



Steady Through Choppy Waters

Mārtiņš Kazāks, PhD
Member of the Council of Latvijas Banka
22 May 2019



Latvijas Banka: our key tasks

Regional euro cash storage & logistics center in the Baltics



- ▶ Ensuring the quality of cash
- ▶ Processing **~140 million** banknotes a year

The most popular **50 €** banknote goes through Latvijas Banka **~3 times a year**

Provider of key infrastructure for interbank settlements





ZIBMAKSĀJUMS
No bankas uz banku. Ātrākais!

Instant payments

Few
seconds

24h

Euro
area

7
days a
week

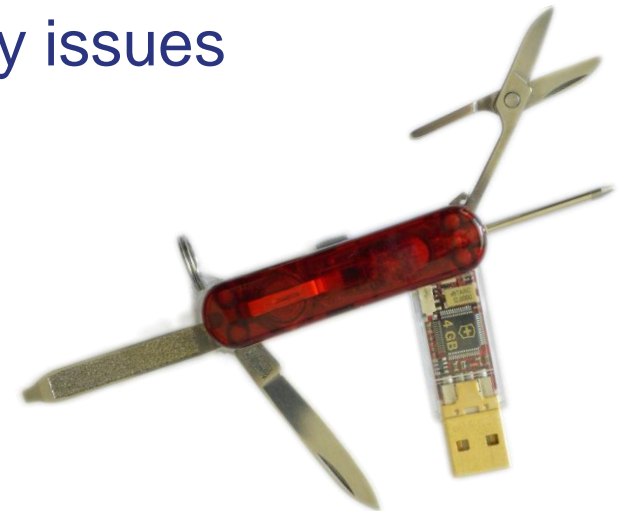
365
days a
year

- ▶ First in the whole euro area
- ▶ Industry standard: now offered by *SEB banka*, *Citadele banka*, *Swedbank* and *Latvijas Banka*
- ▶ Coming soon: payments to recipients identified by their phone number

A key to innovative payment services in the future

But so much more...

- ▶ Formulation and implementation of **monetary policy**
- ▶ In-depth **economic analysis** and modelling
- ▶ **Advisor** to the government and Saeima
- ▶ **Credit register**, macroprudential and financial stability issues
- ▶ **Statistics**, i.e., data collection and analysis
- ▶ **Reserve management...**
- ▶ ... and, yes, we do mint **coins!**



National central banks – important players in the EU



Foto: Monica Sierra, ECB

Latvijas Banka has an equal role in the decision-taking of the ECB's Governing Council and General Council

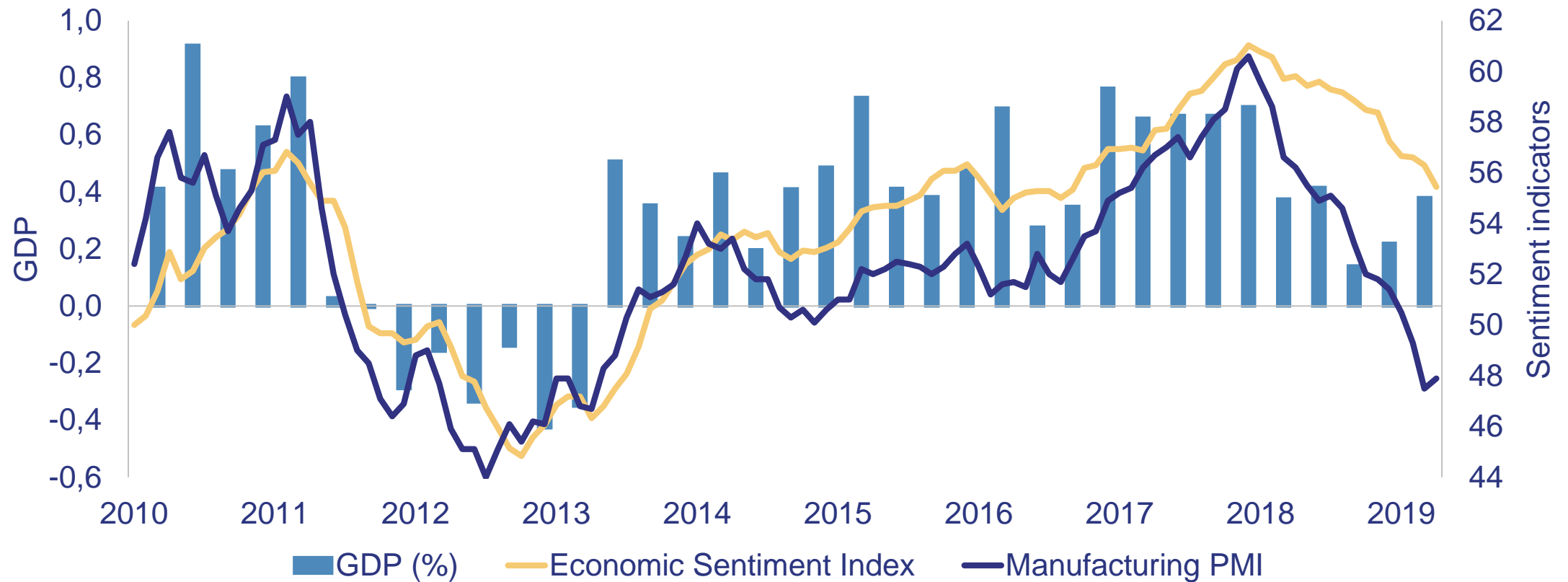
- ▶ Employees of Latvijas Banka work in **130 committees** and working groups of various EU institutions and bodies
- ▶ More than **400 EU level meetings** a year



Global economy

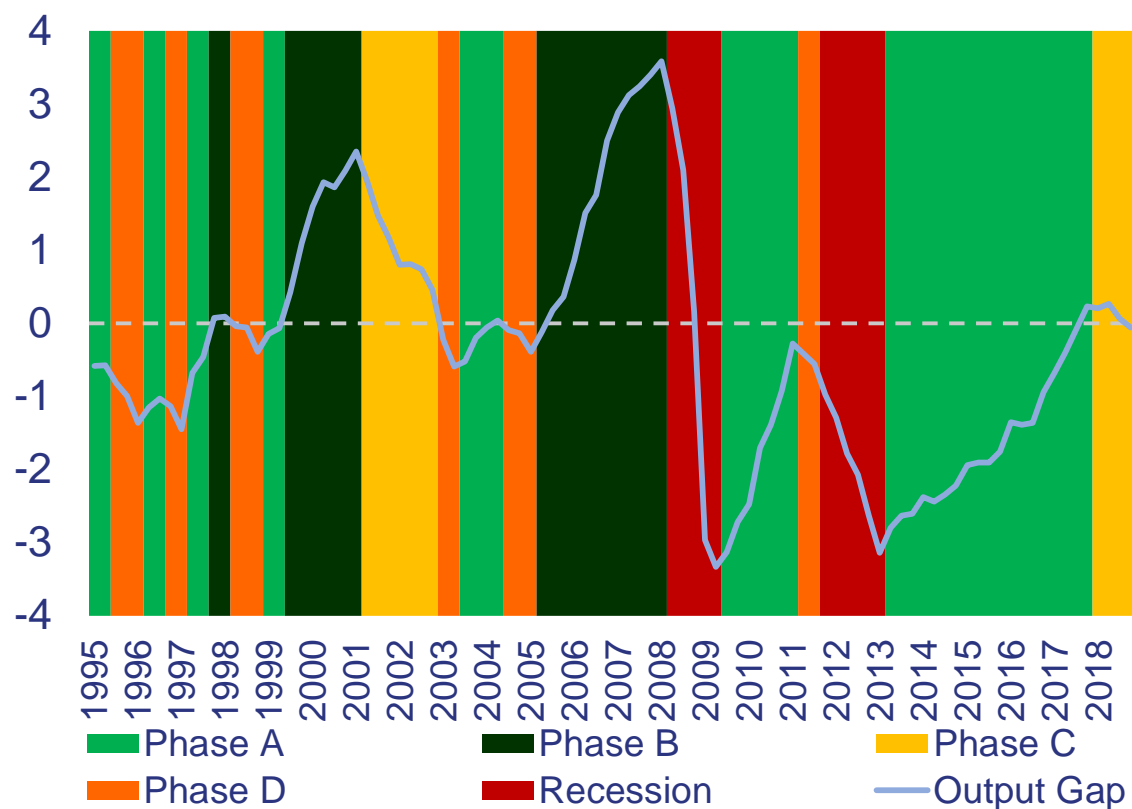
Growth and confidence has weakened since the second half of last year

Real GDP quarter to quarter, sentiment indicators in euro area

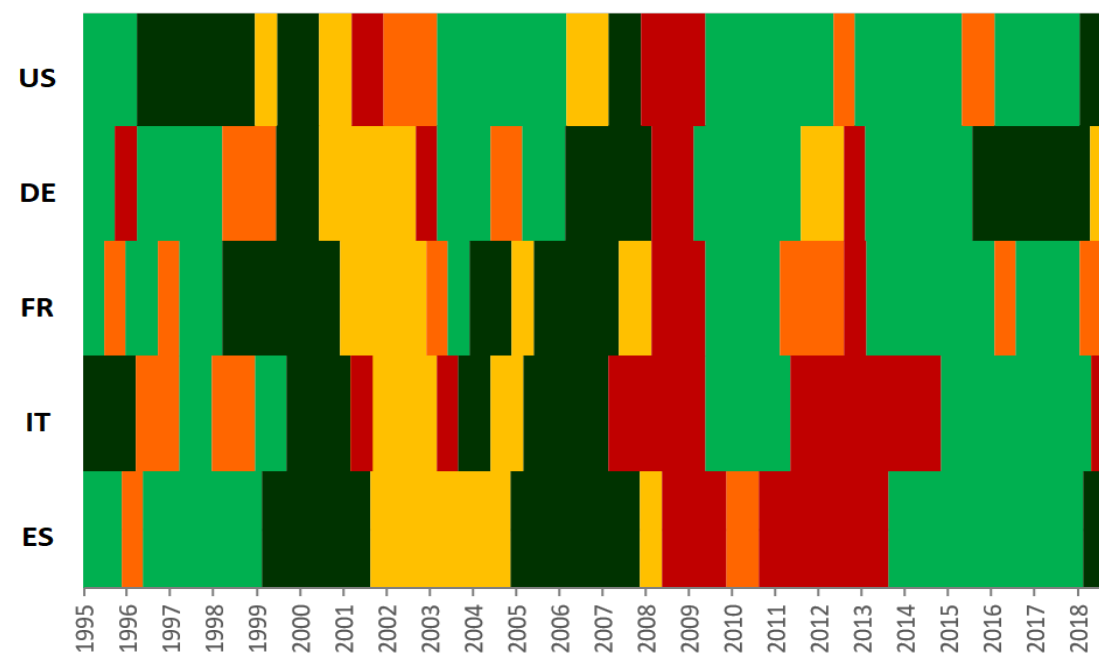


The business cycle is quite mature; probability of a slowdown has increased

Business cycle phases, output gap
(% of potential output)

