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ECONOMIC DEVELOPMENT TRENDS

After the rapid recovery of the economy from the Covid-19 pandemic crisis in 2021, growth in Latvia slowed down to 3.4% in 2022. The economic development in 2022 was significantly affected by the supply chain disruptions caused by the Russian invasion of Ukraine, the rise in inflation caused by energy and food prices, as well as the decrease in global demand.

In the first half of 2022, the consequences of the war were not yet fully felt. The economy grew by 5.8% compared to the first half of 2021. The rise was influenced by the low base at the beginning of 2021 and the gradual lifting of Covid-19 restrictions. However, in the second half of the year, annual growth decreased to 1.2%, as the balance of exports and imports worsened, and private consumption and investment growth rates declined.

In 2023, the economic development continues to be affected by the geopolitical situation and uncertainty, high prices and rising bank interest rates. In Q1 of 2023, economic growth ceased. However, in Q2 of 2023, GDP already declined by 1.1% compared to the corresponding period last year. In the first half of 2023, GDP was 0.6% lower than a year ago.

It is anticipated that moderate growth rates will be observed in the second half of 2023. However, in 2024, the economy will start to grow slightly faster. The Ministry of Economy forecasts in 2023 GDP will remain close to 2022 levels. However, in 2024, GDP growth could reach 3%.

Key Economic Development Indicators

	2018	2019	2020	2021	2022	2023f	2024f
Gross domestic product, at current prices, billion euro	29.2	30.6	30.1	33.3	38.9	42.6	45.2
Changes against the previous year, as per cent							
Gross domestic product	4.0	0.6	-3.5	6.7	3.4	0.3	3.1
Private consumption	3.0	0.0	-4.3	7.3	6.0	-0.2	3.6
Public consumption	1.7	5.6	2.1	3.5	2.8	4.9	2.9
Gross fixed capital formation	11.7	1.5	-2.2	7.2	0.6	7.2	4.6
Exports	4.4	1.3	0.4	9.0	10.3	-2.8	3.8
Imports	6.3	2.2	-1.1	15.1	11.1	-0.9	3.6
Consumer prices	2.5	2.8	0.2	3.3	17.3	9.0	2.5
as per cent							
Changes in the number of employed	1.6	0.1	-1.9	-3.2	2.6	0.3	0.3
Employment rate	64.5	65.0	64.2	62.5	63.9	64.5	65.1
Unemployment rate	7.4	6.3	8.1	7.6	6.9	6.1	6.0
as per cent							
General government balance	-0.8	-0.6	-4.4	-7.2	-4.4	-2.8	-2.3
General government debt	37.0	36.7	42.2	44.0	41.0	40.0	40.6
Net exports	-0.7	-0.7	1.3	-3.2	-4.5	-4.1	-3.9

f-forecast

The high price level affects household consumption. In the first half of 2023, private consumption decreased by 1.9 %.

Public consumption continues to grow largely at the expense of the state budget deficit, in order to be able to finance the support measures implemented by the government to mitigate the negative effects of Covid-19 and the consequences of the war in Ukraine. In the first half of 2023, public consumption increased by 6.3%.

Despite the geopolitical uncertainty, investments are growing. Thanks to the increase in funding from EU funds, in the first half of 2023, investments in gross fixed capital formation were 8.7% higher than a year ago. Investments in housing, buildings, and structures increased by 16% year-on-year, while investments in machinery and equipment increased by 3.1%. Also, investments in intellectual property products rose by 1.3%.

Net flows of FDI attracted in Latvia continue to increase. In the first half of 2023, the net flows of FDI attracted to Latvia constituted 3.1% of GDP, while the accumulated FDI at the end of June 2023 reached 23.8 billion euro, i.e., 59% of GDP. During the year, they increased by almost 10% or 2.1 billion euro.

The situation in the external environment adversely affects foreign trade. The export volumes of goods and services in the first half of 2023 were 2.5% lower than a year ago. Export volumes of goods decreased by 4.6%. The main export goods in the first half of the year were wood and wood products, mechanisms and mechanical devices, as well as electrical appliances and electrical equipment. The export of services continues to recover from the Covid-19 pandemic, which was 3.6% higher in the first half of the year than a year ago. The growth was facilitated by the export of air transport services, as well as professional and technical economic activity services and computer services. Import volumes of goods and services increased by 1% in the first half of the year and the export-import balance in actual prices was -4% of GDP.

In 2022, the current account deficit increased to 4.7% of GDP, which was most significantly affected by the deterioration of the goods trade balance due to the increase in energy prices. In the first half of 2023, it slightly decreased to 4.6% of GDP. The current account is expected to improve in the coming years.

Development trends are highly variant across sectors. Fast growth rates in 2022 remain in the sectors that were most severely affected by the restrictions of the Covid-19 pandemic. Despite the increase in costs, disruptions in supply chains and great uncertainty, growth remained in the manufacturing sector in 2022. Due to the rapid increase in costs, a decline in the construction sector was observed.

In terms of sectors, the total added value in the first half of 2023, compared to the corresponding period of 2022, increased by 0.03%. The decrease in volumes was observed in the manufacturing sectors, which is largely related to the deterioration of export opportunities. Manufacturing sector shrank by 6.3%. On the other hand, a decrease of 5.8% was recorded in the agriculture and forestry sector, which was largely influenced by the decrease in the crop production sector in connection with this summer's unfavourable weather conditions. In other sub-sectors, the decrease in volumes (by 5.5%) was affected by the decline in electricity, gas supply, heat supply, as well as in the mining sector. The decrease in volumes in the transportation and storage sector (by 5.2%) was influenced by land transport and auxiliary activities of storage and transport. In the first half of the year, a year-on-year decrease in volumes in the trade sector was observed – by 6.4%.

The increase in the first half of the year was observed in construction and most service sectors. In the construction sector, the annual increase was 15.4%. Stable growth rates are maintained in the sectors that were most affected by the restrictions of Covid-19 – in the first half of 2023, the accommodation and food service activities grew by 13.3%. The arts, entertainment, and recreation sector rose by 17%. A steady increase can still be observed in the ICT sector – in the first half of the year, the increase was 7%.

The Covid-19 pandemic has caused significant changes in the fiscal policy implemented so far. In 2020, the "Stability and Growth Pact (SGP) general exception clause" was activated in the EU, allowing EU countries to increase the general government budget deficit to the extent necessary to mitigate the economic damage caused by the pandemic. Considering the Russian-Ukrainian war and all the consequences related to it, the SIP general exception clause is also valid in 2023.

As a result of the Covid-19 pandemic, the budget deficit in Latvia increased to 7.2% of GDP in 2021, or 2.4 billion euro. In 2022, it decreased slightly and was 4.4% of GDP, or 1.7 billion euro. The Saeima has approved a budget deficit for 2023 of 1.77 billion euro, or 4.2% of GDP.

Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest in the EU. The outbreak of Covid-19 led to the need to provide a significant amount of funding to mitigate the impact of the crisis caused by Covid-19. In 2021, the amount of national debt increased to 44% of GDP, or 14.7 billion euro. Since the growth of nominal GDP is rapid in conditions of high inflation, in 2022, it decreased to 41% of GDP.

It is anticipated that in the medium term the debt condition of 60% of GDP set by *the Law on Fiscal Discipline* will be respected and the general government debt of Latvia will stabilize.

The banking sector has been able to maintain stability despite the economic turmoil caused by the Covid-19 pandemic and geopolitical tensions. The banking sector is profitable. However, credit development is still considered weak, especially business lending.

Inflation is most significantly affected by the rise in world prices for energy resources and food. In December 2022, consumer prices in Latvia were 20.8% higher than a year ago, while the annual average inflation rose to 17.3%. In December, on an annual basis, food prices had increased by 29.3%, electricity, gas and solid fuel – by 63.9% and fuel – by 17.9%.

In 2023, consumer prices will stabilize, decreasing every month compared to the corresponding month of the previous year – from 21.5% at the beginning of this year to 3.3% in September. Annual average inflation in September was 14%. Considering the tense geopolitical situation and the base effect of inflation dynamics, in 2023 the average annual inflation is forecast to be within 9%.

In the future, the main influence on price changes will continue to be related to energy and food price fluctuations in the world, and their secondary influence on the prices of industrial goods and services will also be observed.

Despite the economic turmoil, the labour market remains stable. The number of employees in Latvia increased by 2.6% in 2022. On an annual basis, this has been the most rapid increase in the number of employed people since 2007, which was partly determined by the recovery of the labour market from the Covid-19 pandemic, as well as the ever-expanding employment of Ukrainian civilians in Latvia. Along with the increase in employment, the unemployment rate continued to decrease. It declined to 6.9% in 2022 (compared to 2021 – by 0.7 percentage points).

Even in the first half of 2023, despite the tense geopolitical situation and the decrease in economic growth, the situation in the labour market did not significantly deteriorate, as the demand for labour is high. In Q2 of 2023, compared to the situation a year ago, the number of employed persons aged 15 to 74 increased by 0.3% or 2.4 thousand. On the other hand, the employment rate increased by 0.4 percentage points – up to 64.4%. The unemployment rate in the second quarter of 2023 was 6.4%, which is 0.2 percentage points lower than in the corresponding period a year ago. In Q2 of 2023, 60.6 thousand people were looking for work of the population aged 15-74, which is 3.5% or 2.2 thousand less compared to Q2 of 2022.

Considering the slowdown in economic growth, it is forecast that the situation in the Latvian labour market in the second half of 2023 will remain tentative. In general, the unemployment rate could decrease to an average of 6.1% in 2023, while the number of employed persons would remain close to the level of 2022.

The monthly average gross wage continues to increase, albeit its growth rate compared to the corresponding period of the previous year from the Q1 of 2022 to the Q1 of 2023 was lower than the growth rate of inflation, causing a decrease in purchasing power. In Q2 of 2023, the real salary increased slightly (by 0.1%). Nevertheless, the average net salary was 1,114 euros or 73% of the gross salary. It grew by 11.7% during the year. This trend – slow growth of real wages – is expected to continue in the short term until the rapid increase in inflation endures.

At the same time, positive pressure on wages will continue to be maintained both by the process of wage convergence closer to the wage level of the economically developed countries of the EU, and by the increasing shortage of qualified labour – the narrowing of the labour market, which makes it necessary for entrepreneurs to think more actively not only about how to attract new specialists, but also how to keep the existing ones , incl. reviewing rates of pay.

The further development of the economy in the medium term depends on the situation in the external environment and the progress of reforms. The largest risk to Latvia's growth is related to the development of the global economy, especially the geopolitical situation. The future development of the EU's common economic space is also important. Latvia's economic advantages in the medium term will mainly be based on the achieved macroeconomic stability, as a result of which Latvia's credit ratings have improved, as well as on the efficiency of the planned EU support programs and improvements in the business environment. As the war in Ukraine drags on, the pace of economic recovery could be slower.

As the competitive advantage of Latvia's economy is based on technological factors, improvement of production efficiency and innovations, to a lesser extent on cheap labour and low resource prices, in the medium term Latvia's growth rates can potentially reach 4-5% growth per year.

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WORLD ECONOMIC OUTLOOK

The world economy is paying a high price for Russia's unprovoked, unjustified and illegal war of aggression against Ukraine. The global economy is showing signs of improvement, albeit the upturn remains weak. Core inflation remains resilient, and the impact of higher interest rates is increasingly felt in the global economy. Global GDP is forecast to grow by 3% and 2.7% in 2023 and 2024[1].

Gross Domestic Product
as per cent

	2022	2023f	2024f
World (excl. EU)	3.3	3.0	2.7
Euro Area	3.4	0.6	1.1
USA	2.1	2.2	1.3
China	3.0	5.1	4.6
Germany	1.9	-0.2	0.9

Source: OECD Economic Outlook, Interim Report September 2023: Confronting Inflation and Low Growth; f – forecast

China's economy grew by 3% in 2022. The easing of housing regulations has stabilized property sales. The implementation of large-scale infrastructure projects of previous years will contribute to the growth of construction. It is predicted that China's GDP will grow by 5.1% and 4.6% in 2023 and 2024, respectively. **India's** economy grew by 7.2% in 2022. However, in 2023 and 2024, it is forecast that GDP will grow by 6.3% and 6%.

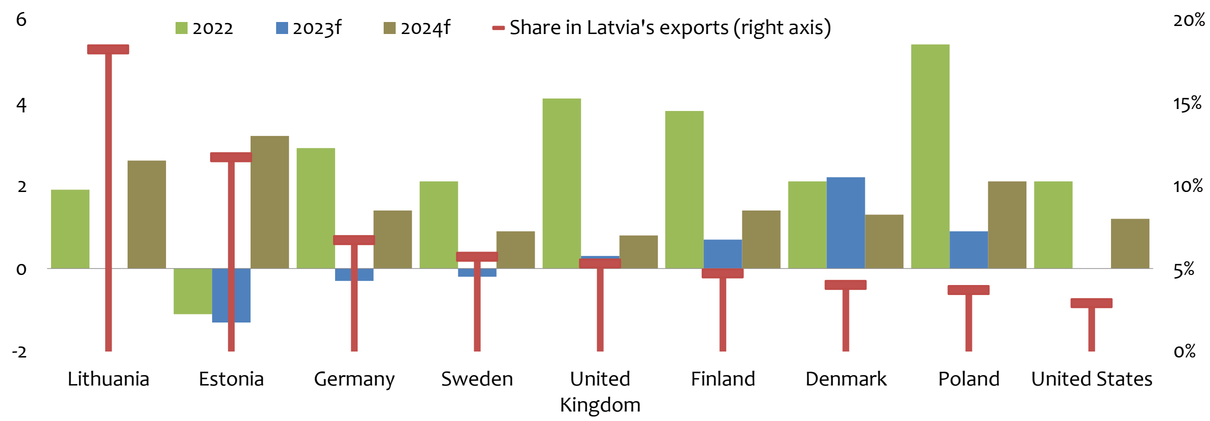
US real GDP grew by 2.1% in 2022. Growth in private consumption and investment is expected to slow in response to the tightening of monetary and financial conditions and a further decline in savings. GDP is expected to grow by 2.2% and 1.3% in 2023 and 2024.

It is forecast that GDP growth in the **eurozone** will slow down to 0.6% in 2023 and then gradually increase to 1.1% in 2024. Private consumption will be supported by strong labour markets, while higher financing costs and uncertainty will weigh on private investment. Lower energy and food prices will help reduce headline inflation in 2023, albeit core inflation will remain elevated.

In the **United Kingdom**, GDP grew by 4.1% in 2022. It is expected that in 2023 GDP will increase by 0.3%, while in 2024 GDP will rise by 0.8%.

In **Germany**, real GDP grew by 1.9% in 2022. Export growth rates are gradually recovering in 2023. Investor and consumer confidence has improved, supported by rising energy prices, rapid replacement of energy imports from Russia and gradual decline in energy prices. It is forecast that in 2023 there will be a recession in the economy, with GDP decreasing by 0.2%. However, in 2024 real GDP will increase by 0.9%. In **Sweden**, real GDP growth reached 2.9% in 2022. It is forecast that the growth of private consumption will slightly increase from mid-2023, as real disposable income will start to recover, with overall real GDP still decreasing by 0.3%. In 2024, it is expected that the GDP will grow by 1.4%. **Estonia's** GDP decreased by 1.1% in 2022. With higher interest rates, house prices fall and investment in them is weak. It is forecast that in 2023 real GDP will decrease by 1.3%, while in 2024 it will increase by 3.2%. **Lithuania's** GDP grew by 1.9% in 2022. It is forecast that GDP will stagnate in 2023, albeit the growth rate will reach 2.6% in 2024. At the same time, high inflation will continue to affect private consumption.

Growth of Latvia's Largest Trade Partners
GDP changes against the corresponding period last year, as per cent – left axis; share as per cent in 2022 – right axis



Source: CSB, *OECD* (2023); f – forecast

[1] In this chapter, data is taken from OECD Economic Outlook, Interim Report September 2023: Confronting Inflation and Low Growth

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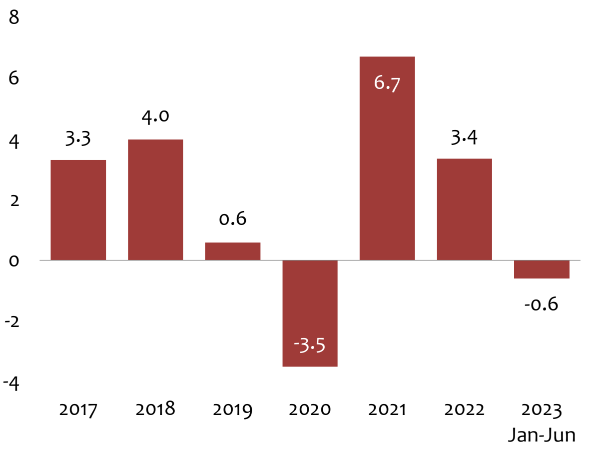
GROSS DOMESTIC PRODUCT

In 2023, economic growth slows down. In the first half of 2023, GDP decreased by 0.6%, which was the sharpest decrease since the 2010 financial crisis, excluding the decrease in 2020 due to the Covid-19 pandemic.

Gross domestic product

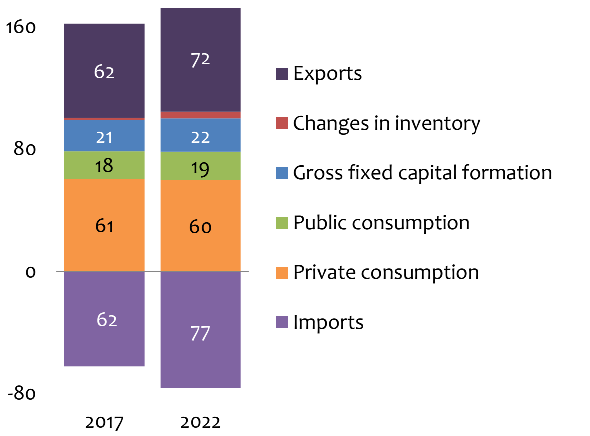
changes compared to the corresponding period last year, per cent



The economic development in the first half of 2023 continued to be affected by the geopolitical situation and uncertainty, high prices, and interest rate increases in the Eurozone. In Q1 of 2023, the GDP remained unchanged, but in Q2 of 2023 its decline was already observed. The largest growth-enhancing effect was the increase in investment and public consumption, while the largest negative contribution provided the decrease in exports and private consumption.

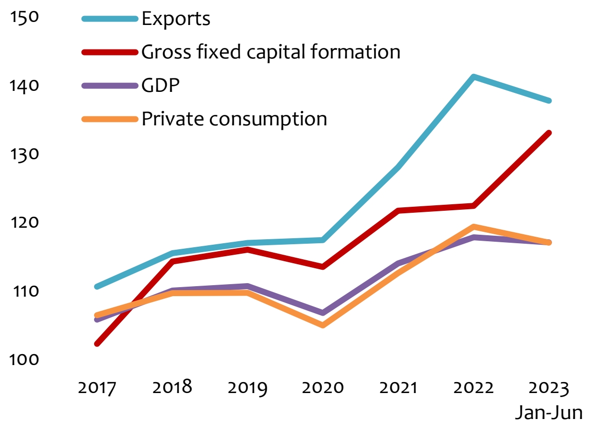
Gross Domestic Product from Expenditure Approach

structure as per cent of GDP



Gross Domestic Product by Expenditure Items

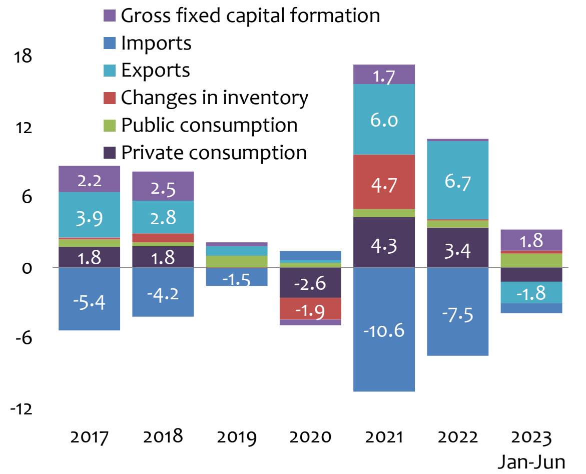
2015 = 100



Investment volumes increased very rapidly, especially in housing, buildings and structures, driven by the growth of the construction. Public consumption also continued to grow rapidly, which was largely determined by state support to compensate for the high prices of energy resources. Exports of services continued to recover after the Covid-19 pandemic. The growth was facilitated by the export of air transport services, as well as professional and technical economic activity services and computer services. On the other hand, the export of goods decreased. The rates of price growth, outpacing the rise in wages and reducing the purchasing power of the population, had a negative impact on private consumption.

Gross Domestic Product by Expenditure Items

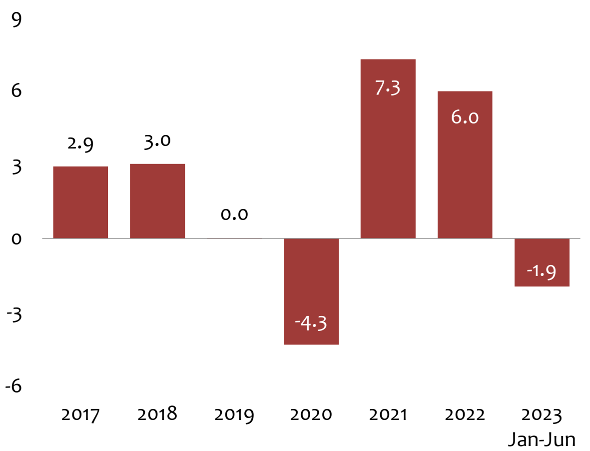
contribution to growth as percentage points



CONSUMPTION

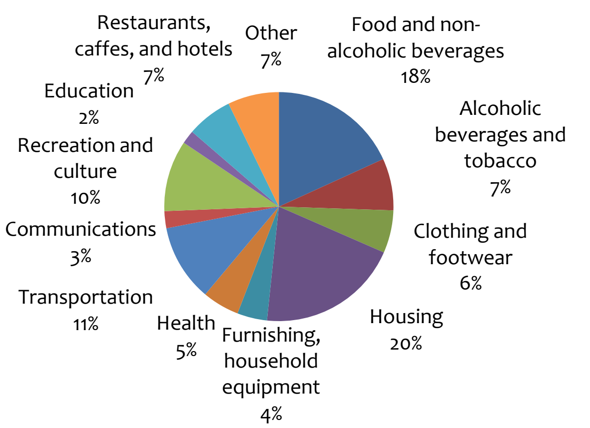
Private consumption will decrease in 2023. As the economy recovered, a rapid increase in private consumption was observed in 2021-2022. However, the pace of price growth was ahead of the salary increase, negatively affecting the purchasing power of the population. Despite the base effect of the lifting of Covid-19 restrictions and the improvement of the situation on the labour market, private consumption declined equally fast.

Private consumption
changes compared to the corresponding period last year, per cent



In the structure of household consumption, the majority is made up of expenses for housing. In 2022, the lifting of restrictions related to reducing the spread of Covid-19 contributed to a rapid increase in spending on recreation and culture, and restaurants and hotels. There was a slight increase in household expenses for transportation, while the volume of expenses for food practically did not change. Rapidly rising prices for energy resources have encouraged households to save and housing-related expenses fell sharply. The decrease was also influenced by warmer weather at the beginning of the heating season.

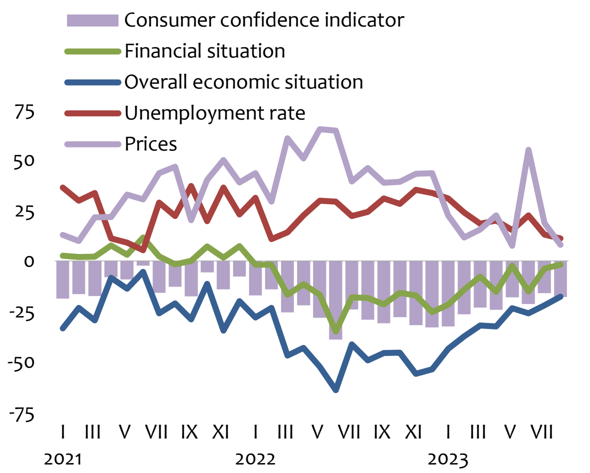
Structure of Household Expenditures
in 2020, as per cent



Consumer confidence has increased significantly in 2023. In the previous year, consumer sentiment had deteriorated sharply following Russia's invasion of Ukraine and was exacerbated by rising inflation.

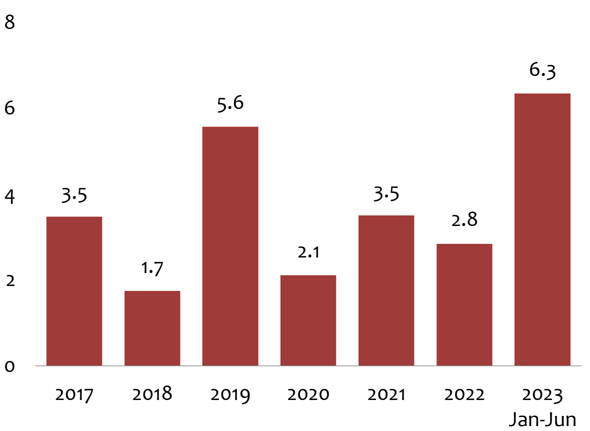
The improvement in the 8 months of 2023 can be seen in all the main items of the confidence indicator: assessment of the financial situation, assessment of the general economic situation, inflation expectations and unemployment expectations. The increase in the wage level and the decrease in inflation allow for a more optimistic assessment of the prospects. Only in the month of June 2023, the planned increase in electricity distribution tariffs damaged consumer sentiment, with a positive trend continuing in the following months.

Consumer Confidence Index
consumer assessment for the next 12 months, response balance, seasonally adjusted data



Public consumption continues to grow. Support measures implemented by the government to mitigate the negative impact of Covid-19 and the rapid rise in energy prices maintained a positive increase in public consumption.

