



Weekly Briefing

Latvia economy briefing:

A Preview of Latvian Economic Development in 2020

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During the last years, Latvia has been experiencing stable economic growth annually. Currently, this has been the longest period of economic development after the renewal of the independence of the Republic of Latvia. However, it has been forecasted that because of the global trends, the pace of Latvia's economic growth will experience a slowdown in 2020. Data from the Bank of Latvia shows that in 2020 the Gross domestic product (GDP) will grow for around 2.6 percent. Even though the percentage of increase in GDP is more significant than the average in the European Union¹, there is still room to grow for Latvia in order to balance out the inequality level of welfare in comparison to the European Union.

The possible slowdown of economics in Latvia in 2020 can be explained due to several reasons. The main factor in the decrease in GDP growth is the global market and external political events. The development of Latvia's Baltic trade partners – Lithuania and Estonia - economy will experience a lower rise than in previous years. Since the predictions of the economic growth of the leading trade partners of Latvia are cut down, it can have a direct impact on the number of exports in Latvia, thus affecting the GDP growth in Latvia. Undoubtedly, since Latvia is a small economy, the unpredictable global political situations such as Brexit, China-USA trade policy, etc. play a significant role in the further economic development of Latvia. The growth of exports in Latvia is predicted to be relatively low in 2020. However, it is foreseen that during the second half of the year the total exports will deliver better results.

In the latest years, lack of labor has been one of the main issues for entrepreneurs in Latvia. There have been massive debates over the attraction of the workforce from neighbor countries. However, in the latest months, Latvian enterprises have noted that it is no longer a limiting factor for the development of businesses as it used to be. Therefore, the import of foreign labor will not be as pressing in 2020 as it was previously. Since the level of unemployment among people of working age are higher in some regions in Latvia, there is a possibility to optimize current human resources in Latvia.

¹ <https://ec.europa.eu/eurostat/databrowser/view/tec00115/default/table?lang=en>

The hourly wage in 2020 will experience growth. However, because of the decrement on the pace of economic growth, it has been forecasted that the salaries would not increase as fast as they used to in the previous years. In the main trade fields of Latvia, the average rise in salaries is predicted to be around 6%.² The growth of price levels is expected to be 2.4% in 2020.³ Since the earnings of labor will increase more than the average price levels, it has been foreseen that customers will experience the growth of purchasing power and will be able to purchase more as they used to therefore promoting the level of welfare in Latvia.

It is expected that consumers will have to spend a larger amount of money on such items as fuel, public transport tickets, post services, and administrative services. The main reason for the price increase is new excise duties that will come in force in 2020. However, consumers will have to pay less money on services such as gas and electricity.

In the year 2020, some of the major participants in the field of Latvia's economy will experience challenges others – success. Because of the planned investments in fields of transport infrastructure as well as regional natural gas, it is predicted to have a positive impact on the economics of Latvia. The investments would allow using tools such as storage and transport infrastructure of natural gas in a more efficient way. By that, it is expected that the enterprises of the industry will have a higher turnover than in the previous years. The development of the construction industry is expected in 2020 as well. However, at the same time, there are still too many unpredictable variables in the transport industry, particularly regarding the implementation of the Rail Baltic project. Rail Baltica is a rail transport infrastructure project with a goal to integrate the Baltic States in the European rail network. The project includes five European Union countries – Poland, Lithuania, Latvia, Estonia, and, indirectly, also Finland. It will connect Helsinki, Tallinn, Pärnu, Riga, Panevėžys, Kaunas, Vilnius, Warsaw. Rail Baltic is currently the most significant project in the transport industry in Baltics. The implementation of Rail Baltic project will bring many benefits for the Baltic countries. Firstly, Rail Baltica will be a powerful catalyst for sustainable economic growth in the Baltic States contributing to each countries GDP in various ways. Secondly, the Rail Baltica project will provide with environmentally friendly sustainable infrastructure by reducing the environmental footprint on human mobility. And Third, Rail Baltica will create new

² Bank of Latvia

³ Bank of Latvia

opportunities for multimodal freight logistics development. Because of the many benefits of Rail Baltica and its impact on Baltic countries, Rail Baltic is one of the most significant projects in the Baltic States.

It is also expected that the manufacturing sector will deliver lower results as previously. For example, the current price levels of timber interfere with the development of the woodworking field, which has a significant role in the economics of Latvia since timber and other related products are the primary goods of export in Latvia. Because of the high competition for customers and downgrade of revenue level in the banking sector, it is expected that for the finance sector, the Year 2020 can be seen as challenging. However, not all industries are expected to face difficult times. The increase in investments in the food processing industry in Latvia might open a new direction for exports in Latvia.

In the upcoming months, the total development of investments is predicted to shrink. The peak of investments from the European Union was reached in the previous decade, and there are no expectations on new significant investments from the European Union. However, there will be further investment projects regarding Rail Baltic that will improve the investment environment in Latvia.

Because of the use of European Union funds and the lack of substantial private construction projects, it can be possible that the construction industry will be affected negatively. It has been foreseen that the total turnover levels of the construction sector will remain the same as in 2019. The construction field in Latvia has reached its top both in Latvia and as well in Eurozone. It is worth noting that there is no reason to expect a crisis in the sector. The demand still exists. However, the question of whether the construction sector will adapt to the new costs remains open. In all, the construction industry could experience a 1-3% fall. That is mainly explainable due to the government's policy to cut the total amount of investments.

The analytical division of the Ministry of Economics of Latvia stressed that in 2020 the exports of the service sector industry are expected to grow in particular accommodation services and the Information Technology sector. Besides, a steady rise is expected as well in sectors regarding private expenses and inner market-oriented fields as retail and commercial services. However, because of the global economic situation, it will be harder for those industries which

are more focused on exports of goods. It is worth noting that the development of trade will continue. However, it is expected to be at a slower pace than previously in 2020, and in some sectors, the overall demand may fall. In some economic fields in Latvia, lack of demand is foreseen to be one of the primary limiting factors. Mainly the reduction of demand will be seen in the woodworking sector. Despite that, it is expected that the strength and importance of the woodworking industry will remain and it will continue to be the leading commercial industry in Latvia.

Conclusion

Despite the forecast that in 2020 Latvia will experience economic growth, the development of various industries will be different. In some fields, entrepreneurs and politicians will have to face challenges and come up with new strategies. However, since currently, Latvia's economy can be described as stable and balanced, and because of that Latvia will be able to avoid potential risks the global economic trends may have caused. The total growth of GDP is expected to reach around 2.6%. It is foreseen that the pace of exports and in-flow of investments such as European Union funds will slow down. At the same time, the worker-friendly labor market, as well as the moderate inflation will show steady growth in private consumption and will be one of the main factors that will contribute to the economic and welfare growth of Latvia. As for the latest years the Information and Technology industry will keep expanding and have a bigger share on the total GDP.