MONITORING REPORT No. 6

08.07.- 07.08.2020.

SUMMARY

1. Preliminary data suggest that in the second quarter of 2020, the EU experienced its worst economic downturn in history. The economies of Lithuania and Latvia have suffered much less than Spain, Portugal, France and Germany.
2. With the phasing out of restrictions introduced in the first months of the year, total EU retail sales returned to February 2020 levels in June. The data also show that construction is recovering faster than industry.
3. EU leaders have agreed on a European recovery plan and multiannual financial framework for 2021-2027 in amount of € 1.8 trillion. If approved, the European Parliament will provide significant support to the Member States hardest hit by the crisis and lagging behind. At the same time, there are concerns about the reduction of resources for the EU's overall investment in the environment and science and other aspects that are the subject of intense debate in the European Parliament.
4. Although in Latvia the confidence indicators are still in the range of negative values, compared to June, the confidence indicator has significantly improved in the retail sector (+ 8.6%). Confidence has also improved in the services (+5.8) and industrial sectors (+5.1). However, the improvement in confidence in the industrial sector does not correlate with the weak performance of the industrial sector itself this year in the 2nd quarter.
5. The mitigation of the effects of Covid-19 has required a rapid inflow of funds into the economy, both through redeployment of EU funds and through borrowing, which has led to a sharp and unplanned increase in debt levels. According to the CSB data, in the 1st quarter of 2020, the value of general government debt reached 11.29 billion euros. Operational data from the Treasury show that since the declaration of the state of emergency in March, the government debt has increased by about 2 billion (1.998 billion) euros.
6. Tax collection continue to improve. In July 2020, more taxes were collected in the basic budget than in July 2019. The special budget is also performing relatively well. In all likelihood, it can be concluded that the lowest point of tax revenue compared to the previous year is already behind us.
7. The government has continued to develop its program of economic support measures, with the planned budgetary impact of the support measures already reaching 9% of GDP, which is relatively high.
8. Interest rates are projected to remain low in the near term, facilitating government debt servicing and refinancing[1]. However, there is a need to be aware of the risks involved and to shape fiscal policy accordingly.
9. In the 1st quarter of 2020, household savings increased by 3.5 percentage points compared to the 1st quarter of 2019, while consumption decreased by 1.7% and real income increased by 2.4%.[2] Data from the Bank of Latvia also confirm that this year in June, compared to June 2019, deposits from residents increased by

[1] Mortens Hansens "Koronaekonomika: vai virzāmies uz jaunu krīzi?",03.08.2020., https://ir.lv/2020/08/03/koronaekonomika-vai-virzamies-uz-jaunu-krizi/.

[2] Eurostat, "Impact of COVID-19 on household consumption and savings," 06/08/2020, https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20200806-2?inheritRedirect=true&redirect=%2Feurostat%2Fnews%2Fwhats-new.

10%. From these facts it can be concluded that state support measures have been effective for at least a large part of the Latvian population, and they also indicate the postponed consumption and savings of the population in conditions of uncertainty.

The Council generally welcomes the government's actions and measures to address the effects of the crisis, but calls on the government to take into account the following:

1. The country's existing and planned support to the economy has reached a significant level. Tax collection is improving and there are signs of economic recovery. Under these circumstances, the government should limit the development of new economic stimulus measures and start thinking about fiscal sustainability. However, OECD Secretary-General Angel Gurria urges countries not to repeat the mistakes made in tackling the previous financial crisis: “The current action of governments to relax the fiscal package is justified, but high deficits and low GDP will result in a much higher debt burden. Strong fiscal support is needed, but it will have consequences. Governments will have to reduce public debt in the future, and yet they should not repeat the mistakes made after the last crisis and try to cut spending or raise taxes too early. Public spending needs to be well targeted to support the most vulnerable and provide the investment needed for a sustainable recovery. " The Council wishes to emphasize the need to start thinking about a gradual reduction in public debt, but agrees with the government's position not to pursue radical spending cuts and to speed up tax reform, which is fully in line with OECD recommendations.

2. There is a need for more effective monitoring of the granting of state aid instruments. Altum has been granted substantial financial responsibility. In the interests of good governance and the prevention of financial risks, information on the aid instruments granted and the projects approved by Altum must be made publicly available. It is also desirable to plan audits of support measures and expenditure in a timely manner.

