

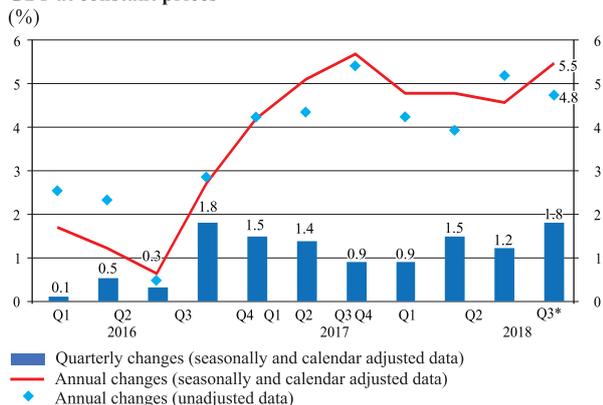


**LATVIJAS BANKA
MONTHLY NEWSLETTER**

NOVEMBER 2018

Latvia reports faster growth than before

GDP at constant prices



* – flash estimate.
Source: CSB data.

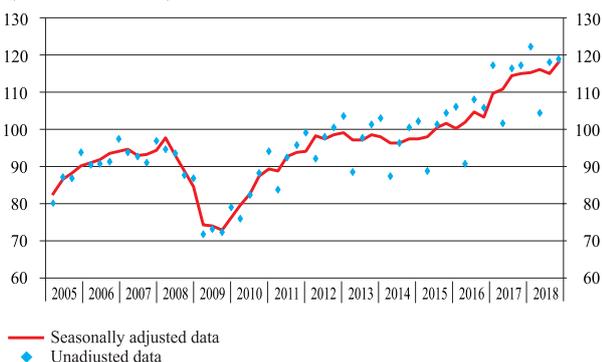
The flash estimate published by the Central Statistical Bureau reveals that the Latvian economy grew by 5.5% year-on-year in the third quarter of 2018 (calendar adjusted data). While the third quarter saw our trade partner growth rates declining, Latvia's economic development was even faster than before. GDP growth was strong on account of some of the large services sectors. The contribution of the transport sector was most likely positive, given the increases in cargo handling volumes at ports and rail freight, and the persistently good performance of the air passenger transport. The available sectoral information also points to a persistently strong contribution by the construction sector. Retail trade has also seen rather moderate development. Nevertheless, the improvement in this sector could mark a short-term effect, i.e. postponed consumption due to the opening

of IKEA in Latvia. A more accurate assessment of the results of the third quarter will be possible at the end of November when more detailed data on the updated GDP and its changes is published.

Growth in manufacturing remains stable

Real manufacturing production

(index; 2015 = 100)



Source: CSB data.

In the third quarter of 2018, manufacturing maintained similar growth rates (2.4% year-on-year) to those in the second quarter. The major obstacle to faster growth is the insufficient capacity on the supply side: as a result of the labour shortage and high degree of production capacity utilisation, the supply fails to satisfy the high demand observed in many sectors. The macroeconomic indicators, however, also show growth deceleration in Latvia's trade partners signalling a potential moderation of the external demand.

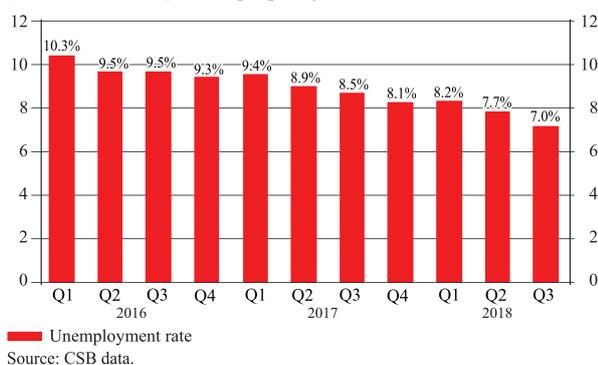
The biggest challenge was the food industry which is important due to its notable share in manufacturing output, i.e. approximately 15%, and which experienced negative year-on-year growth (-3.3%). Other sub-

sectors have achieved quite good results, particularly manufacture of motor vehicles and their components, electrical equipment, chemicals and chemical products, wood industry etc.; however, it is quite difficult to maintain high growth rates after the accelerated growth observed last year.

Unemployment in Latvia continues its downward trend

Unemployment rate

(% of economically active people aged 15-74)



Source: CSB data.

