

## MONITORING REPORT No. 5

03.06.- 07.07.2020.

### SUMMARY

1. The economic downturn peaked in mid-April in the euro area and the economic recovery is better than initially expected. However, a recurrent pandemic wave must be taken into account: OECD and EC economic forecasts show that a recurrent wave will not significantly deepen the current recession, but will significantly slow down recovery in 2021.
2. Latvia has managed to overcome the first wave of the pandemic more successfully than most other EU and world countries, thanks to prudent fiscal policy, membership in the euro area, as well as low levels of household debt. After a sharp decline in activity in April, May and June, the situation in the Latvian economy has significantly improved, and the recovery in domestic trade is much faster than expected. However, weak exports are holding back Latvia's economic recovery.
3. In the first half of 2020, as in previous years, very low lending activity was observed, which limited the growth of domestic consumption. The amount of resources allocated to downtime benefits and other socially oriented measures was insufficient to maintain domestic consumption at the pre-crisis level - so far the decline in GDP has been largely due to the low performance of domestic consumption.
4. Despite the positive developments, the overall macroeconomic environment can be described as volatile. There are negative signs of consumer price trends: deflation was marked in May and strengthened in June, and the situation in the electricity market may exacerbate this trend in the future. Unemployment continues to rise, further limiting the resources available to the population for domestic consumption. Production and retail sales continue to decline. Only economic indicators and capacity utilization indicators suggest some stabilization in May and June.
5. Taxes are collected at a relatively good level. Taking into account the tax holidays granted, in June this year, taxes were collected by 3% more than a year earlier in the respective month. Trends in tax collection give hope that the lowest point of tax revenue compared to the previous year is already behind us. Entrepreneurs are demanding fewer and fewer tax holidays.
6. The decline in tax collection is still smaller than the decline in economic activity. One reason could be the shadow economy, which is not reflected in the official statistics on economic activity.
7. The government has continued to develop its program of economic support measures, with the planned budgetary impact of the support measures already approaching 9% of GDP, which is relatively high. Additional EU support instruments could provide a fiscal stimulus of 16% of GDP with virtually no increase in government debt.

The Council generally welcomes the government's actions and measures to address the effects of the crisis, but calls on the government to take into account the following:

1. The Council sees an inconsistency in leaving the government debt forecast unchanged since the establishment of the Stability Program 2020-2023, while updating the

macroeconomic indicators framework MTBF 2020/23. development. Decisions taken so far on the size of the aid measure, and in particular the restrictions on the application of fiscal conditions, suggest that the increase in debt will be higher than projected;

2. The Council welcomes the short-term government support measures, but urges caution with regard to excessive deficit and debt growth in 2021 and beyond;
3. Existing and planned public support for the economy has reached significant levels (especially in view of potential EU support) and cannot be infinite due to the principles of fiscal sustainability and intergenerational responsibility. Some countries are already talking about the need for spending cuts<sup>1</sup> and more restrictive monetary policies<sup>2</sup>. It is necessary to realize that sooner or later fiscal conditions will have to be returned<sup>3</sup> and that today's support mechanisms should not place a disproportionate burden on future budgets;
4. Given that EU support instruments are very large and have little or no impact on the general government budget balance (GGBB), the government should limit the development of additional economic stimulus measures, given that they directly undermine the GGBB and the country's fiscal sustainability. ;
5. Support must be increasingly selective, better targeted and have an immediate effect. Investment projects must primarily promote the development of Latvia's economic potential, productivity growth and competitiveness. The magnitude of the social protection impact and the fiscal multiplier could be two additional criteria against which support measures are assessed. Some planned public investment projects (Riga Concert Hall, Liepāja Prison) poorly meet or do not fully meet these criteria. There is a need to establish a process for analyzing the effectiveness of aid to help justify the choice of the most effective projects and support mechanisms;
6. The choice of support instruments and projects must be transparent. It is desirable to plan audits of support measures and expenditure in a timely manner;
7. The “Law on Overcoming the Consequences of the Spread of Covid-19 Infection” stipulates that the fiscal conditions of the FDL are not valid also in 2021, therefore there is no “anchor” for the amount of budget expenditures. This poses a political risk to populist spending increases;
8. The Council fully agrees with the Bank of Latvia that long-term (up to 25 years) support instruments for entrepreneurs are unacceptable from the point of view of fiscal risks, extremely risky and disproportionate to the potential benefits. <sup>4</sup>

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<sup>1</sup>Toi Staff, “With deficit rising, Finance Ministry considers major cuts to public sector,” *The Times of Israel*, July 7, 2020, <https://www.timesofisrael.com/with-deficit-rising-finance-ministry-considers-major-cuts-to-public-sector/>.

<sup>2</sup>Jill Ward and David Goodman, “BOE’s Bailey Signals Dramatic Shift Toward Stimulus,” *Bloomberg*, June 20, 2020, [https://www.bloomberg.com/news/articles/2020-06-22/boe-s-bailey-says-he-d-shrink-balance-sheet-before-raising-rates?utm\\_content=business&utm\\_source=twitter&utm\\_campaign=socialflow-organic&cmpid=socialflow-twitter-business&utm\\_medium=social](https://www.bloomberg.com/news/articles/2020-06-22/boe-s-bailey-says-he-d-shrink-balance-sheet-before-raising-rates?utm_content=business&utm_source=twitter&utm_campaign=socialflow-organic&cmpid=socialflow-twitter-business&utm_medium=social).

<sup>3</sup><https://www.politico.eu/article/dombrovskis-eu-budget-rules-to-come-back-after-crisis/>

<sup>4</sup><https://www.delfi.lv/delfi-tv-ar-jani-domburu/raksti/vitenbergs-sola-uznemejiem-garo-naudu-latvijas-banka-bridina-par-lieliem-riskiem.d?id=52283575>

## DETAILED ANALISYS

## 1. General development of the situation

1.1. Table. OECD economic development forecasts						
	One - off recession scenario			Repeated recession scenario		
	2019	2020	2021	2019	2020	2021
Euroarea	1.3	-9.1	6.5	1.3	-11.5	3.5
USA	2.3	-7.3	4.1	2.3	-8.5	1.9
Latvia	2.2	-8.1	6.3	2.2	-10.2	2
Estonia	4.4	-8.4	4.3	4.4	-10.0	1.6
Lithuania	3.9	-8.1	6.4	3.9	-10.4	3.4

Source: OECD Economic Outlook 107 (June 2020)

With restrictive measures declining sharply, economic recovery has begun. According to experts<sup>5</sup>, the lowest point of the economic recession in the euro area was in mid-April and the economic recovery is better than initially expected. However, this recovery is uneven - it is assumed that some sectors of the economy may not fully recover from the recession, while digital services, pharmaceuticals and telecommunications are experiencing rapid growth - and there are still significant risks, such as a repeat of the pandemic.

