

Baltic macro outlook

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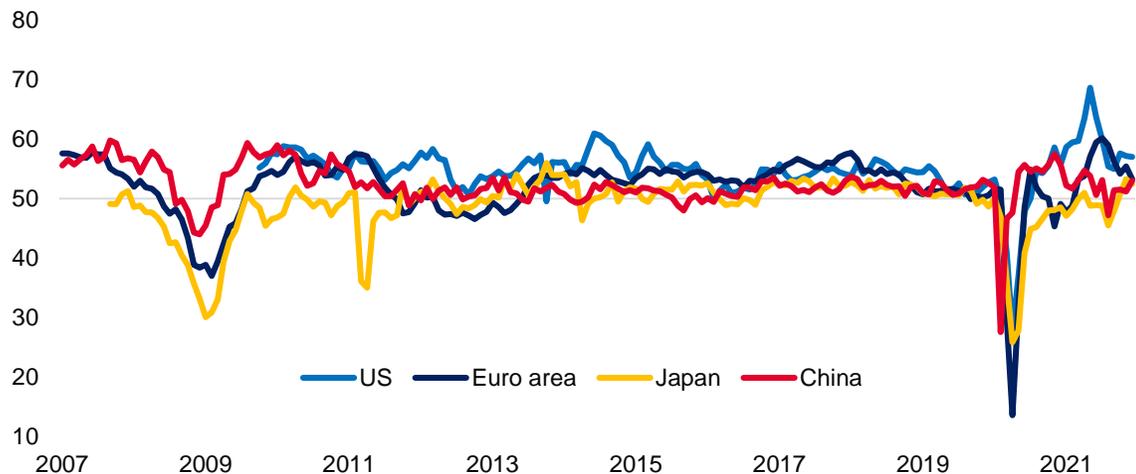
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Global economy

Global macro-outlook remains good despite rising inflation

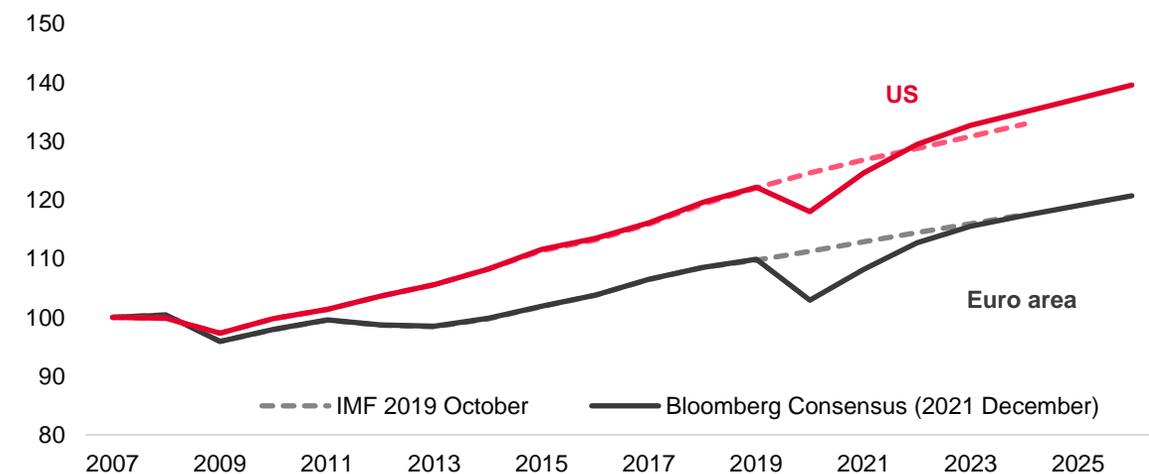
IHS Markit Composite PMI (values above 50 indicate expansion)



World trade and industrial export orders (% YoY)



Real GDP in US and Euro area (2007=100)



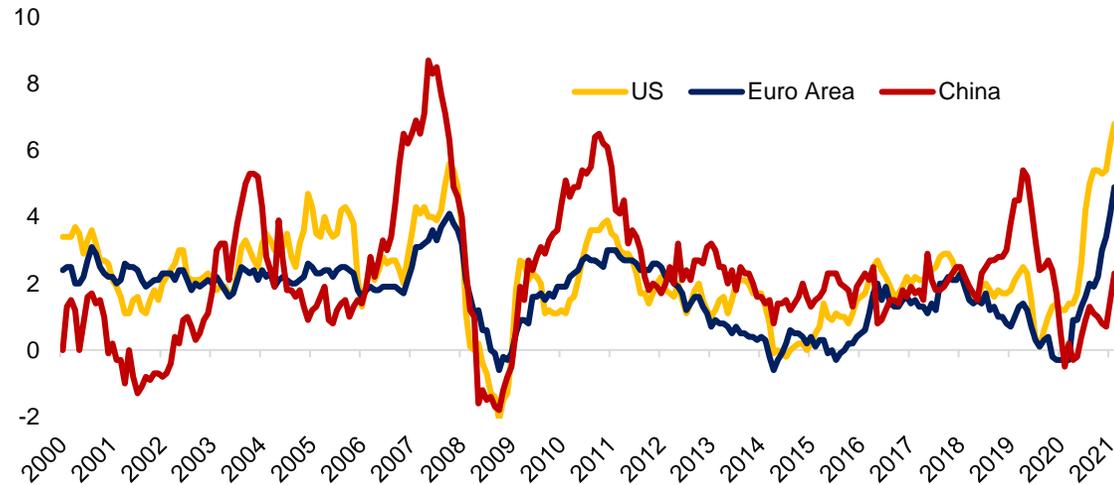
Comments

- Business sentiment in the world's leading economies is strong, world trade and new industrial orders are growing, and unemployment in the US and Europe is approaching pre-crisis levels.
- Economists surveyed by Bloomberg predict that the US and eurozone will fully recovery to pre COVID growth trajectory by 2023.
- The rapid rise in inflation, the energy crisis in Europe, growth slowdown China and turmoil in the Chinese real estate sector, as well as geopolitical tensions and the rapid spread of the COVID-19 omicron variant, are significant risks that will affect both the global economy and the Baltics in 2022.

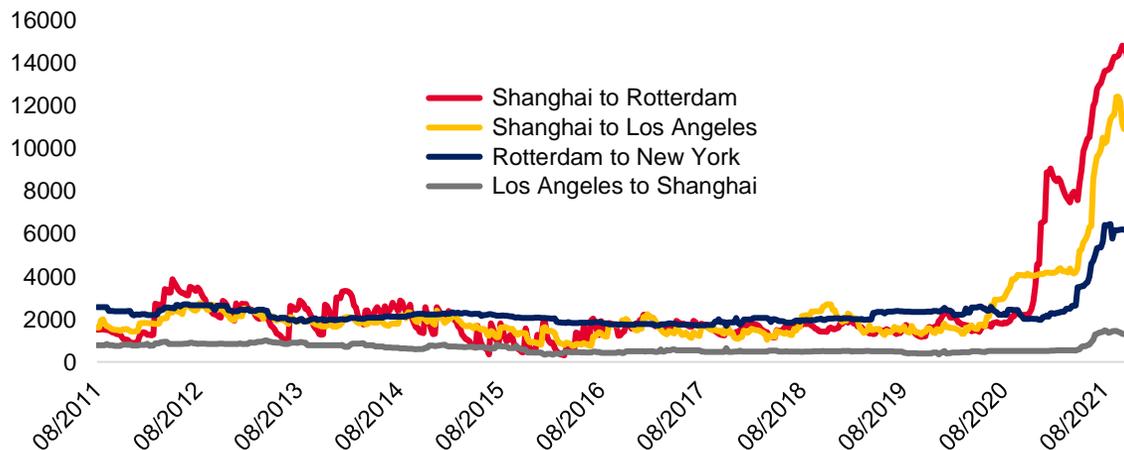
Inflation

Global inflation is now at a multi-decade highs

Consumer price inflation (% YoY)



Freight Benchmark Rate (USD per container)



