

Latvian Macro Monitor

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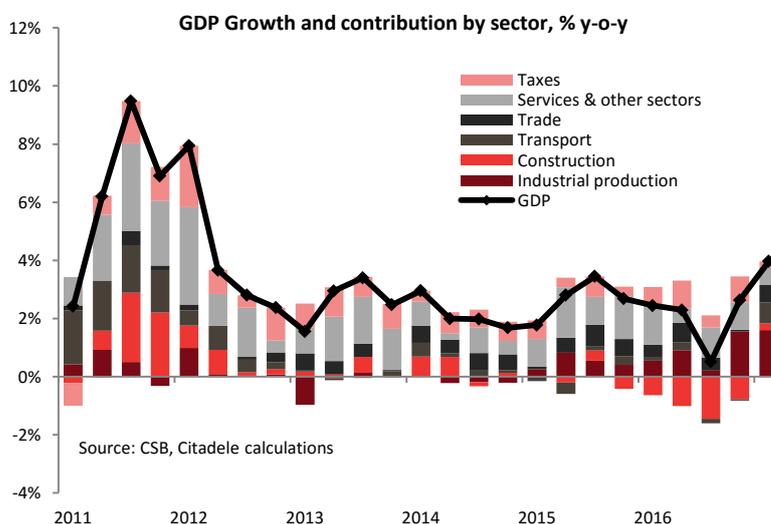
Summary

- Second estimate of Q1 GDP growth has confirmed strong acceleration in Latvian economy as output expanded by 4.0% y-o-y while on a quarterly basis GDP grew by 1.6% which is the fastest quarterly GDP growth in more than 5 years.
- In April retail trade improved somewhat as growth reached a 3 month high but nonetheless growth remained sluggish and sector continues lag behind other sectors of the economy. Compared to previous year retail sales grew by 2.8% y-o-y in April.
- Latvian manufacturing continues to benefit from positive developments in the global economy as well as recovery in world trade as manufacturing output in March grew by 7.4% y-o-y and manufacturing currently remains one of the fastest growing sectors in Latvia.
- In Q1 construction output in Latvia rose by 8.4% as delays in the EU funds are coming to an end. However despite acceleration in EU fund spending in Q1 construction growth was mostly driven by stronger private sector and in particular due to strong growth in construction of commercial and residential buildings.
- As expected in April inflation began to stabilize as headline inflation remained unchanged compared to March at 3.4% y-o-y. In April again inflation was mainly driven by external factors, however in recent months domestic price inflation has also begun to increase and in April service prices rose by 4% y-o-y.
- Acceleration in economic growth over the last two quarters is being reflected also in the labour market. In Q1 unemployment rate declined to 9.4% while registered unemployment reached 7.8% in April. Declining unemployment continues to put upward pressure on wages as average gross wage grew by 7.2% y-o-y in Q1.

GDP

Second estimate of Q1 GDP growth has confirmed strong acceleration in Latvian economy as output expanded by 4.0% y-o-y while on a quarterly basis GDP grew by 1.6% which is the fastest quarterly GDP growth in more than 5 years.

Strong economic growth in Q1 was supported by positive developments in Euro area, stabilization of Russian economy and recovery in world trade which has returned to positive growth for



the first time in more than two years. As a result in Q1 manufacturing grew by 10.3% y-o-y while exports increased by 8.3% as manufacturing together with energy and mining contributed almost 1.6 percentage points to overall GDP growth in Q1.

In addition activity has also begun to pick up in construction sector as output there grew by 8.4% y-o-y due to acceleration in EU fund investment and stronger private sector demand which has benefited from recovery in bank lending. As a result investment in Q1 grew by 8.8% y-o-y.

Besides manufacturing and construction in Q1 output also grew in transport sector (+9.4% y-o-y), trade (+5.0%) and public services (+3.1%). At the same time output in IT services grew by only 0.1% while financial services declined by 10.7% due to drop in net commission incomes.

