Comments on: “How Latvia Came Through the Financial Crisis”

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July 14, 2011
Outline

1. Economic performance under the program
   
   Program “succeeded” – but at great economic cost

2. Was the fixed exchange rate key?
   
   Authors passionate – but unlikely to convince the sceptics

3. What’s missing from the Book – and what’s next for Latvia?
Since mid-2009, CDS spreads have fallen

5-year CDS Spreads of Baltics (basis points)

- Latvia
Overnight interest rates too

Overnight Rigibor (Percent)
Current account shifted from unsustainable deficit to surplus

Latvia: Current Account Balance (percent of GDP)

Source: Haver Analytics

How Latvia Came Through the Financial Crisis

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Non-resident deposits returned (capital inflows)

Latvia. Resident and Non-Resident Deposits

- Resident Deposits
- Non-Resident Deposits

Resident depositors regained confidence in the Lats

Latvia. Share of Lats Deposits in Total Household Deposits

Source: Haver Analytics
International reserves increased (until recently)

Gross International Reserves (Billions of euros)

(includes international support package disbursements)
But GDP fell 25 percent

Baltics: Real GDP Developments, 2007q4=100

Source: Haver Analytics

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Unemployment increased to 20 percent

Latvia: Harmonized Unemployment Rate
SA, %

Source: Central Statistical Bureau of Latvia/Haver Analytics
Unemployment has fallen 60,000 from its peak

![Graph showing unemployment in Latvia from 2000 to 2010](source: Central Statistical Bureau of Latvia/Haver Analytics)
But employment is 200,000 down – 16 percent decline
Outline

• Economic performance under the program
  Program “succeeded” – but at great economic cost

• Was the fixed exchange rate key?
  Authors are passionate – but unlikely to convince the sceptics

• What’s missing from the Book – and what’s next?
Latvia has the most unequal income distribution in the EU

How Latvia Came Through the Financial Crisis

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What’s missing from the book?

- Financial sector stabilization – and reform
- Improving the quality of fiscal adjustment

Role of IMF and EU
How did PSI contribute?
What’s next for Latvia?

- From stabilization to growth?
- Can Latvia join the euro in 2014?
Rebound slower than other Baltics

Baltics: Recovery since 2010: Real GDP Growth (q/q seas adj)

Source: Haver Analytics

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Exports are growing rapidly, like other Baltics
But export share remains low

Baltics: Exports as share of GDP

Source: Haver Analytics
Product mix is not very high tech

Composition of exports in 2010

- Transportation: 36
- Wood: 14
- Machinery: 14
- Metals: 13
- Prepared foodstuffs: 10
- Agriculture: 6
- Other: 6
Scope for improving educational quality and growth

PISA Ranking of 15 Year Old Students (Math, Reading, Science), 2009
Inflation has jumped to 4.8 percent y/y (but supply shocks) - risk of missing Maastricht
Latvia has more to do, but let’s put in perspective:

![5-year CDS Spreads of Balkans (Basis points)](image)
CDS lower than Southern Europe:

5-year CDS Spreads of Southern Europe (Basis points)

- Latvia
- Spain
- Cyprus
- Italy

Jan-10  Jul-10  Jan-11  Jul-11
And well below Euro Area program countries:

5-year CDS Spreads of Euro Area Program Countries (Basis points)

- Latvia
- Greece
- Portugal
- Ireland

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