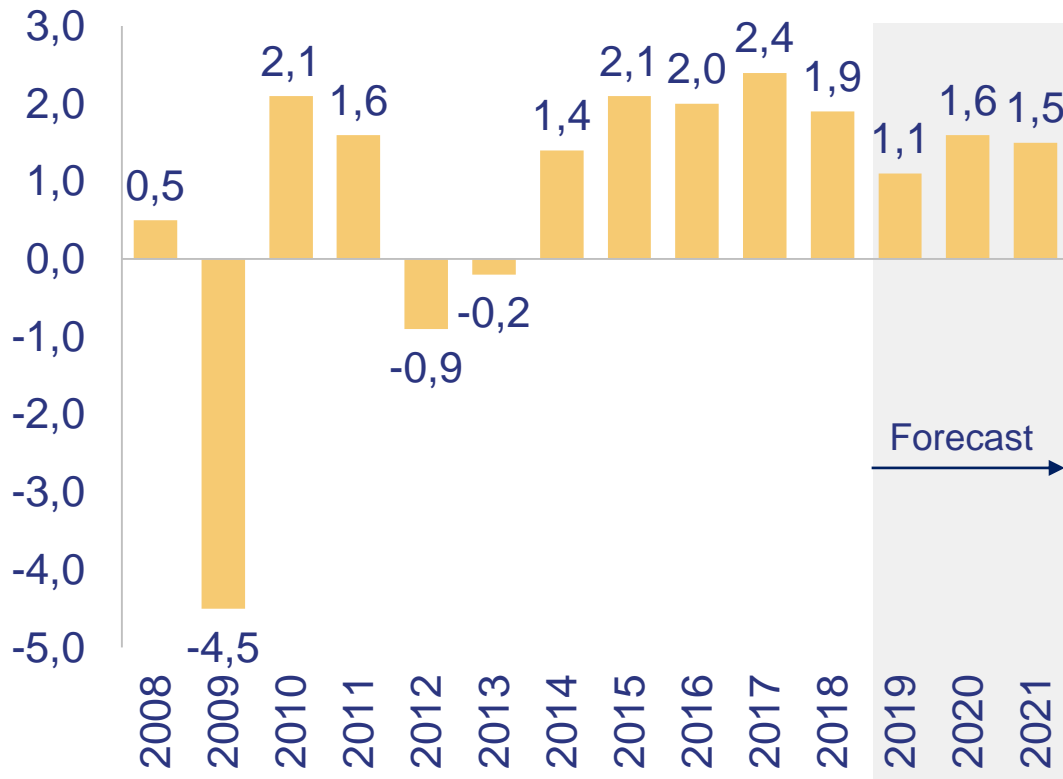


Business cycles in selected euro area countries and US

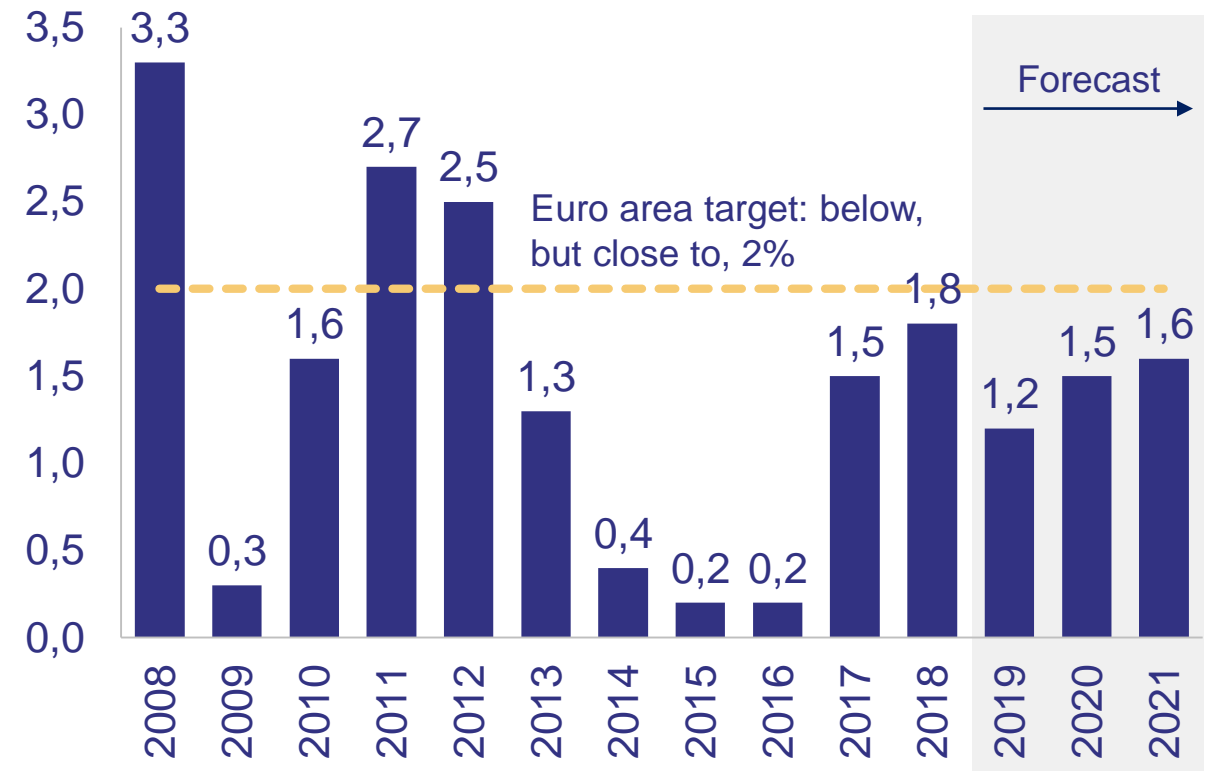


Despite the quite prolonged period of growth, inflation remains below its Eurosystem target

Euro area real GDP growth (%)

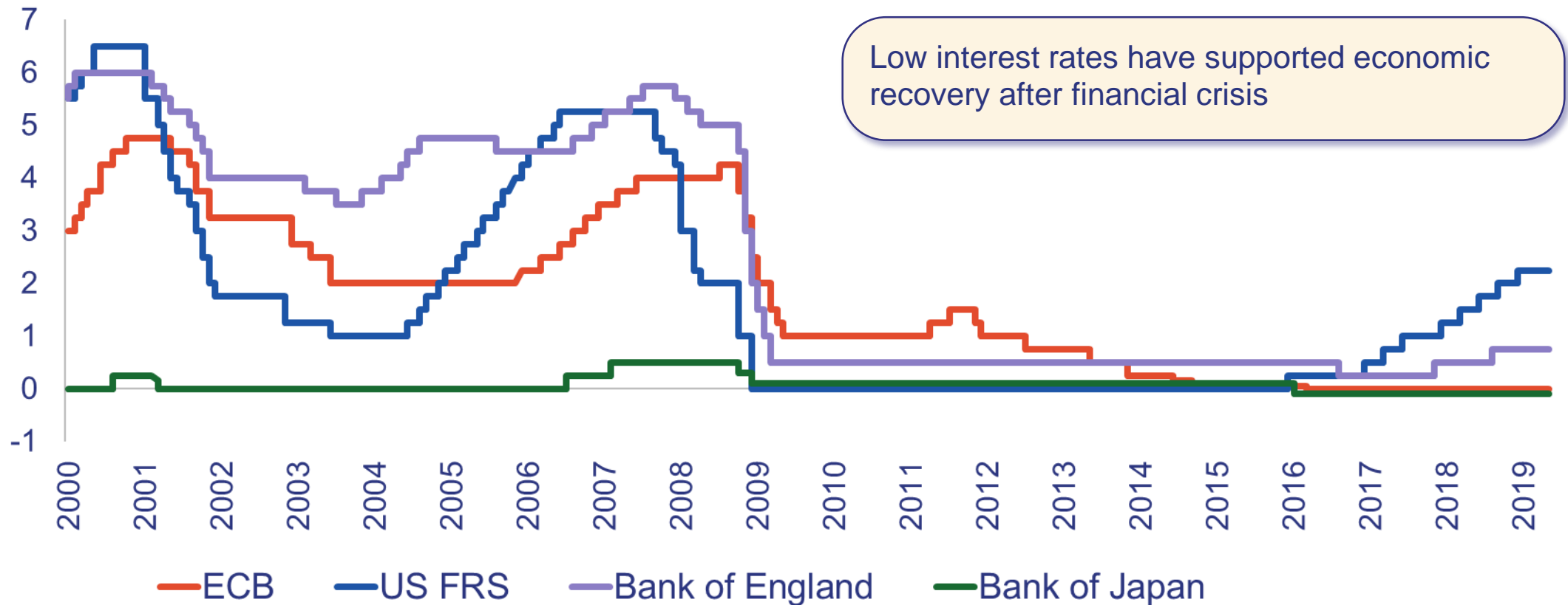


Euro area inflation (%)



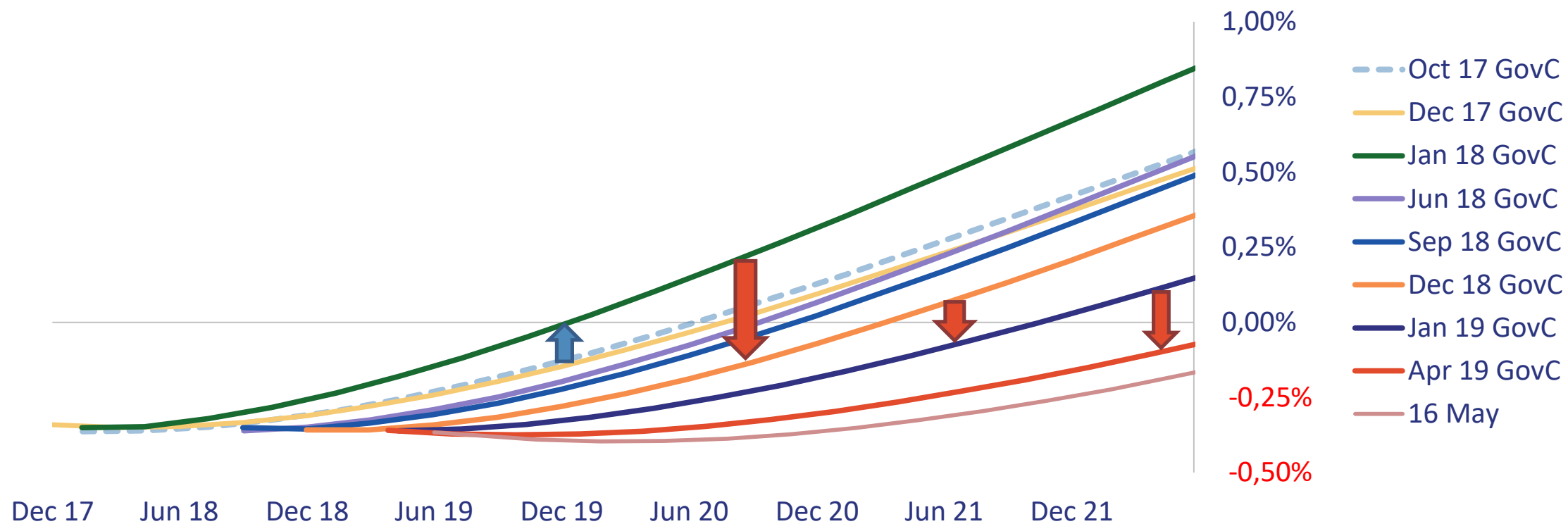
Monetary policy supportive to growth, raising of base rates has been delayed (1)

