

**Project no.**

513705

**Project Acronym**

CEEC AGRI POLICY

**Project title**

**Agro economic policy analysis of the new member states,  
the candidate states and the countries of the western balkan**

**Instrument** Specific Support Action

**Thematic Priority** Scientific Support to Policies

**Monitoring of economy and policy developments**

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**Authors:** J.Bruņinieks  
G.Salputra

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## 1. Section – Monitoring of economy and policy developments

### 1.1. General overview of agricultural and national economy developments

**1.1. table. Latvia - general data**

		2000	2001	2002	2003	2004	2005	2006*
Total area (inland waters excluded)	thous. ha	6229						
Area under (used) agricultural lands	thous. ha	1587,2	1581,8	1595,5	1581,8	1642,1	n.a.	n.a.
Unused agricultural lands	thous. ha	1790,1	1779	1772	1770	1701,4	n.a.	n.a.
Total population (at the beginning of year)	thous.	2377	2364	2346	2331	2319	2306	2295
in urban areas	% of total	68,1	68	67,9	67,8	67,8	68	68
Rural	% of total	31,9	32	32,1	32,2	32,2	32	32

Source: CSB (Central Statistical Bureau of Latvia)

Estimate of the Central Statistical Bureau

**1.2. table. Key Indicators of Economic Development**

	2000	2001	2002	2003	2004	2005	2006 f
(increase over the previous year, in per cent)							
Gross domestic product	(6,8)	8,0	6.5	7.2	8.5	10.2	8.5
Consumer prices	2,6	2,5	1.9	2.9	6.2	6.7	5.5
(% of GDP)							
General government budget fiscal balance	-2,8	-2,1	-2.3	-1.6	-1.1	-1.0 *	-1.5
Central government debt	13,1	13,8	13.1	13.2	13.2	10.7 *	10.5
Current account balance	-6,9	-9,6	-6.6	-8.1	-12.9	-12.5 e	-9.8
Exchange rate, LVL per euro	0,560	0,563	0.583	0.645	0.671	0.703 *	0.703
Exchange rate, LVL per US dollar	0,606	0,628	0.618	0.571	0.540	0.550 *	0.560
Unemployment rate	7,8	7,7	8,5	8,6	8,5	8,5	7,5 *

Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

(xx) – data comparable conditionally because of change in methodology;

f - forecast of the Ministry of Economics;

e - estimate of the Ministry of Economics;

\* - provisional data.

## 1.2. Macroeconomic development

EU accession provides Latvia with new opportunities for economic development. By joining the single EU market Latvia can benefit from the advantages provided by a broad and stable market, free movement of goods and services, labour and capital, i.e., the most favourable terms on the EU market. Support from the EU funds mitigates the effect of structural changes in the economy and helps to reduce the social and economic disproportion.

To ensure balanced development the government is resolved to reduce the budget deficit gradually intending in this way to reduce the current account deficit. The Bank of Latvia implements de facto the policy of the fixed (to the €) exchange rate of the national currency. This reduces uncertainty, averts the currency risks and provides a stable ground to entrepreneurs for planning.

Growth rates in the Latvian economy have been very rapid in recent years. The reforms carried out in the country and integration into the EU has made a positive impact on economic development. In the period between 2001-2005 GDP grew on average by 8% annually. The high growth rates in Latvia are based on the steady increase of domestic demand and export growth.

Economic activity is improving in all main economic sectors. Domestic demand invigorates the development of services especially the development of trade and construction. High growth rates can also be observed in the transport and communications sectors. Manufacturing output in the period between 2001-2004 rose on average by 9% per year.

Economic growth in Latvia was achieved in a stable macroeconomic environment. The general government budget deficit in Latvia is low and does not exceed the level set by the Maastricht criteria. The Parliament has confirmed the general government budget deficit for 2006 at 1.5% of GDP. Although the current account deficit is comparatively large, it should not be considered today as critical as it is covered by foreign direct investment and long-term loans.