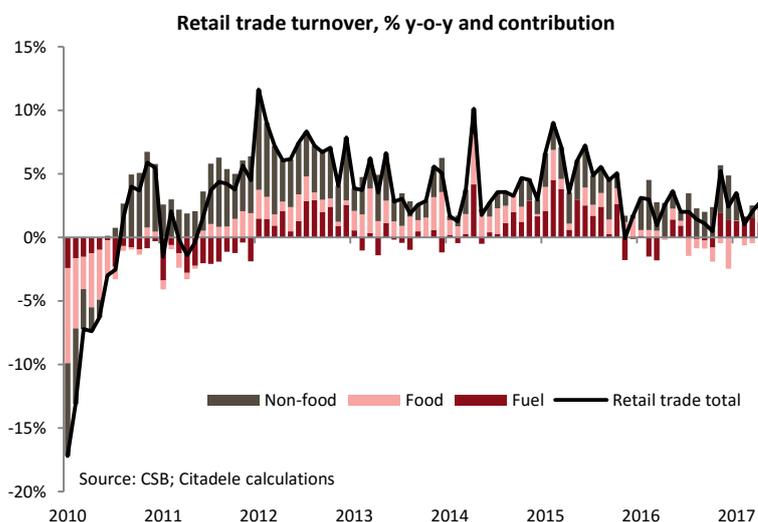
Retail trade

In April retail trade improved somewhat as growth reached a 3 month high but nonetheless growth remained sluggish and sector continues lag behind other sectors of the economy. Compared to previous year retail sales grew by 2.8% y-o-y in April.

Slight acceleration in retail trade in April was mainly caused by food sales (+1.6% y-o-y) which grew at a fastest pace in almost a year and was one of the main reasons behind weak retail trade growth in recent months. At the same time

fuel sales growth slowed to 7.3% in April down from almost 12% in March. In addition retail trade was also negatively affected by non-food items which grew by only 0.7% in April.

In non-food sector online shopping recovered from unexpected slowdown in March as sales there grew by 19.6% y-o-y compared to only 5.0% in March. However this was offset by decline in pharmacy (-2.9%) and jewellery (-2.5%) while clothing sales increased only by 0.5%.



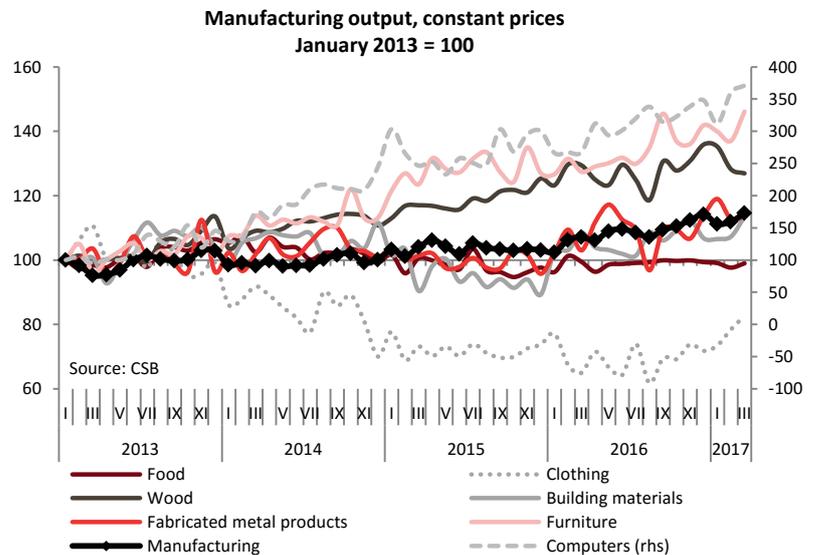
Manufacturing

Latvian manufacturing continues to benefit from positive developments in the global economy as well as recovery in world trade as manufacturing output in March grew by 7.4% y-o-y and manufacturing currently remains one of the fastest growing sectors in Latvia. In addition to manufacturing, energy sector also had another good month in March as favourable weather allowed for a significant increase in electricity production at Latvian hydro power plants. As a result energy sector output rose by 19.1% in March.

