Fiskālās disciplīnas padome

Adopted at Fiscal Discipline Council meeting
No.5(51) Protocol No. §1.1 of 2021

FDP Monitoring Report on the Medium-Term Budgetary Framework 2022-2024 and Budget 2022

2021

FDP_111021_FDUZ.docx

Contents

Summary

1. Latvia's macroeconomic environment is currently assessed as favourable and able to recover and restructure with the existing set of state support measures. Latvia's GDP grew by 10.8 % in the second quarter (seasonally adjusted data), with almost all sectors recovering. The Bank of Latvia has increased GDP this year's forecast to 5.4 % (this year's budgetary projections are based on a forecast of GDP growth of 3.7 % of the FM). In the 8 months of this year, taxes were collected by 12.8 % more than in the corresponding period of 2020.
2. However, a rapid deterioration of the situation in relation to the third wave of COVID-19 cannot be excluded, as vaccination coverage in Latvia did not reach the planned 70 % and infection rates are increasing rapidly. The macroeconomic projections for VTBI 2022/24 were based on the assumption that vaccination coverage would be reached and that the third wave of COVID-19 would not occur. It is now apparent that this has not materialised and creates new risks which are not included in the draft budget. Shortly before the budget review, a state of emergency has been declared and restrictions have been put in place. While the restrictions are "soft" compared to expert advice, they will inevitably slow down economic growth and worsen the country's fiscal position. **Very high conditions of uncertainty remain for the country's economic and fiscal development.** In addition to the epidemiological situation, rising inflation, rising energy prices, discussions in the US and the EU on the need for a downward revision of the asset purchase programme in order to mitigate the risk of inflation create additional uncertainty. All these factors increase the uncertainty of economic and social processes, which also have an impact on the country's fiscal position.
3. The spread of COVID-19 is likely to continue to pick up rapidly despite the restrictions put in place, which will significantly increase the pressure on the healthcare system. As a result, there is a risk of underestimating the additional expenditure needed to support healthcare in the event of congestion which, according to Latvian experts, will already be incurred in the coming months.
4. The EC general escape clause is still in force in 2022 and consequently the numerical fiscal conditions of the Latvian Fiscal Discipline Law (excluding the debt condition) are not applied when establishing the 2022 budget and the VTBI for 2022-24 years. The Corrigendum 'Covid-19 Consequence Management Law' adopted in June[1] provided that the[2] fiscal policy recommendations of the Council of the EU were applied when drafting and implementing the draft law on the state budget for 2022 and the VTBI for 2022-24 years: (i) to control the increase in nationally funded primary current expenditure, (ii) to finance COVID-19 support measures at the expense of the deficit where necessary, and (iii) to maintain the level of nationally funded investment at least at the level of 2021.
5. There is currently uncertainty about the functioning of fiscal conditions in 2023 and beyond, which makes medium-term budgetary planning difficult. The general escape clause will be lifted, with high probability, in 2023, when the new EU fiscal framework enters into force. Taking into account that the legislation currently does not set a

[1] Https://likumi.lv/ta/id/315287-covid-19-infekcijas-izplatibas-seku-parvaresanas-likums
[2] COM-2021-514-1_en_act_part1_v3.pdf (europa.eu)

maximum allowable budget expenditure, the Ministry of Finance in[3] its report proposes to set the level of public debt close to 50 % of GDP as a maximum expenditure anchor in the coming years. The Council agrees with this fiscal policy objective in the coming years.

6. In the medium term, the planned general government debt level is 49 % of GDP for 2021, 52 % for 2022 and 49 % for 2023 and 2024. The projected level of debt in 2022 is slightly above the above-mentioned debt anchor, but is expected to remain within 50 % over the medium term. However, these calculations do not include the consequences of the third wave of COVID-19. The Council understands this situation in view of the rapid and difficult to predict deterioration of the epidemiological situation in October this year, which has led the government to declare a third emergency situation over the past two years. However, it is important to be aware that the 2022 budget does not include expenditure for COVID-19 third wave support measures, which is likely to increase the deficit currently planned. Given the current circumstances, the approach to debt planning is considered to be fiscally responsible and the debt targets can be supported. Controlling the increase in debt requires a focus on high-quality investment, which will allow growth to increase in the future and reduce debt levels without additional fiscal constraints.

7. The 2022 budget is based on a general government deficit of 4.9 % of GDP. In the medium term, the deficit is planned to be reduced to 2.2 % in 2023 and 1.4 % in 2024. The general government structural balance deficit is planned to be 4.7 % in 2022, 2.1 % of GDP in 2023 and 1.4 % of GDP in 2024. The Council draws attention to the fact that the sum of the already accumulated deficits triggers the activation of the correction mechanism provided for in Article 11 of the FDL until the output gap becomes positive. According to the currently endorsed macroeconomic projections, the output gap is projected to be positive at 0.2 % in 2024.

8. The Council calls for the EU Council's recommendations on deficit reduction to be followed. The deficit should be gradually reduced by opting for an optimal and sustainable trajectory. The increase in the deficit should be halted when macroeconomic indicators stabilise at the 2019 level. The Council supports the gradual deficit reduction planned in the current budgetary plan, despite the rapidly changing evolution of COVID-19, which limits the sustainable return of the economy to its 2019 level of development.

9. The level of general government expenditure and the balance of VC are to be assessed on an annual basis. Given the existence of the general escape clause in 2022, there is formally no limit on the size of the deficit, but it should be noted that the revised EU fiscal framework will enter into force in the coming years, which could foresee a deficit and debt reduction trajectory, the size of which is currently unknown.

10. The fiscal space for 2022 has been fully absorbed and exceeded by planning investments authorised by the EC, which has mainly led to an increase in the previously planned deficit of 3.8 % to 4.9 %. The Council notes that the output gap is relatively low in 2022, while the overall deficit is high. In 2022, an amount of 14.6 billion is foreseen, which includes both primary expenditure and investments and more than 500 million COVID-19 related measures. Of the priority measures, 54 % is dedicated to maintenance, 38 % to investments, 8 % to COVID-19 measures. When assessing these plans, the Council wishes to point to the macroeconomic context. Today, employers increasingly point to

[3] Information report "On macroeconomic indicators, revenue and general government budget balance forecasts for 2022-2024", approved by the Cabinet of Ministers on 24 August 2021. Available at: Https://www.fm.gov.lv/lv/budzets2022, accessed on 16.09.2021

labour shortages in sectors that have not been affected by COVID-19, which increase wages. Looking also at the macroeconomic projections, the actual unemployment rate will exceed NAWRU this year and the following years, hence wage pressures will continue. Consumer price inflation could be close to 6 % by the end of the year. Current account figures have deteriorated, from a positive balance in 2020 to a deficit of almost 4 % in the first half of 2021. Lending has intensified, new mortgages have increased significantly in 2021. As this situation develops, it would be advisable for the government to take a critical approach to project planning if construction costs continue to rise and to consider redirecting expenditure to other priorities, such as assistance to underprivileged public utility payments or even the freezing of individual projects.

11. No new COVID-19-related measures are currently planned in the 2023s and 2024s, but the planned maintenance expenditure, which also includes measures to increase the budgetary base, will continue to increase, while the level of investment is falling. In comparison with 2022, capital expenditure of the general budget also decreased.

12. Latvia's fiscal policy, as in other EU countries, has been expansionary and counter-cyclical in response to the evolution of the crisis in 2020 and 2021, but economic growth has to be cautious when planning expansionary fiscal policies, which can stimulate inflation rather than balanced economic growth. The Council of the EU recommends that the level of investment should not be reduced, but already today, taking into account macroeconomic developments, the budget deficit target of 4.9 % for 2022 clearly threatens to increase inflation. The Council stresses that the approach to investment projects must be highly critical, giving priority to those projects that will ensure sustainable economic growth and will not lead to overheating of individual sectors.

13. Following a set of EU Council recommendations, the Council acknowledges that expansionary fiscal policies will continue in 2022, supporting the economy in the post-crisis period. While the growth of government-financed primary expenditure in the VTBI in 2022/24 is manageable, it is close to and above a 10-year average potential growth rate in 2023 and 2024. It should be noted that, in a context of protracted uncertainty and a period of structural economic change that is currently observed, the modelling of GDP potential is difficult, which may lead to a misconception of the available fiscal space. In such circumstances, in particular, an increase in expenditure which is unbalanced with revenue or which does not contribute to increasing the economic potential in the long term should be avoided.

14. The fiscal framework and the budgetary surveillance mechanism are currently being reviewed and discussed in the EU. A new fiscal framework is expected in the coming years, with a post-crisis transition period and a moderate deficit reduction trajectory for EU Member States. Against this background, the Council notes that VTBI2022/24 has an integrated trajectory for the reduction of the general government deficit, but considers that, in times of uncertainty, it needs to be assessed flexibly while respecting economic recovery processes: Without prematurely stifling economic recovery processes, but also without causing excessive overheating.

15. During the crisis, Latvia's economy was supported both by automatic stabilisers and by programmes of measures to support the economy. If the impact of the aid programme on VVBB in 2020 was EUR959 million (3.3 % of GDP), the impact of the 2021 programme is already estimated at EUR2167 million (6.9 % of GDP). The measures are aimed at maintaining liquidity, social protection of workers and the most vulnerable sections of society, supporting entrepreneurs and sectors, strengthening the capacity of

health and other sectors. According to the Council, the government's fiscal response to the COVID-19 crisis has been adequate in the case of the first wave, but slightly delayed, excessive and less well targeted in the second wave[4].

16. Positive and important is the fact that the support measures do not have a significant impact on the budget balances of the following years, as the support measures are short-term and do not affect the budgetary basis. At present, the impact of the aid measures on VVBB in 2022 is only EUR233 million (0.8 % of GDP) and a year later 65 million (0.2 % of GDP). The Council calls on the government to be fiscally responsible and to introduce new support instruments only if the epidemiological situation and constraints so require.

17. The Council calls on the government to carefully assess and avoid general measures to heat the economy that do not have a long-term positive impact on the potential of the economy. GDP has already returned to pre-crisis level in the 2 rd quarter, registered unemployment has fallen to 5.9 % in September, producer price inflation is approaching 20 %, increase of construction materials prices is 12.8 %. At the same time, a significant increase in investment volumes is planned in the budget next year, which could further contribute to the increase in prices. In view of this situation, it would be necessary to assess the validity of all projects and, in the event of significant increases, to refrain from carrying out a project. Otherwise, general measures to heat the economy increase the risks of contributing to macroeconomic imbalances rather than promoting sustainable economic growth.

18. Despite Latvia's intensive economic support programme in 2021, Latvia still has one of the lowest debt levels in the EU. Sound fiscal policy in times of crisis continues to allow the Treasury to borrow in international financial markets under favourable conditions. At the beginning of September, the international credit rating agency "Fitch Ratings" has maintained Latvia's credit rating at the high "A-" level with a solid rating assessment of the future credit rating. However, it is necessary to take into account the rise in global inflation, which may trigger an increase in interest rates and hence the cost of servicing debt.

19. The effectiveness of the implementation of the Recovery and Resilience Plan will determine the significant impact on Latvia's economic development in the coming years. According to the assessment of the MoF, the cumulative additional impact of the ANM plan on GDP growth over the period 2022-2029 would be between 1.3 % and 1.5 %, while the cumulative impact on employment would be around 0.7 percentage points. Following the assessment of the FDP, the ARM programme could increase budget revenues by more than EUR500 million[5].

