Fiskālās disciplīnas padome

Opinion of the Fiscal Discipline Council on the Macroeconomic Forecasts of the Ministry of Finance for the

Fiscal Structural Plan Progress Report 2025-2028.

Preamble

This document provides an opinion of the Fiscal Discipline Council (hereinafter - Council) regarding macroeconomic forecasts developed by the Ministry of Finance (hereinafter - MoF) for 2025-2028. The projections will be used as the basis for the fiscal Structural Plan progress Report (hereinafter - FSP) for 2025-2028 (2025-28), which is planned to be submitted to the Cabinet in April 2025. To support the Government's work an agreement was reached on early approval by the Council for the MoF macroeconomic forecasts.

In accordance with the cooperation agreement signed on 8 February 2016, the Council is responsible for approving the macroeconomic projections of the MoF. Detailed MoF forecast data, including scenarios for the development of gross domestic product ("GDP") and individual components of GDP, were submitted to the Council during the approval procedure.

At the Council meeting on 12th February 2025, the MoF presented the assumptions and changes in the updated macroeconomic forecasts, highlighting key developments since June 2024, as well as the current state of the national economy.During the discussion, the Council inquired about the forecasting assumptions and the rationale behind specific indicators. The MoF provided responses, addressing the methodology and key factors influencing the projections.

The **Council is responsible** for providing an opinion on macroeconomic indicators in accordance with the scope of indicators defined in Section 20 of the Law on Fiscal Discipline (summarized in Table 3 at the end of this document). After an internal discussion, and considering the materials and explanations provided by the Ministry of Finance (MoF), the Council members decided to approve the forecasts.

<u>Overview of the situation</u>

MoF forecasts for real GDP growth rate for 2024 and 2028 have not changed since June 2024. Given the stagnation of the economy in 2024, the MoF maintains a conservative and cautious approach. on September 30, 2024, the Central Statistical Bureau (CSB) published the results of a comprehensive audit of national accounts for the period 1995-2023. As a result of the audit, gross domestic product (GDP) at current prices was reduced for all years from 1995 onwards[1].

MoF projections consider the CSB's comprehensive national accounts audit data for gross domestic product. By renewing macroeconomic projections in the MoF for 2025-2028, they

[1] IKP_2024_gada_revizija_30092024.pdf

have been downgraded due to both economic stagnation and CSB audits of national accounts data.
The MoF's updated real GDP growth rate projections from 2025 to 2028 do not exceed the 2.2% level and the average GDP growth rate is projected at 1.9% over this period.
The inflation forecast reflects a decrease in the rate of consumer price growth, but in the period from 2025 the inflation growth is requested by an average of 2.4% for 2028, above the ECB target value (2%).

Table 1 summarizes the updated forecasts of macroeconomic indicators of the Ministry of Finance and currently available other institutions, data sources: MoF[2], BoL (Bank of Latvia[3]), EC (European Commission[4]), IMF (International Monetary Fund[5]). The most recent macroeconomic projections are currently available from the Bank of Latvia, however, they have been developed in December 2024 and since then the GDP outcome could be lower than initially forecast by BoL, as reported by FDP representatives at the meeting of the FDP GDP Working Group [Protocol reference] [6].

	2024	2025	2026	2027	2028
Real GDP growth					
MoF (2025.g. Feb.)	-0,4	1,2	2,1	2,2	2,2
BoL (2024.g. Dec.)	0,1	2,1	3,0	3,3	-
EC (2024.g. Nov.)	0,0	1,0	2,1	-	-
IMF (2024.g. Okt.)	1,2	2,3	2,5	2,5	2,5
Nominal GDP growth					
MoF (2025.g. Feb.)	2,5	4,3	4,8	4,9	4,6
BoL (2024.g. Dec.)	-	-	-	-	-
EC (2024.g. Nov.)	-	-	-	-	-
IMF (2024.g. Okt.)	3,5	5,1	5,4	5,2	5,2
Inflation (CPI)					
MoF (2025.g. Feb.)	1,3	2,5	2,2	2,5	2,5
BoL (2024.g. Dec.)	1,3	1,4	1,5	-	-
EC (2024.g. Nov.)	1,2	2,2	2,2	-	-
IMF (2024.g. Okt.) *end of period	2,9	1,6	2,7	1,7	2,6
Deflator					
MoF (2025.g. Feb.)	2,9	3,1	2,7	2,7	2,4
BoL (2024.g. Dec.)	-	-	-	-	-
EC (2024.g. Nov.)	-	-	-	-	-
IMF (2024.g. Okt.)	2,3	2,6	2,8	2,7	2,6

1. Table of forecasts for key macroeconomic indicators from various institutions, %.

By comparing MoF's real GDP growth forecast for 2025 with the Bank of Latvia's forecast, it can be seen that MoF's forecast is 0.9 percentage points more cautious. Also for 2026, MoF's GDP growth forecast is below 0,9 percentage points than BoL's.