Bloomberg Commodity Spot Index



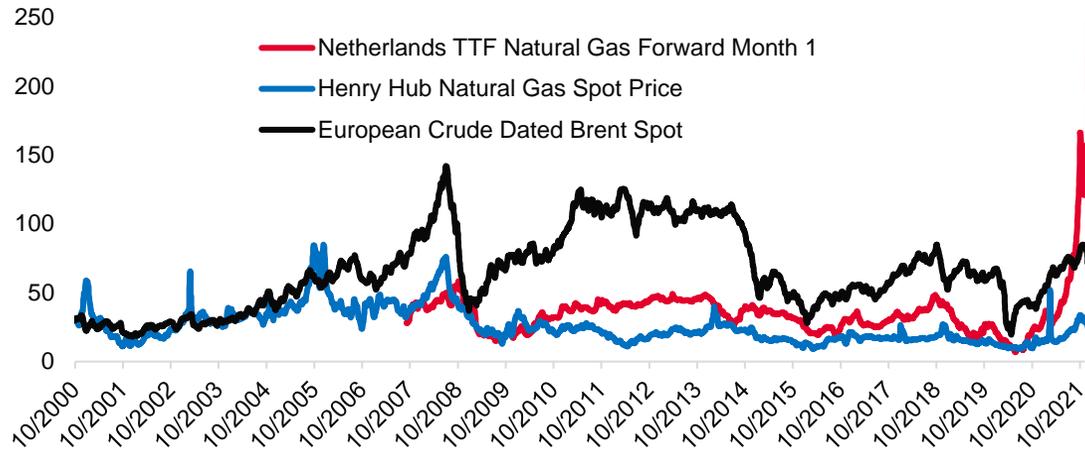
Comments

- Consumer price inflation in the global economy in 2021 has increased to the highest level in many decades. In US inflation is now highest since 1980's and in euorzone since the creation of euro.
- After a long period of low inflation since the 2008 global financial crisis, the pace and the persistence of inflation was certainly one of the biggest surprises for economists and central banks in 2021.
- Limited access to services has significantly increased consumption of goods, leading to rising global prices for a wide range of resources, industrial inputs and transport services.

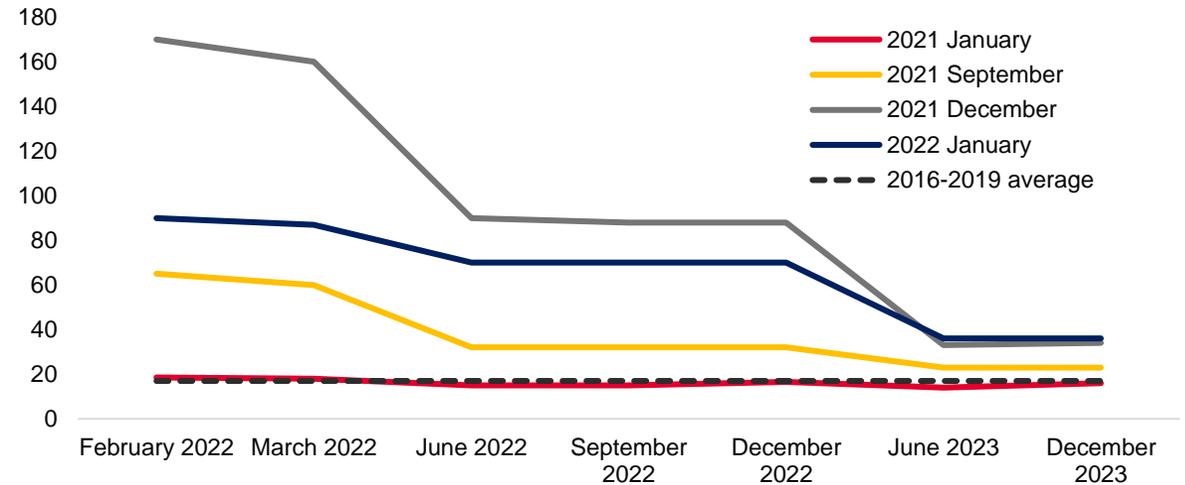
Energy crisis

The energy crisis is a major risk to Europe's economic recovery

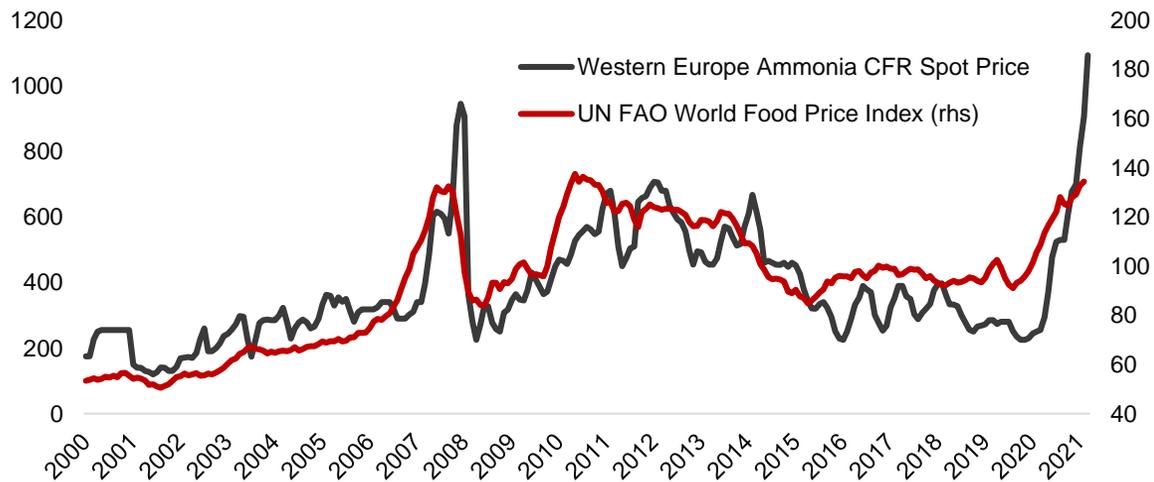
Oil and natural gas prices (USD/Barrel of Oil Equivalent)



Dutch TTF Natural Gas Futures (€/MWh)



Global food and fertilizer prices



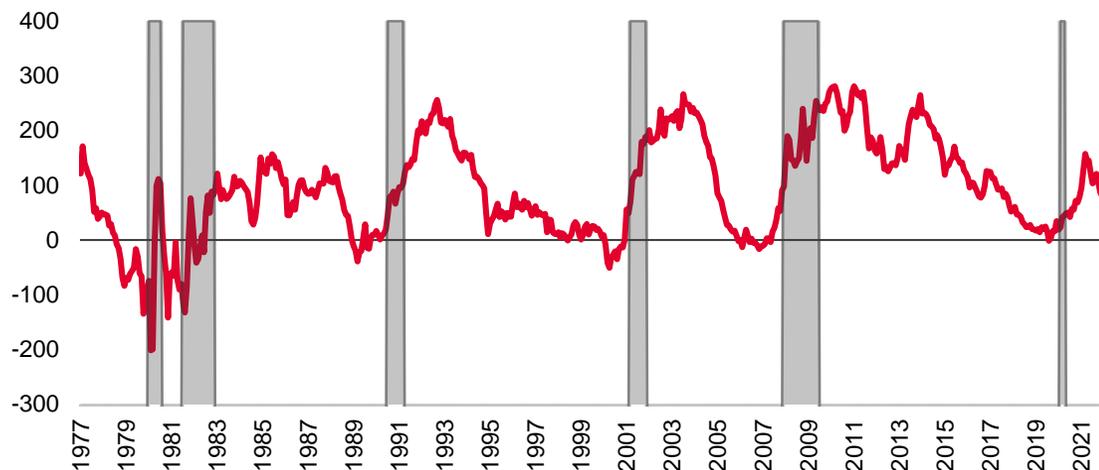
Comments

- Uneven and rapid economic recovery, the strong support measures for the economy and the coincidence of political and climatic factors since the summer of 2021 have led to a very sharp rise in energy prices in Europe.
- Compared to previous years, electricity market prices in Europe have increased 3-5 times and natural gas prices in oil equivalent have reached 150-200 US dollars per barrel.
- Natural gas futures prices for the summer and autumn of 2022 are still significantly higher than in recent years.

