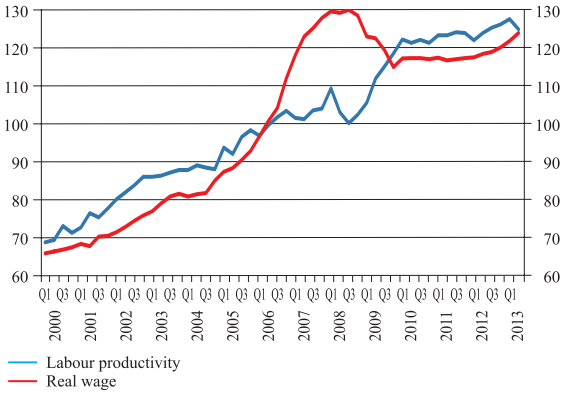
# 3. In Focus

## Wage-productivity developments remain balanced

The balance between wage and productivity growth has been retained and is likely to be sustained during the coming years.

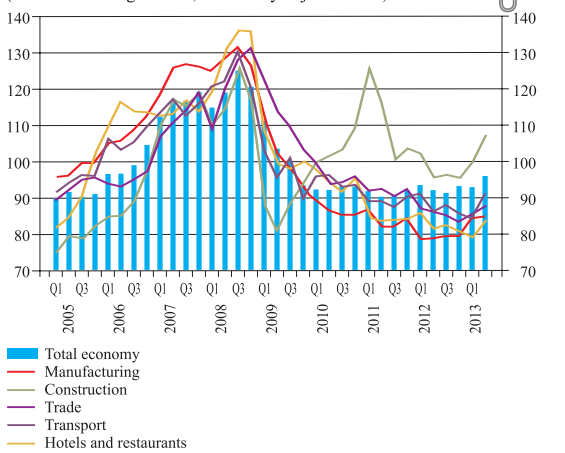
During the overheating period, wage growth in excess of labour productivity increases reflected one of the main internal imbalances. This resulted both in an unsustainable wage-inflation spiral eroding savings (nominal average wages grew by 33% year-on-year in mid-2007 with annual inflation peaking at 18% in mid-2008) and the loss of competitiveness reflected in a real exchange rate appreciation. During the 2008–2009 adjustment period, the balance between wages and labour productivity was restored owing both to a real wage drop and strong productivity gains. As a result, in the second quarter of 2013 these two indicators were just at par, meaning that the adjustment of past imbalances was both full and sustainable.

**Labour productivity and real wage index**
(per hour; historical average = 100; seasonally adjusted data)



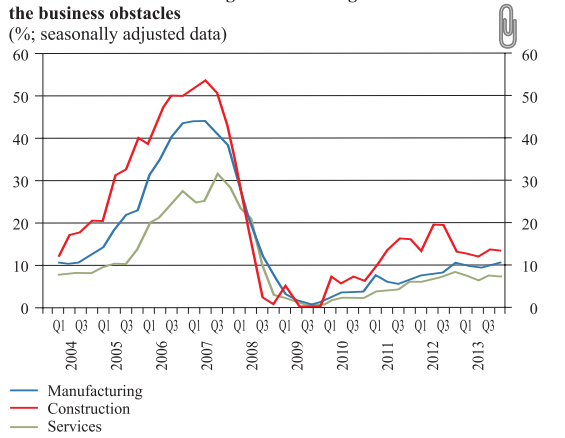

Sources: Central Statistical Bureau of Latvia data; Bank of Latvia staff calculations.

**Real unit labour cost index**
(historical average = 100; seasonally adjusted data)




Sources: Central Statistical Bureau of Latvia data; Bank of Latvia staff calculations.

**Share of businesses claiming labour shortage as one of the business obstacles**
(%; seasonally adjusted data)




Source: European Commission data.

Particularly, manufacturing was the first sector to resume balance between real hourly wage and labour productivity per hour worked – already in late 2009. Consequently, manufacturing became also one of the first sectors that posted year-on-year growth in value added, shaping the economic recovery of 2010–2011. By now the wage-productivity balance is also restored in services and domestic consumption oriented sectors, such as construction, trade, transport, hotels and restaurants, as reflected in the real unit labour cost index.

Wages and labour productivity developments are likely to remain balanced in the medium term. Currently, there are no risks of economy-wide wage growth in excess of labour productivity gains. Particularly, the share of businesses regarding labour shortage as one of the business obstacles is stable at around 10% that may be close to its "equilibrium" level.

Productivity growth will become the main factor of economic growth as the scope for further improvement in employment is gradually diminishing. Combined with a sustainable rate of wage growth, it may foster income convergence with the other euro area countries.