Comparing the MoF real GDP forecast with the EC forecast for 2025, the MoF forecast is higher than the EC – by 0.2 percentage points, while for 2026, the MoF and EC estimates are the same.

Overall, MoF's GDP projections for 2025 are more cautious than BoL, and the IMF. However, the MoF expects growth in 2025 to be slightly higher than the EC.

The MoF inflation forecast reflects the current situation where consumer price growth is no longer as rapid as in 2023, however since September 2024 inflation has been slowly increasing again, reaching 3% in January this year. The MoF predicts 2.5% inflation for 2025. BoL's inflation forecast is 1.1 percentage points lower, while the EC forecast is below 0.3 percentage points. MoF's projected inflation rate for 2026 is in line with the EC forecast, but is 0.9 percentage points below BoL's.

[2]Finanšu ministrija aktualizējusi makroekonomisko rādītāju prognozes | Finanšu ministrija
[3]Latvijas Banka decembra prognozes, Makroekonomiskās prognozes | 2024. gada decembris | Latvijas Banka
[4]Eiropas Komisijas pavasara prognozes, Economic forecast for Latvia - European Commission (europa.eu)
[5]Starptautiskais Valūtas fonds, oktobra prognožu datubāze - World Economic Outlook Database, October 2024
[6] Atsauce tiks papildināta kad protokols tiks ielikts mājas lapā

Given the economic slowdown in 2023 and likely in 2024, the Council believes the MoF's cautious Outlook for 2025 and 2026 is realistic. The University of Latvia's LV PEAK Expert Consultancy forecast, presented on January 15 as part of the "Economic barometer", is slightly more optimistic than the MoF in terms of GDP growth, but the increase in inflation in Latvia will be significantly lower than the MoF. According to LV PEAK, GDP will grow by 1.7% in 2025, while inflation will be moderate by 1.9%%.[7]

Economic developments in late 2024 and early 2025

The Central Statistical Bureau (CSB) will not publish a flash GDP estimate in the coming year; however, the full 2024 GDP estimate will be available on February 29.

Fourth Quarter of 2024

According to seasonally unadjusted data from the Central Statistical Bureau (CSB), **retail trade turnover** increased by 1.9% in the fourth quarter of 2024, marking the fastest growth of the year. Food retail trade turnover declined by 1.4%, while non-food trade grew by 4.3%, which was twice as fast as in the third quarter. Fuel retail trade turnover increased by 1.3%, the slowest growth rate of the year, whereas online and mail-order retail trade rose by 9.1% (compared to 8.9% in the third quarter).

Industrial production declined by 0.4% year-on-year in the fourth quarter of 2024, indicating that the slight increase observed in the third quarter (+0.1%) was not sustainable. The most significant decline among sub-sectors was in electricity and gas supply (-23.7%), primarily due to warm winter weather. However, mining experienced a substantial increase (+30.8%), while manufacturing saw a modest rise (+0.3%), marking its first increase since the third quarter of 2022. Within the **manufacturing sector**, growth returned to the wood industry (+4.4%) and food production (+0.5%). Additionally, the number of manufacturing sub-sectors experiencing a decline in production volume decreased—whereas in the third quarter, production volume fell in half of the 20 observed sub-sectors, in the fourth quarter, the number had dropped to 8 out of 20.

Exports. CSB data for the fourth quarter of 2024 indicate that the volume of goods exports declined by 2% overall. After a 3.4% increase in exports in the third quarter, exports fell again in the fourth quarter. Exports to EU-27 countries increased by 0.9%, while exports to the CIS decreased by 1.8%, and exports to other countries fell by 1%. Among major trading partners, exports increased only to Lithuania (+5.6%) and the United Kingdom (+5.4%). Meanwhile, exports declined to Denmark (-1.2%), Estonia (-3%), Germany (-3.8%), and Sweden (-5.8%). Exports to Russia have also been decreasing rapidly each quarter, with a significant drop of 20% in the final quarter of the year.