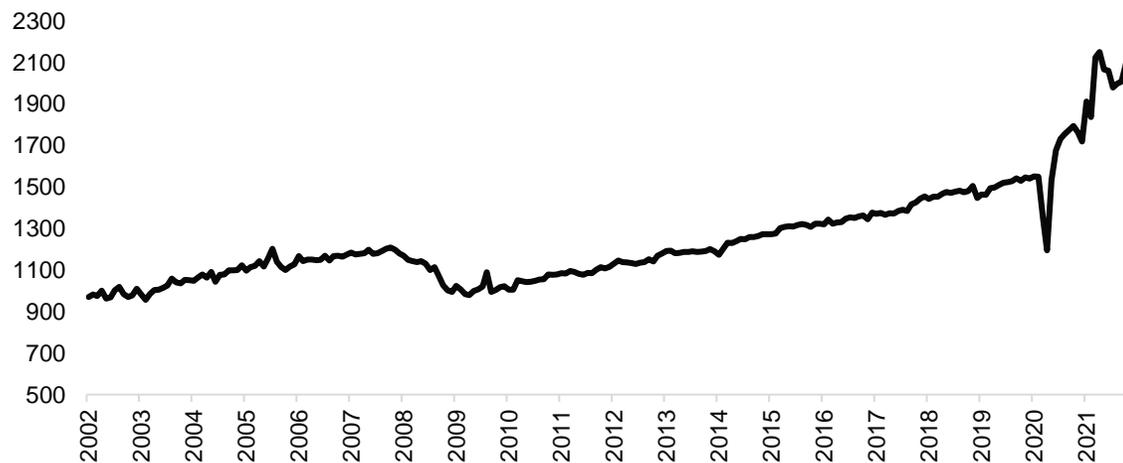
Global economy

Signs of a possible slowdown in economic growth have also emerged in the financial markets

10-2 Year US Treasury Yield Spread



US consumption expenditures (durable goods in nominal terms)



Source: FRED, Bloomberg, Markit

China credit impulse (% of GDP)



Comments

- Developed countries will face a major challenge in 2022 to curb inflation without jeopardizing economic recovery. According to the financial market expectation, the US could raise interest rates 3-4 times in 2022 and even the ECB could start cutting negative rates.
- Expectations of interest rate hikes have led to higher short-term rates, but long-term rates remain low despite high inflation. Flattening of the yield curve is signaling possible slowdown in growth.
- Limited access to services has significantly increased consumption of goods which is unlikely to be sustainable. Reducing economic support measures, together with the normalization of consumer demand, could also mean slower growth in world trade

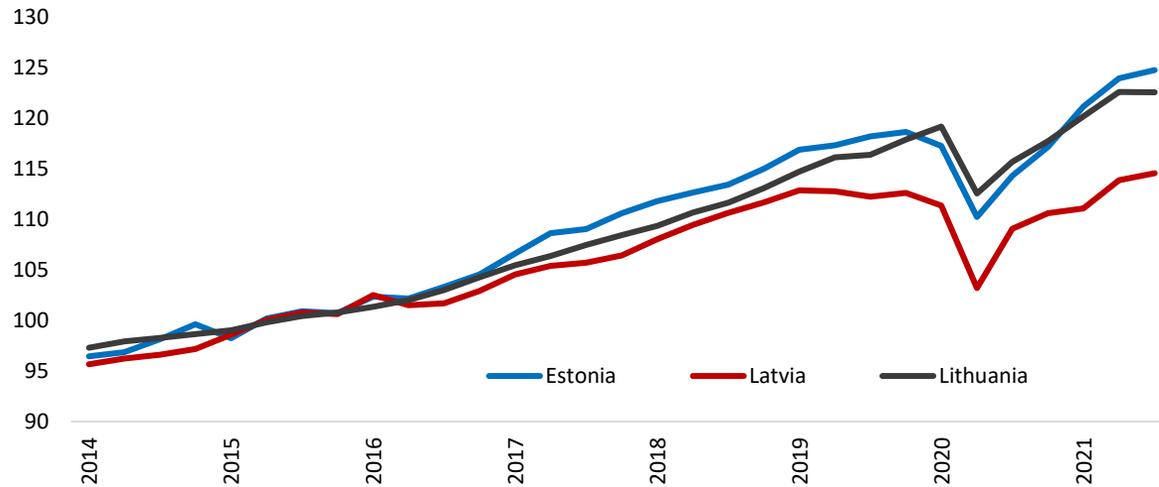
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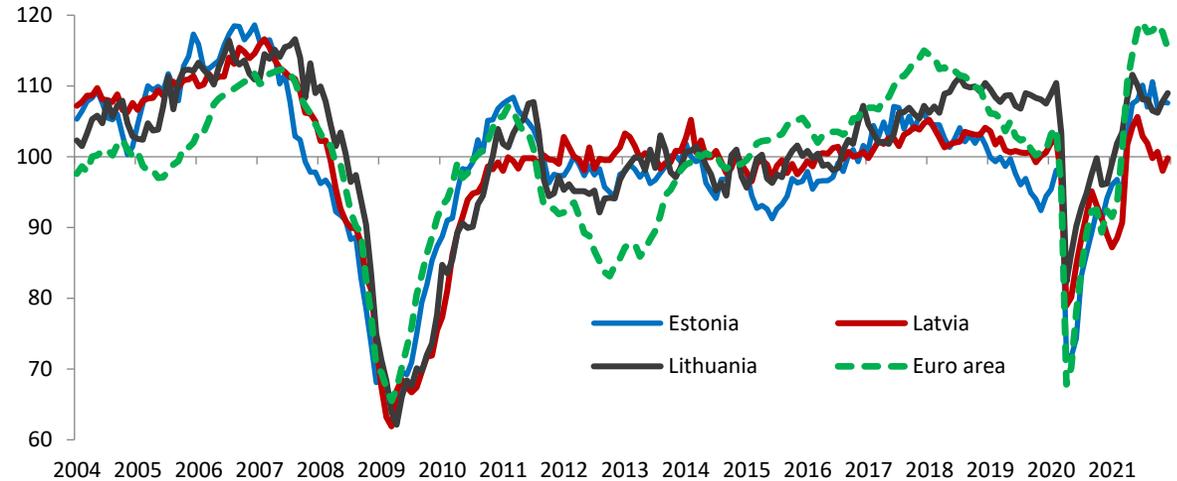
Baltic region

Economic recovery in the Baltics has been significantly faster than in other European countries

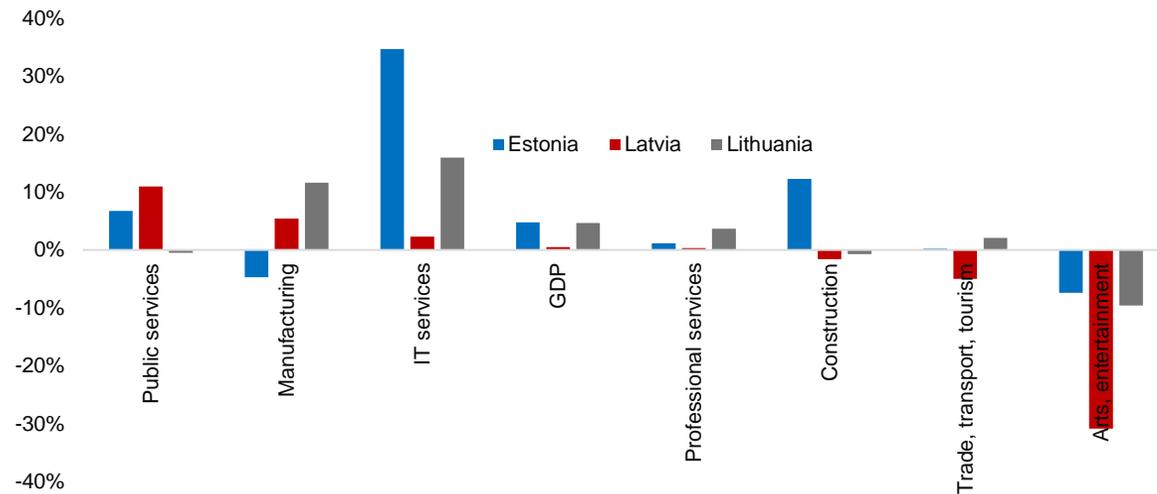
GDP in constant prices (2015=100)



Economic sentiment indicator



GDP in the Baltics by sectors (Q1-Q3 2019 vs Q1-Q3 2021, %)