The rate of job seekers continues on its downward trend in Latvia, standing already at 7.0% in the third quarter of 2018 and representing a decrease of 1.5 percentage point year-on-year. Employment expanded not only on account of declining unemployment, but also as a result of the formerly inactive population entering the labour market. Currently employment and participation rates have climbed to 65.3% and 70.1% respectively, remaining above the EU average and reaching historical highs. Strong labour demand conditions will put further downward pressure on unemployment; nevertheless, a more accelerated fall has not been projected as regional and structural differences are the underlying factors of

this unemployment. For example, compared to Riga, the registered unemployment was 3.5 times higher in Latgale and most of the unemployed have only elementary or secondary education, while employers are mostly interested in qualified workers with specific skills.

	Reporting period	Data (%)
Gross domestic product (GDP)		
Real GDP (year-on-year growth, seasonally and calendar adjusted)	2018 Q3 <i>(flash estimate)</i>	5.5
Real GDP (quarter-on-quarter growth, seasonally adjusted) 02.11.2018 Latvia reports surprising economic growth 	2018 Q3 <i>(flash estimate)</i>	1.8
Public finances		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2018 X	11.1
Tax revenue (since the beginning of the year; year-on-year growth)	2018 X	8.3
Consumer price changes		
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2018 X	3.2
12-month average inflation (HICP)	2018 X	2.5
Consumer Price Index (CPI; year-on-year growth)	2018 X	3.2
Foreign trade		
Exports (year-on-year growth)	2018 IX	-1.0
Imports (year-on-year growth)	2018 IX	10.3
Balance of payments		
Current account balance (ratio to GDP)	2018 Q2	0.5
Foreign direct investment in Latvia (net flows; ratio to GDP)	2018 Q2	0.4
Sectoral performance		
Working day-adjusted manufacturing output index (year-on-year growth) 07.11.2018 Manufacturing: neither fish nor fowl, and lack of cooks and pots and pans 	2018 IX	2.0
Retail trade turnover at constant prices (year-on-year growth)	2018 IX	3.5
Labour market		
Average monthly wage (year-on-year growth)	2018 Q2	8.4
Jobseekers rate (share in working age population) 16.11.2018 Different roads lead to employment 	2018 Q3	7.0
Monetary indicators		
Resident deposits (year-on-year growth)	2018 IX	4.4
Loans to residents (year-on-year growth) 26.10.2018 Trends in monetary aggregates remain unchanged 	2018 IX	-3.3

Sources: Treasury, CSB and Latvijas Banka.

Latvia's energy sector: challenges and prospects



Daina Paula,
Chief Economist
Latvijas Banka

While possibly regarded as the back-bone of the existence of most economic activities, Latvia's energy sector is currently facing a number of challenges. Despite having grown over time and remaining twice as productive as the economy on average (Figure 1), Latvia's energy sector growth has decoupled from overall economic growth and the sector has gradually lost its share in GDP over the recent decades.

The structural changes in the economy as well as improved energy-efficiency could be mentioned among the reasons. Nevertheless, the value-added created in the economy by using an equivalent energy unit has increased.

One of the most obvious medium-term challenges for Latvia's energy sector is the limited scope for increase in demand given the energy-efficiency goals (for instance, Latvia's residential sector has a large room for improvement here), shrinking population as well as the lack of large-scale projects that would be associated with sizable energy consumption. Insufficient demand in a number of areas in Latvia (for instance, in water supply) manifests itself in the fixed components of energy bills as the costs of infrastructure need to be shared by a smaller number of consumers and limited consumption. The Eurostat data on energy prices suggest that a slight tendency to shift the burden of an increase in unit price of electrical energy to households rather than to industrial consumers has been evident across the EU since 2010.

Figure 1
Productivity
(EUR per hour worked)



Liberalised markets, better developed infrastructure and deeper regional integration provide an access to a larger market, at the same time aggravating rivalry. It means that energy production costs remain among the key issues when aiming for higher shares of energy produced from renewables as well as designing support mechanisms for renewable energy producers. So far, Latvia has reached one of the highest shares of renewables in total energy consumption within the EU, given its natural advantages such as water resources. However, a further increase in energy production from renewables (including wind power) poses the question of how to deal with the daily and seasonal volatility of supply that maintains the need for adequate balancing base-load capacities (for instance, combined heat and power plants). This might lead to an underuse of these capacities in terms of one of the energy types produced and result in higher maintenance costs. The future support mechanism for renewables as their share in total energy consumption is supposed to increase is also unclear.

Nevertheless, even with the competitiveness issues of the energy sector aggravating, neither the decreasing population nor the increasing energy-efficiency or its future targets as well as regional and global climate targets doom Latvia's energy sector to stagnation. All those developments provide a number of opportunities as well. For instance, searching for new technical solutions for generating capacities provides growth opportunities for both the energy sector as well as scientific research and manufacturing to satisfy national, regional or global market needs. This does not preclude the possibility of launching some large-scale industrial projects that would generate additional consumption either.

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