

LATVIA

Growth is strong and broad-based, but is projected to moderate to under 3½ per cent by 2020. Private consumption will be supported by a persistently strong labour market. Following a slump, investment rebounded strongly in 2017-18, as investors have drawn on EU structural funds, but growth in capital spending will ease to more sustainable levels in the coming two years.

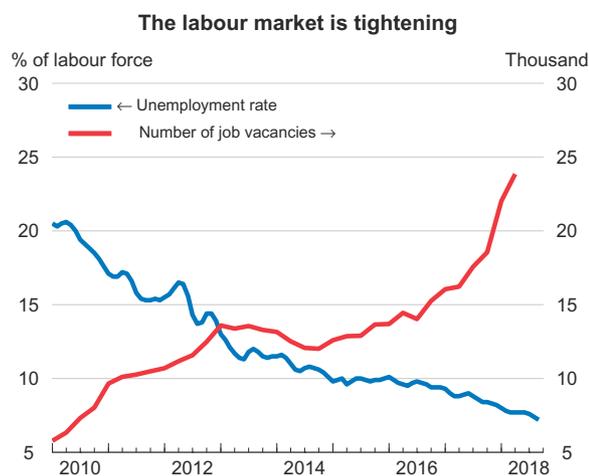
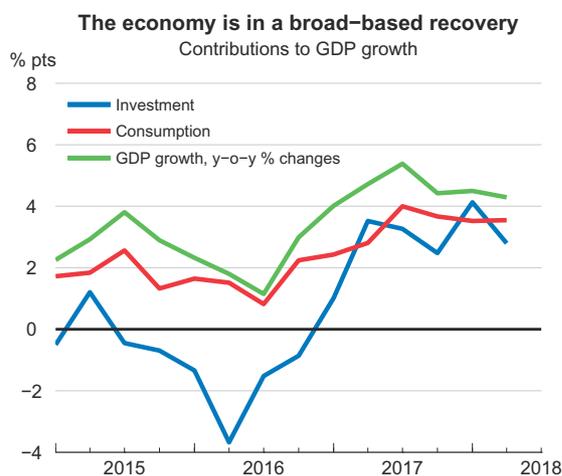
The budget impact of personal and corporate income tax reforms in 2018 and 2019 are compensated only partially by higher excise taxes and some spending restraint. Fiscal policy is mildly expansionary as a result. Higher spending on health helps to improve currently unequal access to health care. The government plans to improve re-training and develop the rental market to strengthen labour mobility, which is a welcome move to address skill shortages and mismatches.

Expansionary monetary and fiscal policies are boosting growth

The economy is growing strongly, led by domestic demand. Strong earnings increases, due to a tightening labour market and a 13% increase in the minimum wage in 2018, are supporting private consumption. Investment surged rapidly, as private and public investors adjusted to the new rules to draw on EU structural funds, pushing GDP growth rates above 4% in 2017 and 2018. Exports have remained strong, as wage growth remains broadly in line with productivity gains in the tradeable sector and Riga has established itself as a centre for business service outsourcing and tourism.

Vacancies are continuing to rise and unemployment has fallen fast to below 8%. Yet, adding involuntary part-time and discouraged workers, and those that are ready to work but not actively searching, still leaves the broad unemployment rate at more than 14%. It is much higher in poorer regions, but a lack of affordable housing makes it difficult for workers to relocate to Riga and other places where labour demand is strongest. Low labour mobility contributes to skill shortages together with continued emigration.

Latvia



Source: Central Statistical Bureau of Latvia; Eurostat; and OECD Economic Outlook 104 database.

StatLink  <http://dx.doi.org/10.1787/888933876993>

Latvia: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	24.3	2.1	4.6	4.7	3.9	3.3
Private consumption	14.7	1.4	4.1	4.4	3.8	3.6
Government consumption	4.4	3.9	4.1	3.5	2.8	2.6
Gross fixed capital formation	5.4	-8.4	13.1	18.6	8.1	4.4
Final domestic demand	24.4	-0.3	5.9	7.2	4.6	3.6
Stockbuilding ¹	0.0	2.3	0.4	-2.1	-0.3	0.0
Total domestic demand	24.4	2.1	6.2	4.9	4.3	3.7
Exports of goods and services	14.7	4.4	6.2	4.7	4.3	4.0
Imports of goods and services	14.8	4.4	8.9	5.0	5.0	4.6
Net exports ¹	-0.1	0.0	-1.5	-0.2	-0.4	-0.3
<i>Memorandum items</i>						
GDP deflator	–	0.9	3.2	3.4	2.6	3.0
Harmonised index of consumer prices	–	0.1	2.9	2.6	3.0	2.7
Harmonised index of core inflation ²	–	1.2	1.7	2.0	2.6	2.7
Unemployment rate (% of labour force)	–	9.7	8.7	7.5	7.2	7.0
Household saving ratio, net (% of disposable income)	–	-5.5	-6.5	-3.5	-2.6	-1.0
General government financial balance (% of GDP)	–	0.1	-0.6	-0.8	-0.8	-0.6
General government gross debt (% of GDP)	–	50.3	48.1	47.4	47.1	46.7
General government debt, Maastricht definition (% of GDP)	–	40.3	40.0	39.3	39.0	38.5
Current account balance (% of GDP)	–	1.6	0.7	0.4	-0.8	-1.0

1. Contributions to changes in real GDP, actual amount in the first column.

2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 104 database.

StatLink  <http://dx.doi.org/10.1787/888933877924>

Re-training and better access to housing would ease skill shortages

Although wage growth has been rising rapidly, the effect on core inflation has been muted, as productivity has risen in line with labour compensation in the manufacturing sector and high profitability has allowed firms to absorb the rise in labour costs. Bank credit growth to households and non-financial corporations is still very weak. Hence, there are few signs that low interest rates contribute much to demand growth and inflation. As the effects of increases in the minimum wage and excise taxes fade after 2018, inflation is expected to stabilise at below 3%.

There is a mild fiscal stimulus in 2018 and 2019 as the government is phasing in a corporate and personal income tax reform. Higher social contributions are financing a welcome increase in health spending. Somewhat more restrictive fiscal policy in 2020 should contribute to a slowing in GDP growth and inflation.

The reduction of taxes on low wages should strengthen incentives for workers to take up work in the formal labour market, raising job security, skill development and tax revenues. Continuing the government's efforts to improve tax collection is much needed to finance increased spending on healthcare and better access to housing, education and training. Developing the rental housing market and strengthening adult learning and

re-training, as planned, would improve inclusiveness and well-being. It should also help to bring more workers into the labour market and address skill shortages and mismatches.

Growth is projected to moderate

GDP growth rate is set to slow towards 3% in 2020. Investment growth should moderate after the strong surge in 2017-18 and export growth will slow along with world trade. Downside risks include the United Kingdom leaving the European Union without an agreement and rising global trade tensions. Both would weigh on Latvia's exports and investment. If the development of the rental market and improved training measures were to take effect faster than expected, employment and economic growth might be stronger for longer.