

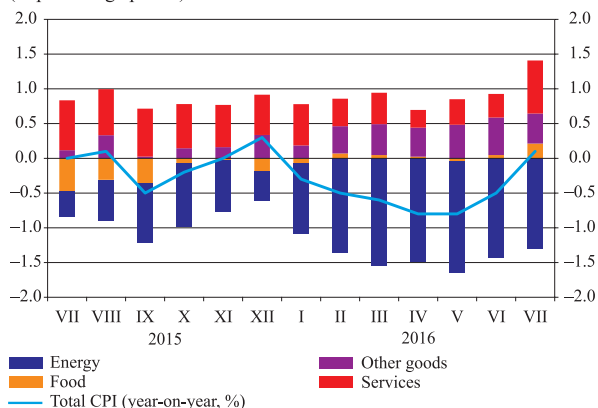


LATVIJAS BANKA
MONTHLY NEWSLETTER

AUGUST 2016

Inflation returns

Inflation and contributions
(in percentage points)



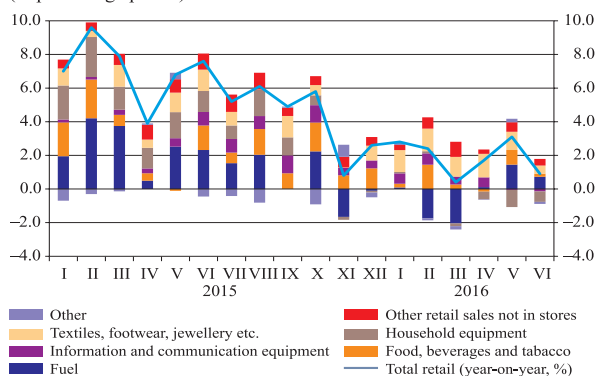
Source: CSB.

In July, inflation edged just above zero, with consumer prices rising by 0.1% year-on-year. Thus, July was the first month with a positive annual inflation in 2016. The increase in consumer prices was mainly driven by supply side factors, as starting from July the standard VAT rate has been applied to home management services, and one of the major mobile telephone operators has increased its tariffs. Both changes pushed up prices of services in July, which therefore continued to be the key contributor on the positive side to the year-on-year inflation. Meanwhile, annual changes in fuel and other energy prices were still in the negative territory, reflecting the relatively low price of oil. Looking forward, in the second half of 2016, inflation is expected to remain positive, albeit just above zero, as

the commodity pressure is not intensifying and the annual wage growth is somewhat slower.

Moderate growth in retail

Retail trade turnover and contributions
(in percentage points)



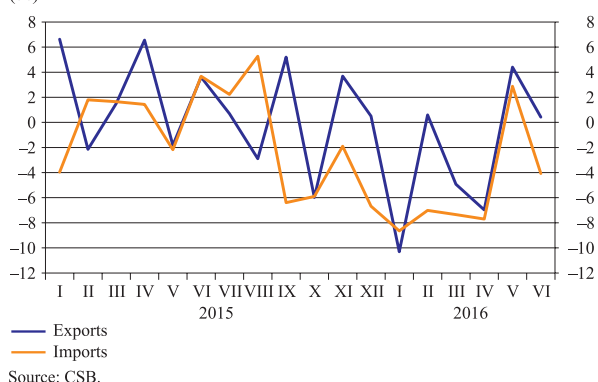
Source: CSB.

In the second quarter, retail trade continued to grow at a moderate pace posting a year-on-year increase of 1.9%. Once again, fuel retail proved to be one of the main drivers behind the retail growth, mirroring the situation we saw for most of 2015, when a prolonged period of low fuel prices positively contributed to fuel retail. Also, food retailing supported the retail growth, but the effect was rather negligible, whereas the retail sale of household electrical appliances accounted for the negative contribution. Retail trade and private consumption will probably continue to be among the main drivers of GDP growth in 2016; however, slower wage growth at the beginning of the year means that the positive contribution

might decline. Consumer confidence indicators as well as the increasing activity in consumer credit market point to growing consumer intentions to make large scale purchases, e.g. a vehicle; this might negatively affect everyday consumption.

Challenging environment for exporters


Annual change in foreign trade
(%)



Source: CSB.

In June, nominal exports of goods increased by a mere 0.4% year-on-year; however, as a result of falling prices, real export volumes have increased more significantly. June proved to be a good month for cereal exporters, as exports of cereals grew more than twice in annual terms, probably still reflecting sales of the last year's record high harvest. As in previous months, exports of wood and other wood products as well as pharmaceutical products and food continued to be important drivers of exports. These positive contributions, however, were partially offset by a sharp drop in exports of steel and iron as well as electrical machinery and equipment.

