



# Fiscal Discipline Council

## Opinion on the Ministry of Finance macroeconomic forecasts for

### Stability Program 2024-2028

#### Preamble

*This document gives an opinion of the Fiscal Discipline Council (hereinafter - Council) on the macroeconomic forecasts developed by the Ministry of Finance (hereinafter - MoF) for the period 2024-2028. The forecasts will be used as the basis for the development of the Stability Program (hereinafter - SP) for 2024-2028 (2024. /28.), which is planned for submitting to the Cabinet in April 2024. To support the Government's work on the medium-term budgetary framework and the development of the Stability Program – an agreement was reached on early approval by the Council for the MoF macroeconomic forecasts.*

Under the Cooperation Agreement signed on 8 February 2016, the Council is responsible for the approval of the MoF macroeconomic forecasts. During the forecast approval procedure, detailed MoF forecast data were submitted to the Council, including scenarios for the development of the gross domestic product ("GDP") and individual GDP components.

At the meeting of the **Council on 12 of February 2024**, the MoF informed about the assumptions and changes in the updated macroeconomic forecasts since June of 2024, and latest outcomes of 2023 as well. The Council discussed with MoF experts and asked explanations on forecasting assumptions and the justification for individual indicators. MoF explanations was plausible, and data based.

Formulation of the opinion on macroeconomic indicators is the duty of the Council, in accordance with the scope of the indicators specified in Section 20 of the Fiscal Discipline Law (indicators are collected in Table 2 at the end of this document). The members of the Council, considering the materials and explanations provided by the MoF, adopted a decision on the approval of the forecasts based on an internal discussion.

#### **Overview of the situation**

MoF forecasts have worsened since June 2023 and are cautious and realistic given the economic stagnation. GDP growth rates are projected to be slow, considering the expected negative outcome of 2023. The inflation forecast reflects the result of the restrictive monetary policy and indicates the return of this indicator to an acceptable level. Table 1 summarizes current forecasts of macroeconomic indicators of the Ministry of Finance and other institutions, data sources: MoF<sup>1</sup>, BoL (Bank of Latvia)<sup>2</sup>, EC (European Commission)<sup>3</sup>, IMF (International Monetary Fund)<sup>4</sup>. Currently, the latest alternative macroeconomic forecasts are

<sup>1</sup>FM updated macroeconomic forecasts: [Tautsaimniecības un budžeta izpildes analīze | Finanšu ministrija \(fm.gov.lv\)](https://www.fm.gov.lv)

<sup>2</sup>Bank of Latvia forecasts [Prognozes | Latvijas Banka](https://www.bankoflatvia.lv)

<sup>3</sup>EUROPEAN Commission Autumn forecasts, [Economic forecast for Latvia - European Commission \(europa.eu\)](https://ec.europa.eu/economy_finance)

<sup>4</sup>International Monetary Fund IMF - World Economic Outlook database: October 2023

available from the Bank of Latvia, which was published in December of 2023. Comparing the MoF real **GDP forecast** with the BoL forecast for 2024, the MoF forecast is more cautious than BoL, by 0.6 percentage points in 2024 and by 0.7 percentage points in 2025. Overall, the GDP forecasts produced by the MoF are more cautious than both the EC and BoL and the IMF forecasts.

**MoF's inflation** forecasts show a rather sharp decline from the indicators observed in the previous year. For 2024, MoF predicts an inflation rate of 1.6%, while BoL forecast is 0.4 percentage points higher. The MoF forecasted inflation level for 2025 is 0.2 percentage points higher than the BoL forecasts. In general, both institutions expect that inflation will not exceed 2.5% in 2024 and in the following period. EC and IMF data are slightly different, which nevertheless predict inflation around 3-4% in 2024, but it will decrease to 1.9-2.5% in the following years.

MoF's forecasts do not contradict the current dynamics of economic indicators of the end of 2023. Forecasting, in conditions of high uncertainty and macroeconomic risks, has become routine since 2020 and it also makes it difficult to do budget planning. The forecasts made at the beginning of 2023 turned out to be too optimistic, and it is currently seen that 2023 ends with recession rather than growth.

