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Latvia: economic growth high current account deficit

Latvia's rapid GDP growth continued throughout 2003 at a rate of 7.5% year-on-year. On the demand side, household consumption and investment activities were the engines of growth. As a result of robust economic growth, unemployment fell from 12% in 2002 to 10.6% in 2003.

Consumer prices rose by 2.9% in 2003; producer prices by 3.2%. Both indices had registered lower inflation rates in 2002 (1.9% and 1%, respectively). The higher inflation was most probably due to the appreciation of the lat, the country's national currency, against the euro. It followed in the wake of the euro's appreciation against the US dollar, the lat being pegged to IMF special drawing rights (SDR). In the first quarter of 2004 CPI inflation reached 4.3% (a six-year high), primarily on account of price and tax adjustments related to EU accession. The central bank's reaction was to introduce an even more restrictive monetary policy; it raised the refinancing rate by 0.5% to 3.5%.

Loans extended by Latvian banks to private persons increased by 77% in 2003. The central bank's intervention was designed not only to prevent the economy from overheating with all its inflationary fall-out, but also to curb the current account deficit that had risen as high as 8.6% of GDP. Unlike 2002, the deficit was not offset by adequate enough an inflow of FDI, but more by an increase in foreign debt. At the end of the year 2003, total FDI stock amounted to some EUR 2.7 billion.

Over recent years, Latvian export revenues (commodities and services) have always covered some 75-85% of import expenditures. Last year, wood and wood products featured as the largest commodity group within all exports; their share increased perceptibly and ultimately amounted to 35% of the total volume of exports. The share of machinery, mechanical appliances and electrical equipment also increased significantly. In imports, the latter group accounted for the largest share: 21% of all imports. In 2003 the United Kingdom (16%) usurped Germany as Latvia's most important export market, whereas on the import side Germany continued to account for the largest share (16%).

In 2004 GDP is expected to expand by about 7.5%. Both domestic demand and foreign trade will remain engines of growth. In 2004 and 2005 alike the current account deficit will stay as high as about 9% of GDP. The budget deficit will be close to 2% of GDP in 2004. The authorities intend to join the ERM II in 2005 and hope to introduce the euro on 1 January 2008.

