LATVIJAS BANKA

BANK OF LATVIA
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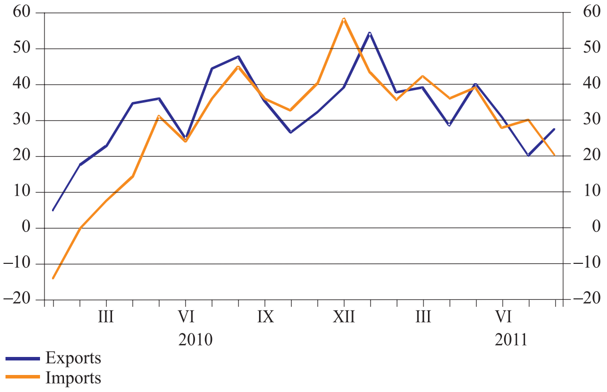
1. Highlights

Exports grow, structure becomes more complicated

Annual growth rates
(%)



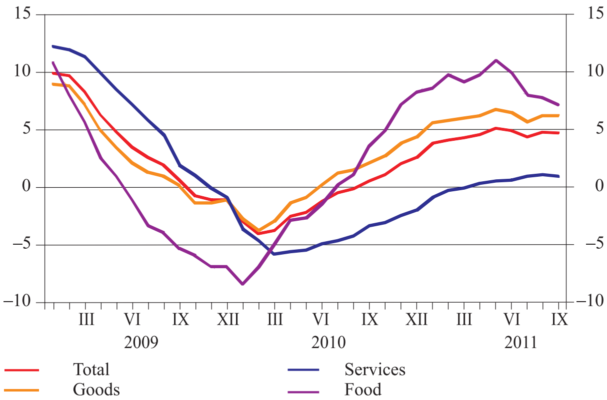
The foreign trade data for August indicate a rise in export volumes, reaching a new export volume record. Over a month, goods exports grew by 13.4% while imports shrank by 1.1%.

A positive development is the fact that the Latvian businesses have expanded their export market shares not only on account of the major groups of export commodities but also because the export structure has become more complicated: new groups of commodities have appeared and the small ones have expanded.

In spite of global developments, Latvian business confidence indicators for the third quarter improved, both in regard to export order volumes and competitiveness. This is a clear sign that the exporters are ready to maintain their existing markets even under less favourable external developments.

Annual inflation falls

Annual rates of CPI inflation
(%)



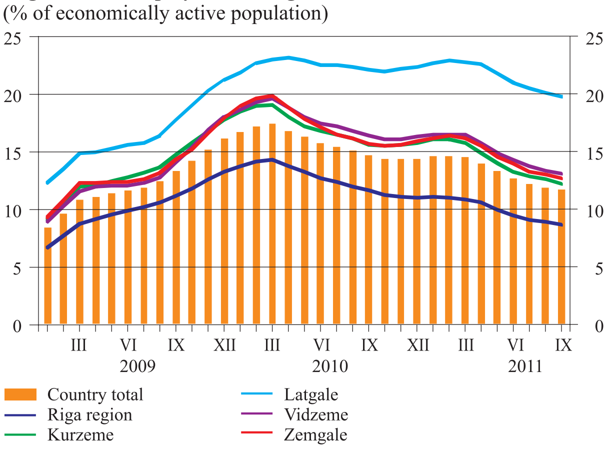
A seasonal rise in prices is usually observed in September and this year was no exception: the average prices went up 0.4% month-on-month. The annual inflation, however, dropped slightly to 4.6%.

Fuel prices were 0.2% lower than in August, reflecting the stabilisation of oil prices. The global price developments found their reflection also in food prices: the prices of bread, fresh fish and oil went down month-on-month.

Inflation can be expected to decline next year. The extent of the decline, however, will depend on the economic growth achieved in European and other countries as well as on the developments in the world commodity markets where uncertainty continues to reign.

Registered unemployment down

Registered unemployment in regions of Latvia
(% of economically active population)



In September, registered unemployment decreased further by 0.2 percentage point and reached 11.6% of the economically active population by the end of the month. The number of registered unemployed has declined by one third in comparison with the peak observed 18 months ago.

In contrast to the 2010 trend, this year the decline in unemployment was broad-based across all regions. It was supported by both the creation of new jobs and gradual restructuring of the unemployment support programme which could have reduced the motivation to register with the State Employment Agency.

2. Macroeconomic Data

	Reporting period	Data (%)
Gross Domestic Product (GDP)		
(quarter-on-quarter growth; seasonally adjusted)	2011 Q2	**2.2**
State budget		
Tax revenue (current month; year-on-year growth)	2011 IX	**20.8**
General government expenditure (since the beginning of the year; year-on-year growth)	2011 IX	**3.5**
Consumer price changes		
Consumer Price Index (CPI; month-on-month growth)	2011 IX	**0.4**
12-month average annual inflation (to comply with the Maastricht Criteria)	2011 IX	**3.6**
10.10.2011 Global food prices continue to drop		
Foreign trade		
Exports (year-on-year growth)	2011 VIII	**27.0**
Imports (year-on-year growth)	2011 VIII	**19.9**
10.10.2011 A new export volume record		
Balance of payments		
Current account balance (ratio to GDP)	2011 Q2	**0.9**
Foreign direct investment in Latvia (net flows; % of GDP)	2011 Q2	**5.3**
12.10.2011 Current account surplus again in August		
Industrial output		
Working day-adjusted industrial output index (year-on-year growth)	2011 VIII	**6.5**
03.10.2011 Manufacturing output in August slightly down		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2011 VIII	**7.4**
30.09.2011 Retail continues to grow yet retailers' outlook dampens		
Employment and unemployment		
Registered unemployment (share of working age population)	2011 IX	**11.6**
11.10.2011 Registered unemployment in Latgale close to level in 2004		
Monetary indicators		
Broad money M3 (year-on-year)	2011 IX	**2.4**
20.10.2011 Uncertainty curbs money supply growth		

