



Macroeconomic Developments and Outlook



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Summary



- High inflation hurts consumers and businesses;
- It is crucial to prevent high inflation from getting entrenched;



- To do so, central banks hike policy rates;
- The ECB Governing Council will adjust all its instruments (TLTRO and others) to achieve 2% medium-term inflation target;



- Governments should do their part: timely, targeted, temporary and proportionate support; structural adjustment; avoiding inflation-accelerating measures.



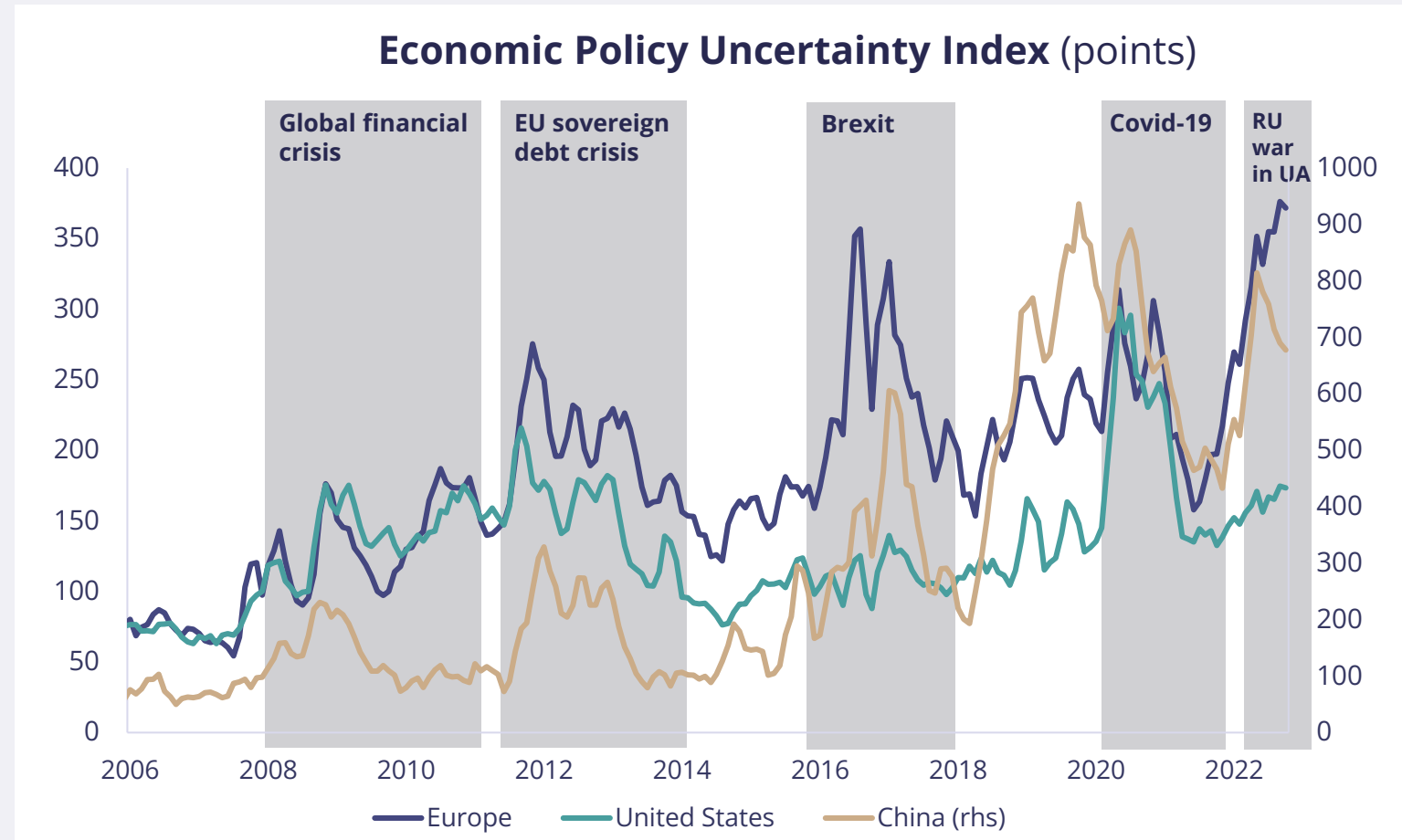


European and global economy



Uncertainty reached new heights in Europe

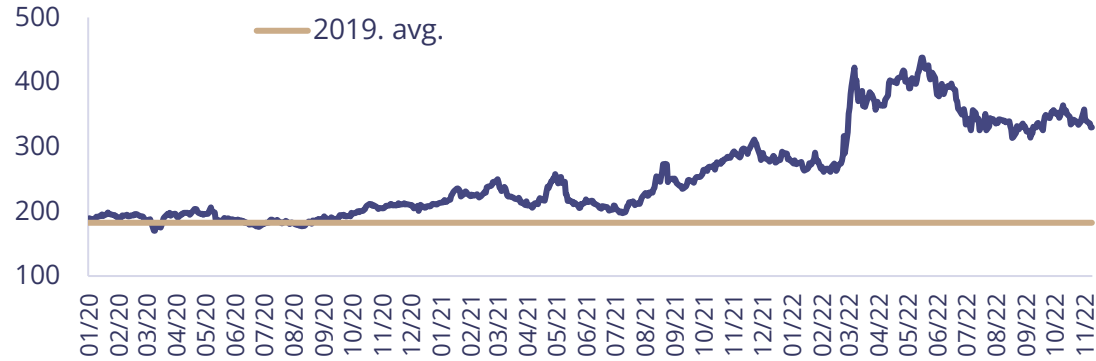
- Russian aggression in Ukraine and global geopolitical tensions
- Energy crisis
- Global inflationary pressures
- Possible resurgence of Covid-19
- Recession fears



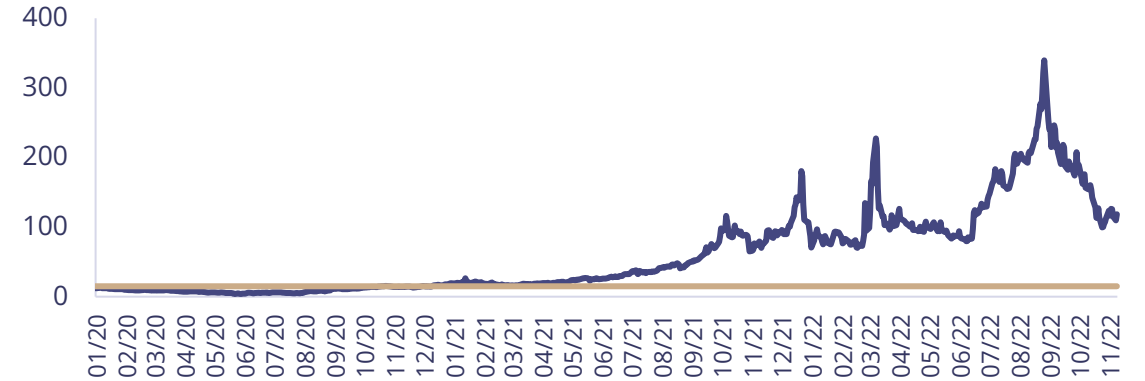
Source: Economic Policy Uncertainty (last obs. 10/22).

Recession fear is one of factors slowing global prices

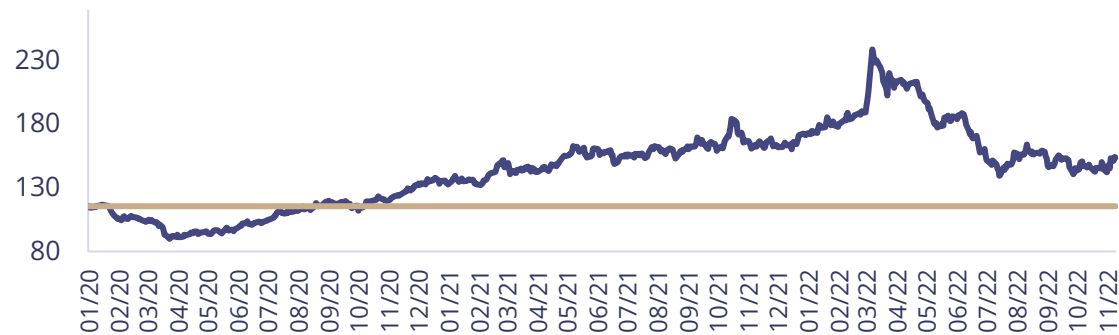
Wheat price in Euronext exchange (EUR/t)



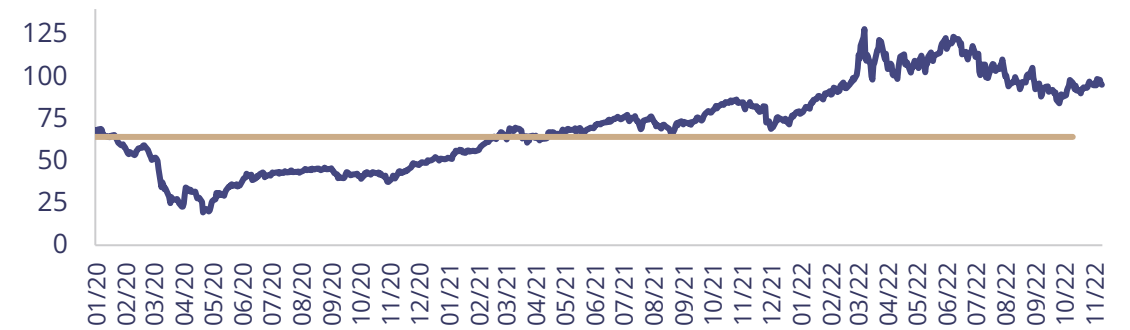
TTF Natural gas price (EUR/MWh)



Industrial Metals price (index)