Growth in manufacturing remains mainly export led as export turnover rose by 16% in March while turnover in domestic market increased only by 2.1%. Strong growth in exports also suggest that Latvian manufacturers remain competitive despite strong wage growth.

March was second month in a row when overall manufacturing output grew rapidly despite decline in wood (-2.0% y-o-y) and food (-0.3%) production which are two of the largest manufacturing sub sectors. While food

production continues to be affected by Russian sanctions and weak domestic demand, decline in wood production could be temporary as exports of wood productions continues to grow and wood production remains strong both in Lithuania and Estonia. However, drop in wood and food production was more than offset by growth in fabricated metal products (+10.1%), computers and optical equipment (+38.8%), car parts (+27.6%) as well as electrical equipment (+28%).



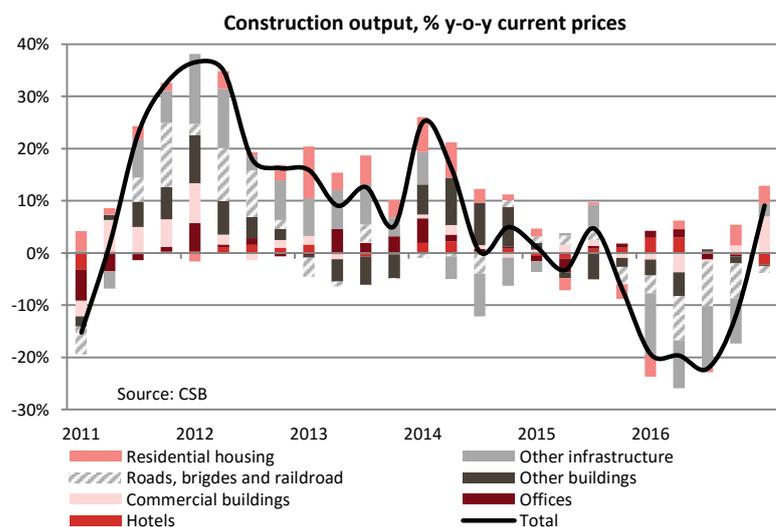
Construction

In Q1 construction output in Latvia rose by 8.4% as delays in the EU funds are coming to an end. However despite acceleration in EU fund spending in Q1 construction growth was mostly driven by stronger private sector and in particular due to strong growth in construction of commercial and residential buildings.

In Q1 construction of residential buildings rose by 20.3% compared to previous year. Meanwhile in commercial sector construction of

retail and wholesale building rose by 143.6% while construction of industrial buildings and warehouses increased by 21.5%. In addition in Q1 construction of agricultural buildings rose by 71.5% driven mainly by EU funded rural development projects.

In infrastructure which is dominated by EU financed projects situation remains mixed as construction of roads fell by 24.4% while construction of bridges rose by 60.8%. Overall infrastructure construction in Q1 rose by 3.7% which reflects gradual pick-up in EU fund spending.

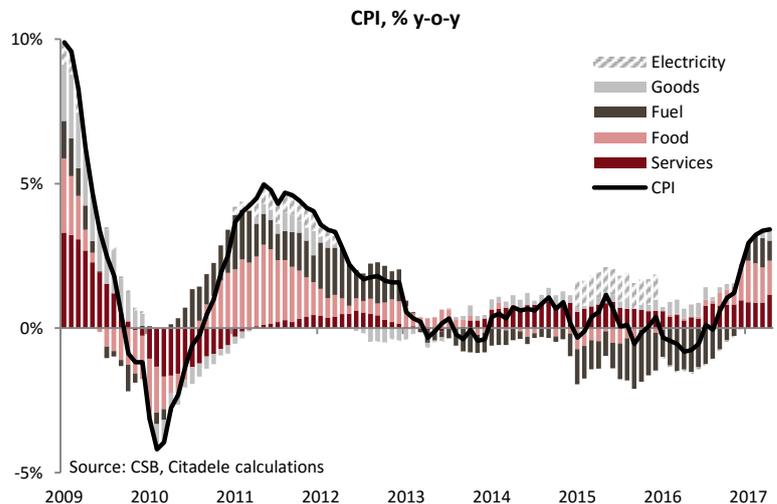


Inflation

As expected in April inflation began to stabilize as headline inflation remained unchanged compared to March at 3.4% y-o-y. In April again inflation was mainly driven by external factors, however in recent months domestic price inflation has also begun to increase and in April service prices rose by 4% y-o-y.