20. A global threat to economic stabilisation is the strong pick-up in inflation, initially triggered by a strong recovery in the world's leading economies after the COVID-19 idle period, accommodative monetary policy and global demand/supply imbalances. However, in the third quarter of this year, overheating in the international energy market has become a growing determinant of inflation. Prices for electricity (+ 12.5 %), natural gas (+ 51.3 %) and fuel (+ 19.3 %) have also increased rapidly in Latvia in September compared to September of the previous year. For Latvia, the electricity price on the NordPool stock exchange in September, compared to August, by 41 %, from EUR

[4]FDP monitoring No 12 available at: Https:// www.fdp.gov.lv/lv/media/1653/download, Access on 07/10/2021

[5]Assessment available at: Https://www.fdp.gov.lv/lv/media/2979/download, Access on 10/08/2021

87.23 per MWh to EUR 123.5 per MWh. This price increase will have a negative impact on: (i) household consumption (social aspect), (ii) the competitiveness of energy-intensive service providers and producers, (iii) promote overall inflation and (iv) impact on local government budgets, especially in municipalities with a high share of natural gas use in heating buildings.

21. The Council considers that the release of the fiscal buffer in 2022. The year – 2024 is now considered adequate. However, given the high epidemiological, economic and fiscal uncertainties, the MoF needs to strengthen its monitoring and management of fiscal risks. Particular attention should be paid to the risks arising from: (i) COVID-19 financial instruments for enterprises, (ii) the financial situation of state-owned capital companies (in particular Airbaltic and Latvian Railways), (iii) developments in the financial sector.

22. The Council calls for the FRD to be extended by at least two more chapters. The EU has declared the Green Deal as one of the EU's priorities and Latvia has agreed on its objectives. Implementation of the Green Deal and environmental protection objectives in the coming years will require additional investments, including from the state budget. Therefore, a specific unit for the analysis of such fiscal risks should be set up in the FRD in the future. Similarly, the Council invites the FRD to include a pessimistic macroeconomic scenario with an appropriately calculated fiscal buffer. This would be desirable in a situation where the fiscal framework is back in place and the fiscal risk buffer plays an important role.

23. Due to the COVID-19 crisis, the budgeting process has been very complex over the past two years and, in general, the government and the Ministry of Finance have met the challenges of this time. However, the Council calls on the government not to rush the budget adoption process, as steeps may worsen the quality of the budget and limit the scope for dialogue. The tight budgeting calendar for the last two years has made it difficult for the Council to better analyse budgetary and fiscal information. In view of the increasing volatility of macroeconomic indicators in today's world, the Council invites the MoF to consider developing the Macroeconomic Forecasts necessary for budgeting in August instead of June.

ABBREVIATIONS

AS	Joint stock company
ANM	EU Economic Recovery and Resilience Facility
DBP	Draft Budgetary Plan
LBFV	Law on Budget and Financial Management
COVID-19 Crisis Law	Law on measures to prevent and manage the state threat and its consequences due to the spread of COVID-19
CSB	European Commission
ECS	European accounting system
EU	European Union
OECD	Organisation for Economic Cooperation and Development
FDL	Fiscal Discipline Law
MOF	Ministry of Finance
FNR	Fiscal provision reserve
FRD	Declaration of fiscal risks
SIA	Personal Income Tax
GDP	Gross Domestic Product
LP	Bank of Latvia
YES.	No data/not applicable
NAWRU	Unemployment rate with no impact on wages
The Council	Fiscal Discipline Council
VAT	Value added tax
SGP	Stability and Growth Pact
SP	Stability programme of Latvia
SP 2021/24	Stability programme of Latvia for 2021-2024
FOR SPBS:	Baseline scenario of the Stability Programme
SRS	State revenue service
Surveillance report	Fiscal discipline monitoring report
VTBI	Medium-term budgetary framework
MR VTBIL	Law on the medium-term budgetary framework
MTO	Medium term target
VVBB	General government balance

1. Fiscal policy developments

1.1. A 2021 perspective

1. As the **economic crisis caused by COVID-19 continues, the general escape clause of the EU's Stability and Growth Pact, activated in 2020, allowing for an increase in the general government deficit, also applies in 2021**. Subsequently, the amendments adopted on 17 June 2021 entitled 'Covid-19 Consequence Management Law'[6] provided that the provisions of Article 5 of EC Regulation No 1466/97 were applied instead of Articles 7, 9, 10 and 13 of the Law on Fiscal Discipline when drawing up the draft law on the State Budget for 2022[7]. The EC made recommendations that current expenditure should be limited in the budget preparation process, but that there are no limits for one-off expenditure and investments to tackle the COVID-19 crisis. Current expenditure growth should be monitored on the basis of the level of current expenditure of the previous year, taking into account 10-year average potential GDP growth, the GDP deflator and discretionary revenue measures. According to the MoF, the fiscal space for 2022 is around EUR300 million.
2. **The economic crisis caused by COVID-19 has had a negative impact on the country's fiscal position, with results 2020 and 2021 forecasts pointing to large deficits.** While in 2020 VVBB was negatively affected by both declining budget revenues and higher budget expenditure caused by government support measures, revenues improved in 2021, but expenditure growth is significantly higher than a year ago. Since the country's economic and financial outlook for SP 2021/24 slightly deteriorated, the MoF now projects VVBB deficits to reach EUR2.9 billion in 2021, or 9.3 % of GDP.

Table 1: Budget balance plans and forecasts for 2021 and outturn for 2020[8], million Euro.

Balance	2021		2020
	Plan	Forecast	Outcome
General government balance	**−1184.9**	**−2,903.3**	**−1326.6**
ESA2010[9] corrections	81..1	42.9	−177.6
General Government Budget	**−1266.0**	**− 2'946.3**	**−1148.9**
National core budget	−1158.0	−2728.5	−1242.0
State special budget	−21.6	−113.8	114.9
Local government budgets	−74.8	−115.8	−39.4
Derived public person b.	−11.7	11.8	17.3

Source: Ministry of finance

3. **In early 2021, the government approved additional support measures aimed at: (i) economic stimulus to reduce the size of the fall in GDP caused by the crisis and preserve potential GDP capacity, (ii) social protection of the**

---

6 Https://likumi.lv/ta/id/315287-covid-19-infekcijas-izplatibas-seku-parvaresanas-likums

7 Information report "On macroeconomic indicators, revenue and general government balance forecasts". Available at http://tap.mk.gov.lv/lv/mk/tap/?pid=40506650&mode=mk&date=2021-08-24, accessed on 25/08/2021

8 FM Bilance_16082021 File

9 According to the SGP and the FDL, the fiscal outturn is assessed on the basis of the European System of Accounts 2010 (ESA2010) methodology, which is based on the accruals method. Meanwhile, the state budget in Latvia is traditionally approved and assessed on the basis of the cash flow method.

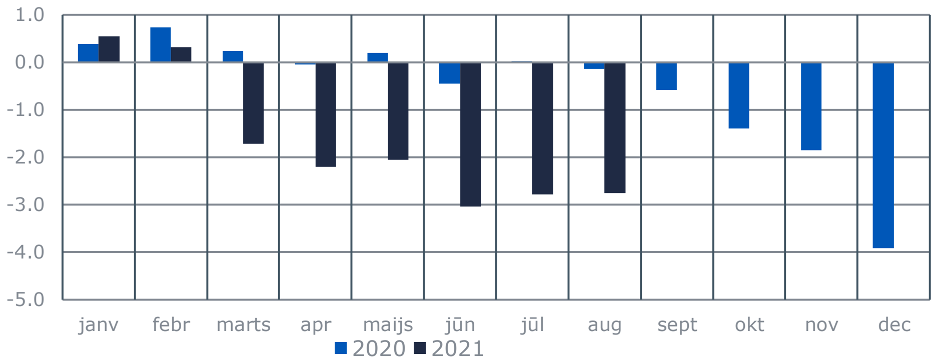
population most affected by the crisis, (iii) strengthening the capacity of the health system, (iv) providing liquidity to businesses and the financial sector. While the support programme achieved these objectives, the Fiscal Discipline Council notes that the main improvements to the programme could be related to: (i) the speed of decision-making and implementation, (ii) better targeting of the measures, (iii) the amount of funding for the measures. A more detailed analysis can be found in section 1.4 of the report. At this point in time, the fiscal impact of the aid measures on VVBB in 2021 is estimated at 2.2 billion, or 6.9 % of GDP. A significant part of the aid instruments came to an end in June 2021.

4. **General government budget expenditure in**the**8th month of has increased by 19.1 % in comparison with the corresponding period of 2020.** The biggest increase in expenditure is for social benefits (45.8 %). Expenditure on subsidies and grants (8.4 %) as well as reimbursement expenditure (8.7 %) also increased significantly. The increase in expenditure reflects the government's intensive support programme in 2021. Adjustments to expenditure levels are possible, taking into account the impact of several aid measures on VVBB in the last months of the year; At this point in time, all planned COVID-19 support has still not been fully disbursed. As a new wave of COVID-19 started in September, there is a possibility that the government will be forced to adopt new measures with the potential to further increase spending in this year's budget.

5. **General government consolidated budget revenue in** the 8th month of has increased by 8.3 % in comparison with the corresponding period of 2020. Taking into account the impact of the COVID-19 crisis on the economy and revenues in 2021, as well as government support mechanisms to stimulate the economy, the improvement in revenue is positive. In the 8th months of 2021, tax revenue increased in comparison with 8 months of the previous year by 12.2 %. The highest percentage increase was in non-tax revenue, which increased by 12.8 %. In the 8 months of, foreign financial assistance decreased by 12.9 %, compared to the corresponding period of 2020. If the new wave of COVID-19 does not worsen the economic situation again, the revenue plan will be reached at the end of 2021.

6. **After eight months of 2021, the general government consolidated budget balance showed a deficit of 864.7 million euros, which is -2.8 % of GDP.** In 2020, after eight months the deficit was 0.1 % of GDP (see figure 1 below). According to estimates by the MoF, the general government balance in 2021 could reach a deficit of EUR2.9 billion, i.e. 9.3 % of GDP. Of course, this indicator depends on a number of factors which are currently difficult to predict. According to the assessment of the MoF, the output gap is -2.6 % of potential GDP in 2021 and the structural balance is projected to have a deficit of 4.7 % of GDP in 2022.

Figure 1. General government balance as % of GDP in units at the end of the month



Source: State Treasury

1.2. Fiscal position 2022-2024 years

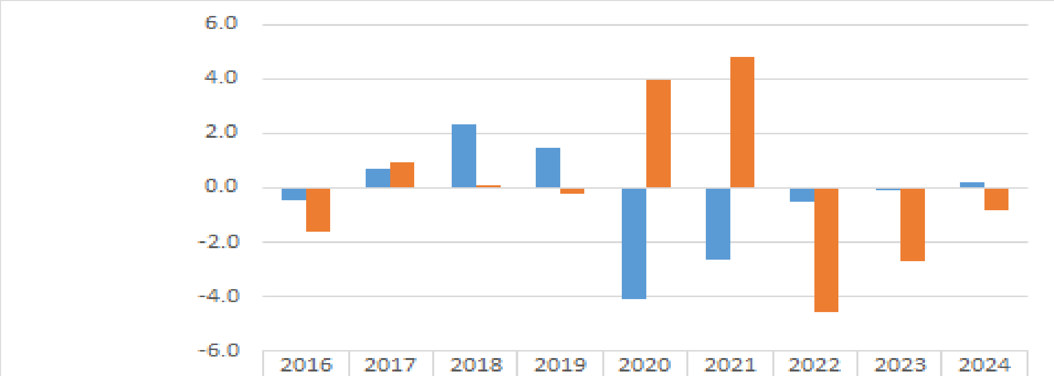
7. The coming years will be difficult from the fiscal point of view of the country: the 2022 elections are approaching, uncertainty remains with the further spread of the COVID-19 virus and changes are also taking place in the external economic and political environment. EC guidance was also developed that countries should gradually return to a sustainable fiscal strategy. In 2022, there will still be no restrictions on COVID-19 support as well as on investment, but current expenditure needs to be contained. **Although the 2023 framework is not yet known, it is highly likely that it will lead to a gradual return to sustainable public finances.**
8. **Although Latvia overcomes the economic crisis caused by COVID-19 relatively well, we are a small and open economy, which will always be influenced by external factors.** The global level of total debt has increased, which has the potential to worsen the fiscal position of countries, in particular in the scenario of rising interest rates. Moreover, as the sectors affected by today's COVID-19 situation remain, there remains a risk that governments will need to support them by increasing public debt and also contributing to inflation. According to August, inflation reached 3.2 % on average in the EU. It is also not entirely clear how vaccination rates and its effectiveness will evolve: although vaccination significantly reduces the probability of serious illness and fatalities, new mutations may emerge in the virus and immunity from the vaccine tends to decrease over time.
9. **The general escape clause of the EC remains in force in 2022 and the fiscal provisions of the Fiscal Discipline Law are therefore not applied, instead applying the recommendations of the Council of the EU, which state: (i) to control increases in nationally financed primary current expenditure, (ii) to finance COVID-19 support measures at the expense of the budget deficit if necessary, and (iii) to maintain the amount of nationally funded investment at least at the level of 2021.** Taking into account that the legislation does not currently

set a maximum allowable budget expenditure, the Ministry of Finance in its[10] report proposes to set the level of public debt close to 50 % of GDP as a maximum expenditure anchor in the coming years.

