



LATVIJAS BANKA

# BANK OF LATVIA

## MONTHLY NEWSLETTER • NOVEMBER 2013

---

1 Highlights

2 Macroeconomic Data

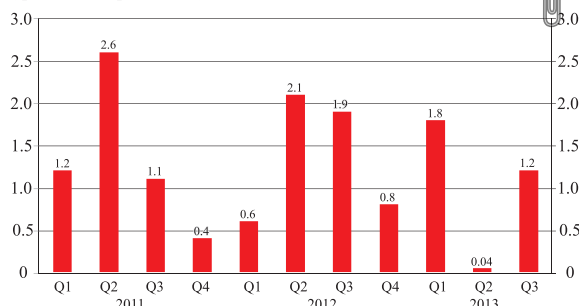
3 In Focus



## 1. Highlights

### GDP grows in the third quarter of 2013

**Real GDP growth**  
(quarter-on-quarter; %)



Source: CSB.

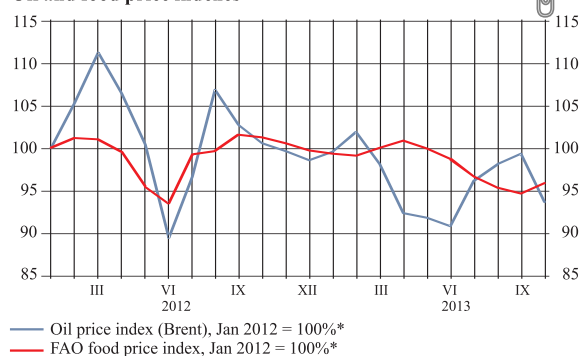
According to the flash estimate by the Central Statistical Bureau, Latvian GDP grew 1.2% in the third quarter of 2013 (quarter-on-quarter, seasonally adjusted). Meanwhile, the rate of annual growth was similar to that of the first two quarters of the year (4.2%), which implies that the Latvian economy might still be the fastest growing economy in the EU. The growth of GDP in the third quarter was most likely determined by the rising private consumption supporting a steep increase in services.

Recent readings of the confidence indicators in Europe compiled by the European Commission and PMI data indicate that the situation is gradually improving. In Russia, the leading indicators of the third quarter signaled weakness; however, the final quarter of the year started with

comparatively better readings pointing to improved business conditions. If the real economy of Latvia's trading partners develops in line with the leading indicators, an increase in external demand can be expected, which might have a further positive impact on the growth of Latvian exports and our export-oriented manufacturers.

### Inflation remained untypically low in October

**Oil and food price indexes**



Sources: Bloomberg, Food and Agriculture Organization, Bank of Latvia calculations.  
\* based on prices in LVL

In October, annual inflation still remained untypically low for a growing economy, with the average consumer prices at the level equivalent to that observed in October 2012. Declining fuel prices, seasonal reduction in potato prices as well as falling travel and hotel service prices due to the end of the tourist season were the primary factors affecting consumer prices over the month. An inflation increasing impact was exerted by another seasonal factor, appearance of autumn/winter clothing and footwear in stores, and probably also by the price-setting policy of companies. Overall, consumer prices increased by 0.3% in October, thus not exceeding the average longer-term price growth observed in October.

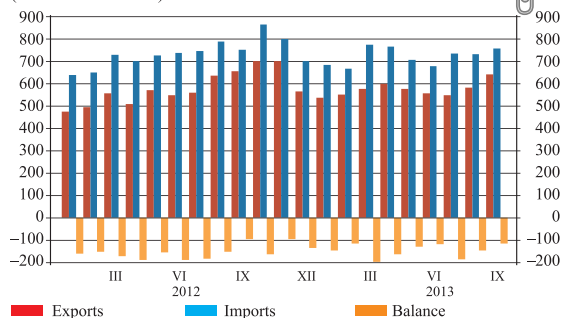
Currently, the developments of global oil and food prices have opposite effects on inflation. Oil price has shrunk since mid-September and has a favourable impact on other

energy prices. However, the data on the global agricultural and food prices reported growth in October.

