors of economic growth, and its dynamics are closely related to the competitiveness of Latvian companies in foreign markets, as well as external demand and rates of development of economies of trade partner countries.

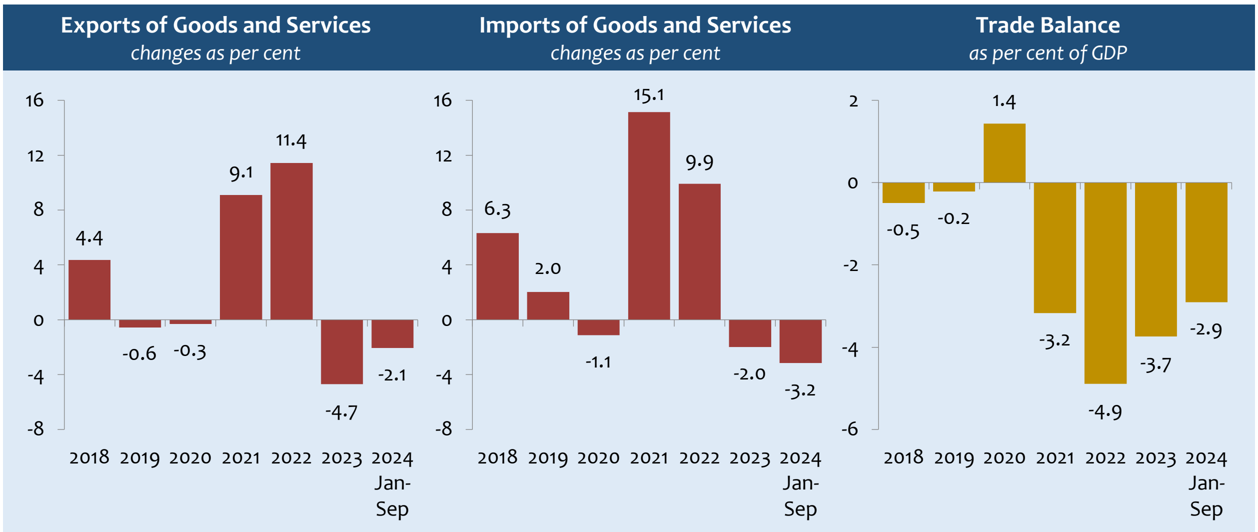
In 2014-2018, the development of exports was fostered by economic growth in EU countries and stable demand in other partner countries. In 2019, as the economic growth rates of partner countries declined, the development of exports was more moderate.

2020 and 2021 will be marked in history as the time of crisis caused by COVID-19, which affected all economic indicators in all countries around the world, also in Latvia. As exports are directly dependent on external demand, this crisis had a significant impact on export volumes. In early 2020, export volumes increased, while in March a sharp decline in rates following the beginning of the pandemic was observed. In Q2 2020, export volumes were already significantly lower than a year before. In the second half of 2020, as external demand increased, exports started to grow moderately. In Q1 2021, export volumes were like a year ago, while in Q2 2021, as the external demand had grown rapidly and partially due to the base effect, export volumes increased significantly. Rapid growth continued also in the second half of the year.

In 2022, despite active hostilities taking place near the country's eastern border, the rapid growth of exports continued. Like in the previous year, it was largely driven by strong external demand. It should be noted that export prices increased significantly in 2022, especially to EU countries – the main trading partner countries of Latvia.

The opposite picture was observed in 2023 – exports fell significantly, partly due to the base effect. Export prices also fell by 4.9%.

Figure 3.11



Similar export trends continued in the first half of 2024, when exports fell by 3.2%, while in Q3 they were already slightly above the level of last year's Q3.

As usual, the most important export markets for Latvia are EU countries, including its neighbours – Lithuania and Estonia.

Exports to CIS countries, including Russia, keep getting smaller. It should be noted that Russian military aggression in Ukraine keeps having a negative impact on the volume of trade deals with Russia, Belarus and other CIS countries. In this region, only Kazakhstan and Tajikistan have seen a slight increase in trade volumes in January-October 2024.

Exports to other countries, to which the United Kingdom belongs since the first half of 2020, make up an increasingly higher share in the total export structure. In January-October 2024, exports to other countries have been three times as high as exports to CIS countries.

The main factors of the development of imports of Latvian goods and services are increases in production volumes in manufacturing and income available to households. Import volumes are growing, as internal demand is growing. In 2020, as internal demand dropped considerably, import volumes slightly reduced. In 2021, disparate trends were observed. In particular, in early 2021, a moderate increase in imports was observed. However, starting from Q2 2021, because of the significant increase in demand and the base effect, imports of goods and services were significantly higher than a year ago. Similar trends still existed in 2022.

The development of imports in 2023 followed a pattern similar to that of exports – both import volumes and prices fell, partly due to the base effect. The first half of 2024 was also negative for imports, but in Q3 there was already some growth in imports.

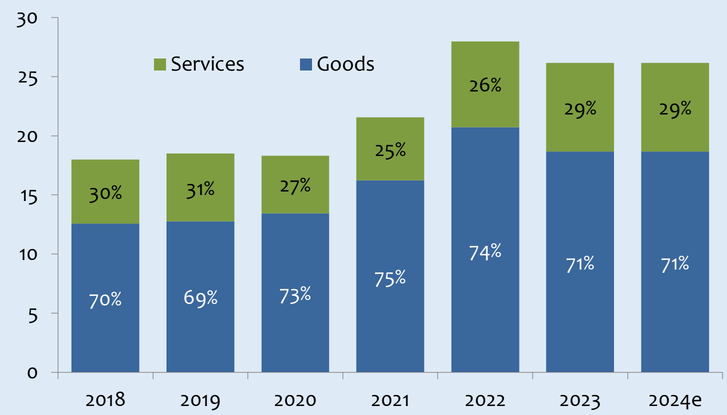
In 2020, when import volumes were declining more rapidly than export volumes under the influence of COVID-19, the export-import balance indicator reached historically the highest positive level. As the rapid increase in trade volumes resumed in 2021-2023, the export-import balance deteriorated considerably. Although the balance is below zero in Q1-Q3 2024, it is still on an upward trend.

EXPORTS

More than two-thirds of Latvian exports are composed of exports of goods. Until 2019, this proportion has not significantly changed. It should be noted that from 2020 to early 2022, when the possibilities of exporting services were considerably restricted due to the COVID-19 crisis, the export structure changed in favour of exports of goods.

Figure 3.12

Exports of Goods and Services
billion euro and percentage



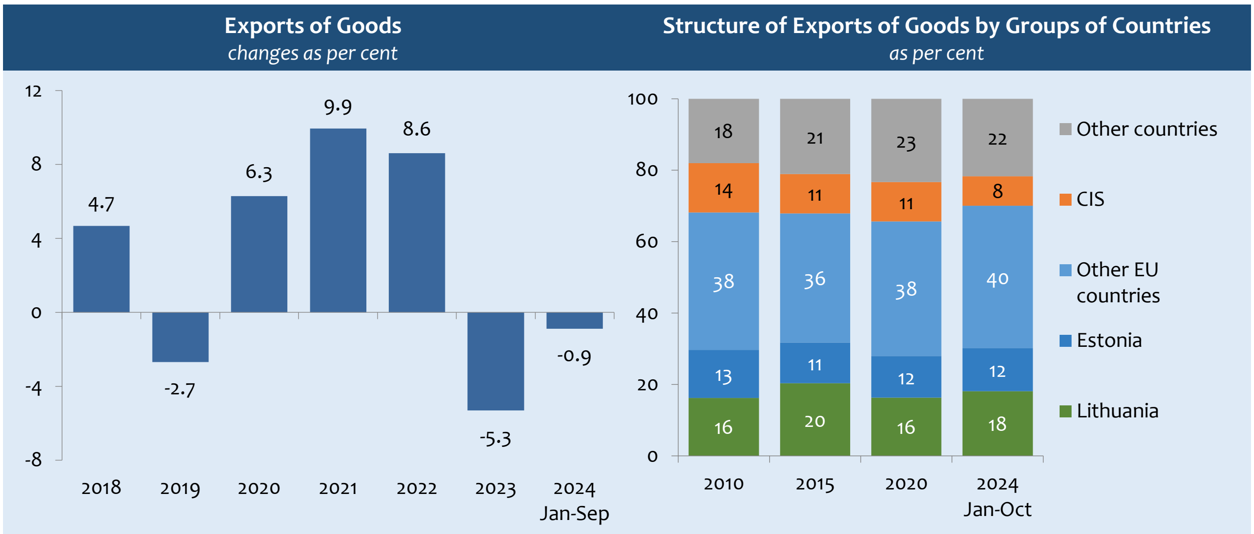
e – evaluation by MoE

Latvia's exports of goods in 2017-2018 developed dynamically. In 2019, exports of goods increased more moderately due to falling external demand.

The first half of 2020 was not favourable to exports of goods or the overall economic development. Export volumes during the crisis were lower than a year ago under the influence of COVID-19. However, rapid growth in exports of goods in the second half of the year, particularly in the last quarter of the year, allowed the year to be concluded with very good growth. In 2021 and 2022, exports of goods continued to develop dynamically, while in 2023, due to limited external demand, exports of goods contracted significantly. In the three quarters of 2024, exports of goods have been slightly below the level of the previous year.

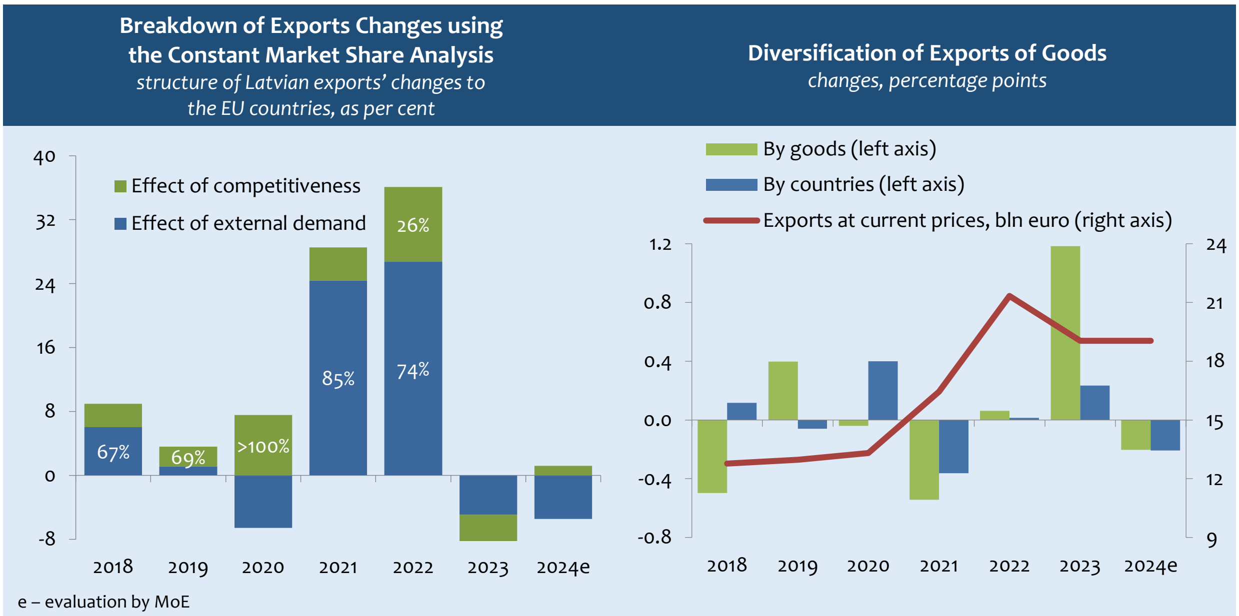
In 2017-2018, the development of exports of goods was positively influenced by changes in export prices. At current prices, exports increased on average by around 10% annually. Export prices declined slightly in 2019 as external demand declined. Similar trends were also observed in 2020. Starting from Q2 2021, the export unit value has been showing rapid growth. During 2021 and in 2022, it was 13.9% and 19.7% higher than a year before, respectively. An opposite picture was observed in 2023 and January-September 2024, when export prices fell by 4.9% and 1.7% respectively. In January-September 2024, the reduction in export prices was most significantly affected by the drop in prices of agricultural products, wood and wood products, mining products, as well as chemical industry products.

Figure 3.13



In 2017-2018, the increase in exports of goods was driven by external demand, with a low or even negative role of competitiveness in export growth. In 2019, however, Latvia's exports to EU countries were driven by a more rapid increase in the competitiveness of Latvian companies. With external demand shrinking rapidly in 2020, the negative export development was partly compensated by the ability of entrepreneurs to compete in external markets. 2021-2022 were marked by a considerable increase in external demand, which largely drove the increase in exports. Negative export growth in 2023 was more influenced by limited external demand.

Figure 3.14



As major groups of goods such as wood and wood products and agricultural and food products are growing more rapidly, the diversification rate of export goods is deteriorating, while faster development of relatively smaller export groups improves this indicator. The diversification indicator has been volatile in the last years. For example, in 2018, when exports of wood and wood products grew considerably in response to the United Kingdom's anticipation of withdrawal from the EU, and this had a negative effect on the diversification indicator for goods. The indicator improved in 2019 when this effect subsided. In 2021, as the value of the largest groups of export goods was growing rapidly because of the influence of COVID-19, the diversification indicator deteriorated. In 2023, as export values of the largest groups of export goods – wood products and mineral products – decreased, the diversification indicator of export products grew. An opposite picture is observed in 2024.

A similar process is observed in the diversification of exports of goods by country. This indicator increases when new export markets are entered, and the indicator deteriorates when exports to major partner countries increase more rapidly. The diversification of goods by country has not changed significantly in the last two years.

Table 3.3

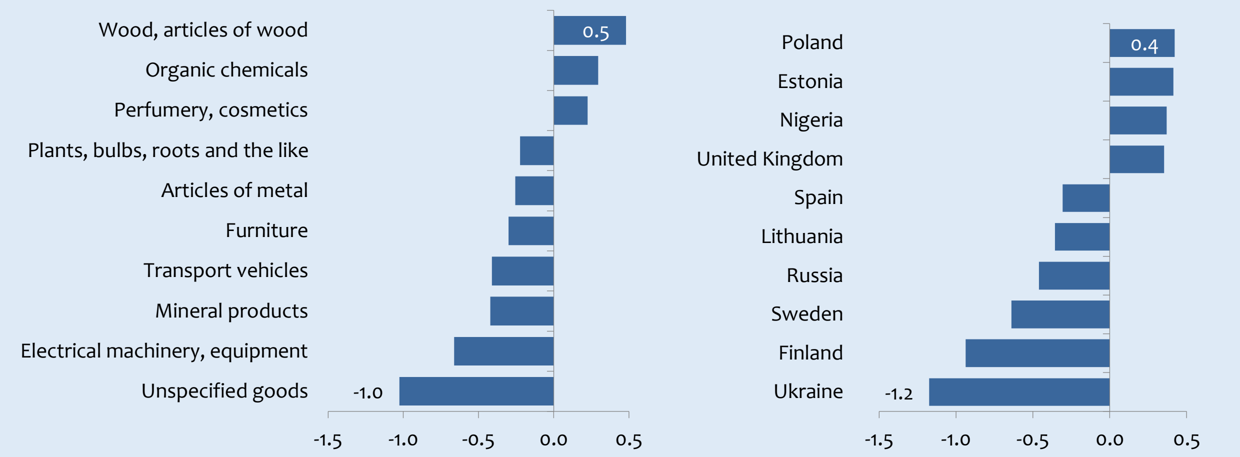
Exports of Goods
as per cent, at current prices

	2023			2024 Jan-Oct		
	structure	changes	contribution to the changes	structure	changes	contribution to the changes
Total	**100**	**-10.7**	**-10.7**	**100**	**-2.3**	**-2.3**
Agricultural and food products	22.6	1.7	0.3	23.0	1.5	0.3
Mineral products	7.8	-45.7	-5.9	7.5	-6.3	-0.5
Chemical industry products	11.7	-7.8	-0.9	12.3	1.7	0.2
Light industry products	3.5	10.7	0.3	4.1	12.7	0.4
Wood and articles of wood	15.0	-22.1	-3.8	16.1	3.1	0.5
Metal and articles of metal	6.5	-15.6	-1.1	6.4	-5.3	-0.3
Machinery, mechanical and electrical appliances	16.2	1.4	0.2	15.6	-5.4	-0.9
Transport vehicles	6.0	15.6	0.7	5.6	-10.3	-0.6
Other goods	10.7	-6.5	-0.7	9.5	-13.2	-1.4

In 2023, exports of goods to Latvia's largest export market – EU countries – (at current prices) declined by 11.5%. This was largely underpinned by the drop in the export value of mineral products. This was partly offset by an increase in exports of electrical appliances and equipment, as well as vehicles to EU countries. Exports to EU countries have slightly declined also in January-October 2024. Similar to 2023, this was largely driven by a drop in the value of mineral exports.

Figure 3.15

Groups of Goods and Countries with Most Effect on Changes in Exports
contribution to changes in January-October 2024, percentage points

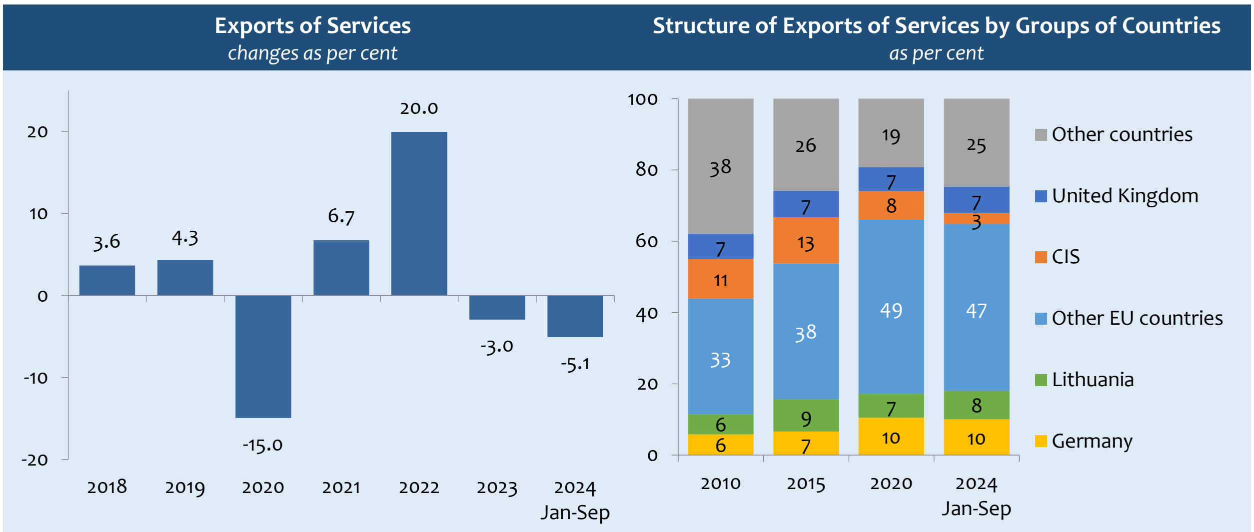


In recent years, exports of goods to the CIS countries have been declining. They contracted by 0.9% at current prices in 2023 and by 9% in January-October 2024. This decline was significantly affected by a drop in the value of exports of machinery and appliances, electrical appliances and equipment. Exports to Russia account for around two-thirds of all exports to the CIS countries.

Exports of goods to other countries, excluding EU and CIS countries, at current prices reduced by 11.6% in 2023 and by 1.4% in January-October 2024. In January-October 2024, they were considerably influenced by the increase in exports of unspecified goods to Ukraine.

In 2020, the growth of exports of services was greatly impacted by restrictions imposed on travelling, food service activities, and other service activities due to the COVID-19 pandemic. In 2020, overall exports of services decreased considerably. The most rapid drop was observed from the middle of 2020 to the beginning of 2021. Since Q2 2021, exports of services have resumed growth at a comparatively rapid pace due to the base effect. Rapid growth rates of exports of services were also preserved in 2022, where the increase in the value of exports of services exceeded 20% in Q1-Q3, being the most rapid growth in exports of services since 1996.

Figure 3.16



The growth of exports of services was positive (+3.3%) in 2023, while it was strongly negative (-8.4%) in the second half of the year, which also contributed to the overall decline in exports of services. It should be noted that exports of services at current prices were higher than a year ago, due to the sharp increase in export prices. In 2024, growth in exports of services remains negative, but volume declines every quarter are reducing from -8.3% at the beginning of the year to -1.5% in Q3.

Table 3.4

Exports of Services
as per cent, at current prices

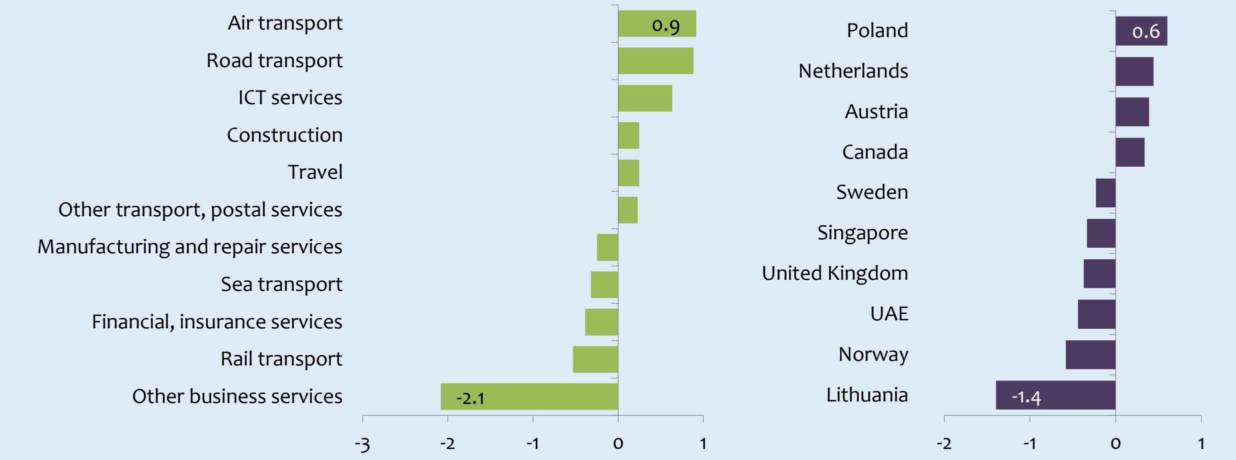
	2023			2024 Jan-Sep		
	structure	changes	contribution to the changes	structure	changes	contribution to the changes
Total	**100**	**3.5**	**3.5**	**100**	**-0.3**	**-0.3**
Transport services, including:	31.7	2.1	0.7	32.7	3.7	1.1
– sea transport	2.2	-28.8	-0.9	1.9	-14.4	-0.3
– air transport	11.7	31.3	2.9	12.6	7.9	0.9
– rail transport	1.8	-14.7	-0.3	1.2	-30.3	-0.5
– road transport	14.6	-7.0	-1.1	15.4	6.1	0.9
– other transport services	1.5	14.4	0.2	1.7	16.0	0.2
Travel	15.7	14.9	2.1	16.5	1.5	0.2
Other services, including:	52.6	1.2	0.7	50.8	-3.2	-1.7
– construction services	4.8	9.7	0.4	4.8	5.5	0.2
– financial and insurance services	2.4	-16.3	-0.5	2.1	-15.8	-0.4
– ICT services	16.9	2.1	0.4	17.4	3.8	0.6
– other business services	27.3	1.1	0.3	25.3	-8.3	-2.3
– other services	1.2	2.4	0.0	1.2	7.7	0.1

Until 2019, about 40% of the exports of services usually consisted of income from transport services. The last few years have not been successful for the export of transport services. In 2019, the exports of services were similar to the previous year. In 2020, exports of services provided by all modes of transport declined significantly under the influence of COVID-19. The value of road transport export services declined moderately. In 2021, the development of exports of transport services was similar to the general trends in exports of services. In 2022, exports of services by all modes of transport increased. Transport by air and road transport grew most significantly, while transport by sea and rail was growing more moderately.

In 2023, the increase in exports of transport services was underpinned by a significant increase in the value of export of air transport, while exports of other types of transport services declined. In the three quarters of 2024, growth in exports of transport services was also driven by growth in exports of air transport and road transport services.

Figure 3.17

Services Items and Countries with Most Effect on Changes in Latvian Exports
contribution to the changes in January-September 2023, percentage points, at current prices



In 2021, income from foreign tourists fell slightly due to the COVID-19 crisis, while in 2022 it increased rapidly. In 2023, income from foreign tourists continued to increase forming a big contribution to the total development of exports of services. Slightly slower growth in travel exports also persisted in the three quarters of 2024. Exports of ICT and construction services also increased during the period, while volumes of business activities and financial and insurance services declined.

Until 2018, slightly less than 60% of total exports of Latvian services were related to EU countries; in 2020, this share rose significantly – by 66%. A similar share of services exports to EU countries persists also in 2023-2024.

In contrast to total exports of services, exports to EU countries in the three quarters of 2024 increased by 1.1%. Exports of air transport and road transport services grew faster during the period, while the value of exports of other business services declined.

IMPORTS

In 2017-2020, the growth of imports of Latvian goods and services followed a downward trend. Weak import growth in 2019-2020 was due to low domestic demand due to the COVID-19 pandemic. However, demand began to grow rapidly in 2021, with import growth rates at their fastest pace in recent years. Import volumes exceeded the level of the previous year considerably also in 2022. Imports of both goods and services increased significantly. In 2023, imports of services continued to grow (by 2.5%), but imports of goods reduced by 2.9% driving the total reduction in imports by 2%. In Q1-Q3 2024, imports of goods fell more moderately, while imports of services fell more sharply, causing an overall decline of 3.2%.

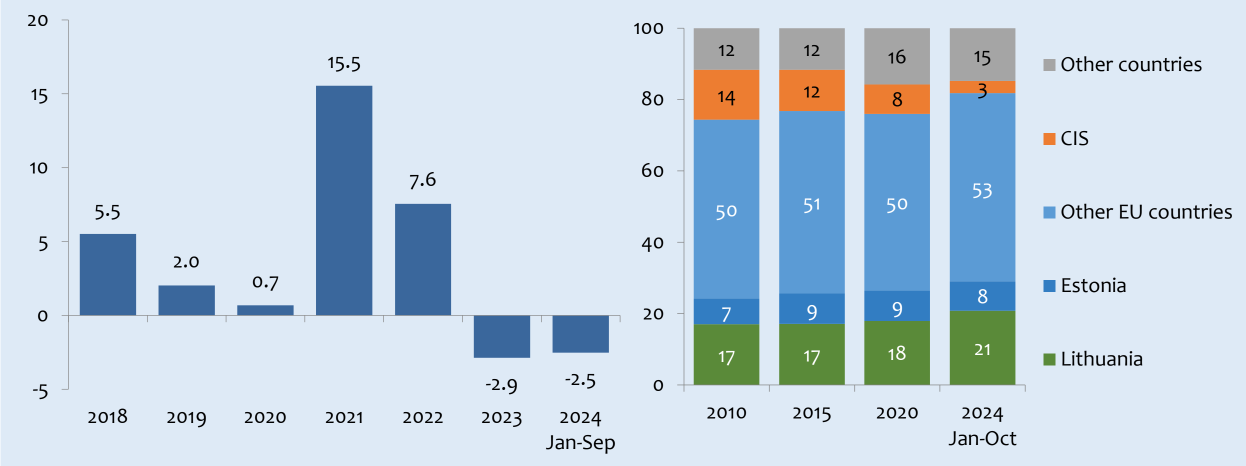
The decrease in imports of goods in 2023 was mainly driven by a decrease in the import value of mineral products. This was partly due to a decline in import prices for this product group. Imports of wood and wood products reduced more moderately. January-October 2024 also saw a similar decline in the value of imports. Imports of mineral products continued to be affected by the decline in both volumes and prices, yet to a lesser extent. Imports of aircraft, parts, vehicles, machinery and electrical appliances also declined during the period.

In 2023, imports from EU countries at current prices reduced in the same way as total imports of goods. In January-October 2024, imports of goods from EU countries decreased in a similar way. The decrease in imports from the EU was driven by the same import groups that drove the overall decrease in imports.

Figure 3.18

Imports of Goods
changes as per cent

Structure of Imports of Goods by Groups of Countries
as per cent



Imports from Russia and Belarus traditionally accounted for about 98% of imports from CIS countries, they reached even 99% in 2021. On the other hand, as extensive Russia's hostilities in Ukraine began, due to the various restrictive measures introduced by the EU and Latvia, imports from Russia accounted for 58% and imports from Belarus – 22% of all imports from CIS in January-October 2024.

As sanctions intensified, imports from CIS countries at current prices decreased by 59% in 2023. This was mainly due to the decrease in mineral products by approximately 800 million euro. Imports of wood and wood products, as well as iron and steel reduced. In January-October 2024, imports to CIS countries continued to decrease considerably – by 22%. This was due to a decline in the import value of cereals, mineral products and vegetables.

Table 3.5

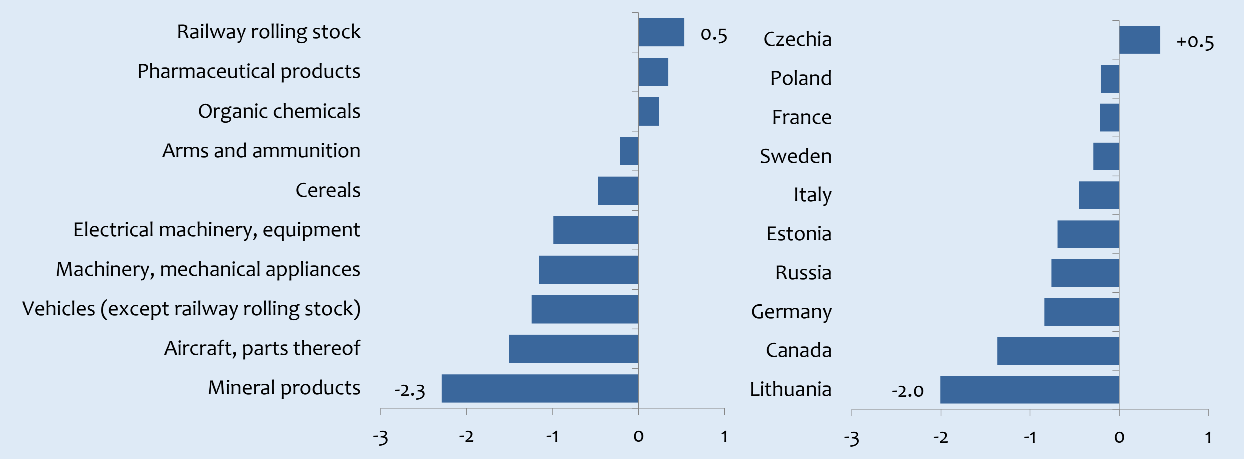
Imports of Goods
as per cent, at current prices

	2023			2024 Jan-Oct		
	structure	changes	contribution to the changes	structure	changes	contribution to the changes
Total	**100**	**-11.7**	**-11.7**	**100**	**-6.7**	**-6.7**
Agricultural and food products	19.0	10.1	1.5	20.2	-0.1	-0.0
Mineral products	12.0	-49.4	-10.3	10.9	-18.6	-2.3
Chemical industry products	14.8	-10.5	-1.5	16.7	3.4	0.5
Light industry products	4.7	5.6	0.2	5.1	2.1	0.1
Wood and articles of wood	2.4	-36.9	-1.3	2.5	-6.4	-0.2
Metal and articles of metal	6.3	-18.1	-1.2	6.7	-4.1	-0.3
Machinery, mechanical and electrical appliances	19.2	-2.0	-0.4	18.2	-11.2	-2.1
Transport vehicles	13.2	17.6	1.7	10.9	-18.0	-2.2
Other goods	8.4	-5.5	-0.4	8.8	-1.5	-0.1

In the group of other countries, except the EU and the CIS countries, imports fell slightly (by 1.9%) in 2023, significantly affected by a fall in the value of imports of chemical industry products, machinery, plastics and articles thereof, appliances and electrical equipment, as well as iron and steel. In January-October 2024, imports of goods from other countries continued to decrease more rapidly (by 9.3%). This was positively affected by a significant decrease in imports of aircraft and its parts. Imports of machinery, appliances and electrical equipment, rubber and rubber products, as well as motor vehicles also declined moderately, while imports of mineral products, furniture and organic chemicals increased.

Figure 3.19

Groups of Goods and Countries with Most Effect on Changes in Imports
contribution to changes in January-October 2024, percentage points



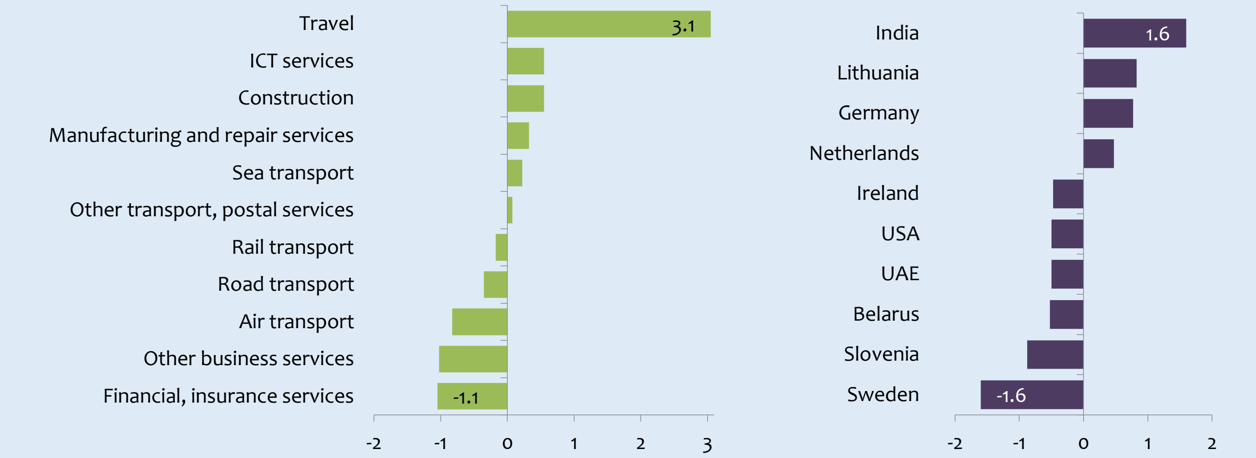
The share of imports of capital goods in the structure of imports of goods by end-use has been gradually declining in recent years. As the share of intermediate goods does not change significantly, imports of consumer goods, as well as passenger cars and other non-classified goods are rising slightly.

Imports of services grew rapidly in 2021-2022, partly due to the base effect. Imports of services related to brokering and travel services increased significantly in 2022. Imports of transport services, in particular air transport, were growing rapidly. In 2023, imports of services continued to increase, albeit at a slower pace. This was driven by growth in imports of travel and air transport. By contrast, imports of services grew only slightly (by 1.5%) in the three quarters to 2024. Imports of travel services grew considerably, while imports of ICT and construction services grew more moderately. Imports of transport, financial and insurance services and other business services declined.

About two-thirds of all services are provided to Latvia by EU countries. The share of imports of services from the EU countries was 57% in 2019 and 66% in Q1-Q3 2024. Moreover, the value of services imported from Russia kept declining.

Figure 3.20

Services Items and Countries with Most Effect on Changes in Latvian Imports
contribution to changes in January-September 2024, percentage points



4. CONTRIBUTION OF SECTORS

4.1. DYNAMICS AND STRUCTURE

In 2009-2010, as labour costs reduced, the competitiveness of Latvian producers improved, which served as a basis for an increase in export volumes and the development of tradable sectors (agriculture, forestry and fishing, industry, as well as transport services). The structure of the economy changed. In 2010, the share of these sectors reached 33.9% of total value added, but in 2023 – 29%. In 2023, compared to 2010, the share has increased in other industry, construction, business services and public services, but the share of agriculture, forestry and fishing, manufacturing, transport, trade and accommodation reduced. The analysis of economic structures from another perspective shows that in 2023 producing sectors (agriculture, forestry and fishing, industry, and construction) accounted for 29.8%, but services sectors – for 70.2% of total value added. Compared to 2010, the share of producing sectors has increased, driven by a rise in construction and other industry.

Since 2011, GDP has been growing by an average of 2.8% per year.

Table 4.1

Structure of the Economy
by value added, as per cent

	2000	2008	2010	2016	2020	2023	2024 Jan-Sep
Agriculture, forestry and fishing	5.1	3.5	4.6	3.8	4.7	4.4	5.1
Manufacturing	15.6	11.3	13.7	12.1	13.2	12.8	11.0
Other industry	4.3	3.5	4.9	4.4	3.6	5.5	5.1
Construction	7.2	10.7	4.9	5.5	6.6	7.1	6.7
Trade, accommodation and food service activities	16.0	16.8	18.1	17.3	16.9	14.0	13.8
Transportation and storage	12.2	9.8	10.7	9.5	7.1	6.2	6.1
Other business services	23.1	27.3	26.8	30.9	29.5	31.3	32.6
Public services	16.5	17.1	16.3	16.5	18.4	18.7	19.6
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Growth was comparatively rapid in 2015-2018. An increase in private consumption and exports, as well as stronger absorption of EU structural funds in 2017-2018 fostered a rapid increase in volumes of producing and services sectors. In 2019, growth was very moderate, which was influenced by weak growth in the EU and thus slower export growth rates. The increase in volumes of agriculture, forestry and fishing had the biggest impact on growth, but the volumes of services decreased, with negative developments in the financial sector having the biggest impact.

In 2020, the economic development was severely affected by the COVID-19 pandemic. The biggest drop in volumes was recorded in construction, trade, transport and business services as they were affected by the restrictions introduced. However, volumes increased significantly in electricity, gas, steam and air conditioning supply, as consumption of these energy sources increased in the context of the COVID-19 pandemic.

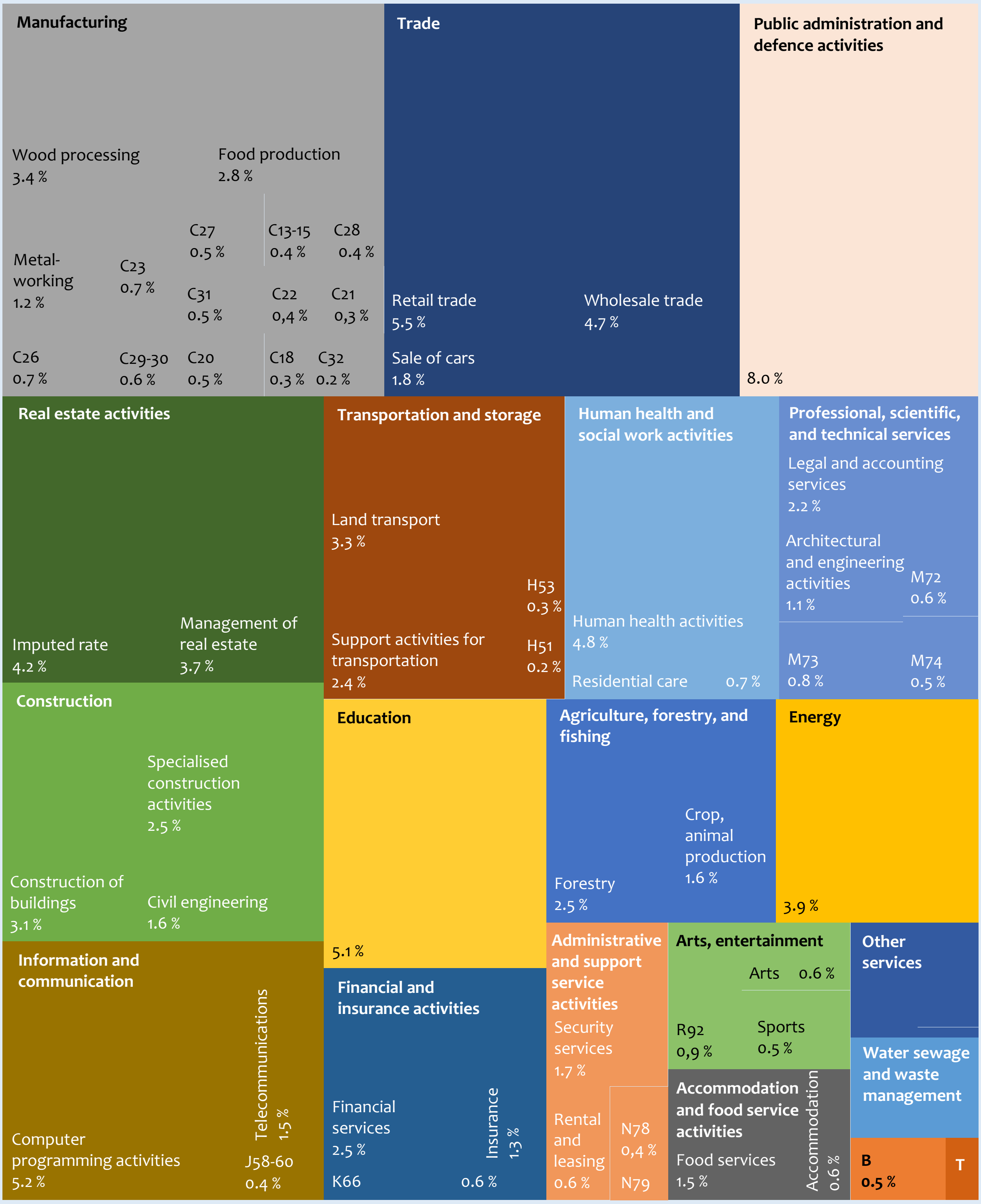
In 2021, very rapid growth was observed in the economy. At the beginning of the year, the COVID-19 pandemic continued to affect sectors with high levels of social contact, while sectors more focused on the export of goods lived through the second wave of the COVID-19 crisis considerably more successfully and several sectors have already significantly exceeded pre-pandemic levels. Overall, in 2021 growth was seen in all sectors except construction, accommodation and food service activities, and education. The biggest impact was the increase in volumes in trade and manufacturing.

In 2022, the Latvian economy continued to recover, yet economic development was significantly influenced by the disruptions in supply chains caused by Russia's invasion of Ukraine, the rise in inflation caused by the rising costs of energy and food, as well as the decline in global demand. Volumes fell in all producing sectors except mining but grew in all services sectors except education.

Figure 4.1

Value Added Structure

*2023, as per cent**



B – Mining and quarrying; C13-15 – Light industry; C18 – Polygraphy; C20 – Manufacture of chemical products; C21 – Manufacture of pharmaceutical products; C22 – Manufacture of rubber and plastics; C23 – Manufacture of non-metallic mineral products; C26 – Manufacture of computer, electronic and optical products; C27 – Manufacture of electrical equipment; C28 – Manufacture of machinery and equipment; C29-30 – Manufacture of vehicles; C31 – Furniture production; C32 – Other production; H51 – Air transport; H53 – Postal, courier activities; J58-60 – Publishing, video, TV programme production; K66 – Activities auxiliary to financial services; M72 – Scientific R&D; M73 – Advertising and market research; M74 – Other professional, scientific and technical activities; N78 – Employment activities; N79 – Travel agencies; R92 – Gambling and betting activities; T – Activities of households

* – MoE assessment

In 2023, economic development continued to be affected by the geopolitical situation and uncertainty, high prices and growing bank interest rates. Volumes declined in agriculture, forestry and fishing, as well as mining, but were virtually unchanged in manufacturing, largely due to the deterioration of export capabilities. By contrast, there was growth in all services sectors except transport, financial activities and education. Construction saw strong growth, boosted by an increase in customer activity, as well as the low base effect of the sector's three-year recession.

While inflation rates are stabilising, the economic situation deteriorates in 2024 due to the unfavourable external environment. The overall decline continues in producing sectors, largely due to weak export opportunities, while overall services remain virtually unchanged. Overall, GDP was 0.5% lower in Q1-Q3 2024 than a year before.

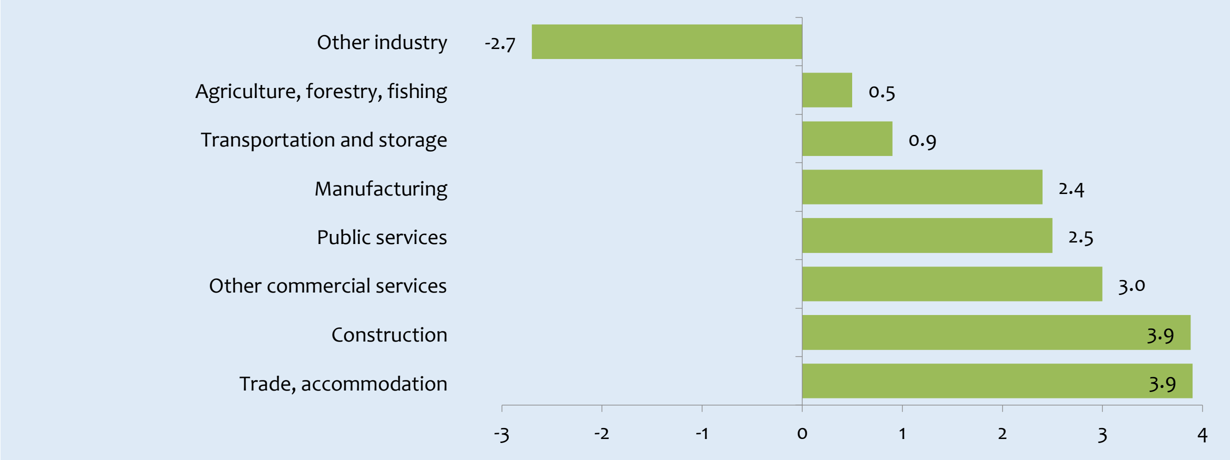
Table 4.2

Development Trends of Sectors
year-on-year changes, as per cent

	2019	2020	2021	2022	2023	2024 Jan-Sep
Gross domestic product	0.7	-3.5	6.9	1.8	1.7	-0.5
Agriculture, forestry and fishing	21.3	-0.2	0.4	-14.1	-8.1	1.7
Mining and quarrying	-8.6	6.2	-5.0	4.9	-19.9	13.4
Manufacturing	1.0	0.8	10.2	-5.5	0.2	-4.7
Food industry	-0.7	-1.7	1.3	1.3	2.8	0.1
Light industry	-2.6	-9.5	11.8	5.1	-7.2	0.0
Wood processing	0.0	4.5	3.7	-1.0	-8.4	-1.4
Paper industry and publishing	5.7	4.7	14.0	-2.7	-23.0	0.1
Chemical industry	3.9	-1.8	14.8	4.1	-7.7	-0.4
Manufacture of other non-metallic mineral products	-2.1	-1.4	4.4	5.4	-16.8	0.0
Metalworking	13.5	-5.6	5.8	16.1	-6.1	-0.4
Manufacture of electrical and optical equipment	11.3	12.1	5.7	3.5	13.6	-0.8
Manufacture of machinery and equipment	-1.9	-2.7	24.1	-12.3	4.2	-0.4
Manufacture of transport vehicles	-7.7	-15.3	17.7	19.5	-15.5	-0.4
Other industries	2.8	-14.2	11.8	3.8	-4.1	0.1
Electricity, gas, steam and air conditioning supply	-10.3	30.3	29.2	-32.2	1.3	6.4
Construction	1.3	-5.8	-13.7	-4.3	20.9	-5.6
Construction of buildings	11.4	-7.9	-16.2	0.0	26.8	-18.0
Civil structures	-11.5	-7.3	-15.3	-17.2	10.8	8.5
Trade	2.2	-4.2	19.7	5.6	2.7	2.3
Retail trade	2.3	1.5	-3.5	3.1	-1.9	0.6
Transportation and storage	-2.2	-15.9	4.9	3.5	-7.2	-8.5
Transport of freight by railway	-15.8	-42.0	-9.5	-2.1	-27.5	-27.4
Freights transhipped in ports	-5.7	-27.9	-7.2	15.2	-19.6	-11.2
Transport of freight by road	-3.8	2.6	7.8	-0.8	-0.3	-8.2
Accommodation and food service activities	-4.8	-31.4	-4.2	35.8	7.6	0.7
Information and communication	4.0	0.8	12.0	8.5	1.8	-1.6
Financial and insurance activities	-9.2	-13.3	18.9	1.4	-3.8	-3.5
Real estate activities	-1.7	-0.5	9.0	4.5	3.6	-2.9
Other business services	-0.5	-1.8	4.9	5.1	4.7	-4.7
Public administration and defence; compulsory social security	-0.2	3.4	0.9	3.9	1.9	1.2
Education	-4.5	1.2	-0.6	-1.4	-1.6	-5.6
Human health and social work activities	4.8	-3.4	6.4	8.1	12.5	17.0
Arts, entertainment and recreation	1.9	-33.8	2.8	35.6	13.6	7.2

Figure 4.2

Change in Value Added
2011–2023, annual average, as per cent



4.2. MANUFACTURING

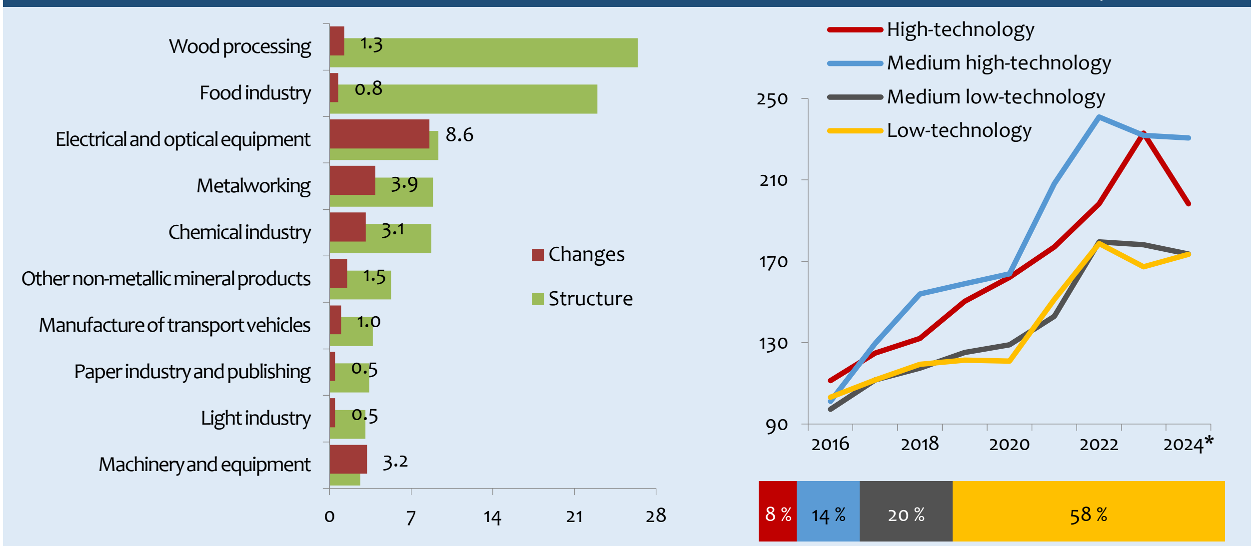
Manufacturing contributes significantly to total economic growth. During five years (from 2019 to 2023), output volumes of manufacturing were growing by an average of 1.2% per year.

2020 was full of challenges for manufacturing as it was for the economy. In April-May, as the COVID-19 crisis hit, manufacturing volumes declined by 10.4%, while in the second half of the year increasingly more sub-sectors showed positive growth, and manufacturing volumes this year were only 0.9% lower than a year before.

Figure 4.3

Growth of Manufacturing in the Medium Term
2024 in comparison with 2015, annual average; structure in 2024*, changes as per cent*

Manufacturing Volumes Index and Structure by Technology Levels
2005 = 100, structure in 2024, as per cent*



* MoE assessment

In 2021, manufacturing developed dynamically. It can partially be attributed to the base effect. In Q1, manufacturing volumes increased more moderately. In Q2, volumes rose particularly rapidly, reaching a total growth of 7.5% during the year. Increases in manufacturing volumes during this period were observed in all manufacturing sub-sectors. Wood processing made the largest contribution to the development of the sector. Manufacturing volumes of the chemical industry, manufacture of electrical and optical equipment, and other sub-sectors also increased significantly.

In early 2022, growth of manufacturing continued. This was fostered by an increase in manufacturing volumes of metalworking and chemical industry. Shrinking manufacturing volumes could be seen in the industry starting from Q2 of the year. In total, manufacturing volumes in this industry grew by 2.7% in 2022.

A similar picture was also observed in 2023. Manufacturing output has been volatile month-to-month, contracting more sharply at the beginning of the year and more moderately in Q2 and Q3. The decline in output of the sector in January-October was significantly influenced by a decline in volumes of computer, electronic and optical products and finished metal products, and more moderately by drops in output volumes of machinery and equipment, motor vehicles and trailers, as well as wood processing. Positive trends during this period were observed in manufacture of non-metallic minerals, chemical and food industry sub-sectors.

Table 4.3

Structure of Manufacturing and Development Trends of Sectors in January-October 2024
as per cent

	Output structure	Structure of occupied posts*	Share of exports in the sales of the sector	Changes in production volumes
Manufacturing – total	**100**	**100**	**65,3**	**-2,3**
Manufacture of food and beverages	22,9	19,9	43,0	-0,1
Light industry	3,1	7,5	82,9	1,7
Wood processing	26,5	19,6	66,3	-0,7
Paper industry and publishing	3,5	4,4	63,7	6,7
Chemical industry and related industries	8,7	7,6	77,1	-11,4
Manufacture of other non-metallic mineral products	5,3	4,9	49,5	3,9
Manufacture of metals and metal articles	8,9	11,3	64,9	-5,5
Manufacture of electrical and optical equipment	9,3	6,2	87,5	-7,6
Manufacture of machinery and equipment	2,6	3,0	89,5	-13,0
Manufacture of transport vehicles	3,6	3,7	93,0	-9,1
Other manufacturing industries	5,7	11,8	72,2	3,2

* – data for January–September 2024

In 2021–2022, the turnover of manufacturing at current prices was growing rapidly. In 2021, export sales of products grew more rapidly, while domestic sales – more moderately, while it was the opposite in 2022 – they were growing more rapidly (by 21.9%) in the domestic market and by 16.7% in exports. In 2023, however, export sales fell slightly faster and domestic sales more moderately, by -3.5% and -0.7% respectively. The reduction in sales, partly due to prices, was significantly influenced by the fall in wood processing product sales.

Similar trends were preserved also in January-October 2024. Domestic sales declined moderately, while export sales declined slightly faster, by -1.1% and -4.2% respectively. This was further affected by weak sales of wood processing products, computer, electronic and optical products and finished metal products. Meanwhile, sales of food products and chemicals increased.

In recent years, as usual, around 2/3 of all products have been exported. The sub-sectors with a share of exports in sales above 85% are manufacture of vehicles, manufacture of machinery and appliances, manufacture of electrical and optical equipment. Traditionally, most of the food industry's products are sold in the domestic market.

About 70% of products produced in manufacturing are sold in markets of the EU countries. The share of sales to CIS countries amounts to 10%. Sales of products in markets of other countries increased to 20%, when the United Kingdom withdrew from the EU in 2020.

In 2021, the number of occupied posts in manufacturing increased by 4.5%, representing the largest increase since 2013. This was largely influenced by the rise in the number of occupied posts in wood processing, chemical industry, and manufacture of vehicles. Meanwhile, a decline in occupied posts is observed in the food industry. In 2022, the number of occupied posts was slightly lower than a year before. In 2023, the decrease was steeper – by 3 thousand or 2.6%. A similar decrease of 3.4 thousand or 3% can be observed in the three quarters of 2024. It was largely affected by fewer jobs in wood processing, light industry and metalworking.

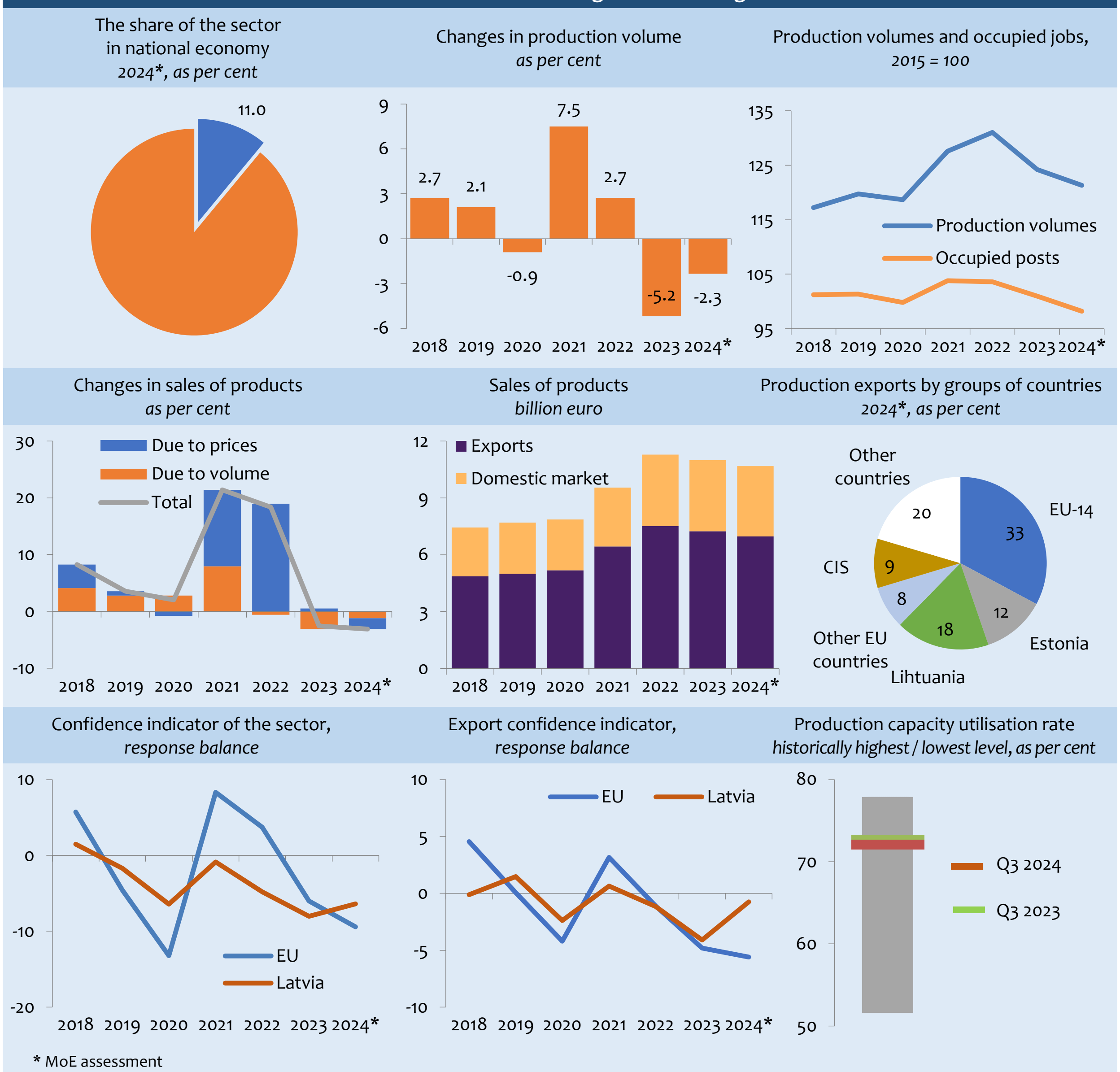
In recent years, the confidence indicator of manufacturing has been volatile. In 2022–2023, confidence in manufacturing had a highly negative trend. The lowest indicators were observed in the manufacture of other non-metallic mineral products, wood processing and manufacture of machinery and equipment. Similar trends persist in 2024, with the lowest rates in wood processing and light industry.

The export confidence indicator in 2020, during the COVID-19 crisis, was strongly negative. In 2021, as COVID-19 restrictions reduced, the assessment of export opportunities by entrepreneurs improved to a positive level. In 2022–2023, however, future export opportunities are evaluated negatively. In 2024, business sentiment has improved, with markedly positive sentiment in some sub-sectors, such as wood processing and manufacture of electrical and optical equipment. The indicator in the light industry sub-sector is strongly negative.

Until 2019, production capacity levels in manufacturing had an increasing trend, exceeding the level of 76%. Changes were introduced by the COVID-19 crisis, when manufacturing capacity levels reduced considerably in 2020. Capacity utilisation rates resumed growing in 2021–2022 but have fallen back to the levels of 10 years ago in 2023-2024.

Figure 4.4

Indicators Characterising Manufacturing



Manufacture of food and beverages is the second largest manufacturing sub-sector in Latvia in terms of both the output and the number of occupied posts. Although it sells 60% of its products in the domestic market, its export sales have slowly increased in recent years. It should be noted that more and more producers are moving to safer outlets. The situation has changed compared to previous years, when the CIS countries, including Russia, were the main market for the sector's products, and the market has shifted towards EU countries. It should be noted that a large part of the beverages produced is still exported to CIS countries.

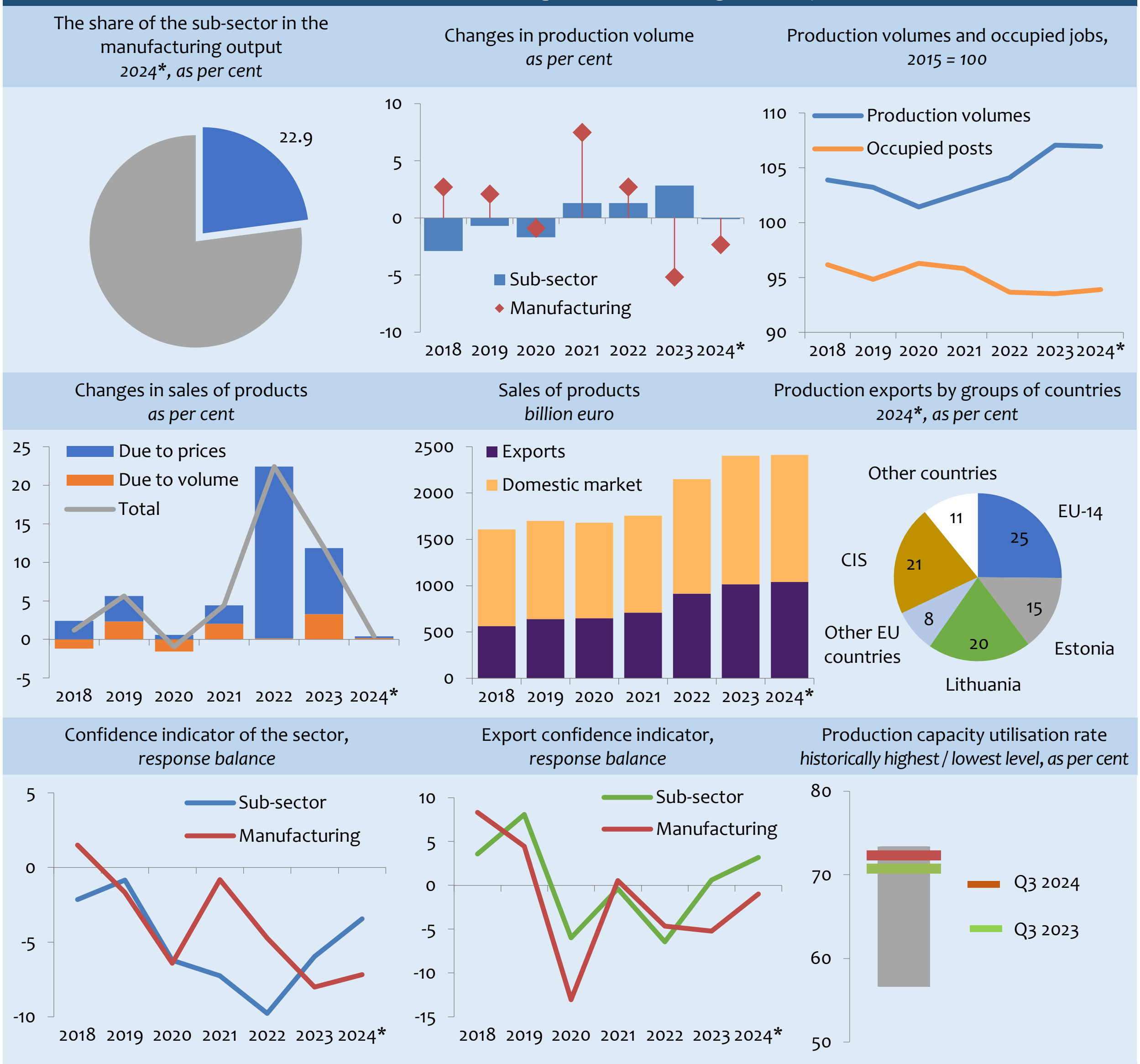
In 2021–2022, volumes of manufacture of food products slightly declined, while volumes of manufacture of beverages increased significantly defining the general development of the sub-sector. In 2023–2024, the opposite was true: food production volumes increased, while beverage production volumes decreased.

Despite price increases in manufacture of food and beverages in all major product groups, the sector's turnover, both domestic and export, in January-October 2024 remained at the level of 2023.

After an increase in 2020, the number of occupied posts in the food industry slightly declined in the following years. By contrast, in the three quarters of 2024, the number of occupied posts remained at the same level as the year before. The confidence indicator of the sector has been strongly negative since 2015. In January-October 2024, confidence of the sector continued to improve, while export confidence during this period remained positive.

Figure 4.5

Indicators Characterising Food and Beverage Industry



* MoE assessment

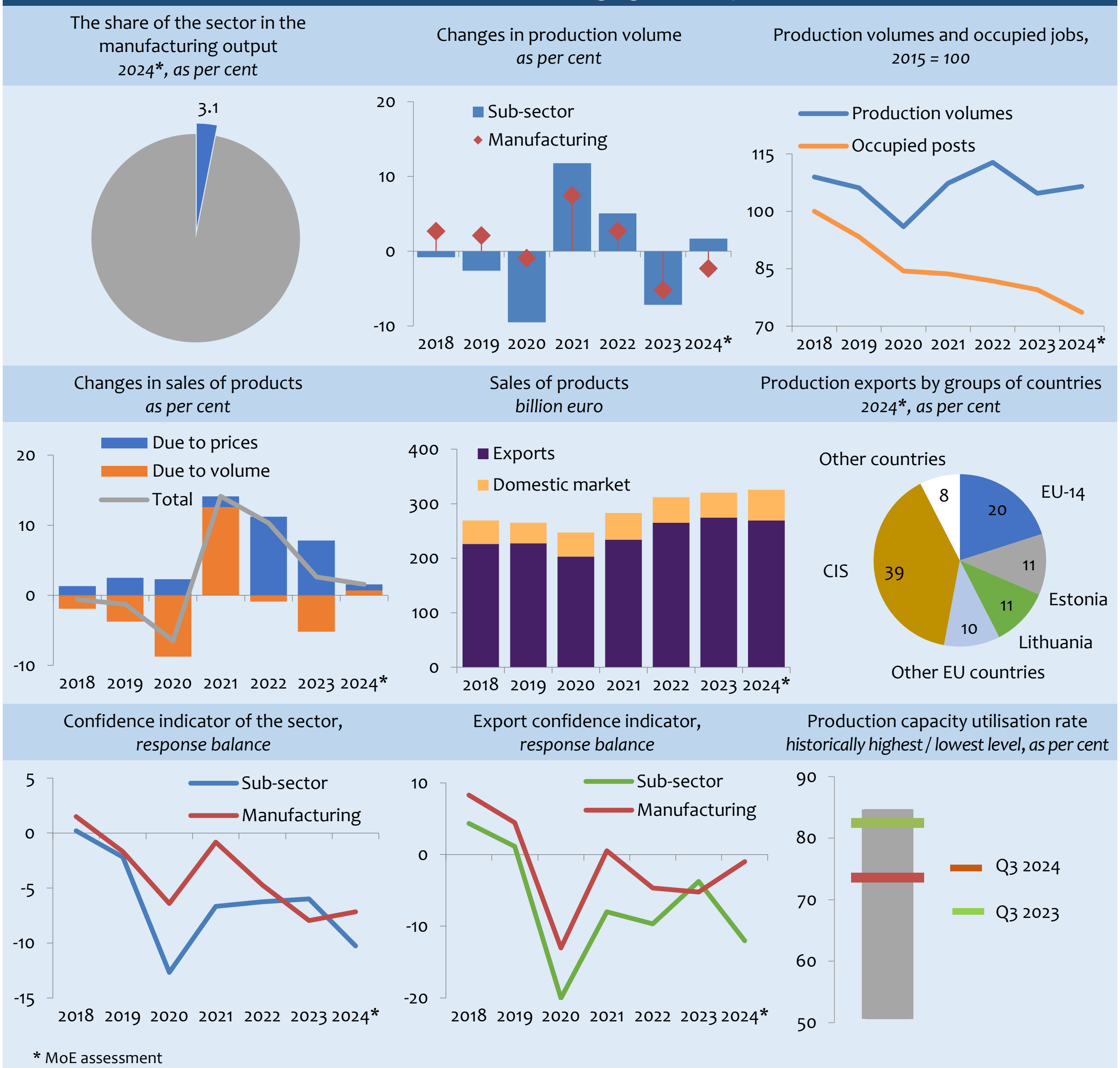
Light industry is considerably affected by global trends, and, under conditions of the open EU labour market, the sub-sector cannot rely on the advantages of a cheap labour force, as is the case in East Asia does. As with other sub-sectors, production volumes in the light industry increased significantly in 2021-2022 but volume of the sub-sector declined in 2023. By contrast, in the ten months of 2024 production volumes of the sub-sector have slightly grown. Volumes of manufacture of textiles and manufacture of wearing apparel increased.