ANALYSIS

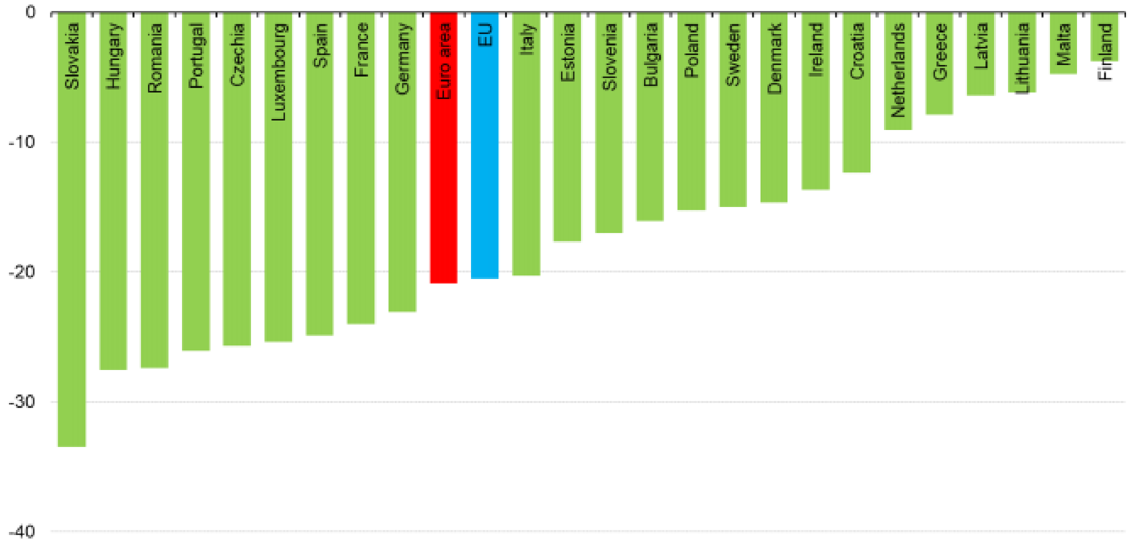
1. General Development

Preliminary data compiled by Eurostat on GDP growth in the second quarter of 2020 suggest that GDP in the EU as a whole has declined by 11.9% and in the euro area by 12.1% quarter on quarter. On an annual basis, compared to the second quarter of 2019, EU GDP has decreased by 14.4% and in the euro area by 15%. The economies of Spain (-18.5%), Portugal (-14.1%) and France (-13.8%) have suffered the most. Germany has also seen a record drop of 10.1%. Lithuania has suffered the least (-5.1%). Latvia's GDP in the second quarter could have decreased by 7.5% compared to the first quarter.[3] At the same time, Eurostat data show that EU retail sales increased by 5.2% in June compared to May 2020 and by 1.3% compared to June of the previous year, due to the lifting of restrictive measures imposed due to the Covid-19 pandemic.

[3] Eurostat Newsrelease Euroindicators 121/2020, 31 July 2020, https://ec.europa.eu/eurostat/documents/2995521/11156775/2-31072020-BP-EN.pdf/cbe7522c-ebfa-ef08-be60-b1c9d1bd385b.

Respectively, in June, retail trade returned to the level of February 2020. The data also show that the construction sector is recovering better than industry. For example, in May, compared to April, construction volumes increased by 21.2% in the EU and by 27.9% in the euro area, and in industry by 11.4% and 12.4%, respectively. However, on an annual basis, compared to May 2019, there is still a significant decline in both construction and industry: -11.9% and -20.9% in the euro area, respectively.

1.1. picture. Industrial production in EU Member States, May 2020 against May 2019,%



Source: Eurostat Newsrelease Euroindicators, 112/2020, 14 July 2020

Looking back at the first quarter of 2020, Eurostat reports that in the first quarter of 2020, value added and hours worked had declined in all sectors of the economy, but the largest declines were in trade, transport, hotels and catering, and the arts and crafts sector as well as in the field of entertainment.[4] Eurostat's analysis shows that in the first quarter of this year, the population made savings in all EU member states and the euro area. The reasons for this phenomenon are uncertainty about future income and the desire to accumulate funds to insure against loss of income. For example, in the first quarter of 2020, the household savings rate increased by 3.5 percentage points compared to the first quarter of 2019, while the consumption rate decreased by 1.7% and real income increased by 2.4%.[5] Data from the Bank of Latvia also confirm that

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[4] Eurostat, "National Accounts: COVID-19 impact on EU industries," 05/08/2020, https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20200805-1?inheritRedirect=true&redirect=%2Feurostat%2Fnews%2Fwhats-new.

[5] Eurostat, "Impact of COVID-19 on household consumption and savings," 06/08/2020, https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20200806-2?inheritRedirect=true&redirect=%2Feurostat%2Fnews%2Fwhats-new.

this year In June, compared to June 2019, deposits from residents increased by 10%[6]. Tax cuts and social benefits have boosted real incomes, despite rising unemployment (7.1% in the EU and 7.8% in the euro area in June [7]) and falling wages.[8]

Many European countries, including Latvia and Lithuania, have experienced some local Covid-19 outbreaks. Restrictions on the movement of people have been renewed for a number of countries, such as the requirement to stay in quarantine after visiting these countries.[9] Consequently, the development of the Covid-19 pandemic is difficult to predict, which in turn poses significant risks to economic recovery, especially in tourism.

Following lengthy negotiations, EU leaders agreed on 21 July on a comprehensive financial package of € 1,824.3 billion, combining the Multiannual Financial Framework (MFF) of € 1,074.3 billion and an emergency recovery effort of the Next Generation EU ("NGEU") instrument of € 750 billion. . Of this money, 80 billion will go to Italy, 70 billion to Spain and 47.5 billion euros to EU Member States in Central and Eastern Europe. The grant component of this financial package amounts to only EUR 390 billion (compared to the EUR 500 billion initially proposed by the European Commission). The reduction in funding has come at the expense of horizontal EU policies - environmental protection, scientific development and total investment. According to experts, in the long run it will have a negative impact on the economic development of the EU and widen the economic gap between the north and the south of the Union.[10] The leadership of the European Parliament, whose approval of this financial package will be needed, has also signaled Members' dissatisfaction with such a reduction in funding. It is also unacceptable for Parliament not to make greater use of common EU resources to fund this package.[11] Negotiations on this financial package will continue in the autumn and, subject to the European Parliament's objections, may change.

The difficult negotiations have ended on favorable terms for Latvia - Latvia will receive almost 8 billion euros from the EU's multi-annual budget over the next seven years. In addition, EU recovery funding will be available, amounting to around € 2.47 billion in grants, and the same amount of funding will be available in soft loans. It will be an unprecedented opportunity for the Latvian state to eliminate the consequences of the Covid-19 crisis, modernize and make the country's economy greener - without a direct impact on the General Government Budget Balance (SGBBB), as the European Commission plans to repay the loan from its own revenues. At EU level, this is a historic event, as EU Member States have, for the first time, decided to borrow large amounts of money together in the financial markets. Work is currently underway on the technical details of the EU's Recovery Instruments and the budget has yet to be approved by the European Parliament. However, funding for the new instrument is expected to be available to Member States as early as next year.

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[6] MFI balance sheets and monetary statistics [https://www.bank.lv/statistika/dati-statistika/mfi-bilances-un-monetara-statistika-k]

[7] Eurostat Newsrelease Euroindicators 119/2020, 30 July 2020, https://ec.europa.eu/eurostat/documents/2995521/11156668/3-30072020-AP-EN.pdf/1b69a5ae-35d2-0460-f76f-12ce7f6c34be.

[8] Eurostat Newsrelease Euroindicators 118/2020, 28 July 2020, https://ec.europa.eu/eurostat/documents/2995521/11146677/2-28072020-AP-EN.pdf/41ab3dee-a9dd-6827-46c9-595050ea3d31.

