LATVIA

Economic growth is projected to pick up in 2017. Stronger growth in the euro area and Russia will support exports, which, along with the disbursement of EU funds, will boost investment. Household consumption will be robust, supported by strong wage growth. However, unemployment will remain high, reflecting regional and skill mismatches between workers and jobs. Higher energy prices will raise inflation somewhat and reduce the current account surplus.

The fiscal stance is expansionary, reflecting in part additional healthcare spending. Inclusive growth could be strengthened by reducing out-of-pocket payments in healthcare services for poor households and by reducing labour taxes on low-income earners. Increasing access to vocational and tertiary education would improve economic opportunities for youth from low-income families.

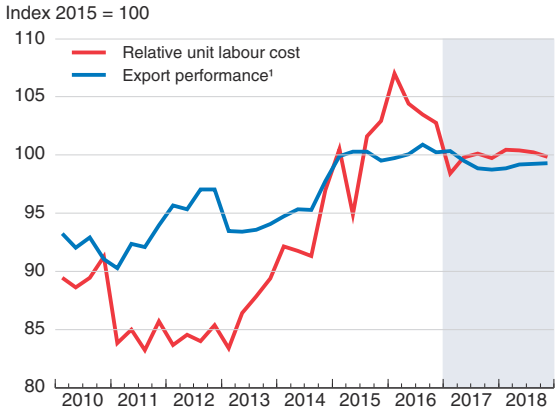
Latvia's participation in global value chains is limited. Enhancing cooperation between small and medium-sized enterprises and research institutions would boost innovation and raise competitiveness in global value chains. Providing more training for the unemployed, combined with better income support, would help to ensure that the benefits of globalisation are widely shared.

Economic growth has recovered

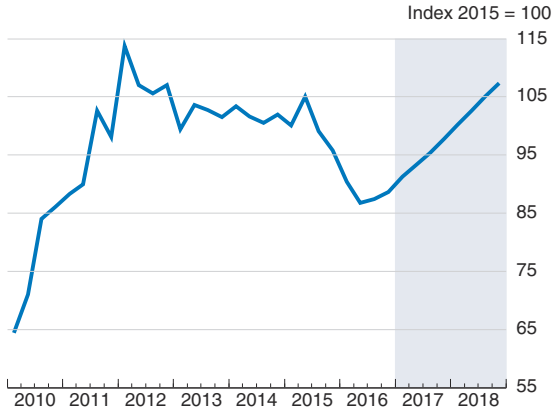
Economic activity is strengthening. Investment has rebounded from the temporary drop in mid-2016 caused by the delay in disbursement of EU funds. Household consumption is robust, supported by strong wage growth. Wages have grown faster than productivity, but Latvia's unit labour costs still fell relative to its key trading partners, as the euro depreciated and the ruble appreciated. Exports are strengthening, especially those directed to Russia. The unemployment rate is declining, but remains high. Despite the expansionary euro-area monetary policy, credit growth is recovering only slowly. The low

Latvia

Relative unit labour costs have fallen somewhat



Investment² is projected to recover



1. Export performance is measured as the ratio of export of goods and services volume to trade-weighted import volumes in export markets.
2. Real gross fixed capital formation.

Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933503434

Latvia: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	22.8	2.1	2.7	2.0	3.5	3.5
Private consumption	14.0	1.3	3.5	3.4	3.3	3.3
Government consumption	4.0	2.1	3.1	2.7	3.2	2.5
Gross fixed capital formation	5.3	0.1	-1.8	-11.7	6.9	10.0
Final domestic demand	23.4	1.1	2.2	0.1	4.0	4.5
Stockbuilding[1]	0.2	-1.1	0.2	2.9	-0.2	0.0
Total domestic demand	23.5	0.1	2.4	3.0	3.7	4.4
Exports of goods and services	13.7	3.9	2.6	2.8	3.5	3.7
Imports of goods and services	14.5	0.5	2.1	4.6	3.9	5.2
Net exports[1]	- 0.7	2.0	0.3	-1.1	-0.2	-0.9
Memorandum items						
GDP deflator	_	1.6	0.4	0.7	1.9	1.6
Harmonised index of consumer prices	_	0.7	0.3	0.2	2.8	2.3
Private consumption deflator	_	1.7	-0.6	0.9	1.9	1.4
Unemployment rate	_	10.8	9.9	9.7	9.2	8.9
General government financial balance[2]	_	-1.6	-1.3	0.0	-0.8	-0.4
General government gross debt[2]	_	47.1	42.0	45.8	45.7	45.2
General government debt, Maastricht definition[2]	_	40.9	36.5	40.1	40.0	39.5
Current account balance[2]	_	-2.0	-0.8	1.5	1.2	0.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of GDP.
Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933506341

loan recovery rate from bankruptcies is holding back lending to firms with a short credit history. Inflation is rising on the back of higher energy prices, which are also reducing the current account surplus.

Fiscal policy should ensure inclusive growth

The fiscal stance is expansionary, in part due to additional spending on healthcare, amounting to 0.3% of GDP. Government investment will also expand with the disbursement of new EU funds. The government increased the basic income tax allowance for low-income households in 2017. The government is also considering reducing the personal income tax rate and raising the corporate tax rate, while making non-distributed corporate income fully tax exempt. These reforms are likely to reduce tax revenues, at least in the short term. Still, the fiscal position is sound and additional spending on priority areas would be welcome. The entitlement period of unemployment benefits is short and only a small share of the unemployed is enrolled in training programmes. Poor households are foregoing medical treatments because of high co-payments for healthcare and some publicly funded healthcare programmes will be cut back towards the end of the year. The lack of means-tested income support is barring the access of students from disadvantaged backgrounds to higher education.

Effective structural reforms are needed to facilitate the integration of Latvian firms into global value chains and lay the foundation for stronger productivity growth. The

government has reduced the time and costs associated with the creation of new businesses. It has also increased the accountability of insolvency administrators, which is expected to raise the loan recovery rate and thereby improve access to credit by entrepreneurs. Measures to support innovation cooperation between firms and research institutions are in place.

Stronger export markets are projected to support growth

Economic growth is projected to strengthen in 2017 and 2018, as rising demand in Russia and euro area countries, coupled with improved competitiveness, will boost exports and business investment. The accelerated disbursement of EU funds will also boost investment. Private consumption is projected to remain robust thanks to strong wage growth fuelled by skill shortages and emigration. Unemployment will remain high, reflecting regional and skill mismatches between jobs and workers. Higher energy prices will gradually translate into higher goods and services prices. The current account surplus will decrease somewhat due to higher commodity prices and strong import growth.

The intensification of geopolitical risks related to Russia and heightened political uncertainties in euro area countries would damp exports and business investment. Increased economic uncertainty may raise precautionary household saving, reducing consumption. On the other hand, stronger economic growth in the euro area and Russia would boost exports beyond the projected level. Past structural reforms that improved business conditions may increase investment at a faster pace than projected.