



LATVIJAS BANKA

# BANK OF LATVIA

## MONTHLY NEWSLETTER • JUNE 2013

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1 Highlights

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2 Macroeconomic Data

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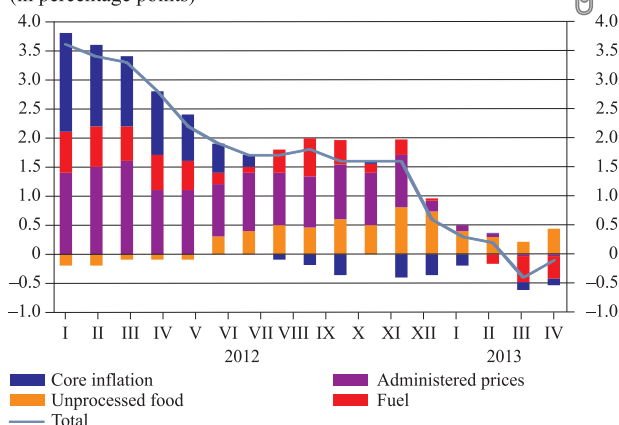
3 In Focus

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# 1. Highlights

## Inflation heading towards record lows

**Contributions to annual inflation**  
(in percentage points)

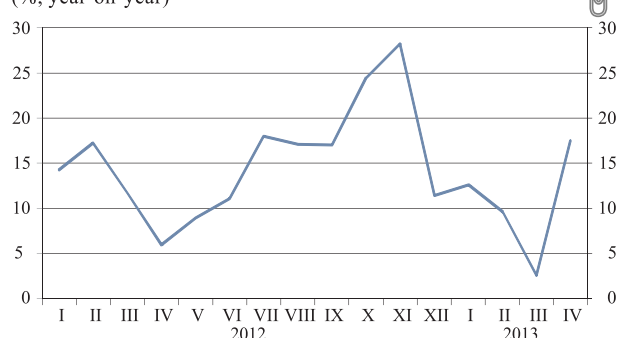


Annual inflation remained slightly negative (−0.1%) in May for the second consecutive month, mainly as a result of dropping fuel and processed food prices.

Going forward, several supply factors continue to signal low inflation. For instance, the thermal energy prices in Riga will be decreased from July as a result of introducing new reduced tariffs (possible because of the launching of the new biofuel plants) as well as lower sales price of natural gas. Under the impact of energy prices, this year's average annual inflation could become the lowest positive average annual inflation since the beginning of the 1990s when data became available.

## Exports picking up despite weak external demand

**Growth in exports of goods**  
(%; year-on-year)



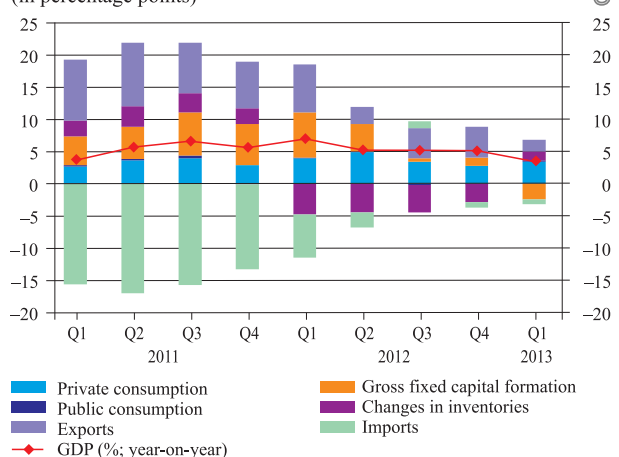
Despite the odds of dropping growth rates, decreasing output of most manufacturing sub-sectors as well as severe problems in manufacture of base metals, the exports of Latvian goods continue to rise. The year-on-year growth rate stood at 17.5% in April, which is a very good performance considering the unstable external environment.

Regardless of the fact that the Latvian exporting sectors, manufacture of wood and base metals, are currently facing a global contraction of production, both the producers of metal structures and wood processing enterprises continue to expand their exports to Denmark, Sweden, Norway, the United Kingdom and

Iceland where many public procurement tenders are organised. This proves that the ability of Latvian exporters to respond flexibly to changes in the external environment is a substantial advantage helping them to maintain external competitiveness even in an unfavourable global situation.

## Resilient domestic consumption supports GDP growth







**Contributions to GDP growth**  
(in percentage points)



According to the adjusted statistical data (an upward adjustment of 0.2 percentage point), GDP grew by 1.4% quarter-on-quarter in the first quarter of 2013, while the annual growth rate was 6.0% according to calendar adjusted data and merely 3.6% according to seasonally non-adjusted data.

With industrial performance weakening and export growth decelerating, private consumption with its contribution of 3.4 percentage points became the main driver of GDP growth in the first quarter of 2013. Private consumption expanded on account of both recently growing employment and the gross average wage increase. The reduction in the personal income tax rate also contributed to this expansion. Thus, private consumption could retain its leading position in the coming months as well. Yet there are limits to its ability to sustain rapid GDP growth in the case of a small and open economy.

