

Latvian Macro Monitor

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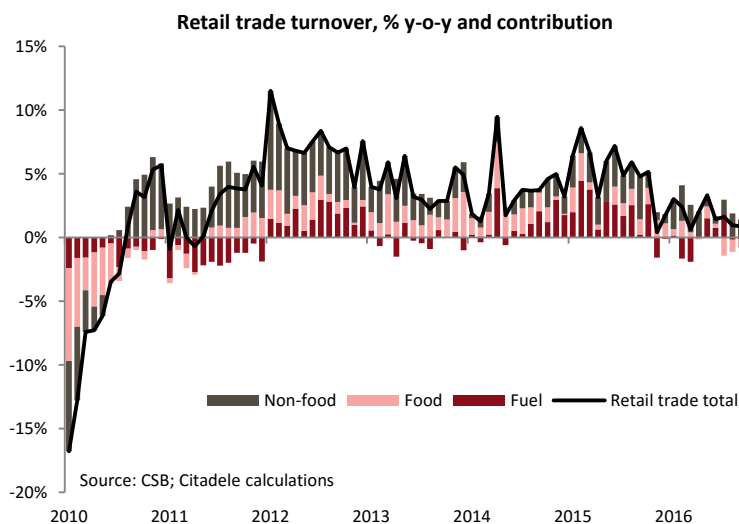
Summary

- Retail trade in Latvia rebounded strongly in November as sales grew by 4.6% compared to previous year which is the fastest rate of annual growth in 2016. Fastest growing segments of retail trade remain online shopping, clothing, pharmacy, as well as various consumer electronic goods.
- Industrial sector in Latvia in November had the best month in more than 4 years as output grew by 11.0% compared to previous year and growth accelerated already for a third month in a row pointing to a strong momentum in industrial production.
- Increase in world food and energy prices continued to drive consumer prices upward also in Latvia and in November inflation reached already 1.3% which is highest rate of inflation since 2013.
- In Q3 activity in Latvian housing market continued to increase as number of real estate transactions rose by 18.9% y-o-y and average housing prices increased by 10.8%.
- After more than 7 years of decline in domestic loan portfolio, credit cycle in Latvia has finally reached turning point as domestic loan portfolio has increased already for two consecutive quarters. Compared to previous year domestic loan portfolio in Latvia in Q3 still declined by 1.2%, however loans to non-financial companies already increased by 0.2%.
- In October Latvian export of goods was again weighed down by weak agricultural harvest and declining re-exports of fuel and electronic goods as overall export of goods in October declined by 3.5% y-o-y. At the same time imports in October rose by 0.4% leading to very slight increase in trade deficit however imports of machinery and equipment continue to decline pointing to ongoing weakness in investment.

Retail trade

Retail trade in Latvia rebounded strongly in November as sales grew by 4.6% compared to previous year which is the fastest rate of annual growth in 2016. By comparison retail trade growth in previous months was below 1% and strong retail trade data in November adds to other data pointing to an acceleration of GDP growth in Q4 of 2016.

But despite strong acceleration in retail trade growth in November, overall trends in have remained



broadly unchanged. Fastest growing segments of retail trade remain online shopping (+32.6% y-o-y), clothing (+22.5%), pharmacy (+7.6%), as well as various consumer electronic goods (+15.5%). But at the same time in November food sales declined by 1.6% y-o-y.

With strong retail trade growth in November it seems more likely that weakness in retail trade during summer was at least partly related to problems in construction sector which has resulted in emigration of some construction workers. This is also supported by strong growth in export of construction services as well as by the fact that in 2016 retail trade growth has been strong Lithuania and Estonia where stronger private sector demand has helped to offset decline EU financed construction. In addition decline in oil prices over the previous year could also have boosted consumption in November as consumers had to spend less on heating bills than in 2015 due to decline in heating prices over the summer.