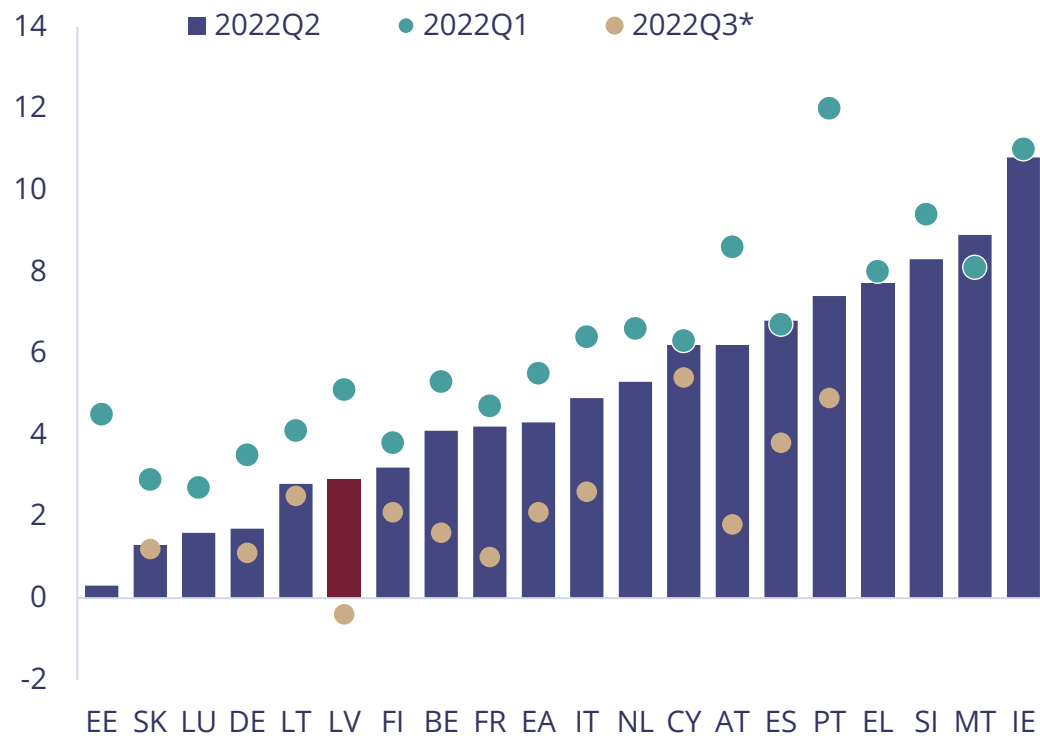


Brent crude price (USD/bbl)

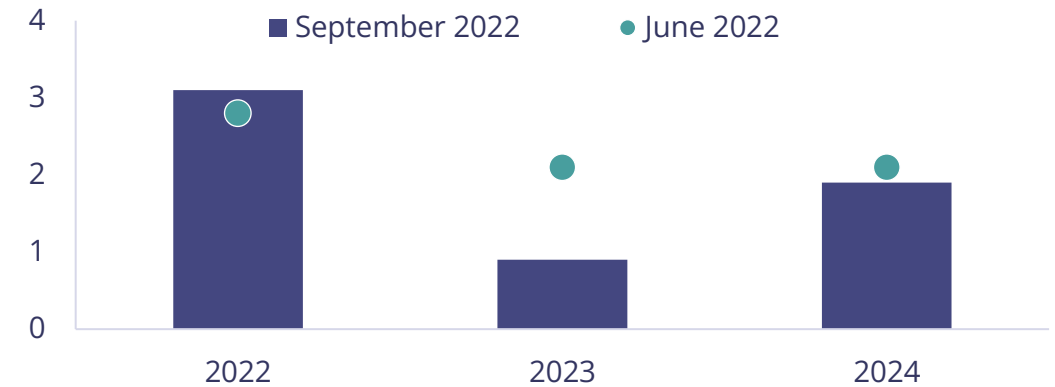


Euro area growth revised downwards; recession risks

Euro area growth (y/y; %)



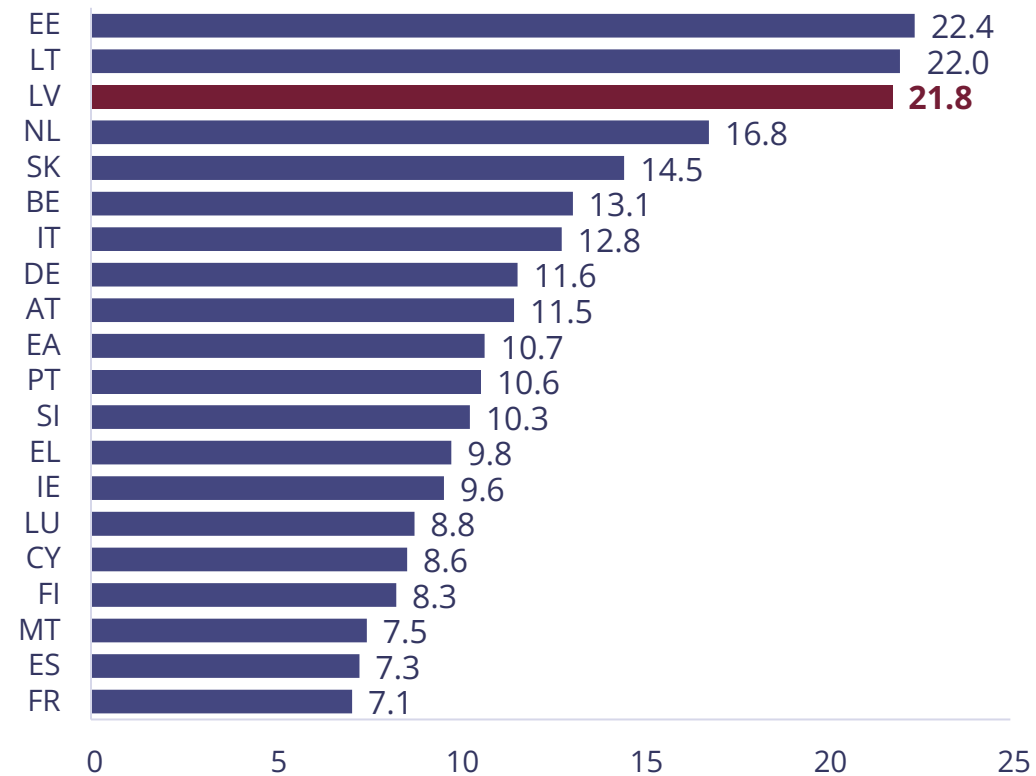
Euro area growth projections (y/y; %)



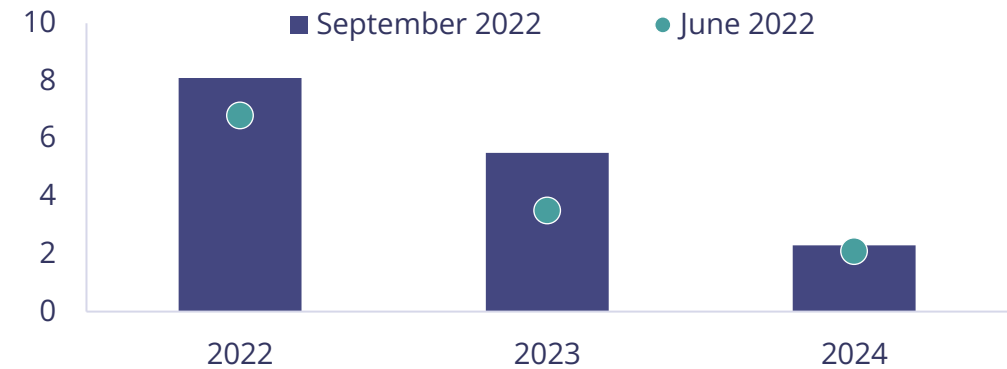
		Baseline			Downside scenario		
	2021	2022	2023	2024	2022	2023	2024
Real GDP	5.2	3.1	0.9	1.9	2.8	-0.9	1.9

Euro area inflation may remain above 2% in the coming years

Euro area HICP inflation (October 2022; y/y, %)



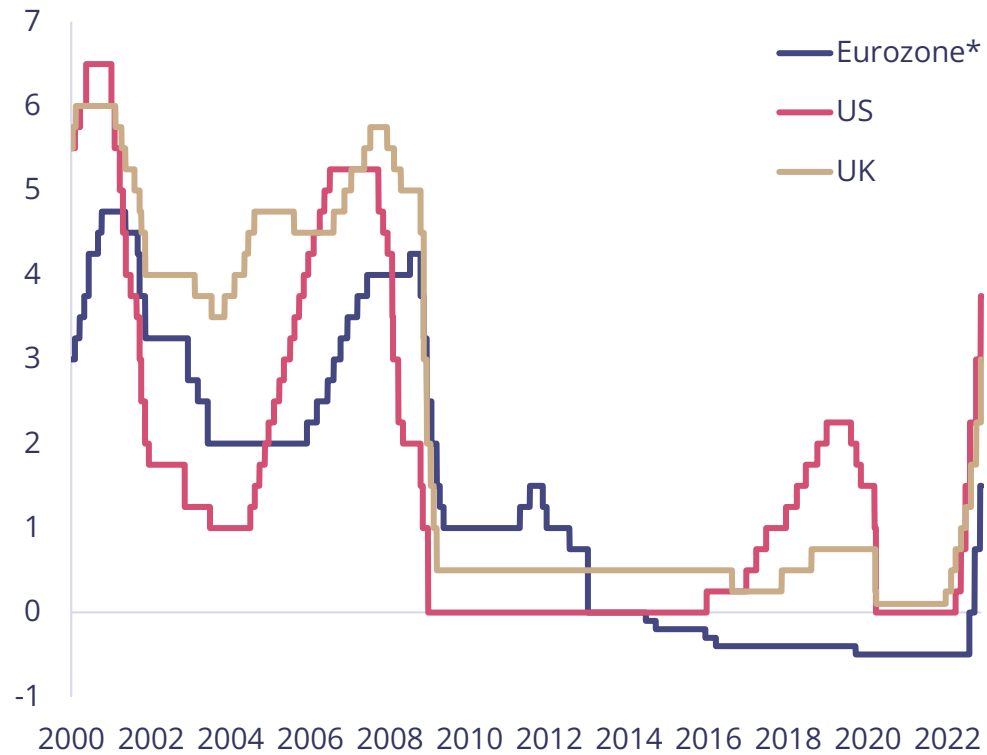
Euro area HICP inflation projections (y/y; %)



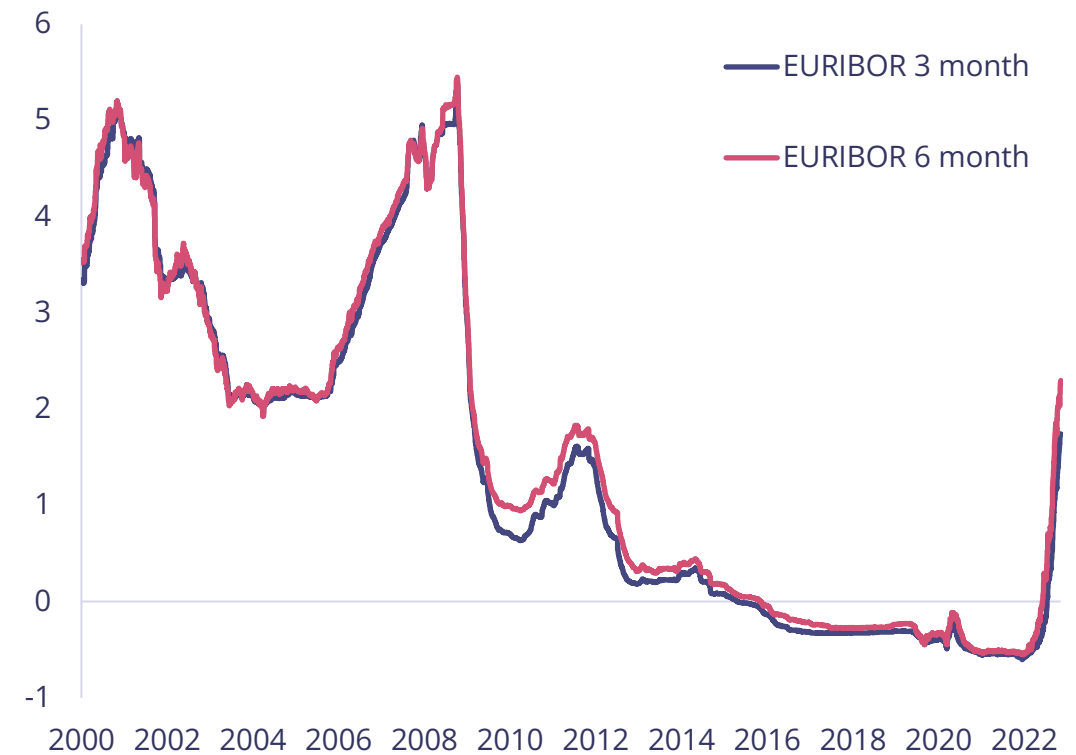
	2021	Baseline			Downside scenario		
		2022	2023	2024	2022	2023	2024
HICP	2.6	8.1	5.5	2.3	8.4	6.9	2.7