A relatively high level of inflation has been observed in recent two years. Its rise in 2004 was accounted for by a combination of several one-off effects (an increase in the administratively regulated prices, harmonisation of the indirect tax rates, inflation expectations due to EU accession and the high oil prices on the global scale). Inflation in 2005 remained on a high level owing mainly to the rises in the global oil prices and the second phase of inflation (spiral). According to forecasts, due to the diminishing influence of the aforementioned price-raising factors, inflation will decrease gradually.

The employment and unemployment indicators are gradually improving. In recent years the number of employed has been rising every year while the unemployment rate has decreased from 14.4% in 2000 to 10.4% in 2004 and in the 4th quarter of 2005 it was 7.8%.

In recent years Latvia has shown high GDP growth rates. The growth rate in 2005 was very rapid - 10.2%. Similarly as in the previous periods, the main reason for growth was the stable domestic demand and, to a lesser degree, the increasing export of commodities and services.

The volume of private consumption has increased. Private consumption is spurred not only by the annual wage increase but also by the availability of consumer credits to private persons at acceptable interest rates as well as credits for dwelling purchase and repair. Private consumption in the three quarters of 2005 exceeded the level of the corresponding period of 2004 by 8.8%.

The favourable financial situation (low interest rates on loans and expanding mortgage lending) encourages investing. Gross fixed capital formation in the three quarters of 2005 was considerably higher (by 21.5%) than in the corresponding period of the previous year.

Growth in agriculture was 4.5% in 2004 and 4.3% in the first 9 months of 2005. Low productivity and external competition are the main obstacles to development of this sector. Development of agriculture will depend on adjustment of agricultural production facilities and products to the EU standards and quality criteria and on the external demand.

Nearly 80% of GDP growth was on account of the development of the services sector fostered mainly by the development of the trade and communications sectors.

### 1.3. GDP by Sectors

**1.3. table. GDP increase over the corresponding period of the previous year, %)**

	2000	2001	2002	2003	2004	2005			
						I	II	III	IV
GDP	6,8	7,9	6.5	7.2	8.5	7.3	11.4	11.4	10.5
Agriculture <sup>1</sup>	11,3	6,3	4.4	-2.4	4.4	-0.9	5.2	4.8	4.5
Industry	4,4	9,6	8.1	6.0	7.3	0.2	8.0	8.0	7.7
Construction	8,2	6,1	10.8	13.7	13.0	16.2	15.8	15.6	14.4
Trade <sup>2</sup>	9,2	10,8	11.9	10.9	10.3	15.2	18.7	17.5	17.6
Transport and communications	7,0	9,5	3.4	8.9	12.9	11.1	18.8	18.4	15.9
Public services <sup>3</sup>	0,2	1,6	2.4	3.8	3.9	2.7	4.0	1.5	2.8
Other services	10,8	9,9	5.4	5.7	7.7	5.4	8.2	9.9	8.7

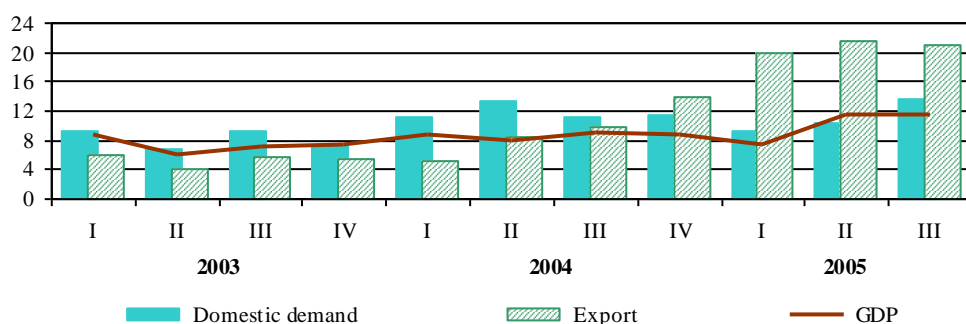
Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

*1 Including forestry and fishing*

*2 Including hotels and restaurants*

*3 Public administration including healthcare and education*

**Figure 1.1. Quarterly Changes in Real GDP and Major Expenditure Items, (% of the corresponding quarter of the previous year)**



Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

## 1.4. Inflation

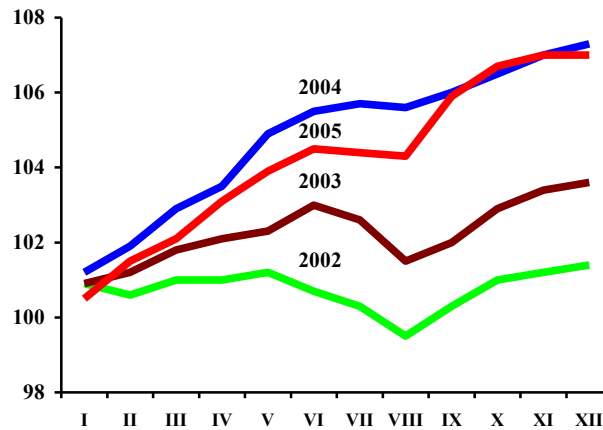
In the period between 1998-2003 consumer price growth in Latvia was close to the inflation level in the developed countries and was one of the lowest among the central- and east-European countries. In 2004 the inflation rate accelerated sharply in Latvia. Inflation in 2004 reached 7.3% (12-month inflation, December over December) and was one of the highest among the EU member states.

In 2005 inflation was 7% (12-month inflation, December over December), of which 7% for goods and 6.9% for services. In the first half of 2005 the inflation rate showed a decreasing trend, but the steep rise in the prices of fuel raised the overall price level substantially by 1.5% (compared to August 2005) and as a result the 12-month inflation mounted to the high level of the previous year.

In parallel with the increase in oil product prices the sharp price rise in 2005 was also due to the increase in the prices of food products related to Latvia's alignment with the common EU agricultural policy, the high exchange rate of the euro, which raised the prices of imported goods considerably and the sufficiently high second-phase effect of inflation.

## 1.5. Consumer Price Index

Figure 1.2. Consumer Price Index. (December of previous year = 100)



Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

## 1.6. Manufacturing

Recent years (2001-2005) have witnessed steady growth in manufacturing, and with the annual growth rate reaching 8%, the increase in manufacturing can be put on the same level as the overall economic growth. Straight after EU accession growth rates in manufacturing decreased and some time had to pass until the enterprises adjusted to the new trade conditions. A remarkable growth started again in May 2005.

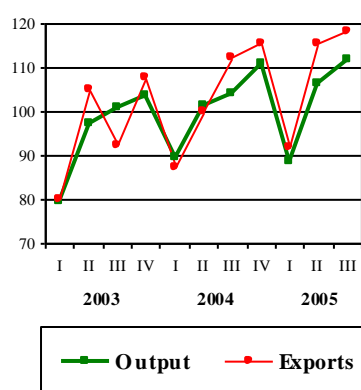
Those sectors, where trade outlets were relatively less connected with `exports, witnessed faster growth in 2005, except the food industry. For example, the growth rates were about 25% in the manufacture of construction materials, 12% in printing and 15% in the chemical industry.

Output of the food industry, the biggest manufacturing sector of Latvia contributing on average a quarter of the total value added in manufacturing, increased in 2005 by 5.1%. Approximately 80% of the products manufactured in this sector are consumed on the local market and the rest is exported, mainly to Estonia, Lithuania and Russia. In 2004 demand for Latvian foodstuffs increased in all trade directions – both to Russia and other CIS countries and to the EU. Exports to the EU member states increased more than 1.5 times mostly due to the increased demand in Estonia and Lithuania. Exports of food products to Lithuania and Estonia constitute almost two-thirds of the total exports of Latvian food products to the EU member states. Growth in the food industry in 2005 was slightly more moderate than in the previous year (by 4.5% in 10 months of the year) owing to a more moderate export expansion. The export of food products increased mainly in the direction of Lithuania and Estonia.