10. **According to the information provided by the MoF, the government forecasts subsequent budget balances at unchanged policies of -4.8 % in 2022, -2.1 % in 2023 and -1.3 %. In 2024.** The above targets, calculated by the Ministry of Finance, would ensure a structural government balance of -4.7 % in 2022, -2.1 % in 2023 and -1.4 % in 2024. As mentioned above, if the structural balance is not fully constrained by the numerical fiscal conditionality in 2022, the 2023 framework is still unknown. In a no-policy-change scenario, the structural deficit exceeds the structural deficit by 1.6 % of GDP in 2023 and by 0.9 % in 2024. Taking into account the expected output gap in 2022 and 2023, respectively -0.5 % and -0.1 %. While the Council considers that the government should respect the principle of countercyclicality, excessive structural deficits pose risks to economic development.

11. **Government countercyclical policies have improved in recent years, especially during the crisis, but should continue to be respected after the end of the COVID-19 crisis.** The graph below shows that the key principle of counter-cyclical fiscal policy is respected from 2019 onwards: the government needs to fiscally stimulate the economy when the economy is operating below its potential and second. Due to the COVID-19 crisis, the output gap is negative in 2020 and 2021. For this reason, the fiscal momentum of the government is the most significant in these years. While fiscal policy will be expansionary in 2022, the fiscal stimulus is planned to be negative, moving towards 0, as the economic recovery is also planned.

Fig. 2: Output gap and fiscal effort[11] (% of GDP) over the period 2016-2024 including forecast 2021-2024



	2016	2017	2018	2019	2020	2021	2022	2023	2024
Izlaižu starpība	-0.5	0.7	2.3	1.5	-4.1	-2.6	-0.5	-0.1	0.2
Fiskālais impulss	-1.6	0.9	0.0	-0.2	4.0	4.8	-4.6	-2.7	-0.8

Source: Ministry of Finance and Council calculations

[10] Information report "On macroeconomic indicators, revenue and general government balance forecasts". Available at http://tap.mk.gov.lv/lv/mk/tap/?pid=40506650&mode=mk&date=2021-08-24, accessed on 25/08/2021

[11] The fiscal stimulus is defined as the deterioration of VVBB compared to the previous year (% of GDP) in order to stimulate the economy. See, for example, the 2019 IMF report on the Latvian economy. Available at: Https:// www.imf.org/en/Publications/CR/Issues/2019/08/06/Republic-of-Latvia-2019-Article-IV-Consultation-Press-Release-and-Staff-Report-48565 Viewed: 07/09/2021

12. **The tax revenue projections of the 2022 Draft Budget appear proportionate in view of the potential for recovery in the aftermath of the COVID-19 crisis.** Table 2 shows that tax revenue is planned to be 9.6 % higher than the expected 2021 collection result next year. The largest increase is expected in CIT, PIT and SSIOI revenues – 12.7 % 12.0 % and 11.1 % respectively. FDP notes that a single tax account was introduced in January 2021, which may result in an inaccurate comparison of the taxes collected in 2020 and 2021, as the single account accumulates monthly unallocated balances according to the new methodology.

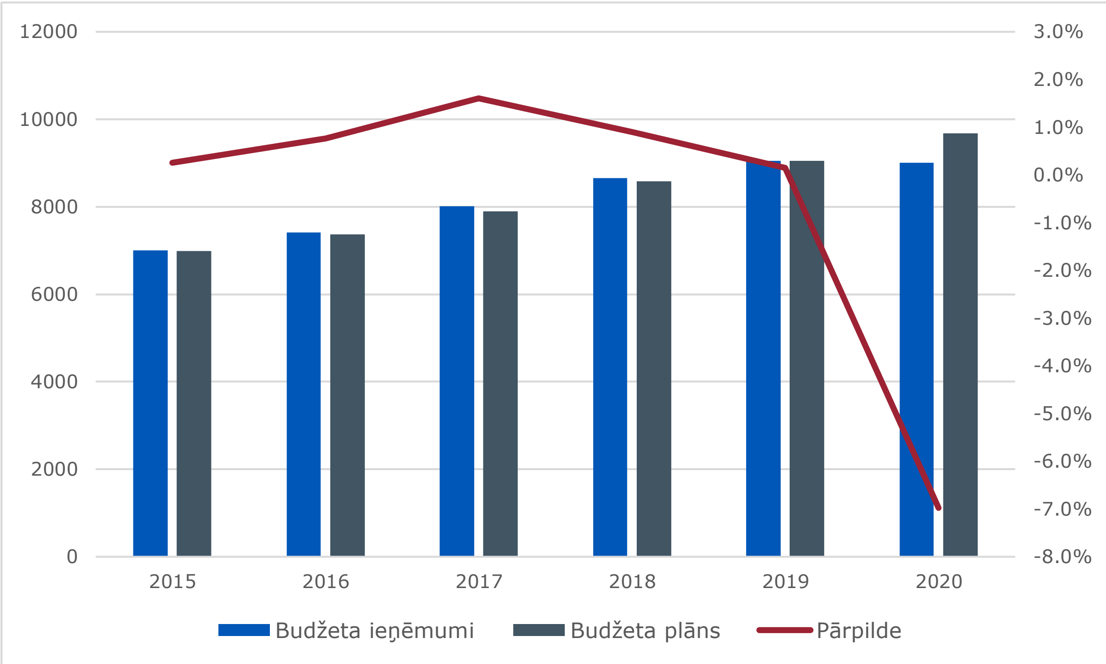
Table 2. Tax revenue dynamics, plans and execution for 2019-2021, %

	2020 fact/2019 fact	2021 forecast/2020 fact	8 m 2021 fact/8 m 2020 fact	2022 Budget for BPP/2021
Tax revenue	**—0.6 %**	**3.6 %**	**12.2 %**	**9.4 %**
UIN	363.3 %	32.6 %	63.8 %	17.8 %
SIA	—5.7 %	—4.0 %	12.1 %	9.9 %
Social contributions	0.6 %	—4.1 %	15.2 %	9.3 %
Immovable property n.	—1.9 %	3.8 %	—8.8 %	1.5 %
VAT	—3.9 %	10.5 %	11.8 %	11.7 %
Excise tax	—0.4 %	5.5 %	3.4 %	4.7 %
Other indirect n.	—3.5 %	—19.1 %	8.6 %	—1.6 %

Source: Ministry of Finance and Council calculations:

13. **Overall, it should be noted that the forecasting of the MoF's tax revenue has been conservative in recent years and real tax revenues have always been higher than expected in the Budget Law, except in 2020, when the impact of the COVID-19 crisis had not yet been taken into account.** Figure 3 below shows the evolution of the tax collection plan. With the exception of 2020, the plan was still slightly overcrowded, even in years with lower than expected economic growth. The COVID-19 crisis was the exception, as such a major recession was not anticipated either in Latvia or in the rest of the world. It should be noted that the implementation of the tax collection plan in 2020 was influenced not only by the decrease in economic activity, but also by the instruments of government support measures, part of which were tax reliefs. Tax holidays were granted and the quickest VAT refund was decided, the total amount of which was estimated by FM at EUR 125.1 million. This year, part of the taxes will be returned to the budget, with the latest figures amounting to EUR28.7 million.

Fig. 3: General budget tax revenue plan, execution and overflow from 2015 to 2020 (thousand euros and overflows)



Source: Ministry of Finance and Council calculations

14. The Council notes that the full potential of the budget expenditure review is not being fully exploited, resulting in no greater savings from structural reforms and cuts in irrational budgetary expenditure. In 2019, as part of the spending review of the budgetary process, savings of EUR93.7 million were found for the 2020 budget (of which 47.7 million were allocated to the overall fiscal space, the rest to the priorities of the ministries concerned). One year back in the expenditure review process, only 53.6 million euro savings were found for the 2021 budget, which is by 43 % less. This year this amount decreased further, with a total of only EUR38.4 million of available resources identified. While the decrease in the amounts identified may be linked to the need for funds during the COVID-19 crisis, the Council notes that especially in times of crisis, the spending review process is a valuable tool for reallocating budgetary appropriations for a more efficient use of budgetary resources and policy priorities.

15. **During the annual audit, the State Audit Office noted improvements in the financial accounts and made reservations on certain aspects**[12]. One of the main shortcomings relates to restrictions on long-term investments, most of which consist of long-term investments by the City of Riga. According to the State Audit Office, these investments have not been properly inventoried since 2015 and are now worth more than EUR1.6 billion. Shortcomings in the measures implemented by the SRS related to the implementation of the accrual principle from 2021 were also noted. The shortcomings are potentially slowing down the reform and, following comments from

[12] Economic Activity Report 2020. Available at https://www.lrvk.gov.lv/lv/revizijas/revizijas/noslegtas-revizijas/par-latvijas-republikas-2020-gada-saimnieciska-gada-parskatu, accessed on 04/10/2021

the State Audit Office, may even result in the reform not being implemented within the specified deadlines.

16. **Overall, the priorities of the 2022 budget are socially oriented, with the potential to fiscally stimulate aggregate internal demand, improve the capacity of the healthcare system and reduce social inequalities.** At its meeting on 24 September 2021, the Cabinet of Ministers approved the information report "On proposals for revenue and expenditure of the state budget for 2022 and the framework for 2022-2024",[13] which set out budget priorities. Fiscal space for 2022 includes EUR310 million, excluding COVID-19 measures and uncapped investments. The largest funding went to reducing the tax wedge on labour (EUR94 million) and to healthcare (EUR87 million). Given that additional budgetary funding is targeted at population groups with relatively low income levels, it can be expected that this expenditure will have a relatively high fiscal multiplier, i.e. a large part of it will increase the country's GDP as well as budget revenues.

17. In a context of the**COVID-19 crisis and high uncertainty in the external environment, the coming years may be challenging for the Latvian economy. In these circumstances, the government needs to be able to react quickly and stabilise the economy.** Overall, the government has so far successfully managed to tackle the consequences of the COVID-19 crisis. However, there may be additional complications that will require an active response from the government. The rapid and effective use of the European Recovery and Resilience Mechanism in the coming years in order to strengthen the potential of the Latvian economy in accordance with the priorities set by the EU is considered as the immediate priority[14]: (i) promoting economic, social and territorial cohesion in the EU, (ii) strengthening economic and social resilience, (iii) mitigating the social and economic impact of the crisis, (iv) supporting green and digital transformations.

