

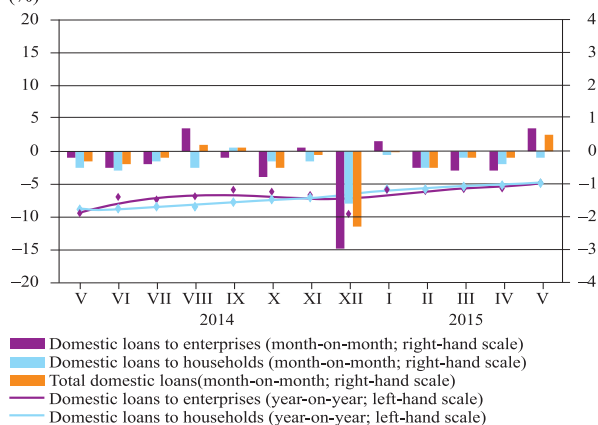


LATVIJAS BANKA
MONTHLY NEWSLETTER

JULY 2015

An increase in bank loan portfolio

Year-on-year/Month-on-month changes in loan indicators (%)



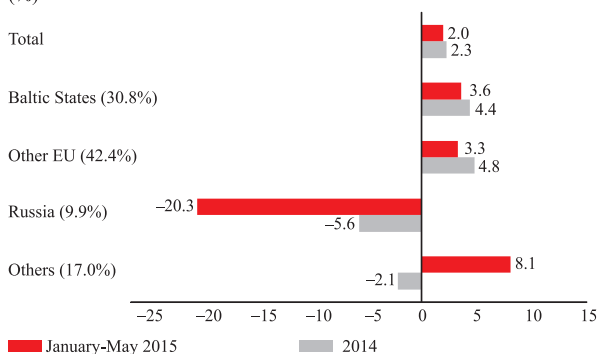
Source: Latvijas Banka.

In May, the domestic loan portfolio of banks grew month-on-month for the first time in the last eight months, expanding by 0.5%, of which loans to non-financial corporations accounted for a 0.7% pick-up. Although consumer credit to households posted a 0.9% increase, the total household loan portfolio shrank by 0.2% in May. The annual rate of decrease in domestic loans improved somewhat and stood at 3.7%. Overall, better availability of resources and low interest rates, partly also due to the Eurosystem's monetary policy measures, are expected to act as drivers behind strengthening of the demand for loans.

Deposit growth continued to be strong in annual terms, despite a slight month-on-month contraction in time deposits, which, however, was almost fully offset by an increase in overnight deposits.

Merchandise exports continue on a successful trend

Annual growth of merchandise exports and share in total exports (%)



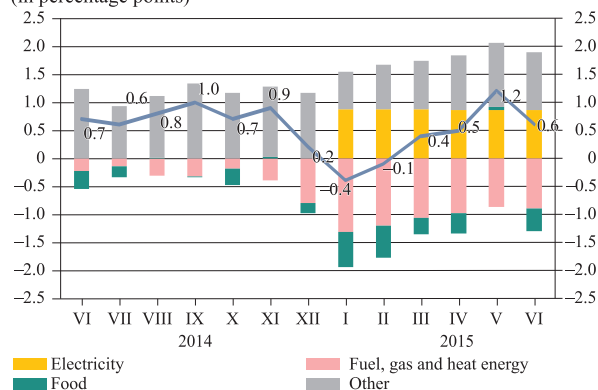
Source: CSB.

In the first five months, exports of goods continued to grow reaching a 2.0% increase year-on-year, despite a 2.8% year-on-year drop in May. The fastest growth rate was observed for machinery and electrical equipment, products of chemical industry, building materials, paper and cardboard products, as well as plastic products. The merchandise export shares in the world import also continued to increase; however, the hardly predictable external environment development remains an issue. Nevertheless, the drop in exports to Russia has been compensated by growth in other markets such as Lithuania, Denmark, the UK and the USA. Furthermore, the situation in Greece has not affected exports of Latvian goods, neither directly due to its small share (a mere 0.2 %) in total Latvian exports, nor indirectly

through Latvia's main export partners in the EU. Meanwhile, good news was received: in April 10 Latvian dairy producers obtained a permission to export their products to China. Moreover, certification of 11 Latvian fish processing enterprises was announced in May. Future holds a promise of pleasant surprises from markets in Europe, represented by a fairly good cyclical recovery of the euro area in the first quarter 2015.

Annual inflation declines in June





Contribution of selected components to the annual increase in consumer prices (in percentage points)



Source: CSB.

In June, annual inflation shrank to 0.6%, down from 1.2% in May. The dynamics was attributable to an expected fall in energy prices and a greater than usual seasonal decrease in vegetable and wearing apparel prices, which was a surprise, suggesting a seasonal price hike trend being reversed. According to first quarter data, a slight decline in the annual growth rate of average wages and salaries also points to no increase in the demand side impact on inflation.