Construction. The volume of construction output decreased by 6.3%, including a 23.2% decline in building construction and a 1.3% decrease in specialized construction. Civil engineering, however, grew by 8.3%, driven by significant increases in the construction of bridges and tunnels (+46.4%), power supply and telecommunications systems (+36%), and municipal infrastructure (+29.1%). Road and railway construction shrank by 2.1%, while other civil engineering projects grew by 16.2%.

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[7] LV PEAK Ekonomikas barometrs

Construction costs rose by 2% in the fourth quarter, including a 5.6% increase in wages and salaries, a 2.5% rise in machinery rental costs, while construction material prices decreased slightly by 0.2%.

Unemployment. The unemployment rate in the fourth quarter stood at 6.8% (according to the State Statistics Service, the registered rate was 5.2%). The highest unemployment rate was recorded in Latgale (10.3%), while in other regions, it remained around 5%—Vidzeme (5.2%), Kurzeme (5.1%), Zemgale (5%), and Riga (3.9%).

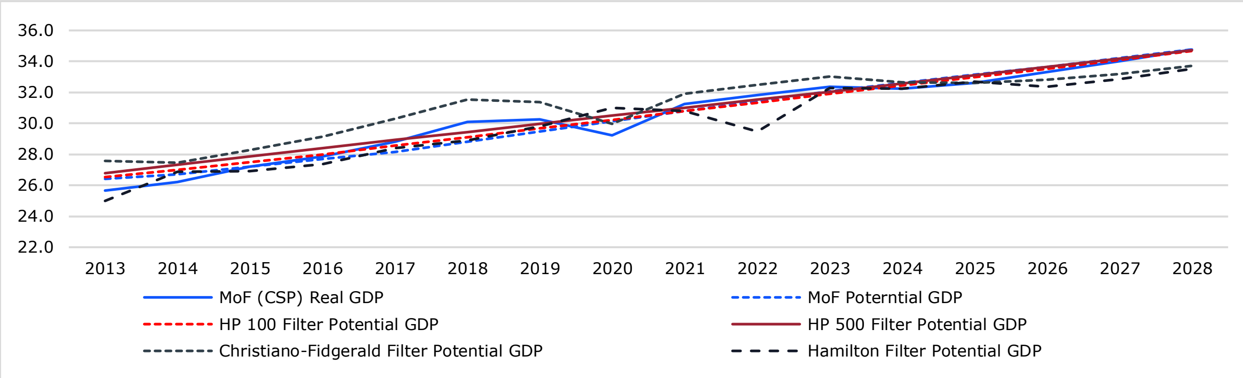
January 2025

In January, annual **inflation** reached 3%. Prices for goods increased by 2%, while service prices rose by 5.8%, driven by rising wages. Prices for food and non-alcoholic beverages increased by 4.6%. Prices for housing management services declined by 0.4%, influenced by decreases in fuel prices (-4.2%), gas (-5%), and heat energy (-9.2%).
Entrepreneurs' sentiment improved in retail trade (+1.7 percentage points) and the services sector (+1.7 percentage points), but worsened in industry (-2.1 percentage points) and construction (-1.4 percentage points). In manufacturing, sentiment had been improving since August, but in January, it declined by 2.1 percentage points, reaching -6.8%. This decline was driven by worsening sentiment in food production (-2.3 percentage points), electronics (-2.5 percentage points), and building materials manufacturing (-4.1 percentage points). In construction, sentiment improved slightly across all sub-sectors, yet the overall indicator remained negative at -11.9%. The biggest limiting factor across all sectors was insufficient demand. However, it is worth noting that concerns about insufficient demand have started to gradually decline, while the number of entrepreneurs reporting no limiting factors has begun to increase.

Assessment of the economic cycle of Latvia

Experts of the Council shall provide their assessment of the economic situation of Latvia in its economic cycle. This assessment uses the Hodrick-Prescott statistical filter method with a levelling parameter of 100 and 500, as well as the Chistiano-Fidgerald and Hamilton filter. The statistical filter method has been used to distinguish between short - and long-term fluctuations in GDP and to assess the level of economic potential, thus allowing the calculation of a comparable output spread value for the estimation of MoF projections. The figure 1.shows that between 2013 and 2028, the closest MoF estimate is the potential GDP obtained by the HP (100) method. The time series calculated with Hamilton's filter differs most from MoF. The valuation obtained by Hamilton's filter shows both a steeper decline in potential GDP in 2022, a shock year for energy prices, and a lower level of potential GDP in the medium term beyond 2025.