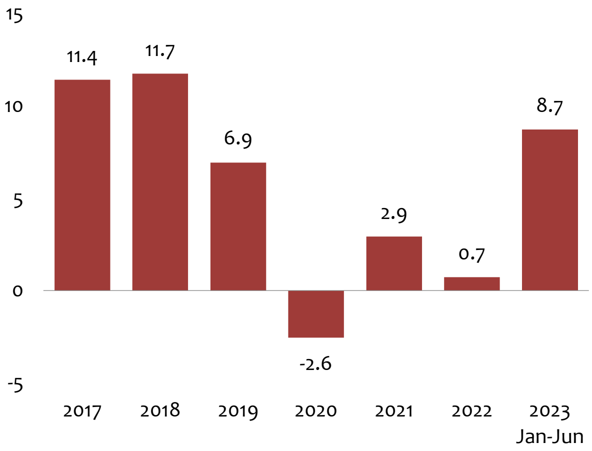
Public Consumption
changes compared to the corresponding period last year, per cent



INVESTMENT

Investment activities since 2020 have been very volatile. In the last three years (2020-2022), the gross fixed capital formation has increased by an average of 1.8% per year, which is much more moderate than before the Covid-19 pandemic in 2017-2019, when the increase was by an average of 8.1% year.

Gross Fixed Capital Formation
changes compared to the corresponding period last year, per cent



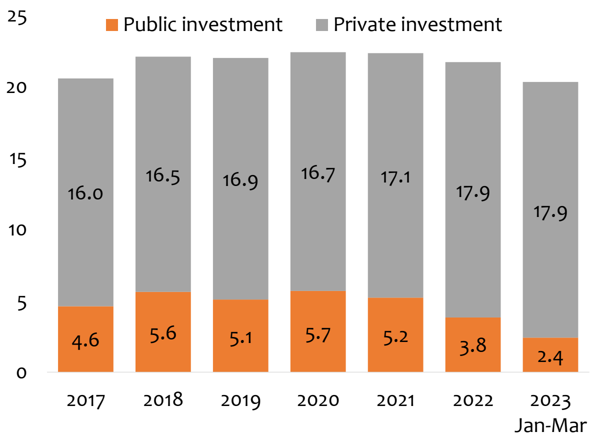
As the economy stabilized after the shock caused by the Covid-19 pandemic, investment volumes increased by 7.2% in 2021. However, the war in Ukraine has increased uncertainty and this is reflected in the dynamics of investment activities. In 2022, investments increased by only 0.6% and accounted for 21.7% of GDP. Investment activities were also limited by the rise in construction prices and delays in the implementation of EU-funded programs.

After three years of moderate growth, investment activities will increase rapidly in 2023. In the first half of 2023, gross fixed capital formation increased by 8.7% compared to the corresponding period of the previous year.

Weak credit, low demand and high uncertainty significantly limit private investment, which remains at a low level for a long time. In 2021, the amount of private sector investments increased by 10.2%, and in 2022, their amount exceeded the 2021 level by almost 8.2%. Positive dynamics remained in 2023 as well – in the first half of the year, the volume of private investments was 10.4% higher than a year earlier.

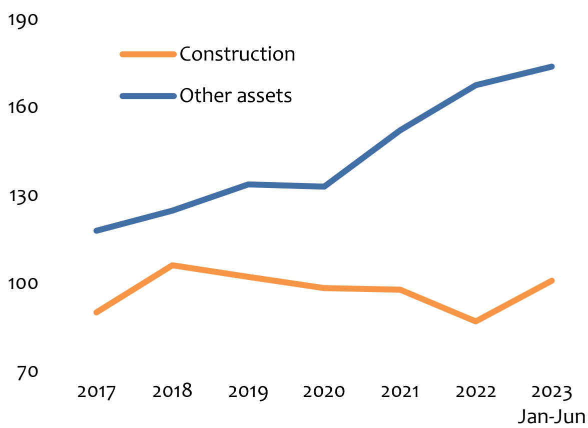
Public investment in Latvia is at a relatively high level, constituting nearly 1/5 of the total investments in the national economy of Latvia, and their dynamics are largely related to the cyclical nature of EU structural funds. Although we experienced the Covid-19 crisis, public investments increased by 7.6% in 2020. On the other hand, in 2021 and 2022 (at comparable prices) they decreased and were respectively 1.4% and 24.6% smaller than a year ago. In Q1 of 2023, compared to the corresponding period of the previous year, the volume of public investments increased by 10.2%.

Public and Private Investment
as per cent of GDP



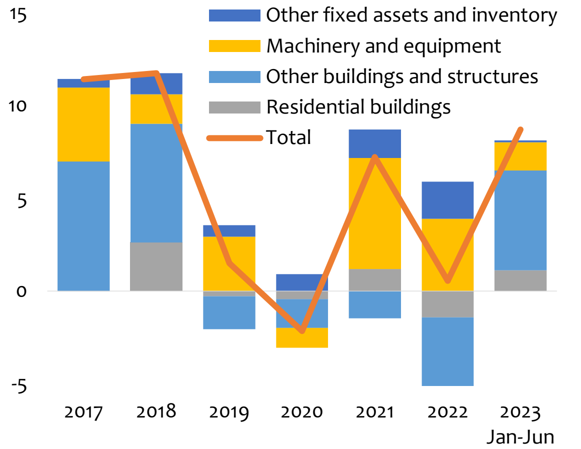
Investments in construction assets constitute most of the total investment volume. These are mainly investments in buildings and structures, which in the last three years before the Covid-19 crisis accounted for almost 45% of the expenses for the formation of the gross fixed capital. Since 2020, investments in construction assets (assessed in comparable prices) have been decreasing – on average by almost 6% per year, including in 2022 – by 11%. In the first half of 2023, investment activities in construction assets increased rapidly – by 16%, which was determined by the increase in investments in engineering structures and buildings – by 17.3%, and the increase in investments in housing by 12.4%.

Gross Fixed Capital Formation by Type of Assets
2015 = 100



The dynamics of investments in machinery and technological equipment (excluding vehicles) is slower than in other assets. In 2022, 9.4% more was invested in machines and equipment than a year ago. Also in the first half of 2023, such investments continued to grow, but much more moderately – exceeding the previous year's level by only 3.1%.

Gross Fixed Capital Formation by Type of Asset
changes compared to the corresponding period last year, per cent
asset type investment, as percentage points



The increase in investments in recent years was largely determined by investments in vehicles, as well as in information and communication technology equipment, which is necessary equipment for remote work.

Non-financial Investment Dynamics
*in January-June 2023, changes compared to the corresponding period last year, as per cent**

* calculated using quarterly data, at current prices

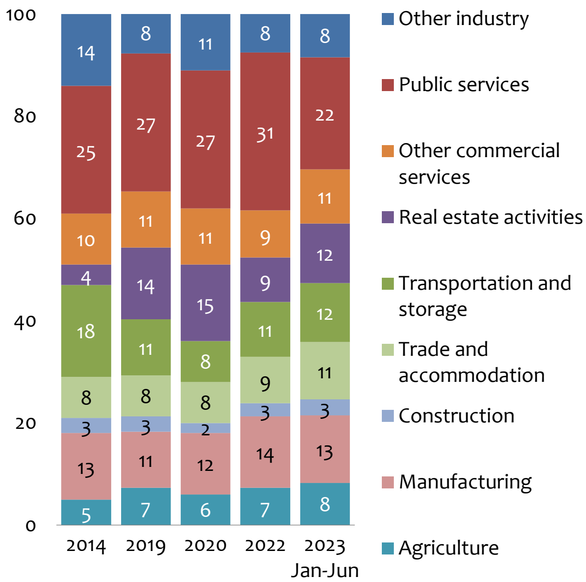
Investments in intellectual property assets constitute approximately 7% of total investments. They are characterized by resilience in the years of economic recession and in general a growing dynamic is observed. Since 2020, investments in these assets increased 1.5 times. In the first half of 2023, intellectual property products were invested by 1.4% more than a year earlier and they accounted for 2.4% of GDP.

Capital investments in tangible fixed assets in the goods production sectors in the first half of 2023 compared to the corresponding period of the previous year (assessed in actual prices) were almost 37.9% higher in volume. On the other hand, capital investments in service sectors increased by 29.7%.

The largest contribution in the first half of 2023 was the increase in investments in real estate transactions (by 88.1%), in trade (by 45.8%), in the manufacturing sector (by 28.2%), as well as in the agricultural sector (by 56 .5%). On the other hand, capital investments in the education sector, as well as in the health and social care sectors, were 4.5% and 23.6% smaller than a year ago.

Surveys conducted by the European Investment Bank (EIB) show that in the field of investment, Latvian entrepreneurs consider the lack of qualified personnel and the uncertainty of the future to be the most significant long-term obstacles. Investments are also limited by the cost of energy resources and gaps in business regulation.

Gross capital investment structure
*by sectors, as per cent**



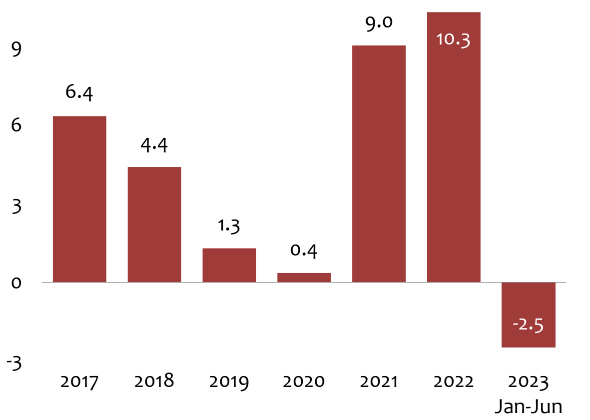
* Gross capital investment in tangible assets (calculated using quarterly data)

The dynamics of investments will continue to be affected by the uncertainty of the international environment. The investment dynamics will be positively influenced by EU funding, which is an important incentive to increase the investment level. It is expected that the Rail Baltica project and several other projects, which are expected to be financed within the framework of the Recovery and Resilience Facility, will make a significant contribution to the increase of investment activities. Increasing the credit portfolio, which has been very small for a long time, is also of great importance. However, it should be noted that in the coming years, investments will be significantly limited by both the rapid rise in inflation and the increase in the cost of lending, as the ECB implements restrictive monetary policy.

EXPORTS

Export is one of the key drivers of economic development. Export growth is closely related to external demand and economic development rates of key partner countries.

Exports of Goods and Services
changes compared to the corresponding period last year, per cent

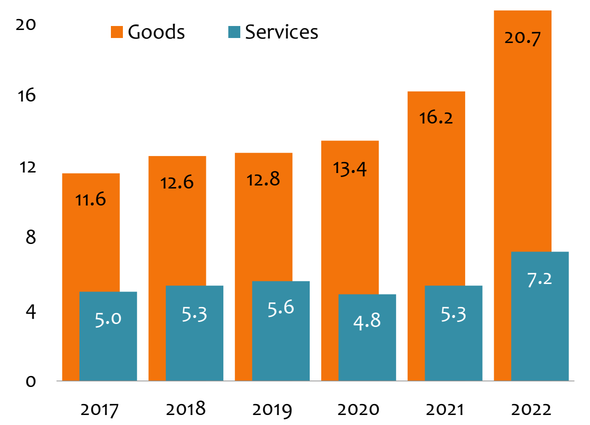


In 2020, the export volumes of goods and services practically did not increase, mainly due to the Covid-19 pandemic. In 2021, thanks to significant external demand, and partly due to the base effect, export growth started to grow again.

In 2022, as external demand continued to grow, export volumes increased significantly. Export growth was equally fast during Q1-Q3 of 2022, while it slowed down a bit in the last quarter of the year.

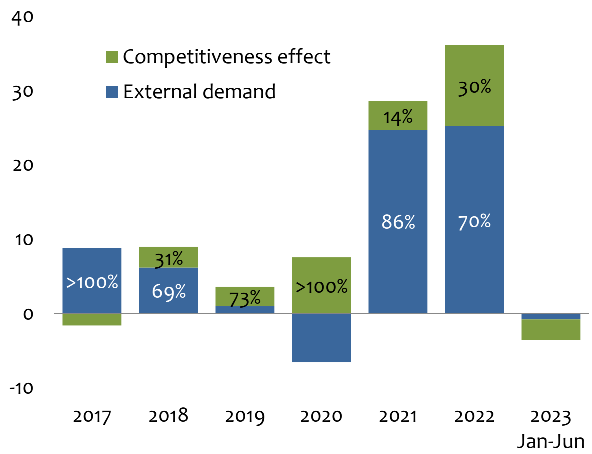
In the first half of 2023, due to weak external demand, export volumes were lower than a year ago.

Exports of Goods and Services
at current prices, billion euro



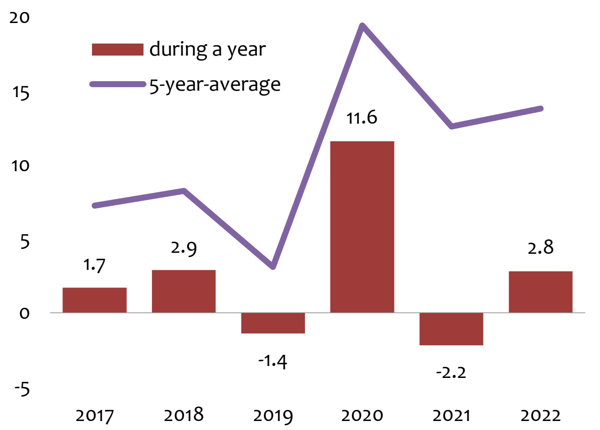
In 2018, export growth was mainly determined by external demand, while the role of price competitiveness in export growth was smaller, but in 2019, export growth was promoted by the competitiveness effect associated with successfully acquiring new markets. In 2020, under the influence of the spread of Covid-19, external demand declined rapidly, which was almost completely compensated by the increase in competitiveness in certain sectors. Both in 2021 and in 2022, the growth of exports was promoted by a rapid increase in external demand, as well as competitiveness. On the other hand, the opposite effect was observed in the first half of 2023.

Changes of Exports by the Constant Market Share
structure of exports' changes to the EU countries, as per cent



Since 2016, the share of Latvian exports in the world market has tended to increase, except for 2019 and 2021, when Latvian export growth rates were lower than the world average. This shows that Latvia remains competitive, despite the rapid increase in labour costs.

Share of Exports in World Trade
changes as per cent

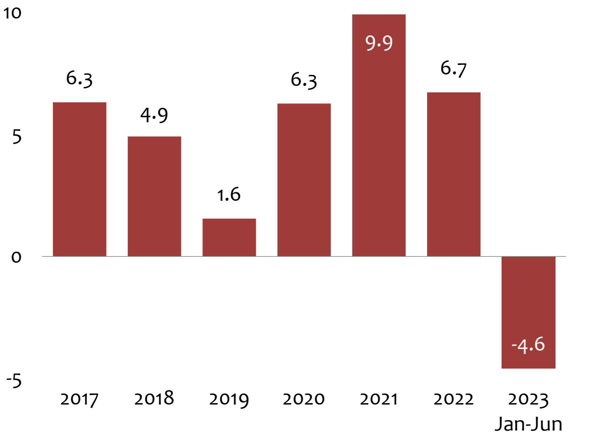


Exports of goods

The proportion of goods exports has not changed significantly since 2020 and constitute approximately 3/4 of Latvia's total exports.

Exports of Goods

at constant prices, changes compared to the corresponding period last year, as per cent

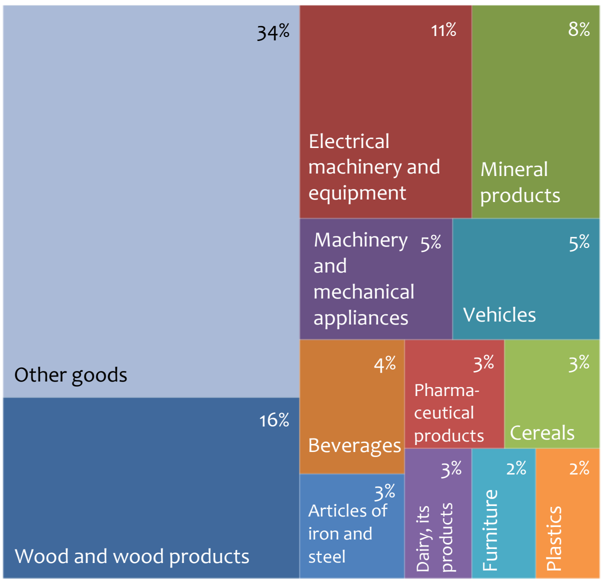


In 2020-2022, the growth of export of goods was relatively fast. In 2022, at constant prices, exports increased by 6.7%, with a significant increase in export prices. The increase in actual prices was much higher – by 27.9%.

The opposite effect was observed in the first half of 2023, export volumes decreased in actual and constant prices.

Exports of Goods

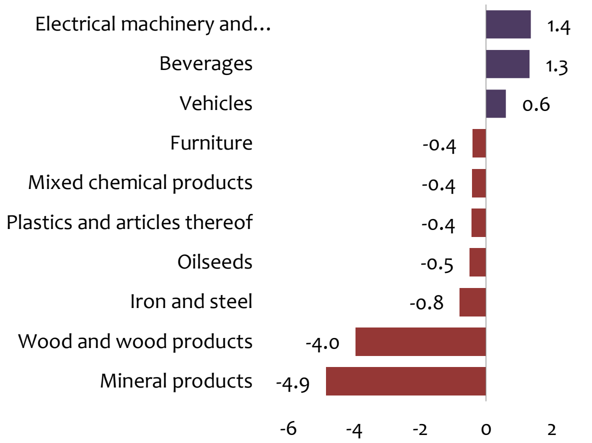
in January-August 2023, structure as per cent



In January-August 2023, the export value of goods decreased by 8.2%, primarily due to the drop in the value of exports of wood and wood products, and mineral products, while it was partially compensated by the growth of exports of electrical appliances and beverages.

Exports of Goods

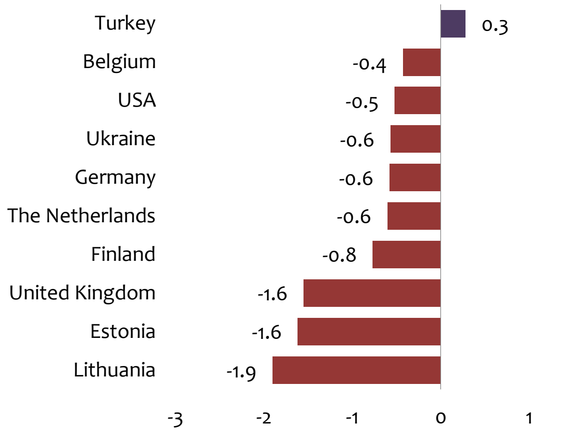
contribution to growth in January-August 2023, compared to the corresponding period last year, percentage points



In January-August 2023, the export of goods increased significantly only to Turkey, but decreased to several main export markets – EU countries and the United Kingdom.

Exports of Goods by Country

contribution to growth in January-July 2023, compared to the corresponding period last year, changes as per cent



The key Latvia's export partner countries in the eight months of 2023 were Lithuania, Estonia, Germany, Sweden, Russia, the United Kingdom, Denmark, Finland, and Poland, constituting two-thirds of total exports.

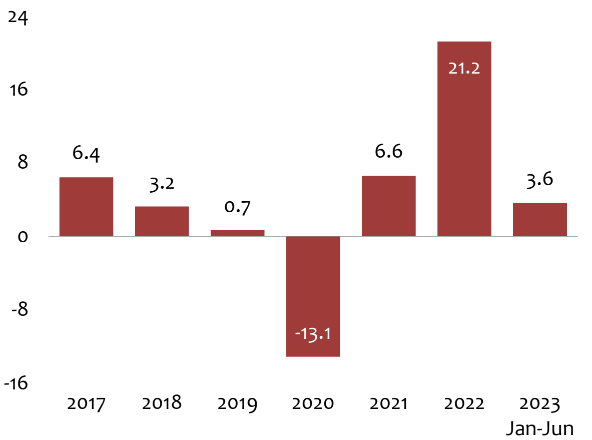
In January-August 2023, the main export goods to EU countries were wood and wood products, electrical devices and equipment, and mineral products. Alcoholic beverages and pharmaceutical products made up a large part of exports to the CIS countries, while to the rest of the countries the largest export groups were wood and wood products, cereals, and electrical devices and equipment.

Exports of services

From 2016 to 2021, Latvia's export of services grew at similar rates as the export of goods. The exception was 2020, when the export of services significantly decreased due to the imposed Covid restrictions. In 2021, the export of services started to grow again, and in 2022 its pace significantly exceeded the growth of the export of goods. The increase will continue in 2023 as well.

Exports of Goods

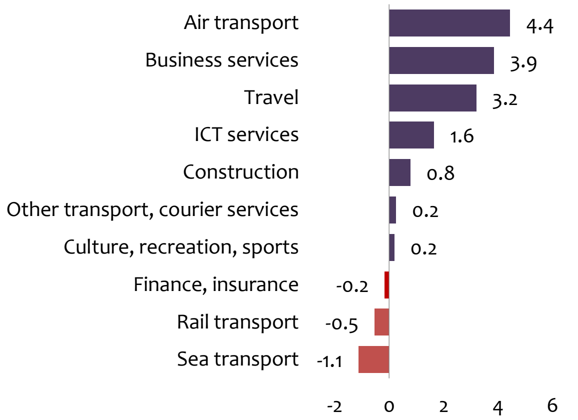
at constant prices, changes compared to the corresponding period last year, as per cent



In 2022, the export of services in actual prices increased by 35.9%, and in the first half of 2023 – by 12.4%. In January-June 2023, a large contribution to the growth of export of services was made by several service items – air transport services, trade mediation services, travel and ICT services. On the other hand, the export value of sea and rail transport, and financial and insurance services decreased.

Exports of Goods

contribution to growth in January-July 2023, compared to the corresponding period last year, percentage points



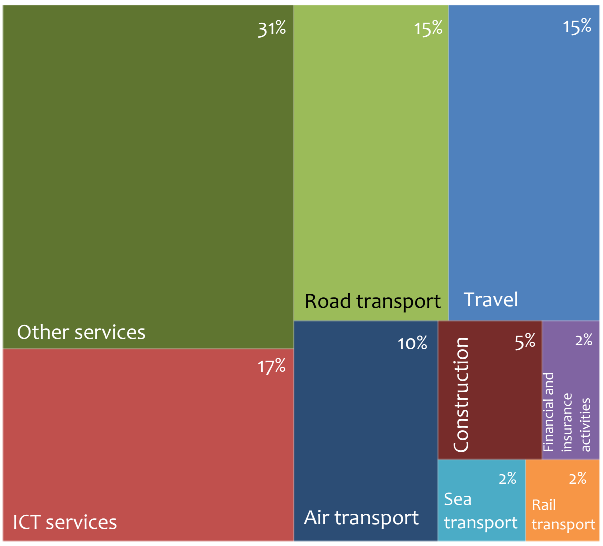
An increasing proportion is made up of exports to EU countries. In 2019, it amounted to 61%, and in the first half of 2023 – 64% of the entire export of services. Trade brokerage, car and air transport, ICT and travel services make up a large part of services exported to the EU.

An increasingly smaller share of service exports is made up of exports to CIS countries, which are mostly related to transit services and their dynamics. It should be noted that the share of service exports to CIS countries has decreased from 12% in 2019 to 3.3% in the first half of 2023.

In the group of other countries, except for the EU and the CIS, the export of services is developing dynamically. In January-June 2023, compared to the first half of 2022, it rose more rapidly to the USA, the UAE, and Switzerland.

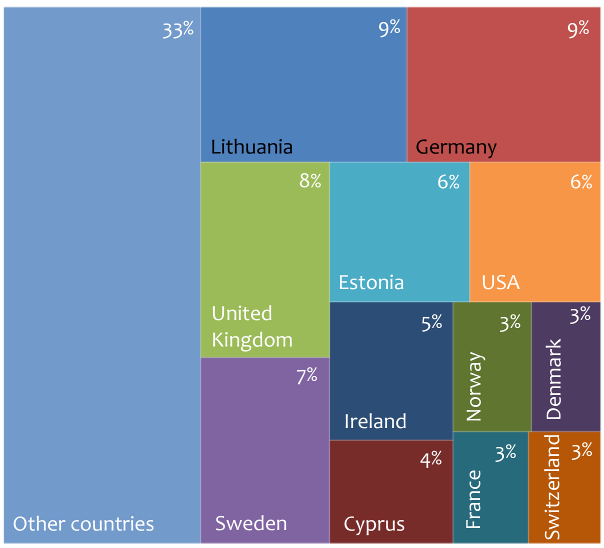
Exports of Goods

in January-July 2023, structure, as per cent



Exports of Goods by Country

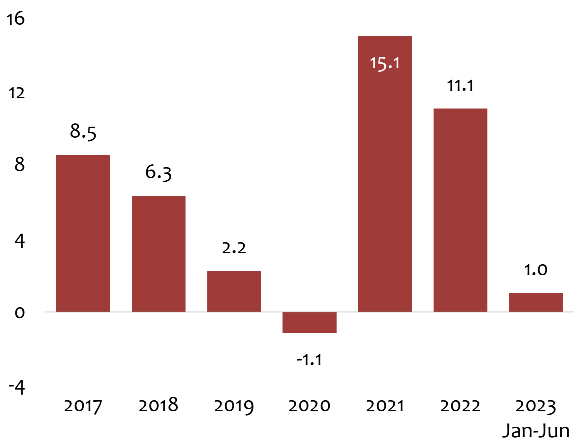
contribution to growth in January-July 2023, compared to the corresponding period last year, changes as per cent



IMPORTS

The growth of imports of goods and services until 2019 was similar to the growth of exports. In 2020, due to the impact of Covid-19, the import of services decreased significantly, while the import of goods increased slightly. However, in 2021, the import of both goods and services increased significantly. In 2022, import growth continued, with services growing more rapidly, goods imports more moderately.

