

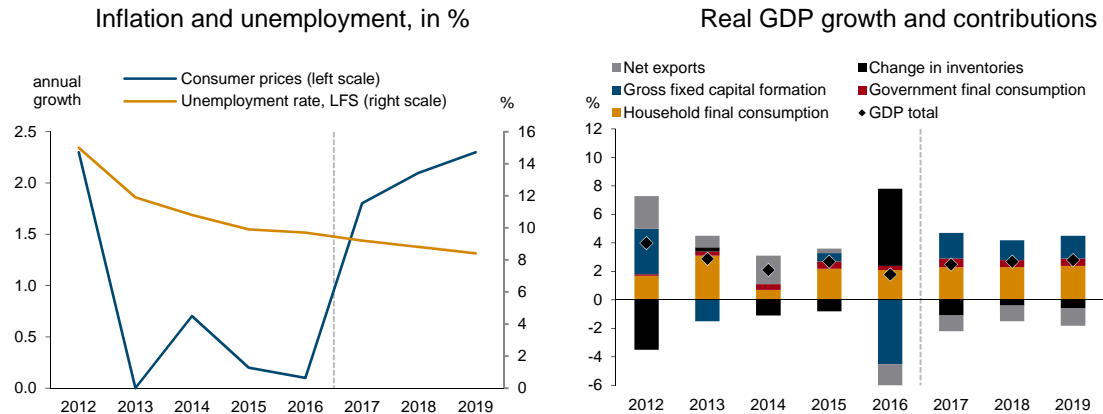


LATVIA: EU funds push up growth rate

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Our GDP growth forecast for Latvia for 2017 stands at 2.5%. Private and particularly public investment activity will rally. The inflow of EU funds is expected to amount to 2.6% of GDP this year. After a steep decline in recent years, exports to Russia have again started to increase. Household consumption has developed rapidly and will continue, due to rising real wages. In both 2018 and 2019, we expect a further upswing in GDP growth to 2.7% and 2.8%, respectively.

Figure 43 / Latvia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

After a difficult few years, the outlook for external demand in 2017 is more positive. In the final few months of 2016, Latvian goods exports started to grow again, in both value-added and nominal year-on-year terms. While trade with Western Europe, the Scandinavian countries and the rest of the world has gradually gained momentum, demand from Russia has increased more rapidly. However, exports of fish and fish products are still suffering because of the Russian embargo, and the same is true of mineral products because of low oil prices. Good news comes from the wood sector and electronic products, both of which have reported strong export growth figures. In general, we expect both goods and service exports to revive again this year, and to continue to strengthen in the years to come. Transit trade with Russia, an important sector for Latvia, will remain weak, however, owing to the Russian government's measures to ship the country's exports from its own ports.

In September 2016, Liepājas Metalurgs, the only steel mill in the Baltic States, was declared insolvent. The former Ukrainian owner KVV Group is to bring the Latvian government before the European Commission's Anti-Monopoly and Corruption Prevention Committees, claiming to have been treated unfair by the government. In February, the insolvency administrator will start the sale procedure by looking for new investors. However, the rest of the metal sector and downstream production such as machinery and equipment, as well as the electric and electronic sectors, have displayed strongly increased activity.

Gross fixed capital investment is set for strong growth in the forecast period. Investment dropped by close to 20% in real terms in 2016. This was primarily a result of a reduction in capital expenditure of about a third, by both the central state and local governments, and a corresponding drop in construction output. For 2017, however, public investment in infrastructure will rally, with fresh EU funds becoming available. The inflow from Brussels is expected to amount to 2.6% of GDP in 2017. Private residential construction output will, however, remain rather anaemic this year. Slightly declining numbers of building permits, for residential and non-residential buildings alike, are reinforcing the negative prospects in the sector. Overall, after the slump in 2016, we expect total gross fixed investment to increase again by 8% in 2017, and to grow at a rate of 6% in real terms in 2018.

As expected, the significantly lower level of prices for imported goods in 2016, compared to the previous year, kept consumer inflation stagnant. Strong wage growth has raised core inflation slightly. As the effect of falling energy prices abates, so rising prices in the services sector and an upswing in import prices will raise consumer inflation to about 1.8% this year and 2.1% in 2018.

Declining activity in construction has led to lower employment there, while job growth has been recorded in the industrial sectors. Overall employment will start to rise again slightly in 2017 after stagnating in 2016. Demographic developments – including continuing net emigration – will, however, result in a further decline in the working-age population; thus, growth in employment is likely to remain at below 1% in the coming years. Towards the end of 2016, the unemployment rate receded to 9.7%. This year, we expect it to decline gradually to 9.2%. Gross real wages will keep on growing by about 4%, not only in 2017 but also in the years ahead. The government increased the minimum wage slightly to EUR 380 in January 2017 – still rather low as a share of the national average wage, when compared to other EU countries. However, growth in household consumption will increase by close to 4% in real terms in the years to come. The government budget for 2017 foresees expenditure growth – particularly in EU-funded investments – in the field of defence, but also in health and education. The budget deficit is expected to amount to 0.8% of GDP in 2017, after attaining 0.9% of GDP in 2016, due to higher than expected government revenues.

Broad-based and fairly robust economic growth is expected in the years to come. For 2017, we expect external demand to grow again, not only in real, but also in nominal terms. After a sharper than anticipated investment decline in 2016, we expect a strong revival this year. Household demand is continuing to evolve at a good pace, and thus our GDP growth forecast for 2017 remains almost unchanged at 2.5%. However, because of the anticipated speed-up in demand in the EU, and a rise in domestic investment activity driven by the inflow of EU funds, we expect GDP growth to accelerate somewhat in 2018 and 2019, to 2.7% and 2.8%, respectively.