In 2022 and 2023, sales of products of the sub-sector were growing stably. Contrary to manufacturing volumes, in 2023, sales of products continued to grow – by 2.6%. This growth was fostered by the increase in exported products, while the volumes of products sold in the domestic market have slightly reduced. An increase in sales of products is also observed in January-October 2024, underpinned by a significant increase in domestic sales.

The number of occupied posts in the sub-sector has been volatile in recent years. In 2021, the number slightly increased, but in 2022, it decreased. The negative trend continued in 2023 and in the three quarters of 2024. The confidence indicator has remained negative over the last four years. Considering the large share of exports in sales of the sector, its development is closely related to changes in demand and competitiveness in the external markets. In the last four years, the capacity utilisation rate of the sub-sector has been steadily increasing and in 2023 it was the highest in manufacturing and exceeded the 80% mark. However, in Q3 2024, the capacity utilisation rate decreased year-on-year to 73.5%.

Figure 4.6

Indicators Characterising Light Industry

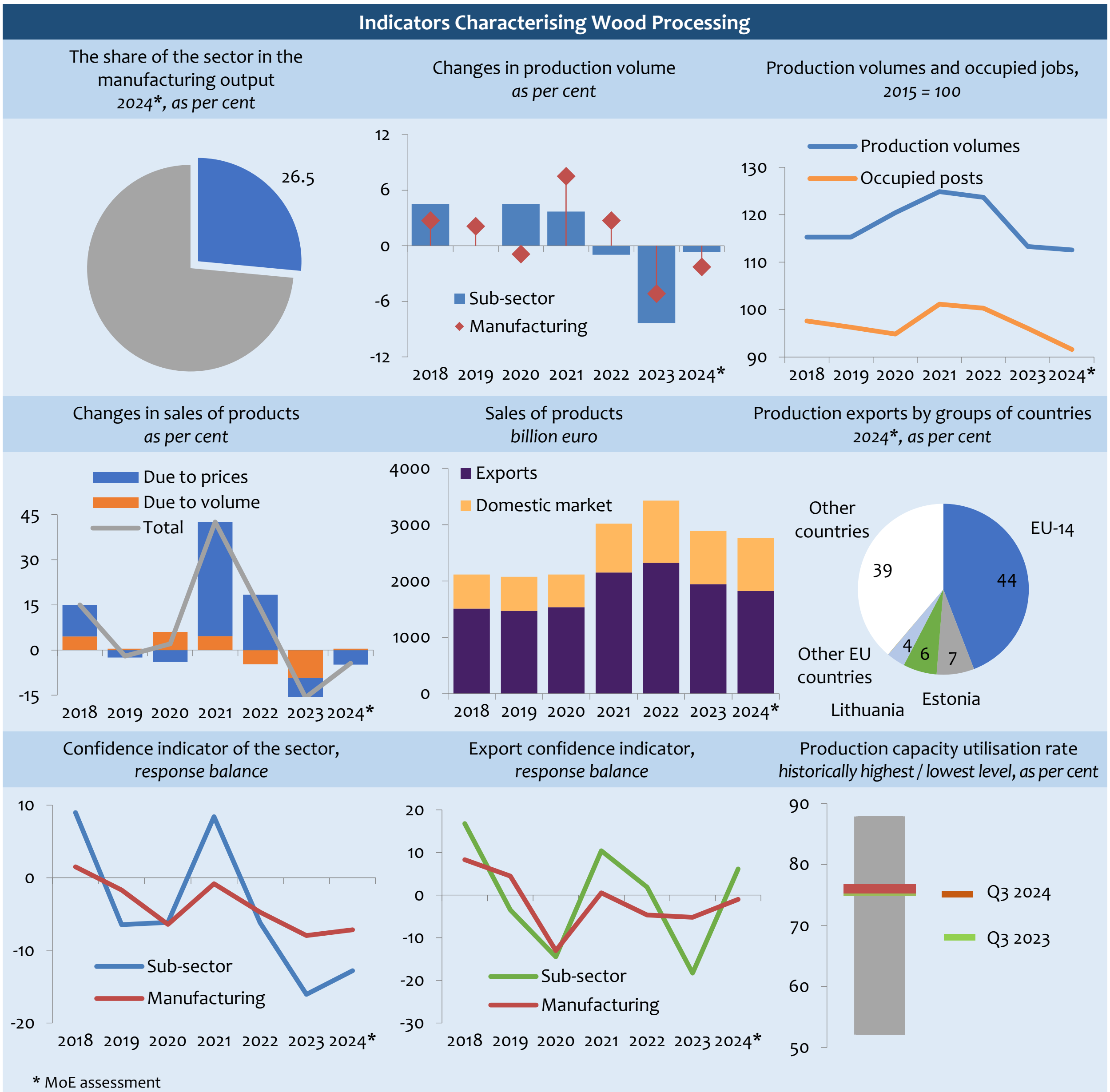


Wood processing is traditionally the largest manufacturing sector of Latvia accounting for one-fourth of the total manufacturing output. In 2020-2021, the sector stood out with stable growth. However, in 2022 and 2023, production volumes declined significantly. In January-October 2024, production volumes of the sector were similar to those a year ago.

Wood processing is also mainly export-oriented – in January-October 2024, about two-thirds of the production of the sector has been exported. In 2021-2022, the increases in product sales in the sub-sector were record high because of high demand and growing prices of timber. In 2023, sales of the sector fell considerably both in the domestic and export markets. In January-October 2024, sales remained similar to a year ago, with a slight decrease in product exports and an increase in domestic sales.

Like in other sub-sectors, the number of occupied posts in wood processing has been volatile year on year. Their most rapid growth was observed in 2021. However, from 2022, the number of occupied posts has been falling. The confidence indicator of the sub-sector was strongly negative in 2022-2023 and remained negative also in Q3 2024. Export opportunities of the sub-sector in Q3 2024 are evaluated positively. The capacity utilisation rate remains one of the highest in manufacturing.

Figure 4.7



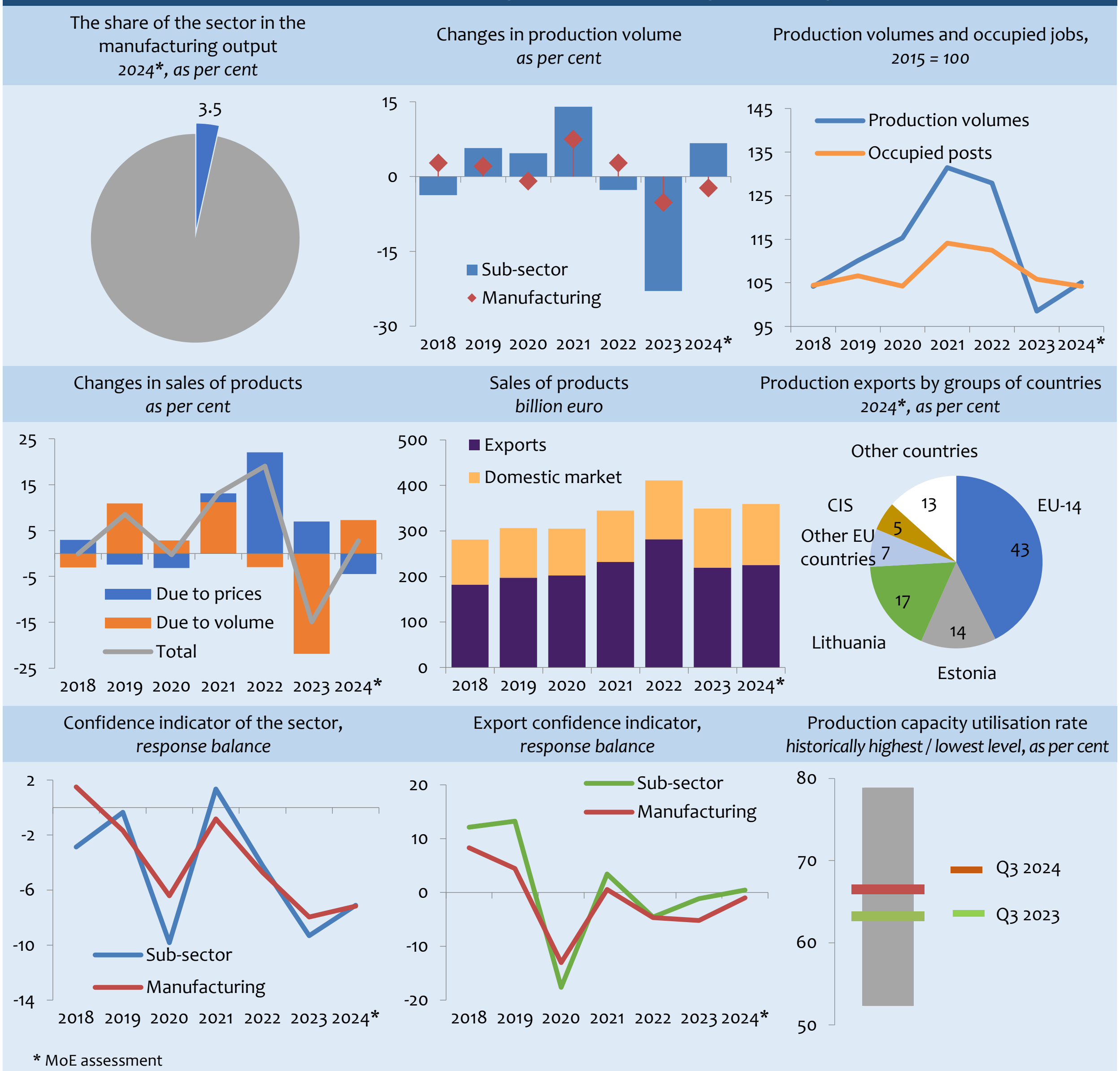
The paper manufacturing and printing sub-sector is gradually shifting from the domestic to export markets. In 2020-2022, the share of their products exported increased significantly every year, while in 2023 it declined. In January-October 2024, volumes of exported products and products sold on the domestic market were growing moderately. The EU countries are the main market for the products of the sector.

In 2021, the growth of the sub-sector was much more rapid than the average rates in manufacturing, but it declined in 2022. 2023 was also not favourable for the sub-sector – manufacturing volumes during the year have shrunk significantly, mainly due to weak external demand. Manufacturing of paper products declined more moderately, while the output of the printing sector more rapidly. In January-October 2024, however, the situation was reversed compared to the previous year showing an increase in production.

Similarly to other manufacturing sub-sectors, the number of occupied posts in the paper industry and publishing has been volatile in recent years. After a more rapid increase in 2021, the number of occupied posts shrank in 2022-2023 and Q1-Q3 2024. The confidence of the sub-sector also remains negative, although there was a positive trend in Q3 2024. Despite that, future export opportunities are evaluated cautiously. The capacity utilisation rate in the paper manufacturing and printing sub-sector in Q3 2024 is higher than in the corresponding period of the previous year.

Figure 4.8

Indicators Characterising Paper Manufacturing and Printing

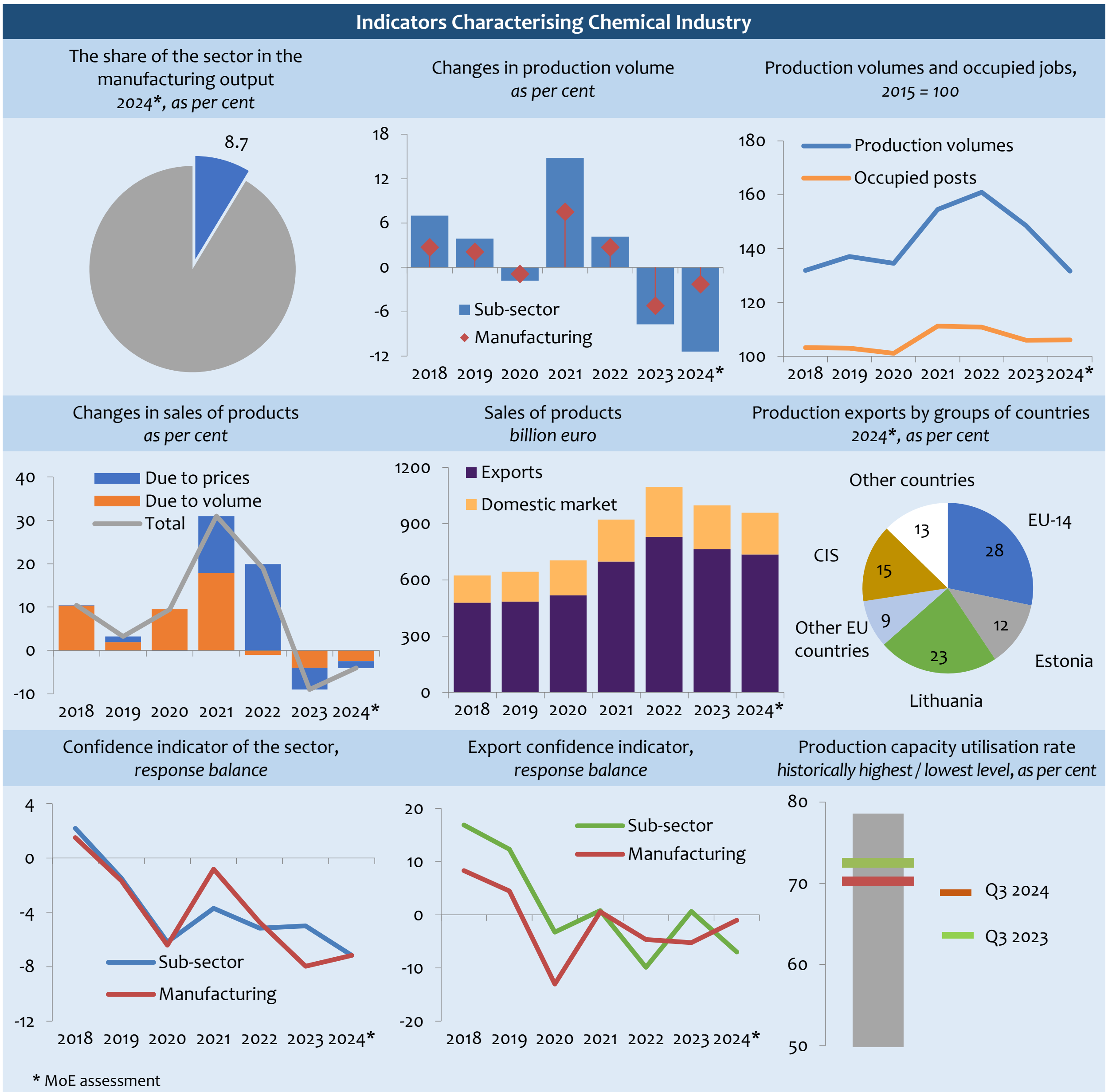


Rapid growth was observed in the chemical industry in 2021. Positive trends were also observed in 2022, particularly in its first half. Like in 2023, the sub-sector's output declined in January-October 2024. Production volumes of pharmaceutical products declined, while those of chemicals, rubber and plastics increased.

Sales of products of the sub-sector in 2021-2022 increased significantly both in the domestic and export markets. By contrast, sales in 2023 declined mainly due to a decrease in domestic sales, and in January-October 2024 remained at the level of 2023 with a decrease in export sales. It should be noted that 3/4 of the products are exported. Compared to the previous year, the sub-sector's market has reoriented, with most products now sold in EU markets.

The number of occupied posts in the chemical industry increased significantly in 2021 but declined in 2022 and in 2023. However, in the first half of 2024, there was no further decline and the number of occupied posts remained at the previous year's level. The confidence of the sub-sector remains negative, as do export opportunities. The average capacity utilisation rate in Q1-Q3 2024 is similar to that of manufacturing.

Figure 4.9



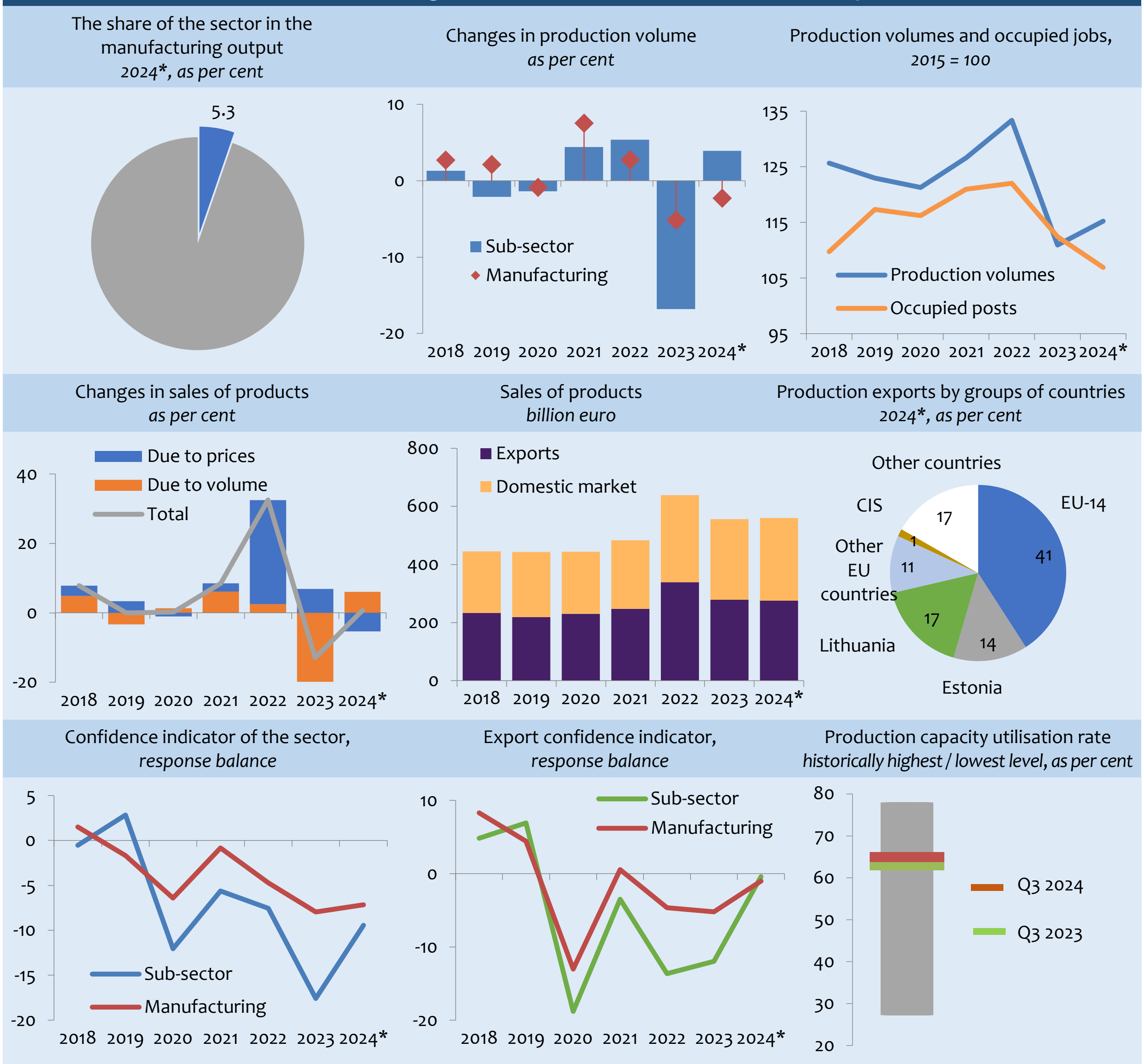
Manufacture of other non-metallic mineral products is closely related to the demand of the construction sector. As the demand for products grew, stable growth was observed in 2021-2022, but an opposite picture was observed in 2023, when the output of the sub-sector reduced significantly. Growth of the sub-sector was observed in January-October 2024.

As product prices increased, a record-high increase in sales of other non-metallic mineral products was observed in 2022. In 2023, it declined more moderately in the domestic market and more sharply in exports. In January-October 2024, both domestic and export sales increased. Traditionally, most of the products are sold on EU markets.

The number of occupied posts in the sub-sector increased in 2021-2022 but declined in 2023 and continued to decline in the three quarters of 2024. In 2022 and 2023, the confidence indicator of the sector was markedly negative. Although the confidence indicator of the sub-sector remained negative in Q3 2024, it followed a positive trend. The assessment of export opportunities in recent years has been volatile, with the manufacturing being above the average in Q3 2024. The capacity utilisation rate in the sub-sector in 2024, like in 2023, is one of the lowest in manufacturing.

Figure 4.10

Indicators Characterising Manufacture of Other non-metallic mineral products



* MoE assessment

In recent years, the growth of metalworking has been significant in the total growth of manufacturing. Stable growth was observed in the sub-sector in 2021-2022. By contrast, in 2023, the reduction in metalworking volumes has been similar to the average indicator in manufacturing. Output volumes of the sub-sector also declined in January-October 2024.

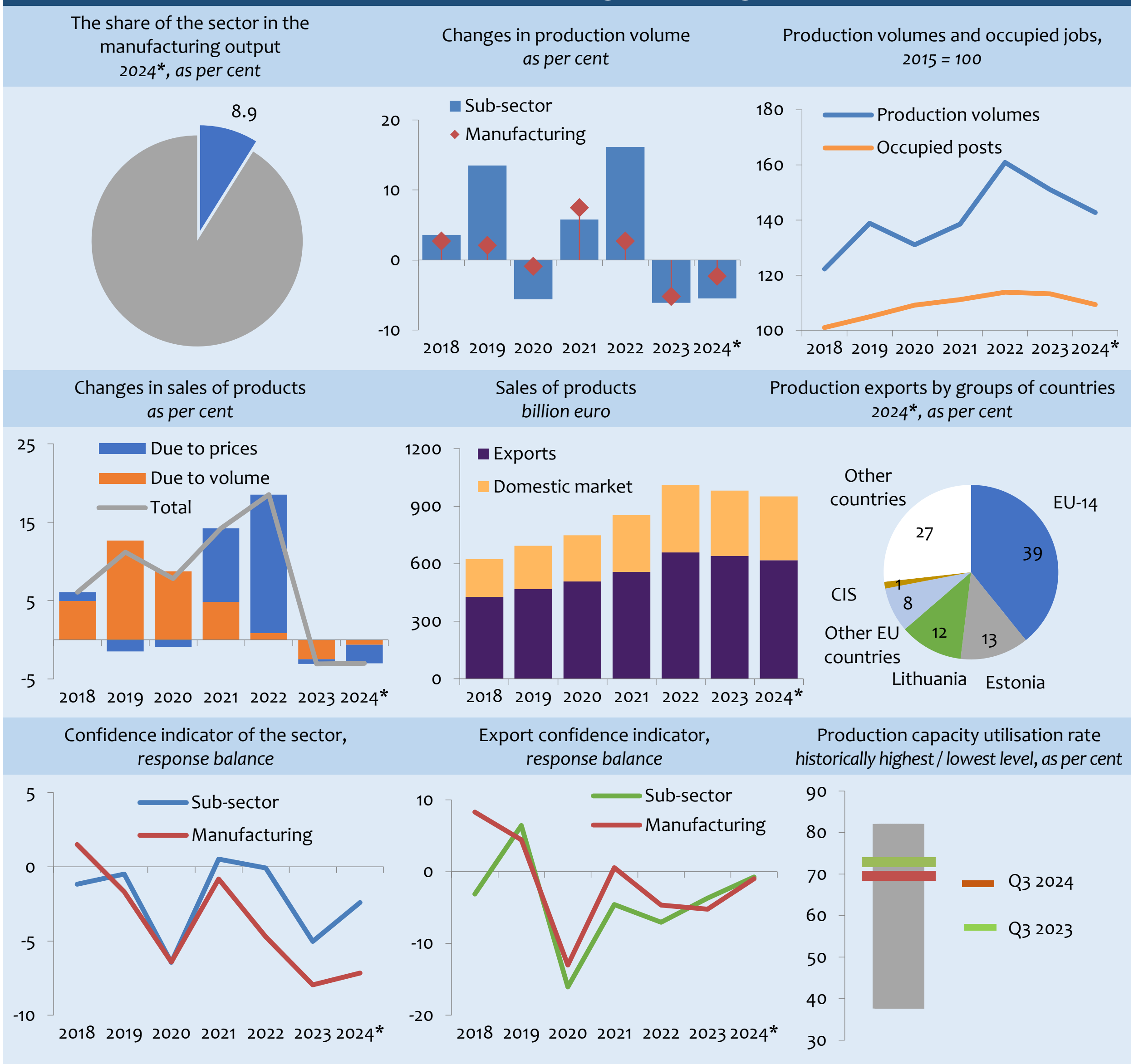
Most of the products produced by metalworking are exported, which means that manufacture of basic metals and articles thereof is significantly affected also by the competitiveness of the EU steel manufacturing sector on the global market, which has been limited in recent years. The EU is the main market for the products, but other countries also account for a significant market share. Until 2022, sales volumes of products of the sub-sector were growing considerably. They were growing equally rapidly in the domestic and export markets. By contrast, in 2023 and January-October 2024 production volumes have slightly shrunk.

The number of posts in metalworking increased until 2022. In 2020, the increase was more rapid, in 2021-2022 – more moderate. The number of occupied posts fell slightly in both 2023 and the three quarters of 2024.

In recent years, the confidence indicator of metalworking has been volatile. It should be considered that in recent years confidence of this sub-sector has been assessed more positively than other sub-sectors, and the sector's confidence indicator was above the average in manufacturing in Q3 2024. Future export opportunities are evaluated cautiously. Capacity utilisation in metalworking remains slightly above the average in manufacturing.

Figure 4.11

Indicators Characterising Metalworking



* MoE assessment

Manufacture of electrical and optical equipment has traditionally been the most rapidly growing manufacturing sub-sector. After a small decline in growth rates in 2021-2022, the sub-sector was the main driver of the development of manufacturing in 2023. However, it experienced a contraction in output in January-October 2024 due to weak external demand.

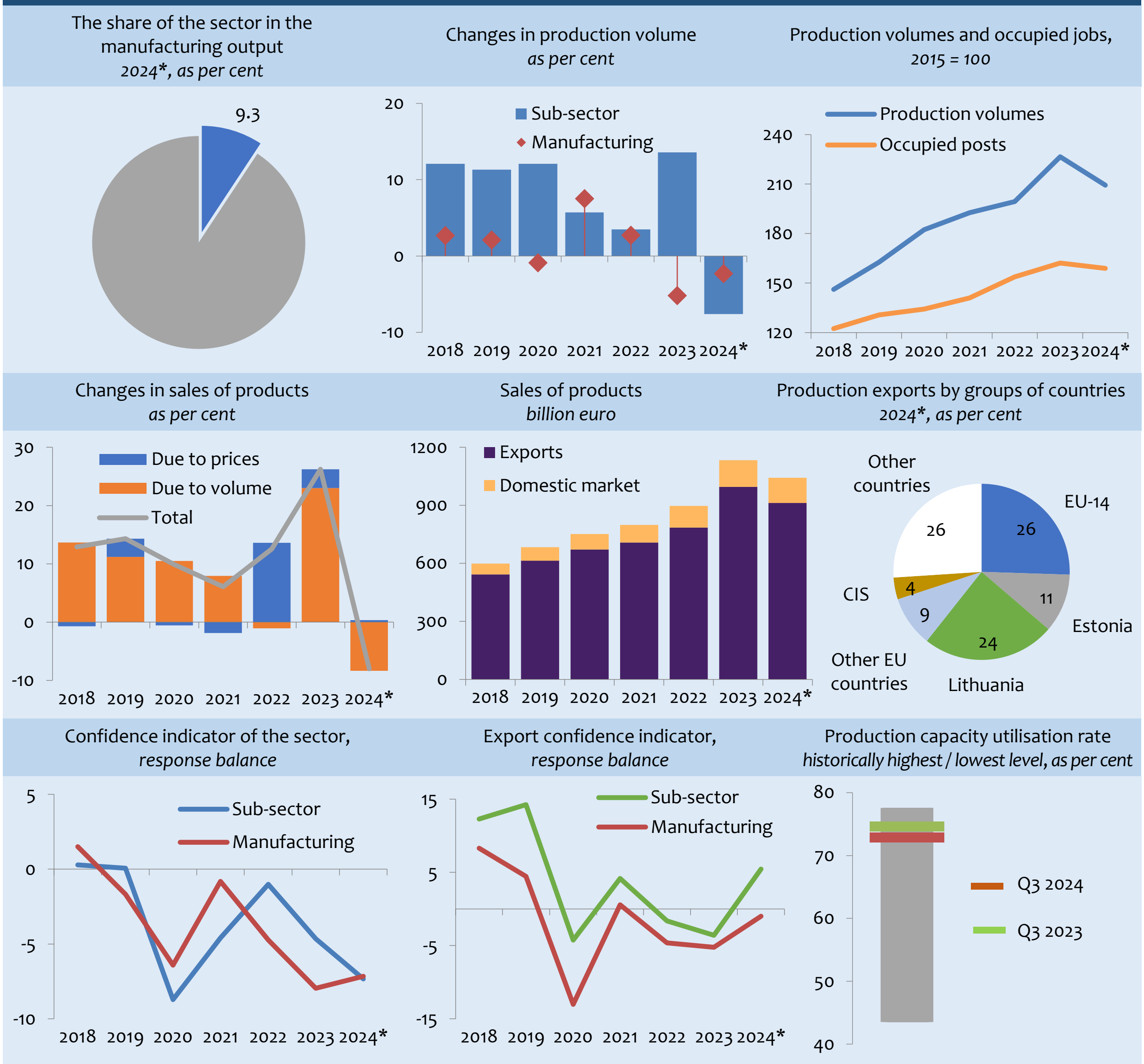
Although producer prices fluctuate, until 2023, sales volumes in the sector have been growing stably and at a fast pace. The development of the sector is closely related to external demand, almost 90% of the production is exported. In recent years, product sales volumes have been growing equally rapidly in the domestic and export markets. While there is a decline in sales of products in 2024, sales in the sub-sector remain higher than in 2022.

Most of the sector's growth in recent years has been driven by increases in both productivity and the number of occupied posts. However, in the three quarters of 2024, both sales and the number of occupied posts declined, which also led to a slowdown in the sector's growth.

The confidence indicator of manufacture of electrical and optical equipment is volatile but still negative, at the same level as the indicator of manufacturing. However, export opportunities are evaluated positively. In Q3 2024, the capacity utilisation rate in manufacture of electrical and optical equipment decreased slightly compared to the same quarter of the previous year.

Figure 4.12

Indicators Characterising Manufacture of Electrical and Optical Equipment



* MoE assessment

Growth in manufacture of machinery and equipment has been volatile in recent years. It was markedly rapid after the COVID-19 crisis in 2021 and negative in 2022, as the external demand reduced. In 2023, manufacture of machinery and equipment grew, while in January-October 2024 it declined.

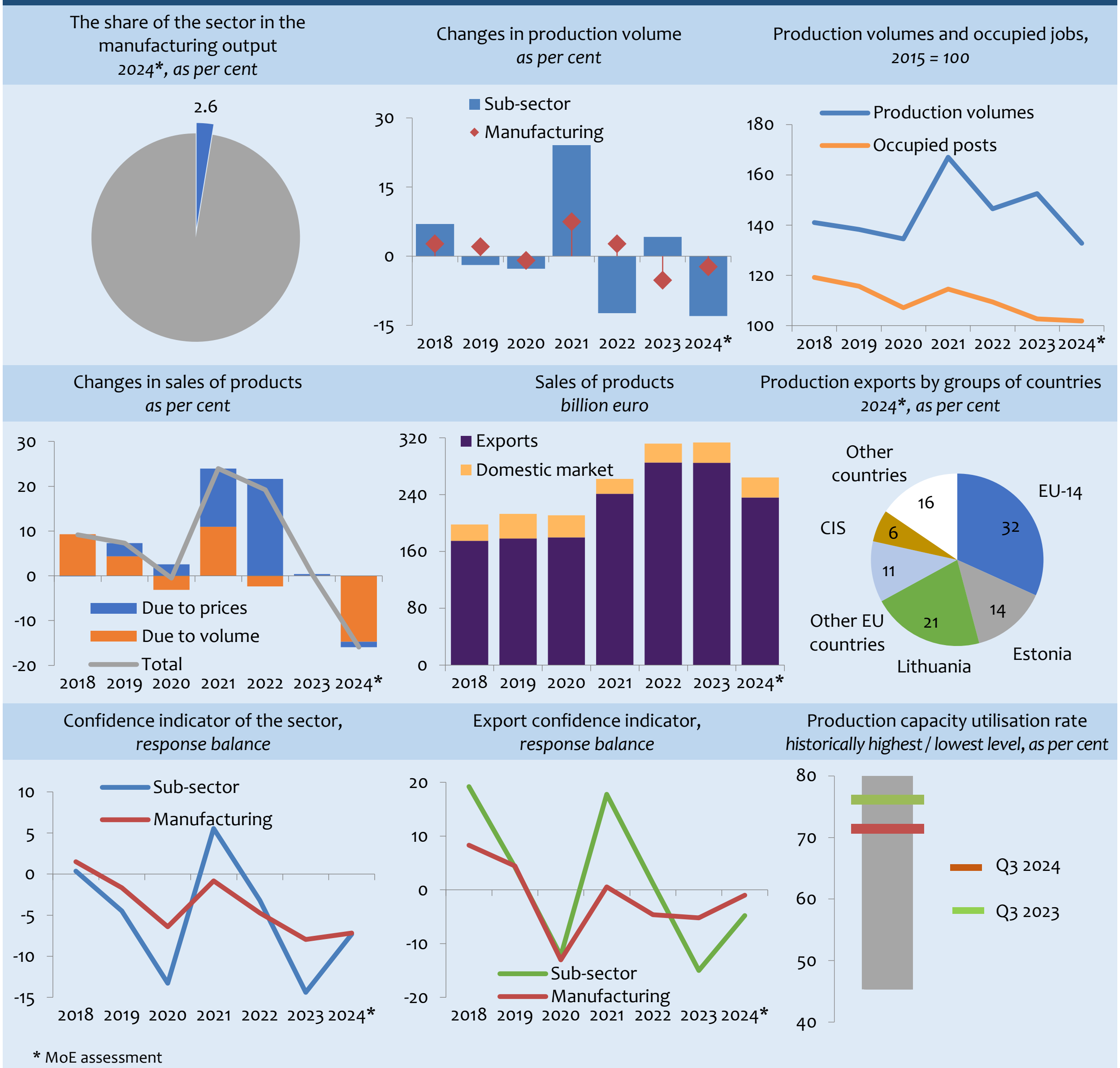
Similarly to other manufacturing sub-sectors, sales volumes of machinery and equipment have been growing more rapidly than output until 2023. In 2021, the increase in turnover of all sub-sectors was secured by sales of products in export markets, while the turnover in the domestic market shrank significantly. It should be noted that more than 90% of the production of the sector is exported. In 2023, sales volumes increased considerably in the domestic market but slightly shrank in the export market. The downward trend continued in Q3 2024, with a small decrease in domestic sales but a significant decrease in exports.

The number of occupied posts in the sector in recent years has been volatile. After a sharp increase in 2021, their number has continued to decline over the last three years.

The sector's sentiment was negative at the end of 2022 and especially in 2023, but showed a positive trend in 2024, although the indicator continues to be negative. There is a similar sentiment in the assessment of export opportunities. The capacity utilisation rates have remained high in recent years.

Figure 4.13

Indicators Characterising Manufacture of Machinery and Equipment



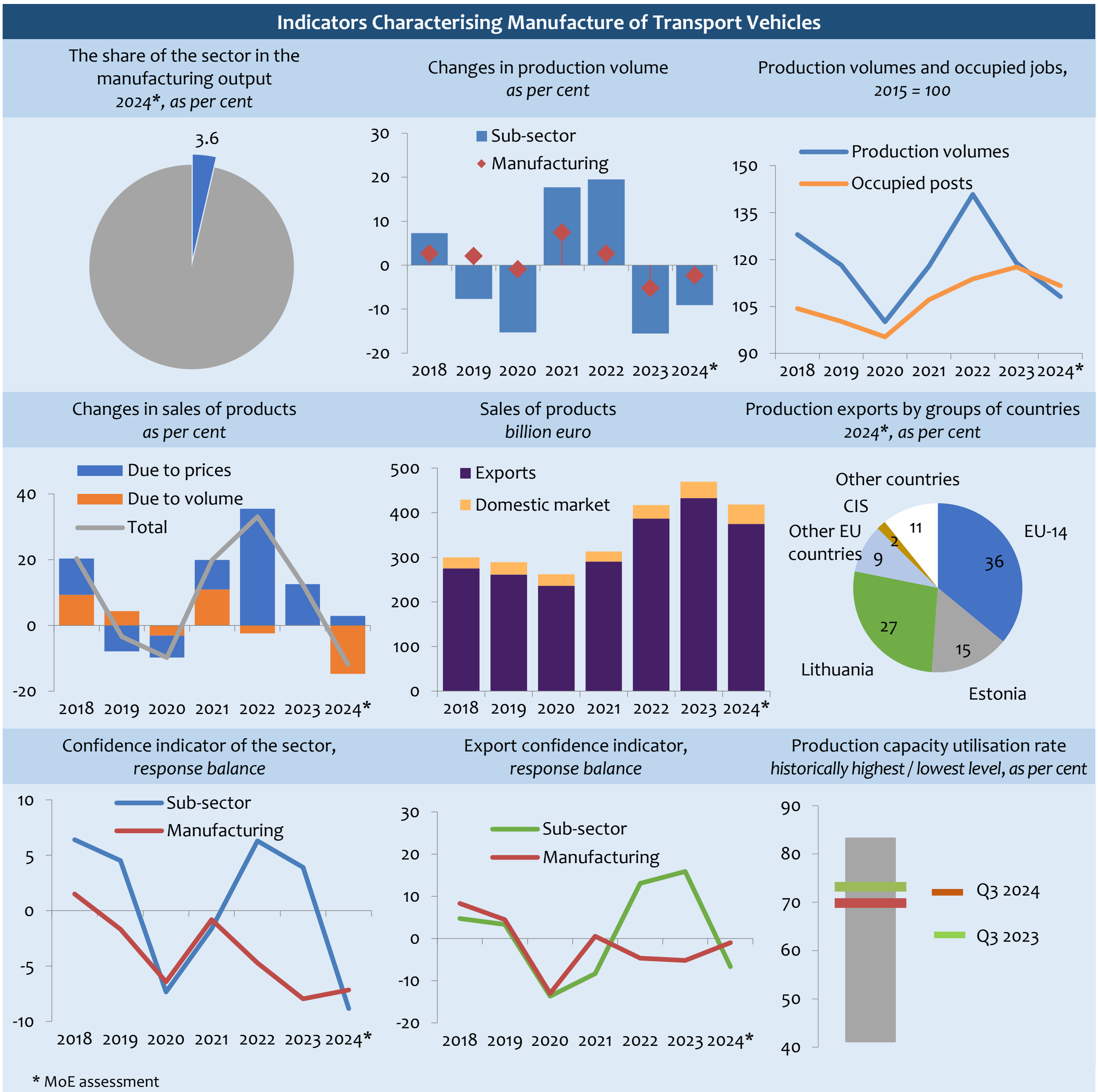
Manufacture of vehicles is evidently focused on external markets – more than 90% of products of the sector are exported. Since the sub-sector largely depends on new orders, and heavily depends on external demand and external shocks, it is characterised by considerable fluctuations in production volumes.

Following the decrease in manufacturing volumes in 2019-2020, rapid growth was observed in the sub-sector in 2021-2022, when external demand increased as prices of raw materials increased. An opposite picture was observed in 2023 and January-October 2024, when manufacturing volumes of the sub-sector reduced by 15.5% and 8.2% respectively, partially due to the base effect.

In recent years, sales volumes of vehicles have been developing dynamically. In 2023, production volumes have slightly increased thanks to stable producer prices, but in January-October 2024 they declined. There was a significant contraction in the export market, accompanied by a decline in domestic sales.

The number of occupied posts in manufacture of vehicles in recent years has not significantly changed. After a small decline in 2020, the number of jobs has been growing every year and declined again in the three quarters of 2024. The confidence indicator was the highest in manufacturing in 2022-2023 and declined sharply to negative in Q3 2024. Export opportunities are also assessed in the same way during this period. The capacity utilisation rate in manufacture of vehicles has decreased compared to Q3 2023 and is above the average level in manufacturing.

Figure 4.14



4.3. OTHER INDUSTRY

Electricity and gas supply dominate in the structure of other industry (mining and quarrying; electricity, gas, steam and air conditioning supply; water supply, sewerage, waste management and remediation activities). After a drop in 2017-2019, the share of other industry in total value added has resumed growth since 2020. The dynamics in production volumes in electricity and gas supply sectors are related to weather, as the amounts of electricity and heat produced depend on it.

After the increase in manufacturing volumes in 2015-2016, volumes of other industry declined in 2017-2019 caused by weather and consumed amounts of electricity and heat. However, in 2020-2021, other industry experienced a rapid increase in production volumes again, driven by an increase in electricity and natural gas supply, as their consumption increased under the conditions of the COVID-19 pandemic and due to weather.

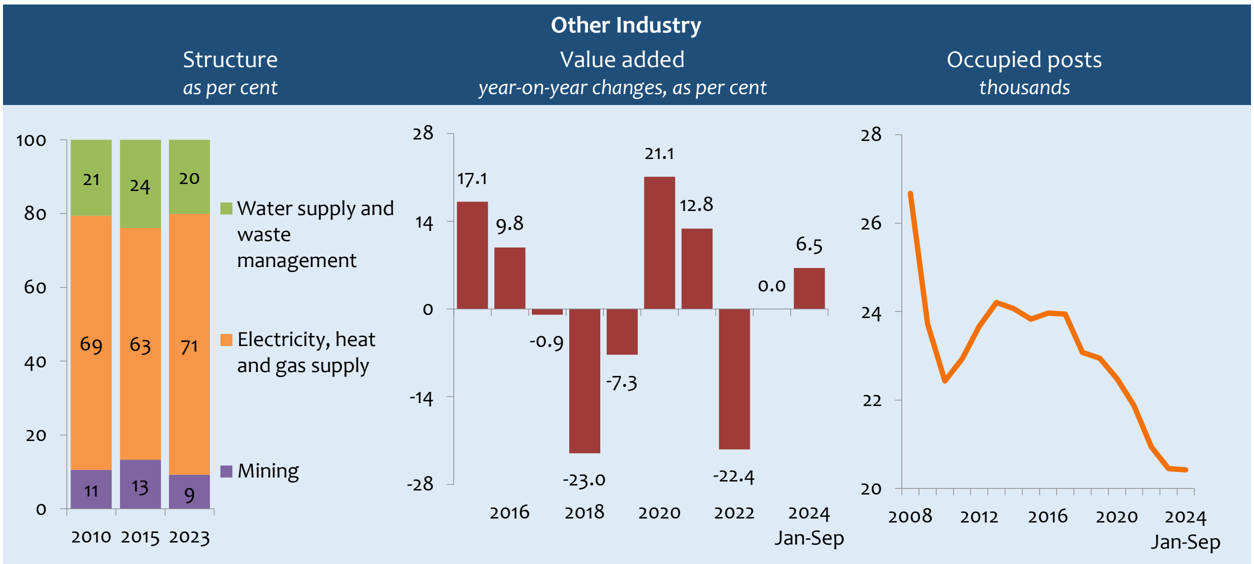
In 2022, volumes of other industry sectors showed a sharp decline. Volumes decreased significantly in electricity, gas, steam and air conditioning supply due to the disruption of natural gas supplies from Russia, moreover, natural gas consumption declined due to the price increase. Production of electricity and the amount of heat produced in combined heat and power plants reduced considerably because of higher average air temperature during the heating period, as well as austerity measures due to high energy prices.

In 2023, volumes in other industries remained unchanged. The biggest impact came from the drop in volumes of mining and quarrying. This was driven by lower volumes in extraction and processing of peat and quarrying of gravel and sand. Electricity, gas, steam and air conditioning supply, on the other hand, saw a slight increase, largely due to a surge in hydroelectric power generation. However, higher energy prices led to a decline in consumption.

In Q1-Q3 2024, compared to the corresponding period of the previous year, volumes of other industry sectors increased. The most significant impact came from the increase in volumes in electricity, gas, steam and air conditioning supply as the amounts of electricity produced by combined heat and power and solar plants increased and their consumption increased due to the decrease in the price of energy sources. Volumes increased rapidly in mining and quarrying caused by the increase in volumes in quarrying of gravel and sand, and extraction and processing of peat.

In recent years, the number of occupied posts in mining has been growing, while in other sectors it has been declining rapidly. It declined in all sub-sectors in 2023, but increased in mining and quarrying, water supply and waste management in the three quarters of 2024.

Figure 4.15

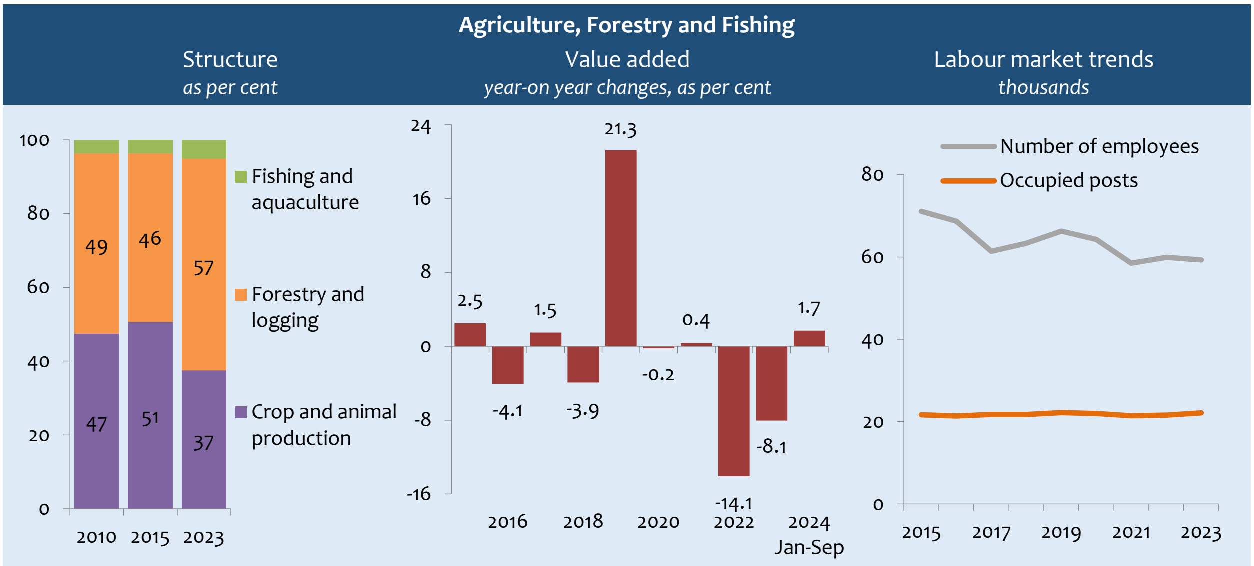


4.4. AGRICULTURE, FORESTRY AND FISHING

Agriculture and forestry dominate in the structure of agriculture, forestry and fishing. The activity of the industry is closely related to weather conditions; therefore, its growth is generally volatile. After the fall in 2016, the sector's share in total value added rose again from 2017 to 2022 but declined significantly in 2023.

In 2015, despite Russia's embargo on food imports, there was growth in agriculture and forestry fostered by a good harvest of cereals. In 2016 and 2018, the sector was affected by a fall in crop production, while in 2017 the sector showed some growth due to a rise in forestry volumes. In 2019, very rapid growth was observed, which was attributed to an increase in crop production – that year Latvia had the highest total cereal harvest in its history.

Figure 4.16



In 2020, volumes of the sectors reduced slightly, with production volumes in crop production reducing more rapidly than production volumes in forestry increased. In 2021, volumes of the sectors grew moderately, with the rise in production volumes in forestry and fishing still being the cause of this growth. In 2022, volumes of the sectors declined significantly, driven by sharp falls in agriculture and forestry, while fishing continued to grow.

In 2023, volumes of the sectors continued to decline sharply in agriculture and forestry. In agriculture, it was caused by a reduction in production volumes in crop production, mainly attributed to the decrease in the total cereal harvest by 16.3% compared to the previous year. Due to weather, crop production has been the lowest over the last five years. Animal production volumes remained practically unchanged in 2023. The number of farmed live cattle, pigs, sheep and goats at farms reduced, while an increase was observed in the number of poultry. At the same time, the number of exported livestock and pigs increased. In 2023, volumes of manufacture of meat, egg and raw milk in milk processing companies fell, while manufacture of dairy products rose.

Despite a 15% increase in the total volume of timber harvested and a 5% increase in reforestation volumes, the average cost of reforestation and maintenance in Latvia increased in 2023 and the average purchase price of logs (of both coniferous and deciduous trees) decreased, which contributed to a decline in volumes in forestry and logging. It should be noted that the highest log procurement prices in recent years were reached in the second half of 2022. In 2023, the continuing unstable geographic situation, high inflation and rising bank interest rates led to a sharp increase in construction costs, while its activity and orders declined, which also reduced demand for timber. Forestry and logging were also affected by the spread of bark beetles and the storm in the second half of the summer.

Because of the drop in global prices of food, in 2023, prices of agricultural products decreased also in Latvia. In 2023, compared to 2022, the agricultural price index declined by 18.9%, driven by a 24.3% decrease in the crop price index and an 8.9% decrease in the livestock price index. The average purchase price of grain decreased considerably – to 208.39 euro per ton, i.e. by 27.3%. In animal production, the reduction in the purchase price for raw milk to 355.05 euro/tonne, i.e. a decrease of 24.6%, had a significant impact. Prices also fell for beef, sheep and goat meat, while prices rose for pork and eggs. Pork prices rose by 34.1% to their highest level in 30 years.

After a sharp decline in the previous two years, production output increased moderately in the three quarters of 2024, driven by growth in crop production, forestry and logging, while production output declined in animal production and fishing.

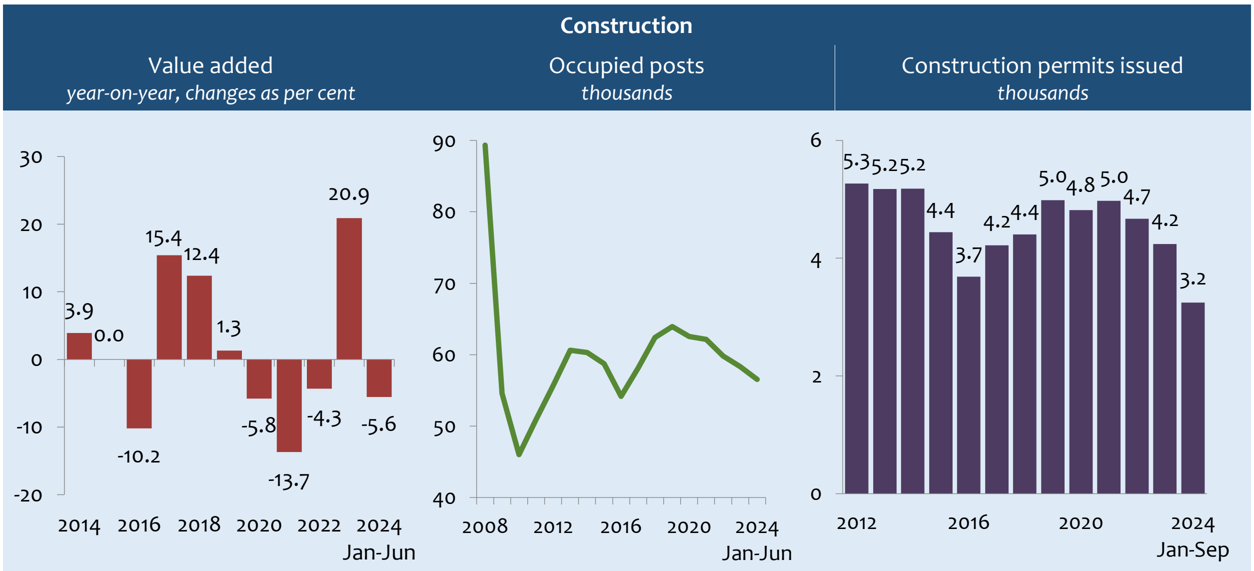
In recent years, up until the pandemic, there was a slow increase in both the number of employed individuals and the number of occupied posts. However, by 2020, the impact of Covid-19 caused a decline in jobs in agriculture and forestry, whereas there was an increase in fisheries. In 2021, occupied posts shrank in all sub-sectors, but in 2022 – only in agriculture. In 2023, the number of jobs increased only in forestry, while in the first three quarters of 2024, job growth is observed in both forestry and agriculture.

4.5. CONSTRUCTION

The growth of construction is largely subject to cyclical fluctuations. During the period from 2000 to 2007 the sector developed rather rapidly. During the last years of the period, there were signs of overheating. The annual average output increased by 14.2% and the average increase from 2006 to 2007 was 25.2%. The construction was actively attracting employees in the period before the crisis. From 2005 to 2007, the number of occupied posts increased by almost 30 thousand reaching 91.7 thousand. Construction costs increased gradually until 2005. From 2006 to 2008, construction costs virtually exploded, labour costs increased 2.6 times, but costs of maintenance and operation of machinery and mechanisms almost doubled.

Production volumes dramatically declined during the crisis; industry output shrank more than twice in the period from 2008 to 2010. During the economic recession, the number of persons employed in the sector was significantly adjusted and reduced almost twice. The reduction also affected construction costs (mostly – labour costs). It should be noted that they remained at a higher level than before the overheating.

Figure 4.17



The demand for services of the sector resumed growth in 2011. During the period until 2019, the construction development rates were steeper than economic development rates. Average growth was 6.4% annually. The recovery of the construction sector was largely driven by public procurement and more active absorption of EU structural funds. Along with the increase in internal demand, the development of the sector was positively affected by the ability to reorient to external markets during the crisis. For example, in 2011, the volume of construction products outside Latvia exceeded the indicator of 2008 more than five times. The increase in construction activities also reflected in the increase in the number of granted building permits.

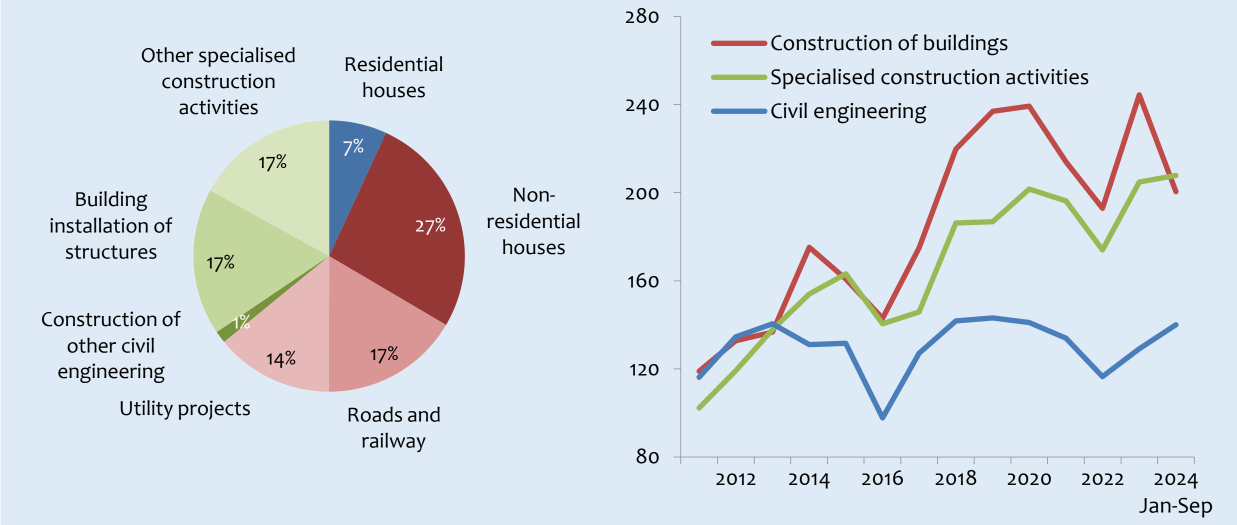
It should be noted that during the transitional period of the EU Structural Funds, construction output decreased by 5.2% annually from 2015 to 2016 because of a reduction in investment in construction. Construction activities shrank in all groups, most rapidly in the group of civil engineering. Negative trends also contributed to the reduction in the number of granted building permits in this period. In the next years, starting from 2017, the sector's development driver was the increase in the intensity of implementation of projects of EU structural funds after a transition period, as well as the inflow of private investments for the construction of large construction objects.

Figure 4.18

Construction Products

Structure
January-September 2023, as per cent

Construction products indices
2010 = 100

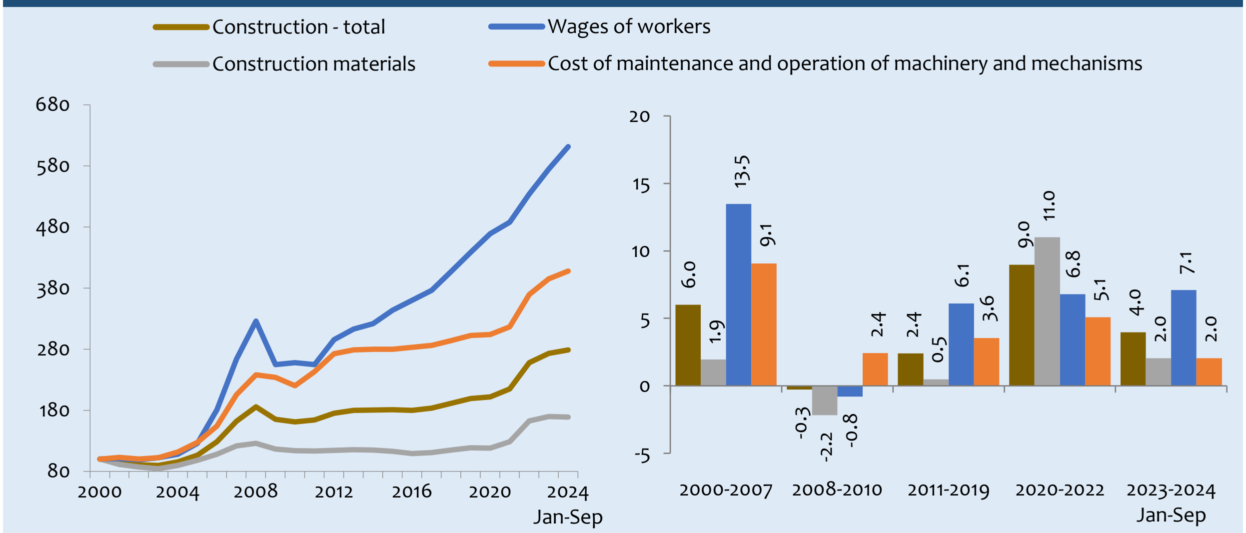


As economic activity increased, the number of the employed started to evenly increase in 2011. A reduction was observed in 2015 and 2016, when outputs of construction products reduced. In 2019, the number of employees exceeded 60 thousand and was higher than in 2010; however, the increase rates were considerably slower than the increase in outputs. This means that the sector was largely developing at the account of the increase in productivity. Construction costs increased uniformly during this period, with a more rapid increase between 2017 and 2019. Labour costs and costs of maintenance and operation of machinery and mechanisms made the biggest pressure, while the costs of materials remained almost unchanged.

Figure 4.19

Dynamics of Construction Costs by Types of Resources

2000 = 100 *2000 = 100*



From 2020 to 2022, the impact of several external factors was particularly pronounced. Both the COVID-19 pandemic and the war in Ukraine caused by Russia had an overall negative impact on the sector, with an average annual output decrease of 8% during this period. The most rapid drop was observed in 2021, when the sector experienced a bigger drop in demand due to the global rise in construction costs, in particular prices of timber and metal. The increase in construction costs had a strongly negative influence on the dynamics of activities of the sector. In 2022, pressure on construction costs was stepped up by Russia's invasion of Ukraine, which considerably reduced the availability of individual construction materials, as well as considerably increased the costs of energy sources. The decline also affected labour demand; the number of construction jobs declined in 2020 – 2022.

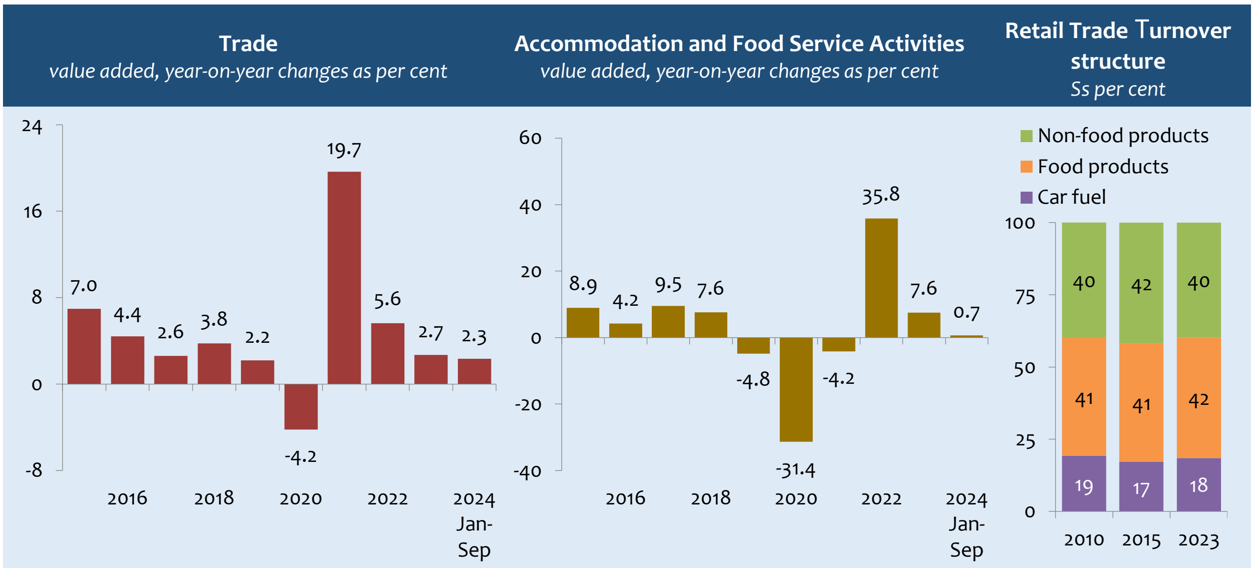
In 2023, construction activity resumed. Overall, construction output during the year was 18.9% higher than in 2022. The industry and customers overcame the challenges of recent years and the increase in customer activity had a positive impact on industry performance. The low base effect of the previous years' recession in the sector is also an influencing factor. The increase in construction costs started to moderate in 2023 and has returned to its pre-recession level in 2024. The increase in construction material prices driven by external factors has subsided and labour costs have resumed the role of cost growth driver.

Construction activity is decreasing in 2024. In the three quarters of this year, construction production volumes year-on-year are 3.6% lower than in the three quarters of 2023. This was due to a significant contraction in activity in the construction of buildings, where relatively high lending rates are still a factor.

4.6. TRADE, ACCOMMODATION AND FOOD SERVICE ACTIVITIES

Trade dominates in trade, accommodation and food service activities – approximately 85%. Volumes of services provided in the sectors have been generally growing rapidly since 2015. The trade sector was positively influenced by an increase in private consumption and retail turnover. Furthermore, accommodation and food service activities were positively affected by the development of the tourism sector.

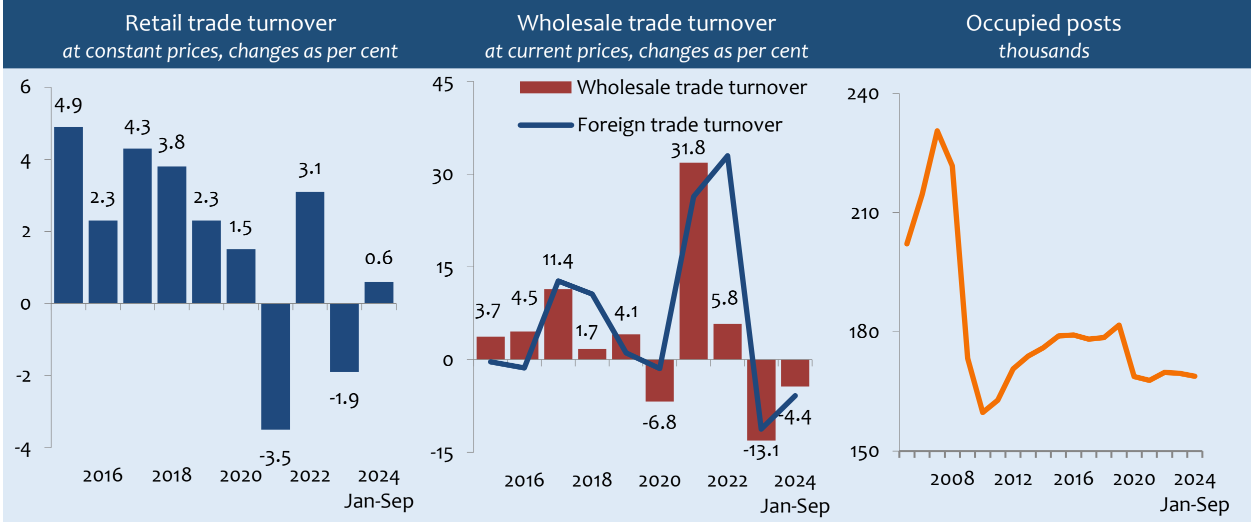
Figure 4.20



Between 2015 and 2019, services in trade increased every year and overall growth was rapid – on average by 4% per year. In general, accommodation and food service activities also experienced a sharp increase in volumes in this period – an average annual increase of 4.9%, but in 2019, there was a drop in service volumes. The increase in wages and improvements in the labour market ensured the growth of retail turnover, which increased by an average of 3.5% per year. The dynamics of the total retail trade turnover were mostly affected by the increase in non-food retail trade volumes, the turnover increased sharply for automotive fuel, while retail volumes increased somewhat slower in the group of food products. The dynamics of the retail sector were affected by external trade activities.

Figure 4.21

Key Indicators of the Trade Sector



In 2020, the volume of services provided in trade, accommodation and food services activities generally reduced. The trade sector was negatively affected by the decline in private consumption, rising unemployment and falling incomes caused by the COVID-19 crisis. Retail turnover increased very moderately, wholesale turnover shrank rapidly, but the strict virus containment measures had a particularly negative effect on accommodation and food service activities.

In 2021-2022, the volume of services provided in trade, accommodation and food services activities grew rapidly again. The trade sector was positively influenced by the easement and lifting of the restrictions introduced due to the COVID-19 pandemic. Accommodation and food service activities have been growing strongly from the second half of 2021, recovering from the decline in previous years.

In 2023, total volumes of the sectors grew more moderately than in the previous two years, largely driven by growth in accommodation and food service activities. Trade continued to be negatively affected by the unfavourable situation in the external environment, which reduced wholesale volumes even more. The increase in consumer prices at the beginning of the year exceeded the increase in income, real income of the population shrank and negatively affected household consumption, resulting in a 1.9% decline in retail turnover in 2023. The turnover of food products reduced at the fastest pace due to high prices of food. It shrank more moderately for non-food products but increased for fuel affected by lower trade volumes in 2022 due to higher fuel prices.

In 2024, the volume of services provided in trade, accommodation and food services activities continued to grow moderately. Overall, trade volumes increased by 2.3% in the three quarters of 2024 compared to the corresponding period of 2023. In early 2024, the unfavourable external environment continued to affect the reduction in wholesale volumes. Sales of cars and motorcycles also fell in the first two quarters. Retail sales, on the other hand, grew by only 0.6% over the three quarters, amid a still cautious population sentiment to make larger purchases. Retail turnover was growing stronger for fuels, more moderately for non-food goods and declined for food. Volumes of accommodation and food service activities grew very moderately (by 0.7%) in the three quarters to 2024, largely driven by a decline in food service activities.

The largest share of occupied posts is in trade, but it has been shrinking in recent years with jobs growing faster in accommodation and food services activities.