Rate hikes by leading central banks to continue, but slower

Leading central bank interest rates



Money market indexes



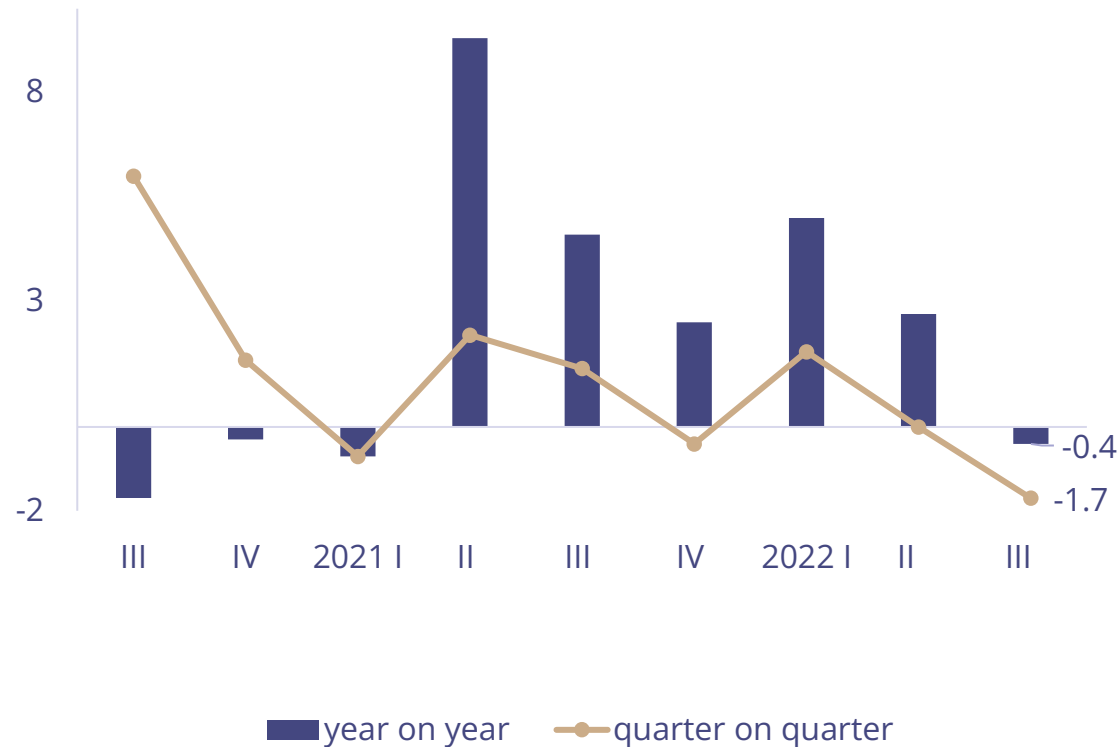
* Till 21.12.2011 main refinancing rate, afterwards – deposit facility rate.
Source: Bloomberg.

Latvia's economic outlook

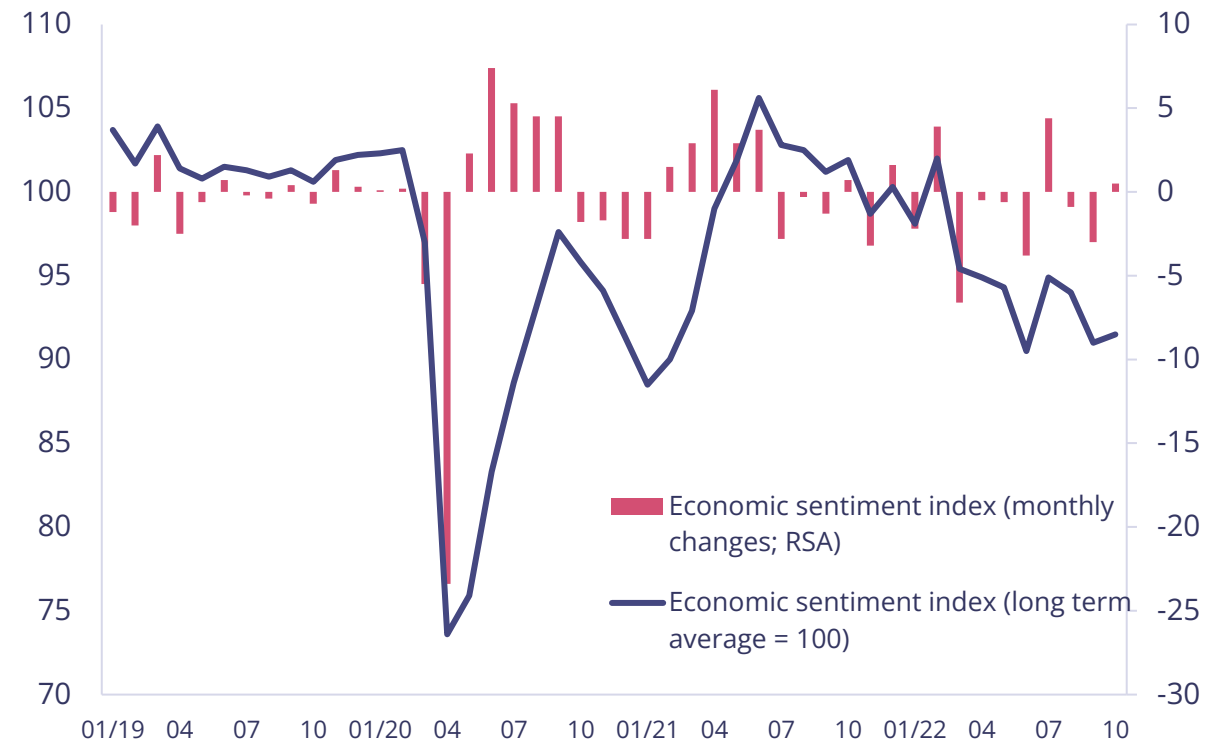


Economic activity is weakening and sentiment is deteriorating

GDP (%); in real terms; sa)

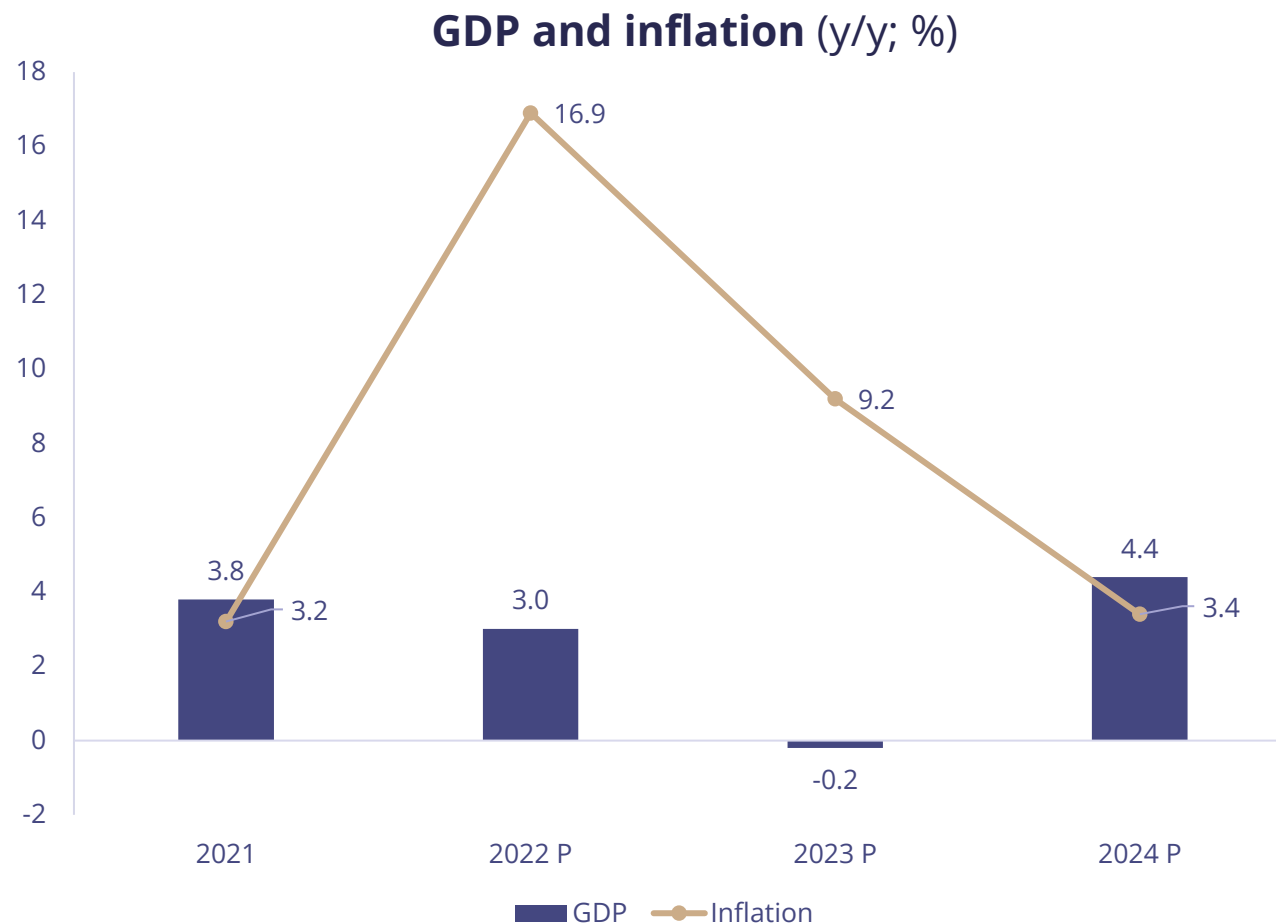


Economic sentiment indicator (100=long term average)



