

LATVIA

Following an exceptionally strong 2017, economic growth will moderate somewhat in 2018, to around 4%, as investment decelerates due to the slower pace of disbursements of EU funds. Emigration and low domestic labour mobility lead to skills shortages and mismatches, contributing to strong wage growth and rising inflationary pressures. Strong domestic demand will keep import growth high.

Fiscal policy will remain expansionary following tax reforms and welcome spending increase on health care. Reallocating spending toward higher minimum income support, better access to health care, more generous financial support for poor students, and policies to improve access to affordable housing in regions with strong employment growth would reduce poverty and boost productivity growth.

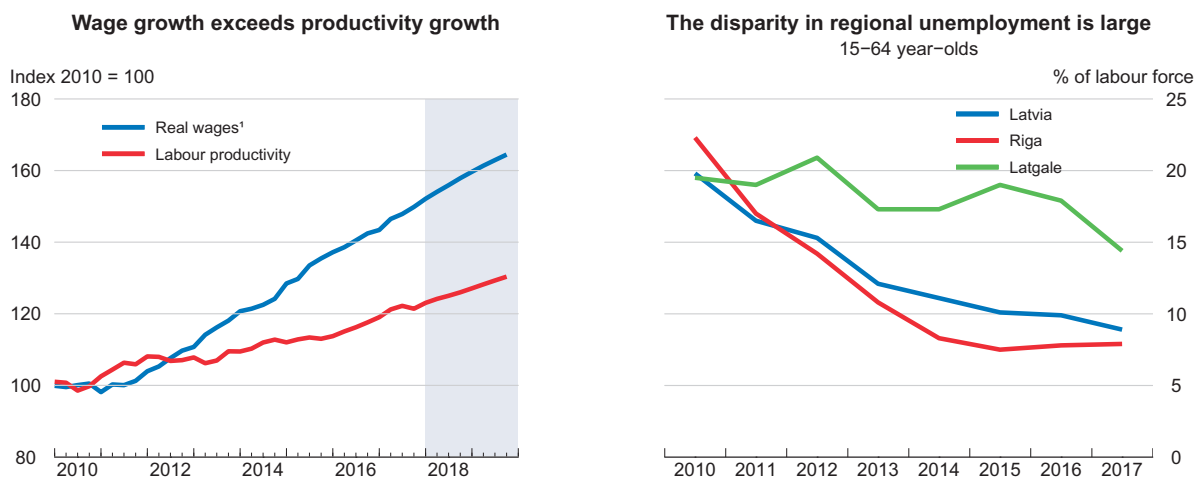
Strong economic growth is driven by investment and exports

Economic growth rose sharply in 2017, reflecting the disbursement of EU funds and a pick-up in business investment. The economic recovery of the euro area and Russia also boosted exports and investment. The current account balance turned into deficit on the back of strong domestic demand for imported capital goods. Unemployment has declined but remains very high in some regions due to low domestic labour mobility, contributing to high poverty. Inflationary pressure is building up as wage growth remains high, owing to emigration and skills shortages. The financial market remains sound in spite of the liquidation of a large bank and the on-going reduction of foreign deposits.

Reallocating spending to poverty relief, health care, education and housing would boost inclusive growth

Fiscal policy is expansionary. The increase in healthcare spending, improvement in pension adequacy and the gradual rise in non-taxable income are welcome steps to reduce large health and income inequalities. A 2017 law introduced a progressive personal income

Latvia



1. Real wages refer to average real labour compensation per employee (deflated by the harmonised consumer price index).

Source: OECD Economic Outlook 103 database; and Central Statistical Bureau of Latvia.

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Latvia: **Demand, output and prices**

	2014	2015	2016	2017	2018	2019
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	23.6	3.0	2.2	4.5	4.1	3.6
Private consumption	14.5	2.5	3.3	5.1	5.1	4.2
Government consumption	4.1	1.9	2.7	4.1	3.4	2.8
Gross fixed capital formation	5.3	-0.5	-15.0	16.0	10.6	7.5
Final domestic demand	23.9	1.7	-0.8	6.9	5.9	4.6
Stockbuilding ¹	0.0	0.7	3.2	0.5	-0.6	0.0
Total domestic demand	24.0	2.4	2.5	7.4	5.2	4.6
Exports of goods and services	14.3	3.0	4.1	4.8	4.7	3.6
Imports of goods and services	14.7	2.1	4.5	9.5	6.5	5.3
Net exports ¹	-0.3	0.5	-0.3	-2.7	-1.1	-1.1
<i>Memorandum items</i>						
GDP deflator	–	0.0	0.3	3.1	2.9	2.6
Harmonised index of consumer prices	–	0.2	0.1	2.9	2.6	2.6
Harmonised index of core inflation ²	–	1.5	1.2	1.7	2.1	2.6
Unemployment rate (% of labour force)	–	9.9	9.6	8.7	7.9	7.7
Household saving ratio, net (% of disposable income)	–	-9.9	-7.6	-7.2	-5.6	-4.5
General government financial balance (% of GDP)	–	-1.4	0.1	-0.5	-0.9	-0.9
General government gross debt (% of GDP)	–	46.6	50.5	48.4	48.1	47.9
General government debt, Maastricht definition (% of GDP)	–	36.8	40.5	40.1	39.8	39.6
Current account balance (% of GDP)	–	-0.5	1.4	-0.8	-0.9	-1.9

1. Contributions to changes in real GDP, actual amount in the first column.

2. Harmonised index of consumer prices excluding food, energy, alcohol and tobacco.

Source: OECD Economic Outlook 103 database.

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tax rate schedule and exempted undistributed corporate profits from taxation. However, an increase in minimum income support is also needed to improve well-being of the poorest households. Decrease in personal and corporate income tax will be partly offset by an increase in social security contributions and excise taxes as well as new measures to enhance tax collection. Overall, the government estimates that the tax reform package will reduce revenues by 0.6% of GDP, when fully implemented by 2020.

Increasing the supply of affordable housing in areas with strong employment growth would enhance labour mobility, promote a better match of workers' skills with jobs and help unemployed or low-income individuals find better-paid jobs. Providing more generous grants for students from low-income families attending vocational schools and universities would also alleviate skills shortages and enhance inclusiveness. Latvia has made significant progress in upgrading its vocational education and training. The government should guarantee steady financing for further improvement in the quality of vocational education, such as curriculum reforms. Promoting innovation co-operation between firms and research institutions would help Latvia diversify its exports toward technology intensive goods and services and boost productivity.

Economic growth will moderate

Economic growth will moderate to 4% as the exceptionally fast pace of disbursement of EU funds is expected to slow down. Inflation will rise as the output gap closes and wage growth remains high. The intensification of geopolitical risks related to Russia or weaker-than-expected euro area growth could dampen exports and investment. On the other hand, recent reforms that improved the quality of vocational and higher education, tax collection and the transparency of the insolvency regime could encourage investment and raise productivity more than expected by alleviating skills shortages, reducing informality and increasing business dynamism.