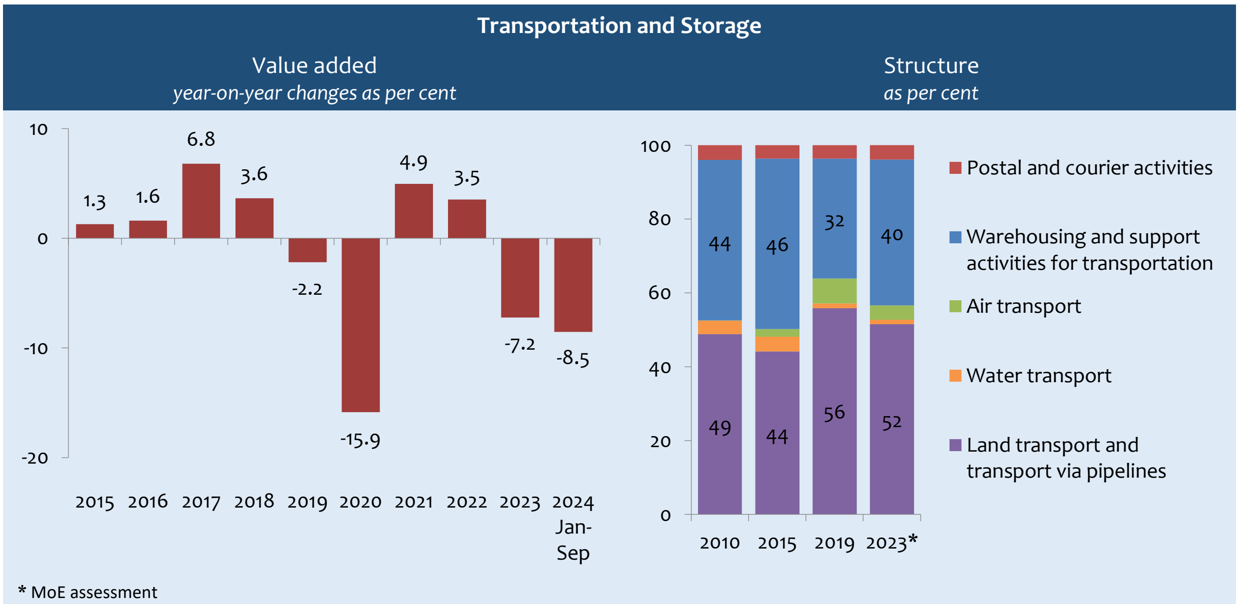
4.7. TRANSPORTATION AND STORAGE

Transportation and storage are closely related to international transportation, including volumes of freight transported by railway, as well as through ports.

After a slight increase in 2015-2016, the volumes of the sector grew faster in 2017-2018. Although the volume of transit freights by railway and in ports declined, the growth of the sector was fostered by the increase in freight transport by road, and the increase in the number of passengers in the airport and seaports. In 2019, the increase in volumes in land transport was unable to compensate for the decline in other transportation sub-sectors. However, in 2020, volumes of the sector reduced sharply due to the movement restrictions caused by the COVID-19 crisis, having a significant impact on aviation, land transport and railway operations.

In 2021, as the epidemiological situation improved and the restrictions introduced were removed, the sector's volumes increased rapidly again. In 2022, production volumes in the sector also continued to increase. Ports saw a sharp increase in freight volumes, while rail and road freight volumes declined slightly. In 2022, passenger transport increased rapidly as the flow restored after the COVID-19 restrictions were lifted, particularly rapidly in air transport, where passenger numbers more than doubled compared to 2021.

Figure 4.22

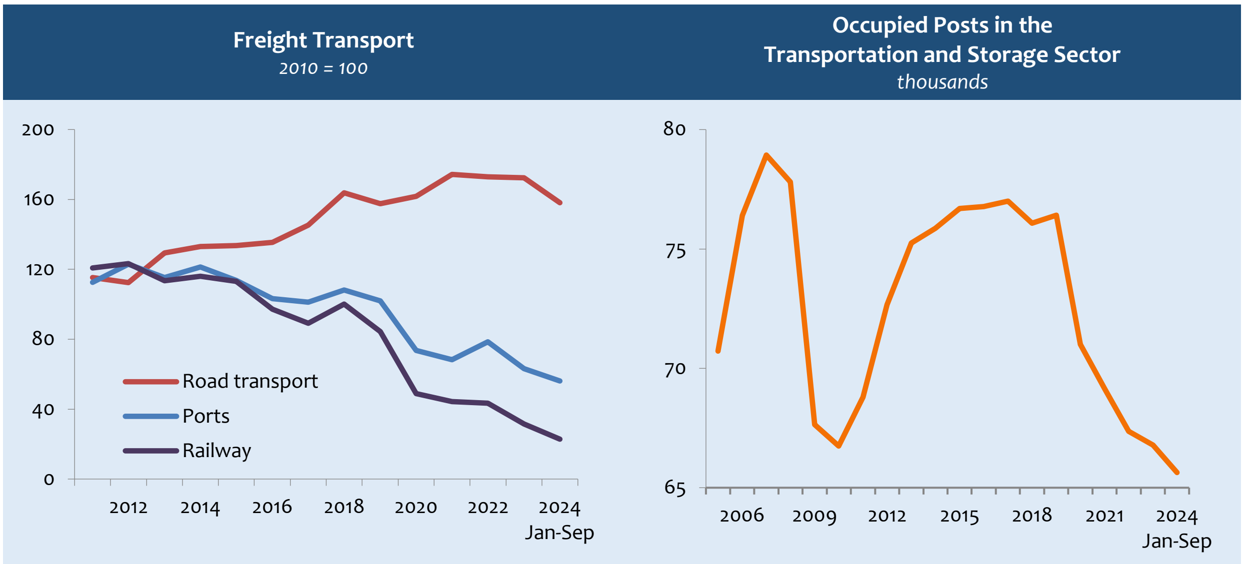


After growth in the previous two years, volumes of the transportation industry shrank rapidly in 2023 due to a drop in all transportation sub-sectors, except air transport. Volumes of services declined at the fastest pace in land transport, transport via pipeline, and warehousing and support activities for transportation. Volumes of freight carried reduced in all modes of transport, underpinned by the drop in the volume of freight carried in international transportation. In 2023, passenger transport has grown most rapidly in air transport – by 23.2%, it increased by 15.4% in land transport and by 2.5% in ports.

In the first three quarters of 2024, volumes in the transportation sector continued to decline, with the only positive contribution coming from growth in the air transport sector. The fastest decline was in water transport services. Volumes of freight carried reduced in all modes of transport. Rail freight volumes reduced most rapidly driven by a drop in international freight volumes, while the rise in road freight was secured by a drop in domestic transportation. In Q1-Q3 2024, passenger transport was growing most rapidly in air transport – by 5.3%, it increased by 1.7% in land transport and by 5.6% in sea transport.

The biggest share of occupied posts in transportation and storage is in land transport, transport via pipeline, and warehousing and support activities for transportation. In 2020, the number of occupied posts declined rapidly in all transportation and storage sub-sectors under the influence of the COVID-19 pandemic. Since 2021, the number of occupied posts has continued to decline in all sectors, except air transport, and has already fallen below the level of the transportation and storage sector at the time of the financial crisis in 2010.

Figure 4.23



4.8. BUSINESS SERVICES

Real estate activities dominated in the structure of business services (information and communication, financial and insurance activities, real estate activities, professional, scientific and technical activities and administrative and support service activities, arts, entertainment and recreation).

In 2015-2019, volumes of business services increased moderately – by an average of 1.5% annually. They increased in all main business services sectors, except for financial and insurance activities, which was largely attributed to the decline in the volume of non-resident business in Latvia, the consolidation and liquidation of banks, and real estate activities. In 2020, due to the impact of the COVID-19 crisis, volumes in commercial services decreased in all sectors except for information and communication services, where a slight increase in volumes was observed. Volumes in arts, entertainment and recreation fell particularly rapidly due to stringent measures to contain the COVID-19 pandemic.

In 2021 and 2022, volumes of business services in all sectors rose rapidly as they recovered from the COVID-19 crisis. The increase in volumes in information and communication services and real estate activities had the biggest impact. In 2022, most rapid increase rates were also observed in arts, entertainment and recreation, one of the sectors hit the hardest by the COVID-19 restrictions. In 2023, business services also showed strong growth, but at a more moderate pace than in the previous two years. Volumes increased in all business services sectors, except for financial and insurance activities, mainly affected by the decline in financial services. The biggest impact was from the increase in real estate activities, and arts, entertainment and recreation.

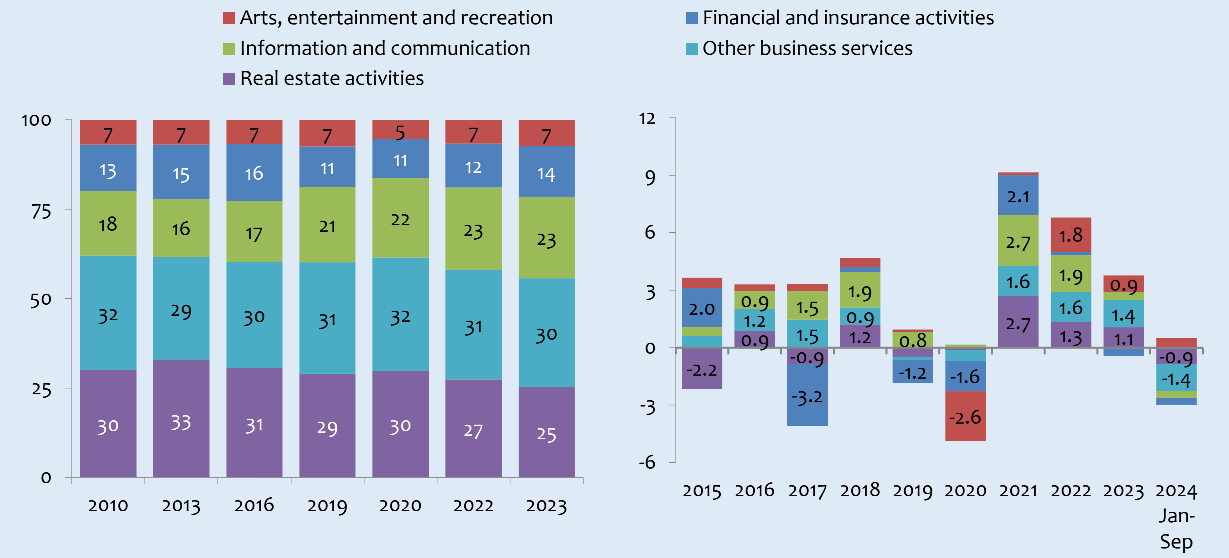
In Q1-Q3 2024, volumes of business services showed a decline, compared to the corresponding period of 2023. Volumes shrank in all business services sectors, except arts, entertainment and recreation. The biggest impact was from the decline in real estate activities. The most significant impact came from the decline in financial activities, which was largely driven by a fall in financial services due to the increase in costs of monetary financial institutions, and in information and communication services, where the telecommunication services sector showed a negative result in all three quarters.

The largest share of occupied posts in business services is in information and communication, professional, scientific and technical activities, and administrative and support service activities. After the decline in the number of jobs in all sectors in 2020, in 2021-2023, the number of jobs increased only in information and communication but remained virtually unchanged in financial activities and administrative and support service activities. In the first three quarters of 2024, the number of jobs increased in all sectors, except professional, scientific and technical activities, as well as real estate activities.

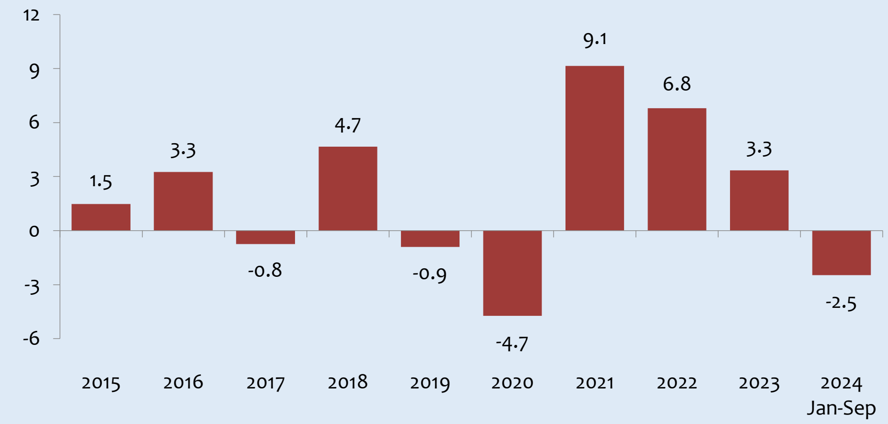
Figure 4.24

Business Services

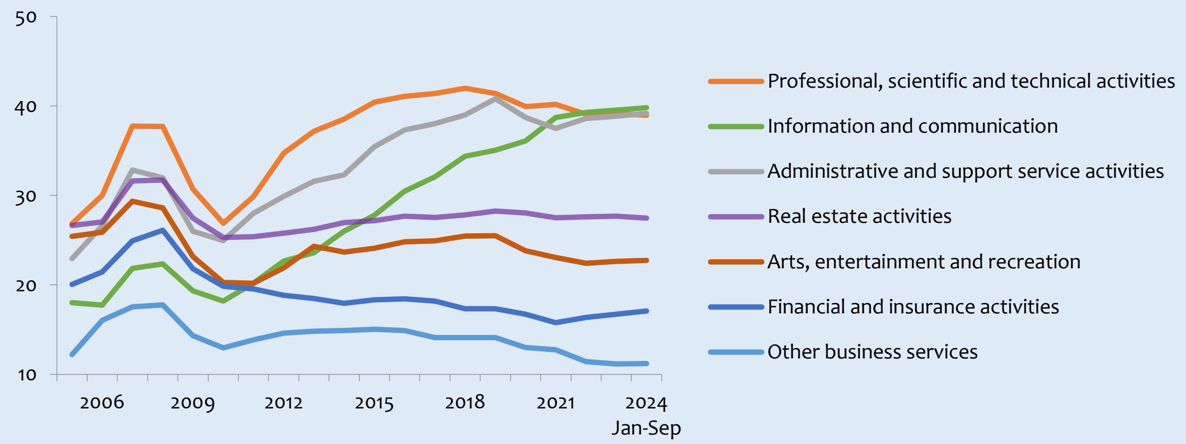
Structure *as per cent* | **Contribution to growth** *percentage points*



Value added *year-on-year changes as per cent*



Occupied posts *thousands*



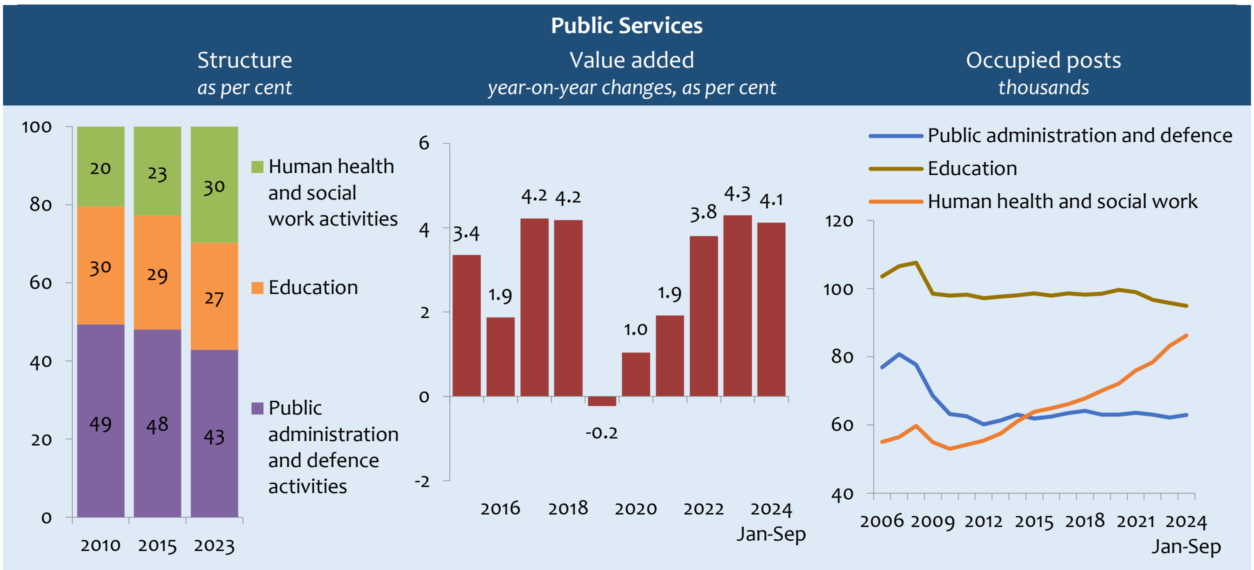
4.9. PUBLIC SERVICES

Public administration and defence activities dominate in the structure of public services (public administration and defence activities, education, health and social work activities). With the government expenditure increasing, steady growth was observed in the public services sectors in 2015-2018. It was slower in 2016 when only public administration and defence activities had a stable rise in volumes. Overall, in 2015-2018, volumes of public services increased by 3.4% per year on average. The most rapid increase was observed in health and the slowest – in public administration and defence activities. In 2019, volumes of public services almost did not change, with the increase in health compensating for the decline in education.

In 2020-2021, total volumes of services showed a moderate increase caused in 2020 by the increase in human health and social work activities (by 3.4%), while in 2021 they increased rapidly as this process was affected by the availability of services during the COVID-19 pandemic. In 2020, public administration and defence activities, as well as education increased most rapidly, while in 2021 public administration and defence activities showed very moderate growth, but volumes of education declined.

In 2022 and 2023, total volumes of public services increased rapidly. This process was more rapid in human health and social work activities – by 8.1% and 12.5%, more moderate in public administration and defence activities – by 3.9% and 1.9%, but volumes of education services reduced – by 1.4% and 1.6%. Public consumption to increase the defence.

Figure 4.25



In Q1-Q3 2024, total volumes of services also continued to increase rapidly. Volumes of human health and social work activities continued to grow rapidly – by 17%. Volumes of public administration and defence activities increased by 1.2% but continued to shrink in education – by 5.6%.

The highest share of occupied posts is in education. A rapid increase in jobs in recent years has been observed in health, while the number of jobs in education reduced. In 2022 and the first three quarters of 2023, the number of jobs in public administration and defence activities also fell, while in the three quarters of 2024, the number of jobs fell only in education.

5. ECONOMIC DEVELOPMENT FORECASTS

ECONOMIC DEVELOPMENT IN 2025[1]

In 2024, GDP will remain close to its level in 2023, though with a slight reduction – the MoE estimates that GDP at constant prices of 2020 could be 0.2% lower than in 2023 year-on-year. The situation in the economy is expected to improve in 2025. International institutions forecast economic growth in Latvia's major export markets in 2025 (more rapid than in 2024), which will positively impact also Latvia's export opportunities. At the same time, falling interest rates and rising real income will boost private consumption. The interest rate reduction and wider access to credits, as well as the implementation of EU fund programmes, will have a positive impact on investment dynamics. If the developments in the external environment do not significantly deteriorate economic growth could reach 2.6% in 2025.

Stabilising energy and food prices, as well as rising real wages, have a positive impact on private consumption in 2024. Overall price levels are expected to remain stable in 2025 (inflation could be close to 1.8% in 2025), and after-tax wages are expected to increase, which will continue to support real income growth in households. Lower interest rates and greater availability of credits could also have a positive impact on private consumption dynamics next year. Overall, private consumption could grow by 2.1% in 2025.

Both high interest rates and generally sluggish business lending had a negative impact on investment dynamics in 2024. With interest rates falling and lending expanding, private investment could also grow in 2025. Investment flows will also be positively influenced by the investments of the EU funds programming period and the implementation of the measures of Latvia's RRF Plan. The MoE forecasts that, in 2025, investments in gross fixed capital formation could increase by 2.7%.

In 2024, weak demand in the main trading partner countries has negatively affected the performance of Latvian exporters. Also, a sharp rise in manufacturing factor costs has had a negative impact on the export capacity of companies. Energy prices, labour and capital costs have all risen sharply in recent years. The tense geopolitical situation and Russia's war in Ukraine also continue to affect both raw material supplies and sales of finished products. International institutions predict that economic development in other Baltic States, Scandinavia and Western European countries will be more sustainable in 2025 than in 2024. This means that for those Latvian exporters whose main market is EU countries, the situation will improve, and external demand will increase. The increase in exports of goods and services is expected to grow by 3.1% in 2025.

A rapid rise in import volumes was observed in 2022 largely underpinned by the high uncertainty surrounding Russia's war in Ukraine and sanctions imposed by the EU. This resulted in increased stockpiling of goods by many companies. In 2023, the dynamics of imports were increasingly influenced by the decrease in trade flows of goods with Russia, with broadly similar trends continuing also in 2024. Given the reduction of flows of Russian goods in Latvia's import structure in previous years, the negative impact of market reorientation on import flows is expected to be less pronounced in the coming years and import dynamics are expected to be increasingly determined by Latvia's domestic demand dynamics in the future. Goods and services imports are expected to grow by 3% in 2025.

Given the stabilisation of the situation in Latvia's foreign trade partners and the growth in domestic demand, in 2025, growth is expected to return to the sectors that were in decline in 2024. Growth is expected in manufacturing, construction and business services.

In 2025, the fastest growth is expected in the construction sector. The development of the sector will be positively influenced by EU funds and public orders, and also the increase in lending. According to forecasts, the growth in construction volumes may exceed 4.6% in 2024.

Manufacturing is expected to grow by 4.5% in 2025, mainly driven by improving export opportunities. Some businesses linked to the markets of Russia and CIS countries will keep facing difficulties and will have to keep looking for new supply opportunities and new markets. Domestic market oriented industry sectors will be influenced by the purchasing power of the population.

Relatively stable growth rates in 2025 will persist also in agriculture and forestry. Growth in agriculture and forestry could be close to 2% in 2025.

Trade is also expected to grow steadily. This will be positively influenced by the increase in foreign trade flows and the dynamics of wholesale trade. Retail trade will be positively affected by the increase in private consumption.

[1] The latest forecasts of the IMF and EC were used by the MoE to analyse external markets and evaluate the global economic development trends when making forecasts about economic development (see Chapter 2).

However, negative dynamics in 2025 will persist in transportation and storage (0.8% decrease), although to a lesser extent than in 2023-2024. The geopolitical situation and decreasing commodity flows from Russia will affect both railway and port performance, and there is no reason to expect significant improvements in transit cargo flows in the near future. On the other hand, sector development will be positively affected by the development dynamics of land and air transport services.

Business services will also return to growth in 2025. According to the forecasts, the volume of services in information and technology sectors could increase by 4% in 2025. The dynamics in other business services will be more moderate. After the sharp recovery from the restrictions imposed by the COVID-19 crisis, high growth rates in accommodation and food service activities have become more moderate. In 2025, growth in accommodation and food service activities could be close to 3.8%, while in arts, entertainment and recreation – 3%. Moderate dynamics are expected also in financial services and real estate management. Public services could grow by 2.2% in 2025.

DEVELOPMENT PROSPECTS FOR 2026–2030

Two scenarios of slower and more rapid (or target) growth are developed for the medium term until 2030. The basic assumptions are based on different perspectives for the development of the global economy and the ability to successfully overcome the consequences of Russia's war in Ukraine, as well as the effectiveness of the structural policy implemented by Latvia because without structural changes it is not possible to increase productivity and change the path of growth of Latvia.

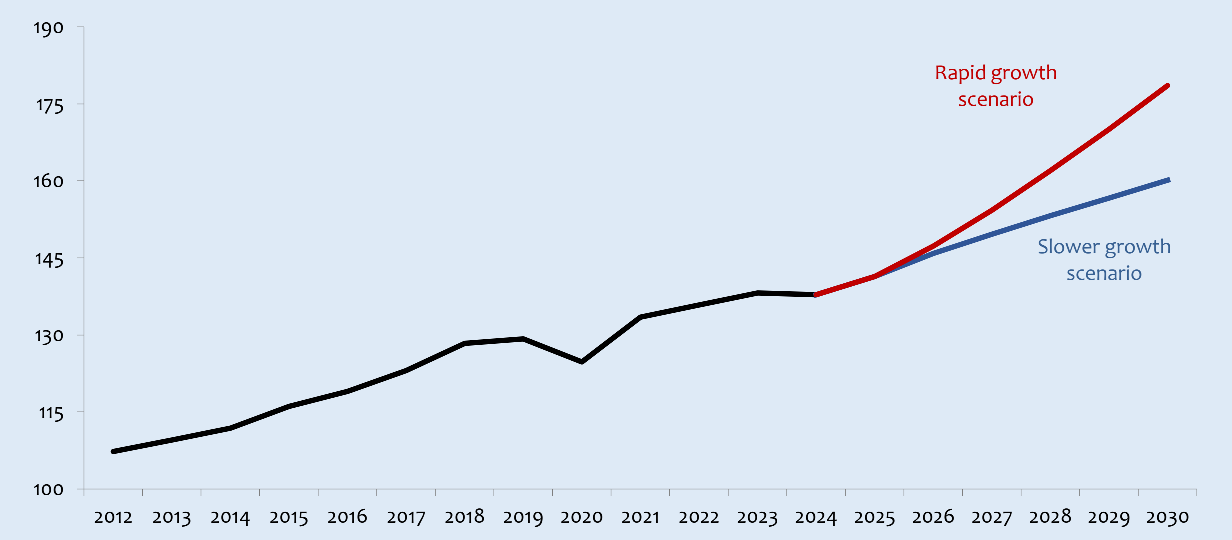
The essence of socio-economic development lies in gradual qualitative changes in several areas, such as manufacturing, education, science, culture and the well-being of the population. These changes are characterised by structural changes in the economy or structural transformation. Structural transformation is the process of moving labour and other production resources from low productivity to high productivity areas, sectors and economic activities. Structural transformation increases overall productivity levels and strengthens the potential for sustainable growth. Economic transformation involves fundamental changes in the economy, which increase the overall level of productivity while ensuring adequate quantity and quality of employment, fair income and its distribution, access to quality public services. The main purpose of structural policy is to promote the motivation of entrepreneurs to change their business model, learn and create new competitive advantages.

The slower growth scenario assumes that the process of economic transformation is slow, and the transition to a higher value-added economy will be gradual. Coping with the shock of high inflation, the economy will return to the average growth rates of the previous decade, which, in the medium term between 2026 and 2030, could reach 2.6% per year. During this period, growth rates of exports, investment and private consumption could be close to 2-3% per year.

Figure 5.1

Forecast of Latvian GDP

2011 = 100



Global technology development trends, the EU Green Deal and the development of strategically important sectors under the new geopolitical conditions open new opportunities for increasing the export capacity of the Latvian economy, increasing productivity level by investing in technology development, digitisation and innovation. Greater effect can be achieved through strategic and synergistic investment of public funds available both in the short and medium term. The medium-term scenario of more rapid growth foresees a more rapid increase in investments, which promotes the introduction of the latest technologies, the development of new products and services, the wider use of digital solutions, and the efficiency improvement of processes. In the rapid growth scenario, private investments will also play a vital role stimulating an increase in lending, the development of the capital market and the use of financial instruments. In this scenario, GDP growth rates until 2030 can on average reach 4.8% annually.

Efficient solutions to the labour shortage problem are also the most important factor in ensuring more rapid growth. Investments in human capital are very important. It is critical to provide the growing and productive sectors with the labour force needed for growth, which means reviewing existing adult education programmes and encouraging labour overflows from less productive sectors to productive sectors.

Table 5.1

Forecast of Latvian GDP by Expenditure Items
changes as per cent

	Fact		Forecast			
	2021	2022	2023	2024	2025	2026–2030 annual average
Gross domestic product	**6.9**	**1.8**	**1.7**	**-0.2**	**2.6**	**2.5 .. 4.8**
Private consumption	8.1	5.1	-1.0	0.8	2.1	2.8 .. 4.8
Public consumption	3.7	2.4	7.0	8.0	3.4	2.1 .. 2.8
Gross fixed capital formation	6.8	-1.6	9.9	-5.6	2.7	2.6 .. 5.5
Export	9.1	11.4	-4.7	-0.6	3.1	2.6 .. 5.1
Import	15.1	9.9	-2.0	-1.2	3.0	2.7 .. 4.7

The rapid growth scenario envisages that exports and manufacturing retain a relatively rapid growth rate in the medium term, based on both the increase in competitiveness of Latvian producers and growing external demand. More rapid development is expected in high and medium-high technology sectors. Medium-term exports would have to grow faster than the rest of the economy.

Table 5.2

Forecast of Latvian GDP by Sectors
changes as per cent

	Fact		Forecast			
	2021	2022	2023	2024	2025	2026–2030 annual average
Gross domestic product	**6.9**	**1.8**	**1.7**	**-0.2**	**2.6**	**2.5 .. 4.8**
Agriculture, forestry	0.4	-14.1	-8.1	1.7	2.0	2.1 .. 4.0
Manufacturing	10.2	-5.5	0.2	-3.6	4.5	2.9 .. 5.7
Other industry	12.8	-22.9	0.0	6.5	2.3	1.9 .. 4.0
Construction	-13.7	-4.3	20.9	-5.4	4.6	3.6 .. 6.3
Trade, accommodation	17.7	7.7	3.1	2.3	2.6	2.6 .. 5.1
Transportation and storage	4.9	3.5	-7.2	-8.5	-0.8	1.4 .. 3.8
Other business services	9.1	6.8	3.3	-2.5	2.7	2.7 .. 5.2
Public services	2.8	7.8	7.2	6.6	2.2	2.1 .. 3.3

In the medium term, rapid growth rates are anticipated in construction. On the one hand, it will be affected by public investment and the implementation of large investment projects (Rail Baltica). On the other hand, growing industries and the need for new industrial buildings will create a demand.

In the target scenario, rapid development is expected in information and communication technology services. This is related to the increasingly growing demand for digitalisation of production and services processes, as well as global ICT sector development trends. The availability of a qualified labour force will affect it as well.

6. ECONOMIC STABILITY AND COMPETITIVENESS

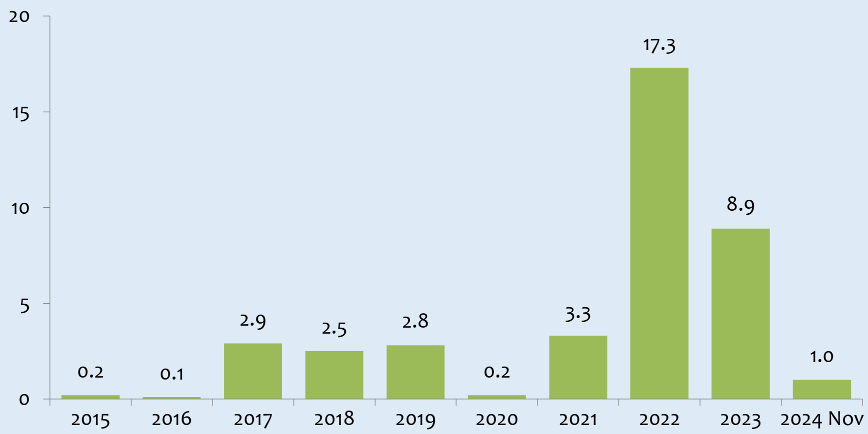
6.1. PRICES

CONSUMER PRICES

After the deflation caused by the financial crisis, consumer prices started to grow again in 2011. External factors and global price fluctuations for crude oil and food started to affect the total price level increasingly more seriously. Price increases were also driven by internal factors, such as increased excise taxes on fuel, alcoholic beverages and tobacco products, fluctuations in administrative prices, as well as population income and increased private consumption. From 2013 to 2016, consumer price growth was very moderate, but it was more rapid from 2017 to 2019. The reduction in demand caused by the restrictions introduced to combat the COVID-19 pandemic had a significant influence on the drop in consumer prices in 2020. In 2021 and 2022, consumer prices increased rapidly again, driven both by the economic recovery after the COVID-19 crisis and by global rises in energy and food levels, exacerbated by the Russian invasion of Ukraine.

Figure 6.1

Consumer Prices
annual average changes, *as per cent*



		changes compared to previous month	*changes compared to corresponding month of the previous year*	*annual average changes*
2023	September	-0.4	3.3	14.0
	October	-0.4	2.1	12.3
	November	0.0	1.0	10.6
	December	-0.8	0.6	8.9
2024	January	0.8	0.9	7.3
	February	0.1	0.4	5.8
	March	1.2	0.9	4.5
	April	0.5	1.1	3.4
	May	0.3	0.1	2.5
	June	-0.1	1.4	1.9
	July	0.1	0.7	1.5
	August	-0.5	0.7	1.1
	September	0.3	1.4	0.9
	October	0.2	2.0	0.9
	November	0.2	2.2	1.0

In 2023, consumer prices stabilised and were shrinking every month compared to the corresponding month of the previous year – from 21.5% at the beginning of this year to 0.6% in December. This continued to be influenced by global prices and the unstable geopolitical situation. Considering the base effect of inflation dynamics, the annual average inflation remained high (8.9%) in 2023. The main impact came from price increases in services – with significant increases in outpatient, food service activities, transport, recreational and cultural services, the rise in prices of food and non-alcoholic beverages, with prices increasing in all major food groups except dairy products, oils and other fats, the rise in prices of alcoholic beverages and tobacco, as well as the decline in prices of energy – for all home-related energy sources and transport fuels.

In the eleven months of 2024, the rise of prices was faster than in the corresponding period of the year before. In November 2024, compared to December 2023, consumer prices rose by 3.0%. Compared with November of the previous year, consumer prices rose by 2.2%. The average annual inflation in November was 1.0%.

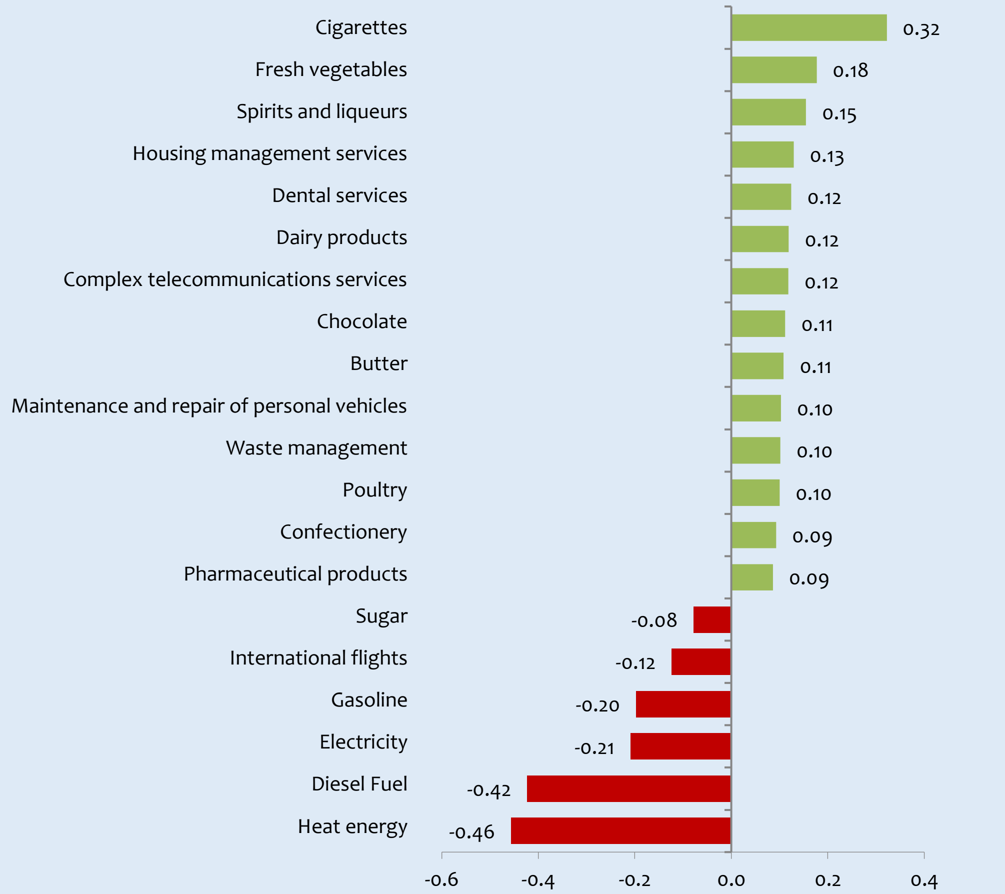
The main factors affecting prices in Latvia in 2024 are mentioned below.

- The increase in prices of services had the most significant impact on the total increase in prices in January-November 2024. Prices of services generally rose by 5.4%, which increased the overall level of consumer prices by 1.4 percentage points. In the services sector, the biggest boost came from outpatient services, mainly due to higher prices for dental and specialist medical services. Recreational and cultural services (including television subscriptions, leisure and sporting events, museum, theatre, concert visits), telecommunication services, housing management services, maintenance and repair of personal vehicles, waste collection, and food service activities also had a large impact. Prices for passenger air transport declined significantly.
- In 2024, food prices kept growing. Overall, in January-November, prices of food and non-alcoholic beverages have increased by 4.3% increasing the total level of consumer prices by 1.1 percentage points. Prices increased in most food groups. The most important contributors to the increase in the average price level were milk and dairy products, meat and meat products. Local changes in food prices are largely determined by global price fluctuations. Since mid-2020, global food prices have been rising rapidly, driven by a sharp rise in import demand, delays in processing and transportation due to the shortage of labour force caused by COVID-19 and rising crude oil prices. The situation was worsened by Russia's invasion of Ukraine in February 2022, raising concerns about future global food supplies, as both Ukraine and Russia are important suppliers of agricultural products. However, after reaching an all-time high in March 2022, global food prices have been declining since April 2022. In 2024, global food prices were still falling at the beginning of the year but have resumed rising since March. Overall, in November 2024, compared to December of the year before, global food prices increased by 7.1%. The most rapid price rises were for vegetable oils and dairy products, while meat prices rose more moderately, but prices of cereals and sugar decreased. The price increase for vegetable oils was driven by lower-than-expected production volumes and also by concerns about expected output cuts in major producing countries, while for dairy products it was driven by strong demand for immediate deliveries and limited stocks in major producing regions, especially in Western Europe. For cereals, the decline in prices was driven by strong competition between exporters, in particular, the increase in exports from the Black Sea region and Russia, and for sugar – by higher production in India, Thailand and Brazil. It should be noted that in November 2024, compared to December 2019, global food prices increased by 26.5%. The increase in prices of food in Latvia during this period was 49.7%.
- In November 2024, compared to December 2023, the average level of prices of alcoholic beverages and tobacco products increased by 6.9%, which increased the overall price level by 0.5 percentage points. Prices of alcoholic beverages increased by 3.7%, while prices of tobacco products increased by an average of 13.1%. The increase in the prices of cigarettes had the most significant effect.
- In January-November 2024, the largest diminishing impact came from the drop in prices of energy sources related to housing – electricity, gas, solid fuel and heating energy that decreased the overall level of prices by 0.5 percentage points. The practically constant increase in heating energy prices in all months except July-September had the most significant impact in January-November. Overall, in January-November prices of heating energy decreased by 9.0% due to the decrease in prices of natural gas and wood chips, permitting several local governments to reduce heating energy rates. Prices of solid fuels and electricity declined moderately – by 2.9% and 1.3% respectively over the eleven months. Electricity prices were significantly hampered by the increase in the tariff for the distribution system service from 1 January, following the end of state support to partially compensate for the increase in its cost and the entry into force of new tariff values and new rules on the maximum allowable tariff increase for households. It should be noted that the average price of electricity for the Baltic region in the Nord Pool system in January-November 2024, compared to the corresponding period of the previous year, had shrunk by 8.0%, mainly due to the higher generation of renewable energy sources – by solar, wind and hydroelectric power plants – as well as natural gas prices in Europe slightly lower than average. Natural gas prices, on the other hand, declined by only 0.6%, with a larger impact from the reduction of natural gas prices for the next trading period for fixed-price services to households from 1 May, the increase of natural gas prices for the next trading period from 1 November and the increase of distribution system service tariffs from 1 January.

– Fuel prices in Latvia in January-November 2024 declined by 3.5% reducing the overall level of consumer prices by 0.2 percentage points. The increase in fuel prices at the beginning of the year, in July and in October was offset by steeper price falls in May-June and August-September. Diesel prices fell faster. It should be noted that global oil prices in November 2024 declined by approximately 5.4% compared to December 2023. World oil prices rose at the beginning of the year, mainly due to OPEC+ oil production cuts, Ukrainian attacks on Russian oil refineries, uncertainty over the ceasefire between Israel and Hamas and Yemeni Houthis' attacks on Red Sea cargo shipping, raising concerns about disruptions to oil supplies. However, oil prices fell sharply in May, August and September, falling to around 69 US dollars per barrel in the first half of September, the lowest level since early December 2021. This was mainly driven by signs of a possible increase in oil supply on the market, with Saudi Arabia announcing an increase in production from December, as well as the expected resumption of oil production in Libya as the government settles its internal disputes, and continued concerns about a slowing Chinese economy that could fall short of its growth targets, adding to concerns about a slowdown in demand from the largest oil consumer. However, the oil price increased again in October, boosted by a sharp increase in oil prices at the beginning of the month, with *Brent* oil price rising to 81 US dollars per barrel, due to rising geopolitical risks in the Middle East, before falling back to 71-73 US dollars per barrel at the end of the month and remaining at this level in November, as Israel's response was more restrained and proportionate than markets feared, raising hopes for a further de-escalation of the regional conflict. The oil price was also affected by signs of weak economic activity in the largest consumer, China, with data pointing to a contraction in industrial profits despite recent government stimulus. Market participants also watched the possible OPEC+ oil production corrections and the aftermath of the US elections.

Figure 6.2

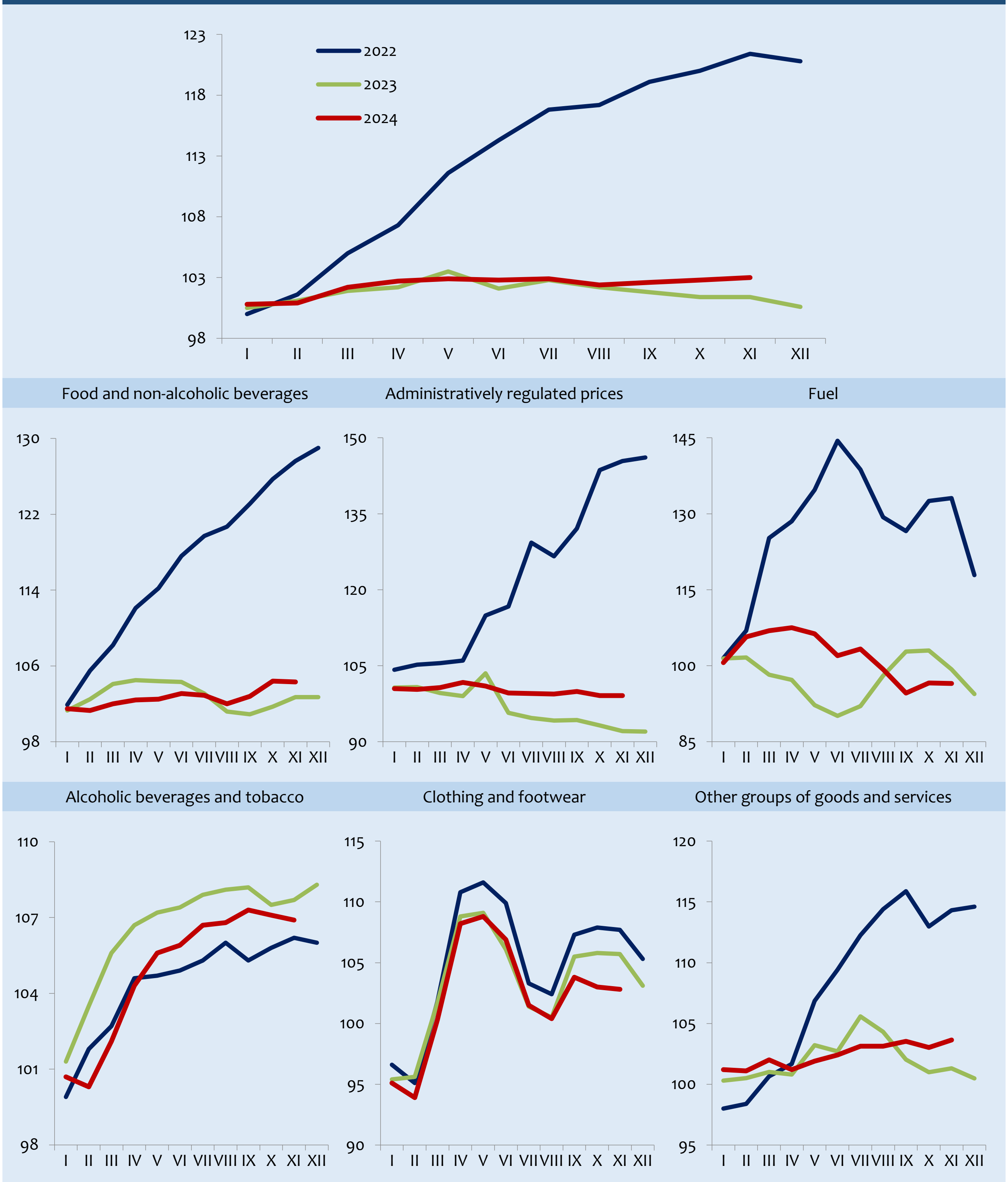
Goods and Services with Most Effect on Changes in Consumer Prices
contribution to 12-month changes in November 2023, percentage points



The annual average inflation will reach 1.2% in 2024. The main impact on price changes will continue to be linked to the fluctuations in global prices for energy and food and will be determined by global development. At the same time, inflation in Latvia will be affected by different supply-side factors related to the increase of taxes and tariffs, as well as the demand side promoted by the increase in wages. Overall, the average annual inflation in 2025 is expected within 2% and may stabilise at about 2-2.5% also in the following years.

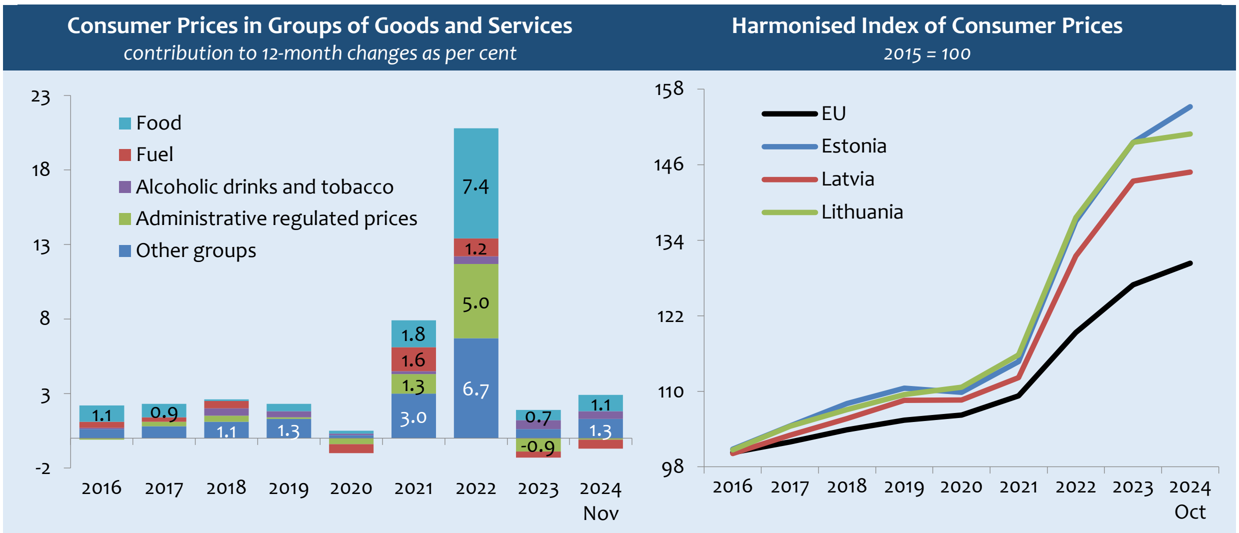
Figure 6.3

Consumer Price Index by Groups and Subgroups
by months, December of the previous year = 100



In the European Union, following a very moderate increase in prices in 2015-2016 driven by relatively weak economic growth, as well as by the drop in global prices for food and crude oil, a sharper rise in prices was seen in 2017-2019 as economic activities increased. On the other hand, in 2020, COVID-19 reduced consumer prices. With economic activity increasing after the COVID-19 restrictions have been lifted, consumer prices increased sharply in all main consumption groups in 2021 and 2022. Russia's invasion of Ukraine at the beginning of 2022 and protest sanctions, which resulted in a shortage of energy and production raw materials, have added even more to the impact on price growth all over the world. The biggest boosting impact came from the increase in energy and food prices.

Figure 6.4



Even though global energy and food prices returned to the levels of 2021, before Russia invaded Ukraine, with the tense geopolitical situation continuing and given the base effect of inflation dynamics, the average annual inflation in 2023 remained high. In 2023, it was 6.4% in the EU. Prices became even higher in all major consumption groups, except clothing and footwear, and communications, where prices remained stable. The biggest impact came from the rise of food prices, even though global prices of unprocessed food fell. By contrast, energy prices remained unchanged year-on-year. Price increases for heat and electricity were offset by falling prices for fuel and natural gas. A considerable increasing impact came from the increase in prices of services, among them the most in food service activities and accommodation, package recreational services and housing rent. As global energy and food prices stabilise, average annual inflation is declining in 2024. In October 2024, it was 2.7% in the EU.

When comparing the Baltic countries, in 2023, the highest annual average inflation was in Estonia and Latvia, and slightly lower inflation was in Lithuania. In all three countries, the biggest impact came from the increase in food and services prices. Energy prices rose in Latvia and Estonia but fell in Lithuania. Latvia was more affected by energy price increases than Estonia.

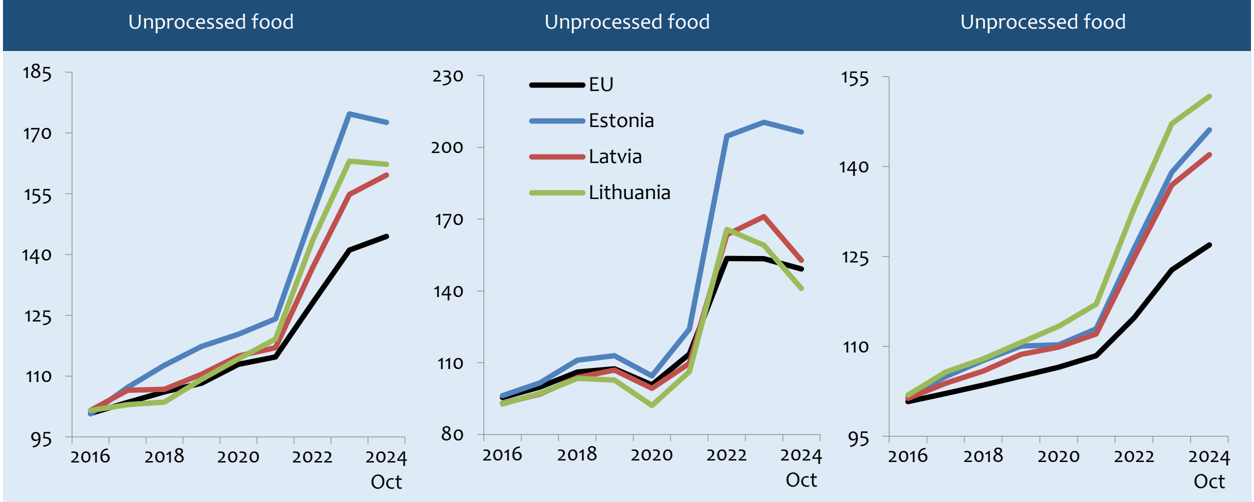
It should be noted that since 2015 Latvia has been having the lowest core inflation among the Baltic countries because the increase in private consumption in Latvia is slower than in the two other countries and the increase in prices of services is slower as well. Prices of alcoholic beverages and tobacco in Latvia also increased slower, while the equalisation of the excise tax with the EU level in Estonia and Lithuania is more rapid. Prices of communication increased in Latvia more rapidly.

In October 2024, the Baltic countries showed different annual average inflation indicators. While in October 2024, average annual inflation in Estonia was higher than the EU average (3.8%), average annual inflation in Latvia and Lithuania was much lower (1% and 0.9% respectively). The biggest impact came from the increase in service prices (highest in Estonia, lowest in Latvia). In Latvia and Estonia, food price increases had a similar effect, while in Lithuania food prices declined. Energy prices fell in all three Baltic countries. The impact of the decline in energy prices was the strongest in Latvia and the smallest in Estonia.

Figure 6.5

Components of the Harmonised Index of Consumer Prices

2015 = 100

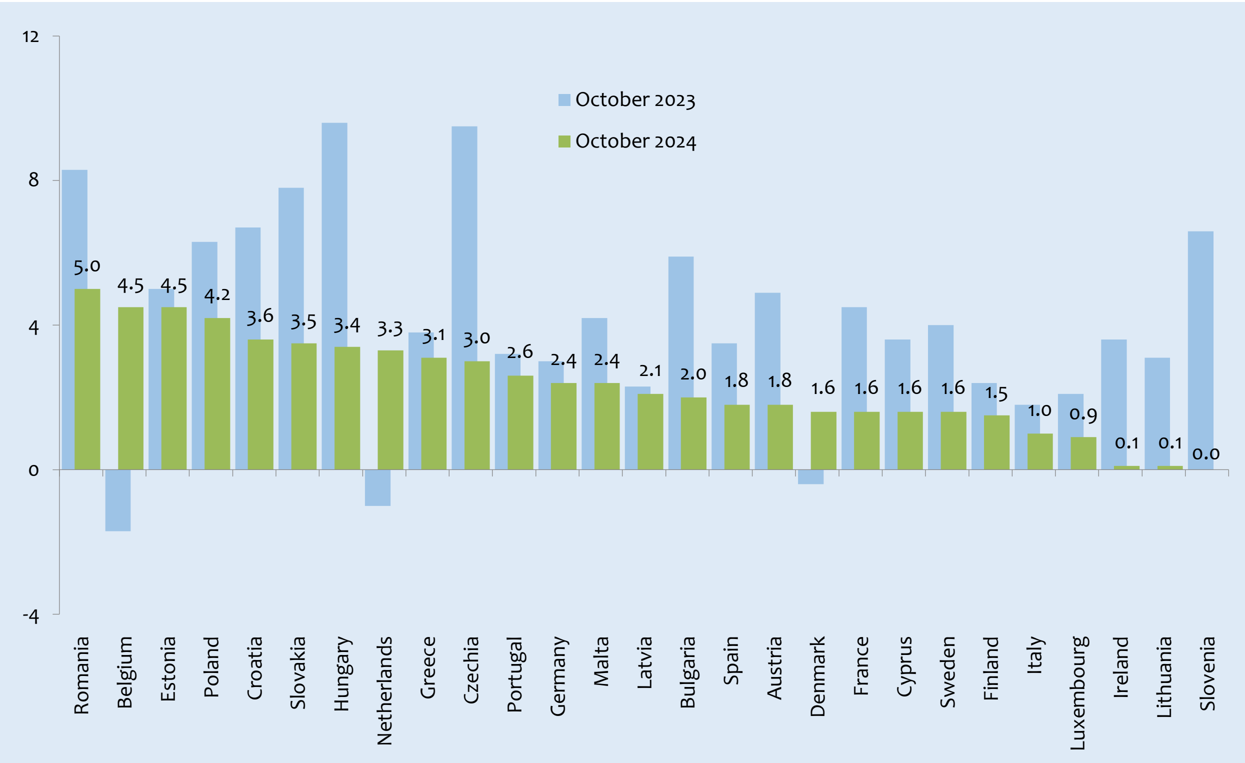


In October 2024, compared to October 2023, the price level grew by 2.3% in the EU countries, and by 2% in the Euro Area. The highest inflation rates in October 2024 were in Romania, Belgium, Estonia and Poland.

Figure 6.6

Changes in the Harmonised Index of Consumer Prices in the EU Member States

12-month inflation, as per cent



PRODUCER PRICES

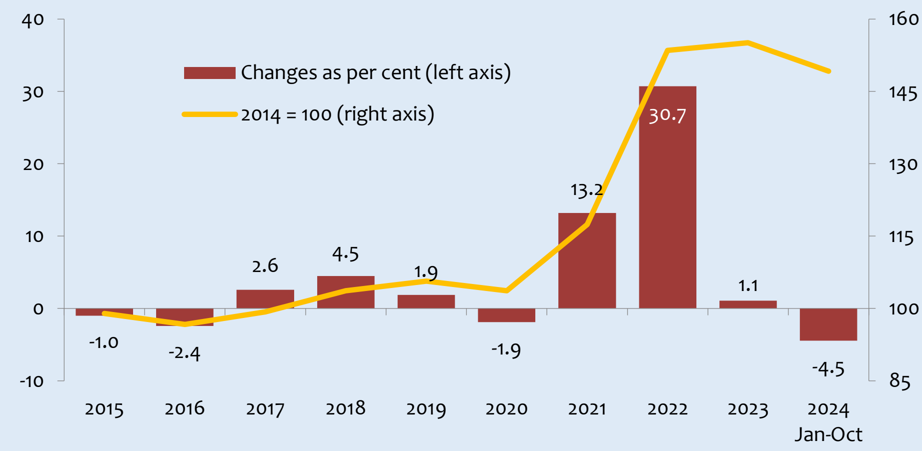
After a drop in 2015-2016, producer prices showed an increase in 2017-2018, which slowed down in 2019. In 2020, producer prices reduced under the influence of COVID-19 in all major industry sectors (mining, manufacturing, electricity, gas, steam and air conditioning supply, and water supply, sewerage, waste management and remediation activities). In 2021 and 2022, however, the energy crisis led to a very sharp increase in this price group, reinforced by the Russian invasion of Ukraine.

In 2023, the increase in producer prices has decreased, largely influenced by falling global energy prices. Energy prices returned to the level of 2021, before Russia invaded Ukraine, and stabilised. Producer prices in the industry increased by 1.1% in the three quarters of 2023. Prices of products sold on the domestic market grew by 2.3%, while prices of exported products reduced by 0.8%. Producer prices increased in all major industrial sectors, except electricity, gas, steam and air conditioning supply.

In 2024, producer prices are declining mainly due to weak global development and geopolitical uncertainty. Energy and raw material prices also continued their moderate decline in the first half of the year. In January-October 2024, prices of industrial producers shrank by 4.5% compared to the relevant period of the year before. Prices of products sold on the domestic market fell by 7.4%, while prices of exported products – by 1.5%. Producer prices fell significantly in electricity, gas, steam and air conditioning supply, moderately in manufacturing, mining and quarrying, and remained virtually unchanged in water supply, sewerage, waste management and remediation activities.

Figure 6.7

Producer Prices



A similar trend has been observed in producer prices in manufacturing since 2015. Following a faster increase in 2017-2018, in 2019, producer prices in manufacturing experienced very moderate increases related to slower growth in the EU and a slight drop in prices of energy sources and raw materials. Although 2020 was marked by the COVID-19 pandemic and a drop in energy prices, producer prices in manufacturing reduced just slightly during this period. However, they increased very sharply in 2021-2022 due to the energy crisis but increased very moderately in 2023 and declined in 2024 as energy and raw material prices declined. In 2023, producer prices in manufacturing continue growing for the products sold on the domestic market – by 3.5% but reduced by 1% for the exported products. Furthermore, in January-October 2024, compared to the corresponding period of the previous year, the decline in producer prices in manufacturing was more rapid for the products sold on the domestic market – by 2.9% but reduced by 1.4% for the exported products.

Slightly more than 60% of the manufacturing products are exported; therefore, the overall producer price dynamics of the sector are largely affected by the fluctuations in producer prices of products for exports. The prices of products for exports are mainly determined by the price dynamics of the Latvian key export goods, including timber, metal products, and food, in global markets. It should be noted that global energy and raw material prices decreased in 2023 but stabilised in 2024 and no high fluctuations are observed, which could also affect producer price dynamics. Uncertainty in the supplies of raw materials in the context of the tense geopolitical situation continues to have a significant impact on producer prices. Prices of products sold in the domestic market are mainly influenced by the dynamics of global prices of both energy sources and raw materials (for example, wood, unprocessed food, etc.) in the world and in the domestic market. At the same time, the dynamics of producer prices for products sold in the domestic market are influenced by growth rates, which will be generally very weak or negative this year.

By sectors, the most impressive increase in producer prices in manufacturing in 2023 was in manufacture of food, which was affected the most by the growing prices of products sold in the domestic market. It should be noted that despite the drop in global food prices since April 2022, the rapid rise in food prices in Latvia has not stopped until April 2023. The increase of producer prices in manufacture of other non-metallic mineral products was also significant, but after the rapid increase in previous years, producer prices decreased in wood processing, which also had the biggest diminishing effect. The drop in prices in wood processing was largely affected by the drop in prices of exported products. The drop in producer prices in manufacture of chemical substances also had a big effect.

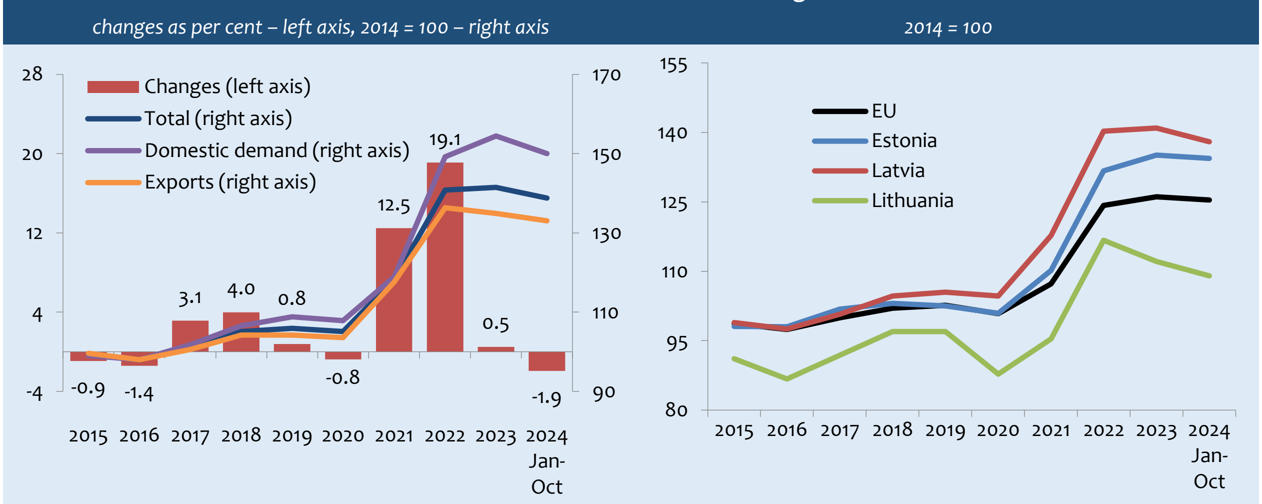
The most impressive decrease in producer prices in January-October 2024 was in wood processing, where the impact of the drop in producer prices of products sold in the domestic market and exported products was almost similar. On the domestic market, the price decrease is mainly due to a drop in construction volumes, while European producers are facing strong competition from China, which may be using timber from Russia, which is banned from exporting timber to Europe, affecting both European price levels and domestic product sales. Price falls in other non-metallic mineral products, chemicals and fabricated metal products also had a major impact in January-October 2024, while the most influential producer price increases in manufacturing were in manufacture of other transport equipment and manufacture of electrical equipment.

Following a faster increase in producer prices in the EU in 2017-2018, the rise slowed down in 2019 mainly due to the drop in world energy prices and the slowdown of global economic growth. The fluctuations in supply and demand of energy sources and raw materials due to the COVID-19 pandemic affected the fall in producer prices in 2020. Producer prices in the EU increased very rapidly in 2021, with the economy recovering and significantly growing demand for raw materials and energy sources. This continued also in 2022, when the crisis of energy prices and supplies was enhanced by the Russian invasion of Ukraine. In 2022, producer prices in manufacturing saw the most rapid increase both across the EU and in all three Baltic countries. As prices of energy sources and other raw materials declined, the increase in producer prices in manufacturing in 2023 reduced and they were already dropping in 2024. In January-October 2024, compared to the corresponding period of the previous year, they decreased by 0.5% in the EU – most rapidly in Luxembourg, Poland, Lithuania, Finland and Latvia, but increased most rapidly in Denmark and Hungary.

When comparing the Baltic countries, producer prices in manufacturing in January-October 2024, compared to the corresponding period of the previous year, shrank most rapidly in Lithuania – by 2.8%, and declined by 2.1% in Latvia and 0.5% in Estonia.

Figure 6.8

Producer Prices in Manufacturing



FOREIGN TRADE UNIT VALUE INDICES

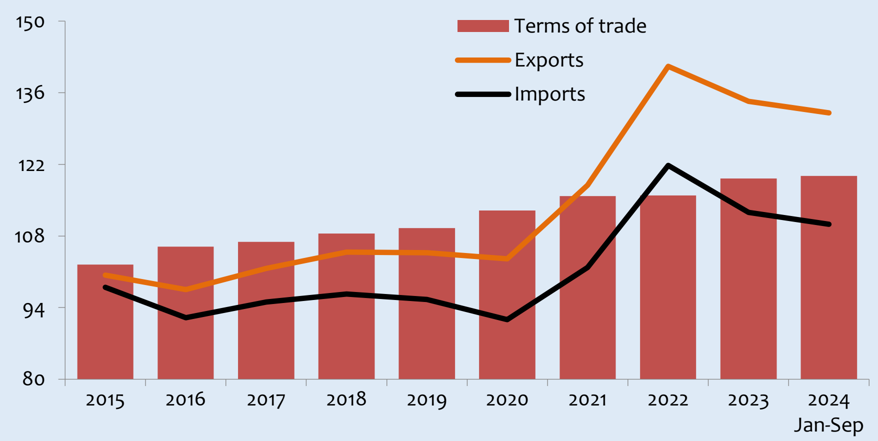
Trade conditions have been improving rapidly since 2016. In 2016-2019, the biggest impact on the export unit value and import price came from the fluctuations in prices of wood and its products, as well as coke and refined petroleum products. In 2020, trade conditions continued to improve with the import price index declining more rapidly than the export unit value index. In 2021, trade conditions still improved, and the unit value index for exported goods exceeded the price index for imported goods, but in 2022 trade conditions remained almost unchanged.

In 2023, trade conditions continued to improve with the import price index declining more rapidly than the export unit value index – by 7.5% and 4.9% respectively. The total export unit value index was most affected by the drop in the unit value of agricultural products, mining of valuable minerals, wood and wood products, and chemical substances and chemical products. The total import price index was most affected by the drop in prices of mining of valuable minerals, coke and refined petroleum products, base metals, as well as chemical substances and chemical products. The biggest increasing effect came from the increase in export unit value of beverages and food and the increase in import prices of food products, machinery and equipment not elsewhere classified.

In 2024, trade conditions remained almost the same: the unit value index for exported goods was declining in the same way as the price index for imported goods. In January-September 2024, the unit value of exported goods reduced by 1.7% compared to the relevant period of the year before, while the prices of imported goods – by 2.1%. The unit value index for exported goods exceeded the price index for imported goods by almost 22 percentage points. The export unit value index was most affected by the drop in the unit value of agricultural products, wood and wood products, chemical substances and chemical products, computers, electronic and optical equipment, as well as the increase in the unit value of food products. The total import price index was most affected by the drop in prices of mining of valuable minerals, coke and refined petroleum products, chemical substances and chemical products, food products, base metals, as well as the rise in prices of machinery and equipment not elsewhere classified, fish and other fishing products.