The baseline scenario forecast is a short-lived and shallow recession

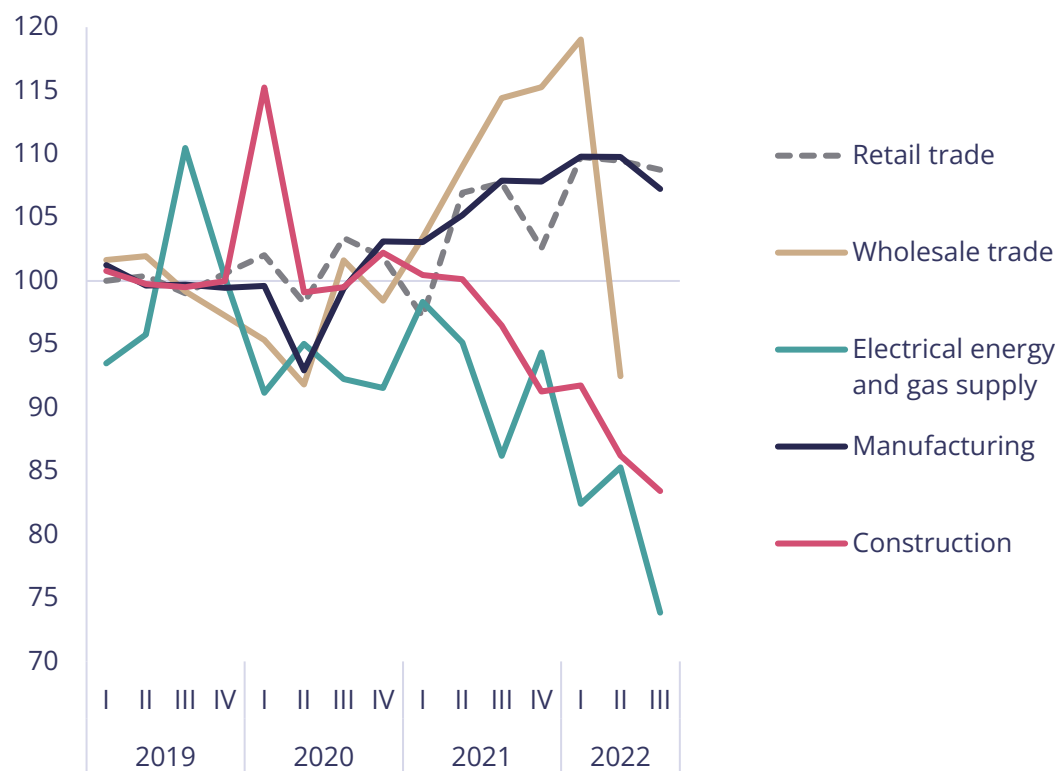
- Entering crisis with rather sound economic fundamentals;
- Transition to alternative energy supplies and energy efficiency will stabilize energy prices;
- Low unemployment, savings, state support and EU funds' inflows are supportive to economic activity;
- State support improves confidence.



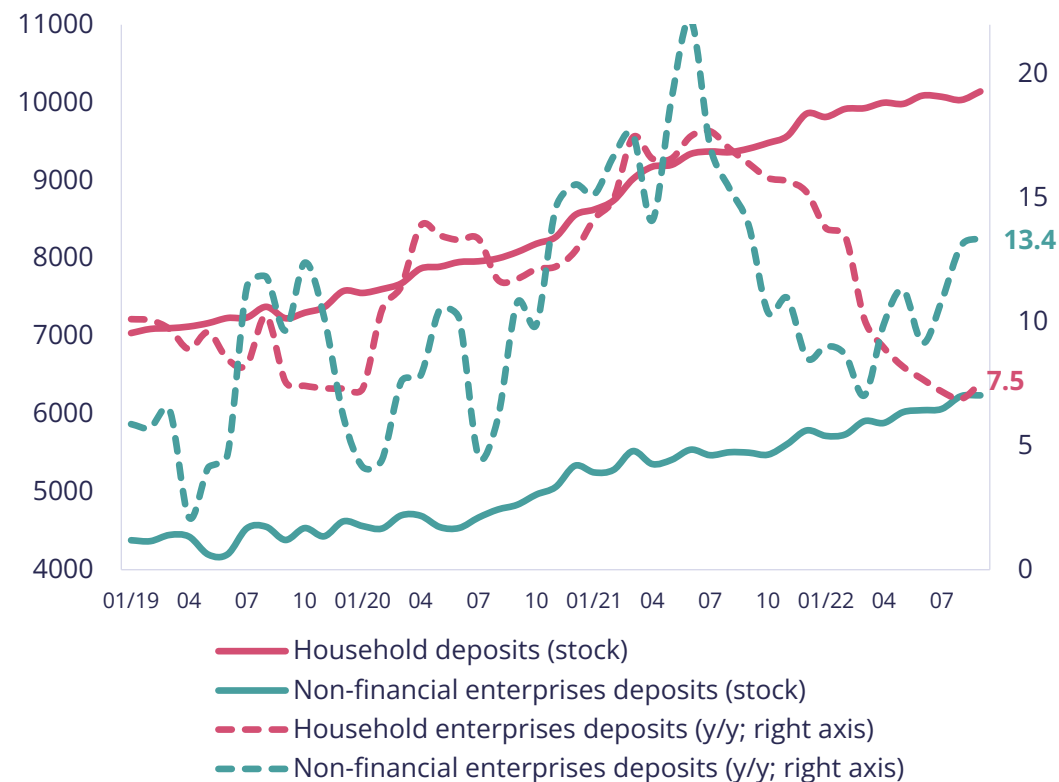
Source: Central Statistical Bureau of Latvia ; P - Latvijas Banka's September 2022 forecast.

Short-term sectoral developments point to a slowdown; deposits only partially to mitigate a fall in consumption

Output or turnover of selected sectors (constant prices; index; 2019 average=100; s.a.)

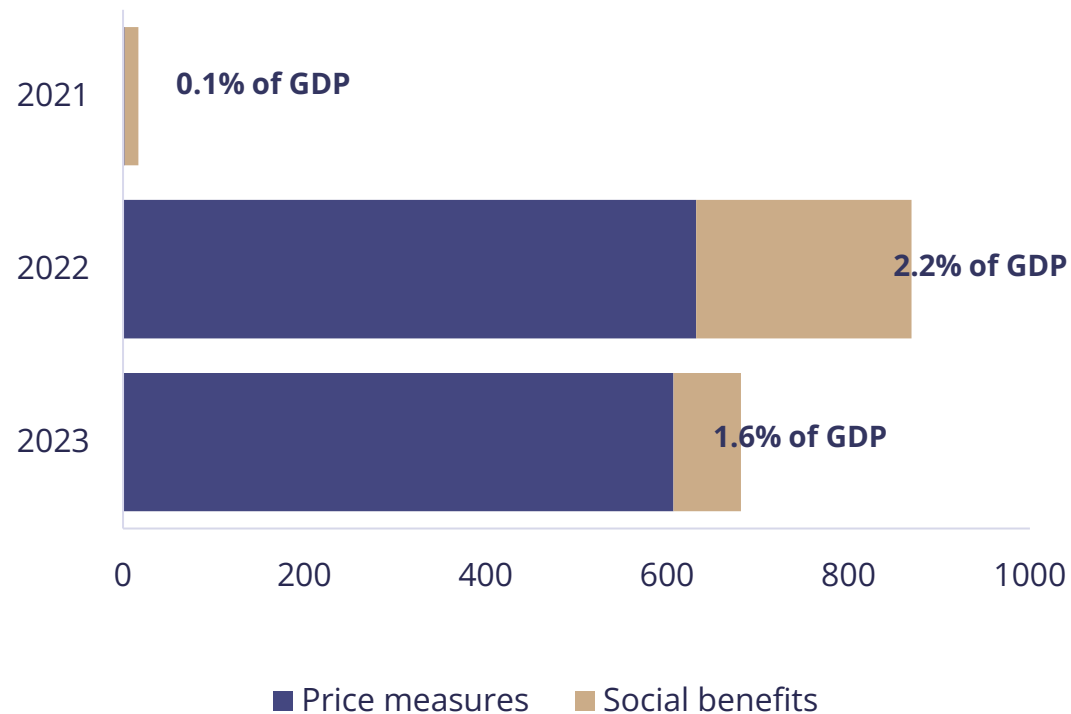


Deposits of households and non-financial enterprises (mill. EUR; y/y; %)

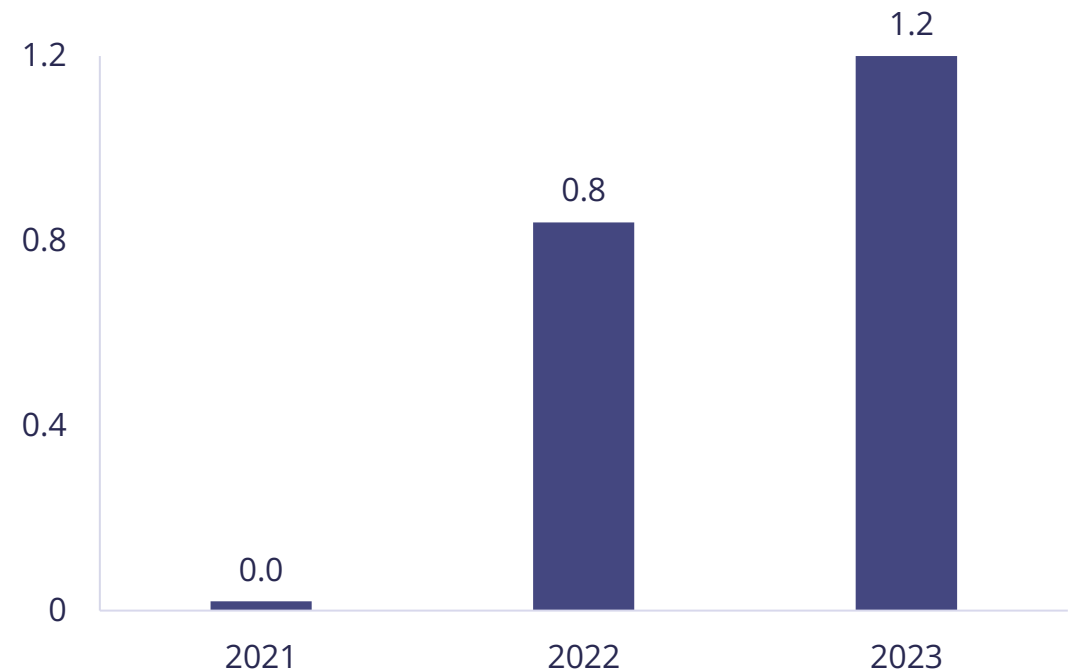


The surge in energy prices is a headwind to growth; negative impact is mitigated by government support

State support measures through the energy crisis, breakdown by sectors and by years (mill. EUR)