Central banks' base rates (%)



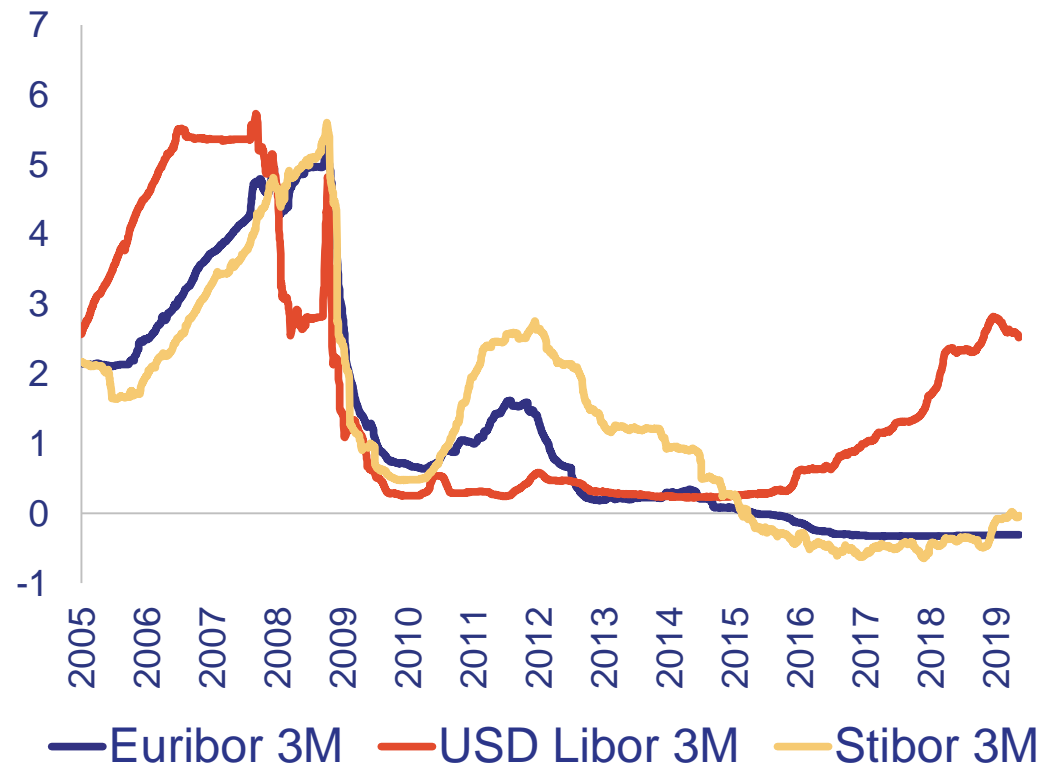
Monetary policy supportive to growth, raising of base rates has been delayed (2)

EONIA EUR forward rates (%)

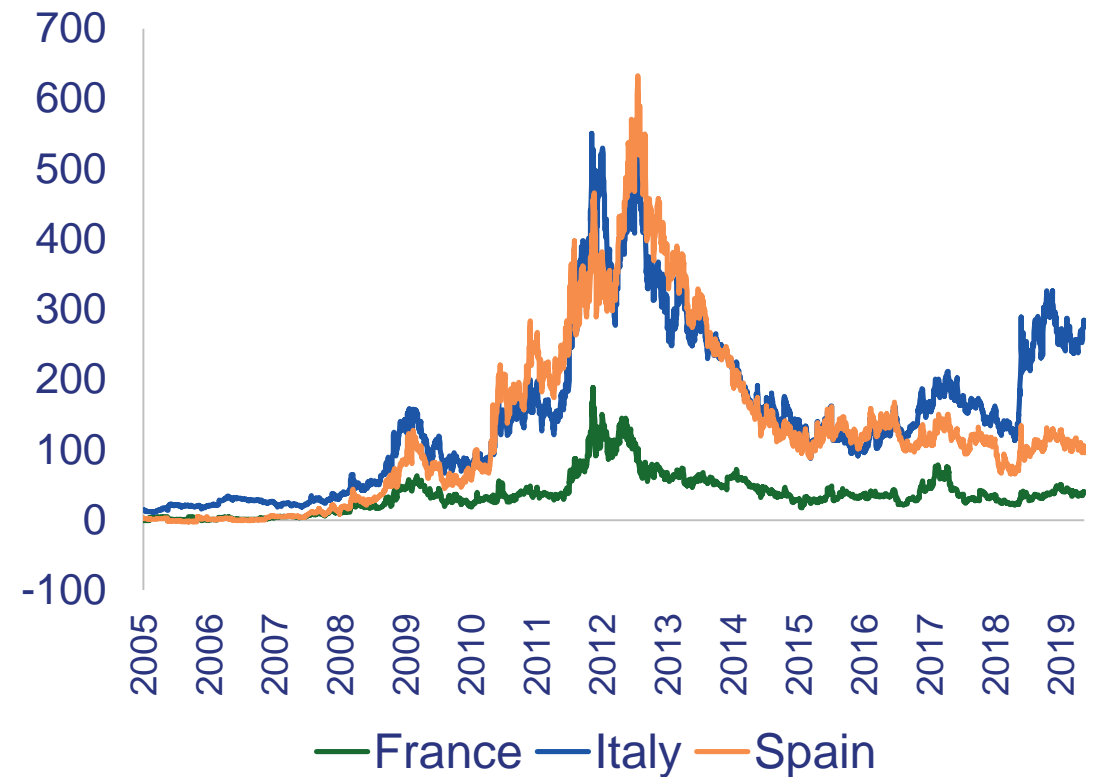


Interest rates at much higher levels in the US, country risk premia at risk of massive swings

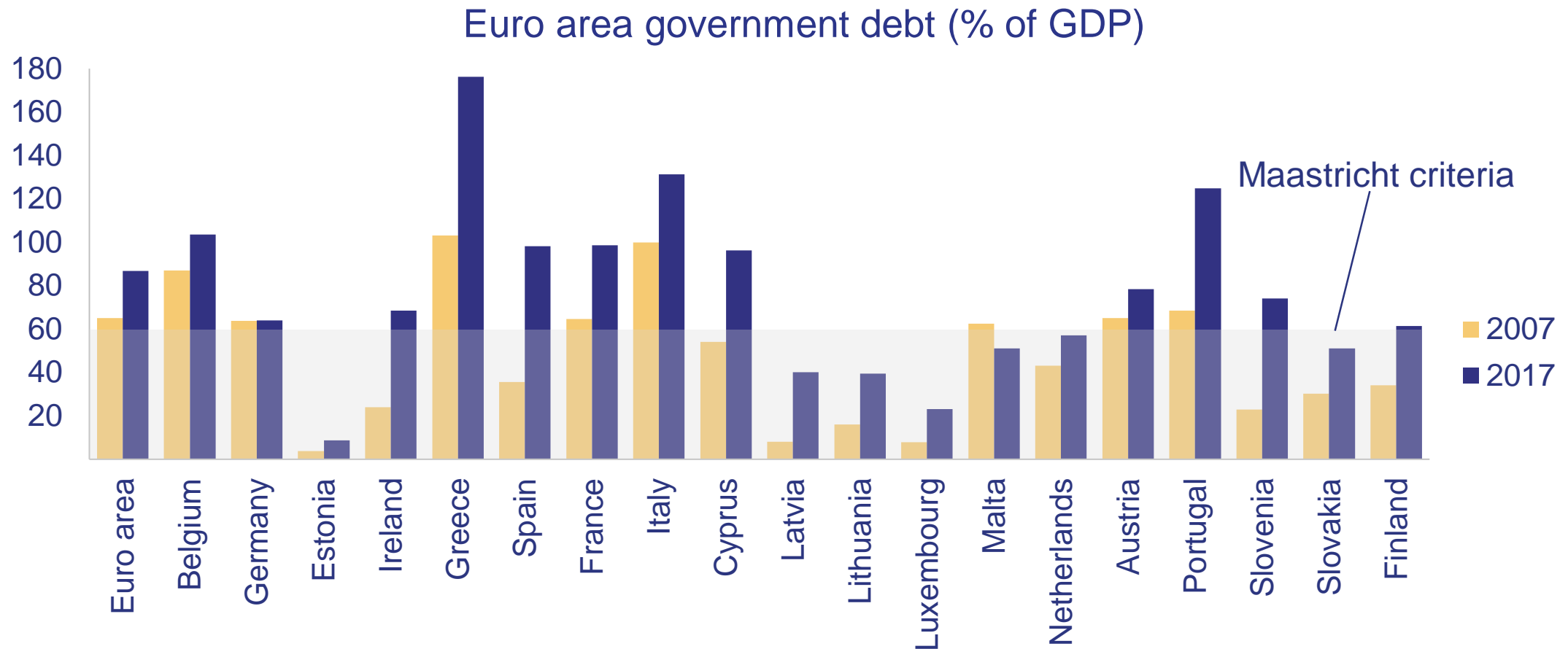
Money market 3M interest rates (%)



10Y government bond spreads vs Germany (bps)