The Executive Board of the ECB, taking into account the depth of the economic recession and the outlook for falling inflation, At its June meeting, the Council decided to both extend (by an additional € 600 billion) and extend (until June 2021) the Pandemic Extraordinary Securities Purchase Program (PEPP).

The European Commission's summer economic forecasts<sup>6</sup>, published in July, predict that euro area GDP will contract by much more in 2020 than projected in the spring. Namely, a drop of 8.7% is expected (only a 7.7% drop was forecast in the spring), which in 2021 will be followed by 6.1% growth.

As the Covid-19 pandemic continues to spread, the OECD bases its economic forecasts on the likelihood of a recession. 1.1.table shows that the US is projected to have a less deep recession than the euro area. In Latvia and other countries, the negative economic impact of the pandemic is projected less than the euro area average. The US's most successful recovery is based on a larger share of digital services in its economy. The eurozone, on the other hand, is suffering more from the disruption of traditional supply chains, which will take much longer to rebuild.<sup>7</sup>

The media<sup>8</sup> reports that, according to the OECD, Latvia is the second most successful country after South Korea in curbing the pandemic. Lithuania and Estonia rank fourth and fifth respectively in the list of 33 countries evaluated.

Although the incidence of COVID-19 is declining rapidly in many European countries and countries are lifting border crossing restrictions, the prevalence of the disease is still high

<sup>5</sup>“When the alphabet fails to describe a recovery,” *Eurointelligence Professional Daily Morning Newsbriefing*, 01.07.2020.

<sup>6</sup>European Commission, Summer 2020 Economic Forecast: An even deeper recession with wider divergences (July 7, 2020), [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_1269](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1269).

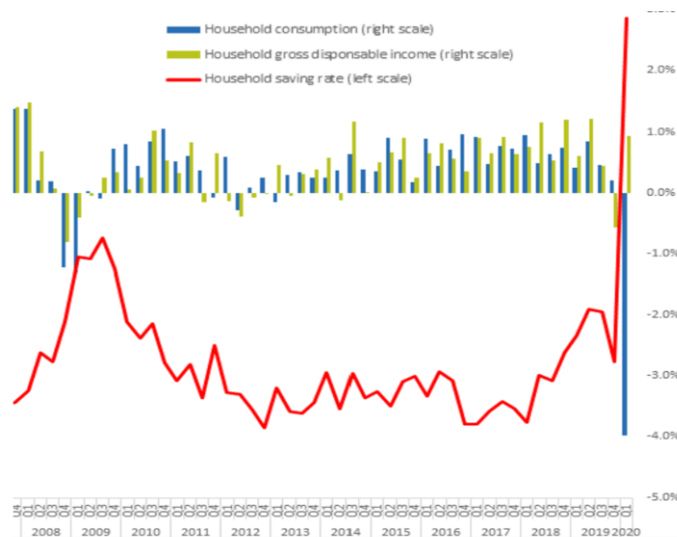
<sup>7</sup>“How the pandemic will accelerate Europe's decline,” *Eurointelligence Professional Daily Morning Newsbriefing*, 08.07.2020.

<sup>8</sup>Latvija ieņem otro vietu OECD dalībvalstu vidū Covid-19 epidēmijas kontrolē, Delfi, 07.07.2020., <https://www.delfi.lv/news/arzemes/latvija-ienem-otro-vietu-oecd-dalibvalstu-vidu-covid-19-epidemijas-kontrole.d?id=52284629>.

in several countries important for Latvia's trade (Sweden, Belarus, Russia and the United Kingdom), which will continue to negatively affect Latvia's economic development.

EU Member States are continuing negotiations on the establishment of a European Reconstruction Fund and the next EU Multiannual Budget Framework (2021-2028). No concrete agreement has yet been reached on the scope or principles of these financial instruments.

## 1.2. figure. Household savings and factors affecting them in the euro area



Source: Eurostat Newsrelease No. 105/2020 (3 July 2020), [\[https://ec.europa.eu/eurostat/documents/2995521/10300279/2-03072020-AP-EN.pdf/2edaf9a9-b5e5-db10-f6a9-5b05615e79f0\]](https://ec.europa.eu/eurostat/documents/2995521/10300279/2-03072020-AP-EN.pdf/2edaf9a9-b5e5-db10-f6a9-5b05615e79f0)

Eurostat's analysis shows that, despite the crisis, household incomes in the euro area have increased in early 2020, and consumption has also increased since early 2019 (Figure 1.2). Although wages have fallen, government support schemes and deferred tax payments have avoided a fall in real incomes. The problem is that the increase in household income and savings has come at the expense of rising public debt.<sup>9</sup> There is a risk that rising public and private debt will result in lower investment, which will have a negative impact on economic development.

According to the European Fiscal Monitor,<sup>10</sup> the depth of the economic recession is measurable from -2% to -13%. As a result of economic support programs implemented by governments, the government budget deficit will increase to 8% of GDP on average - in Great Britain the deficit will increase even to 16%. Italy has applied for the largest amount of aid in relation to national GDP, at 50% of GDP, but most of this aid (44%) consists of guarantees with an indirect impact on the national budget. Germany has done the same: total aid in Germany is 37% and guarantees 25% of GDP. It should be noted that the level of guarantees in Germany represents almost half of the amount of guarantees provided in all EU countries, which - according to experts<sup>11</sup> - may pose a significant threat to fair competition in the EU single market.

<sup>9</sup>"Household saving rate all time high at 16.9% in the euro area while household investment ratedown to 8.7%," Eurostat Newsrelease No. 105/2020 (3 July 2020), <https://ec.europa.eu/eurostat/documents/2995521/10300279/2-03072020-AP-EN.pdf/2edaf9a9-b5e5-db10-f6a9-5b05615e79f0>.

<sup>10</sup>European Fiscal Monitor Special Update (June 2020).

<sup>11</sup>The covid-19 pandemic puts pressure on the EU," *The Economist* (May 14th, 2020).

