

# Macro Monitor

## Latvia

- On the following pages we present an updated outlook on the Latvian economy taking into account the latest economic releases for October and November.
- The Latvian economy has started to show strong growth. In Q3 economic growth rose to 2.9% y/y, significantly up from a decline by 2.1% y/y in Q2. The faster-than-expected rebound was driven not only by high export growth, but also by significant improvement in domestic demand. The positive growth was reflected in private consumption expenditure (2.5% y/y); after a double-digit drop investment posted 0% y/y growth rate, what can be evaluated as an unprecedented recovery. Based on this information we have revised up our GDP forecast for this year and next. We now forecast the Latvian economy to contract 0.5% y/y this year and to grow 2.9% y/y next year.
- Latvian consumer prices accelerated further, largely due to external factors. We continue to expect average deflation of 1.1% y/y for 2010. However, for 2011 we now expect inflation to increase to 2.4% y/y. A hike in VAT rates will be the main contributor to the higher inflation this year.
- Due to weak domestic demand external balances have developed positively. The current account is expected to decline gradually, but to remain in surplus in the medium term.

### Macro forecasts

Year	Gdp <sup>1</sup>	Private cons <sup>1</sup>	Fixed Inv <sup>1</sup>	Export <sup>1</sup>	Import <sup>1</sup>
2009	-18.0	-24.0	-37.1	-13.9	-33.3
2010	-0.5	-0.3	-17.6	6.4	6.9
2011	2.9	1.9	13.5	8.8	6.3
2012	3.1	3.2	3.6	8.3	9.4

1) Average % y/y 2) % of GDP 3) % of total work force 4) Export and import prices, EUR

Source: Reuters Ecowin and Danske Markets

### Macro forecasts

Year	Trade Balance <sup>2,4</sup>	Current acc. <sup>2,4</sup>	Industrial prod. <sup>1</sup>	Unemployment <sup>3</sup>	Wages <sup>1</sup>	Inflation <sup>1</sup>
2009	-7.1	8.6	-15.9	19.7	-3.9	3.6
2010	-6.4	4.8	13.7	17.6	-2.3	-1.1
2011	-4.6	6.5	14.9	16.5	2.0	2.4
2012	-5.3	5.4	13.1	15.7	2.2	2.0

1) Average % y/y 2) % of GDP 3) % of total work force 4) Export and import prices, EUR

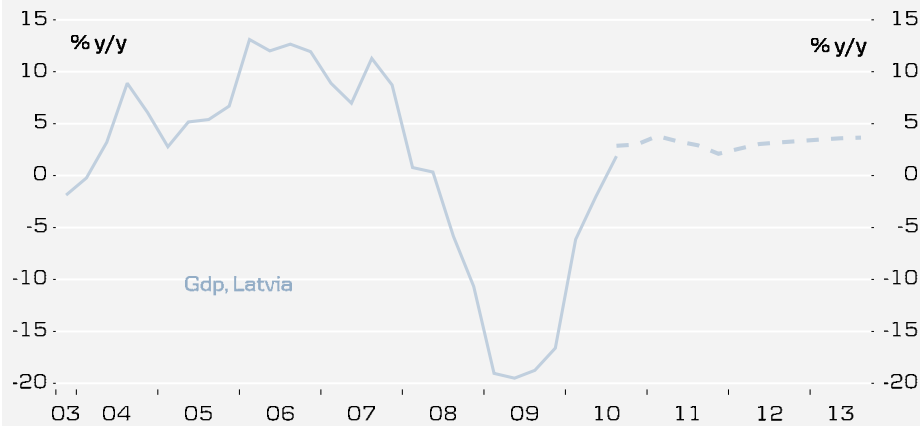
Source: Reuters Ecowin and Danske Markets

