



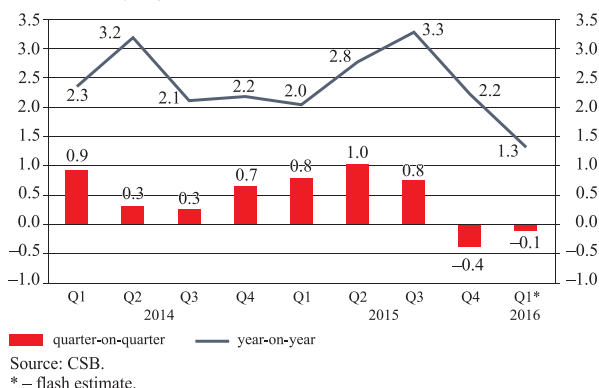
**LATVIJAS BANKA**  
**MONTHLY NEWSLETTER**

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**MAY 2016**

## Economy faces temporary slowdown

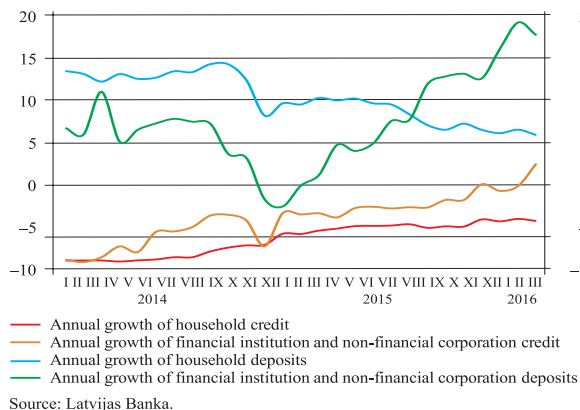
**Real GDP growth**  
(%; seasonally adjusted)



In accordance with the flash estimate of the Central Statistical Bureau of Latvia (CSB), gross domestic product (GDP) at constant prices increased by 1.3% on a year-on-year basis (according to calendar adjusted data). Meanwhile, on a quarter-on-quarter basis, GDP fell by 0.1% in the first quarter of 2016. These data confirm concerns expressed earlier that GDP growth could be slower this year than in previous years. The major factor holding back GDP growth was considerably smaller output of construction works (-22.0% year-on-year). This cannot be considered a great surprise, since currently, especially in the first half of the year, the growth will see the anticipated slowdown due to the disruption of the European Union funding cycle. In the absence of new substantial shocks, GDP is likely to grow faster in the second half of the year and also in 2017 on the back of strengthening foreign demand and investment recovery.

## Loan portfolio is showing some signs of moderation

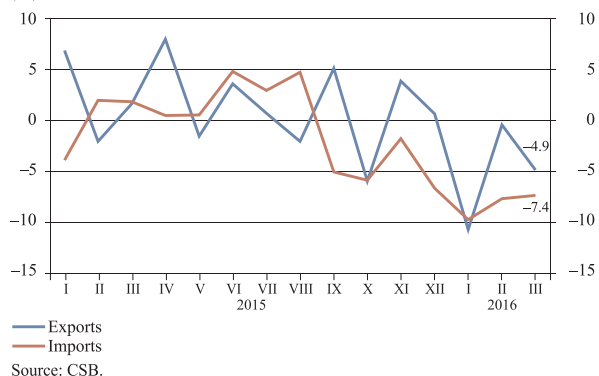
**Credit to and deposits from the private sector**  
(year-on-year; %)



The domestic deposit growth rate stood at 10.9% in March of 2016. But various trends persisted – deposits of financial institutions and non-financial corporations remained at a high level (17.3% in March of 2016), reflecting relatively high profitability rates of the corporate sector. Meanwhile, household deposits decelerated somewhat, to 5.8% on an annual basis, most likely because of low interest rates on deposits. In March, loans to domestic companies and households grew by 1.1%, mostly on account of loans granted to non-bank financial institutions. The annual rate of decrease in total domestic loans improved, to stand at -0.6%, albeit posting slight declines in loans to non-financial corporations and households. The results reflect a continuous ongoing deleveraging of the loan portfolio. It is expected that loans to corporations will be positively affected by the boost of EU funding starting with the new planning period. Latest developments in the real estate market also point to a further (but still moderate) improvement of household loan portfolio.








## External trade activity drops due to slowdown in re-exports

**Annual growth of merchandise exports and imports**  
(%)



In the first quarter of 2016, exports of goods contracted by 5.4% in year-on-year terms. A positive contribution was maintained by increased exports of vegetable products (cereals), wood and articles of wood, products of the chemical industry, prepared foodstuffs, building materials and articles of paper. At the same time, negative contributors were exports of machinery and mechanical appliances; electrical equipment. It should be stressed that the same groups of goods were behind the drop in imports (8.2% year-on-year), thus pointing to a decrease in re-export volumes instead of domestically produced goods. As evidenced by confidence indicators published by the European Commission, the complicated situation in the global market has not prevented Latvian entrepreneurs from positively assessing the volume of orders in the second quarter of 2016, and export prospects are considered good.