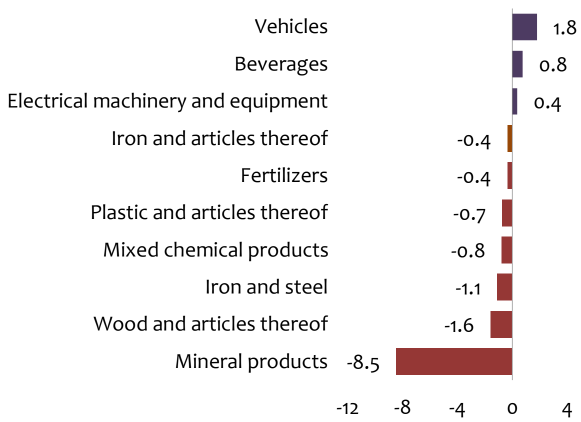
Imports of Goods and Services
at constant prices, changes compared to the corresponding period last year, as per cent



In the first half of 2023, the import of goods was 1% lower, while the import of services was 11.9% higher than a year ago.

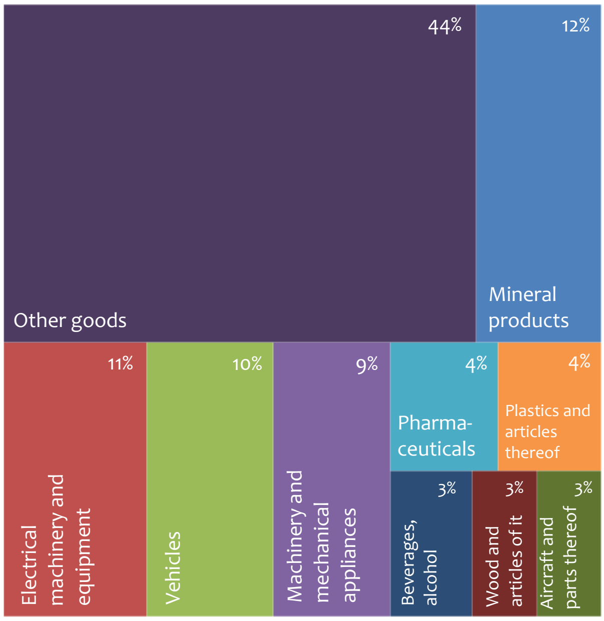
The decrease in the import of goods in January-July 2023 was significantly affected by the decrease in the value of the import of mineral products, while the import of vehicles, beverages and electrical appliances and equipment increased.

Imports of Goods
contribution to changes in January-August 2023, percentage points



The main import partner countries of Latvia are Lithuania, Germany, Poland, Estonia, the Netherlands, Finland, China, and Italy. Imports from these countries in the eight months of 2023 made up more than two thirds of the total import of Latvian goods. It should be noted that the import from Russia has significantly decreased, which was only 2.7% of the total import of goods. For comparison, in 2021, imports from Russia accounted for 9.1% of all imports.

Structure of Imports of Goods
in January-August 2023, as per cent



In the eight months of 2023, the main groups of imported goods from EU countries were mineral products, vehicles, mechanisms and electrical appliances. Mineral products, as well as fodder and grain products, still make up a large part of imports from the CIS countries. Imports from Russia make up two thirds of all CIS imports.

Latvia's import of services developed dynamically in 2017-2019, but in 2020, due to the spread of Covid-19 and related restrictions, it decreased slightly. In 2021-2022, partly due to the base effect, the import of services started to grow again. In the first half of 2023, the import of services at constant prices was similar to a year ago, albeit in actual prices it continued to grow relatively rapidly – by 12.5%.

A large part of the import of services is made up of the trade brokerage, transport services, and travel services.

Approximately 2/3 of the services import structure is made up of EU countries. In the first half of 2023, imports from Ireland, Germany, Estonia, Lithuania, Sweden, Turkey and the USA grew faster. On the other hand, import of services from Russia and Belarus significantly decreased in January-June 2023.

2023 | 2

SECTORAL DEVELOPMENT

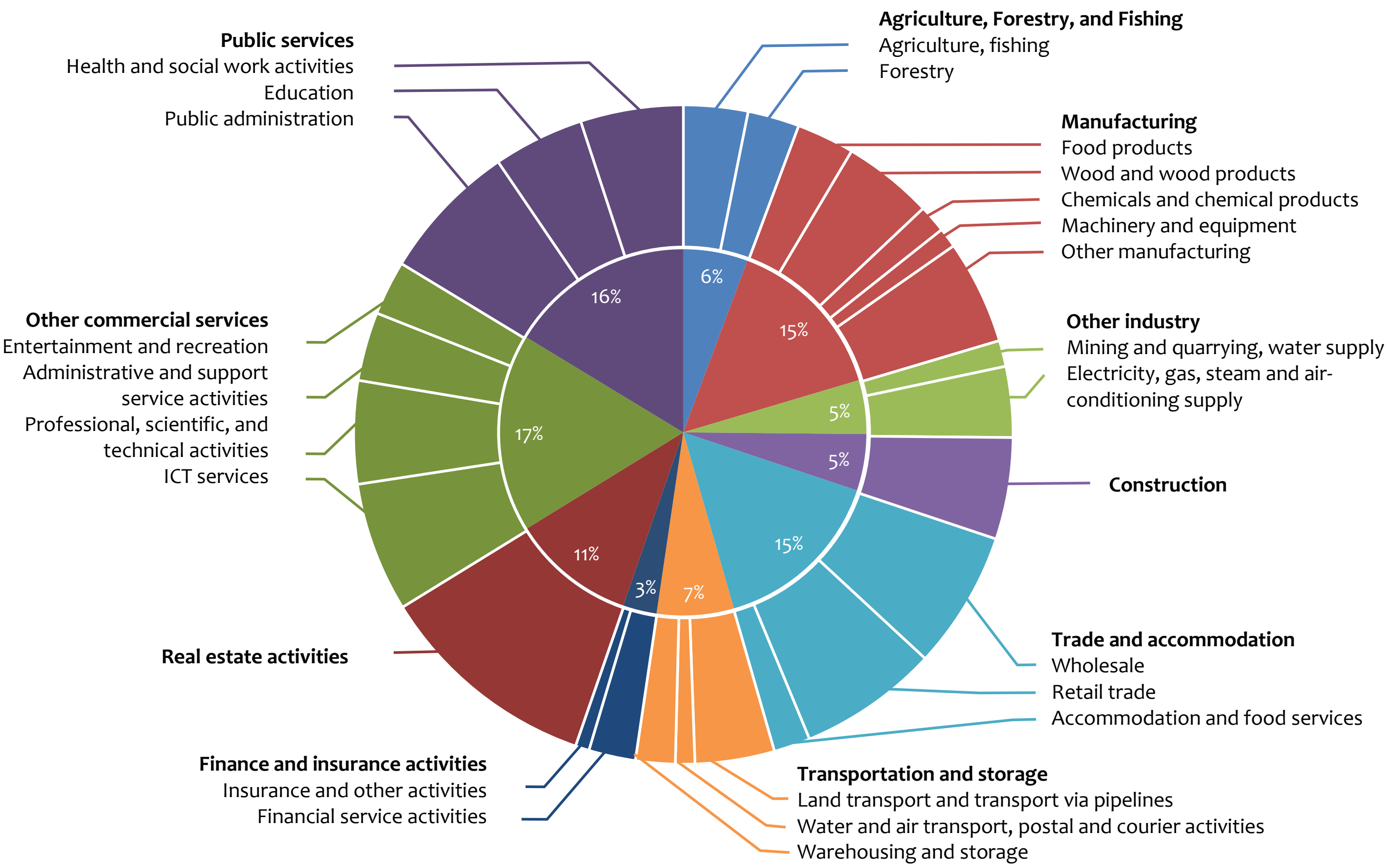
In 2009-2010, as labour costs decreased, the competitiveness of Latvian producers improved, which was the basis for export growth. The structure of the national economy changed. In 2010, the productive sectors (agriculture, forestry and fisheries, industry, as well as construction) accounted for 27.6%, and in 2022 – 30.1% of the total added value. In 2022, compared to 2010, the share in the structure of the national economy has increased in agriculture, forestry and fisheries, manufacturing industry, commercial services and public services sectors, but decreased in the rest of industry, trade and transport.

In 2015-2019, there was growth in all sectors, except for electricity, gas supply, heating and air conditioning, financial activities, and real estate activities. The increase in the volume of trade and manufacturing had the largest impact on growth.

In 2020, the Covid-19 crisis negatively affected practically all industries, and the biggest impact was the drop in volumes in many service industries and construction. As the economy recovered, in 2021-2022 growth was observed in all sectors, except for construction and other industries. The largest impact provided the increase in volumes in trade and manufacturing.

In the first half of 2023, as the economy slowed down, volumes decreased in all manufacturing sectors, except for construction, but increased in all service sectors, except for trade, transportation, and healthcare. The largest impact yielded the rise in volumes in ICT services and construction, as well as the decline in manufacturing and trade.

Structure of Value Added
2022, as per cent*



* calculations by the Ministry of Economics

Development of Sectors

changes compared to the corresponding period last year, as per cent

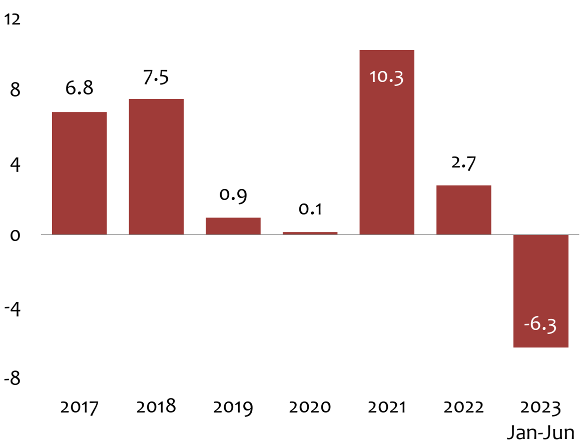
	2017	2018	2019	2020	2021	2022	2023 Jan-Jun
Gross domestic product	**3.3**	**4.0**	**0.6**	**-3.5**	**6.7**	**3.4**	**-0.6**
Agriculture, forestry, and fishing	1.9	-3.6	20.0	-0.4	1.1	7.3	-5.8
Mining and quarrying	9.1	9.1	-8.6	6.2	-5.0	-0.4	-18.9
Manufacturing	6.8	7.5	0.9	0.1	10.3	2.7	-6.3
Manufacture of food products	5.2	-2.9	-0.7	-1.7	1.3	1.3	3.4
Light industry	7.6	-0.8	-2.6	-9.5	11.8	5.1	-1.1
Manufacture of wood and articles of wood	2.1	4.5	0.0	4.5	3.7	-1.0	-12.1
Manufacture of paper and paper products	4.5	-3.7	5.7	4.7	14.0	-2.7	-26.2
Manufacture of chemicals and chemical products	11.4	7.0	3.9	-1.8	14.8	4.1	-12.2
Manufacture of non-metallic mineral products	11.1	1.3	-2.1	-1.4	4.4	5.4	-19.3
Manufacture of basic metals	12.0	3.6	13.5	-5.6	5.8	16.1	-10.1
Manufacture of computer, electronic and optical products	15.8	12.1	11.3	12.1	5.7	3.5	27.7
Manufacture of machinery and equipment	21.5	7.0	-1.9	-2.7	24.1	-12.3	3.9
Manufacture of motor vehicles	22.8	7.3	-7.7	-15.3	17.7	19.5	14.5
Other manufacturing	4.3	-1.8	2.8	-14.2	11.8	3.8	2.9
Electricity, gas, steam, and air-conditioning supply	-1.9	-38.8	-10.4	30.4	29.3	-14.0	-6.8
Construction	14.7	12.4	1.3	-5.9	-13.6	-8.8	15.4
Construction of buildings	11.7	16.1	11.4	-8.1	-16.1	-9.8	23.2
Civil engineering	26.6	6.5	-11.5	-7.4	-15.3	-13.1	2.6
Trade	2.6	3.9	2.2	-4.2	19.8	-6.1	-6.4
Retail trade	0.4	1.2	-2.0	-0.3	16.7	4.3	-2.1
Transportation and storage	6.6	3.8	-2.1	-18.6	6.6	3.0	-5.2
Freight rail transport	-8.4	12.5	-15.8	-42.3	-9.5	-2.1	-36.0
Cargo handling	-2.0	6.9	-5.7	-27.9	-7.2	15.2	-14.2
Freight transport by road	7.0	12.8	-3.8	2.6	7.8	-0.8	-9.8
Accommodation and food service activities	9.3	7.6	-4.9	-31.4	-4.1	57.3	13.3
Information and communication services	8.7	9.6	3.6	0.6	12.6	12.6	7.0
Finance and insurance activities	-17.7	-2.4	-9.9	0.6	16.0	-6.0	0.5
Real estate activities	-1.6	2.3	-1.0	-1.9	5.8	1.6	2.8
Other service activities	4.6	2.7	-0.6	-2.1	5.2	17.5	2.7
Public administration and defence; compulsory social security	3.7	2.7	0.2	2.8	0.5	3.7	5.7
Education	4.4	3.1	-4.4	1.1	-0.8	4.1	9.2
Health and social work activities	4.4	9.3	4.8	-3.4	6.1	1.0	-5.4
Arts, entertainment, and recreation	5.1	6.1	1.9	-33.5	2.8	29.4	17.0

MANUFACTURING

The development of manufacturing is promoted by the improvement of the competitiveness of Latvian producers, as well as the dynamics of demand in the largest export markets. Production volumes increased particularly rapidly in 2017 and 2018, albeit more slowly in 2019.

Due to the impact of the Covid-19 crisis, the growth of the manufacturing slowed down in 2020. However, production volumes were even slightly higher than a year ago.

Manufacturing
change in value added compared to the corresponding period last year, as per cent

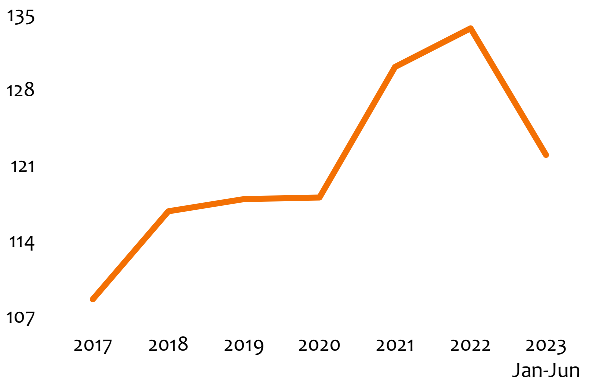


In 2021, more rapid growth resumed in the manufacturing sector. Relatively rapid growth rates of the sector endured at the beginning of 2022 as well.

In January-August 2023, the production volumes of the manufacturing sector were lower than a year ago. This was mainly due to reductions in woodworking, as well as chemical industry, and non-metallic mineral production sub-sectors. The decline was partially offset by growth in the electrical and optical equipment and food industries.

In January-August 2023, the turnover of manufacturing in actual prices was similar to a year ago. The volume of products sold on the domestic market increased, albeit the volume of exported products decreased slightly.

Manufacturing
value added, 2015 = 100



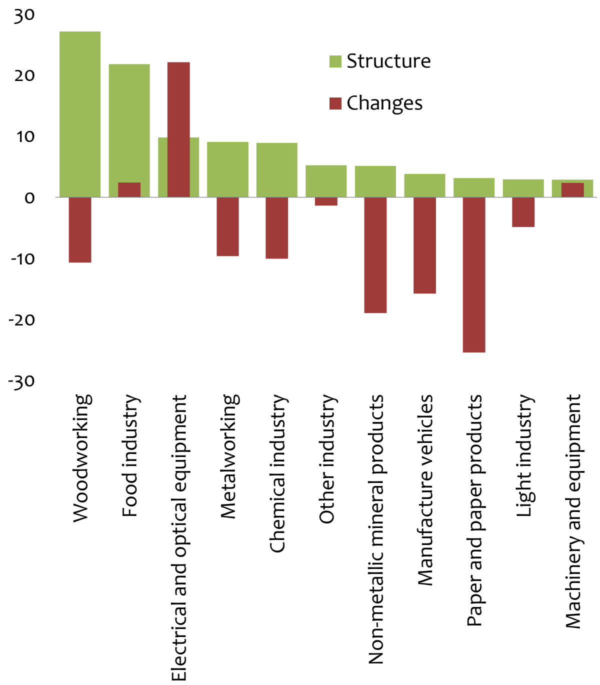
In 2018-2019, the number of occupied posts in manufacturing did not change significantly. In 2020, the number of occupied posts decreased by 1.7 thousand. In 2021, it rose by 5 thousand. However, in 2022 and the first half of 2023 it declined again – by 1 and 3 thousand, respectively. In the first half of 2023, the decrease in the number of occupied posts was observed in woodworking, furniture, mechanism and machine production, pharmaceuticals, and printing. However, the number of occupied posts increased in the production of computers, electrical and optical equipment.

Structure of Manufacturing and Development Trends by Field
as per cent

	Structure in 2022			Changes in production volumes				
	Output	Occupied posts	Exports in total sales	2019	2020	2021	2022	2023 Jan-Aug
Manufacturing	**100**	**100**	**67.1**	**2.1**	**-0.9**	**7.5**	**2.7**	**-6.3**
Food industry	19.3	18.7	42.3	-0.7	-1.7	1.3	1.3	2.4
Light industry	2.8	8.0	88.1	-2.6	-9.5	11.8	5.1	-4.9
Manufacture of wood and wood products	30.2	20.4	65.8	0.0	4.5	3.7	-1.0	-10.7
Manufacture of paper and paper products	3.7	4.4	64.7	5.7	4.7	14.0	-2.7	-25.4
Manufacture of chemicals and chemical products	9.2	7.5	80.1	3.9	-1.8	14.8	4.1	-10.1
Manufacture of non-metallic mineral products	5.7	5.3	60.2	-2.1	-1.4	4.4	5.4	-19.0
Manufacture of basic metals	9.2	11.2	69.4	13.5	-5.6	5.8	16.1	-9.7
Manufacture of electronic products	7.9	5.7	87.5	11.3	12.1	5.7	3.5	22.1
Manufacture of machinery and equipment	2.8	3.1	89.7	-1.9	-2.7	24.1	-12.3	2.4
Manufacture of motor vehicles	3.8	3.6	94.3	-7.7	-15.3	17.7	19.5	-15.8
Other manufacturing	5.4	12.1	64.9	2.8	-14.2	11.8	3.8	-1.4

Growth of Manufacturing

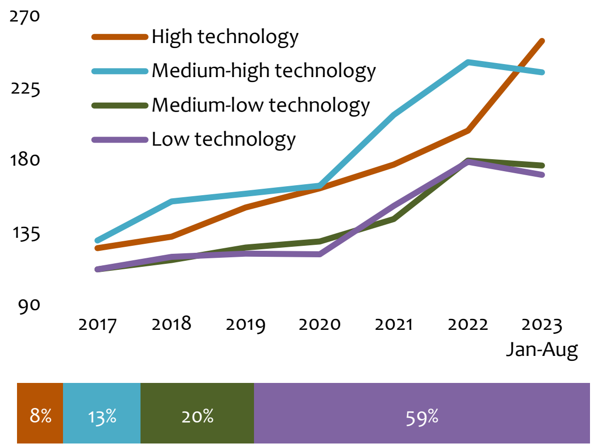
structure and changes in January-August 2023, compared to the corresponding period last year, as per cent



Weak demand in the largest market for Latvian goods in the EU largely determines the decline in the growth of the manufacturing sector in 2023. Also, the development of the sector continues to be negatively affected by the war in Ukraine, as a result of which the existing supply chains of raw materials are disrupted. Companies that were connected to the markets of these countries should continue to look for new supply opportunities and new markets for goods.

Manufacturing Volume Index and Structure by Levels of Technology

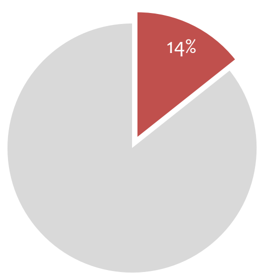
2015 = 100, structure in January-August 2023, as per cent



Main Indicators of Manufacturing [1]

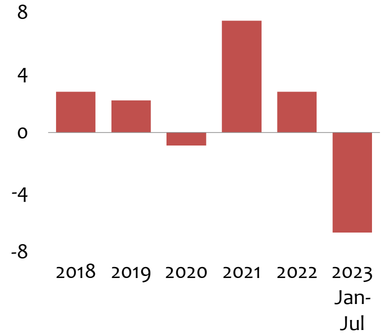
Share in total value added

in January-June 2023, as per cent



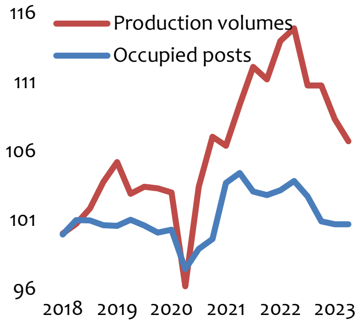
Changes in production volumes

compared to the corresponding period last year, as per cent



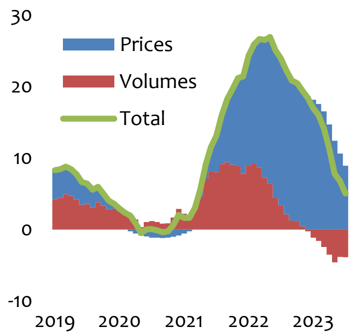
Production volumes and occupied posts

Q4 2017 = 100



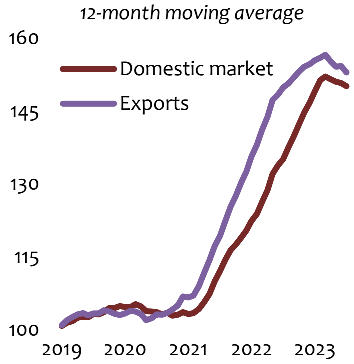
Changes in sales of production

12-month moving average, as per cent



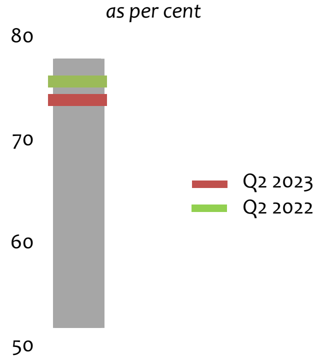
Production sales

December 2018 = 100,
12-month moving average



Capacity utilization rate

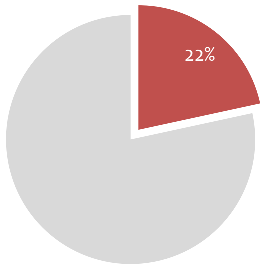
Historically highest/lowest level, as per cent



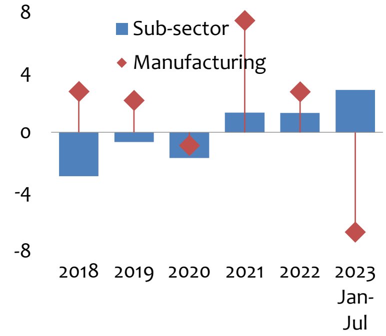
[1] data on sales of products until July 2023

Manufacture of food products and beverages

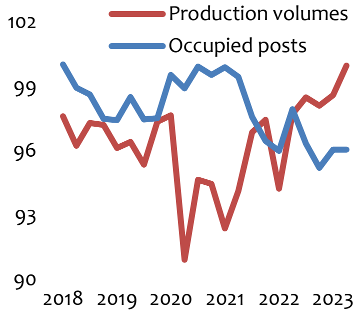
Share in total value added
in January-July 2023, as per cent



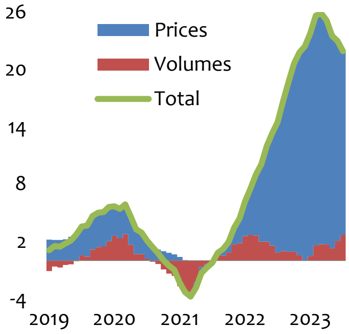
Changes in production volumes
compared to the corresponding period last year, as per cent



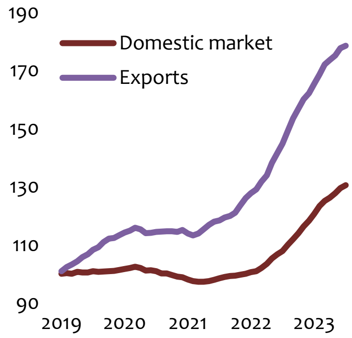
Production volumes and occupied posts
Q4 2017 = 100



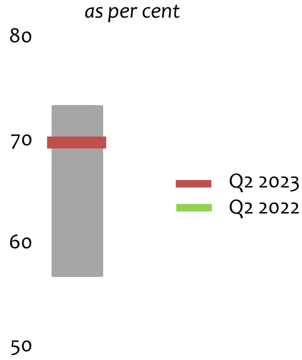
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

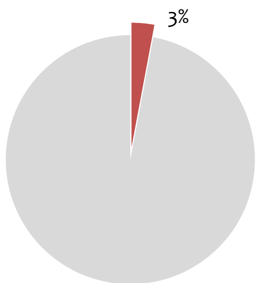


Capacity utilization rate
Historically highest/lowest level, as per cent

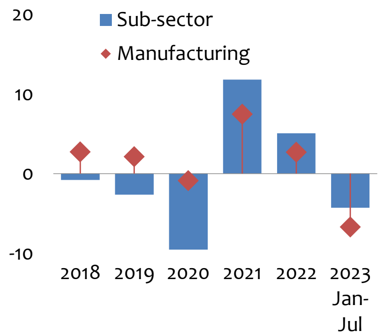


Light Industry

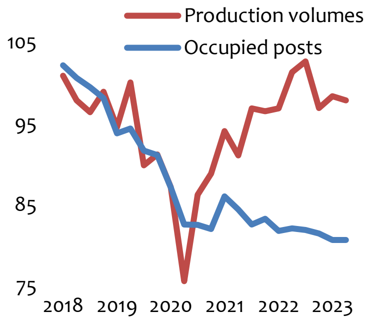
Share in total value added
in January-July 2023, as per cent



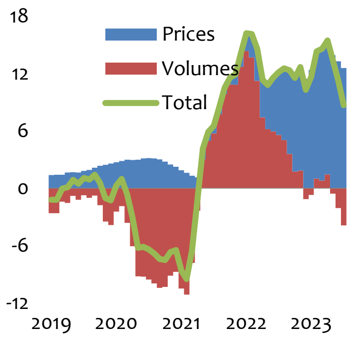
Changes in production volumes
compared to the corresponding period last year, as per cent