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# National account

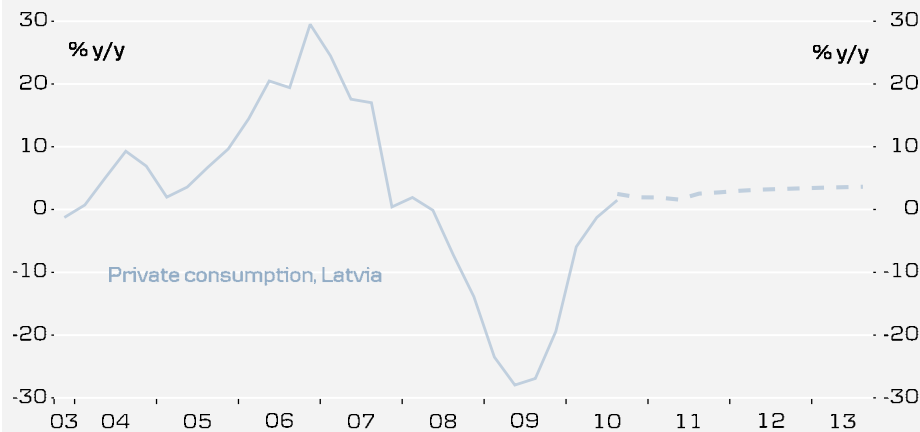
## Gross domestic product



Source: Reuters Ecowin and Danske Markets

- We expect the gradual recovery of the Latvian economy to continue.
- Annual growth should resume in 2011 based on positive contributions from export and domestic demand.
- We expect GDP to contract on average 0.5% y/y in 2010 and to grow 2.9% y/y in 2011.

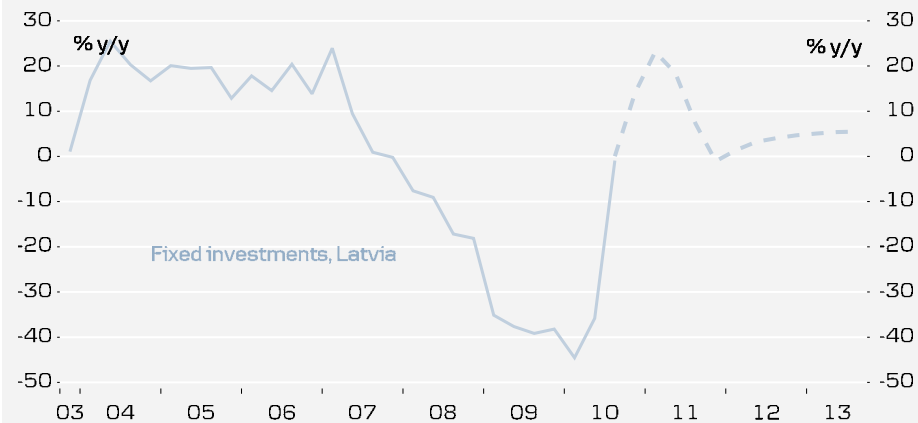
## Private consumption



Source: Reuters Ecowin and Danske Markets

- In Q3 private consumption posted positive growth of 2.5% y/y. This resulted in a low base effect, as well as the first signs of stabilization in the labour market.
- We expect private consumption to recover faster than in our previous forecast. We forecast it to contract 0.3 % y/y in 2010 and to grow 1.9% y/y in 2011.
- However, we see additional risk to our forecast as rapidly rising consumer prices may adversely affect the recovery trend of private consumption.

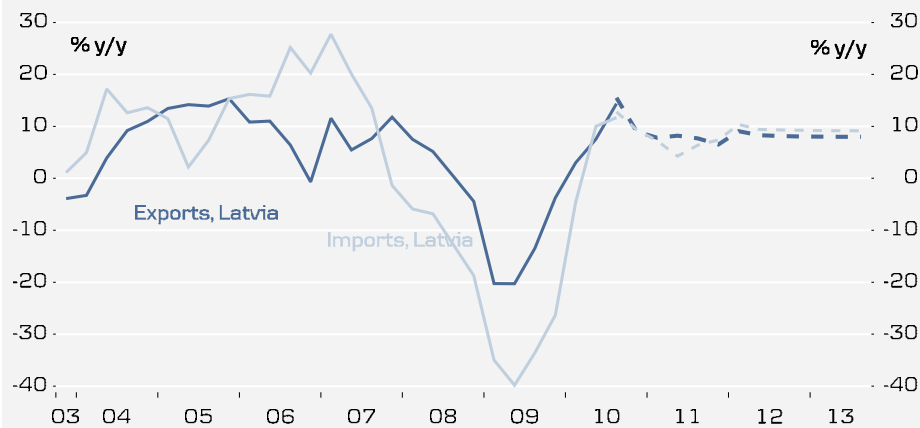
## Investments



Source: Reuters Ecowin and Danske Markets

- Investments improved considerably in Q3. Latvian export-oriented manufacturing is doing relatively well and we expect the growth in investments to continue. Investments will start to increase from the low level and growth is expected to be double-digit in 2011.
- However, slow growth in credit might be a key constraint on the more rapid recovery of investments in coming years.
- We forecast investments to contract by up to 17.6% y/y this year and to grow by 13.5% y/y in 2011.