## 2. Macroeconomic situation in Latvia

According to Latvian economists,<sup>12</sup> prudent public finances, location in the euro area, as well as the low level of household debt have allowed to reduce the negative impact of the crisis on the Latvian economy. After a sharp decline in activity in April-May, the situation in the Latvian economy has significantly improved, and the recovery in domestic trade is much faster than expected. However, weak exports are holding back Latvia's economic recovery. It is also acknowledged that, in general, Latvia has managed to overcome the first wave of the pandemic more successfully than most other EU and world countries.<sup>13</sup> The European Commission also acknowledges that Latvia's GDP dynamics forecast for this year and next could be better than the EU and euro area average.<sup>14</sup>

Since the Latvian Stability Program 2020/23. (SP CoV 2020/23) The Ministry of Finance has changed the forecasts of real GDP growth for 2021, 2022 and 2023. The forecast for real GDP growth for 2020 remains unchanged and is projected to decline by 7%. Compared to the previous forecast in April 2020 (SP CoV), which was prepared for the development of the Stability Program 2020/23 in the context of the Covid-19 crisis, the real GDP growth rate has increased by 4.1 percentage points by 2021, decreased by 0.4 percentage points by 2022. and increased by 0.7 percentage points for 2023 (Table 2.1).

### 2.1. Table. Comparison of Latvia's GDP development forecasts

	2020	2021	2022	2023
<b>Real GDP growth, change in %p</b>	–	<b>+4.1</b>	<b>-0.4</b>	<b>+0.7</b>
MTBF 2021/23	-7.0	5.1	3.1	3.1
SP (CoV) 2020/23	-7.0	1.02	3.53	2.40
<b>Nominal GDP growth</b>	<b>+0.5</b>	<b>+4.1</b>	<b>-0.4</b>	<b>+0.8</b>
MTBF 2021/23	-7.4	6.5	5.3	5.2
SP (CoV) 2020/23	-7.9	2.4	5.6	4.4
<b>Inflation (consumer prices)</b>	<b>-0.2</b>	<b>-0.5</b>	–	–
MTBF 2021/23	0.2	1.2	2.0	2.0
SP (CoV) 2020/23	0.4	1.7	2.0	2.
<b>GDP deflator</b>	<b>+0.5</b>	–	–	<b>+0.1</b>
MTBF 2021/23	-0.5	1.3	2.0	2.0
SP (CoV) 2020/23	-1.0	1.3	2.0	1.9
<b>Potential GDP growth</b>	<b>-0.5</b>	<b>-0.4</b>	<b>-0.3</b>	<b>-0.4</b>
MTBF 2021/23	2.4	2.5	2.5	2.4
SP (CoV) 2020/23	2.9	2.9	2.8	2.9
<b>Output gap</b>	<b>+0.9</b>	<b>+4.9</b>	<b>+4.8</b>	<b>+5.8</b>
MTBF 2021/23	-7.9	-5.6	-5.0	-4.4
SP (CoV) 2020/23	-8.8	-10.4	-9.8	10.2

Source: FDP opinion on macroeconomic forecasts: [<https://fdp.gov.lv/17062020-fdp-viedoklis-par-finansu-ministrijas-makroekonomisko-raditaju-prognozēm-2020-gadam-un-2021-2023gadam>]

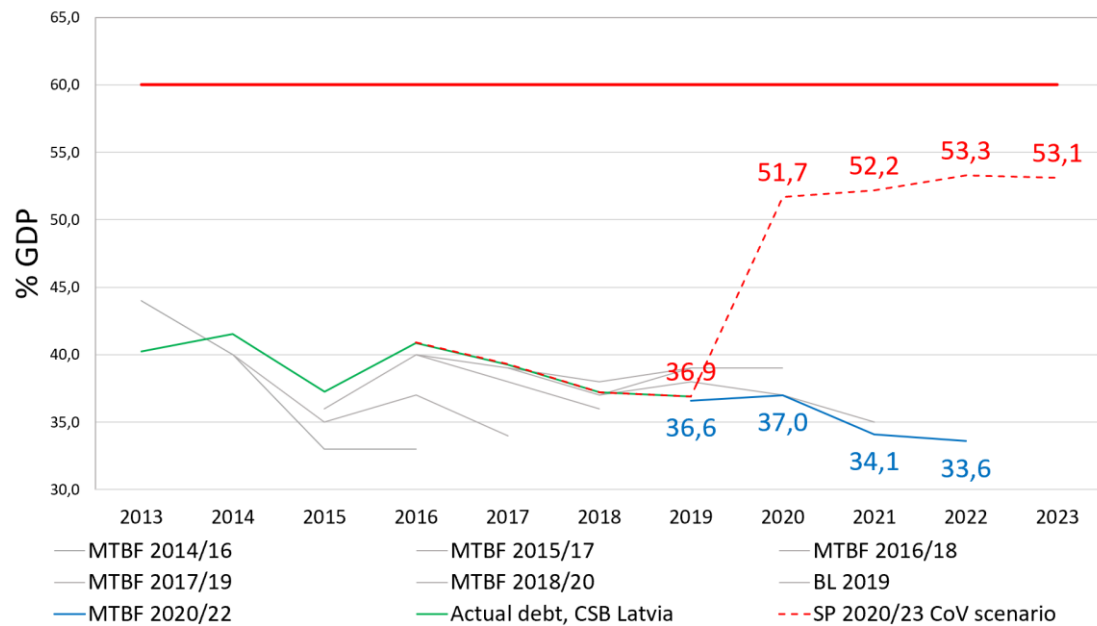
<sup>12</sup>“Ekonomisti: krīzes pirmā fāze Latvijā beigusies, tomēr eksporta vājums 'dzesēs' ekonomiku,” *Delfi*, 26.06.2020., [https://www.delfi.lv/bizness/biznesa\\_vidē/ekonomisti-krizes-pirma-faze-latvija-beigusies-tomer-eksporta-vajums-dzeses-ekonomiku.d?id=52261683](https://www.delfi.lv/bizness/biznesa_vidē/ekonomisti-krizes-pirma-faze-latvija-beigusies-tomer-eksporta-vajums-dzeses-ekonomiku.d?id=52261683).

<sup>13</sup>“Mārtiņš Āboliņš: Pandēmijas pirmais vilnis pārvarēts veiksmīgāk nekā cerēts”, *Delfi*, 06.07.2020., <https://www.delfi.lv/bizness/versijas/martins-abolins-pandemijas-pirmais-vilnis-parvarets-veiksmigak-neka-cerets.d?id=52276273>.

<sup>14</sup>Artjoms Konohovs, “EK vasaras prognoze: ES ekonomika šogad saruks par 8,3%; kritums lielāks par iepriekš lēsto, *Lsm.lv*, 07.07.2020., <https://www.lsm.lv/raksts/zinas/ekonomika/ek-vasaras-prognoze-es-ekonomika-sogad-saruks-par-83-kritums-lielaks-par-ieprieks-lesto.a366312/>.

At the same time, the government debt forecast has remained at the level projected in the Stability Program (Figure 2.2), indicating inconsistencies.

