

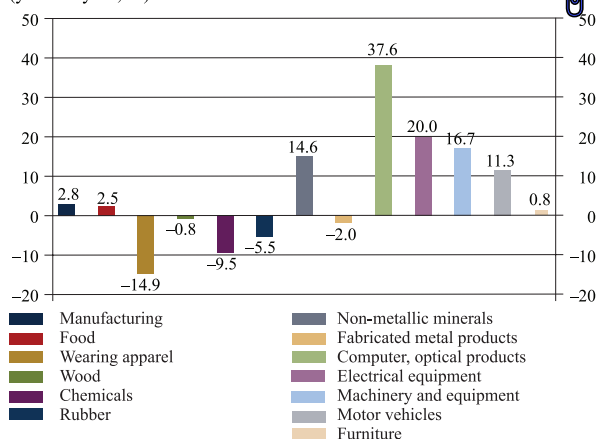


LATVIJAS BANKA
MONTHLY NEWSLETTER

OCTOBER 2016

Substantial increases in high technology sectors

Manufacturing real output growth in August 2016
(year-on-year; %)



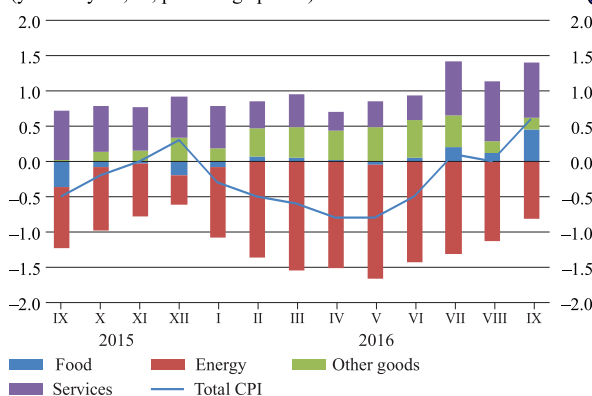
Source: CSB.

Year-on-year, the amount of manufacturing output augmented by 2.8% (calendar adjusted data) in August. This positive annual rate of increase was mainly driven by substantial gains in the so-called high technology sectors: manufacture of computers, electronic and optical equipment, electrical equipment, machinery and equipment, as well as automobiles, trailers and semi-trailers. A few years ago, the above branches accounted for only about 7–8% in the total manufacturing structure, but lately the figure is around 11–12% which is a positive piece of news. The real amount of manufacturing output in August dropped by 1.7% month-on-month (seasonally adjusted data at constant prices). The August data represent the negative growth rate of the wood industry which is gradually decelerating due to the deterioration of the global situation.

Inflation is rising, but to a large extent owing to last year's developments

Inflation and contributions

(year-on-year; %; percentage points)

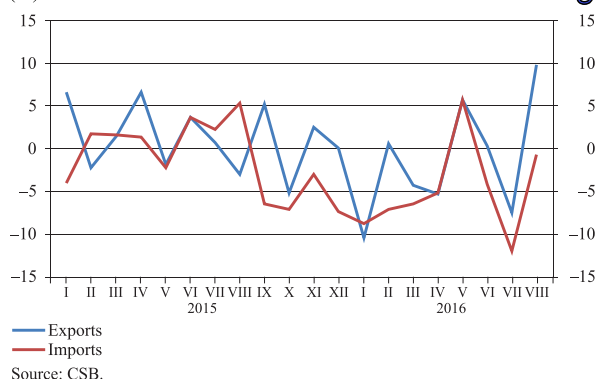


Source: CSB.

The consumer price level in September was 0.5% higher month-on-month and 0.6% higher year-on-year. This dynamics partly resulted from last year's developments. For instance, in the second half of 2015, the drop in energy prices in the global market intensified. Thus, against the backdrop of these prices, the current energy prices are not much lower. Several factors pushed up inflation in September, mostly on the supply side. This was driven by price trends of global resources, i.e. a rise in food prices. Monthly inflation also resulted from a seasonal increase in prices of wearing apparel and footwear. September also saw a slight price rise in education services which is specific to this month. Owing to a slower economic growth, a wait-and-see approach is likely to be applied on the demand side. However, this will not foster a steep rise in inflation in the coming months.

External trade in August testifies to the power of Latvian cereal exports





Annual change in foreign trade
(%)



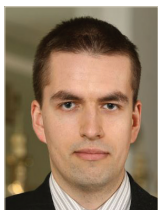
Source: CSB.

In August 2016, the turnover of Latvia's external trade in goods increased by 8.5% month-on-month, with exports and imports of goods growing by 9.9% and 7.4% respectively. The export value of goods increased by 9.7% and import value dropped by 0.7% year-on-year. In August, the export value of goods reached the highest peak since November 2015. Exports of goods benefited from the substantial increase in exports of vegetable products fostered by a rise in demand for cereals in the European Union and from the stocks of last year's record cereals harvest in Latvia. Year-on-year, exports of vegetable products, articles of base metals, transport vehicles and chemicals saw positive growth.

