

LATVIJAS BANKA

BANK OF LATVIA

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1 Highlights

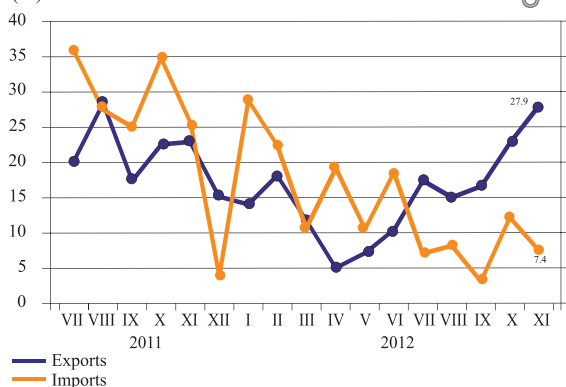
2 Macroeconomic Data

3 In Focus

1. Highlights

Latvian exporters continue their good performance

Annual growth in exports and imports of goods (%)

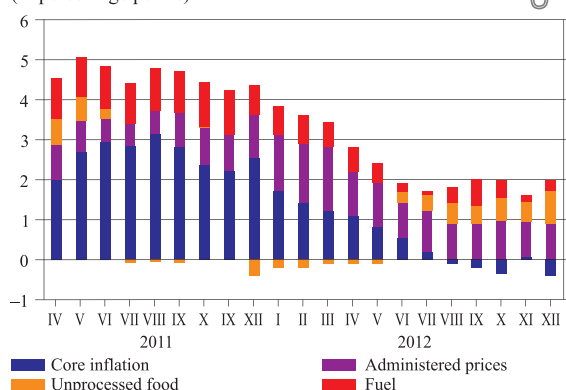


In November, Latvian goods exports increased by 27.9% year-on-year. In the first 11 months of 2012, the year-on-year growth rate was 15.4%, with a rise reported in all commodity groups, except transport vehicles and products of the chemical industries. Thus, the overall growth for 2012 will exceed 10%.

The explanation for the successful performance of our exporters despite unfavourable developments in external markets could be the small size of Latvia's market share. For this reason, the Latvian exporters are much more flexible in terms of what they supply to the common market and it is easier for them to refocus.

Inflation remains low, prices expected to be stable in 2013 as well

Main components of annual inflation (in percentage points)

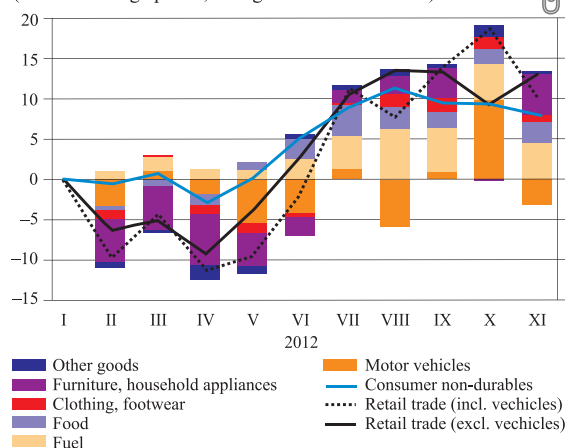


Annual inflation in Latvia remained low in December (1.6%), with the average consumer price level unchanged in comparison with November.

In 2012, the average annual inflation was 2.3%, thus lower than in the previous year. This year-on-year decline was primarily determined by supply-side factors, whereas the pressures from the demand side were still contained on account of balanced wage and productivity developments. In 2013, the average annual inflation could be even slightly lower than in 2012, partly because of base factors and partly because of the expected slight deceleration of economic growth.

Retail trade buoyant as local purchasing power and tourist spending rise

Retail commodity groups in comparison with January 2012 (at 2005 average prices; changes in millions of lats)



The latest retail trade data point to a rise in spending, hence the demand has recovered from the drop experienced in October. According to seasonally adjusted data, the retail turnover grew by 1.4% at constant prices in November, or 8.7% year-on-year.

Overall, spending was supported by the improved purchasing power of the population: employment and average wages increased, whereas the effect of price rises on the purchasing power weakened.

In 2010–2011, retail trade was boosted by the growing number of tourists itself, whereas higher sales during 2012 could be particularly related to a rise in the number of visitors from Russia and their travel and spending habits.

2. Macroeconomic Data

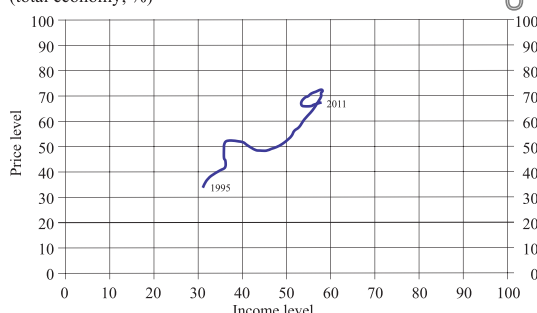
	Reporting period	Data (%)
Gross Domestic Product (GDP) (quarter-on-quarter growth; seasonally adjusted)	2012 Q3	1.7
State budget Tax revenue (current month; year-on-year growth) General government expenditure (since the beginning of the year, year-on-year growth)	2012 XII 2012 XII	7.9 3.5
Consumer price changes Consumer Price Index CPI (month-on-month growth) 12-month average annual inflation (to comply with the Maastricht Criteria) 09.01.2013 As consumer optimism grows, inflation remains low 	2012 XII 2012 XII	1.6 2.3
Foreign trade Exports (year-on-year growth) Imports (year-on-year growth) 10.01.2013 Latvian exporters continue their good performance 	2012 XI 2012 X I	27.9 7.4
Balance of payments Current account balance (ratio to GDP) Foreign direct investment in Latvia (net flows; % of GDP) 18.01.2013 A surplus in Latvia's current account in November 	2012 Q3 2012 Q3	-1.8 4.2
Industrial output Working day-adjusted industrial output index (year-on-year growth) 03.01.2013 Manufacturing holds more surprises 	2012 XI	7.9
Retail trade turnover Retail trade turnover at constant prices (year-on-year growth) 03.01.2013 Retail growth determined by a rise both in tourist expenditures and purchasing power of locals 	2012 XI	8.7
Employment and unemployment Registered unemployment (share in working age population)	2012 XII	10.5
Monetary indicators Broad money M3 (year-on-year) 21.01.2013 Economic stability provides for a more balanced money supply 	2012 XII	2.8