High debt levels reduce monetary policy efficacy and resilience to downturns

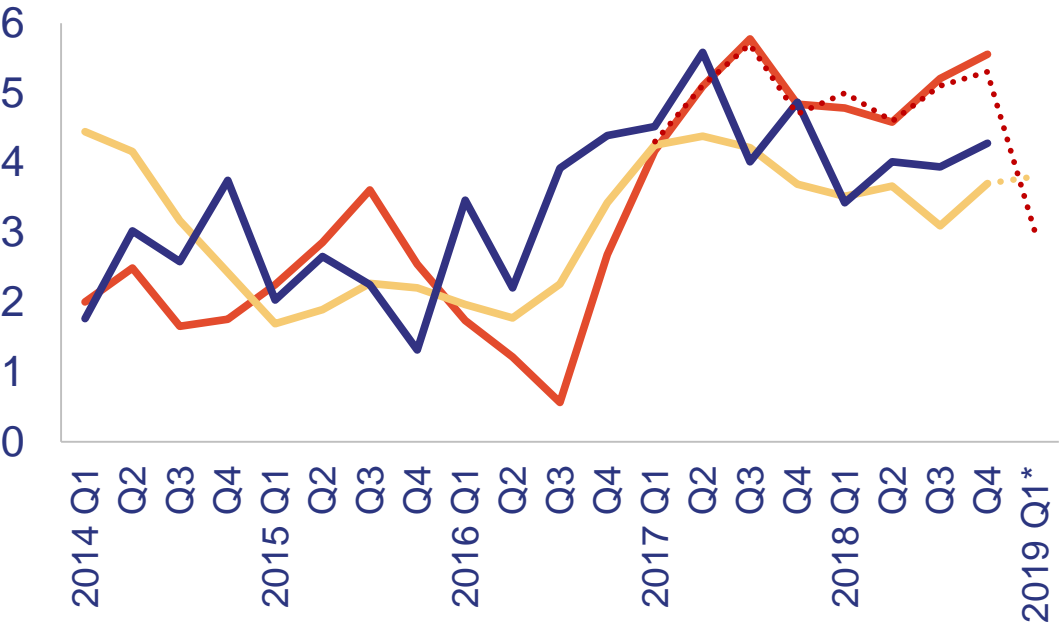




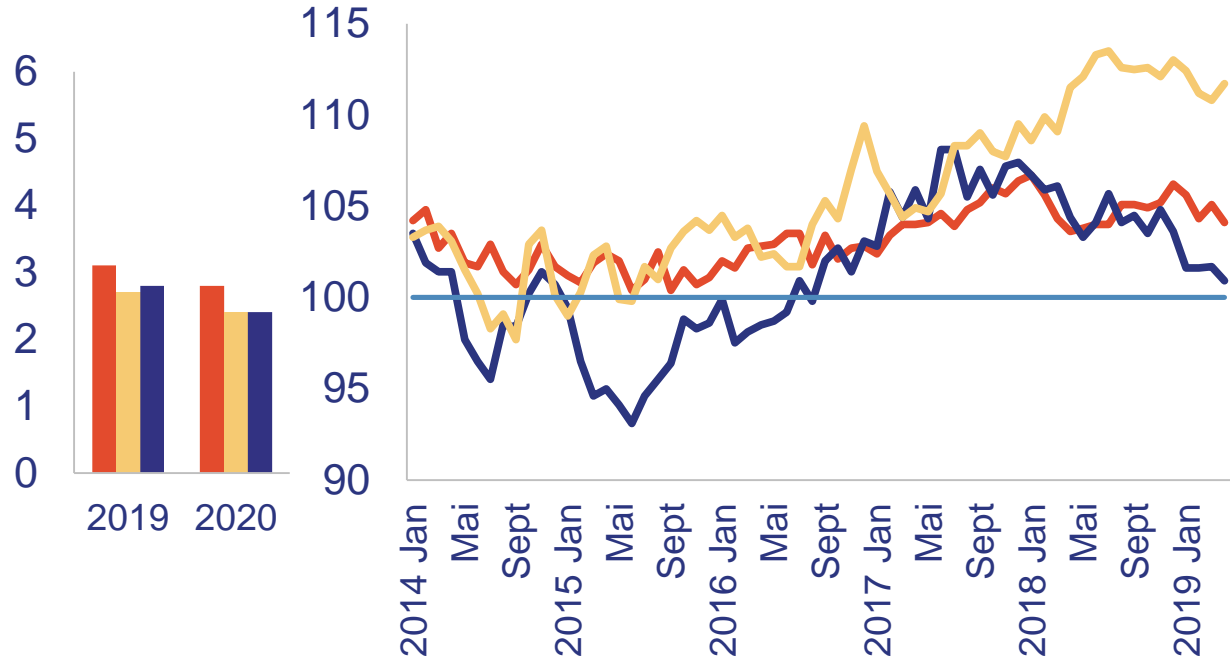
Latvian economy

The fastest growth phase of this business cycle is behind us also in the Baltics

Real GDP growth
(%; YoY)



Economic sentiment indicator
(long-term average=100)

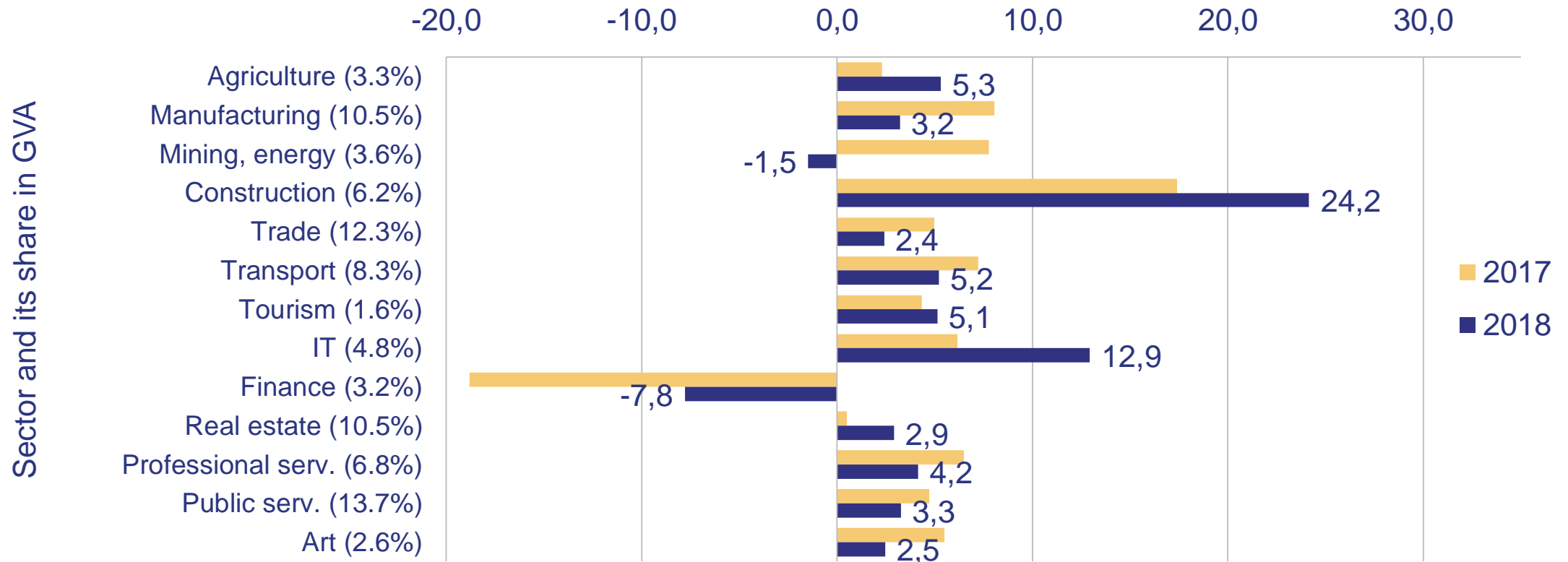


— Latvia — Lithuania — Estonia Lithuania flash Latvia flash

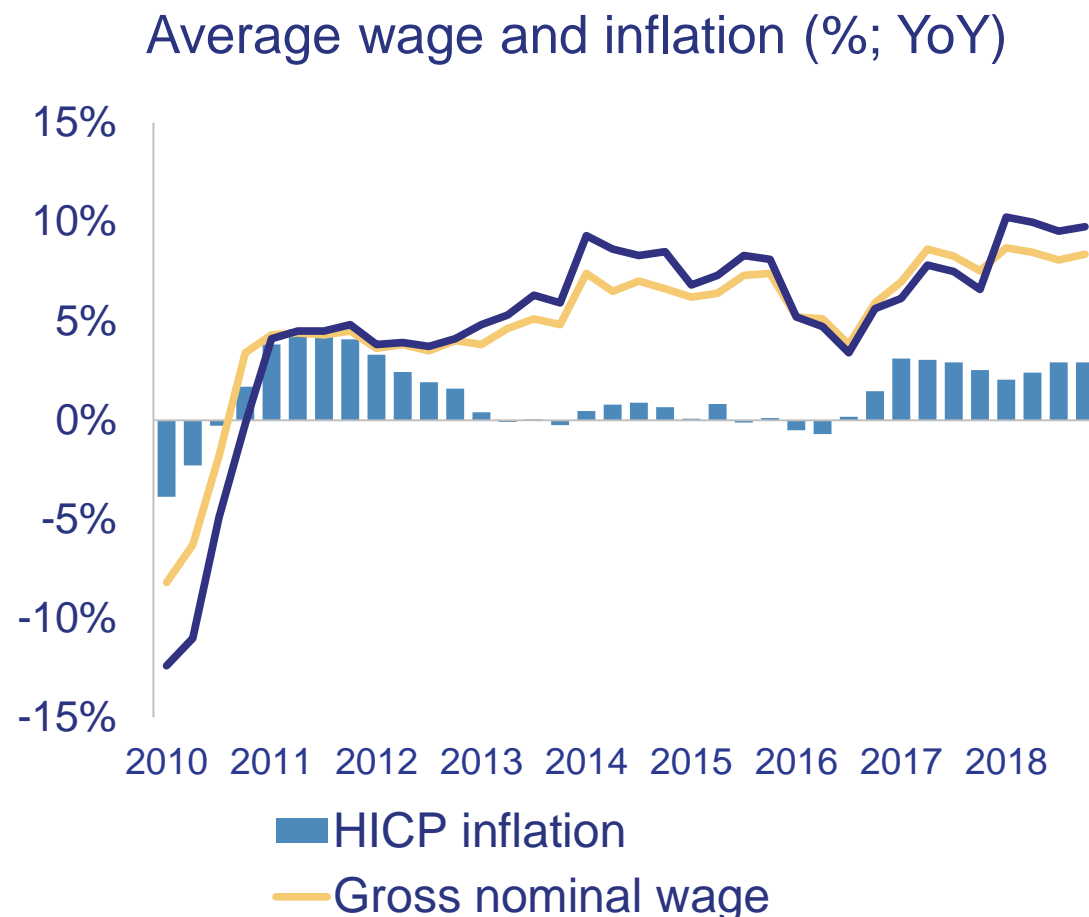
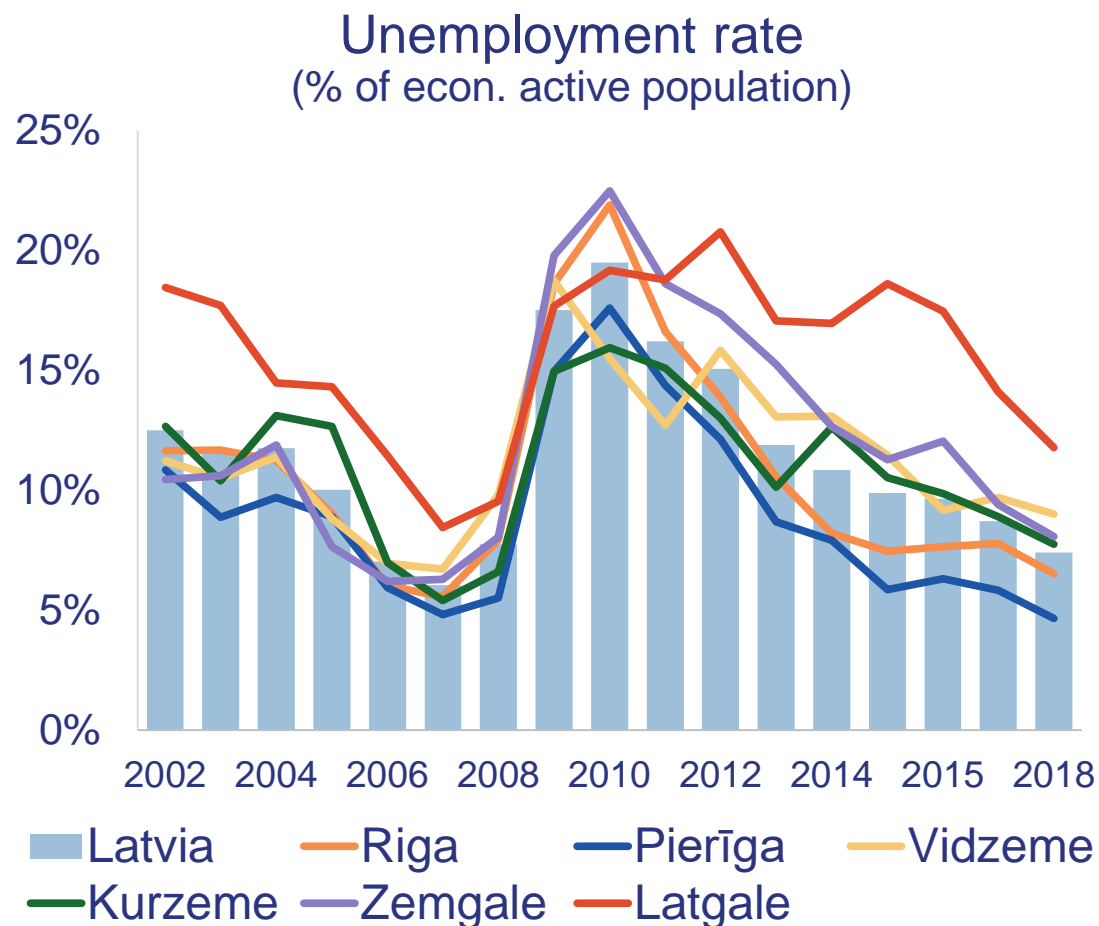
Source: Eurostat, European Commission spring forecast; *Lithuania statistics, Central Statistical Bureau of Latvia (CSB) flash estimate (s.a. rates renewed starting from 2017 Q1)

Growth broad-based and quite balanced; "hot spots" increasingly visible

Growth of value added (%; YoY; s.a.)