Figure 1. Real GDP (actual and projected), MoF estimate of potential GDP and Council estimate of potential GDP (HP 100, HP 500, CF, and Hamilton statistical filter method)

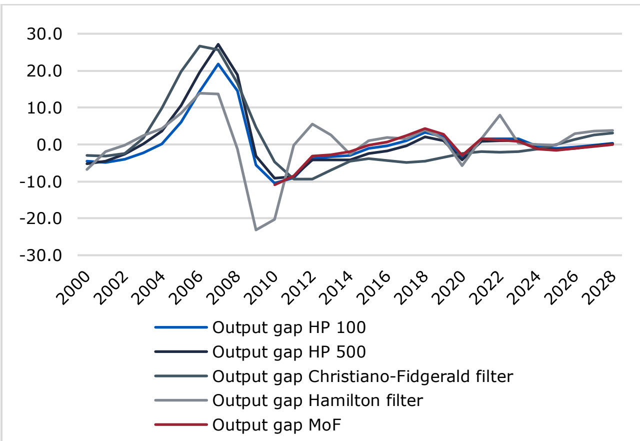


Source: MoF and FDP calculations

Using the statistical filter approach described above, alternative output spreads were obtained. It can be concluded that output differences calculated with different statistical filters have a similar trajectory to MoF data between 2013 and 2028. The output difference calculated by the Hamilton filter shows higher and positive values, while the output difference calculated by HP filters (100) and (500) is minimally different from MoF estimates, see **Figure 2.**

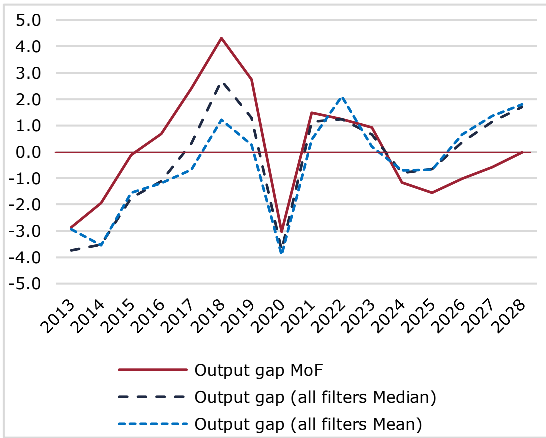
It should be noted that previous Council evaluations [8], [9], [10] concluded that, between 2013 and 2026, the results of different statistical filtering methods essentially follow the same trajectory as MoF data.

Figure 2. Output gap calculation result comparison of three statistical filters with MoF



Source: MoF and Council calculations

Figure. 3 Average of the comparison of output difference calculation results and median of statistical filters compared to MoF



Source: MoF and Council calculations

[8] 14.02.2022. Makroekonomisko prognožu apstiprināšana | fiskālās disciplīnas padome (fdp.gov.lv)
[9] 12.08.2022. Makroekonomiskās prognozes 2022. gadam un VTBI 2023/25. | fiskālās disciplīnas padome (fdp.gov.lv)
[10] Koriģētās makro prognozes 2022. gadam un VTBI 2023. –2025. gadam (1.12.) | fiskālās disciplinārkolēģijas (fdp.gov.lv)

The figure 3 shows the calculated median and mean of all statistical filters and a comparison with the output difference calculated by MoF. The median points to a negative output gap in both 2024 and 2025, yet subsequent years show a return of output spreads to positive values. The average and median of all filters indicate a negative output gap in 2025. However, given the current set of risks in the economy and the persistent global uncertainty, the scope for long-term measurement of output spreads is limited. The Council agrees with the valuation of MoF, the output gap corresponding to the current economic situation, and in consultation with experts from BoL whose output gap estimates are similar to those of MoF, see Table 2.

