

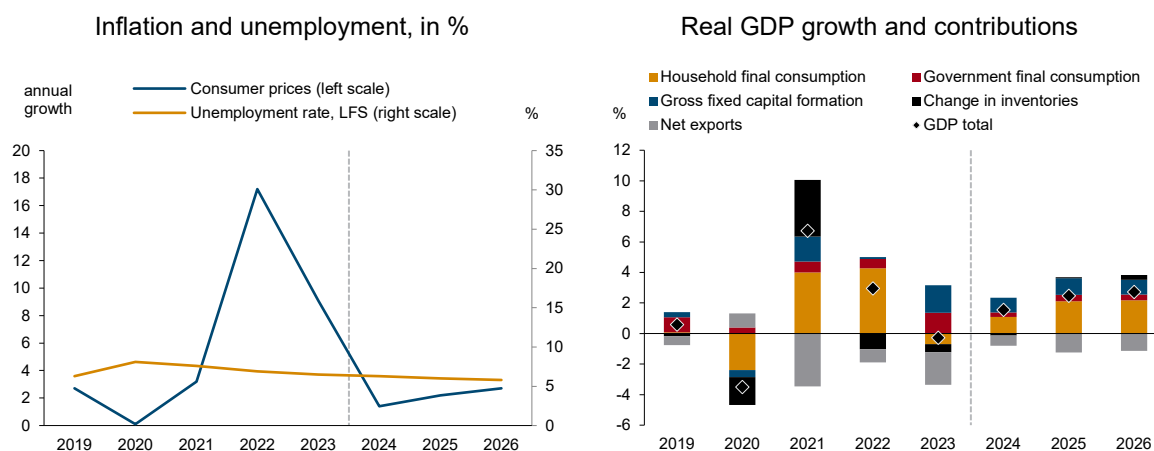


## LATVIA: Slight upswing expected, backed by domestic demand

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While 2023 ended with GDP declining slightly (0.3%), this year will see an upswing of 1.6%. We expect external demand to shrink further, but by less than last year. Lower inflation will result in real wages rising – and accordingly in growth in household consumption. The government plans to further increase public investment in 2024, though private business remains reluctant to expand further. Given the still rather tight labour market, the unemployment rate fell slightly in 2023 – and will do so even more in the coming two years. Assuming that Latvia's trading partners also find their way back on track next year, we expect the economy to pick up, with GDP growth of 2.5% in 2025 and 2.7% in 2026.

Figure 6.11 / Latvia: Main macroeconomic indicators



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

**Latvian goods exports are expected to continue to decline for another year – by 0.2% in real terms, following the slump of almost 6% in 2023.** The Northern European economies, Latvia's main trading partners, are expected to grow only slowly in 2024. Exports of wood products and building materials generally will continue to falter, since the volume of housing construction in the Scandinavian countries will be much reduced over the coming two years. Moreover, the export of electrical machinery and mineral fuels – two of the country's most important export goods – is on the wane. The transport sector reports declining cargo volumes. Latvian producers are further disentangling themselves from inputs originating in Russia and Belarus: over the course of 2023, imports from those two countries almost halved. Exports to Russia are also declining; however, re-exporting to that country and to Belarus is still an important business. Given the anticipated upswing in household consumption, goods and services imports are expected to increase again this year in real terms. Since import prices are likely to

drop more sharply this year, we expect the current account deficit to continue to fall from the 4% of GDP seen last year to slightly above 3% in 2024.

**Latvia was among the EU countries worst affected by inflation over the past two years, due to escalating energy and commodity prices; however, now prices are stagnating.** In February 2024, consumer price inflation (CPI) increased by only 0.4% year on year. While our central scenario is that CPI will fall to 1.4% in 2024 on average, there are downside risks of consumer price deflation, since producer and import prices are sliding.

**The substantial drop in inflation will result in a revival of household incomes, and we expect real wages to increase by 6.5% in 2024.** In January 2024, the government increased the statutory minimum wage by a further 13% (to EUR 700 a month), following a hike of 24% in 2023. This will help lower-income groups maintain their consumption levels. Retail trade, which declined in 2023, had stabilised by the beginning of 2024. With increased purchasing power, we expect households to boost their consumption again gradually this year – and even more so in 2025.

**Although economic growth will revive this year, employment is still likely to stagnate in 2024.** The decline in industrial production has resulted in the number of manufacturing jobs falling slightly. Bigger falls are reported for both wholesale and retail trade. In business services, however, the steady growth in jobs is continuing. Job vacancy rates are continuing to decrease – though only slightly in recent months. We expect the unemployment rate to rise by only a little in 2024, and then to fall again gradually next year.

**Public investment will further push growth in 2024, while private entrepreneurs remain reluctant to expand capacity.** The budget envisages a rise in public investment from 4.8% to 6.3% of GDP this year: alongside rail and road infrastructure, the Recovery and Resilience Facility funds are being used to develop electricity grids, undertake additional energy projects and digitalise the economy. Moreover, defence and security are government functions that have been allocated far more resources in the wake of Russia's war in Ukraine. Loan statistics show that the increase in interest rates by the European Central Bank (ECB) has resulted in Latvian entrepreneurs reducing their stock of debt. Following substantial growth in construction output in 2023, recent figures on the number of building permits granted and construction started suggest that investment in real estate will grow much less in the medium term – and may even decline.

**The government deficit is likely to attain 3.2% of GDP in 2024, slightly higher than last year.** Apart from substantially greater public investment and increased defence spending (to as much as 3% of GDP in 2025), the government will considerably raise the salaries of teachers (in particular). Should the economic upswing materialise, a decline in the fiscal deficit to close to 2.3% of GDP is likely towards 2026. In general, the government envisages higher expenditure in the medium term, and thus also increased government revenue – to close to 40% of GDP. This should allow welfare expenditure to be maintained, while at the same time covering the cost of the war in the neighbourhood.