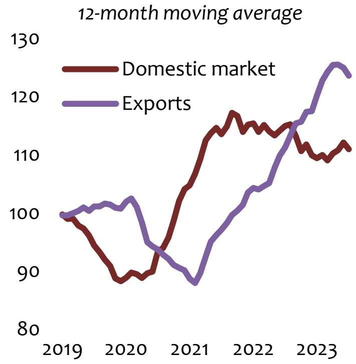
Production volumes and occupied posts
Q4 2017 = 100



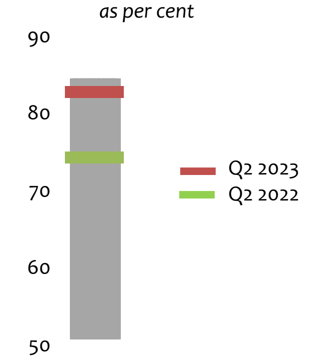
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

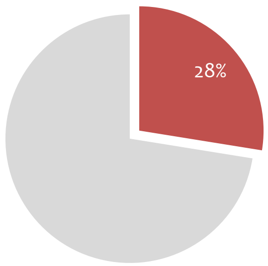


Capacity utilization rate
Historically highest/lowest level, as per cent

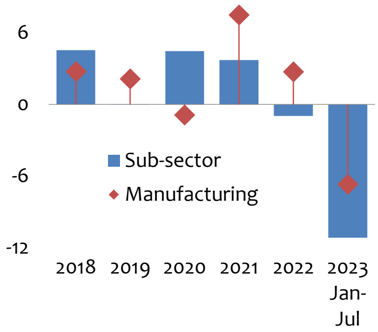


Manufacture of wood and wood products

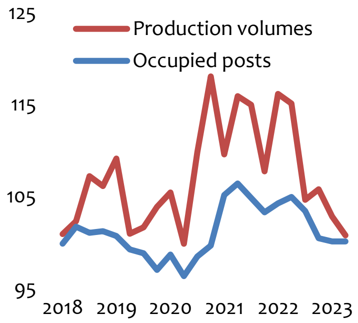
Share in total value added
in January-July 2023, as per cent



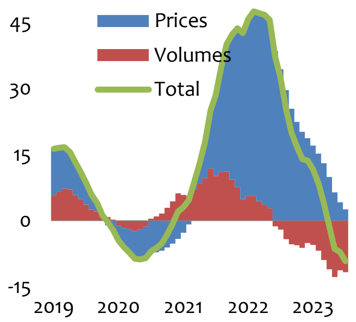
Changes in production volumes
compared to the corresponding period last year, as per cent



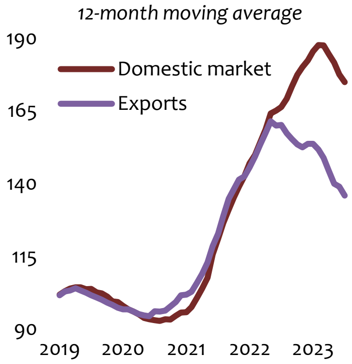
Production volumes and occupied posts
Q4 2017 = 100



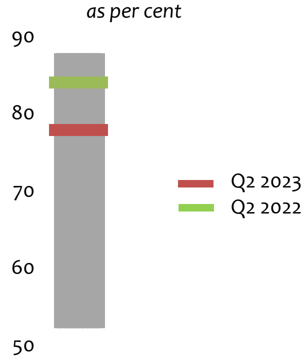
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

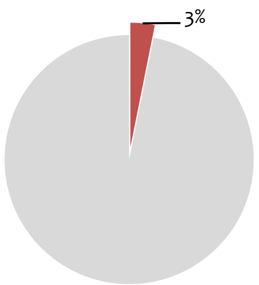


Capacity utilization rate
Historically highest/lowest level, as per cent

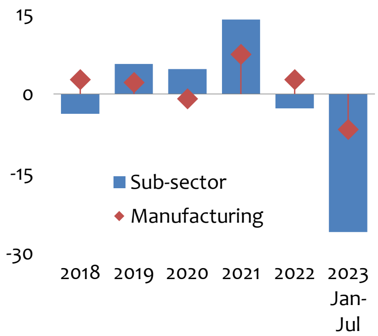


Manufacture of paper and paper products

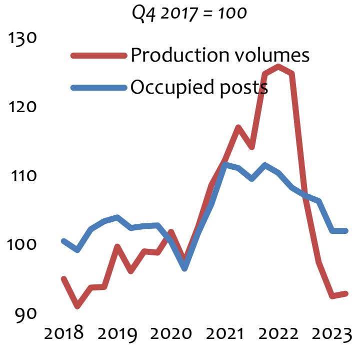
Share in total value added
in January-July 2023, as per cent



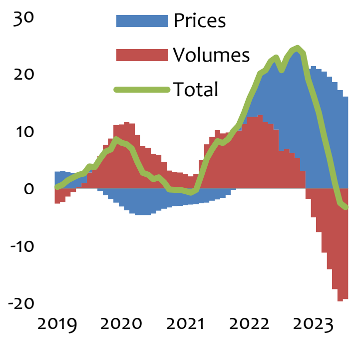
Changes in production volumes
compared to the corresponding period last year, as per cent



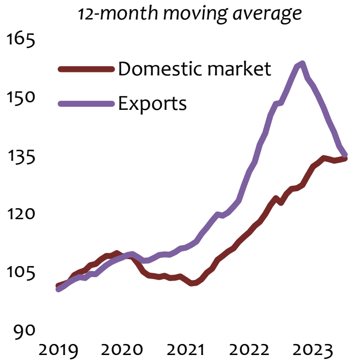
Production volumes and occupied posts
Q4 2017 = 100



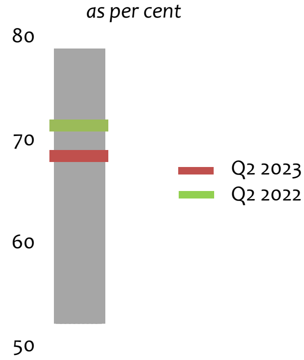
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

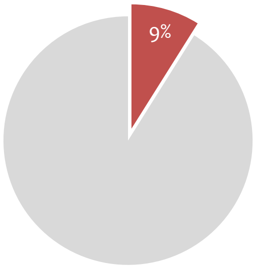


Capacity utilization rate
Historically highest/lowest level, as per cent

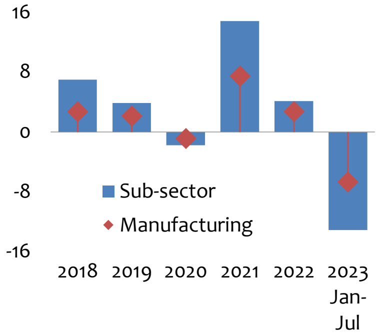


Manufacture of chemicals and chemical products

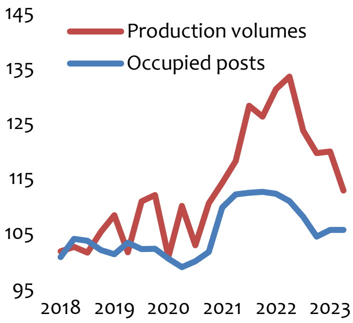
Share in total value added
in January-July 2023, as per cent



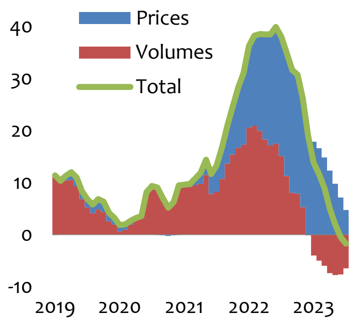
Changes in production volumes
compared to the corresponding period last year, as per cent



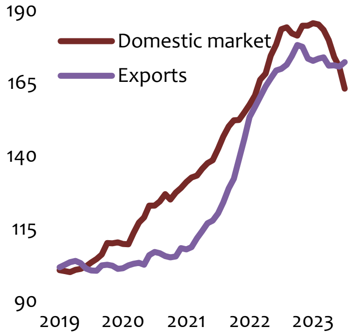
Production volumes and occupied posts
Q4 2017 = 100



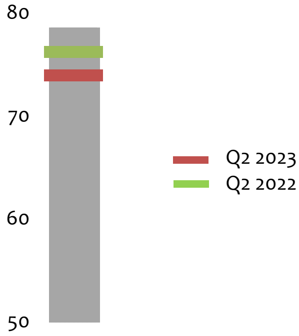
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

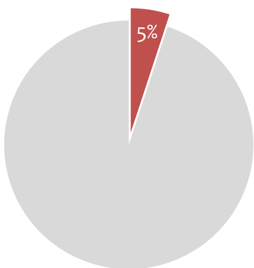


Capacity utilization rate
Historically highest/lowest level, as per cent

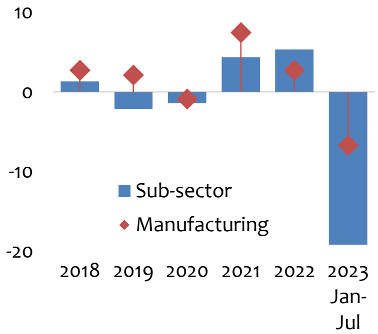


Manufacture of non-metallic mineral products

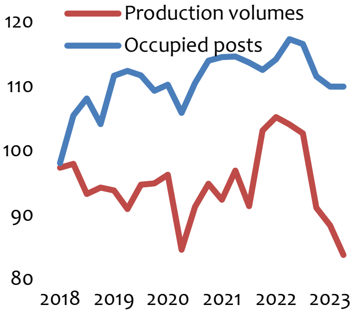
Share in total value added
in January-July 2023, as per cent



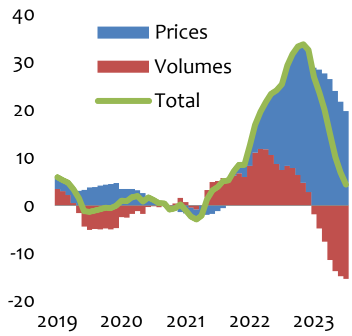
Changes in production volumes
compared to the corresponding period last year, as per cent



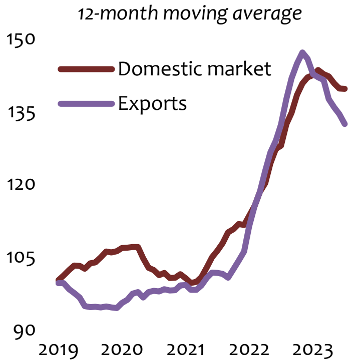
Production volumes and occupied posts
Q4 2017 = 100



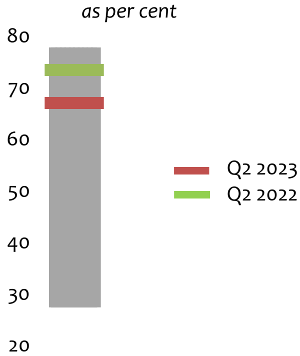
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

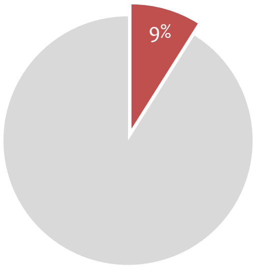


Capacity utilization rate
Historically highest/lowest level, as per cent

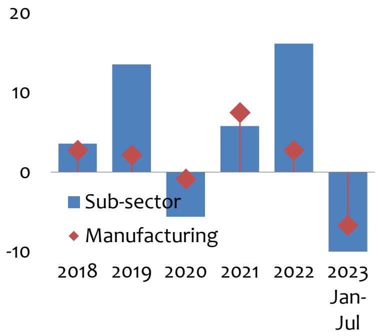


Manufacture of basic metals and fabricated metal products

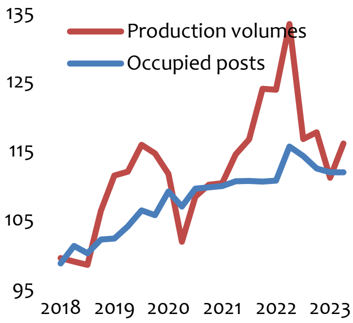
Share in total value added
in January-July 2023, as per cent



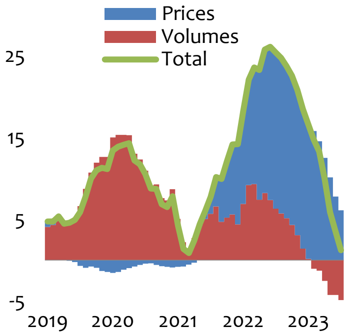
Changes in production volumes
compared to the corresponding period last year, as per cent



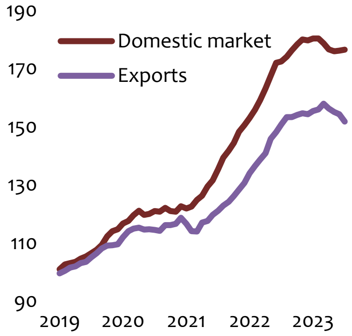
Production volumes and occupied posts
Q4 2017 = 100



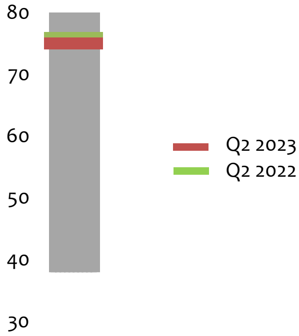
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

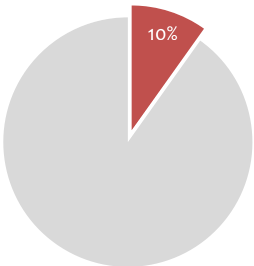


Capacity utilization rate
Historically highest/lowest level, as per cent

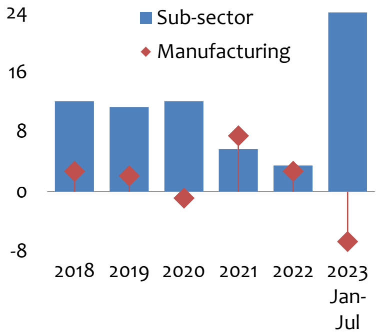


Manufacture of electronic and optical products

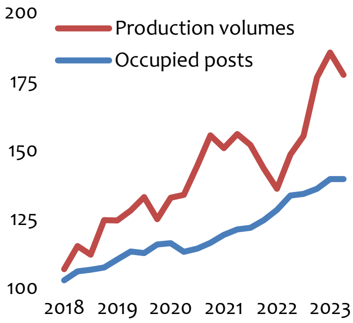
Share in total value added
in January-July 2023, as per cent



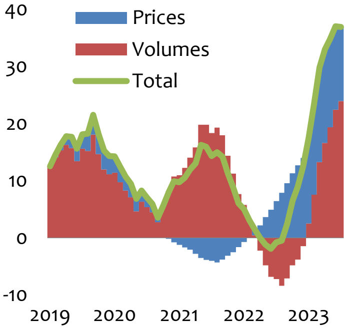
Changes in production volumes
compared to the corresponding period last year, as per cent



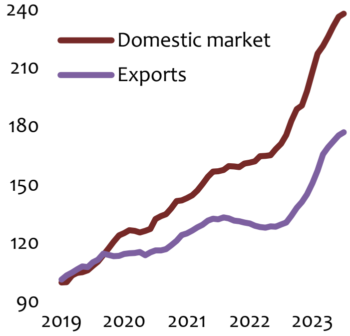
Production volumes and occupied posts
Q4 2017 = 100



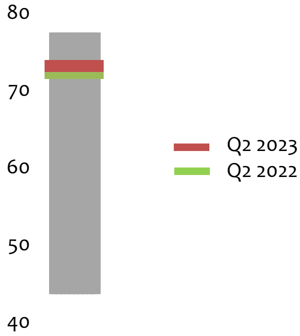
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

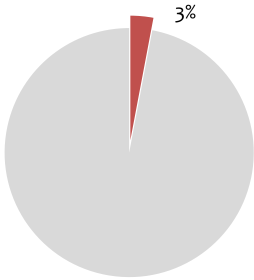


Capacity utilization rate
Historically highest/lowest level, as per cent

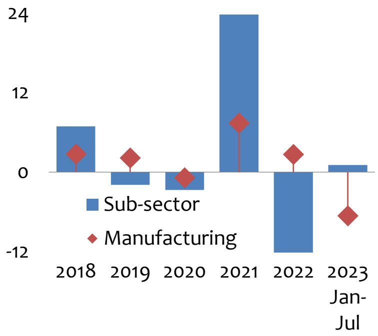


Manufacture of machinery and equipment

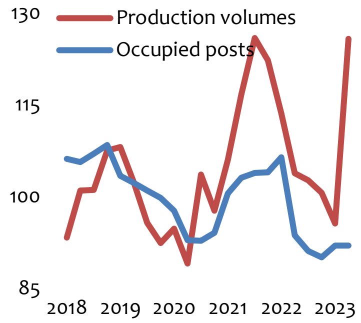
Share in total value added
in January-July 2023, as per cent



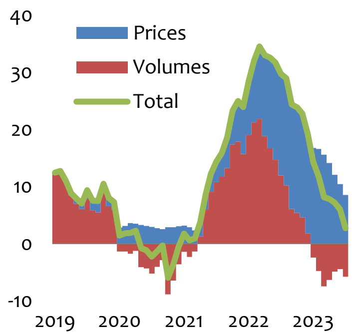
Changes in production volumes
compared to the corresponding period last year, as per cent



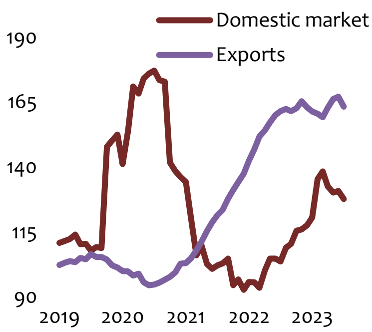
Production volumes and occupied posts
Q4 2017 = 100



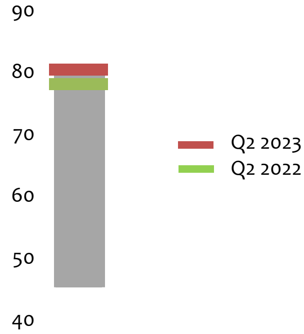
Changes in sales of production
12-month moving average, as per cent



Production sales
December 2018 = 100, 12-month moving average

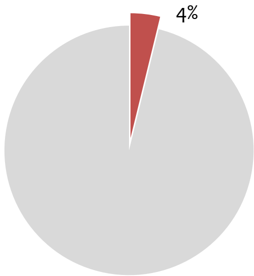


Capacity utilization rate
Historically highest/lowest level, as per cent

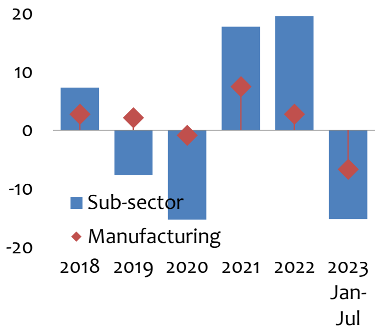


Manufacture of motor vehicles

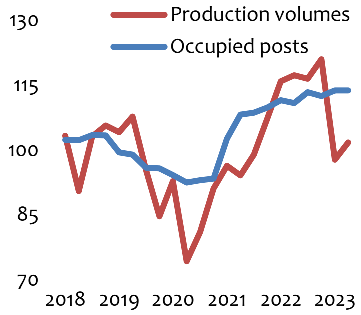
Share in total value added
in January-July 2023, as per cent



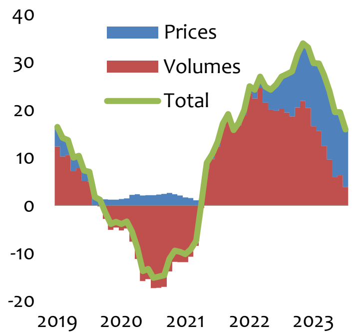
Changes in production volumes
compared to the corresponding period last year, as per cent



Production volumes and occupied posts
Q4 2017 = 100

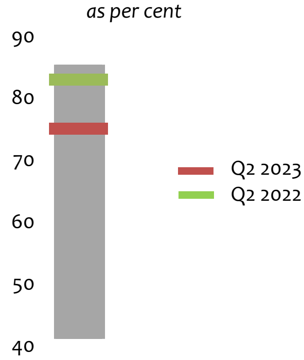


Changes in sales of production
12-month moving average, as per cent



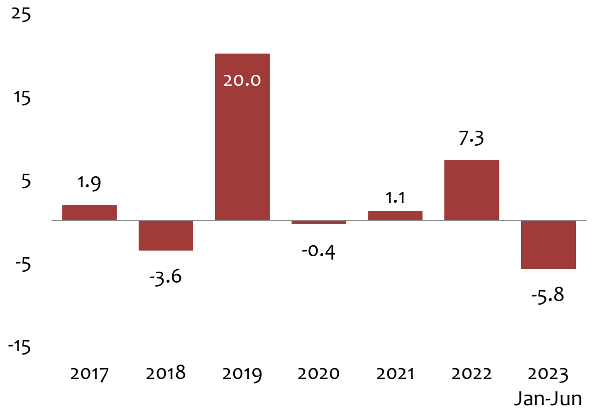
Production sales
December 2018 = 100, 12-month moving average

Capacity utilization rate
Historically highest/lowest level, as per cent



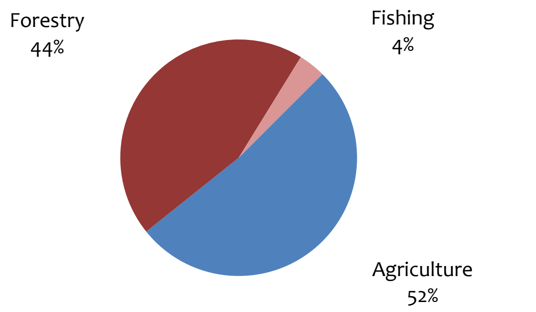
AGRICULTURE, FORESTRY, AND FISHING

Agriculture, Forestry, and Fishing
value added, changes compared to the corresponding period last year, as per cent



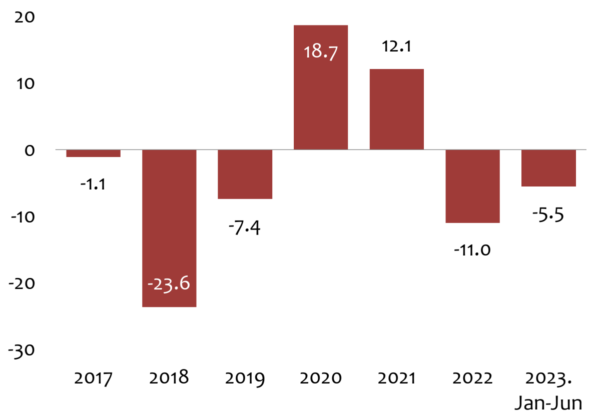
Agriculture and forestry provide the largest contribution to growth within the sector. The activity of the sector is closely related to the weather conditions, therefore the sector experiences fluctuating growth. After the rapid increase in 2022, in the first half of 2023, the production volume decreased, which was facilitated by the decline in the volume of production in crop and animal husbandry and forestry and logging, alebit a rapid increase was observed in the fishery sector. Overall, in the last years until the pandemic, the number of employed and occupied posts slowly increased. However, in 2020, due to the impact of Covid-19, the number of occupied posts decreased in agriculture and forestry. In 2021, occupied posts declined in all sub-sectors, albeit in 2022 – only in agriculture. In the first half of 2023, the number of occupied posts increased only in forestry.

Structure of Agriculture, Forestry, and Fishing
2022, as per cent



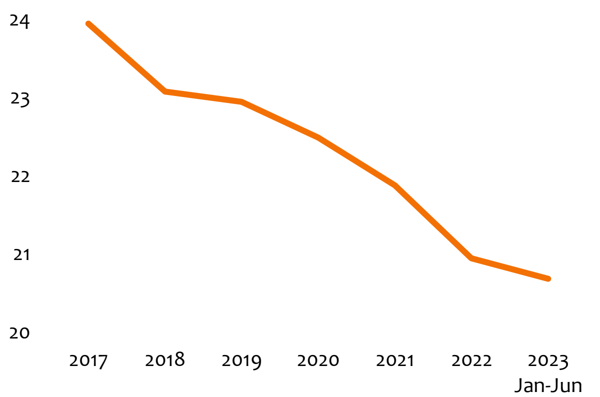
OTHER MANUFACTURING

Other Manufacturing
value added, changes compared to the corresponding period last year, as per cent



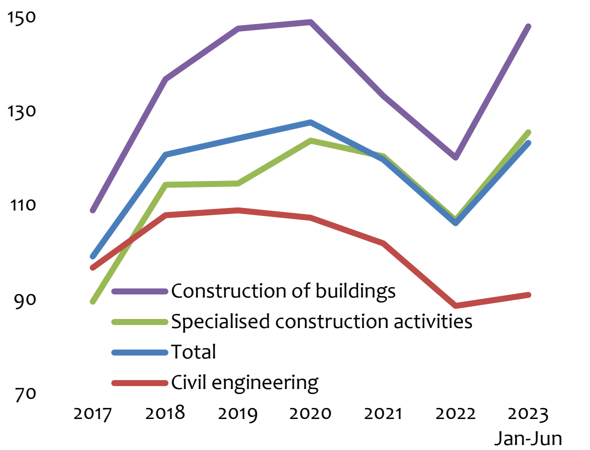
The largest share of added value in other manufacturing (incl. mining and quarrying, electricity, gas, steam, and air-conditioning supply, water supply, and waste management) provide electricity and gas supply sub-sectors. In the first half of 2023, the volumes of other manufacturing continued to shrink rapidly. The largest impact yielded the drop in volumes in the electricity, gas supply, heat supply and air conditioning sector, as the amount of electricity produced in cogeneration stations decreased and their consumption decreased due to the increase in the price of energy resources. A sharp decline was also observed in the mining and quarrying, which was determined by both the reduction of volumes in the development of gravel and sand quarries, as well as in the extraction and processing of peat. The number of occupied posts filled has increased in recent years in the mining sector, but it has fallen sharply in other sectors. On the other hand, in the first half of 2023, it decreased in all sub-sectors.

