

Latvian Macro Monitor

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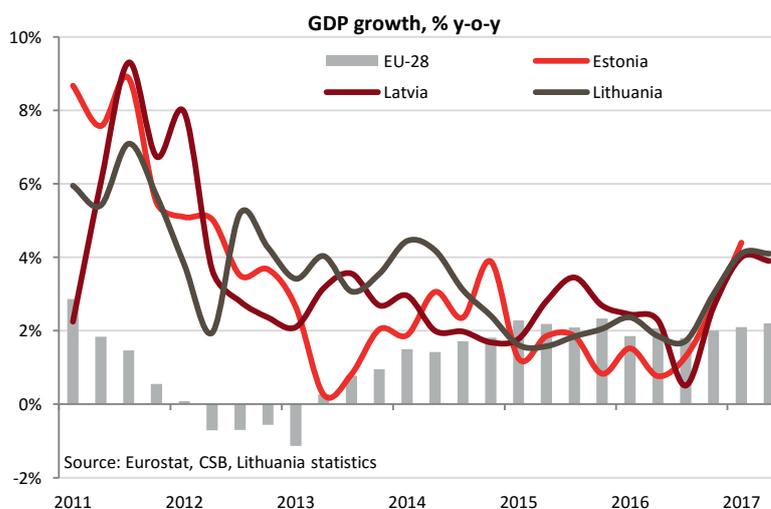
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Summary

- Continued recovery in the global economy and improving outlook in euro area as well as pick up in previously delayed EU funded investment continued to support rapid economic growth in Latvia. In Q2 GDP in Latvia grew by 4.1% compared to previous year while compared to previous quarter economy expanded by 1.3%.
- Retail trade continues to lag behind overall economic growth as sales rose by 3.1% y-o-y in June. Retail trade growth has remained broadly constant since late 2015 despite more than 7% wage growth.
- In June main trends in Latvian manufacturing sector remained unchanged as growth reached 10.1% y-o-y which is more than twice the rate of overall economic growth as sector continues to benefit from favourable external situation and rebound in international trade.
- Inflation has stabilized as headline inflation in Latvia in June stood at 3.0% which is a slight increase compared May. Overall inflation remains driven by external factors as food prices rose by 6.5%, however in recent months domestic prices have also begun to trend upwards.
- Following weak growth in April, exports rebounded strongly in May as export of Latvian goods rose by 9.2% y-o-y as export growth remains broad based and in line with developments in manufacturing sectors.

GDP

Continued recovery in the global economy and improving outlook in euro area as well as pick up in previously delayed EU funded investment continued to support rapid economic growth in Latvia. In Q2 GDP in Latvia grew by 4.1% compared to previous year while compared to previous quarter economy expanded by 1.3%. In addition short term indicators remain positive while household and business confidence continued to improve in June and July pointing to further acceleration in GDP growth in the second half of 2017.



Main growth drivers remained unchanged in Q2 compared to Q1 as industrial production grew by 8% y-o-y while construction expanded by 14% which was supported 50% increase in government

investment as EU funded investment. Such a strong growth in consumption is likely to boost consumption.

Meanwhile other sectors grew at a slower pace while transport sector remains one of the main risks to economic growth due to reduction in transit volumes from Russia. In addition, despite strong growth in IT sector, other export of business services is no longer increasing while tourism revenue has even decreased despite increased number of tourists. As a result service sectors grew by only 3% in Q2.