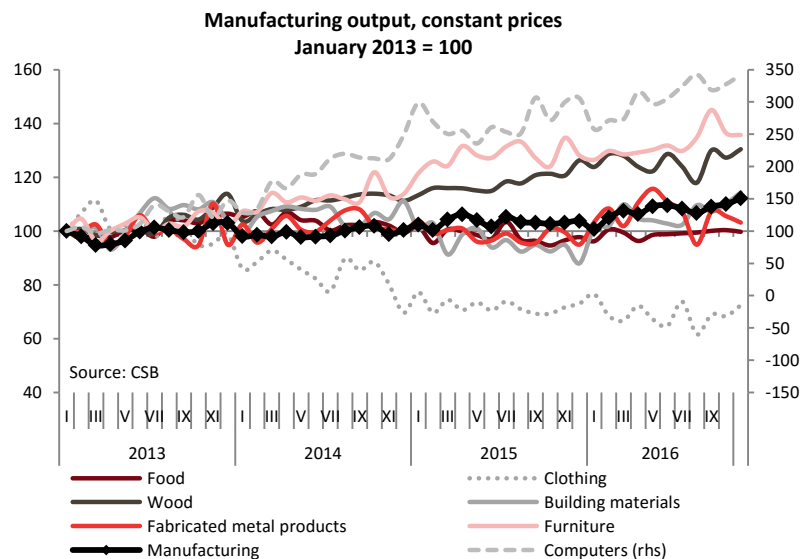
Manufacturing

Industrial sector in Latvia in November had the best month in more than 4 years as output grew by 11.0% compared to previous year and growth accelerated already for a third month in a row pointing to a strong momentum in industrial production. November was a very good month for energy production where output grew by 18.6% supported by favourable weather conditions while manufacturing in November grew by 9.1%.

Improving situation in food production has been one the main factors behind strong manufacturing growth in recent months as food sector has returned to stable growth for the first time since the introduction of Russian sanctions. Compared to previous year food production grew by 3.2% y-o-y.

Apart from food production growth in manufacturing was also supported by manufacture of wood products (+8.1% y-o-y), computer and optical devices (+14.6%), electrical equipment (+31.3%), construction materials (+17.8%), as well as car parts (+46.6%) while chemical sector was the only sector where output declined by 7.1%.

In addition to solid retail trade manufacturing data also adds to evidence that growth in Latvian economy is picking up after almost grinding to a halt in Q3. Growth in manufacturing is now supported both by domestic and external demand even despite declining exports and weak global trade, however growth in some sectors of manufacturing is likely to be due to one-off factors and as a result growth could slow somewhat in the next few months.

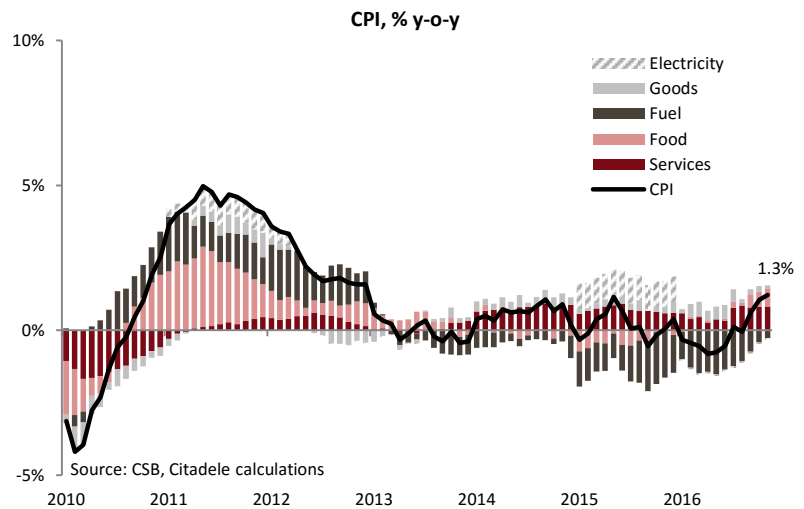


Inflation

Increase in world food and energy prices continued to drive consumer prices upward also in Latvia and in November inflation reached already 1.3% which is highest rate of inflation since 2013. Compared to October consumer prices in November increased by 0.3%. As a result Latvia now has one of the fastest rates of inflation in the EU

According to data from the Food and Agriculture Organization of the United Nations world food prices have increased by 16% since the beginning of 2016 driven mainly by rising sugar and dairy prices. As a result food price inflation in Latvia in November reached 2.9% y-o-y, which is the highest level of food price inflation in Latvia since 2012. Meanwhile increase in world oil prices has led to 3.2% y-o-y increase in fuel prices.