Figure 6.9

Export Unit Value and Import Price Index and Trade Conditions
export unit values and import price index 2014 = 100; trade conditions as per cent



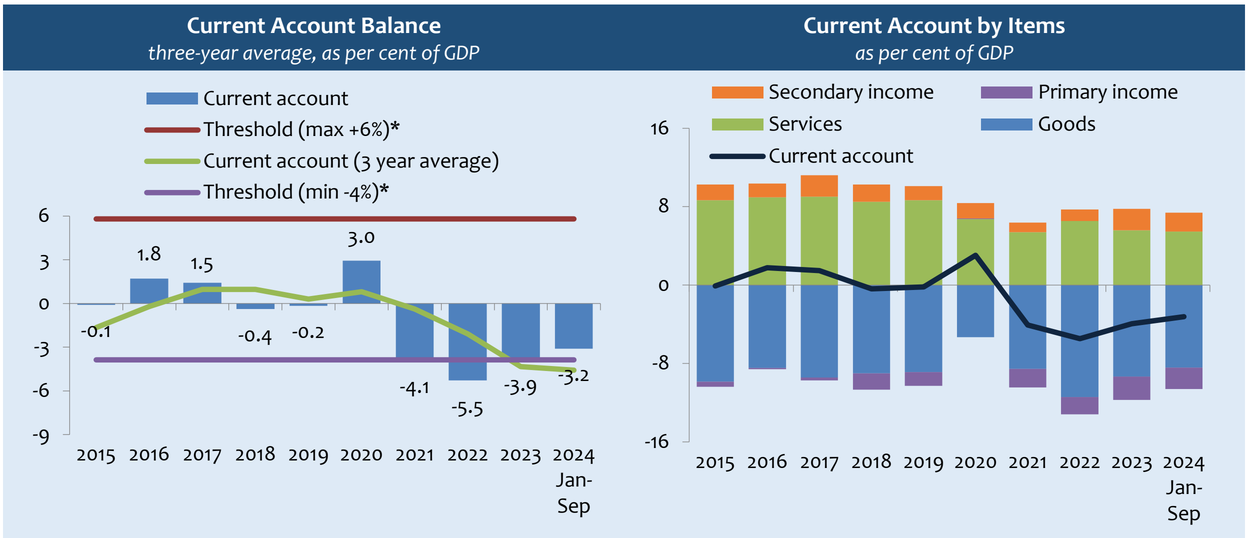
6.2. BALANCE OF PAYMENTS

CURRENT ACCOUNT

Since 2021, the deficit of the current account is increasing. It was significantly influenced by the rise in energy prices, which began in the second half of 2021 as economic activity recovered, and rapidly increased in 2022 due to Russian aggression against Ukraine. The current account deficit remained at a relatively high level also in 2023 and 2024.

Before the COVID-19 pandemic (2015 – 2019), the current account balance was positive – 0.3% of GDP. Its fluctuations were moderate, yet the general trend was turned downwards – from a surplus of 1.8% of GDP in 2016 to a deficit of 0.2% of GDP in 2019.

Figure 6.10



* Indicative threshold set in the EU alert mechanism

The reduction of the COVID-19 pandemic restrictions and the increase in economic activity caused significant corrections in the current account. The current account balance improved under the conditions of the rapid decline in global trade reaching a surplus of 3% of GDP in 2020. With economic activity and domestic demand increasing, in 2021 the current account balance was negative – 4.1% of GDP. In 2022, the current account deficit reached 5.5% of GDP, significantly affected by the changes in the geopolitical environment after the Russian invasion of Ukraine.

Although the current account condition has somewhat improved in the following years, it remains at a relatively high deficit level. In 2023, the negative balance of the current account reached 3.9% of GDP, mainly due to a contraction in imports. In January-September 2024, it was 3.2% of GDP, down 1.8 percentage points from the year before.

With downward trends in the current account preserved, external imbalance risks increased as well. In 2023, the indicative threshold for the three-year average current account deficit set by the EU Alert Mechanism was surpassed.

The state of the current account is mainly determined by changes in the balance of goods and services and, to a lesser degree, by net flows of primary income and secondary income.

Weakening of external trade flows has been observed in recent years. Economic shock was its main reason. It was first caused by the COVID-19 pandemic, then the Russian invasion of Ukraine, which enhanced the uncertainty of the external environment.

In 2020, imports of goods shrank due to low demand. The drop in imports along with stable goods export dynamics reduced the deficit of the external trade balance from 8.9% of GDP in 2019 to 5.3% of GDP in 2020. In the following two years, the export value of goods grew slightly faster than the import value, which also determined the increase in the foreign trade balance deficit.

In 2022, export dynamics were more moderate than import dynamics. High prices of energy sources and the need to change their sources of supply due to the Ukrainian war significantly increased the import value. As exports continued to grow at a slower pace than imports, the trade deficit increased to 11.4% of GDP (8.6% in 2021). In 2023 and January-September

2024, the value of both exports and imports declined. However, the external trade balance improved slightly as the value of imports declined more rapidly – to 9.3% and 8.4% of GDP respectively. Geopolitical developments have contributed to Latvia's foreign trade shifting away from Russia, where EU countries have an increasingly bigger share in imports.

Table 6.1

Balance of Payments of Latvia
as per cent of GDP

	2019	2020	2021	2022	2023	2024 Jan–Sep
Current account	**-0.2**	**3.0**	**-4.1**	**-5.5**	**-3.9**	**-3.2**
Trade balance	-8.9	-5.3	-8.6	-11.4	-9.3	-8.4
Export	43.2	46.0	50.2	57.4	47.7	46.7
Import	52.0	51.4	58.8	68.8	57.1	55.1
Balance of services	8.7	6.8	5.4	6.5	5.6	5.5
Primary income	-1.4	0.0	-1.9	-1.8	-2.4	-2.2
Secondary income	1.5	1.6	1.0	1.2	2.2	1.9
Capital account	**1.5**	**1.8**	**1.4**	**0.7**	**1.9**	**1.4**
Financial account	**1.4**	**6.3**	**-0.7**	**-1.6**	**0.2**	**1.9**
Direct investment	-3.1	-2.2	-2.7	-3.6	-1.6	-2.4
Assets	0.3	0.6	7.2	-0.3	2.4	-0.1
Liabilities	3.4	2.8	9.9	3.3	4.0	2.3
Portfolio investment*	-1.8	13.5	-0.8	3.8	-4.3	-6.5
Assets	1.1	10.7	0.7	4.0	-0.1	-0.9
Liabilities	2.9	-2.8	1.5	0.2	4.2	5.6
Other investment	6.7	-6.5	2.3	-0.7	5.4	10.3
Assets	0.2	-0.3	1.1	8.2	0.7	11.3
Liabilities	-6.4	6.2	-1.2	8.8	-4.7	1.0
Reserve assets	-0.3	1.5	0.4	-1.2	0.6	0.4
Deviation	**0.1**	**1.5**	**1.9**	**3.1**	**2.2**	**3.7**

* Portfolio investment and financial derivatives

The trade surplus in services has been maintained yet at a lower level than before the COVID-19 crisis.

In 2020, the surplus of the balance of services decreased under the influence of the COVID-19 pandemic from 8.7% of GDP in 2019 to 6.8% of GDP in 2020. Although the partial cancellation of the pandemic restrictions contributed to an increase in exports and imports of services, in 2021 the surplus of the services balance continued to shrink, reaching 5.4% of GDP, and increased to 6.5% of GDP in 2022.

In 2023, growth rates of services imports and exports were much slower than in 2022. Imports grew by 8.7% at current prices, while exports grew more moderately (3.5%), and the surplus of the balance of services reached 5.6% of GDP – 0.9 percentage points lower than in 2022. In January-September 2024, compared to the corresponding period in the previous year, changes in imports and exports of services were rather insignificant and the surplus of the balance of services reached 5.5% of GDP.

Overall, in the last three years (2021-2023), the positive balance of services was 5.8% of GDP on average, which is a 2.9 percentage points lower level than in the pre-pandemic years (2017-2019).

The primary income balance in the last three years (2021-2023) has been negative – 2% of GDP per year on average, which is slightly lower than in the years before the COVID-19 pandemic. The fluctuations in primary income balance were relatively small and were mainly driven by changes in non-residents' deposit income. As the income earned by foreign investors in Latvia declined under the influence of the crisis; in 2020, the primary income balance was in balance. By contrast, in 2021 and 2022, it was already in deficit, 1.9% and 1.8% of GDP, respectively. The primary income balance continued to deteriorate in 2023 and January-September 2024, with the deficit increasing to 2.4% and 2.2% of GDP respectively, mainly driven by the increase in FDI earnings.

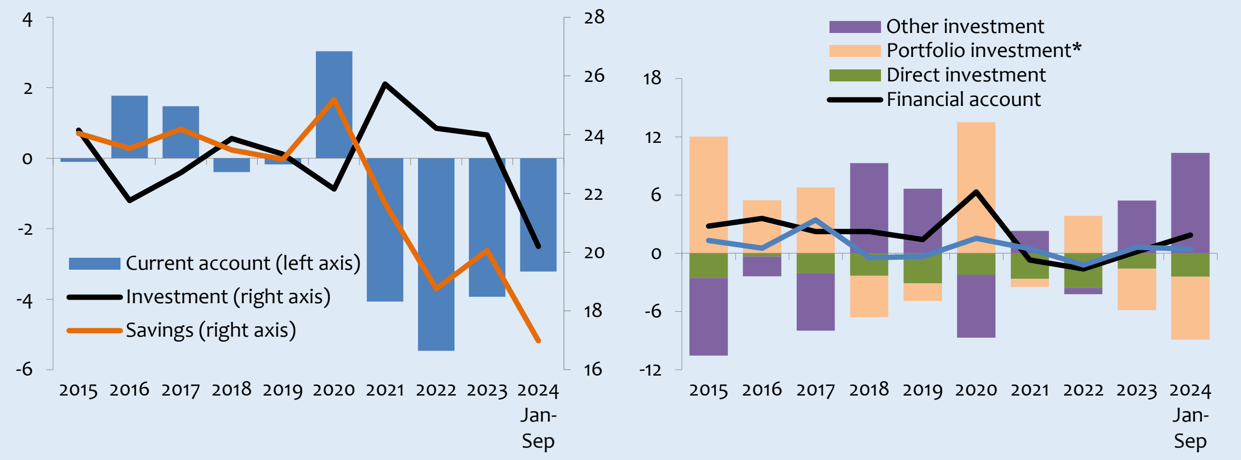
The condition of the secondary income and capital account is mainly affected by flows of EU funds, as well as Latvia's contributions to the EU budget. External shocks have not significantly affected the condition of the secondary income account. In the last three years (2021-2023) it had a surplus – 1.4% of GDP per year on average, which is equivalent to that in the years before the COVID-19 pandemic. The secondary income account balance was positive (1.9% of GDP) also in January-September 2024.

The inflow of EU structural funds dominates in the capital account. Since 2021, the average capital account surplus has been 1.4% on average, including 1.9% of GDP in 2023. In January-September 2024, the capital account surplus decreased reaching 1.4% of GDP. Changes in capital account surplus are mainly related to changes in EU funds uptake activities.

Figure 6.11

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

Financial Account by Investment Types
as per cent of GDP



* Portfolio investment and financial derivatives

The condition of the current account balance until 2019 proved that savings and domestic investments were balanced. In 2020, the current account surplus was determined by an increase in "forced" savings and a decrease in investments. In the next two years, the increase in the current account deficit has been mainly affected by the increase in investment activities, while savings decreased. However, the level of investment and savings has been declining since 2023.

CROSS-BORDER FINANCIAL FLOWS

In recent years, the status of the financial account balance has been determined by the geopolitical instability in the region, the restructuring of debts of the public sector, as well as the implementation of restrictive monetary policy by the ECB for combatting inflation.

From 2017 to 2019, external assets generally increased more than liabilities, and the financial account balance (assets less liabilities) was positive – 2% of GDP on average. In 2020, the positive financial account balance increased to 6.3% of GDP compared to 2019, which was significantly affected by the increase in assets of the Bank of Latvia and credit institutions in the form of portfolio investments. Since 2021, financial account assets have been growing more modestly than liabilities, which determined a negative annual average financial account balance of 2.2% of GDP. The trends observed in the previous years were still present in 2024. In January-September of this year, the financial account balance (with reserve assets) was positive – 1.9% of GDP. The status of the balance of payment accounts in the near future will be determined by changes in the geopolitical situation and their impact on global supply chains, cross-border flows and the Latvian economy in general.

The foreign gross debt of Latvia has slightly increased. This was mainly due to an increase in long-term debt liabilities of the government. Moreover, foreign liabilities of non-financial corporations and households are declining. According to Latvia's international investment balance data, at the end of September 2024 gross external debt was almost 106.8% of GDP, including the government's gross external debt amounted to 14,342 million euro (36.3% of GDP). The balance of international investment at the end of September 2024 was -26% of GDP and did not exceed the indicative threshold defined in the EU Alert Mechanism (-35% of GDP). Since Latvia's liabilities mainly consist of government bonds and foreign direct investment, the balance of international investment is assessed as stable.

6.3. FOREIGN DIRECT INVESTMENT

In recent years, the intensity of FDI flows in the world has been generally moderate. This was mainly affected by the COVID-19 pandemic containment restrictions, as well as instability in the global economy. The war in Ukraine increased the uncertainty caused by geopolitical events and caused a negative impact on global FDI flows.

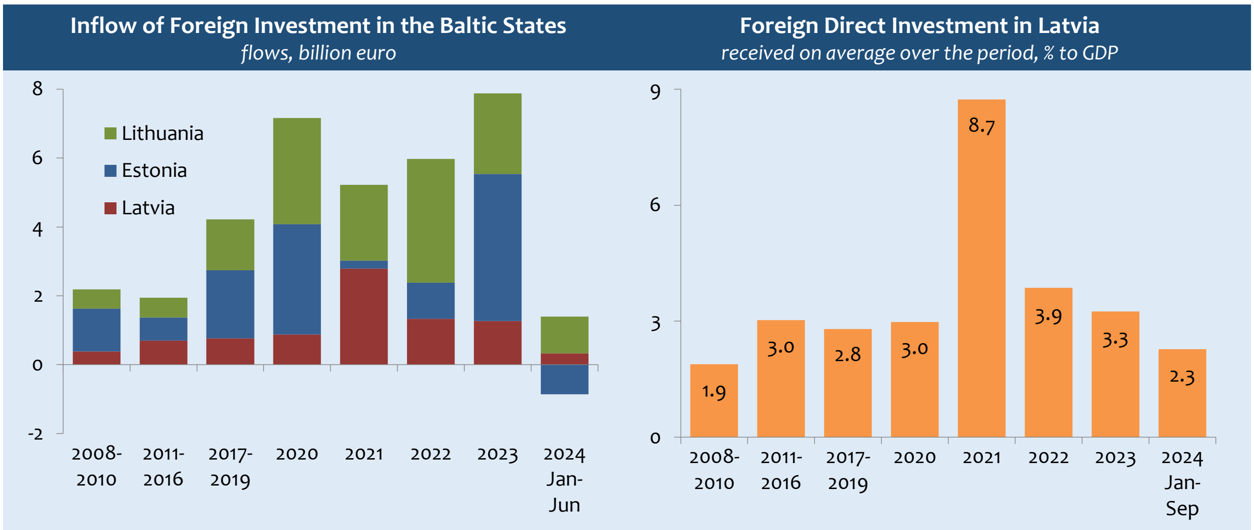
Global foreign direct investment has been declining since 2022. In 2023, it amounted to 1.3 trillion US dollars, which was almost 23% less than in 2019. The global environment for international investment in 2024 remains complex. Weakening global economic growth, trade and geopolitical tensions, industrial policy and diversification of supply chains are changing FDI patterns. The uncertain investment environment makes international investors cautious. However, the gradual improvement in financing conditions, as well as the high level of profit of international investors, may have a positive impact on global FDI flows.

The intensity of FDI flows in EU countries remains low. In the last three years (2021-2023), compared to the years before the COVID-19 pandemic (2017-2019), the volume of attracted FDI was almost five times lower. Moreover, in 2022, FDI flows in the EU countries were generally negative evidencing an outflow of capital. Although FDI flows increased in 2023, they were much lower than in 2019.

Cross-border flows of direct investment in the Baltic States in the last three years were 1.5 times higher than before the COVID-19 pandemic in 2017-2019. In the Baltic countries as a whole, cross-border FDI flows were moderate in the first half of 2024, reaching almost 0.5 billion euro, i.e. 0.8% of GDP. This was significantly affected by FDI outflows from the Estonian economy, which amounted to 0.9 billion euro in the first half of 2024. The biggest decline in direct investment in Estonia was in financial and insurance activities. In Lithuania, net FDI flows amounted to 0.3 billion euro, and FDI net flows in Latvia retained positive dynamics in the first half of this year.

FDI flows into the Latvian economy in recent years (2021-2023) have fluctuated between 3.3% and 8.7% of GDP on average per year, and were overall 3.5 times higher than in the pre-recession years (2017-2019). In 2021, net FDI flows attracted to Latvia reached 2,820 million euro, i.e., 1,992 million euro more than in 2019. This was due to the extensive investments of the Swedish company *Swedbank AB* in the equity capital of companies registered in Latvia. FDI flows attracted to the Latvian economy as a result of this transaction reached 8.7% of GDP. In 2022, the attracted net FDI flows were half of those a year before, which is partially explained by the high base effect. Moreover, these trends were also driven by negative flows of investment in companies' equity in response to EU sanctions against Russia. Although FDI inflows into Latvia's economy decreased by 8.8% in 2023 compared to 2022, they were higher than in 2019.

Figure 6.12



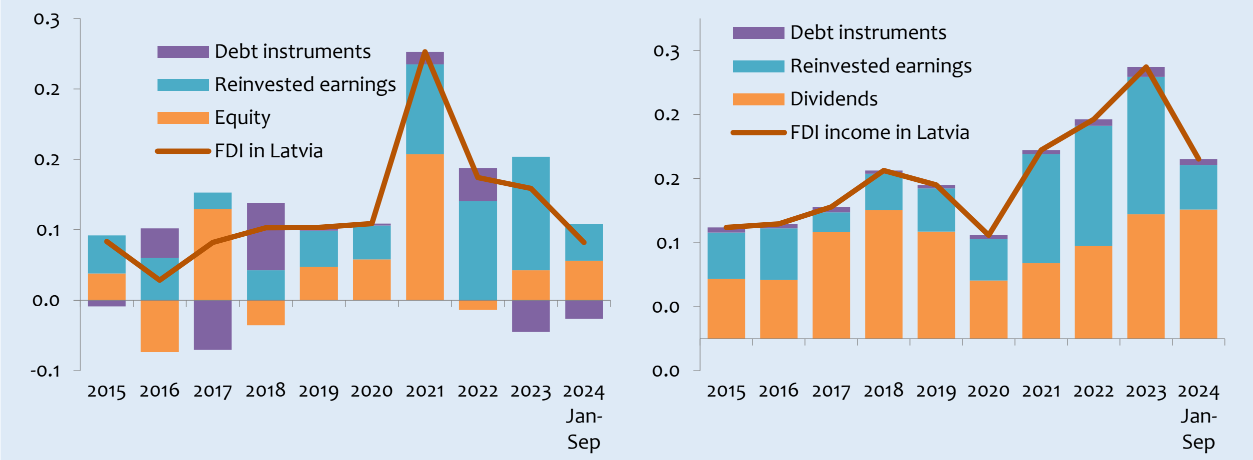
In January-September 2024, FDI transactions were almost half of those the year before and amounted to 2.3% of GDP (in January-September 2023 – 4.3% of GDP). This was largely due to a more moderate increase in reinvested profit. By contrast, investment in the equity of companies was almost 2 times higher year-on-year. FDI inflows were higher in professional, scientific and technical activities, manufacturing, as well as energy and agriculture.

The long-term income of foreign direct investors has a positive dynamic, reflecting the high profitability of FDI in Latvia. From 2010 to 2018, direct investment income in Latvia was growing by an average of 35% per year. After peaking in 2018 (5.4% of GDP), FDI income in Latvia decreased in 2019 and 2021, as economic growth slowed down. However, in the next three years, it almost doubled compared to 2020 and 2023 and reached 6.5% of GDP. The weakening of economic activity has had an impact on FDI inflows, and their dynamics are rather moderate in 2024. In January-September, compared to the corresponding period of the previous year, the income of foreign direct investors was 15.4% lower than a year before and amounted to 5.8% of GDP (7% in January-September 2023). Most of it was paid in dividends.

Figure 6.13

Foreign Direct Investment in Latvia
received, billion euro

Foreign Direct Investment Income
billion euro



The amount of FDI accumulated in the Latvian economy is growing year on year. The amount of FDI accrued at the end of September 2024 reached 25.7 billion euro (61% of GDP). It grew by 3.6%, compared to the end of 2023, mainly underpinned by the increase in professional, scientific and technical activities.

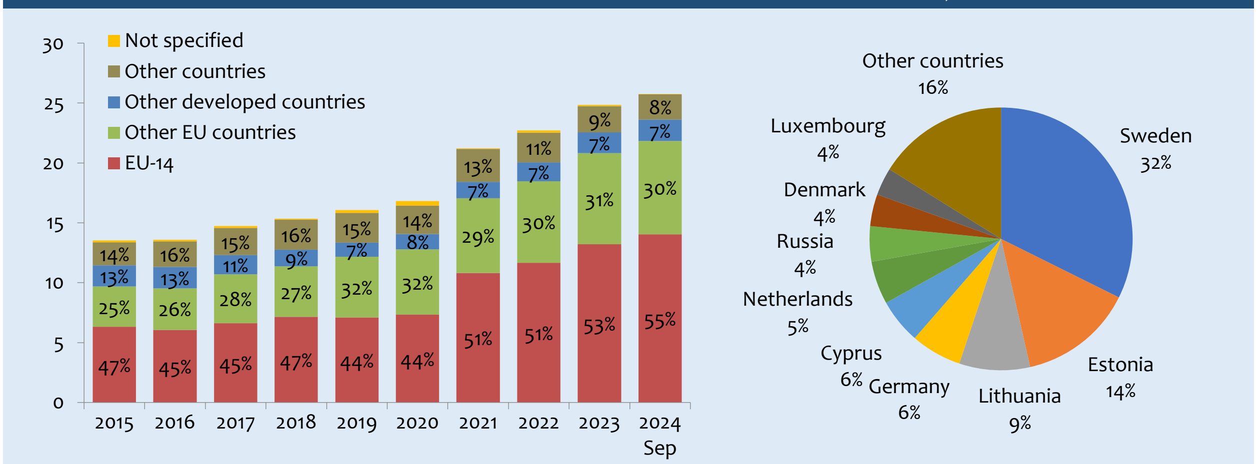
The geopolitical structure of FDI accrued is relatively stable. Investments of businesses from the EU countries dominate, amounting to 83.5% of the total FDI accrued in the Latvian economy at the end of September 2024.

Figure 6.14

Foreign Direct Investment Accrued in Latvia at the End of September 2024

By groups of countries
million euro

FDI by countries
accrued, %



Sweden is the largest investor in the economy of Latvia. Its business investment stock has grown 2.8-fold since 2020 and accounted for 30.5% of all FDI stock at the end of September 2024. There are also significant investments from entrepreneurs from Estonia (13.3%), Lithuania (8.2%), Germany (5.9%), Cyprus (5.2%), the Netherlands (5%), Russia (4.1%) and Denmark (3.7%).

The introduction of sanctions against Russia affected investments of its businesses in the Latvian economy. At the end of September 2024, direct accrued investments of Russia were almost 43% lower than at the end of 2021. However, it should be noted that Russia is still the seventh largest investing country in the economy of Latvia by accrued FDI.

Investments by Lithuanian and Estonian businesses make up almost one-fifth of accrued FDI in Latvia. Activities of Latvian businessmen in the Baltic neighbouring countries are, on the contrary, much more moderate.

Table 6.2

FDI by Sectors
balances at the end of the period

	million EUR			*structure, as per cent*		
	2019	2023	2024 Sep	2019	2023	2024 Sep
Agriculture	669	1017	1060	4.2	4.1	4.1
Manufacturing	1906	3176	3402	11.9	12.6	13.2
Other industry	681	945	832	4.2	4.4	3.2
Construction	452	367	413	2.8	1.6	1.6
Trade and accommodation	2734	3604	3638	17.0	15.1	14.1
Transportation and storage	789	783	793	4.9	3.2	3.1
Financial intermediation	3902	3897	3902	24.3	15.3	15.2
Real estate activities	2683	3287	3228	16.7	13.5	12.5
Other services	1187	6835	7628	7.4	26.4	29.6
Unclassified activity	1066	944	853	6.6	3.7	3.3
Total	**16 069**	**24 855**	**25 750**	**100**	**100**	**100**

Most of FDI is attracted in service sectors. At the end of September 2024, the accrued FDI in the services activities constituted 77.8% of the accrued FDI in the economy of Latvia. It rose by 62.1%, compared to the end of 2019. At the same time, the structure of sectors of accrued FDI changed. At the end of 2021, the direct investment of Sweden in credit institutions of Baltic Countries was reoriented through a Latvia-registered undertaking because of the *Swedbank* group reorganisation strategy. Thus, foreign direct investment of Sweden in Latvia increased in the field of professional services. At the end of September 2024, the share of this sector in the total amount of accrued FDI increased to 23.8% (1,7% at the end of 2019).

Almost 83% of accrued FDI in service sectors are investments in financial intermediation, real estate and trade activities, as well as professional activities. Investment dynamics in these sectors are generally positive (except financial intermediation). The stock of foreign investment fell by 10.5% between 2019 and 2022. The attractiveness of the sector for foreign investors increased in the following years and the level of direct investment stocks at the end of September 2024 was at the level of 2019.

At the end of September 2024, the accrued FDI in commodity producing sectors amounted to 22.2%. Almost 13.2% of total accrued FDI was invested in manufacturing and mainly in traditional sectors. Only one-fifth of accrued FDI in manufacturing was invested in high-technology and medium-high-technology sectors evidencing of low attractiveness of these activities for foreign capital. Since the end of 2019, the amount of accrued FDI in manufacturing has increased 1.8 times. Although the FDI attraction dynamics are positive, the volume of FDI accrued in manufacturing in Latvia is smaller than in Lithuania and Estonia.

In the nearest years, FDI flow intensity will most probably be moderate. This will largely be driven by the geopolitical tension maintaining uncertainty in the investment environment. An active FDI attraction policy will be particularly important under the conditions of high uncertainty.

The Investment and Development Agency of Latvia (LIAA) plays a major role in the attraction of foreign investment in Latvia. The strategy of the LIAA for attracting investment is oriented towards qualitative servicing of incoming investment projects and active action in attracting investment projects through addressing potential investors.

The process of improvement of the FDI attraction policy is ongoing in close cooperation with the Foreign Investors' Council in Latvia (FICIL). The surveys of foreign investors in Latvia conducted by FICIL make it an important contribution to the improvement of the investment environment. (For details about FDI attraction policy see Chapter 12.4.)

6.4. MONETARY INDICATORS

The banking sector has managed to maintain its stability after the economic and geopolitical shock caused by the COVID-19 pandemic and Russia's invasion of Ukraine and is working with profit. The development of lending is still evaluated as weak – lending to businesses is stagnant while lending to households has positive signs. Deposit volumes continue to rise.

In accordance with the information from the Bank of Latvia, bank profitability has been improving in recent years. The bank sector's profit performance has increased significantly due to the increase in credit rates caused by the ECB's policy to combat inflation. This was particularly rapid in 2023. In the first half of 2024, the profit of the banking sector was slightly lower and amounted to 305 million euro or 12.7% less, compared to the same period in 2023.

The banks' windfall profits suggested a broader discussion about their taxation. Several EU Member States have introduced additional taxes. Amendments to the Corporate Income Tax Law were adopted in Latvia and entered into force in 2024, which provides for introducing a mandatory advance payment for banks. In addition, a partial refund of interest payments on fixed-term mortgages has been introduced and is effective in 2024.

In Latvia, fixed-term bank solidarity contributions are being introduced to be in effect from 2025 to 2027. They would be levied on the share of banks' net interest income that exceeds average annual net interest income by more than 50% over the period of 2018 to 2022. When lending activates, contribution levels would be reduced.

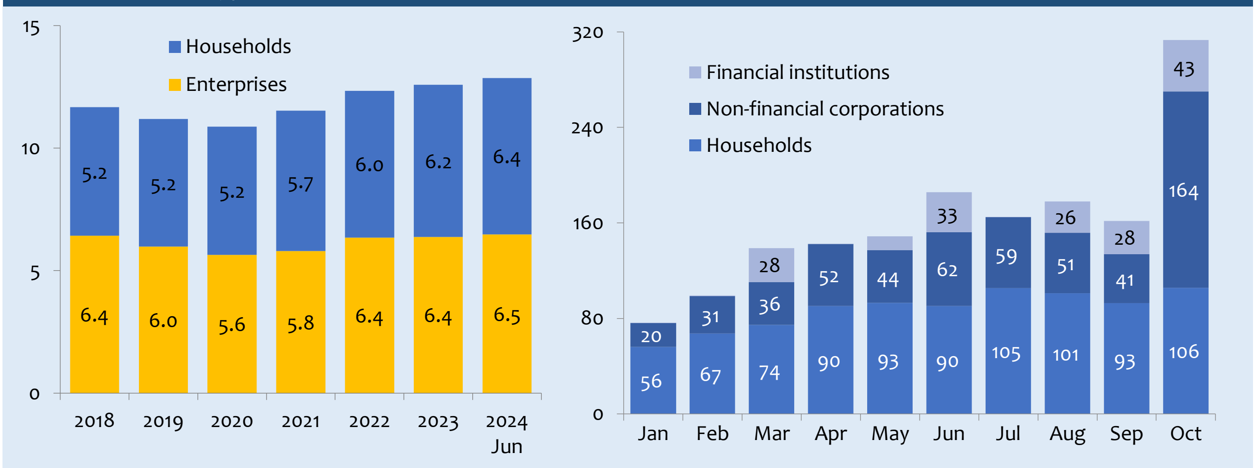
Overall, 10 banks and 4 branches of EU banks are operating in Latvia. Competition in the banking sector increased in 2024, with *Indexo banka* starting operations in August. It is the first new bank in Latvia to be licensed after joining the euro area. The capitalisation level of the banking sector remained high. In Q2 2024, the average capital adequacy ratio of the banking sector reached 20.71% (21.56% – a year ago). The return on assets (ROA)[1] and the return on equity (ROE)[2] of the banking sector slightly reduced after the rapid drop and were 2.15% and 18.29%, respectively (2.56% and 23.02% – a year ago).

A constant increase in the assets of Latvian banks has been seen since Q2 of 2020. This trend continued in 2024 and at the end of Q2 banks' assets were 28.6 billion euro, 5.1% higher than a year before. The share of non-bank credits in total assets was at the previous year's level – amounting to 56.2%. The share of debt securities was 7.9% or 1.9 percentage points down compared to the previous year.

Figure 6.15

Credit Portfolio of Households and Non-Financial Corporations
end-of-period, billion EUR

Loans Newly Issued to Residents by Categories of Borrowers
2024, million EUR



Source: Bank of Latvia

Although the volume of issued loans is generally slightly growing, the development of lending is still generally evaluated as weak. According to the data of the Bank of Latvia, outstanding amounts of loans to non-banks in Q2 2024 exceeded the indicator of 2023 at that time by 4.5%. The domestic lending portfolio increased by 3.7% during this year. The credit

[1] ROA – profit/loss to assets ratio
[2] ROE – profit/loss to capital and reserves ratio

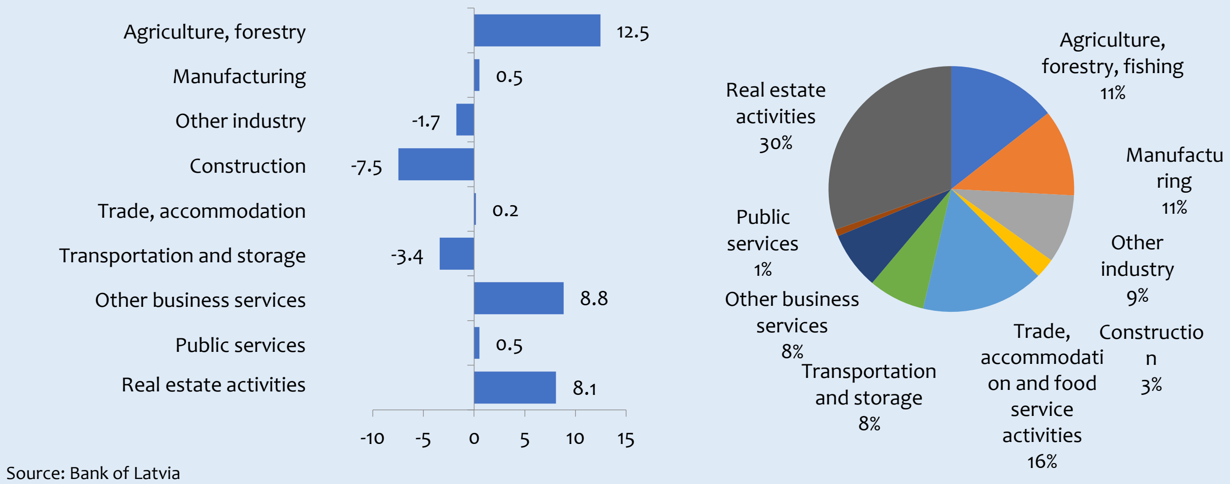
portfolio of non-financial corporations increased by 4.1% but lending to small and medium-sized enterprises developed more rapidly. Lending to households grew at a slightly faster annual rate of 4.8%.

The overall dynamics of the credit portfolio of households are positive. Most of the loans granted to households are loans for house purchase, reconstruction and repair. Lending to businesses is still developing slowly and unevenly. Most or almost 3/5 of loans to enterprises have been issued to microenterprises and medium-sized enterprises.

Figure 6.16

Credit Portfolio of Domestic Non-Financial Corporations by Economy Sectors

changes, at the end of Q2 2024, compared to the end of Q2 2023, as per cent | *structure, at the end of Q2 2024, as per cent*



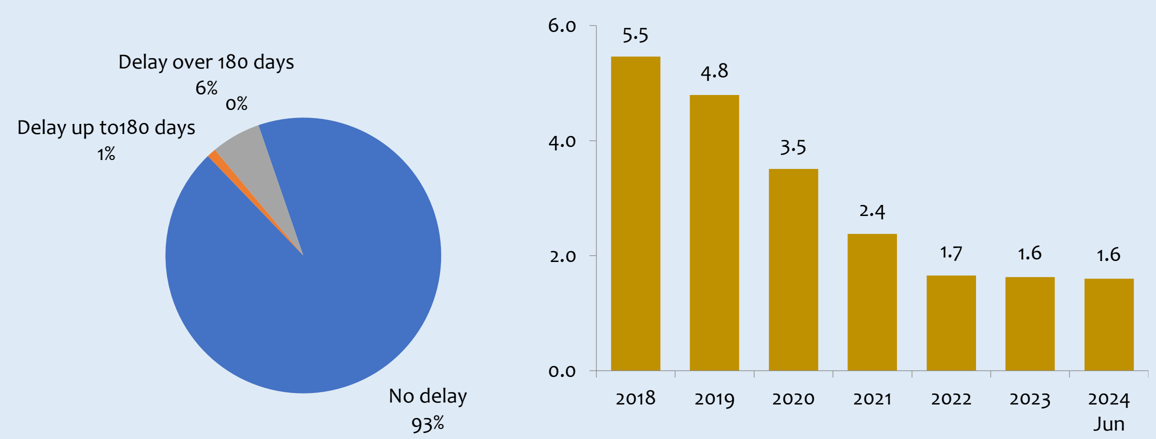
Source: Bank of Latvia

When analysing the credit portfolio of sectors, real estate activities (30.4% of issued loans) and trade (16.2% of issued loans) remained leaders at the end of Q2 2024. The sector with the strongest growth over the year is agriculture, forestry and fishing.

Figure 6.17

Structure of Overdue Liability Payment Days
by liability balance share in October 2024, as per cent

Share of Non-Performing Loans in the Portfolio of Domestic Non-Bank Customers
as a per cent



Source: Bank of Latvia

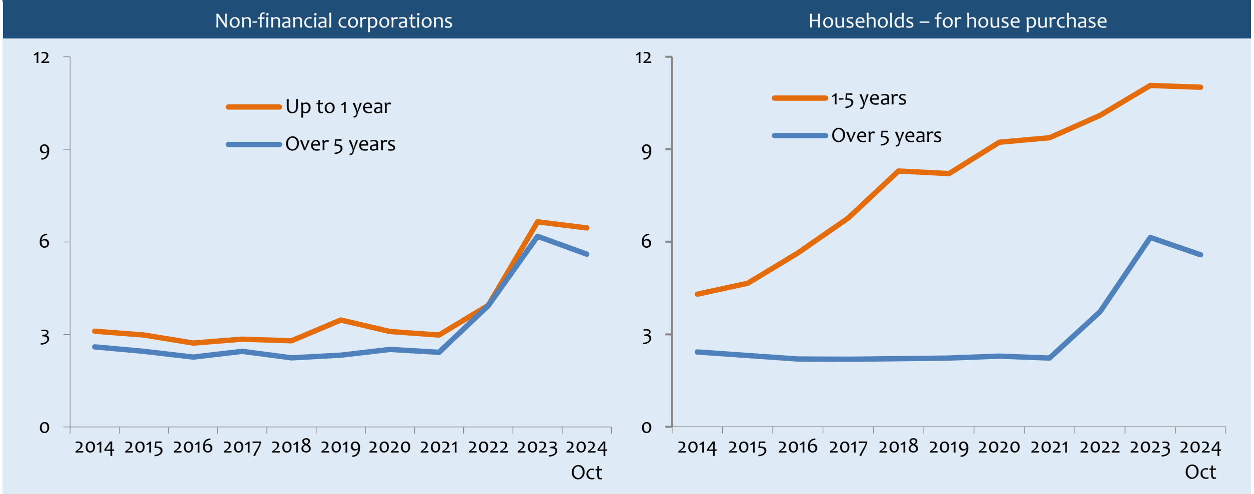
Before the pandemic, the quality of the credit portfolio had been gradually improving since 2011, mainly due to the improvement of the economic situation and writing off bad debts. The quality of the credit portfolio remained high also during the pandemic. The situation was improved by the credit moratorium and other solutions offered by banks implemented for the support of borrowers and therefore they helped entrepreneurs and households to overcome short-term liquidity problems. The quality of the credit portfolio continues to improve gradually, as evidenced by a steady decline in the share of non-performing loans. At the end of June 2024, 1.6% of loans to domestic non-bank corporations were non-performing.

New lending is developing unevenly. Loans amounting to 320.6 million euro were newly issued in October 2024. The amount of loans issued to households was 105.7 million euro. Most of them or 72.6% were mortgage loans for purchasing housing, and the share of loans issued for purchasing consumer goods was 22.6%.

The development of lending to businesses is also uneven. The Credit Register Data evidence that loans amounting to 164.4 million euro were newly issued to non-financial corporations in October 2024. Most or almost 2/3 of these loans have been issued to large enterprises and 1/4 to microenterprises. During this period, most of new loans by sector were issued in electricity, gas, steam and air conditioning supply and financial and insurance activities.

Figure 6.18

Weighted Average Interest (Outstanding Amounts) Rates for Loans Granted in Euro in Credit Institutions
at the end of the period, as per cent



Source: Bank of Latvia

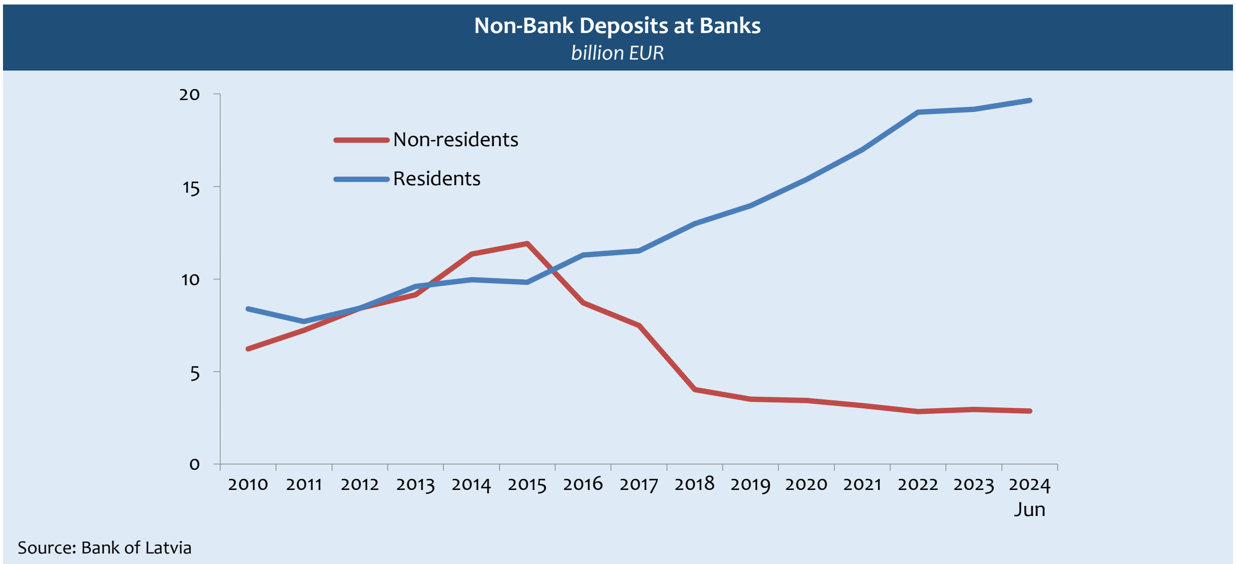
During the last decade, interest rates (on outstanding amounts) for credits granted to non-financial corporations – long-term and short-term – were very stable until 2022, when their rapid increase started. The peak in lending interest rates was reached in the final months of 2023. Long-term interest rates increased from 2.4% at the end of 2021 to 6.2% at the end of 2023; the dynamics of short-term rates during this time were from 3.0% to 6.7%. Similar trends were observed in the dynamics of long-term interest rates of credits granted to households for purchasing housing. The increase was from 2.2% at the end of 2021 to 6.1% at the end of 2023. On the other hand, short-term (1-5 years) credit rates have been showing a stable upward trend in the last decade. The significant increase in credit rates at this time was triggered by the ECB's decisions to raise base interest rates to curb inflation. A gradual decline in interest rates started in 2024, with long-term rates falling more rapidly, e.g. in October, the long-term lending rate for both non-financial corporations and households for housing purchases stood at 5.6%. The ECB is also contributing to this by returning to lowering its base interest rate since June.

A more rapid increase in non-bank deposit volumes started in the second half of 2020, which coincided with the onset of the COVID-19 crisis, when the population was more cautious in its spending and was more inclined to make savings because of the uncertainty of future economic developments. The formation of savings was also boosted by the limited opportunities to spend due to the restrictions on trade in the country. The growth of savings stopped in 2021 along with the increase in personal spending. The overall growth trend resumed in the next year. At the end of the first half of 2024, non-bank deposits amounted to 22.5 billion euro.

The structure of non-bank deposits by customer nationality has experienced significant changes. The share of deposits of non-residents has shrunk from 56.0% at the end of Q1 2015 to 12.7% at the end of Q2 2024. In addition, there has been a marked decline in non-EU non-resident deposits in recent years. The balance of non-bank deposits of non-residents in Q2 2024 amounted to 2.9 billion euro, which is 5.7% more than a year before.

When looking at the volume of resident deposits, generally positive dynamics can be seen during the year. At the end of Q2 2024, banks attracted 19.6 billion euro in deposits of residents. The growth rate was 5.4% compared to the end of Q2 2023.

Figure 6.19



Overall, in the financial sector, as in other sectors, further development of the situation will largely depend on the stabilisation of the economic and geopolitical situation in the region and the world in general and the ECB's decisions to activate the economy.

6.5. FISCAL POLICY AND PUBLIC DEBT

The COVID-19 pandemic has led to significant changes in the fiscal policy that has been implemented so far. In 2020, the general escape clause of the *Stability and Growth Pact* (SGP) was activated in the EU, enabling EU countries to increase their general government deficits in 2020-2022 to the extent necessary to mitigate the economic harm caused by the pandemic. Given the Russia-Ukraine war and all the related consequences, the general exception clause of the SGP also remained in force in 2023.

In 2024, the application of EU fiscal rules resumed, ending the effect of the EU's general escape clause. On 30 April 2024, the EU's economic governance framework reform package (the new EU fiscal rules) entered into force. It requires EU Member States to prepare a medium-term Fiscal Structural Plan (replacing the annual Stability Programme and National Reform Programme) every four or five years in April (see chapter 9.1) and sets out the fiscal trajectory in such a way that the projected general government budget deficit and debt does not exceed 3% and 60% of GDP, respectively, over the life of the Fiscal Structural Plan and 10 years thereafter.

Due to the COVID-19 pandemic, the budget deficit in Latvia increased to 4.1% of GDP or 1.2 billion euro in 2020 and to 7.2% of GDP or 2.3 billion euro in 2021. It slightly reduced in 2022 and was 4.9% of GDP or 1.8 billion euro. The general government budget deficit in 2023 amounted to 0.9 billion euro or 2.4% of GDP. (see Table 6.3).

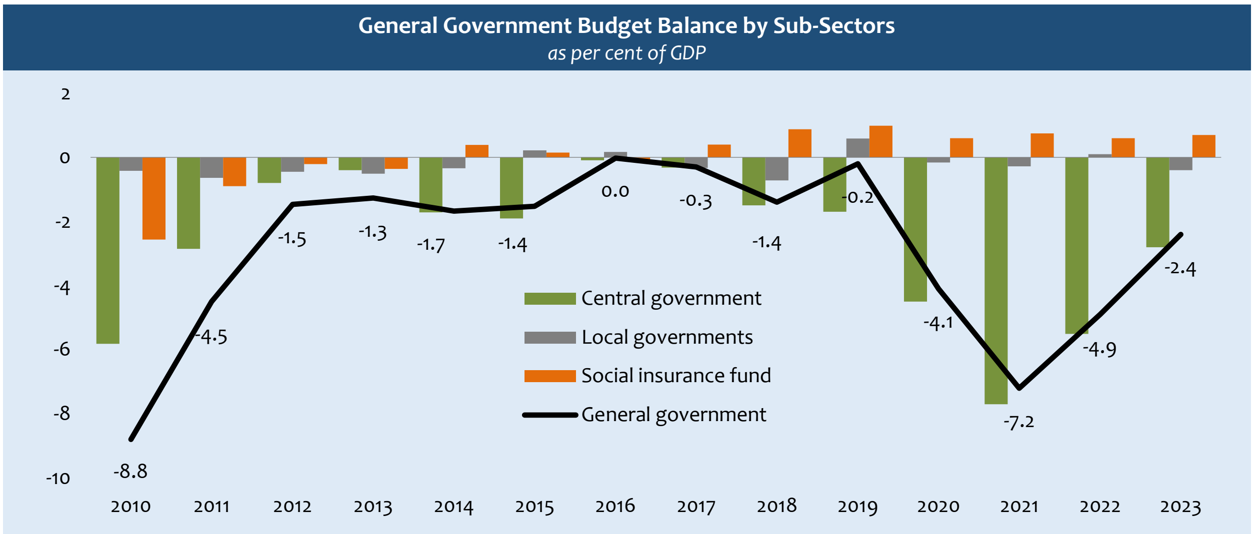
Table 6.3

General Government Budget

	billion EUR					*as a per cent of GDP*				
	2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
Revenue	11.7	11.7	12.7	14.2	16.3	39.5	40.2	39.3	39.4	41.6
Expenditure	11.7	12.9	15.0	16.0	17.2	39.7	44.3	46.5	44.2	44.0
Balance	-0.0	-1.2	-2.3	-1.8	-0.9	-0.2	-4.1	-7.2	-4.9	-2.4

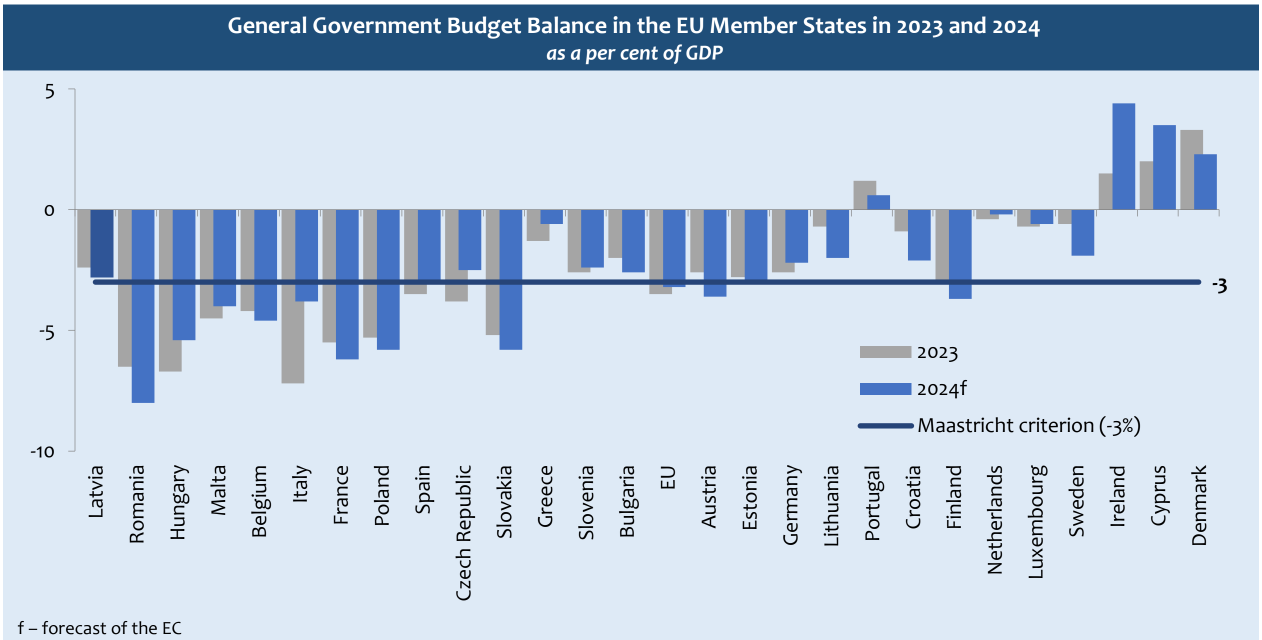
In 2023, the budget deficit was in central government budget and local government budget. There was a surplus in the Social Insurance Fund (see Figure 6.20).

Figure 6.20



According to Figure 6.21, in 2023, the Latvian budget balance to GDP showed a lower deficit than the average in the euro area and EU countries. In 2023, the average budget deficit in the euro area was 3.6% of GDP, while the average budget deficit level for EU countries was 3.5% of GDP. It was the highest in Italy, Hungary and Romania (6.5% or more in all of them). 10 EU countries had deficits above 3% of GDP. The budget had a surplus in four EU Member States.

Figure 6.21



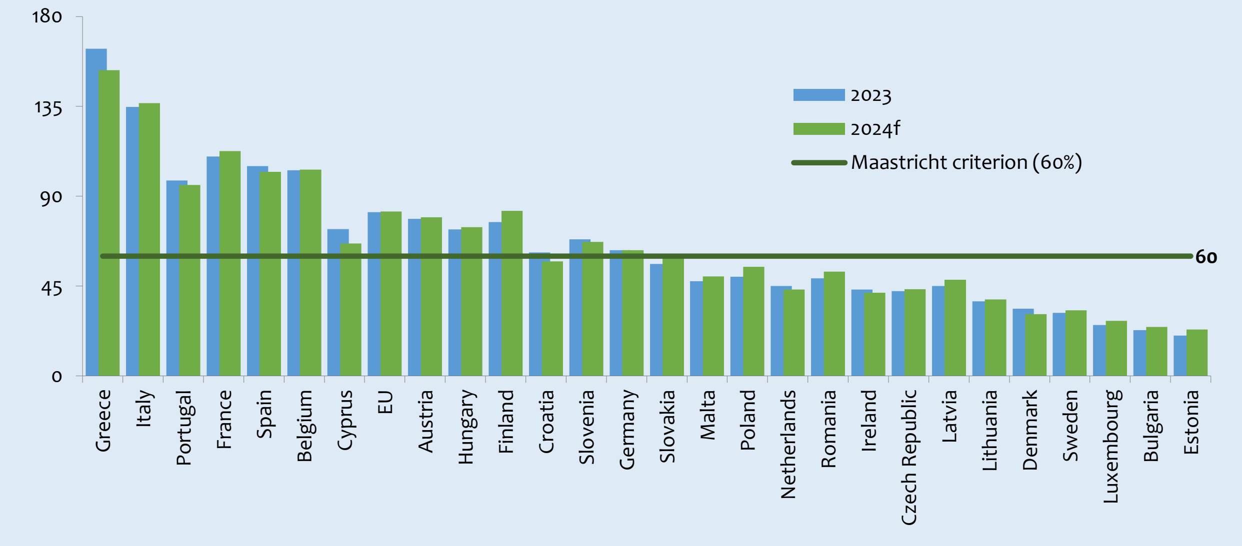
In accordance with the EC's forecasts made in autumn 2024, the average level of budget deficit in the EU is expected to be 3.1% of GDP in 2024 and 3.0% in 2025. The highest budget deficit in 2024, which may exceed 5.0% of GDP, is expected in Romania, France, Slovakia, Poland, and Hungary.

The Saeima approved the budget for 2024 with a deficit of 2.8% of GDP. According to the October forecasts of the Ministry of Finance, the budget deficit could be 2.6% of GDP in 2024. The government has presented a budget to the Saeima with a deficit of 2.9% of GDP in 2025, 2.6% in 2026 and 2.4% in 2027.

The general government debt in Latvia is still among the EU's lowest (see Figure 6.22).

Figure 6.22

General Government Debt in the EU Member States in 2023 and 2024
as a per cent of GDP



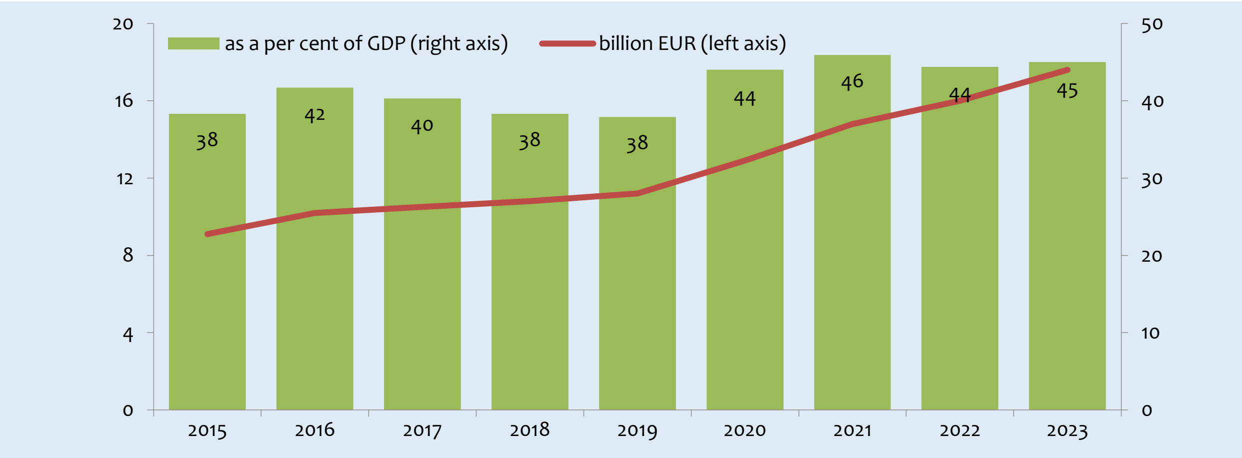
p – forecast of the EC

The average level of public debt in the euro area in 2023 was 88.9% of GDP and 82.1% of GDP in the EU. In 2023, the public debt exceeded the Maastricht criterion (60% of GDP) in 13 EU Member States. The highest public debt to GDP in 2023 was in Greece, Italy, France, Spain and Belgium, where it exceeded 103% of GDP. The lowest general government debt to GDP was registered in Estonia, Bulgaria, and Luxembourg. As indicated by the EC forecasts made in autumn 2024, in 2024, the average level of public debt in the euro area will slightly increase to 89.1% of GDP and to 82.4% in the EU.

The outbreak of COVID-19 caused the need to provide considerable amounts of funding to mitigate the impact caused by the COVID-19 crisis. Government debt increased to 45.9% of GDP or 14.8 billion euro in 2021. Since the nominal GDP increase under high inflation conditions was rapid, its ratio to GDP in 2022 reduced to 44.4% but increased to 16 billion euro in nominal terms. The public debt was 17.6 billion euro or 45.0% of GDP in 2023. It should be noted that the increase in general government debt in 2023 was affected by three new Eurobond issues.

Figure 6.23

General Government Consolidated Gross Debt by Nominal Value at the End of the Year



According to the MoF assessment, general government debt will reach 45.8% of GDP in 2024 and 47% of GDP in 2025.

In the long term, general government debt will be maintained at a moderate, sustainable level, ensuring that debt liabilities are refinanced on optimal terms. The debt provision of 60% of GDP defined in the *Fiscal Discipline Law* is expected to be observed in the medium term. According to the MoF's indicative projections, debt servicing expenditure will gradually increase in the coming years, but it will remain moderate at around 1.3% of projected GDP in the medium term.

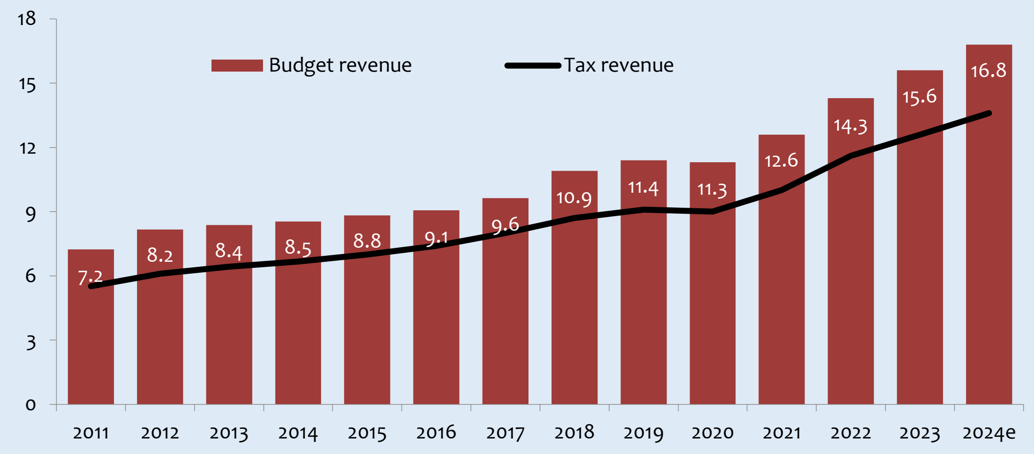
6.6. BUDGET REVENUE AND EXPENDITURE

BUDGET REVENUE [1]

After the economic crisis was tackled, the budget revenue has been increasing since 2011. From 2010 to 2023, consolidated general budget revenue increased 2.4 times. In 2023, budget revenue amounted to 15.6 billion euro or 1.3 billion euro more compared to 2022. The budget revenue growth trend continues also in 2024, and it was 12.3% higher in January-October 2024 than in January-October 2023.

Figure 6.24

General Government Consolidated Budget Revenues
billion EUR



e – evaluation by the MoE

Tax revenue is the main revenue item and constitutes approximately 4/5 of all budget revenue. A stable increase in this revenue was observed in 2011-2019. In 2020, there was a small reduction in tax revenue due to the COVID-19 pandemic, and the growth trend has resumed since 2021.

In recent years employment taxes have accounted for approximately half of all tax revenue. After the fall caused by the COVID-19 pandemic in 2020, employment tax revenue has been growing in the following years.

In 2012-2019, personal income tax revenue increased, primarily affected by improvements of the situation in the labour market. After the fall in 2020, positive dynamics resumed in 2021. The favourable labour market situation and wage growth affect the dynamics of employment taxes. In January-October 2024, personal income tax revenue was 12.6% higher compared to the corresponding period of 2023. In January-October 2024, revenue from mandatory state social insurance contributions was 10% higher than in January-October 2023.

[1] The official data of monthly reports of the Treasury was used in this chapter.

Table 6.4

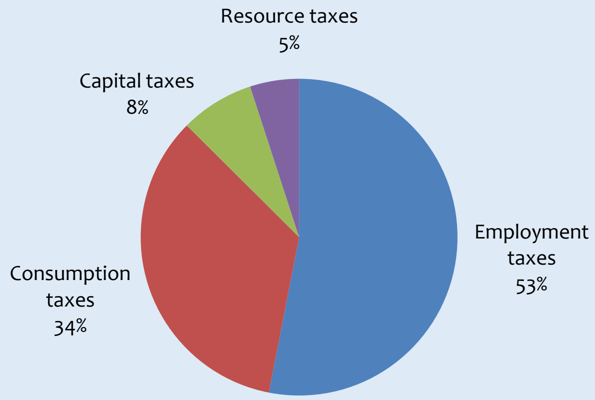
Budget Revenue
as per cent of GDP

	2018	2019	2020	2021	2022	2023	2024 Jan-Sep
General government consolidated budget revenues	**38.6**	**38.6**	**38.8**	**38.9**	**39.6**	**40.0**	**45.3**
I Tax revenues	**30.8**	**30.6**	**30.8**	**31.1**	**32.0**	**32.2**	**34.5**
1. Indirect taxes	12.6	12.7	12.5	12.2	13.2	13.0	13.0
– value-added tax	8.7	9.0	8.7	8.6	9.9	9.9	9.8
– excise tax	3.7	3.6	3.6	3.4	3.1	3.0	3.1
– customs duty	0.2	0.2	0.2	0.2	0.2	0.1	0.2
2. Income taxes and property taxes	8.0	7.4	7.7	7.5	8.0	8.4	9.8
– corporate income tax	1.1	0.2	0.7	0.9	1.0	1.4	2.1
– personal income tax	6.1	6.5	6.2	6.0	6.3	6.4	7.0
– real estate tax	0.8	0.8	0.8	0.7	0.6	0.6	0.7
3. Social insurance contributions	9.5	9.8	10.0	9.7	10.2	10.3	11.4
4. Other taxes	0.7	0.7	0.7	1.7	0.7	0.5	0.3
II Other revenues	**7.9**	**7.9**	**8.0**	**7.8**	**7.6**	**7.7**	**10.8**

Consumption taxes revenue constitutes slightly more than 1/3 of all tax revenue. In recent years, consumption taxes revenue has increased due to the rise in private consumption and, consequently, the increase in retail turnover. The dynamics of consumption taxes in 2024 in relation to wage growth are an indication of an increasing propensity for saving. In January-October 2024, they reduced 1.7% compared to the corresponding period of the previous year.

Figure 6.25

General Government Consolidated Budget Tax Revenues by Tax Groups
January-October 2024, as per cent



In 2024, the increase of excise duty on alcoholic beverages, non-alcoholic sweetened beverages, tobacco products, liquids used for electronic smoking devices and tobacco replacement products continued.

From 2010 to 2019, value added tax revenue increased. After the fall in 2020, the increase resumed the following year. This trend changed in 2024, when revenue from this tax in January-October was 2.8% lower than in the respective period of 2023. Meanwhile, the consumption share of the excise duty continued to grow moderately in 2024.

Capital taxes revenue increased until 2017. The reduction in 2018 and 2019 was underpinned by the changes made within the tax reform in the field of corporate income tax. In 2020, capital tax revenue resumed growth. In January-October 2024, corporate income tax and real estate tax revenue exceeded the indicator of the respective period of 2023 – by 33.7% and 0.8%, respectively.

Since 2010, resource taxes revenue has been growing. Growth trends are observed in revenue from natural resource tax and excise tax on petroleum products and natural gas. Resource tax revenue in January-October 2024 increased by 3.0% compared to January-October 2023.

BUDGET EXPENDITURE

Since 2011, after an extensive cutting down of expenditure during the economic crisis, the general government consolidated budget expenditure has gradually increased (except in 2016, when general government budget expenditure slightly declined). In 2023, it amounted to 17.0 billion euro or 1.2 billion euro than in 2022. The increase is observed also in 2024. In January-October, general government consolidated budget expenditure increased by 8.6%. The main impact on the dynamics of the budget expenditure items was from the increase in expenditure on remuneration for staff in the defence, security and justice sectors, as well as teachers. The next largest impact came from the increase in social payments from the state special budget.

Since 2011, current expenditure has been growing. In January-October 2024, the growth trend has continued with a growth rate of 9.4% compared to the corresponding period of 2023.

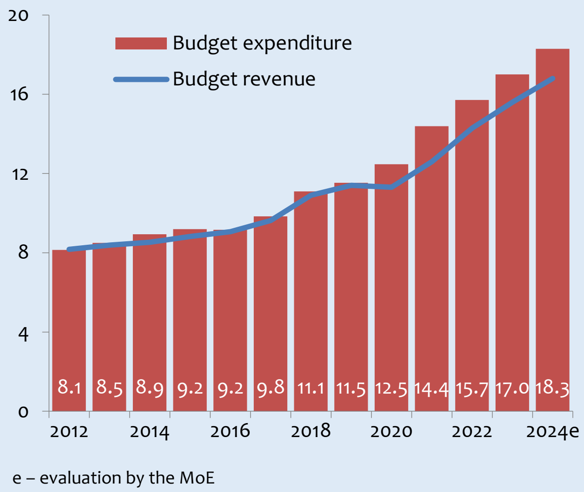
Since 2016, expenditure on subsidies and grants has been growing. In January-October 2024, this expenditure group was 3.9% higher than in January-October of the previous year.

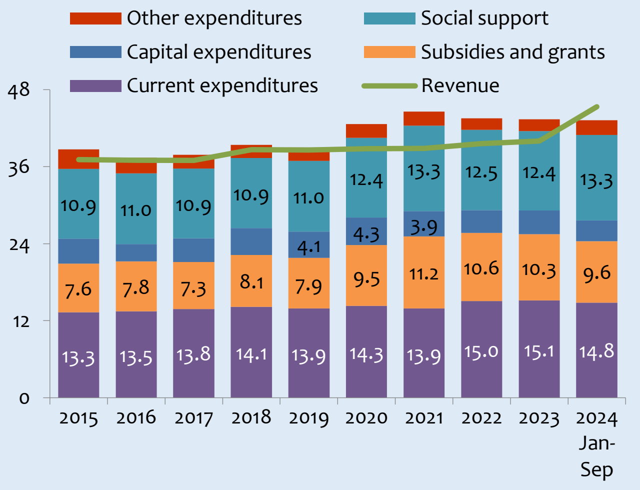
Expenditure on social payments has been increasing since 2013. In January-October 2024, the growth rate was 7% compared to the corresponding period of the previous year.

Capital expenditure growth has been observed since 2017. This trend continued in January-October 2024 as expenditure of this group increased by 13.9%.

Figure 6.26

General Government Consolidated Budget Expenditure

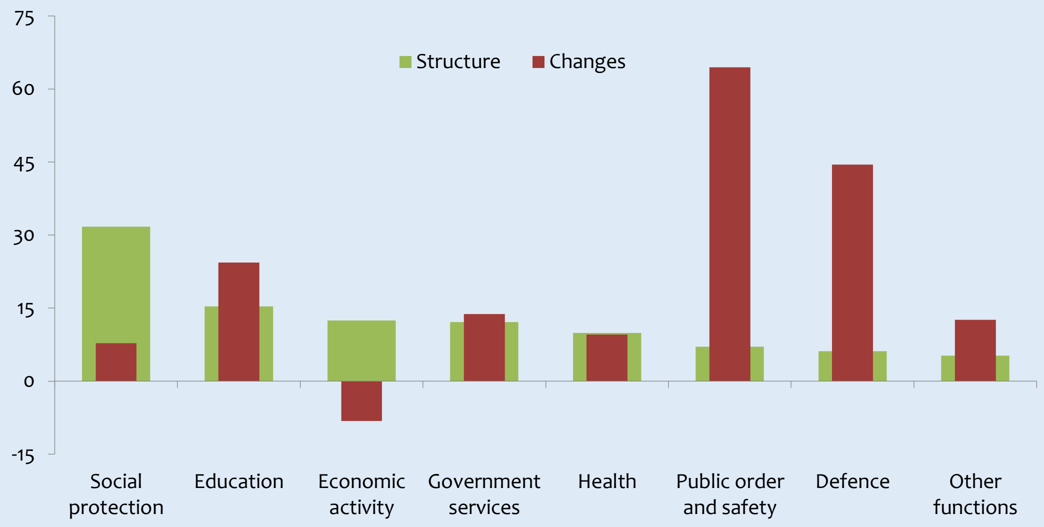




When analysing budget expenditure by functional category, in January-October 2024, a more rapid increase has been observed in areas like public order and safety activities, defence, and education. In structural terms, social protection expenditure accounts for the largest share of the budget, accounting for almost 1/3 of consolidated budget expenditure.

Figure 6.27

General Government Consolidated Budget Expenditure by Function in January– October 2024
as per cent



6.7. PRODUCTIVITY AND COMPETITIVENESS

PRODUCTIVITY

Latvian economic growth is supported by the increase in productivity. However, productivity rates tend to decrease in the long term, while the increase in labour costs remains persistently high.

The most rapid increase in productivity was observed before 2008, especially after Latvia acceded to the EU, which became a significant incentive for the inflow of foreign investments. From 1996 to 2007, the convergence process accelerated – the productivity gap among the EU-15 countries fell by almost 26 percentage points.

The global financial crisis influenced not only the decline in economic activities, but also productivity dynamics. In the years of economic recession (2008-2010), it reduced by almost 3%, which was a rather moderate reduction compared to the drop in GDP (by 17.4%). This was mainly due to the rapid adjustment of the labour market to the drop in economic activities. As employers optimised the attraction of resources, entrepreneurs reduced labour demand, and the number of employees shrank by nearly 15%, which partially offset the drop in productivity.