## 2.2. Figure. General government debt development dynamics and forecasts under the Covid-19 crisis



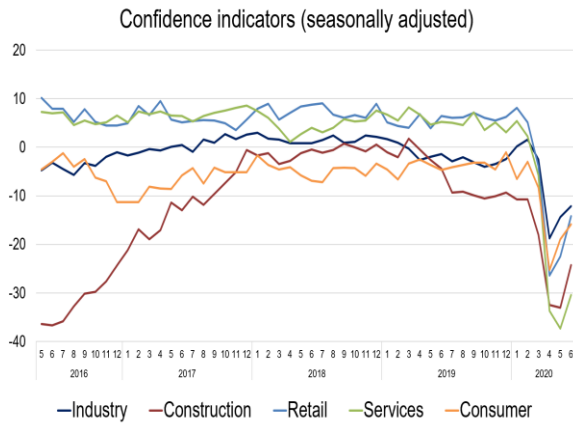
Source: CSP, VTBIL 2014-2022, State Treasury, MoF

### 2.1 Business cycle indicators

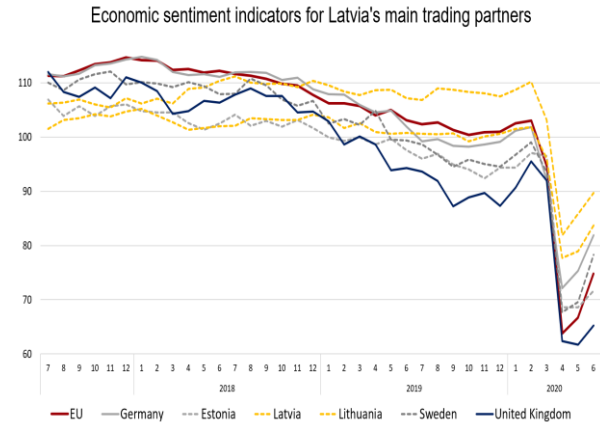
Since April / May, business sentiment and outlook for the future have started to improve, although confidence and sentiment indicators are still very low and values are negative. The return of some optimism to the business environment was influenced by news of the success of pandemic containment measures and the phasing out of mobility restrictions. Trends in confidence indicators characterizing the economic situation in Latvia have started to improve since April, and the most significant improvement was observed in the retail sector. Previously, in March, the services and construction sectors were the leaders in the decline in confidence, and the confidence indicator remains the lowest in the services sector. Confidence in the construction sector has remained low since the second half of 2019 and the current decline has started from a low point, however, the improvement in sentiment in construction is taking place relatively faster than in services.

After a historically sharp decline in economic sentiment indicators in Latvia's main trading partners in April and June, there has been a slight improvement, but confidence indicators remain negative. It should be noted that the improvement of business sentiment is more optimistic for Lithuanian entrepreneurs, while in Estonia this indicator is significantly more moderate. The lowest decline and slowest recovery can be observed for the UK sentiment indicator.

### 2.1.1. Figure. Confidence indicators by industry and major trading partners



Confidence indicators (saldo, %)  
Source: CSB (KR020m)



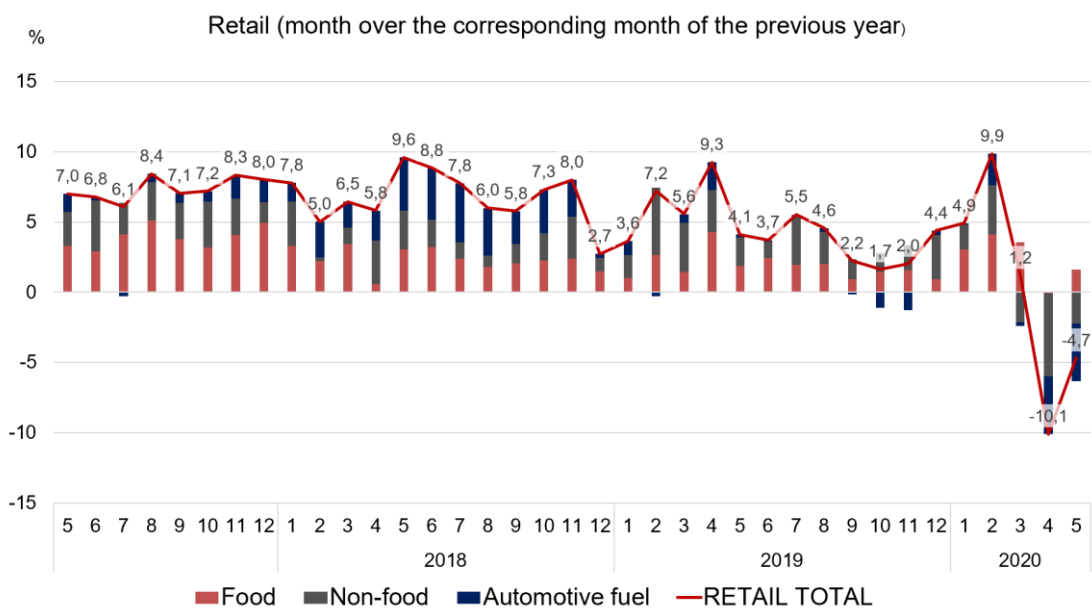
Economic sentiment indicator by trading partner countries  
Source: Eurostat

### 2.2. Retail and industry

Data from the Central Statistical Bureau (CSB) on retail trade turnover in April show that, compared to April 2019, the total retail trade turnover at current prices decreased by more than 10%: the largest decrease in turnover was observed in non-food retail trade (-6%) and automotive fuel in retail trade (-4%). In May, the decline in turnover continued, but was no longer going to be sharp. Compared to May 2019, in May of this year the turnover decreased by 4.7%. According to calendar adjusted data, the decline in constant prices was 0.6%. In May, the turnover of retail sale of automotive fuel decreased by 4%, while the turnover of trade in non-food products decreased by 2% compared to May 2019. In May, the turnover in the food retail segment increased by 1.6%. (Table 2.2.1.)