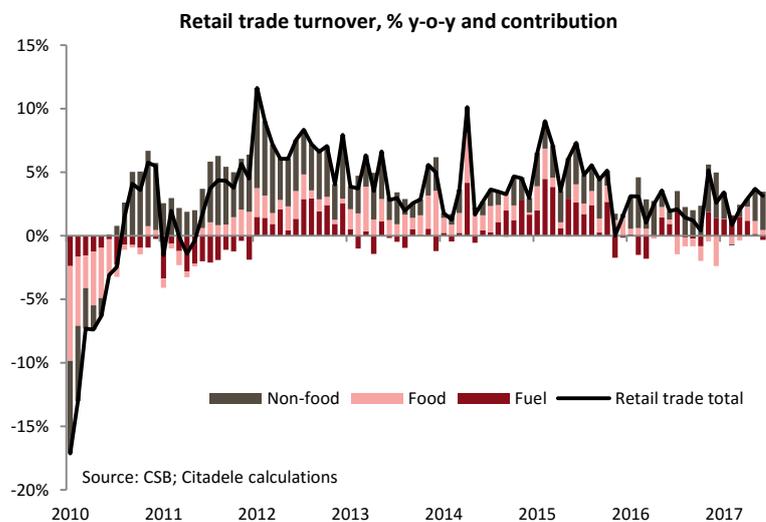
Retail trade

Retail trade continues to lag behind overall economic growth as sales rose by 3.1% y-o-y in June. Retail trade growth has remained broadly constant since late 2015 despite more than 7% wage growth and recent rapid decline in unemployment as recovery in construction and inflows of EU funds have not yet translated in stronger retail trade growth.

At the same time sales of non-food items saw the fastest pace of growth in 2017 as in June sales of non-food items excluding auto fuel

expanded by 7.3%. In June non-food sector was supported by strong growth in the sales of clothing (+13.9%) and electrical appliances (+18.9%), while previously strong online shopping grew by only 3.1% which is the slowest pace of growth in this segment since 2010.

In addition to positive trends in non-food sales, food sales also remained in positive territory for the third month in a row as sales of food items increased by 1.0% y-o-y. However this was mostly due to almost 40% growth in specialized beverage sellers which have taken advantage of significant difference in excise tax on alcohol to between Latvia and Estonia to increase sales in border regions. Meanwhile fuel sales remain volatile and in June declined by 1.9%



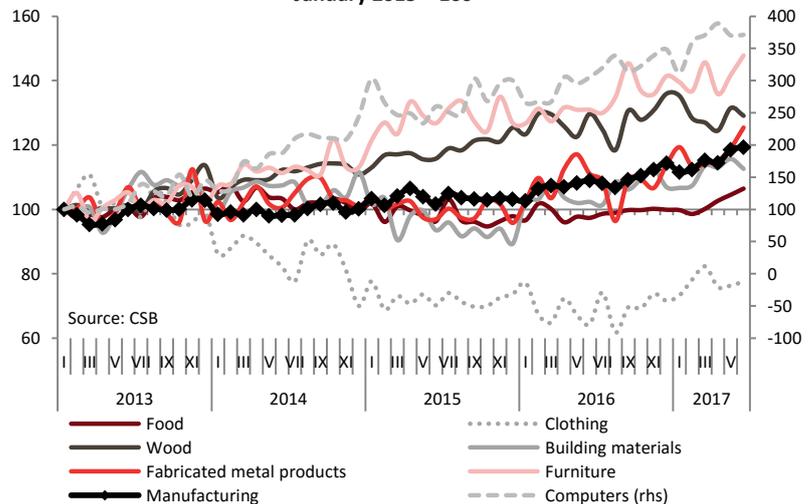
Manufacturing

In June main trends in Latvian manufacturing sector remained unchanged as growth reached 10.1% y-o-y which is more than twice the rate of overall economic growth. Compared to May manufacturing grew by 0.7% which followed a 3.5% growth in previous months which points to a strong underlying trend in manufacturing as sector continues to benefit from favourable external situation and rebound in international trade.

Most of manufacturing industries remain in positive territory, but growth again was led by production of electrical equipment (+23.1% y-o-y), car and car parts (+48.8%), fabricated metal products (+13.0%), computers and optical equipment (+21.6%) as well as other machinery (+42.5%). These sectors have showed relatively consistent growth throughout the year. In addition to this food sector is finally beginning to recover from the impact of Russian sanctions as output in this sector increased by 9.3% due to both strong export and domestic demand.

Only major expectation to generally positive trends in manufacturing in June was in wood sector where output declined by 0.5% y-o-y even though wood sector continues to expand both in Lithuania and Estonia, and usually wood sector dynamics are closely correlated between Baltic countries. However, despite weakness in wood production manufacture of furniture grew by 12.9% in June.

