

Macroeconomic development of Latvia

Growth rates in Latvia are among the highest in the EU. Since 2000 the GDP growth has averaged at 7.6% per annum, significantly above the EU average. GDP growth in 2004 was 8.5%, stronger than estimated. Growth accelerated in particular in the third quarter of 2004, immediately after Latvia joined the EU.

Key Indicators of Economic Development

	2001	2002	2003	2004	2005 f
(increase over the previous year, in per cent)					
Gross domestic product	8.0	6.4	7.5	8.5	7.5
Consumer prices	2.5	1.9	2.9	6.2	5.0
(% of GDP)					
General government budget fiscal balance	-2.0	-2.3	-1.6	-1.1	-1.7
Central government debt	13.8	13.3	13.4	13.2	13.3
Current account balance	-7.6	-6.7	-8.2	-12.3	-9.8
Exchange rate, LVL per US dollar	0.628	0.618	0.571	0.540	0.520
Exchange rate, LVL per euro	0.563	0.583	0.645	0.671	0.703
Unemployment rate (rate of job seekers as % of economically active population, aged 15-74 years)	13.1	12.0	10.6	10.0	9.5

f - forecast of the Ministry of Economics

Growth is observed in all main sectors of the economy and it is based on stable domestic demand and increase in exports.

The rise in domestic demand promotes the development of services, especially in trade and construction. High growth rates are also observed in the transport and communications sectors, most notably in 2004. Since 2001 manufacturing output has been rising by 9-10% annually (7.9% in 2004). The competitiveness of Latvian manufacturers is based on productivity growth, which was spurred by the investments made in previous years. Strong export growth shows the competitiveness of several industries in the external markets where conditions are not quite favourable.

In 2004 Exports increased considerably (by 28%) in all Latvian export sectors. The sharpest increases were in the exports of base metals and base metal products, machinery and wood products. The value of commodity exports continues increase also in January-February 2005 (by 34% higher than corresponding period of the preceding year).

Latvian economic growth potential is best described in terms of growth of investment. Latvia has experienced high investment growth for several years, owing to stable macroeconomic and financial environment, positive evaluation of the Latvian investment environment by independent international organisations, and investment-supportive governmental policy.

Investment in fixed assets in Latvia from 2001 until 2004 has increased by 40%, i.e., by 12% annually. Share of investment in GDP over the last three years has made 24.5% on average, indicating that nearly a quarter of national income has been used for the total fixed capital formation annually.

The rapid growth of investment is related to our success in attracting foreign capital inflows. Since restoration of Latvia's independence in 1991, foreign direct investments (FDI) have been one of the main driving forces of our economy. The accumulated FDI stock has doubled every 3 – 4 years since early 1990s. At the end of September 2004 foreign direct investment stock totalled 2.3 billion lats or approximately 30% of the annual GDP.

Accession to the EU provides Latvia with new opportunities for economic development. By joining the EU single market Latvia is able to use advantages offered by broad and stable market, free movement of goods and services, labour and capital, i.e., the most favourable terms on the EU market. Use of EU structural funds and the Cohesion Fund fosters structural changes in the national economy, helps to lessen social and economic disproportion, and affords greater opportunities for improvement of infrastructure than before. The aim of the government is to ensure full absorption of the EU funds.

However, the Latvian government is well aware that the EU membership does not mean an easy and swift solution to all problems – new goals and objectives have to be set and efforts made within the framework defined by the EU. The government thinks that one of the most important goals during the current stage of development is to build Latvia into a competitive, highly developed country where everybody can live well.

In order to achieve these goals, the Latvian governmental economic policy plans to strengthen further the macroeconomic environment, to create more favourable conditions for business, to ensure equal and fair competition, to complete privatisation and carry out other projects.

The reforms carried out in the previous decade have strengthened the private sector and created favourable macroeconomic conditions; the business environment is also improving. Investments continue to grow rapidly promoting the modernisation of production and transition to new and more productive technologies. Accession to the EU has a particularly positive impact on the development of the economy. This strengthens confidence that growth in the coming years will also be sustainable. If there are no external shocks GDP can be expected to grow by 6-8% in the medium term.