	2024	2025	2026	2027	2028
<b>Real GDP Growth</b>					
MoF (Feb .2024)	1.4	2.9	2.5	2.3	2.3
BoL (Dec 2023)	2.0	3.6	3.8		
EC (Nov. 2023)	2.4	3.0			
IMF (Okt. 2023)	2.6	3.2	3.2	3.3	3.2
<b>Nominal GDP growth</b>					
MoF (Feb .2024)	4.1	6.0	5.3	5.1	5.1
BoL (Dec 2023)					
EC (Nov. 2023)					
IMF (Okt. 2023)	7.4	7.1	6.0	5.9	5.9
<b>Inflation (CPI)</b>					
MoF (Feb .2024)	1.6	2.5	2.5	2.5	2.5
BoL (Dec 2023)	2.0	2.3	1.8		
EC (Nov. 2023)	3.2	1.9			
IMF (Okt. 2023)	4.3	2.5	2.4	2.3	2.3
<b>Deflator</b>					
MoF (Feb .2024)	2.7	3.0	2.7	2.7	2.7
BoL (Dec 2023)					
EC (Nov. 2023)					
IMF (Okt. 2023)	4.6	3.7	2.7	2.6	2.5

**Table 1 Forecasts for key macroeconomic indicators of different institutions, %.**

Economic growth is currently constrained by the economic slowdown of trading partners, weak external and domestic demand, the decline in manufacturing, and restrictive monetary policy. Another negative factor is delay in the absorption of EU funds, which slows down the growth of the contribution of investments in the structure of GDP. The experts of the PEAK think tank of the University of Latvia predicted economic growth of 1.8% for 2024, indicating the still high geopolitical risks and the growing gap in productivity and wages<sup>5</sup>.

According to flash assessment published by the CSB in January, real GDP dropped by 0.1% in Q4

and by 0.3% in whole 2023, comparing to corresponding period of previous year (seasonally adjusted data).

<sup>5</sup> [LV PEAK BAROMETRS LV 2023 II.pdf \(lu.lv\)](#)

In 2023, foreign trade turnover in actual prices decreased by 11.9%. The value of exports amounted to 18.94 billion euros (a decrease of 2.39 billion euros or 11.2%), while the value of imports was 23.2 billion euros (a decrease of 3.3 billion euros or 12.5%).

The volume of industrial production decreased by 4.5% on average in 2023, however, there was an increase in the volume of production (+1.7%) in December. Also in the manufacturing, the annual average production volume decreased by 4.5%, but December ended with a +1.4% increase.

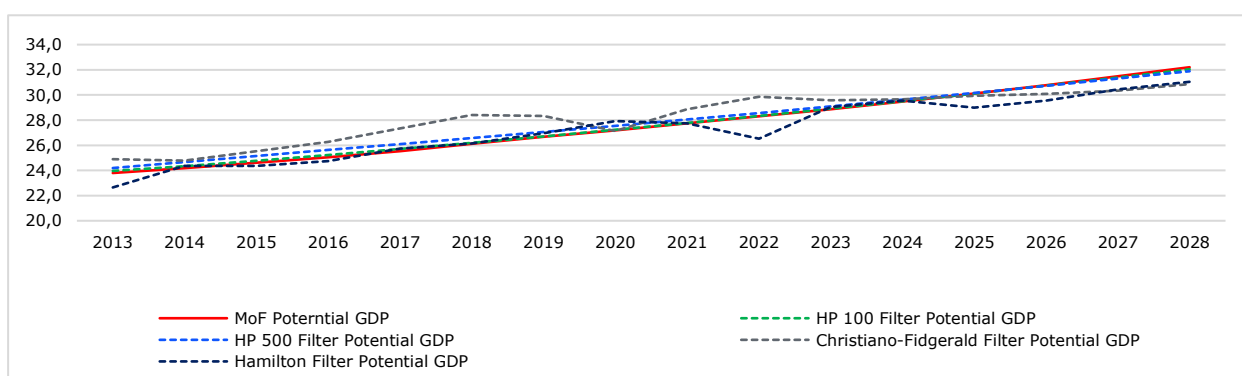
Exports of services gradually slowed down but entered a recession in the third quarter of 2023 (-0.2%).

Wages increased by 12% on average in three quarters, real wages also increased in the second and third quarters. However, considering the rapid growth of inflation in previous years, domestic consumption is still limited.

### **Assessment of the Latvian economic cycle**

The Council's experts give their assessment of the state of play of the Latvian economy during its economic cycle. This evaluation uses the Hodrick-Prescott statistical filter method with a smoothing parameter of 100 and 500, Chistiano-Fidgerald and Hamilton filter as well. The statistical filters method has been used to separate short-term and long-term fluctuations in GDP and to provide an understanding of the economic potential, thereby allowing the calculation of a comparable output gap value that can be used for MoF's forecasts assessment. **Figure 1** shows that, in the period from 2013 to 2028, the closest to the MoF calculation is the potential GDP obtained by the HP (100) method. The time series estimated with the Hamiltonian filter differs the most from the MoF, which shows both a faster decline in potential GDP in the 2022 (energy prices shock year) and a lower level of potential GDP in the medium term.