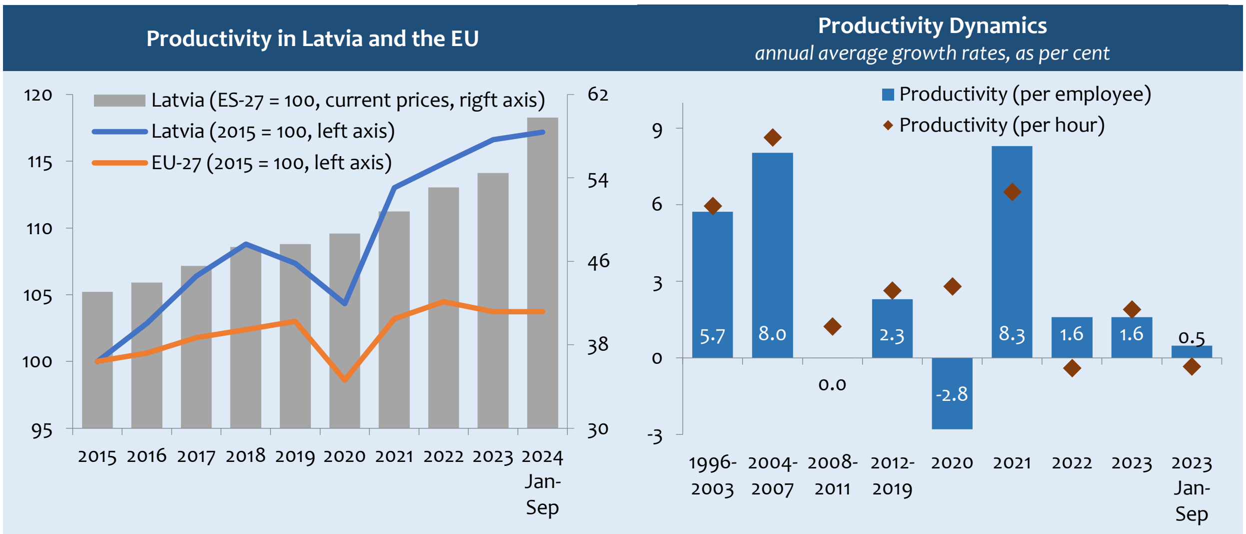
Productivity dynamics have been volatile in recent years. In 2020, productivity was 2.8% lower than in 2019 under the influence of the measures for containment of the COVID-19 pandemic. Moreover, the impact of the crisis caused by the pandemic on productivity indicators was unclear. When calculating productivity per employee, in 2020, it decreased, but, when calculating productivity per hour, it increased by 2.8% – equivalent to the average over the past decade. Markedly different fluctuations in productivity rates in the first year of the COVID-19 pandemic were largely affected by state support, mainly in the form of subsidised wage schemes, which contributed to the preservation of jobs, while the number of hours worked reduced.

As economic activity resumed, in 2021, productivity (per employee) in the Latvian economy was at an 8.3% higher level than in the period concerned a year ago, but hourly productivity was 6.5% higher. This was mainly driven by a sharp increase in productivity in services sectors, including trade, transport services and financial intermediation. Productivity grew by 10.8%.

Although economic growth moderated in 2022 and 2023, this was mainly due to stronger productivity growth than employment growth. Productivity has increased by 1.6% in the last two years compared to the previous year. Productivity remained moderately positive in 2024. In January-September of this year, they were 0.5% higher than a year ago.

Despite significant productivity fluctuations and more moderate dynamics than in previous years, the convergence of Latvia to the EU-average productivity level continues. Overall, in 2023, GDP per employee in the Latvian national economy reached almost 54.5% (72.8% according to PPS) of the EU average. Since 2019, the productivity gap with the EU average (according to PPS) narrowed by almost 3 percentage points.

Figure 6.28



In the short term, productivity fluctuations lead to changes in product, labour and capital markets as businesses respond to external and internal shocks (such as COVID-19 pandemic, energy crisis, etc.) and to measures to prevent them and stabilise the economy. The impact of these measures on long-term productivity trends will largely determine change in business models and consumer behaviour. In recent years, there have been significant changes in labour and product markets and the level of digitisation increases (e-services, remote work, etc.). However, great uncertainty regarding the stability of these changes and their impact on long-term productivity trends remains. Structural changes in the Latvian economy towards higher value-added activities and knowledge-intensive industries will also greatly determine the positive dynamics of productivity.

COST AND PRICE COMPETITIVENESS

Latvia is in one of the leading positions by productivity growth rates among the EU Member States, yet wages have been growing faster than productivity, thus weakening the competitiveness of Latvian entrepreneurs in the field of costs. The increase in nominal unit labour costs (ULC)[1] also evidences of the growing risks of losses in cost competitiveness.

Latvia has long been showing that the gap between productivity and labour costs was widening in years of high economic growth, while it was getting smaller during recession. However, labour costs have continued to rise rapidly since 2021, despite declining economic activity and slow productivity growth. This is a sign of the growing mismatch between labour demand and supply.

Particularly strong dynamics of nominal ULC were observed in the last years before the COVID-19 pandemic. In 2019, compared to 2015, ULC rose by 21.1%, driven by a nearly fourfold faster increase in labour costs (in nominal terms) compared to productivity growth. Before 2019 the increase in labour costs was affected both by wage convergence processes in the EU labour market and the tenser situation in the Latvian labour market due to the increase in labour shortage.

ULC continued to grow also in the years of the COVID-19 pandemic. Due to the decline in economic activity, labour costs increased more slowly in 2020 than a year ago – by 2.7% (by 5.2% in 2019). Despite a more moderate increase in labour costs, ULC still increased by 5.7% due to the drop in productivity (by 2.8%). In 2021, labour costs kept growing rapidly and exceeded the level of the year before by 7.6%. This did not put pressure on labour unit labour costs, because productivity increased more rapidly, and ULC decreased by almost 1%.

From 2021 to 2023, labour costs grew at an average annual rate of 12%, while productivity growth rates were much more moderate – an average annual rate of 3.8%.

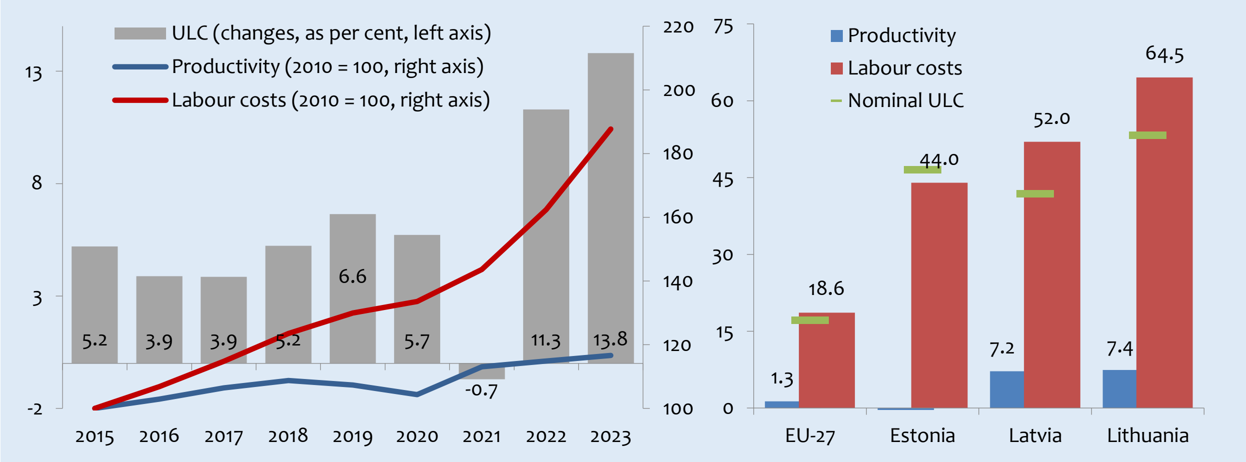
[1] ULC is a relationship between labour costs and productivity. If productivity is growing faster than the wages, then ULC is decreasing, which is an indication that competitiveness of state costs increases, and the other way around.

In 2022, the labour costs growth rate accelerated even more. The remuneration of employees increased by 13.1% and productivity increased by only 1.6%, this significantly worsened the cost competitiveness indicator – nominal ULC increased by 11.3%. Labour costs rising faster than productivity growth have significantly undermined cost competitiveness. Nominal product unit labour cost (ULC) grew by 13.8% in 2023 showing the steepest rise in the past decade. Labour costs are growing also in 2024. In January-September of this year, labour costs increased by 10.5% and ULC increased by 10% compared to the corresponding period of 2023.

Figure 6.29

ULC, Productivity and Labour Costs

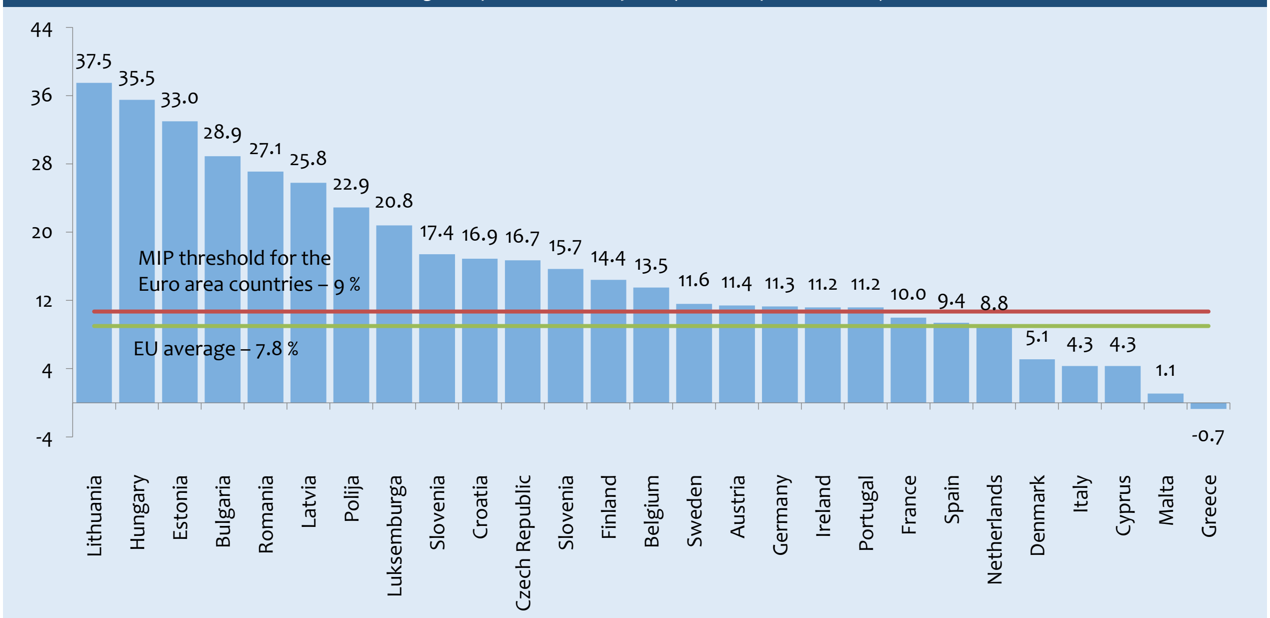
ULC, Productivity and Labour Costs in the Baltic Countries and in the EU
2023, compared to 2018, as per cent



Nominal ULC in the neighbouring Baltic States in recent years has been growing at a faster pace than in Latvia. In 2023, compared to 2020, nominal ULC increased by 25.8% in Latvia, by 33% in Estonia and by 37.5% in Lithuania. Overall, ULC growth in the Baltic States is much faster than the EU average (7.8%) and this indicator is significantly above the threshold set by the EU Alert Mechanism (MIP) (9%) (see Chapter 6.8 for details).

Figure 6.30

Nominal ULC in the EU Countries
changes,as per cent, over 3 years (2023 compared to 2020)



Cost competitiveness reduction risks are observed in both manufacturing and market services sectors. The dynamics of labour costs in the last five years (2015-2019) before the COVID-19 pandemic in both mentioned groups of sectors were very similar – they increased by almost 4.3% and 5.7% on average every year, respectively. However, productivity in producing sectors increased more rapidly than in services sectors – by 3.6% and 0.5%, respectively. Therefore, also the nominal ULC increase in producing sectors was more moderate.

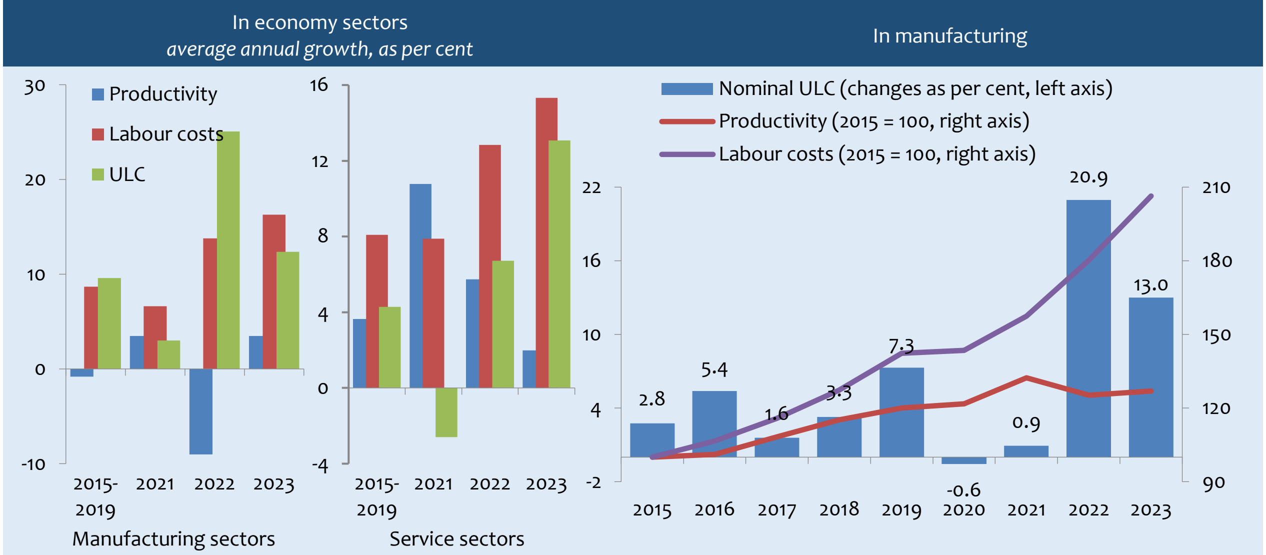
The shock related to the COVID-19 pandemic and Russia's war in Ukraine has a stronger impact on the products market than the labour market. In four years (2020-2023), labour costs (at current prices) in producing sectors increased by 39.5% but in services sectors – by 50.2%. Productivity dynamics in the manufacturing sector were rather weak and could not compensate for the increase in labour costs. In 2023, nominal unit labour costs increased by 44.2% compared to 2019. In market services sectors, the lagging of productivity growth rates behind the dynamics of labour costs was more moderate than in producing sectors, and ULC also grew slower (by 26%). The largest increase in nominal ULC in the four years was observed in construction, agriculture, manufacturing and real estate activities.

In manufacturing the gap between the rise in productivity and labour costs is slightly more moderate than in the economy. However, annual changes in nominal ULC are rather volatile; they are largely affected by factors in the goods market, while labour costs show stable upward dynamics. Labour costs in manufacturing were growing two times faster than productivity in the last five years before the COVID-19 pandemic (2015-2019).

In the last four years (2020-2023), productivity grew at a faster pace than labour costs – by an average of 1.4% and 9.7% per year, respectively, thus increasing nominal unit labour costs of products every year by almost 8.2%.

Figure 6.31

ULC, Labour Costs and Productivity



The labour costs dynamics in Latvian manufacturing significantly exceed EU average labour costs and nominal ULC growth rates. Considering that the EU countries are Latvia's main trade partners, such trends reduce the competitiveness of Latvian producers in the field of costs.

The real effective exchange rate (REER) is growing. The consumer price index (CPI) based REER to 42 trade partner countries has increased by 10.8% in the last three years (2020-2023), which significantly exceeded the threshold set by MIP for the euro area countries (3%).

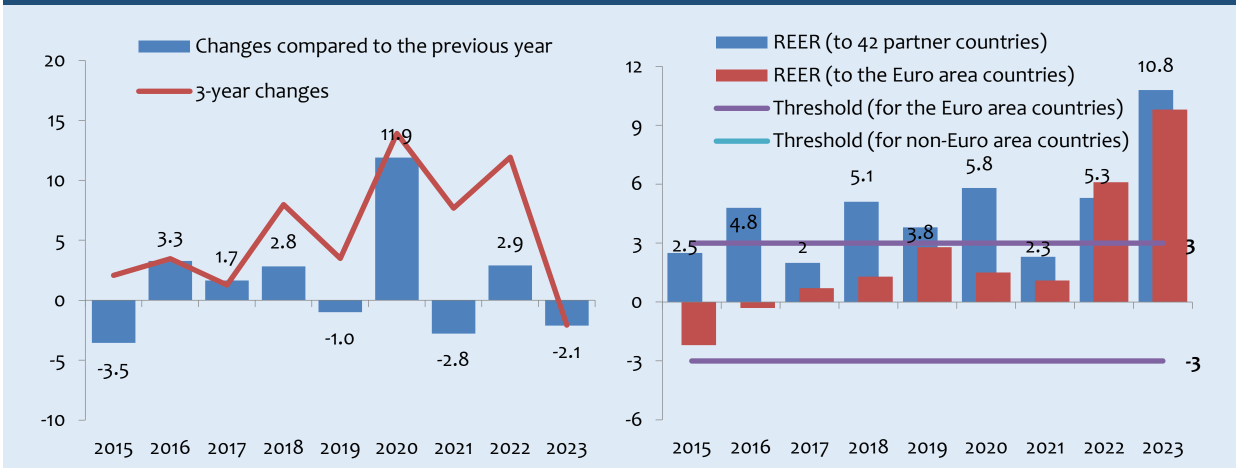
The long-term dynamics of Latvia's export market share in world markets are slowing down. In the three years (2021-2023), Latvia's export market share in world markets decreased by 2.1%, largely affected by the negative changes in the goods and services export market in 2020. Since 2020, Latvia's share in the export market of goods decreased by 2.4%, while the share of services decreased by 2.4%, mainly due to the decrease of the market share by 5.1% in 2021 due to the pandemic containment restrictions.

So far, Latvia's export performance against advanced economies, expressed as a 3-year percentage change, has never exceeded the threshold. However, in 2023, Latvia's share of exports to developed markets fell by 4.8%, while the EC assessment for Latvia for 2024 and the forecast for 2025 show that the MIP threshold (3% change over 3 years) will be exceeded.

Figure 6.32

Changes in Export Market Share
as per cent

Changes in Real Effective Exchange Rate (REER)
3-year changes, as per cent



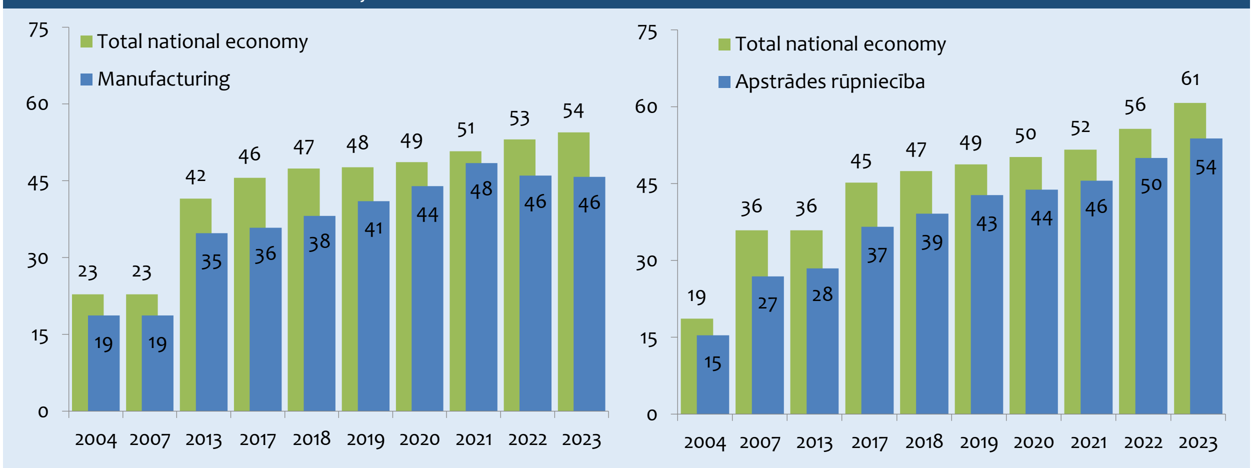
Trends in Latvia's export share in world markets show that the risks of a decline in competitiveness are growing. In the long term, the increase in labour costs, which is not compensated by a corresponding rise in productivity, may have a negative impact on competitiveness and reduce the share of company profits, which entrepreneurs will be forced to adjust to keep price competitiveness in external markets.

Labour costs in Latvia are among the lowest in the EU Member States. In 2023, labour costs per employee in the Latvian economy were almost 61% of the EU average, whereas in the manufacturing industry – 54%. Compared to 2019, in 2023, the labour cost gap decreased by 12 percentage points (in manufacturing – by 11 percentage points), while in terms of productivity in the economy it fell by a total of 6.8 percentage points (by 4.7 percentage points in manufacturing). This means that the wage convergence process is faster than the productivity convergence process in the economy as a whole and in manufacturing.

Figure 6.33

Productivity and Labour Costs
as per cent of the EU-27 average

Productivity | Labour costs



In the context of slow productivity dynamics, the increase in labour costs puts significant pressure on the cost competitiveness of Latvian entrepreneurs. The weakening of economic activity has had little impact on the labour market situation. This shows that the problem of labour shortages is acute for entrepreneurs and, despite the slowdown in economic activity, jobs are preserved. Wages, on the other hand, continue to rise influenced by inflation. These trends keep widening the gap between productivity and labour costs. The increase in productivity is the main factor determining competitiveness, and structural changes in the Latvian economy towards higher value-added activities and knowledge-intensive industries will also greatly determine the positive dynamics of productivity.

6.8. ALERT MECHANISM

According to the economic and fiscal policy surveillance rules adopted in 2011, a macroeconomic imbalance procedure (MIP) was created in the EU in addition to the existing excessive budget deficit procedure. The procedure aims to identify imbalances that hinder the uniform development of Member State economies and to spur the right policy responses. The implementation of the MIP is embedded in the European Semester of economic policy coordination (see Chapter 9.1) to ensure consistency with the analyses and recommendations made under other economic surveillance tools.

On 18 December 2024, the EC published the Alert Mechanism Report[1] (AMR) for 2025, which identified the countries with macroeconomic imbalances or excessive macroeconomic imbalances – Cyprus, Germany, Greece, Italy, Hungary, the Netherlands, Romania, Slovakia and Sweden. Risks of macroeconomic imbalances have been stated in Estonia. In-depth reviews were prescribed for the countries. Latvia was not mentioned among the countries with any macroeconomic imbalances.

The list of MIP indicators and indicator thresholds was revised in 2024. The scoreboard for Latvia shows that four indicators were beyond their thresholds in 2023, namely the current account balance, real effective exchange rate, nominal unit labour cost index and labour force participation rate (see Table 6.5).

It is noted in AMR that, in accordance with EC's forecasts, Latvia's GDP will stagnate (will be 0.0%) in 2024, but will increase by 1.0% in 2025. Headline inflation will fall substantially to 1.2% in 2024 but will rise to 2.2% in 2025. The unemployment rate will rise slightly to 6.7% in 2024 and remain unchanged in 2025.

The EC notes that Latvia's current account deficit did not decrease in 2023. As a result, the three-year average current account balance slipped below the lower threshold of -4%. From the saving-investment perspective, lower government savings combined with relatively resilient investment have been the key drivers of persistent current account deficits in the past two years. The current account deficit narrowed to around 3% in Q2 2024 and is projected to reduce further next year. Capital transfers from the EU, including the RRF funding, are set to noticeably lower external financing needs. The net international investment position (NIIP) remained broadly stable at -26% of GDP in 2023. Latvia's liabilities largely consist of government bonds and foreign direct investment. Their amount exceeds the amount of other financial instruments.

Pressure on cost competitiveness is easing. In 2023, HICP (harmonised index of consumer prices) based real effective exchange rate (REER) appreciated strongly, driven by both nominal exchange rate appreciations and high inflation differentials. However, by mid-2024 it depreciated on account of favourable inflation reduction trends. Nominal wage growth remained relatively high in 2023, despite strong productivity growth, pushing unit labour cost (ULC) to increase by almost 14%. ULC growth is expected to slow in 2024 on the back of more moderate wage increases and strong productivity growth.

Debt of non-financial corporations remained broadly constant in 2023, reaching 36% of GDP. Despite an increase in interest expenses, the interest coverage ratio is still comparatively high. Overall financial risks increased somewhat during 2023, as profitability was low and debt service capacity deteriorated but remained limited. Household debt remained low, at 19% of GDP in 2023.

Since 2015, house prices have been growing slightly faster than household incomes. The number of house transactions and building permits has fallen adjusting to the higher interest rates of the last two years. House prices are estimated to be overvalued by around 15%, but growth slowed significantly to 3.7% in 2023. The Latvian housing market is exposed to low risks.

Government debt increased to 45% of GDP in 2023. As the fiscal deficit is planned to average 3% of GDP in 2024 and 2025, government debt will increase slightly.

The banking sector is sound and well capitalised. The Common Equity Tier 1 capital ratio declined in 2023 but remains the highest in the EU. Profitability improved significantly in 2023 and is well above the EU average. The non-performing loans ratio was 1.2% in Q1 2024 – one of the lowest in the EU. Credit dynamics remain rather muted.

[1] The report is available at: https://commission.europa.eu/publications/2025-european-semester-alert-mechanism-report_en

Table 6.5

List of Indicators of the Macroeconomic Imbalance Procedure for Latvia							
	Thresholds	2018	2019	2020	2021	2022	2023
External imbalances and competitiveness							
Current account balance (% of GDP, 3-year average)	-4 % / 6 %	1.0	0.3	0.8	-0.4	-2.2	-4.5
Net international investment position (% of GDP)	-35 %	-47.0	-41.4	-35.0	-27.9	-28.2	-26.0
Real effective exchange rate – 42 trading partners, HICP deflator (3-year % change)	±3 %* / ±10 %	5.1	3.8	5.8	2.3	5.3	10.8
Export performance against advanced economies (3 year % change)	-3 %	8.8	5.1	14.5	10.1	15.9	-1.7
Nominal unit labour cost index (per hour worked) (3 year % change)	9 %* / 12 %	13.2	16.0	17.4	11.2	16.2	25.8
Internal imbalances							
General government gross debt (as % of GDP)	60 %	38.3	37.9	44.0	45.9	44.4	45.0
Household (including non-profit institutions serving households) debt – consolidated (as % of GDP)	55%	21.2	20.5	20.7	20.3	19.7	18.6
Non-Financial Corporations debt, consolidated (as % of GDP)	85%	49.4	47.3	45.3	39.9	37.2	35.8
Household (including non-profit institutions serving households) credit flow, consolidated (% debt stock (t-1))	14%	1.6	2.4	0.3	8.7	6.1	5.2
Non-Financial Corporations (excluding Foreign Direct Investment) credit flow, consolidated (% debt stock (t-1))	13%	-4.4	1.9	-4.3	-4.6	7.7	1.8
House price index, nominal (1 year % change)	9 %	9.6	9.0	3.5	10.9	13.8	3.7
Employment indicators							
Unemployment rate (% of labour force aged 15-74)	10 %	7.4	6.3	8.1	7.6	6.9	6.5
Labour force participation rate (3-year change in percentage points (% of population aged 15-64))	-0.2 percentage points	1.9	1.1	1.1	-1.8	-0.5	-1.4

* for countries of the Euro area
Note: highlighted number exceed the limits of thresholds set in the alert mechanism
Source: MIP Scoreboard, *Eurostat*

Indicators of the macroeconomic imbalance procedure (both on the primary list and on the auxiliary list) have been selected to better and faster warn about each potential macroeconomic imbalance, as well as help to characterise the processes ongoing in the economy.

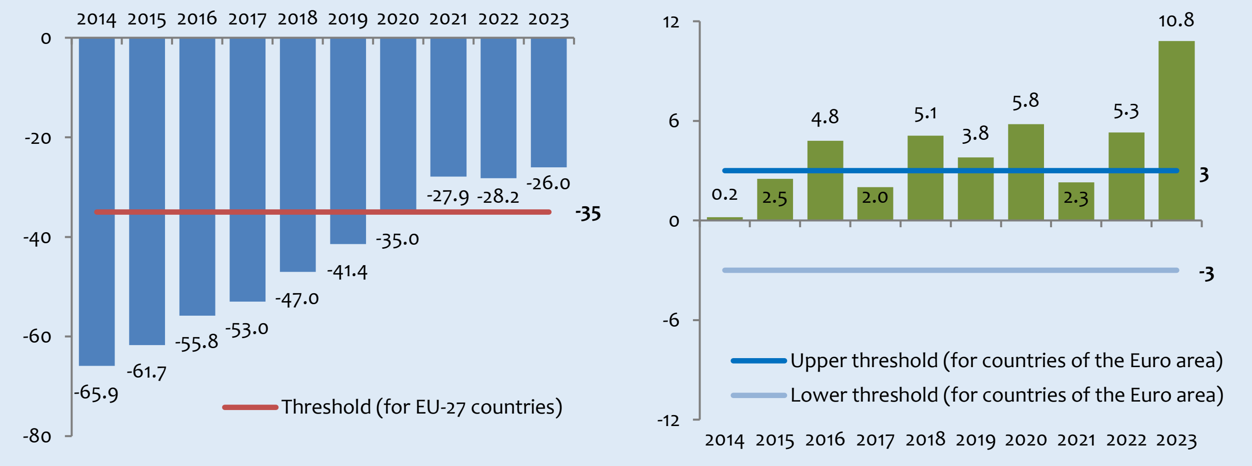
External imbalances and competitiveness are characterised by current account balance, net international investment position, real effective exchange rate, export performance against advanced economies and nominal unit labour cost index.

The 3-year average current account balance of Latvia surpassed the lower threshold for the first time in 2023. From 2016 to 2020, including, it was positive. The countries, where the 3-year average current account balance in 2023 surpassed the upper threshold, were Denmark, Ireland, the Netherlands, Luxembourg and Sweden, and the lower threshold was surpassed in Romania, Greece, Cyprus, Slovakia and Latvia.

Figure 6.34

Net International Investment Position of Latvia
as per cent of GDP

Real Effective Exchange Rate for Latvia (42 trading partners, HICP deflator)
3 year change, as per cent



Source: *Eurostat*

Since 2021, the net international investment position (NIIP) of Latvia no longer surpasses the threshold (see Figure 6.34). Meanwhile, in 2023, NIIP exceeded the threshold in Hungary, Romania, Spain, Slovakia, Portugal, Cyprus, Ireland and Greece. FDI is considered the safest means of raising foreign capital included in NIIP. In 2023, FDI constituted 42.2% of the total attracted foreign capital in Latvia.

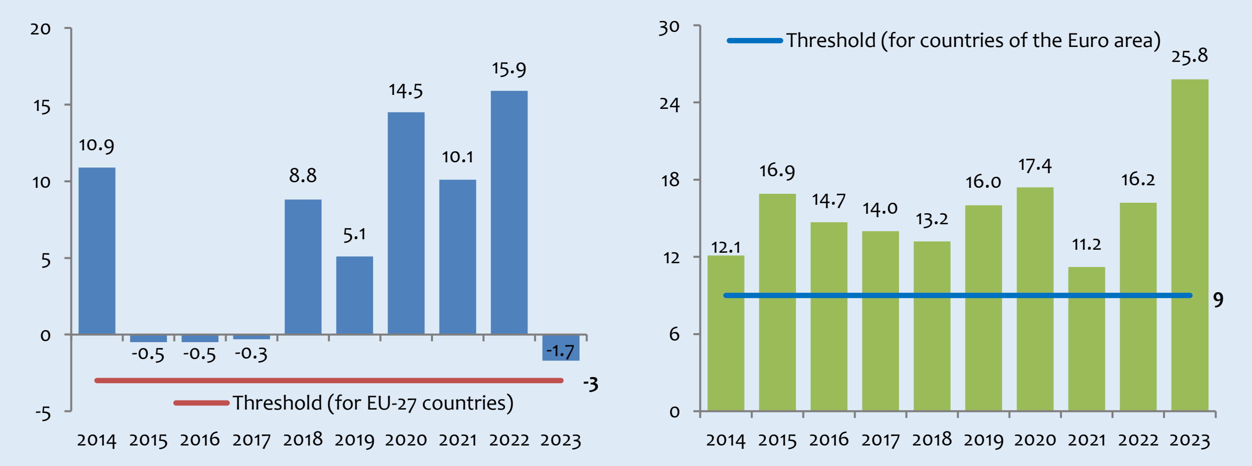
Since 2018, Latvia did not surpass the real effective exchange rate 3-year change threshold (revised in 2024) only in 2021 (see Figure 6.34). The EC's assessment shows that this threshold will also be surpassed in 2024. Out of the EU-27 countries, euro area countries such as Estonia, Lithuania, Slovakia, Croatia and non-euro area countries such as Czechia and Hungary surpassed the real effective exchange rate three-year changes thresholds in 2023.

So far, Latvia has never exceeded the threshold in export performance against advanced economies, expressed as a 5-year percentage change (see Figure 6.35). However, the EC's assessment for Latvia for 2024 and the forecast for 2025 show that the thresholds will be surpassed. Out of EU-27 countries, Slovakia, Finland, Belgium, Germany, Ireland, Malta and Luxembourg were above this indicator's threshold in 2023.

Figure 6.35

Latvia's Export Performance Against Advanced Economies
5-year change, as per cent

Nominal Unit Labour Cost Index (per hour of work) in Latvia
3 year change, as per cent



Source: *Eurostat*

Since the accession of Latvia to the euro area in 2014, the nominal unit labour cost index exceeds the threshold set for euro area countries (see Figure 6.35). In 2023, out of EU-27 countries, only euro area countries such as Italy, Cyprus, Malta, Greece and non-euro area countries such as Sweden and Denmark were below the thresholds for this indicator.

Internal imbalances are measured by general government debt, household debt, non-financial corporation debt, household credit flows, non-financial corporation credit flows and the house price index.

The general government debt of Latvia reached its highest level (47.6% of GDP) in 2010, however, it did not exceed the threshold. Then government debt reduced to 37.9% of GDP with small variations in 2019, but later government debt increased again and stabilised at about 45% of GDP (see Figure 6.36). In 2023, this indicator was above the threshold for EU-27 countries such as Slovenia, Hungary, Cyprus, Finland, Austria, Portugal, Belgium, Spain, France, Italy and Greece.

In 2024, the debt and financial flows indicators were replaced in the list of MIP indicators to analyse directly households and non-financial corporations. The level of consolidated household debt (including non-profit organisations serving households) has never exceeded the threshold for Latvia. In 2023, this indicator was above the threshold for EU-27 countries such as the Netherlands, Denmark, Sweden, Luxembourg, Cyprus, Finland, France, Belgium and Portugal.

The consolidated household (including non-profit organisations serving households) credit flow has never exceeded the threshold for Latvia. In 2023, this indicator exceeded the threshold only in Bulgaria.

The consolidated non-financial corporation debt has never exceeded the threshold for Latvia. In 2023, this indicator was above the threshold for EU-27 countries such as Luxembourg, Cyprus, Sweden, the Netherlands, Ireland, Denmark, Belgium and France.

The consolidated non-financial corporation (excluding foreign direct investment) credit flow level only exceeded the threshold for Latvia in 2014. In 2023, this indicator was above the threshold for EU-27 countries such as Malta and Ireland.

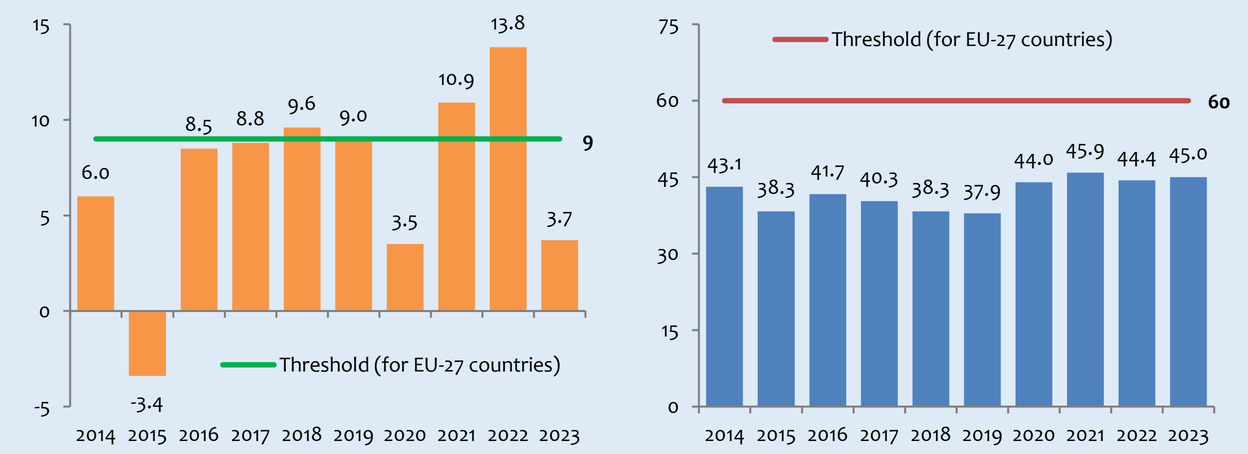
The nominal price index will now be used instead of the deflated house price index, but the threshold has been raised from 6% to 9%. Latvia has exceeded this threshold quite often in the past, but it was not exceeded in 2023. In 2023, this indicator was above the threshold for EU-27 countries such as Greece, Croatia, Bulgaria and Lithuania.

The EC does not predict surpassed thresholds for Latvia in any internal imbalance indicators in 2024 and 2025.

Figure 6.36

House Price Index in Latvia
annual changes, as per cent, nominal

General Government Debt of Latvia
as per cent of GDP



Source: *Eurostat*

To avoid duplication with the list of Social Indicators, only the unemployment rate and labour force participation rate have been retained in the list of key MIP indicators as indicators characterising employment. However, the list of additional MIP indicators also includes several youth and other unemployment indicators.

The unemployment rate in Latvia last exceeded the 10% threshold in 2014 (see Figure 6.37). In 2023, this indicator was above the threshold for EU-27 countries such as Greece and Spain.

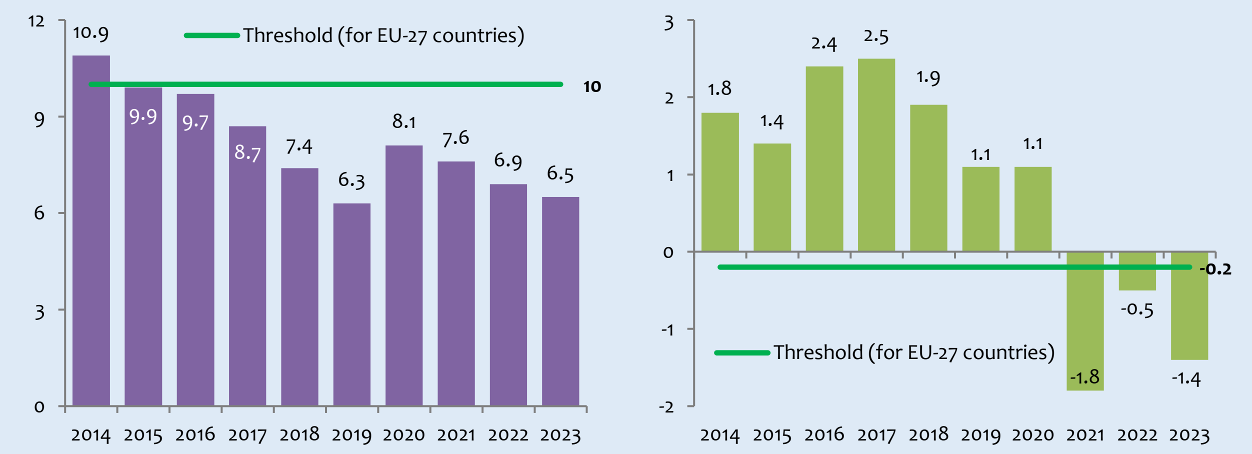
Three-year changes in percentage points in the labour force participation rate in Latvia have not exceeded the threshold since 2012, but in 2021 the threshold was exceeded under the influence of the COVID-19 crisis. In 2022, the decline was not as large, but, in 2023, it continued to worsen and exceeded the threshold for the third consecutive year (see Figure 6.37). In 2023, this indicator did not exceed this threshold in any EU-27 countries.

The EC does not predict surpassed thresholds for Latvia in any indicators characterising employment in 2024 and 2025.

Figure 6.37

Unemployment Rate in Latvia
of the labour force aged 15-74, es per cent

Changes in Labour Force Participation Rate in Latvia
of total population aged 15-64 (3 year change, percentage points)



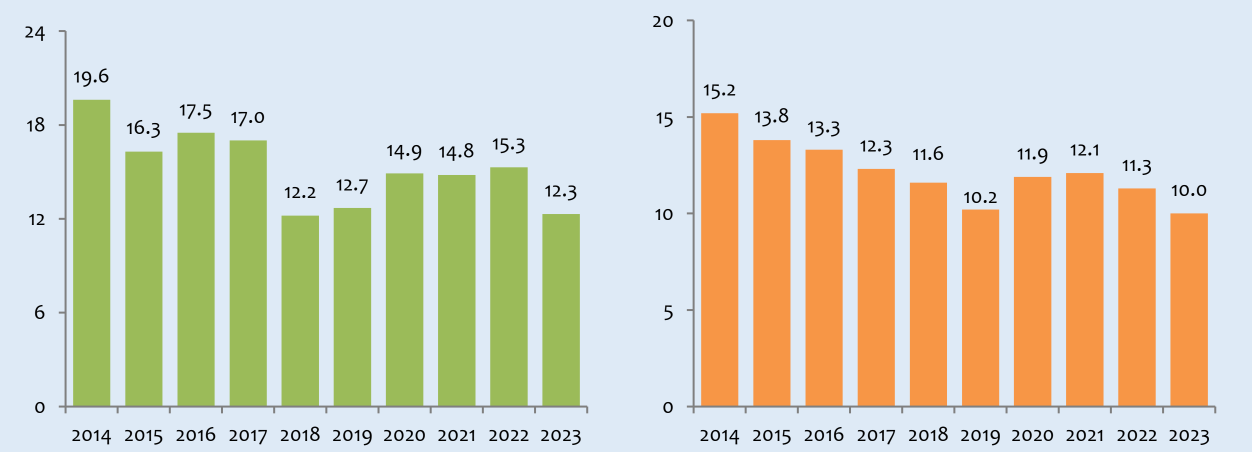
Source: *Eurostat*

The indicators on the list of additional MIP indicators characterise youth unemployment. Youth unemployment among 15-24 year-olds in Latvia decreased to 12.3% in 2023 (see Figure 6.38). The share of young people aged 15-29 who were not in employment, education or training in Latvia fell to 10% in 2023, 1.2 percentage points below the EU-27 average.

Figure 6.38

Youth Unemployment Rate in Latvia
of the economically active population aged 15-24
(as per cent)

Young People not in Employment, Education or Training in Latvia
as per cent of young people aged 15-29



Source: *Eurostat*

6.9. LATVIA IN INTERNATIONAL RATINGS

INDICES

The indices created by different international organisations characterise Latvia as a country, which carries out many reforms to improve its competitiveness improving the business environment, human resources, ICT infrastructure and other areas, at the same time ensuring also free press and not endangering other countries of the world in a military way.

The indices below have been arranged starting from the highest place reached (see Figure 6.39), but their descriptions are broken down into main thematic groups. The most recent year of publication is indicated for each index, and the description indicates by how many places Latvia has improved or worsened its position compared to the index's previous publication.

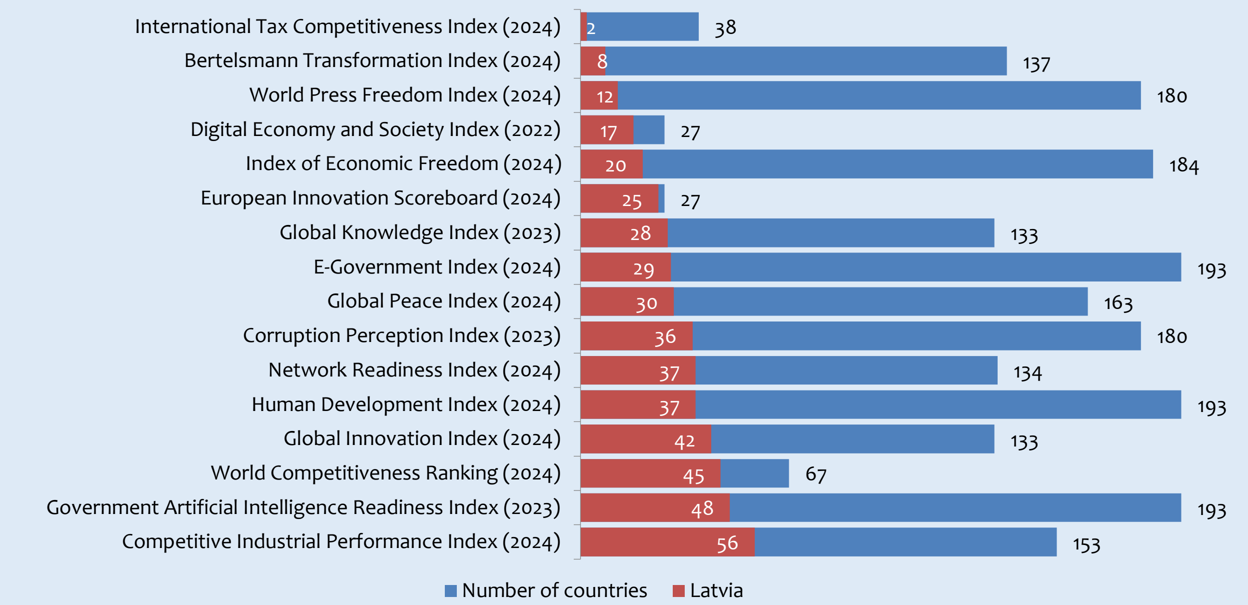
Comprehensive indices

In the *World Competitiveness Ranking 2024* published annually by the International Institute for Management Development (IMD), Latvia was ranked 45th (Estonia – 33rd, Lithuania – 30th) among 67 countries of the world moving 6 positions up compared to 2023. Improvements were reported in a number of areas such as international trade, business legislation, business efficiency management practices, attitudes and values, as well as basic infrastructure and technological infrastructure. Meanwhile, the economic performance was significantly impaired by the price indicator based on the result of 2023, when the consumer price index had peaked. At the same time, it is noted that the foreign investment level remains high relative to GDP and that skilled labour is a factor in the attractiveness of the economy.

In the *Human Development Index* created by the UN Development Programme in 2024, which summarises the data of 2022 and includes life expectancy, literacy, education level, GDP per capita and other indicators, Latvia was ranked 37th (Estonia – 31st, Lithuania – 37th) among 193 countries, where its place moved two positions up compared to the Human Development Index 2022.

Figure 6.39

Latvia's Position in the Most Popular International Ratings in 2024
position according to the year of the latest publication; number of countries in the index



Sources: International Tax Competitiveness Index 2024, Tax Foundation; Bertelsmann Stiftung's Transformation Index 2024, Bertelsmann Stiftung; 2024 World Press Freedom Index, Reporters Without Borders; Digital Economy and Society Index, European Commission; Index of Economic Freedom 2024, The Heritage Foundation; European Innovation Scoreboard 2024, European Commission; Global Knowledge Index 2023, United Nations Development Programme; United Nations E-Government Survey 2024, United Nations; Global Peace Index 2024, Institute for Economics and Peace; Corruption Perceptions Index 2023, Transparency International; The Network Readiness Index 2024: Benchmarking the Future of the Network Economy, Portulans Institute; Human Development Report 2023/2024, United Nations Development Programme; The Global Innovation Index 2024: Unlocking the Promise of Social Entrepreneurship, World Intellectual Property Organization; World Competitiveness Ranking 2024, International Institute for Management Development; Government Artificial Intelligence Readiness Index 2023, Oxford Insights, International Development Research Centre; Competitive Industrial Performance Index 2024, United Nations Industrial Development Organization.

Indices characterising institutional environment

In the *Transformation Index 2024* created by *Bertelsmann Stiftung*, which evaluates the quality of democracy, market economy and political governance, Latvia is placed 8^{th} among 137 countries of the world (Estonia – 1^{st}, Lithuania – 3^{rd}) having worsened its performance by one position compared to 2022.

In the *Corruption Perceptions Index 2023* created by the international anti-corruption organisation *Transparency International*, Latvia was ranked 39^{th} (Estonia – 14^{th}, Lithuania – 33^{rd}) among 180 countries of the world moving three positions up compared to 2022.

In the *2024 World Press Freedom Index* created by the international press and freedom of expression organisation *Reporters Without Borders*, Latvia was ranked 12^{th} (Estonia – 6^{th}, Lithuania – 13^{th}) among 180 countries of the world having improved its rank by four positions compared to 2023.

In the *Global Peace Index 2024* created by the Institute for Economics and Peace, Latvia was ranked 30^{th} (Estonia – 24^{th}, Lithuania – 31^{st}) among 163 countries of the world having moved three positions down compared to 2023 as expenditure on social security and military needs increased.

Indices characterising ICT development

In the *E-Government Survey 2024* created by the UN Department of Economic and Social Affairs, which analyses the progress of using e-government, Latvia was ranked 29^{th} (Estonia – 2^{nd}, Lithuania – 21^{st}) among 193 countries of the world keeping its position compared to 2022.

In the *Government Artificial Intelligence Readiness Index 2023* by *Oxford Insights* and the International Development Research Centre, which analyses government's artificial intelligence implementation strategies, technological opportunities and data quality, Latvia was ranked 48^{th} (Estonia – 17^{th}, Lithuania – 35^{th}) among 193 countries moving 2 positions down compared to 2022.

In the *Network Readiness Index 2024* created by the *Portulans Institute*, which analyses digital transformation by four pillars (technology development, human capital, governance, economic and social effects), Latvia was ranked 37^{th} (Estonia – 18^{th}, Lithuania – 31^{st}) among 133 countries moving 2 positions up compared to 2023.

In the *Digital Economy and Society Index (DESI) 2022* created by the EC, Latvia is 17^{th} (Estonia – 9^{th}, Lithuania – 14^{th}) among EU-27 countries. Since 2021, the DESI index has been structured into four key areas: human capital, connectivity, integration of digital technology and digital public services. Since 2023, countries' overall results are no longer aggregated in a single index, so it is no longer possible to determine countries' positions. Latvia performs above the EU-27 average in indicators such as the share of internet users in the total population (aged 16-74), the share of ICT graduates in the total graduates, the share of fixed broadband internet connections in all internet connections (with a speed at least 100 Mbps), the share of the population using a mobile broadband connection, the share of 5G SIM card holders in the total population, and the share of businesses analysing data, the share of e-government users among all internet users, the range of digital services offered to both citizens and businesses, the use of data held by public administration institutions for initial form filling, transparency of service provision, development and personal data, provision of online user support, mobile friendliness, access to e-health data.

Indices characterising business environment

In the *International Tax Competitiveness Index 2024* published annually by the US Think Tank *Tax Foundation*, Latvia was ranked 2^{nd} (Estonia – 1^{st}, Lithuania – 5^{th}) among 38 OECD countries of the world, retaining the second position since 2020. The International Tax Competitiveness Index includes more than 40 tax policy variables measuring not only the size of tax rates, but also how taxes are structured. The index looks at national corporate taxes, personal income taxes, consumer taxes, property taxes and attitudes toward foreign profits. Latvia is noted in the index report as the country that has adopted the highest-ranked corporate income tax system and has a relatively efficient system for taxing labour income. A version (*2023 European Tax Policy Scorecard*) was created for this index, including 32 European countries (27 EU countries and Switzerland, Iceland, the United Kingdom, Norway and Türkiye). Latvia is placed 5^{th} among the European countries (Estonia – 1^{st}, Lithuania – 10^{th}) showing the best performance in the corporate income tax system.

In the *2024 Index of Economic Freedom* created by the *Heritage Foundation*, which consists of four pillars characterising rule of law, government size, regulatory efficiency and open market, Latvia was ranked 20^{th} as mostly free economy (Estonia – 8^{th} as mostly free economy, Lithuania – 15^{th} as mostly free economy) among 184 countries moving 3 positions down compared to 2023.

In the *Competitive Industrial Performance Index 2024* created by the UN Industrial Development Organization, which is based on the data of 2022 and analyses the ability of industrial enterprises of countries to produce and export competitively by adapting to change, Latvia was placed 56th (Estonia – 49th place, Lithuania – 39th) among 153 countries of the world, improving its place by one position compared to the index of 2023.

Indices characterising innovation environment

In the *Global Innovation Index 2024* created by the World Intellectual Property Organisation, Latvia was ranked 42nd (Estonia – 16th, Lithuania – 35th) among 133 countries of the world moving five positions down compared to 2023. Highlighted Latvia's strengths are: tertiary enrolment with secondary education, number of foreign students, ICT use, share of firms offering formal training, share of females employed with advanced degrees, number of ISO 9001 certificates, cultural and creative services exports, number of national feature films, creative industry goods exports, number of mobile apps created.

In the *European Innovation Scoreboard 2024* created by the EC, Latvia, like a year ago, is placed 25th among EU-27 (Estonia – 11th place, Lithuania – 18th place) and is included in the group of moderate innovators. The report notes that Latvia's relative strengths are population with tertiary education, trademark applications, and public-private co-publications.

In the *Global Knowledge Index 2023* created by the UN Development Programme, which assesses the performance of countries in the development of the knowledge economy, technology, education and innovation, Latvia was placed 28th (Estonia – 11th, Lithuania – 32nd) among 133 countries of the world improving its performance by three positions compared to 2021. Latvia scores highly on the following indicators: the share of the workforce enrolled in short-cycle tertiary education programmes, mobile broadband internet traffic per connection, adult literacy rates, the ratio of teachers to pupils in basic education, the share of the population with basic ICT skills.

CREDIT RATINGS

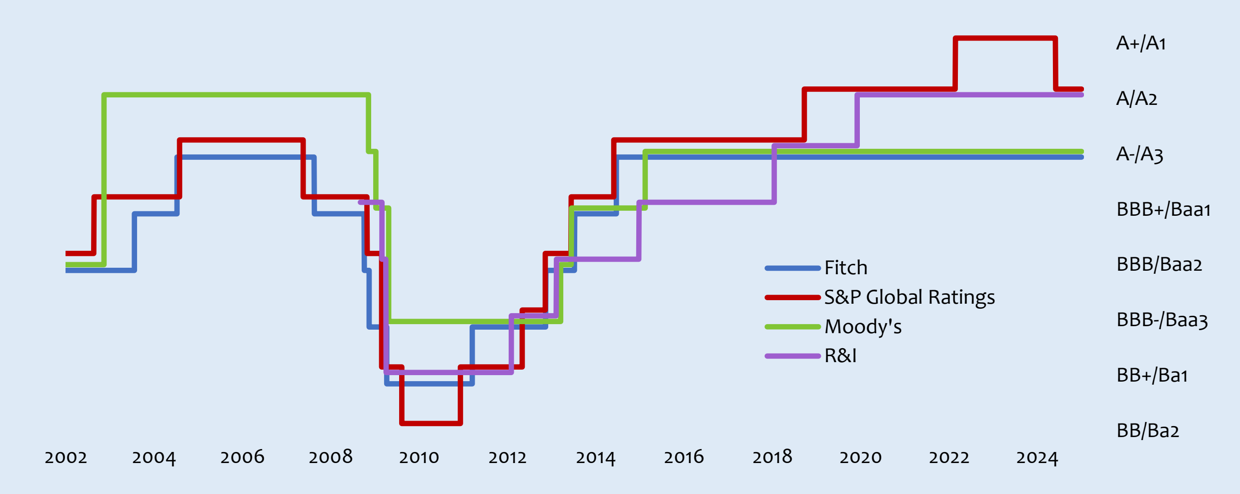
The credit rating of a country is the evaluation of its creditworthiness, which is an essential indicator for potential creditors and investors. The higher it is, the more beneficial the terms of borrowing financial resources are making it possible to reduce service costs of the public debt. The credit rating reflects the condition of the economy and governance of a country.

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

According to the assessment of credit rating agencies, Latvia holds a stable position in group A of the credit rating, which is evaluated as low risk class.

Figure 6.40

Credit Ratings for Latvia for Long-Term Liabilities



Avots: Valsts kase

The international rating agency *S&P Global Ratings* has long had Latvia's credit rating in the high A category. Between February 2020 and June 2024, Latvia's credit rating was A+, but it is currently set at the slightly lower A level with a positive outlook (see Figure 6.40). The Agency's decision was based on the fact that Latvia's medium-term fiscal performance, economic growth and international competitiveness have so far been resilient to the indirect impact of Russia's aggression against Ukraine, but that this improvement may be delayed by increased spending on priority areas such as internal security and defence. A stable political situation and membership in the euro area, as well as a moderate level of public debt keep the credit rating at A level.

Other credit rating agencies have not changed their assessments of Latvia's credit rating since 2020, and only *Fitch Ratings* has changed its credit rating future outlook by increasing credit rating future outlook from stable to positive on 28 July 2023, justifying this by Latvia's relative resilience to external shocks, exceeding its pre-pandemic GDP level. The credit rating agency pointed out that Latvia has managed to free itself relatively easily from dependence on Russia in energy imports. However, on 15 November 2024, *Fitch Ratings* changed the outlook from positive to stable again, as Latvia's economic growth will be slower than previously estimated. It will continue to be influenced by the geopolitical situation, leading to higher budget deficit and a gradual increase in the general government debt-to-GDP ratio.

The credit rating of Baltic countries is determined by the following international rating agencies: *Moody's Investors Service*, *Fitch Ratings* and *S&P Global Ratings*. Estonia has the highest credit rating among the Baltic countries, but credit ratings of Latvia and Lithuania are similar.

Table 6.7

Credit Ratings of the Baltic Countries for Long-Term Liabilities in 2024

	Moody's Investors Service	*S&P Global Ratings*	*Fitch Ratings*
Estonia	A1/Stable	A+/Stable	A+/Stable
Lithuania	A2/Stable	A/Stable	A/Stable
Latvia	A3/Stable	A/Stable	A-/Stable

Sources: *Moody's Investors Service, S&P Global Ratings, Fitch Ratings*

The credit rating of Estonia is one to two levels higher than the credit rating of Latvia and Lithuania. On 31 May 2024, *S&P Global Ratings* downgraded Estonia's credit rating from AA- to A+ and changed its outlook from negative to stable, justifying this by the negative impact of the protracted Russian war in Ukraine on the Estonian economy, which weakens the country's financial position, economic growth, international competitiveness and export performance. The agency estimates that Estonia will resume economic growth in 2025. In 2024, *Moody's* and *Fitch Ratings* kept the credit rating of Estonia at the existing level and kept the same future outlook.

Lithuanian credit ratings are lower than Estonian credit ratings, but future outlooks are similar. On 31 May 2024, *S&P Global Ratings* downgraded Lithuania's credit rating from A+ to A and changed its outlook from negative to stable, justifying this by the negative impact of the protracted Russian war in Ukraine on the Lithuanian economy. Geopolitical risks continue to negatively affect foreign direct investment (FDI) inflows to the country, which will hinder the return of Lithuania's economic growth rate to pre-pandemic levels. In 2024, *Moody's* and *Fitch Ratings* kept the credit rating of Lithuania and their future outlooks without changes.

6.10. OECD PRODUCT MARKET REGULATION

In 2000, the OECD published a document[1] on methodologies and indicators for analysing product market regulation with the aim of comparing the situation in the field of product market regulation in OECD countries. Since then, the OECD has carried out an assessment of product market regulation in OECD countries every five years.

Scientific evidence shows that competitive product markets can boost productivity, employment and living standards. The OECD Product Market Regulation indicators measure each OECD country's regulatory framework against internationally recognised best practice. OECD Product Market Regulation indicators show the distortions of competition that can result from barriers to entry and government involvement in economic processes.

1 Nicoletti, G., Scarpetta S., Boylaud O. (2000) "Summary indicators of product market regulation with an extension to employment protection legislation", OECD

Figure 6.41

OECD Product Market Regulation Methodology Framework

Distortions induced by state involvement			Barriers to domestic and foreign entry		
Distortions induced by public ownership	Involvement in business operations	Regulations impact evaluation	Administrative and regulatory burden	Barriers in service and network sectors	Barriers to trade and investment
• Quality and scope of public ownership • Governance of commercial state-owned enterprises	• Retail price controls and regulation • Involvement in business operations in network sectors • Involvement in business operations in services sectors • Public procurement	• Assessment of impact on competition • Interaction with stakeholders	• Administrative requirements for limited liability companies and privately owned companies • Communication and simplification of administrative and regulatory burden	• Barriers to entry in services sectors • Barriers to entry in network sectors	• Barriers to foreign direct investments • Barriers to trade facilitation • Tariff barriers

Network sectors

Quality and scope of public ownership

Energy		Transport				E-communications	
Electricity	Natural gas	Air	Rail	Road	Water	Fixed	Mobile
Regulation (entry, vertical integration, retail prices)		Regulation (entry, retail prices, foreign entry)	Regulation (entry, vertical integration)	Regulation (entry, retail prices, foreign entry)	Regulation (entry, retail prices, vertical integration, foreign entry)	Regulation (entry, retail prices)	

Professional services

Lawyers	Notaries	Accountants	Architects	Civil engineers	Real estate agents

- Entry regulation
- Conduct regulation

Retail

Retail distribution	Retail sale of medicines
• Registration and licensing • Regulation of shop opening hours • Regulation of retail price • Regulation of online sales	• Quantitative restrictions • Ownership restrictions • Regulation of opening hours • Regulation of sales outside pharmacies • Regulation of retail price

Digital markets

- Assessment of competition challenges
- Merger control
- Fair trading for business users
- Market contestability
- Use and access to data

The OECD Product Market Regulation methodology is based on a questionnaire on the regulatory framework. The questionnaire is completed by each OECD country. The answers to the questionnaire are coded and weighted, allowing OECD experts to calculate product market regulation indicators and compare them across OECD countries. For example, one of the questions in the questionnaire's section on administrative burdens about limited liability company regulation is related to the company registration procedure, i.e. whether the country has a one-stop shop for company registration and whether it is possible to register a company online or in person. This question has multiple answers, i.e. whether or not there is a one-stop shop for company registration, and whether or not there are online registration possibilities. Each answer is coded on a scale from 0 to 6, where 0 means more favourable regulation (more friendly to competition and business) and 6 means stricter regulation (less friendly to competition and business). For example, if the answer is that the country has a one-stop shop for company registration, then this answer is coded with 0. Similarly, the answer is coded with 0 if the company can be registered online. This means that the process of registering a company is convenient, simple and free of administrative burdens.

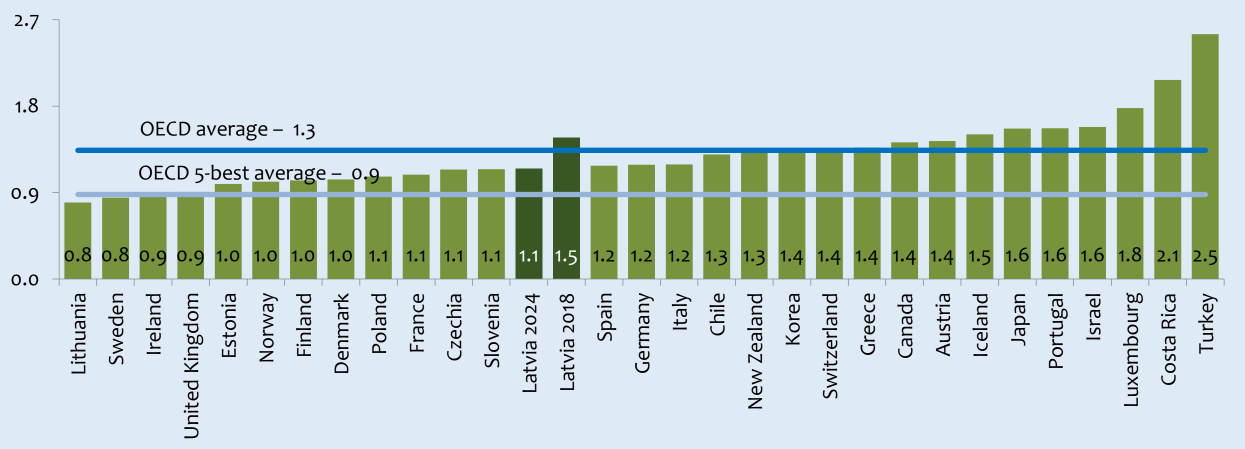
The OECD Product Market Regulation questionnaire is very large and covers a wide variety of questions on regulation in different sectors. Figure 6.41 illustrates the structure of the OECD Product Market Regulation methodology and the areas of the questionnaire. Given the rapidly changing global landscape and the introduction of new technologies and processes, such as digitalisation, the OECD is adapting the questions and methodology of the questionnaire and recalculating the previous results according to the updated methodology to compare progress in the field of product market regulation across the years of the assessment, e.g. to compare 2024 with 2018.

At the beginning of 2023, the OECD distributed an updated Product Market Regulation questionnaire for OECD countries. Given the rapid development of digital markets in OECD countries, the OECD has added a new section on digital markets to the questionnaire of 2023. After receiving a completed questionnaire from all OECD countries, the OECD carried out the necessary calculations and analysis and published the results in June 2024. Figure 6.42 shows the overall OECD Product Market Regulation score for all OECD countries. As can be seen, Latvia's performance in 2024 has improved compared to 2018 and overall product market regulation in Latvia is slightly better than the OECD average but worse than the average of the top five best OECD countries.

Figure 6.42

Economy-wide OECD Product Market Regulation Indicator 2024

The closer to 0, the more favourable the product market regulation is for business and competition



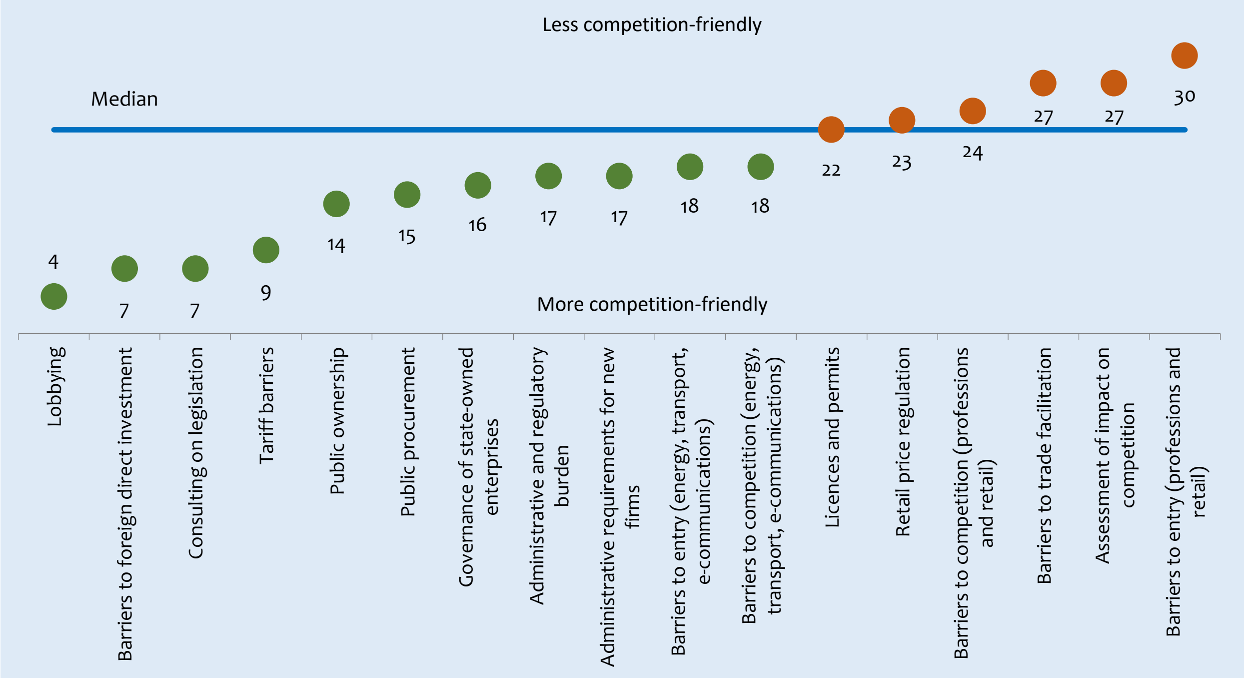
According to the OECD Product Market Regulation data 2024[1], Latvia has the most stringent regulation compared to other EU Member States in some professional services (notaries and lawyers), retail sale of medicines, market entry in service sectors and freight transport by road. The least restrictive regulation is for trade and investment, including foreign direct investment, accounting and real estate agent professions, and the quality and scope of public ownership.