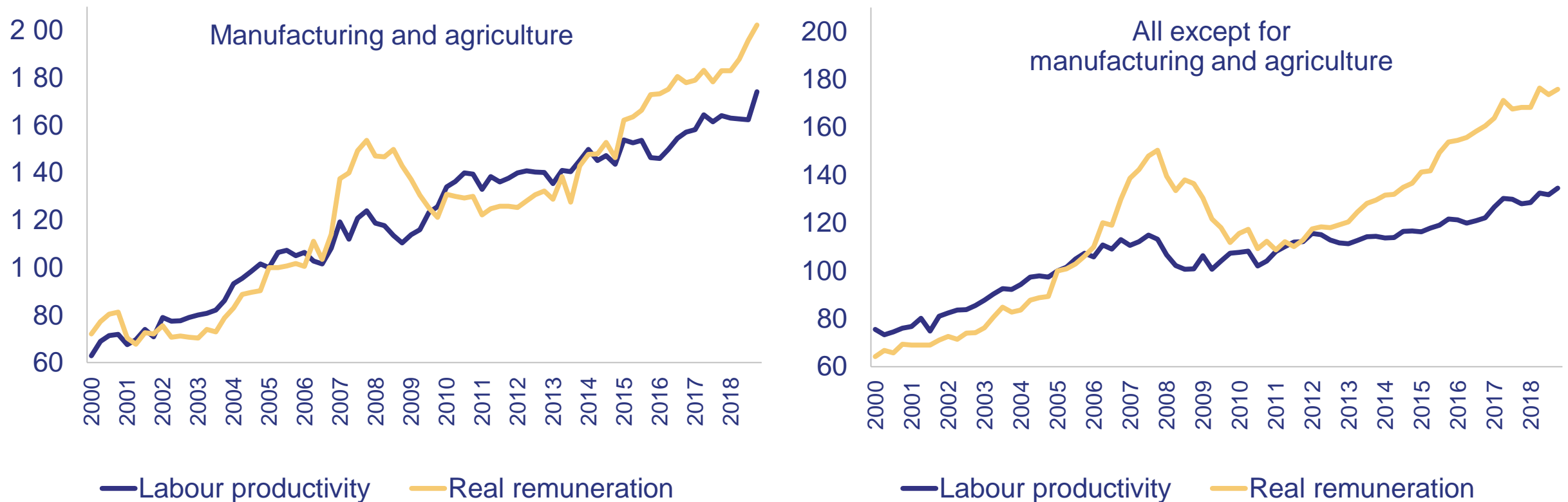


With growth ensuing, the labor market will tighten further



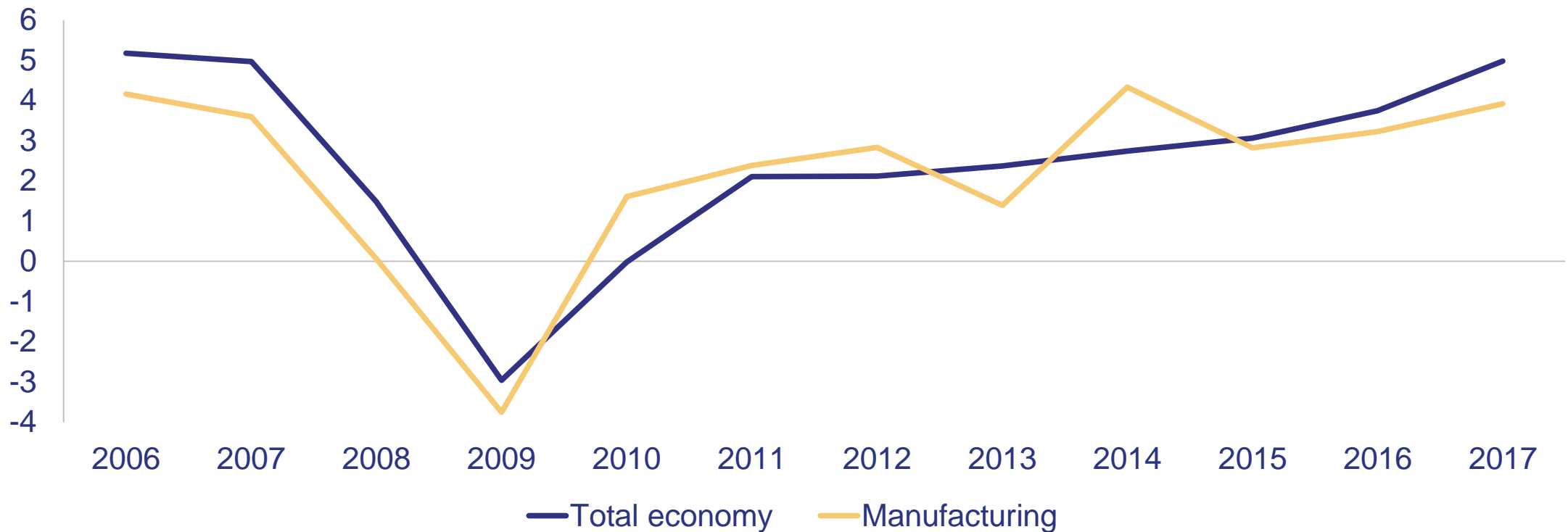
Wage-productivity gap widening, especially for non-tradeables and services

Labour productivity and real remuneration per hour worked
(index; quarterly data; 2005 Q1=100)



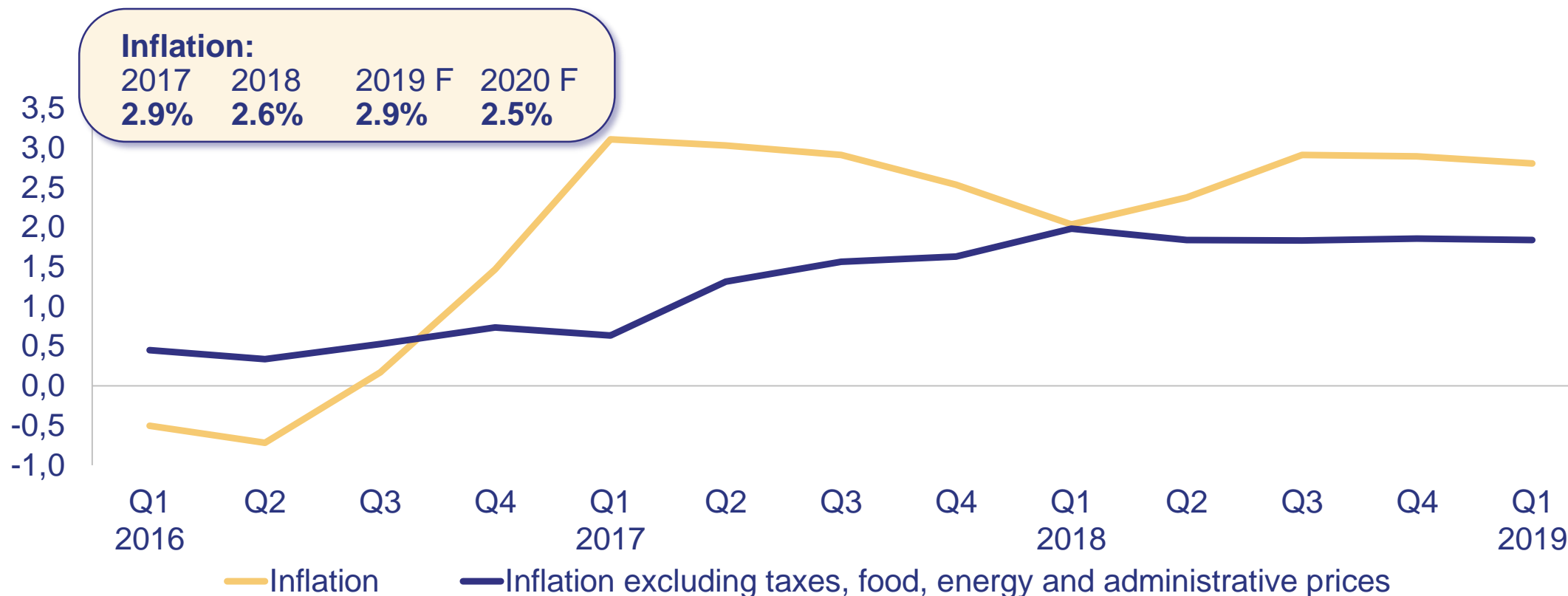
Despite the labour market warming-up, profitability of firms remains good

Profits after taxes / turnover
in total economy and manufacturing (%)



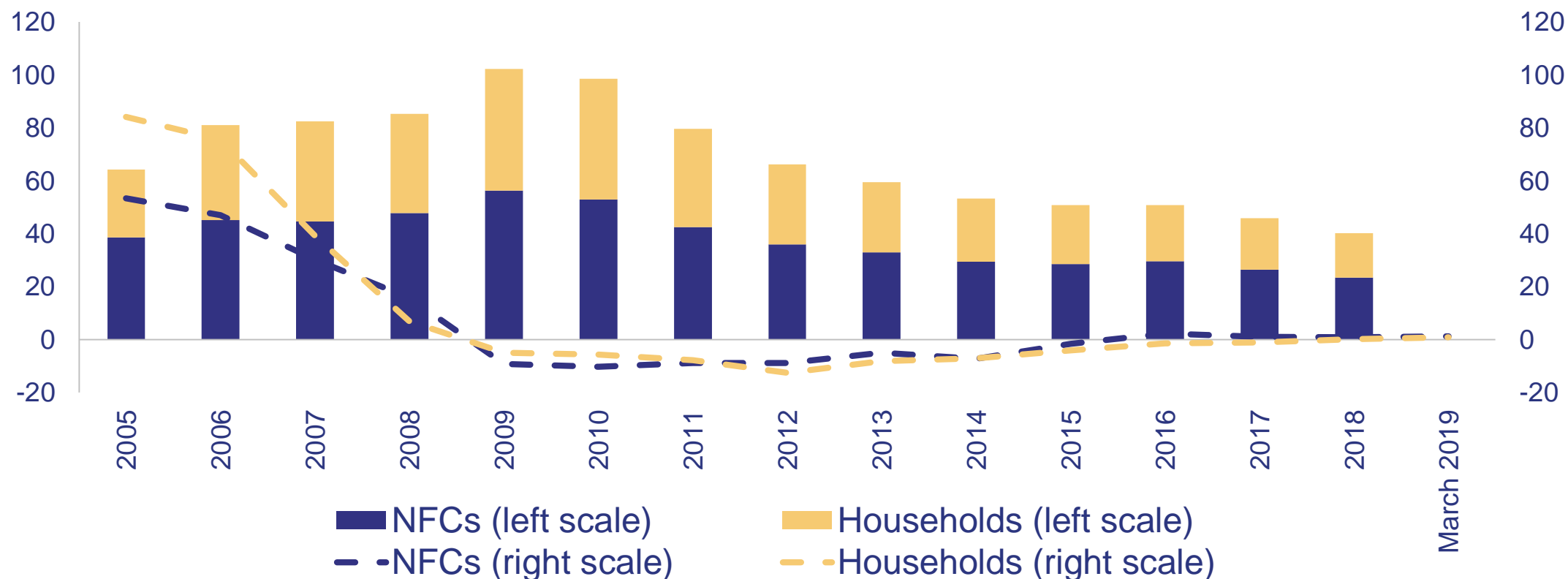
Inflation is moderate with pressures shifting from external to domestic factors

