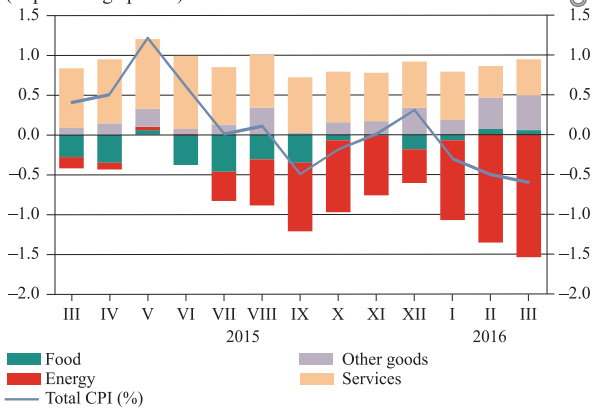
Energy prices keep annual inflation below zero

Contribution of product groups to the annual growth of consumer prices and annual CPI
(in percentage points)



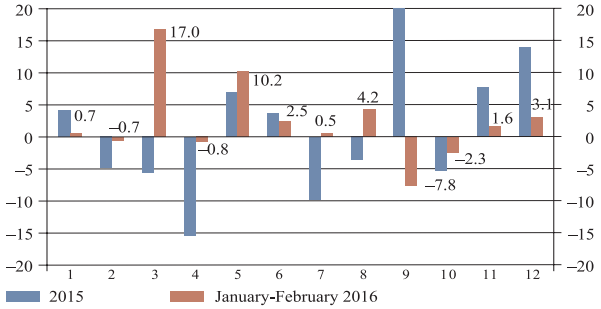
Sources: CSB and Latvijas Banka's staff calculations.

In March, consumer prices grew by 0.7% month-on-month, annual inflation remained negative at –0.6%, food and oil prices crept up, but they began to spill over to Latvia's consumer prices only gradually. However, as natural gas tariffs are set with a delay in time, heat energy prices declined even stronger. Moreover, according to the JSC *Latvijas Gāze* April estimate, natural gas tariffs for heat producers are likely to go down both in April and May. Core inflation is positive but still low, reflecting the negative impact of costs.

In the coming months, inflation may be pushed up by rising excise tax on alcoholic beverages as of April and the introduction of VAT on management services of dwelling from July. However, the impact of the demand side is likely to be moderate because of weaker anticipated wage rises and somewhat higher savings.

Manufacturing growth regains momentum

Changes in the output of manufacturing subsectors in 2015 and in January–February 2016
(%)



1 Manufacturing
2 Food
3 Textiles
4 Wearing apparel
5 Wood
6 Chemical products
7 Other non-metallic minerals
8 Fabricated metal products
9 Computer, electronic products
10 Electrical equipment
11 Machinery and equipment
12 Furniture

Source: CSB.

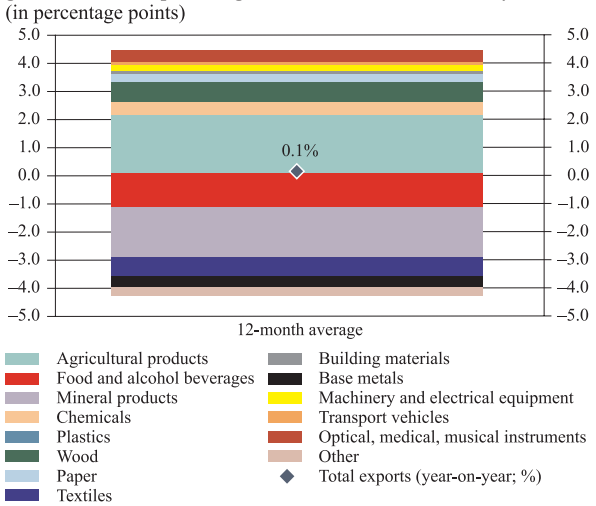
Manufacturing growth turned positive in February (+4.3%) year-on-year. It was driven by favourable developments in the wood industry, which reached a historically high level (+11.2%), and by the manufacture of fabricated metal products (+10.0%). Moreover, the food industry reported a 4.3% increase in output. This has been the best result achieved since 2014.

The industrial confidence indicator merely fluctuated within a narrow range over the past two years. Although currently it is premature to speak about any marked trend, a slightly positive signal emerged in March 2016, i.e. the assessment of order volume had improved substantially.

Overall, manufacturing growth is likely to remain rather weak this year. It will, to a large extent, depend on economic growth outside Latvia since almost two thirds of the sector's output are exported. Likewise, the performance of the food industry will depend on the extension or lifting of sanctions imposed against Russia and by Russia.

Latvia's exports: a zigzag path maintained

Group's contributions to the annual growth of exports and annual growth of total exports of goods in March 2015–February 2016
(in percentage points)



Source: CSB.

Latvia's foreign trade turnover grew by 10.8% month-on-month in February 2016, contracting by 3.3% year-on-year. Over the past 12 months, exports of goods reported a 0.1% year-on-year rise on average. Although the slow euro area recovery and contraction of Russia's demand contributed to a decline in exports of goods to several Latvia's major trade partners, various previously less traditional export markets reported an increase.

In the coming months, Latvia's exports are likely to be hindered by slower than expected recovery of the euro area economy and continued deceleration of economic growth in emerging Asian economies. Despite sluggish demand, Latvian companies still have a growth potential in several sectors. For instance, the wood industry proved its ability to transform outputs into higher added value articles. Moreover, Latvia is well-positioned to benefit from food demand gradually switching to organic, ecological and top quality products.