The export opportunities are still limited by the uneven growth of Latvia's major external trade partners and the weak external demand. Therefore, investment in raising competitiveness and acquiring new markets is essential to increase export volumes.

| | Reporting period | Data (%) |
|--|------------------------------------|-------------|
| Gross domestic product (GDP) | | |
| Real GDP (year-on-year growth) | 2016 Q2 <i>(flash estimate)</i> | 0.7 |
| Real GDP (quarter-on-quarter growth; seasonally adjusted) | 2016 Q2 <i>(flash estimate)</i> | 0.4 |
| 01.08.2016 In the second quarter of 2016, economic growth remains sluggish  | | |
| Public finances | | |
| General government budget expenditure (since the beginning of the year; year-on-year growth) | 2016 VII | -0.8 |
| Tax revenue (since the beginning of the year; year-on-year growth) | 2016 VII | 5.4 |
| Consumer price changes | | |
| Consumer Price Index (CPI; year-on-year growth) | 2016 VII | 0.1 |
| Harmonised Index of Consumer Prices (HICP; year-on-year growth) | 2016 VII | 0.1 |
| 12-month average inflation (HICP) | 2016 VII | -0.3 |
| 08.08.2016 There IS Inflation in Latvia  | | |
| Foreign trade | | |
| Exports (year-on-year growth) | 2016 VI | 0.4 |
| Imports (year-on-year growth) | 2016 VI | -4.1 |
| 09.08.2016 Some enterprises boldly invest despite the uncertain external environment  | | |
| Balance of payments | | |
| Current account balance (ratio to GDP) | 2016 Q1 | 1.8 |
| Foreign direct investment in Latvia (net flows; ratio to GDP) | 2016 Q1 | -1.6 |
| Industrial output | | |
| Working day-adjusted manufacturing output index (year-on-year growth) | 2016 VI | 8.2 |
| 04.08.2016 Manufacturing accelerated in the second quarter  | | |
| Retail trade turnover | | |
| Retail trade turnover at constant prices (year-on-year growth) | 2016 VI | 0.9 |
| 01.08.2016 Retail trade suffers yet supports growth  | | |
| Labour market | | |
| Registered unemployment (share in working age population) | 2016 VII | 8.3 |
| Jobseekers rate (share in working age population) | 2016 Q2 | 9.5 |
| 17.08.2016 Minimum wage hike can deteriorate Latvian labour market  | | |
| Monetary indicators | | |
| Resident deposits (year-on-year growth) | 2016 VI | 12.4 |
| 28.07.2016 Moderate growth continues in the monetary sector  | | |

Sources: Treasury, CSB and Latvijas Banka.

ICT is almost a perfectly performing sector



Igors Kasjanovs
Chief Economist
Latvijas Banka

Over the last few years, the information and communications technologies sector (ICT) has been among those with fastest growth. It is no secret that in recent years rapid expansion of different ICT services could be observed in Latvia: programming, data storage, development of mobile applications, development of various complex ICT solutions, etc. However, unlike retail trade or manufacturing, the sector usually is not in the spotlight of economic analysts and policy makers. This can be

explained by the size of the sector – ICT only accounts for about 5% of the total value added, even though this level is close to the European Union's average. Nevertheless, the success of the sector should be noted: it is one of the fastest growing, with high productivity levels, high average salary, implementation of latest technologies, and other positive features.

In recent years rapid expansion of different ICT services could be observed in Latvia

The ICT sector consists of six subsectors: publishing activities, video and television programme production, programming and broadcasting activities, telecommunications, computer programming and the related activities as well as information service activities. Historically, the largest part of the ICT sector turnover in Latvia has been generated in the telecommunications sector (about 60%), where important players of the telecommunications market are operating. But over the last few years, computer programming and information service activities have been rapidly gaining their relative share.

The ICT sector employs 2.9% (2015) of the total number of working population. Taking into account that the sector accounts for about 5% of total value added, it is easily seen that the sector's productivity hovers above the average level. In fact, it has the most elevated productivity level among all sectors. But, certainly, labour productivity of such a level can also be explained by a comprehensive degree of automation and capital intensity. For instance, the telecommunications sector is very capital intensive (technologies are cost intensive), thus providing ample value added per person employed. However, the huge capital and technology intensity is the factor why the salaries paid by the sector are among the largest across all sectors. Higher average salaries are paid only in the financial sector. The large salaries of the ICT sector are determined by several factors. Comprehensive technological intensity has already been mentioned. It means that there are fewer workers employed but their skills have to be very advanced. For instance, computer programming requires very specific training. The main reason, however, is the fact that Latvia's ICT sector is operating in an environment of open market competition. The ICT sector has almost no transnational barriers in comparison to other sectors. Latvian ICT companies are competing and collaborating with companies from all over the world. That is why the ICT sector plays an important role in external trade. For instance, in 2015 the ICT sector accounted for almost 10% of the current account surplus.

What future challenges does the ICT sector face in Latvia? During the last decade, the availability of PCs and the internet in households and companies has increased substantially. That has been a significant factor driving the growth of the ICT sector. Further challenges will be related to an increase in computer/internet literacy of the population. The range of activities using ICT is still very narrow in Latvia. Many do use the internet for entertainment purposes, but only a few take the advantage of the full spectrum of offered opportunities, like communication with the public sector, e-learning, e-purchases, etc. Moreover, the ICT sector is transforming: the importance of mobility is increasing, therefore, the development of mobile applications and solutions is currently the main driver of changes in the ICT sector.

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