Comments

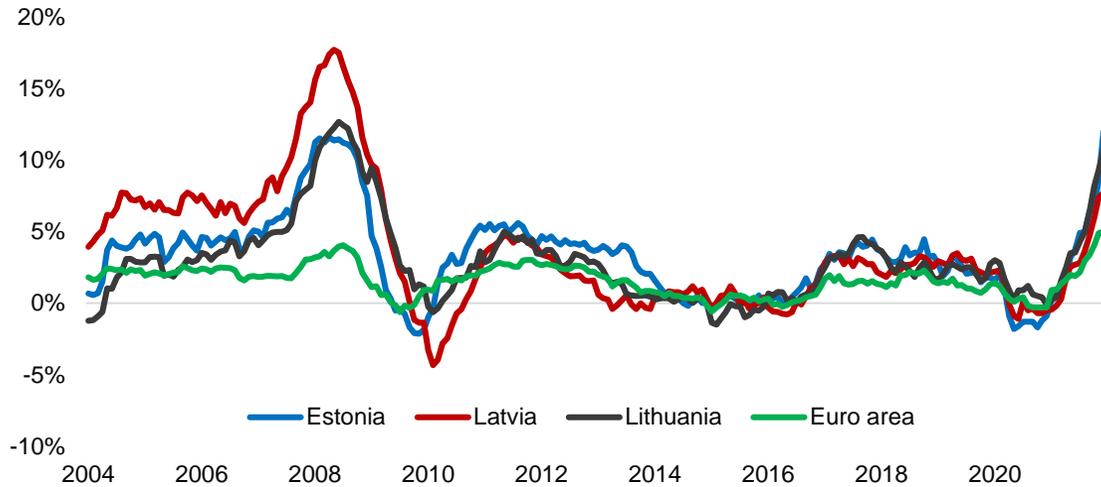
- Less than two years after the start of the pandemic, all three Baltic States have exceeded previous GDP levels.
- Latvia's GDP in the third quarter of 2021 was 1.7% higher than in the fourth quarter of 2019, while Lithuania and Estonia's GDP is now respectively 4% and 5.1% higher than at the end of 2019.
- However, the economic recovery is uneven and large-scale global economic support measures are increasingly contributing to rising prices.

Source: Eurostat, DG ECFIN

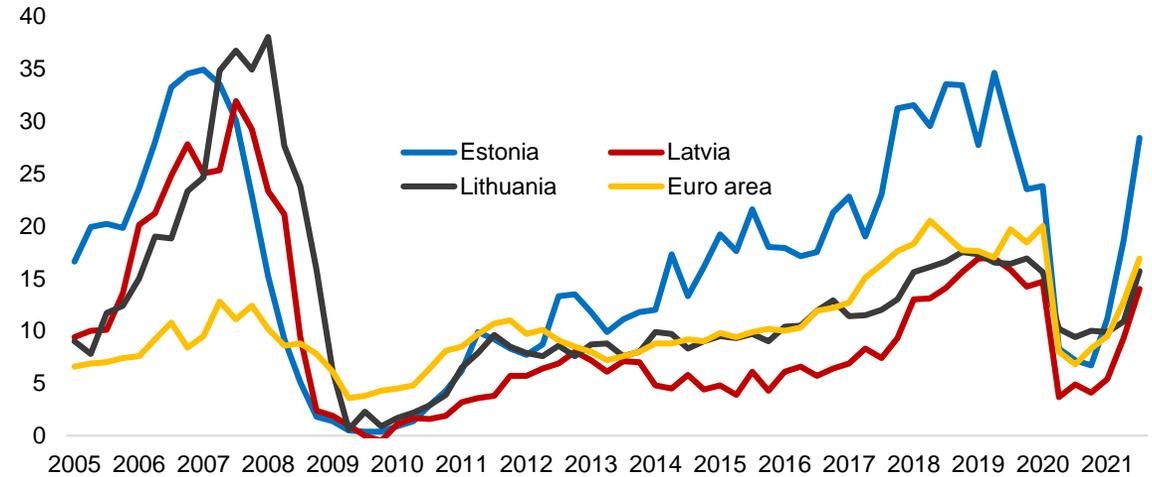
Inflation

Inflation in the Baltics has now reached its highest level since 2008-2009

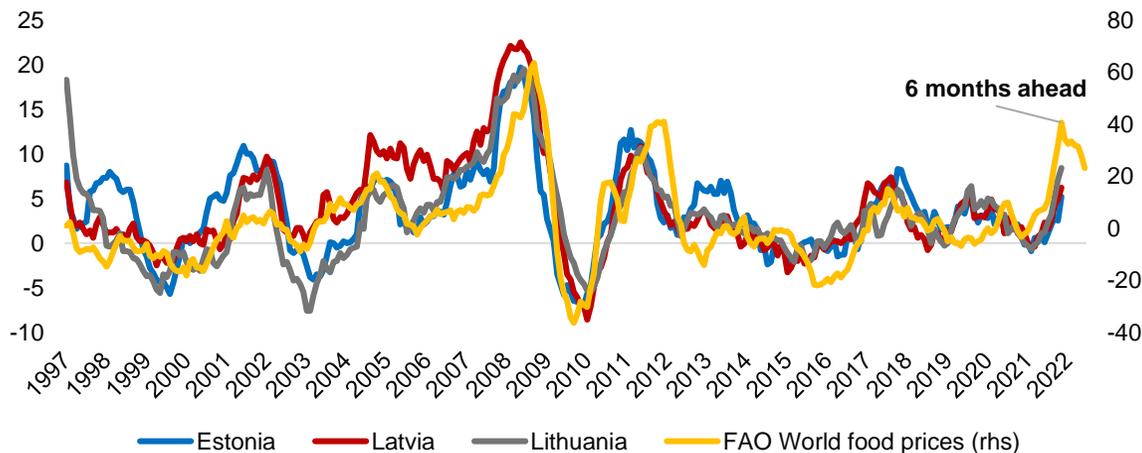
Consumer prices (% YoY)



Shortage of labour in services (factors limiting growth, %)



Food prices (% YoY)



Comments

- The share of energy and food in consumption in the Baltic States is high and we are therefore more sensitive to global price fluctuations. More than half of inflation in the Baltics is driven by rising fuel, electricity, natural gas and heat prices.
- Producer price inflation in the Baltics has exceeded 20% and the pressure to pass on price increases to consumers is high.
- The rise in energy prices has not yet been fully reflected in final consumer prices, and entrepreneurs have to reckon with a sufficiently rapid rise in wages, as the working age population continues to decline and wage growth has long outpaced productivity growth.

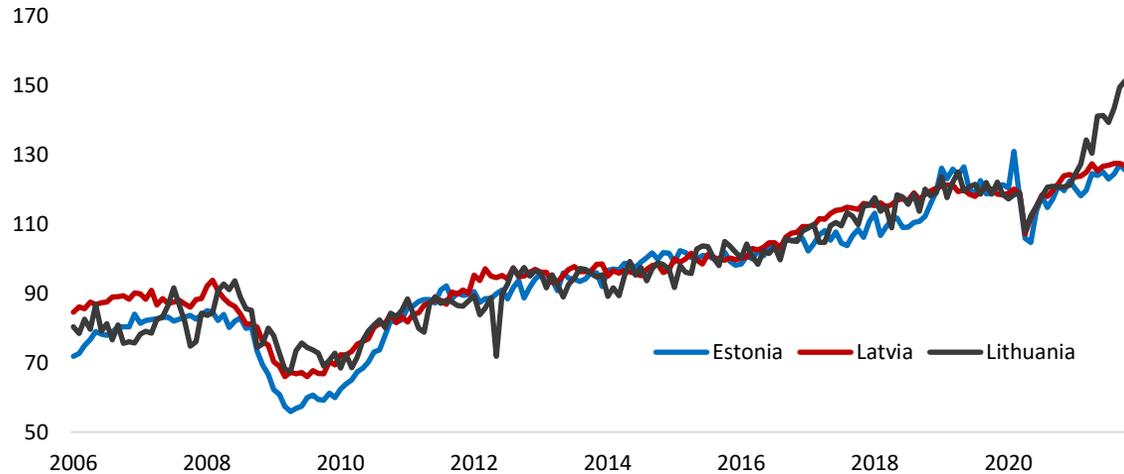
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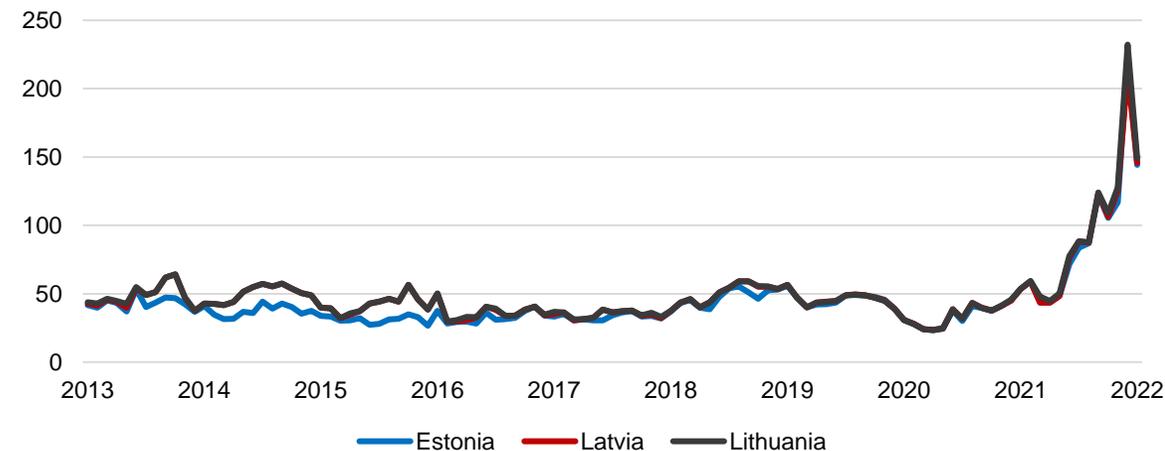
Manufacturing