Consumer price inflation and core inflation
(%; YoY)



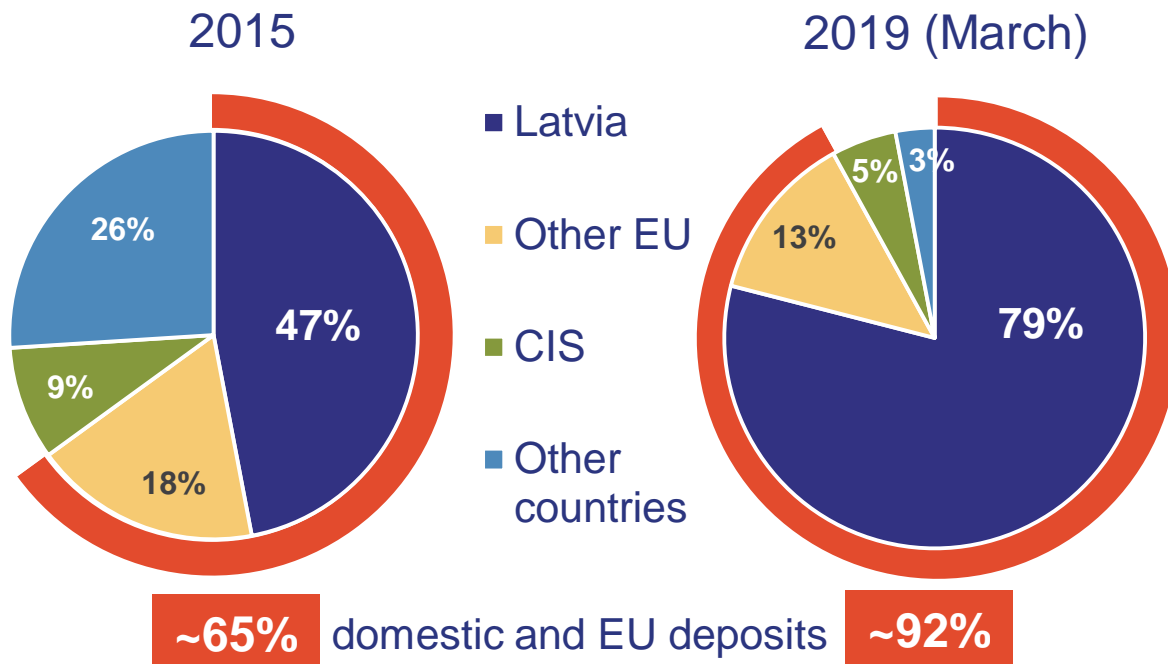
Bank lending improving, but still very pale; no major change expected in this business cycle

Bank lending to resident households and non-financial corporations
 (% of GDP to the left scale; YoY % to the right scale)

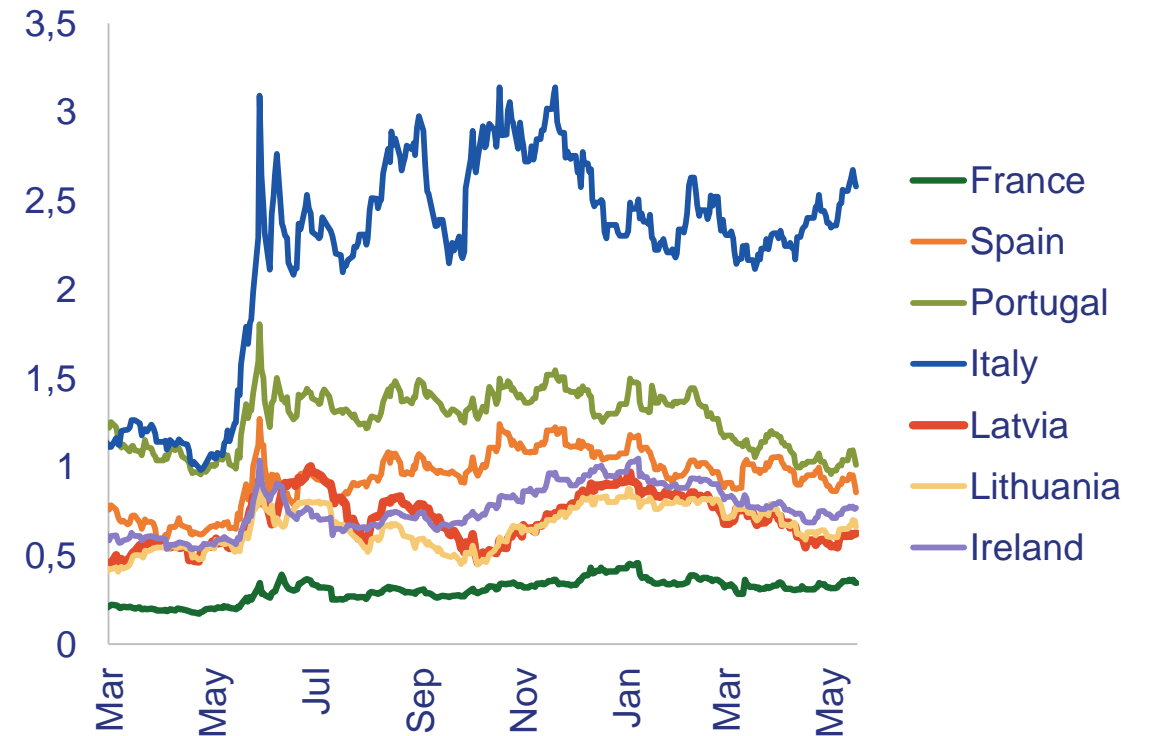


So far market reaction from AML issues to financing cost has been muted

Geographical breakdown of deposits

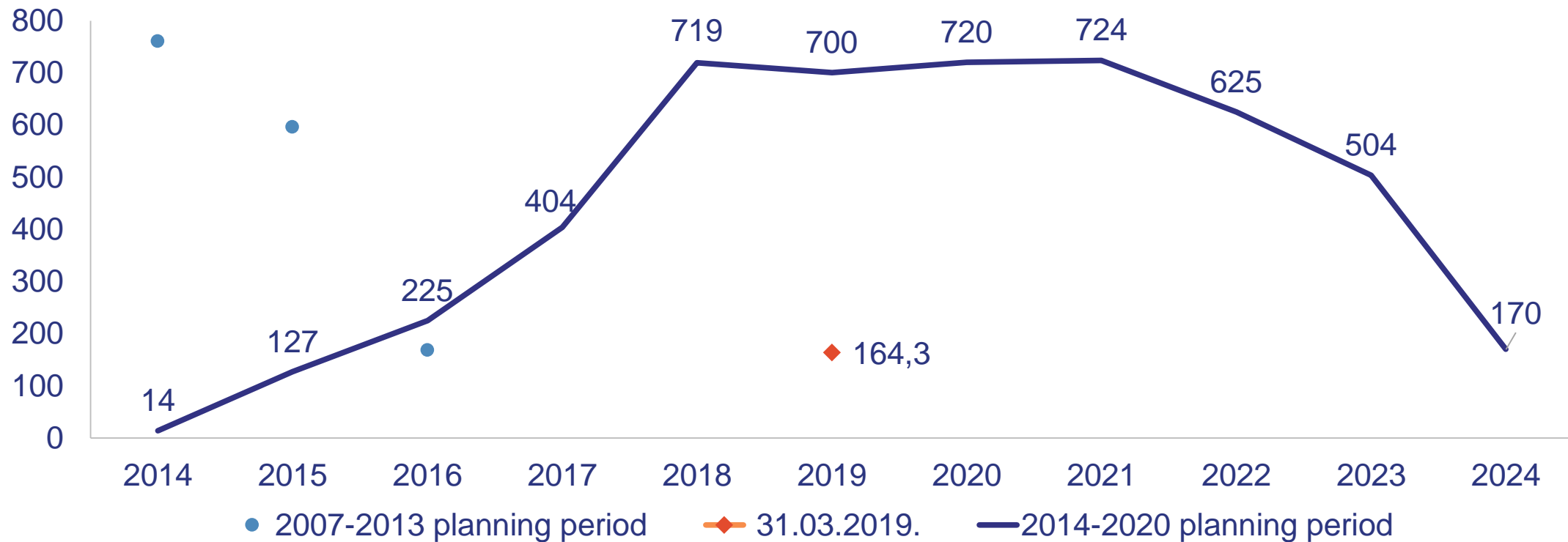


Spread to DE 8Y bond for various EA countries (%; 2018-2019)



EU fund inflow has reached its peak

EU structural funds-related general government expenditure
(millions of euro)



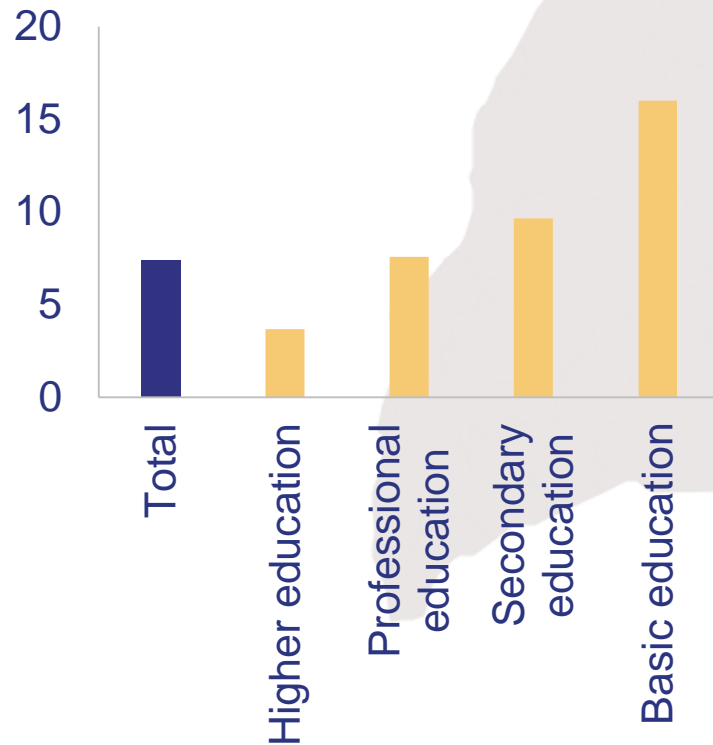
Growth is slowing, key risks to look out for

- ▶ Global **business cycle** is far from young, **trade war** rhetoric does not bode well for global trade... growth will weaken
- ▶ **Global populism** and geopolitics... all the bad fundamentals are still there
- ▶ **Moneyval report** and... whatever it takes to fix it

How to better use local labour force: education and skills...