Table 2

Output gap: MoF calculations and median and average of the results of the statistical filters calculated by the Council

	Output gaps MoF	Output gap (all filters median)	Output gap (all filters average)
2024	-1,2	-0,8	-0,7
2025	-1,5	-0,7	-0,7
2026	-1,0	0,4	0,7
2027	-0,6	1,2	1,4
2028	0,0	1,7	1,8

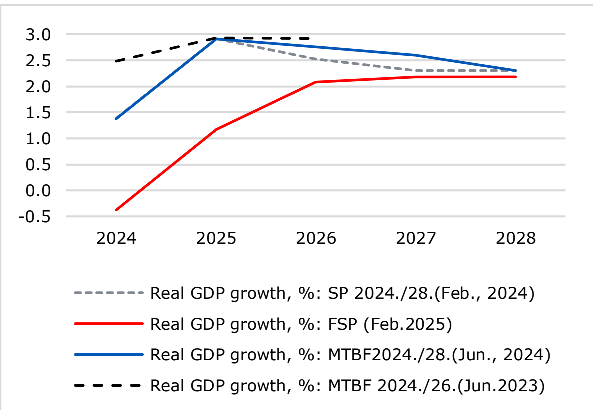
Source: MoF and Council calculations

Comparison of current and previous MoF forecasts

Below is a comparison of the projections made in June 2024 (MTBF 2024/28) and the current projections in FSP 2025./28. On the basis of the current economic developments and the assumptions of the MoF on which the forecasts are based, the **Council has decided to approve the following projections:**

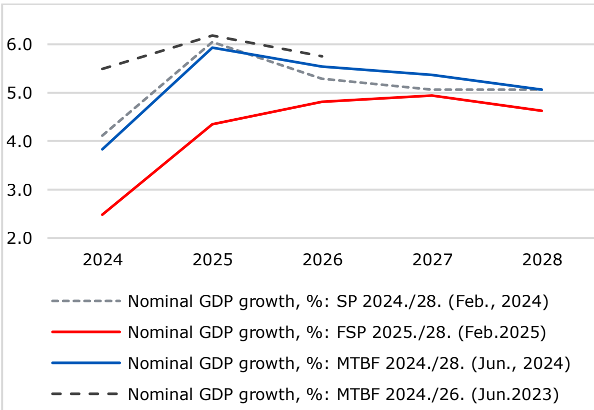
The Council confirms the real GDP growth forecast for the four-year period 2025-2028. Compared to the June forecast (MTBF 2024/28), GDP growth rates have been reduced for all projected years - by 1.7 percentage points for 2025, 0.7 percentage points for 2026, 0.4 percentage points for 2027 and 0.1 percentage point for 2028. (see Figure 4).

Figure4. Real GDP growth forecast.



Source: MoF

Figure5. Nominal GDP growth forecast.

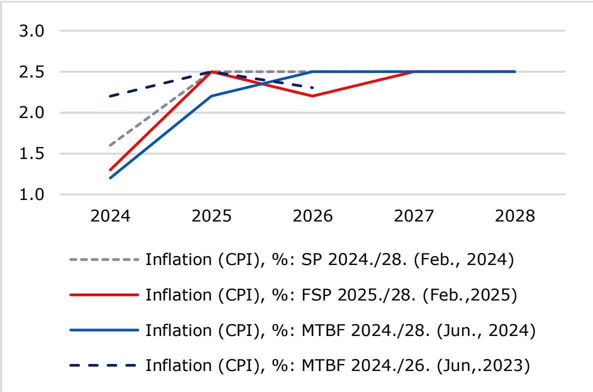


Source: MoF

The Council confirms the forecast for nominal GDP growth over the four-year period 2025-2028. Compared to the previous forecast (MTBF 2024/28), the nominal GDP growth forecast was reduced by 1.6 percentage points for 2025, 0.7 percentage points for 2026 and 0.4 percentage points for 2027 and 2028 (see Figure 5).

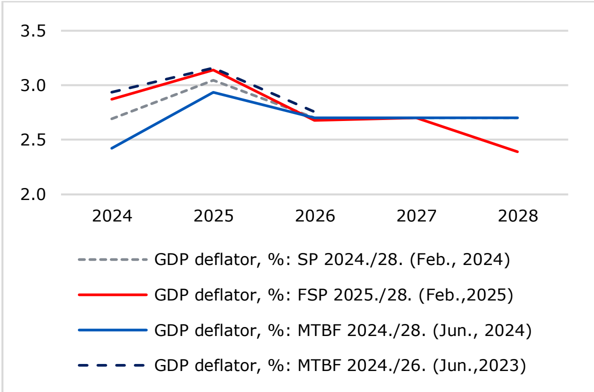
The Council approves the inflation forecast for the period 2025-2028. The forecast for 2025 has been raised by 0.3 percentage points, reduced by 0.3 percentage points for 2026, while for 2027 and 2028 it has not been changed and remains at 2.5% (see Figure 6).