Manufacturing in the Baltics has grown significantly faster than the economy as a whole

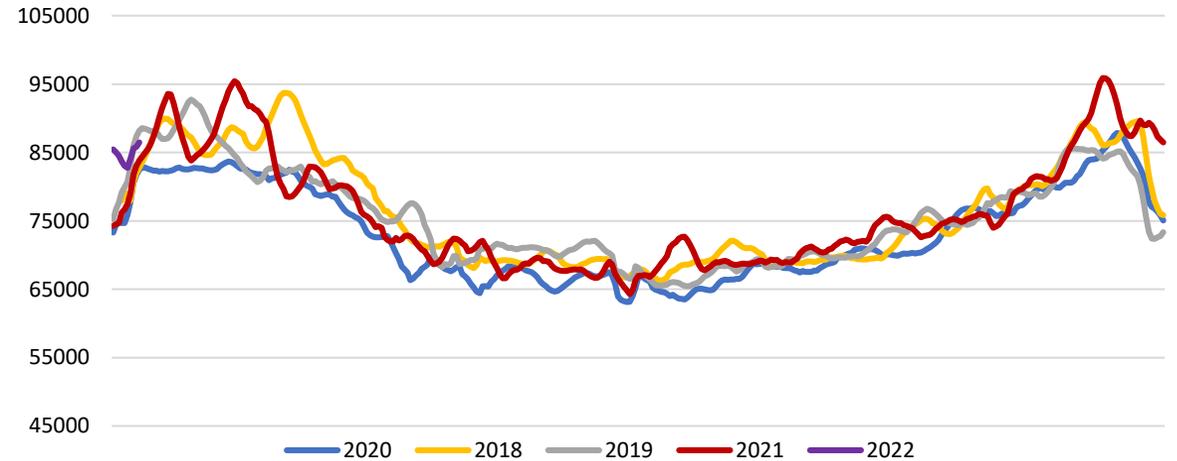
Manufacturing output (constant prices, 2015=100)



Electricity prices (€/MWh)



Electricity consumption in Baltics (MWh, 7 day average)



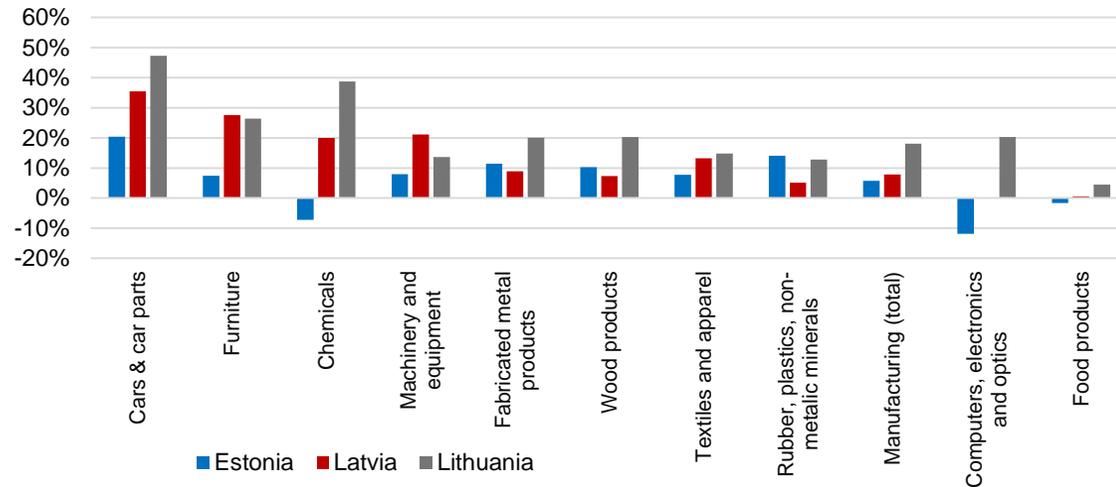
Comments

- In Latvia and Estonia, production volumes in the first 10 months of 2021 have grown by 6-8%, while in Lithuania the growth of the manufacturing output has reached 18%.
- European energy crisis is also a significant risk for Baltic industry. However, so far the rise in electricity prices has not had a significant impact on industry and electricity consumption in the Baltics continues to grow.
- For companies with fixed tariffs, electricity prices have not risen as fast as market indices, and energy costs for producers in the Baltics generally do not exceed 4-7% of turnover.

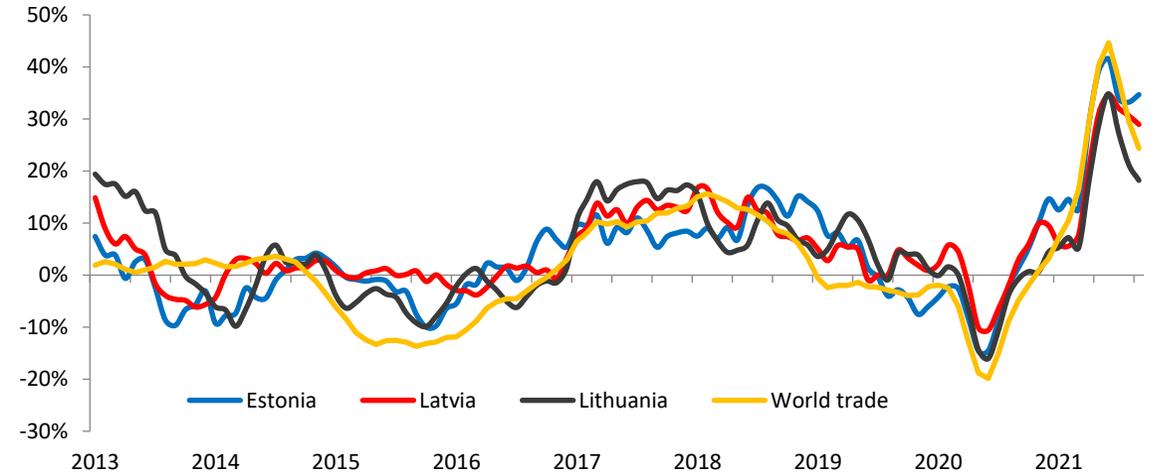
Manufacturing

Baltic producers have been able to successfully take advantage of the growing external demand

