LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

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Baiba Bāne
State Secretary
Ministry of Finance
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Inta Vasaraudze
The Director of
Department of Economic Analysis

On the endorsement of the macroeconomic indicator forecast

Dear Mrs B. Bāne,
Dear Mrs I. Vasaraudze!

According to Article 20 of the Fiscal Discipline Law (hereafter – FDL) medium-term macroeconomic forecasts, including forecasts of growth rate of the gross domestic product (hereafter – GDP), deflator forecasts of the GDP and forecasts of growth rate of the potential GDP shall be developed by the Ministry of Finance (hereafter – MoF). According to the Article 28, Part 2 of the FDL, the Fiscal Discipline Council (hereafter – Council) shall perform an independent assessment of potential GDP and nominal GDP calculation by the MoF.
Article 4, Part 4 of the Regulation (EU) Nr.473/2013 (21 May 2013) of the European Parliament and the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, stipulates that draft annual state budget and draft medium term budget framework (hereafter – MTBF) shall be based on independent macroeconomic forecasts that are prepared or endorsed by independent bodies.
According to the Memorandum of Understanding (hereafter – MoU) between the MoF and the Council, signed on 8 February 2016, the Council shall assume the responsibility of the independent body and endorse the MoF macroeconomic forecasts twice a year – (i) while preparing the Stability Programme, and (ii) the annual state budget and the MTBF.

On 11 February, the Council expressed its opinion on the MoF's macroeconomic projections for the Stability Program 2020/23 and endorsed it with comments, in accordance with MoU point 4.4.2.

Due to the **extraordinary situation** connected with COVID-19 outbreak, the Ministry of Finance has revised the macroeconomic development forecasts, envisaging a deviation from scenario projected for Stability Program 2020/2023 at the February 2020, and endorsed by Council.[1].

On 3 April, this year the Council received updated macroeconomic forecasts (hereinafter - CoV SP 2020/23), which include the consequences of the impact of the COVID-19 crisis and which will be used to develop the Stability Program 2020-2023.

In accordance with point 4.9. of the Memorandum of Understanding, the Council complements its opinion on macroeconomic forecasts endorsed in February, as macroeconomic developments deviate from the previously agreed scenario due to the pandemic.

The Council and the MoF discussed the forecasts in the form of a written consultation, asked questions and received explanations from the MoF representatives. Based on currently available information, the Council is delivering an opinion on key macroeconomic indicators included in Annex 1.

The Council whants to underline, that, if the MoF's forecasts are realized, the share of VTBL 2020/2022 expenditures will significantly exceed the financial possibilities of the budget. According to the preliminary assessment, maintaining the planned level of expenditures and revenues of VTBL 2020/2022, and taking into account the fiscal impact of COVID-19 mitigation measures, the general government budget balance could reach -5.5% of deficit in 2020. Keeping the planned amount of expenditures for 2021 and 2022 unchanged, the deficit will reach more than -4% in these years. The Council therefore draws attention to the potential need to plan budgetary expenditure restraint measures in a timely manner from 2021 onwards, already assessing priority, sustainable sectors and envisaging expenditure restraint measures as part of the exit strategy.

Overall, the Council notes that a rapid economic recovery is not expected, especially in the tourism and related sectors. An example is the 2003 SARS outbreak, which had a major impact outside China. It is already clear that the COVID-19 outbreak is global and will have much more severe consequences.

It should already be borne in mind that there is a real possibility that the government debt level will reach around 44% of GDP at the end of the year. This possibility exists if GDP declines by 7% and grow even more.

The Council expresses its gratitude for the co-operation and data exchange with colleagues from the MoF, especially in view of the challenges of the COVID-19 lockdown measures.

Table 1. Macroeconomic forecast indicators endorsed by the Council.

	2019	2020	2021	2022	2023
Real GDP growth	2,2	-7,0	1,0	3,5	2,4
Nominal GDP growth	4,9	-7,9	2,4	5,6	4,4
Inflation (consumer prices)	2,8	0,4	1,7	2.0	2,0
GDP deflator	2,6	-1,0	1,3	2,0	1,9
Potential GDP growth	3,0	2,9	2,9	2,8	2,9
Output gap	0,9	-8,8	-10,4	-9,8	-10,2

Kind regards

Chair of the Fiscal Discipline Council — I. Šteinbuka

[1] 17.02.2020. Macroeconomic forecast endorsement: https://fiscalcouncil.lv/17022020-macroeconomic-forecast-endorsement