[9] The Center for Disease Prevention and Control (SPKC) informs that starting from 31.07. travelers must comply with the quarantine regime of the following countries: Luxembourg, Romania, Andorra, Spain, Bulgaria, Belgium, Sweden, Portugal, Malta, Monaco, the Czech Republic and Croatia. https://www.spkc.gov.lv/lv/valstu-saslimstibas-raditaji-ar-covid-19-0/valstu-sarakstam-lv.pdf

[10] "The big quid pro quo," *Eurointelligence Professional Daily Morning Newsbriefing*, 27 July 2020.

[11] European Parliament, "EU long-term budget deal must be improved for Parliament to accept it," Press Release, 23 July 2020, https://www.europarl.europa.eu/news/en/press-room/20200722IPR83804/eu-long-term-budget-deal-must-be-improved-for-parliament-to-accept-it.

2. Macroeconomic situation in Latvia

2.1 GDP Dynamics

As predicted, the greatest impact of the Covid-19 pandemic on the economy was observed in the 2nd quarter of 2020. Unlike until recently, incl. Popular in Latvia, the assumption that the impact of COVID-19 will start to decrease already this year. In the second half, the European Central Bank has already included new risk factors in June, when updating its macroeconomic forecasts: The ECB's baseline scenario assumes that "the virus will be only partially controlled and recurrence will occur in the coming quarters, necessitating prolonged restrictive measures until a medical solution is found (assuming this could be in mid-2021)."

The ECB forecast weakening supply and demand, high uncertainty and deteriorating labor market conditions, which will have a negative impact on household and business spending. According to the ECB, real GDP in the euro area will contract by 8.7% in 2020, before growing again in 2021 (5.2%) and 2022 (3.2%). This implies that real GDP will be around 4% lower than projected by the ECB in March 2020 at the end of the projection horizon.[12].

The latest published OECD Economic Outlook also models two equally possible scenarios, one in which the second wave of Covid-19 with repeated strict restrictions will take place by the end of 2020, and the other in which the second wave of Covid-19 is eliminated. Latvia's GDP is forecast to decrease (-8.1%), while in the second case it is projected to decrease (-10.2%). Maastricht debt growth for Latvia is forecast (+ 8.35%) if the second Covid-19 outbreak does not occur, but in the event of a second wave of pandemics, debt could increase by 14%[13].

2.1.1. picture. Forecasts of macroeconomic indicators for Latvia in the assessment of various institutions

Real GDP growth, %	2020	2021	2022	Last update
MoF	-7,0	5,1	3,1	Jun 2020
BoL	-7,5	6,7	5,0	Jun 2020
EC	-7,0	6,4	x	Jul 2020
IMF	-8,6	8,3	x	Apr 2020
Swedbank	-7,5	4,3	x	Mai 2020
SEB Bank	-9	5,0	x	Mai 2021
Average	**-7,8**	**6,0**	**4,1**	
Inflation, %	**2020**	**2021**	**2022**	
MoF	0,2	1,2	2,0	Jun 2020
BoL	0,0	0,2	1,3	Jun 2020
EC	0,4	0,2	x	Jul 2020
IMF	-0,3	3,0	x	Apr 2020
Swedbank	0,1	1,6	x	Mai 2020
SEB Bank	0,3	1,8	x	Mai 2021
Average	**0,1**	**1,3**	**1,7**	
Unemployment rate, %	**2020**	**2021**	**2022**	
MoF	10,5	9,8	8,1	Jun 2020
BoL	9,6	10,3	9,6	Jun 2020
EC	x	x	x	Jul 2020
IMF	8,0	6,3	x	Apr 2020
Swedbank	9,5	8,5	x	Mai 2020
SEB Bank	10,5	9,5	x	Mai 2021
Average	**9,6**	**8,9**	**8,9**	

Sources: MoF[14], BoL[15], EC[16], IMF[17], Swedbank[18], SEB bank[19]

In the 2nd quarter of 2020, compared to the 2nd quarter of 2019, the volume of gross domestic product (GDP) in Latvia has decreased by 9.8% according to seasonally and calendar-adjusted data, according to the quick preliminary assessment of the Central Statistical Bureau (CSB). Compared to seasonally and calendar adjusted data for the first quarter of 2020, GDP decreased by 7.5% in the second quarter.[20]

As Latvia's economy is closely linked to Lithuania and Estonia, Latvia's ability to recover quickly will depend in part on factors affecting neighboring economies. The following is a brief overview of the impact of these factors on the economies of the Baltic States, based on the materials of the European Commission's Summer 2020 forecast.

As shown in 2.1.1. table below, the set of factors influencing the Baltic economies is quite different, mainly because the downturn occurred when the economies were in different "starting" positions. For example, Lithuania's relatively good performance in the first quarter is due to strong GDP growth in the first months of the year. As Lithuania is one of Latvia's most important export partners, growth in Lithuania also had a positive effect on Latvia. Estonia, on the other hand, experienced a sharper decline, as its economy suffered the most from declining exports to other countries.

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12 Eurosistēmas speciālistu 2020. gada jūnija makroekonomiskās iespēju aplēses euro zonai, https://www.ecb.europa.eu/pub/projections/html/ecb.projections202006_eurosystemstaff~7628a8cf43.lv.html.

13 OECD Economic Outlook https://www.oecd.org/economic-outlook/june-2020/?utm_source=facebook&utm_medium=social&utm_campaign=ecooutlookjun2020&utm_content=en&utm_term=pac

14 FM Galvenie makroekonomiskie rādītāji un prognozes, https://www.fm.gov.lv/lv/sadalas/tautsaimniecibas_analize/tautsaimniecibas_analize/galvenie_makroekonomiskie_raditaji_un_prognozes/

15 Latvijas Bankas prognozes, [https://www.bank.lv/darbibas-jomas/monetaras-politikas-istenosana/prognozes.

16 EK Summer 2020 (Interim) forecast, https://ec.europa.eu/info/sites/info/files/economy-finance/summer_2020_economic_forecast_-_statistical_annex.pdf.