Occupied Posts in Other Manufacturing
in thousands

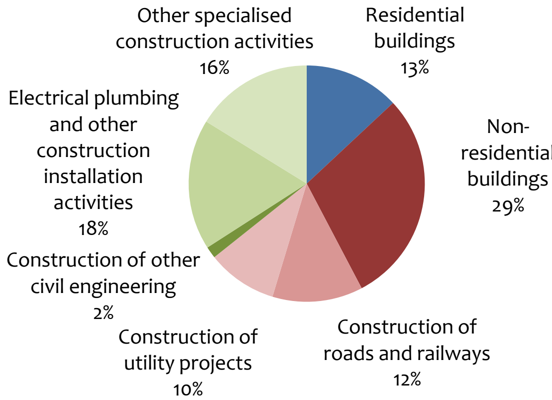


CONSTRUCTION

Development of Construction
2015 = 100



Structure of Construction
in January-June 2023, as per cent

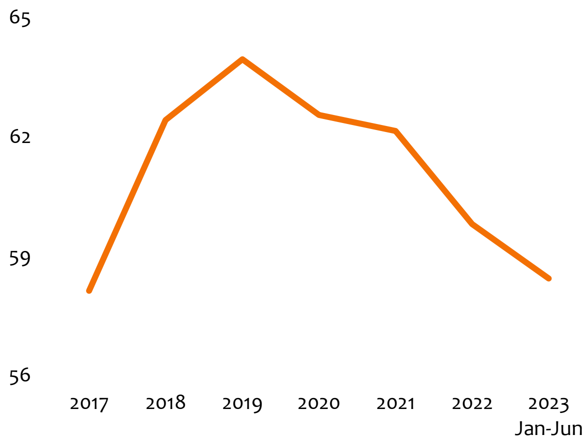


Construction indicators improve in 2023, returning to growth. The increase in the volume of construction production in the first half of the year was 16.1% compared to the first half of 2022. The industry and customers have adapted to the challenges of recent years, such as the rapid increase in construction costs and difficulties in the availability of construction materials. The low base effect of the industry's two-year recession can be mentioned as another factor of the rapid growth.

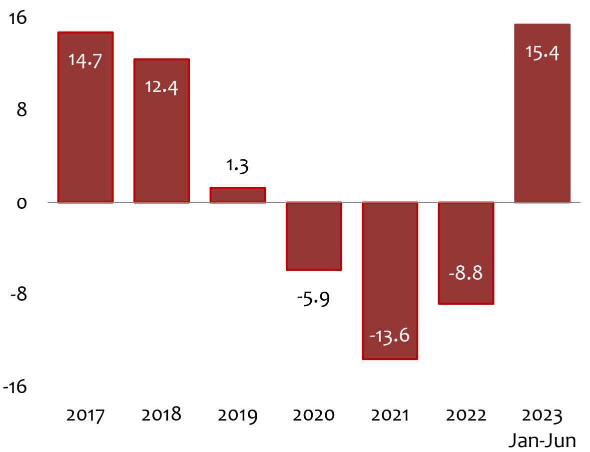
The growth in the first half of 2023 is not uniform in all basic construction groups. There is a rapid increase in building construction and specialized construction works, 23.2% and 17.5% respectively, while in engineering construction a slight increase of 2.6% was observed.

The number of building permits issued in the first half of 2023 was 2157, which is 13.8% less than a year ago. The estimated floor space has increased slightly – by 3%.

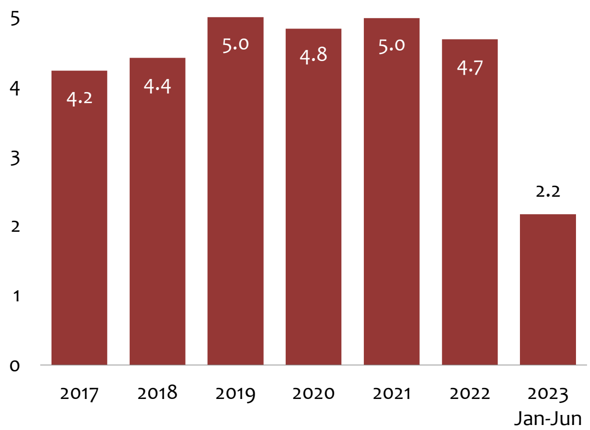
Occupied Posts in Construction
in thousands



Construction
value added, changes compared to the corresponding period last year, as per cent

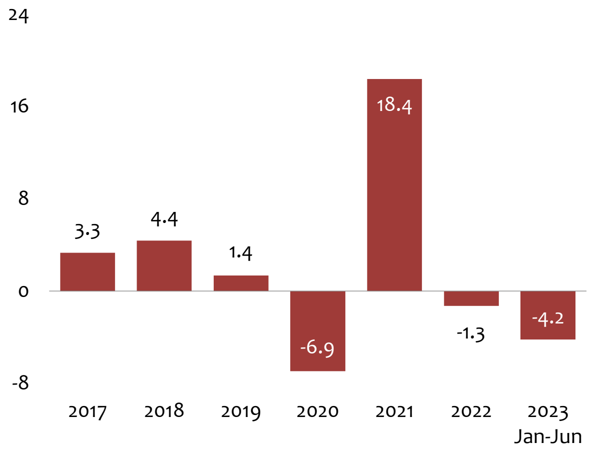


Building Permits Granted
in thousands



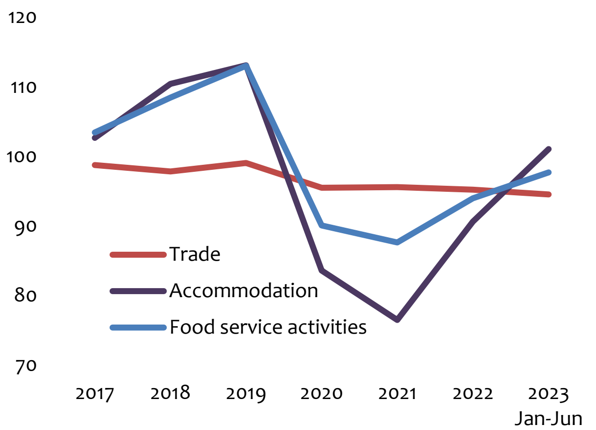
TRADE, ACCOMMODATION, AND FOOD SERVICE ACTIVITIES

Trade, Accommodation, and Food Service Activities
value added, changes compared to the corresponding period last year, as per cent

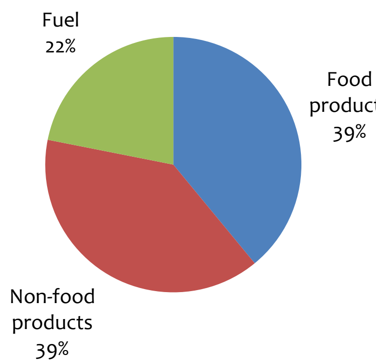


The volumes of services provided in the trade, accommodation, and food service activities continue to decline. In the first half of 2023, the trade sector continued to be negatively affected by the decrease in the turnover of goods with the markets of Russia and Belarus due to the sanctions imposed by the EU, as a result of which the wholesale volumes decreased rapidly (by 14.9%). Due to the high prices, the retail turnover also decreased – by 2.1%. Retail turnover of food products decreased most rapidly. It declined more moderately for non-food items, but increased for fuel, which was affected by lower trade volumes in the corresponding period of 2022 due to rising fuel prices. The growth of the accommodation and food service activities endured in the first half of 2023 (by 13.3%) and already exceeded the pre-Covid-19 crisis level. At the same time, the number of occupied posts also increased rapidly in the accommodation and food service activities but decreased in trade. The largest share of occupied posts is in trade.

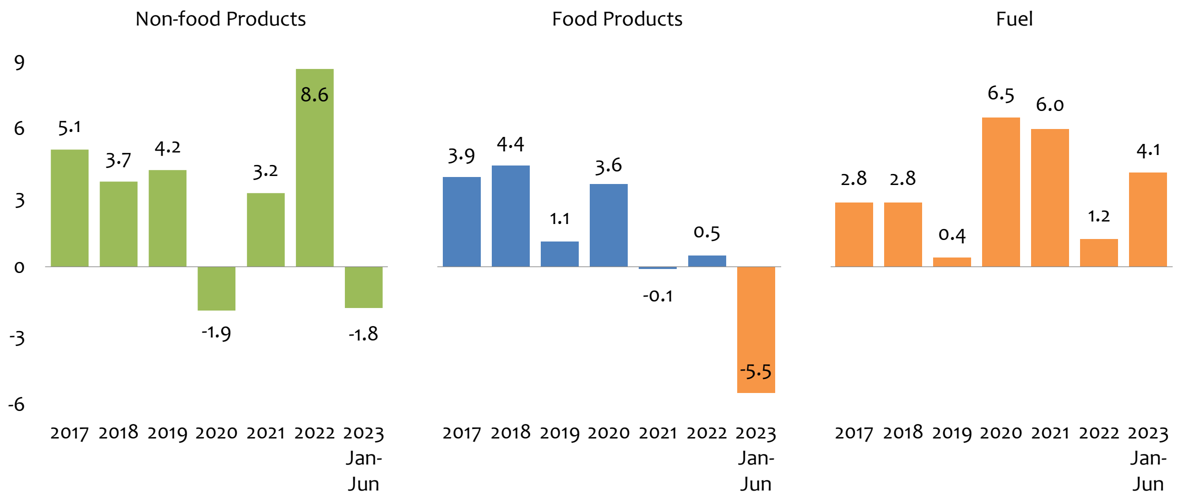
Occupied Posts in Trade, Accommodation, and Food Service Activities
2015 = 100



Structure of Retail Turnover
2022, as per cent



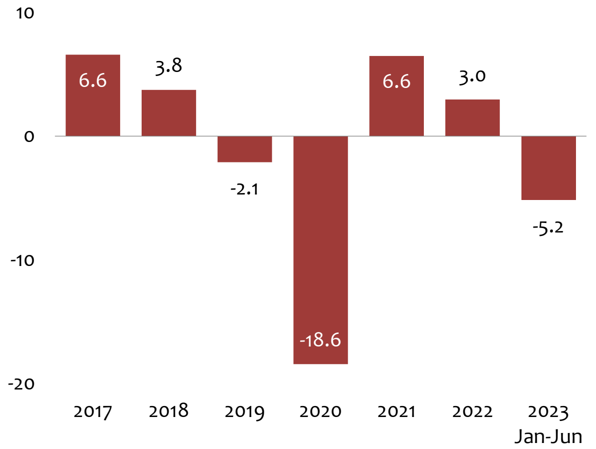
Retail Turnover
changes compared to the corresponding period last year, as per cent



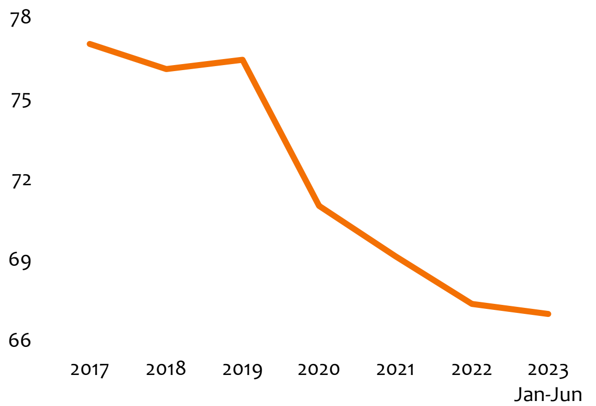
TRANSPORTATION AND STORAGE

The transportation and storage sector is closely linked to international transportation. After growth in the previous two years, in the first half of 2023, the volumes of the transportation sector decreased, which was determined by the decrease in all transport sub-sectors, except for air transport. Service volumes in land and pipeline transportation, as well as in storage and transport auxiliary activities, decreased the most rapidly. The volume of transported cargo decreased in all modes of transport, with a more rapid decrease in the volume of railway cargo, which was determined by the drop in the volume of cargo transported in international transport, while road transport of cargo decreased both in domestic and international transport. Passenger transportation in the first half of 2023 grew most rapidly in air transportation – by 37.1%.

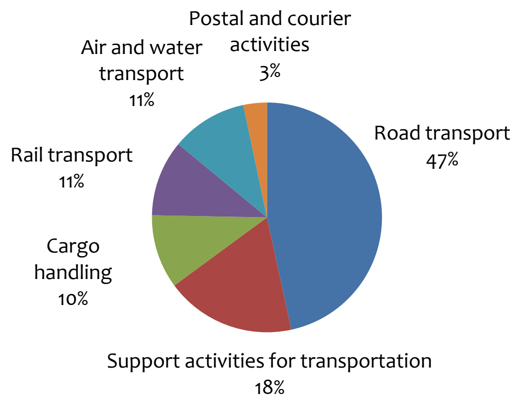
Transportation and Storage
value added, changes compared to the corresponding period last year, as per cent



Occupied Posts in Transportation and Storage
in thousands

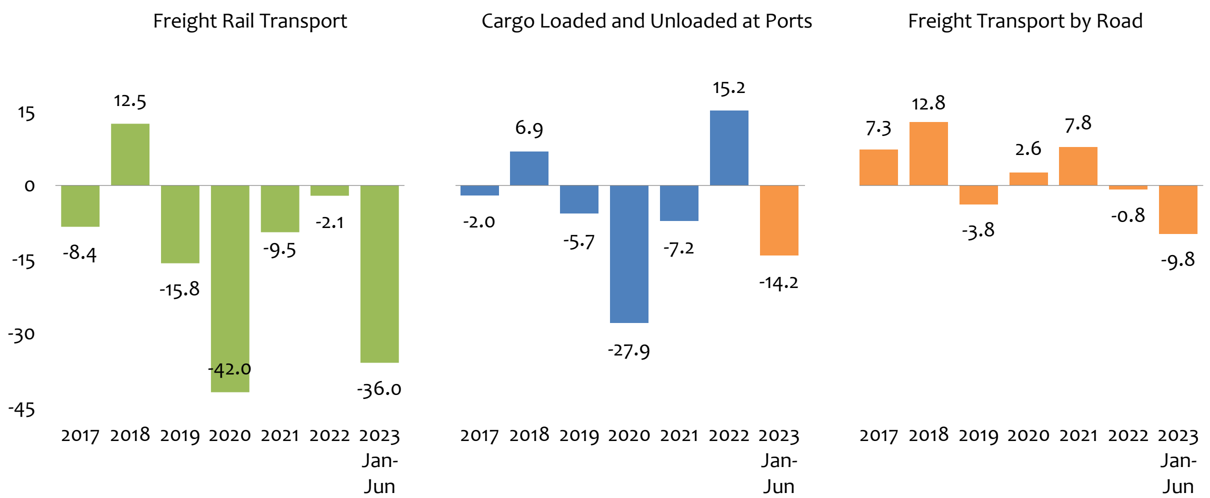


Structure of Transportation and Storage
2022, as per cent*



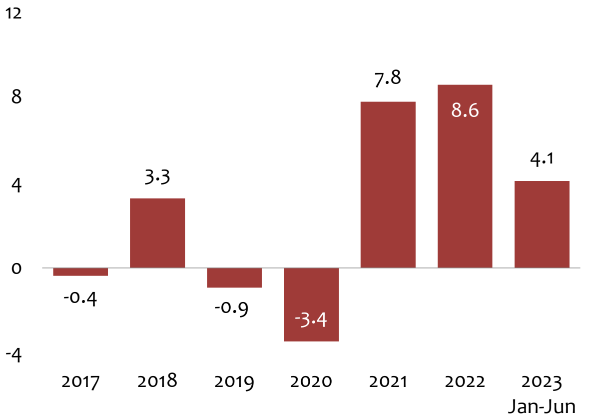
* – forecast by the Ministry of Economics

Freight Traffic
changes compared to the corresponding period last year, as per cent



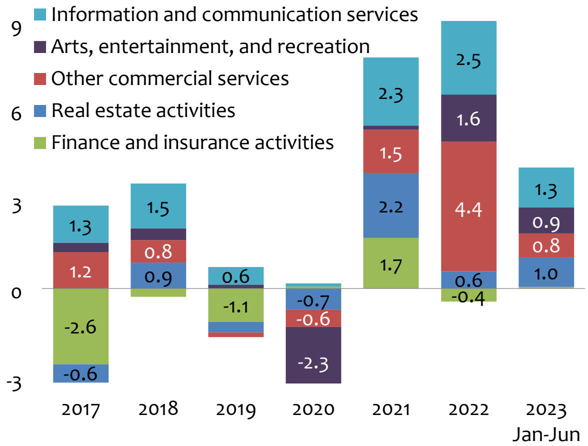
COMMERCIAL SERVICES

Commercial Services
value added, changes compared to the corresponding period last year, as per cent



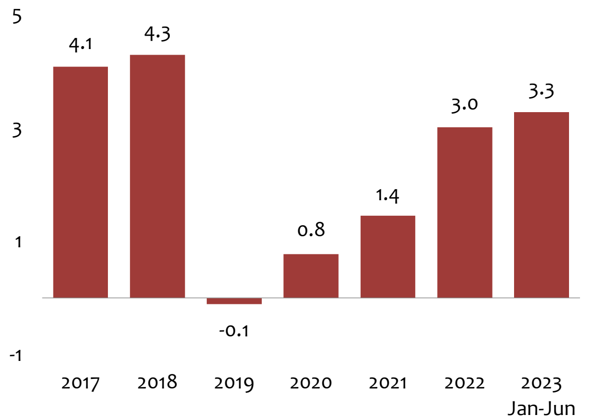
The largest share of added value in commercial services (incl. information and communication services, financial and insurance activities, real estate activities, professional, scientific, and technical services, administrative and support service activities, arts, entertainment, and recreation) provide real estate activities. In 2021-2022, recovering from the Covid-19 crisis, the volumes of commercial services increased. Also, in the first half of 2023, a rapid increase in volumes can be observed. Volumes increased in all commercial services sectors. The largest impact yielded the increase in service volumes in ICT services and real estate activities. The largest share of occupied posts remains in ICT services, professional, scientific, and technical services, and administrative and service activities. In the first half of 2023, the number of occupied posts increased in all sub-sectors.

Contribution of Commercial Services
changes in percentage points



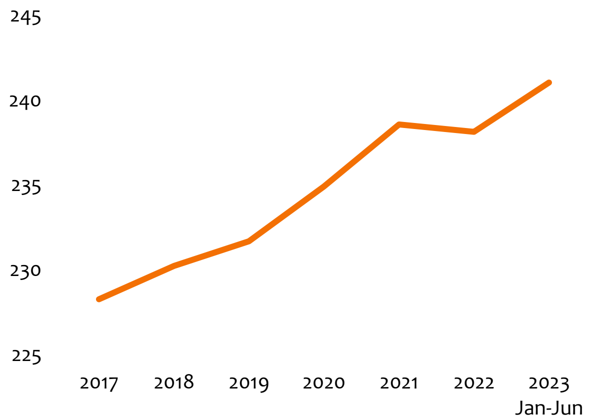
PUBLIC SERVICES

Public Services
value added, changes compared to the corresponding period last year, as per cent



The largest share of value added in public services (incl. public administration and defence, education, health and social work activities) provide public administration and defence. After a moderate increase in 2020-2021, 2022 and the first half of 2023, the total volumes of public services grew more rapidly. In the first half of 2023, the volumes increased faster in education – by 9.2%. The volumes of state administration and defence services increased by 5.7%, while health and social care declined by 5.4%. The largest proportion of occupied posts remains in education. In the first half of 2023, the number of occupied posts increased only in the health and social care sector. The most rapid decline in occupied posts is observed in education.

Occupied Posts in Public Services
in thousands



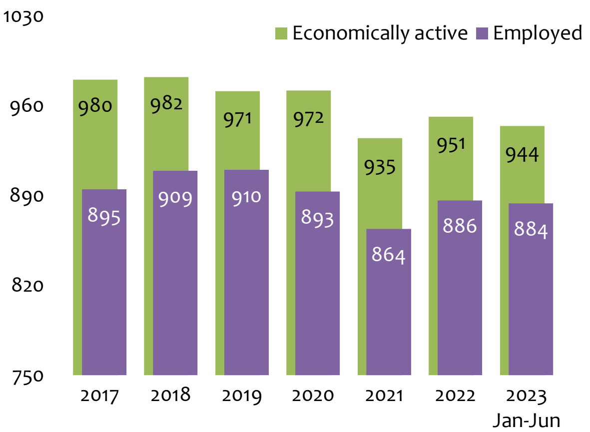
2023 | 2

LABOUR MARKET

EMPLOYMENT AND UNEMPLOYMENT

Given the slowdown in economic growth, overall labour demand and employment growth is slowing. Nevertheless, labour market activity remained at a high level, which continues to be sustained by supply-side factors. Unemployment continues to decrease and the population's employment rate increases. Likewise, certain sectors are increasingly facing a shortage of workers, considering the return of unemployment indicators to the level of 2019, as well as the increase in the number of vacancies and employment. At the same time, the negative impact of the supply side on the labour shortage has been slightly reduced by the influx of Ukrainian war refugees in Latvia; however, it should be considered that some of the war refugees are returning home, so the negative impact of demographic factors on the dynamics of labour supply could become more pronounced in the future.

Employed and Economically Active
aged 15-74, in thousands



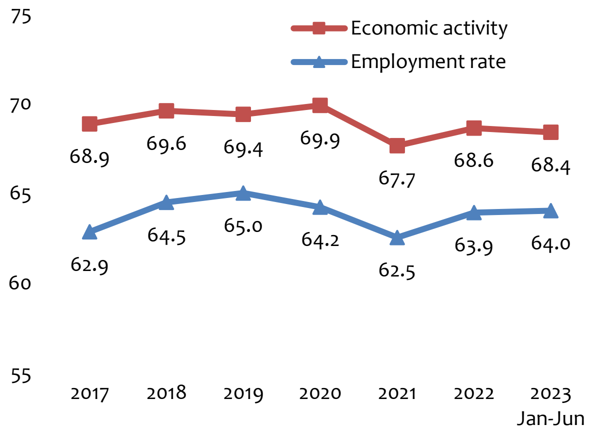
Despite the increase in employment, the overall demand for labour remains limited, as indicated by the slow increase in the number of occupied posts. With increasing pressure from the labour supply side, both in terms of the availability of human resources and in terms of wages, it is increasingly difficult for employers to create new jobs and attract employees.

Since April 2021, the employment has been increasing. In the first half of 2023, the number of employed persons increased by 0.8% or 6.7 thsd, compared to the corresponding period of 2022, while in Q2 of 2023 it increased by 0.3% (2.4 thsd), compared to Q2 of 2022.

Overall, in the first half of 2023, an average of 884 thousand people, or 64% of all residents aged 15-74, were employed. However, in Q2 of 2023, the number of employed persons increased to 887.6 thsd, and the employment rate – to 64.4%, which is 0.4 percentage points higher than a year ago.

The increase in the number of employed in the first half of 2023 continued to be affected by the low base effect of the post-pandemic labour market – in Q2 of 2023, the number of employed was still 18 thsd, or 2%, less than in Q2 of 2019, as well as a wider entry of Ukrainian refugees into employment.

Employment and Economic Activity
aged 15-74, as per cent

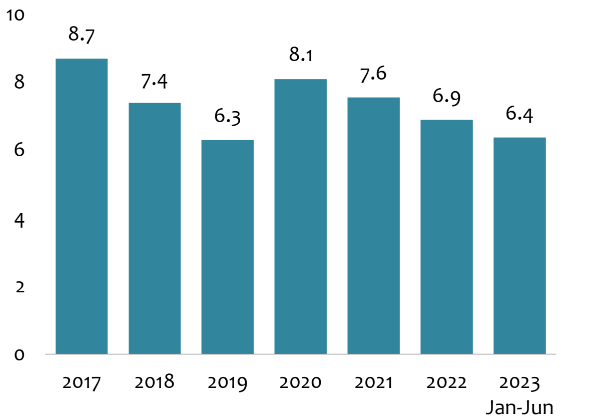


The level of economic activity of the population increased to 68.4% in the first half of 2023, which was 0.1 percentage points more than in the first half of 2022 (68.3%). In the first half of 2023, the number of economically active population aged 15-74 reached 944.2 thsd, i.e., by 1.5 thsd exceeding the number of economically active population in the corresponding period of 2022.

Along with the increase in the population's economic activity, the dynamics of the number of economically active population in the first half of 2023 was also favourably influenced by the increase in the number of economically active population – it rose by approximately 1 thousand, compared to the first half of 2022.

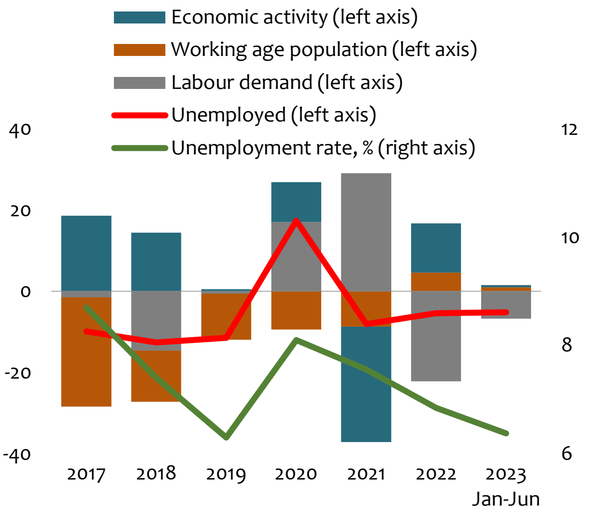
At the same time, it should be noted that the number of economically active population is still lagging behind the level of 2019, which is affected by both the lower number of economically active population (compared to 2019) and the lower level of population participation in the labour market, which still continues to maintain negative pressure on the labour market on the supply side, and as the demand for labour increased, the shortage of qualified labour emerged as a more significant problem, especially in the fastest growing sectors.