#### 2.2.1. Table. Economic situation by sectors

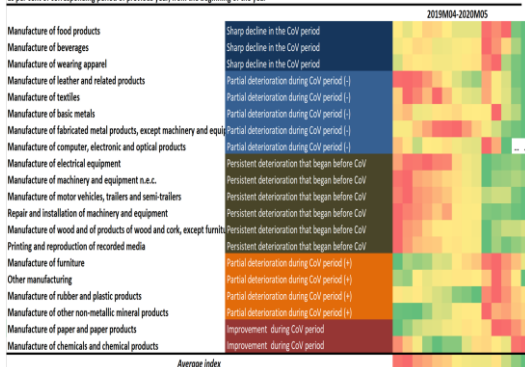
- a) Total turnover of retail trade enterprises by kind of activity, by months, at current prices, thous. euro



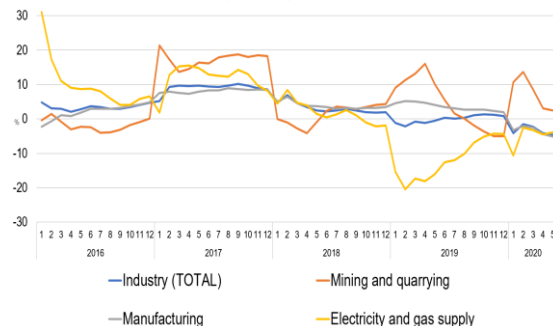
Source: CSB (TI030m)

b) Manufacturing indicators by sectors (% of the corresponding period of the previous year) and volume indices by sectors (from the beginning of the year), calendar adjusted data

RU030m. Volume indices of industrial production by economic activity (from the beginning of year), calendar adjusted data as per cent of corresponding period of previous year, from the beginning of the year

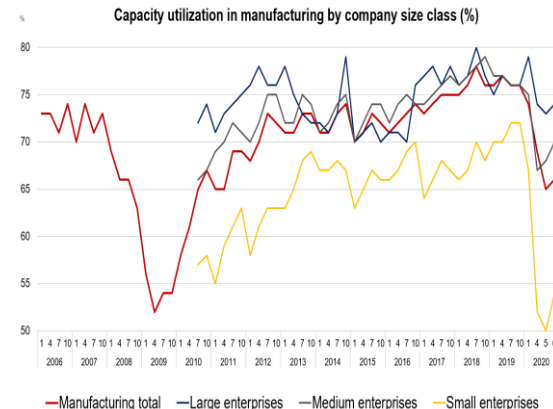
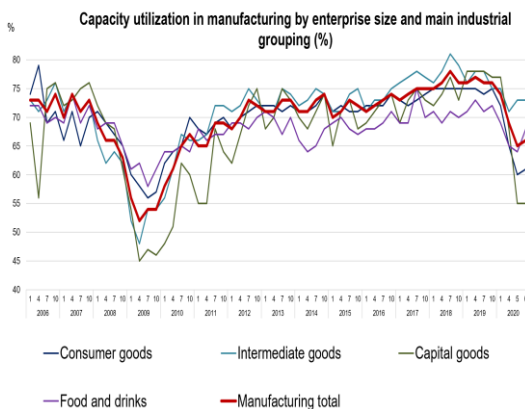


Volume of industrial production by economic activity from the beginning of the year (months over the corresponding months of the previous year)



Source: CSB (RU030m)

c) Capacity utilization in manufacturing by enterprise size class and by main grouping of production (per cent)



Source: CSB, KR060c

The CSB calendar adjusted data on industrial production output as a percentage of the corresponding period of the previous year show that since the beginning of the year industrial production has decreased by 4.6% in May: manufacturing production decreased by 5.1%, electricity and gas supply by 3.9% , while mining and quarrying output increased by 2.5%.

Looking at the dynamics of industrial production volume indices on an annual basis (2019M4-2020M5), a gradual decrease in production activity can be seen, which can be generally explained by the impact of the Covid-19 outbreak. However, the production activity of different types of products has been different. For example, during the Covid-19 restriction period (especially in April), the production of food, beverages and clothing products fell sharply and was sufficiently active throughout the year. This phenomenon can be explained by the saturation of the market in February and March, when there was a high demand in the food segment. Food production grew particularly sharply in March, but fell sharply in April. A gradual decline in production in March and April was observed in the manufacture of leather, textiles, metals and metal products, as well as in the manufacture of computers and optical equipment.

Already since 2019, and especially since the beginning of 2020, the production of electrical and other equipment, the production of cars, trailers and semi-trailers, the repair and installation of equipment, and the production of wood and wood products, printing and reproduction of records have been steadily declining. Since the beginning of the year, there has



been only a slight decrease in activity in the manufacture of furniture, rubber and plastic products and furniture. Some industries also showed increasing activity, such as chemicals and paper products.

Average capacity utilization in manufacturing has started to stabilize in June after a sharp decline in April, although it is still at 2011 levels. Since the beginning of the year, there has been a decrease in capacity utilization in the production of capital goods - in both May and June, capacity utilization in these sectors remained unchanged at 55%. In general, a downward trend is also observed in the capacity utilization of consumer goods. A minimal stabilization can be observed in the production of intermediate goods and a slight improvement can be seen in the capacity utilization of food and beverage production, especially in June.

Observing the capacity utilization of companies by their size, minimal improvements can be seen in all segments. Already in previous reports, it was found that the small business segment, which is the largest in Latvia in terms of number, has suffered the most. In May 2020, the situation in these companies continued to deteriorate, reaching only 50%, the weakest result since 2010. However, already in June, the small business segment has started a slow recovery and the workload reached 54%. Signs of recovery are also observed in the segment of medium-sized companies, but they remain at the level of the end of 2011 and 2014. It should be noted that the Covid-19 crisis has had a minimal impact on the large business segment, which can be explained by the impact of targeted economic stimulus measures and accumulated funds in previous years.

### 2.3. Employment and unemployment

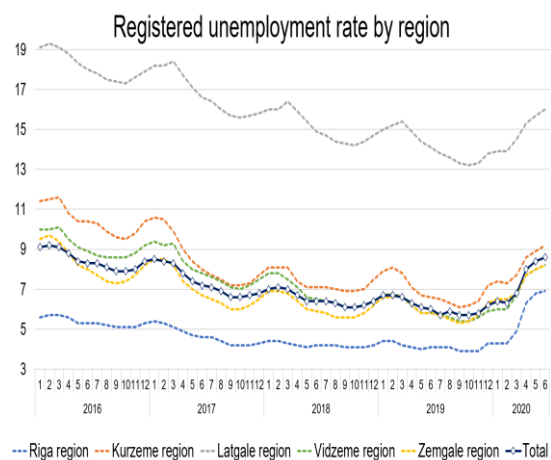
The seasonally adjusted data of the CSB show that the unemployment rate in the country continues to rise, reaching 9.8% in May. The registered unemployment rate of the State Employment Agency reached 8.6% in June. In June, the unemployment rate continued to grow on average by 0.2 percentage points in all regions. The indicators of Vidzeme region have leveled off with the unemployment rate of Zemgale since April and reached 8.2% in June. The highest unemployment has been observed in the Latgale region for many years, reaching 16% in June.