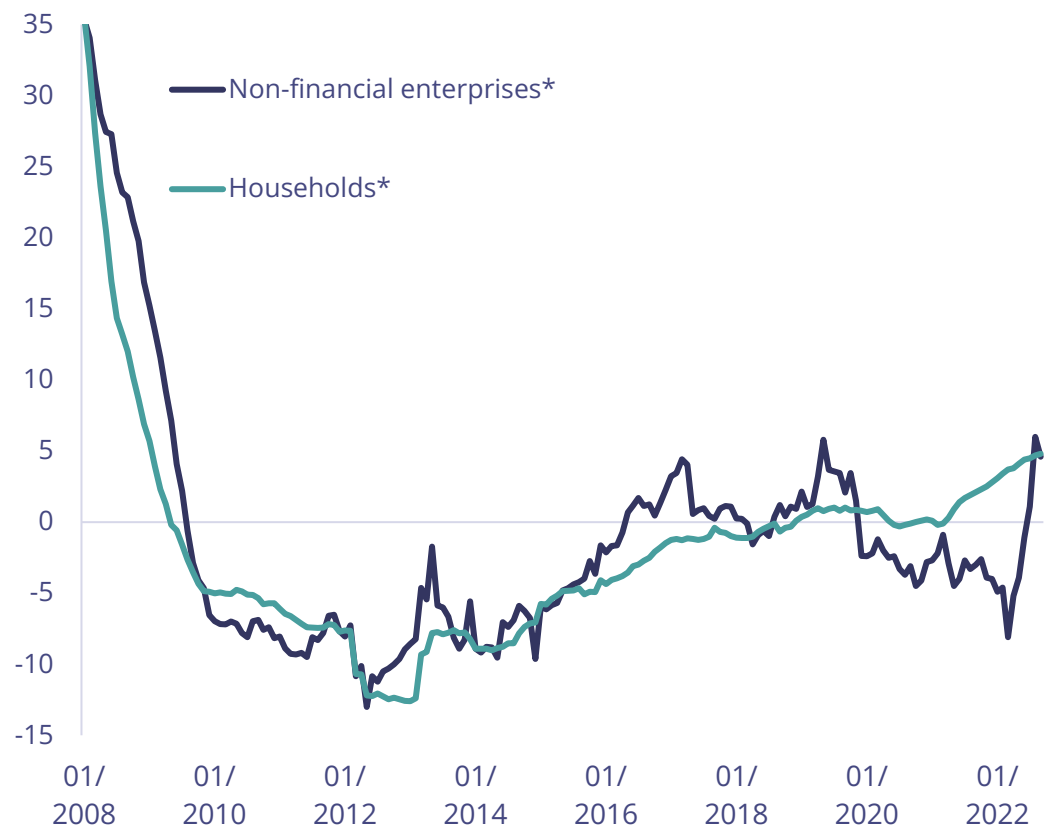


Impact of state support measures through the energy crisis on GDP (cumulative; deviation %)

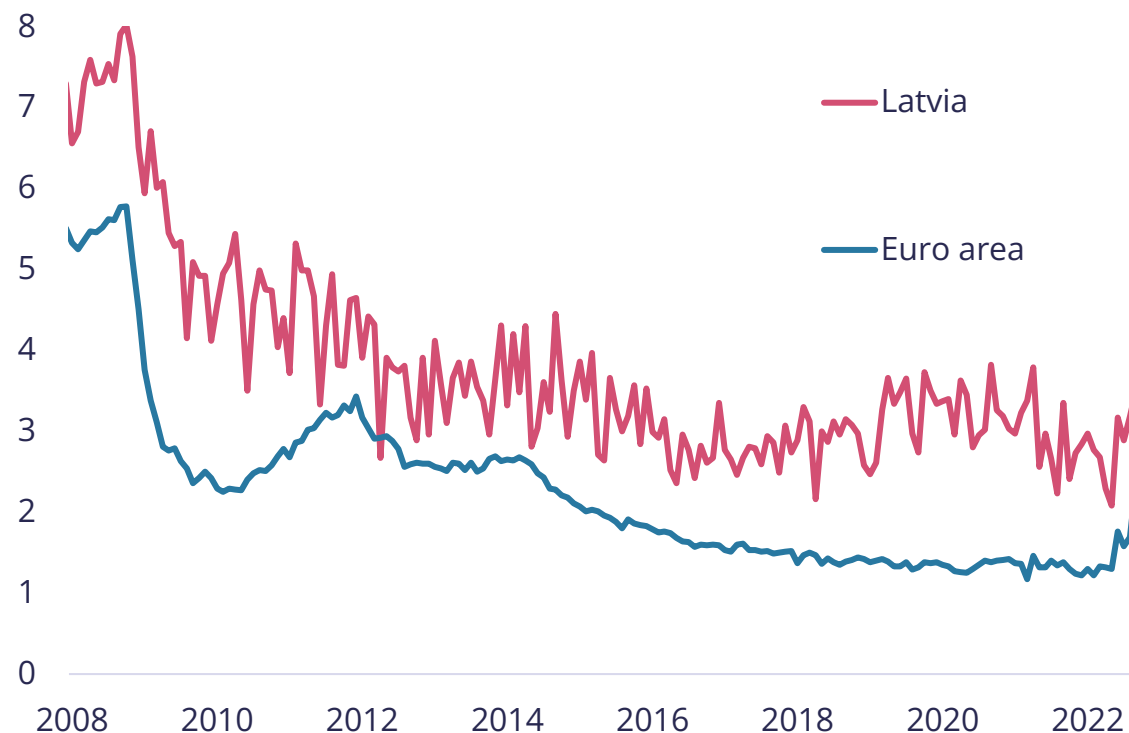


Lending in Latvia has been weak chronically; interest rates are among the highest in the euro area

Domestic loans (stock; y/y; %)



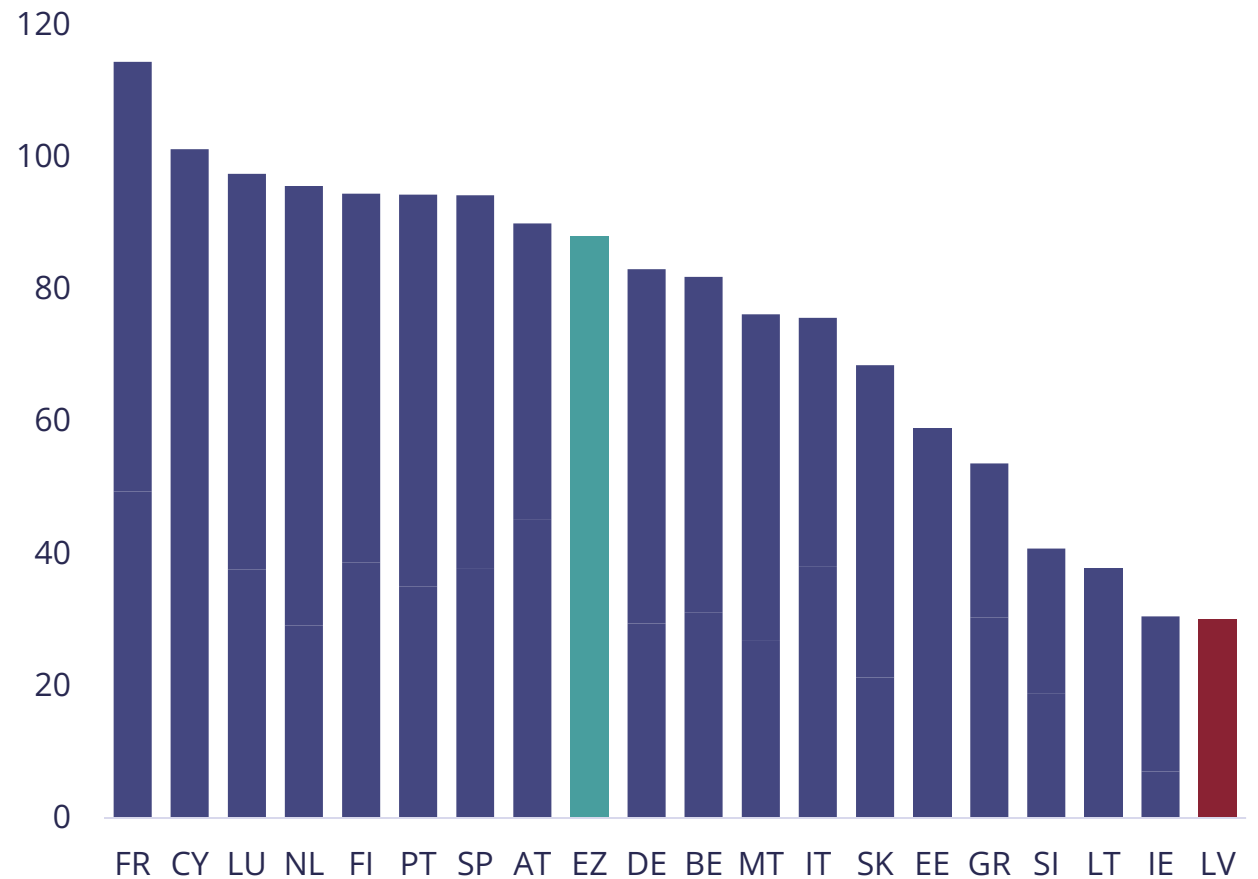
Interest rates on newly issued loans to non-financial corporations in Latvia and Euro area (%) **



ECB GovC decisions to raise rates → the largest impact on Latvia's economy is expected through export

- Higher interest rate on loans → higher loan payments:
 - for companies → debt burden is rather low → interest payments are also rather limited
 - for households → debt burden is low → more loans for higher income households → for them loan payments account for a relatively small part of disposable income
- Decline in foreign demand → lower Latvia's export, especially to trade partners with high outstanding amount of loans.

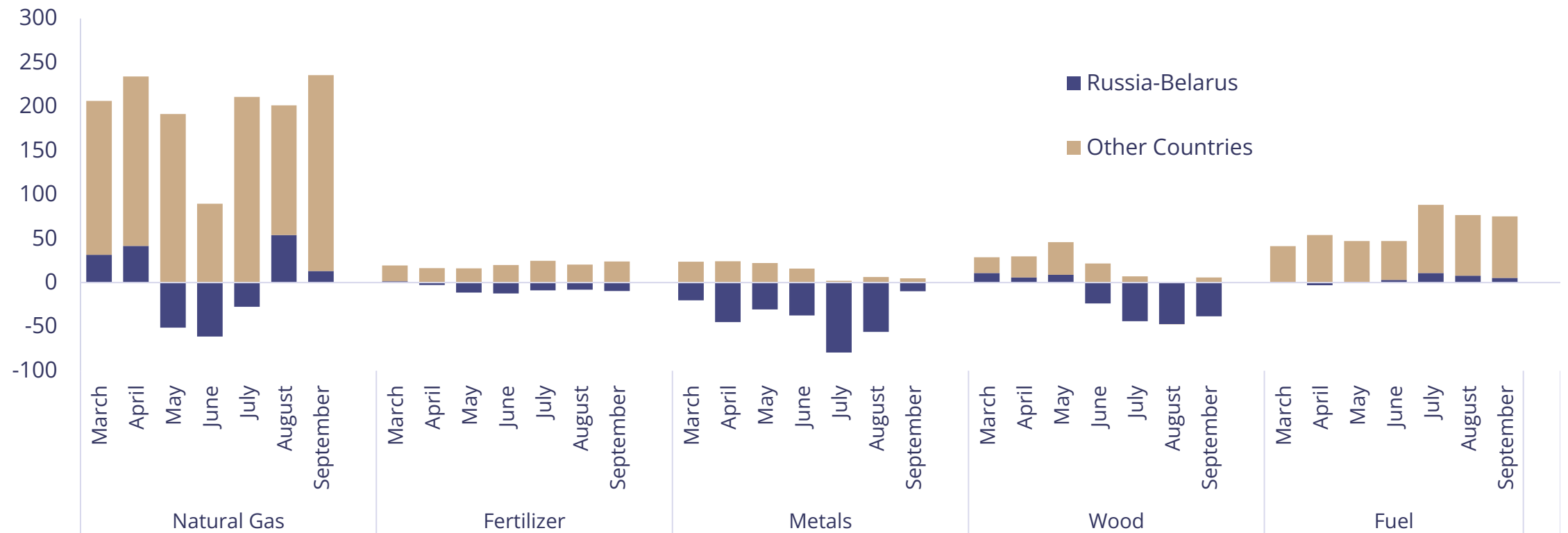
Loans to enterprises and households in Q1 2022 (outstanding amounts; % of GDP)



Source: ECB.

