

LATVIJAS BANKA

BANK OF LATVIA

MONTHLY NEWSLETTER • OCTOBER 2012

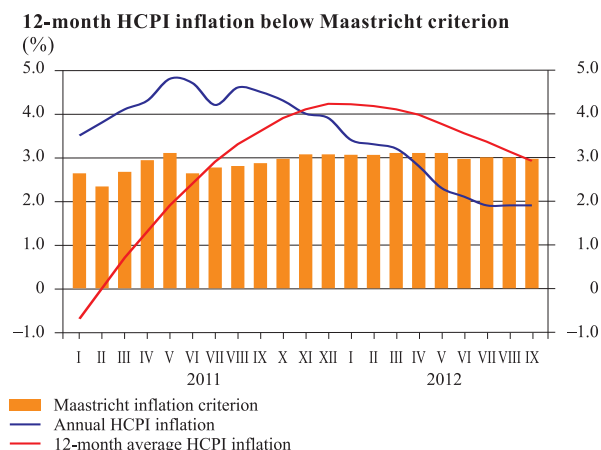
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1. Highlights

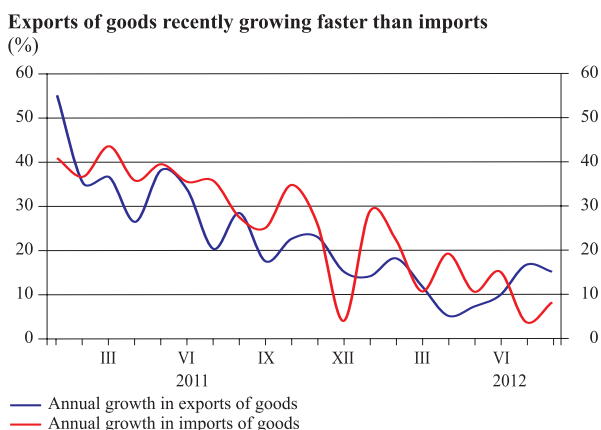
Inflation remains low, below Maastricht criterion in September



In September 2012, with the consumer price level rising by 0.5% month-on-month, the annual inflation remained low at 1.8%.

As a result of seasonal factors, it was mostly the prices of clothing and footwear that increased. Compared with August, fuel prices also rose in September. However, the annual core inflation in September continued to decline. This points to the absence of any renewed demand-side pressure on prices. In September, the 12-month average HCPI reached 2.9% in Latvia, while the average 12-month inflation of the three best-performing EU Member States in terms of inflation amounted to 3.0%. Thus, Latvia's inflation fell below the Maastricht threshold.

Latvian exports reach new heights

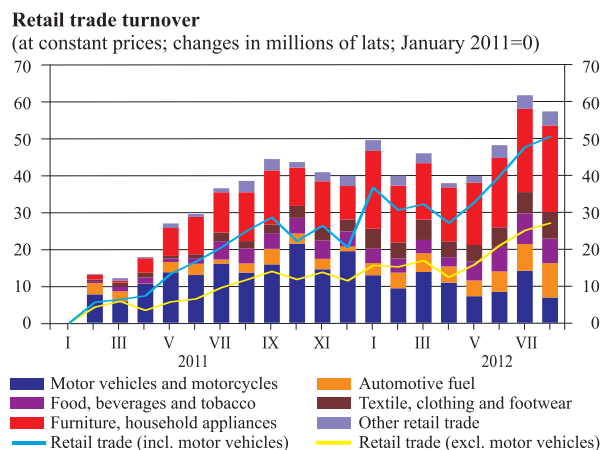


Against the background of persistent concerns about an economic recession in Western Europe, Latvia's export volumes continued to expand rapidly, reaching a new monthly high in August. Exports and imports grew by 12.7% and 4.6% month-on-month respectively. Thus, the trade balance improved.

Within a year, the export value of goods has increased by 14.9%. Even though there was a rapid rise in exports in August of last year, the high base has not acted to dampen the growth and the annual increase in the export value of goods has remained substantial.

Previously, exports grew on account of both rising prices and export volumes, whereas now, with the price effect weakening, the growth in real volumes is beginning to gain importance. Given the positive performance of the manufacturing sector which improved in August for the third consecutive month, there is no doubt that intensified production is the main driver behind Latvia's export growth.

Retail trade continues to grow at robust speed



After two months of growth, retail turnover continued on an upward trend in August (1.0% month-on-month increase; seasonal factors excluded). Year-on-year growth of 10.0% was retained and it should be considered high, because growth continued despite the high base effect.

Even though the retail and consumer confidence indicators published by the European Commission remain relatively stable, such consistently high growth seems surprising in light of the modest gains in purchasing power and still declining stock of loans to households.

Therefore, the good performance of the retail trade is most likely related to a general improvement in consumer confidence regarding both the current and future economic development as well as personal financial health which results in smaller or even shrinking savings.