17 World Economic Outlook Database, https://www.imf.org/external/pubs/ft/weo/2020/01/weodata/index.aspx.

18 SWEDBANK ekonomikas apskats, https://www.swedbank-research.com/latvian/ekonomikasapskats/2020/q1_1/index.csp.

19 SEB Latvijas ekonomikas prognozes, https://www.seb.lv/infotelpa/analitika/latvijas-ekonomikas-prognozes.

20 CSP IKP novērtējums, https://www.csb.gov.lv/lv/statistika/statistikas-temas/ekonomika/ikp/meklet-tema/2721-ikp-atrais-novertejums-2020-gada-2-ceturksni.

2.1.1. table. The main positive / negative factors in the Baltic economies under the influence of Covid-19

Latvia		Lithuania		Estonia	
2020 GDP	2021 GDP	2020 GDP	2021 GDP	2020 GDP	2021 GDP
-7.0 (P)	6.4 (P)	-7.1 (P)	6.7 (P)	-7.7 (P)	6.2 (P)
(-)Due to the uncertainty of income and job opportunities, consumers save and avoid buying durable goods.		(-) A more pronounced economic downturn is expected in the second quarter, as quarantine measures in Lithuania and abroad disrupt traditional consumption patterns and have a negative impact on investment and international flows of goods and services.		(-) GDP fell faster than projected in the first quarter. The Estonian economy is strongly affected by declining exports and the slow recovery of partner countries. Pessimism in the manufacturing sector remains high.	
(-) Latvia needs more time to renew ties with European trading partners.		(-) In April, exports of goods fell by almost a quarter, while industrial production fell by 8% compared with March.		(-) In the first quarter, growth in household consumption came to a halt and investment in business equipment declined.	
(-) Exports and investment are expected to be delayed in the third quarter as entrepreneurs wait for support measures to become available.		(-) Facilitating mobility will also face a high degree of uncertainty for businesses and households. This will mean shorter term contracts and lower investment for companies		(-) The Estonian labor market has reacted relatively sharply to the deteriorating economic situation. At the end of June, the registered unemployment rate reached almost 8%, compared to 4.7% a year ago. Many companies have either eliminated jobs, reduced wages, or implemented both. Unemployment growth slowed in May and June thanks to state support programs.	
(+) Consumption trends improved slightly in May due to a gradual easing of restrictions.		(+) Real GDP in Lithuania was relatively good in the first quarter of 2020, compared with the euro area as a whole, declining by only 0.3%. Strong growth in January and February offset the impact of Covid-19 in March.		(+) Construction is not significantly affected and continues to grow.	
(+) The growth of public consumption is maintained by the demand of the health care sector.		-		(+) Imports declined faster than exports, increasing the current account surplus.	
(+) At the end of the year, work on Rail Baltica will resume, which will stimulate growth.		-		(+) The decline in GDP was mainly driven by factors unrelated to Covid-19, such as the decline in energy production and the impact of the decline in automotive fuel stocks in 2019. Q4	

Source: European Economic Forecast Summer 2020[21]

2.2 Exports

According to the CSB data, in May 2020, due to the epidemiological crisis caused by Covid-19, Latvia's foreign trade turnover amounted to 1.93 billion euros, which was 24.1% less in real prices than a year ago, including a 16.8% decrease in exports and a 16.8% decrease in imports. 29.6%[22].

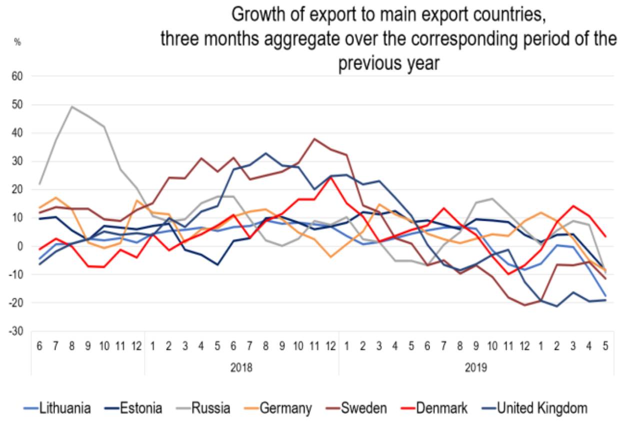
As shown in 2.2.1. In the figure, Latvia's exports continue to decline and a particularly worrying situation is emerging for the Baltic States, which confirms the assumption that Lithuania, which has always been an important trading partner for Latvia, is currently feeling the effects of Covid-19 on the economy. In May, the volume of trade with Lithuania decreased by -17.5%. Exports to Estonia have similarly weak results (-8.4%), which raises concerns about Latvia's exports to neighboring countries. In this context, the fact that the EC has approved a decision on state aid to Latvian exporters affected by Covid-19 is positive news. The support is intended for companies

[21] European Economic Forecast Summer 2020, Institutional Paper 132, July 2020, https://ec.europa.eu/info/sites/info/files/economy-finance/ip132_en.pdf.

[22] CSP, https://www.csb.gov.lv/lv/statistika/statistikas-temas/areja-tirdznieciba/apkopojums/meklet-tema/2715-latvijas-areja-tirdznieciba-2020-gada-maija.

in the amount of 25% of the social contributions made in 2019 and can reach up to 800 thousand euros.

2.2.1. picture. Exports and imports by Combined Nomenclature sections and countries, groups of countries and territories by month



Source: CSB AT051m.