At the same time as global food and energy prices have stabilized and in recent months, food and fuel inflation has begun to slow also in Latvia. In April food prices in Latvia rose by 5.5% while fuel prices increased by 11.6%.

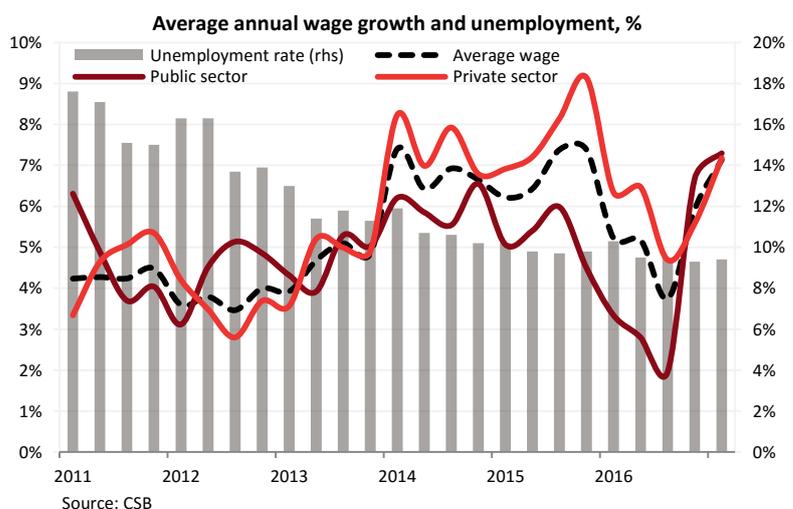
In April service price inflation reached highest level since 2008 as telecom and insurance price increased by 7.6% and 15.2% y-o-y respectively, however both of these sectors are somewhat specific. Telecoms operators have increased tariffs in response to abolition of roaming charges in the EU as well as due to need to invest in network development while insurers have significantly increased prices in the compulsory car insurance segment due rising pay-outs and to sectors weak financial results in recent years. At the same time strong wage growth is also significant factor behind faster service price inflation as prices are rising also in other service sectors.



Labour market

Acceleration in economic growth over the last two quarters is being reflected also in the labour market. In Q1 unemployment rate declined to 9.4% while registered unemployment reached 7.8% in April. Meanwhile number of unemployed dropped to 91.3 thousand and the only time when number of unemployed has been lower than this was between 2006 and 2008.

Decline in unemployment reflects both faster economic growth and declining population. Since the beginning of 2016 economically active population in Latvia has shrunk by 26 thousand and only record level of labour market participation (68% for 15-74 year olds) has kept unemployment at a relatively high level.



Declining unemployment continues to put upward pressure on wages as average gross wage grew by 7.2% y-o-y in Q1 with broadly similar growth in both public (+7.3%) and private (+7.2%) sector. Fastest wage growth in Q1 wage was in education (+10.2%) where wages have increased as a result of structural reforms in education sector and additional funding from state budget. Besides education in Q1 wages grew rapidly also in trade (+9.1%), IT services (+8.6%), agriculture (+7.7%) and manufacturing (+7.6%). The only sector where wages decline in Q1 was real estate services (-1.3%), while in other services and construction wages only grew by 1.9% and 3.0% respectively. Wage pressures remain strongest for the lowest wages as wages in lowest paid sectors continue to grow faster than in higher paid sectors and in the private sector from 2012 till end 2016 median (+9.7% annual average) wage growth has significantly exceeded average (+6.9%) wage growth.

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