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The path to stability: the future of Latvia in the context of economic forecasts for the years 2023-2024

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Despite having to grapple with issues such as the effects of the war between Russia and Ukraine or – earlier – the COVID-19 pandemic, Latvia's economy has demonstrated its ability to adapt and maintain growth dynamics. Notwithstanding the anticipated slowdown in export growth due to a decrease in foreign demand, the second half of 2023 is likely to see a significant increase in the pace of investments supported by EU funds. Changes in inflation are also forecasted – in 2023, it is expected to reach 9.3%, and in 2024, a decrease to 1.7% is anticipated. Such a situation may contribute to reducing economic uncertainty and, consequently, stimulating further investments. Therefore, it can be expected that the prospects for stabilizing the economic situation in Latvia are real, and its economy will likely maintain an upward trend.

Positive GDP growth forecasts for Latvia. In 2021, when Latvia's economy emerged from the crisis caused by COVID-19, it recorded a 4.1% increase in GDP. However, in 2022, confronted by Russia's invasion of Ukraine, Latvia's GDP growth decreased to 2.8%. It should be noted that this slowdown in growth was nevertheless lower than predicted at the outbreak of the war ([„Komentarze IEŚ”, nr 750](#)). Contrary to the forecasts, the negative effects were felt less in foreign trade and disruptions in supply chains and more in high inflation and production costs, as energy commodity prices on the world markets dramatically increased. In 2023, economic growth is primarily hampered by high inflation, which curtails private consumption and delays the implementation of public investment programs. According to the economic forecasts of the European Commission “European Economic Forecast. Spring 2023”, published in May 2023 for EU member states and covering the years 2022-2024, the GDP will increase by 1.4% in 2023 compared to the previous year. Optimistic scenarios indicate that economic growth should accelerate in the second half of the year when inflation starts to decrease and investments increase. The year 2024 is expected to continue this trend with a projected GDP growth dynamic at 2.8%. It is worth noting that the forecasted GDP growth of Latvia is higher than the EU average in 2023 and 2024 by 0.4 and 1.1 percentage points, respectively, which should be assessed positively. A similar situation is observed when comparing the five-year average growth rates from the periods 2004-2008 and 2014-2018, excluding the period covering the effects of the economic crisis. Generally speaking, these forecasts seem promising for Latvia. Considering that it is a country that felt the effects of the 2008 economic crisis quite strongly, this is certainly a sign that the economy is on the right track for further development.

Factors of economic growth. The dynamically increasing inflation and the slowdown of the employment process decelerated GDP growth towards the end of 2022. The dynamics of investments also decreased which was caused by rising prices in the construction sector and delays in implementing programs funded by the EU. The European Commission forecasts indicate that in 2023 and 2024, private consumption and investments will be the engines of Latvia's economic growth. It has been assessed that the beginning of 2023 brought slower economic growth, as real disposable income decreased due to high inflation (the HICP inflation was 11.3% in 2022), and households struggled with high heating costs. However, it is expected that the reduction of inflation will partially stabilize the purchasing power of households, stimulating consumption. Additionally, in the second half of 2023, an acceleration of investments financed by EU funds is expected, including through the Recovery and Resilience Facility. It is worth mentioning that the Latvian recovery and resilience plan consists of 60 investments and 25 reforms. These will be supported by grants amounting to EUR 1.8 billion: 38% of the plan will support climate objectives and 21% – digital transition. Meanwhile, exports are likely to slow down due to the continuation of the

decline in foreign demand, especially in the construction sector. In 2024, an acceleration of economic growth is forecasted, as the assumed slowdown in inflation should contribute to stimulating private consumption. A further increase in investments financed by EU funds is also expected, and the decrease in the prices of building materials will additionally accelerate this process. It is highly likely that there will be an increase in exports, as the slowdown in inflation in other EU regions will stimulate external demand.