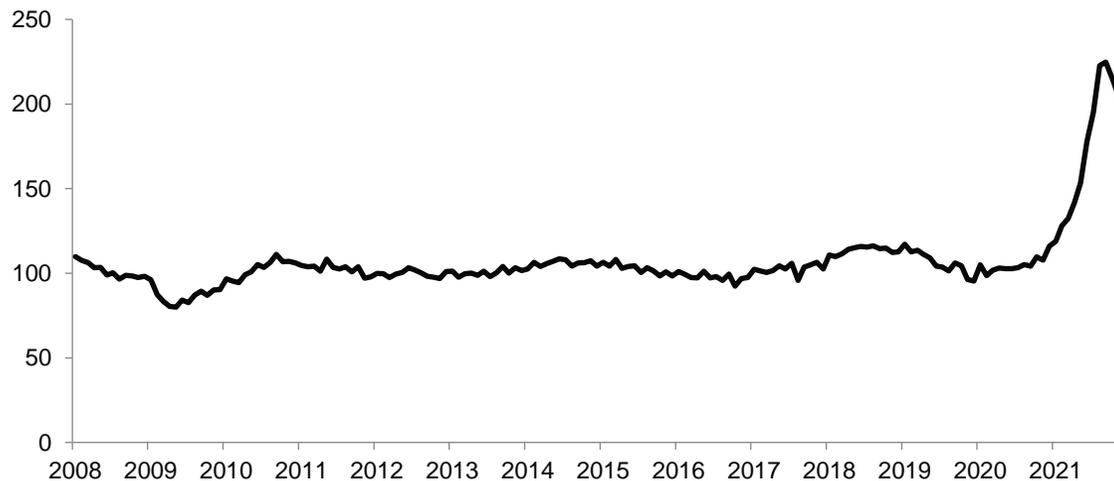
Manufacturing output (I-X 2021 vs I-X 2020, %)



Export of goods (% YoY)



Lumber product export price in Latvia (2008-2016 = 100)



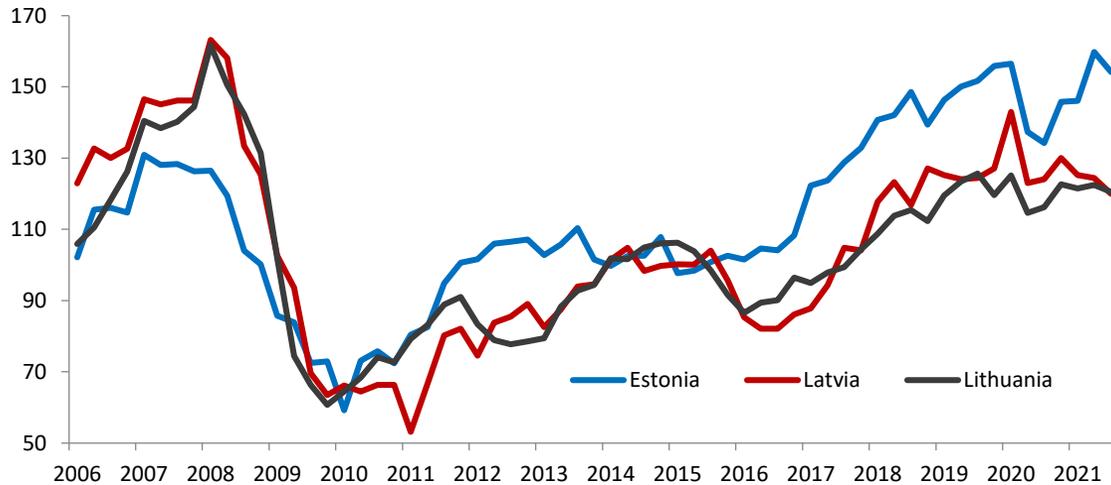
Comments

- Global demand for goods remains strong, inventory levels are relatively low in many sectors, and production and supply chains remain strained.
- Manufacturing growth in 2021 in the Baltics has been broad based with most major sectors showing positive growth.
- Export growth has been supported by higher commodity prices and especially wood prices as well as strong competitiveness. In 2021 exports in Baltics continue to grow in line with global trade.

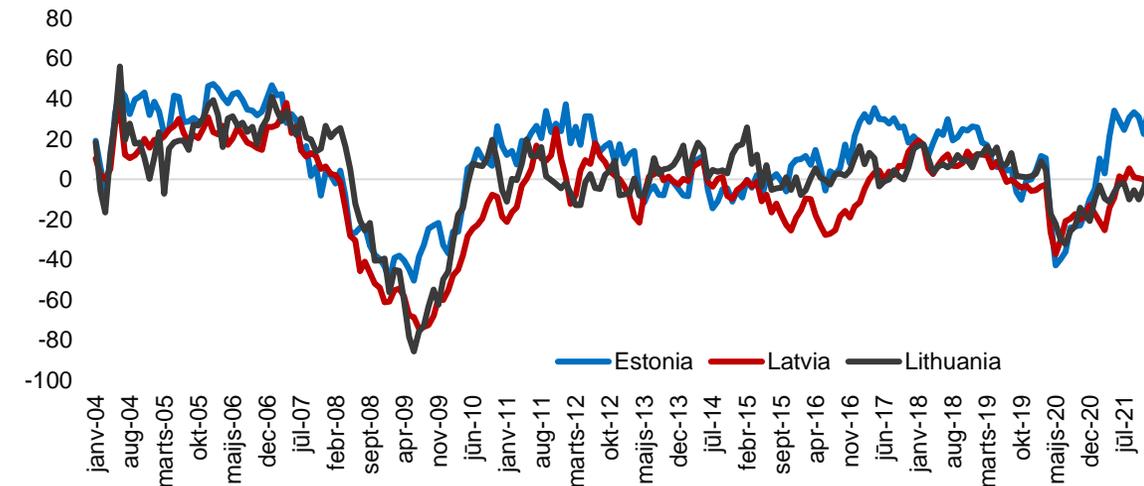
Construction

Investments from EU funds will support the construction sector in 2022

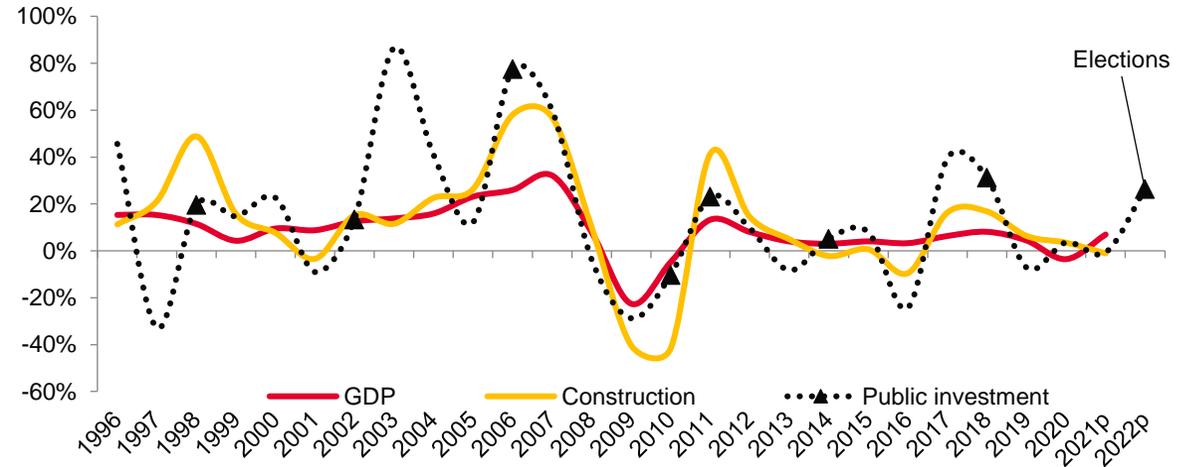
Construction in constant prices (2015=100)



Construction activity in the last 3 months



Construction sector in Latvia (% YoY)



Comments

- An active real estate market and rising real estate prices, investments by EU economic recovery funds, a gradual increase in lending and an increase in investment in industry should make 2022 a good year for construction in the Baltics.
- Latvia will hold the Saeima elections in 2022 and the election years are usually good in construction. In the Latvian state budget for 2022 investment expenditure is set to increase by 25%.
- In Q3 2021 the prices of construction materials in the Baltics increased by 12-17% compared to 2020. The rise in energy resources is likely to mean a further rise in building material prices in 2022.