1.3. Fiscal retro-reflection of recent years

18. In 2020, the consolidated general budget of the State had a deficit of EUR 1148.9 million, which is by EUR 1031.5 million more than in 2019, and 964.5 million more than estimated in the Law on the State Budget for 2020. A more negative general budget balance is explained by higher subsidy and grant expenditure and social expenditure due to the COVID-19 crisis, which increased by 444.3 and 362.0 million euro respectively. The negative ESA adjustments slightly improved the preliminary result of the 2020 consolidated budget, but overall the balance has deteriorated significantly due to the crisis. However, the result was better than expected at the beginning of the crisis. The general government balance in 2020 is EUR -1326.6 million, which is -4.5 % of GDP. The budgetary balance plan and outcomes for 2020 and 2019 can be found in the table below.

[13] Report available at: Https:// www.fm.gov.lv/lv/media/8323/download, Access on: 29/09/2021
[14] EC working document Guidance for Member States on recovery and resilience plans. Available at: Https:// eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021SC0162&qid=1624627879387 , available at: 07/09/2021

Table 3: Budget balance plans and outturns between 2019 and 2020, mln euro.

Balance	2020 Plan[15]	2020 Outcome	2019 Plan[16]	2019 Outcome
General government balance	**−111.3**	**−1326.6**	**−168.6**	**−63.2**
ESA2010[17] corrections	73.1	−177.6	103.1	54.4
General Government Budget	**−184.4**	**−1148.9**	**−271.7**	**−117.6**
National core budget	−342.0	−1242.0	−438.3	−485.0
State special budget	234.5	114.9	223.8	299.6
Local government budgets	−78.6	−39.4	−61.4	50.1
Budget of derived public persons	1.7	17.3	4.2	17.9

Source: Ministry of finance

19. **In 2020, the consolidated budget revenue decreased by 0.8 % or 87.1 million euro compared to the previous year, reaching 11.3 billion euro.** The main source of revenue in the general government budget in 2020- tax revenue decreased by 0.6 %. Taxes were collected 7 % less than foreseen in the budget plan. Overall, 2020 can be described as ‘recessive’, as revenue was below planned and lower than the previous year’s revenue.

20. **The revenue plan administered by the SRS and its execution in 2020 can be found in Table 4 below.** Despite the failure of the general budget tax plan, this result was expected as the forecasts were prepared before the COVID-19 crisis started. Almost all of the tax revenue was not collected in the planned amount – only the SIA and the non-tax revenue plan were slightly overloaded. Some of the most important tax plans were not executed by more than 10 % (CIT, VAT, AN). The total tax plan for the lowest tax wedge was also only implemented by 85.7 %.

[15] Law on the State Budget for 2020. Available at: Https://likumi.lv/ta/id/310965-par-valsts-budzetu-2020-gadam 07/09/2021
[16] Law on the State Budget for 2020. Available at: Https://likumi.lv/ta/id/306232-par-valsts-budzetu-2019-gadam 07/09/2021
[17] According to the SGP and the FDL, the fiscal outturn is assessed on the basis of the European System of Accounts 2010 (ESA2010) methodology, which is based on the accruals method. Meanwhile, the state budget in Latvia is traditionally approved and assessed on the basis of the cash flow method.

Table 4. Revenue plan administered by the SRS and its execution in 2020 (thousand euros)

Revenues	2020 fact	2020 Plan	Execution (%)
UIN	207.5	261.0	79.5
VAT	2 544.7	2 884.9	88.2
Excise tax	1 059.7	1 203.4	88.1
SIA	1 817.4	1 758.3	103.4
Other taxes	237.6	277.2	85.7
Nontax revenues	495.0	475.5	104.1
VSAOI	3 501.2	3 643.1	96.1
Total	**9 863.0**	**10 503.4**	**91.9**

Source: SRS

21. **According to the VID's assessment, in 2020 the SSIOI and PIT gap decreased by 0.4 percentage points compared to 2019.**[18] **For the fifth year, the** State Revenue Service (SRS) has carried out an assessment of undeclared wages and results show that the amount of undeclared PITs and SSIOI is decreasing. The SRS notes that the narrowing of the gap is affected by various macroeconomic factors, as well as by the business initiative. In most cases, wages are not declared for company drivers, truck drivers, sellers, construction workers and accountants. Most often, wages are not declared in Riga and near-Riga territory.

22. General government **consolidated budget expenditure for 2020 increased by 8.1 %, reaching 12.5 billion euro.** The highest percentage of general government consolidated budget expenditure is for social benefits – around 29 %, which increased by 11.1 % in 2020. The second most important item of expenditure is subsidies and grants, with a share of around 22 %, which increased by 19.1 % in 2020, which is also the largest increase between types of expenditure on a yearly basis. Reimbursement expenditure increased by 8.1 %, expenditure on goods and services decreased by 2.2 %, while costs for EU and international cooperation increased by 6.3 %.

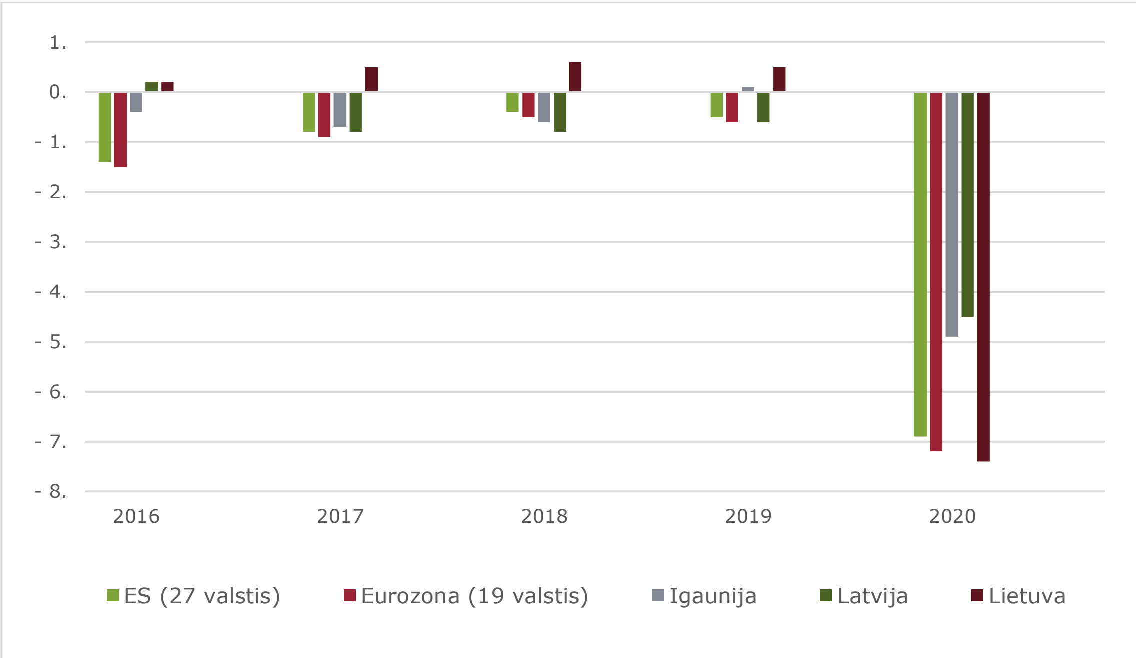
23. The general government structural balance target of -0.46 % of GDP set in the **Budget Law was not met in 2020, as VVBB was much lower than expected at the end of the year due to the COVID-19 crisis. As a result, the structural balance of the government was -5.4 % at the end of 2020.** The results of the central government basic budget and the special budget, as well as the ESA adjustments, worsened the result of the structural balance relative to the planned budget. This outcome was also due to the fact that expenditure aimed at overcoming the crisis following the EC decision was not classified as one-off and was therefore included in the structural balance.

24. **In 2020, the general government deficit was 4.5 % according to Eurostat data, which is lower than in the rest of the Baltic States, as well as the average in the EU and euro area countries.** At **the beginning of the crisis, the government used resources sufficiently efficiently, preserving the country's fiscal**

[18] SRS tax gap assessment. Available at: Https:// www.vid.gov.lv/lv/algas-nodoklu-plaisa-lenam-bet-stabili-samazinas-0 accessed on 07/09/2021

sustainability. Estonia was slightly lagging behind from Latvia, with a deficit of 4.9 % at the end of 2020. Lithuania, as well as the EU and euro area countries, had a relatively higher deficit of around 7 % (see Figure 4). When assessing the general government deficit of Latvia in recent years, it can be concluded that the deficit was at a controlled level until 2021. **However, the Governing Council is of the opinion that the results for 2021 will be less positive in view of the amounts of this year's aid, which significantly worsens the forecast of the 2021 balance sheet. In addition, the COVID-19 crisis has not been fully overcome and there is still a likelihood that new aid measures will need to be adopted, which will further aggravate the VVBB.**

Figure 4: General government deficit (% of GDP) in the EU27, the euro area and the Baltic States for the period 2016-2020.



Source: Eurostat

1.4. Fiscal impact of economic stabilisation measures

25. **The Latvian government reacted to the COVID-19 crisis and established economic stabilisation and citizen support mechanisms, in line with the recommendations of international organisations.** According to the present assessment of the MoF, the impact of the aid measures on VVBB will reach almost EUR2.2 billion in 2021, representing 6.9 % of GDP. In fact, the economic impact of the measures will be even greater, as part of the measures, such as guarantees, do not have an impact on VVBB. At present, some of the measures have not yet been implemented; According to the assessment of the MoF in mid-September, the impact of the aid measures on VVBB is around EUR1.7 billion (see Table 5 below). The measures are limited to the duration of the crisis and are aimed at maintaining liquidity, social protection of workers and the most vulnerable sections of society, supporting

entrepreneurs and sectors, and strengthening the capacity of the health and other sectors.

26. Initially, Article 28 of the Law on measures to prevent and manage state threats and its consequences due to the spread of COVID-19 provided that all support measures were to be considered as one-off, with no impact on the structural budget balance. However, the EC decided that the expenditure related to the management of the crisis is not one-off and has an impact on the structural deficit. Consequently, the law on the management of the consequences of the spread of COVID-19 no longer provided for an article of the law, which would provide that measures to mitigate the impact of the COVID-19 outbreak are one-off measures. Consequently, the structural deficit in 2020 and the expected deficit in 2021 are significantly higher.

27. **Overall, the Council supports the programme of support measures put in place by the government, although the resources spent on some measures may have** been **used more efficiently**. For example, the over 200 million infrastructure investment programme, according to the Council, overheated the construction sector rather than providing support to the COVID-19 victims. However, overall, support to victims was provided in a timely manner and to a large extent targeted. At present, a significant proportion of the mechanisms have already ceased operations, although a small part remains in place. Due to the fact that the future situation with COVID-19 is not entirely clear, there is a likelihood that the government will need to adopt new support mechanisms. However, as the number of people vaccinated increases, new COVID-19 outbreaks will not have a potential impact on this group of people. More objective evaluation of support programmes will be possible after the end of the crisis.