**Figure 1. Real GDP (actual and projected), MoF estimated potential GDP and Council estimated potential GDP with HP 100 and HP 500.**

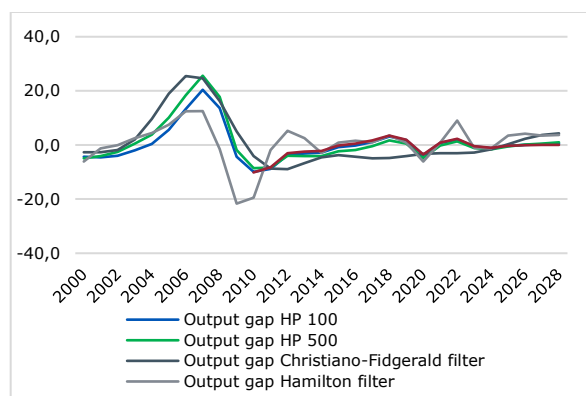


**Source: MoF and FDC calculations**

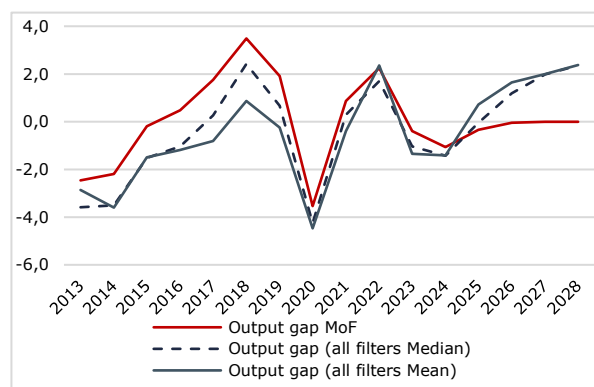
Alternative measures of the output gap were obtained based on the above statistical filters. It can be concluded that in the period from 2013 to 2028, the results of various alternative statistical filtering methods basically follow a similar trajectory as the MoF data. The output gap estimated by the Hamilton filter shows higher and positive values, while the output gap calculated with the HP filters (100) and (500) differs minimally from the MoF estimate ones, see **Figure 2**.

It should be noted that in previous Council assessments<sup>6,7,8</sup> it was concluded that, in the period from 2013 to 2026, the results of various statistical filtering methods basically follow a similar trajectory as MoF data.

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



**Figure 3. Output gap calculation result comparison mean and median of statistical filters compared to MoF**



Source: MoF and Council calculations

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**Figure 3** shows a comparison between the mean, median and MoF calculated output gap of all filters used for the calculation of the output gap. Both the median and mean value curves indicate a negative output gap in both 2023 and 2024; however, in the following years, a faster trend of the output gap, to positive values than calculated by MoF. However, considering the set of existing risks and high uncertainties, a long-term assessment of the output gap is currently challenging, and current-day assessments are more reliable, see **Table 1**.

**Table 1**

**Output gap: MoF calculations and mean and median of statistical filter results calculated by Council.**

	Output gap MoF	Output gap (all filters Median)	Output gap (all filters Mean)
<b>2023</b>	-0,4	-1,0	-1,3
<b>2024</b>	-1,1	-1,4	-1,4
<b>2025</b>	-0,3	-0,1	0,7
<b>2026</b>	0,0	1,2	1,6
<b>2027</b>	0,0	2,0	2,0
<b>2028</b>	0,0	2,4	2,4

Source: MoF and Council calculations

### **Comparison of current and previous MoF forecasts**

Below is a comparison between the forecasts for MTBF 2023/26 in June 2023 and update for SP 2024./28. Given the latest economic developments and the MoF assumptions underpinning the forecasts, the Council has adopted a decision on the endorsement of the forecasts described below.

