

**LATVIJAS BANKA**
EIROSISTĒMA

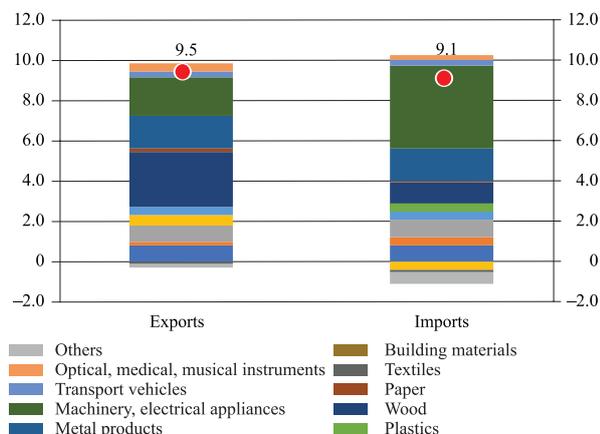


LATVIJAS BANKA
MONTHLY NEWSLETTER

SEPTEMBER 2018

Goods exports growing chiefly due to expansion of domestic exports

Annual growth in total merchandise exports and imports and contribution by product groups in January-July 2018
(%; percentage points)

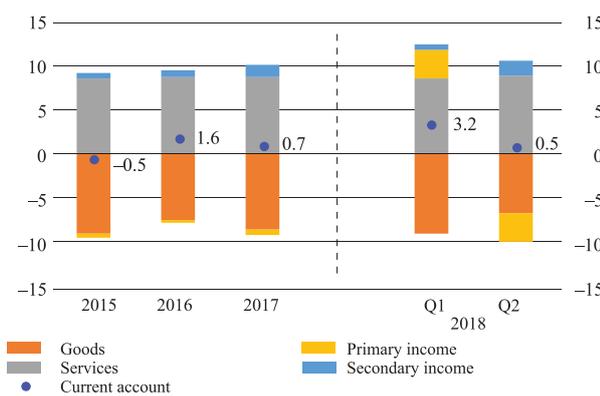


Source: CSB.

In the first seven months of 2018, nominal goods exports increased by 9.5% year-on-year. The key contributors were the largest export product groups like wood and wood products, metals and metal products as well as machinery and electrical appliances. Analysis by Latvijas Banka suggests that, as in 2017, domestic exports (including, most notably, wood products, agricultural and metal products) rather than re-export flows drove the growth. It is also noteworthy that Latvian export market shares in world imports continued to increase in the first half of 2018. Imports expanded at a similar pace as exports in the first seven months of the year (9.1%). Most of this year's nominal export and import growth has been driven by a rise in real volumes rather than price effects.

Current account surplus reflects the strong export growth

Current account balance
(% of GDP)

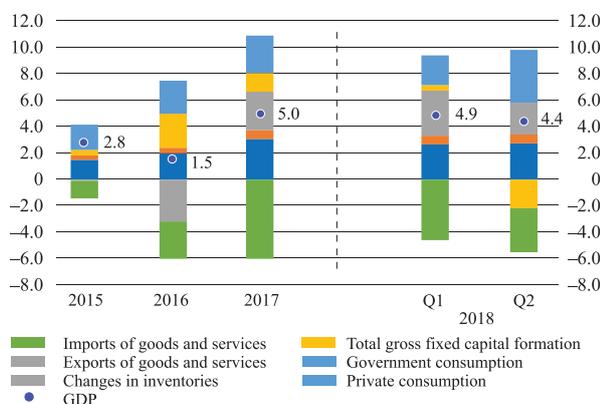


Source: Latvijas Banka.

The current account recorded a surplus also in the second quarter of 2018. Unlike the situation observed in the first quarter, when the surplus was largely driven by inflows from EU funds, second quarter developments were due to a stronger increase in exports of goods (8.2%) and services (10.6%) and a concurrent weaker import growth (4.3% and 4.9% respectively). Overall, the current account surplus amounted to 35.4 million euro or 0.5% of GDP in the second quarter of 2018. Exports of telecommunication and IT services remained the key drivers of the impressive performance of exports of services. In the first half of the year as a whole, growth in exports of services was also supported by travel services, while exports of transportation and financial services, despite a notable improvement in the second quarter, were a drag on services export growth.

Latvia at the top of the charts of fastest-growing euro area economies

Year-on-year GDP growth and contribution
(seasonally adjusted; %; percentage points)



Source: CSB.

The Latvian economy continued on a robust growth path in the second quarter of 2018 (+4.4% annually, in seasonally adjusted terms). The more detailed second estimate by the Central Statistical Bureau of Latvia revealed that despite slower growth in Latvia's main trade partner – the euro area – as well as heightened uncertainty over global trade, exports have provided a strong positive contribution to GDP growth. Investment, a key driver of growth since 2017, has been supported by both large private investment projects and strong absorption of EU funds. Furthermore, the average gross wage in Latvia exceeded the long-awaited threshold of 1 000 euro in the second quarter of 2018, with the year-on-year growth amounting to 8.4%. The rise in remuneration as well as the declining unemployment (7.7% in the second quarter) help sustain a stable and

strong contribution of private consumption to overall GDP growth. All this has ensured that Latvia is among the fastest growing European economies in the first half of the year.