28. Table 5 summarises the statistics of the Latvian support measures, broken down by group of beneficiaries. Currently, the proposed calculations are only provisional, based on decisions of the Cabinet of Ministers and approved programmes. In 2021, companies received arelatively high level of support through grants for working capital, different population groups (including vulnerable groups), as well as the health sector. The legislation provides that almost **all aid measures are of limited duration. In June 2021, most of the support mechanisms ceased to operate.**

Table 5: Aid measures with estimated or actual budgetary impact in 2020 and 2021 (million EUR)

Event type	2020 Actual support	2021 planned aid	2021 Actual support	2022 planned aid
Replenishment for the population and the workforce	**131.7**	**526.4**	**508.5**	**0.0**
Outage allowance (including assistance)	64.0	139.8	139.8	
Various types of benefits – unemployment, families, children, etc.	18.1	345.5	345.5	
Human capital and demography, retraining of workers	0.0	15.2	0.0	
Subsidised jobs for the tourism industry and exporters, subsidised employment	49.6	25.9	23.2	
Support for entrepreneurs	**266.9**	**742.9**	**679.7**	**–35.6**

Aid relating to time limits for payment of taxes	125.1	28.7	62.4	—35.6
Altum loans for working capital	13.1	5.0	10.5	
Altum guarantees and investments	18.5	7.4	17.6	
Grants for working capital	0.0	501.3	501.4	
Aid for the road sector	72.5	155.0	80.3	
Aid to enterprises in the agri-food sector	37.5	45.5	7.6	
State and AS sector aid	**560.2**	**897.2**	**527.6**	**290.8**
Aid to the air transport industry	260.5	127.1	37.1	
Support for public transport	75.4	11.5	11.5	
Support to the health sector	123.6	463.8	308.7	170.3
Aid for the cultural sector and sport	26.1	43.2	30.1	
Support for local government investments	50.1	104.5	51.9	27.7
Aid to the education sector	17.1	41.5	25.6	
Other, including private and public media	7.4	105.7	62.7	92.8
Total	**958.8**	**2166.6**	**1715.9**	**255.2**
Of GDP	**3.27 %**	**6.91 %**	**5.47 %**	**0.75 %**

Source: Ministry of Finance data and FDP calculations

29. **One of the types of support instruments during the COVID-19 crisis was various benefits to the population, including the outage allowance, which was originally planned as the most comprehensive support measure. In the first phases, the impact potential did not reach the expected impact due to the criteria for beneficiaries. Over time, the government extended the eligibility criteria, offered other benefits such as the unemployed, families with children and people with disabilities, and tried to improve the targeting of benefits.** As a result, only EUR 64 million were provided out of the planned 170 million euro out of the 170 million idle allowances in 2020, while the amount granted in 2021 was already twice as high. Almost all other benefits also related specifically to 2021, when the COVID-19 morbidity peaked at EUR345.5 million in 2021. According to the FDP, although the support was provided in sufficient amounts, the mechanism was activated slightly late. In addition, some of the decisions on benefits were also of a political nature and, as a result, were not sufficiently targeted. Since 15 June, the benefit scheme ceased its activities.

30. **The national financial development institution ALTUM is the main institution providing assistance to entrepreneurs through various COVID-19 instruments**: loans, guarantees, equity investments. It was initially planned that most of the aid would be provided in the form of guarantees, however, after discussion with the business community, the government decided to offer other support mechanisms, including grants for working capital, which exceeded EUR 500 million in 2021. The use of these

guarantees was lower, e.g. the total amount of credit guarantees is expected to be only 340 million in 2020 and 2021. In order to cover the potential losses of the guarantees issued, the government has increased its share capital in ALTUM. Part of this group support mechanism is still available until the end of 2021.

31. **Airbaltic has received significant State aid in the context of the crisis, which is likely to receive an additional EUR90 million after EC authorisation in 2021.** The national airline has chosen to use the crisis as an opportunity to increase its market share and increase its competitiveness. The Council has no information at its disposal to assess the advantages and risks of such a strategy. Overall, the air transport sector received a significant share of State aid in 2020 and 2021, with aid amounting to EUR387.6 million, which represents more than 12 % of the total amount of aid.

32. The 2022 budget also includes expenditure for support measures. The above-mentioned EC recommendations foresee that, if necessary, the government may adopt new one-off support mechanisms for COVID-19. On 5 October, the impact of the total aid on VVBB is estimated to reach EUR 255.2 million in 2022, or 0.75 % of GDP. The government will continue to support the health sector and local government investments. It is also planned that companies that received tax holidays in the past will repay them in 2022.

33. **In assessing the government's action in the context of support measures, the Council considers that, overall, the programme of support measures in 2020 was proportionate and effective.** Although the level of support in 2020 was among the lowest in the EU, the COVID-19 situation in Latvia was better than in other EU countries and the support itself was provided in a relatively targeted and effective manner. **The government's action during the second wave of COVID-19 was slightly delayed and initially relatively low.** However, in consultation with enterprises in the sectors, the support programmes were improved and their volume increased. **The government then fell to the second extreme from an overly modest amount of aid, with an excessive increase in the amount of aid. Some decisions were not particularly well targeted and were taken for more political than economic reasons.** However, the Council appreciates the government's dialogue with business and citizens during the crisis, as well as the fact that most of the support mechanisms ceased to operate in June 2021. In the event that new support measures need to be adopted, the Council calls on the government to act fiscally responsibly and to provide support in an effective and targeted manner.

34. **On 10 September 2021, the VID published[19] an analysis of the support measures for the period from 1.12.2020 to 31.08.2021, where descriptive statistics of the measures are shown.** In total, 77 thousand natural persons received outage allowances, while 30 thousand natural persons received subsidies in this period. Most support was provided to trade workers (24.8 %), accommodation and catering workers (10.0 %), as well as hairdressers and beauty workers (8.7 %). As regards the working capital for grants, most grants were granted to the commercial sector (25.3 %), to construction-related companies (11 %) and to manufacturing companies (10.9 %). Given that construction is one of the sectors with a significant share of the informal economy, the government needs to pay attention to ensuring that money is efficiently and targeted towards non-shadow enterprises. In addition, the price index in

[19] Analysis of SRS support. Available at: Https://www.vid.gov.lv/lv/vid-izmaksajis-atbalstus-covid-19-krizes-parvaresanai-66759-miljonu-eiro-apmera-0?fbclid=IwAR0W_QTAs4CKbDVBN9N1Zkb4C1QU8nHrj62NdDmOJv3Hpgk0-w9sfAjLzCY, Access on 15/09/2021

construction has increased in recent months, so that even higher aid may lead to overheating of the sector.

35. In order to ensure the financing of the support measures, the Treasury has borrowed on the financial markets as well as provided borrowing opportunities from international financial institutions. Loans were made on favourable terms for Latvia, which again demonstrates the confidence of the financial market in Latvia's fiscal policy and the effectiveness of monetary policy. The most recent auction of securities took place on 25 August, where the weighted average yield on securities was -0.179 %[20]. On 3 September, the Fitch rating agency renewed Latvia's rating at[21] "A-" level with a robust rating of the future rating.

[20]Auction of GMTN securities. Available at https://www.kase.gov.lv/jaunumi/tresdien-25-augusta-tika-izsoliti-gmtn-vertspapiri-iekseja-tirgu-ar-dzesanas-terminu-2029#article-text, accessed on 05/10/2021
[21] Treasury article. Available at: Https:// www.kase.gov.lv/jaunumi/starptautiska-kreditreitingu-agentura-fitch-ratings-saglaba-latvijas-kreditreitingu-limeni#article-text, Access on 08/09/2021

2. Fiscal risks

36. **While macroeconomic instability caused by the COVID-19 crisis remains the main source of fiscal risks, there are still other risks that may potentially worsen the country's fiscal position.** In autumn 2021, the number of new COVID-19 cases started to rise again and, formally, more than 4.5 million people worldwide have died from COVID-19, which is likely to be larger in reality. According to the infectologists, the vaccine against COVID-19 significantly reduces the probability of mortality and disease in mild and severe form. Currently, the fiscally intensified support mechanisms are not working. COVID-19 infection rates are also rapidly increasing in Latvia.

37. **Deepening and broadening the assessment of fiscal risks remains desirable.** The Governing Council expects further improvements by broadening the range of quantified fiscal risks. International experience shows that most of the fiscal shocks are caused either by macroeconomic imbalances or by problems in the financial sector. The former is often called the second, thus exacerbating fiscal risks and the country's ability to meet its fiscal targets. The FRD analyses the outcome of fiscal risks in comparison with the projected impact, often concluding that the fiscal risk is symmetric. However, the FRD could be improved by analysing the factors that led to the shift.

38. **The Council invites the FRD to include a pessimistic macroeconomic scenario, with the fiscal buffer calculated accordingly.** This would be desirable in a situation where the fiscal framework is in place again.

39. **The Council notes the need to establish a fiscal reserve for the potential negative impact of the activities of public limited liability companies on VVBB**. This is the case both for ICs belonging to the general government sector and for those that do not qualify for it. The historical performance of state-owned ICs indicates that they are one of the largest sources of fiscal risks. Corporate governance problems in state and local government capital companies, which are to be classified as the general government sector, also have the potential to have a negative impact on the general government budget balance, As shown by recent events in Rigas Satiksme and Latvijas Dzelzceļš.

40. **FDP points to the relatively high level of State budget support to AirBaltic and the simultaneous lack of information on the company's business plans and the use of money, which would allow an assessment of the adequacy of the aid amount.** The government has agreed conceptually to allocate an additional EUR90 million to the company to compensate for the losses caused by the COVID-19 crisis this year. In 2020, a similar decision had already been taken to allocate EUR250 million to the company. Given that it is currently unclear when the COVID-19 crisis will be overcome, the Council calls on the government to take into account the risk that the aviation sector may still need support next year. In view of the sizeable state budget support to the company over the past two decades, the Council invites the government to assess whether it is appropriate for the State to be a shareholder in this business sector.

41. **The national financial development institution ALTUM has been entrusted with large budgetary resources in the context of COVID-19 support instruments for enterprises.** Increased accountability requires in-depth monitoring. The FRD states that the 'FM continues to monitor the activities of ALTUM in depth' and that the fiscal risk associated with the activity of ALTUM is symmetric. Since the fiscal risk may arise

both from the administrative side and from the portfolio management side, if the actual losses of ALTUM clients exceed expectations, the **Council calls for further in-depth oversight of the ALTUM and for this to be reflected in as much detail as possible in the FRD.**

42. **The Council welcomes the improvement of the financial sector chapter of the FRD.** However, there is still room for expansion and improvement, for example by including planned disbursements from the Deposit Guarantee Fund. Traditionally, the financial sector is one of the biggest sources of fiscal risks and therefore needs to be adequately addressed in the FRD.
43. **The functioning of the maintenance fund has become a significant fiscal risk.** According to the FDP, the debt of non-payers increases each year and amounted to EUR 429 million as of 1 July 2021, which is a significant amount. This indicates that the Fund has systemic problems that need to be addressed without delay. The FRD should provide for an analysis of the functioning of the Fund.
44. Implementation of the **Green Deal and environmental protection objectives in the coming years will require additional investments, including from the state budget.** Therefore, the Council calls for the creation of a dedicated chapter in the FRD in the future to assess potential investment needs to achieve the "green deal" objectives as well as the risks of non-achievement.
45. **The political situation in the world also creates risks that have the potential to influence Latvia's fiscal position.** Belarus is organising the emigration of Iraqi and Afghan refugees and migrants to the EU through Latvia. The European Court of Human Rights dealt with a case concerning Afghan refugees, where it was decided that Latvia should accept them[22]. Uncontrolled immigration can also trigger a case crisis with fiscal consequences. The political situation remains fragile also in Belarus itself, whose relations with the EU have deteriorated following various political events, as well as the repression of the Belarusian population. Although currently only 1.1 % of all Latvian exports go to Belarus, the situation could potentially show fiscal risks.