Despite a weaker demand in external markets driven by a multitude of problems, there are enterprises that plan to increase the proportion of exports by reinforcing and expanding their positions both in Scandinavia and Western Europe, which are considered prospective markets. Moreover, they also increase their activities in Asia.

| | Reporting period | Data (%) |
|---|------------------|-------------|
| Gross domestic product (GDP) | | |
| Real GDP (year-on-year growth) | 2016 Q2 | 0.8 |
| Real GDP (quarter-on-quarter growth; seasonally adjusted) | 2016 Q2 | 0.6 |
| | | |
| Public finances | | |
| General government budget expenditure (since the beginning of the year; year-on-year growth) | 2016 IX | -0.1 |
| Tax revenue (since the beginning of the year; year-on-year growth) | 2016 IX | 5.5 |
| | | |
| Consumer price changes | | |
| Consumer Price Index (CPI; year-on-year growth) | 2016 IX | 0.6 |
| Harmonised Index of Consumer Prices (HICP; year-on-year growth) | 2016 IX | 1.4 |
| 12-month average inflation (HICP) | 2016 IX | -0.2 |
| 11.10.2016 Inflation is rising but, to a great extent, owing to last year's 'laurels'  | | |
| | | |
| Foreign trade | | |
| Exports (year-on-year growth) | 2016 VIII | 9.7 |
| Imports (year-on-year growth) | 2016 VIII | -0.7 |
| 12.10.2016 External trade in August testifies to the power of Latvian cereal  | | |
| | | |
| Balance of payments | | |
| Current account balance (ratio to GDP) | 2016 Q2 | -0.6 |
| Foreign direct investment in Latvia (net flows; ratio to GDP) | 2016 Q2 | -2.7 |
| | | |
| Industrial output | | |
| Working day-adjusted manufacturing output index (year-on-year growth) | 2016 VIII | 2.8 |
| 13.10.2016 Manufacturing takes another step backwards  | | |
| | | |
| Retail trade turnover | | |
| Retail trade turnover at constant prices (year-on-year growth) | 2016 VIII | 1.1 |
| | | |
| Labour market | | |
| Registered unemployment (share in working age population) | 2016 IX | 7.9 |
| Jobseekers rate (share in working age population) | 2016 Q2 | 9.5 |
| | | |
| Monetary indicators | | |
| Resident deposits (year-on-year growth) | 2016 VIII | 10.3 |
| 28.09.2016 Stability with a positive note  | | |

Sources: Treasury, CSB and Latvijas Banka.

#reformasLV or why Latvijas Banka cares about education and healthcare?

Dr.oec.
Oļegs Krasnopjorovs,
Chief Economist
Latvijas Banka

Several years ago "economics guru" could argue that economic growth is hindered by "expensive money". Nowadays, with historically low interest rates and Latvian commercial banks literally rolling in money (having 3 billion euro on corresponding accounts with Latvijas Banka), the economic growth is indeed weak. Despite the fact that politicians have been mentioning the word "reforms" for years and the need to address bottlenecks in crucial sectors is obvious to everyone, little is being done in reality, and the majority of true reforms die out because of red tape.

Therefore, on 28 September Latvijas Banka hosted a conference fully dedicated to structural reforms in education and healthcare, the two sectors in which reform postponement has the highest cost to Latvian society. Several bottlenecks on which structural reforms should focus in these sectors have been identified. We invited President of Latvia Raimonds Vējonis, Minister for Health Anda Čakša, State Secretary of the Ministry of Education and Science Līga Lejiņa as well as key experts to discuss our concepts.

Latvia has a record-high population share with unmet needs for medical treatment because of its expensiveness and long waiting lists. As a result, Latvia has high mortality from cancer and circulatory system diseases as well as one of the lowest healthy life expectancy among the EU countries. Hospitals are well-equipped with magnetic resonance imaging units and computed tomography scanners, but they are often underused. Deficit of publicly funded quota forces patients to wait for weeks or even months while medical equipment is just gathering dust. Thus, diseases might progress to advanced stages which are difficult and expensive to cure. The share of decentralised private out-of-pocket spending (least efficient healthcare financing channel) is high, while the amount of public healthcare spending is one of the lowest in the EU.

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Contrary to the widespread view, the Latvian healthcare system incurs problems not only due to low public spending. For instance, public expenditure on education in Latvia is the highest (as percent of total public spending) among the EU countries, yet study achievements are rather modest. In Latvia, there are lots of school teachers, with one per every 9 pupils, while the respective figure for Estonia and Finland is more than 12 (population density is lower in the latter two countries, but pupils' performance measured by PISA tests – better). In Latvia, teachers receive low wages and their remuneration primarily depends on quantity (the number of hours worked and pupils), with little motivation for quality. There are too few young teachers, even taking into account the population age structure. Twenty-one subjects of detached nature result in a rather fragmented image of the world. Long 3-month summer holidays go hand in hand with overload and burn-out (topical for both children and teachers) during the remaining nine months. As a result, Latvian pupils skip classes most often in the EU, more than half of pupils complain about boring lessons, and every third pupil feels unhappy at school.

Governor of Latvijas Banka Ilmārs Rimšēvičs emphasised the significance of structural reforms in education and healthcare for sustainable economic growth. I did some calculations and found that the impact of these sectors is really important. For instance, only due to the fact that extra 4 000 working age people die every year (compared to the number of people who would die according to Western European mortality rates), the annual growth rate of Latvia's GDP decreases by 0.2 percentage point, let alone a noteworthy impact on output from improving human capital (education and health quality).

All conference materials are available at: <https://www.makroekonomika.lv/latvijas-bankas-konferences-reformas-konkuretspejas-un-izaugsmes-atslega-materiali> (in Latvian)

You may want to participate in Twitter discussion using a hashtag #reformasLV