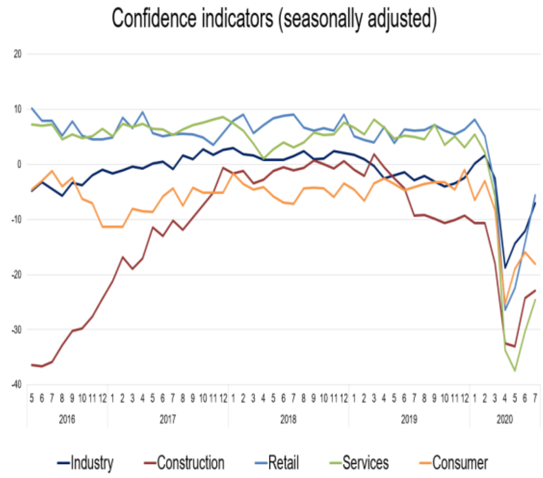
In May, Latvia's most important export partners in trade with the European Union countries were Lithuania (17% of total exports), Estonia (12.1%), Germany (7.6%) and Sweden (7.1%). The most important import partners are Lithuania (19.1% of total imports), Poland (10.3%), Germany (9.4%) and Estonia (8.6%). The most important partner in trade with third countries was Russia, which accounted for 6.7% of Latvia's total exports and 6.5% of imports in May. In May, Latvia exported goods worth 906.1 million euros and imported goods worth 1.03 billion euros. Compared to May 2019, the foreign trade balance improved slightly, with exports increasing from 42.8% to 46.9% of total foreign trade.

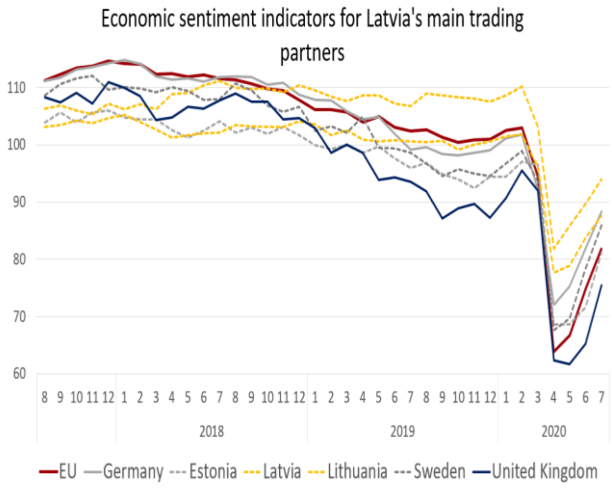
2.3. Economic indicators and market sentiment

Confidence indicators for economic activity, especially in the construction and services sectors, remain low, but after a dramatic decline in March and April, confidence has risen in May and beyond. However, entrepreneurs are still cautious in responding to the current uncertainty in the business environment, and the values of confidence indicators are still in the range of negative values. Compared to June, the retail sector improved the most in July (+ 8.6%), but retail sales are still negatively affected by consumer uncertainty, which is also reflected in the decline in consumer confidence (-2.2%) compared to June. Confidence has improved in the service provider sector (+ 5.8%) and the industrial sector (+ 5.1%). It should be noted here that the improvement of confidence in the industrial sector does not correlate with the weak performance of the industrial sector itself this year. In the 2nd quarter.

The sentiment rate in the European Union has started to recover since June, rising by 7%. Economic sentiment indicators are also becoming more positive for Latvia's main trading partners, for example, compared to June, the sentiment indicator in Great Britain has increased by (+ 10.3%), which is the fastest growth among trading partners, followed by an increase in Estonian sentiment (+ 9.6%). , however, the most cautious optimism is observed in Lithuania (+ 4.3%).

2.3.1. picture. Confidence indicators by sector and major trading partner countries

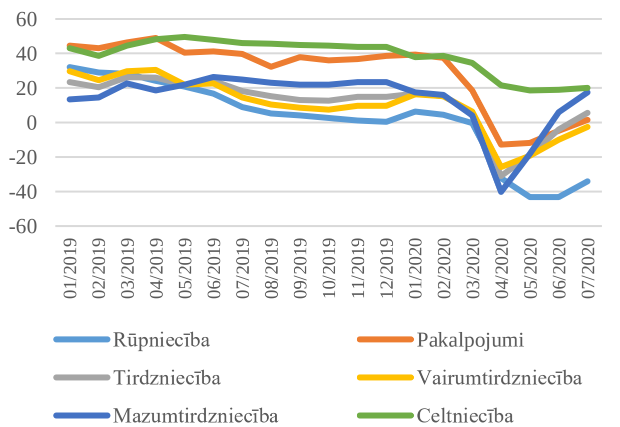




Source: CSP KR020m

Source: Eurostat

1.3.2. picture. Economic indicators in Germany, seasonally adjusted data, quarterly



Source: Ifo Business Climate Index, 27.07.2020.

Germany should be mentioned separately as the most influential economy in the European Union. The economic indicators of the German economic sectors show that the recovery in industry is much slower than in other sectors (Figure 1.2). According to experts, this demonstrates the structural changes caused by the Covid-19 pandemic, ie if the services sector is experiencing a "V" resumption and construction has only slowed down, the business climate in manufacturing is still poor due to global supply chain disruptions.[23]

2.4. On Manufacturing and Processing Industry

From April to June, industrial production has been steadily declining by an average of 4.3% per month. The worst situation was observed in manufacturing (a three-month average decline of 4.6%) and in the electricity and gas supply sector (-3.6%, respectively). At the same time, the mining and quarrying sector remained positive (average growth of 3.1% in 3 months).

In the second quarter of 2020, manufacturing output and turnover fell by 5.7%. The wood and wood products industries (-2.2%) and "other industries" (-3.3%) suffered the most. In turn, a slight increase was observed in the production of chemicals and chemical products (+ 0.7%), which is related to the high demand for disinfectants and detergents needed to combat Covid-19 in Latvia and in the international market.

