LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

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Baiba Bāne
State Secretary
Ministry of Finance
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Inta Vasaraudze
The Director of
Department of Economic Analysis

On the endorsement of the macroeconomic indicator forecast

Dear Mrs B. Bāne,
Dear Mrs I. Vasaraudze!

According to Article 20 of the Fiscal Discipline Law (hereafter – FDL) medium-term macroeconomic forecasts, including forecasts of growth rate of the gross domestic product (hereafter – GDP), deflator forecasts of the GDP and forecasts of growth rate of the potential GDP shall be developed by the Ministry of Finance (hereafter – MoF). According to the Article 28, Part 2 of the FDL, the Fiscal Discipline Council (hereafter – Council) shall perform an independent assessment of potential GDP and nominal GDP calculation by the MoF.
Article 4, Part 4 of the Regulation (EU) Nr.473/2013 (21 May 2013) of the European Parliament and the Council on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, stipulates that draft annual state budget and draft medium term budget framework (hereafter – MTBF) shall be based on independent macroeconomic forecasts that are prepared or endorsed by independent bodies.
According to the Memorandum of Understanding (hereafter – MoU) between the MoF and the Council, signed on 8 February 2016, the Council shall assume the responsibility of the independent body and endorse the MoF macroeconomic forecasts twice a year – (i) while preparing the Stability Programme, and (ii) the annual state budget and the MTBF.

Macroeconomic forecasts for MTBF 2021-2023. were originally submitted to the Council on 12 June 2020. At the Council meeting on 15 June 2020, the Ministry of Finance informed about the assumptions and justifications taken into account for preparing the forecasts. The Council's discussion on macroeconomic forecasts noted significant risks and made recommendations for further work.
The Council approves macroeconomic forecasts to support the development of MTBF 2021/23, while underlining existing risks to long-term instability.

The Council is aware that the calculation of the potential GDP-output gap is challenging in the current highly volatile context. The Council welcomes the conservative assumptions regarding the level of potential GDP. Analysing the sharp increase in the output gap in 2021, as well as its increase in 2022 and 2023, we see that the MoF reflects the V-shaped recovery scenario and the assumption that no potential significant risks will fulfil. The Council emphasizes that the scenario of a lasting negative output gap is rather risky, as it could lead to unjustified expectations of available fiscal space in the coming years. The Council keep in mind, those calculating expenditure ceilings, and the medium term objectives is tested by the Stability and Growth Pact's balance rule scenario as well as against the expenditure growth rule, where the expenditure ceiling depends on 10-year average potential GDP growth, but does not exclude risks, associated with the effects of persistent negative output gaps.

The Council considers that the size of the fiscal stimulus should be adequate and proportionate to the actual damage caused by Covid-19. Given that projected real productivity growth in the coming years is volatile compared to SP (CoV) 2020/23 and insufficient to deliver strong economic growth, there is a lack of justification for planed investment in warming up the economy. If productivity growth, which will boost economic growth, is not promoted in the future, unpopular expenditure restraint policies may be needed after generous economic stimulus. The Council considers that maintaining the output gap in the negative range over time is not justified and will encourage excessive fiscal stimulus measures in the long run.

The Council welcomes short-term government support measures, but urges caution with regard to excessive deficit and debt growth in 2021 and coming years.

The Governing Council notes the inconsistency in leaving the government debt forecast unchanged since the establishment of the Stability Program 2020-2023, while updating the macroeconomic indicators framework for MTBF 2020/23. development.

Recommendations

1) Develop a scenario for reducing the government debt-to-GDP ratio as soon as possible and gradually returning to pre-Covid-19 levels.

2) Taking into account the rapidly changing situation in the world and in Latvia, it would be useful to carry out an operative revision of macroeconomic forecasts this year in the fall.

3) Revision of the potential GDP and output gaps closer to pre-Covid-19 levels is highly recommended at the period when economic environment recovers on the stabilization path.

	2020	2021	2022	2023
Real GDP growth	-7.0	5.1	3.1	3.1
Nominal GDP growth	-7.4	6.5	5.3	5.2
Inflation (consumer prices)	0.2	1.2	2.0	2.0
GDP deflator	-0.5	1.3	2.0	2.0
Potential GDP growth	2.4	2.5	2.5	2.4
Output gap	-7.9	-5.6	-5.0	-4.4

Table 1. Macroeconomic forecast indicators endorsed by the Council.

On 15 June 2020, the Council by voting endorsed the macroeconomic forecast to underpin the fiscal projections for the MTBF for 2021-2023.

The Council expresses its gratitude for the co-operation and data exchange with colleagues from the MoF.

Kind regards

Chair of the Fiscal
Discipline Council

I. Šteinbuka