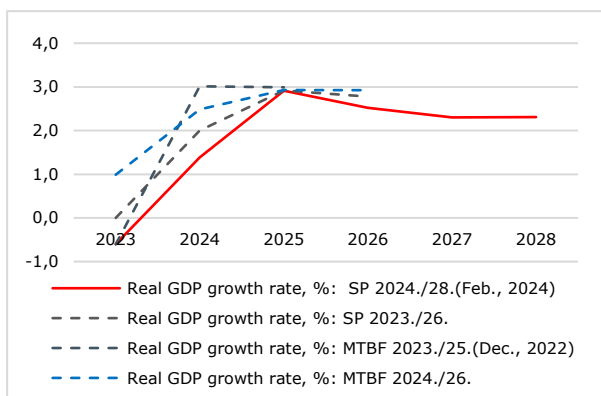
<sup>6</sup>14.02.2022 Approval of macroeconomic forecasts | Fiscal Discipline Board (fdp.gov.lv)

<sup>7</sup>12.08.2022. Macroeconomic forecasts for 2022 and VTBI 2023/25 | Fiscal Discipline Board (fdp.gov.lv)

<sup>8</sup>Adjusted Macro Forecasts 2022 and VTBI 2023-2025 (1.12) | Fiscal Disciplinary Board (fdp.gov.lv)

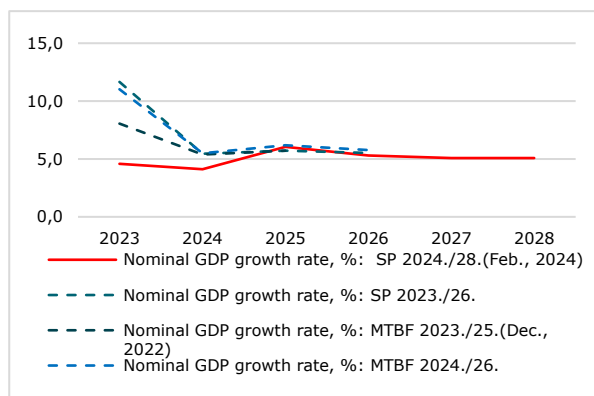
**The Council approves the real GDP growth forecast for five-year period 2024. - 2028.** Compared with the previous MTBF 2024/26 forecast, the real GDP forecast was downgraded by 1.1%p. for 2024, forecast for 2025 was without changes, but forecast for 2026 dropped by 0.4 %p. The forecast for 2027 and 2028 is the same 2.3%. (see page Figure 4).

**Figure 4. Real GDP growth forecast.**



Source: MoF.

**Figure 5. Nominal GDP growth forecast.**

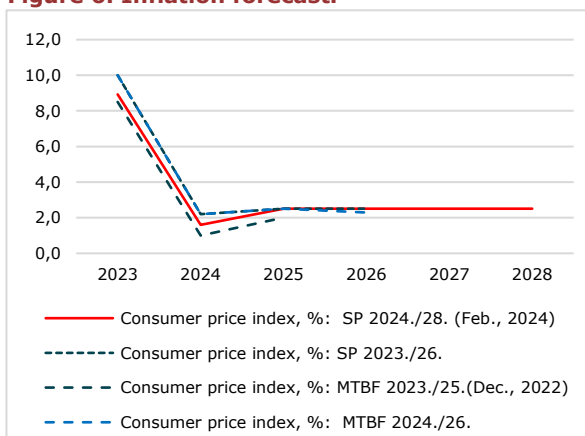


Source: MoF.

**The Council approves the nominal GDP growth forecast for five-year period 2024.- 2028.** Compared to the previous MTBF 2024/26 forecast, the nominal GDP forecast for 2024 was reduced by 1.4%p. The forecast for 2025 reduced by 0.1%p. and by 0.5%p for 2026. The forecast for 2027 and 2028 is the same 5,1%. (see page Figure 5).

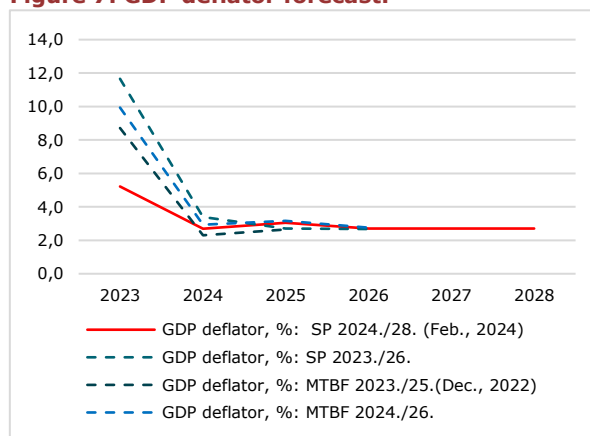
**The Council approves the inflation forecast for period 2024-2028.** The inflation forecast for the 2024 dropped by 0.6%p., for 2025 was not changed and hold on 2.5% level. Forecast was revised upwards by 0.2%p. for 2026. The inflation forecast for 2027 and 2028 is the same 2,5%. (see page Figure 6).

**Figure 6. Inflation forecast.**



Source: MoF.

