



Weekly Briefing

Latvia economy briefing:
Prospects of the Latvian economy for 2020 under the impact of the
COVID-19
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Prospects of the Latvian economy for 2020 under the impact of the COVID-19

The exports of Latvia have been significantly impacted due to the Covid-19 crisis

Data from the Central Statistical Bureau on foreign trade in Latvian goods in April this year show that the value of exports of goods amounted to 927.7 million euros, which was 13.9% lower than in April last year. The fixed decline in exports in April was the sharpest since October 2009, largely due to the effects of the pandemic. A significant decline in global external demand was predictable, as indicated by economic sentiment indicators in the European Union (EU), the US and China, as well as forecasts by international organizations on global economic development and foreign trade. Many countries in the world were declared to be in a state of emergency and their borders were closed in April, but the international movement of goods was not as severely restricted as the movement of people. However, self-isolation and the introduction of quarantine, especially in the EU countries or in the largest Latvian export market, significantly reduced economic activity, as a result of which the demand for Latvian goods also decreased.

In addition, the assessment of Latvian manufacturers of export orders for the second quarter of this year has significantly decreased. Thus, it is expected that in May and June the decline in the value of exports of goods could reach double digits compared to the corresponding period of the previous year, and in the second quarter of this year, the decline in the value of exports will be significant. Assessing the outlook for exports in the second half of the year, the decline in exports is expected to ease, given both the stabilization of EU economic sentiment and the planned lifting of the emergency, and the implementation and planned EU support instruments to help national economies recover more quickly from the COVID-19 pandemic.

The fall in exports of goods in April this year was recorded for all groups of goods. The largest decrease is in vehicles, by 59.8% in total, which was negatively affected by the decrease in car re-exports.¹ A significant decline was also recorded for wood and wood products, by a total of 15.9%. A similar decline in timber exports was recorded from the beginning of the year, which is mainly due to the high base last year. At the beginning of last year, timber exports increased, which was supported by the high volume of exports of timber and timber products

¹ <https://www.fm.gov.lv/lv/aktualitates/jaunumi/makroekonomika/62381-fm-pandemija-butiski-samazinaja-latvijas-precu-eksporta-vertibu>

to the United Kingdom due to Brexit. However, the positive effect of this factor disappeared in May last year, and in the second half of the year the total value of timber exports began to decline, reaching 15% in some months. The consequences of the pandemic in March this year reduced the price of timber on world stock exchanges, which also had a negative impact on the export value of timber and timber products of Latvia.

Exports of agricultural and food products decreased by 8.2%, which was largely influenced by the decline in exports of cereals and alcoholic beverages. Exports of mineral products, on the other hand, decreased by 37.6%. The decline in exports in this product group was determined by a decrease in electricity exports by 74.4%, as well as a decrease in oil exports by 75.9%. Electricity exports were negatively affected by lower electricity prices in all trading areas of the Nord Pool exchange due to lower electricity consumption due to warm weather conditions as well as lower economic activity during the emergency. In turn, the decline in oil exports was influenced by both the fall in oil prices on world stock exchanges and the volume of less transported oil products in Latvian ports.

Analyzing foreign trade, it is important to note that imports of goods in April this year have decreased even faster than exports, by a total of 27.4%. As a result, the foreign trade deficit in goods has significantly decreased from 290 million euros in April 2019 to 65 million euros in April this year. The sharper decline in imports of goods compared to exports is related to both the decline in Latvia's domestic consumption and the decline in re-exports of goods. Similar import dynamics are expected in June. However, with gradual economic recovery the dynamics of imports and exports are expected to slowly improve.

Economic prospects of the year 2020

The current economic prognosis from the Ministry of Finance show that Latvia will experience fall of Gross Domestic Product in 2020 by approximately 7%.² Additionally it is seen that due the Coronavirus crisis the unemployment level will have increased by 4.9% in comparison to 2019 reaching 11.2% in 2020. The data from the Ministry of Finance shows that during the Year 2020 the total import will have decreased by 10.0% in comparison to 2019 and total export levels will have fallen by 9.0%.

The current prognosis shows that the restrictions in field of service (e.g. cancelation of private and public events) and restricted travel opportunities have significantly impacted consumption, which is also reduced by the fall in income. Uncertainty about the severity and

²https://www.fm.gov.lv/lv/sadala/tautsaimniecibas_analize/tautsaimniecibas_analize/galvenie_makroekonomiskie_raditaji_un_proгноzes/

duration of the consequences of the Covid-19 pandemic is forcing citizens to be cautious about spending, so the fall in consumption is estimated to outweigh the decline in income. Exports of services are suffering significantly as the flow of tourists and air passengers is depleted due to the constraints of the emergency. At the same time, a comprehensive decline in activity in foreign markets reduces the export sales of goods.

A significant decrease in investment is forecasted for 2020. Although investment flow will be strengthened by the increase in public investment set out by government decisions, high uncertainty will deter new private investment income.

Restrictions imposed to cope with the Covid-19 pandemic had a rapid impact on the labor market, as companies were no longer able to continue functioning as they did before. However, the rise in unemployment is expected to be lower than during the previous global financial crisis, with the government providing support to businesses and citizens affected by the crisis. Low economic activity has forced entrepreneurs to consider optimizing costs and thus reducing labor costs. In addition, rising labor supply as a result of unemployment will not contribute to wage growth, even as economic activity recovers, thus weakening price increases next in the future.

The transition to digitalization will only accelerate and the process is already underway. And, given the developed infrastructure, Latvia could be in a good position in the digitization process. Shared service exports and start-ups could be some of the Baltic success stories. However, the environment still needs to be strengthened to make its positive impact on the economy more significant.

Undoubtedly Covid-19 will leave impact on the economics of Latvia. However, in comparison to the financial crisis in the Year 2008, it is important to note that in the last years Latvia has experienced strong economic development with good fundamentals, including fiscal discipline and surpluses in current accounts during the past years, which have all facilitated strong labor markets. Additionally, it is important to stress that the economy of Latvia within the past years has well integrated into Eurozone and comparing to the previous crisis has strengthened the banking sector. In assumption that the Euro area countries will slowly transfer from the emergency situation to previous business environment, the crisis for Latvia will be sharp, but with smaller impact in the upcoming years if comparing to the financial crisis in 2008. Overall, the combination of European Union and national response to the crisis will be critical to amortize the consequences of the Covid-19 crisis.

Summary

Due to the Covid-19 crisis the field of Latvian export has been significantly affected by the shift in consumption. Latvian goods in April this year show that the value of exports of goods amounted to 927.7 million euros, which was 13.9% lower than in April of 2019. The fixed decline in exports in April was the sharpest since October 2009, largely due to the effects of the pandemic. Overall in comparison to 2019 total export levels will have fallen by 9.0%. As for the outlook of the upcoming months during 2020 will overall be devoted for mitigating the consequences of the Covid-19 crisis as the amount of public investment funded by the state will increase. Although investment flow will be strengthened by the increase in public investment set out by government decisions, high uncertainty will deter new private investment income. The current economic prognosis from the Ministry of Finance show that Latvia will experience fall of Gross Domestic Product in 2020 by approximately 7%. Additionally, it is seen that due the Coronavirus crisis the unemployment level will have increased by 4.9% in comparison to 2019 reaching 11.2% in 2020. Low economic activity has forced entrepreneurs to consider optimizing costs and thus reducing labor costs. In addition, rising labor supply as a result of unemployment will not contribute to wage growth, even as economic activity recovers, thus weakening price increases next in the future.