	Reporting period	Data (%)
Gross domestic product (GDP)		
Real GDP (year-on-year growth, seasonally and calendar adjusted)	2018 Q2	4.4
Real GDP (quarter-on-quarter growth, seasonally adjusted)	2018 Q2	0.9
04.09.2018 Economy is riding a cyclical growth wave 		
Public finances		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2018 VIII	10.2
Tax revenue (since the beginning of the year; year-on-year growth)	2018 VIII	9.4
Consumer price changes		
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2018 VIII	2.8
12-month average inflation (HICP)	2018 VIII	2.5
Consumer Price Index (CPI; year-on-year growth)	2018 VIII	2.8
Foreign trade		
Exports (year-on-year growth)	2018 VII	8.3
Imports (year-on-year growth)	2018 VII	14.5
12.09.2018 Imports of goods have reached a historic high; exports witness the sustainability of business competitiveness 		
Balance of payments		
Current account balance (ratio to GDP)	2018 Q2	0.5
Foreign direct investment in Latvia (net flows; ratio to GDP)	2018 Q2	0.4
07.09.2018 The current account surplus stood at 0.5% of GDP in the second quarter 		
Sectoral performance		
Working day-adjusted manufacturing output index (year-on-year growth)	2018 VII	1.2
Retail trade turnover at constant prices (year-on-year growth)	2018 VII	4.3
Labour market		
Average monthly wage (year-on-year growth)	2018 Q2	8.4
30.08.2018 The average wage is rising, but it varies notably across regions 		
Jobseekers rate (share in working age population)	2018 Q2	7.7
Monetary indicators		
Resident deposits (year-on-year growth)	2018 VII	4.1
Loans to residents (year-on-year growth)	2018 VII	-8.2
28.08.2018 Structural changes leave the trends of monetary aggregates unaltered 		

Sources: Treasury, CSB and Latvijas Banka.

The dynamics of productivity and wages is more balanced than in the pre-crisis period

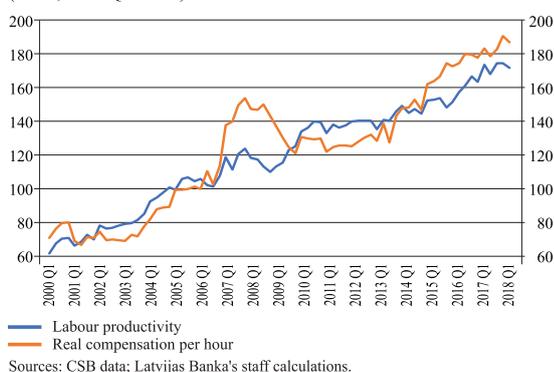


Agnese Rutkovska,
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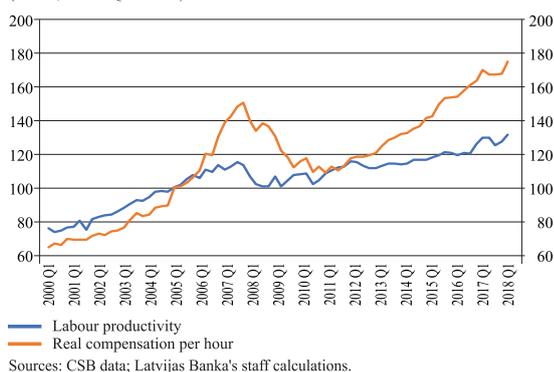
Economists have been concerned about the overall dynamics of Latvia's economic productivity and wage increases for quite some time, trying to figure out whether the time has come to ring alarm bells regarding unbalanced development as productivity growth starts to lag behind. To understand whether these concerns are well-founded, it is worth looking at the indicators for individual industries and their contribution to the overall economic development.

When looking at the contribution of industries to changes in productivity, we see that manufacturing and trade are the largest contributors to overall growth due to their high share in the economy and rapid productivity growth. The third strongest contribution to changes in productivity comes from public administration, health and education. Meanwhile, four sectors have recorded a decline in productivity: ICT services, financial and insurance activities, real estate activities and arts, entertainment and other services.

Productivity and real compensation per hour in manufacturing and agriculture
(index; 2005 Q1 = 100)



Productivity and real compensation per hour in total economy except manufacturing and agriculture
(index; 2005 Q1 = 100)



The dynamics of labour productivity and the factors affecting it vary across industries. The crisis in 2008–2010, leading to a rapid downturn in domestic and external demand, posed challenges for almost all sectors and countries across a wide geographical area. However, after the crisis the industries exhibit very different development trends. There are sectors undergoing structural changes or having faced external demand related problems: the narrowing of the segment of credit institutions servicing foreign customers in the financial sector and the shrinking freight transportation by rail and by sea due to Russia shifting its freight flows to its own ports. Some industries (e.g. the manufacture of food products) were more hit by the Russian sanctions and affected by changes in the Russian ruble exchange rate in 2014–2015. These processes did not allow to ensure a high degree of capacity utilisation and had an adverse effect on profitability and also productivity. In these cases, we have to think about the export market and product diversification which has already been largely carried out by enterprises of the sectors.

From the perspective of competitiveness, it is particularly important how wage and productivity indicators develop in the tradable or export-oriented industries; therefore, it is worth having an insight into the development of manufacturing and agriculture.

The productivity of manufacturing and agriculture has been rising over the last two years along with wage developments; moreover, their productivity growth is much stronger than that of other industries.

Thus, at this stage, the development of exporting sectors is relatively balanced, and the gap between wages and productivity mostly persists in the non-tradable segment.