Data for January–October suggest that the annual inflation in 2013 will be the lowest observed under circumstances of positive growth.

### Latvian goods exports continue to rise

**Imports, exports, balance of goods**  
(in millions of lats)




Source: CSB.

In September 2013, the external trade turnover of Latvian goods grew by 6.4% month-on-month. Despite complicated external conditions, our businesses have managed to increase exports. For a second consecutive month, exports of Latvian goods posted growth (9.8% month-on-month), whereas the respective imports grew by 3.7%. Due to lower activity in some commodity groups of goods, exports of goods dropped by 2.3% year-on-year in September. Despite the high growth rate reported in September, vegetable products have maintained the largest negative impact on the overall annual goods exports. This was determined by the last year's record-high harvest. The exports of iron and steel have dropped as a result of the continued suspension of production at "Liepājas metalurģs". Positive annual growth was retained in the exports

of the two largest economic sectors: wood and articles of wood as well as foodstuffs.

The latest economic forecasts of the European Commission for the coming year point to improving growth rates in all of Latvia's main trading partners compared to this year. Thus next year export growth could be supported by higher external demand followed by rising investment activity in order to increase the export capacity.

## 2. Macroeconomic Data

	Reporting period	Data (%)
<b>Gross Domestic Product (GDP)</b> (quarter-on-quarter growth; seasonally adjusted) 11.11.2013 <a href="#">After the weak performance in Q2, GDP growth in Q3 gives rise to optimism</a> 	2013 Q3 <i>(flash estimate)</i>	<b>1.2</b>
<b>State budget</b> Tax revenue (current month; year-on-year growth) General government expenditure (since the beginning of the year, year-on-year growth)	2013 X 2013 X	<b>2.2</b> <b>5.1</b>
<b>Consumer price changes</b> Consumer Price Index CPI (month-on-month growth) 12-month average annual inflation (to comply with the Maastricht Criteria) 11.11.2013 <a href="#">Inflation remained atypically low in October</a> 	2013 X 2013 X	<b>0.3</b> <b>0.3</b>
<b>Foreign trade</b> Exports (year-on-year growth) Imports (year-on-year growth) 11.11.2013 <a href="#">Notwithstanding weak external demand, Latvian goods exports continue to rise</a> 	2013 IX 2013 IX	<b>-2.3</b> <b>0.8</b>
<b>Balance of payments</b> Current account balance (ratio to GDP) Foreign direct investment in Latvia (net flows; % of GDP)	2013 Q2 2013 Q2	<b>0.8</b> <b>3.0</b>
<b>Industrial output</b> Working day-adjusted industrial output index (year-on-year growth) 05.11.2013 <a href="#">Manufacturing grows on account of higher wood industry output</a> 	2013 IX	<b>1.9</b>
<b>Retail trade turnover</b> Retail trade turnover at constant prices (year-on-year growth) 30.10.2013 <a href="#">Retail trade paradox this year: confidence deteriorates, yet the turnover grows</a> 	2013 IX	<b>2.1</b>
<b>Employment and unemployment</b> Registered unemployment (share in working age population) 14.11.2013 <a href="#">The slight rise in unemployment does not point to labour market deterioration</a> 	2013 X	<b>9.1</b>
<b>Monetary indicators</b> Broad money M3 (year-on-year) 21.11.2013 <a href="#">Money supply has resumed climbing</a> 	2013 X	<b>0.8</b>

