

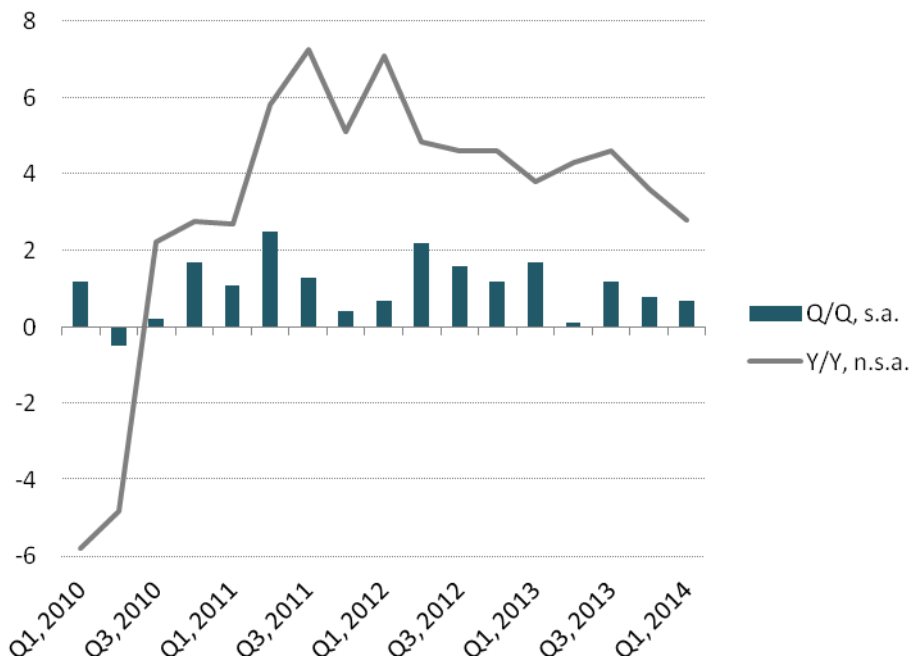
Snapshot

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Latvia: slowdown continued in Q1 2014, but growth is likely to improve

According to preliminary data, GDP grew by 2.8% YoY in Q1, 2014. This is the slowest pace since Q1 2011 and is likely to remain the lowest point of relative weakness that started in Q2, 2013. Annual GDP growth rate in remaining quarters will be helped by more favourable base effects - quarterly growth rate in Q1 2013 was 1.7%, but in Q2 growth fell to just 0.1%, partly due to *Liepājas Metalurģs* insolvency. Incoming data (for example, confidence indices, corporate news) suggest that in Q2 this year the growth will be stronger. Retail trade growth was sluggish in the beginning of 2014 probably due to the psychological effect of euro — nominally larger prices, but this effect is diminishing from month to month. Construction industry is in a cyclical upswing, funds allocated to road construction are up this year. Other manufacturing sectors have offset the almost complete collapse of metal production and are poised for further growth.

Chart. Annual growth rate (seasonally adjusted) and quarterly growth rate (not seasonally adjusted) since 2010



The biggest source of uncertainty is obviously the Ukraine crisis and the associated risk of economic sanctions between Russia and EU. However, the danger is less acute now than in the beginning of the crisis. Russia has proceeded more cautiously to preserve its crucial economic interests that have come under threat. So far production and trade data does not show any strong negative effect on production and exports in sectors that are sensitive to the Russian market — fish and milk processing, light industries, pharmaceuticals. The effect on transit has been surprisingly positive as part of Russian and Belorussian traffic is diverted from Ukraine ports.

It is likely that the flash Q1 GDP estimate will be revised slightly upwards in June. Statistics Latvia says that services (apart from retail and construction) grew by 3% - that seems low on the basis of our industry knowledge and reported data about transit volumes. Reported manufacturing growth (1.0%) is close to the reported change in output (0.3%) though the difference between output and added value growth might have been bigger due to structural changes in the sector. The main change is that previously large metal production sector has declined by >4/5 and it was characterized by very low share of value added in the output.

We are still working on our updated forecasts, but on the basis of our present knowledge Latvia's GDP growth in 2014 is likely to be slightly above 4%.