Figure 6.43 and Figure 6.44 show Latvia's position among the 43 countries[2] in the different areas and service sectors of the OECD Product Market Regulation Indicators 2024. Despite a relatively good overall performance (Figure 6.43), there are some areas in Latvia where the regulatory framework could be more competition and business friendly, such as improving mechanisms to assess the impact of new and existing laws and regulations on competition and reducing retail price regulation. Overall, tariff barriers to trade in Latvia are low, but there are barriers to entry in some occupations and retail trade.

[1] OECD Product Market Regulation data are available on the OECD website: https://www.oecd.org/en/topics/product-market-regulation.html.
[2] All 38 OECD countries and OECD candidate countries (Brazil, Croatia, Bulgaria, Indonesia and Peru).

Figure 6.43

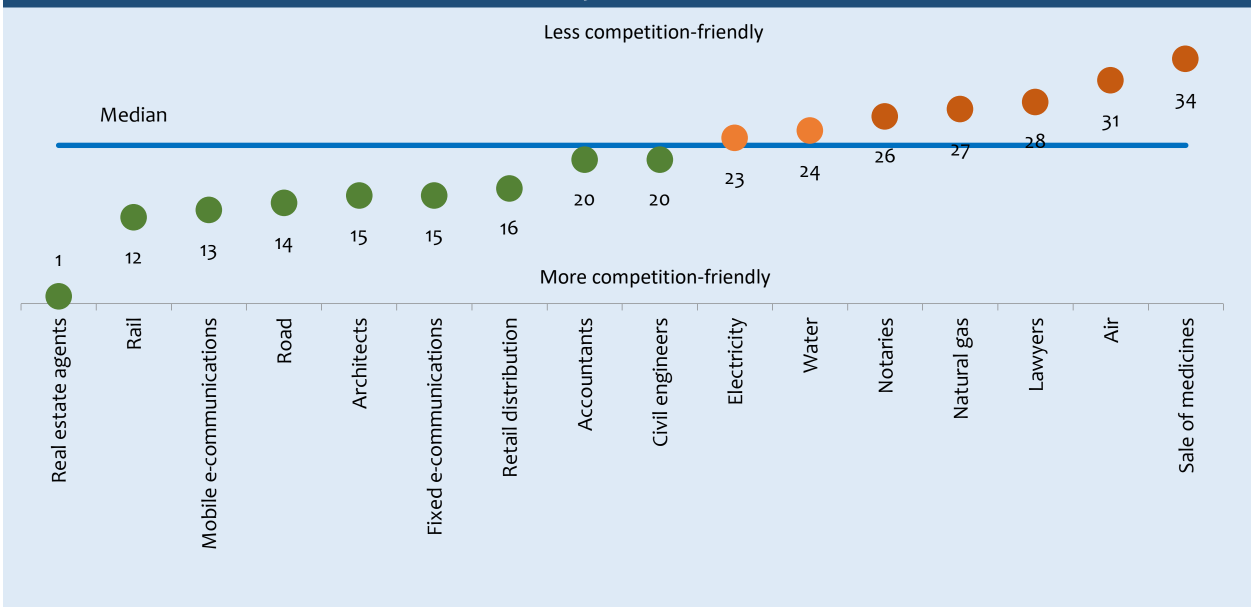
Latvia's Position in Different Areas of the OECD Product Market Regulation Indicators 2024
43 countries



As regards services sectors (Figure 6.44), Latvia could improve regulation by reducing barriers to competition in most services sectors, in particular sale of medicines, in the professions of lawyers and notaries, in air transport and natural gas sectors.

Figure 6.44

Latvia's Position in Different Services Sectors of the OECD Product Market Regulation Indicators 2024
43 countries



Overall, the OECD Product Market Regulation indicators allow for a detailed assessment of restrictive regulation in a given area and, where necessary, for regulatory improvement by initiating amendments to the relevant legislation. It is also possible to compare countries with each other and see their strengths and weaknesses in terms of competition and business-friendly regulation. However, EU Member States are also regulated by directives and regulations adopted at the EU level, so in some areas EU Member States may be more strict or, conversely, more business-friendly than the third countries. It should also be borne in mind that the absence of regulation, or the presence of overly liberal regulation in certain areas and sectors, is not always favourable for the functioning of the market and the interests of all market players. Conversely, sometimes stricter regulation should not necessarily be regarded negatively.

An example is the regulation of various professions, where the need to obtain a permit, licence or certificate is not only an obstacle, on the one hand, but also a guarantee, on the other hand, that the service provider in the profession, such as an accountant, will provide a quality service to the client, because obtaining a licence or certificate could be a guarantee of the quality of the service provided and would mean that the accountant would be a chartered accountant. Against this background, the OECD Product Market Regulation indicators, like all other indices, should be evaluated with a caution.

7. LABOUR MARKET

7.1. EMPLOYMENT AND UNEMPLOYMENT

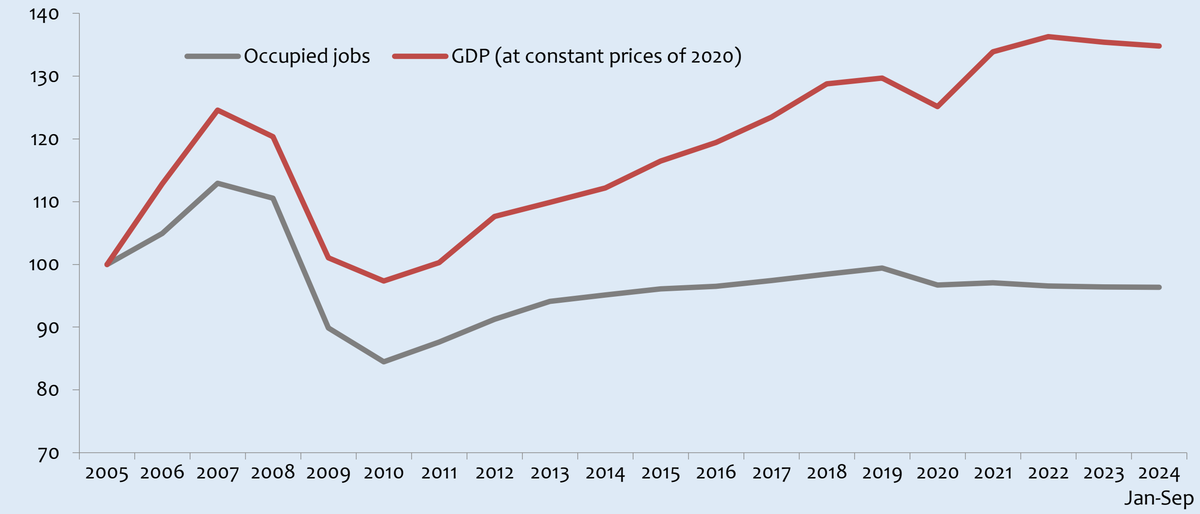
Since 2021, the increase in economic activity has contributed to a rise in employment. However, a slight decrease in employment is observed in Q3 2024, which is at the same time linked to an increase in unemployment. While labour demand has not increased significantly and remains limited, the labour market continues to face serious challenges from labour shortages, demographic changes and a reduction in labour supply. These factors increase the risks of labour shortages and hold back labour market growth.

Employment has increased moderately in recent years, with a slight decline in Q3 2024. Overall demand for the labour force remains limited and there is still a slight decrease in the number of occupied posts. As pressure from the labour supply side increases, both in terms of access to human resources and in terms of remuneration, it is more difficult for employers to create new jobs and attract employees.

Figure 7.1

GDP and Occupied Jobs*

2005 = 100



* From 2021, data of the State Revenue Service are used to calculate occupied jobs, and this has caused a break in time series

In Q1-Q3 2024, the number of employees has decreased by 5.5 thousand or 0.6%, compared to the corresponding period of 2023. In Q1 and Q2 2024, the number of employees remained close to the level observed in the first half of 2023, with a slight downward trend, and in Q3 2023 there was a decrease of 10.8 thousand employees, or 1.2% compared to Q3 2023. The decrease in the number of employed persons in Q3 2024 was largely influenced both by the slowdown of the economic growth rate and factors of the labour market supply side – the decrease of the working-age population, as well as the decline of the total labour supply and the decrease in the inflow of Ukrainian war refugees.

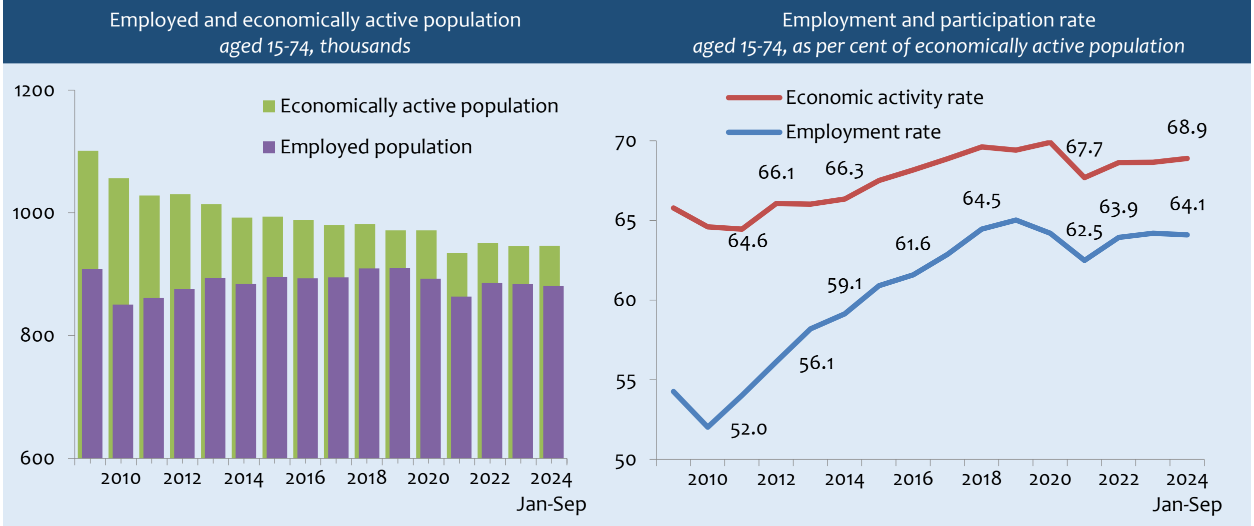
In Q3 2024, the total employment increased to 880.1 thousand people in the age group of 15 to 74. These were 64.2% of the total population aged 15-74 in private households. The employment rate of the population decreased by 0.5 percentage points over the year. At the same time, the unemployment rate in Latvia is still lower than in its neighbours – 4.9 percentage points lower than in Estonia (69.1% in Q3 2024) and 2.5 percentage points lower than in Lithuania (66.7% in Q3 2024).

As labour demand has decreased, the downward trend in unemployment has generally stopped. However, despite this, the unemployment rate remains low and close to the pre-pandemic (2019) rate. The unemployment rate in Q3 2024 was 6.7%, up 0.2 percentage points from Q3 2023 (6.5%). At the same time, the average unemployment rate in Q1-Q3 increased to 7%, up 0.6 percentage points from the corresponding period of 2023. In Q3 2024, the unemployment rate in Latvia was 0.1 percentage points lower than in Lithuania (6.8% in Q3 2024) and 0.7 percentage points lower than in Estonia (7.4% in Q3

2024). Overall, 63 thousand people aged 15-74 were looking for a job in Q3 2024, which is 2.5% or 1.6 thousand more than in Q3 2023.

Figure 7.2

Employment and Economic Activity of the Population



* 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.

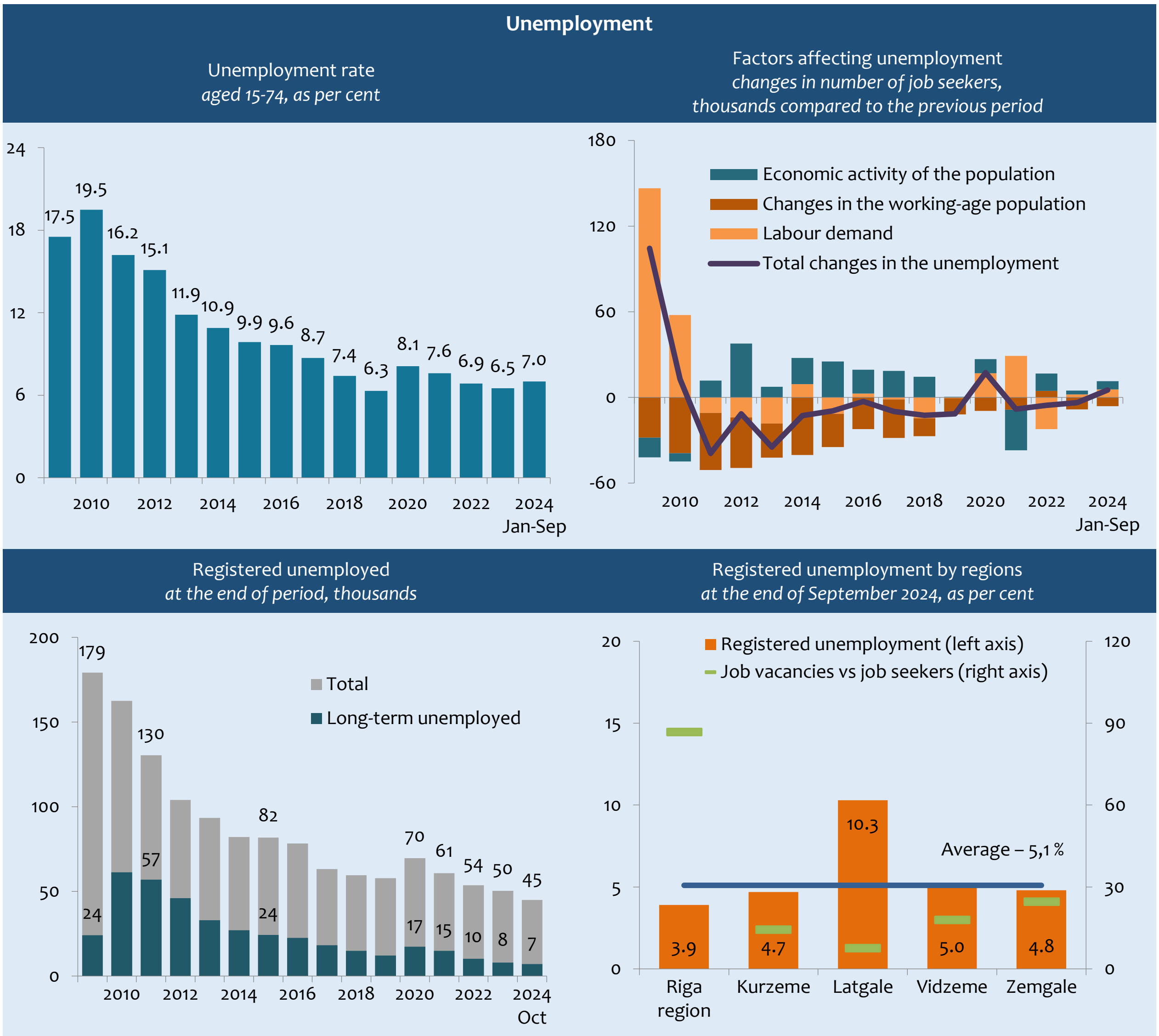
Positive trends are also observed in the dynamics of the long-term unemployed. Both the number of long-term unemployed and their share in the total number of job seekers is gradually decreasing. Between the end of September 2023 and the end of September 2024, the number of registered long-term unemployed decreased by 15.6% or approximately 1.3 thousand, which is a general indication of a more pronounced decrease in labour stock. At the end of September 2024, approximately 7.1 thousand unemployed or about 15.9% of the total number of registered unemployed were unemployed for more than one year.

Despite the decrease in unemployment, there remains a risk that some of the unemployed may have problems finding jobs that match their skills since the complete recovery in the sectors that had most jobs in the previous years might be long, but in sectors where job opportunities are created, skills previously acquired will not necessarily be required. It should also be considered that long-term unemployment can cause structural unemployment risks, namely, the longer this person is unemployed, the greater the risk of losing job skills and abilities, and the more difficult it is to adapt to new labour market requirements.

It should be considered that structural changes in the labour market have accelerated fostering automation of workplaces in labour-intensive industries and thus reducing the demand for low and medium qualification workforce without professional skills and increasing the share of jobs requiring higher qualification, in information and communication services.

Similarly, structural problems are significantly influenced by regional differences in the labour market, which together hinder the recovery of the labour market. Although regional disproportions are gradually converging, the process is still slow. Distinct problems have long been observed in the Latgale region, where the unemployment rate is almost twice as high as the average rate in the country and almost three times higher compared to the Riga region, which, amid the low geographic mobility of the labour force, amplifies the risks of structural unemployment.

Figure 7.3



Supply-side factors are still restricting the labour market considerably. In Q3 2024, compared to Q3 2023, the number of economically active population aged 15-74 decreased by 9.3 thousand – to 943.1 thousand. The decrease in the economically active population has been influenced both by the decrease in the economic activity of the population and by the decline in the number of the population capable of working.

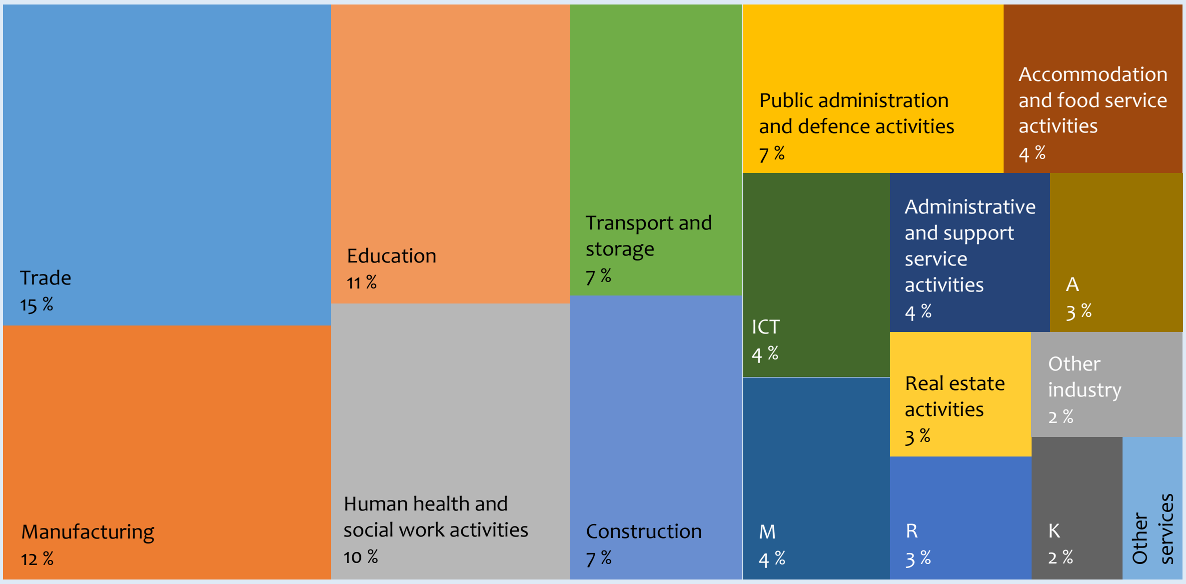
The economic activity rate of the population decreased by 0.3 percentage points to 68.8% in Q3 2024, compared Q3 2023. At the same, in 2024, the number of persons in private households was 10.2 thousand smaller compared to the previous year.

It should be noted that along with the decrease in the inflow of Ukrainian war refugees, this positive effect of the flow on the dynamics of labour supply is gradually waning. It should also be considered that some of the war refugees are returning home, so the negative impact of demographic factors on the dynamics of labour supply could become more pronounced again in the coming years.

Despite the stable population employment indicator, at the end of Q3 2024, the number of occupied posts declined to 885.9 thousand – a reduction of 2.4 thousand posts or by 0.3%, compared to the corresponding period of 2023.

Figure 7.4

Occupied Jobs by Sectors
structure at the end of September 2024, as per cent

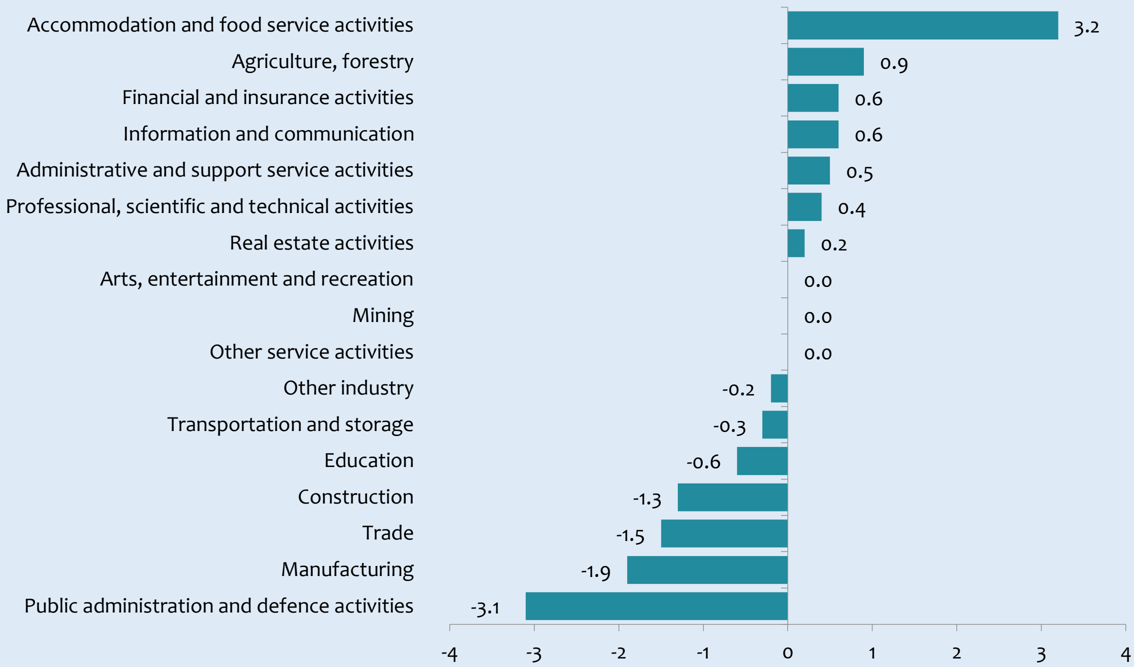


A – Agriculture, forestry and fishing; K – Financial and insurance activities; M – Professional, scientific and technical activities; R – Arts, entertainment and recreation

The most significant decrease in occupied posts was observed in manufacturing and trade – by 3.1 thousand or 2.81% in manufacturing and 1.9 thousand or 1.31% in trade.

Figure 7.5

Changes in the Number of Occupied Jobs in Economic Sectors*
Q3 2024 compared to the corresponding period of the previous year, thousands



* From Q1 2021, data of the State Fevenue Service are used to calculate occupied jobs, and this has caused a break in time series.

At the same time, the most significant increase in occupied posts in Q2 2024 was in human health and social work activities, public administration and defence activities, as well as accommodation and food service activities. Compared to the same quarter in 2023, the number of occupied posts increased by 3.7 thousand or 4.5% and in public administration and defence activities by 0.7 thousand or 1.1%. Despite the gradual recovery of those sectors, the number of occupied posts in them is still lower than it was before the COVID-19 crisis in 2019.

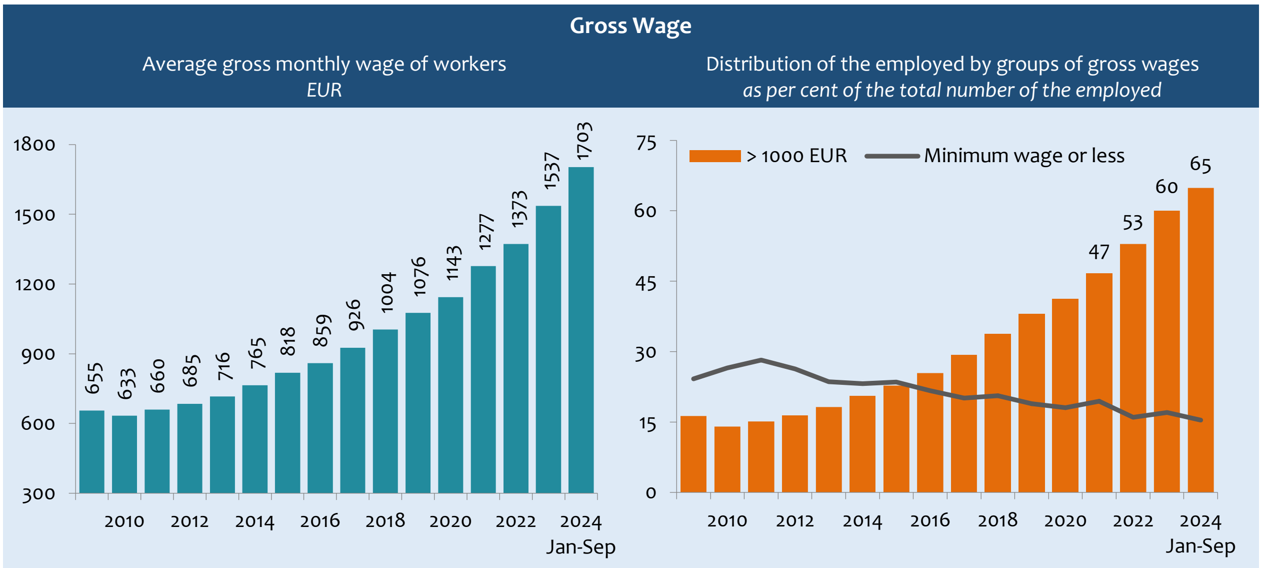
Overall, in the past 10 years (between Q3 2014 and Q3 2024) the total number of occupied posts decreased by 4.9 thousand or 0.5%. The largest increase in jobs was observed in human health and social work activities (by 25.2 thousand), information and communication (by 13.8 thousand) and administrative and support service activities (by 7.0 thousand). Meanwhile, the biggest job cuts were observed in trade (by 11.5 thousand), as well as transportation and storage services (by 11.2 thousand).

7.2. WAGES

The average wages continue to rise at a rapid pace, considering both the increase in the minimum wage and the revised wages in some public sector fields. In Q3 2024, the average annual increase in wages over the year reached 9.9%, while the average gross wage increased to 1,703 euro. It should be noted that over the past three years, the economy has experienced stable growth in average gross wages, with gross wages rising by almost a third. The average annual growth rate over the period was 10.1%.

The increase in average wages in 2024 was significantly affected by an increase in the minimum wage rate by 12.9% – to 700 euro (from 620 euro in 2023), as well as structural changes in labour demand in favour of higher-paid occupations, e.g. occupied posts increased in professionals and associate professionals, while other occupations, with the exception of NBS occupations, saw a decrease in jobs. Wage growth continues largely to be driven by both acute shortage of workers and the inclusion of the inflationary pressures (price increases) of previous periods into wages. An increase in real wages is observed in Latvia. In Q1-Q3 2024, real wages increased by an average of 8.5% compared to the corresponding period of 2023 a year earlier, while in Q3 real wages increased by 8.3%.

Figure 7.6



It should be noted that stable wage growth has persisted in Latvia since the end of 2010, moreover, in the last five years the average annual growth rate of gross wages has been 9.6% on average. A positive pressure on wages keeps coming from the wage convergence process closer to the wage levels of the EU's economically developed countries as well as from the growing shortage of skilled labour – shrinking of the labour market, which makes it necessary for entrepreneurs not only to think more actively about how to attract new professionals but also how to keep existing ones, including through a review of wage rates.

Wage growth in previous years partly ensured labour productivity growth – real labour productivity per employee in 2023 was approximately 32.4% higher than in 2010. At the same time, the average wage growth in previous years has significantly exceeded the increase in labour productivity, thus negatively impacting the competitiveness of Latvian enterprises. Between 2010 and 2023, real wages have grown by an average of 6% per year, while real labour productivity has increased only by an average of 2.3% per year.

In the first three quarters of 2024, wages have increased in both the private and public sectors. Compared to the corresponding period of 2023, the average gross wage in the public sector increased by 12.3% (to an average of 1758 euro) and by 9.0% in the private sector (to an average of 1684 euro). Comparing Q3 and Q2, the average gross wage increased by an average of about 0.9% for those working in the public sector and by 2.4% for those working in the private sector.

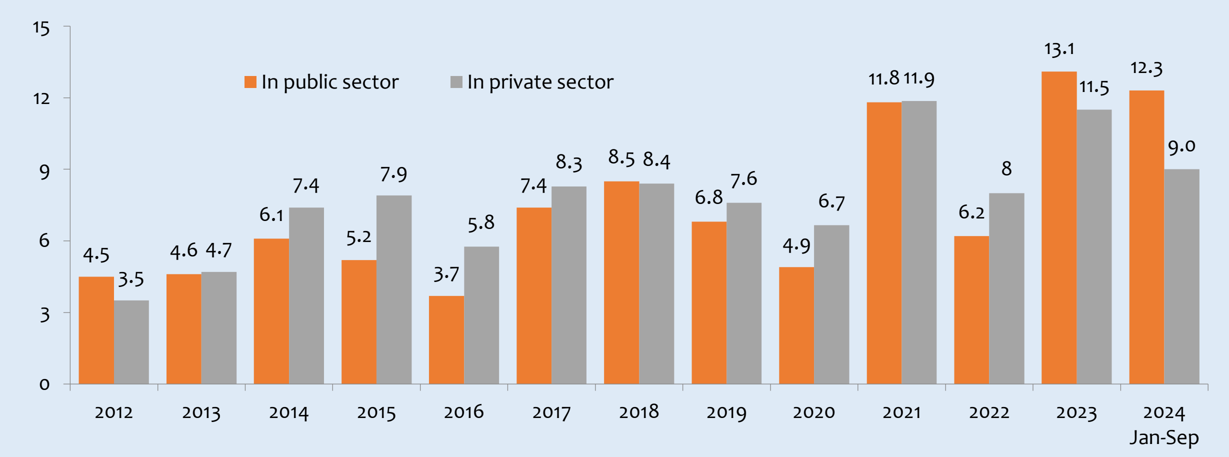
Since 2010, wages have increased in both the private and public sectors. At the same time, wage growth in the public sector has been on average more rapid in the last two years, partially affected by a more significant increase in labour demand – in 2011-2024 (three quarters), the number of occupied posts grew by 15.3% in the private sector and only by 0.4% in the public sector.

Along with the average wage increase, positive trends are also observed in the remuneration structure – on the one hand, the proportion of recipients of the minimum wage continues to decrease, but on the other hand, the share of employees who receive a wage above 1,000 euro per month increases. In the three quarters of 2024, more than half (about 65%) of all employees had gross remuneration exceeding 1,000 euro; meanwhile the share of employees receiving a minimal wage or less has reduced to 15.4%.

Between 2010 and September 2024 the share of employed receiving a minimal wage or less has reduced by approximately 11 percentage points, while the share of employed receiving more than 1000 euro has increased by almost 51 percentage points during this period.

Figure 7.7

Wages in the Private and Public Sector
changes as per cent compared to the previous year

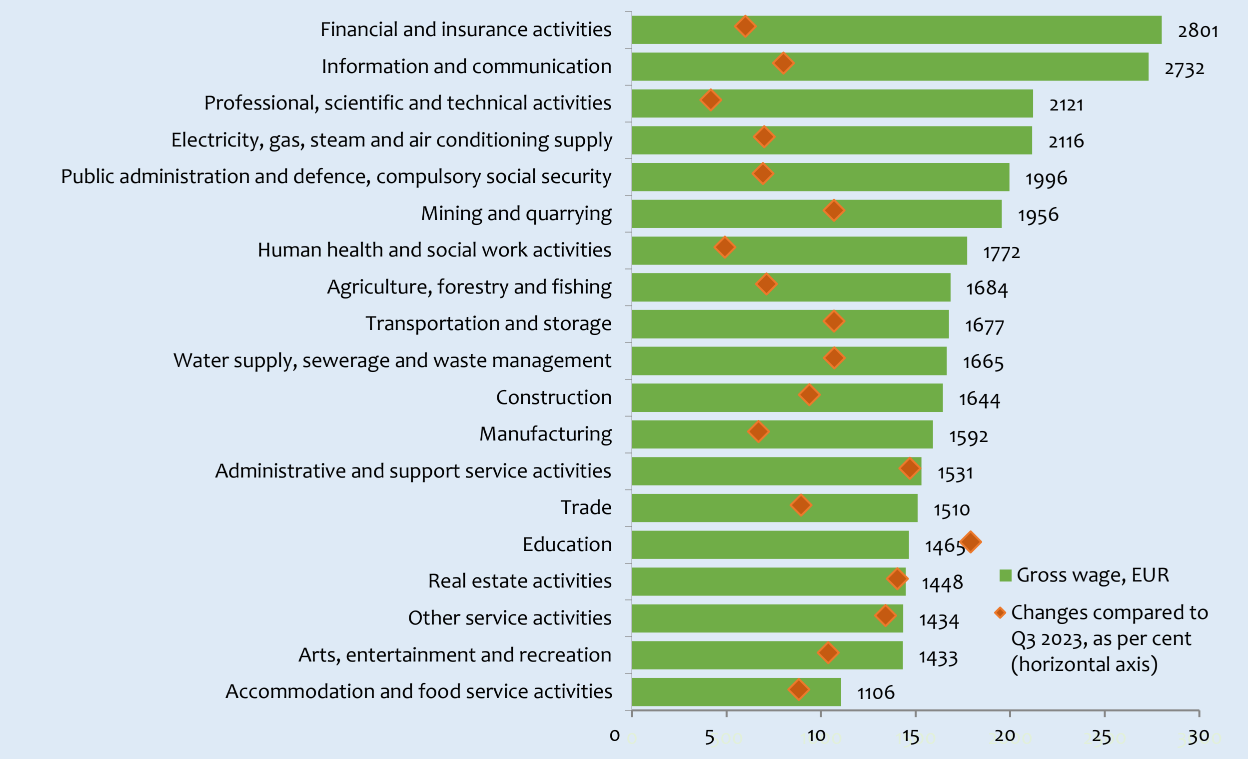


In Q3 2024, an increase in wages was observed in all sectors of the economy. The most significant annual wage increase during the year (in Q3 2024 compared to Q3 2023) was in the education sector – by 19.2%. Wage increases were also recorded in administrative and support service activities (15.9%), real estate activities (15.2%), other service activities (14.4%) and transportation and storage (11.6%).

The highest wage level in Q3 2024 remained in financial and insurance activities (monthly average gross wage 2,801 euro), information and communication (2,732 euro), professional, scientific and technical activities (2,121 euro), energy (2,116 euro), public administration (1,996 euro), mining and quarrying (1,956 euro), human health and social work activities (1,772 euro) and agriculture, forestry and fishery (1,684 euro). The lowest wages for full-time work were paid in accommodation and food service activities – 1,106 euro before tax.

Figure 7.8

Average Gross Monthly Wage in Economic Sectors
Q3 of 2024



7.3. LABOUR MARKET FORECASTS

The labour market forecasts until 2030 have been developed in accordance with the medium-term economic growth forecasts (see Chapter 5).

The slowdown of economic growth in 2024 has overall impacted the labour market situation. According to the provisional MoE estimates, the number of employees in 2024 will decrease by 0.4% compared to 2023, or by 900 employees on average, so that in 2024 they could represent 880.5 thousand or 64.2% of the population aged 15-74. The most significant decrease in employment in 2024 was observed in construction (according to MoE estimates – 7.2 thousand less than in 2023), education (7.1 thousand less) and manufacturing (6.2 thousand less). The most significant increase in labour demand was noted in human health and social work activities (an increase by 8.9 thousand).

Alongside weaker demand, supply factors also continued to influence the labour market in 2024. As inflows of Ukrainian war refugees diminished, so did the positive impact of this flow on the labour supply side. According to MoE estimates, the population aged 15-74 has declined by 5.7 thousand or 0.4% in 2024. At the same time, given both wage growth and labour shortages in the labour market in general, economic activity continued to increase in 2024, maintaining the number of economically active population (labour supply) close to the previous year's level.

Considering both labour demand and supply trends, according to MoE's provisional estimates, the average unemployment rate in 2024 may be close to 6.9%.

Overall, in the coming years, available labour resources will continue to diminish, and the issue of labour shortages will become more pronounced. The decline in labour stocks will be largely determined by the decrease in the working-age population, as well as the ageing of the existing labour force and their exit from the labour market.

LABOUR MARKET DEVELOPMENTS IN 2025

Given the projected increase in economic activity in 2025, overall labour market activity is also expected to generally increase. It should be noted that the change of economic cycles in the labour market was reflected with an average of 2-3 quarter shift, so the slowdown of economic rates in 2024 could partly affect the dynamics of labour demand also in Q1 2025, therefore a more noticeable return of activities could be observed starting from Q2 2025. According to MoE forecasts, the increase in employment in 2025, compared to 2024, could be 0.3%, while the unemployment rate could decrease to 6.4%. The total number of employees in 2024 could get close to 883.1 thousand or approximately 64.9% of the population aged 15-74 (0.5 percentage points higher than in 2024), but the number of job seekers should decrease to an average of 60 thousand per year.

In 2025, labour market supply factors will continue to drive the situation in the labour market. Given the demographic processes (in 2025, the population aged 15-74 could decrease by approximately 0.8% or 11 thousand, compared to 2024), the total economically active population count in 2025 could decrease to an average of 943 thousand or 0.2%, compared to 2024. At the same time, labour supply will be positively affected by the increase in economic activity of the population – by 0.4 percentage points (up to 69.3%), compared to 2024 driven by both the overall tense situation concerning the sufficiency of the labour force in the labour market and by the increase in labour remuneration (according to MoE forecasts, gross wages could increase by 7.8% in 2025 compared to 2024).

Overall, in 2025, the most significant increase in labour demand is expected in business services, in particular professional, scientific and technical activities, as well as ICT services. Employment could also resume growth in construction, which will be affected by the construction of the Rail Baltica main line, as well as other infrastructure facilities of national importance. The increase in employment could also be observed in accommodation and food service activities, as well as in public services.

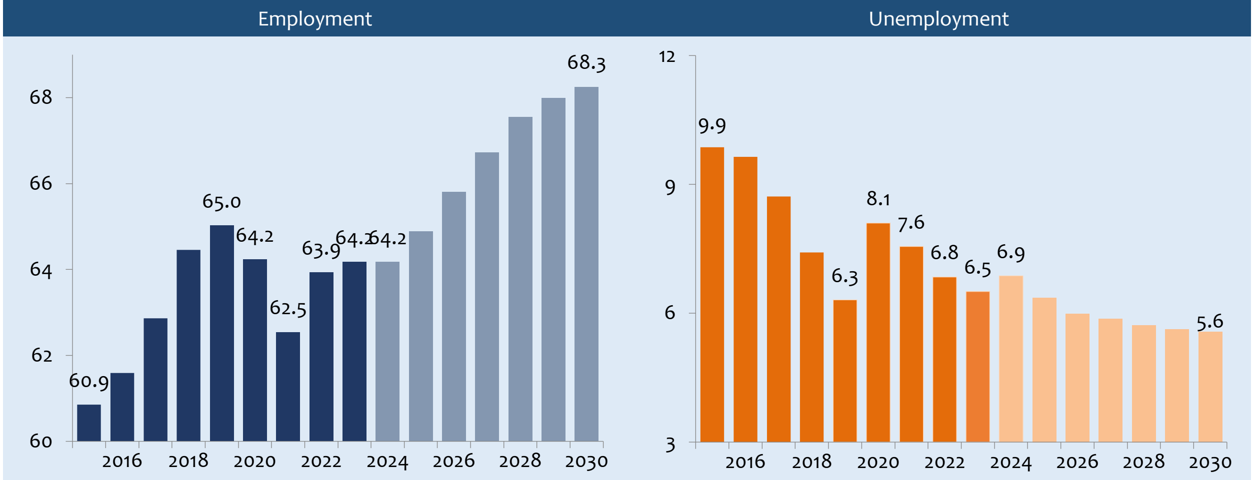
LABOUR MARKET FORECASTS FOR 2026-2030

From 2026 to 2030, economic growth will further be based on the increase in labour productivity, therefore the total labour demand and increase in the number of employed persons will be slower than economic growth. Until 2030, the number of employed persons is expected to grow by an average of 0.5% per year and the total labour demand in 2030 could be close to 903 thousand.

Although employment could grow slowly, the population employment rate (the share of the employed in the total population of the relevant age) will keep growing stably. From 2026 to 2030, the employment rate in age cohort 15-74 could grow by an average of 0.5 percentage points per year and could reach an average of 68.3% in 2030.

Figure 7.9

Employment and Unemployment Rate
as per cent



The decline in the population will become slower in the medium term, but the ageing of society will continue and working age population will reduce, which will also affect the overall labour supply. At the same time, the negative impact of demographic trends on labour supply will be compensated by the increase in the participation of the population in the labour market. The inflow of Ukrainian war refugees into Latvia has also had a positive impact on the working population, which has also increased the potential labour supply in the labour market. However, such an effect is limited in the long term because part of the war refugees gradually returns home.

According to demographic forecasts of the Ministry of Economics (2024), the Latvian population might decrease to 1.80 million or by approximately 74 thousand by 2030, compared to the beginning of 2024. The most significant reduction will be observed among people of working age. The population aged 15-64 is expected to fall by approximately 67 thousand or 5.7% by 2030, which will have a negative impact on the overall labour supply.

In the medium term, economic growth and increasing labour shortages will contribute to increasing participation of the population in the labour market, thus opening wider possibilities to many groups of inactive population (housekeepers, students, retirement-age people, etc.). Wage increases will also play an essential role in promoting workforce participation. Considering this, by 2030, the participation rate for the 15-74 age group could increase to 72.3%. Overall, the labour supply could increase to 957 thousand by 2030 (11.2 thousand or 1.2% higher than in 2024).

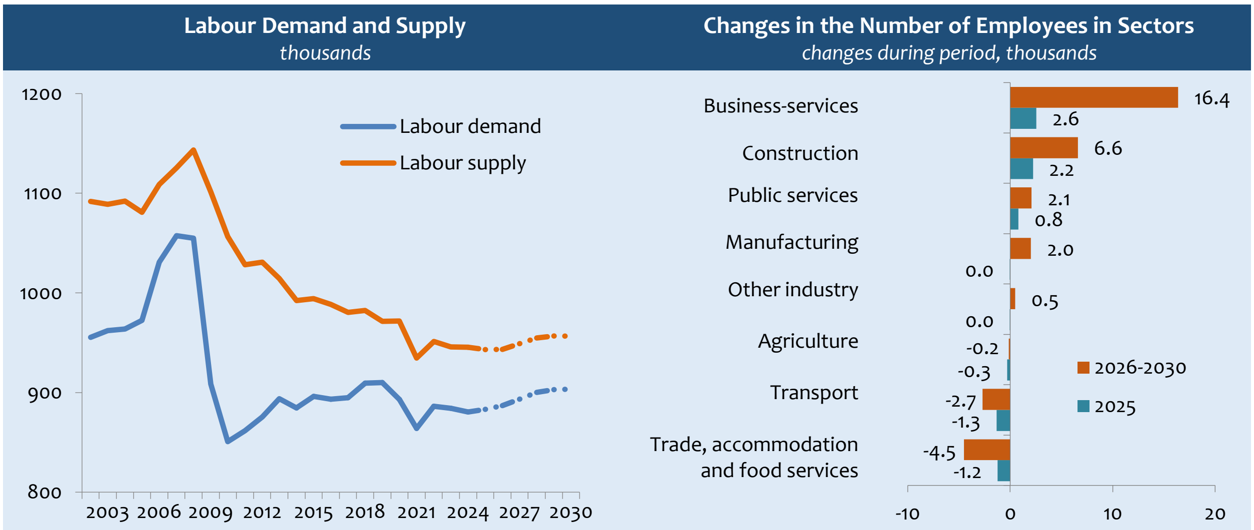
Given the trend towards an ageing workforce, the main job opportunities in the coming years will come from replacement demand. According to the MoE projections, about 56% of all vacancies between 2025 and 2030 could be due to replacement demand.

Considering the demographic trends, unemployment will generally keep shrinking until 2030 and will be close to the natural level (within 6%). The unemployment rate is expected to reduce to 5.6% by 2030. The highest unemployment risks are expected among the population with a low level of education and without professional skills/professional qualifications.

From 2025 to 2030, labour demand is expected to further restructure in favour of business services. The most significant increase in labour demand until 2030 is expected in the commercial services sector, in information and communication and professional, scientific and technical activities. Overall, the number of employed in commercial services sector might increase by 19 thousand by 2030, compared to 2024.

Considering the implementation of Rail Baltica and other large infrastructure projects, labour demand will remain high in the construction sector in the medium term. In construction, the highest level of labour demand is expected to be reached around 2027, with the most active construction phase of Rail Baltica. Overall, the number of employed in construction might increase by about 8.8 thousand by 2030, compared to 2024.

Figure 7.10



In the second half of 2025, labour demand is also expected to gradually pick up in manufacturing. However, the employment increase in manufacturing and other traditional tradable sectors will remain sluggish, as the growth of those sectors will mainly depend on the productivity increase, which is crucial for ensuring competitiveness. Overall, employment in manufacturing might increase by approximately 2 thousand by 2030, compared to 2024.

A slight increase in labour demand in the medium-term is also expected in other industrial sectors – mining and quarrying; electricity, gas, steam and air conditioning supply; water supply, sewerage, waste management and remediation activities, due to both the increase in demand for raw materials in the construction sector and the transformation of energy sectors and the implementation of the EU Green Deal. Overall, employment in other industrial sectors could increase by almost 500 thousand employees from 2025 to 2030.

The reduction in employment could be seen also in agriculture and logging largely due to the continued effectivization of the sectors. In the period from 2026 to 2030, employment in agriculture and logging could decline by 500 thousand employees.

Given the geopolitical situation and the reorientation of logistics routes, employment in transport services is likely to continue to decline in the medium term. Between 2026 and 2030, the number of people employed in transport services is expected to decrease by 4 thousand.

Along with job automation trends, employment could continue to decline in the retail segment in the coming years along with the broader entry of self-service cash register systems as well as other automated trading solutions in the sector. Employment in trade is expected to increase by 5.7 thousand employees from 2025 to 2030.

PART II. ECONOMIC POLICY PRIORITIES

8. HUMAN CAPITAL DEVELOPMENT

8.1. MANAGEMENT OF HUMAN CAPITAL DEVELOPMENT MATTERS

The Latvian labour market has been facing challenges for a long time, influenced by negative demographic trends and an ageing workforce, the concentration of jobs in the middle and low productivity levels, as well as the insufficient supply of skills (for information on labour market projections see chapter 7.3).

Labour market mismatches are also aggravated by pronounced regional disparities. New jobs mainly appear in more economically active regions and larger cities, while high unemployment persists in less developed regions, particularly Latgale. The regional disparities impede a balanced development of the labour market. Meanwhile, the regional equalisation of the labour market is hampered by the low regional mobility of the labour force, i.e., the ability to rapidly change their place of work and residence. A significant impact on Latvia's sustainable economic growth and global competitiveness can be seen in the shadow of these challenges.

The MoE has developed the *Human Capital Development Action Plan 2024-2027* (hereafter – the Action Plan), with an overarching aim to ensure coordinated management of human capital issues, facilitating the effective integration of the workforce into the future labour market.

The Action Plan sets out five main lines of action, which are imbued with two horizontal components: data and evidence-based decisions, analytics and human capital management:

- STEM education and skills – the measures identified aim to increase employers' participation in human capital development, especially in STEM fields, strengthen quality and governance, improve the financial support system for students, especially in STEM fields, and provide study materials, especially in STEM fields;
- labour market expansion – the measures identified focus on labour mobility and housing affordability, motivation and participation of economically inactive groups in the labour market, labour force ageing trends and healthy working environment;
- attraction of qualified employees – the measures identified are aimed at improving workforce immigration processes and attracting Latvian students studying abroad and foreign students studying in Latvia;
- supply and quality of adult education, skills – the measures identified aim to develop an adult learning culture in society and ensure employee skills development and reskilling;
- support for the entrepreneurial spirit of entrepreneurs – the measures identified focus on making support available to entrepreneurs for reskilling and knowledge capacity building.

In order to foster changes in the labour market providing specialists required for the economy and, thus, contributing to economic growth, an Employment Board was established in 2016 consisting of three ministers (the Minister of Economics, the Minister of Education and Science and the Minister of Welfare). On 6 June 2023, the Cabinet of Ministers approved the *By-laws of the Human Capital Development Council*, supporting the agreement of the three Ministers (the Minister of Economics, the Minister of Education and Science and the Minister of Welfare) to transform the current Employment Board, forming a closer link with the tasks specified in the government declaration in the field of management of labour matters and human capital development.

In 2024, the Human Capital Development Council:

- will conceptually support the MoE's proposal to apply the "green corridor" criteria to foreigners to reduce the administrative burden and speed up administrative processes;
- will conceptually support the MoE's adult learning governance model for publicly funded adult learning;

- conceptually support the MoE’s idea to set up a One-Stop Shop for attracting highly skilled workers from abroad, the work to improve the concept is still ongoing;
- reviewed proposals for amendments to the *Labour Law* and encouraged their further discussion;
- launched discussions on the possibilities of artificial intelligence training in the public sector.

By order of the Minister for Economics, a Joint Adult Education Coordination Commission was established on 17 July 2024, composed of experts from the MoE, MoW, MoES, ECL, LABS and other represented institutions, to ensure coordinated inter-institutional cooperation and governance coordination in the field of adult education. The Commission’s task is to identify, review, approve and update the priority target groups, training directions and areas, educational programmes or planned training courses in the adult education measures financed by the state budget, Latvia’s RRF Plan and EU funds under the responsibility of the MoE, determining the scope of training and the skills to be acquired as a priority where necessary, as well as other support measures to promote the competitiveness of the employed, unemployed, job seekers and persons at risk of unemployment in the labour market, in accordance with the strategic objectives of human capital development, labour market and economic sectors development forecasts.

Commission’s work and achievements in 2024:

- a framework for a mechanism/methodology for identifying adult learning needs has been prepared and reviewed prioritising professional qualifications and ordering adult learning in line with labour market demand and the development of economic sectors;
- the adult learning offer SO 4.2.4.2 *Support for Adult Learning Based on the Individual Needs of Adults* has been approved;
- discussions with employers and institutions involved in improving the methodology for identifying adult learning needs, including non-formal learning and skills, continued.

8.2. SUPPORT FOR BUSINESSES IN HUMAN CAPITAL DEVELOPMENT

MoE, alongside MoW and MoES, has developed and implements several measures to support human capital development. The measures within the competence of MoE are mainly related to support to entrepreneurs for the improvement of skills of employees and the attraction of qualified labour.

DEVELOPMENT OF SKILLS

To provide support for the acquisition of qualifications, reskilling or acquisition or improvement of skills by employees of employers to foster an increase in labour productivity, on 25 June 2024, the CM approved Regulations No. 413 *Implementing Regulations of the First Round of Activity 4.2.4.1 Support for Sectoral Needs Based Adult Education of Specific Objective 4.2.4 Promoting Lifelong Learning, in Particular by Offering Flexible Skills Improvement and Reskilling Opportunities for All, Taking into Account Business and Digital Skills, Better Anticipating Change and the Need for New Skills Based on Labour Market Needs, Facilitating Career Change and Promoting Professional Mobility of Priority Axis 4.2 Education, Skills and Lifelong Learning of the European Union Cohesion Policy Programme 2021-2027*. Overall, 13 associations will receive support for a total of 12.2 million euro. According to the plan, at least 8,000 employed persons will be involved in training by the end of 2029.

To promote the digital transformation and competitiveness of companies, on 12 September 2023, the CM approved Regulations No. 529 *Implementing Regulations of Investment 2.3.1.2.i. Development of Digital Skills of Enterprises of Reform and Investment Direction 2.3 Digital Skills of Component 2 Digital Transformation of the Recovery and Resilience Facility Plan of the European Union*, which provides support for the development of digital skills of employees of companies starting from 2024. The objective is to improve the digital skills of micro, small, medium-sized and large Latvian enterprises, including skills that contribute to export promotion, basic high-level digital management skills at the level of enterprise management and skills for the use of digital technologies in different business processes. Training for the improvement of digital skills development for company employees is available through European Digital Innovation Hubs (EDIHs) or organisations representing companies or industry associations selected in a competition. The RRF funding available for the investment is 20 million euro. By the end of 2024, training will be provided to about 500 merchants. The investment is expected to support at least 2,500 merchants to improve their employees’ digital skills by mid-2026.

In 2023, the EC Technical Support Instrument project *Support Employers in Promoting Skills Development in Latvia*[1] was concluded. It was implemented by the OECD in cooperation with the EC Directorate-General for Structural Reform Support. The project's objective was to support Latvia in developing a regulatory framework that would support and stimulate employers to improve their employees' skills or promote reskilling. As a result of the project, Latvia has been provided with recommendations aimed at improving and adapting different types of support to SMEs and building skills of companies and learning culture in companies. Several measures have been initiated to implement recommendations and ensure sustainable reform in the improvement of skills of employees of employers.

On 7 December 2023, the Saeima adopted draft law *Amendments to the Law on Personal Income Tax* to implement the OECD recommendation to extend tax exemptions in higher education and general education programmes. They provide that the tuition fees paid by employers for the acquisition of higher education by their employees in state-accredited educational institutions of Latvia, EU educational institutions of Member States and European Economic Area countries are not considered income from paid employment if the acquisition of higher education is related to the acquisition of the skills necessary for the employer. The amendments entered into force on 1 January 2024. Thus, the above amendments to the *Law on Personal Income Tax* provide an opportunity for employers to pay for the higher education of employees without this benefit for the employee/employer being subject to labour taxes.

One of the priorities of the MoE in 2024 is to boost human capital and productivity development, which includes reviewing expenses exempt from labour taxes and returning young parents back to the labour market faster. In the Tax Policy Improvement Coordination Working Group led by the MoF, the MoE promoted an initiative to ensure payment of a higher share of the parental allowance for working parents – 75% instead of the current 50%. Such a regulation would contribute to reducing the shadow economy and labour shortages. To promote employee mobility, the MoE proposed to extend the scope of the personal income tax relief for payments made by the employer under collective bargaining agreements for medical and catering expenses, accommodation and transport expenses. The initiatives have been included in the draft laws *Amendments to the Law on Personal Income Tax* and *Amendments to the Law on Maternity and Sickness Insurance*, which were adopted by the CM on 8 October 2024, included in the package of draft laws accompanying the draft law *On the State Budget for 2025 and Budgetary Framework for 2025, 2026 and 2027* and are currently under consideration by the responsible committees of the Saeima.

ATTRACTION OF QUALIFIED LABOUR FORCE

Work is underway to improve labour force immigration processes. Legislation was amended in 2024 to avoid long-term labour shortages:

- cases were included in the *Immigration Law*, in which the Office for Citizenship and Migration Affairs may decide on a prohibition to a natural or legal person to invite foreigners;
- Amendments to CM Regulations No. 225 *Regulations Regarding the Amount of Financial Means Necessary for a Foreigner and the Determination of the Existence of Financial Means* provide that if a foreigner obtains a visa and the right to employment, the wage shall not be less than the average gross monthly wage of workers in the sector in Latvia in the previous year or the minimum wage established by the sectoral general agreement concluded pursuant to Section 18(4) of the *Labour Law*;
- Amendments to CM Regulations No. 55 *Regulations Regarding Employment of Foreigners* aim to reduce the risks of dishonest use of the labour immigration system by establishing an obligation for employers to cooperate with the State Employment Agency, thus facilitating cooperation between employers and state institutions, supporting the attraction of labour necessary for the Latvian labour market;

Work continues on the development of the CM Regulations *Procedure for the Provision of Priority Public Services to Merchants*, which aim to create a business environment friendly for export promotion and investment attraction, including ensure the attraction of foreign labour to meet the needs of the Latvian economy and securing labour needs by reducing the administrative burden and speeding up administrative approval processes for merchants important to the Latvian economy.

In addition, in 2024, the MoE, in cooperation with the public authorities involved started working on the establishment of a One Stop Shop for attracting highly qualified foreign talents. The One Stop Shop will provide foreigners with comprehensive information on all stages of the foreign talent pathway and a range of services in one place. Representatives of the national authorities involved in migration issues will be available at the centre on site, providing in one place all necessary services, such as advice on residence permits, tax and labour law issues and other services.

The MoE is currently testing various innovative solutions to obtain real-time data on occupations and skills in demand in the labour market, including plans to use artificial intelligence solutions to identify labour market needs in the future.

[1] For more information about the project, see: https://www.oecd.org/skills/employer-training-support-latvia.htm.

9. INTEGRATION OF LATVIA IN THE EU ECONOMIC AND STRUCTURAL POLICIES

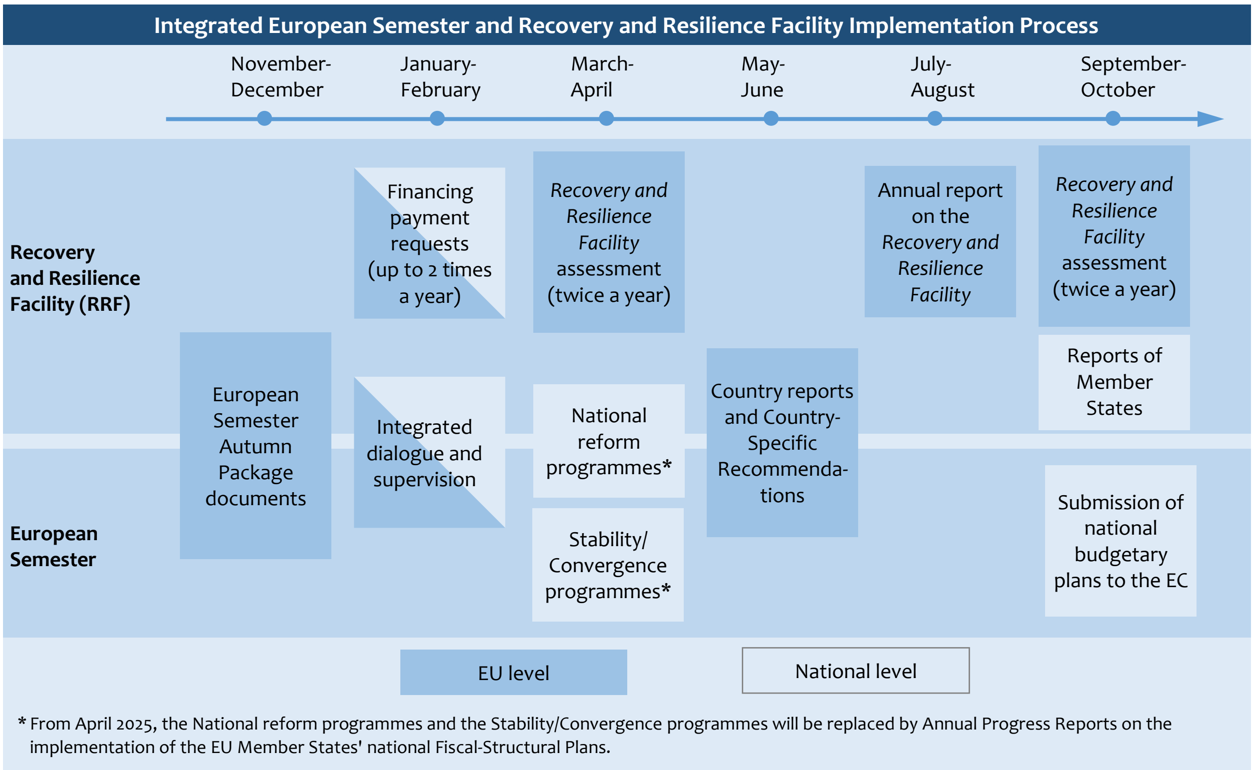
9.1. EUROPEAN SEMESTER

On 12 January 2010, the EC published its *Annual Growth Survey* offering to launch a new economic policy surveillance and coordination mechanism in the EU – the European Semester. Since 2011, the European Semester starts every year in November, when the EC publishes the key documents (the so-called *European Semester Autumn Package*), the evaluation of which starts the European Semester of the next year, and those are: the *Annual Sustainable Growth Survey*, the *Alert Mechanism Report*, the *Draft Joint Employment Report*, the *Proposal for EU Council's Recommendations to the Euro Area* and other documents. In these documents the EC evaluates the economic situation across the EU and offers economic policy priorities for the next year. These documents are the basis for further discussions between EU Member States and the EC at different meetings of the EU Council.

Meanwhile, at the level of respective Member States in accordance with the European Semester process, every year Member States should draft and submit to the EC by mid-April national programmes (the *National Reform Programme*, *Stability Programme* or *Convergence Programme*). After both documents have been submitted, the EC prepares its assessment and at the end of May makes proposals for EU Council's Country-Specific Recommendations, which are discussed at different EU Council meetings and approved at the European Council meeting in June.

The EC reports on each EU Member State (Country Reports), which are published every year in spring, are another important element of the European Semester. In these reports, the EC offers a detailed analysis of each EU Member State, its economic situation, main challenges and ongoing reforms.

Figure 9.1



With the establishment of the EU *Recovery and Resilience Facility*[2], which was integrated into the European Semester process, EU Member States should report twice a year to the EC on the implementation of the *Recovery and Resilience Plans* of EU Member States, the achievement of their milestones and targets, etc. In addition, *Reform Programmes* of EU Member States should contain references to the *Recovery and Resilience Plans* as both processes are integrated. In Country Reports, the EC evaluates progress in the implementation of the *Recovery and Resilience Plans* (see Figure 9.1).

The National Reform Programme of Latvia for the implementation of the Europe 2020 strategy (hereinafter – NRP of Latvia) was approved by the CM on 26 April 2011 together with the *Convergence Programme of Latvia 2011-2014*. Both programmes were submitted to the EC on 29 April 2011. Since then, every year Latvia drafted and submitted to the EC Progress Reports on the implementation of the NRP of Latvia.

2024 Country Report – Latvia

2024 Country Report – Latvia provides analysis of the development of Latvian economy, characterises EU funding priorities and use, incl. in the context of the Cohesion Policy and Latvia's RRF Plan, reflects the EC vision of Latvian economic policy priorities requiring government's attention, and reflects the main conclusions of the EC.

2024 Country Report – Latvia notes that Latvia's economic growth was negatively affected by high inflation and interest rates in 2023, but moderate growth is expected in 2024. The Latvian labour market is still tight due to labour force shortages, and real wage growth has resumed in the second half of 2023. Despite Latvia's relatively low level of public debt, there are challenges to the implementation of Latvia's fiscal policy in the coming years. These fiscal policy challenges are linked to the need to ensure budgetary spending on internal and external security, improving public services and co-financing large-scale EU-funded projects. Latvia's economic development challenges are also linked to its low productivity levels compared to the EU average and the need to foster productivity and income convergence, reduce income inequality and poverty, ensure social protection and social inclusion, and reduce regional disparities.

The EC proposes the following priority measures requiring government's attention:
- adapting tax policy to the growing needs of public services;
- tackling poverty and income inequality;
- providing adequate funding for healthcare and long-term care;
- improving the business environment;
- improving access to labour and skills;
- promoting the use of renewable energy, increasing energy efficiency and decarbonisation.

2024 Country Report – Latvia is the basis for the EC's proposal for *EU Council's Country-Specific Recommendations for Latvia*.

The EU Council's Country-Specific Recommendations for Latvia 2024

The following recommendations are made for Latvia for 2024–2025:
1) Submit the medium-term fiscal-structural plan in a timely manner. In line with the requirements of the reformed Stability and Growth Pact, limit the growth in net expenditure in 2025 to a rate consistent with maintaining the general government deficit below the 3% of GDP Treaty reference value and keeping the general government debt at a prudent level over the medium term. Broaden taxation, including of capital and property, and strengthen the adequacy of healthcare and social protection.
2) Continue with the swift and effective implementation of the recovery and resilience plan, including the *REPowerEU* chapter, ensuring completion of reforms and investments by August 2026. Accelerate the implementation of cohesion policy programmes. In the context of the mid-term review continue focusing on the agreed priorities, taking action to better address persistent regional disparities and inequalities while considering the opportunities provided by the Strategic Technologies for Europe Platform initiative to improve competitiveness.
3) Improve the business environment by reducing the administrative and regulatory burden for companies and improving access to finance for small and medium-sized enterprises, including through public lending and guarantee schemes aimed at facilitating investments of strategic importance and boosting competition in the financial markets. Address labour and skills shortages, in particular in STEM, and in other specialisations needed for the green and digital transition, as well as in the social and healthcare sectors, including through targeted upskilling and reskilling.
4) Accelerate the deployment of wind and solar energy by improving permit-granting procedures and promoting demand-side flexibility. Foster the transition to a circular economy through eco-innovation and sustainable resource management practices.

According to the European Semester process and timeline, on 14 May 2024 the CM approved the thirteenth *Progress Report on the Implementation of the NRP of Latvia* (hereinafter – Progress Report) submitted to the EC together with *Latvia's Stability Programme for 2024-2027*.

The Progress Report contains an updated medium-term macroeconomic scenario described in the NRP of Latvia, evaluates the progress of Latvia in addressing the recommendations issued by the EU Council in 2023, provides information on the implementation of the *European Pillar of Social Rights* in Latvia and characterises the progress of Latvia in the achievement of objectives of the UN sustainable development goals. The Progress Report shows that the implementation of

[2] See Chapter 9.2 of the Report on the Economic Development of Latvia for 2023: https://www.em.gov.lv/lv/media/18864/download?attachment.

all the EU Council Recommendations is ongoing and Latvia is generally moving towards the achievement of the UN sustainable development goals.

When evaluating the programmes submitted by the EU Member States and their implementation, on 19 June 2024 the EC published Country Reports, including about Latvia, and proposals for EU Council's Country-Specific Recommendations for the EU Member States, which were approved at the meeting of the European Council on 17 October 2024 after discussions at different EU Council's meetings.

The measures planned by the government for the fulfilment of EU Council's Country-Specific Recommendations are included in the government's action plan. EU Council's Country-Specific Recommendations for Latvia are considered to be a significant element when setting economic policy priorities, formulating necessary reforms and policy activities, as well as successfully implementing the *National Reform Programme of Latvia*, *Latvia's Recovery and Resilience Facility Plan* and *Stability Programme of Latvia*.

It should be noted that the *National Reform Programme of Latvia*, *Latvia's Recovery and Resilience Facility Plan* and the *Stability Programme of Latvia* are being implemented in close cooperation with the EC. The progress in the implementation of the above-mentioned programmes is being regularly discussed in the bilateral meetings between Latvia and the EC.

CHANGES TO THE EUROPEAN SEMESTER IN 2024 – FISCAL STRUCTURAL PLANS

The regulatory enactments adopted as part of the reform of the EU *Stability and Growth Pact* (the new EU fiscal rules) entered into force on 30 April 2024. With the entry into force of the regulation, each EU Member State[3] must draft a new document – a ***Fiscal-Structural Plan*** (replacing the previous *Stability Programme* and *National Reform Programme,* which were prepared and submitted to the EC each year as part of the European Semester process). The *Fiscal-Structural Plan* therefore covers the country's fiscal policy, as well as investments and reforms over the next four years.

In accordance with the CM Order No. 235 of 28 March 2024 *On the Timetable for the Preparation of the Draft Law On the State Budget for 2025 and the Budgetary Framework for 2025, 2026 and 2027*, Latvia prepared the *Fiscal Structural Plan 2025-2028*[4] (hereinafter – the FSP), which was approved by the CM on 14 October 2024 and submitted to the EC and the EU Council.

***Fiscal Structural Plan of Latvia 2025 – 2028* – brief summary**

The FSP of Latvia consists of a fiscal policy part (prepared by the MoF) and a structural part (prepared by the MoE in cooperation with other ministries and public institutions). The MoF is responsible for the implementation and monitoring of the FSP of Latvia.

Fiscal policy part

Under the new EU economic governance model EU Member States should ensure that, in the long term (until 2038), public debt is below 60% of GDP (or credibly declining from current high levels) and deficits are below 3% of GDP. Thus, during the period between 2025 and 2028, the state will have to be gradually put on the new "fiscal trajectory" from the 2024 situation – through consolidation, expansion, or through just a slight adjustment of the direction. It should be noted that Latvia is already close to its necessary trajectory, so there is no need for consolidation, but there is also not much positive fiscal space for expansion. The fiscal policy planned under the FSP of Latvia involves "a slight adjustment of direction".