46. The fiscal risk statement plays a role in managing fiscal risks and serves as the basis for the calculation of the fiscal buffer. However, in the light of Article 33 of the 'Covid-19 Consequence Management Law', which essentially abolishes the state budget expenditure ceiling for the 2022 State budget, the fiscal security reserve is of a formal nature in the context of the 2021 budget process. **Therefore, the Fiscal Discipline Council's Fiscal Risk Task Force accepted a fiscal buffer of 0.1 % of GDP for 2022. In the** current situation, there are too many legal, macroeconomic and fiscal unknowns, so the Working Party on Fiscal Risks is currently postponing the necessary size of the fiscal buffer for the years 2023 and 2024.

[22] Ahmed and Others v. Latvia. Available at https://hudoc.echr.coe.int/app/conversion/pdf/?library=ECHR&id=003-7117548-9641291&filename=Court%20lifts%20interim%20measures%20in%20respect%20of%20Iraqi%20nationals%20at%20Belarusian%20border%20with%20Latvia.pdf accessed on 20/09/2021

3. Macroeconomic environment assessment

3.1. Current review of the macroeconomic environment of Latvia

47. **Latvia's GDP growth has resumed after the slowdown in 2020 and reached 5.1 % in the first half of 2021. In addition to GDP growth, inflation has rebounded to 2.3 % in the second quarter, with inflation expectations high for the period ahead. Producer price inflation is approaching 20 %, while the increase in the prices of construction materials is 12.8 %. Current account figures have deteriorated, from a surplus in 2020 to a deficit of almost 4 % in the first half of 2021. Lending has intensified, new mortgages have increased significantly in 2021, also activating the real estate market. Labour market demand is high, unemployment rates have been decreasing every month since June, and actual unemployment reached 7.1 % in August, close to the average of 6.3 % in 2019. It can be seen that the actual unemployment rate will exceed NAWRU's forecast this year and the following years, so that already existing pressures on wages will continue. The combination of these indicators and those analysed below suggests that the economy is recovering faster than expected and its stimulus measures need to be increasingly critical.**

48. **According to seasonally adjusted CSB data, GDP in constant prices fell by 0.2 % in the first quarter, but already increased by 10.5 % in the second quarter, reaching an increase of 5.1 % in the first half.** In September, the CSB has carried out an extensive audit of GDP data. According to the audited data, in the first half of the year, in terms of use, the largest contribution to GDP growth for exports (10 %), investments (4 %), also increased public consumption by 4 %. Private consumption was very volatile when comparing the first and second quarters. In the first quarter, due to various COVID-19 restrictive measures, it fell by 9 %. Broad support measures for households were introduced in the second quarter, but restrictions were gradually lifted – as a result private consumption grew by 16 %. Overall, the contribution of private consumption to GDP growth in the first half was 3.5 %.

Table 6: Current and projected macroeconomic development indicators of Latvia

Macro-economic indicators (seasonally adjusted)	2020 actual data				2020	2021 actual data				Forecast (14.06.2021[23])				2021 g Execution /Forecast
	I	II	III	IV		I	II	III	IV	2021	2022	2023	2024	
Real GDP growth	−1.3 %	−8.4 %	−2.9 %	−1.8 %	−3.6 %	−0.2 %	10.5 %	YES.	YES.	3.7 %	5.0 %	3.5 %	3.4 %	Above forecast
Nominal GDP growth	0.6 %	−9.2 %	−4.2 %	−1.8 %	−3.7 %	1.7 %	16.5 %	YES.	YES.	6.9 %	8.5 %	6.2 %	5.3 %	Above forecast

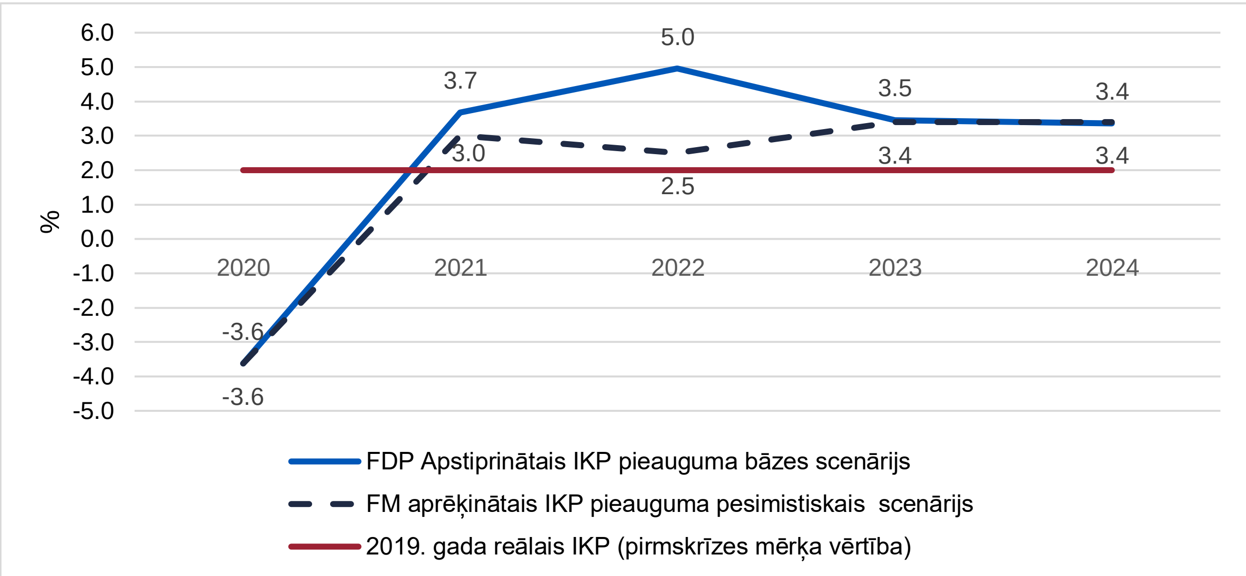
[23] 14.06.2021. Approval of macroeconomic forecasts by the Ministry of Finance for the medium-term budgetary framework ?? Fiscal Discipline Council (fdp.gov.lv)

Inflation (consumer prices)	1.9 %	—0.4 %	0.0 %	—0.6 %	0.2 %	—0.1 %	2.3 %	YES.	YES.	2.0 %	2.4 %	2.2 %	2.0 %	Above forecast
GDP deflator	0.7 %	—1.2 %	—0.4 %	0.2 %	—0.2 %	2.7 %	5.6 %	YES.	YES.	3.1 %	3.3 %	2.6 %	1.9 %	Above forecast

Source: CSB, FM, FDP

49. **While some of the economic growth rates in 2019 may already be achieved in 2021, in the light of the experience of 2020, the risks of a sharp deterioration in the epidemiological situation, which also draw attention to the pessimistic scenario, cannot be excluded.** On 14 June 2021, the Council endorsed the MoF's macroeconomic forecasts for VTBI 2022/24. Real GDP growth is projected at 3.7 % for 2021 and 5 % for subsequent years (2022), 3.5 % (2023), 3.4 % (2024).

Figure 5: Confirmed real GDP growth scenario and pessimistic (third wave scenario).



Source: FM, CSB

50. **Some of the risks alerted by the Council when approving the macroeconomic forecasts have now materialised**[24].

(1) vaccination coverage is below the basic forecast assumption (currently around 44 % instead of 70 % required);

(2) inflation is growing faster, already above the 2 % level;

(3) VTBI forecast VVB deficit of -4.9; —2.2 % and -1.4 % of GDP for the years 2022, 2023 and 2024 are above the levels projected in the Stability Programme, which leads to the conclusion that the return to fiscal discipline will be challenging despite the return of economic growth.

[24] Available at: 14.06.2021. Approval of macroeconomic forecasts by the Ministry of Finance for the medium-term budgetary framework ?? Fiscal Discipline Council (fdp.gov.lv), see: 06.09.2021.

51. Forecasts from **Latvia and foreign countries have largely adjusted GDP growth projections in an optimistic direction.** For example, the European Commission has revised the 2021 GDP forecast in July and compared to a spring GDP growth of 3.5 %, the forecast now improved by 0.3 % to 3.8 %[25]. The Bank of Latvia adjusted its GDP forecast at the beginning of October, increasing it by 2 percentage points to 5.3 % compared to the June forecast. As an exception, the International Monetary Fund, which adjusted Latvia's GDP forecast in September by reducing it by 0.3 percentage points to 3.6 % this year, leaving it unchanged at 5.2 % for 2022. The Ministry of Finance produced a forecast of 3.7 % of GDP growth in June[26].

Table 7: Forecasts of GDP of various institutions for Latvia in 2021, 2022

GDP/Year	2020	2021 (P)	2022 (P)	Last update
Latvia (FM)	—3.6	3.7	5	June. 2021[27]
Latvia (LB)		5.3	5.1	SEP 2021[28]
Latvia (IMF)		3.6	5.2	SEP 2021[29]
Latvia (EC)		3.8	6	OH, yeah. 2021[30]
Latvia (Swedbank)		4	5	Aug.2021[31]
Average	*YES.*	*3.8*	*5.3*	*YES.*

Source: FM,LB,SVF,EK,AS Swedbank, FDP; *LB Forecast Notification Conference took place on 30 September.

52. Confidence indicators of the **Latvian economy improved during the year, even approaching pre-crisis sentiment. However, the latest data in September show that business sentiment has become more cautious as a new wave of morbidity resumes and may be reflected in weaker economic growth in the last and next quarter of this year.** According to seasonally adjusted CSB data, in September the confidence indicator of entrepreneurs in retail trade was 3.7 %. Compared to August, this figure decreased by 2.5 percentage points. However, the confidence indicator in the services sector was positive (0.6 %) compared to August, but decreased by 6.3 percentage points. Despite the sensitivity of the services sector in the context of epidemiological risks, positive sentiment has been observed since May. In construction, the confidence rate -10.2 % deteriorated by 0.3 percentage points compared to August. Labour shortages as well as shortages of equipment and materials are increasingly becoming a constraint in construction. In the short term, expectations about falling orders have been worsened by expectations, however, compared to the previous year, the construction company surveyed, which pointed to subdued demand as a restrictive factor, decreased. Confidence indicator in manufacturing in September was 0.3 % – increase in comparison with August by 0.2 percentage points. The largest increase in the confidence indicator compared to August was in the manufacture of basic pharmaceuticals and pharmaceutical products, production of other transport vehicles, manufacture of non-metallic mineral products, manufacture of electrical equipment and repair and installation of machinery and equipment.

---

[25] EC Summer Macroeconomic Forecast Report. Available at: For Summer 2021 Economic Forecast: Reopening fuels recovery ?? European Commission (europa.eu), see: 17/08/2021

[26] FDP's opinion on macroeconomic forecasts. Available at: Download (fdp.gov.lv), accessed: 17/08/2021

[27] Available at: FDP Opinion on the Macroeconomic Forecasts of the Ministry of Finance: Download (fdp.gov.lv), viewed at: 06.09.2021

[28] Available at: Information for the media – the Bank of Latvia reviews Latvia's macroeconomic forecasts, see: 01.10.2021

[29] Available at: IMF Country Report 21/194 1LVAEA2021001.pdf, available at: 21.09.2021

[30] Available at: For Summer 2021 Economic Forecast: Reopening fuels recovery ?? European Commission (europa.eu), see: 21.09.2021

[31] Available at: Swedbank Economic Outlook seo_aug_2021_eng_final.pdf (swedbank-research.com), accessed at: 21.09.2021

53. **Capacity utilisation continued to increase in the three quarters of 76, already at 74.5 % in the second quarter and 76.1 % in the third quarter, which is close to pre-crisis indicators.** In the third quarter, the highest load (78 %) was in the production of intermediate goods, followed by 77.2 % of capital goods and 73.2 % of consumer goods.