Figure 6. Inflation forecast.



Source: MoF

Figure 7. GDP deflator forecast.



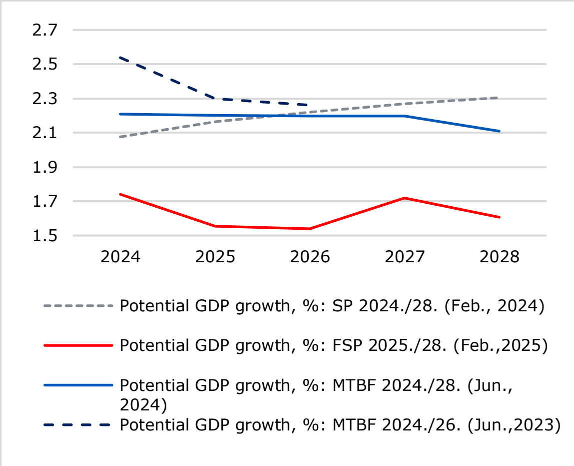
Source: MoF

The Council approves the GDP deflator forecast for the period 2025-2028. Compared to the previous forecast (MTBF 2024/28), the GDP deflator for 2025 is up 0.2 percentage points, for 2026 and 2027 the forecast is unchanged and remains at 2.7%, while for 2028 the deflator forecast is down 0.3 percentage points (see Figure 7).

The Council confirms the projection of potential GDP growth for the period 2025-2028. Compared to the previous forecast (MTBF 2024/28), the projection of potential GDP growth has been deteriorated for the whole period – it has been reduced by 0.6 percentage points for 2025, 0.7 percentage points for 2026 and 0.5 percentage points for 2027 and 2028 (see Figure 8).

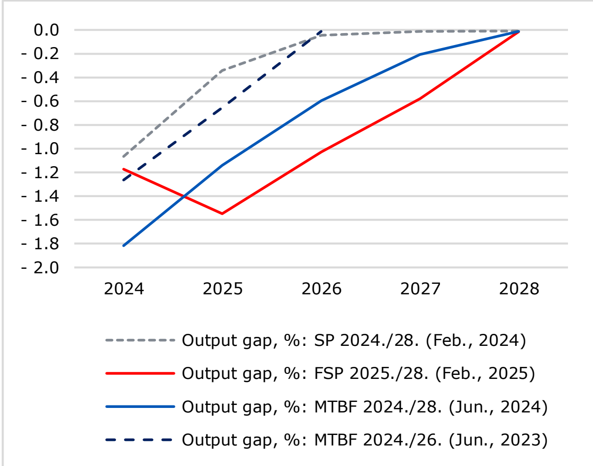
The Council approves the output gap forecast for the period 2024-2028. Compared to the previous forecast (MTBF 2024/28), the output gap for 2025-2027 has been adjusted downwards by 0.4 percentage points, while for 2028 the forecast has not been changed, with the potential and real GDP value expected to align this year and the output gap to be 0. (see Figure 9).

Figure8. Forecast for potential GDP growth,%.



Source: MoF

Figure9. Output gap,% of potential GDP forecast.



