1. The epidemiological situation is improving in many parts of the world, with infectious agents falling and restrictions on economic activity being phased out. Latvia is one of the few countries in the EU where infection rates do not actually decrease, of the EU countries, the average Covid-19 infection rate in the last 14 days (data of 17 May) is higher only in Sweden (616) and Lithuania (559) than in Latvia (428). Although some restrictions on economic activity are gradually easing, various sectors in the economy are still not fully functioning. The rate of vaccination in Latvia has increased significantly, however, the proportion of vaccinated persons is still significantly lower than in other EU countries (on 14 May, 5.72% of the population in Latvia, 13.44% in Estonia, 15.79% in Lithuania completed the full vaccination cycle). Achieving collective immunity is a very important factor for stable economic growth.
2. Political stability is an important precondition for responsible fiscal policy. Conflicts in Latvia's domestic politics have intensified and the stability of the coalition has been shaken. The forthcoming local elections are also one of the risk factors that may destabilize the balance of Latvia's leading coalition. The Council is concerned about the coalition's ability to pursue responsible fiscal policies in the light of these disagreements and disputes.
3. Latvia is one of the first EU Member States to submit a Recovery and Resilience Facility (RRF) plan to the European Commission (EC). The FDC, in cooperation with the Latvian Productivity Council (LV PEAK), carried out an evaluation of the RRF plan, involving independent researchers and experts. It was concluded that although the RRF plan includes many measures useful for economic and social development, the plan lacks the ambition of a “big goal” that would significantly accelerate sustainable economic and social development of the country. According to the assessment of the Ministry of Finance, the cumulative additional impact of the RRF plan on GDP growth in 2022-2009. would be 1.3-1.5%, but the cumulative effect on employment would be around 0.7 percentage points. According to the FDC, the RRF program could increase budget revenues by more than € 500 million[[1]](#footnote-1).
4. The Ministry of Finance, submitting to the European Commission the Stability Program for 2021-2024 approved by the Cabinet of Ministers, marked the beginning of the annual state budget draft law and medium-term budget framework draft law preparation cycle. In 2021, the Ministry of Finance forecasts economic growth of 3.0%, while in 2022 it is already 4.5%; inflation is forecast at 1.4% this year, reaching 2% next year; the budget deficit in 2021 is estimated at 9.3% of GDP, but in 2022 at 2.7% of GDP. In its surveillance report, the Council endorsed[[2]](#footnote-2) the forecasts prepared by the MoF, but noted a number of risks, including the spread of Covid-19 infection, state aid, inflation and the financial sector.
5. Compared to the Ministry of Finance of the Republic of Latvia, the European Commission is more optimistic about Latvia's growth prospects. In Latvia, economic growth is forecast at 3.5% in 2021 and 6% in 2022. In general, the EC has significantly improved the growth potential of the EU countries in its spring 2021 economic forecasts[[3]](#footnote-3) compared to the winter forecasts of 2021 - the EU economic growth is planned at 4.2% in 2021 and 4.4% in 2022. Although growth rates will vary widely across the EU, all economies will return to pre-crisis levels by 2022 at the latest.
6. In the 1st quarter of 2021, Latvia's GDP decline it was -2.2% compared to the 1st quarter of 2020. The structural downturn has been driven by a 1.3% decline in manufacturing and a 4% decline in services. Latvia's GDP growth forecasts this year are higher than in other Baltic countries, but the decline in both 2020 and the 1st quarter of 2021 was also larger than in neighboring countries. Achieving the projected 3% (FM) or 3.5% (EC) GDP growth will depend on whether the economic "breakthrough" is achieved in the second quarter of this year or later. The EC, like the Ministry of Finance, forecasts higher growth this year. on the other side. Faster GDP growth is projected to be largely driven by delayed consumption.
7. Latvia's export performance continues to be gratifying - the first quarter was marked by a convincing increase in the volume of exports, which allowed GDP indicators not to fall below, despite the limitation of the functionality of many sectors. In the 1st quarter of this year, the value of exports reached 3.55 billion euros and, compared to the first quarter of the previous year, increased by 282.5 million euros or 8.6%.