## Net exports

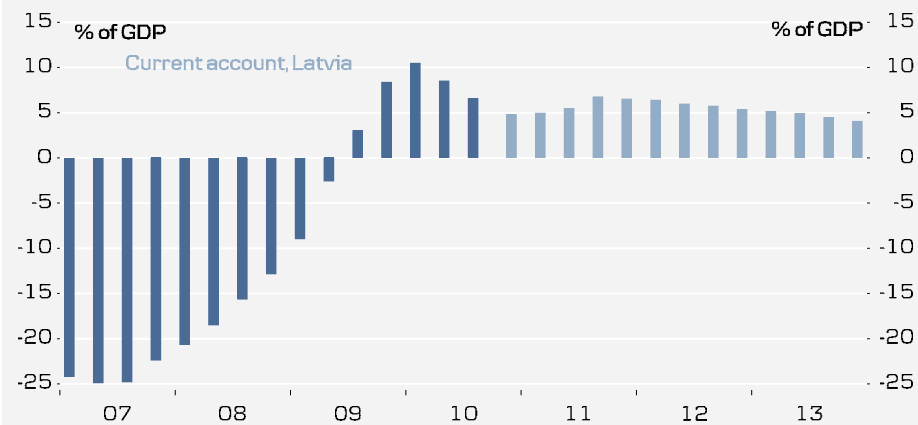


Source: Reuters Ecowin and Danske Markets

- Export growth has almost reached pre-crisis rates and in the coming quarters the growth rate might slow down.
- We expect exports to grow 6.4% y/y in 2010 and 8.8% y/y in 2011.
- Imports will follow the export trend. We expect imports to grow 6.9% y/y in 2010 and 6.3% y/y in 2011.

## External balances

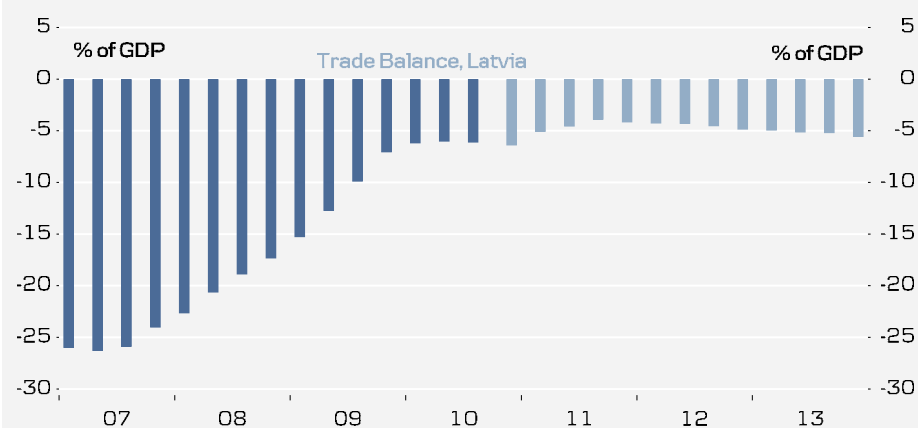
### Current account



Source: Reuters Ecowin and Danske Markets

- The unsustainable large current account deficit has improved sharply and Latvia now runs a significant current account surplus.
- The current account is expected to decline gradually but remains in surplus in the medium term.

### Trade balance

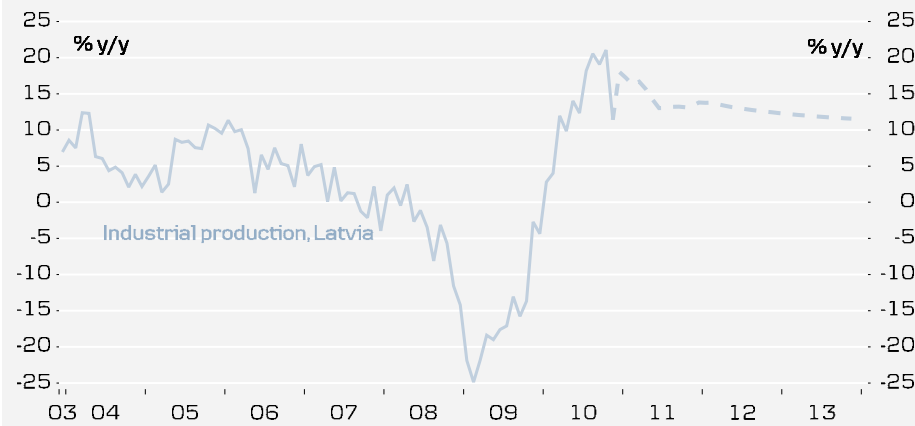


Source: Reuters Ecowin and Danske Markets

- The Latvian trade balance continues to show a small deficit.
- No great improvement in the foreign trade balance is expected in coming quarters.
- We expect the trade deficit to remain at 4-5% of GDP level in 2011 - 2012.