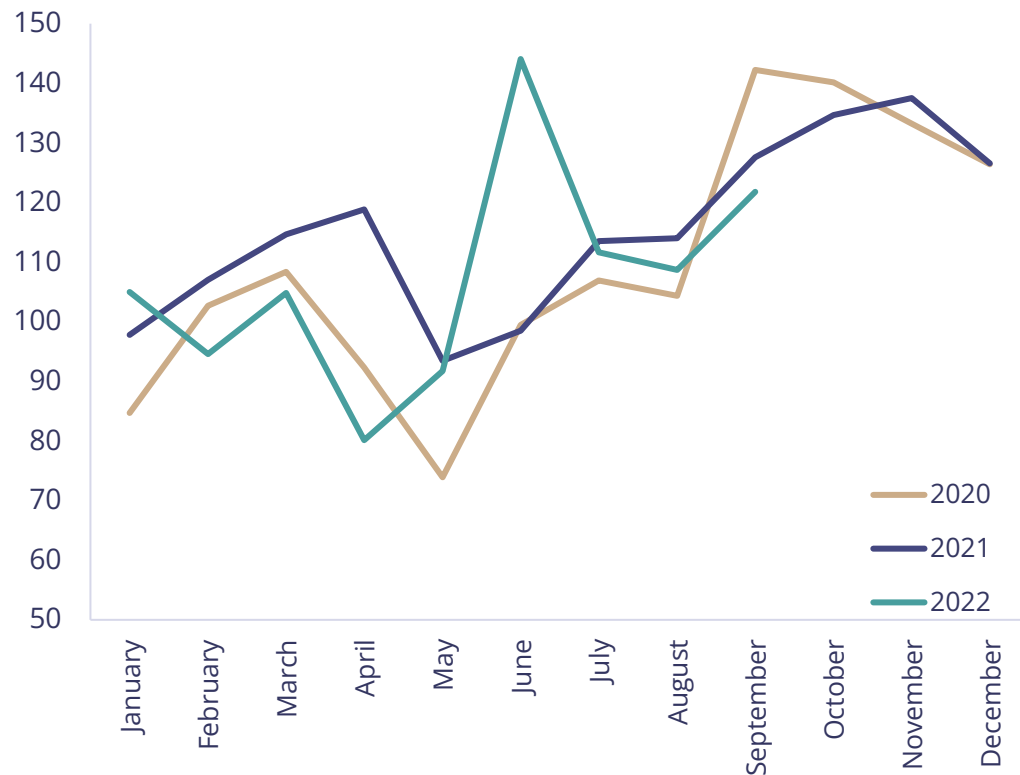
Decrease in imports from Russia and Belarus has largely been substituted

Imports (y-o-y; million euro)

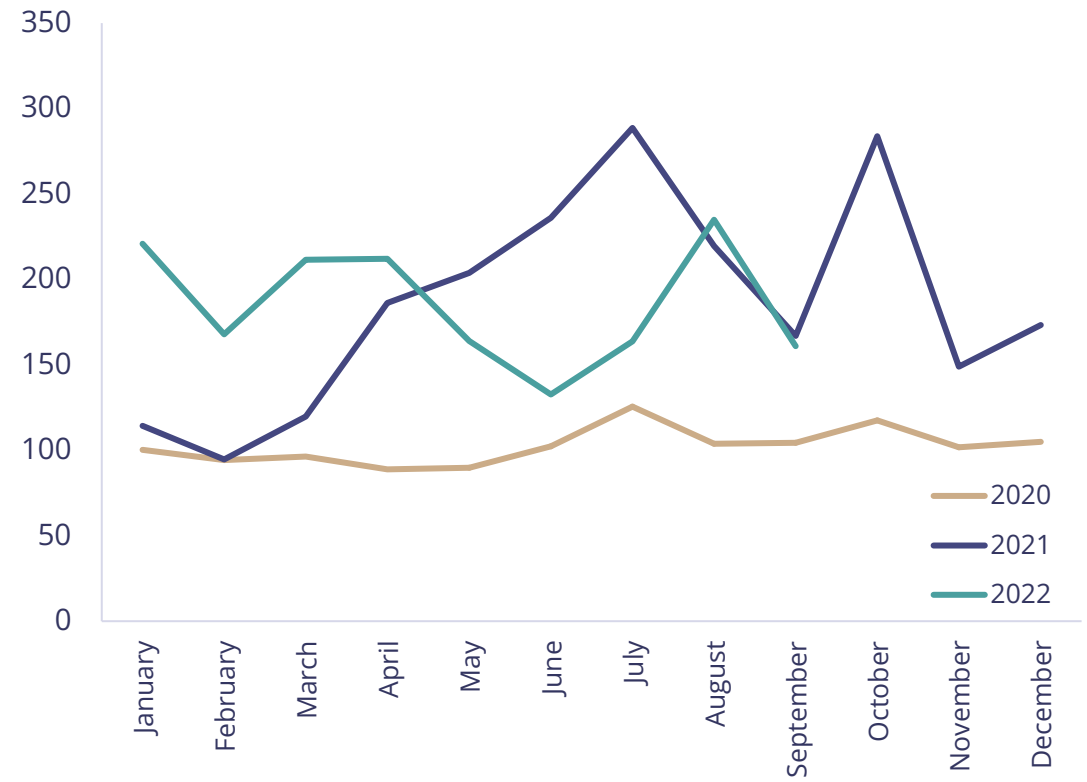


Suspension of trade with Russia and Belarus is rather slow

Exports to Russia and Belarus (million euro)

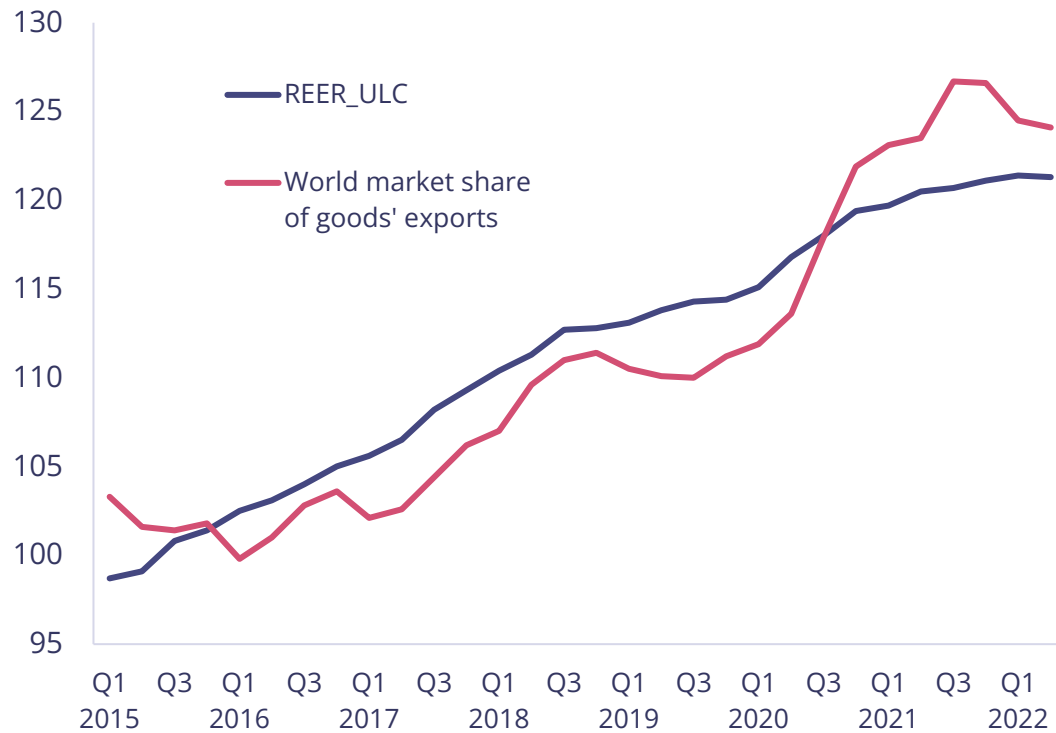


Imports from Russia and Belarus (million euro)

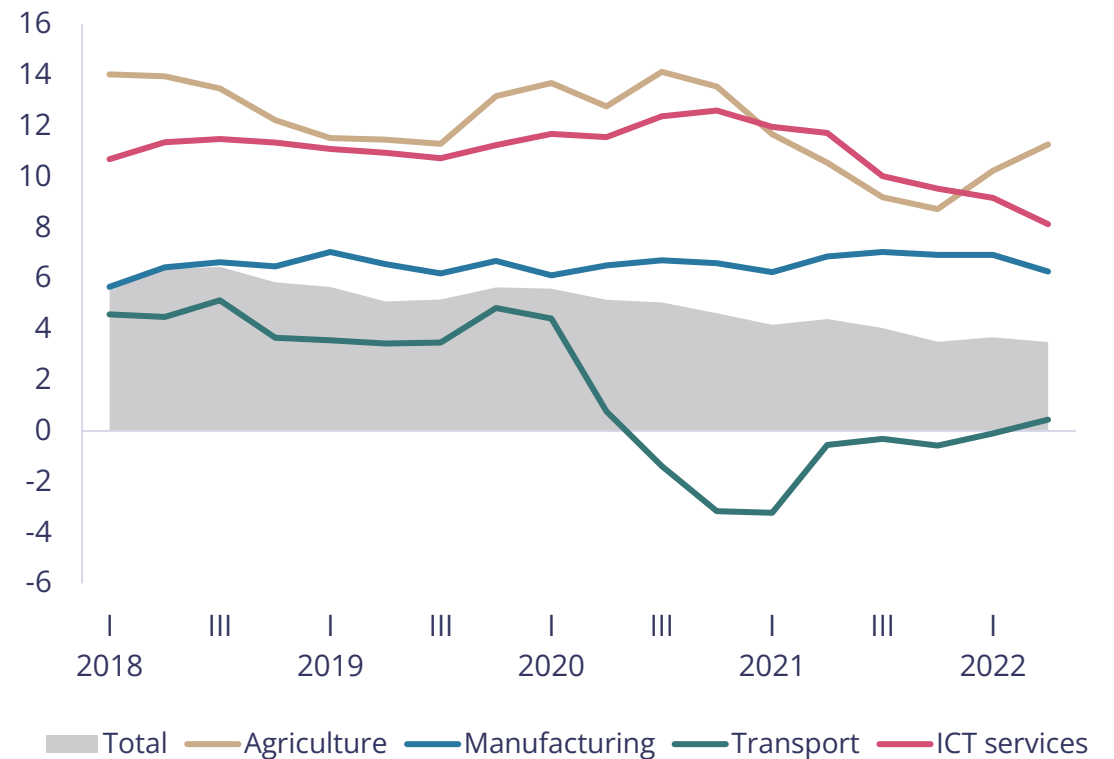


Despite increase in costs, export remains competitive

Market share of exports and the real effective exchange rate* (2015=100)



