

Flash Estimate of GDP in Q1 of 2022

The start of the year is positive for the economy; however, the geopolitical situation will dampen growth and increase inflationary pressures

In Q1 of 2022, compared to the corresponding period last year, according to the flash estimate of gross domestic product (GDP) by the Central Statistical Bureau (CSB), the economy grew by 5.9%. During this period, volumes declined in productive sectors by 0.2%. However, in the services sectors volumes increased by 6.3%.

Growth was anticipated at the beginning of the year. It was largely affected by the base effect - the first quarter of last year was the only quarter in which the economy contracted as a result of the Covid-19 restrictions. In January-February 2022, retail sales were 12.6% higher than a year ago, and retail sales of non-food products grew particularly sharply. The catering, accommodation, arts, entertainment, and recreation, as well as aviation, which have been hit hardest by the covid-19 crisis, are gradually recovering. Despite the high energy prices, growth in the manufacturing continued in the first two months of the year - an increase of 7.1%, compared to January-February 2021. However, the increase in exports of goods at current prices during the same period reached almost 30%.

However, the positive developments in the economy are significantly affected by Russia's invasion of Ukraine on February 24. The impact of the war on Latvia is greater than the EU average, as Latvia borders Russia and, although declined significantly since 2014, still has historical ties in economic co-operation. The main export goods - alcohol, food, pharmacy, mechanical engineering products. In 2021, Latvia's exports of goods to Russia, Belarus, and Ukraine accounted for 9.5%. Also, imports from these three countries accounted for 12.7% of total imports. Several product categories constitute nearly one third of Latvia's total imports from these countries - mostly raw materials - metals, wood, mineral fertilizers. The war has already caused significant economic and financial turmoil, especially in commodity markets, with soaring oil and gas prices.

"The war in Ukraine will not affect all Latvian companies uniformly. Enterprises that have had close trade ties with the countries involved in the conflict will be affected more significantly and will find it difficult to find new partners and markets. In the current situation, the only solution for Latvian enterprises is new and diversified raw material supply markets and reorientation from Russia to Western markets. This will only increase the potential of the Latvian economy in the future. The second important direction is the strengthening of Latvia's energy independence, looking for new supply alternatives. At the same time, given the sharp rise in prices, the government is actively working on various support instruments for the people who need it most. It is planned that the measures will be targeted at those groups of the population for whom financial support would be most needed - seniors with low incomes, persons with disabilities, low-income households. It is also planned to expand the availability of housing benefits," emphasizes Minister of Economics Jānis Vitenbergs.

A great deal of uncertainty prevails regarding how the war and related sanctions will affect the future development of the Latvian economy. The Ministry of Economics forecasts that in 2022 economic growth will decrease by at least 3 percentage points, compared to the previous forecast due to geopolitical factors. However, growth will remain positive and could reach 2% on an annual basis. Uncertainty will affect consumer consumption, business investment, and foreign trade. Latvia, as a food-producing country, could benefit from a good harvest from the agricultural sector. As the share of raw material prices in the final product increases, enterprises offering goods and services with higher added value will become more competitive, provided that these enterprises are able to adapt to rising energy prices and the challenges of increasing productivity. At the same time, the extent of the economic impact of the conflict will depend on the length of the war and political reactions; nevertheless, it is clear that the war will stifle growth and increase inflationary pressures.