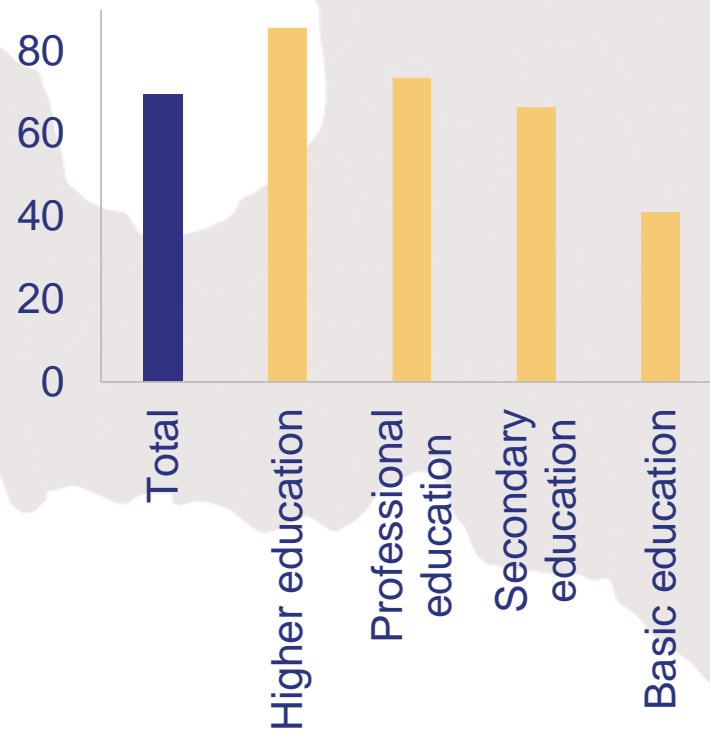
Unemployment rate

(% of economically active population; 2018)



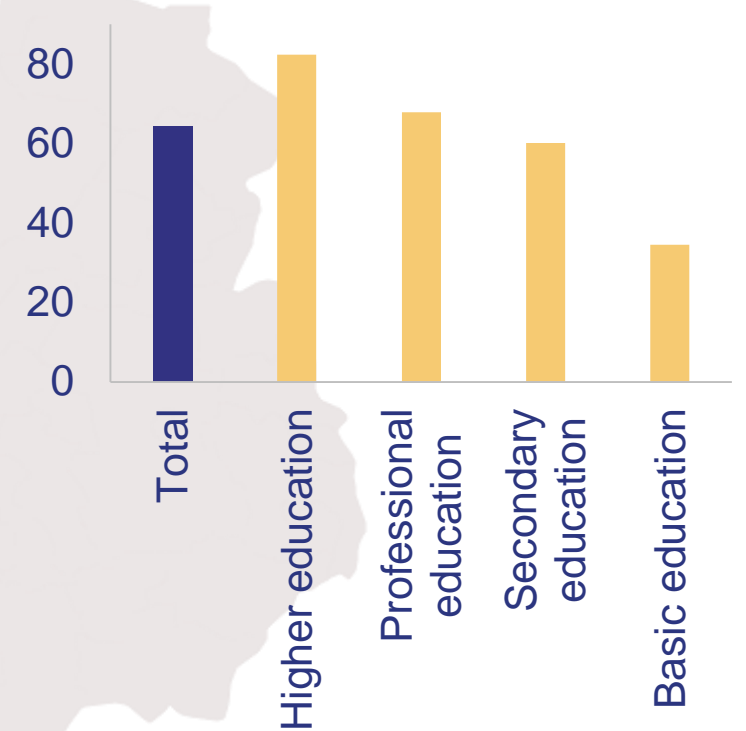
Participation level

(% from working-age population; 2018)



Employment rate

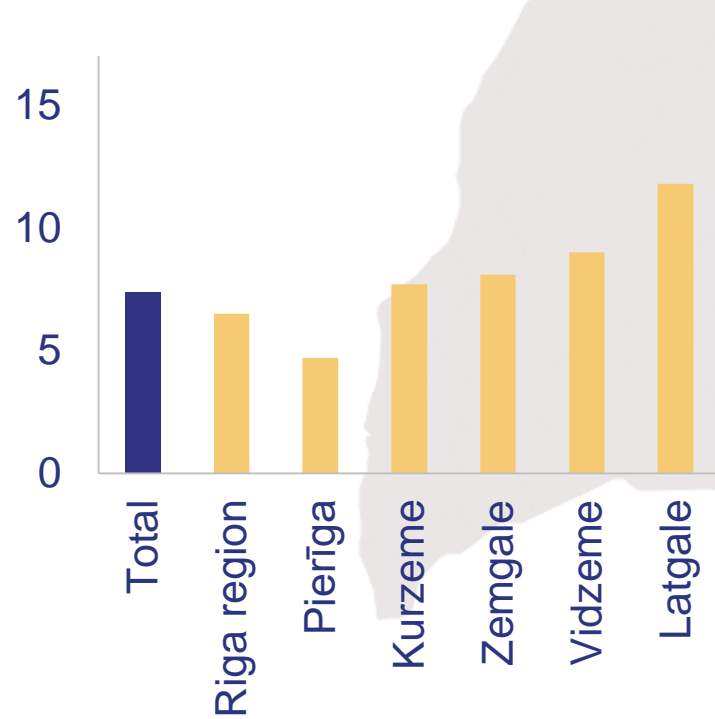
(% from working-age population; 2018)



... regional mobility...

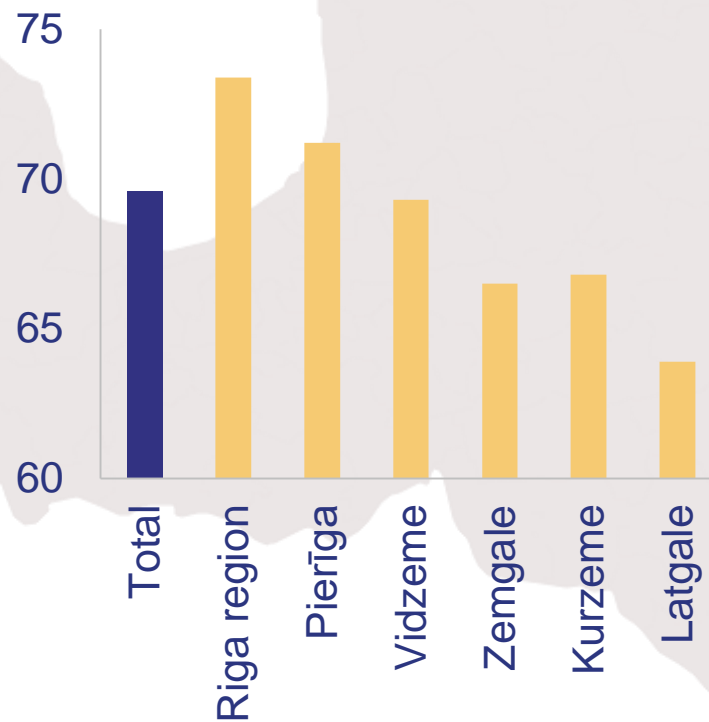
Unemployment rate

(% of economically active population; 2018)



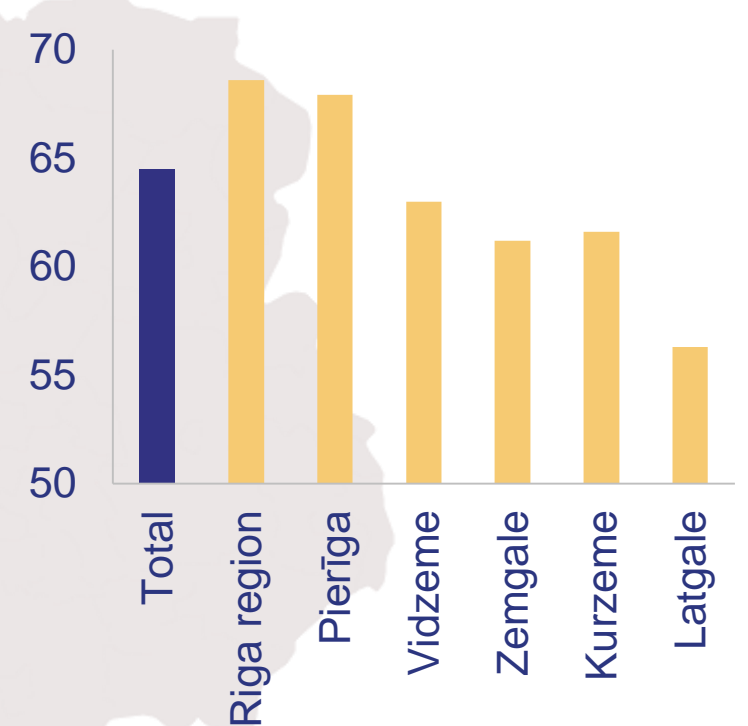
Participation level

(% from working-age population; 2018)



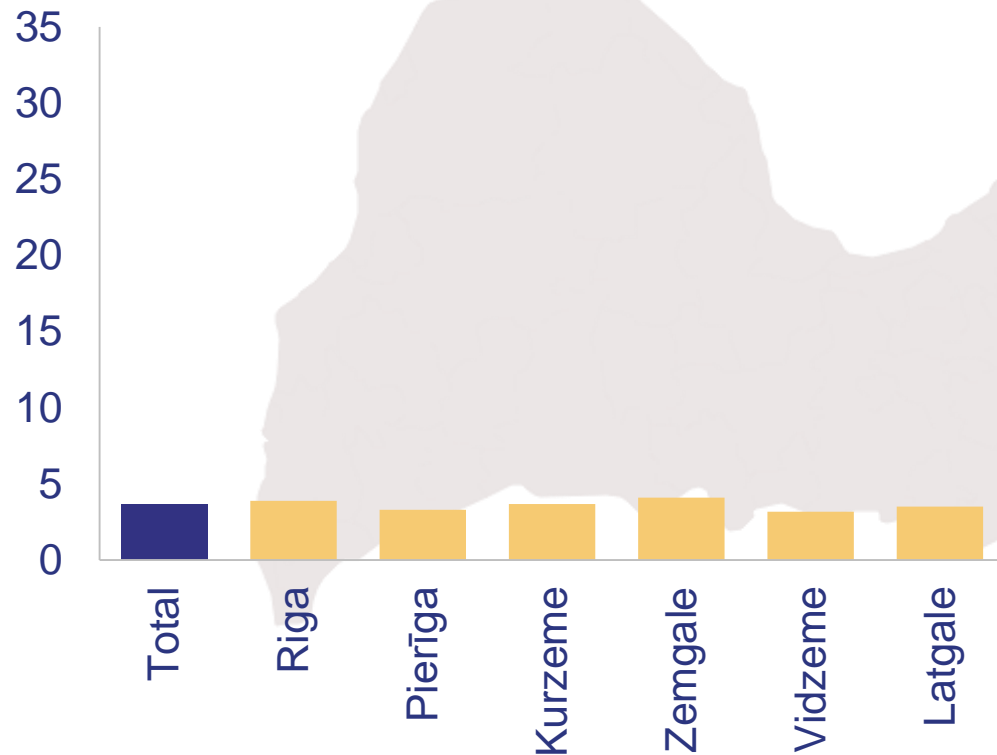
Employment rate

(% from working-age population; 2018)

