





## **Weekly Briefing**

**Latvia economy briefing:**  
**Economic Forecast and Financial Sector Development**  
**inspires optimism for Latvian Economic Recovery**  
**Institute of Economics of the Latvian Academy of Sciences**

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# **Economic Forecast and Financial Sector Development inspires optimism for Latvian Economic Recovery**

## **Summary**

*As the epidemiological situation improves, faster economic growth is expected in the second half of the year and the Latvian gross domestic product (GDP) may grow by 3.5% in 2021, according to the Economic forecast of the European Commission (EC). Due to the pandemic, the Latvian GDP decreased by 3.6% last year. One of the most important tools for economic growth is the Financial Sector Development Plan for 2021-2023, which sets out the priority directions for the development of the financial sector for the next three years. The plan aims to continue to support an innovative and affordable financial sector that promotes and supports sustainable economic development.*

## **Introduction**

As European Union is starting to get back on track after the pandemic and economic forecast by European Commission is also becoming more optimistic. Latvian indicators in this forecast are not the exception. In this briefing, figures provided by the EC Spring 2021 Economic Forecast are analysed. Also, the financial sector is playing a big role in the recovery of the country after the pandemic, so understanding the trajectory of its development is essential. Considering that the financial sector in Latvia is one of the most developed areas in the country, the issue of faster and more efficient improvement remains even more acute. The question is what are the measures, which can be implemented by the government in order to improve the economic situation and speed up the recovery process in Latvia?

## **Economic growth forecast in Latvia**

In May European Commission has published Spring 2021 Economic Forecast for EU countries. The result of this forecast for Latvia are provided in the Table 1:

Table 1

**Economic forecast for Latvia<sup>i</sup>**

<b>Indicators</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
GDP growth (% , yoy)	2,0%	3,6%	3,5%	6,0%
Inflation (% , yoy)	2,7%	0,1%	1,7%	2,0%
Unemployment (%)	6,3%	8,1%	8,2%	6,9%
General government balance (% of GDP)	-0,6%	-4,5%	-7,3%	-2,0%
Gross public debt (% of GDP)	37,0%	43,5%	47,3%	46,4%
Current account balance (% of GDP)	-0,6%	3,0%	-0,4%	-0,4%

The Latvian economy will grow by 3.5% this year (GDP growth) and consumption are going to return to the pre-Covid level, additional stimulus to the economy will be provided by an increase in investment, including due to a significant inflow of European Union (EU) funding.<sup>ii</sup> In 2021 Latvia's state support for entrepreneurs and households has significantly increased compared to 2020, while the state budget deficit is growing accordingly. The budget deficit reached 4.5% of the GDP in 2020, but this year it is already forecasted at 7.3%. In turn, the EC forecasts that next year the Latvian GDP will grow by 6% and the budget deficit will be reduced to 2%.

Consumer price inflation was lowered in 2020, displaying decreasing energy prices and low service prices, because of the low demand. More expensive energy and service prices over the projection period are set to raise headline inflation to 1,7% in the current year and 2% in 2022.

Employment decreased by 2.3% in 2020 with massive job losses in the COVID-affected labour-intensive service sectors. Labour demand is foreseen to bounce with the economic recovery over the current and next years. The situation with the unemployment rate is forecast to stabilize in 2022. In 2019 it was on the level of 6,3%, which is the national minimum for Latvia. During the pandemic, the unemployment rate increased to 8,1% in 2020 and 8,2% in 2021. However, in 2022 it is expected that the unemployment rate will be decreased again to 6,9%.

Optimistic forecasts are reflected not only in the increase in vaccination rates but also in the easing of restrictions imposed by Covid-19 and the implementation of the Recovery and Sustainability Mechanism. One of the examples for Latvia is that at the beginning of May restaurants were able to finally open terraces, which will have a positive impact on the situation

with the national economy in general. The growth of the consumption and rehabilitation of business in Latvia will lead to the growth of GDP starting from the second quarter of 2021.