Table LV

Latvia: Selected Economic Indicators

	1999	2000	2001	2002	2003 ¹⁾	2003 1st quarter	2004	2004 forecast	2005
Population, th pers., mid-year ²⁾	2390.5	2373.0	2355.0	2338.6	2325.3	.	.	.	.
Gross domestic product, LVL mn, nom.	4224.2	4685.7	5168.3	5691.1	6322.5	1412.6	1603.0	7100	7900
annual change in % (real)	3.3	6.9	8.0	6.4	7.5	8.8	8.8	7.5	7.0
GDP/capita (EUR at exchange rate)	2833	3526	3900	4177	4216	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	6990	7690	8370	9180	9970	.	.	.	.
Gross industrial production ²⁾									
annual change in % (real)	-5.4	4.7	9.2	5.8	6.5	8.7	9.2	8.5	8.3
Construction industry ²⁾									
annual change in % (real)	7.8	8.0	6.0	10.8	13.7	17.5	13.0	.	.
Consumption of households, LVL mn, nom.	2445.5	2693.5	3045.3	3259.3	3643.2	877.8	.	.	.
annual change in % (real)	3.7	7.4	7.8	6.9	8.0	9.0	.	6.5	6
Gross fixed capital form., LVL mn, nom.	980.0	1151.5	1297.4	1370.6	1527.8	273.6	.	.	.
annual change in % (real)	-6.8	10.2	11.4	13.0	7.4	19.7	.	12	12
LFS - employed persons, th, avg. ³⁾	968.0	941.0	962.0	989.0	1006.9	993.6	1002.4	.	.
annual change in % ³⁾	-1.8	-2.8	2.2	2.8	1.8	4.5	0.9	.	.
LFS - employed pers. in industry, th, avg. ³⁾	193.0	193.0	176.0	192.0	.	.	.	.	.
annual change in % ³⁾	-7.2	0.0	-8.8	9.1	.	.	.	.	.
LFS - unemployed persons, average ³⁾	161.0	159.0	145.0	134.5	119.2	119.3	130.8	.	.
LFS - unemployment rate in %, average ³⁾	14.2	14.5	13.1	12.0	10.6	10.7	11.5	10.3	10
Reg. unemployment rate in %, end of period	9.1	7.8	7.7	8.5	8.6	8.9	9.2	9	8.5
Average gross monthly wages, LVL ⁴⁾	141	150	159	173	192	177	196	.	.
annual change in % (real, gross)	2.9	3.0	3.5	6.0	.	-5.5	6.3	.	.
Consumer prices, % p.a.	2.4	2.6	2.5	1.9	2.9	1.9	4.3	4.5	3.8
Producer prices in industry, % p.a.	-4.0	0.6	1.7	1.0	3.2	2.1	5.4	3	3.3
General government budget, EU-def., % GDP ⁴⁾									
Revenues	44.9	42.5	40.8	41.9	41.5	.	.	.	.
Expenditures	50.2	45.2	42.4	44.6	43.3	.	.	.	.
Deficit (-) / surplus (+)	-5.3	-2.7	-1.6	-2.7	-1.8	.	.	-2	-2
Public debt in % of GDP ⁴⁾	13.7	13.9	16.2	15.5	15.6	.	.	16	16.1
Discount rate, % p.a., end of period	4.0	3.5	3.5	3.0	3.0	3.0	3.5	.	.
Current account, EUR mn	-609	-538	-819	-680	-842	-114	-202	-1000	-1040
Current account in % of GDP	-9.0	-6.4	-8.9	-7.0	-8.6	-5.0	.	-9.3	-8.8
Total reserves minus gold, EUR mn	832	915	1307	1209	1150	1034	1142	.	.
Gross external debt, EUR mn	3791	5056	6335	6782	7337	6267	.	.	.
FDI inflow, EUR mn	325	445	182	407	319	106	76	450	470
FDI outflow, EUR mn	-16	-10	-14	-8	-28	-6	-19	.	.
Exports of goods, BOP, EUR mn	1777.6	2229.4	2473.0	2726.1	2804.4	644.4	714.6	3060	3400
annual growth rate in %	-1.0	25.4	10.9	10.2	2.9	3.9	10.9	9	11
Imports of goods, BOP, EUR mn	2736.9	3379.5	3981.8	4251.1	4568.7	1003.1	1155.2	4980	5450
annual growth rate in %	-2.2	23.5	17.8	6.8	7.5	8.6	15.2	9	9.5
Exports of services, BOP, EUR mn	961.0	1313.2	1327.0	1327.4	1352.1	324.5	306.9	.	.
annual growth rate in %	-2.8	36.6	1.1	0.0	1.9	-1.6	-5.4	.	.
Imports of services, BOP, EUR mn	645.8	834.9	773.8	748.3	834.1	172.2	181.5	.	.
annual growth rate in %	-10.1	29.3	-7.3	-3.3	11.5	7.6	5.4	.	.
Average exchange rate LVL/USD	0.58	0.61	0.63	0.62	0.57	0.58	0.54	.	.
Average exchange rate LVL/EUR (ECU)	0.62	0.56	0.56	0.58	0.64	0.63	0.67	0.66	0.67
Purchasing power parity LVL/USD, wiiw	0.23	0.24	0.24	0.25	0.25	.	.	.	.
Purchasing power parity LVL/EUR, wiiw	0.25	0.26	0.26	0.27	0.27	.	.	.	.

Notes: 1) Preliminary. - 2) Enterprises with 50 employees and more. - 3) From 2002 persons aged 15-74, up to 2002 persons aged 15 and over. - 4) According to ESA 95, excessive deficit procedure.

Source: wiiw Database incorporating national statistics; AMECO; wiiw forecasts.