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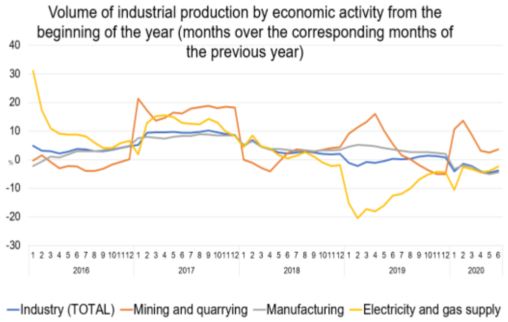
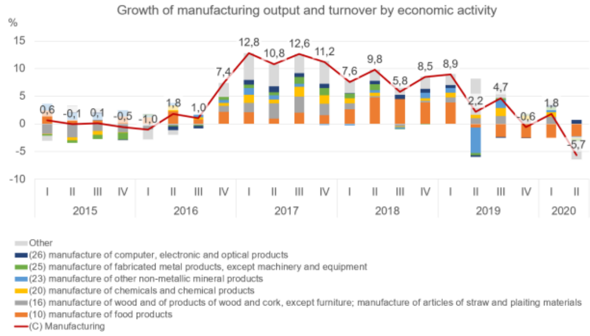
[23] "A V it seems to be, but not for manufacturing," Eurointelligence Professional Daily Morning Newsbriefing, 28 July 2020.

2.4.1. Industrial production output and turnover



Source: CSP [RU03.]



Source: CSP [RU04]

2.5. Employment

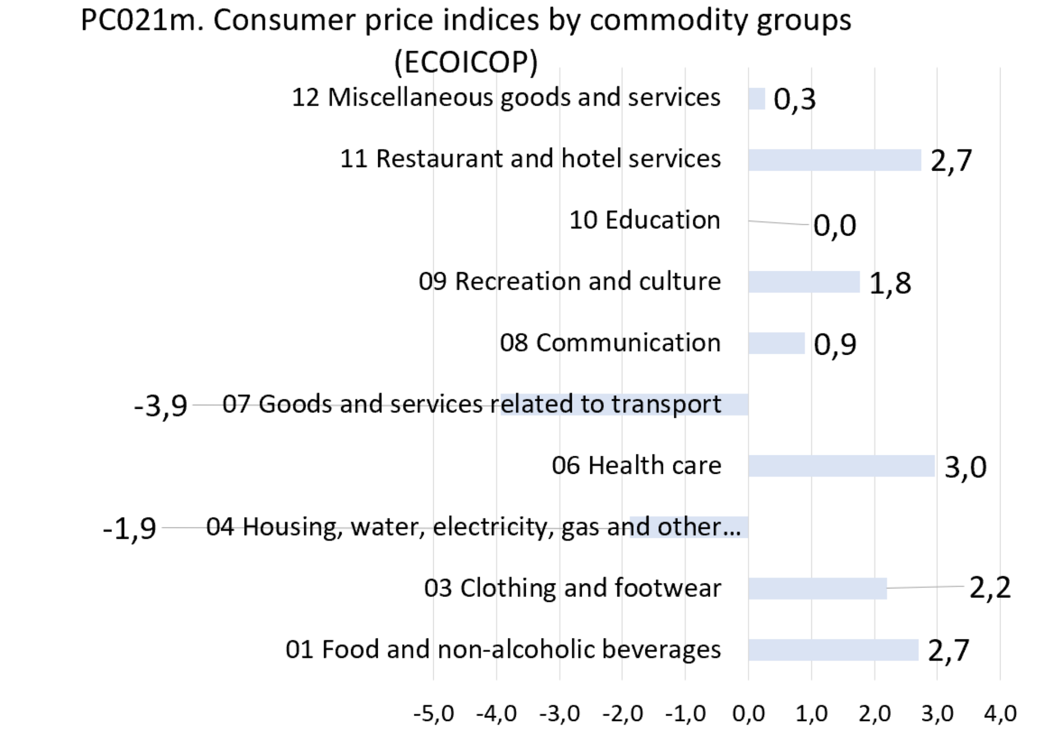
The unemployment rate has approached the forecast values of the Ministry of Finance (MoF) and SEB Banka. The seasonally adjusted data of the CSB show that the unemployment rate in the country continues to rise, reaching 10.1% in May (Figure 2.5.1). The registered unemployment rate reached 8.6% in June. In June, the unemployment rate continued to grow on average by 0.2 percentage points in all regions. The indicators of Vidzeme region have leveled off with the unemployment rate of Zemgale since April and reached 8.2% in June. The highest unemployment has been observed in the Latgale region for many years, reaching 16% in June.

2.5.1. picture. Unemployment rate by sex by months, age 15-74

Source: CSP NB002

2.6.Consumer prices

2.6.1. picture. Consumer price indices in groups and subgroups (ECOICOP)



Source: PC021m.

According to the latest CSB data, in July 2020, compared to April 2019, the average consumer price level increased by 0.5%. Prices for goods remained unchanged, but for services increased by 1.6%. Looking at the price dynamics by product groups since 2015 (2015 = 100), the rise in prices in July was observed in health care (+ 3%), it was still observed in the hotel and restaurant services segment by 2.7%, as entrepreneurs try to recover the income lost at the beginning of summer[24]. Prices have fallen in the housing, water and energy segment (-1.9), as well as prices for transport services continue to fall (-3.9)%, it should be noted that the decline in this segment is no longer so sharp.

In July, annual prices also increased in the group of food and non-alcoholic beverages by 2.7%, which was determined by an increase in the price level for fresh fruit (+ 19.6%). Prices also increased for dried, salted or smoked meat (+ 8.3%), pork (+3.8%), meat products (+ 5.4%) and poultry (+ 2.2%). Cheese and cottage cheese (+ 2.8%), confectionery (+ 2.4%), bread (+ 1.7%), buckwheat (+ 19.4%), coffee (+ 2.5%), ice cream (+ 5.7%) and breakfast cereals (+ 9.8%). On the other hand, fresh vegetables (-7.7%), butter (-6.4%) and yoghurt (-2.2%) became cheaper[25].

2.7. On State Debt

In order to provide financial coverage for support measures to mitigate the effects of Covid-19, since March 2020 the Latvian government has borrowed in both the domestic and international financial markets by issuing bonds. Eurobonds were issued in both the additional issue and the new issue, as well as domestic debt bonds were auctioned intensively.