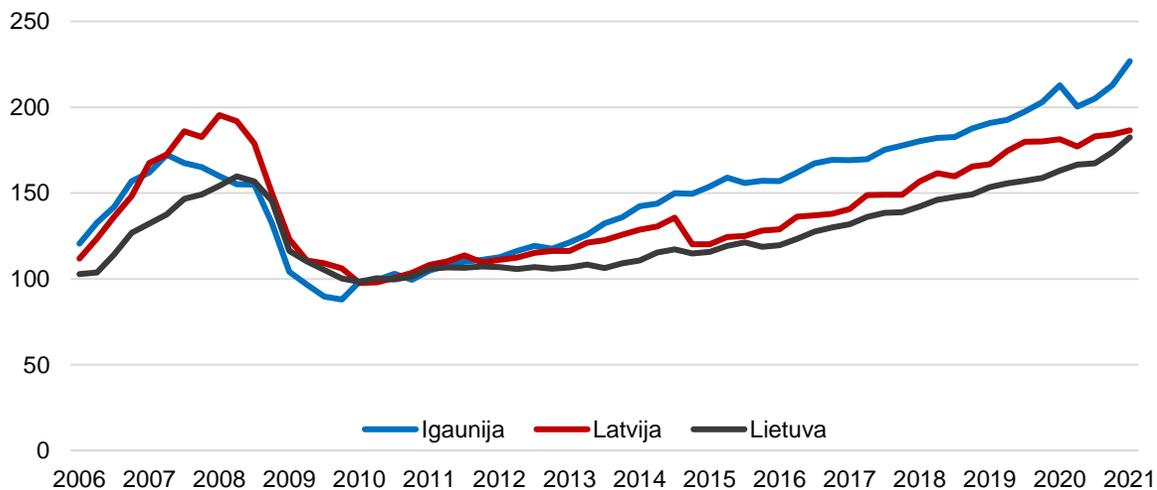
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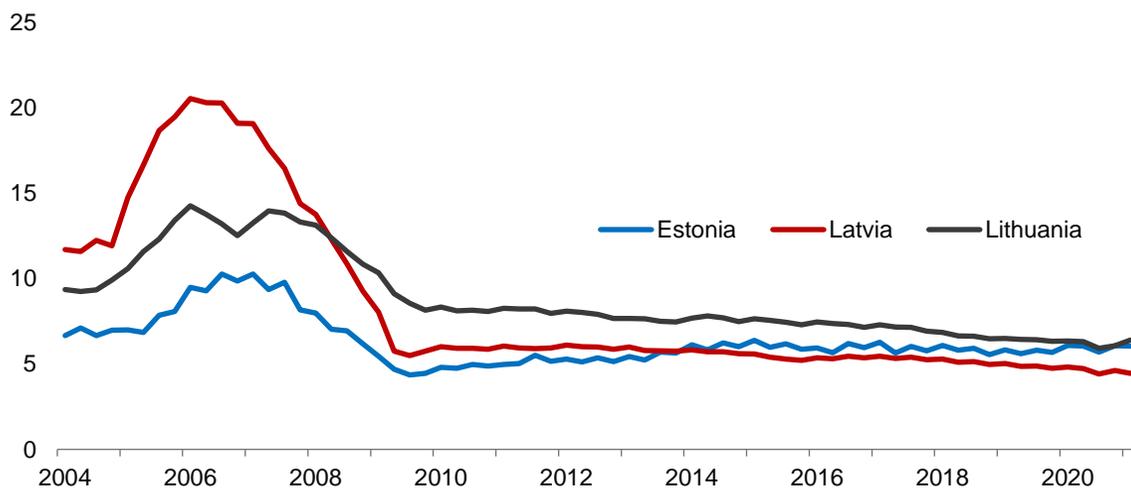
Real estate

Real estate prices in the Baltics continue to increase

House price index (2015 = 100)

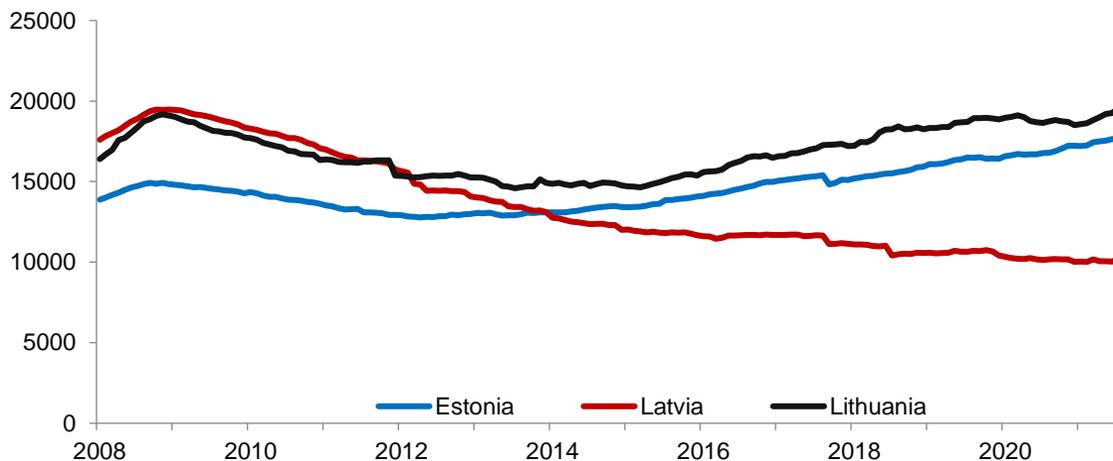


Price to income ratio (relative to gross average annual income)



Source: Eurostat, Bank of Latvia, Bank of Lithuania, Bank of Estonia

Loans to resident households and companies (MEUR)



Comments

- Low level of debt, rising household savings and deposits, rising wages and pick up in inflation has led to surge in activity in real estate market and in 2021 real estate prices rose by more than 10%
- Relative to incomes real estate prices in the Baltics remain low while wages continue to grow by 7-10% per year and loan growth does not exceed deposit growth.
- In Latvia new mortgage lending doubled in 2021 from ~50 MEUR per month to 100 MEUR.

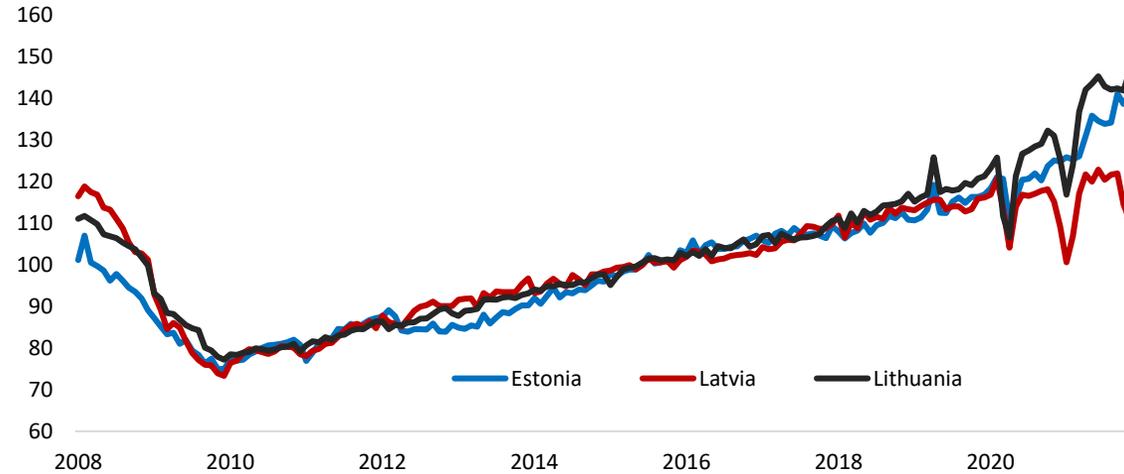
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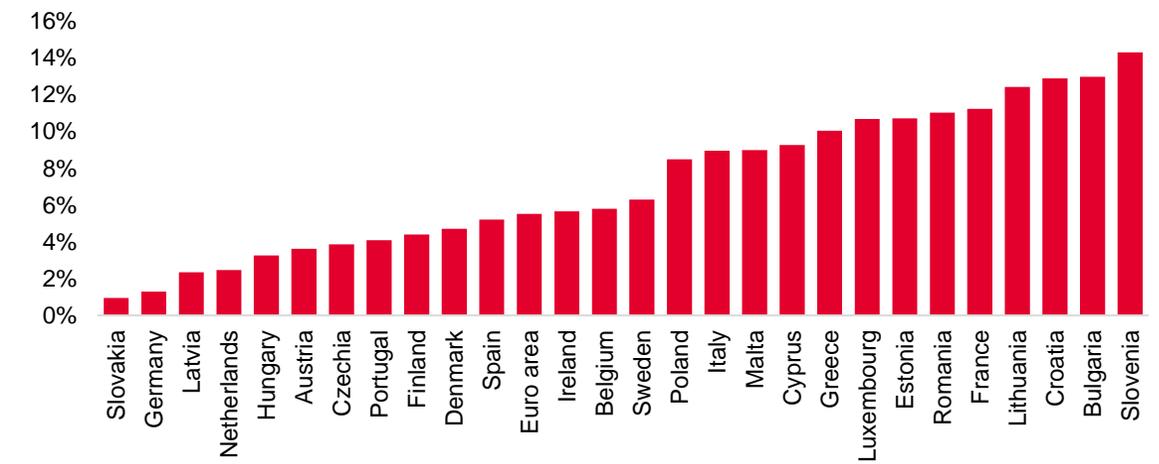
Retail trade