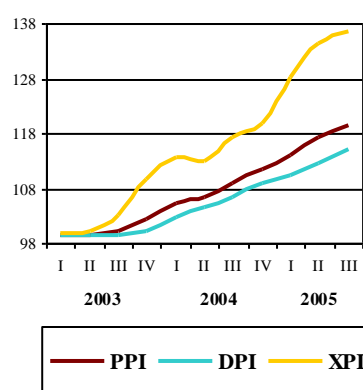
Export prices grew very rapidly in 2004, while prices for products sold in the domestic market increased more moderately. This trend continues also in 2005. Export prices in the 3rd quarter of 2005 were by 16% higher than in the 3rd quarter of the preceding year, while producer prices for products sold in the domestic market exceeded the level of the previous year by 8%.

## 1.7. Food Industry Indicators

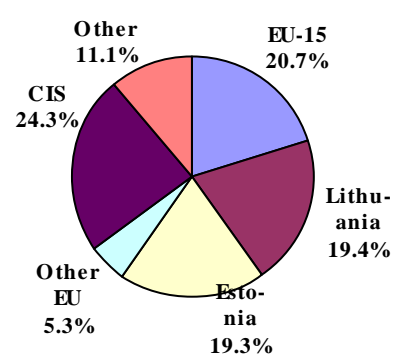
**Figure 1.3. Output and exports**  
(4th quarter of 2002 = 100)



**Figure 1.4. Producer\* price changes**  
(4th quarter of 2002 = 100)



**Figure 1.5. Exports by groups of countries**  
(January-November 2005)



Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

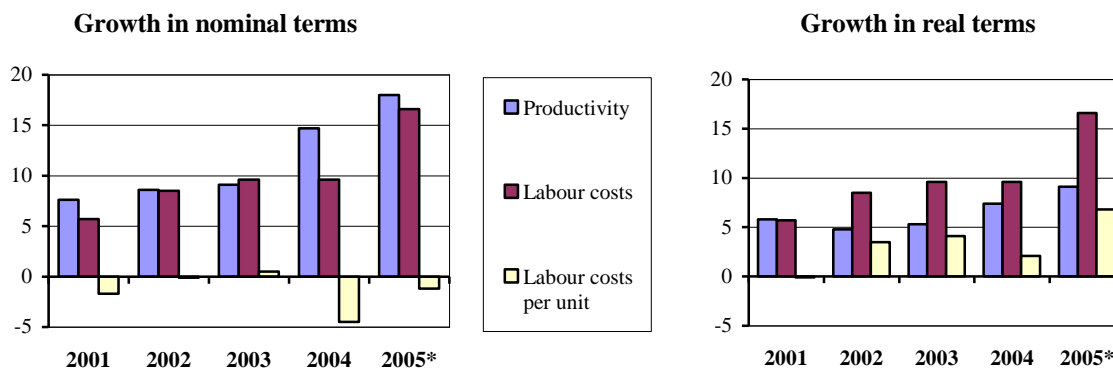
\* PPI – producer price index, DPI – producer price index for products sold in the domestic market, XPI – producer price index for exported products

### 1.4. table. Dynamics of Investment in Food Industry

	Growth rates (% over previous year)			Structure (% of total)		
	Average 2001-2004	2004	9 months of 2005	Average 2001-2004	2004	9 months of 2005
Food industry	13.9	5.4	5.6	29.3	30.5	27.4

Source: Ministry of Economics

**Figure 1.6. Labour Costs (economy-wide) (percentage changes against the preceding year)**



Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

## 1.8. Foreign trade

The value of Latvian commodity exports in 2005 was much higher (by 34%, at current prices, in LVL) than in the previous year. The increase in the value of imports was, in turn, slightly less conspicuous by 27%.