54. **The industrial sector suffered less than service providers in the crisis and was also more prone to recovery.** The volume of industrial production increased on average in the months of the second quarter of 8.2 %. The average increase in the supply of electricity and gas in 3 months was 8.5 %, but in manufacturing 8.4 %. Growth was also observed in mining and quarrying sector, on average by 5.4 % in 3 months. Production output of manufacturing increased by 27.3 %, compared to the second quarter of 2020. The largest contribution to this increase was made by the production of wood and timber products (14.1 %), which at the same time was reflected in the increase in wood exports.

55. Despite temporary restrictions, the **construction sector has remained active and continues to affect the macroeconomic environment in the medium term. Major construction projects are planned to be implemented in the coming years (especially 2022, 2023) including: Rail Baltica, as well as the inflow of massive public and EU funds into the sector, which also bears the risks of overheating the sector.** Production volume of the construction sector fluctuated rapidly in the first two quarters of 2021, compared to the quarters of 2020. The sector experienced a decline of 12.4 % in the first quarter, mainly due to adverse weather conditions. Already in the second quarter, construction production grew by 1.1 %. Production increased in all types of construction, except construction of buildings, where the volume fell by 4.7 %. The largest increase in construction production was ensured by specialised construction works (6.8 %) and civil engineering (1.3 %). The number of building permits issued in the second quarter has increased by 37 %, while the construction area provided for in building permits has increased by 28 %.

56. The increase of **Latvian exports in the first quarter of this year shows strong contacts with the main trading partners, and given the positive economic sentiment indicators of trade partners, there are stable prospects for exports. The value of** Latvia’s exports reached EUR 7.35 billion in the first half of this year, which is by 20.3 % more than in the first half of the previous year and by 17 % more than in the first half of 2019. In the 2nd quarter of this year, the value of exports reached EUR 3.79 billion and increased by 954.7 million euros, i.e. 33.6 % compared to the first quarter of the previous year. Of this total, the value of exports to EU countries increased by 28.4 % and by 2.2 % to CIS countries. On the other hand, the value of exports to other countries increased by 3 %. The share of exports by main trading partner countries in the second quarter of showed strong trade relations with the Baltic neighbours: 18.3 % of exports relate to Lithuania and 11.6 % to Estonia. Germany and the United Kingdom were also important trading partners in this period, where the share of exports to these countries was the same: FIGURE 7.2 The structure of exports by main trading partner countries in the first seven months of this year, compared to the corresponding period of 2020, shows that exports of fats and oil (366 %) as well as production of chemical and allied industries (53 %) increased to Germany. The largest increase in exports to Estonia was for mineral products (76 %) and metals and metal articles (61 %). The largest increase in exports to England was in the trade of mineral

products (529 %) and wood and wood products (118 %). Exports to Lithuania increased by 86 % in trade in Mineral Products.

57. The increase in **retail trade turnover will have a positive short-term effect on growth in 2021. On average in the second quarter, retail trade turnover increased by 13.5 %, mainly due to non-food retail trade, where turnover increased by 7 % on average. According to the latest data available to the CSB, retail trade turnover increased by 8.6 % in August still reflecting the sentiment of deferred consumption.** The largest increase was observed in the retail trade of automotive fuel (23 %), followed by retail sales of non-food products (13 %), while the retail trade turnover of food fell by 2 %.

58. **Labour market activity is increasing, but still falls short of pre-crisis levels. Despite this, employers increasingly note labour shortages as a limiting factor. Restrictions on labour supply in the economy may put pressure on wage growth, which will not be linked to the increase in labour productivity.** According to data collected by the State Employment Agency, the unemployment recorded in August has fallen to 6.5 %, while according to the CSB data, the actual unemployment rate in Latvia was 6.9 %, which is by 0.6 percentage points lower in July. Similarly, according to the CSB data, the number of vacancies offered has been increasing since the fourth quarter of 2020, reaching 25 290 vacancies in the second quarter of this year, or 2.6 %.

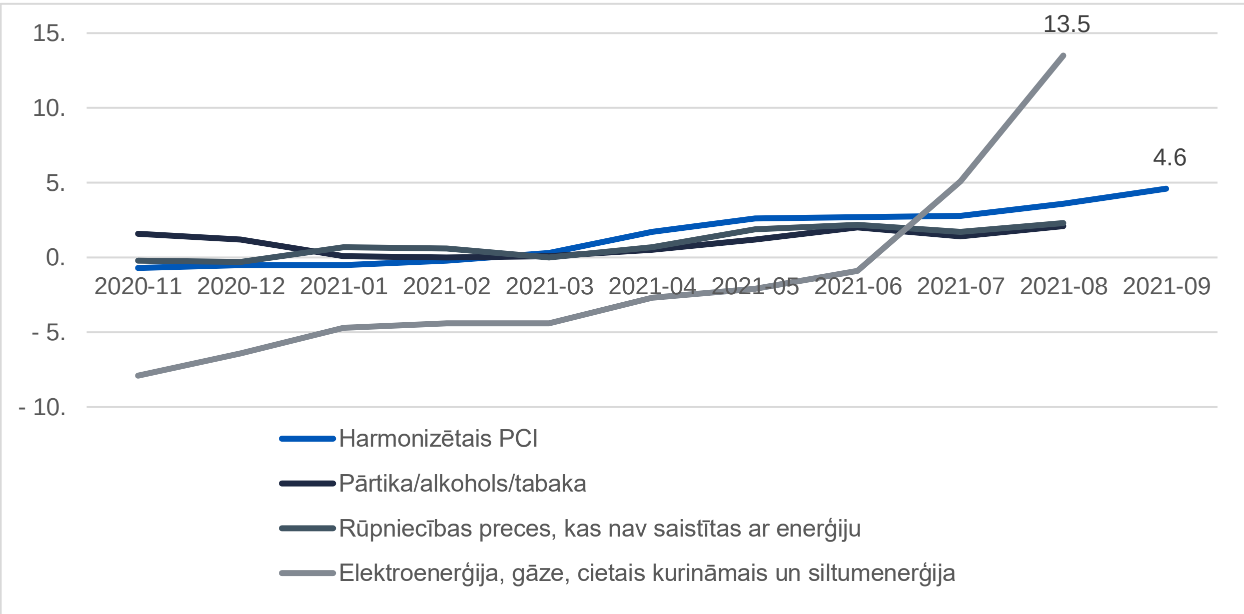
59. **In the labour market, the COVID-19 crisis has marked a structural shift, pointing to labour inflows in higher value-added sectors, such as the information and communication (ICT) sector. Although this is a positive change in the context of the transformation of the economy, it is too early to conclude that there is a lasting trend in this area. Since the beginning of the crisis, there have been some structural changes in the labour market in** Latvia, which can be observed by analysing changes in the number of occupied jobs by type of activity. Comparing data in the second quarter of 2019 and the second quarter of 2021, it can be seen that the number of occupied jobs in information and communication services (ICT) has increased by 20 %, by 13 % in professional, scientific and technical services, by 10 % in health and social care services. Compared to the same period, the number of occupied jobs in accommodation and food services (-21 %), transport and storage services (-8 %) and financial and insurance activities (-5 %) decreased. Overall, the number of occupied jobs in all activities has increased by 1.7 % or 15.9 thousand people compared to the pre-crisis in the 2nd quarter of 2019.

60. As **economic activity resumed, there was also an increase in the amount of wages, which was influenced by the increase in the volume of various allowances at the end of 2020 and at the beginning of 2021, including for employed persons in medicine and education. However, the latest observation for the second quarter suggests that the share of regular or contractual wages is also on the rise.** Average wage growth of 10.2 % was recorded in the second quarter of – the gross wage on average was EUR 1237. Wages for public sector employees have increased faster (+ 13.4 %), reaching an average of EUR 1291 compared to the private sector – wages are on average higher than EUR 76. The fastest increase in wages in the public sector can be observed in the health and social care sector (+ 35.1 %) and education (+ 12.4 %). In the private sector, wages increased by 9 %, reaching EUR

1215 before tax, with the most rapid increase attributable to the trade sector (+ 11.7 %). The increase in the overall wage level in 2021 was also influenced by the increase in the minimum wage to EUR 500. Today, employers increasingly flagged labour shortages, rising wages in sectors that have not been affected by COVID-19, also looking at macroeconomic forecasts, show that the actual unemployment rate will exceed NAWRU this year and the following years, hence wage pressures will continue.

61. **Global** imbalances in **demand and supply and the effect of delayed consumption on the world market continue to maintain high consumption of energy resources. In the first half of, economists noted the strong growth of the world's leading economies after the COVID-19 idle period and the accommodative monetary policy as the main drivers of inflation. In the second half of the year, energy prices (fuel, gas, electricity) are becoming an increasingly worrying factor in the inflation structure in Europe and Latvia, which will continue to increase the costs of food, production and maintenance of housing as they approach the cold season.** According to Eurostat data for August, the energy price in Latvia has increased by13.5 % in comparison with the corresponding month of the previous year. According to Eurostat's flash estimate, annual inflation in the euro area has reached 3.4 % in September. The highest level of consumer prices has been observed again in Estonia, reaching 6.4 %, followed by Lithuania with 6.3 %. Annual inflation in Latvia is higher than in the EU and the euro area – in September it stood at 4.6 %.

Figure 6: Annual inflation in Latvia by major components



Source: Eurostat [PRC_HICP_MANR]

62. According to CSB data, in August consumer prices in Latvia increased by 3.7 %, but in comparison with July, by 0.4 %. Prices increased in all consumption groups, especially for housing, transport and food. According to the CSB's in-depth study, housing-related goods and services, the average price level increased by 6.8 %, mainly due to increase in natural gas tariffs by 51.3 %. Prices increased for electricity, heat,

maintenance and repair services of the dwelling, renting of dwellings, solid fuels, waste collection, as well as materials for maintenance and repair of the dwelling. For goods and services related to transport, prices increased by 8.8 % during the year, which was determined by an increase in fuel prices by 19.1 %. In the food and non-alcoholic drinks group prices increased by 2.2 % during the year, while prices increased for everyday products such as meat, cereals, oil, etc. with inflexible demand.

63. **In the third quarter of this year, overheating in the international energy market has become an increasingly strong determinant of inflation, largely due to an unprecedented rise in natural gas prices.** According to CSB data, prices for electricity (+ 12.5 %), natural gas (+ 51.3 %) and fuel (+ 19.3 %) have increased rapidly in September compared to September of the previous year. According to NordPool exchange data, the electricity price for Latvia in September compared to August, by 41 %, from EUR 87.23 per MWh to EUR 123.5 per MWh. Such price increases will have a negative impact on household consumption, on the competitiveness of energy-intensive service providers and producers, as well as on local government budgets, especially in municipalities with a high share of natural gas use in the heating of buildings.

4. Fiscal numerical conditions

4.1. Development of the legal framework

64. **In line with the changes to the fiscal framework applicable to the COVID-19 crisis and post-crisis periods when planning and executing the 2022/24 budget, the application of the numerical fiscal conditions of the Latvian FDL has been suspended, with the exception of the debt condition. In addition, it is stated that fiscal policy in the medium term needs to be based on the EU Council[recommendations31 on fiscal] policy.**

The following procedure is laid down in the amendments to the COVID-19 Consequence Management Law of 20 June this year by adding a second paragraph to Article 33:

"*(2) When drafting and implementing the draft law "On the medium-term budgetary framework for 2022, 2023 and 2024" and the draft law on the state budget for 2022, the conditions of the opinion issued in accordance with the second paragraph of Article 5 of Council Regulation (EC) No 1466/1997 of 7 July 97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies shall not be applied.*"

65. **Following this procedure, when assessing the draft law on the medium-term budgetary framework for 2022/24, the condition of public debt and the recommendations of the Council of the EU, which currently run until 2022, are assessed primarily. The Council of the** EU recognises that the fiscal adjustment indicators set out in Regulation (EC) No 1466/97 need to be seen in the context of the current circumstances. Firstly, there is currently considerable uncertainty regarding the measurement of the output gap, secondly, fiscal policy needs to be flexible and quickly adapt to the evolution of the pandemic or the normalisation of the epidemiological situation. Third, the current context is characterised by policy action to support economic activity (e.g. the impact of ANM grants), so the previously applicable criteria do not cover the full fiscal stimulus of fiscal policy to the economy. For these reasons, the Council of the EU notes that the structural balance is currently insufficiently adequate for the assessment of fiscal policy, while the expenditure growth benchmark should be adjusted to fully assess fiscal policy.