Profitability (profits after taxes to turnover; 4-q moving average; %)



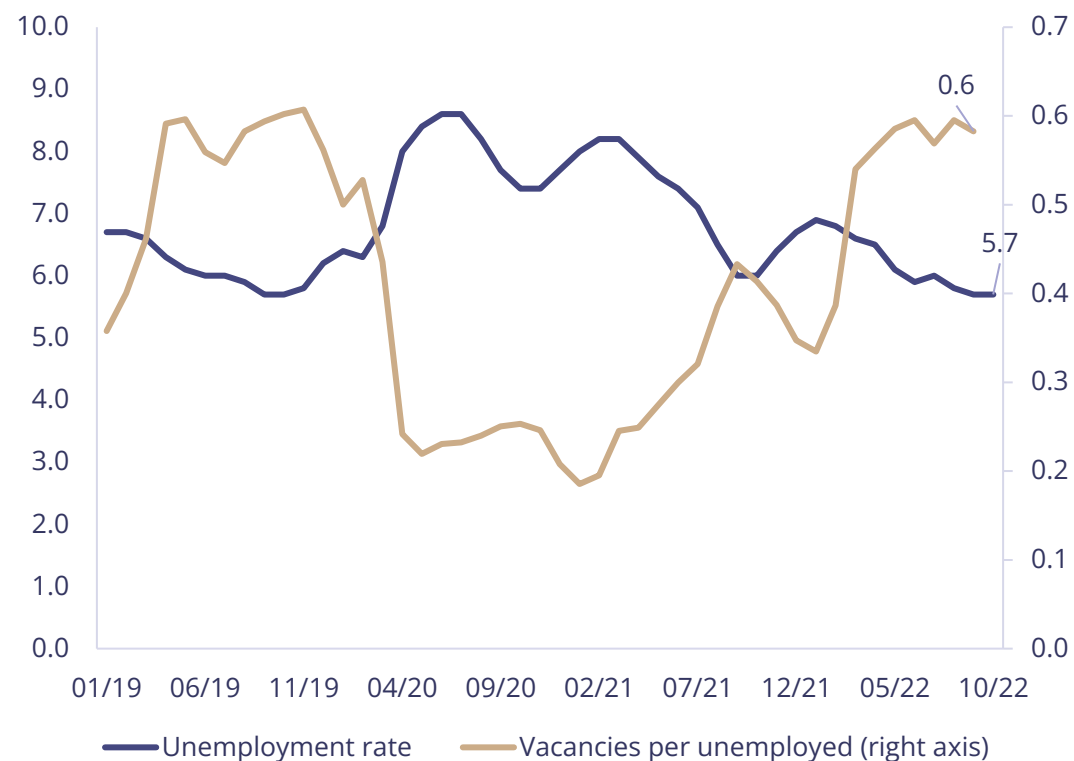
* REER vis-à-vis 37 trading partner countries.

Unemployment is low; tight labor market keeps upward pressure on wages

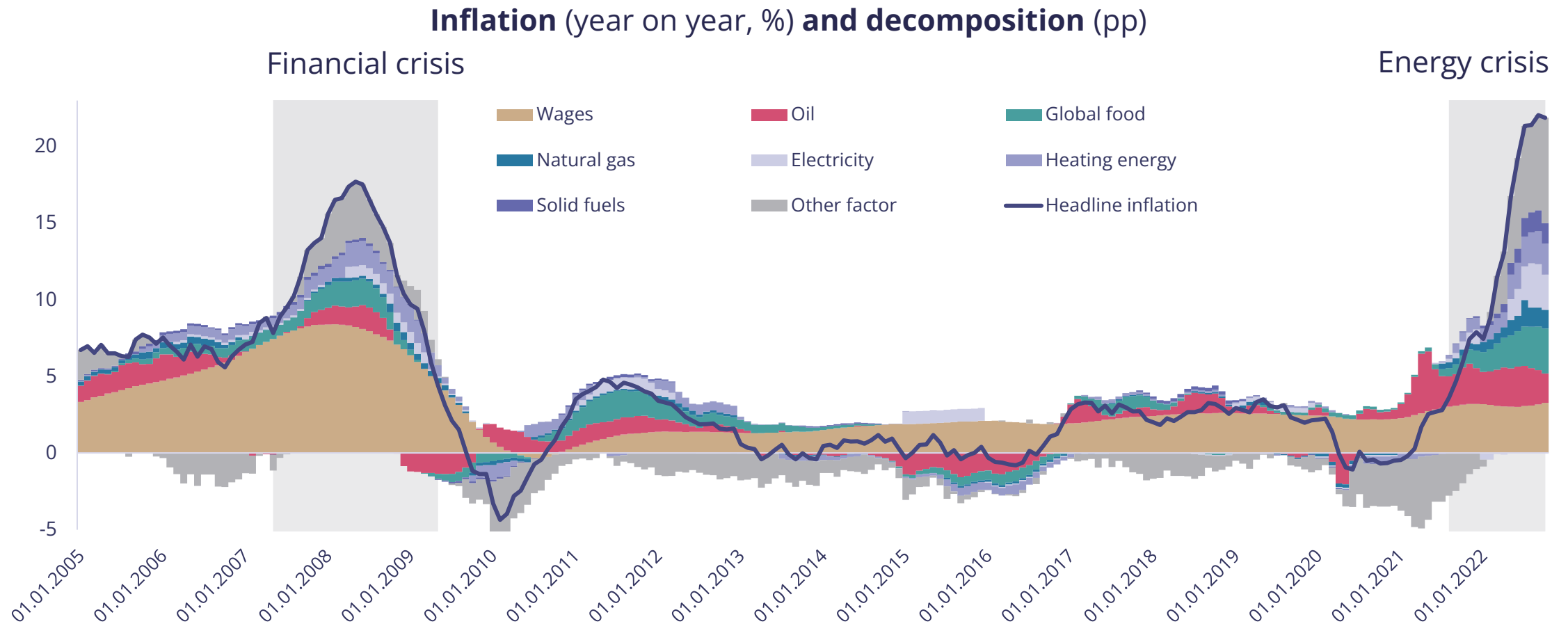
Average gross wage (y-o-y; %)



Vacancies (per 1 unemployed) and registered unemployment rate (% of econ. active)

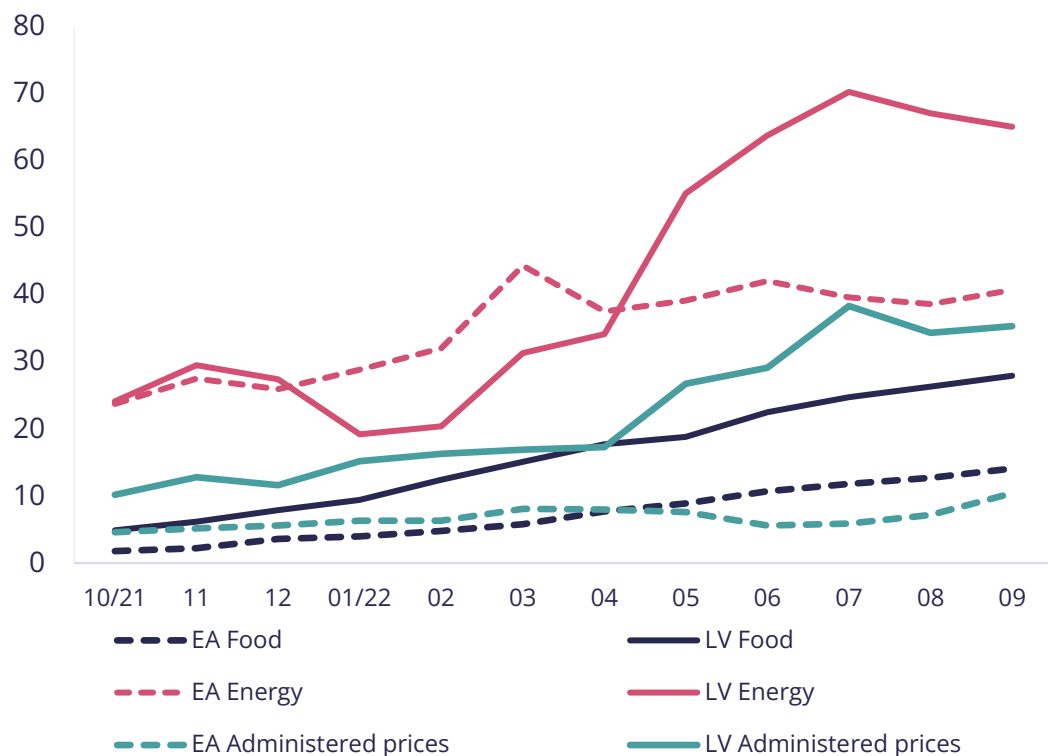


Financial crisis vs. energy crisis – inflation is similarly high, but different reasons

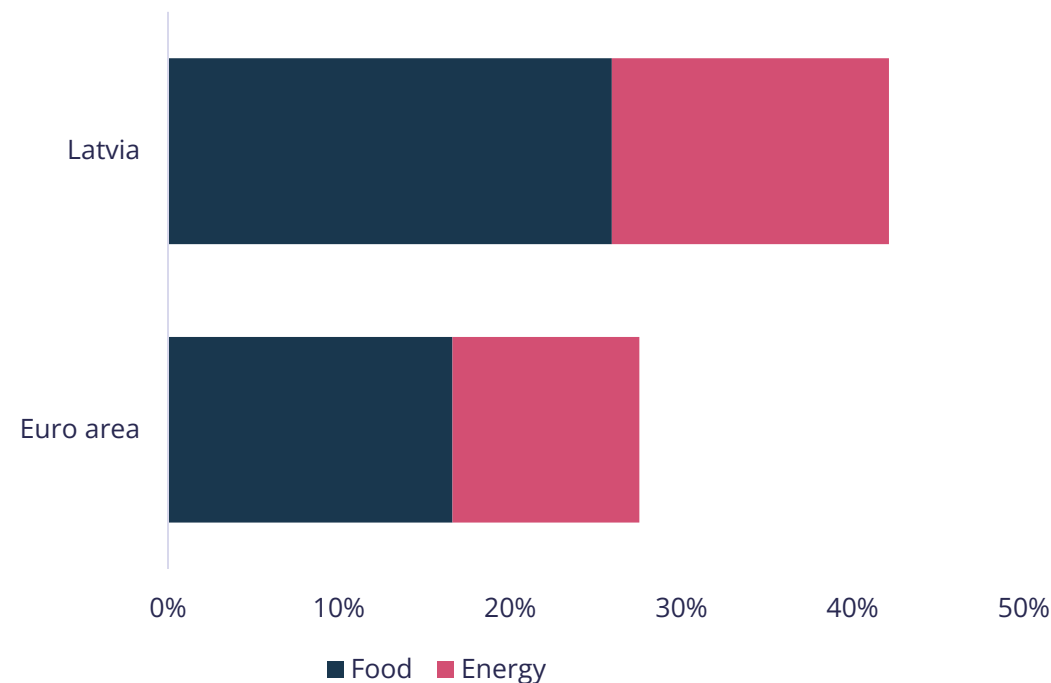


High inflation largely reflects large share of energy and food in consumption and more flexible pricing