According to the current data of the State Employment Agency (SEA), as of 6 July, 15,962 vacancies have been registered in Latvia, of which 2,496 new current vacancies became available by 6 July, but the total number of unemployed is 78,611. By 6 July, 47 employers have submitted notifications of collective redundancies to the SEA and 5,157 planned redundancies have been announced.

#### 2.3.1. Figure. Unemployment rates



Source: CSB (NNB002)

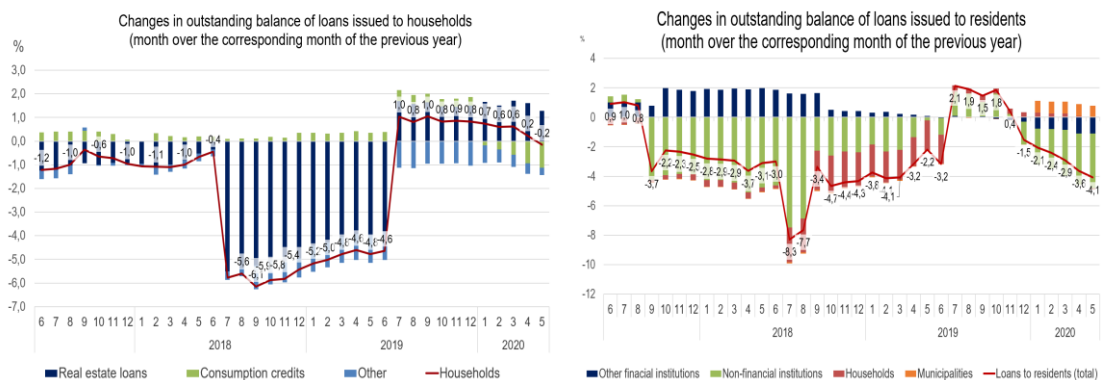


Source: SEA

## 2.4. Lending and consumer prices

In the lending market, borrowers still face restrictive lending policies. The Bank of Latvia's data on loans issued in May, compared to May of the previous year, show that loans to Latvian residents have fallen by 4.1% and that such a downward trend has been observed since December 2019. In the group of residents, as an exception category should be noted local governments, whose lending has been relatively active since the beginning of 2020 and is related to government decisions on the expansion of Treasury loans. Compared to May 2019, lending to households has decreased by 0.2%. The breakdown by type of loan shows that mortgage loans are predominantly available, and the activity of such loans is partly stimulated by the support available to ALTUM for the purchase of housing.

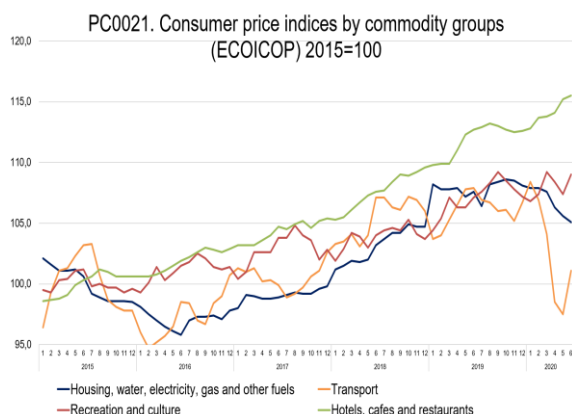
### 2.4.1. Figure. Loans by non-MFIs by residence, sector, subsector and target, currency group and maturity



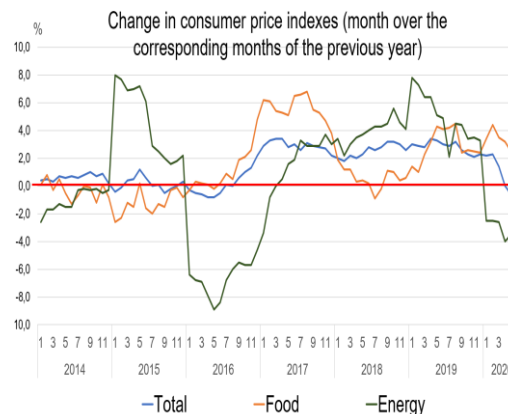
Source: BoL (O2 MFI)

According to the CSB data, the consumer price level for all goods and services already reached the **deflation rate (-0.6%) in May this year, and the June data reaffirmed this situation, with the consumer price level falling to (-0.7%) compared to the corresponding period of the previous year**. This effect was mainly caused by the situation in the electricity and gas markets, as well as the subsequent decline in transport costs (-6.2%) and a decrease in housing maintenance costs (-2.3%). The decline in the overall consumer price level was also influenced by the fall in clothing and footwear prices (-2.7). In general, electricity prices in both Latvia and Lithuania were still very low at the end of May-beginning of June, but on July 6, the Nord Pool exchange recorded an atypical situation in all Baltic countries, when the price of electricity was -0.09 euros per megawatt hour. Consumer prices continued to rise in June in the restaurant and hotel services sector, where the average price level continued to rise compared to June 2019 (+ 2.5%). According to the information compiled by the CSB, the increase in prices was mainly determined by catering services, including the average price level for restaurant and cafe services increased by (+ 2.7%), canteen services - by (+ 4.6%). In June, prices for food (+ 1%), health care (+ 2.6%) and leisure / cultural services (+ 1.8%) also rose year-on-year.

**2.3. Figure. Consumes Price indices**



Source: CSB (PC021m)

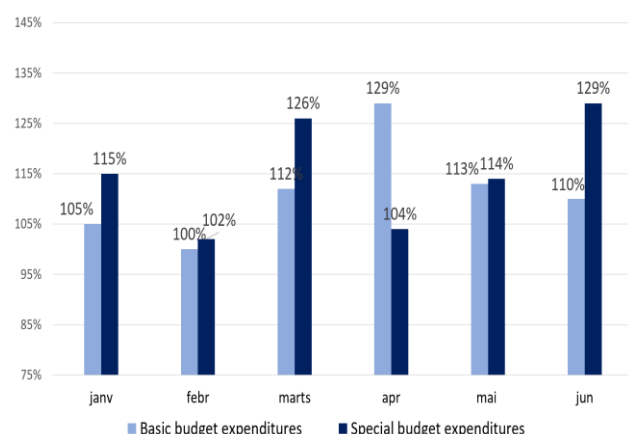


Source: CSB (PC041m)

**3. Dynamics of budget balance and tax revenues**

The government has set up a program of support measures to stimulate the economy and socially protect the population, which will have a lasting impact on budget balances in the coming years.

**3.1. Table. Dynamics of the state basic budget and special budget expenditures in 2020 against 2019 in the respective period**



Source: State Treasury operational data

and socially protect the population, which will have a lasting impact on budget balances in the coming years.