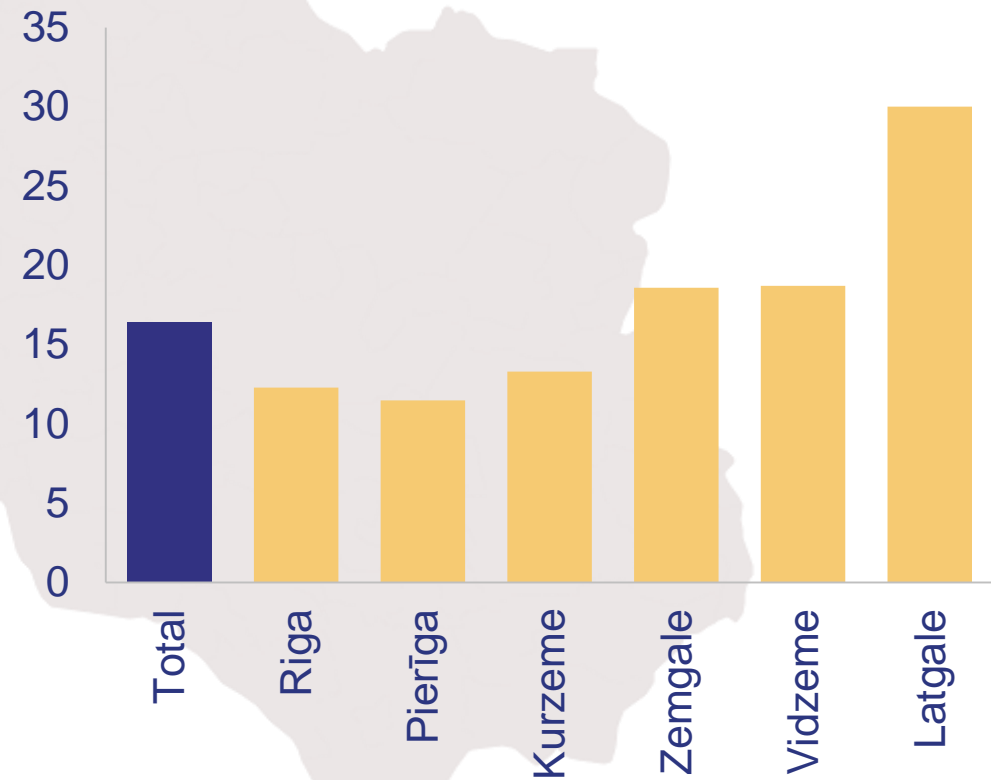


...and the interaction between them

Unemployment rate: higher education
(% of economically active population; 2018)

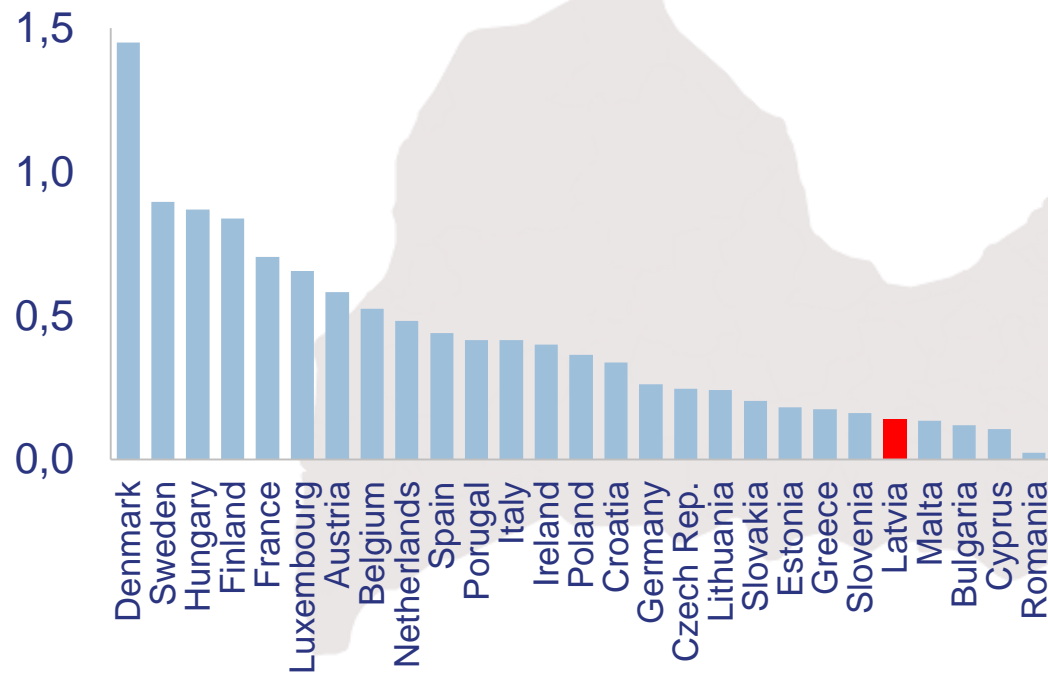


Unemployment rate: basic education
(% of economically active population; 2018)

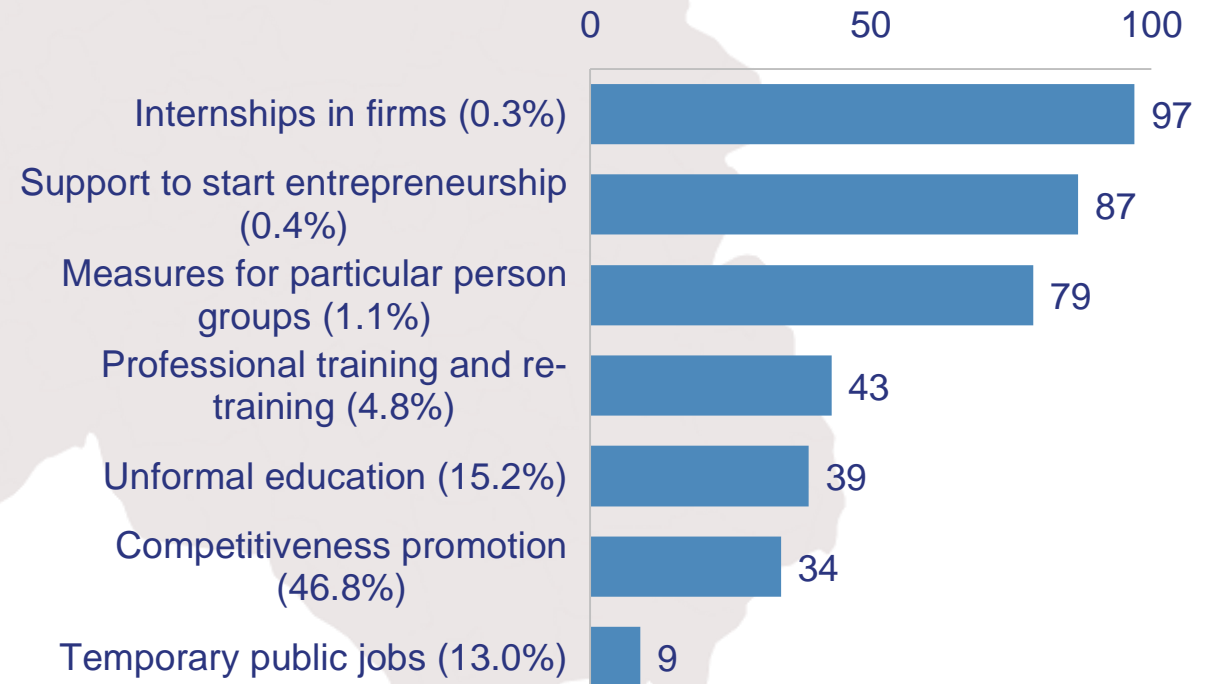


Active labour market policy: too little and wrong choices?

Active labour market (ALM) spending
(% of GDP; 2016)

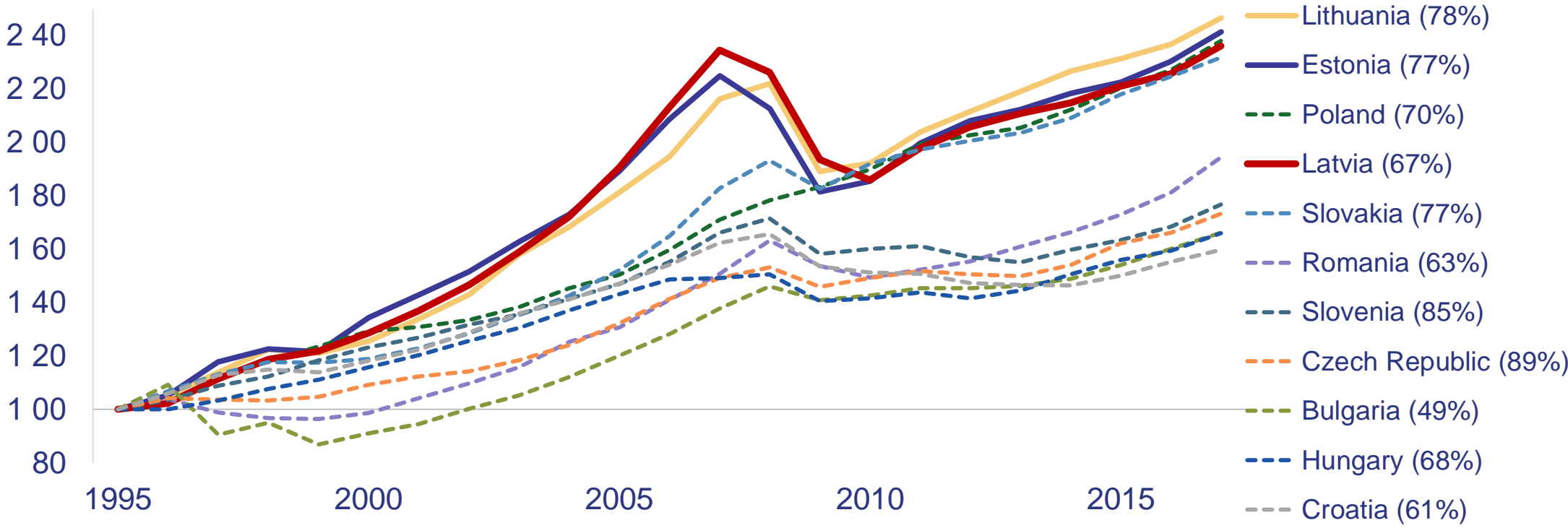


Found a permanent job in 6 months
(%; program ending period: 2017 July – 2018 June; % of participating in ALM policy in particular program)



Latvian growth among the fastest, but income still falling behind that of the closest neighbors

Real GDP index, 1995=100
(in parentheses 2017 GDP per capita, PPS, % of EU average)





Our country, our bank
