Moderate current account deficit – sustainable for Latvia

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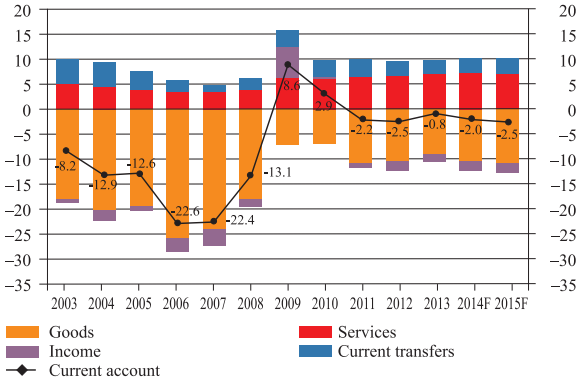
Latvia's balance of payments data over the last three years suggests that after several "peaks and troughs" the level of the current account deficit has stabilised.

In 2013, the deficit was merely 191.1 million euro, i.e. 0.8% of GDP (2.5% and 2.2% of GDP in 2012 and 2011 respectively). The deficit is expected to remain broadly similar also in the following years. According to one of the indicators included in the scoreboard for the surveillance of macroeconomic imbalances used by the European Commission to evaluate the risks to stable and sustainable development, the threshold for the current account deficit is 4% of GDP. Latvia's current account deficit is well below this threshold; therefore, there are no doubts about the sustainability of its macroeconomic development.

Balance of payments
(% of GDP)



Source: Latvijas Banka.

Latvia's current account runs a deficit mainly because the imports of goods exceed the respective exports. Latvia is unable to produce all the necessary products itself. Moreover, further development and strengthening of exports requires investment goods and intermediate goods and these goods are mostly imported. In 2013, the foreign trade deficit in goods totalled 2093.6 million euro or 9.0% of GDP. This deficit was smaller than a year ago because of lower imports. Export growth has also decreased in comparison with the previous year because in 2012 Latvian exports were strengthened by record-high exports of agricultural products, thereby forming a high basis. Additionally, the suspension of operations at Latvia's metallurgical plant "Liepajas metalurgs" had a downward effect on both exports as well as imports of metals and their products.

There is a small deficit also in the income account suggesting that foreign direct investment (FDI) inflows into Latvia are significantly larger than Latvia's direct investment abroad. In 2013, this deficit was 332.2 million euro (1.4% of GDP).

Latvia has performed better in the services sector, where exports exceeded imports significantly and covered more than 2/3 of the foreign trade deficit in goods. Due to Latvia's geographical location and access to ports, transportation has traditionally been an important services subsector in Latvia. The exports of transportation services, however, decreased in 2013 both due to cyclical reasons and weak foreign demand as well as increased competition from other ports of the Baltic Sea region. Nevertheless, better performance of many other services subsectors (including travel, financial services, computer and information services etc.) enabled exports of services to increase faster than imports. As a result, the surplus of external trade in services increased to 1658.3 million euro or 7.1% of GDP.

In addition to that, inflows of current transfers, both from EU funds (such as the European Social Fund and agricultural funds) as well as in the form of other transfers, also help to improve the current account balance every year. In 2013, net current transfers amounted to 576.3 million euro or 2.5% of GDP.

Latvia's current account deficit is fully covered by FDI and EU funds inflows that increase the capital stock. In 2013, the EU funds inflows into the capital account totalled 567.6 million euro or 2.4% of GDP. These inflows consisted mostly of financing for large-scale infrastructural development projects from the Cohesion Fund and public infrastructure improvement and business support projects from the European Regional Development Fund.

Moreover, FDI inflows into Latvia's economic sectors enhancing the export potential (i.e. excluding FDI in real estate activities and in financial and insurance activities) amounted to 452.9 million euro or 1.9% of GDP in 2013. It is obvious that the availability of EU funding, foreign direct investment and a sustainable macroeconomic environment leaves no doubt about Latvia's capability to finance the current account deficit. Based on the planned EU fund flows and FDI forecasts for the next years, Latvia's current account deficit can be expected to remain moderate, but sustainable.