Inflation and selected component price increase in LV and EA (year on year; %)

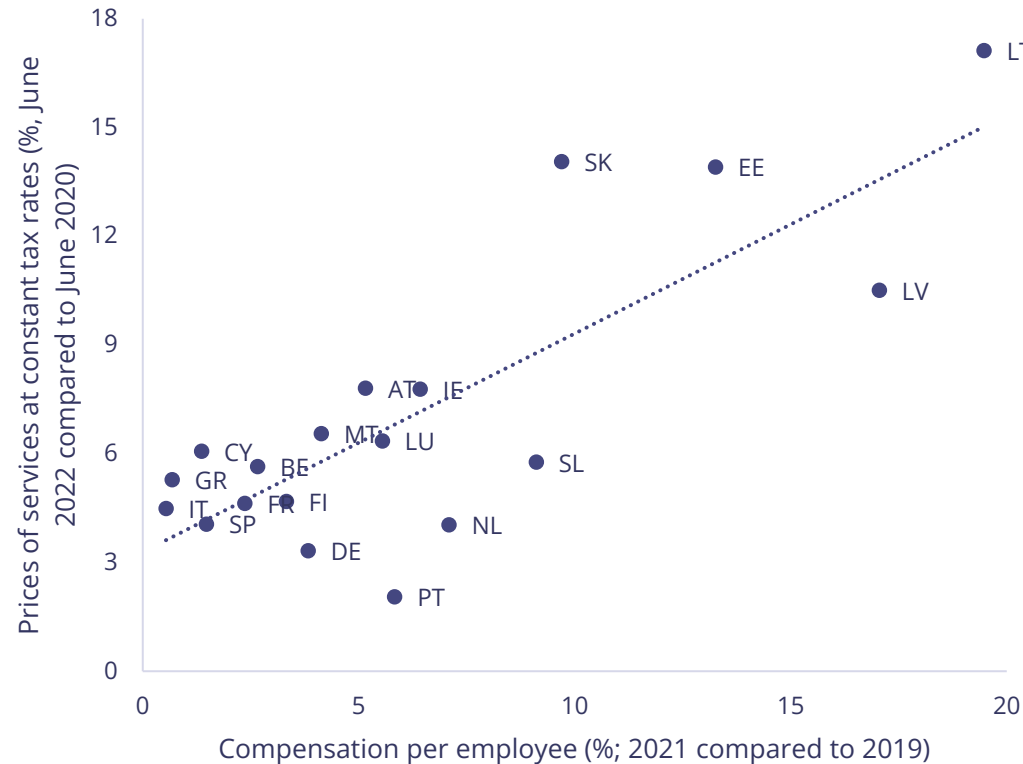


Structure of consumption basket (% of total)



Other factors: faster wage growth, different support measures

Compensation per employee and prices of services

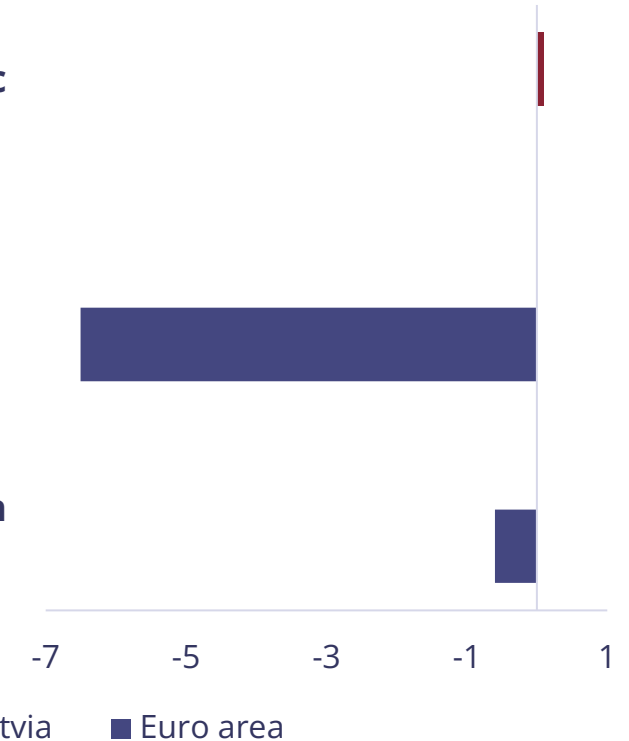


Consumption tax impact on annual inflation (percentage points; September 2022)

Food and non-alcoholic beverages

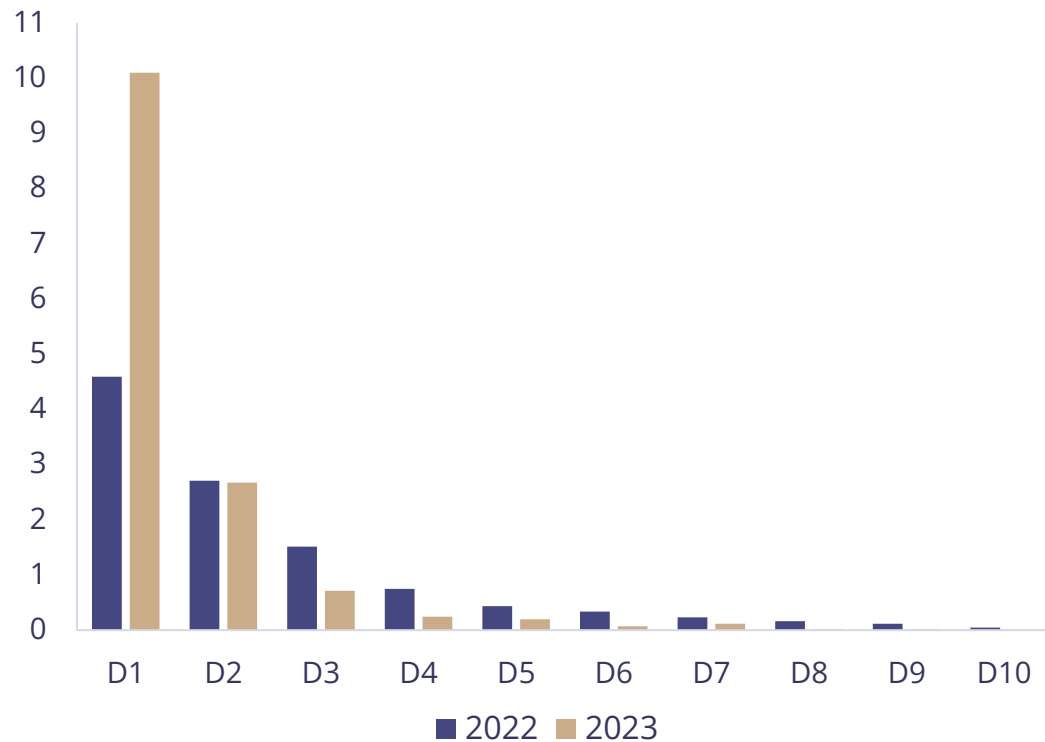
Energy

Inflation

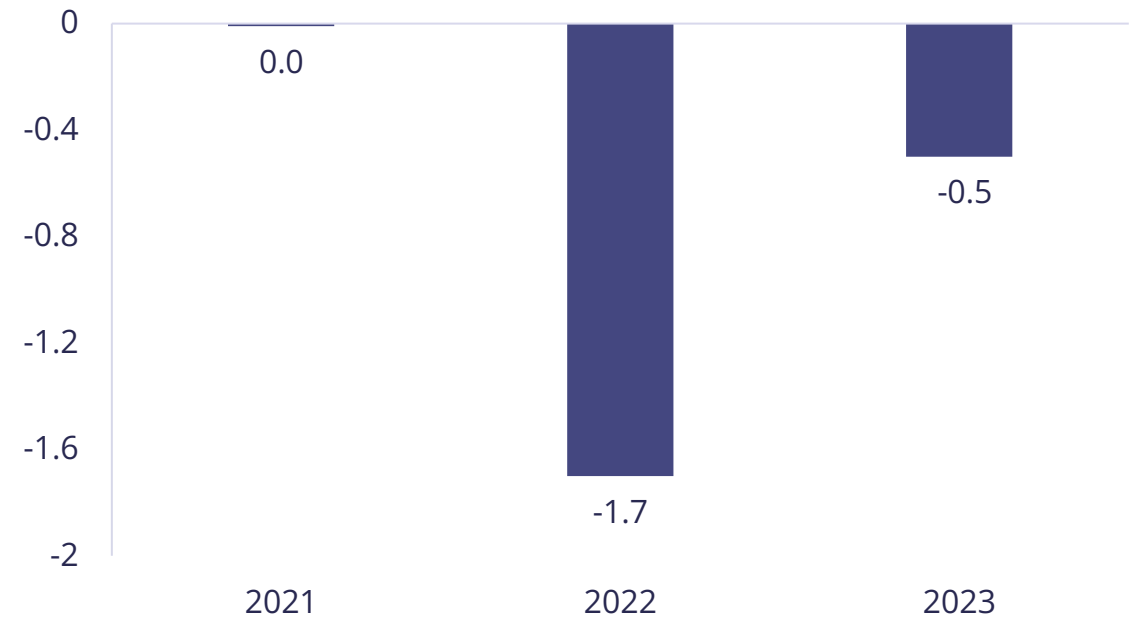


Government support targeted towards low income households

Changes in the equivalent disposable income of consumers (effect of benefits; %)



Government support impact on HICP inflation* (pp, compared to scenario with no support)



Takeaways

1

Global challenges:

- Central banks will continue raising interest rates; the era of cheap money is over.
- Trade ties with Russia and Belarus will continue to shrink, development should be sought in other markets.

2

Latvia: must act beyond the current heating season

- In the short term: shallow recession at the end of 2022, severe winter => state support should be timely, targeted, temporary and proportionate.
- In the medium term: higher interest rates mean more expensive debt servicing costs => fiscal sustainability is essential.
- In the long term: structural changes in energy sector towards self-sufficiency.
- Topical issue – to maintain competitiveness through the energy crisis.



Our country, our bank