Gradual slowing of inflation. Driven by the rise in energy prices, the HICP inflation grew relatively quickly in Latvia throughout 2022, reaching a level of 17.2% (the average for the EU in 2022 was 9.2%, and in Estonia 19.4%) ([„Komentarze IEŚ”, nr 670](#), [„Komentarze IEŚ”, nr 878](#)). It should be added that both the rise in energy prices and the prices of goods and consumer services peaked in early autumn 2022. It is projected that in 2023, inflation will be at 9.3%, with slightly higher core inflation. It is worth noting that with the expected acceleration of economic growth in the second half of 2023, an increase in tension in the labour market is anticipated, partly due to rising demand. We can expect that during this period there will be a rise in wages, which will also be influenced by an increase in the minimum wage. Meanwhile, in 2024, it is expected that inflation will drop to 1.7%, while core inflation will remain above 2%, mainly due to the rise in service prices. These optimistic forecasts of low inflation reduce economic uncertainty, which can lead to increased investment. It is very likely that businesses will accelerate the implementation of long-term investments due to more predictable costs and profits, which may accelerate growth in the entire Latvian economy.

Forecasted Deficit Reduction in 2023. Due to significantly reduced financial support measures related to the pandemic, Latvia's budget deficit decreased from 7.0% of GDP in 2021 to 4.4% in 2022. It is projected that in 2023 the budget deficit will drop to 3.8% of GDP. This will be due to the continuation of the gradual withdrawal of most of the pandemic-related support measures and slightly smaller budgetary funds needed to mitigate the effects of high energy prices. It should be added that the budgetary cost of financial support in the energy sector is forecasted in the European Commission's Spring 2023 forecast to be 1.0% of GDP in 2023, compared to 1.5% in 2022. The European Commission currently assumes the complete withdrawal of pandemic-related support measures in 2024. At the same time, pressures for deficit increase are caused by expenditures foreseen in the 2023 budget package such as salary increases for administrative and medical personnel, additional funding for oncology, science, and research, and a significant package of public investment for defence and internal security. Additionally, higher expenditures are expected on pensions and benefits as well as for the temporary protection of refugees from Ukraine. The European Commission predicts that in 2024 Latvia's budget deficit will fall to 2.7% of GDP. The forecast also takes into account expenditures financed by grants from the Recovery and Resilience Facility, which are expected to gradually increase from 0.3% of GDP in 2023 to 0.6% of GDP in 2024. The debt-to-GDP ratio is expected to be 39.7% in 2023 and will increase slightly to 40.5% in 2024.

Conclusions:

- Despite facing challenges such as the COVID-19 pandemic and Russia's invasion of Ukraine, Latvia's economy has demonstrated the ability to adapt and maintain economic growth. Long-term forecasts, even in the context of the last two decades, suggest that the Latvian economy is resilient to shocks and retains the ability to achieve sustained growth.
- The year 2023 is a time of challenges for the Latvian economy associated with high inflation and delays in the implementation of public investment programs. Nevertheless, forecasts predict that GDP will increase by 1.4%, a figure higher than the EU average. The forecasts for the second half of the year are particularly optimistic, with a predicted decrease in inflation and an increase in investment.
- In the second half of 2023, a significant acceleration of investments financed from EU funds is anticipated, although export growth is likely to slow down due to a decrease in foreign demand.

- With the predicted economic acceleration in the second half of 2023, an increase in demand in the labour market is expected. In this context, wage increases are also likely, further supported by rises in the minimum wage.
- It is forecasted that in 2023, the budget deficit will decrease to 3.8% of GDP, mainly due to the withdrawal of pandemic-related support measures and a reduction in budgetary funds needed to mitigate the effects of high energy prices.
- Inflation is projected to be 9.3% in 2023 and decrease to 1.7% in 2024. This forecast optimistically signals lower inflation, which can contribute to reducing economic uncertainty and, consequently, increasing investments. Therefore, it can be expected that the economic situation in Latvia will stabilize, and the economy will continue its growth trajectory.