66. The recommendations of the Council of the **EU in the area of fiscal policy include: (i) to control the increase in nationally funded primary current expenditure, (ii) to finance COVID-19 support measures at the expense of the deficit where necessary, and (iii) to maintain the level of nationally funded investment at least at the level of 2021.** The recommendations for 2022 aim to maintain a supportive fiscal policy, including the fiscal stimulus provided by the Recovery and Resilience Facility, to maintain sufficient public investment, and to control the growth of government-financed primary current expenditure. If economic conditions allow, pursue fiscal policies aimed at prudent medium-term fiscal positions and ensuring fiscal sustainability over the medium term. At the same time, increase investment to boost growth potential. Pay particular attention to public finances as regards the revenue and expenditure side of the budget, as well as the quality of budgetary measures, ensure a sustainable and inclusive economic recovery. Priority shall be given to sustainable and growth-enhancing investments, in particular by supporting the transition to a green economy and digitalisation. There is a need to promote structural reforms, promote the long-term sustainability of public finances, including by strengthening health and social

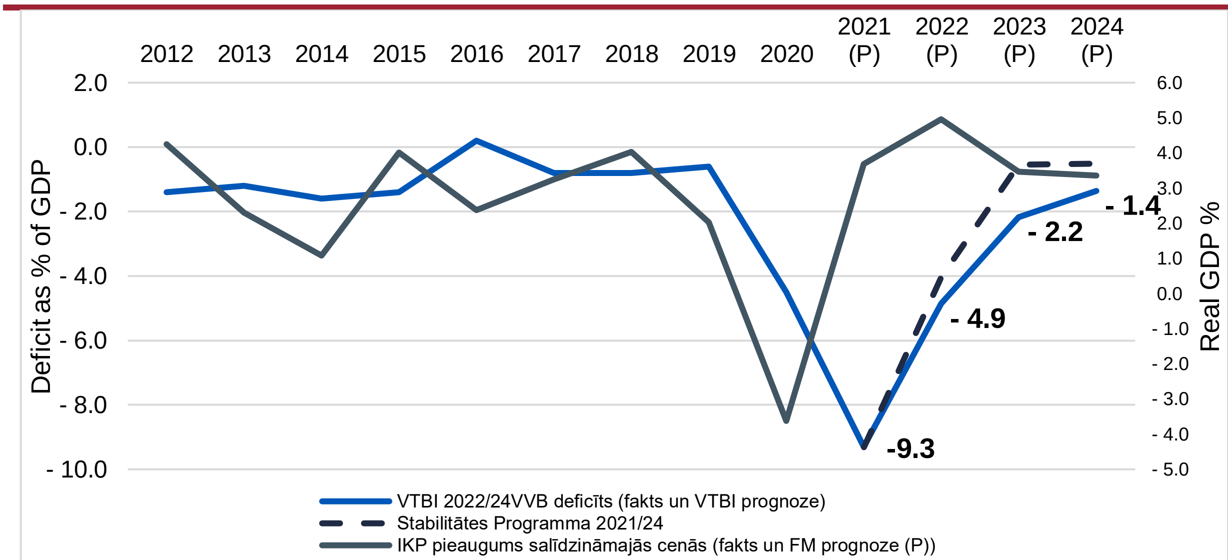
coverage, adequacy and sustainability of protection systems for all. **The deficit should be gradually reduced by opting for an optimal and sustainable trajectory. The increase in the deficit should be halted when macroeconomic indicators stabilise at the 2019 level.**

67. The **EU fiscal framework is currently in the process of transformation, both in terms of the use of numerical conditionality and in terms of deficit and debt reduction trajectories.** Following the lifting of the general escape clause, a renewed fiscal framework with a post-crisis transition period and a moderate deficit reduction trajectory for EU Member States is expected in the coming years. Against this background, the Council notes that VTBI2022/24 has an integrated trajectory for the reduction of the general government deficit, but considers that, in times of uncertainty, it needs to be assessed flexibly while respecting economic recovery processes: Without prematurely stifling economic recovery processes, but also without causing excessive overheating.

4.2. Fiscal framework VTBI 2022/24

68. **The Council supports the gradual deficit reduction planned in the current budgetary plan, despite the rapidly changing evolution of COVID-19, which limits the sustainable return of the economy to its 2019 level of development.** The 2022 budget foresees a general government deficit of 4.9 % of GDP. In the medium term, the deficit is planned to be reduced to 2.2 % in 2023 and 1.4 % in 2024. The general government structural balance deficit is planned to be 4.7 % in 2022, 2.1 % of GDP in 2023 and 1.4 % of GDP in 2024. The Council draws attention to the fact that the sum of the already accumulated deficits triggers the activation of the correction mechanism provided for in Article 11 of the FDL until the output gap becomes positive. According to the currently approved macroeconomic forecasts, the output gap is projected to be positive (0.2 %) in 2024.

Figure 7: General government deficit and GDP actual level and forecasts



Source: MoF and Eurostat [gov_10dd_edpt1], Ministry of Finance

69. **The use of fiscal space in terms of investment growth is encouraged and in line with the recommendations of the EU Council, but at the same time, fiscal space funds are planned for measures that will increase the basic budget expenditure, which will make it challenging in the future both to reduce the debt and reduce the deficit.** The fiscal space for 2022 has been fully absorbed and exceeded by investments authorised by the EC, leading to an increase in the previously planned deficit of 3.8 % to 4.9 %. In 2022, an amount of 14.6 billion is foreseen, which includes both primary expenditure and investments and more than 500 million COVID-19 related measures. Of the priority measures, 54 % is dedicated to maintenance, 38 % to investments, 8 % to COVID-19 measures. No new COVID-19-related measures are currently planned in the 2023s and 2024s, but the planned maintenance expenditure, which also includes measures to increase the budgetary base, will continue to increase, while the level of investment is falling. In comparison with 2022, capital expenditure of the general budget also decreased.

70. **Latvia's fiscal policy has been expansionary and counter-cyclical in response to the evolution of the crisis in 2020 and 2021, as in other EU countries, but economic growth has to be cautious in planning expansionary fiscal policies, which can stimulate inflation rather than homogeneous economic growth.** With the development of macroeconomic imbalances and rapid increases in inflation, it is necessary to critically approach the quality of investment projects and to delay, as far as possible, the realisation of projects that will not contribute to sustainable and balanced growth but lead to overheating in certain sectors. Moreover, rising energy prices against the backdrop of an unequal income structure for citizens may lead to an increased need for mechanical support from the population.

71. **Taking into account that the legislation does not currently set a maximum allowable budget expenditure, the Ministry of Finance[32] proposed in its report that a maximum expenditure anchor should be set at a level close to 50 % of GDP in the coming years. The Council agrees with this fiscal policy objective in the coming years.** However, at the moment of setting up the VTBI, debt is planned to increase to 52 % in 2022 and to decrease to 49 % of GDP in 2023/24. On 24 August6, the scenario approved by the Cabinet of Ministers envisaged a general government debt level of **49.6 % this year and 50.9 % in 2022, gradually decreasing to 49.8 % and 49.9 % in 2023 and 2024, respectively.**

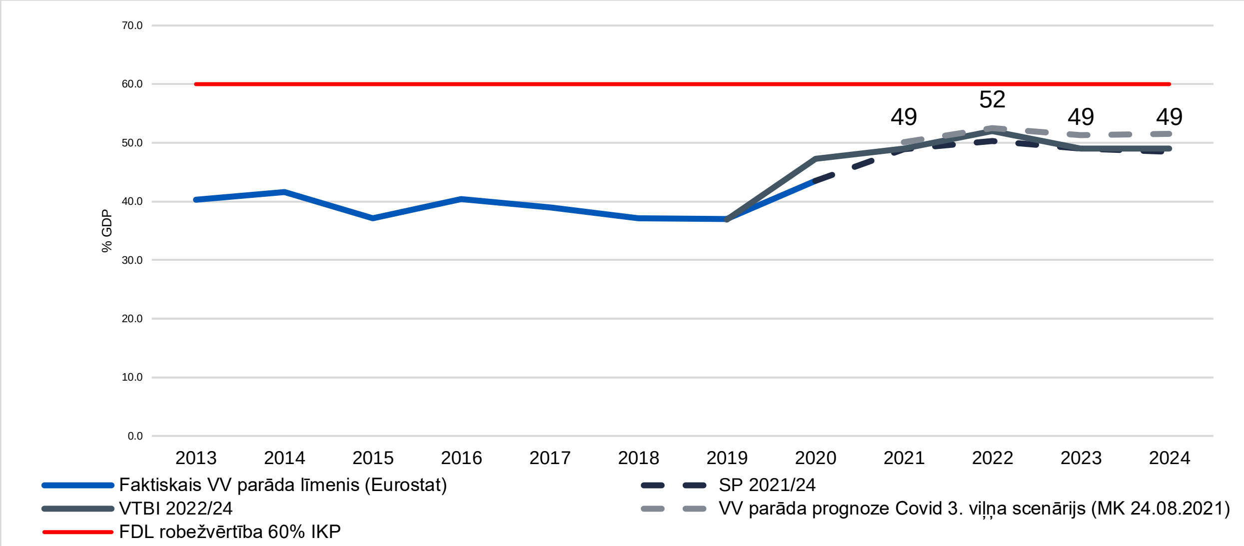
72. **Currently, Latvia's debt service costs are relatively low and Latvia's credit rating is also high enough to be able to borrow safely in international markets.** Latvia is currently able to take advantage of the best opportunities thanks to a high rating agency, e.g. Moody's awarded Latvia the highest rating A3, agency S&P Global A+, while Fitch placed Latvia in category A-. All agencies agree that Latvia's future assessment is stable. This is a positive result of the responsible fiscal policy of Latvia for several years, which has also resulted in historically low public debt service costs.

73. **Despite the favourable situation for Latvia in the context of high credit ratings, it is not permissible to increase the amount of debt after 2022, but a clear strategy to reduce both the debt level and the deficit has to be set out in this period.**

---

[32] Information report "On macroeconomic indicators, revenue and general government budget balance forecasts for 2022-2024", approved by the Cabinet of Ministers on 24 August 2021. Available at: Https://www.fm.gov.lv/lv/budzets2022, accessed on 16.09.2021

Figure 8: Actual level of general government debt and projections



Source: Eurostat [GOV_10DD_EDPT1] and Ministry of Finance

74. **The projected level of debt in 2022 is slightly above the above-mentioned debt anchor, but is expected to remain within 50 % on average over the medium term. The Council understands this situation in view of the rapid and difficult to predict deterioration of the epidemiological situation in October this year, which has led the government to declare a third emergency situation over the past two years.** Given the current circumstances, the approach to debt planning is considered to be fiscally responsible and the debt targets can be supported. Controlling the increase in debt requires a focus on high-quality investment, which will allow growth to increase in the future and reduce debt levels without additional fiscal constraints.