Unemployment Rate
aged 15-74, as per cent



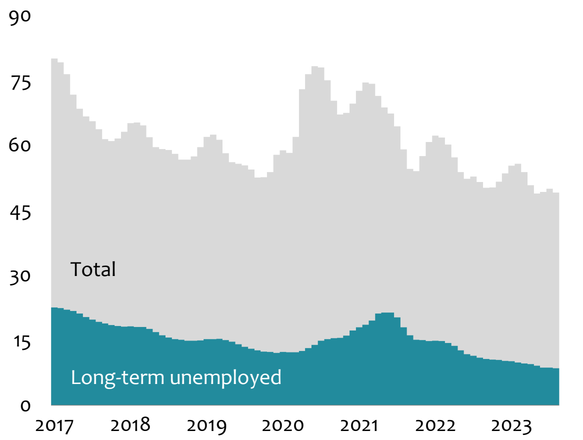
Along with the increase in employment, unemployment rates continue to decrease. The unemployment rate decreased to 6.4% in the first half of 2023, which was 0.6 percentage points lower than in the first half of 2022 (7.0%). In the first half of 2023, 60.2 thsd people aged 15-74 were looking for work, which is 8% (i.e., 5.2 thsd) less than in the first half of 2022.

Unemployment Rate and Its Determinants
*changes against the corresponding period last year, thousands**



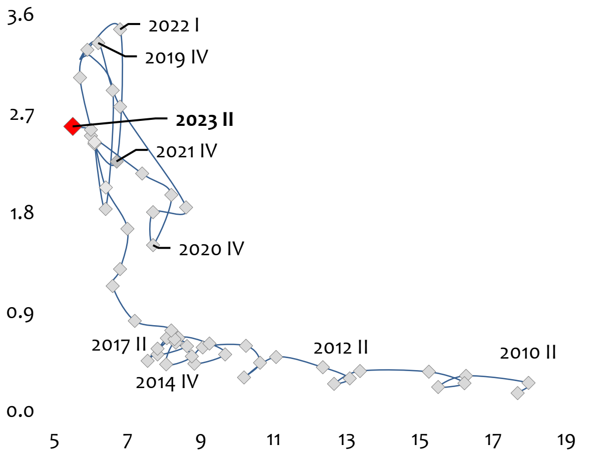
Positive trends can also be observed in the dynamics of the long-term unemployed. From the middle of 2021, both the number of long-term unemployed and their share in the total number of jobseekers will gradually decrease. Between August 2022 and August 2023, the number of registered long-term unemployed decreased by approximately 22%, or 2.4 thsd. Overall, at the end of August 2023, approximately 8.6 thsd registered jobseekers, or approximately 17% of all registered unemployed, were unemployed for more than a year.

Registered Unemployed
in thousands



Despite the decrease in unemployment, a risk that some of the existing unemployed might have problems finding a job that matches their skills persists, because the full recovery in the sectors where the most jobs were lost in the past years could be long, but in the sectors where new job opportunities were created, the previously learned skills may not be in demand. It should also be considered that being out of work for a long time creates risks of structural unemployment, i.e., the longer a person is unemployed, the greater the risk of losing previous work skills and abilities, as well as the more difficult it is to adapt to new labour market requirements.

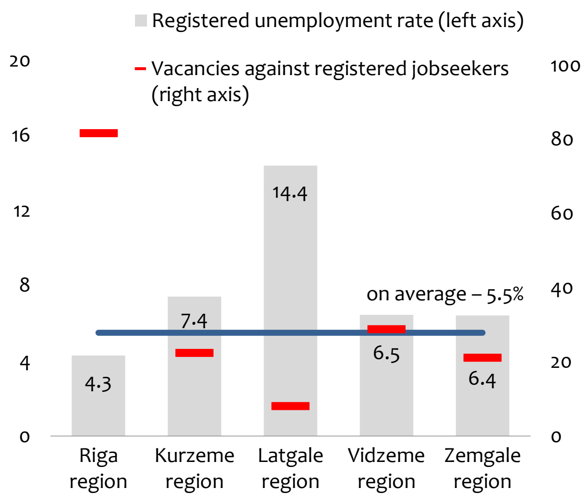
Beveridge Curve
by quarters, as per cent; horizontal axis – unemployment rate; vertical axis – vacancies against the economically active population



It should be noted that the Covid-19 pandemic has generally accelerated structural changes in the labour market, promoting the automation of jobs in labourintensive sectors. Therefore, the demand for low- and medium-skilled labour without professional skills has decreased, while the share of higher-skilled jobs has increased, especially in ICT services.

Also, structural problems deepen regional differences in the labour market, which in general hinders the recovery of the labour market. Although regional disproportions are gradually levelling off, the process is slow. Pronounced problems can be observed for a long time in the Latgale region, where the unemployment rate is still more than twice as high as the average in the country, but more than 3 times higher than in the Riga region, which, together with the low geographical mobility of the workforce, increases the risks of structural unemployment.

Registered Unemployment by Region
at the end of August 2023, as per cent



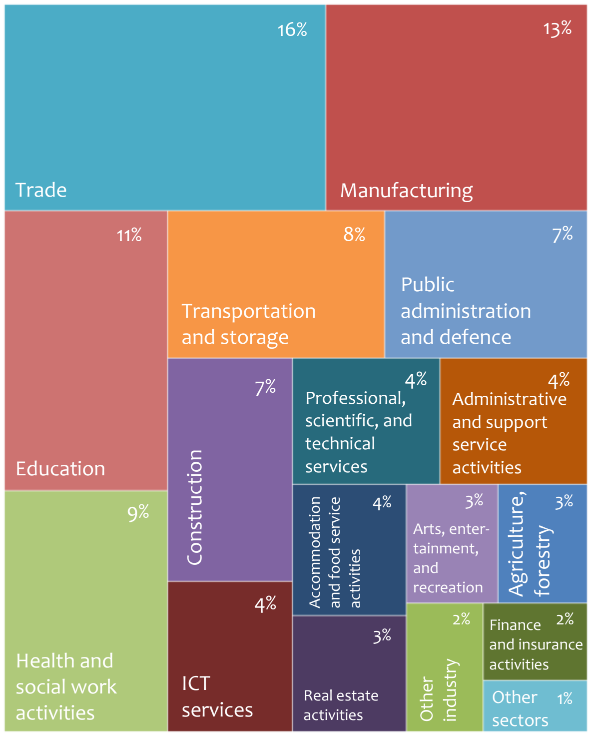
Although the situation in the Latvian labour market continues to improve, it should be noted that the improvements are slower than in the neighbouring countries. The employment rate in Latvia in Q2 of 2023 was 4.8 percentage points lower than in Estonia (69.2%) and 1.7 percentage points lower than in Lithuania (66.1%). Likewise, the unemployment rate in Latvia in Q2 of 2023 remained on average 0.4 percentage points higher than in Lithuania (6%) and 0.3 percentage points lower than in Estonia (6.7%).

The number of occupied posts increased to 887.7 thsd in the first half of 2023 – i.e., by 1.7 thsd, or 0.2%, compared to the corresponding period of 2022.

At the same time, the number of occupied posts, where employees are employed in the main job, has increased significantly, as well as the average number of employees in normal working time units has increased, which in general indicates a tendency in a decline of both the number of part-time jobs and the number of employees employed in several jobs at the same time.

The number of occupied posts for employees in the main job increased by 12.6 thsd in the first half of 2023, or 2%, compared to the first half of 2022, reaching 631.2 thsd. On the other hand, the average number of employees in normal working time units increased by 13.6 thsd in the corresponding period, or 1.9%, reaching 742.5 thsd in the first half of 2023.

Occupied Posts by Sector
structure in January-June 2023, %

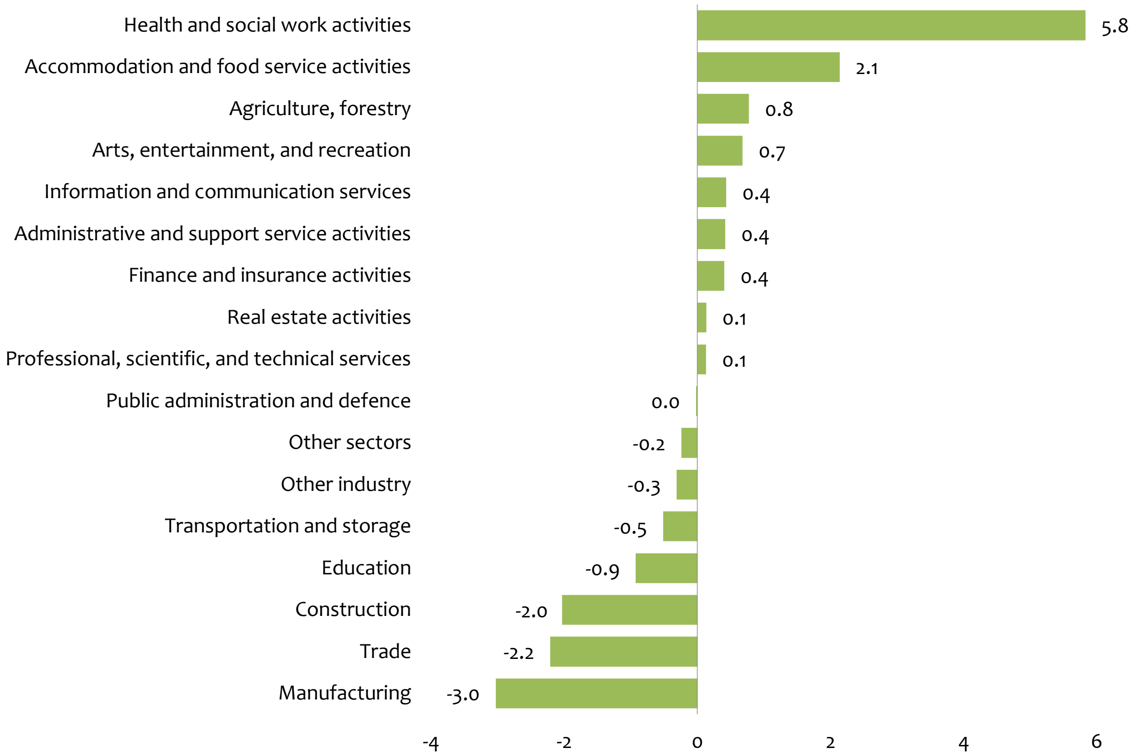


In the first half of 2023, the most significant increase in occupied posts was observed in the health and social care sector, accommodation and food service activities, as well as in agriculture and forestry. Job growth in the accommodation and food service activities, the arts, entertainment, and recreation, as well as administrative and support service activities continues to be largely affected by the low base effect in the sectors after the Covid-19 pandemic, and despite the gradual recovery of the sectors, the number of occupied posts in these sectors is still significantly lower than before the Covid-19 crisis in 2019.

The largest decrease in occupied posts in the first half of 2023 was observed in manufacturing, which was largely affected by the decrease in the output of the sector, considering the weak external demand.

Also, a significant decrease in the number of occupied posts can be observed in trade – a decrease of 2.2 thsd, or 1.6%; in construction – a decrease of 2 thsd, or 3.4%; in the education sector – a decrease of 0.9 thsd, or 1%, compared to the first half of 2022.

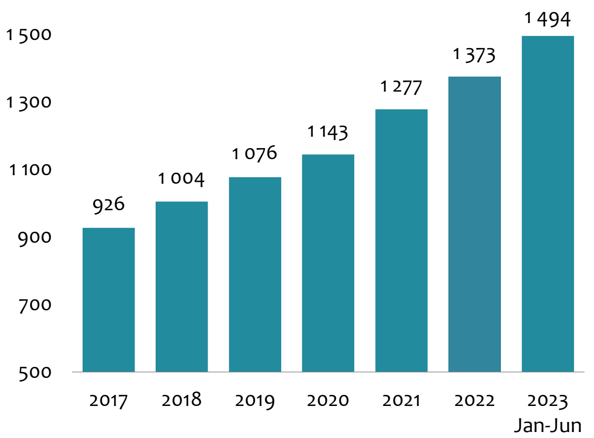
Changes in Occupied Posts
in January-June 2023, compared to the corresponding period last year, in thousands



WAGES AND SALARIES

Along with the increase of activities in the labour market, the average wage also continues to increase. The average monthly gross wage in the first half of 2023 increased by 12.2% compared to the corresponding period of 2022, rising to an average of 1,494 euros. At the same time, in the Q2 of 2023, the average gross wage increased to 1 525 euros. It should be noted that over the past 3 years, the average gross wage in the national economy has increased by more than 1/3.

Average Monthly Gross Wage
euro

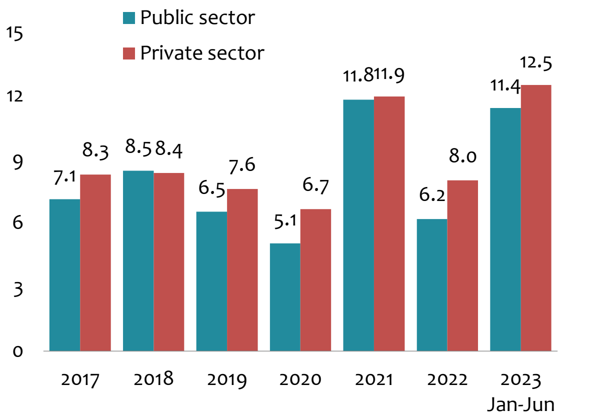


The increase in the average wage in the first half of 2023 was significantly affected by the increase of the minimum wage rate by 24% – to 620 euros from 500 euros in 2022, as well as the decrease in the proportion of lower-paid jobs.

Also, wage growth continues to be affected by the lack of labour, as well as the general inflationary pressure. Despite the rapid increase in wages, overall, since 2022, a decrease in real wages has been observed. In the first half of 2023, real wages decreased by an average of 6% compared to the corresponding period of 2022.

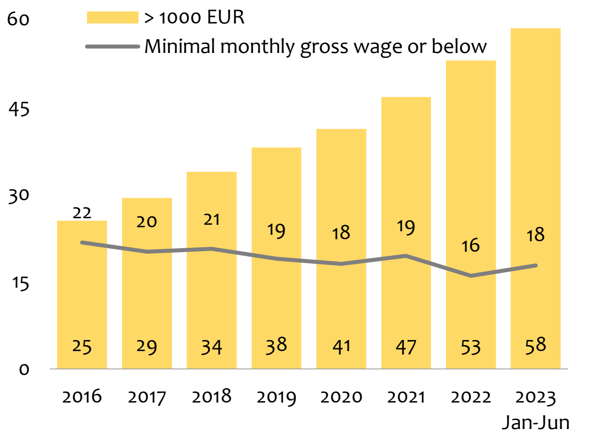
In the first half of 2023, wages have increased for those working in both the private and public sectors. Compared to the corresponding period of 2022, the average gross wage in the public sector (excluding foundations, associations, funds and their commercial companies) increased by 11.4% (to an average of 1 485 euros), and in the private sector – by 12.5% (to an average 1 501 euros). On the other hand, in Q2 of 2023, the average wage for employees in the public sector increased to 1,549 euros, and in the private sector to 1 519 euros. Overall, the growth of wages in the private sector over the past 5 years has remained more rapid than for those working in the public sector, and in 2022 the average gross wage in the private sector on an annual basis exceeded the average gross wage in the public sector for the first time in the last two decades.

Average Monthly Gross Wage
changes, as per cent



Overall, the tendency of the decline in the proportion of low-paid employees remained stable, which is evidenced by the ever-increasing tendency in the proportion of employees who receive a wage above 1 000 euros per month. In the first half of 2023, the gross wage of 58% of all employees exceeded 1 000 euros.

Employee Gross Wage
as per cent of employed in total



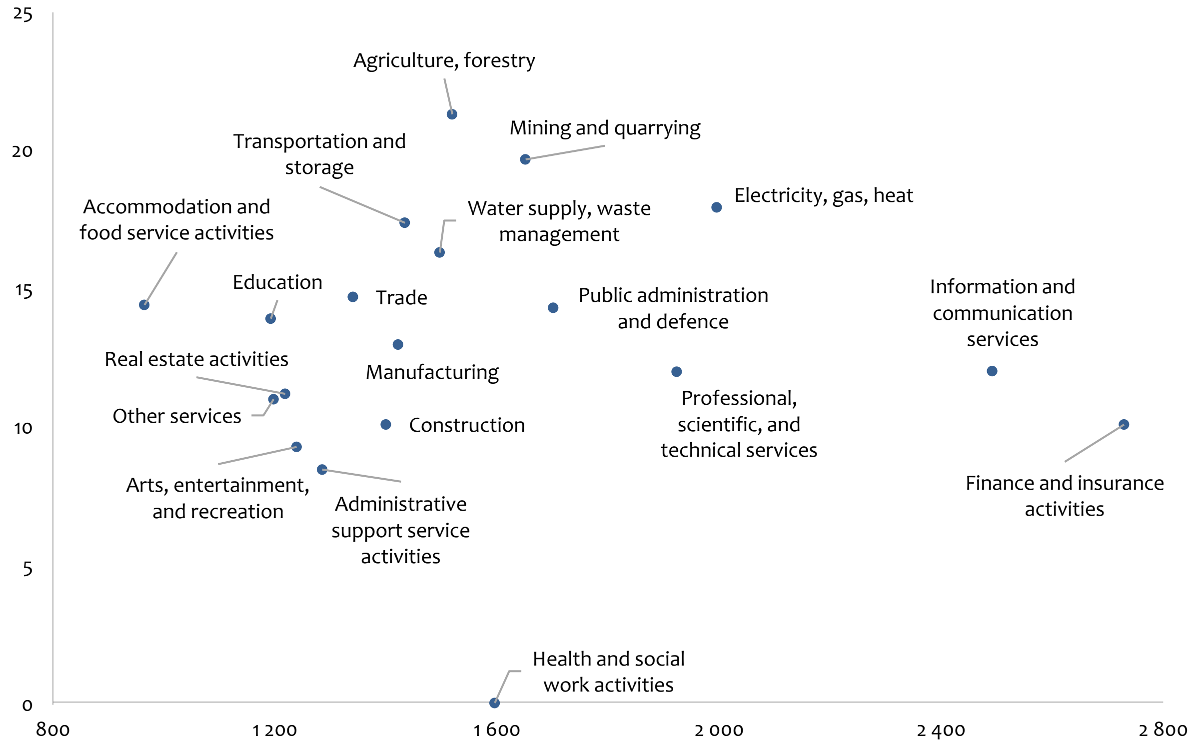
In the first half of 2023, wage growth was observed in all sectors of the economy. The most rapid wage increase was observed in agriculture and forestry – compared to the first half of 2022, the average gross wage increased by 21.2%. Similarly, wages have grown rapidly in the mining industry (increase by 19.6%), in electricity, gas and heat supply (by 17.9%), as well as in the transportation and storage sector (by 17.3%).

Wages have remained flat in the health and social care sector, largely due to the reduction in premiums in the sector that were prevalent during the Covid-19 pandemic. It should be noted that health and social care still maintained the second most rapid wage increase compared to the pre-pandemic period. In the first half of 2023, the average gross wage in health and social care was 50.1% higher than in the first half of 2019.

The highest wage level in the first half of 2023 remained in the financial services sector – the average monthly gross wage was 2 730 euros, while the lowest wage was observed in the accommodation and food service activities – an average of 965 euros per month.

Gross wages in economic sectors

in January-June 2023;
horizontal axis – average gross wage, euro;
vertical axis – average gross wage changes, compared to the corresponding period last year, as per cent



2023 | 2

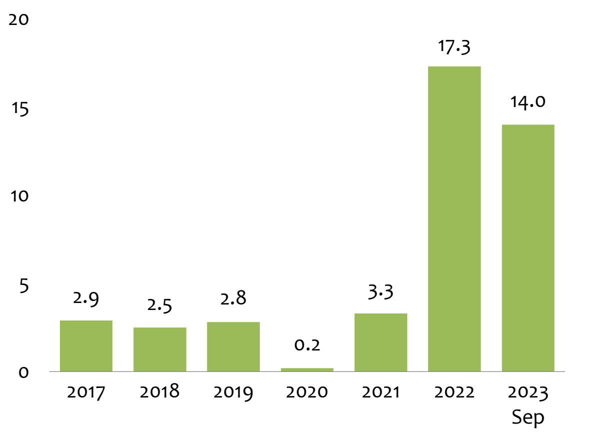
ECONOMIC STABILITY AND COMPETITIVENESS

PRICES

In 2022, a rapid rise in prices was observed. Consumer prices rose by 20.8%, while the annual average inflation was 17.3%. The high level of consumer prices was affected by the rise in global prices for energy resources and food, exacerbated by the Russian invasion of Ukraine.

In the nine months of 2023, prices continued to rise. Consumer prices in September 2023, compared to December 2022, increased by 1.8%, which was a significantly more moderate increase than in the previous two years during this period. It continued to be affected by global prices and the unstable geopolitical situation. Compared to September 2022, consumer prices increased by 3.3%. Annual average inflation in September was 14%.

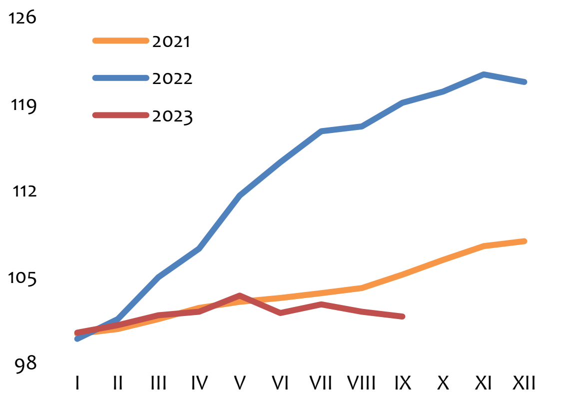
Consumer Price Changes
annual average, as per cent



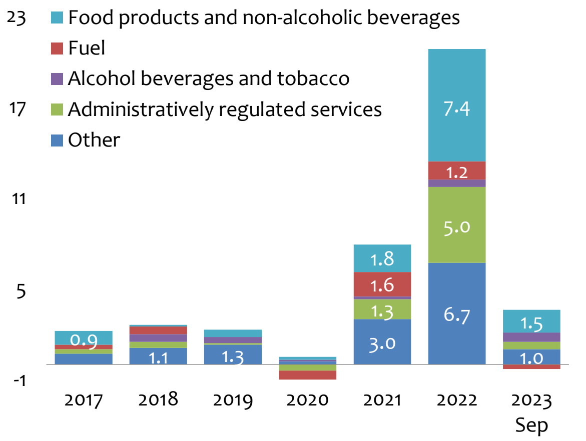
The main factors affecting prices in the nine months of 2023:

(1) the largest impact yielded the rise in prices for services – a significant increase in the price of outpatient, catering, recreational and cultural services, housing rent.
(2) price increase for alcoholic beverages and tobacco, where the largest impact provided the price increase for strong alcoholic beverages and cigarettes.
(3) rise in prices for clothing and footwear.
(4) price increase for food, where the largest impact yielded the price increase for meat, coffee, and bread. It should be noted that the rapid rise in food prices has ceased since April.
(5) the increase in fuel prices, which was affected by the sharp rise in world oil prices in the last three months. This was fuelled by oil production restrictions imposed by OPEC+, Saudi Arabia, and Russia.
(6) falling prices for housing-related energy resources. The largest impact provided the drop in prices for thermal energy, the prices for natural gas and solid fuel also fell significantly. However, the price drop for electricity was very moderate. This was determined by the conclusion of state aid in May 2023, as well as the increase in distribution tariffs in July, partially compensating them in September 2023.

Consumer Price Index
December of the previous year = 100

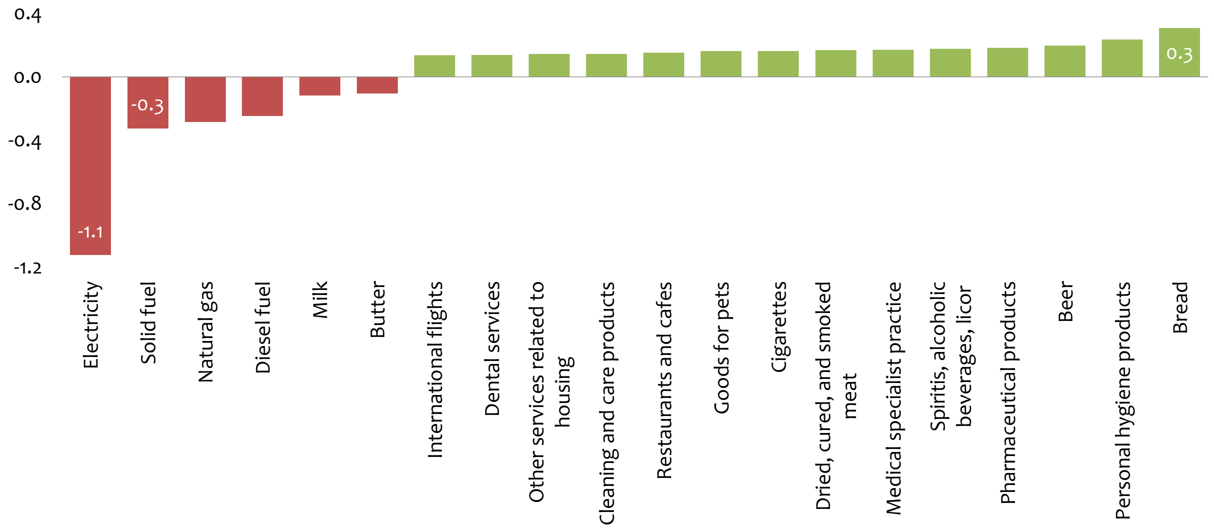


Consumer Prices by Goods and Services
contribution to 12-month changes, as per cent



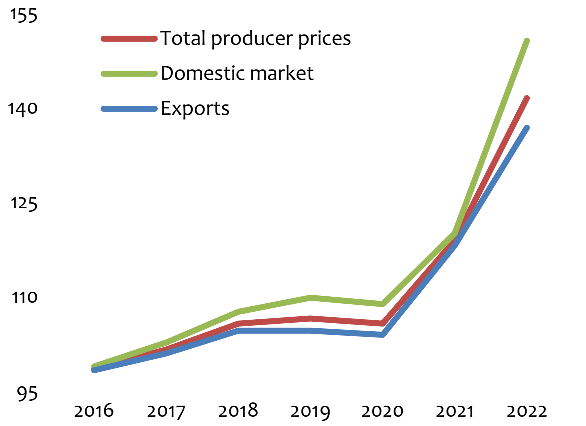
Overall, the average annual inflation in 2023 will be lower than observed in 2022. In the future, the main influence on price changes will continue to be related to energy resource and food price fluctuations in the world, and their secondary effects will also be observed. Considering the tense geopolitical situation and the base effect of inflation dynamics, in 2023, the average annual inflation is forecast to be within 9%.

