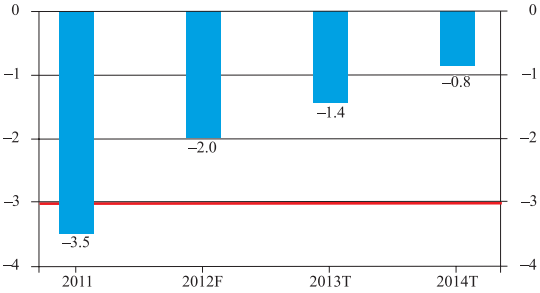
3. In Focus

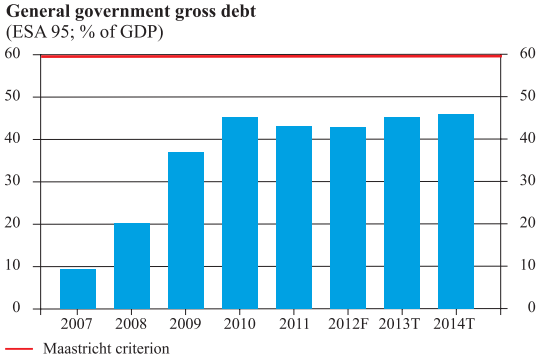
Latvia: meeting the Maastricht criteria

General government balance
(ESA 95; % of GDP)



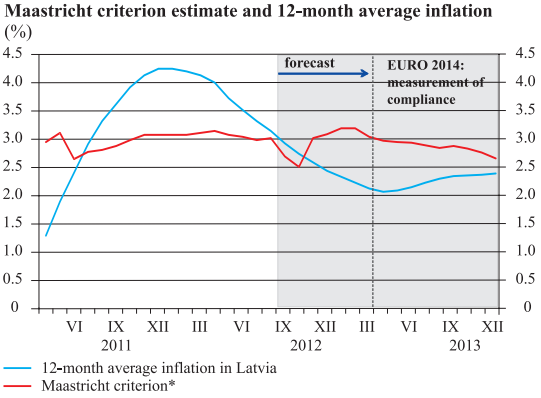
Sources: Eurostat, F – Bank of Latvia forecast, T – Ministry of Finance budget target

General government gross debt
(ESA 95; % of GDP)



Sources: Eurostat; F – Bank of Latvia forecast, T – Ministry of Finance target

Maastricht criterion estimate and 12-month average inflation
(%)



Sources: Eurostat, EC and Bank of Latvia estimates; * – negative inflations excluded.

The government of Latvia has set the introduction of the euro in January 2014 as a national target. The Latvian economy is moving forward successfully, and soon Latvia will comply with the convergence criteria[1] for qualifying for the euro area, which is required for the adoption of the single currency in January 2014.

• Latvia has made remarkable progress toward meeting the Maastricht fiscal criteria. Fiscal consolidation of more than 15% of GDP during 2009–2012 has pushed the deficit down toward the Maastricht criterion and restored debt sustainability. Consolidation has been backed by structural reforms that set Latvia firmly on the path towards long-term fiscal sustainability. The government's commitment to tight fiscal discipline is manifested in the steady reduction of the budgetary deficit targets and the approval of the Fiscal Compact. The considerable margin of the targeted deficits with respect to the Maastricht criterion provides a safety buffer against any potential adverse economic developments.

• The general government debt level has stabilised after having peaked in 2009–2010 in the wake of the financial crisis. Moreover, having tapped into emergency funding from the IMF/EC programme during the crisis, Latvia has successfully returned to international credit markets borrowing at competitive rates since 2011. The level of government debt as a percentage of GDP is expected to stabilise before declining as the economic stabilisation programme loan is replaced by market funding.

• As a result of both external and domestic factors, the 12-month average HICP declined to 3.1% in August 2012, slightly above the level of the Maastricht criterion which was estimated at 3.0% (in January, these figures were 4.2% and 3.1% respectively). At the moment, the main risks surrounding inflation forecasts are the external ones, i.e. the future oil and non-oil commodity (cereals) price developments. However, since the world energy and food prices are likely to affect the inflation in both Latvia and the reference countries symmetrically and the domestic inflationary pressures are contained (owing to sustainable wage and productivity developments), the inflation criterion is expected to be fulfilled over the next few months' time. The annual average inflation is projected to decline to 2.4% by December 2012 already, while a notable decrease in the inflation criterion is not expected and it is projected to stay close to 3.0%.

• Latvia already fulfils the exchange rate criterion as it has been participating in the ERM II since May 2005 (with a unilateral commitment to maintain the exchange rate of the lats against the euro with a fluctuation band of +/– 1% around the parity).

• Turning to the interest rate criterion, the long-term interest rate for the Latvian government debt was 5.3% in August 2012, lower than a year ago. As the economic recovery gains momentum and the fiscal situation continues to improve, interest rates could be expected to continue on the downward trend.

Even though at the current juncture the uncertainty surrounding the forecasts is high, Latvia's prospects of becoming the 18th euro zone member in 2014 look increasingly more realistic. The Latvian economy has benefited from the internal adjustment process and the structural reforms it has implemented as demonstrated by the country's economic performance: Latvia was the fastest growing economy in the EU during the first half of 2012. Latvia's compliance with the Maastricht convergence criteria helps to ensure steady and sustainable economic growth going forward.

[1] The EMU economic entry criteria are intended to ensure economic convergence – they are known as the 'convergence criteria' (or 'Maastricht criteria') and were agreed by the EU Member States in 1991 as part of the preparations for introduction of the euro (for further details please refer to the European Commission website http://ec.europa.eu/economy_finance/euro/adoption/who_can_join/index_en.htm).