	Reporting period	Data (%)
<b>Gross domestic product (GDP)</b>		
Real GDP (year-on-year growth)	Q1 2016 (flash estimate)	1.3
Real GDP (quarter-on-quarter growth; seasonally adjusted)	Q1 2016 (flash estimate)	-0.1
03.05.2016 No economic growth at the beginning of 2016 either 		
<b>Public finances</b>		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2016 IV	0.9
Tax revenue (since the beginning of the year; year-on-year growth)	2016 IV	4.5
<b>Consumer price changes</b>		
Consumer Price Index (CPI; year-on-year growth)	2016 IV	-0.8
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2016 IV	1.0
12-month average inflation (HICP)	2016 IV	0.0
11.05.2016 Consumer prices in April driven up by supply factors 		
<b>Foreign trade</b>		
Exports (year-on-year growth)	2016 III	-4.9
Imports (year-on-year growth)	2016 III	-7.4
12.05.2016 Export pauses before continuing ahead 		
<b>Balance of payments</b>		
Current account balance (ratio to GDP)	Q4 2015	1.4
Foreign direct investment in Latvia (net flows; ratio to GDP)	Q4 2015	1.0
<b>Industrial output</b>		
Working day-adjusted manufacturing output index (year-on-year growth)	2016 III	3.7
09.05.2016 Manufacturing concludes the quarter on a positive note 		
<b>Retail trade turnover</b>		
Retail trade turnover at constant prices (year-on-year growth)	2016 III	0.3
03.05.2016 Is retail trade growth held back by inability to expand fuel consumption? 		
<b>Labour market</b>		
Registered unemployment (share in working age population)	2016 IV	8.8
Jobseekers rate (share in working age population)	Q1 2016	10.3
19.05.2016 Employment figure will remain close to 900 thousand 		
<b>Monetary indicators</b>		
Resident deposits (year-on-year growth)	2016 III	10.9
28.04.2016 In March monetary aggregates fluctuated on account of one-off factors 		

Sources: Treasury, CSB and Latvijas Banka.

## Retail trade developments



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With the level of income gradually rising while that of consumer prices remaining nearly unchanged, the growth of retail trade was among major driving forces of the Latvian economy in 2015. The year-on-year rise in retail trade in goods other than fuel maintained rather stable positive values also in the first quarter of 2016. However, the contribution from sales of fuel to total retail trade started to shrink gradually already in the

second half of 2015, with lower prices playing an ever decreasing role in boosting fuel consumption. What are the main characteristics and main factors driving current developments in retail trade?

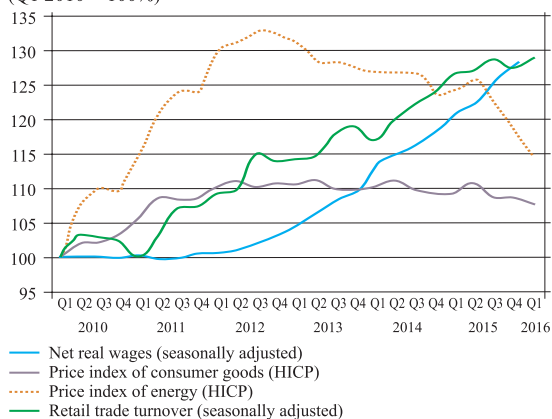
The price level does matter in the short run. In the longer run, the income level, lending developments as well as demographic trends and consumer habits are more important.

The abovementioned example of sales of automotive fuel suggests that the price level might have underpinned fuel consumption in 2015, while a decrease in other energy prices, such as heating, might have affected other retail trade on account of reduced energy bills. However, prices of oil products are on the reverse trend at the moment, and their negative effects on year-on-year changes in consumer prices are expected to fade gradually.

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Retail trade developments in early 2016 might have partly been brought about by short-term or one-off factors. Among them, mention should be made of colder winter weather and an earlier flu season, which both seem to have induced specific purchases. In addition, bonuses paid out in December 2015 exceeded those of 2014. In the longer run, however, it is the income level that determines the trends in retail sales (see Figure).

**Growth of real net wages, retail trade turnover and consumer prices of selected groups of goods**  
(Q1 2010 = 100%)



In 2015 and early 2016, income was among the main factors influencing the sales of IT and communication products as well as household appliances and furniture. Lending in terms of consumer loans is reviving gradually; there is also some evidence of the growth of new mortgage loans, albeit from a low basis. Nevertheless, these trends are yet to strengthen retail sales in the course of 2016.

The combination of income and habits largely explains the robust growth in retail sales of food in real terms, as consumers' earnings tend to allow for a higher quality demand or healthier choices rather than an increase in physical consumption alone. The influence of changing habits on retail sales might be reflected by other examples, such as a steady rise in

purchases made outside stores and markets, e.g. online shopping. The year-on-year growth of sales in this segment exceeded 30% in 2015 and in the first quarter of 2016 as well. This is where modern purchasing trends can be observed while probably contributing more to the redistribution between channels of retail trade than to the retail trade turnover.

In 2016, the growth of average wages is expected to slow somewhat as the positive impact of legislation on net wages is substantially weaker, and productivity improvements would contribute more. Thus, the effect of retail trade activities to GDP growth is expected to be smaller.