Source: Treasury, Central Statistical Bureau of the Republic of Latvia, and Bank of Latvia data.

3. In Focus

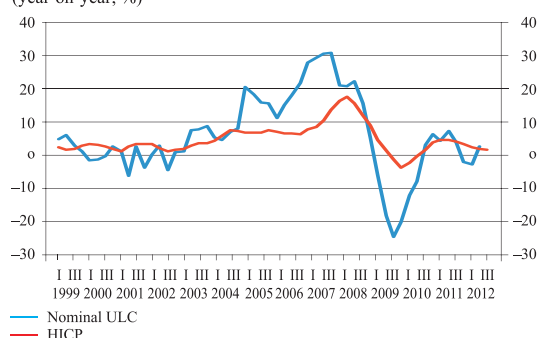
Inflation trends and its sustainability in Latvia

Relative income and price level in Latvia compared to EU27
(total economy; %)



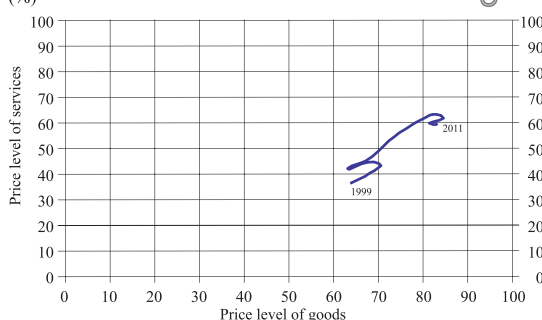
Source: Eurostat.

Growth of unit labour costs and HICP
(year-on-year; %)



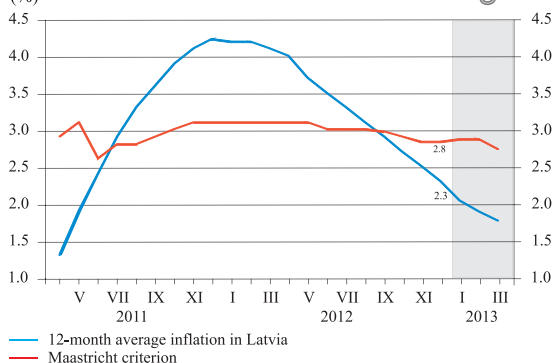
Sources: Eurostat, CSB and Bank of Latvia estimates.

Relative price levels of consumer goods and services in Latvia compared to EU27
(%)



Source: Eurostat.

12-month average HICP and the estimated level of Maastricht inflation criterion
(%)



Sources: Eurostat, EC and Bank of Latvia estimates.

Since the second half of 2011, the year-on-year inflation has been gradually declining and reached 1.6% in the fourth quarter of 2012 (both national inflation measure and HICP). The average annual inflation was 2.3% in 2012: well below the estimated value of the Maastricht criterion at 2.8%. This decline was influenced by both domestic and external factors such as sustainable wage-productivity developments, fading base effects of indirect taxes and stabilising global commodity prices.

In 2013, the average annual inflation could be even slightly lower. This will partly stem from a lower economic growth rate in comparison with the previous year, with the expected moderate global commodity price rises also contributing.

After a brief surge in grain prices in mid-2012, average global food prices have started to decrease in recent months, thereby easing the supply side pressure. The world energy price developments are contained by the persistently rather weak demand and moderate growth prospects in the EU, Russia and the USA. The recent slight decrease in the 9-month average price of heavy fuel oil has already resulted in lowering the natural gas and heating tariffs in Latvia as of January 2013.

As concerns the domestic supply side factors affecting the prices, there is no evidence of any upward inflationary pressure potentially caused by the unit labour costs in the nearest future, as producer prices mainly increase in the industries that do not quote labour shortage as an obstacle to their development. It is worth mentioning that, irrespective of the global energy price trends, a number of domestic thermal energy providers have already been able to reduce their tariffs as a result of production modernisation. Moreover, due to the improved fiscal stance, new indirect tax increases (which contributed notably to the average annual inflation in 2009–2011) are no longer required. On the demand side, both a flexible labour market and decentralised wage setting help keeping the wage-productivity developments sustainable.

The sustainability of inflation is, however, conditional on the real convergence. The average price level in Latvia has converged notably towards the EU average since the late 90-ties. The prices of consumer goods have reached around 80% of the EU average, while those of services (determined by the income level rather than tradability) constitute about 60% of the EU average. The high degree of convergence in the case of commodity prices and the gradual income convergence suggest a moderate increase in the price level: this may imply slightly higher inflation rates than the EU average, with the difference depending largely on the relative wage-productivity developments.