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Annual inflation and contribution to annual inflation
(%; in percentage points)



In November, annual inflation reached 0.9%. On the one hand, the consumer price level in November was substantially affected by a drop in world oil prices causing a reduction in fuel prices. On the other hand, prices of other consumer goods and services remained relatively stable on average. To compare, a more pronounced monthly drop in the consumer price level was observed in November last year.

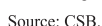
The continued fall in world oil prices in November was promoted by the OPEC countries' announcement that they would not reduce the production. In November, the *Brent* oil price decrease of 8.6% also exceeded the 1.6% rise in the value of US dollar; thus fuel prices in Latvia recorded the most prominent month-on-month drop (3.8%) since the beginning of 2009. The world food price level remained broadly unchanged. Mostly the prices of dairy products went down due to sufficient supply and reduced demand from China and Russia, while the rise in prices

Volume index of industrial production
(2010 = 100)











In October 2014, the amount of manufacturing output grew by 0.3% month-on-month (seasonally adjusted data) and 1.5% year-on-year (calendar-adjusted data). This continued growth is seen as a highly positive development: despite the pronounced dependence of the Latvian manufacturing on exports, it still has been able to resist the unfavourable circumstances in external markets. For the second consecutive month, Latvia's food industry saw monthly growth, thus confirming the previous observation that the impact of the Russian economic sanctions was rather limited even on the sector most affected by the sanctions. Meanwhile, in October the wood industry stepped back slightly from its historical maximum reached in September, yet the output level still remained high, indicating that both largest industries showed good results.

Annual growth rate of average gross wages and real private consumption
(%)



The gross monthly average wage rose by 7.4% year-on-year in the third quarter of 2014. The net rise was slightly higher at 8.7%, which can be explained by favourable changes in taxation legislation: lowering of the social insurance payment rate as well as raising of the untaxed minimum and the personal income tax relief for dependents as of 1 January 2014.

Since wage growth is the main factor determining household expenditure, it is also reflected in the growth of private consumption. Private consumption grew by 2.1% in the third quarter and accounted for the major contribution to economic growth. Judging by the wage growth, an even higher activity of private consumption would have been expected. Yet the negative geopolitical situation and the previous lessons drawn from the economic crisis have made households more cautious. There are indications that this year household savings may have increased, which is reflected in the rate of rise in private consumption lagging behind the rise in real disposable income.

	Reporting period	Data (%)
Gross Domestic Product (GDP)		
Real GDP (year-on-year growth)	2014 Q3	2.4
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2014 Q3	0.5
28.11.2014 GDP growth slightly weaker; private consumption is the main engine 		
Public Finances		
General government budget expenditure (since the beginning of the year, year-on-year growth)	2014 XI	3.5
Tax revenue (since the beginning of the year; year-on-year growth)	2014 XI	4.1
Consumer price changes		
Consumer Price Index CPI (year-on-year growth)	2014 XI	0.9
Consumer Price Index HICP (year-on-year growth)	2014 XI	0.9
12-month average inflation (HICP)	2014 XI	0.6
09.12.2014 The annual inflation in November will be circumscribed by the impact of oil prices 		
Foreign trade		
Exports (year-on-year growth)	2014 X	7.2
Imports (year-on-year growth)	2014 X	5.4
11.12.2014 For the first time, exports exceed 1 billion euro month-on-month 		
Balance of payments		
Current account balance (ratio to GDP)	2014 Q3	-4.0
Foreign direct investment in Latvia (net flows; ratio to GDP)	2014 Q3	0.2
04.12.2014 Latvian current account deficit is at 250 million euro 		
Industrial output		
Working day-adjusted manufacturing output index (year-on-year growth)	2014 X	1.5
04.12.2014 Manufacturing continues up, despite problems and uncertain future 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2014 X	4.7
Labour market		
Registered unemployment (share in working age population)	2014 XI	8.2
Job seekers rate (share in working age population)	2014 Q3	10.6
25.11.2014 The resource potential has been exhausted – for continued growth, Latvia must raise productivity 		
01.12.2014 The rate of annual increase of average wage remains high in the third quarter 		
Monetary indicators		
Resident deposits (year-on-year growth)	2014 X	9.1
28.11.2014 The money supply remains stable 		

Sources: Treasury, Central Statistical Bureau of the Republic of Latvia, and Latvijas Banka data.