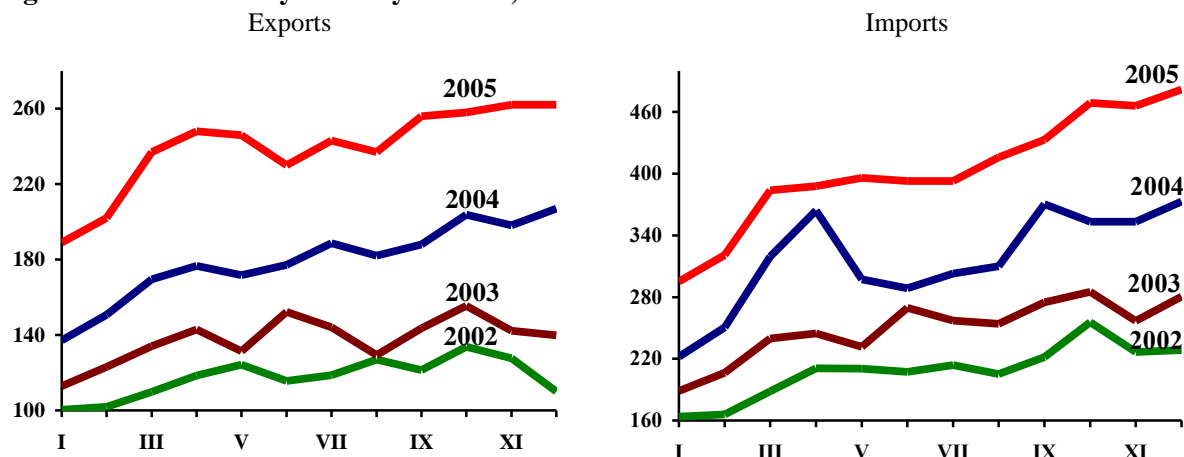
The sharp increase in the export unit value in 2005, which in comparison with the previous year exceeded 10%, made a favourable impact on commodity exports. The price increase was accounted for by the rise in world prices for several commodity groups, especially for food and mineral products. Exports in 2005 increased substantially on all the markets trading Latvian goods, especially in the direction of the new EU member states.

After accession to the EU Latvia's foreign trade with Lithuania and Estonia has increased very rapidly. A comparison with EU pre-accession period shows that within two years Latvia's foreign trade with other Baltic states has more than doubled.

Agricultural and food products constitute 12,2% of overall value of exports (2005).



**Figure 1.7. Commodity trade by Months, mln lats**

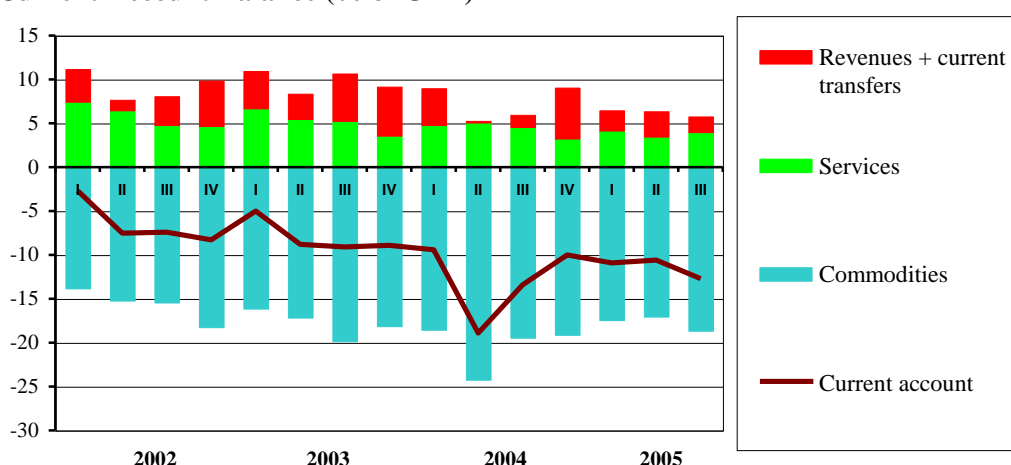


Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

There is a relatively large current account deficit in Latvia. The main source of the deficit is the markedly negative trade balance. The positive balance on services covers about one fifth of the deficit. The negative current account balance is covered mainly by foreign direct investment and other long-term capital flows.

In 2004 the trade balance worsened, with commodity imports outpacing commodity export growth. This was primarily due to the growing domestic demand and stockpiling of goods before accession to the EU, as well as owing to several one-off purchases of large-scale investment goods. Compared to the corresponding period of the previous year, the negative trade balance against GDP in the 9 months of 2005 decreased because of the improving trade balance.