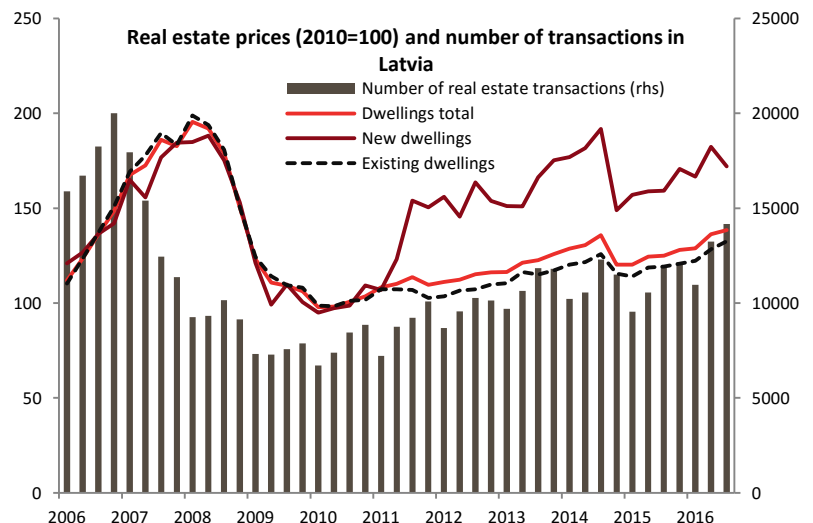
But at the same time overall energy price inflation in November remained negative due to ongoing decline in heating tariffs, however forecasts from JSC "Latvijas Gāze" regarding the price of natural gas suggests that heating tariffs will begin to increase already in December. In November service price inflation remained almost unchanged at 2.9% driven mainly by increased VAT on residential housing maintenance services in July.



Real estate

In Q3 activity in Latvian housing market continued to increase as number of real estate transactions rose by 18.9% y-o-y and average housing prices increased by 10.8%. In Q3 prices in existing dwellings rose by 11.1% while prices in new dwellings went up by 8.1%

Increased activity in the real estate market compared to previous year partially reflects weak real estate market at the beginning of 2015. But at the same time real estate price have increased also in Estonia and Lithuania, thus reflecting improving situation in the labour markets in all three Baltic countries.

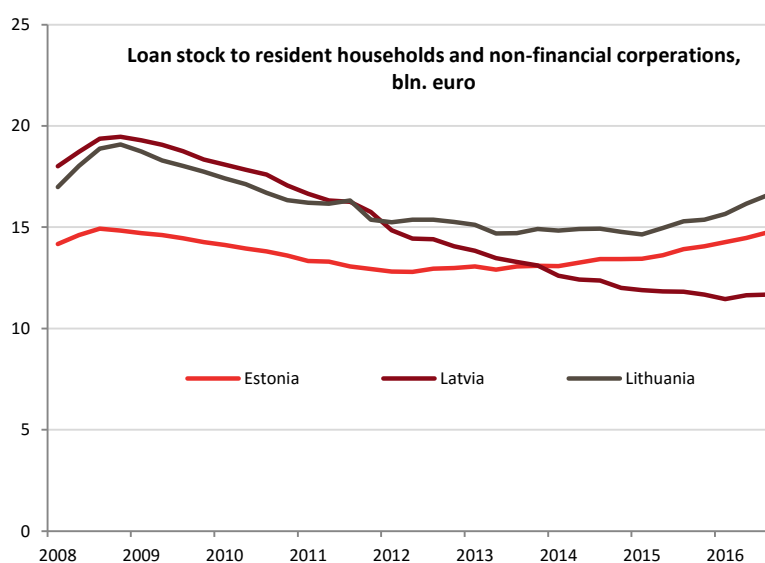


In addition to positive labour market developments activity in the real estate market in Estonia and Lithuania has also been supported by renewed growth in mortgage lending and as a result real estate

prices in Lithuania are now only 23% below pre crisis peak while in Estonia real estate prices have already surpassed pre crisis peak by more than 4%. At the same time in Latvia real estate prices remain 28% below pre crisis peak as mortgage lending has lagged behind both Lithuania and Estonia. However in recent month's mortgage lending in Latvia is finally showing signs of stabilization and return to positive growth in mortgage lending could further boost activity in the Latvian real estate market.

