



*Based on information provided by the Ministry of Finance.*

## FINANCE MINISTRY: LATVIAN ECONOMY BACK ON TRACK

Guided by prudent forecasts and detailed analysis in its budget preparation for 2010, the Latvian Finance Ministry believes now that the economic downturn has been stopped, returning Latvia to a path of growth.

*According to Minister of Finance Einars Repše, “Now it can be seen that the economic situation in the state is on the right stabilisation path and it is the result of the government’s work in managing the fiscal policy. We are still, however, worried about the excessive budget deficit. This is why Latvia continues the work that was started in balancing state revenue and expenditure. This, in turn, will ensure wholesome economic growth in coming years. Not many countries have managed the crisis more successfully. On the international scene Latvia is no longer being described as a state in crisis, as it was in the beginning of the year, but as a potential example for other countries such as Greece, Spain and Portugal. We will be able to reorganise ourselves and perform necessary reforms, and Latvia will get out of the crisis stronger than before.”*

### **Budgetary Consolidation**

Since 2009 Latvia has achieved significant downsizing of budgetary deficit by consolidating expenditures and incomes. In 2009 consolidation in the amount of LVL 878 million (EUR 1.3 billion) or 16% from overall state budget expenditure was achieved. In 2010 budgetary consolidation amounted to LVL 507 million (EUR 720 mln), including a decrease of expenditure by 6%.

Current estimates and agreements with lenders show that an indicative consolidation amount in 2011 could be LVL 392 – 440 million (EUR 557.8 – 626.1 mln), but the exact amount of the required consolidation under the 2011 budget and the basic budget figures would be determined when preliminary economic results for the third quarter become available.

Consolidation is to be ensured by increasing incomes and decreasing expenditures. The government is working in both directions – ensuring additional incomes by implementing actions under the Action Plan of Combating Shadow Economy and considering taxation policy changes, as well as undertaking expenditure cuts by evaluating functions performed by the state, carrying out structural reforms and following the recommendations of foreign experts.

The government continues intensive work at on a complex list of measures for 2011. The goal is to increase consolidation so that the newly elected Parliament and subsequent Cabinet of Ministers can take immediate, well-informed actions.

### **Background on the International Loan**

The global financial crisis and overheating of national economies in 2008 significantly reduced the availability of financial resources, requiring the government to turn to international lenders for support. At the end of December 2008, the European Commission, International Monetary Fund, World Bank, European Reconstruction and Development Bank and several Member States of the European Union agreed on provisions of financial support to Latvia in the amount of EUR 7.5 billion. The financing within international financial borrowing program will be available in parts until the end of 2011.

Taking into account the improvement of Latvia's economical situation and sufficient financial reserve in the Treasury, international lenders have agreed that, within the international financing borrowing program, Latvia will utilize only funds provided by institutional lenders (International Monetary Fund, the European Commission and World Bank), while resources ensured by European countries will be used as credit line only in case of necessity.

According to agreement with international lenders, the loan is provided to ensure general financing of the state budget (including financing of budget deficit and loan, re-financing of the government debt) and to guarantee stability of financial sector. Until July 31, 2010, in the framework of international financial borrowing program, Latvia has received EUR 4.1 billion, from which EUR 2.5 billion have been spent to finance state budget liabilities.

### **Bailed – out Parex Bank**

The decision to take over the Parex Bank was adopted on November 8, 2009, to stabilise the bank's financial situation and ensure its liquidity and capital sufficiency indicators, which had deteriorated seriously as a result of the global financial crisis. Since the takeover, the activities of the Parex Bank have been stabilised and restructuring plan has been adopted and submitted to the European Commission.

Restructuring is based on a division of the Parex Bank by creating the Citadele Bank which has started up full-service operations, and leaving part of the assets at Parex Bank which is now working as resolution bank to return the state's investments by restructuring loans and managing those assets and pledges, mostly property. Co-owner of the newly established Citadele Bank is also the European Reconstruction and Development Bank.