2. Macroeconomic Data

	Reporting period	Data (%)
Gross Domestic Product (GDP) (quarter-on-quarter growth; seasonally adjusted)	2012 Q2	1.2
State budget		
Tax revenue (current month; year-on-year growth)	2012 IX	3.9
General government expenditure (since the beginning of the year, year-on-year growth)	2012 IX	2.1
Consumer price changes		
Consumer Price Index CPI (month-on-month growth)	2012 IX	0.5
12-month average annual inflation (to comply with the Maastricht Criteria)	2012 IX	2.9
08.10.2012 Domestic factors behind continued low inflation in Latvia 		
Foreign trade		
Exports (year-on-year growth)	2012 VIII	14.9
Imports (year-on-year growth)	2012 VIII	8.0
11.10.2012 Export value reaches a new record high 		
Balance of payments		
Current account balance (ratio to GDP)	2012 Q2	-2.7
Foreign direct investment in Latvia (net flows; % of GDP)	2012 Q2	1.1
12.10.2012 Export growth in August improves the current account balance 		
Industrial output		
Working day-adjusted industrial output index (year-on-year growth)	2012 VIII	10.9
04.10.2012 Manufacturing continues to triumph 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2012 VIII	10.0
28.09.2012 Retail turnover continues growing for a third consecutive month 		
Employment and unemployment		
Registered unemployment (share in working age population)	2012 IX	11.0
16.10.2012 Registered unemployment rate in 2013 will drop to a one-digit number		
Monetary indicators		
Broad money M3 (year-on-year)	2012 IX	2.3
18.10.2012 Stability with a plus sign 		

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

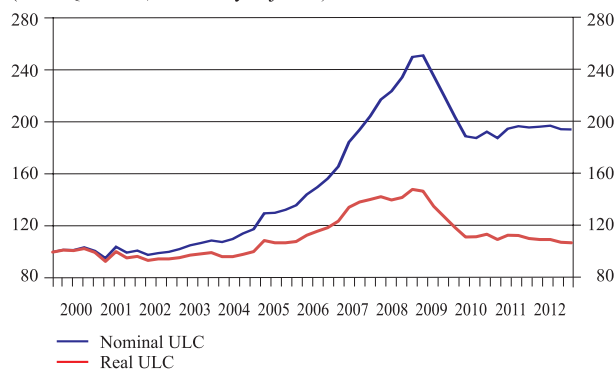
3. In Focus

Labour market revival broadens the base for sustainable economic development

Real wages have recovered, posting 1.5% year-on-year growth in Q2 2012, the strongest since the wage-productivity gap has closed. Together with the increase in employment this provides a solid foundation for the private consumption recovery.

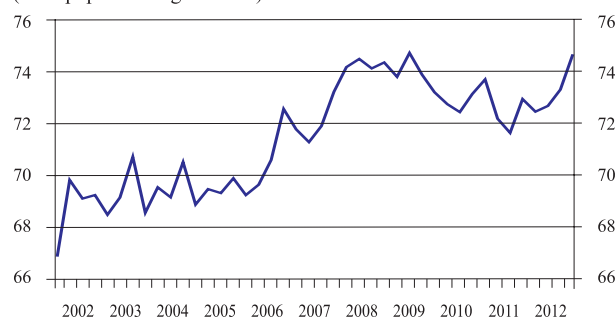
The purchasing power of wages has improved as a result of the dropping inflation, whereas the nominal wage rise has remained moderate and stable at 3.7% year-on-year. The wage growth is sustainable and does not create an upside risk to inflation as it is broadly in line with the labour productivity developments. Thus, Latvia's commitment to fulfil the Maastricht criteria in spring 2013 is not under major challenge. The return to competitiveness observed during the recent years has been sustainable: overall, unit labour costs have lost 23% and 28% in nominal and real terms respectively compared to their peak in the second half of 2008, and the year-on-year growth is still negative. Sizeable competitiveness gains have promoted a significant increase in Latvia's export shares in the imports of other countries.

ULC index
(2000 Q1 = 100; seasonally adjusted)



Source: Bank of Latvia calculations based on Eurostat data

Participation rate
(% of population aged 15-64)



Source: Bank of Latvia calculations based on the CSB data

As a result of robust labour productivity development, this was not a jobless economic recovery. Employment started to recover in Q2 2010 (two quarters later than GDP) and, according to the Eurostat national accounts concept, Latvia ranked second among other EU Member States in terms of the pace of employment creation in Q2 2012. Strong employment growth is confirmed by all available statistical data sources (Labour Force Survey, Business Survey, National Accounts, State Revenue Service data) and comes, almost entirely, from the private sector. However, both the closure of a major part of the public temporary jobs programme in Q4 2011 and Q1 2012 as well as the strong growth in the economic activity have resulted in a sticky unemployment rate that (disregarding the employment data) might be wrongly interpreted as a jobless recovery.

Real wage improvements in combination with higher employment have increased the real wage bill, thereby notably accelerating the retail turnover, with private consumption becoming a significant GDP growth driver recently. Given the deteriorating business confidence and the economic prospects of Latvia's main trading partners, broadening of the base for sustainable economic development requires the revival of private consumption.