LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

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Fiscal discipline council
Potential and nominal GDP assessment working group.
Minutes No. 2 (25)

Riga 6of June 2025

The meeting is chaired by:
Janis Priede Member of Fiscal Discipline Council, Head of Nominal and Potential GDP working group (here and after GDP WG).

Participants of the meeting:

Chairwoman of the Fiscal Discipline Council	I.Šteinbuka
Member of Fiscal Discipline Council	A.Jakobsons
Member of Fiscal Discipline Council	U. Kāsiks
Sekretariāts –	
Fiscal Discipline Council secretary	N.Malnačs
Fiscal Discipline Council macroeconomic expert	V.Zaremba
Fiscal Discipline Council fiscal risks expert	I.Vepakovska
Fiscal Discipline Council lawyer-clerk	I.Jansone

Invited persons:

Chief Economist of the Macroeconomic Analysis Division, Monetary Policy Department of Bank of Latvia	D.Paula

Taking minutes:

Meeting secretary I.Jansone

The meeting starts at 9:00 AM and takes place in partly remote meeting mode via MS Teams.

Opening of the meeting - I. Šteinbuka opens the meeting and announces the meeting's agenda and and gives the floor to Daina Paula.

1. Base scenario for the development of the national economy of Latvia, including potential GDP growth and assumptions regarding output gap

D. Paula reports that updated GDP forecasts were recently discussed during the ECB meeting and are scheduled for public release on June 10. At this working group session, she presents an overview of key developments in the Latvian economy during the early months of 2025, along with the composition of GDP in the first quarter.
At the beginning of her presentation, D. Paula highlights the main factors currently influencing the economy.
Macroeconomic indicators suggest stagnation — GDP growth has remained close to 0% in recent years. However, declining interest rates have encouraged an increase in savings, including a notable rise in deposits. More detailed national accounts data, including figures on gross savings, are expected in October.

The business environment is stabilizing. Following a period of significant downturn, company viability has improved, and average return on equity (ROE) stabilized in Q4. Investment activity is primarily directed toward equipment purchases and construction, especially in infrastructure projects such as bridges and tunnels, likely tied to the development of military infrastructure.
At the same time, exports of both goods and services are beginning to recover. However, the U.S. reciprocal tariffs on steel and aluminum have introduced uncertainty in international markets. While Latvia’s main trading partners — Lithuania and Estonia — are not deeply embedded in U.S.-linked supply chains, indirect impacts may arise via Germany and Poland. Nevertheless, the overall effect of these tariffs on Latvian exports is expected to be limited.
Inflation continues to be significantly driven by price changes in services and food. Overall trade turnover remains flat, with the exception of car sales, which are currently influenced by tax policy in Estonia. The rise in consumer prices in April may partly reflect seasonal factors such as Easter and public holidays, which typically boost consumption. Service prices also continue to climb.
Core inflation in Latvia remains above the EU average but has decreased substantially compared to previous years.
In the labor market, Latvia maintains a competitive edge due to lower labor costs relative to the EU and the Baltic region. Although the official unemployment rate is not high, there remains a substantial gap between registered and actual unemployment. Many individuals do not register with the State Employment Agency either because they are ineligible for benefits or because benefit levels are too low to offer a strong incentive for registration.
Regarding economic potential, D. Paula notes that demographic trends are a limiting factor for growth. The output gap is currently negative and is projected to remain so through 2026. Forecasts suggest it may close by 2027.
U. Kāsiks inquires about wage trends, specifically the reason behind the downward revision of the 2025 wage growth forecast, and the implications of increased defense spending on the state budget.
D. Paula explains that the revision is linked to the government's decision to cap public sector wage growth at 2.6%, in line with fiscal constraints. As for defense spending, an increase from 4% to 5% of GDP is under consideration, but any implementation would likely be gradual, utilizing all available flexibility within the fiscal framework. These decisions are influenced by both economic conditions and the government’s fiscal capacity.
N. Malačs raises a question on household consumption: how is it measured, and are transactions made through Revolut included?
D. Paula clarifies that household consumption is estimated using multiple data sources, not limited to payment card data. This multifaceted approach enables a more accurate and comprehensive understanding of domestic consumption patterns.
Data sources include:

- Production-side indicators, such as turnover data from grocery stores or service providers (e.g., hair salons), which directly reflect consumption;
- Income-side data, which offer insights into consumption potential based on household income levels;
- Import statistics, which distinguish between capital and consumer goods.

She notes that survey responses may sometimes underreport consumption of specific goods (e.g., alcohol or tobacco), but sales and import data often contradict these claims. Goods not re-exported are considered to be consumed within the domestic market.
Payment card statistics provide greater detail than publicly available figures. Public datasets typically reflect transactions made with Latvia-issued cards (issuer side), but acquiring-side data — which include all card payments made in Latvia, including those with foreign-issued cards such as Revolut — are also used. These foreign card payments are reflected in retail and services sector statistics, ensuring they are not overlooked in consumption estimates.
V. Zaremba asks two questions regarding investment trends:

1. Why do European Commission forecasts project a negative investment contribution to GDP growth in 2025?

2. Is there evidence that businesses are investing in technologies that address labor shortages, such as automation, or are they mainly replacing outdated equipment?

D. Paula confirms that the European Commission projects a negative year-on-year investment figure, and national data may show similarly weak trends, although potentially to a lesser extent. This is largely due to a low base effect caused by a sharp drop in investment in the latter half of the previous year. As a result, even with positive quarterly growth, annual figures could remain subdued if strong growth does not resume in the coming quarters.

There were some unexpectedly positive results in Q1 investment data, particularly in public sector investment. However, seasonally adjusted figures also contain some unexplained components that may be revised later.

Regarding equipment investments, while internal data is limited, informal feedback from businesses suggests that investments are primarily focused on modernizing and automating production processes — not merely on replacing obsolete machinery. These figures exclude vehicle imports (e.g., trains), which were high in recent years but showed no significant increase in Q1 2025.

The main drivers of investment include:

- Modernization of production processes;
- Expansion of production capacity;
- Addressing labor shortages through automation.

Surveys, including those conducted by the European Commission, indicate that investment motivations are typically mixed — combining equipment replacement with modernization and capacity expansion. However, in light of labor market tightness, automation and efficiency improvements have gained increasing prominence.

Discussion among those present on the agenda topic .

Decided:

1.1. To take note of the presentation by the Bank of Latvia on current developments in the development of the Latvian economy.

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I.Šteinbuka – votes for;
J.Priede - votes for;
U.Kāsiks - votes for.

The meeting is closed at 11.00.
6of June 2025

Chairwoman of the Fiscal Discipline Council I.Šteinbuka

Meeting secretary I.Jansone

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