Consumer Price Changes by Goods and Services
September 2023, contribution to 12-month changes, as per cent



In 2022, under the influence of the energy crisis, a very rapid rise in producer prices in manufacturing endured.

Producer Prices in Manufacturing
2015 = 100



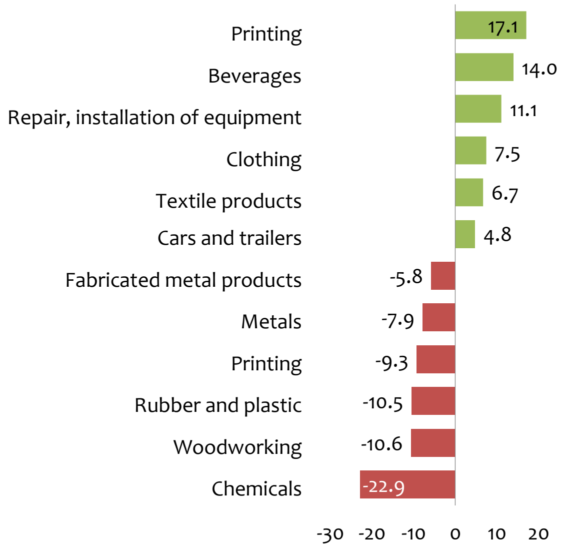
In 2023, producer prices in manufacturing will decrease. In January-August 2023, they fell by 4.3%. Prices for products sold on the domestic market declined by 6.2%, while for exported products – by 3.2%.

In eight months, the largest declines were observed in woodworking and chemical production. While the largest positive effect was in beverage production, automobile, trailer, and semi-trailer production, and printing.

In 2023, the prices of the producers of the manufacturing sector will decrease or increase very moderately. The level of producer prices is largely influenced by the price fluctuations of producers of exported products, which are determined by the dynamics of global raw material prices.

It should be noted that world energy and raw material prices fell in the first half of the year, which could affect the dynamics of producer prices. Uncertainty in raw material supplies will continue to have a significant impact on producer prices. The prices of the products sold on the domestic market decline, and the drop is faster than for the exported products, mainly affected by the drop in the prices of energy resources and raw materials in the world and in the domestic market, such as wood, in recent months also unprocessed food, etc. At the same time, the dynamics of producer prices for products sold on the domestic market are affected by growth rates, which will be very moderate or even negative this year.

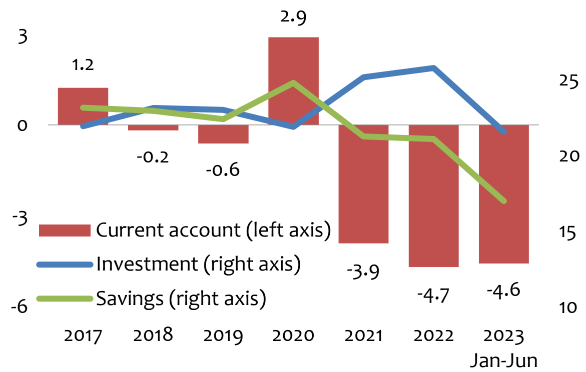
The Most Rapid Producer Price Changes in Manufacturing in August 2023
against the corresponding period last year, as per cent



BALANCE OF PAYMENTS

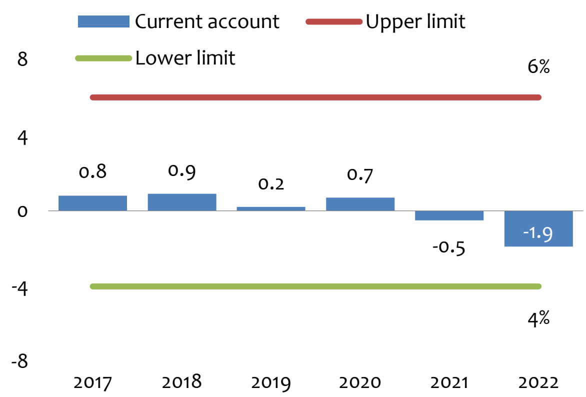
Under the influence of external shocks, the negative balance of the current account has been increasing since 2021. The easing of the restrictions of the Covid 19 pandemic and the increase in economic activities determined significant corrections of the current account – from a surplus of 2.6% of GDP in 2020 to a deficit of 3.9% of GDP in 2021. Due to the changes in the geopolitical environment after Russia's invasion of Ukraine, also in 2022 and Q1 of 2023, the negative balance of the current account continued to deteriorate and reached 4.7% and 4.6% of GDP, respectively.

Current Account, Savings, and Investment
as per cent of GDP



Despite the increase in the current account deficit of the balance of payments, it does not exceed the indicative thresholds set by the EU warning mechanism and can be assessed as sustainable. However, it should be noted that if the downward trends of the current account remain, the risks of external imbalances increase.

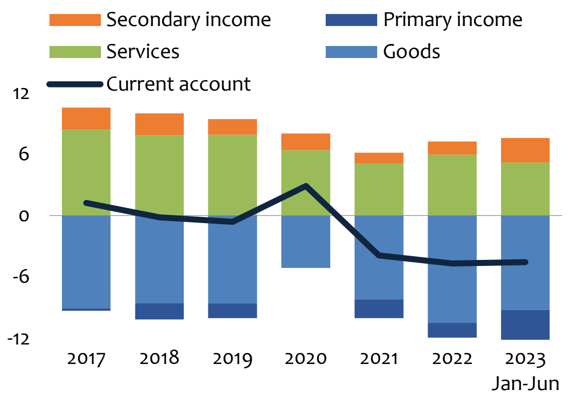
EU Alert System Indicative Threshold and Current Account
three-year average, as per cent of GDP



The weakening of foreign trade flows has been observed in recent years. Its main cause was the economic shock caused first by the Covid-19 pandemic, then by the Russian invasion of Ukraine, which increased the uncertainty of the external environment. In 2022, the dynamics of exports was more moderate. The increase in the price of energy resources and the need to change their supply sources due to the war in Ukraine significantly increased the value of imports. Since exports continued to grow more slowly than imports and price increases had a greater impact on the prices of imported products, the trade deficit rose to 10.5% of GDP (8.3% in 2021).

In the first half of 2023, as the export value remained at the previous year's level and the import value decreased by 3.8%, the foreign trade balance reached 9.3% of GDP.

Current Account
as per cent of GDP



The services trade surplus remained, albeit at a lower level than before the crisis caused by the Covid-19 pandemic. In the last three years (2020-2022), the positive balance of services was on average 5.8% of GDP, which is less than in the years before the Covid-19 pandemic (8.1% of GDP on average). In 2022, the import of services in actual prices was 36% higher than a year ago, but exports grew slightly more moderately – by 35.6%, and the balance of services surplus reached 6% of GDP. Also, in Q1 of 2023, the import of services grew faster than exports, which reduced the surplus of the balance of services to 5.8% of GDP.

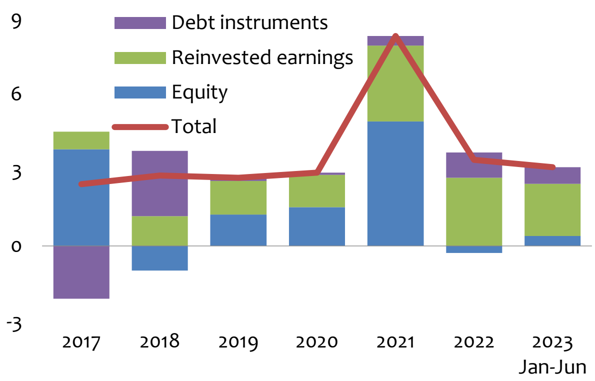
Changes in the income and capital account are related to the appropriation of EU funds. The capital account balance surplus in the first half of 2023 was 1.7% of GDP.

The state of the financial account balance in recent years was determined by financial sector stabilization measures, public sector debt restructuring, the Bank of Latvia's measures within the extended asset purchase program, as well as the European Central Bank's restrictive monetary policy to combat inflation. In the first half of 2023, financial account assets grew more moderately than liabilities and the financial account balance (with reserve assets) was -1.3% of GDP. The balance of payments accounts in the near future will be determined by changes in the geopolitical situation and their impact on global supply chains, cross-border flows, and Latvia's economy.

FOREIGN DIRECT INVESTMENT

The intensity of foreign direct investment (FDI) flows is moderate, mainly influenced by the restrictions on the spread of the Covid-19 pandemic and instability in the world economy. The war in Ukraine added to the uncertainty caused by geopolitical events and put negative pressure on global FDI flows.

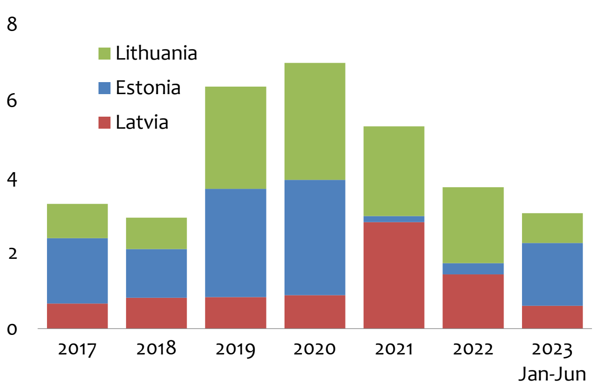
FDI in Latvia
flows, as per cent of GDP



Overall, the cross-border flows of FDI in the Baltic States in the first half of 2023 reached of 4.3% of GDP, where most of the FDI flows were in the Estonian economy. In the first half of 2023, the net flows of FDI attracted in the Baltic States were almost 3 billion euro.

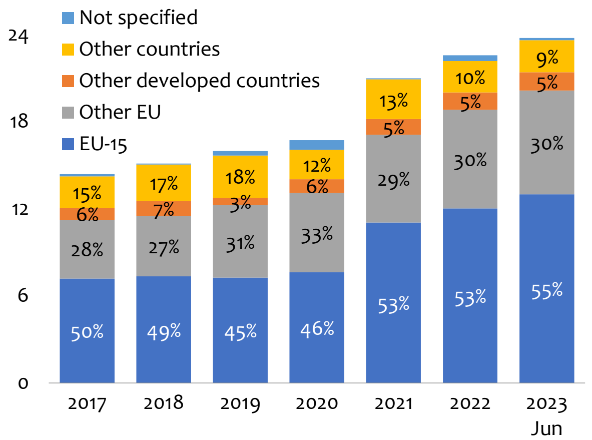
Approximately 20% of the total volume of FDI transactions was in the Latvian economy. The share of Estonia and Lithuania in the total volume of FDI transactions was 26% and 54%, respectively.

FDI in Latvia
transactions, billion euro



In the first half of 2023, the volume of FDI transactions was 7.8% lower than a year ago, accounting for 3.1% of GDP, largely due to an increase in liabilities. Investments in company equity (mainly in the form of reinvested profits) were nearly 3 times larger than a year ago. Weak economic activities have not significantly affected FDI income. In the first half of 2023, they were 16.9% higher than a year ago.

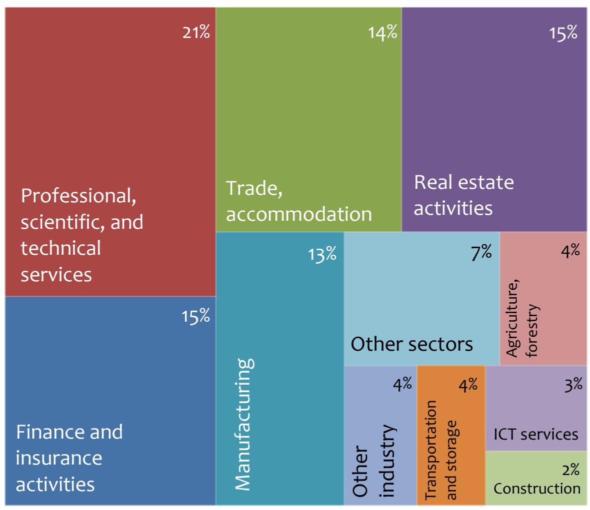
FDI Stock in Latvia by Groups of Countries
closing balance at the end of the year, billion euro and per cent



Accumulated FDI in the Latvian economy at the end of June 2023 reached 23.8 billion euro, i.e., 59% of GDP. During the year, they increased by almost 10%, or 2.1 billion euro. The geopolitical structure of accumulated FDI is relatively stable, dominated by the investments of EU entrepreneurs, which at the end of June 2023 made up 83% of the accumulated FDI. Sweden is the largest investor in Latvia's economy. The Sweden's accumulated FDI have grown 2.4 times since 2020. At the end of June 2023, it made up 29%. Investments by entrepreneurs from Estonia, Lithuania, Germany, Cyprus, Russia, the Netherlands and Denmark are also large.

Thanks to large-scale investments in the professional, scientific, and technical services sector, its share in the total accumulated FDI at the end of 2021 increased to 21%. Significant investments have been made in financial intermediation (15.2% of all FDI), trade (13.5%), real estate transactions (14.1%), and manufacturing (12.6%).

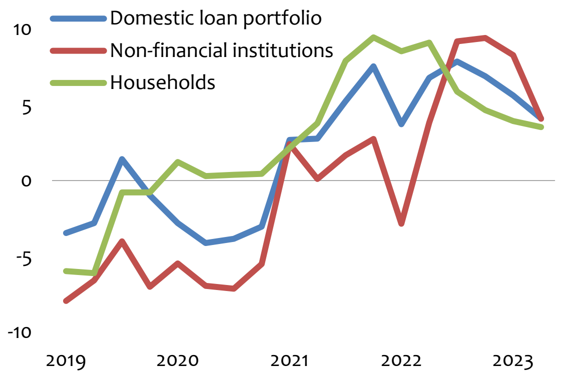
FDI by Sector
closing balance at the end of June 2023



MONETARY INDICATORS

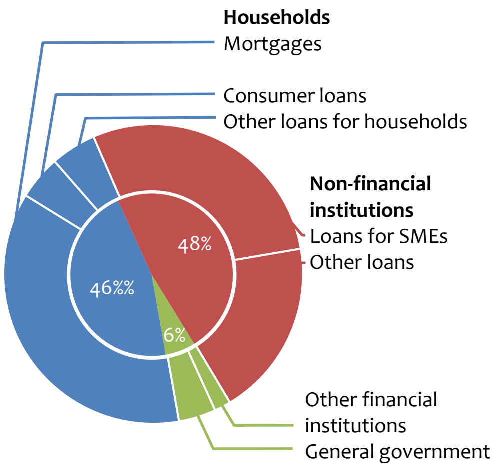
The banking sector remains stable[1]. The volumes of deposits continue to grow; however, activity in lending is still moderate, business lending can be assessed as weak.

Domestic Credit Balances
changes, compared to the corresponding period last year, per cent



At the end of June 2023, the total bank credit portfolio amounted to 15.6 billion euros. Of this, 13.2 billion euros were granted to domestic non-bank customers, i.e., a rise of 4.1%. The credit portfolio of non-financial corporations increased at the same pace, but the lending to small and medium-sized enterprises developed more slowly. Household lending had a slower growth rate of 3.5%.

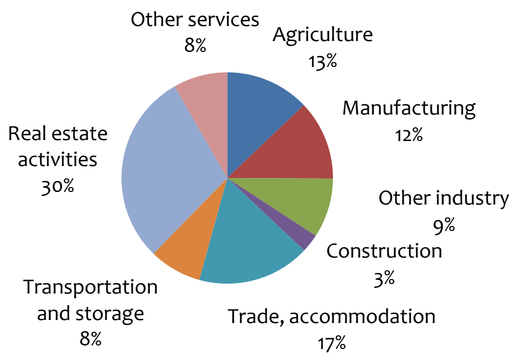
Lending Portfolio of Non-Financial Institutions by Sector
at the end of June 2023, as per cent



The distribution of loans by sector shows that at the end of June 2023, operations with real estate activities were still the leader, i.e., 29% of all company loans were issued to this sector. Trade and agriculture and forestry sectors followed with 14% and 13%, respectively.

Until 2022, the interest rates of long-term loans issued in euro did not change significantly. In Q4 of 2022, there was a rapid rise in credit interest rates, which was determined by the ECB's decisions on raising base interest rates to limit inflation. In 2023, this increase will endure. At the end of the first half of the year, interest rates for non-financial companies for long-term loans were 5.46%, and for short-term loans – 6.27%. For households at that time, long-term interest rates for housing loans were 5.23%, and short-term interest rates were 5.9%.

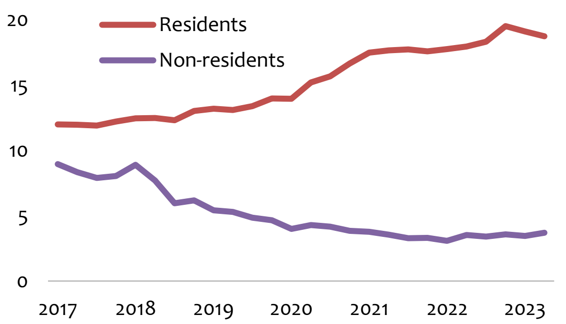
Lending Portfolio of Non-Financial Institutions by Sector
at the end of January-June 2023, as per cent



The increase in the ECB's base interest rates is seen not only in the rise in the cost of loans. The profitability of banks has grown markedly. In the first half of 2023, they exceeded the indicator of the first half of 2022 by 2.6 times. The excess profits made by the banks prompted a wider discussion about its taxation. Several EU member states have introduced additional taxes. Amendments to the CIT law have been developed in Latvia, which require banks to introduce a mandatory advance payment.

At the end of June 2023, deposits reached 22.4 billion euros, i.e., 4.4% more than a year ago. Domestic deposits at the end of June 2023 were 4.3% higher than a year ago and made up 84% of the total amount of deposits. The growth rate of foreign deposits was 4.9% and their share reached 16%. For comparison, in 2015, the proportion of foreign deposits exceeded half of all deposits.

Non-Bank Deposits in Banks
billion euro



[1] In this section, data from the Bank of Latvia are used

BUDGET AND GOVERNMENT DEBT

The Covid-19 pandemic has caused significant changes in the policies implemented so far. In 2020, the "General Exception Clause of the Stability and Growth Pact (SGP)" was activated in the EU, allowing EU countries to increase the general government budget deficit in 2020-2022 to the extent necessary to mitigate the economic damage caused by the pandemic. Considering the Russia-Ukraine war and all the consequences related to it, the SGP general exception clause will also be valid in 2023.

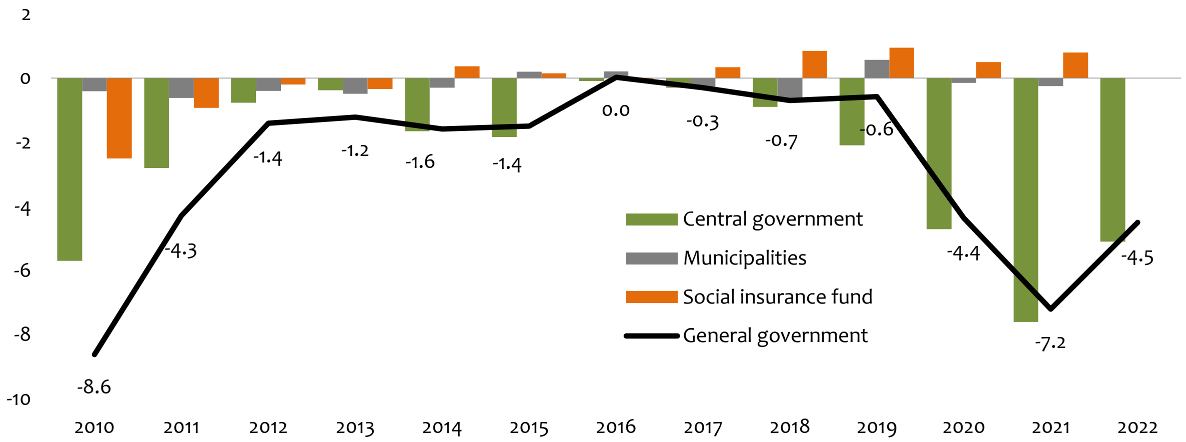
As a result of the Covid-19 pandemic, the budget deficit in Latvia increased to 4.3% of GDP in 2020, or 1.3 billion euros. However, in 2021 – up to 7% of GDP or 2.4 billion euros. According to the assessment of the Ministry of Finance, the budget deficit of the general government in 2022 was 4.7% of GDP. The Saeima has approved a budget deficit for 2023 of 1.8 billion euros or 4.2% of GDP.

General Government Budget

	2018	2019	2020	2021	2022
Revenues, bn euro	11.2	11.6	11.5	12.5	14.0
% of GDP	38.5	37.8	38.1	37.3	36.0
Expenditures, bn euro	11.5	11.7	12.8	14.8	15.7
% of GDP	39.4	38.4	42.5	44.5	40.4
Net, bn euro	-0.2	-0.2	-1.3	-2.4	-1.7
% of GDP	-0.8	-0.6	-4.4	-7.2	-4.4

General Government Budget Balance by Sector

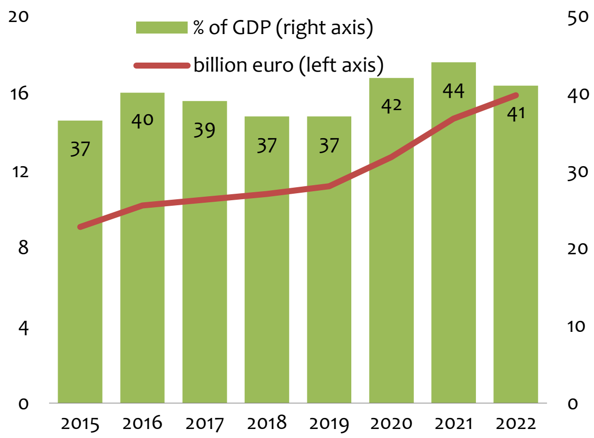
as per cent of GDP



Despite the increase in the budget deficit in recent years, the general government debt level in Latvia is one of the lowest in the EU. The outbreak of Covid-19 led to the need to provide a significant amount of funding to mitigate the impact of the crisis caused by Covid-19. In 2021, the amount of national debt increased to 44% of GDP, or 14.7 billion euro. Since nominal GDP growth is rapid in conditions of high inflation, in 2022, it decreased to 41% of GDP.

It is expected that in the medium term the debt condition of 60% of GDP set by the Law on Fiscal Discipline will be respected and the general government debt of Latvia will stabilize at a level below 40% of GDP.

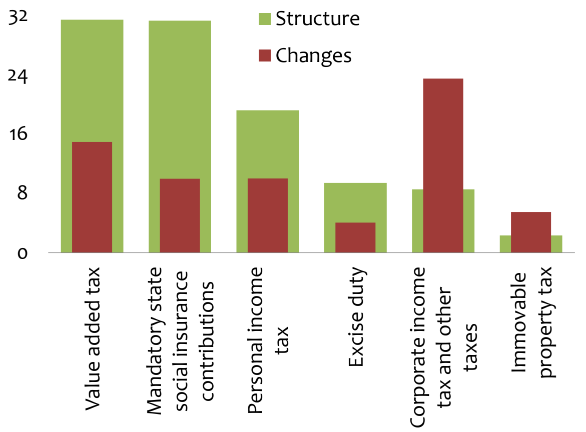
General Government Consolidated Gross Debt nominal value at the year end



BUDGET REVENUES AND EXPENDITURES

Since 2011, the revenues of the state's consolidated budget have increasing. It is expected that in the medium term, the debt condition of 60% of GDP set by the Law on Fiscal Discipline will be respected and the debt of the general government of Latvia will stabilize at a level below 40%. As economic growth resumes, the positive trend continues. Budget revenues in the 8 months of 2023 increased by 12.8% compared to the corresponding period of 2022.

Tax Revenues
structure and changes in January-August 2023, compared to the corresponding period last year, as per cent



Revenues in the 8 months of 2023 increased in all major tax groups. Positive labour market indicators and wage growth were reflected in the dynamics of employment taxes. Income from personal income tax in this period was 10% higher than a year ago, and income from state social insurance contributions – by 9.9%.

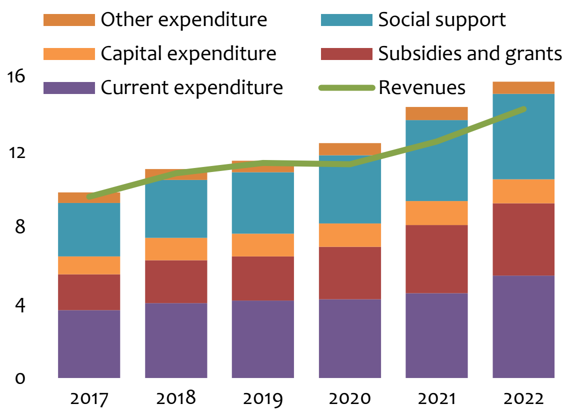
Consolidated General Government Budget

	billion euro			changes as per cent
	2021	2022	2023 Jan-Aug	2023 Jan-Aug
Revenues:	12.5	14.3	10.4	12.8
Tax revenues:	10.0	11.6	8.2	11.3
Mandatory State Social Insurance Contributions	3.0	3.5	2.6	9.9
Value added tax	2.8	3.6	2.6	14.9
Personal Income Tax	1.9	2.3	1.6	10.0
Corporate Income Tax	0.3	0.4	0.4	47.6
Excise Duty	1.1	1.1	0.8	4.1
Immovable Property Tax	0.2	0.2	0.2	5.5
Other taxes	0.4	0.4	0.3	1.4
Other revenues	2.5	2.7	2.2	18.7
Expenditures	14.4	15.7	10.3	12.2

The dynamics of consumption taxes in 2023 is determined more by the trends in the growth of wages and consumer prices. Revenues from value added tax in 8 months were 14.9% higher and from excise duty – 4.1% higher than a year ago. Also, corporate income tax revenue increased by 57.6% and immovable property tax revenue – by 5.5%.

