

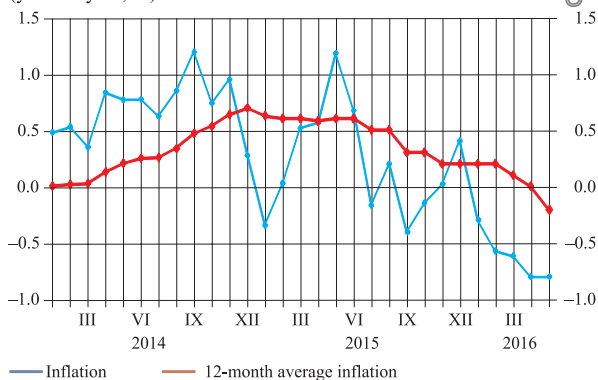


LATVIJAS BANKA
MONTHLY NEWSLETTER

JUNE 2016

Consumer prices are on the rise though annual inflation remains negative

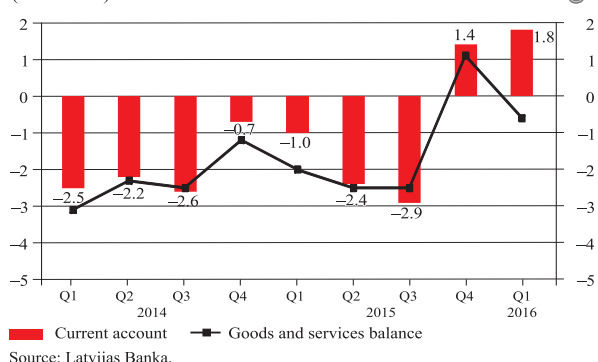
Inflation rate
(year-on-year; %)



The consumer price level in May was 0.6% higher month-on-month and 0.8% lower year-on-year. The month-on-month price rise was primarily on account of seasonal volatility of prices of several goods, an increase in prices of fixed line services and changes in fuel prices. Even though the lagged effect of the reduced costs of some resources is still topical, inflation will gradually change its course in the coming months. The impact of drivers of higher inflation will increase, but since the first half of the year is likely to end with negative annual changes in consumer prices, a gradual price rise in the second half of the year may not return the average annual inflation of 2016 to positive territory.

Surplus in the current account for the second consecutive quarter

Current account and goods and services balance in Latvia's balance of payments
(% of GDP)



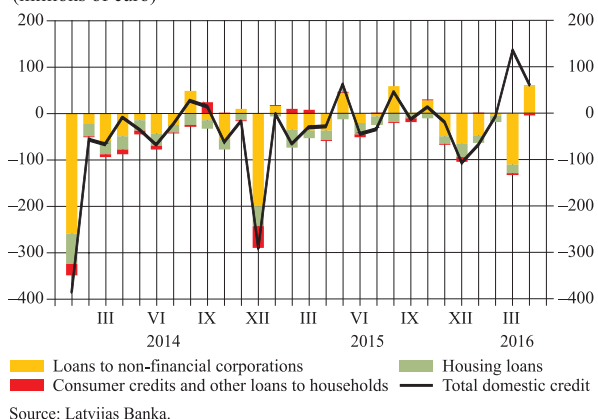
For the second consecutive quarter, the current account recorded a surplus in the first quarter of 2016. The formation of the 1.8% of GDP surplus was primarily due to inflows of European Union (EU) funds into the primary income account and due to dynamics of the goods account. The latter is still characterised by decreasing imports affected both by dropping commodity prices and declining imports of capital goods.

The surplus in services shrank slightly quarter-on-quarter primarily owing to seasonal factors. However, it improved year-on-year as income generated from foreign guests arriving to Latvia for the purposes of recreation, education or improvement of their health grew. The surplus of the secondary income account decreased as a result of annual contributions to the EU's own resources

from the value added tax and gross national income. The current account deficit is expected to be small in Latvia in the medium term which is considered appropriate for a country with a low savings ratio to support investment capacity and growth potential.

Lending is back

Monthly changes in the domestic credit stock
(millions of euro)



April was characterised by a long-awaited event which finally came to pass, i.e. the annual growth rate of domestic loans returned to positive territory. For the second consecutive month, the volume of the domestic loan portfolio of banks also expanded. Loans granted to non-financial corporations grew as did, albeit slightly, housing loans to households. Loans to domestic enterprises and households granted by banks in April augmented by 0.5%, with loans to non-financial corporations increasing by 1.0%, loans to financial institutions picking up by 0.6% and housing loans to households growing by 0.02%. The annual rate of change in total domestic loans improved and reached +0.1%.

Even though individual months have seen fluctuations in lending dynamics, the trend is becoming more pronounced, i.e. lending is growing. Moving from a very cautious approach to a policy of moderate rise in support lent to competitive entrepreneurship plans by granting loans and with mortgage lending recovering, new loans have been increasingly granted. This trend is expected to persist also in the future. It will be supported both by the necessity to ensure co-financing of EU funds and by the general sentiment of market participants.