# Production and labour market

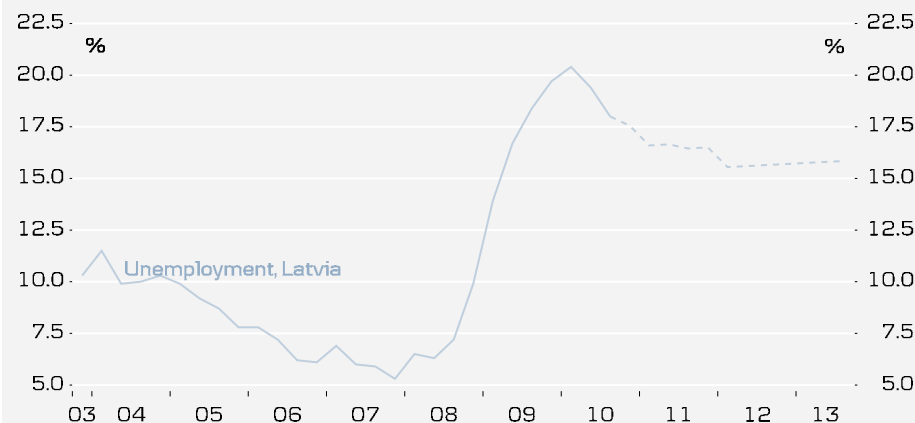
## Industrial production



Source: Reuters Ecowin and Danske Markets

- The recovery of Latvian industrial production (IP) slowed down somewhat in October. It might be a one-off, or manufacturing started to show signs of capacity constraints.
- We expect the recovery to continue to be gradual, as the upward trend relies mainly on external demand. A more sustainable recovery in the industry depends on new investments.
- We expect IP to grow to 13.7% y/y in 2010 and 14.9% y/y in 2011.

## Unemployment

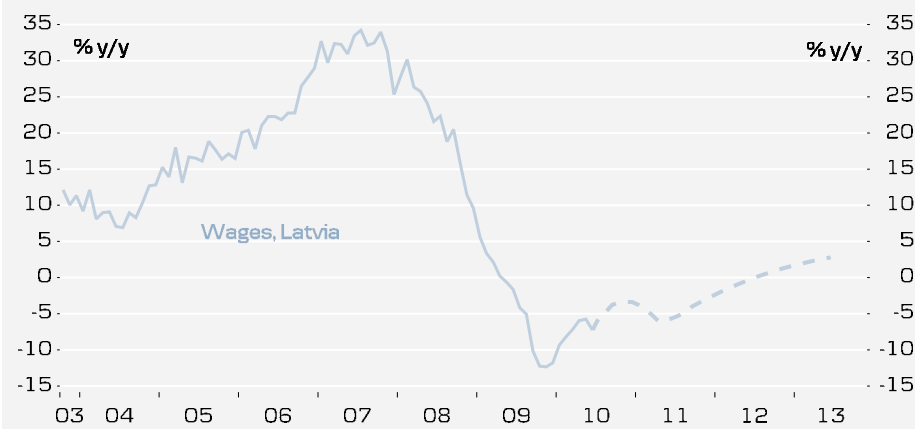


Source: Reuters Ecowin and Danske Markets

- The more intense recovery in the economy reduces unemployment: in Q3 it declined to 18.2% and the average for 2010 could amount to 17.6%.
- Latvian labour survey statistics confirm that unemployment is structural in nature and the current gap between the skills demanded and supplied might be here to stay for a while.
- GDP growth above its potential level (3% in real terms) will lead to a more rapid decline in the unemployment rate.

# Wages and prices

## Wages



Source: Reuters Ecowin and Danske Markets

- Wages continued to decline in Q3 by 1.9% y/y mostly due to a sharp drop in wages in the public sector by 4.5%.
- We expect to see a gradual rebound in wage growth. However, unemployment remains at a high level, which will limit the acceleration of wage growth recovery.
- On average wages should decline 2.3% y/y in 2010 and growth by 2.0 y/y in 2011.

## Inflation



Source: Reuters Ecowin and Danske Markets

- Latvian CPI inflation continues its upward trend. Increased uncertainty regarding the inflation outlook for 2011 arising from the VAT tax increase, together with the rise in global food and energy prices, may boost inflation expectations significantly.
- We estimate average inflation at minus 1.1% in 2010 and an acceleration to 2.4% in 2011.

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