3. In Focus

Bank of Latvia's Economic Forecast

Several international organizations (e.g. IMF and OECD) have revised downwards the 2013 growth forecasts for some leading economies. At the moment, Latvia is more than ever dependent on external market developments. Nevertheless, due to the regained competitiveness, Latvia's exporters have proven capable of operating successfully and boosting their exports even in difficult external conditions. The ability to increase the market shares, export market diversification and steeper growth of exports to partners outside the EU have so far helped the Latvian producers to compensate the falling demand for imports in some EU Member States. Therefore, it is possible that the Latvian export growth will continue to outpace the import growth in Latvia's trade partners, thereby supporting higher economic growth than currently expected.

Analyzing the risks stemming from the domestic environment, several aspects should be mentioned. Firstly, private consumption is expected to increase at roughly the same pace as the real wage bill. Moreover, if the increase of the share of consumer non-durables in the overall trade composition really is a signal for a potential improvement in the purchasing power of a larger part of the population, consumption can be expected to continue expanding steadily. In addition, with the conditions in the public finances sector improving, the tendency of making precautionary savings could weaken and thereby give an additional push to the rising consumption. On the other hand, private consumption growth could be dampened by the changing consumer sentiment. So far, the consumer outlook on future economic development has been unusually optimistic; nevertheless, with the confidence indicators in Latvia converging with those in other EU Member States, the growth of consumption could decelerate.

The Bank of Latvia's overall GDP growth forecast for 2013 is 3.6%. According to this baseline scenario, the slowdown of growth in comparison with the previous year will be determined by both deceleration of exports and lower investment and private consumption growth. In 2013, the most significant deceleration of the year-on-year growth of economic activity is expected in construction and transport sectors as well as in some manufacturing sub-sectors (manufacture of metals and wood). Changes in the above factors may act to increase as well as to dampen the economic growth; therefore, the GDP growth could range from 3.1% to over 4% in 2013.

As regards price developments, average annual inflation is expected to remain low in Latvia in the medium-term mainly due to supply-side factors. The currently stabilized oil and global food prices will have a mitigating impact on the Latvian inflation in the course of 2013. The latest gas tariff forecast for the first half of 2013 is also assuming lower nine-month average heating oil prices, which translates into reduced natural gas trading prices. On the other hand, the 2012 costs are gradually passing through to the core inflation, and both the import prices and producer prices have increased. Moreover, the upside risks to inflation will be increasingly more affected by the demand side factors: the expected positive increase in real wages and sustainable purchasing power could support a rise in consumption. However, considering the fact that the real purchasing power is reflected in the demand side inflation with a lag, the effect of the demand side factors is expected to grow in 2014.

Overall, the average inflation in 2013 is forecast at about 2%. At the beginning of the year, the inflation growth will be lower and it could accelerate gradually in the course of the year, although it is not expected to exceed 3% also at the end of the year.