Table 14 / Latvia: Selected economic indicators

	2012	2013	2014	2015	2016 ¹⁾	2017 Forecast	2018 Forecast	2019
Population, th pers., average	2,034	2,013	1,994	1,978	1,961	1,950	1,945	1,940
Gross domestic product, EUR mn, nom.	21,849	22,774	23,608	24,349	24,800	25,900	27,200	28,600
annual change in % (real)	4.0	2.9	2.1	2.7	1.8	2.5	2.7	2.8
GDP/capita (EUR at PPP)	16,000	16,600	17,500	18,600	19,200	.	.	.
Consumption of households, EUR mn, nom.	13,065	13,780	14,166	14,584	15,100	.	.	.
annual change in % (real)	2.9	5.2	1.1	3.7	3.5	3.8	3.8	4.0
Gross fixed capital form., EUR mn, nom.	5,551	5,291	5,337	5,497	4,400	.	.	.
annual change in % (real)	14.4	-6.0	0.1	2.8	-20.0	8.0	6.0	7.0
Gross industrial production ²⁾								
annual change in % (real)	6.2	-0.9	-1.0	3.6	5.4	4.0	5.0	5.0
Gross agricultural production								
annual change in % (real)	17.3	2.3	4.5	14.2	-5.9	.	.	.
Construction industry								
annual change in % (real)	13.7	8.1	7.9	-1.2	-17.9	.	.	.
Employed persons, LFS, th, average	875.6	893.9	884.6	896.1	895.0	900	905	910
annual change in %	1.6	2.1	-1.0	1.3	-0.1	0.6	0.6	0.6
Unemployed persons, LFS, th, average	155.1	120.4	107.6	98.2	96.0	90	90	80
Unemployment rate, LFS, in %, average	15.0	11.9	10.8	9.9	9.7	9.2	8.8	8.4
Reg. unemployment rate, in %, end of period ³⁾	10.5	9.5	8.5	8.7	8.4	.	.	.
Average monthly gross wages, EUR	684.4	715.7	765.0	818.0	850.0	900	950	1,010
annual change in % (real, gross)	1.4	4.6	6.2	6.7	3.8	4.0	3.8	4.0
Average monthly net wages, EUR	488.0	515.4	560.0	603.0	630.0	660	700	740
annual change in % (real, net)	1.6	5.6	8.0	7.4	4.3	3.5	3.2	4.0
Consumer prices (HICP), % p.a.	2.3	0.0	0.7	0.2	0.1	1.8	2.1	2.3
Producer prices in industry, % p.a.	4.2	1.6	0.4	-1.0	-3.0	1.0	1.5	2.0
General governm.budget, EU-def., % of GDP								
Revenues	36.3	36.1	35.9	35.8	35.8	36.2	36.0	36.0
Expenditures	37.1	37.0	37.5	37.1	36.6	37.0	36.5	36.5
Net lending (+) / net borrowing (-)	-0.8	-0.9	-1.6	-1.3	-0.9	-0.8	-0.5	-0.5
Public debt, EU-def., % of GDP	41.3	39.0	40.7	36.3	40.0	36.0	35.0	34.0
Stock of loans of non-fin.private sector, % p.a	-11.7	-7.0	-8.8	-3.4	0.5	.	.	.
Non-performing loans (NPL), in %, Dec	11.1	8.3	6.9	6.0	5.0	.	.	.
Central bank policy rate, % p.a., end of period ⁴⁾	2.50	0.25	0.05	0.05	0.00	.	.	.
Current account, EUR mn	-794	-621	-463	-189	391	0	-300	-500
Current account, % of GDP	-3.6	-2.7	-2.0	-0.8	1.6	0.0	-1.1	-1.7
Exports of goods, BOP, EUR mn	9,645	9,810	10,214	10,322	10,281	10,700	11,200	11,700
annual change in %	16.2	1.7	4.1	1.1	-0.4	3.9	4.7	4.5
Imports of goods, BOP, EUR mn	12,282	12,431	12,414	12,364	12,008	12,800	13,600	14,400
annual change in %	13.6	1.2	-0.1	-0.4	-2.9	6.7	6.3	5.9
Exports of services, BOP, EUR mn	3,768	3,900	3,853	4,038	4,204	4,400	4,600	4,900
annual change in %	8.6	3.5	-1.2	4.8	4.1	3.6	4.7	5.6
Imports of services, BOP, EUR mn	2,145	2,127	2,101	2,273	2,337	2,400	2,500	2,600
annual change in %	7.7	-0.8	-1.2	8.2	2.8	4.3	4.1	4.7
FDI liabilities, EUR mn	840	743	813	684	354	.	.	.
FDI assets, EUR mn	127	373	441	112	344	.	.	.
Gross reserves of NB excl. gold, EUR mn ⁵⁾	5,373	5,565	2,448	2,957	3,100	.	.	.
Gross external debt, EUR mn	30,254	30,501	33,794	34,505	36,200	36,300	37,500	38,600
Gross external debt, % of GDP	137.4	133.7	143.1	141.7	146.0	140.0	138.0	135.0
Average exchange rate EUR-LVL/EUR	0.9922	0.9981	1.0000	1.0000	1.0000	1	1	1

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) In % of labour force (LFS). - 4) From 2014 official refinancing operation rate for euro area (ECB), refinancing rate of National Bank before. - 5) From January 2014 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.