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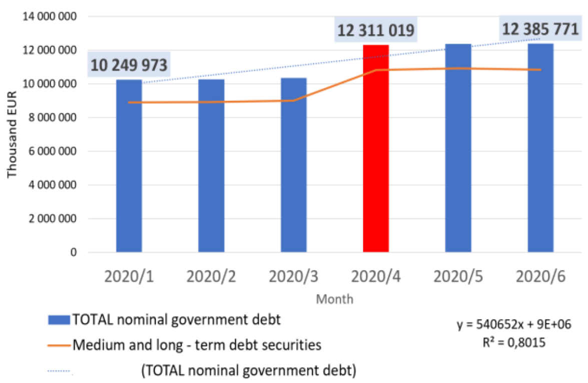
[24] Viesu nami Latvijā ceļ pakalpojumu cenas https://www.tvnet.lv/7019805/viesu-nami-latvija-cel-pakalpojumu-cenas

[25] Average consumer price level increased by 0.5% over the year https://www.csb.gov.lv/lv/statistika/statistikas-temas/ekonomika/pci/meklet-tema/2722-paterina-cenu-parmainas-2020-gada-julija

2.7.1. picture. Government debt dynamics before / after COVID-19



* Nominal value - the nominal value of a debt at the end of the reporting period is the nominal value of the issue of debt-creating liabilities
Source: Treasury operational data

Borrowing has led to a sharp and unplanned increase in debt levels. According to the CSB data, in the 1st quarter of 2020, the value of general government debt reached 11.29 billion euros.[26] The operative data of the Treasury show that this year At the end of the first quarter, the total nominal value of central government and local government debt was 10.487 billion. At the end of the second quarter, it reached 12.485 billion euros. euro. As a result, public debt has risen by around € 2 billion (€ 1.998 billion) since the state of emergency was declared in March. As shown in 2.7.1. In the figure, the "jump" in government debt took place in April.

Since the beginning of 2020, the Treasury has issued both EUR 2,130 billion in debt securities in the domestic and international financial markets and EUR 740.8 billion in debt securities previously issued in the financial markets (information and related online documents are summarized in Table 2.6.1). In total, the financial markets
The amount of debt securities issued in government debt in the first seven months of 2020 increased by 1.409 billion euros in nominal value.

2.7.1. table. Government debt securities issued and redeemed in financial markets, January - July 2020

Type of securities	Year of redemption of securities (in brackets: original maturity of securities)	Volume of securities issue in nominal value, million euros	Interest (coupon) rate	Yield at issue,%
Additional issue of Eurobonds	2026. (10 years)	550.000	0.375%	0.406
New Eurobonds	2023. (3 years)	1 000.000	0.125%	0.209
* Domestic debt bonds	2022.-2027. (2, 5 7 years)	599.500	0.000%	(-0.150) līdz 0.309
Total securities auctioned in euro	-	**2 149.500**	-	-
USD denominated Eurobonds (USD 698,069 million nominal value)	2020. (7 years)	-628.325 **	2.750%	-
Domestic debt bonds	2020. (5 years)	112.446	0.625%	-
Total redemption of euro - denominated securities	-	**740.771**	-	-

* Updated at the State Treasury 29.07.2020

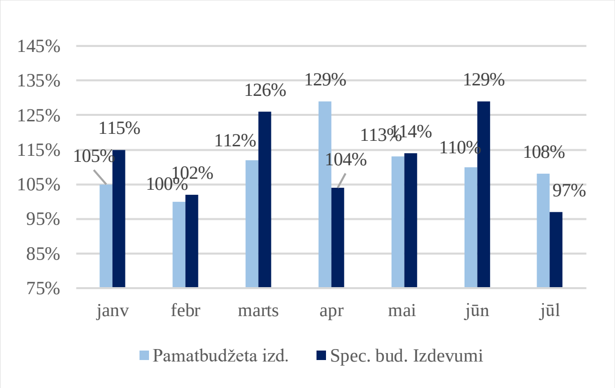
[26] CSP datu matrica [VF020c.] Vispārējās valdības parāds sadalījumā pa apakšsektoriem pa ceturkšņiem perioda beigās (milj. euro). CSP dati par 2. ceturksni sagaidāmi š.g. 20.oktobrī.

** euro equivalent at the exchange rate on the date of the transaction, excluding borrowed derivatives
Source: State Treasury

3. Budget balance and tax revenue dynamics

In July of this year, the increase in budget expenditures compared to the previous year has also slowed down. If in July the expenditures in the basic budget have increased by 8% - compared to 2019, then the expenditures in the special budget have even decreased by 3%. Far-reaching conclusions should not be drawn from this positive development, as the financing of support measures is not balanced, however, the reduction of expenditures in the social budget is unexpected. In addition, large EU repayments to the state budget were received in July - 273.8 million euros. Thus, according to the operative data of the Treasury (SAO), both the central government basic budget and special budget balances were positive in July, 109.4 million euros and 42.7 million euros, respectively.

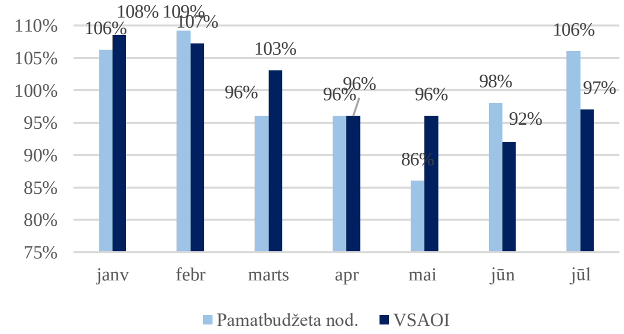
3.1. picture. Dynamics of the state basic budget and special budget expenditures in 2020 against 2019 in the respective period



Source: Treasury operational data

As previously projected, the lowest tax collection point was reached in May 2020 due to the Covid-19 crisis. In July, basic budget taxes were already collected in the amount of 106% of the 2019 amount. The level of mandatory state social insurance contributions (SSIAI) in July also increased to 97% of the level of July 2019 (these indicators do not yet take into account the tax holidays granted by the SRS). In July, compared to the previous year, excise duties and corporate income taxes were collected particularly well.

