



Weekly Briefing

**Latvia economy briefing:
Inflation Levels in Latvia Exceed Records:
what to expect in the near future?**
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Inflation Levels in Latvia Exceed Records: what to expect in the near future?

Summary

In June 2022, compared to June 2021, the average level of consumer prices increased by 19.3%. The existing uncertainty about the sufficiency of energy resources does not allow us to make accurate forecasts for the future, however, in some groups, the rise in the prices of raw materials has slowed down. There is a good chance that the highest inflation point will be reached in autumn and the rate of inflation will slow down in the future - the price level will continue to rise, but more slowly. However, it is impossible to make exact forecasts, because everything will be affected by the geopolitical situation and the course of the energy resource crisis.

Introduction

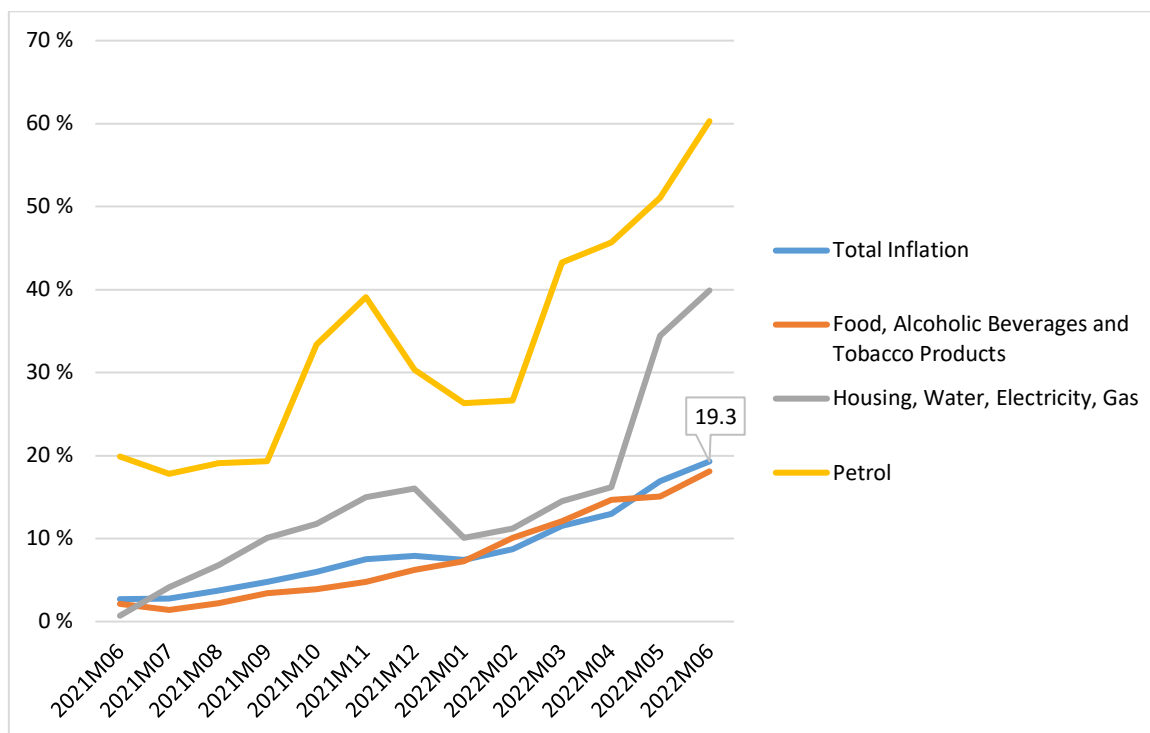
The war in Ukraine, the increase in prices, especially for energy and food, as well as the still-present problems of supply chains create risks of recession both in the USA and in Europe, thus also in Latvia. Annual inflation in the Eurozone increased to 8.1% in May, which is a record high level. Ever faster price growth has been observed in Latvia since the spring, and the forecasts of bank analysts indicate the expected rise in inflation. This month, inflation exceeded what was experienced in May 2008, shortly before the global economic crisis. In this July Latvia Economic Briefing, read more about the increase in consumer prices in Latvia and experts' forecasts for what is expected in the coming months.

I Rise in Consumer Prices Rapidly Continues

Compared to 2015, consumer prices in June 2022 were 33.5% higher. Prices for goods increased by 35.7%, and for services - by 25.6%.

Figure 1. Changes in consumer prices in Latvia in percentage compared

to the corresponding period of the previous year.



Source: Chart drawn up by the author based on the Central Statistical Bureau's data, 2022

The biggest impact on changes in the average consumer price level in June 2022, compared to June 2021, was the increase in prices for housing-related goods and services, food and non-alcoholic beverages, transport-related goods and services, restaurant and hotel services, various goods and in the service group, goods and services related to recreation and culture, alcoholic beverages and tobacco products, health care.

In the group of food and non-alcoholic beverages, prices increased by 22.1% during the year. Cheese and cottage cheese (+30.2%), dairy products (+33.7%), milk (+39.2%) and yogurt (+25.8%) had the most significant impact on the increase in the average price level in the group. Bread (+21.0%), flour and other cereals (+58.0%), confectionery (+19.1%), pasta (+28.5%), rice (+28.8%) became more expensive.