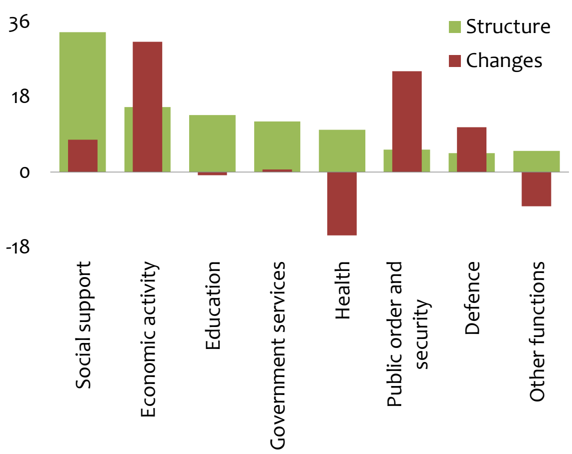
State consolidated budget expenditures increased by 12.2% in the 8 months of 2023, compared to the corresponding period last year. The dynamics of the budget expenditure items was determined by a smaller allocation of funds to support measures than in previous years and a much better absorption of EU funds. The fastest growth rate was for capital expenditures – by 25.5%, while current expenditures – by 14.3%. The growth rate was lower for social support expenses and expenses for subsidies and grants, by 10.7% and 10.2%, respectively.

Consolidated General Government Budget Expenditures
billion euro



Analysing budget expenditures by functional categories, in the 8 months of 2023, expenditures increased more rapidly in areas such as economic activity, public order and security, and defence.

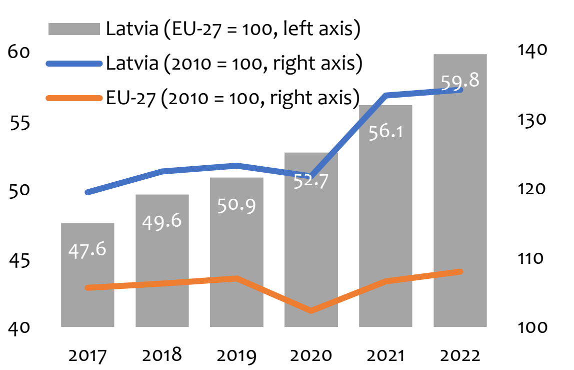
Consolidated General Government Budget Expenditures by Functions
structure and changes in January-August 2023, as per cent



PRODUCTIVITY AND COMPETITIVENESS

Productivity dynamics have been volatile in recent years, driven by adjustments in product and labour markets in response to external shocks. As economic activities resumed, productivity increased by 9.5% in 2021, albeit in 2022 it exceeded the previous year's level by only 0.6%. Also, in the first half of 2023, economic growth was weak and productivity, compared to the corresponding period of the previous year, decreased by 1.2%. In 2022, GDP per capita in Latvia reached 59.8% (74.9% according to PPS) of the average EU level. Since 2017, the productivity gap with the EU average level (according to PPS) has decreased by almost 8 percentage points.

Productivity Dynamics



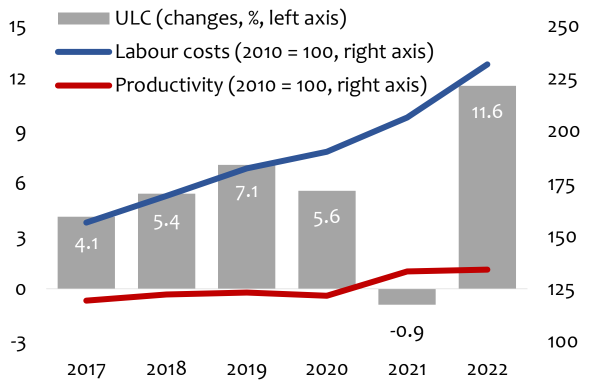
Labour costs continue to rise. Due to the increase in economic activities, labour costs increased by 8.5% in 2021, which is more moderate than the increase in productivity. In 2022, the increase of labour costs was even faster – 12.2%. Also, while productivity remained at the last year's level, the increase in labour costs significantly worsened the cost competitiveness indicator. Nominal ULC increased by 11.6%, the highest increase in ten years. Also, in 2023, labour costs are growing rapidly. In the first half of 2023, compared to the first half of 2022, labour costs increased by 13% and ULC – by 14.3%.

In the Baltic neighbouring countries, the nominal ULC has been growing faster than in Latvia in the last three years. In 2022, compared to 2019, the nominal ULC in Latvia increased by 16.7%, in Estonia – by 19%, and in Lithuania – by 27.7%. Overall, the growth of ULC in the Baltic States is much faster than the EU average (7.8%) and this indicator has significantly exceeded the threshold set by the EU Alert Mechanism (MIP) (9%).

The real effective exchange rate (REER) is increasing. The REER based on the consumer price index against 42 trading partner countries increased by 5.7% from 2019 to 2022, which was higher than the threshold set by the MIP.

Despite the negative trend of cost competitiveness generators, the long-term dynamics of Latvia's export market share is improving. In five years (2018-2022), Latvia's export share in world markets increased by 13.8%, which was largely influenced by the positive changes in the goods export market in 2020. Since 2018, the share of Latvia in the export market of goods increased by 18.9%, while the share of services – by 3.1%, which was mainly determined by the decrease of the market share in 2019 and 2021, respectively by 3.4% and 4% due to the spread of the pandemic due to restrictions.

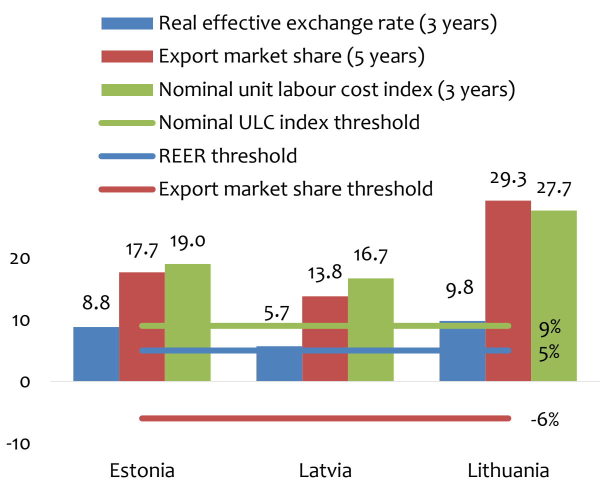
Labour Costs and Productivity



In the conditions of the slow dynamics of productivity, the increase in labour costs puts significant pressure on the cost competitiveness of Latvian entrepreneurs. The weakening of economic activities has had little effect on the labour market situation. This shows that the problem of labour shortage is urgent for entrepreneurs, and despite the slowdown of economic activities, jobs are preserved. On the other hand, wages continue to rise under the pressure of high inflation. These trends are increasingly widening the gap between productivity and labour costs. Increasing productivity is the main factor determining competitiveness, and its persistently positive dynamics will largely be determined by structural changes in the Latvian economy in the direction of higher value-added activities and knowledge-intensive industries.

Competitiveness Indicators

as per cent



EU ALERT MECHANISM

In line with the economic and fiscal policy surveillance rules adopted in 2011, a macroeconomic imbalances procedure was also established in the EU alongside the Excessive Deficit Procedure, aimed at identifying (through the Alert Mechanism Scoreboard) and correcting macroeconomic imbalances.

In the 2023 Alert Mechanism Report (AMR), Latvia is not noted among the 10 EU member states that were found to have macroeconomic imbalances. However, unlike other years, 7 new countries, including Latvia, were additionally selected for in-depth analysis in one of the 3 themes (housing market, competitiveness dynamics, external sustainability and balance), as they are at risk of imbalances.

The compilation of Latvian results for 2021 shows that four indicators exceeded the indicative thresholds, namely the nominal labour unit cost index, housing price index, changes in the level of the economically active workforce, and changes in the youth unemployment rate.

AMR has noted that external sustainability risks are limited; however, there are concerns regarding cost competitiveness. The growth of nominal unit labour costs slowed down in 2021. High inflation puts additional pressure on wage growth, affecting productivity growth.

The high increase in nominal housing prices was also a cause for concern. However, mortgage lending is moderate and household debt is low and falling, while the banking sector is stable and well capitalized.

The level of economic activity decreased significantly in 2020, ending an almost ten-year improvement trend. Youth unemployment has not improved after the increase in 2020.

The latest *Eurostat* data show that in the next AMR Latvia will also have 4 indicators that will exceed the thresholds: the real effective exchange rate, the nominal labour unit cost index, the economically active workforce, and the youth unemployment rate.

List of Indicators for the Macroeconomic Imbalances Procedure for Latvia

External imbalances and competitiveness	Threshold	2017	2018	2019	2020	2021	2022
Current account (% of GDP, 3-year average)	-4%/6%	0.7	0.9	0.2	0.7	-0.5	-1.9
Net international investment position (% of GDP)	-35%	-51.1	-45.1	-40.1	-34.0	-27.3	-26.5
Real effective exchange rate – 42 partner countries, HICP deflator (% changes over the last 3 years)	±5%* & ±11%	1.7	5.1	3.7	5.9	2.3	5.7
Export market share – % of world export (% changes over the last 5 years)	-6%	7.2	8.2	3.1	19.4	12.6	13.8
Nominal unit labour costs index (% changes over the last 3 years)	9%* & 12%	14.2	14.7	17.5	19.2	12.0	16.7
Internal imbalances							
House price index (% annual changes)	6%	5.3	6.4	5.8	2.7	7.2	-0.3
Private sector credit flow (% of GDP, consolidated)	14%	2.8	-0.2	1.1	-1.8	0.9	3.0
Private sector debt (% of GDP, consolidated)	133%	75.6	69.8	66.4	65.2	58.5	52.4
General government debt (% of GDP)	60%	38.9	37.0	36.5	42.0	43.7	40.8
Unemployment rate (3-year average)	10%	9.4	8.6	7.5	7.3	7.3	7.5
Financial sector liabilities (% annual changes)	16.5%	6.2	-3.5	4.6	10.6	13.3	4.1
Employment indicators							
Economically active population – % of population aged 15-64 (% over the last 3 years)	-0.2 pp	2.5	1.9	1.1	1.1	-1.8	-0.5
Long-term unemployment rate – % economically active population (% changes over the last three years)	0.5 pp	-1.5	-1.5	-1.7	-1.2	-1.1	-0.7
Youth unemployment rate – % of economically active population (% over the last 3 years)	2 pp	-2.6	-4.1	-4.8	-2.1	2.6	2.6

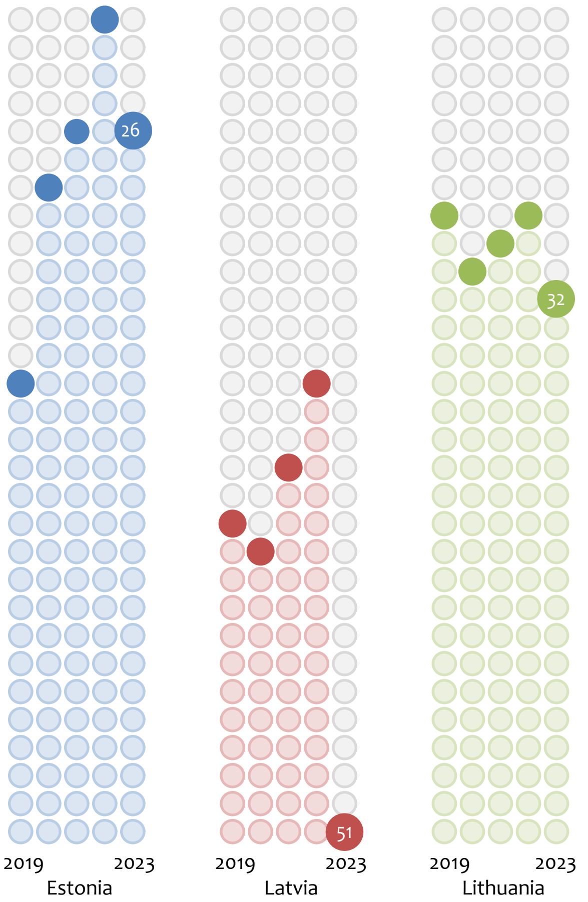
* – Euro area countries.
Note: highlighted numbers exceed the thresholds set out in the Early Alert Mechanism Report.
Source: List of Indicators for the Macroeconomic Imbalances Procedure for Latvia, *Eurostat*

2023 | 2 LATVIA IN INTERNATIONAL RANKINGS

The ratings created by the International Management Development Institute, the World Intellectual Property Organization, the European Commission and other organizations describe Latvia as a highly developed country that overcomes various external shocks with varying degrees of success, but at the same time maintains a high development potential.

In the World Competitiveness Ranking 2023 (World Competitiveness Ranking 2023) published annually by the International Institute for Management Development (IMD), Latvia is ranked 51st among 64 countries, decreasing its position by 16 positions compared to 2022.

Baltic Countries in Global Competitiveness Ranking

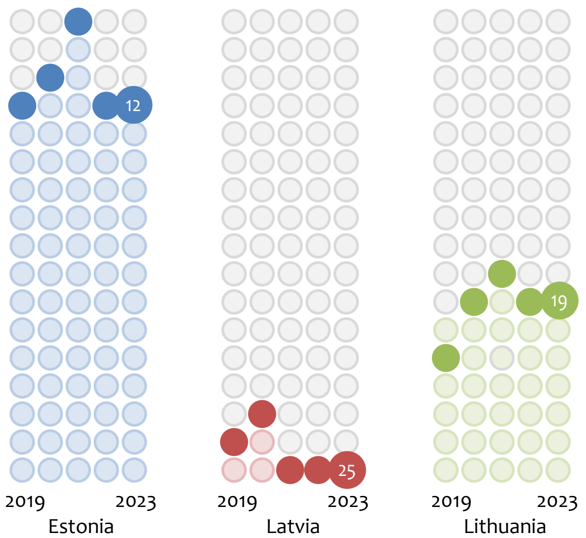


Source: *IMD, World Competitiveness Ranking 2023*

Factors that in 2022 were associated with concerns about Latvia's ability to maintain economic security at the start of Russia's aggression against Ukraine have had the largest impact on the rating drop. Rising energy prices led to high consumer price inflation, which in turn put pressure on wages and labour costs. There was a high risk of economic recession. As a result, the mood of entrepreneurs was reflected both in the assessment of the government's work and in the assessment of business efficiency. Also, some long-term risks such as labour availability in the long term, the low level of stock market capitalization, etc. worsened the overall rating. However, at the same time, the evaluation recognizes that the level of foreign investment in relation to GDP is relatively high and that the main attractiveness factor of the economy is the skilled labour force.

In the European Innovation Scoreboard 2023 published annually by the European Commission, Latvia is ranked 25th among the 27 EU countries and is in the group of modest innovator countries. The report notes that over the past two years, Latvia's rating in points has improved due to both the increase in the number of people employed in the ICT sector and the increase in the number of people employed in science and technology in general.

Baltic Countries in Global Innovation Index *

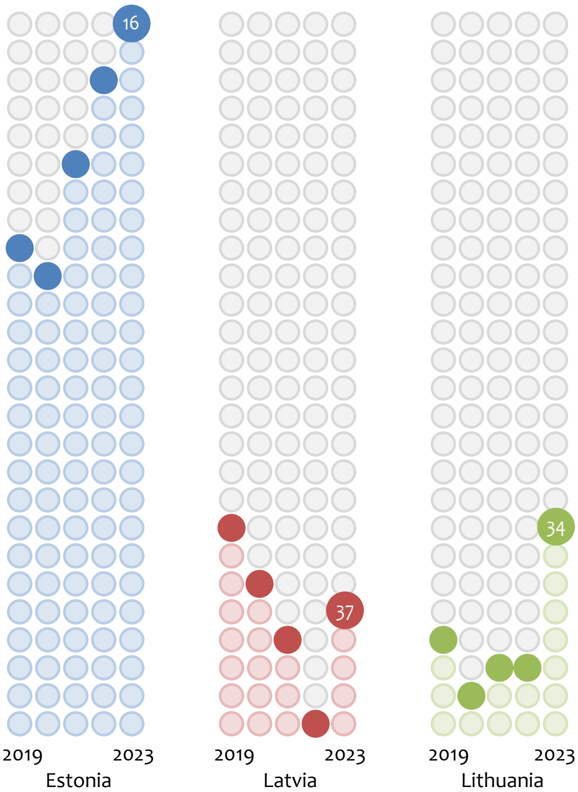


Source: *European Commission, European Innovation Scoreboard 2023*
** since 2020 excluding the UK.*

In the Global Innovation Index 2023 prepared by the World Intellectual Property Organization (WIPO), Latvia is ranked 37th among the 132 surveyed countries.

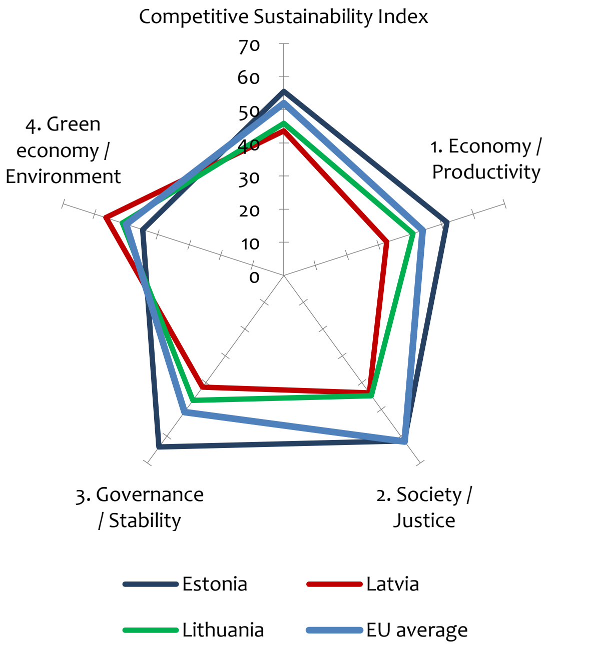
The strengths of Latvia have been highlighted: the proportion of secondary education students enrolled in universities, the number of foreign students, the use of ICT, ecological efficiency, the proportion of employed women with scientific degrees, high-tech exports, FDI net inflows, exports of cultural and creative services, the number of national feature films, export of creative industries goods.

Baltic Countries in Global Innovation Index



Source: *Cornell University, INSEAD, WIPO, Global Innovation Index 2023: Innovation in the face of uncertainty*

Performance of the Baltic States in the Competitive Sustainability Index and its dimensions
(rating scale from 0-100)



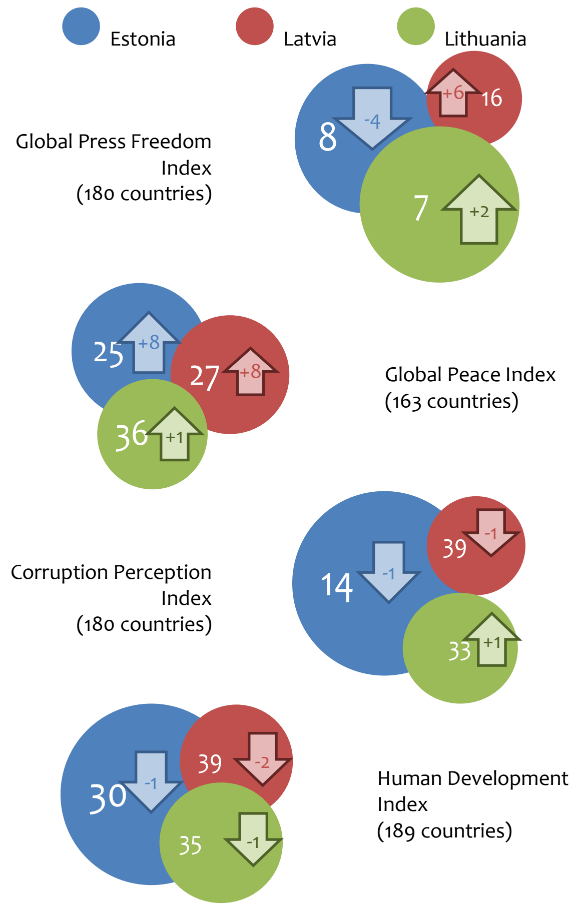
Source: *University of Cambridge Institute for Sustainability Leadership, Competitive sustainability index 2022*

In the Competitive Sustainability Index 2022 developed under the leadership of the Institute of Sustainable Management of the University of Cambridge, which measures competitiveness in connection with the transition to a smart, green and climate-neutral economy, Latvia is ranked 19th among the 27 EU countries and is in the group of moderately performing countries (Estonia – in 11th place and is included in the group of good performers, Lithuania – in 16th place and is included in the group of moderate performers).

The competitive sustainability index has 4 dimensions, of which Latvia's performance exceeds the EU-27 average in only one dimension – green economy and environment, thanks to preserved biological diversity, good water, forest and wind resources and their rational use.

In the World Press Freedom Index 2023 compiled by the international press and freedom of speech organization "Reporters without Borders", Latvia took 16th place in 2023 (180 countries were surveyed), improving its position by 6 positions compared to 2022.

Baltic Countries in International Rankings
place and its changes during a year



Source: *Reporters Without Borders, 2023 World Press Freedom Index; The Institute for Economics and Peace, Global Peace Index 2023; Transparency International, Corruption Perceptions Index 2022; United Nations Development Programme, Human Development Report 2021/2022.*

In the World Peace Index 2023 created by the Institute of Economics and Peace, Latvia took 27th place in 2023 (surveyed 163 countries). Compared to 2022, Latvia has improved its position by 8 positions, as it has transferred part of its armament as aid to Ukraine, as well as provided social support to refugees from Ukraine, maintaining the security situation in the country.

In the Corruption Perception Index 2022 created by the international anti-corruption organization Transparency International, Latvia took 39th place in 2022 (out of 180 surveyed countries), decreasing its position by 3 places compared to 2021.

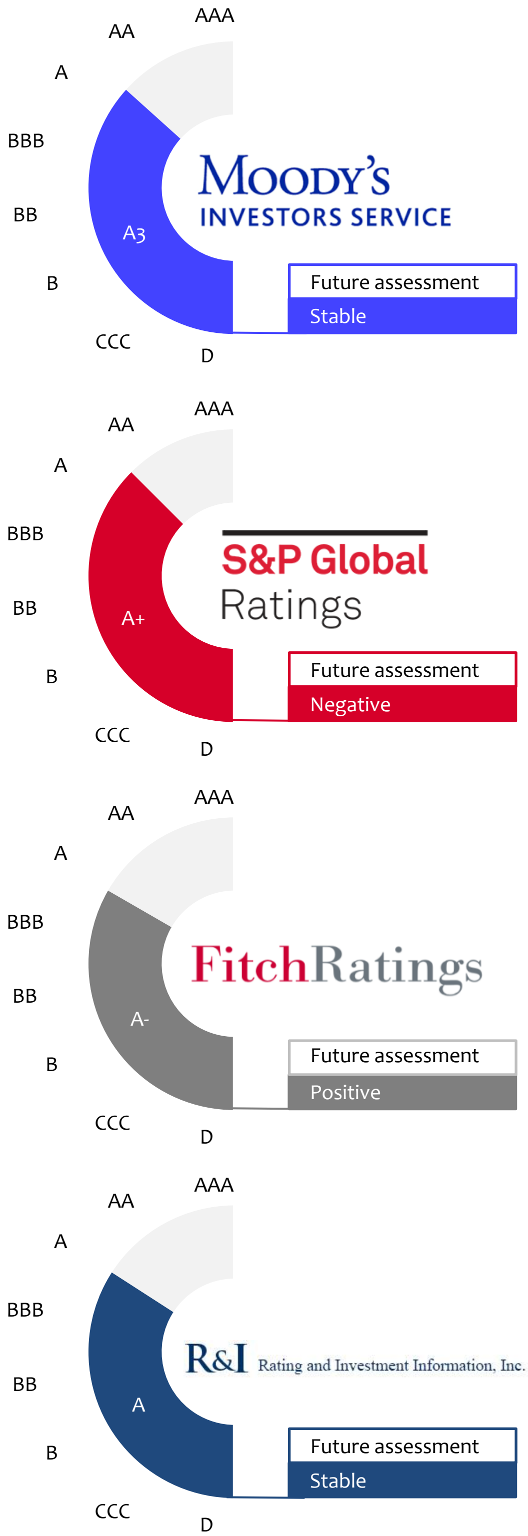
In the Human Development Index 2022 created by the United Nations Development Program (UNDP), Latvia took 39th place in 2022 (out of 189 surveyed countries), decreasing by 2 positions compared to the 2020 result.

In February 2020, the international rating agency S&P Global Ratings raised Latvia's credit rating from the "A" level to the "A+" level, which is the highest credit rating level determined for Latvia so far. In December 2022, this credit rating agency was cautious in its assessments of the development of the economic situation in connection with the continuation of hostilities in Ukraine and high inflation, therefore confirming that Latvia still corresponds to the "A+" level but reduced the future assessment from stable to negative. Other credit rating agencies did not change their future assessment in 2022.

In July 2023, the credit rating agency Fitch Ratings maintained Latvia's credit rating at the existing "A-" level and was the first of the credit rating agencies to raise the future rating of the credit rating from stable to positive. This agency stated that Latvia, as a small and open economy, has shown relative resilience against external shocks. The level of GDP exceeds the pre-pandemic level, as the impact of the pandemic has generally been lower than the EU average and the complications related to the availability of energy resources, where Russia had a large share, have been successfully resolved.

The credit rating agency *Fitch Ratings* states that the strengths of Latvia's credit rating are the relatively low level of national debt to GDP and its servicing costs, as well as the moderate level of debt obligations of the private sector. On the other hand, the relatively lower GDP per capita compared to countries with a similar credit rating, uncertainty with negative current account development trends and unfavourable demographic trends may limit the growth of Latvia's credit rating in the future.

Credit Rating of Latvia for Long-Term Liabilities in Foreign Currency



Source: State Treasury