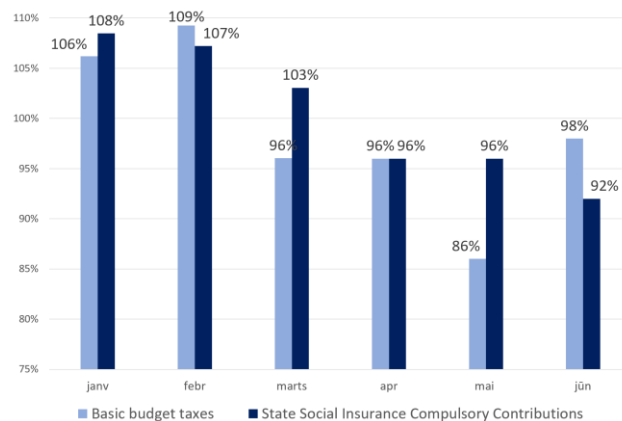
3.1. The figure shows that the impact of the crisis on the state budget was already felt in March. In turn, higher expenditures have fallen on both the basic budget and the special budget. While in May the expenditures of the basic budget and the special budget increased almost equally compared to the expenditures of 2019, in June the expenditures of the social budget increased significantly again.

If in April and May higher EU repayments were received to the state budget than in the previous year, then in June of this year EU repayments were received by 273 million less than in June 2019. Thus, according to the

operative data of the Treasury (SAO), both the central government basic budget and special budget balances were negative in June, -116.7 million euros and -37.7 million euros, respectively (in May they were positive - 78.3 million and 4.2 million euros, respectively).

The lowest level of tax collection is likely to have been reached in May 2020 3.2. The figure shows that basic budget taxes in May were collected in the amount of 86% of the 2019 level in the respective period, but the State Social Insurance Mandatory Contributions (SSIAI) - in the amount of 96%. In June, the collection of basic budget taxes increased significantly - 98% from June 2019, while the SSIAI decreased slightly - to 92%. According to operational data, in June the State Revenue Service (SRS) has granted “tax holidays” in the amount of approximately 41 million euros. If this amount were hypothetically added to the June revenue, the taxes collected in June and the SSIAI would exceed the previous year's level by 3%. In addition, in June, the SRS prematurely reimbursed VAT to entrepreneurs in the amount of approximately 56.5 million euros. This indicates a stabilization of tax collection in June. Entrepreneurs also demand less tax holidays from the SRS.

**3.2. Figure. Dynamics of central government basic budget revenue and SSIAI in 2020 against 2019 in the respective period**



Source: State Treasury operational data

Overall, tax revenues can be assessed as relatively good. It is still observed that the decline in tax revenues is smaller than the decline in economic activity. One reason could be the shadow economy, which is not fully reflected in official statistics.

#### **4. Analysis of economic support measures from a fiscal point of view**

On June 10 of this year, the “Law on Coping with the Consequences of the Spread of Covid-19 Infection” entered into force, the aim of which is to restore the general legal order after the expiration of the established emergency period on June 9. This law also provides a set of measures to deal with the consequences of the spread of Covid-19 infection. With this law, the law “On Measures to Prevent and Overcome the State Threat and its Consequences Due to the Spread of Covid-19” was repealed, which initiated the process of establishing support mechanisms aimed at economic stabilization, support for entrepreneurs and workers, and social inclusion of the most vulnerable. protection.

Although most of the support mechanisms will continue to operate after the end of the emergency, one of the main support mechanisms, the downtime allowance and the related downtime assistance allowance, expired on 30 June. A total of 110,043 downtime benefits were paid at the request of 16,524 companies and 5,917 self-employed persons. The total amount paid out amounted to 46.2 million euros. Although a more detailed analysis of the benefit scheme is needed, it is already clear that overall support has not been as large and comprehensive as, for example, in Estonia. One of the main reasons for the relatively low costs of downtime benefits is the significant size of the shadow economy in Latvia and the link between support costs and the amount of tax payments. The Ministry of Economy is currently developing a mechanism to support subsidized jobs, which will partially replace downtime benefits. The budget for this will be EUR 20 million.

At the June 2 sitting, the Cabinet of Ministers approved the Informative Report prepared on the basis of the new law “On Measures to Prevent and Overcome the State Threat and its Consequences Due to the Spread of Covid-19”. It aims to identify measures to prevent and deal with national threats and their consequences, specific support mechanisms, as well as expenditure directly related to the containment of Covid-19 after the end of the emergency. The planned measures are only broadly outlined - ministries will still have to prepare a detailed description of the measure and the legal framework. They will be implemented in both 2020

and 2021 and will be financed from both the state budget and over-commitments of EU funds. Although the measures are planned in three main blocks - modernization of sectors, improvement of infrastructure and support for maintaining the current situation of persons (benefits), the FDP has grouped them according to the main beneficiaries of the measures (Table 4.1). The estimates are approximate, but give an idea of the amount of aid and its beneficiaries.

<b>4.1. Table. Estimates of MoF and the FDC on the impact of support measures on the State General Budget Balance (SGBB) in 2020</b>					
<b>Activity</b>	<b>Crisis activities (Meiro)*</b>	<b>Redistribution of EU funds (no impact on GGBB)</b>	<b>After-crisis activities (Meiro)*</b>	<b>Total</b>	<b>Share of total%</b>
<b>Support for the population and the workforce</b>	<b>203.3</b>	<b>88.7</b>	<b>55.1</b>	<b>347.1</b>	<b>14</b>
Downtime (including assistance) allowance	67.7	32.3		100.0	4
Different types of benefits - unemployment, families, children, etc.	134.8	30.7		165.5	7
Retraining of employees		25.7		25.7	1
Subsidised employment, support for tourism	0.8		20.0	20.8	1
Human capital and demographics			35.1	35.1	1
<b>Support for entrepreneurs</b>	<b>612.2</b>	<b>59.5</b>	<b>223.0</b>	<b>665.0</b>	<b>36</b>
Aid towards time limits for payment of taxes	331.0			331.0	13
ALTUM working capital loans	50.8	35.0		85.8	3
ALTUM credit guarantees and portfolio guarantees	50.0			50.0	2
ALTUM investment fund for modernisation and support of large enterprises			165.0	165.0	7
Support to road sector	75.0			75.0	3
Support to improve international competitiveness		17.8		17.8	1
Support to agriculture and food manufacturing companies	105.3	6.7	58.0	170.0	7
<b>Support to State Corporations and Sectors</b>	<b>603.0</b>	<b>357.5</b>	<b>311.9</b>	<b>1272.4</b>	<b>51</b>
Aid to the air transport sector	346.5			346.5	14
Support for public transport		283.0	66.0	349.0	14
Support for the healthcare sector	84.5	30.0	120.0	234.5	9
Support for culture and sport	10.6		37.0	47.6	2
Support for municipal investments	150.0	44.5	35.0	229.5	9
Other, including support for private and public media	11.4		53.9	65.3	3
<b>Total</b>	<b>1418.5</b>	<b>505.7</b>	<b>600.0</b>	<b>2524.1</b>	<b>100</b>
<b>Of GDP (28 206 Meiro)</b>	<b>5.0%</b>	<b>1.8%</b>	<b>2.1%</b>	<b>8.9%</b>	
*MoF data and FDC estimates					