Banking sector

After more than 7 years of decline in domestic loan portfolio, credit cycle in Latvia has finally reached turning point as domestic loan portfolio has increased already for two consecutive quarters. Compared to previous year domestic loan portfolio in Latvia in Q3 still declined by 1.2%, however loans to non-financial companies already increased by 0.2%. At the same time loans to resident households continued to decline by 2.7% although rate of decline is slowing. However, in terms of lending cycle Latvia still lags behind Lithuania and Estonia where overall lending has been growing already for several years.



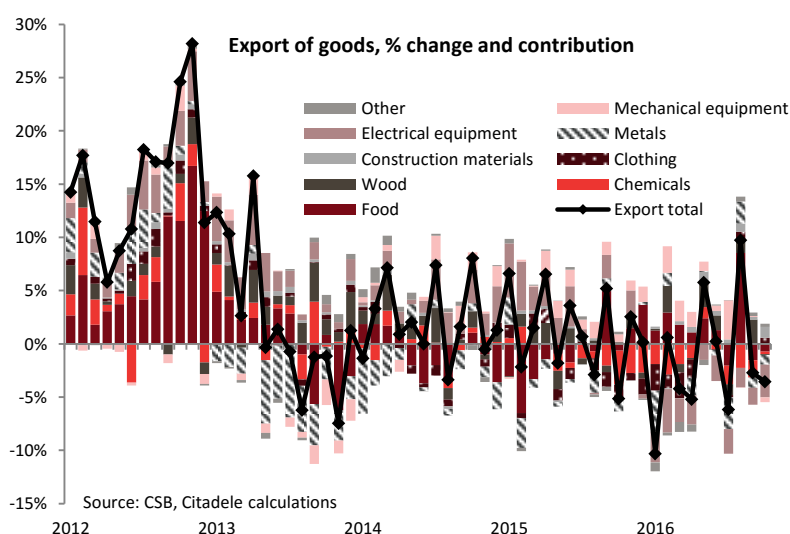
New lending in Latvia has seen rapid growth in 2016 as in the first three quarters of 2016 compared to same period in 2015 new lending in Latvia has increased by 40%, while new mortgage lending has jumped by more than 50% although this partly reflects very weak lending at the start of 2015 due to uncertainty about new insolvency regulation. In Q3 new lending was up by 15% while new mortgage lending increased by 21%.

Despite relatively weak consumption growth and sharp decline in investment in recent quarters, both household and non-financial company deposits continued to grow in Q3 by +7.1% and 3.4% respectively. Deposit growth of non-financial companies in Q3 has slowed down compared to first half of the year when deposits grew by 9.0% and currently is growing at slowest rate since 2014. This slowdown most likely reflects weak economic growth and still rather rapid wage growth that is putting pressure on corporate profits.

External trade

In October Latvian export of goods was again weighed down by weak agricultural harvest and declining re-exports of fuel and electronic goods as overall export of goods in October declined by 3.5% y-o-y although raising oil prices mean that in the coming months oil prices will no longer drag down external trade. At the same time imports in October rose by 0.4% leading to very slight increase in trade deficit.

In October overall export was dragged down by drop in the export of food (-2.7% y-o-y, of which rapeseed -72.9%) and fuel (-20.7%) products, electronic goods (-22.0%) as well as rather surprisingly wood products (-5.1%), despite growing manufacturing output in wood sector. However, at the same time export of furniture (+19.9%), pharmacy (+28.3%) and plastics (+11.3%) grew strongly in October as well as for the first time in more than two years also export of milk products increased by 17.3% in part due to rapid increase in global dairy prices in recent months.



At the same time on the import side strongest growth was recorded in of metals (+66.5%) and pharmacy products (+17.8%) suggesting that growth in pharmacy exports is mainly driven by re-exports. In addition in October import of wood grew by 11.0% pointing to a limited availability of wood resources in Latvia, however imports of machinery and equipment (-9.5%) continue to decline pointing to ongoing weakness in investment.

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