At the moment consultants are preparing a selling strategy for both banks.

### **Macroeconomic Indicators**

- ✓ Latvia's economy is showing signs of stabilisation. Quarterly growth of GDP compared to Q1 of 2010 (seasonally adjusted data) showed an increase by 0.1%, thus maintaining positive growth for two quarters in a row.
- ✓ In Q2 of 2010 yearly growth of industrial production reached 12.1%, for exports yearly growth reached 30.3%.
- ✓ Consumer price index in July 2010 increased by 0.2% comparing to June, showing persistent price growth throughout year thus reducing yearly deflation (year 2010 comparing to year 2009) down to approximately -1.5% or lower, while before mentioned forecast planned -2%.
- ✓ Unemployment remains a challenge as registered unemployment rate rose to 17.3% in March 2010 and started to decrease in April. Registered unemployment rate in June – 15.6%. According to data provided by Eurostat, jobseekers rate reached 20% in April 2010. The State Employment Agency introduced a programme within social security network providing unemployed temporary jobs mostly in local municipalities. Although these are not highly paid jobs, they have helped thousands of unemployed.
- ✓ Regaining competitiveness through corrections of wage level - during Q1 of 2010 average wage in economy decreased by 8.3% (of which 14.1% in public sector and 4.7% in private sector) compared to Q4 of 2009 and was 431 LVL (613 EUR).
- ✓ Tax and non-tax income in 7 months covers already 60% of planned total performance in 2010, where non-taxes – 74% of budget plan.

**Conservative medium-term forecasts** of the Ministry of Finance suggest that in 2010 gross domestic product (GDP) in constant prices in Latvia will still decrease by 3.5%, but in 2011 the economic growth in Latvia will restart by 3.3%, in 2012 – by 4%, in 2013 – by 3.9%.

To stabilise the economy and facilitate growth revival, Latvian government made firm steps in the direction of the **arrangement of national fiscal policy** – in 2009 and 2010 considerable budget consolidation was performed decreasing expenditure and increasing revenue. Therefore

Latvia managed to finish 2009 with 8.98% of GDP (according to ESA 95) which is less than initially forecasted 10% of GDP.

The Latvian government has decided that January 1, 2014 will be the **euro changeover target date**, therefore fiscal and economic policy in coming years will be made so to ensure Latvia's compliance with Maastricht criteria and accession to the euro area in 2014. The budget law envisages that the budget outcome in 2010 shall be in line with deficit ceiling -8.5 % of GDP. The goal of the government is in 2011 to decrease the budget deficit down to 6% of GDP, in 2012 – to 3% of GDP to comply with Maastricht criteria.

**Preparatory work of 2011 budget is well underway.** The main task is to reach optimal balance between budget consolidation and stimulation of economical growth.

The draft state budget for 2011 is being prepared according to the schedule approved by the Cabinet of Ministers – macroeconomic development forecasts, base expenditure forecasts, draft tax policy guidelines for medium-term, shadow economy combating plan have been developed, public function evaluation is being done. Necessary budget consolidation is planned to be done by balancing expenditure cuts and revenue increase. Revenue increase is planned to be reached according to medium-term tax policy guidelines aimed at ensuring stable state budget revenue, ensuring stability and predictability of tax policy, improving competitiveness of Latvian economy and promotion of social justice.

The Latvian government has also stepped up activities **to seriously combat the shadow economy** by approving comprehensive medium-term action plan for the reduction of illegal economy and promotion of fair competition. This includes: facilitation of legal economy, support for businessmen facing economic difficulties, unique possibility to legalise undeclared income, building the analytical capacity of controlling institutions, effective sanctions, fair social policy, comprehensive communication and more responsible utilisation of budget resources.

#### **THE LATVIAN INSTITUTE**

The Latvian Institute promotes knowledge about Latvia abroad. It produces informative materials and works closely with international media professionals in developing a wide variety of communications projects.

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