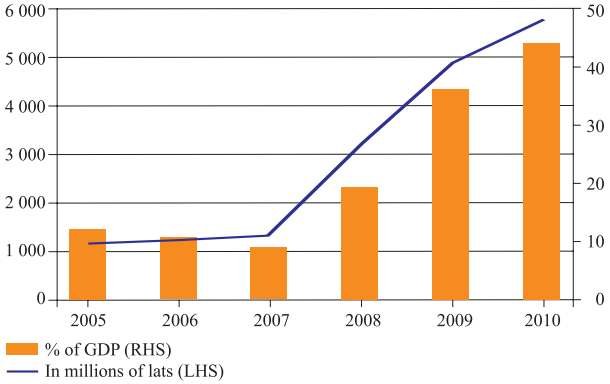
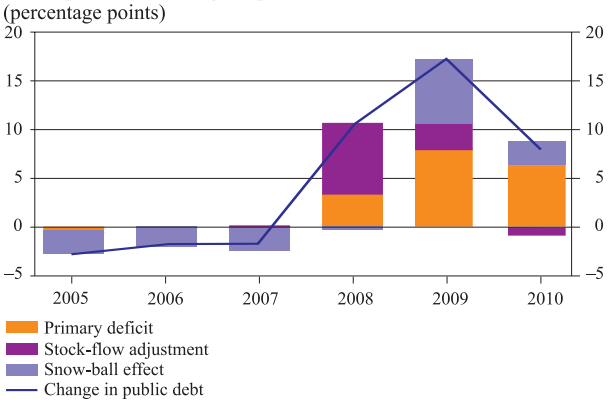
3. In Focus

Maastricht criterion for public debt expected to be complied with

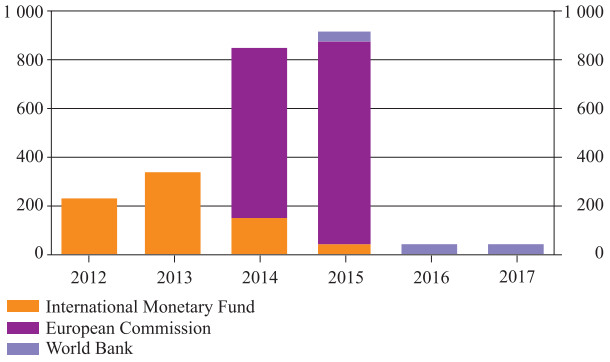
Latvia's public debt



Decomposition of change in public debt ratio
(percentage points)



Refinancing of the loans provided by international creditors
(in millions of lats)



Public debt in Latvia has grown from the exceptionally low level of 9% of GDP in 2007 to 44.7% of GDP in 2010: in nominal terms, it has quadrupled over three years. The increase in the public debt ratio was driven by high levels of primary deficit (as budget revenue fell dramatically), negative economic growth/interest rate differential ("snow-ball" effect) and a debt-increasing stock-flow adjustment (on the background of financial assistance to Parex Banka). Due to wide-ranging austerity measures amounting to 16% of GDP, broadly equally distributed between revenue and expenditure sides, Latvia's Government succeeded in preventing the public debt ratio from growing even further and managed to stabilise it at the level of 40–50% of GDP. Additional consolidation efforts in 2012 and prudent fiscal policy onwards are crucial to ensure the sustainability of public debt (bearing also in mind the forthcoming effect stemming from ageing population). Continuation of structural reforms, inter alia the recently announced old-age pension system reform, would contribute to bringing Latvia's public finances back on a sustainable path.

70% of the increase in public debt was determined by funds provided by international creditors as Latvia turned to international institutions for financial assistance at the end 2008. Due to a revival in economic activity and the implemented austerity measures, the Latvian authorities are not expected to draw the loan in full. Looking forward, Latvia will have to refinance quite substantial amounts in the medium-term. Financing needs will be especially significant in 2013–2015. In light of this, the Government has already made the decision to start negotiations with potential investors in order to return to international capital markets. Latvia's economic recovery, credit rating upgrade, wide-ranging austerity measures and progress toward Latvia's goal of euro adoption are projected to bring about favourable borrowing conditions.

In the medium term, the Latvian public debt ratio is expected to increase slightly (with the debt-increasing effect stemming from primary deficits partly offset by debt-decreasing "snow-ball" effect), remaining comfortably below the Maastricht threshold of 60% of GDP. Therefore, the Maastricht criterion for public debt is expected to be complied with when assessing Latvia's readiness for euro adoption in 2014.