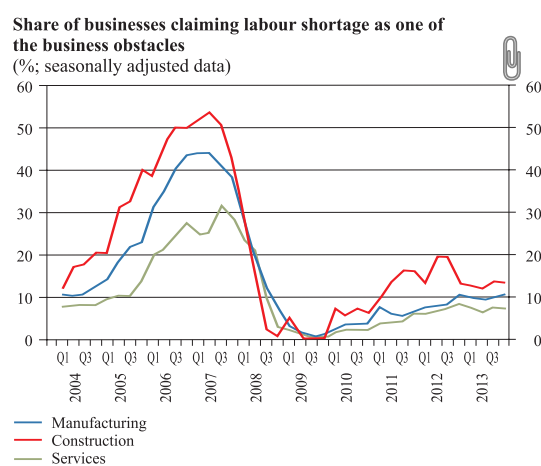
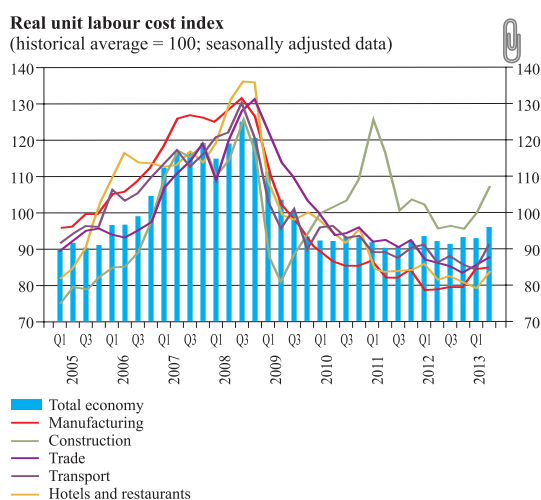
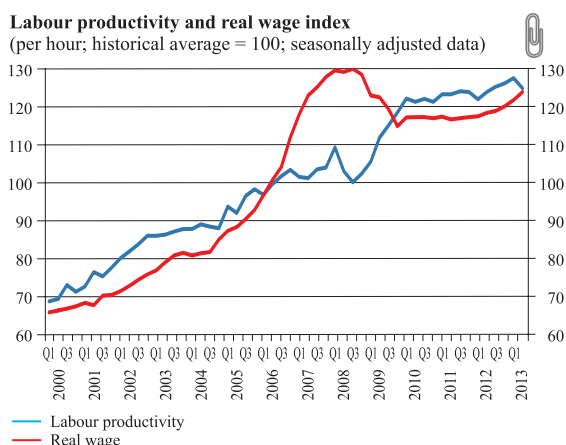
Source: Treasury, Central Statistical Bureau of the Republic of Latvia, and Bank of Latvia data.

## 3. In Focus

### Wage-productivity developments remain balanced

The balance between wage and productivity growth has been retained and is likely to be sustained during the coming years.

During the overheating period, wage growth in excess of labour productivity increases reflected one of the main internal imbalances. This resulted both in an unsustainable wage-inflation spiral eroding savings



(nominal average wages grew by 33% year-on-year in mid-2007 with annual inflation peaking at 18% in mid-2008) and the loss of competitiveness reflected in a real exchange rate appreciation. During the 2008–2009 adjustment period, the balance between wages and labour productivity was restored owing both to a real wage drop and strong productivity gains. As a result, in the second quarter of 2013 these two indicators were just at par, meaning that the adjustment of past imbalances was both full and sustainable.

Particularly, manufacturing was the first sector to resume balance between real hourly wage and labour productivity per hour worked – already in late 2009. Consequently, manufacturing became also one of the first sectors that posted year-on-year growth in value added, shaping the economic recovery of 2010–2011. By now the wage-productivity balance is also restored in services and domestic consumption oriented sectors, such as construction, trade, transport, hotels and restaurants, as reflected in the real unit labour cost index.

Wages and labour productivity developments are likely to remain balanced in the medium term. Currently, there are no risks of economy-wide wage growth in excess of labour productivity gains. Particularly, the share of businesses regarding labour shortage as one of the business obstacles is stable at around 10% that may be close to its "equilibrium" level.

Productivity growth will become the main factor of economic growth as the scope for further improvement in employment is gradually diminishing. Combined with a sustainable rate of wage growth, it may foster income convergence with the other euro area countries.