**Figure 1.8. Current Account Balance (% of GDP)**



Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

## 1.9. Employment and unemployment

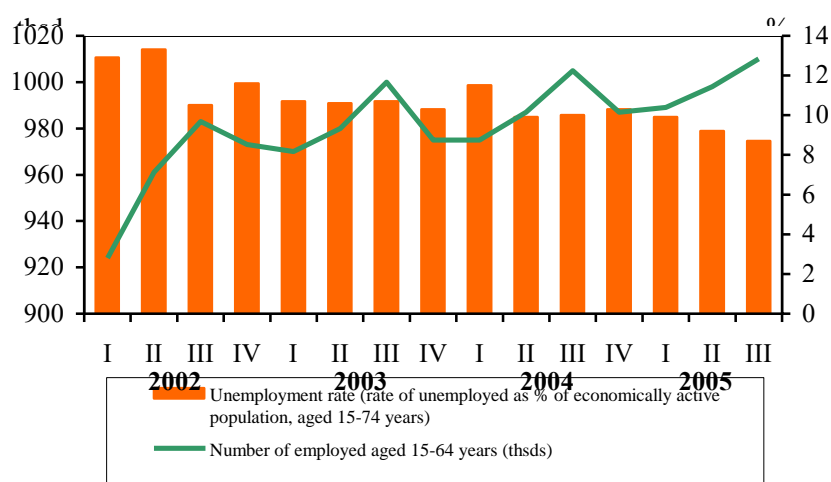
Economic development in recent years has positively influenced the situation in the labour market. Although the number of working age population decreases, the number of economically active population is rising and the employment rate is also increasing.

In five year period (2000 - 2004) the employment rate increased by 4.8 percentage points. In comparison with EU average, the employment rate in Latvia was lower by 4.9 percentage points, whereas in 2004 it lagged behind only by 1 percentage point. The employment rate in 2005 continued to rise and reached 63.1% (results of the first three quarters), which is by 0.8 percentage points higher compared to the corresponding period of 2004.

According to CSB Labour Force Survey data, the unemployment rate has decreased from 14.4% to 10.4% in 2004 in comparison with 2000. The unemployment rate in the 4th quarter of 2005 was 7.8%. The highest unemployment prevails in the Latgale region (12.8% in 2004) and this is due to the poorly developed entrepreneurship, the low number of self-employed and bad traffic infrastructure.

At the end of 2005 the registered unemployment rate in Latvia was 7.4%, a considerably lower level compared with the previous year (8.5%).

**Figure 1.9. Number of Employed Persons (thsd) and Rate of Unemployed.**



Source: CSB (Central Statistical Bureau of Latvia) and Ministry of Economics;

**1.5. table. Number of Employed Persons by Kind of Activity (thousand persons, aged 15-64)**

	2000	2001	2002	2003	2004	3 <sup>rd</sup> quarter of 2005
Total	917.6	937.5	962.5	981.5	988.2	998.8
Agriculture	104.4	107.4	103.4	96.7	88.5	80.1

Source: Labour Force Surveys, (Central Statistical Bureau of Latvia) and Ministry of Economics;

## 1.10. Aggregate growth of Agricultural sector

Examining the changes of value of the most significant agricultural products it's evident, that in 2004 the main sectors experienced essential growth, except pig breeding. If the increase of price was the principal reason for the milk, then area payments and partially also the augment of amount - for the grain. In its turn the increase of prices, amount, as well as of assistance provided augment for cattle breeding.

**1.6. table. Dynamics of the value of final products in 2000 - 2004 (mill. LVL, at basic prices)**

	2000	2001	2002	2003	2004	2005
<b>Milk</b>	56,7	65,8	69,1	64,0	89,7	
<b>Pork</b>	28,5	35,3	33,7	35,8	34,9	
<b>Beef</b>	13,9	26,7	21,0	16,7	25,3	
<b>Grain</b>	52,1	49,1	55,8	59,9	78,1	

Source: (State Institute for Agricultural Economics of Latvia, SIAEL)

For this section, each country will provide a concise and specific country report that will be annexed to the main report. The main report will present a synthesis of the main points identified by the national contributions.