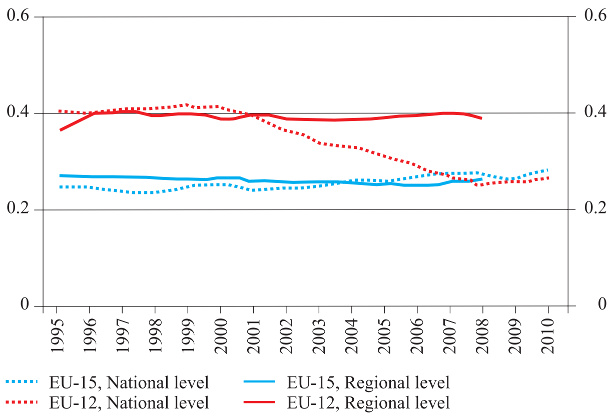
Sources: Treasury, Central Statistical Bureau of Latvia, and Bank of Latvia data.

3. In Focus

Global crisis triggered structural convergence

At the Bank of Latvia annual conference *"Global Challenges and Local Opportunities: Achievements and Prospects in the Baltic States"*, the results of a research on the process of structural convergence in Latvia and in Europe were presented. The research was conducted by Aleksejs Meļihovs and Igors Kasjanovs, two economists of the Bank of Latvia. It involved estimation of β- and σ-convergence in Europe as well as of the structural convergence process in the Latvian economy.

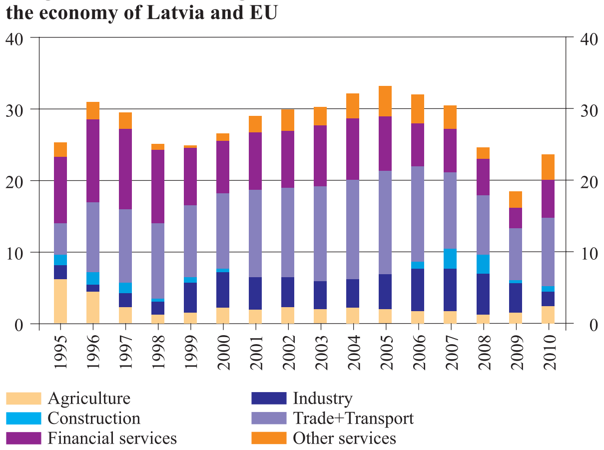
σ-convergence process in the EU



Income convergence can be defined as a process in which countries of a group become more similar to each other in terms of income (or GDP). While β-convergence focuses on detecting any potential catching-up processes, σ-convergence simply refers to reduction of regional disparities over time. The two concepts are, of course, closely related. The research revealed that β-convergence was present in Europe both at national and regional levels, although historically it was notably slower at the regional level. In the period from 1995-2008, for example, the average β-convergence speed in EU-27 was 2.7% and 1.7% at the national and regional levels respectively. The research also proved that the β-convergence process in the EU relied mostly on the convergence of the new Member States. So, for example, the average β-convergence speed in 1995–2008 was 4.3% in EU-12, while no β-convergence at all was observed in EU-15. It must be noted that the β-convergence speed increased already in the pre-accession period and even more after the accession.

Meanwhile, σ-convergence was also observed in the EU, but it was halted by the onset of the financial crisis in 2008. As in the case of β-convergence, σ-convergence also relied mostly on the convergence of the new Member States. More in-depth data analysis revealed that the σ-convergence process in Europe was observed only at the national level in the new Member States. There was no σ-convergence in EU-15 and at the regional level.

Krugman index measuring the structural difference between the economy of Latvia and EU



The term of structural convergence is used to describe a process in which countries of a group become more similar to each other in terms of their economic structure. The Krugman index was used to evaluate the process of structural convergence. The index compared the share of particular sectors in the economy of Latvia to the share of the respective sectors in the EU. The absolute sum of difference is the meaning of the index. The lower the index value, the more similar the productive structures are. While catching-up in terms of nominal convergence, Latvia was diverging in terms of structural convergence. And vice versa, in later years when Latvia faced a sharp downturn in GDP growth, structural convergence was evident. Trade sector in combination with transportation as well as financial services sector contributed to the process of structural divergence during the boom years. In most years structural divergence in Latvia persisted in the presence of economic growth and vice versa. Nevertheless, Latvia has improved both indicators in the long-term: there has been some structural convergence (as measured by Krugman index) as well as some real convergence (at least if we judge by the GDP per capita figures).