**Figure 7. GDP deflator forecast.**



Source: MoF.

**The Council approves the forecast of the GDP deflator for period 2024 - 2028**

Compared with the previous MTBF 2023/26 forecast, the GDP deflator for 2024 is dropped down by 0.2 %p. Forecast for 2025 and 2026 dropped by 0.1%p. Deflator forecast for 2027 and 2028 is the same 2,7% (see page Figure 7).

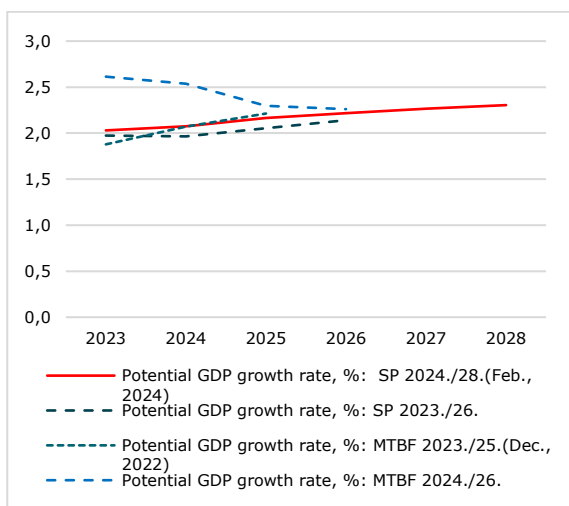
**The Council approves the forecast for potential GDP growth for 2024 – 2028.**

The forecast for potential GDP growth, compared with previously MTBF 2023/26, has been dropped down by 0.5%points for 2024 and by 0.1 %p. for 2025. The forecast for 2026 was not changed. Potential GDP growth forecast for 2027 and 2028 is the same 2.3% (see page Figure 8).

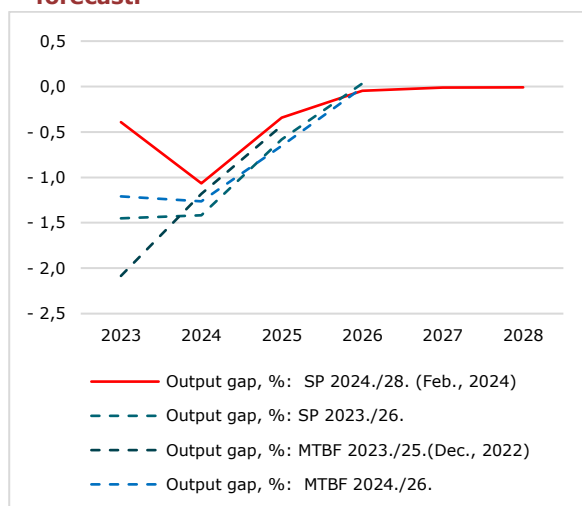
**The Council approves the output gap forecast for 2024 – 2028.**

The output gap, compared to the previous forecast MTBF 2023/26, has been adjusted upward by 0.2 %p. for 2024 and by 0.3%p. for 2025. The output gap forecast for 2026 was not changed. The output gap will close in 2027 and 2028, the forecasted value for these years is around 0%. (see figure 9).

**Figure 8. Forecast for potential GDP growth, %.**



**Figure 9. Output gap, % of potential GDP forecast.**



Source: MoF.

Source: MoF.

**Conclusions**

**The Council broadly endorses the MoF macroeconomic forecasts for period 2024 - 2028 and consider them reasonable with the actual economic situation. However, the Council is aware of the current set of hard-to-predict risks especially in five-year period.**

The Council notice the following risks:

- the geopolitical tensions in the region,
- increasing constraints on labour availability and slow productivity growth,
- limited availability of financial resources for business development and innovation,
- the slowdown in global economic growth,
- return of inflation, influenced by political risk, including supply chain disruptions and trade wars,

- possible overheating of the construction sector due to limited labour resources,
- delays in the absorption of EU fund projects and especially in the of the RRF. Investments coming from EU funds are essential for sustaining economic growth, but delays in their absorption have a negative impact on the GDP outcome,
- risks related to financial management of public joint-stock companies, especially in the transport sector (AirBaltic and construction of RailBaltica).

The identified risks are largely in line with the risk assessment of the LV PEAK think tank, based on an expert survey<sup>9</sup>.

**Table 2.**

**Macroeconomic forecasting indicators approved by the Council, %**

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

**Source: MoF**

<sup>9</sup>[LV\\_PEAK\\_BAROMETERS\\_LV\\_2023\\_II.pdf \(lu.lv\)](#)