No increase in oil prices was observed in June as compared to the May average, while the value of the US dollar recorded a slight decline. Energy prices also had a dampening effect on inflation as a result of reduced tariffs for industrial consumers, followed by a drop in the heat energy price. Moreover, the low inflation observed in other euro area countries is hardly expected to facilitate strengthening of the import price impact on inflation in Latvia. Therefore, inflation estimate levels for 2015 remain low.

	Reporting period	Data (%)
Gross Domestic Product (GDP)		
Real GDP (year-on-year growth)	2015 Q1	2.0
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2015 Q1	0.3
Public Finances		
General government budget expenditure (since the beginning of the year, year-on-year growth)	2015 VI	6.9
Tax revenue (since the beginning of the year; year-on-year growth)	2015 VI	4.9
Consumer price changes		
Consumer Price Index CPI (year-on-year growth)	2015 VI	0.6
Consumer Price Index HICP (year-on-year growth)	2015 VI	0.7
12-month average inflation (HICP)	2015 VI	0.6
10.07.2015 Annual inflation declines in June: supply side tends to understand demand 		
Foreign trade		
Exports (year-on-year growth)	2015 V	-2.8
Imports (year-on-year growth)	2015 V	-0.9
14.07.2015 Latvian exporters stand their ground in the global market 		
Balance of payments		
Current account balance (ratio to GDP)	2015 Q1	-0.4
Foreign direct investment in Latvia (net flows; ratio to GDP)	2015 Q1	3.9
Industrial output		
Working day-adjusted manufacturing output index (year-on-year growth)	2015 V	8.5
07.07.2015 Manufacturing growth subsided for a moment in May 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2015 V	4.9
Labour market		
Registered unemployment (share in working age population)	2015 VI	8.6
Job seekers rate (share in working age population)	2015 Q1	10.2
Monetary indicators		
Resident deposits (year-on-year growth)	2015 V	7.2
30.06.2015 A rise in bank loan portfolio 		

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

Competitiveness, productivity and quality of labour force – key words for sustainable growth in Latvia



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Boosting productivity and labour productivity: these key words were repeatedly pronounced at the discussion "Has Latvia's economy reached the ceiling?", held at Latvijas Banka on 11 June and dedicated to ensuring sustainable growth, with experts of economics and representatives of business associations and government taking part in it ([see complete video and presentations](#)).

Why did Latvijas Banka raise this issue and hold a discussion? If we proceed as before and do nothing, we will have to put up with Latvia's economic growth rate of 2%–3% of GDP instead of 4%–5% of GDP, reached in the post-crisis period. Consequently, reaching the living standards of the most advanced West European economies will still remain just a dream for many future generations.

Despite the deep crisis, Latvia saw faster economic growth on average over the last decade in comparison with other European countries. Nevertheless, Portugal and other countries show that more accelerated growth exceeding the average pace of development has not been guaranteed to any economy, even if its average income level is relatively low. Complacency may bring about a risk of falling into a [middle income trap](#).

The low level of average income in Latvia results from the labour productivity level; hence, productivity should be improved. It can be achieved by introducing modern production technologies, creating more innovative and unique products with the aim of selling them for a higher price, or by reviewing the range of goods and services we are competing with on the global export markets.

Nevertheless, whichever way we choose, the above changes will not be automatic. A specific and conscious government strategy and policy is necessary, aimed at ensuring and supporting these changes. Government support is required, and it should be targeted at companies with potential. At this stage the government support policy is aimed at supporting all companies; as a result, the current situation is maintained instead of making an effort to improve it. Moreover, in order to make positive changes in the economic structure sustainable, the quality issue of labour force available in Latvia is of paramount importance, and is closely related to the overall quality of the educational system in this country.



The main conclusions of the discussion are as follows: Firstly, an increase in the number of high value added producers and service providers is a prerequisite for a rise in wages and salaries in the economy. However, it is not and will never be an automatic process, but a logical result of the economic policy implemented in this country which is likely to require policy makers to take measures unpopular in the short term but necessary for the economy in the long run.

Secondly, boosting productivity not only in the sectors producing goods but in all sectors of the economy, inter alia public services, is a mandatory precondition for any sustainable growth. Consequently, a government

strategy and top level leadership is necessary. Moreover, an organisational structure identifying productivity problems and formulating and steering changes should be created. The Strategic Analysis Commission, planned to be re-established by the newly-elected President, is a potential driving force to be focusing on developing and further supporting significant reforms. Responsibility of the Prime Minister and the relevant ministries should be envisaged in this process.

Thirdly, the poor linkage of education and research with business and the development of this country is clearly a long-identified problem we are well aware of in Latvia. A clear-cut strategy and tactics with measurable targets in education and research are necessary. This issue, one of the components of the reform in education should be set as one of the priorities of the government, inter alia the Ministries of Education and Science and the Economy, with business associations being its active driving force.

Latvijas Banka is ready to maintain the discussion on challenges and obstacles in Latvia's sustainable growth.