The average price level of housing-related goods and services increased by 39.9%. The most significant price increase during the year was for electricity, thermal energy, natural gas, and solid fuel. Garbage collection, housing rent, water supply, materials for housing maintenance and repair, sewerage services, as well as housing maintenance and repair services became more expensive.

Prices of goods and services related to transport increased by 32.2%, which was determined by the increase in fuel prices by 60.3%. Diesel fuel rose in price by 64.9%, gasoline - by 57.5%, and auto gas - by 30.4%. Maintenance and repair of personal vehicles, spare parts

and accessories for personal vehicles, used cars, new cars, as well as passenger transportation by road were more expensive.

Although the rise in raw material prices has slowed down in some groups, economists are cautious about a possible reduction until the sufficiency of energy resources is clear. However, the Ministry of Finance has predicted that inflation will grow in the coming months as well. It is predicted that the price increase will be for all product groups. Fuel, gas is needed to grow potatoes, tomatoes, to milk cows. Resources are expensive, so one should not expect that the price drop will be rapid either, however, there is hope that such a big increase, as is currently observed, will not happen at the end of the year.

The higher prices of certain products have also been caused by excessive hysteria created by buyers, for example the higher prices of salt after buying out this product for several weeks. Latvijas Radio conducted a study in which it was concluded that a large number of consumers are currently paying more attention to promotional prices in stores, they buy specific products in different stores. Residents also notice an increase in the prices of certain everyday goods, which is also discussed on social networks. A large part of the surveyed population does not believe in price stabilization in the near future.

II Forecasts for Upcoming Months

Out of all the countries of the European Union, the increase in inflation is felt most severely in Latvia and the other Baltic states. The Baltic countries feel it especially, because they are relatively poorer and a larger part of their monthly income has to be spent directly on energy and food, while the residents of large and wealthy countries have money left over for something else.

Currently, quite different forecasts of inflation trends can be observed, since the uncertainty is very high. Experts estimate that it is likely that the highest point of inflation will be experienced in the fall. Next year, the pace will tentatively slow down, though this will be determined by the weakening of economic growth and the subsequent changes in consumption and, primarily, the dynamics of energy and food prices. Also, sharp increases in energy prices are possible in winter if there is a sharp gas shortage in Europe. Even though inflation rates may begin to moderate next year, secondary factors will be felt, therefore increased inflation will persist and still have a negative impact on the purchasing power of the population.

There are also scenarios in which inflation may adjust more rapidly, including downwards. It is primarily related to the development of the global economy, which will determine the demand for goods and services. At the moment, certain positive features are emerging, such as the reduction in wheat prices, which may indicate an easing of price pressure

on food. However, the inertia of rising costs for food will continue to be reflected on store shelves.

The greatest uncertainty is with energy prices, where the risk of reaching new records is high, without excluding the possibility that the price trend may also be in the opposite direction. The high prices of oil, gas and electricity will affect the economy of the entire European Union, which will also affect the demand for these resources. A decline in economic activity is also likely to lead to lower demand for oil. Generally, energy resource prices tend to fluctuate much less synchronously. However, the level of oil, gas and electricity prices can be so destructive that instead of encouraging the use of oil, it causes problems in the economy and leads to lower demand for oil.

Price changes in the Baltics are determined by many similar factors when compared to other eurozone countries. Latvia's economy is recovering strongly, especially in those sectors that were restricted during the pandemic, which creates favourable conditions for price increases. It is also possible to see cases where prices are raised well beyond the cost increase justified by strong demand. Traders play a big role and in big countries big traders set the tone, are in stronger positions and limit price increases. Producers are also larger, able to accumulate more cost increases. The weak point of the Baltic states is the energy market, which creates conditions for its faster price growth and, accordingly, inflation. Similarly, compared to the wealthiest eurozone countries, support measures in the Baltics to compensate for the increase in energy prices are much smaller in scope. The increase in wages in Latvia continues at a rapid pace and also maintains a faster increase in costs.

The decline in purchasing power is accelerating, despite the fact that wage growth is still reasonably fast. However, rarely will wage growth outpace inflation for any individual. At the moment, inflation is not yet fully manifested, because, for example, the consumption of communal services is lower in the summer. At the end of the year, when the heat bills appear, other conditions will develop: from the weather conditions and the actions of countries, especially Russia, which will result in energy prices and citizens' bills.

Conclusions

The wave of inflation continues to roll over Latvia, creating more and more complicated conditions for economic growth. This is a big challenge for the population, because such high inflation has not been seen since the beginning of the 90s, when the economy went through ambitious times of change. The inflation rate in the rest of the eurozone countries, although lower than in the Baltic countries, has reached the highest level of many decades. Residents feel the increase in prices more strongly. It is likely that as the situation worsens, the purchasing power of the population will decrease, as well as the demand for various secondary goods.

Residents will buy essential goods and products, but in smaller quantities. The current inflation forecasts and trends in the market of several resources, including oil products, allow us to make cautious predictions that the prices of food products will stabilize and decrease slightly in the coming year, however, the scenarios put forward by experts are different and directly depend on the changes in the prices of energy resources, as well as the impact of the war in Ukraine caused by Russia.

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