3.2. picture. Dynamics of state basic budget revenue and SSIAI in 2020 against 2019 in the respective period



Source: Treasury operational data

Overall, tax revenues can be assessed as quite good. It is still the case that the decline in tax revenues is smaller than the decline in economic activity. One reason could be the shadow economy, which is not fully reflected in official statistics. The second explanation is the postponed purchases of the population due to the crisis, which are now being made with a delay of a few months.

4. 4. Detailed analysis of economic support measures from a fiscal point of view

As mentioned above, if approved by the European Parliament, Latvia will have access to significant EU recovery funding, in the form of around € 2.47 billion in grants, and the same amount of funding will be available in soft loans. It is planned that the loan will be repaid by the European Commission from its own revenues. In that case, the Latvian state will have the opportunity to eliminate the consequences of the Covid-19 crisis without a direct impact on the SGBB.

In July, the government launched a series of previously planned support measures. The most important are subsidized jobs for exporting taxpayers to overcome the consequences of the Covid-19 crisis (expected impact on the SGBB - EUR 51 million), subsidized jobs for tourism companies (EUR 19.2 million), a tool for capital investment in businesses affected by Covid-19 proliferation (EUR 50 million), guarantees for large companies affected by the proliferation of Covid-19 (EUR 90 million). It is important to note that support from all the above-mentioned support instruments must be granted by the end of this year.

Also in July, significant support was granted to passenger and freight carriers - 66 million euros. Consequently, according to the calculations of the Ministry of Finance and the FDC, the amount of existing and planned government support measures has already reached 9% of GDP, although some of the support measures do not directly affect the SGBB. Most of the measures will affect the VSE in 2020.

The FDC has grouped the support measures according to the main beneficiaries of the measures (Table 4.1). The groupings and estimates are approximate: for example, the beneficiaries of subsidized jobs are both workers (who are not made redundant) and employers (cheaper labor), but the table gives an idea of the amounts of aid and its beneficiaries.

4.1. table. Estimates of the MoF and FDC on the impact of support measures on the State General Budget Balance (SGBB) in 2020 and 2021

Activity	SGBB 2020/2021 (milj. eiro)*	ES fondu pārdales (bez ietekmes uz SGBB)	Pasākumi bez ietekmes uz SGBB	Kopā	Kopējā atbalsta īpatsvars %
Support for the population and the workforce	**272.0**	**88.7**	**19.7**	**380.4**	**15**
Downtime (including assistance) allowance	59.9			59.9	2
Different types of benefits - unemployment, families, children, etc.	134.6			134.6	5
Retraining of employees		25.7		25.7	1
Subsidized jobs for the tourism industry and exporters; support for young professionals	77.6			77.6	3
Subsidized employment		63.0		63.0	2
Human capital and demography			19.7	19.7	1
Support for entrepreneurs	**703.1**	**52.8**	**113.7**	**869.6.0**	**34**
Aid towards tax deadlines	331.0			331.0	13
ALTUM working capital loans	50.8	35.0		85.8	3
ALTUM credit guarantees and portfolio guarantees	190.0			190.0	8

ALTUM investment fund for modernization and support of large companies			165.0	165.0	7
Support for the road sector	75.0			75.0	3
Supporting companies for international competitiveness		17.8		17.8	1
Support for agriculture and food businesses	56.3		113.7	170,0	7
Support for state JSCs and sectors	**792.4**	**354.5**	**135.8**	**1282.7**	**51**
Aid to the air transport industry	310.4		36.1	346.5	14
Support for public transport	66	283.0		349.0	14
Support for the healthcare sector	204.8	30.0	42.4	277.2	11
Support for the culture and sport	37.0			37.0	1
Support for municipal investments	150.0	41.5	35.0	226.5	9
Others, including private and public media	24.2		22.3	46.5	2
TOTAL	**1767.5**	**496.0**	**269.3**	**2532.8**	**100**
Of GDP (28 206 Meuro)	**6.3%**	**1.8%**	**1.0%**	**9.0%**	
*MoF data and FDC Calculations					

Most of the support mechanisms continue to operate after the end of the emergency, but one of the main support mechanisms, the downtime allowance and the related downtime assistance allowance, expired on 30 June. The latest data show that a total of 133462 downtime benefits were paid and the total amount paid amounted to 53.6 million euros. Although a more detailed analysis of the benefit scheme is needed, it is already clear that, in general, support has not been as large and comprehensive as, for example, in Estonia or Lithuania. According to the latest statistics, EUR 256.3 million has already been paid in downtime benefits in Estonia and EUR 139.6 million in Lithuania.[27]. In Lithuania, downtime benefits are still paid. One of the main reasons for the relatively low costs of downtime benefit in Latvia is the significant amount of the shadow economy and the link between support costs and the amount of tax payments. For example, in Estonia in 2019, about 7,133 euros were collected in taxes per capita, while in Latvia - only 4,766 euros[28]. This points to the need to improve tax collection and the fight against the shadow economy.

Considering that the planned amount of state aid has already reached 9% of GDP and the impact of the support instruments on the VSE has reached about 6.3% and that grants from the European Reconstruction Facility should be available in 2021 (provisionally 8.8% of GDP), The FDC reiterates its call on the government to limit the development of additional economic stimulus measures, given that they directly undermine the fiscal sustainability of the SGBB and the country. Budget-funded support must be increasingly selective, better targeted and have an immediate effect. Investment projects must primarily promote the development of Latvia's economic potential, productivity growth and competitiveness.

An increasing percentage of state aid is organized by the state financial institution Altum, which both provides guarantees on various terms, grants soft loans and invests in the capital of companies. Given the high concentration of responsibilities and public financial resources in one institution and the problems of good governance in state or municipal capital companies in recent years, it would be necessary to create a more effective Altum monitoring mechanism.

At the sitting of the Cabinet of Ministers on 14.07.2020, "Regulations on Guarantees for Large Merchants Affected by the Spread of Covid-19" were approved. The FDC is

[27] Estonian FDC and Lithuanian FDC data as of July 28.

[28] FDC calculations

pleased that the original purpose of granting guarantees for up to 25 years is not enshrined in the regulations. However, in the FDC's view, the eight-year guarantees are also sufficiently risky, and proper monitoring of their allocation must be a priority.