The new EU economic governance model makes the condition of expenditure growth the main fiscal indicator (the structural balance was the main fiscal indicator in the previous model). The annual increase in expenditure is set for the entire period 2025-2028 once in this FSP and is not changed thereafter. This means that, unlike the old model, where the permissible level of expenditure was adjusted according to changes in revenue (and the economy), in the new model, better or worse developments in revenue (and the economy) do not allow for increase in expenditure or do not require reduction in expenditure. These changes ensure the stability of fiscal policy over the medium term.

Latvia commits to the following maximum increase in annual net nationally financed primary expenditure: 5.9 % in 2025, 3,6 % in 2026, 3.4% in 2027 and 3.3 % in 2028.

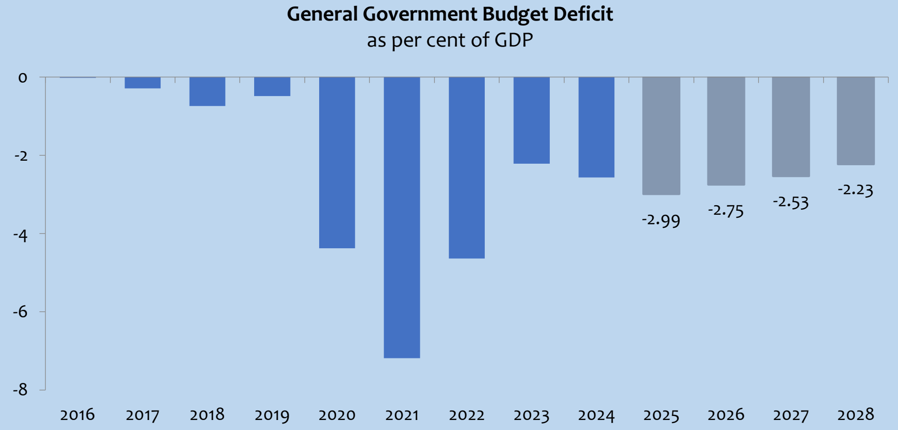
The package of measures contained in the FSP of Latvia ensures that increase in the general government budget deficit stops and deficit gradually decreases during the period of 2025 – 2028.

The FSP of Latvia also includes policy measures, which ensure putting the state on an appropriate "fiscal trajectory". These measures have a stronger role in the new EU fiscal governance framework than in the Stability Programme developed so far, as no new measures will be possible before 2028 unless tax policy changes will be made or an existing measure will be abandoned.

So, the plan includes not only fiscal indicators, but also a set of policies (structural policies of the plan) that are implemented with the public finances specified in the plan and are in line with the EU Council's Country-Specific Recommendations made in 2019-2024.

[3] In accordance with the requirements of Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024 on effective coordination of economic policies and multilateral surveillance of budgetary developments and repealing Council Regulation (EC) No. 1466/97.

[4] Fiscal Structural Plan of Latvia 2025 – 2028: https://tapportals.mk.gov.lv/attachments/legal_acts/document_versions/aafdc2f9-ca0f-406c-8fd1-dcd9e19f4d9e/download.



Structural part

Chapter 9 of the Latvian FSP contains information on measures, reforms and investments that are being implemented to meet the country-specific recommendations of Member States of the EU Council for Latvia and common EU priorities in the 2019-2024 period. It shows details of all measures, reforms and investments, as well as how they relate, where relevant, to the EU's multiannual financial framework for 2021 -2027, Latvia's RRF plan, the European Pillar of Social Rights and the UN Sustainable Development Goals.

In view of the EU Council country-specific recommendations addressed for Latvia in the 2019 -2024 period and common EU priorities, the implementation of measures, reforms and investments in the structural part of Latvia's FSP is taking place in the following policy areas:

1) tax policy (shifting the tax burden towards capital and indirect taxes, improving tax payment and compliance);
2) social protection and security (adequacy of social protection, improving minimum income);
3) healthcare (increased funding, efficiency, quality and access);
4) education and skills (quality of education, green skills development, digital skills development, vocational and adult education);
5) employment policy (active labour market policy);
6) business environment (reducing administrative and regulatory burdens, promoting competition in the financial sector);
7) promotion of investments (access to finance for SMEs, investment in green and digital transition);
8) energy and energy efficiency (interconnections, renewable energy, reducing dependence on fossil fuels, energy efficiency);
9) affordable housing (construction of low-rent housing, accessibility of social housing, accessibility of the housing environment for persons with disabilities);
10) transport sustainability (improving rail infrastructure, zero-emission transport, development of a unified public transport ticket system);
11) digital infrastructure (modernising government processes and services, efficiency and interoperability of the use of public ICT resources, development of the economy's data and digital services economy, developing "last mile" infrastructure for broadband or very high performance networks, etc.);
12) transition to a circular economy;
13) efficiency of public administration (efficiency of public administration, efficiency of governance of state and municipal owned companies, improvement of the regulation for preventing conflicts of interest);
14) other reforms and investments aimed at the implementation of EU common priorities (a fair green and digital transition; social and economic resilience, incl. European Pillar of Social Rights; energy security; the build-up of defence capabilities).

In accordance with the Article 13 of Regulation (EU) 2024/1263 of the European Parliament and of the Council, EU Member States are required to explain in the FSP how they will ensure the delivery of reforms and investments responding to the main issues and challenges identified in the context of the European Semester, in particular in the EU Council recommendations, and how that EU Member States will address the following common priorities of the EU:

- a fair green and digital transition, including the climate objectives set out in the Regulation (EU) 2021/1119;
- social and economic resilience, including the European Pillar of Social Rights;
- energy security;
- the build-up of defence capabilities.

To facilitate the preparation of FSPs by EU Member States, the EC has developed guidelines for the preparation of FSPs.[5] According to these guidelines, each EU Member State is required to complete a table within the FSP identifying the main and most relevant measures (reforms and investments), including those related to the EU Council's Country-Specific Recommendations addressed in 2019-2024 and their implementation, paying particular attention to those EU Council recommendations which, in the EC's opinion, have not made substantial progress or have not been fully implemented. The FSP should consider how these reforms and investments are in line with the EU Council's Country-Specific Recommendations and contribute to the implementation of the EU's common priorities. For example, this could include measures in the social, health, education and training, pension and labour market policies, product market reforms, tax reforms, R&D, innovation, policy promotion or substantial investments in green and digital transition, in particular those set out by EU Member States in their *Energy and Climate Plans* and *National Digital Decade Strategic Roadmaps*.

EC's assessment of EU Member States' draft *Fiscal-Structural Plans* and draft national budgetary plans for the euro area for 2025

The EC believes that, of the twenty-one *Fiscal-Structural Plans* submitted to the EC, twenty are in line with the new EU principles of economic governance, which means that the fiscal trajectory of twenty EU Member States (Croatia, Cyprus, Czechia, Denmark, Estonia, Finland, France, Ireland, Greece, Italy, Latvia, Luxembourg, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden) will contribute to a sustainable and downward public debt development. For these EU Member States, the EC recommends that the EU Council approves the net budgetary expenditure figures included in these plans. In the case of the Netherlands, the EC proposes to the EU Council to recommend the net budgetary expenditure values defined in the technical paper set out by the EC in June 2024.

In five of the twenty *Fiscal-Structural Plans* that have been positively assessed by the EC, the period for achieving the net budgetary expenditure trajectory has been extended from four to seven years. This applies to the *Fiscal-Structural Plans* of Finland, France, Italy, Spain and Romania.

According to the **EC's proposal for an EC Council Recommendation to Latvia on the Fiscal Structural Plan of Latvia 2024-2028**, Latvia must ensure that net expenditure growth does not exceed the maxima established, and that reforms and investments are delivered in response to the main challenges identified in the context of the European Semester, in particular in the EU Council country-specific recommendations, and addressing the common priorities of the EU.

After assessing the draft national budgetary plans for 2025 submitted by seventeen euro area countries, the EC found that Greece, Cyprus, Latvia, Slovenia, Slovakia, Italy, Croatia and France comply with the EC's fiscal recommendations. Estonia, Germany, Finland and Ireland do not fully comply with the EC's fiscal recommendations. Despite complying with the net expenditure maxima, Luxembourg, Malta and Portugal have failed to comply with the EC's fiscal recommendations by not lifting emergency energy support measures as recommended by the EU Council. In the case of the Netherlands, the EC forecasts a surpassing of the net expenditure maximum, which means that the Netherlands is also negatively assessed by the EC. In the case of Lithuania, the EC considers that the country is at risk of surpassing the net expenditure maximum.

In the context of the FSP of Latvia, following an agreement with the Ministry of Finance, the MoE, as the institution responsible for coordinating the European Semester process, prepared the section of the FSP of Latvia on reforms and investments, including the implementation of EU Council's Country-Specific Recommendations (previously the *National Reform Programme of Latvia* and the annual Progress Reports on the implementation of this programme were prepared by the MoE together with the institutions involved in the European Semester process).

Following the European Semester process, on 26 November 2024, the EC published the first part of the *European Semester Autumn Package*: the EC's Proposal for EU Council's Recommendations to twenty-one EU Member States on their medium-term *Fiscal-Structural Plans*; EC's Proposal for EU Council Recommendations to eight EU Member States on the termination of the excessive budget deficit procedure under Article 126(7) of the Treaty on the Functioning of the European Union; EC report under Article 126(3) of the Treaty on the Functioning of the European Union on compliance of two EU Member States compliance with the 3% of GDP deficit criterion; EC's opinions on the draft budgetary plans of seventeen euro area countries. The other documents in the *European Semester Autumn Package* (2025 *Alert Mechanism Report*, *Draft Joint Employment Report*, Proposal for *EU Council's Recommendations to the Euro Area*) were published on 18 December 2024.

[5] Guidelines for the preparation of the FSP: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52024XC03975.

EC proposal for EU Council's Recommendations on the Economic Policy of the Euro Area

The EC proposal for *EU Council's Recommendations on the Economic Policy of the Euro Area* published on 18 December 2024, urges euro area countries to take action, individually, in 2025-2026, including through the implementation of their national *Recovery and Resilience Plans*, and collectively within the Eurogroup, fostering productivity, economic resilience, macroeconomic and financial stability:

1) Foster productivity by moving resources towards high-productivity and high productivity potential sectors, through improved functioning of goods and services markets. Address the fragmentation of the innovation ecosystems and strengthen their ability to generate groundbreaking innovations, including in cutting-edge digital and clean technologies and infrastructure, and raise the adoption of new digital and clean technologies and innovative activities more broadly. Encourage expenditure by businesses on applied research and innovations and the transition to marketable products. Pursue policies to encourage the take-up of digital and high-tech solutions in firms. Enhance firms' efficiency and ability to reach optimum scale, notably by deepening the single market. Improve the business environment by reducing administrative burden and regulatory complexity and by removing investment obstacles. Ensure that industrial policy is effectively targeted towards strategic sectors and technologies, ensuring that public support does not distort the level playing field in the Single Market, and effectively contributes to the competitiveness of the euro area and its open strategic autonomy. Encourage entrepreneurship and the creation of new businesses.
   Develop a European Savings and Investment Union, including by deepening the links between Capital Markets and Banking Union projects, to support growth and investments and improve competitiveness. Further develop the Banking Union by making progress on all its elements and finalise the reform of the crisis management and deposit insurance framework, with the aim of delivering an ambitious, coherent, and effective outcome that addresses the objectives of the review. Adopt the outstanding measures of the 2020 Capital Markets Union action plan and ensure swift implementation of the already agreed measures, and advance work on the measures identified by the Eurogroup towards a competitive and consistent regulatory and supervisory system for capital markets. Improve access to the appropriate funding for businesses to grow and invest, especially innovative SMEs, as well as citizens' access to a larger choice of investment possibilities on capital markets. Leverage Union support through financial instruments to improve access to capital for SMEs, notably for innovation and expansion, maximising the impact of Union funding. Mobilise venture capital – particularly for start-ups and scale-ups – through well-functioning and integrated European capital markets to channel savings and risk capital, both from inside and outside the Union.
   Promote upskilling and reskilling of the workforce and quality jobs with a view to increase productivity and support a fair green and digital transition. Foster the labour market integration notably of underrepresented groups, including by enhancing active labour market policies (ALMPs). Improve education and training policies, including vocational education and training, to improve educational outcomes and ensure a better match between demand and supply of skills profiles.
   Promote tangible and intangible investment in critical technologies, infrastructure and areas of common priorities, such as the digital and green transitions, and the build-up of defence capabilities by mobilising private capital and ensuring necessary public investment. Stimulate investment in research and development (R&D), particularly by facilitating private sector spending through enhanced framework conditions for investment, structural reforms and by improving coordination of public funding, including at the Union level. Continue the swift implementation of Recovery and Resilience Plans and make full use of cohesion policy programmes. Enhance the effectiveness of policy action aimed at raising productivity by ensuring adequate identification, coordination and prioritisation of measures including by means of improved governance, involvement of local and regional authorities, and more effective use of National Productivity Boards.
2) Further increase labour market participation, facilitate the labour market integration of underrepresented groups, in particular women, young people, low-skilled as well as persons with disabilities, and people with a migrant background. Remove obstacles to the labour force participation including by improving the access to and quality of early childhood education and care and long-term care. Take measures to facilitate, managed legal migration of third country nationals in shortage occupations, in complementarity with fair labour mobility and harnessing labour supply and skills from within the Union.
   In accordance with national practices and respecting the role of social partners, strengthen the conditions that support sustainable wage and productivity growth especially for low- and middle-income earners. Wage bargaining should consider the competitiveness dynamics of each Member State and avoid contributing to lasting divergences in competitiveness within the euro area. Ensure the effective involvement of social partners in policymaking and strengthen social dialogue.
   Strengthen incentives to work by shifting the tax burden away from labour, including by targeted reforms of tax and benefit systems. Take action in fighting poverty by safeguarding and strengthening sustainable social protection and inclusion systems, including access to affordable and sustainable housing.
   Develop and implement a comprehensive Union-wide strategy to complement and bring together national strategies for effective electrification and the green transition, including via a sharp increase in the production of renewable energy and further cuts in the use of imported fossil fuels. In particular, sufficient and efficient grid interconnections, notably cross-border interconnections, are crucial for connecting producers and consumers across wide geographic areas. Step up efforts to improve preparedness for adverse developments, including climate change and nature related risks, especially in regions most exposed.
3) To ensure compliance with the new fiscal framework and improve debt sustainability, keep the national growth rates in net expenditure in each Member States as recommended by the Council. This should deliver appropriately differentiated fiscal adjustments and an overall slightly contractionary euro area fiscal stance in 2025 and 2026.
   When defining fiscal strategies, aim to improve the quality and efficiency of expenditure and revenue measures, aimed at reducing tax avoidance and evasion, and to align the strategies with policy objectives, such as redirecting the tax burden from labour to less distortive tax bases.
   Monitor risks to macro financial stability related to asset quality, asset repricing and strengthen macroprudential supervision of the non-bank financial intermediation sector.

In taking further steps in deepening the Economic and monetary union (EMU) consider the lessons learnt from the design and implementation of the Union's comprehensive economic policy response to the COVID-19 crisis. Continue making progress in deepening the EMU in full respect of the Union's internal market and in an open and transparent manner towards non-euro area countries. Continue strengthening the international role of the euro and make further progress in the work on the digital euro.

9.2. EU SINGLE MARKET

In 2024, 20 years have passed since Latvian businesses started to enjoy the free movement of goods, services, capital and people in the EU Single Market. It unites 30 countries (27 EU Member States and 3 countries of the European Economic Area (EEA), i.e. Norway, Iceland and Liechtenstein) having over 470 million consumers. The EU Single Market as we see it today is the result of continued work. By coordinating decisions gradually, step-by-step the requirements have been harmonised and closer integration has been achieved – unified principles and rules for economic operators have been developed, border control has been cancelled, consumers have been provided with a wider range of goods and services, freedom for citizens to live, work and study in other Member States has been provided, a possibility was found to introduce a single currency, and those are not the only benefits. Nevertheless, the Single Market is still being improved.

While the EU Single Market has been a success, recent analyses, including those carried out in 2024 by Enrico Letta, President of the *Jacques Delors* Institute and former Italian Prime Minister, and Mario Draghi, former European Central Bank President and also former Italian Prime Minister, clearly show that it remains highly fragmented, limiting the ability of EU businesses to expand and compete internationally and preventing EU citizens and businesses from getting all the benefits that the Single Market could bring. For example, 60% of the barriers that businesses face today are of the same type as those reported 20 years ago. The two reports are consistent on many issues, including the need for swift action to deepen the Single Market. The Single Market requires action in a number of policy areas, including for adapting to its digital and green transition.

As a result, the EU Council has recognised the need for a new EU Single Market strategy and invited the European Commission to prepare a new strategy for a modernised Single Market by June 2025.

In parallel, the EU has taken the next step in developing sustainability and energy efficiency by adopting a new ecodesign regulation on 13 June 2024. The Ecodesign Regulation will gradually replace the existing Ecodesign Directive, which already sets energy efficiency requirements for 31 product groups, including computers, fans, washing machines, telephones, refrigeration equipment and light sources. The Ecodesign Regulation is designed as a horizontal framework that can introduce new requirements for products aimed at reducing their environmental impact throughout their life cycle, promoting a circular economy and improving overall resource efficiency. The Regulation provides for a significant extension of the range of products that can be covered by the new requirements. In fact, almost any product or intermediate product can be covered by the Ecodesign Regulation. The priority products identified by the European Commission are iron and steel, aluminium, textiles (in particular clothing and footwear), furniture (including mattresses), tyres, detergents, paints, lubricants and chemicals.

Along with some initiatives and legislative proposals, active work is ongoing in the EU to progress towards open strategic autonomy of the EU to maintain the economic, technological and industrial competitiveness of Europe and the resilience of the single market in crisis situations. Thus, for example, to reduce shortcomings in supply chains of goods and services and promote a more resilient EU Single Market in crisis situations, discussions on the proposal package for the Internal Market Emergency and Resilience Act concluded in 2024. This Instrument aims to introduce a horizontal set of measures capable of resolving emergencies, forecasting a potential crisis in the EU, monitoring and offering response measures to a potential crisis, which would be uniform and applicable across all economic sectors and all Single Market areas.

On 6 February 2024, the European Parliament and the Council reached a political agreement on the Net-Zero Industry Act, an initiative under the Green Deal industrial plan aimed at expanding clean technology manufacturing in the EU. This means that the EU will promote the production of technologies that support the clean energy transition and have extremely low, zero or negative greenhouse gas emissions during operation.

In addition, in March 2024, the Council adopted the European Critical Raw Materials Act, as demand for rare-earth metals is expected to increase exponentially in the coming years. Critical raw materials are those raw materials that are of high economic importance for the EU and are at high risk of supply disruptions due to the concentration of their sources and the lack of good and affordable substitutes. The objectives of the Act are: to increase and diversify the EU's supply of critical raw materials; to strengthen circularity, including recycling; and to support research and innovation in the field of resource efficiency and the development of substitutes.

Since March 2023, the European Commission set the objective to reduce administrative burdens for entrepreneurs by reducing reporting requirements by 25% by simplifying and combining them. To achieve this objective, in 2023, the European Commission published 15 proposals for streamlining reporting requirements and in 2024 made another 26 proposals. The EU statistics regulation was one of the first areas that was revised to reduce the number of reports to be completed and submitted by companies to statistical institutions of Member States.

The freedom of provision of goods and services and the right to do business provided for in Articles 34 to 36 and 49 to 62 of the Treaty on the Functioning of the European Union (TFEU) in Latvia are supervised and coordinated by the MoE.

Within the scope of its competence is also the identification of legal provisions which may hinder the use of freedoms of the Single Market, including the evaluation of draft laws and regulations.

The technical regulations notification is a preventive, unified and transparent monitoring tool to evaluate and prevent the inclusion of requirements into laws and regulations, which might create barriers to the free circulation of goods, as well as information society services. Not only responsible authorities of EU Member States, but any economic operator can participate in the process and provide comments and objections regarding draft laws prepared by any Member State, which might potentially affect product export or cross-border information society services. Draft technical regulations notified by the Member States can be found in the database of the Technical Regulations Information System TRIS[6] in the field of goods and in the Internal Market Information System (IMI) notification summary[7] in the field of services. If an economic operator has any objections to draft technical regulations of other countries which might potentially or actually affect sales of its product or provision of its services in the market of a specific EU country, the economic operator has the right to submit its objections to the responsible ministry which is competent to coordinate the respective policy area in Latvia.

When providing support and public services to businesses and residents, authorities of Member States have to verify the information indicated in applications of legal entities and individuals, the authenticity of documents issued in other Member States and clarify other issues according to respective EU laws and regulations. The Internal Market Information System (IMI) is a tool for faster and more effective communication and document exchange among the public authorities with EU/EEA countries. Hence, the applicant is free from bureaucratic barriers in the resolution of different cross-border issues in the Single Market. MoE is the coordinator of the IMI system in Latvia. In 2024, the IMI system covered 95 administrative cooperation procedures in 19 different policy areas. In 2024, Latvia processed 268 information requests in the IMI system: 153 in the area of professional qualifications, 108 in the area of posting of workers, 4 in the area of patients' rights and 3 in the services area.

SOLVIT Centre is an alternative Single Market problem solution network, created by the EC and the Member States, operating in Latvia since 2004. Its task is to find a fast and practical solution to the Single Market's problems caused by administrative decisions of public authorities in case of incorrect application of EU law. In situations, when a resident or a businessman is harmed by incorrect decisions taken by responsible authorities of Member States, the SOLVIT Centre operates as a free of charge pre-trial problem-solving tool. There are SOLVIT Centres in each EEA Member State. In 2024, the Latvian SOLVIT Centre received 36 complaints on problems of Latvian citizens in other EU countries and 13 complaints on problems of EU citizens in Latvia. In this period, all submitted problems were resolved within the defined time – not more than 10 weeks. To submit a complaint to the SOLVIT Centre, the case must meet the following criteria: 1) the decision has been taken by a public authority; 2) the public authority is located in another Member State (cross-border element); 3) norms arising from the EU law (regulations, directives, etc.) have been violated. Most frequently the Latvian SOLVIT Centre receives complaints from individuals related to social benefits and issues of residence permits, while complaints of businesses are related to restrictions on the freedom of provision of goods and services, repayment of value added tax and recognition of professional qualifications.

[6] http://ec.europa.eu/growth/tools-databases/tris/lv/search
[7] https://ec.europa.eu/internal_market/imi-net/repositories/services-directive-notifications/index_en.htm

10. IMPROVEMENT OF THE BUSINESS ENVIRONMENT

A favourable business environment is one of the most important elements for increasing the competitiveness of the national economy. The better business conditions a state is able to create, the higher investments flow into the national economy, subsequently leading to new jobs and better welfare of people. There are several obstacles to business identified by entrepreneurs as disruptive in long-term planning of activities and development, such as frequent and unpredictable changes in the regulatory framework, tax system, sectoral supervision and control measures, deficiencies in tax administration, as well as slow decision-making process of the state administration. The business environment should be accessible and understandable to entrepreneurs reducing the bureaucratic and administrative burden as much as possible, simplifying the regulatory environment and strengthening cooperation with sectoral associations.

ACTION PLAN FOR IMPROVEMENT OF THE BUSINESS ENVIRONMENT

Different measures for the improvement of the business environment in Latvia have been implemented since 1999. The MoE, with the participation of a wide range of sectoral ministries and organizations representing entrepreneurs, is implementing business environment improvement measures to create for entrepreneurs an attractive business environment with accessible and understandable services.

In 2024, the MoE continued the study of bureaucratic obstacles identified in 2023 and discussions with stakeholders (Latvian Chamber of Commerce and Industry, Employers' Confederation of Latvia and FICIL and RIS3 management groups) to find solutions to reduce administrative and fiscal burdens.

To improve the regulatory enactments regulating entrepreneurship and the services provided by the state administration to promote the competitiveness of the Latvian business environment, the MoE, together with cooperation partners, defined the following five areas requiring an evaluation process as a priority, so that a decision in the public administration is taken much faster:

- the decision-making process of the Register of Enterprises on services. In 2024, active cooperation was implemented with the involved cooperation partners – MoE, MoF, MoJ, RE, SRS. It has been established that there is a need to amend the *Law on the Register of Enterprises of the Republic of Latvia* with regard to the regulation on sending information to the SRS for verification. In 2025, it is planned to continue working on streamlining the decision-making process;
- customs procedures for importing goods (release of goods into circulation). In cooperation with the MoF, the SRS and market surveillance authorities, it has been concluded that it is necessary to raise the level of knowledge of entrepreneurs on the requirements applicable to goods that are to be released for free circulation in the EU. The possibility for the SRS to organise information events for entrepreneurs was considered;
- issuing permits in the energy sector. Discussions have been held with the SCCB on possible improvements to the process and recommendations have been received from the SCCB which will be used to continue discussions with other authorities and bodies involved in the process, for example on how to ensure the exchange of information between authorities, preventing the current situation where company representatives have to resubmit information already held by another public authority;
- preparation of *de minimis* forms. Changes have been made to the system in 2024 so that any business will now be able to prepare a *de minimis* form without time limits. Thus, aid applicants can access the *de minimis* system without time limits;
- simplification of the requirements for cash register and cash system conformity checks in the context of bona fide businesses. In July 2024, a meeting was held with MoF, MoE, SRS and LCCI, where problems were identified and the need for amendments to the regulatory framework to significantly reduce the administrative burden on honest businesses was stated. The MoF is expected to draft amendments to the CM Regulations No. 96 of 11 February 2014 *Procedures for Using Electronic Devices and Equipment for the Registration of Taxes and Other Payments*. The draft amendments are expected to be submitted to the SC in early 2025.

In 2024, the MoE continued active cooperation with social and other partners to build a business environment focused on sustainable development and economic transformation.

Further discussions are expected between the parties concerned on the lines of action, where no solution has been reached so far, in order to reach agreements on specific works to be done, the result indicators to be achieved, and to coordinate these measures with the responsible national regulatory authorities.

DIGITALISATION OF THE BUSINESS ENVIRONMENT (see also Chapter 12.5)

One of the priorities in creating an excellent business environment is the formation of a favourable and modern business environment based on innovation, the full use of modern technologies, the availability of proactive and life-oriented business-related services, increasing business productivity and boosting competitiveness at local, European and global levels.

Modern digital technologies (broadband, big data, data centres, cloud services, artificial intelligence, etc.) create unprecedented opportunities for the improvement of existing processes, procedures, the development of new products and services, and process analysis and optimisation. At the moment, however, Latvian companies are significantly lagging behind in the use of digital technologies, entrepreneurs lack digital skills and the necessary knowledge, skills and proper tools for transformation (such as productivity tools for digital trade, online cross-border trade, etc.) compared with OECD member states.

Industry associations recognise that ICT solutions and services are too expensive. Many entrepreneurs lack skills and experience, as well as information on the benefits of digitisation in business. Given that most of the companies in Latvia are SMEs, it is necessary to stimulate SMEs to use advanced technologies and new innovative business methods, thus implementing digital transformation in enterprises and promoting their competitiveness.

Ambitious European digital targets provide that 90% of businesses reach at least the basic level of digital intensity by 2030. According to the DESI assessment, there are 38% of such businesses in Latvia, an average of 55% in Europe, which means that the progress of businesses must be very important in the coming years. Almost half of Latvian enterprises have digitised at least 50% of all processes taking place in the company, as well as most enterprises have introduced some basic ICT solutions, but the acquisition of state-of-the-art technologies is hampered by the lack of finances and knowledge, which is consistent with generally low digital skills in Latvia.

Improving citizens' digital skills is a prerequisite for creating inclusive labour markets, and for increasing the productivity of the companies that currently enjoy very little digital benefits. Regions still have untapped potential for broadband-optic internet connectivity, which would provide reliable and fast digital infrastructure for businesses, as well as remote job opportunities for employees. Despite the availability of basic infrastructure in regional centres, the provision of electronic communications services to citizens in regions is still not possible until the "last mile" connection and adequate service provision policy are provided.

Ongoing dialogue with entrepreneurs on the latest technologies and trends in the digital economy is an important tool in the digital age. It is necessary to assess all public investment in digital transformation solutions, which include transforming business processes with the latest technological opportunities, including in the public sector. Public investment in digital transformation must have clearly defined benefits for entrepreneurs.

11. INNOVATION AND NEW TECHNOLOGIES

A precondition for the transition to a knowledge economy is strengthening of the Latvian innovation system by eliminating its current deficiencies and facilitating cooperation between all parties to the innovation system – business, science and education, as well as public sector representatives. Innovation also boosts productivity and increases the ability of companies to enter international supply chains with more sophisticated products, while strengthening competitiveness.

According to the *European Innovation Scoreboard* prepared by the EC, Latvia ranks 25th among the 27 EU Member States in 2024 and is included in the group of moderate innovators (group score between 30 and 80, while the EU-27 average is 110 (in 2017, the EU-27 average was defined as 100)).

Latvia's relative strengths in the *Summary Innovation Index* are population with tertiary education, trademark applications, and public-private co-publications.

Latvia's relative weaknesses include direct and indirect government support of business R&D, innovation expenditures per person employed, R&D expenditure in the business sector.

Latvia's performance in the Summary Innovation Index increased from 56.3 points in 2017 to 59 points in 2024, with the strongest increase in indicators such as public-private co-publications, international scientific co-publications, and trademark applications.

Since 2017, however, strong decreases have been in indicators such as environment-related technologies (as a percentage of all technologies), venture capital expenditures (as a percentage of GDP), and individuals with above basic overall digital skills.

Proportion of innovative businesses in Latvia

Between 2020 and 2022, Latvia had a total of 1,480 innovative companies, 33.1% of the total number of companies, but is still below the EU average (51% in EU-27 in 2022). Compared to the previous three-year period (2018-2020), the number of innovative companies has increased by 1.1 percentage points. Additional support and regulation improvement measures, as well as encouragement and incentive programmes for companies, were implemented to reach the target of 40% innovative companies by 2024 set in the *National Industrial Policy Guidelines 2021-2027* (NIP2027). The latest data on this indicator will be available in 2026 when the results of the CSB survey for 2022-2024 will be published.

In the report *Innovation Development Trends and Proposals to Promote Innovation during the Economic Crisis* drafted within the project *Economic, Political and Legal Framework for Preserving the Potential of the Latvian National Economy and Promoting the Growth of Competitiveness in the Wake of the Crisis Caused by the Pandemic (reCOVery-LV)* of the national research programme *For Mitigation of COVID-19 Consequences*, the researchers have concluded that during the period 2019-2020 63% of the companies surveyed in the course of preparation of the report (37 companies from all regions of Latvia) have introduced at least one product or business process innovation, or have carried out an innovative activity that is still ongoing. The result of such an alternative survey, although based on a small sample, shows that more targeted work on raising awareness of businesses may lead to a larger number of innovative companies appearing in statistics.

INVESTMENT IN RESEARCH AND DEVELOPMENT

Total expenses of Latvia on R&D in 2022 amounted to 293.2 million euro or 0.81% of GDP. The increase compared to 2023 was underpinned by an increase in funding from the European Structural and Investment Funds. Almost half of R&D investment is in the tertiary education sector, mainly related to fundamental research. Investment in the business sector accounted for 37.3% of total R&D investment, most of it in experimental development. Financial investment in R&D by companies in 2022 was 1.3 times higher than in 2019, with the largest contribution coming from investment in manufacturing sectors. At the same time, R&D investment dynamics from 2020 to 2022 were slightly more moderate than in the last three years (2017-2019) before the COVID-19 pandemic. On current trends, the target for R&D investment (1.5% of GDP) will not be met.

All sectors contribute to overall R&D investment, but large state-owned enterprises (SOE) play a key role in boosting R&D. The total assets of SOEs reached 12.4 billion euro in 2022, an increase of 1.1 billion euro compared to 2021. Similarly, the total turnover of the SOE increased by 1.66 billion euro or 41.5% and the total profit reached 492.3 million euro, a twofold increase compared to the previous period. However, there is still a discrepancy between the national targets in promoting R&D in SOEs and the existing regulation, the shortcomings of which create obstacles to holders of capital shares or boards of directors in setting R&D targets in SOEs, thus delaying the achievement of the R&D target value set by the state. Differences in the regulatory framework in Latvia from trends in other countries show that SOEs play a key role in achieving the country's R&D targets. Work is needed to revise the regulatory framework to improve the competitiveness of

SOEs, for example, by removing restrictions on SOEs to enter export markets, invest in R&D and innovation, and by facilitating resource attraction through capital market instruments.

IMPLEMENTATION OF THE INNOVATION GOVERNANCE REFORM

In 2024, the implementation of the innovation institutional governance and *Smart Specialisation Strategy* (RIS3) governance model continued. The reform provides for the involvement of the LIAA in the coordination of RIS3 areas, leading the work of the five RIS3 management groups and envisaging a long-term strategy and action plan for each RIS3 area. Similarly, within the framework of the reform for the approximation of innovation and research policies, including the supervision of RIS3, an Innovation and Research Governance Council (IRGC) has been established, where the Minister of Economics, Minister of Education and Science, as well as officials of the LIAA and Latvian Council of Science cooperate.

In 2024, the information report *Monitoring the Smart Specialisation Strategy. Report for 2024* was drafted. RIS3 monitoring aims to identify competitive advantages and technology niches, as well as to assess progress in economic transformation. The monitoring process also focuses on existing barriers and challenges, while assessing the relevance of the contribution of the support measures to the RIS3 objectives.

CREATING INNOVATION DEMAND IN THE PUBLIC SECTOR

The public sector may play a crucial role in fostering innovation and research activities forming demand for innovation. Europe is increasingly using innovation public procurement for this purpose. The need to develop innovation procurement is mentioned in the NIP guidelines and other policy planning documents. The MoE, in cooperation with the Procurement Monitoring Bureau and other stakeholders, has developed guidelines for the implementation of innovation procurement to raise awareness of innovation procurement and its implementation in Latvia, as well as to provide methodological support to public procurers. The Procurement Monitoring Bureau in cooperation with the MoE has prepared a self-study course "Strategic Procurement", which includes a section on innovation procurement to raise awareness about it.

In 2023, the MoE joined the *PPI4Cities* project of the *Interreg* Baltic Sea Region programme to promote innovation procurement. The project brings together partners from Lithuania, Finland, Estonia, Germany, Denmark and Latvia. The project aims to support municipalities of the Baltic Sea Region in the use of public procurement for innovation for the development of smart city solutions. Both physical and digital tools that will support selected BJR municipalities are intended to be developed for the achievement of this objective to create an environment in which they can test how to apply new business models needed to successfully implement public procurement for innovation. At the same time, the MoE is identifying the current situation in Latvia regarding the use of innovation procurement, asking Latvian municipalities and SOEs to provide information on public procurements implemented in 2021-2023, within which innovative solutions (products, services, technologies) or modernised services were purchased. At the same time, LIAA collected information on the private sector's supply of innovative solutions (potential participants in innovation procurement – suppliers/developers of innovative solutions).

In November 2023, the CM approved support for the improvement of the technology transfer system (1.2.1.4 *Support for the Improvement of the Technology Transfer System*). The support will be available to undertakings for new products to be developed within the framework of innovation procurement and their commercialisation. State support will be available to undertakings who have been awarded contract rights as a result of the innovation partnership procedure with a public buyer to implement the following activities: 1) experimental development; 2) product or technology certification and testing services. State support is provided in the form of grants – within the framework of one application, support to an undertaking for the implementation of one of the abovementioned activities is available in the amount of 50% of the contract price with the contracting authority (public buyer), but not more than 50 thousand euro. However, the remaining part of the contract price shall be covered by the contracting party.

On 27 June 2023, CM Regulations No. 350 governing the implementation of activity 5.1.1.4 *Smart Municipalities* (hereinafter referred to as the activity) were approved. The activity aims to promote the development of smart municipalities by introducing smart solutions for ensuring the fulfilment of autonomous functions of local governments and the administrative tasks arising therefrom. Local governments and other applicants for support may choose to organise public procurement for innovation for smart solutions. The primary beneficiaries of the support and the parties involved in the activity are local governments, local government institutions, capital companies, planning regions, scientific institutions, digital innovation hubs and other stakeholders.

LONG-TERM NATIONAL RESEARCH PROGRAMME *INNOVATION FUND – LONG-TERM RESEARCH PROGRAMME*

In 2024, the MoE launched Latvia's first long-term national research programme *Innovation Fund – Long-Term Research Programme*.

The overarching objective of the long-term programme is to develop new knowledge, products and technology solutions approved in Latvian *Smart Specialisation Strategy* areas *Biomedicine, Medical Technologies and Pharmaceuticals* and *Photonics and Smart Materials, Technologies and Engineering Systems* in the long-term, but the objective is to develop academic research and applied science competences for the development of innovative and commercialisable products and technologies in close cooperation with the Latvian biomedical, medical technology, pharmaceutical, photonics, smart materials, electronics, electrical engineering, technology and engineering systems sectors.

The programme plans to establish a platform of research organisations in these two fields, which will work closely with Latvian industry representing their respective fields to create a joint state and industry order for research work and, together with foreign experts, select promising research projects, while applying flexibility in project monitoring.

The long-term national research programme created by the MoE will be implemented in cooperation with the Latvian Council of Science in several phases until 2032. The following phases are planned: 2024-2026, 2027-2029, 2030-2032, where MoE funding of 18 million euro is available for the first phase (2024-2026) with the possibility of increasing funding for the next three phases by 8 million euro (24 million euro per triennial cycle).

INNOVATIVE BUSINESS AND PRIORITY PROJECT AID LAW

On 14 March 2024, the Saeima approved the *Innovative Business and Priority Project Aid Law*, which aims to increase high value-added and export-oriented investments in Latvia and create an environment for testing innovative products, technologies and services, thus contributing to the development of the national economy. The law includes delegations to the MoE to prepare and to the CM to issue regulations that will determine the procedure for servicing priority projects ("green corridor"), as well as the possibility for the CM to prepare relevant business support programmes or *ad-hoc* programmes for the implementation of priority projects of importance for the national economy, where necessary.

In order to facilitate the development of innovations and their introduction into the market, work was carried out in 2024 to draft CM Regulations, which would include the conditions and procedures for the establishment, implementation, monitoring and termination of the special regulatory environment. A special regulatory environment or "regulatory sandbox" is an environment where companies can test new technologies or innovative solutions with the permission of the supervisory authorities but with less stringent rules than normal. This approach helps to test new ideas in real market situations, accelerate the commercialisation of these ideas without conflicting with the existing regulation, and allow improvements to be made before the solution is fully implemented.

SPACE INDUSTRY

Considering that the Latvian space industry has inherited large and high value added infrastructure (instruments, radio telescopes, equipment, etc.), and modern space technologies contributing to international space missions, as well as satellite data processing competences, Latvia is competitive in the international space industry.

Currently, the Latvian space ecosystem is maintained by the status of an Associate Member of the European Space Agency (since 2020), the EU Space Programme, EC innovation support programmes, as well as bilateral international cooperation projects and national support instruments. The potential of the Latvian space industry is, however, not fully exploited. The hindering factors include insufficient human resources, limited access to funding opportunities for infrastructure maintenance and modernisation, as well as the unavailability of the state budget to meet international obligations under Latvia's Association Agreement with the European Space Agency, which have a significant negative impact on the continued development of the sector and the retention of Latvian space industry companies and experts in Latvia.

The Latvian space industry (like that of other countries) needs to ensure development to the stage of commercialization of technology to make a full contribution to the global space industry and benefit from the opportunities provided by the global space industry. MoE, in close cooperation with other institutions, is actively raising awareness of the Latvian space industry, related industries and the general public about national, European and global level space industry opportunities and promoting active participation in them. Particular attention is paid to internationalisation and the involvement of non-space businesses, as the space industry offers versatile opportunities for commercialisation, export and technological development.

The MoE and the LIAA have organised several space-themed events to position Latvia as an active player in the global space industry and provide valuable networking opportunities, and they also provide the necessary support for the Latvian space industry to be represented at major industry conferences and exhibitions across the world (e.g. the International Astronautical Congress), as well as in committees of international organisations such as the European Space Agency, the European Union Agency for the Space Programme (EUSPA), the United Nations, etc., thus facilitating both the launch of new bilateral cooperation projects and the visibility of Latvia within and outside the EU. The MoE, in cooperation with the MoES, ensured the establishment of the European Space Agency Business Incubation Centre in Latvia, which started operating in 2024 with the aim of fostering space business development capabilities.

ESTABLISHMENT OF A KNOWLEDGE TRANSFER SYSTEM SUPPORTING INNOVATION

The LIAA is a central element, and a mediator in the ecosystem of innovations in Latvia, which fosters cooperation between research organisations and industries along with competence centres. The LIAA also develops the awareness and development of technology transfer in public research organisations, improves their industrial property management policy, promotes the takeover of international knowledge and skills for the organisation of technology transfer processes and ensures the introduction of innovation vouchers support instruments.

To support innovation in the knowledge transfer system during the EU funds programming period 2021-2027, in spring 2024 LIAA started to implement activity 1.2.1.4 *Support for the Improvement of Technology Transfer System* of specific objective 1.2.1 *Strengthening Research and Innovation Capacity and Introducing Progressive Technologies in Businesses*. The knowledge and technology transfer system needs to be improved to develop cooperation skills of the research and business sectors, foster a closer link of scientific activity with the demand from the business sector, satisfying the needs of companies for new technologies and innovative solutions.

Activity 1.2.1.4 *Support for the Improvement of Technology Transfer System* provides an opportunity to commercialise and thus convert into new products and services the results of research funded from public resources, and the private sector will thus ensure further development of the research results and their introduction into the market. Activity 1.2.1.4 *Support for the Improvement of Technology Transfer System* aims to ensure the availability of funding for entrepreneurs to develop and commercialise new products, services or research projects in order to increase the share of innovative entrepreneurs in the economy by creating a link between the final beneficiaries and research organisations that would facilitate the direct transfer of knowledge and become a catalyst for long-term deeper cooperation between the two parties, thus contributing to the achievement of Latvia's RIS3 objectives. At least 200 businesses are planned to be supported by 31 December 2029. At least 38 of them will cooperate with research organisations.

Within activity 1.2.1.4 *Support for the Improvement of Technology Transfer System*, LIAA received 59 applications from entrepreneurs by 31 October 2024, 37 of them were approved for the total amount of 1.08 million euro.

CREATION OF START-UPS

The objectives set out in the *National Industrial Policy Guidelines 2021-2027* provide for building a new economic model based on knowledge and innovation, focusing on strengthening innovation capacity, improving the quality of the institutional environment and increasing business dynamism. Start-ups play an important role in the overall innovation "ecosystem" providing an inflow of innovative business ideas and contributing to a faster shift in the economic paradigm towards the knowledge economy.

The Latvian start-up "ecosystem" consists of at least 626 start-ups, of which 447 are registered in the database of the Latvian Start-up Association. More than half of them are active in information and communication, and more than 20% in manufacturing and professional, scientific and technical activities. In 2022, Latvian start-ups raised 93 million euro in investment and provided more than 3,200 jobs, contributing to the influx of innovative business ideas into the start-up "ecosystem", the development of high value added products and services, the attraction of investment and the transition of the economy to a modern and innovative economy.

One of the priority tasks of the MoE is not only to strengthen cooperation with representatives of the start-up environment and their representative organisations but also to create an environment supporting entrepreneurship through a joint strategy in which start-ups can form and develop their innovation thereby creating preconditions for the growth of the Latvian economy. On 7 September 2022, the MoE, LIAA, Altum, *TechChill* Foundation, Latvian Private and Venture Capital Association, Latvian Startup Association, Riga Technical University, *TechHub* Foundation and *Business Angel Network* Association signed a Memorandum of Cooperation *On the Latvian Start-up "Ecosystem" Development Strategy 2022-2025*, which sets out several activities aimed at promoting strong and unified development of the start-up "ecosystem" and attracting talent to start-ups. It should be noted that these non-governmental organisations representing Latvian start-ups bring together more than 250 members. The Latvian Start-up "Ecosystem" Development Strategy 2022-2025 envisages not only planned activities but also the results to be achieved by 2025, and they are:

- to promote the attraction of investment of 300 million euro to start-ups;
- to increase the number of employees in start-ups by 1500.

In order to implement the directions and activities specified in the Strategy, in 2024, the MoE continued cooperation with the Latvian Startup Association, Latvian *Business Angel Network*, *TechChill*, *TechHub*, Riga Technical University and Latvian Private and Venture Capital Association for a funding of 400 thousand euro from the state budget. Within the framework of the agreements, the organisations implement activities promoting the start-up ecosystem, which included, for example, the development of the *startin.lv* database, the organisation of investment sessions, consultations, and masterclasses for start-ups and investors; the organisation of an international conference *TechChill 2024*, as well as the Start-up day.

In 2024, the MoE has developed amendments to the *Law on Aid for the Activities of Start-up Companies*, which provides for permanent delegation of the legislator to promote activities of the start-up "ecosystem" and attract investment, i.e. enabling the MoE to enter into cooperation agreements with organisations representing start-ups specified in CM Regulations in order to continue promoting the activities supporting start-ups and attraction of investment.

In support of the abovementioned organisations representing the Latvian start-up environment, which have developed a common approach or strategy to promote the development of the Latvian start-up "ecosystem", the state reinforced its clear position regarding the role of the start-up "ecosystem" in the development of the national economy and continued working on both local and international level to promote the image of Latvia as a country favourable to start-ups and attracting investment.

SME INNOVATION SUPPORT AND BUSINESS INCUBATION

In continuing the activities motivating to start business and business incubation across Latvia and enter foreign markets, on 13 July 2023, the CM approved *Implementing Regulations of Activity 1.2.3.1 Support for Innovative SME Business Development of Specific Objective 1.2.3 To Promote Sustainable Growth, Competitiveness and Job Creation for SMEs, Including Through Productive Investments of the EU Cohesion Policy Programme for 2021-2027* proposed by the MoE, which provides for channelling 87.2 million euro by the end of 2029. One of the support activities within the SME aid programme is support for business incubation, which includes grants for services for business development, rental of premises and workplaces, prototyping and development of technologies, purchase of production equipment, purchase of raw materials, as well as one minimum monthly wage and mandatory state social insurance contributions for one employee once in a 12-month period only for an innovative business. A total of 22 LIAA representations are planned throughout the territory of Latvia, which also provide advisory support to Latvian entrepreneurs regarding aid possibilities. Support for business development and promotion measures, such as seminars, consultations, mentoring, as well as grant support to promote international competitiveness (participation in exhibitions, marketing activities for arranging conferences and other activities), will also be provided within the SME aid programme. Within the framework of the SME aid programme, LIAA must establish close cooperation with local governments to ensure the effective implementation of the programme.

A total of 2000 companies developing their business projects are planned to be supported within activity 1.2.3.1, of which at least 600 will be authors of new ideas, and at least 300 new products will be created. Based on the estimates of the responsible authority, the turnover of the companies supported by the activity and LIAA is planned to grow and exports are planned to increase by 20% (between 2024 and 2029). 700 exporting companies would also be supported and 1000 new jobs would be created, thus it could be ensured within the activity that supported businesses will pay 150 million euro in taxes annually.

Within activity 1.2.3.1 *Support for Innovative SME Business Development*, 161 businesses have been supported in the business incubation activity by 31 October 2024, 13 of them with grants, while 278 businesses have been supported in the export promotion activity, 233 of them with grants and 89 with non-financial support. The total funding spent was 10.5 million euro.

COMPETENCE CENTRE PROGRAMME

One of the most important tasks is to build understanding of companies about research, development and innovation as drivers of growing productivity and competitiveness of companies.

Support for the development of new products and technologies is provided as smart specialisation continues to be implemented in Latvia:

- On 5 July 2022, the CM approved *Implementing Regulations of the First Round of Investment 5.1.1.2.i Instrument to Support Research and Internationalisation of Reform 5.1.1.r Innovation System Governance and Private Research & Development Investment Motivation of Reform and Investment Direction 5.1.r Increasing Productivity by Increasing Investment in R&D of Latvia's Recovery and Resilience Facility Plan* proposed by the MoE. A total support of 25 million euro was granted to 8 projects;
- On 9 January 2024, the CM approved three more support measures for research activities promoted by the MoE: *Implementing Regulations of Activity 2 of Investment 1.2.1.2.i " Development of Innovative Products and Technologies" and Investment 2.2.1.3.i Support for the Introduction of New Products and Services into Business of the Second Round of Investment 5.1.1.2.i Instrument to Support Research and Internationalisation of the Recovery and Resilience Facility*. The total support was 111.9 million euro and it was granted to 24 projects in 2024;
- On 22 October 2024, the CM approved a support measure for the development of new dual-use products and technologies. Support will be provided for industrial research, experimental development and feasibility studies to develop products and technologies that are adaptable to both defence and civilian needs, enhance Latvia's strategic resilience and have a wider economic impact.

In total, it plans to support more than 410 businesses, create 1,850 new jobs and attract private co-financing of 95 million euro.

FOSTERING INTERNATIONAL COOPERATION

Lat.Tech, Latvian Innovation and Technology Representation established in Brussels in April 2021, continues its activities aiming to strengthen the position of Latvian enterprises and research institutes in cooperation projects of international organisations. The representation acts as a bridge between Latvian enterprises and research organisations to facilitate their participation in *Horizon Europe*, for example, to engage in international consortia of projects and initiatives. A significant task of the representation is to belong to a family of similar offices of other countries, as well as to highlight Latvia's excellence in smart specialisation in the lobbying and decision-making environment of Brussels.

In October 2023, the LIAA Innovation and Technology Representation started functioning in Geneva. Its task is to support Latvia's progress towards the status of a fully-fledged Member State of the European Organization for Nuclear Research (CERN) and to work in one of the most important science laboratories in the world to increase the R&D capacity of Latvian enterprises through industry procurement in CERN and closer involvement in the organisation's technology transfer projects. Latvia has been an Associate Member State of CERN since 2021 and Latvia intends to become a full member of this organisation in the next few years. CERN can potentially provide Latvia with new opportunities for the development of both science and business.

Latvia continues successful cooperation with the European Space Agency as an Associate Member. For Latvia, this cooperation means direct access to large-scale international missions and export markets, as well as the development of science-intensive innovation and STEM human capital. In the last two years, several success stories have been created that will mark Latvia's name in global space missions. In order to continue the growth of the Latvian space sector and Latvia's future participation in the European Space Agency, it is necessary to ensure the fulfilment of the contractual obligations by paying the membership contributions to the extent stipulated in Latvia's Association Agreement. Latvia's contributions to the European Space Agency are guaranteed to be returned to Latvia through the participation of Latvian organisations in European Space Agency projects and international consortia, as well as administrative and expert services under an agreement.

12. PROMOTING PRODUCTIVE INVESTMENTS AND EXPORTS

12.1. PROMOTION OF ACCESS TO FINANCE

The purpose of the implementation of financial instruments is to reduce market failures and to promote the creation of new economic operators and the growth of existing ones, ensuring access to funding to make possible the implementation of prospective and viable business projects for those economic operators, who due to insufficient security, history of economic activity, credit history, net income flow or the amount of current credit obligations were unable to attract funding from participants of the financial market (commercial banks, private investors) for the implementation of business projects in the necessary amount.

The ERDF funding of 161 million euro was channelled to financial instruments in the 2014-2020 programming period of EU funds. In addition, Altum raised its funding or used repaid funding of the funds growing its portfolio to 1 billion euro during the period. Overall, more than 1500 companies were supported and private funding of 327 million euro was raised for the implementation of different business projects – from starting a business to entering foreign markets.

Taking care of the continuity of availability of funding to SMEs also in the new programming period of EU funds 2021-2027 state support programmes continue to be implemented in the form of financial instruments, providing loans for starters of business and entrepreneurs extending their activities. Guarantees, loans with a capital rebate and venture capital instruments are also provided to entrepreneurs. Overall, EU CF funding of 506 million euro is planned to be channelled to financial instruments with 231 million euro channelled for productivity activities and 275 million euro – for energy efficiency. In total, 2000 companies are planned to be supported and private funding of 800 million euro is planned to be raised.

INVESTMENT FUND

To ensure access to finance for large investment projects aimed at economic recovery following the COVID-19 crisis, on 6 July 2021, the CM approved Regulations No. 503 *Regulations regarding Loans with Capital Rebate for Investment Projects for Merchants for Promotion of Competitiveness* (hereinafter – Investment Fund). 282.56 million euro are currently available in the Investment Fund. The objective of the Investment Fund is to stimulate an influx of new investments to expand entrepreneurship by stimulating entrepreneurs to make new investments and thus create a value added chain throughout the economy.

The application for the support programme for large investment projects started in 2022. The programme is planned for development projects from 10 million euro. When achieving the objectives of the project and fulfilling certain criteria, a company can qualify for a loan with a capital rebate of 30% or repayment of the portion of the loan granted by Altum. Since October 2023, entrepreneurs can apply for an additional loan of up to 30 million euro (excluding the amount of the capital rebate) in the Investment Fund. Overall, 3 selection rounds of the loan programme were organised within the support programme, within the framework of which it is planned to support 33 businesses whose investment projects are expected to create more than 1,473 new well-paid jobs, ensuring an export volume of at least 470.4 million euro per year and investment in R&D of at least 20.1 million euro. Until now, Altum has approved 18 investment projects for total eligible costs of 424.67 million euro and with a capital rebate of 115.9 million euro (including agreements were concluded with 14 businesses).

PORTFOLIO GUARANTEES

On 12 September 2017, the state support programme *Portfolio Guarantees* was approved. It is implemented in cooperation with funders selected in an open selection process (credit institutions and alternative financing service providers), who can grant loans to entrepreneurs with an Altum guarantee, without Altum's direct involvement, within a certain amount of financing.

The guarantees provide entrepreneurs with the opportunity to receive investment and working capital loans and financial leasing with a term ranging from 1 to 10 years up to a volume of 250 thousand euro. 14.2 million euro of repaid public funding are available for issuing of the guarantees. At the same time, ALTUM plans to use the available funding of 9.8 million euro under activity 1.2.3.4 *Guarantees, Portfolio Guarantees for Full-Cycle Business* of the 2021-2027 EU Funds programming period for the issuance of guarantees from Q4 2024. By 31 September 2024, a total of 1,475 financial services have been issued with ALTUM portfolio guarantees in the three rounds of the portfolio guarantee programme, bringing the total amount of guarantees to 65 million euro.

VENTURE CAPITAL SUPPORT

To continue the support to start-ups started and provided in the 2014-2020 programming period providing for venture capital investments, on 15 August 2023, CM approved at its meeting a new EU Structural Funds support programme for venture capital investments in business with total financing of 80.6 million euro.

Around 50 million euro are planned to be invested and at least 27.5 million euro are planned to be raised in private investment within the activity. 400 companies (of which at least 300 are start-ups) are planned to be supported and 300 new jobs are planned to be created during the implementation of the activity. The support of the companies will result in at least 12 million euro paid in taxes every year and exports for at least 20 million euro every year. In September 2024, a procurement procedure was concluded with the selection of three start-up venture capital fund managers and one growth fund manager, and the process of concluding contracts with the above fund managers is now underway.

MICROCREDITING

The *Start Loan Programme* in the 2014-2020 programming period of EU funds is implemented within the framework of activity 3.1.1.4 *Microcrediting and Loans to Starters* of the specific objective 3.1.1 *To Foster Creation and Development of SMEs, in Particular in Manufacturing and in RIS3 Priority Sectors* of the Operational Programme *Growth and Employment*. Starters can receive loans in the form of direct financial instruments. The Start Loan Programme is an important type of state aid for companies at an early stage.

Since June 2016 start loans can also be received for the implementation of viable business projects – for investments and working capital. The loans are issued to economic operators, which have been registered in the Commercial Register no longer than five years (of their establishment). Start loans play a pivotal role for business starters, granting them access to the necessary funding for prospective and viable projects. This is particularly beneficial for economic operators who, due to factors such as insufficient security, a limited history of economic activity, credit history, net income flow, or existing credit obligations, face challenges securing funding from traditional financial market participants like commercial banks or private investors.

750 start loans for 18.3 million euro and 227 microloans for 3.1 million euro had been issued by 30 September 2023. To ensure the continuity of support, the support programme *Start and Growth Loans* (hereinafter – activity 1.2.3.3) is also foreseen for the 2021-2027 EU programming period. On 19 September 2023, the CM approved amendments to CM Regulations No. 328 of 31 May 2016 *Regulations Regarding Micro-Loans, Start and Growth Loans*, which aim to continue providing support for investments and current assets. The maximum amount of the loan is 250 thousand euro with a loan maturity of up to 15 years. Activity 1.2.3.3 has supported 200 businesses for a total amount of 8,38 million euro. Of these, 119 are new businesses.

LOAN GUARANTEE PROGRAMMES

Loan guarantee support activities for starting business and development in situations, when own funds of the company are not sufficient to attract the necessary funding from commercial banks or the company is classified as too risky.

The support programme has ERDF funding of 49.8 million euro from 2014-2020 programming period of EU funds for the support of small and medium-sized enterprises and 3.51 million euro reimbursed from previous periods of EU Funds for the support of large enterprises. At the same time, additional funding of 29.6 million euro is foreseen from 2024 for the issuance of guarantees under the EU Cohesion Policy Programme 2021-2027.

The programme has been functioning since June 2016 and by 30 September 2024 944 guarantees were issued, totalling 248.06 million euro, guaranteeing financial services for at least 293.4 million euro, which evidences of constantly high demand for such financial instruments.

EXPORT CREDIT GUARANTEES

The MoE continues the export support measures initiated in the previous years. Altum short-term export credit guarantees are a significant support for exports. From the beginning of the current export credit guarantee programme in 2017 until 30 September 2024, export credit guarantees have been issued for 332.01 million euro (declared export amount – around 181.1 million euro) and 143 companies have been supported (unique). On 19 September 2023, the EC provided coordination for the extension of the term of issuance of export credit guarantees to EU and developed OECD countries, thus Latvian undertakings will be able to receive short-term export credit guarantees until 31 December 2028 regardless of the size of the exporting company and the (buyer's) debtor's country.

SME LOANS

In the SME loan programme, since the end of 2021, activity 3.1.1.7 *Loans for the Development of Micro, Small and Medium-Sized Economic Operators* and activity 13.1.1.1. *Loans to Promote the Development of Micro, Small and Medium-Sized Economic Operators* provide financing for loans for the implementation of SME projects, incl. providing loans for sustainability of companies. By 30 September 2023, 209 applications for 54.1 million euro have been approved. To continue support for the sustainability of companies started and provided in the 2014-2020 programming period, the activity will also be implemented in the 2021-2027 programming period, and support has already been provided to 37 businesses, concluding agreements for a total of 12.6 million euro. 50 economic operators are expected to be supported.

CAPITAL MARKET DEVELOPMENT SUPPORT

To move towards increased access to financing for businesses and promote the development of the capital market, on 17 October 2023, the CM approved the support programme of the new FU Funds programming period 2021-2027 *Support for Participation of Enterprises in Capital Markets*, which provides support to entrepreneurs for inclusion of stocks and debt securities in a trading place – costs of attracting consultants and services, not exceeding 50% of the eligible costs of the project. SMEs and small midcaps will be supported. 10 businesses are planned to be supported and private financing of 2 million is planned to be raised. Project applications can be submitted until 31 December 2026.

On 13 June 2023, the CM supported the creation of an initial public offering fund for SMEs in the Baltics (IPOs), thus providing financing for the initial listing and inclusion of SMEs in the Baltic stock market (both on the regulated market and the alternative market of the multilateral trading facility (MTF) on the *Nasdaq* Baltic stock exchange). The fund will act as a specialised financial intermediary and will focus on profitable SMEs. An average of 2-3 million euro is expected to be invested in one company. Altum and Lithuanian Development Finance Institution INVEGA are expected to participate in the creation of the fund. The total planned amount of the IPO Fund is 48.8 million euro, of which 20 million euro will be Altum's contribution, 18.8 million euro will be INVEGA's contribution, and the fund manager will have to raise 10 million euro from private investors. In 2024, the fund is being created and the manager is selected.

12.2. PROMOTING ENERGY EFFICIENCY

By approving *Latvia's National Energy and Climate Plan 2021-2030* (National Energy and Climate Plan 2030) by CM Order No. 46 of 4 February 2020, the Latvian government has set energy efficiency targets to be reached by 2030:

- total indicative national energy efficiency – total primary energy consumption not more than 165 – 170 PJ and final energy consumption not more than 145 – 149 PJ;
- annual final energy consumption saving of 0.8% – final energy saving of 1.76 Mtoe (20,472.02 GWh) accumulated in 2021 – 2030;
- annual renovation of 3% of the state-owned building area (maximum estimates – 500 thousand m^2).

The main task of introducing energy efficiency improvement measures is to limit the increase in consumption of primary energy sources and final energy consumption and to reduce overall energy consumption. Energy savings for end consumers are obtained through financial support programmes for undertakings (economic operators), households (residential houses) and the public sector.

The measures taken by the parties responsible for the energy efficiency obligation scheme and the measures stated in mandatory energy audits and introduced by companies have also contributed to progress towards state energy efficiency targets. Energy efficiency improvements in enterprises are an important element in facilitating EU competitiveness, therefore, since 2015 all large enterprises in the EU are obliged to conduct regular energy audits.

Support Programmes for Improvement of Energy Efficiency (as of 8 November 2024)

Several programmes supervised by the MoE are currently being implemented to support energy efficiency projects.

Recovery and Resilience Facility support programme

Improving the energy performance of multi-apartment houses:

- funding has been reserved for 166 projects for all the available funding of the Recovery Fund of 57.282 million euro and detailed documentation is being developed for these projects. Agreements on the implementation of 53 projects have already been concluded (Recovery Fund – 14.074 million euro, total eligible project costs – 35.775 million euro).

Improving the energy performance of public sector buildings, including historical buildings:

- funding has been reserved for 9 projects for the total Recovery Fund financing of 23.956 million euro and detailed technical documentation is being developed for these projects to be able to conclude agreements on the implementation of projects.

Increasing energy efficiency in business:

- funding has been reserved for 419 projects for the total Recovery Fund financing of 36.997 million euro;
- planned CO_2 reduction per year for the applied projects – 9.9 thousand tons.

Support programmes implemented from funds that are not EU support

Energy efficiency programme for private houses (the programme was closed on 2 August 2024):

- 1,222 projects requesting funding of 5.3 million euro were approved by Altum;
- the implementation of the projects will increase the energy efficiency class of the private house at least to class C and reduce heating consumption at least by 20%.

Repair fund:

- Altum has granted 247 loans amounting to 17.3 million euro for repair and improvement of multi-apartment residential houses;

Indicators achieved in the EU funds programming period 2014-2020

Energy efficiency programme for multi-apartment houses:

- 627 projects for the requested CF funding of 200.864 million euro were supported at Altum, which achieved the following indicators:
  - the average energy consumption reduction in homes – 60%;
  - the annual average energy consumption for a renewed house – 57 kWh/ m^2;
  - annual CO_2 reduction – 24.4 thousand tons.

Energy efficiency programme for public buildings:

- 130 projects for the requested CF funding of 86.78 million euro were supported, which achieved the following indicators:
  - the total area of state-owned buildings, which was renewed within projects – 112,583 m^2;
  - the annual average energy consumption of the buildings after a year of implementation of the project – 110 kWh/ m^2.

Energy efficiency programme for production buildings:

- 91 projects for the CF funding of 18.61 million euro were supported, which achieved the following indicators:
  - annual energy savings of economic operators that have received support – 124,015 MWh;
  - additional capacity generated from renewable energy sources (heating boilers + solar collectors) – 6.32 MW;
  - annual CO_2 reduction – 20,244 tons.

Energy efficiency programme for the district heating system:

- 126 projects for the CF funding of 70.557 million euro were supported, which achieved the following indicators:
  - additional installed capacity of renewable energy sources – 23 MW;
  - reconstructed production capacity– 292.51 MW;
  - reconstructed heating networks – 61.37 km;
  - annual reduction in heating energy losses in reconstructed heating networks – 56,749 MWh;
  - annual CO_2 reduction – 256,198 tons.

12.3. SUPPORTING ACCESS TO FOREIGN MARKETS

Intergovernmental treaties and agreements, hereinafter – agreements, on economic cooperation are concluded with the aim to strengthen and extend economic, industrial, scientific, and technical cooperation, while fostering favourable conditions for cooperation among economic operators. At present, Latvia has concluded and maintains intergovernmental agreements on economic cooperation with the United Arab Emirates, Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Kuwait, China, Moldova, Saudi Arabia, Tajikistan, Turkey, Turkmenistan, Ukraine, and Uzbekistan.

In 2022, based on a CM decision, the previously concluded agreements on economic cooperation with Russia and Belarus were suspended in response to hostilities in Ukraine conducted by Russia and backed by Belarus and in view of sanctions imposed against Russia and Belarus.

Latvia's bilateral economic cooperation agreements provide for the establishment of an Intergovernmental Commission (IGC) or Joint Committee (JC) to ensure regular monitoring of the functioning of these agreements and to analyse ways to improve future economic cooperation between the contracting parties. Their agenda includes issues of bilateral economic cooperation, which are important for contracting countries at the level of governments and businesses in various areas: trade and investment attraction, industry, transport and logistics, pharmaceuticals, agriculture and forestry, IT, financial services and start-ups, clean technologies, innovation, tourism, etc.

Two IGC meetings (with Kazakhstan and Ukraine) were held in 2024.

The 9th meeting of the Latvia-Kazakhstan IGC on economic, scientific and technical cooperation was held in Riga on 16 May 2024. The meeting was chaired by the Minister of Welfare of Latvia and discussed the current developments in bilateral economic cooperation, as well as opportunities for expanding cooperation in trade and investment, transport, clean technologies, agriculture, education and science, information and communication technologies, start-ups, digital connectivity, tourism, workforce, etc. The parties also agreed to continue to work on broadening the contractual legal framework in the areas of agriculture and air transport.

The 10th meeting of the Latvia-Ukraine IGC was held in Kyiv on 22 May 2024. The meeting was chaired by the Minister of Economics of Latvia and focused on trade and investment, energy, transport, agriculture, environmental protection, conformity assessment, intellectual property and innovation, space, health, etc. The Latvian delegation's visit to Ukraine included two business forums in Kyiv and Vinnytsia, as well as a series of meetings, including to discuss opportunities for cooperation in transport, energy and defence, and Latvia's involvement in Ukraine's reconstruction.

To continue intergovernmental dialogue, meetings and visits were also held in 2024, including with the participation of entrepreneurs, to explore opportunities to intensify and diversify Latvia's cooperation with Germany, France, the United States, Estonia, Finland, Norway, Japan, South Korea, Ukraine, Moldova and other countries.

In September 2024, the President of the Republic of Latvia, the Minister of Economics and a delegation of entrepreneurs visited the United States. The visit included San Francisco and neighbouring Silicon Valley, the world's technology hub, Denver and Houston, the energy capital of the United States. The purpose of the visit was to establish contacts with investors, potential clients and US partners, to develop new cooperation opportunities and Latvian-US joint projects, as well as to learn more about US market opportunities and regional economic trends.

LATVIA'S FOREIGN ECONOMIC REPRESENTATIONS

LIAA representations operate in several countries of the world to solve economic issues and support Latvian businesses. They organise national stands at international trade shows abroad, organise trade missions, provide advice on foreign markets and organise meetings with potential business partners.

In 2024, Latvia's foreign economic missions provided support in 18 countries (South Korea, UAE, France, the Netherlands, Denmark, Sweden, Australia, Norway, Italy, Germany, Austria, Japan, Uzbekistan, Ukraine, the United States, UK, Canada, Finland) with 21 representatives working there. There are have 2 representatives in Norway, Sweden and Germany, one in investment attraction and the other in export promotion.

Representations in Russia and Belarus stopped working because of Russia's war against Ukraine. Having assessed the geopolitical situation, the representation in China was also closed.

LIAA also offers economic operators the services of the Enterprise Europe Network (EEN) – assistance in searching for international partners, preparation of market information, consultations on legislation and business aspects, consultations on access to finance (*Horizon 2020, Erasmus, Creative Europe, Interreg*, etc.) and other consultations. EEN successfully complements the services provided by the LIAA – providing advice to economic operators regardless of the industry, access to information in 69 countries around the world and specific resources developed by the EC. The EEN project is implemented in cooperation with the Latvian Technological Centre and the Latvian Chamber of Commerce and Industry.

In 2024, Latvian companies also made active use of the matchmaking events offered by EEN, especially when they were offered at exhibitions where companies participated either with their own stand or at already organised national stands.

During the 9 months of 2024, 915 consultations on foreign markets and other business-related matters were provided, 32 broker activities and foreign trade missions were organised and information activities were organised in the framework of the EEN project involving 279 participants. 7 innovation and technology audits were conducted in companies. The mandatory "customer path" model introduced by the EC has been successfully used in the day-to-day work with companies, i.e. an evaluation of the company has been carried out and an action plan has been developed based on a questionnaire in line with EC requirements, which is an agreement between EEN and the company on the provision of a successful service. EEN has gained popularity among members of the Latvian Chamber of Commerce and Industry and, as a result, there is also a high interest in EEN services. Based on the interest of companies, a business evaluation is of course also carried out. In January-September 2024, this business evaluation was been carried out for 157 companies. 37 partnership achievements have been registered with other companies and research institutions, and 15 business, technology and research cooperation agreements have been concluded.