**All in all, we have kept our forecast for GDP growth for 2024 unchanged at 1.6%.** According to the baseline scenario, GDP growth will pick up to 2.5% in 2025 and 2.7% in 2026. This scenario assumes that the ECB will realise the potential danger if inflation should fall further, and lowers its interest rates accordingly. That would stimulate private investment and could boost employment and household consumption.

**Table 6.11 / Latvia: Selected economic indicators**

	2020	2021	2022	2023 <sup>1)</sup>	2024	2025	2026
					Forecast		
Population, th pers., average	1,900	1,884	1,879	1,880	1,885	1,880	1,875
Gross domestic product, EUR m, nom.	30,110	33,349	38,386	40,348	41,500	43,500	45,900
annual change in % (real)	-3.5	6.7	3.0	-0.3	1.6	2.5	2.7
GDP/capita (EUR at PPP)	21,540	23,210	25,420	26,640	.	.	.
Consumption of households, EUR m, nom.	16,805	18,645	22,741	24,269	.	.	.
annual change in % (real)	-4.2	7.2	7.7	-1.2	1.8	3.5	3.6
Gross fixed capital form., EUR m, nom.	6,752	7,461	8,453	9,730	.	.	.
annual change in % (real)	-2.2	7.2	0.6	8.2	4.0	4.5	4.0
Gross industrial production <sup>2)</sup>							
annual change in % (real)	-1.4	6.6	0.9	-5.9	-1.0	4.0	4.0
Gross agricultural production							
annual change in % (real)	4.9	-10.2	2.1	-6.3	.	.	.
Construction industry							
annual change in % (real)	2.7	-6.1	-11.4	19.0	.	.	.
Employed persons, LFS, th, average <sup>3)</sup>	893.0	869.5	891.2	889.9	892	895	898
annual change in %	-1.9	-3.0	2.5	-0.1	0.2	0.3	0.3
Unemployed persons, LFS, th, average <sup>3)</sup>	78.7	70.6	65.2	61.5	60	57	55
Unemployment rate, LFS, in %, average <sup>3)</sup>	8.1	7.6	6.9	6.5	6.3	6.0	5.8
Reg. unemployment rate, in %, eop <sup>4)</sup>	7.7	6.7	6.1	5.7	.	.	.
Average monthly gross wages, EUR	1,143	1,277	1,373	1,537	1,670	1,810	1,930
annual change in % (real, gross)	6.0	8.2	-8.3	2.8	7.0	6.0	4.0
Average monthly net wages, EUR	841	939	1,006	1,119	1,210	1,300	1,380
annual change in % (real, net)	5.8	8.1	-8.7	2.2	6.5	5.5	3.5
Consumer prices (HICP), % p.a.	0.1	3.2	17.2	9.1	1.4	2.2	2.7
Producer prices in industry, % p.a.	-2.0	13.3	32.9	-0.5	-2.0	2.0	4.0
General governm. budget, EU def., % of GDP							
Revenues	38.0	37.5	36.3	39.0	38.0	37.5	37.3
Expenditures	42.5	44.7	40.9	42.0	40.8	39.8	39.3
Net lending (+) / net borrowing (-)	-4.5	-7.2	-4.7	-3.0	-2.8	-2.3	-2.0
General gov. gross debt, EU def., % of GDP	42.2	44.0	41.5	41.0	41.5	41.0	40.0
Stock of loans of non-fin. private sector, % p.a.	-3.8	3.2	7.1	0.7	.	.	.
Non-performing loans (NPL), in %, eop <sup>5)</sup>	3.1	2.5	2.3	2.4	.	.	.
Central bank policy rate, % p.a., eop <sup>6)</sup>	0.00	0.00	2.50	4.50	.	.	.
Current account, EUR m	875	-1,312	-1,833	-1,618	-1,300	-2,000	-2,600
Current account, % of GDP	2.9	-3.9	-4.8	-4.0	-3.1	-4.6	-5.7
Exports of goods, BOP, EUR m	13,448	16,213	20,740	18,332	18,100	18,600	19,300
annual change in %	5.4	20.6	27.9	-11.6	-1.3	2.8	3.8
Imports of goods, BOP, EUR m	14,994	18,970	24,833	22,069	21,700	23,000	24,800
annual change in %	-2.6	26.5	30.9	-11.1	-1.7	6.0	7.8
Exports of services, BOP, EUR m	4,842	5,326	7,241	7,513	7,400	7,600	8,300
annual change in %	-13.3	10.0	36.0	3.8	-1.5	2.7	9.2
Imports of services, BOP, EUR m	2,905	3,621	4,908	5,332	5,200	5,400	5,800
annual change in %	-7.9	24.6	35.5	8.6	-2.5	3.8	7.4
FDI liabilities, EUR m	826	3,166	1,120	1,386	.	.	.
FDI assets, EUR m	171	2,338	-105	804	.	.	.
Gross reserves of CB excl. gold, EUR m	3,982	4,504	3,819	4,088	.	.	.
Gross external debt, EUR m	36,763	36,854	39,270	39,728	39,000	39,600	40,400
Gross external debt, % of GDP	122.1	110.5	102.3	98.5	94.0	91.0	88.0

Note: Introduction of new index 2021=100 (new weights) for gross industrial production and producer prices in industry.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2021 new LFS methodology in line with the Integrated European Social Statistics Regulation (IESS). - 4) In % of labour force (LFS). - 5) Loans more than 90 days overdue and those unlikely to be paid. - 6) Official refinancing operation rates for euro area (ECB).

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