The post-crisis package of measures in the amount of 600 million euros has not changed the share of support measures by groups of beneficiaries: still the largest support - about 51% - is directed to the state JSC and sectors. Entrepreneurs will receive about 36% of the support,

while residents and the workforce will receive about 14%. It is positive that in the post-crisis period, sufficient support has been directed to the health care sector, including investments - now the health sector will receive about 9% of the total amount of support.

Overall, the planned support is already approaching 9% of GDP, which is relatively high. In 2021, the European Reconstruction Fund could also be available. If this project is supported by the EU member states, it will be additional fundamental support to Latvia of about 16% of GDP - 2.9 billion euros in grants and 1.6 billion euros in loans have been provisionally earmarked for Latvia. In addition, Latvia will also have access to funding from the EU support instrument "Reducing Unemployment Risks in an Emergency Situation (SURE)". This instrument is intended to finance measures that keep people in the labor market and improve health at work.

Given that EU support instruments are very large and have little or no impact on the GGBB, the government should limit the development of additional economic stimulus measures, given that they directly undermine the fiscal sustainability of the GGBB and the country. Budget-funded support must be increasingly selective, better targeted and have an immediate effect. Investment projects must primarily promote the development of Latvia's economic potential, productivity growth and competitiveness. The magnitude of the social protection impact and the fiscal multiplier could be two additional criteria against which support measures are assessed. Some planned public investment projects (Riga Concert Hall, Liepāja Prison) poorly meet or do not fully meet these criteria. It is important that projects cannot be implemented quickly. Construction in a few years' time will not help overcome this crisis. There is a need to set up an aid effectiveness analysis process to help justify the choice of the most effective projects and support mechanisms.

The new "Covid-19 Infection Management Act" stipulates that in 2020 and 2021 the provisions of Section 7, Paragraph three, Section 9 and Section 12, Paragraph three of the Fiscal Discipline Law shall not apply. Such restrictions on the regulation of fiscal discipline increase the risk that the government's fiscal behavior in the event of an economic downturn will be disproportionate. The FDC's view on allowable expenditures in the context of the economic downturn helps to reduce fiscal risk, so the FDC will continue to monitor the impact of the introduction of support measures on the state budget.

### **List of government decisions related to COVID-19 containment and economic support**

04.06.2020. the government decided:

- Provide funding of EUR 10,613,063 to the Ministry of Culture to mitigate the negative effects of the Covid-19 crisis on the cultural sector;

9/9/2020 the government decided:

- Provide additional resources for the early diagnosis and treatment of Covid-19 disease caused by SARS-CoV-2 coronavirus, while respecting epidemiological safety requirements. Impact on the state budget - 23,669,734 euros.

6/16/2020 the government decided:

- Provide support to agricultural producers, food producers, as well as companies and municipalities and educational institutions that provide catering in educational institutions and whose activities have been affected by the measures taken to control Covid-19. The decision has no impact on the state budget;

- The Ministry of Defense to provide the Ministry of Foreign Affairs with disinfectants worth 35,000 euros and to organize the delivery of disinfectants to Georgia to provide support to Georgia in limiting the spread of Covid-19. The decision has no impact on the state budget;

- Provide the unemployed with more effective job search support and support measures to mitigate the consequences of declaring a state of emergency and facilitate the faster return of the unemployed to the labor market in the post-crisis period. The decision has no impact on the state budget;

- To provide funding in the amount of 30,075 euros to the Central Election Commission in order to ensure the adaptation of the electronic voter information exchange application and ensuring its operation in the Riga City Council elections, observing health protection measures;

- To approve the list of municipal investment projects to be granted a state budget loan in the amount of 22,727,861 euros to reduce and prevent the impact of the emergency situation related to the spread of Covid-19;

- Provide funding of up to EUR 800,000 to the Ministry of Economics to enable the Consumer Protection Center to cover the repatriation costs of tour operators affected by the spread of Covid-19;

- Allocate EUR 9 756 937 to the Ministry of Culture to reduce the impact of the Covid-19 crisis on the cultural sector;

- To allocate 394,501 euros to the Ministry of Culture to invest in cultural infrastructure as part of measures to prevent and cope with the spread of Covid-19.

6/30/2020 the government decided:

- Establish arrangements for patent payers affected by Covid-19 to extend the patent fee. The decision has no impact on the state budget;

- Reduce the total funding of the measures “Improving the Quality of Disability Examination Service” and “Research and Monitoring of Inclusive Labor Market and Poverty Risks” by

directing it to another measure of the Ministry of Welfare to provide employment and financial support to people who have lost their jobs in crisis and post-crisis situations. The decision has no impact on the state budget;

- To amend the regulations for the implementation of the specific support objective measure "Promotion of energy efficiency improvement in residential buildings" by providing additional funding for the implementation of energy efficiency improvement measures for multi-apartment residential buildings, as well as new conditions for the selection of suppliers. Impact of the decision on the state budget - 1,672,500 euros;

- Allocate € 5,000,000 to the Ministry of Education and Science to mitigate the negative effects of the Covid-19 crisis on the sports sector;

- Provide funding to the Ministry of Welfare to ensure the payment of unemployment benefits to persons whose unemployment benefit payment period ends after the state of emergency declared by Covid-19 and to ensure the prevention of risks of continuity of unemployment benefit expenses. The decision has no impact on the state budget;

- Allocate € 1,040,928 to the Society Integration Fund to ensure the operation of the Media Support Fund and to provide the public with comprehensive information on coping with the Covid-19 crisis and to provide support for the cost of subscribing to press and electronic media. The decision has no impact on the state budget;

- To provide a new specialist allowance for persons who, during the year before the emergency, have completed their studies at a university or college where they have obtained higher education and have acquired the status of unemployed during the emergency or within three months after its end. Impact of the decision on the state budget - 6,597,401 euros;

- Support amendments to the European Union Structural Funds and the Cohesion Fund 2014-2020. in the Operational Program "Growth and Jobs" for the 2007-2013 programming period. The direct impact on state and local government budgets will be assessed.