### **Development plan for an innovative and accessible financial sector**

The anti-money laundering system has been significantly improved in recent years in Latvia. The implementation, monitoring and control of risk-based requirements are continuously improving, and changes are made in the regulatory framework as well. Therefore, now is a perfect time to implement a strategy for the further development of the financial sector, which will allow entrepreneurs and individuals to ensure both the availability of financing and investment opportunities. The digital and “green” transformation of the Latvian economy and the financial sector itself will also be promoted.<sup>iii</sup> It is important to mention that the financial sector is one of the most developed areas in the country, therefore, constant improvement may allow bringing this field to the leading positions in the international arena.

The Ministry of Finance in co-operation with the involved institutions has started active work on the measures marked by the Financial Sector Development Plan in three priority development directions:

- Availability of financing and investment opportunities;
- Digitization and access to innovative services;
- Sustainable finances.

In order to promote lending within the plan, the factors hindering lending to businesses and individuals will be regularly assessed. In turn, work on the development of the capital market will ensure the diversity of funding sources.

### **Boost of Latvian capital market**

Together with the Financial and Capital Market Commission and other involved institutions, the Ministry of Finance has started work on the implementation of a 10-step program for capital market development. Within the framework of this program, it is planned to promote investment activity in the Latvian capital market, to invest more in the Latvian capital market of state-funded pension scheme funds and to provide qualitative information to potential capital market issuers. The program includes more active involvement of small and medium-sized enterprises in the capital market, more active participation of state capital companies in the capital market, as well as promotion of financial literacy of the Latvian society

in investment-related issues. More about Latvian capital market and 10-step program for capital market development can be found in the [Latvian April economic briefing](#).

One more important step for the Latvian financial market is that work is continuing on the inclusion of the Baltic capital market in international financial indices. Global index providers are being consulted in cooperation with the European Bank for Reconstruction and Development and the European Commission.

### **Fintech sector development**

In order to promote digitization and the availability of innovative services, the development of a Fintech sector development strategy has been started, which will promote the development of digital and innovative services in the financial sector. Cooperation and an ecosystem supporting financial technologies will increase the activity of the financial sector and ensure the sustainable growth of the fintech sector. A developed financial innovation sector provides high value-added services, well-paid jobs and supports overall economic activity.

A wider discussion on the development of the strategy will start already in May 2021, when the involved institutions and cooperation partners plan to discuss the measures to be taken for the development and implementation of the Fintech sector strategy. For the Latvian economy, it is a very important step to support Fintech development on the national level as Latvian Fintech companies are one of the biggest and most innovative in Europe. Therefore, state support can boost even stronger and faster development of the sector to increase the influence of Latvian fintech on other continents.

### **Conclusion**

Economic growth is foreseen to resume in the second half of 2021 and in 2022 driven by individual consumption and investment, mostly due to EU funding and public investments related to Rail Baltica and implementation of the Recovery and Resilience plan. The labour market is foreseen to recover accordingly, with labour shortages possibly resurfacing by the end of 2022. The government deficit is projected to further increase to almost 7,3% of GDP in 2021 due to temporary support measures, before decreasing to 2% by 2022. Additionally, the financial sector is playing a big role in the recovery of the country after Covid-19, so understanding the vector of its development is crucial. Considering that the Latvian financial sector is one of the most developed fields in the country, the question of a more rapid and

efficient improvement is actual for the economy of the country. The government is currently preparing and implementing a development plan for the financial sector, boost the capital market and building a strategy for fintech sector development.

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<sup>i</sup> European Commission. (12.05.2021). Economic forecast for Latvia. Available at: [https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/latvia/economic-forecast-latvia\\_en](https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-performance-country/latvia/economic-forecast-latvia_en)

<sup>ii</sup> LSM.lv. (13.05.2021). Eiropas Komisija šogad Latvijai prognozē ekonomikas pieaugumu par 3,5%. Available at: <https://www.lsm.lv/raksts/zinas/ekonomika/eiropas-komisija-sogad-latvijai-prognoze-ekonomikas-pieaugumu-par-35.a404232/>

<sup>iii</sup> Finanšu ministrija. (30.04.2021). Attīstības plāns inovatīvam un pieejamam finanšu sektoram. Available at: <https://www.fm.gov.lv/lv/attistibas-plans-inovativam-un-pieejamam-finansu-sektoram>