Source: MoF

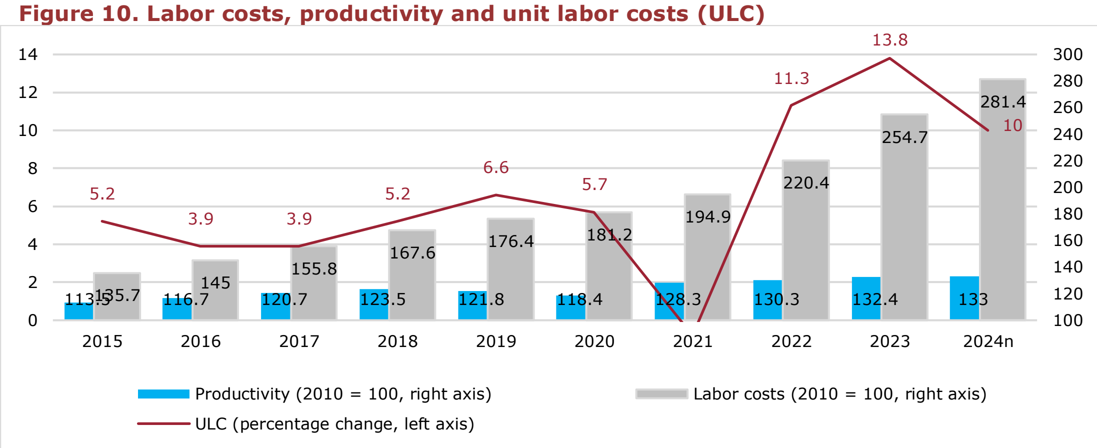
Conclusions

The Council approves the Ministry of Finance's (MoF) macroeconomic forecasts for the FSP 2025-2028, considering them conservative. However, the Council highlights that the forecasts do not consider the latest geopolitical trends regarding U.S. trade policy and the growing importance of the military sector in the economy, both in terms of expenditure and revenue. The Council acknowledges that these factors are currently difficult to quantify and calls for their consideration in future forecasts. The Council also draws attention to the current risks that may negatively affect the projected economic growth trajectory.

1. **The security situation in the region remains highly tense and uncertain, with increasing risks of hybrid attacks.** The unstable geopolitical environment is impacting private consumption, investment, the business climate, and public fiscal policy.
2. **Regional and global economic uncertainty persists.** The protectionist trade policies of the U.S. and potential EU countermeasures, such as raising tariffs on U.S. goods, could escalate trade wars, negatively affecting both EU and Latvian companies as well as the investment climate.
3. **The expansion of Chinese goods in Europe poses an additional challenge.** U.S. tariffs on Chinese goods may lead China to seek new markets in Europe, increasing competition for European businesses and reducing the competitiveness of European, including Latvian, manufacturers.
4. **Weak external demand and slow exports continue to be concerns.** The ongoing economic stagnation in the European Union, particularly in the construction and industrial sectors, may continue to negatively impact Latvian exports, especially in the wood industry.
5. **Structural problems in the labor market and a decline in Latvia's competitiveness remain significant.** Employers face a shortage of skilled workers, limiting business development, while labor productivity is not growing fast enough to compensate for rising wages. Over the past three years, wage growth has averaged 12.5%, with no direct correlation to productivity improvements, leading to a widening

gap between productivity and labor costs. Productivity indicators are improving very slowly, which could weaken the ability of Latvian businesses to compete in international markets. The Ministry of Finance has also projected very slow productivity growth in the coming years, forecasting a growth rate of 1.2% for 2025 and an average growth of 2.1% for the period 2025-2028.

Figure 10. Labor costs, productivity and unit labor costs (ULC)



Source: Eurostat un LV PEAK estimate (n)[11]

6. **Wage increases in the public sector may create additional pressure for wage increases in the private sector, which is particularly challenging in an environment of slow economic growth.** According to CSB data, in the first three quarters of 2024, the average national wage increased by 10.2%. At the same time, wage growth in the public sector was 13.7%, while in the private sector, it was 8.7%. Part of the public sector wage increase is attributed to salary raises for teachers and internal affairs employees; however, a notable increase of 13.2% was also observed in ministries, central government institutions, and other state structures. While the government has taken steps to control this process, the wage commitments already made pose a significant fiscal burden.
7. **Inflationary pressures persist in the services and food sectors.** Despite the overall decline in inflation, wages continue to rise, which may keep service prices high. The increase in food prices may affect household consumption patterns and purchasing power.
8. **Energy price fluctuations remain uncertain**. The development of oil and other energy prices is unpredictable, and an increase could create additional inflationary pressure and raise business costs. The planned disconnection from BRELL may, under certain conditions, lead to an increase in electricity prices.
9. **Risks related to the financial management of public joint-stock companies still exist and are growing, especially in the transport sector.** The capitalization of AirBaltic and the construction of Rail Baltica could create additional fiscal and financial risks if the projects do not achieve their planned objectives or exceed the initially estimated costs.

[11] LV_PEAK_BAROMETRS_Nr6_Dec_2024_LV.pdf

Table 3.

Macro-economic forecast indicators approved by the Council,%

Macroeconomic indicators	2024	2025	2026	2027	2028
Real GDP growth	-0,4	1,2	2,1	2,2	2,2
Nominal GDP growth	2,5	4,3	4,8	4,9	4,6
Inflation (consumer prices)	1,3	2,5	2,2	2,5	2,5
GDP deflator	2,9	3,1	2,7	2,7	2,4
Potential GDP growth	1,7	1,6	1,5	1,7	1,6
Output gap	-1,2	-1,5	-1,0	-0,6	0,0

Source: MoF