8. According to the CSB data, the unemployment rate stabilized at 8.7% in March, while the SEA registered unemployment data in March showed an unemployment rate of 8.2%. The latest data published by the SEA for April show a 7.9% registered unemployment rate, which is a 0.3 percentage point decrease. It should be noted that in April, labor shortages were already indicated by 19% of the CSB surveyed manufacturing companies and 11% of the surveyed construction companies as a limiting factor. Entrepreneurs in surveys indicate that they are already having problems attracting labor. Therefore, it is important that state support mechanisms do not hinder the return of workers to the labor market. Policymakers need to anticipate that labor shortages will continue to grow as growth picks up, and solutions need to be found now to reduce deficits.
9. Latvian economists predict that inflation will continue to rise in the coming months, however, the factors that will affect it are named different and complementary. The main factors are the rise in global oil prices and the consequent rise in transport costs, the expansionary economic policies of the United States and other countries, rising commodity prices, supply / demand imbalances and the effect of deferred consumption.
10. The FDC has repeatedly pointed to the risks of overheating in the construction sector. Analyzing the data of the construction sector published by the CSB in the 1st quarter, it can be seen that the workload in the sector is not homogeneous both in the volume of construction products indicating the outcome and in the issued building permits indicating the future perspective. Construction is very active in the segment related to the construction of road and railway infrastructure, including Rail Baltic facilities. In this segment, activity is expected to continue, as evidenced by the increase in the construction area approved in the building permits. It is expected that overheating is possible here, which will be determined by the shortage of employees (it is already emerging), the rise in raw material prices, as well as large public orders are expected during the implementation of the RRF plan.
11. Currently, according to the operational data of the Treasury, it can be seen that in March the government debt reached 13.207 billion. euros, or 43.1% of the projected GDP in 2021. Public debt accounts for the largest share of general government debt and is one of the lowest in the EU for Latvia, although it continues to rise due to the crisis. It is forecasted that Latvia's public debt in 2022 could reach about 50% of GDP. For comparison, in its spring forecast, the EC estimates the average debt of EU countries at the end of 2021 at 94.4% of GDP. The moderate increase in general government debt is one of the main reasons why the international credit rating agency Moody's maintained Latvia's credit rating at the current A3 level in May this year with a stable future outlook.
12. As economic growth is expected to resume in Latvia this year and the cumulative result of EU and national investment will lead to an economic breakthrough in the coming years, it will be necessary to gradually reduce the debt level to pre-crisis levels in order to restore the fiscal cushion in future crises.
13. The amount of collected taxes in March and April 2021 reached 96% and 140% of the level of the respective period of the previous year, respectively. The operative data of the SRS on 12 May also show that the amount of collected taxes at the beginning of May increased significantly compared to the corresponding period in 2020. Although taxes were collected relatively well throughout the pandemic, last month's figures are surprisingly good. This may indicate a resumption of economic activity in the second quarter, as well as possibly pointing to the relatively large size of the shadow economy in services, which is still not fully operational but at the same time does not affect good tax collection. It is possible that “extra” tax revenues from paid “child” and “pensioner” benefits also played a role.
14. In recent weeks, the government has formally approved some of the planned support measures, which currently have an impact on the GGBB of almost € 1.9 billion, or more than 6% of GDP. As a result of the support measures, the budget deficit could exceed 9% of GDP this year. The Council welcomes and fully supports the call of PM Krišjānis Kariņš at the sitting of the Cabinet of Ministers on April 20 to start thinking about the termination of state aid, as well as calls on the government to carefully assess the introduction of new support instruments.
15. The Council considers that the government needs to develop a fiscal "exit" strategy or roadmap that will mark a return to a balanced or even surplus budget in the post-crisis period of Covid-19, as the national phase of RRF projects will have to be financed by the national budget. In the event of rapid economic growth, tax revenues will increase, which could compensate for the lack of EU grants. But if economic growth is modest, fiscal consolidation may be needed to prevent public debt growth.
1. Available <https://fdp.gov.lv/files/uploaded/AMN_Novertejums_FINAL.pdf> [↑](#footnote-ref-1)
2. Available <https://fdp.gov.lv//files/uploaded/FDP_1_08_112_20210408_FDP_viedoklis_par_LatvijasStabilit%C4%81tesprogrammu2021.-2024.gadiem_PIELIKUMS.pdf> [↑](#footnote-ref-2)
3. Available <https://ec.europa.eu/commission/presscorner/detail/en/ip_21_2351> [↑](#footnote-ref-3)