	Reporting period	Data (%)
Gross domestic product (GDP)		
Real GDP (year-on-year growth)	Q1 2016	1.5
Real GDP (quarter-on-quarter growth; seasonally adjusted)	Q1 2016	0.1
01.06.2016 Year 2016 begins with a sluggish growth 		
Public finances		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2016 V	2.2
Tax revenue (since the beginning of the year; year-on-year growth)	2016 V	4.5
Consumer price changes		
Consumer Price Index (CPI; year-on-year growth)	2016 V	-0.8
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2016 V	1.2
12-month average inflation (HICP)	2016 V	-0.2
08.06.2016 Consumer prices rise in May but annual inflation does not 		
Foreign trade		
Exports (year-on-year growth)	2016 IV	-7.0
Imports (year-on-year growth)	2016 IV	-7.7
09.06.2016 Exports down for a fourth consecutive month 		
Balance of payments		
Current account balance (ratio to GDP)	Q1 2015	1.8
Foreign direct investment in Latvia (net flows; ratio to GDP)	Q1 2015	-1.6
03.06.2016 In the first quarter of 2016 the surplus in the current account was 101.0 mil. euro 		
Industrial output		
Working day-adjusted manufacturing output index (year-on-year growth)	2016 IV	-0.3
06.06.2016 Manufacturing in April departs from previous achievements 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2016 IV	1.8
Labour market		
Registered unemployment (share in working age population)	2016 V	8.4
Jobseekers rate (share in working age population)	Q1 2016	10.3
31.05.2016 Too high a minimum wage can have an adverse effect on the economy 		
Monetary indicators		
Resident deposits (year-on-year growth)	2016 IV	11.7
31.05.2016 Lending Is Back 		

Sources: Treasury, CSB and Latvijas Banka.

Macroeconomic forecasts

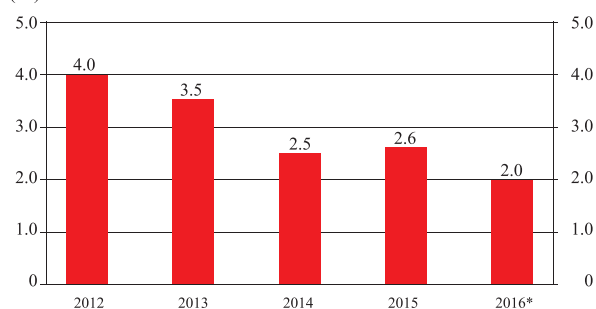


Igors Kasjanovs
Chief Economist
Latvijas Banka

Latvia's economic growth remains moderate: according to seasonally and calendar adjusted data, GDP increased by 2.6% in 2015. In general, the economic growth currently relies on strong private consumption, which offsets, to a certain extent, the weak external demand and absence of steadiness in investment growth. At the current juncture, external factors do not support export and investment acceleration; hence measures leading to improvements in

Latvia's business environment and other areas of activity via structural reforms aimed at boosting economy's competitiveness are gaining in importance.

GDP growth rate (%)



Sources: CSB and Latvijas Banka.

* Latvijas Banka forecast.

Recent macroeconomic data have been relatively weak. After the GDP drop in the fourth quarter of 2015, the data for the first quarter of 2016 likewise have been sluggish: growth was merely symbolic – one tenth of a percent (0.1% quarter-on-quarter, seasonally adjusted data). Economic growth in Latvia was primarily impeded by the low investment activity. The decrease in the amount of investment reflects the poor results of the construction sector – a year-on-year drop of 19.0% in value added. This confirms the previously expressed concerns by Latvijas Banka about the dependence of the construction sector and

investments on the availability of the European Union (EU) structural funds. However, it should be stressed that the sharp drop in the construction sector output is only a temporary factor as it is expected that access to EU funding will improve towards the end of 2016. Also, private consumption has been somewhat lagging behind the rise in disposable income of households, pointing to a tendency to keep rainy-day savings or to hold back funds for larger purchases in the future, which in turn leads to a potential upside risk in the medium term. The above suggests that 2016 will be marked by somewhat slower growth.

In March 2016 Latvijas Banka reduced its GDP projection for 2016 from 2.7% to 2.3%. The change was determined by the tense geopolitical situation, worsening of external demand and weak investment dynamics. Taking into account the latest macro-

economic data, growth projections are lowered further – the rate of GDP growth in 2016 is projected to be 2.0%. Given the expected rise in the external demand and higher investment activity, related to a renewed flow of EU funds, GDP is forecast to increase by 3.0% in 2017 or even slightly higher.

Taking into account the latest macroeconomic data, the rate of GDP growth in 2016 is projected to be 2.0%.

In 2015, average inflation (HICP) stood at 0.2%. Its year-on-year decline was primarily on account of commodity (e.g. oil and agricultural and food products) price falls on a global scale, while upward contribution to inflation came from the domestic factors like a gradual increase in income and some administrative price rises. The average consumer price level (CPI) in the first five months of this year was lower than a year ago, this trend still being a result of low world energy prices or largely their lagging effect. Heating energy prices, for example, are still continuing to fall, despite the fact that the prices of oil products and natural gas have begun to recover in the world market. Even though inflation is gradually going to change course in the coming months due to growing global commodity prices and gradually unwinding negative cost factors, the negative annual inflation in the first half of the year suggests that there will be a negative average annual inflation of 0.4% in 2016. Although some deceleration in wage growth is forecasted, the demand side effect on inflation will be maintained by gradual renewal of lending. With an outlook of growing commodity prices and rising disposable income, inflation for 2017 is expected to return to a positive figure of 1.3%.