Latvia is catching up in terms of quality



dr. oec. Konstantins Benkovskis

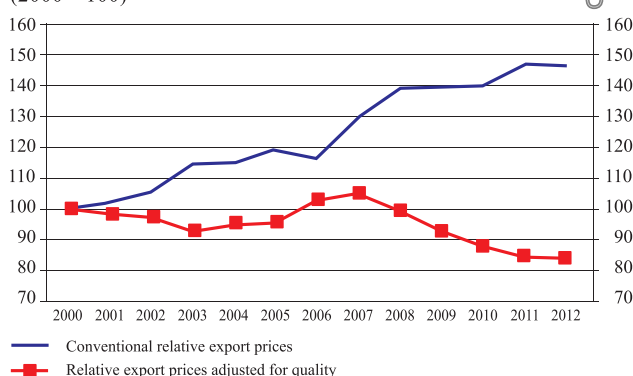
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How can we reconcile deterioration in price and cost competitiveness with rising world market shares? Regarding Latvia, these two seemingly contradictory developments have often been observed over the past years. Maybe we miss out the most decisive determinants of competitiveness when restricting attention to just whether nation's export products have become more expensive or cheaper? Clearly, competitiveness is to be assessed taking into account other additional factors as well, e.g. the quality, which is broadly interpreted, captures also shifts in consumer tastes and is generally missing in analyses.

Despite the absence of hard data on the quality of export flows, researchers can evaluate this quality factor indirectly. We construct two indices using observed unit values of trade flows. The first index is named "the conventional relative export price" and is based on unit values (dollars per kg), thus measuring only cost competitiveness. An increase in the conventional index means that Latvia's products become relatively more expensive, signalling losses in price competitiveness.

The second index is named "the relative export price adjusted for quality". In contrast to the conventional relative export price index, it uses "dollars per unit of utility". The statement that the modern smartphone is more expensive than the usual mobile phone is just a simple example. Does it mean that no one will buy the expensive smartphone? No, because smartphones provide much more higher utility to consumers offering more functions, a better design, etc. Thus the smartphone's "price per unit of utility" can be even lower than the "price per unit of utility" of a usual mobile phone! That is how our "relative export price adjusted for quality" index captures changes in quality¹. An increase in the quality adjusted index denotes losses in overall competitiveness. However, the contribution of quality can be assessed by comparing conventional relative prices and relative prices adjusted for quality. The results for Latvia's merchandise exports are shown in the figure below.

Conventional relative export prices and relative export prices adjusted for quality
(2000 = 100)



Sources: LB and OeNB calculations, UN Comtrade.

The conventional relative export price shows a rise in relative prices of Latvia's products and deterioration in producer's price competitiveness. This, however, fails to explain the impressive gains in Latvia's export market shares in the world market, which have almost doubled since 2000. On the other hand, the relative export prices have adjusted to quality decline and can be interpreted as gains in overall competitiveness. Thus, the missing part of the story is the growing relative quality of Latvia's export products, which has overcompensated higher prices and boosted export market shares.

References

- K. Benkovskis and J. Wörz (2013), "Non-Price Competitiveness of Exports from Emerging Countries", ECB Working Paper No. 1612, November.
K. Benkovskis and J. Wörz (2014), "Lower import prices = 100% welfare gains? Not necessarily: don't forget the impact of consumer taste and product quality", www.voxeu.org, 15 July.

¹ For more details see Benkovskis and Wörz 2013; 2014.