NATIONAL PLATFORM FOR BUSINESS DEVELOPMENT

To improve the awareness of potential and existing economic operators of business developments, enhance LIAA's customer service processes, and simplify obtaining information and communication, LIAA has developed a national platform for business development *business.gov.lv*, which contributes to the digitisation of services and the development of e-services.

The platform *business.gov.lv* has been set up as a *web*-based customer self-service platform for the acquisition of personalised information and communication, where an economic operator can create its profile, indicating industries of interest, topics and other criteria for receiving personalised information, apply electronically to the services provided by LIAA, including the possibility to submit forms, payment requests and other documents electronically. The platform provides in one place information about industry news, news abroad, and different events addressed to economic operators. The creation of the content of the portal is supported by the sectoral ministries, the CSB, Altum, the Latvian Chamber of Commerce and Industry, the Bank of Latvia and other commercial banks and institutions.

To ensure further development of the platform, on 10 May 2023, the CM approved Order No. 265 "On the approval of the passport and centralised function or shared services development plan of investment project 2.1.2.1.i *Digital Services Platform for Promotion of Business Development*, which is planning to invest 1.68 million euro in the platform by 31 December 2025 within the framework of the EU Recovery and Resilience Facility providing it as a single platform for entrepreneurs and a single digital gateway for cooperation of entrepreneurs with the state. As a result of the investment project, the business section of the Latvian government services portal *www.latvija.gov.lv* will be gradually taken over and developed in the existing LIAA-administered portal *business.gov.lv* in line with modern usability requirements and business needs of entrepreneurs. In 2024, LIAA started working on defining the vision and principles of *business.gov.lv* platform and developing its architecture, testing an approach to displaying, searching and digitally fulfilling business requirements and services.

EXPORT MARKETING ACTIVITIES

In 2024, the CM approved the reallocation of the budget appropriation of 6 million euro to provide the funding needed by MoE and LIAA for the implementation of export promotion and investment attraction activities in 2024, including 2.9 million euro to the budget programme *Implementation of Foreign Economic Policies*, 3 million euro to the budget programme *Implementation of Tourism Policy*, 123 thousand euro to the budget programme Sectoral Management and Policy Planning.

These funds are earmarked for the implementation of export promotion and investment attraction activities (trade missions, meetings between Latvian and foreign companies, matchmaking events, etc.) to meet the performance indicators set for 2024:

- the amount of export contracts concluded 30 million euro in 2024;
- the number of foreign tourists in Latvia increased by 200 thousand in 2024, generating additional tourism and event export revenues of at least 41.2 million euro in 2024;
- success stories of proactively attracted investment projects for at least 35 million euro in 2024.

In January-September 2024, LIAA organised 15 trade missions, which were attended by 174 representatives of Latvian companies, and 20 thematic events with diaspora involvement for export promotion, investment attraction, business development and promotion of Latvia's international visibility.

The export capacity of Latvian businesses continued to be strengthened by launching marketing campaigns organised around the country's image, for example, during two international exhibitions in Germany(*Berlinale*) and France(*Marche du Film*). The website *latvia.eu* is maintained on a daily basis as a digital business card for Latvia, providing a unified message about Latvia. The "toolbox" section of the website is regularly updated with presentations, video materials and other useful information about Latvia, including investment attraction and RIS3 sectors, so that anyone interested can use these materials in their daily work when presenting Latvia to potential partners abroad.

PREPARATIONS FOR EXPO 2025 OSAKA

In 2024, Latvia actively worked on its participation in Expo 2025 Osaka. The aim is to create a joint pavilion of the Baltic countries, which will promote the region's visibility while preserving each country's individual programmes. The Baltic countries will be represented at Expo 2025 Osaka by Latvia and Lithuania. Latvia has been nominated as the lead country for organising the Baltic pavilion and the pavilion will be rented from the organisers of the exhibition.

The exhibition is scheduled to be held from 13 April to 13 October 2025. 153 countries and 8 international organisations have confirmed their participation in the exhibition. About 28 million visitors are expected to visit the exhibition. Participation in Expo 2025 is a unique opportunity to position Latvia internationally as a country focused on technology and innovation development. At the same time, it is an opportunity for companies to expand their network of contacts and meet potential partners from many countries around the world.

In preparation for Latvia's participation in Expo 2025 Osaka, several export promotion events were organised in the second half of 2024, such as participation with a national stand in the building materials exhibition Japan Build in Tokyo and the ICT industry exhibition CEATEC in Tokyo, as well as a Latvia-Japan business seminar in Kobe as part of the 50th anniversary of the Riga-Kobe twinning. The range of exhibitions taking place in Japan has been assessed. Latvian companies are offered the opportunity to participate in these exhibitions at Latvian stands, so that Osaka companies can assess their potential and the opportunities offered by this distant, promising but not easy export market before Expo 2025.

SUPPORT FOR THE DEVELOPMENT AND EXPORT OF INNOVATIVE BUSINESS OF SMES

The ERDF project *Development of Innovative Business of SMEs* developed by the LIAA was approved on 26 September 2023 to ensure the availability of financing for the implementation of a business idea and the development of business, promoting activities aimed at increasing the proportion of innovative entrepreneurs in the economy and promoting business aimed at creating high added value in the field of medium-high and high-tech and creative industries, and promoting export growth in supported companies. In the project, the LIAA implements activities covering the full support of the business development cycle – from the idea of creating a new technologically intensive company to a stable, competitive, growth-oriented business with high added value. To support enterprises entering foreign markets, as part of the project support is provided both in the form of grants and by offering participation in export promotion activities organised by the LIAA such as national stands in international exhibitions, trade missions, etc.

The project was launched on 29 November 2023. With existing resources, it is planned to be implemented until 30 June 2027. The total funding of the project is 66 million euro, incl. ERDF funding of 56 million euro. The project funding for export support activities is 31.4 million euro. The export support funding for project grants amounts to 15.4 million euro, and 7.25 million euro is earmarked for export support activities organised by LIAA over 3.5 years, including for the organisation of national stands.

Within the framework of the project, the LIAA carries out activities such as consultations of foreign economic representations of Latvia, implementation of educational and training programmes directed towards the development of business and innovations, organisation of measures for promotion of innovation and business export, including providing support in the form of grants, awarding of prizes and money prizes to the winners of business idea competitions, cooperation with organisations and institutions, etc.

A total of 1500 companies developing their business projects are planned to be supported within the project, of which at least 300 will be authors of new ideas. The increase in turnover of LIAA-supported companies is expected to increase by 12%, exports are forecast to increase by 20% or 0.6 billion euro annually (from 2024 to 2029). 700 exporting companies will be supported, 1,000 new jobs will be created within the project, and supported businesses will pay 150 million euro in taxes annually.

Since the project was launched, LIAA has already received 531 export activity plans, 300 applications for participation in national stands and 444 applications for LIAA-organised trade missions, 447 support agreements have been concluded, and various (1546) export grant activities have been applied for. The total funding reserved for export grants as of 12 November 2024 is 4.14 million euro, which represents 33.3% of the funding available for grants in the project.

SUPPORT TO THE PRODUCTION OF FOREIGN FILMS IN LATVIA

On 15 March 2022, the CM approved a new support programme for the production of foreign films in Latvia – *Procedure by which state budget co-financing is granted for the production of foreign films in Latvia*. The total annual state funding of the support programme until 2025 constitutes 850 million euro. The amount of co-financing available for one project is 20% of the total amount of eligible expenditure indicated in the co-financing agreement, while for eligible remuneration cost items the amount of co-financing is 30%.

The seventh project application selection for the production of foreign films in Latvia was organised in 2024. In total, six film projects were supported in this round, with total eligible costs of their production in Latvia planned at 18.8 million euro in 2024 and 2025, and the planned state budget co-funding for the production of these films is 3.7 million euro. At the same time, the production of these films is expected to result in an increase in VAT revenue for the general state budget by 2.9 million euro.

12.4. POLICY FOR ATTRACTION OF FOREIGN INVESTMENT

The export promotion and foreign investment attraction policy is enshrined in the *National Industrial Policy Guidelines for 2021-2027*. FDI attraction policy is aimed at raising the competitiveness of Latvia as an attractive investment environment, considering the most important aspects for investors: macroeconomic indicators of states, the business environment – simplicity of bureaucratic procedures and the stability of tax policy, availability of an appropriately qualified labour force, market potential, accessibility of the necessary infrastructure, available support instruments and incentives. It is important to attract foreign investment in sectors which ensure changes in the economy structure in favour of external demand oriented sectors, especially those that are defined as medium-high and high technology sectors. The priority in the FDI attraction process must be geographically closest neighbouring countries where Latvia is recognised and no extensive additional resources have to be invested for informative activities; also it has to be oriented towards economically stable and developed countries where the development potential and needs of economy sectors are appropriate for Latvian perspective cooperation opportunities; and countries with Latvian foreign economic representations.

The LIAA plays a significant role in the attraction of foreign investment in Latvia. The strategy of the LIAA for attraction of investment is oriented towards qualitative servicing of incoming investment projects and active operation in attracting investment projects by addressing potential investors. Attraction and promotion of FDI are broken down into four main processes such as strategy and planning (creation of the national level investment policy, setting of goals, investment promotion structure, positioning of competitiveness, targeted analysis of sectors), promotion of interest (marketing and addressing of companies), servicing (project management) and provision of investment services (aftercare and improvement, monitoring of services).

Like in 2023, in 2024, LIAA continued active attraction of investment in RIS3 areas, purposefully promoting the growth of FDI in knowledge-intensive sectors with high added value. 15 trade missions were organised in January-September 2024, in which 174 representatives of Latvian companies participated and more than 1500 contacts have been obtained. There has been active cooperation with Germany, with several exchange visits. In February 2024, an information seminar on the Latvian economy and the advantages it offers took place at Hamburg's Senate for Economics and Innovation. Around 30 Hamburg companies from the ICT and logistics sector attended the seminar. In April, Hamburg's Senator for Economics visited Latvia with more than 20 entrepreneurs from the ICT sector. The delegation met with the Minister of Economics, visited *LMT* and Riga Technical University (RTU), where they learned about RTU's planned activities in the field of microchips.

In May 2024, Latvia hosted a major business event, the Latvia-France Business Forum, focusing on transport, security and energy. The Forum was attended by around 70 guests from France, Lithuania, Italy, Spain and Estonia, around 70 Latvian entrepreneurs and representatives of 10 government institutions – ministries. On the Latvian side, the Forum was opened by the Ministers of Defence and Transport.

Latvian companies made several visits to Ukraine. Large business delegations attended the business forums in Vinnytsia and Kyiv in May, which took place within the framework of the visit of the Minister of Economics to Ukraine.

In addition to the abovementioned initiatives, investment marketing activities are also being implemented, covering both the organisation of events abroad, for example, the Business Forum in Lisbon (as part of the President's visit), the *Spotlight Latvia* conference, Latvian days in Korea, and the provision of meetings for investors at events organised in Latvia. Events like *DeepTech Atelier*, *5G Techritory*, and the Precision Medicine Networking Forum are worth mentioning, within the framework of which separate events were organised for foreign investors representing the sector to present Latvia's cooperation offers.

The LIAA is actively informing foreign investors about Latvia's investment environment also through Latvia's external economic representations abroad.

COOPERATION WITH THE FOREIGN INVESTORS' COUNCIL IN LATVIA

The process of improvement of the FDI attraction policy has been taking place in close cooperation with the *Foreign* Investors' *Council* in Latvia (FICIL). In September 2024, the twenty-eighth high level meeting between the Latvian government and the FICIL was held, where government representatives and investors discussed human capital, data-driven decisions, good governance and sustainable procurement in the public sector.

During the meeting, the FICIL emphasised the need for a clear long-term development strategy for Latvia. Discussions focused on topics such as access to labour and upskilling/reskilling, combating the shadow economy, modernising the public sector and reducing administrative burdens, promoting fair competition and a more transparent, predictable business environment. Progress in addressing investors' challenges was reflected and efforts were made to ensure that investors stay in Latvia and expand their business. Against this background, the FICIL made key recommendations to improve the business environment in the country. In conclusion, the next steps were listed that need to be taken to boost Latvia's competitiveness and attract investment.

COORDINATION COUNCIL FOR LARGE AND STRATEGICALLY IMPORTANT INVESTMENT PROJECTS

In 2024, the work of the Coordination Council for Large and Strategically Important Investment Projects (hereinafter – the Council) was resumed by CM Decision No. 43 of 9 April 2024 approving amendments to the Council's By-laws, improving the organisation of the Council's work and introducing a more efficient decision-making process. The purpose of the Council is to ensure coordinated inter-departmental cooperation for the successful implementation of investment projects in the national interest of Latvia, including the consideration and resolution of issues of bureaucratic burden and administrative obstacles related to the implementation of investment projects.

The Council is chaired by the Prime Minister, and the Deputy Chairperson is the Minister of Economics. Other participants of the Council are the Minister of Finance, the Minister of Smart Administration and Regional Development, the Minister of Transport and the Minister of Foreign Affairs. The secretariat's functions are provided for the Council by the LIAA. The Secretariat organises the Council meetings and provides the support procedures necessary for the Operational Working Group on Major and Strategically Important Investment Projects established by the MoE. The Operational Working Group agrees on the topics to be discussed at the Council meeting, studies them in depth and develops proposals.

The Council meetings are held every two months. There were three meetings in 2024 – on 9 May, 17 July and 4 September. They addressed issues such as easing the procedure for obtaining a personal identification card (eID card) by foreigners, improving the regulation of wind farm licensing and survey, and the challenges of implementing municipal investment projects. More information about the Council, including the approved minutes of the meetings, is available on the MoE website, in the section on advisory councils.

For a company to initiate a review of the complications or challenges of its investment project by the Council, a representative of the company should contact the secretariat, providing as specific information as possible on the identified problems that make the implementation of the investment project in Latvia difficult and, if possible, what inter-institutional solutions should be provided to solve these problems or mitigate their impact.

SUPPORT FOR INVESTMENT PROJECTS

The *Large Investment Loan with a Capital Rebate* programme plays an important role in the attraction of foreign investment, which provides a capital rebate of up to 10 million euro for strong and large investment projects. The support programme in question has given rise to a high level of interest among entrepreneurs and shows that its activities need to continue, ensuring the continuity of access to finance.

Since 2021, Latvia has had a “green corridor” initiative up and running, which allows investment projects in priority areas to receive certain services from public authorities, such as construction permits, spatial planning permits or residence permits, using an accelerated procedure. During this period, 38 companies with a total planned investment of 1.8 billion euro and 2,529 planned jobs have obtained the “green corridor” status.

In April 2024, the *Innovative Business and Priority Project Aid Law*, developed by the MoE, entered into force, which includes the so-called “green corridor” for certain priority investment and export projects. Under the “green corridor”, Latvian-registered businesses planning to implement specific projects in priority sectors have the possibility to receive state services using an accelerated procedure (e.g. construction, environmental impact assessment, spatial planning and migration government services).

Currently, in accordance with the delegation in the *Innovative Business and Priority Project Aid Law*, the MoE is drafting CM Regulations expanding the scope of the existing regulation and applying more flexible qualification criteria to entrepreneurs. The CM Regulations provide that not only the implementers of a priority project but also traders who have secured a significant volume of investment and export of goods or services in the previous reporting year may apply for the “green corridor” or priority status for 36 months.

12.5. DIGITAL TRANSFORMATION

Investment in the development of the digital transformation of businesses is one of the priorities for promoting productive business. To achieve these objectives, until 2029 companies have access to support for digitisation of business processes, improvement of digital skills, development of new products and services, as well as testing and purchasing of technological equipment.

The MoE is planning to invest 183.5 million euro in digital transformation support programmes within the EU CF for 2021-2027 and Latvia’s Recovery and Resilience Facility Plan.

Two European Digital Innovation Hubs (EDIH) have been approved to help entrepreneurs better identify their needs in digital transformation. They will provide consultations, mentoring, technological services, first and second digital maturity tests, digital development roadmap and report development services.

SUPPORT OF EUROPEAN DIGITAL INNOVATION HUB

On 13 September 2022, by Regulations No. 577 *Implementing Regulations of Investment 2.2.1.1.i. Support for Creation of Digital Innovation Hubs and Regional Contact Points of 2.2.1.r. Establishment of Full Cycle Support for Digital Transformation of Entrepreneurship with Regional Scope of Reform and Investment Direction 2.2 Digital Transformation and Innovations of Enterprises of Component 2 Digital Transformation of Latvia’s Recovery and Resilience Facility Plan* the CM approved the support programme forwarded by the MoE, which aims to promote the competitiveness of businesses through the introduction of digital technologies, as well as digital and innovative public administration, which uses technologies as advanced as in the private sector, to promote the introduction of solutions in conjunction with the Smart Specialisation Strategy, to raise the awareness of businesses regarding the advantages provided by digital technologies, as well as to ensure access to support for digital transformation processes throughout the territory of the Republic of Latvia and to ensure full involvement of Latvia in the joint EDIH network.

Target groups or final beneficiaries of the programme are the micro, small, medium-sized enterprises and large enterprises, associations and foundations, which unite several businesses or represent their interests, public persons or institutions, capital companies of public persons, research and knowledge distribution organisations, agricultural farms, cooperative society doing business. As part of the support, any interested person can receive advice on the degree of digitisation of their company or institution, a road map for identifying priority investments and mentoring on how to digitise the processes of the company or institution. The total investment funding is 10 million euro. According to the plan, at least 2000 companies will be able to receive support until 30 June 2026.

GRANTS FOR DIGITALISATION OF SERVICES AND PRODUCTION PROCESSES OF COMPANIES

On 10 January 2023, by Regulations No. 10 *Implementing Regulations of Investment 2.2.1.2.i. Support for Digitisation of Processes in Commercial Activities of 2.2.1.r. Establishment of Full Cycle Support for Digital Transformation of Entrepreneurship with Regional Scope of Reform and Investment Direction 2.2 Digital Transformation and Innovations of Enterprises of Component 2 Digital Transformation of Latvia's Recovery and Resilience Facility Plan* the CM approved the support programme proposed by the MoE, which aims to issue grants for the development or introduction of digital products, services and applications or acceptance of digital solutions to transform their existing services, products or processes to improve business processes and increase productivity.

The programme is open not only to micro, small, medium-sized and large enterprises (including foreign branches of legal entities, farms, cooperative societies) but also to associations and foundations, which unite at least three undertakings or represent their interests, as well as research and knowledge dissemination organisations and capital companies of a public person. To receive the grant, an EDIH report will have to be submitted, which is an assessment of digital and innovation maturity after the second test and of the compliance of the investments made with the Digital Development Roadmap, as a confirmation that the Digital Development Roadmap has been fulfilled and that the acquisition of the specific equipment or software has contributed to the digitisation of the processes. The total investment funding is 36.14 million euro. According to the plan, at least 200 companies will be able to receive support until 30 June 2026. This investment is also planned to continue within the EU CF 2021-2027, with extra 27.6 million euro channelled to it.

This investment will also be continued from 2025 by Activity 1.2.2.1 Digital Transformation and Innovations of Enterprises of Specific Support Objective 1.2.2 Exploiting the Benefits of Digitisation for Business Development of the European Union Cohesion Policy Programme 2021-2027. The total funding of the activity is 27.6 million euro. By December 2029, it is planned to support 1,750 businesses with grants, 300 businesses with non-financial support and 3,367,541 euro in private investment to complement public support.

LOANS WITH A CAPITAL REBATE FOR DIGITALISATION AND AUTOMATION OF COMPANIES

On 5 July 2022, by Regulations No. 421 *Implementing Regulations of Investment 2.2.1.4.i Financial Instruments for Promotion of Digital Transformation of Businesses of Reform and Investment Direction 2.2 Digital Transformation and Innovations of Enterprises of the European Union Recovery and Resilience Facility Plan*, the CM approved the support programme proposed by the MoE in the form of a financial instrument. The objective of the investment is to promote the digital transformation of businesses, development of businesses and increase turnover by supporting investments in tools for digital transformation of business aimed at productivity growth. Within the framework of the RRF investment, support can be received as a loan with a capital rebate of up to 35% of the total amount of the investment project, but not more than 200 thousand euro.

It is planned as an Altum loan with a capital rebate if no other financer is involved in financing the project and the Altum loan amounts at least to the capital rebate. Similarly, a parallel loan with a capital rebate is possible within the framework of an investment if the project is co-financed together with one or more other financers. The parallel loan in the Altum part amounts at least to the capital rebate. Micro, small, medium-sized and large enterprises will be eligible for the support. To apply for the Altum loan capital rebate, an EDIH report will have to be submitted, which is an assessment of digital and innovation maturity after the second test and of the compliance of the investments made with the Digital Development Roadmap, as a confirmation that the Digital Development Roadmap has been fulfilled and that the specific investment has contributed to the digitisation of the processes. The funding available for the investment is 47.1 million euro. According to the plan, at least 133 companies will be able to receive support until 30 June 2026 raising at least 37 million euro of private funding.

IMPROVEMENT OF DIGITAL SKILLS

To provide Latvian micro, small, medium-sized and large enterprises with digital skills, including skills that contribute to export promotion, basic high-level digital management skills at the level of enterprise management and skills for the use of digital technologies in different business processes, support in the form of grants and non-financial support is planned within the RRF. The RRF financing available for investment 2.3.1.2.i is 16.5 million euro, and support is provided by EDIH or industry organisations representing entrepreneurs.

DEVELOPMENT OF NEW DIGITAL PRODUCTS AND SERVICES

Within the framework of the RRF, support is available for the creation of new digital products and services, which will help the Latvian economy recover from the crisis and promote competitiveness in the future with the introduction of state-of-the-art automation, robotics and labour control tools in the manufacturing facility, as well as support the introduction of personalised e-commerce solutions tailored for the company into sales processes.

The support is available in the form of grants up to 1 million euro with 25%-80% intensity depending on the type of research project (industrial research; experimental development; feasibility study) and the size of its implementer. When starting the implementation of the project the research project implementer will perform a digital maturity test and develop a digital development roadmap. The RRF funding available for the investment is 24.3 million euro. The investment will support at least 60 entrepreneurs, develop 120 new products and technologies, 35 of which will be put into production.

13. CONSTRUCTION POLICY

In 2024, the MoE continued working on the improvement of construction processes finding solutions to improve and simplify the administrative process of construction while maintaining a high level of protection of the public interest and contributing to the safety of construction, at the same time paying particular attention to construction digitalisation and reducing bureaucratic burden.

A plan to limit the shadow economy in the Latvian construction sector was approved, which includes the following measures – to lower the threshold for the introduction of the electronic working time registration system (EDLUS); to encourage the construction industry association to review the general agreement; to provide in the legislation the obligation of the construction concept initiator to submit information on the construction contract price to the Building Information System (BIS); to improve the data exchange format between BIS and the information systems maintained by the SRS; to oblige a private person to provide information in the BIS on the origin of the financing planned for the construction works throughout the construction process; to reduce the area of a residential house construction project where the builder can build on his own without involving a construction contractor from 400 m^2 to 170 m^2. The plan aims to make more efficient use of existing mechanisms rather than developing new ones.

According to the MoE, the EDLUS and the generally binding minimum wage agreement are among the most effective instruments for reducing the shadow economy in construction. In parallel with the measures included in the *Shadow Economy Reduction Plan 2024-2027* regarding the use of the EDLUS, amendments to the *Law on Taxes and Fees*, as well as amendments to CM Regulations No. 21 of 7 January 2020 *Procedures for Providing Electronic Working Time Registration System Data for Inclusion in the Unified Electronic Working Time Registration Database and Requirements for External Security Checks and Audit Trails of the Electronic Working Time Registration System* entered into force on 1 July 2024, providing for the obligation: 1) to submit data to the Unified Electronic Working Time Registration Database (VEDLUDB) on all construction contracts concluded with subcontractors in the previous month, as well as the new contract amount, if any, and the date of the contract amendment; 2) to submit data to VEDLUDB on the contract amount, or part thereof, paid in the previous month. In turn, according to the *Shadow Economy Reduction Plan 2024-2027*, from 1 January 2025, it is planned to lower the threshold for introducing the EDLUS (to reduce the minimum contract value for construction from 350 thousand to 170 thousand euro).

The generally binding general agreement setting minimum wage levels in the construction occupations was also revised: from 1 January 2024 – 930 euro (gross) and 780 euro for elementary occupations. On 25 September 2024, a new agreement was reached to raise the minimum monthly wage to 1,050 euro for normal working hours from 1 January 2025. An exception is the right to retain 930 euro until 31 December 2025 for occupations in Group 9 – employees with the lowest or no qualifications, and, from 1 January 2025, the right to pay 830 euro per month during normal working hours and 4.97 euro/h for employees with less than six months' service record with a particular employer in the last twelve months. By paying the permitted reduced wage (930 euro and 830 euro) and the corresponding hourly tariff rates, the makeup for overtime work shall be payable at 100%, losing the right to pay for overtime at a reduced rate of 50%.

In 2024, the draft *Latvian Construction Sector Strategy 2025-2030* was developed. It is a medium-term planning document for achieving the strategic goals of the construction sector to promote the competitiveness of the sector and its sustainable development. The Strategy reflects the strengths, weaknesses, development opportunities and threats of the Latvian construction sector, which are the decisive factors for defining strategic objectives and implementing specific activities to promote the sector's growth. The objective of the strategy by 2030 is a competitive and sustainable development oriented construction sector that provides high-quality, safe and efficient construction services to society, creating a long-term modern living environment for current and future generations.

In 2024, the MoE developed the *Shelter Construction Standard LBN 210-24*, which sets out the technical requirements for category I and II shelters to be used for the safe shelter of people in the event of a military attack which provide the necessary infrastructure for people to stay in the shelter for extended periods of time.

Amendments have also been made to CM Regulations No. 529 of 2 September 2014 *Construction Regulations for Buildings*. The procedure for constructing prefabricated buildings by introducing a technical passport for prefabricated buildings was integrated into the regulatory framework. This will ensure that prefabricated buildings will be offered on the Latvian market with a level of documentation equivalent to a construction design and will enable the purchaser of a prefabricated building to ensure that it complies with the requirements of the construction regulations when purchasing the building.

The Building Information System has been improved in the area of digitalisation in the construction sector. Improvements to the BIS system in 2024 include more accurate checking of data on cultural monuments and identification of protection zones, and the process of applying for these permits has been simplified. The coordination of construction design documents has been supplemented with new tools, such as the possibility to compare the coordinated design with the original version.

Automatic invoice generation using SRS data has been introduced in the Register of Construction Merchants. New jobs were created, for example, for the Jurmala Cultural Space and Environmental Design Centre or for independent experts. Improvements, including the merging of certificates, have been made to ensure the transition to a fully digital data exchange between the register and managers. The functionality of the Register of Energy Certificates of Buildings has been extended with the possibility to label buildings with specific systems, such as heating or ventilation systems with a nominal capacity above 290 kilowatts, and built-in statistics selection capabilities. A process for merging and dividing groups of rooms was set up. The functionality for requesting and receiving technical rules and opinions was extended to include the automatic cancellation of outstanding tasks and clarification or correction of issued technical rules.

On the public portal, asynchronous download of the construction logbook has been introduced, mandate and delegation rights have been extended, the possibility for construction participants to comment on performance or deadline changes to the construction authority has been created, as well as the processing of project comments has been improved.

In 2024, the MoE implemented measures to improve the competence of construction specialists. The Ministry has delegated the assessment of the competence of construction specialists and the supervision of independent practice to several associations, each of which performs the delegated function in its own field of activity. Given that the competence testing authorities are supported by the supervision fees received, the price list of services of competence testing authorities for architects and construction specialists was revised this year, which has not changed since 2019.

To reduce the administrative burden in the process of concluding a delegation agreement, the CM approved the possibility of concluding delegation agreements for the performance of a public administration task with competence testing bodies for 10 years, instead of 3 years as was the case before. To identify associations willing to take on this public administration task, the MoE launched a call for tenders for On the Conclusion of Delegation Agreements because the 3-year delegation agreements concluded in 2022 with the competence testing bodies will expire on 1 January 2025. The Latvian Association of Architects, the Latvian Association of Construction Engineers, the Latvian Union of Heat, Gas and Water Technology Engineers, the Latvian Association of Electric Energy and Energy Construction Specialists and the Railwaymen Association of Latvia applied for the competition, covering almost all regulated areas and spheres of activity in the construction sector. At its meeting on 29 November 2024, the CM authorised the MoE to delegate to the above-mentioned associations for 10 years the assessment of the competence of construction specialists and the supervision of their independent practice in the field of architecture and in the specialities and areas of activity of a construction engineer or related engineering occupation.

The specialities of construction management and construction supervision were merged to reduce the administrative burden, with effect from 1 January 2024. Construction specialists who have practised in both areas no longer need to maintain two certificates. In view of the fact that the number of construction specialists is decreasing and, in some areas, the number of construction professionals is very small and unable to meet the demand, the MoE together with the competence testing authorities and the construction industry is working on merging certain fields of activity or extending the scope of activity of construction specialists to certain works in similar areas of activity.

In order to promote the renovation and energy performance improvement of serial multi-apartment residential buildings by providing quality standard solutions at the order of the MoE, a standard project for the renovation and energy performance improvement of a series 103 multi-apartment residential building was developed and published in BIS in 2024. The standard design includes solutions for increasing energy performance to Class A, as well as solutions for rebuilding all engineering systems and constructing a decentralised ventilation system. The standard design solutions can be used for the preparation of construction concept documents for the energy performance improvement and renovation of buildings.

The MoE continues its work on the development of standard projects for the renovation and energy performance improvement of multi-apartment residential buildings. In 2024, the development of standard projects for series 316 and 602 multi-apartment buildings was started, providing solutions for building heat insulation, reconstruction of engineering systems, construction of a ventilation system, as well as replacement of lifts in series 602 buildings. For both of these series, a solution for facade heat insulation with prefabricated insulation panels will also be developed.

14. HOUSING POLICY

High-quality, affordable and modern energy-efficient housing is one of the basic needs of the population in both state cities and municipalities and is an important element of the investment environment. Ensuring that housing is affordable to the widest possible range of the population is important, as it affects not only people's well-being but also their ability to participate actively in the labour market and the economy as a whole.

Although the disposable income of households is growing year-on-year, it has not been sufficient to create significant savings for the purchase or rental of housing meeting contemporary needs, as well as poses challenges in maintaining and renovating the existing housing stock. The MoE has developed several support programmes and continues working on new projects to address the issue of the availability of quality housing in Latvia, as well as improvements in decision-making in apartment buildings have been made to facilitate their timely maintenance.

To promote housing affordability, at its meeting of 7 November 2023 the CM approved *Housing Affordability Guidelines 2023-2027*. The guidelines include directions of action, policy indicators and a set of tasks, providing solutions for ensuring housing affordability to households with different income levels, including the lowest-income households, as well as investing in improving the existing housing stock and encouraging investment in the development of new housing stock.

SUPPORT FOR THE CONSTRUCTION OF LOW-RENT HOUSING AND ESTABLISHMENT OF A LONG-TERM HOUSING AFFORDABILITY FUND

Given the existing housing affordability problems, particularly in regions, and the OECD recommendations, support programmes for the construction of low-rent housing are among the priorities of MoE in 2024.

Since 22 November 2022, real estate developers may start applying for a new ALTUM state support programme for the construction of low-rent houses in the regions of Latvia. The total funding of the programme is 42.9 million euro and it is financed from the EU Recovery Fund.

This year, the programme has seen strong demand, even exceeding the programme's available funding, with 5 loan agreements already signed for the construction of 374 apartments in Valmiera, Jelgava, Bauska, Tukums and Ventspils.

RESTORATION OF SOCIAL HOUSING AND CONSTRUCTION OF NEW SOCIAL HOUSING

Both the EC and the OECD have stated in their evaluation that social housing in Latvia is insufficient and in bad technical condition. At the same time, due to lack of funding, the local governments do not supplement the residential fund or improve its technical condition. As a result, the most vulnerable households, even if they qualify for limited housing assistance, may have to wait in line for years until local governments rent them an apartment.

On 19 September 2023, a new EU Structural Funds support programme for the renewal of social housing and the construction of new social housing was approved, which will bring significant improvement of the social housing stock of municipalities and reduction of lines in municipalities for rental and social apartments.

The support is intended in the form of grants for local governments, their institutions or capital companies to renovate or rebuild separate groups of premises (apartments) or buildings owned by local governments and not rented out, as well as for the completion of buildings not previously commissioned and the new construction of residential houses. The homes constructed and renovated within the programme will have to be rented out to persons in accordance with the regulation of the *Law on Assistance in Solving Apartment Matters*, moreover, to the most vulnerable categories of persons specified in this law, such as low-income persons who are evicted from apartments, children left without parental care after the age of majority, special categories of low-income persons (persons with disabilities, persons reaching retirement age), etc., as well as to the categories of persons specified in the binding regulations of local governments.

The total planned funding of the support programme is 60.9 million euro, consisting of ERDF funding of 51.8 million euro and local government co-financing of at least 9.1 million euro. In Q1 2024, round 1 of the selection and evaluation of project applications of the support measure was completed with more than 900 local government housing renovations approved and started. With the support of the programme, it is planned that, by 31 December 2029, local governments will be able to provide a place of residence in at least 1,865 newly built or upgraded social homes.

HOUSING SUPPORT PROGRAMME

The housing support programme has been highly appreciated by the population so far simplifying for families with children payment of the first instalment for the loan for acquisition or construction of housing. During the years of functioning of the programme, since 2015 it has helped more than 28 thousand families to get housing of appropriate size. Since 2018, when the programme was extended providing that also persons under the age of 35 and having higher or vocational education can get a guarantee for the first instalment for the loan for acquisition or construction of housing. In 2020, an additional support programme named "Balsts" was created, which provides large families with the possibility of obtaining a non-repayable state subsidy for the acquisition or construction of housing. The amount of the subsidy, according to the number of children in the family, is between 8 and 12 thousand euro. The subsidy was increased by 2 thousand euro if the housing meets the energy efficiency requirements for nearly zero-energy buildings. Since the programme started, more than 1600 large families have received subsidies.

In order to promote the population's ability to buy housing in the regions, in 2024, the MoE has improved the housing guarantee programme by providing that households with children will be able to receive a significantly higher level of guarantee when buying housing in the regions (up to 50%). These changes were necessary to address the difficulties for households with children in receiving home loans in the regions.

MINORITY VOTE

In order to improve the decision-making of the general meeting of apartment owners and thus facilitate the management of residential buildings, on 30 May 2024, on the initiative of the MoE, amendments to the *Law On Residential Properties* were adopted, which provide for the possibility for the general meeting of apartment owners to adopt a decision with the participation of at least one-third of the apartment owners in the residential building, if the initial general meeting had no quorum to decide. The new regulation will protect the interests of apartment owners who are actively involved in the management of the residential house but are in a minority compared to the passive apartment owners, thus being unable to take decisions due to the inactivity of the majority.

15. TOURISM POLICY

The geopolitical situation negatively affects neighbours of the countries involved in the war, including the Baltic countries, threatening the reputation of the Baltics as a safe tourist destination. Before the war in Ukraine, approximately 30% of tourists visiting Latvia came from Russia, Belarus and Ukraine. To be able to return to the figures of 2019 in terms of tourists attracted, this number has to be offset by tourists from other countries such as Germany, Finland, Sweden, Norway, and the United Kingdom.

Tourism development trends in Latvia in 2024

Inbound tourism

Latvia is successfully adapting to the global changes in the tourism industry, and thanks to targeted efforts to promote Latvia as a safe and interesting tourism destination in Western European countries, Latvia has managed to attract more Western tourists, who are replacing tourists from Russia. In January-August 2024, Latvian travel accommodations served 1.9 million foreign and domestic guests, 1.1 million and 0.8 million, respectively, 10.5% more than in January-August 2023. However, this is down 5.9% from January-August 2019 before the pandemic.

In the summer months (June, July and August) of 2024, which are typically the busiest months of the tourist season in Latvia, 1.1 million guests stayed in tourist accommodations - 0.6 million foreign tourists and 0.5 million domestic tourists. The number of both domestic (7.4%) and foreign guests (14.6%) has increased compared to June-August 2023.

In January-August 2024, the number of nights spent by foreign guests was 1.9 million nights, an increase of 8% compared to 2023. The average duration of stays of foreign guests in tourist accommodations in January-August 2024 was 1.8 nights.

In January-August 2024, the most popular places of stay for foreign guests were Riga (750 thousand), Jurmala (106 thousand) and Liepaja (35.4 thousand). In January-August 2024, most foreign visitors were welcomed from Lithuania (206 thousand), Estonia (128 thousand), Germany (122 thousand), Finland (83.9 thousand) and the United Kingdom (59.4 thousand).

In January-October 2024, Riga Airport served 6 million passengers or 5% more than in January-October 2023. Considering that Riga Airport has the widest route network in the Baltics, which meets the various needs and wishes of tourists, in October this year Riga Airport was used by 667 thousand or 7% more passengers than in October 2023.

Domestic tourism

In January-August 2024, the number of nights spent by domestic guests was 1.3 million nights, an increase of 2% compared to 2023, and the most popular places of stay for domestic guests were Riga (49.3 thousand), Cesis (21.8 thousand) and Jurmala (19.7 thousand).

Tourism exports

Bank of Latvia foreign payment card data show that in Q1 and Q2 2024 the expenditures of foreign tourists in Latvia were 525 million euro, an increase by slightly less than 1% compared to Q1 and Q2 2023. Most was spent on items like hotels and other accommodations, financial institutions – automated cash payout, catering places and restaurants, as well as supermarkets.

According to the information report *On the Export Promotion Strategy for the Latvian Tourism and Events Sector until 2027*, the main priorities of the MoE are to promote sustainable development of the sector, introduction of new digital technologies and legislation alignment.

In 2024, the MoE has started working on the CM Regulations, which lay down the procedure for co-financing of large and important public events in Latvia from the state budget, facilitating the attraction of large-scale events, thus promoting Latvia's name in the world and contributing to the country's economy and regional development.

To address the main competitiveness challenges – fragmentation of tourism supply and the high share of small enterprises in the tourism sector – in 2024, based on the *Tourism Product Development Programme* with a total financing of 6.4 million euro for the development of new tourism products approved by the CM on 22 August 2023, agreements were concluded with four thematic networks (Nature and Active Tourism Cooperation Network, Health Tourism Cooperation Network, Culture and Creative Industries Cooperation Network and Business and Events Tourism Cooperation Network), as well as four geographical networks (Zemgale Tourism Cooperation Network, Vidzeme Tourism Cooperation Network, Gauja National Park Tourism Association and Pieriga Tourism Cooperation Network).

Several major events have taken place in the tourism sector in 2024:

– in July 2024, the FIA World Rally Championship (WRC) stage took place in Latvia, attracting more than 100 thousand spectators over the four days of the rally. The WRC stage in Latvia generated more than 24 million euro for the regional economy, as well as tax revenue of 2.6 million euro of VAT and fuel excise duty on the turnover of foreign guests and participants;

– 31 restaurants were included in the *Michelin Guide* in 2025, adding 6 newcomers (*JOHN Chef's Hall* (*Michelin* star), *B7, BABO, LOWINE, Seasons, Stage 22*) to the selection of restaurants, which shows the determination and desire of

Latvian entrepreneurs to improve and is a significant contribution to the growth of Latvian culture and tourism, which will attract new global travellers, facilitating the flow of tourists not only to the capital but also to the regions.

LIAA TOURISM PROMOTION AND SUPPORT MEASURES

Within the framework of export promotion and investment attraction measures, LIAA provides the activities envisaged in the *Latvian Tourism Marketing Strategy 2021-2027* in the target markets. Activities are planned for the professional and final consumer audiences, promoting priority tourism types – cultural, nature, health and business tourism. Tourism sector organisations and businesses are involved in the marketing activity planning, and the work is organised in the Marketing and Product Development Sub-Group of the Latvian Tourism Advisory Council. LIAA implements cooperation among the countries of the Baltic Sea region in the fields of tourism product development and marketing, ensuring regular communication with the tourism organisations of the Baltic countries within the framework of the Joint Tourism Committee of Baltic States. LIAA is involved in the European Travel Commission ensuring the efficient use of resources from international organisations.

In Q1-Q3 2024, marketing activities for Latvian tourism in foreign markets were implemented:

- national stands and participation of Latvian tourism representatives in three international tourism fairs were organised;
- participation in 13 Latvian tourism promotion events abroad was organised;
- 10 tourism publicity events were organised;
- 7 business networking events for Latvian and foreign tourism companies (matchmaking events) were organised;
- 31 foreign media visits to Latvia were organised;
- 23 visits of foreign tour operators, agents and event organisers to Latvia were organised, during which around 400 industry professionals visited Latvia;
- tourism marketing campaigns were implemented to promote Latvia's tourism offer in Lithuania and Estonia;
- the content of the Latvian tourism portal *latvia.travel* is updated and the portal is regularly maintained and improved, attracting 1.27 million visitors;
- tourism promotion on *Latvia Travel* social network platforms was implemented, printed information materials were provided;
- cooperation with the *Michelin Guide*, international restaurant guide, continued, tourism campaign activities in priority tourism markets and a health tourism promotion campaign were launched.

In 2024, LIAA continued to implement domestic and regional tourism development measures, as well as sector development activities:

- the Home Cafe Days 2024 local marketing campaign was implemented for the fourth time welcoming 86 thousand visitors in 617 home cafes in 41 destinations between July and September, an increase of 20% compared to the previous year;
- to promote domestic tourism, Latvian Television Channel 1 broadcasted five episodes of the programme "It Happened Here" about lesser-known places in Latvia (Liezēri, Trikāta, Vabole, Kurmene un Pope) and their historical events. Shows of season 5 have been watched with replays by more than 488 thousand viewers and are also available on *Replay* without a time limit;
- four experience exchange seminars for tourism entrepreneurs and conferences in four Latvian regions were organised for the development of regional tourism;
- the Latvian Tourism Forum was organised, attracting 400 tourism entrepreneurs and professionals;
- the *Most Exportable New Tourism Product* competition was organised within the framework of the *Export and Innovation Award*, with a special focus on newly created tourism offers with potential in foreign markets;
- the Student Research Competition was organised for research papers highlighting and analysing issues and problems relevant to the tourism sector.

16. CONSUMER RIGHTS PROTECTION AND MARKET SURVEILLANCE

Consumers are the largest driver of the economy. Today the range of fundamental rights of consumers is rather extensive: the right to secure own needs, the right to safe goods and services, the right to be informed, the right to choose, the right to resolution of disputes, etc. To ensure compliance with them and to protect consumers' economic interests, it is essential to implement consumer policy in different directions. Moreover, consumer rights protection requirements should be considered, also when developing and implementing other policies.

Activities of the Consumer Rights Protection Centre (CRPC) in 2024

In 2024, the CRPC continued its activities to protect the interests of Latvian consumers and promote a safe and transparent market environment. There has been an increasing focus on monitoring the digital environment and protecting the economic interests of consumers. In January-September 2024, the CRPC provided 20.8 thousand **consultations** and examined 3,078 consumer **applications and complaints**, an increase of 11% year-on-year.

Consumers are more actively involved in protecting their rights, in particular in matters of conformity of goods (577 complaints), unfair commercial practices, misleading advertising and e-commerce violations (487), and flight and other passenger rights violations (367).

In January-September 2024, most consumer applications in the categories of goods were about clothing and footwear (174 applications), electrical appliances (153) and vehicles (57), while most consumer applications in the categories of services were about airline services (365 applications), entertainment, sports and recreation services (117) and parking services (116). In 2024, the matter of the procedure for the free use of paid car parks and the behaviour of undertakings in imposing contractual penalties, such as failure to enter the car registration number in the registration terminal, incorrect parking, etc., remains a concern for consumers.

In order to carry out monitoring quickly and efficiently, the CRPC continued to proactively monitor information on social media and to expand the range of digital solutions used, including for price monitoring. In 2024, particular attention was paid to monitoring "green notices" and false claims about a product's environmental impact, as well as combating illegal advertising, especially on online platforms.

The CRPC is cooperating with traders more actively to promote voluntary actions by traders to prevent violations and sort out the market, using the *Consult First* principle. In January-September 2024, 63% of the traders to whom CRPC sent an appeal for voluntary elimination of violations have taken voluntary action to eliminate their violation (70 cases completed, action to eliminate a violation taken in 41 cases) or submitted a written commitment (3 cases) to eliminate their violation. However, during the reporting period, the CRPC has also adopted several **significant decisions** imposing fines and legal obligations on traders to eliminate violations. In one case, a trader selling food supplements was ordered to immediately stop unfair commercial practices and a penalty of 20 thousand euro was applied, while two other traders were ordered to stop distributing prohibited advertising of electronic cigarettes and tobacco replacement products and the fine of each them amounted to 50 ,000 euro. In the context of the supervision of the laws and regulations on the prevention of money laundering, financing of terrorism and proliferation, 5 decisions were adopted, obliging traders to eliminate the violations states, for which fines totalling 17,000 euro were imposed.

More and more violations are being detected in the **digital environment** and this proves the need to strengthen supervision in this sector. To better coordinate the monitoring of online intermediation services and actions to combat illegal online content, including the offering of prohibited products and services, misinformation, hate speech, etc., in June 2024, a new structural unit was created alongside the amendments to the *Law on Information Society Services*. It should be noted that in November 2024, there were 8 CRPC decisions about websites access to which was restricted and content access to which was denied in Latvia. The CRPC intends to make increasingly active use of its rights to block websites that violate fair commercial practices in the digital environment, as well as work with the European Commission and other authorities to ensure a common approach to monitoring digital services.

It is important to note that, in the first three months, the new structural unit has initiated 27 administrative cases, carried out 11 preventive monitoring measures, examined 9 applications, provided 60 consultations and processed 97 electronic investigation requests. It is expected that, in cooperation with other Latvian administrative and judicial authorities that monitor digital content, user safety will be increasingly ensured and unfair online practices will be eradicated. A Memorandum of Cooperation is also expected to be concluded by the end of the year.

Another of CRPC's priorities is **monitoring the safety of goods and services**, in particular electrical appliances, construction products and toys. In January-September 2024, 95% of the 1,725 products inspected did not comply with the energy labelling requirements. Similarly, inspections of toys and dangerous equipment revealed more than 45% of non-conformity cases. These results reflect the need for tighter controls and further strengthening of monitoring in these areas.

As a result of growing interest in the use of short-term (shared) vehicles such as electric scooters and cars, the CRPC has launched an evaluation of the terms and conditions of shared rentals and services, mobile apps and websites provided by undertakings. Based on the findings of the monitoring, it is planned to make recommendations both to consumers, informing them of the aspects that should be considered when choosing and using shared rental services, and to undertakings, drawing attention to non-conformities and the improvements needed.

In addition to local monitoring, the CRPC continues to actively cooperate with the European Consumer Centres Network (ECC-NET) to **support Latvian consumers in resolving cross-border disputes.** In January-September 2024, 887 consultations were provided and 543 complaints were examined, showing an increasing demand for support relating to online shopping and other cross-border issues. 92.6% of the consultations provided were related to the conditions for delivery and the right of withdrawal. 33.4% of the consultations were related to air travel, accommodation, leisure and entertainment and car rental services, showing that consumers have started to travel more after the COVID-19 pandemic.

The modern consumer policy includes protection of rights by law, help in quick and effective resolution of disputes with traders, guarantee of safety of any goods purchased in the single market, alignment of consumer rights with economic and social changes, in particular in the area of digital technologies, energy, financial services, as well as provide consumers with the possibility to choose the goods and services they need and want on the basis of clear, accurate and consistent information. Considering the dynamics under the influence of the rapid development of globalisation, digitalisation and technologies, also the consumer rights protection policy is made as flexible as possible to respond to the changes operatively.

Over the past years, the market situation has been affected both by Russia's war against Ukraine and by the global energy crisis, which also directly affects commodity prices and increases the cost of living. At this difficult time, consumer rights still need to be protected. In particular, the issue of cost increases has been pressing and service providers and traders must act in accordance with the principles of fair commercial practices. The consumer rights protection system in Latvia is constantly being developed to ensure effective market surveillance and consumer rights protection. The MoE is working to improve the existing framework and ensure a high level of consumer rights protection. There is active participation in shaping the international consumer protection policy, research and adoption of good practices of other countries.

In the field of consumer protection, the MoE is working closely with the Consumer Rights Protection Centre (CRPC). The CRPC is the main coordinating authority in the surveillance of compliance with the laws and regulations on consumer protection, and the goal of its operations is the efficient protection of consumer rights and interests. To perform the entrusted functions, the CRPC implements different activities related to the monitoring of consumer rights protection, considers consumer complaints, informs and advises consumers and entrepreneurs, implements monitoring activities to prevent unfair commercial practices, controls e-commerce and advertising, licences non-bank credit providers and extrajudicial debt recovery service providers, takes measures on the safety and compliance of goods and services, carries out the national metrological supervision, supervision of dangerous equipment and investigations of dangerous equipment accidents.

Taking into account the current economic situation in the world and the tense geopolitical situation in neighbouring countries, as well as the rapid pace of innovation and digitalisation, not only the adaptation of supervisory work to new market conditions is taking place, but also the regulatory framework is being updated and EU regulation is being transposed into national regulatory enactments.

In March 2024, the directive as regards empowering consumers for the green transition (Green Transition Act) entered into force. The Green Transition Act requires implementers of commercial practice to provide clear, relevant and reliable information about goods, services, goods with digital elements, digital services or digital content by obliging sellers to remind consumers of the existence of the legal guarantee of conformity for goods, including its minimum duration of two years, and obliging to remind of a commercial guarantee of durability, if offered, as well as other after-sales services and their conditions, the availability of spare parts and other aspects related to the repair of the goods.

In addition, specific rules are introduced to prevent unfair commercial practices that currently mislead consumers, for example, by preventing commercial practices related to the early obsolescence of different products, misleading environmental claims (greenwashing), misleading information about the social characteristics of the product, service or the social characteristics of the implementer of commercial practice, or non-transparent and non-credible sustainability labels, as well as circularity aspects, such as durability, reparability or recyclability. In this context, the MoE has drafted amendments to the *Consumer Rights Protection Law* and the *Unfair Commercial Practices Prohibition Law*.

On 21 June 2024, amendments to the *Law on Information Society Services* entered into force, implementing the requirements of Regulation (EU) 2022/2065 of the European Parliament and of the Council of 19 October 2022 on a Single Market For Digital Services and amending Directive 2000/31/EC (Digital Services Act). The amendments to the *Law on Information Society Services* designate CRPC as the competent authority and coordinator for digital services, which will monitor compliance with the requirements of the Digital Services Act and is responsible for the implementation in the country of all tasks set out in the Digital Services Act.

The Digital Services Act aims to contribute to the proper functioning of the internal market for intermediary services by setting out harmonised rules for a safe, predictable and trusted online environment that facilitates innovation and in which fundamental rights enshrined in the EU Charter of Fundamental Rights, including the principle of consumer protection, are effectively protected. It imposes new obligations on intermediary service providers in the digital sector (providers of 'mere conduit', 'caching' and 'hosting' services) to prevent the spread of illegal content online.

The Digital Services Act will have a positive impact on the recipients (including consumers) of services of intermediary service providers, as it will ensure a higher level of protection of fundamental rights online as enshrined in the EU Charter of Fundamental Rights, as well as more effective protection against illegal content in the online environment.

In July 2024, the Directive on common rules promoting the repair of goods also entered into force. It aims to increase the possibility of repairing and re-using defective goods both during and after the legal guarantee period and sets out repair requirements and repairer's obligations, including that repairers must provide consumers with a European repair information form (paper format) standardised at EU level with information on the repairer, the repair process, etc. Member States are required to use the online platform developed by the EC which will allow consumers to find repairers and information on repair services in one convenient place. Work on implementing this EU regulation in the Latvian legal system will start in the first half of 2025.

The EU is also currently discussing a proposal for a Green Claims Directive, which will require that if companies use a green claim for their products or services, they will have to comply with minimum standards on how they justify and present such claims and that these claims must be independently verified and scientifically proven. At the same time, environmental labelling will be regulated. The proposed regulation is expected to provide consumers with more clarity that if a product is sold as "green", it is actually "green", and to make better information available to help consumers choose environmentally friendly products and services.

On 15 May 2024, a general agreement was reached among EU Member States on their preferred wording for the proposal for a toy safety regulation published by the European Commission on 28 July 2023, revising the current rules on protecting children from the risks of non-compliant toys. Toys placed on the EU market are among the safest in the world, but the proposed Regulation will further strengthen this protection, in particular against harmful chemicals. The proposal to the regulation aims to reduce the large number of unsafe toys still sold in the EU, especially online, and this will contribute to a more level playing field for EU-made toys and toys imported while ensuring the free movement of toys within the single market. Negotiations with the European Parliament on its proposed wording for the proposal for the Regulation are ongoing.

In light of the damage caused by the regional-scale storm, rainfall and flood in the territory of Latvia on 28 and 29 March 2024 and the evaluation of related insured events, the process of paying and refusal of payment of insurance indemnities due to the flood, on the basis of the proposals submitted by the Bank of Latvia, the MoE has started working on amendments to the regulatory enactments regulating the insurance sector to improve the provision of insurance services, thereby enhancing policyholders' understanding of the set of documents constituting an insurance contract, the content of the terms of the insurance contract, including insured and uninsured risks, as well as establishing the insurance distributor's burden of proof in the event of a dispute regarding the provision of an insurance product information document.

Regulation (EU) 2023/988 of the European Parliament and of the Council of 10 May 2023 on general product safety, amending Regulation (EU) No 1025/2012 of the European Parliament and of the Council and Directive (EU) 2020/1828 of the European Parliament and the Council, and repealing Directive 2001/95/EC of the European Parliament and of the Council and Council Directive 87/357/EEC will be in force from 13 December 2024. As this Regulation supersedes the current Directive 2001/95/EC of the European Parliament and of the Council on general product safety, the MoE has drafted and is forwarding for approval amendments to the Latvian legislation transposing it, as well as related draft laws, to ensure that the Regulation is applied accordingly. As a result, the *Law on the Safety of Goods and Services* will be repealed and replaced by a new *Law on the Safety of Services*, as well as amendments to the *Law on Conformity Assessment*. The Regulation aims to update and modernise the general framework for the safety of non-food consumer products while maintaining the function of the consumer safety net currently carried out by the General Safety Directive. This regulation incorporates solutions to the various market surveillance challenges posed by new technologies and online sales. The introduction of uniform requirements for non-food consumer products ensures a level playing field for businesses. The regulation lays down the general requirement that consumer goods should be safe, defines certain obligations for businesses and includes the conditions for the development of standards necessary to implement the general safety requirement.

To improve bank competition and to protect borrowers a regulatory framework for consumer mortgage remortgaging to another credit service provider has been developed. This regulation reduces barriers to mortgage remortgaging, including the costs and time required for the process, and promotes competition among providers of consumer lending services by developing solutions for mortgagers and reducing high mortgage rates. To this end, amendments to the *Consumer Rights Protection Law*, the *Credit Institutions Law*, the *Notariate Law* and the *Insurance Contract Law* have been drafted and adopted by the Saeima in the final reading on 15 February 2024.

17. COMPETITION POLICY

The provision of a fair competitive environment is also considered to be an essential element in promoting competitiveness in the country. A pressing topic in the competition policy is to keep supervising that companies do not breach the law and act fairly, as well as fostering equal and non-discriminating competition between public persons (for example, state or local government capital companies) and the private sector.

Free and fair competition stimulates the development of businesses and allows consumers to get diverse goods of higher quality for competitive prices. Competition has become the foundation for the general economic competitiveness increase, promotion of efficiency of operations and innovation of businesses, as well as public welfare.

The goal of the competition policy is to protect free and fair competition, promote its development in all national economy areas among market players, create new and innovative products, as well as to prevent different anti-competitive restrictions, incl. unjustified involvement of public administrative bodies in business.

The Competition Council (CC) is responsible for the implementation of the competition policy in the country. The CC investigates and prevents infringements of the competition law, controls market concentration, monitors that state and municipal regulatory enactments do not create unjustified obstacles for free and fair competition among companies, and educates society, thereby promoting understanding of the competition law and contributing to intolerance towards distortion of competition. To strengthen the application of the competition law, the CC cooperates not only with other national level law enforcement institutions but also with international level organisations and foreign competition supervisors.

For market surveillance to be effective, the CC has the right to set priorities in its activities to prevent above all severe violations of the competition law. When a smaller potential violation is identified, the CC uses alternative methods, incl. the *Consult First* public administration principle allowing to preventively improve the competition environment in national economy sectors.

In 2024, the CC set for itself several priority tasks:

- to strengthen fair competition in public procurement;
- to make market players compete more effectively in markets that are significant for society;
- to improve the regulatory framework to strengthen fair competition and introduce new functions;
- to improve and modernise internal and external processes to improve the efficiency and quality of the institution's work;
- to create a culture of effective competition in the interests of the Latvian economy.

According to the CC's long-term observations and the results of the last opinion poll conducted in 2024, Latvia has two important issues in the field of competition: bid rigging and distortions of competition caused by state and local governments or public administrative bodies, which often take the form of creating uneven conditions of competition, discrimination of entrepreneurs or pushing them out of the market.

The CC devoted significant resources to combating prohibited agreements, including discovered two high-priority violation cases and warned 60 market players about potential smaller violations in January-September 2024. Public administrative bodies have been particularly topical on the CC's agenda since 2020, when amendments to the Competition Law came into force, which gave the CC broader powers to confront competition distortions caused by public administrative bodies. To prevent violations of competition neutrality, it is essential to ensure immediate changes in the conduct of public administrative bodies, which also provides immediate benefits to the public, so the CC uses negotiation procedures as the most effective tool for preventing possible violations.

The CC continues to prepare summaries by sector or industry, emphasising the most important conclusions and challenges arising from the state and local government shareholding self-assessment in capital companies, the involvement of public administrative bodies in various markets.

To identify barriers to free and fair competition promptly, in 2024 the CC focused on sectors with significant influence in the national economy and consumer welfare, and on markets where rapid development is taking place or innovations are being introduced. The institution pays particular attention to digital markets, as well as to the markets of heat supply services, waste management, health services and accommodation services, as well as to the retail food sector with widespread resonance in society due to regular complaints about high food prices.

In markets that are not functioning efficiently, the CC monitors and takes action against market players that are dominant in the relevant market and abuse market power by restricting or distorting competition.

Activities of the Competition Council (CC) in 2024

Two priority violation cases were completed in January-September 2024 to ensure the **identification of significant competition violations and market distortions**. The CC has discovered a prohibited agreement between two traders in the construction sector who distributed among themselves heat insulation projects for multi-apartment residential houses in Saldus. Both companies confirmed their guilt of the violation and undertook not to appeal the CC's decision by entering into a settlement agreement with the institution, for which they received a reduction of the fine and the total fine is 108.5 thousand euro. The CC has also found a prohibited vertical agreement in the wholesale and retail of lighting products by LLC *Mirastyle*. The prohibited agreement manifested itself as setting the resale price for certain retailers who purchased goods from LLC *Mirastyle* and in allocating customers by limiting their possibilities to choose. The company responsible received a fine of 34.5 million euro for the stated violation.

Using the ***Consult First*** principle, 7 preventive activities were implemented in January-September 2024 in cases of small market participants and minor potential violations, with a total of 60 legal persons warned about possible violations of the *Competition Law*.

In January-September, the CC was able to ensure an **evaluation of merger** in 17 cases. An in-depth investigation was conducted in two merger cases. In one case, the CC allowed packaging distributor JSC *ANTALIS* to acquire sole decisive influence over LLC *PAKELLA* and its subsidiaries in Estonia and Lithuania by acquiring all the shares in the LLC *PAKELLA* group. In the second case, the CC allowed the aviation fuel trader LLC *BALTIC GROUND SERVICES* to expand and acquire a decisive influence over LLC *Gulfstream Oil* by allowing it to start trading and refuelling aviation fuel in the territory of Riga International Airport. All the above-mentioned 17 mergers examined were permitted without objections because no significant negative risks to competition were identified.

In 2024, significant resources were devoted to the **representation of the CC in courts**. In January-September 2024, applications for 16 decisions of the CC were examined in different instances. During the reporting period, five proceedings were concluded, in four cases upholding the CC's decision. The Senate of the Republic of Latvia upheld the judgment of the Administrative Regional Court upholding the CC's finding of a prohibited agreement between two manufacturers of construction materials and four traders on long-term price fixing of construction materials. By the decision of the Senate of the Republic of Latvia, LLC *Depo Diy* received a fine of 3.7 million euro. The Supreme Court also confirmed the right of the CC to impose a legal obligation on an individual to appear before the institution and provide explanations in the case, as well as, in case of refusal, to apply a procedural violation. During the reporting period, the judgment of the Administrative Regional Court, which rejected the application of JSC *Liepājas Autobusu parks* against the decision of the CC, also came into force, as the CC refused to initiate a case of possible violation of competition neutrality, as the elements of a violation had not been established.

The CC implemented several measures to integrate the **principle of competitive neutrality** among public administrative bodies. In Q1-Q3 2024, the CC received 83 different applications regarding the behaviour of public administrative bodies mostly related to discriminatory behaviour of public administrative bodies, for example when organising procurements. At the same time, in January-September 2024, 36 public administrative bodies received assessments regarding shareholding in capital companies, which results from Section 88 of the *State Administration Structure Law*, at least once in five years to reassess their shareholding in capital companies, and a report should be submitted to the CC, and a total of 12 reports submitted not only in 2024 but also in late 2023 have been evaluated.

To promote understanding of fair competition among market participants, in Q1-Q3 2024 the CC participated in 52 educational events (seminars, webinars, conferences), where the basic principles of competition law were presented to entrepreneurs and contracting authorities, as well as society as a whole. For example, in 2024, together with the Procurement Monitoring Bureau and the Corruption Prevention and Combating Bureau, a large-scale series of educational seminars for businesses on fair participation in procurement and the characteristics of collusion will be organised, explaining the principles that businesses must follow in order not to violate the *Competition Law*. In total, nearly 150 company representatives were educated in three joint seminars. In 2024, active educational work with companies, associations, representatives of law firms, representatives of state and local government authorities and other interested parties was also carried out within the framework of the Competition Law School to educate them on prohibited vertical agreements, prohibited agreements in procurement, unfair trading, abuse of dominant position, mergers and other topics. Nearly 2,300 market players were educated in 18 seminars.

In 2024, the CC strengthened its **information technology capacity** by fully setting up an IT laboratory and organising training for employees to improve their skills in using state-of-the-art IT technical equipment for more efficient acquisition and processing of electronic evidence, paying particular attention to international cooperation and experience exchange, continuing working on the development of an automated cartel screening tool. Additional resources are devoted to strengthening the institution's economic analysis capacity, ensuring deeper and more economically accurate investigation of mergers, market surveillance, abuse of dominant position cases, etc., paying more attention to the economic assessment of the impact on competition.

To organise closer and more efficient cooperation with partners in matters of development and application of competition policy, for example, by providing the competition supervisory authority with recommendations regarding the operational strategy, competition supervision directions and possibilities for improvement of work, as well as opinions regarding the guidelines prepared by it, CC's operational priorities and performance review, the 7-member CC's **Advisory Board** of the Competition Authority held five Advisory Board meetings in 2024.

The CC needs to implement extensive communication activities both at national level and in the international environment to make entrepreneurs understand the benefits of fair and free competition and also to act in good faith. The CC has defined building an effective competition culture as one of its key priorities.

The CC continues to develop educational tools that encourage entrepreneurs and public administrative bodies to control their actions and participate in the prevention of competition violations, for example, by developing easy-to-use self-assessment tools. Initiatives on which practical work has started include the development of an automated cartel screening tool, the introduction of an e-file, a large-scale information request and analysis tool, and a digital merger notification tool.

The CC also participates in the identification and elimination of undue restrictions of competition from laws and other regulatory enactments, as well as in the process of improvement of the regulatory framework of competition law.

The CC continues to systematically demonstrate its effectiveness and public benefit from the implementation of a fair competition policy. The authority's priority objective is not to penalise companies, but to raise awareness of fair competition among market participants and to prevent potential infringements. It is the benefit of consumers from competing markets that is one of the efficiency indicators of the CC, which the CC focuses on when carrying out both investigative, supervisory and educational activities. In January-September 2024, companies have already paid more than 6.3 million euro into the state budget for violations of competition law.

The CC's work has been appreciated also internationally. In 2024, the CC maintained its high three-star rating in the international Global Competition Review (GCR) ranking for the tenth consecutive year, ranking among the world's 29 leading competition authorities. Competition authorities of Belgium, Lithuania, Poland, Switzerland and other countries are ranked the same as Latvia's. More than 140 countries of the world have competition authorities, but only 29 of them are included in the GCR rating.

On 14 March 2024, the amendments to the *Competition Law* drafted by the MoE entered into force, implementing the requirements of Regulation (EU) 2022/1925 of the European Parliament and of the Council of 14 September 2022 on contestable and fair markets in the digital sector and amending Directives (EU) 2019/1937 and (EU) 2020/1828 (Digital Markets Act) and Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market (Foreign Subsidies Regulation). The amendments provide that the CC is the competent authority monitoring the application of the Digital Markets Act and the Foreign Subsidies Regulation in Latvia, supporting the EC in its investigative activities.

The Digital Markets Act sets out a list of *ex ante* obligations and prohibitions for gatekeepers or digital platforms with high market power they need to comply with in their day-to-day activities, which will prevent unfair commercial practices of gatekeepers and their interference with competition in the digital market. It will facilitate the availability of a wider range and better quality of digital services to consumers and provide a fairer business environment for companies selling goods and services in the digital environment that depend on the influence of gatekeepers, enabling them to reach new markets across the EU and offer better and more varied products at more competitive prices, including by giving innovative start-ups more opportunities to compete and innovate in the online platform environment.

The Foreign Subsidies Regulation complements existing competition and public procurement regulations. The Foreign Subsidies Regulation aims to address regulatory gaps in the EU Single Market which, in recent years in particular, have been distorted by foreign (third country) subsidies, including by giving recipients an unfair advantage to buy European companies or conclude public procurement contracts in the EU, thus creating an uneven playing field. The EC assesses whether foreign subsidies distort the internal market and may decide on corrective measures to remedy the distortion (if any) or, in the case of non-cooperation, on the fine to be imposed.

In order to more actively and purposefully target the prevention of the most serious competition law infringements – prohibited agreements – and to achieve a sufficient level of general and specific prevention, proposals for the improvement of the *Competition Law* were prepared in 2024 and are in the process of being coordinated, which also envisage imposing liability on the officials of market players. Such liability would increase the motivation of officials to take active steps to prevent violations or to cooperate with the CC in the prevention of violations of competition law or in the discovery of violations that have already been committed.

It should also be noted that in 2024, amendments to the *Competition Law* were prepared and supported by the CM to facilitate more active involvement of public commissioning authorities in recovering losses incurred in procurement due to violations of competition law by market players. In particular, the amendments introduced a new function for the CC – providing methodological support to public commissioning authorities in identifying, assessing and calculating damages caused by a breach of competition law.

In 2024, the CC concluded market surveillance for eggs, fish, milk, meat, cereals and bread, which concluded that for 50% of the products covered by the market surveillance, on average over a 17-month period, about one-third of the retailers covered by the market surveillance applied on average higher mark-ups to products manufactured in Latvia compared to equivalent products manufactured in other countries, as well as significant differences in mark-ups between private label products and manufacturer branded products were observed. Accordingly, considering the findings of the market surveillance, the CM instructed the MoE, in cooperation with the CC, to prepare proposals for necessary amendments to the regulatory enactments to eliminate the different treatment in pricing between food products produced in Latvia and other countries and to promote fair trade practices and equal competition in the retail food market. In 2024, in fulfilment of the task given by the CM, proposals for amendments to the *Prohibition of Unfair Trading Practices Law* were prepared, which aim to eliminate the different conditions of cooperation and trade applied by agricultural and food traders so far, including mark-ups for goods from one supplier or group of suppliers compared to equivalent goods from other suppliers, as well as to balance relations between traders and agricultural and food suppliers, thus promoting fair trade practices and equal competition in the retail food market.

In late 2024, the Minister of Economics presented to the government coalition proposals for the alignment of the trade sector: to reduce prices for everyday food products, to eliminate differential pricing between food products produced in Latvia and those produced in other countries, to balance the relationship between retailers and suppliers (preventing the retailer that is economically stronger from taking unfair advantage of this position to the detriment of the supplier) and to increase the share of local food products on the shelves. Accordingly, active work started on the detailed development of the proposals and taking them forward for submission to the CM at the end of 2024, and work will continue on the development and implementation of the above proposals in 2025.