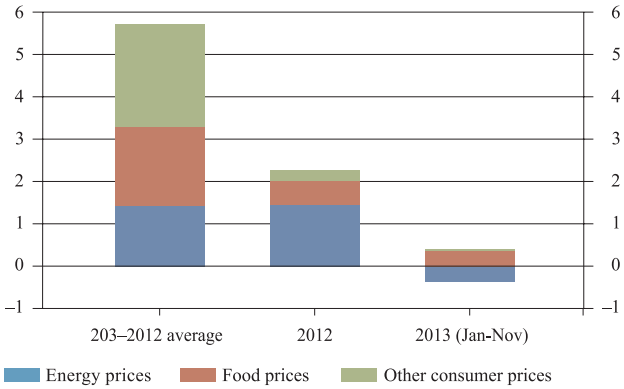
3. In Focus

The main characteristics of inflation trends in 2013 and 2014

The year on year inflation in 2013 may be considered to be untypically low: the contribution of the main components (energy, food and the rest of consumption groups) is very different from both the long-term averages and the inflation level characteristic of a growing economy (see Chart). Overall, price developments were mainly driven by the supply side in 2013.

Contributions to the year-on-year inflation
(in percentage points)



Sources: Central Statistical Bureau of Latvia, Bank of Latvia calculations.

The decline in the contribution of energy prices in January–November 2013 as compared to 2012 stems mainly from two sources. First, the decreasing global oil prices lead to price reductions for motor fuels as well as natural gas and heating because the prices of the latter two are related to those of the heavy fuel oil. Second, the thermal energy production process has been changed or modernised in several cities of Latvia. Companies have either switched their production to the co-generation mode completely or increased the share of production in the co-generation mode.

Moreover, the above-mentioned energy prices had positive effects on food prices: 1) the energy price component in agricultural prices decreased; and 2) food processing industries did not suffer from increasing energy costs. Consumer prices of food also benefitted from favourable weather conditions as the harvest of cereals exceeded that of the previous season.

Price developments in other consumption groups were largely influenced by the commensurate growth rates of wages and productivity as well as the non-existent energy price pressure. Some positive effects might also stem from the price monitoring. This was one of the activities launched by the government prior to the expected euro changeover to enable the comparison of the prices of approximately 120 goods and services within the period of 12 months prior and 12 months after the cash changeover.

Like in 2013, the 2014 average inflation is expected to be mainly influenced by the supply side factors affecting food and energy prices. However, the particular factors will be different and the direction and magnitude of their impact on prices will also vary. While some of the thermal energy price reductions having taken place in 2013 will have a lagged downward effect on inflation and although this year's favourable oil price developments now determine slightly lower natural gas prices, other factors could limit any further decreases of energy prices. First, the potential for introducing any structural changes in the production of thermal energy might be temporarily exhausted in the cities that were able to reduce their tariffs for this reason in 2013. Second, the main inflation generating source in this field could be the liberalisation of the electricity market for households.

Overall, the future path of the oil prices remains uncertain, even though Iran and Libya could increase their production capacity in the nearest months.

As to other supply side factors, a slight increase in fuel and tobacco prices is expected due to higher excise duty rates.

We can expect that the influence of the demand side factors on the level of prices will remain very gradual and highly moderate: the fiscal measures are expected to have a minor effect on supporting demand and the wage-productivity developments are expected to remain balanced.