## 2. Macroeconomic Data

	Reporting period	Data (%)
<b>Gross Domestic Product (GDP)</b> (quarter-on-quarter growth; seasonally adjusted) 07.06.2013 <a href="#">The engine for economic growth switches from export to consumption</a> 	2013 Q1	1.4
<b>State budget</b> Tax revenue (current month; year-on-year growth) General government expenditure (since the beginning of the year, year-on-year growth)	2013 V 2013 V	6.4 6.8
<b>Consumer price changes</b> Consumer Price Index CPI (month-on-month growth) 12-month average annual inflation (to comply with the Maastricht Criteria) 10.06.2013 <a href="#">This year's average inflation could become the lowest positive annual average inflation</a> 	2013 V 2013 V	0.1 1.1
<b>Foreign trade</b> Exports (year-on-year growth) Imports (year-on-year growth) 10.06.2013 <a href="#">Despite the unfavourable conditions, exports of Latvian goods are on the rise</a> 	2013 IV 2013 IV	17.5 4.7
<b>Balance of payments</b> Current account balance (ratio to GDP) Foreign direct investment in Latvia (net flows; % of GDP) 04.06.2013 <a href="#">A small deficit in the current account in the first quarter</a> 	2013 Q1 2013 Q1	-1.4 2.7
<b>Industrial output</b> Working day-adjusted industrial output index (year-on-year growth) 04.06.2013 <a href="#">External economic uncertainty may play out to increase the role of domestic demand in the development of manufacturing</a> 	2013 IV	-2.7
<b>Retail trade turnover</b> Retail trade turnover at constant prices (year-on-year growth) 30.05.2013 <a href="#">Trade still growing well but pointing to a slowdown in rise of purchasing power</a> 	2013 IV	6.2
<b>Employment and unemployment</b> Registered unemployment (share in working age population) 31.05.2013 <a href="#">Wage purchasing power is growing</a> 	2013 V	9.9
<b>Monetary indicators</b> Broad money M3 (year-on-year) 20.06.2013 <a href="#">As Latvia moves towards euro area, demand for cash currency drops</a> 	2013 V	4.2

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

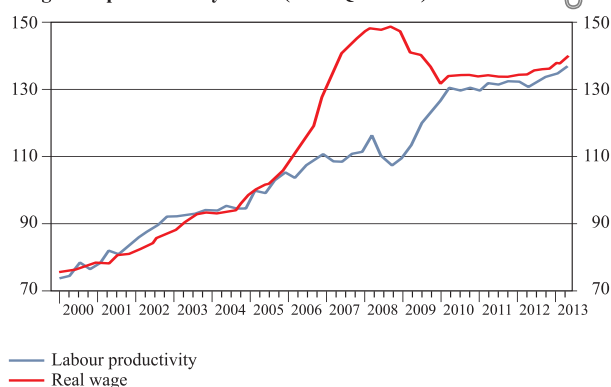
### 3. In Focus

#### Labour market recovery is well underway, yet posing no risks to price stability

In just three years, Latvia managed to move down from the first to the eighth position in EU in terms of the highest unemployment rate. During this period, Latvia recorded one of the fastest employment growth rates among the EU Member States. For instance, Latvia ranked first in terms of job creation in 2012. Furthermore, employment growth was driven solely by the private sector. In the first quarter of 2013, the unemployment rate decreased to 12.4% which is at par with the euro zone average. However, the decline of unemployment was somewhat hindered by the increase in economically active population owing to the robust rise of participation rate.

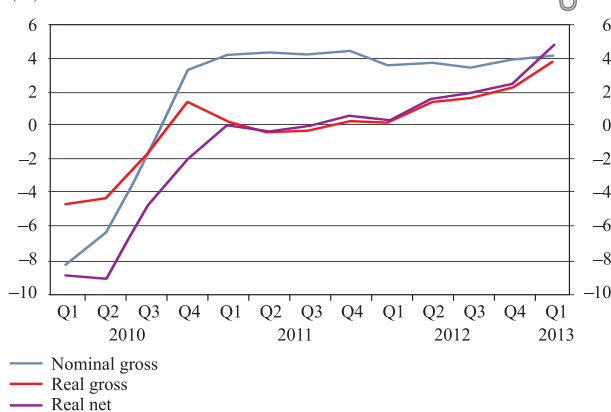
Net labour outflow has virtually stopped. The Net emigration slowdown witnessed in CSB flash data (net emigration in 2012 decreased to 11 000 as compared to 23 000 in 2011 and 36 000 in 2010) is further confirmed by the passenger flows in Riga airport. The difference between passenger departures and passenger arrivals fell to a marginal 2 000 in 2012 as compared to 20 000 in 2011 and 35 000 in 2010. Youth unemployment halved as well. The only concern is associated with the already two decades' old unemployment enclaves, particularly in rural areas of the eastern part of the country. Going forward, investment inflows and structural policies for promoting business activity should aim at benefiting municipalities where unemployment is still high.

Wage and productivity index (2005 Q1 = 100)



Source: CSB data, Bank of Latvia staff calculations..

Nominal and real wage growth (%)



Source: CSB data.

Wages are growing, especially in real terms: the average real net wage grew by 4.8% year-on-year in the first quarter of 2013. On a seasonally adjusted basis, the average wage for full-time work in the first quarter of 2013 just exceeded its pre-crisis peak in nominal terms and was only 6% lower than the historical maximum in real terms. Yet this does not pose any risks to price stability. The wage rise is commensurate with labour productivity increase. The wage-productivity gap which accumulated during the period of economic overheating was closed both owing to the wage adjustment and labour productivity gains. The share of businesses claiming labour shortage as the main business obstacle is stable and below 10%. Thus, the labour shortage concern expressed by particular companies is not sufficient to cause economy-wide wage increases exceeding labour productivity growth. Furthermore, the annual growth of the nominal wage is stable at around 4% for the third consecutive year, while the real wage growth acceleration was driven by decreasing inflation (in May 2013, inflation was the second lowest in the EU) and the 1 percentage point cut of personal income tax rate (to 24%) as of January 2013.