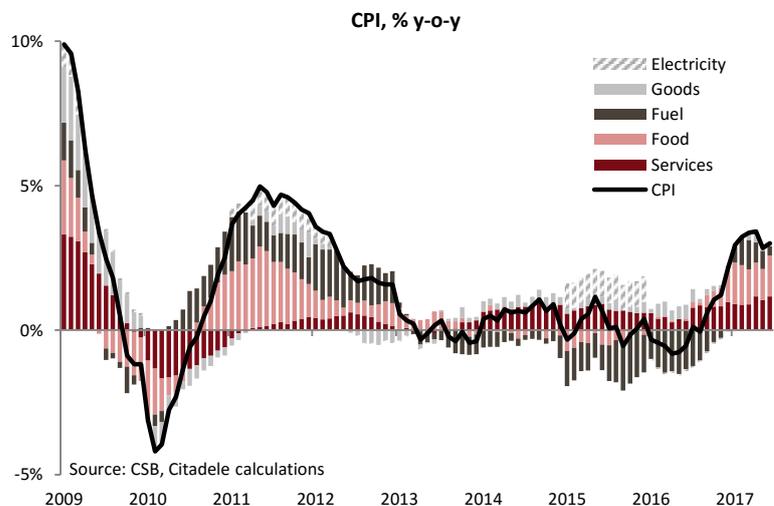
Manufacturing output, constant prices
January 2013 = 100



Inflation

Inflation has stabilized as headline inflation in Latvia in June stood at 3.0% which is a slight increase compared May. Overall inflation remains driven by external factors as food prices rose by 6.5%, however in recent months domestic prices have also begun to trend upwards.

In June services prices rose by 1.0% compared to previous month and although some of this increase is seasonal due to price fluctuations in hotel sector, annual service price inflation reached 4.0% in June driven mainly by insurance, where prices rose by 31.5% due to surge in cost of car insurance, and telecoms (+4.1%), where prices on domestic services have risen in part due to termination of roaming charges in the EU.

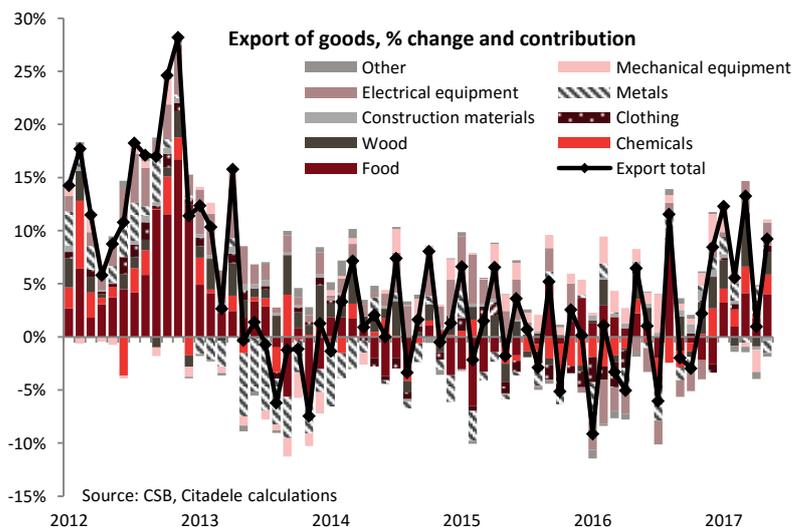


Meanwhile fuel prices declined by 1.9% in June due to slight decline in global oil prices and annual fuel price inflation dropped to 2.5% as previous year's surge in world oil prices has mostly dropped out from headline inflation.

External trade

Following weak growth in April, exports rebounded strongly in May as export of Latvian goods rose by 9.2% y-o-y as export growth remains broad based and in line with developments in manufacturing sectors. Export growth in Latvia is mainly driven by external demand as international trade which rose by 9.7% (current prices) in May.

In May export growth was mainly driven by strong growth in milk products (+45%), wood products (+6.9%), beverages (+43.6%) and electrical devices (+14.5%) although beverages was mostly driven by re-exports to Russia. At the same time imports in May rose by 12.5% due to higher energy prices, increased trade activity with Russian and recovery in private sectors investment and as a result trade balance deteriorated slightly in May.



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