Growing personal incomes and limited access to services have boosted retail sales in the Baltics

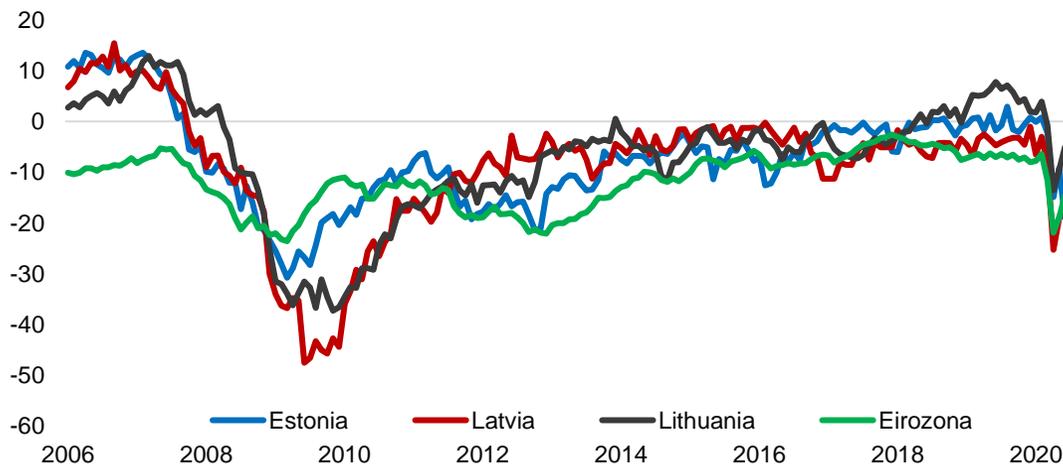
Retail trade excluding fuel (constant prices, 2015=100)



Retail trade excluding fuel (I-X 2021 vs I-X 2020, %)



Consumer sentiment



Comments

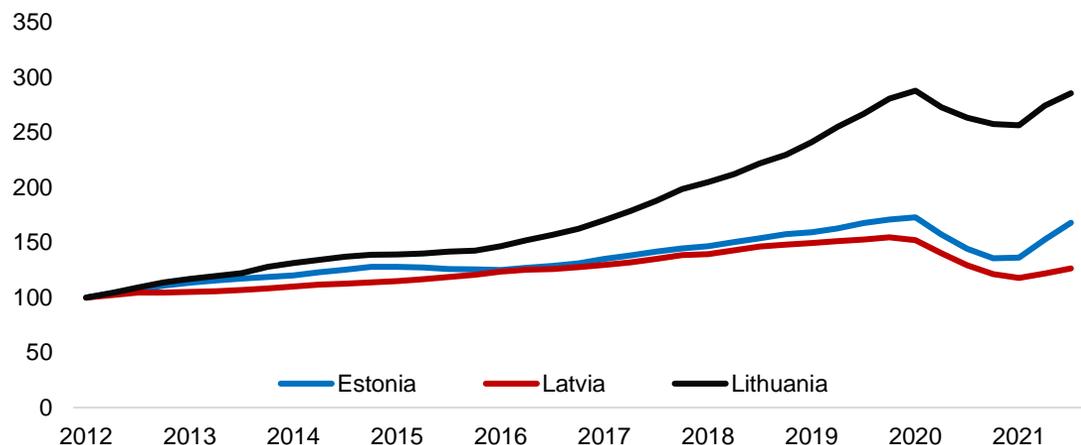
- In the first eleven months of 2021, the total retail trade turnover at constant prices in Lithuania and Estonia has grown by more than 10% compared to 2020, but in Latvia the retail trade growth was only 1.8%.
- The economic growth of Lithuania and Estonia in 2021 has been slightly better than in Latvia, and consumption in Estonia has been boosted by the possibility for people to withdraw their 2nd pillar pension savings.
- Wage growth in the Baltics is similar and household deposits in the Baltic States have increased by 16-21% in 2021. However, epidemiological restrictions on trade in Latvia have been more widespread than in Lithuania or Estonia.

Source: Eurostat, DG ECFIN

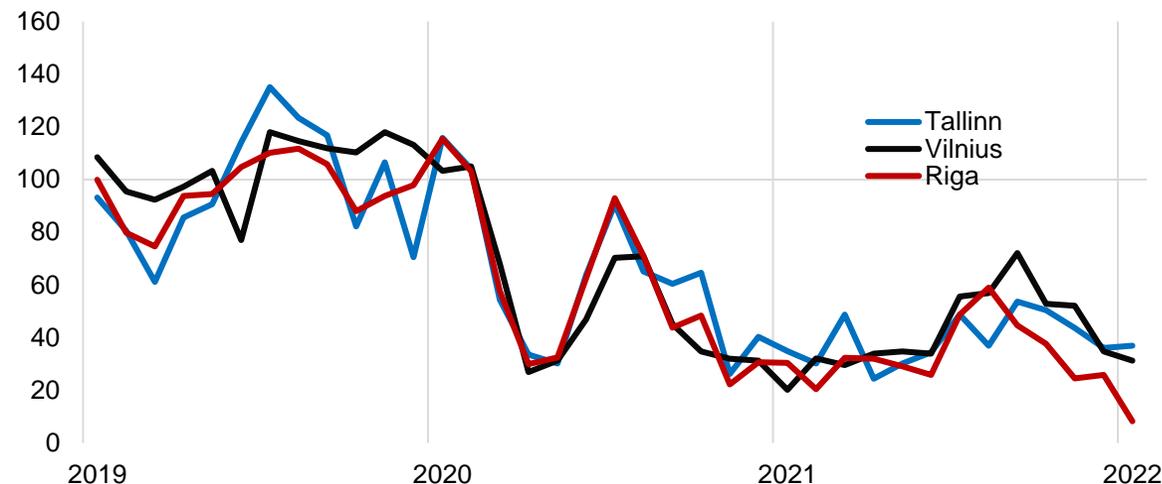
Services

IT and professional services have continued to grow despite COVID-19

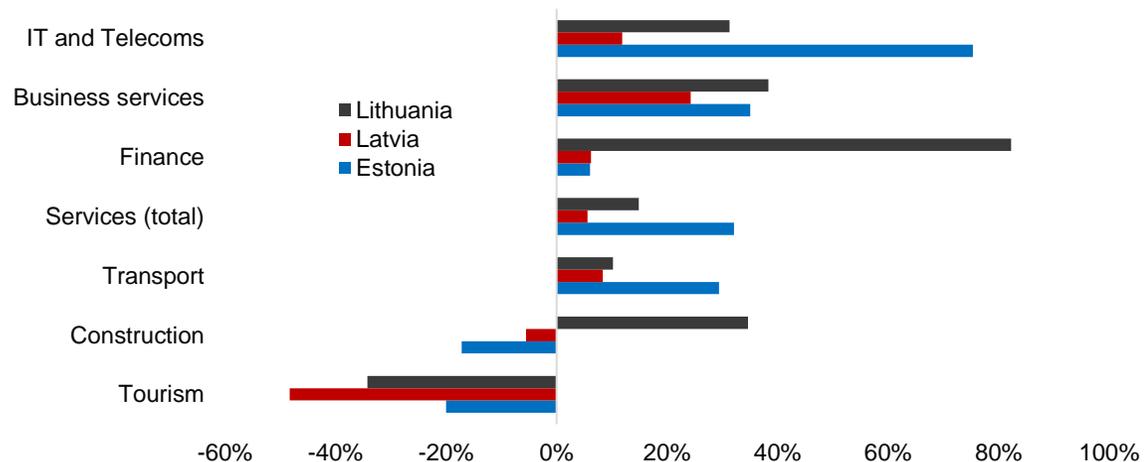
Export of services (2012=100, 4 quarter moving average)



Google trends (Hotels in Baltic capitals, 2017-2019 average=100)



Export of services by sector (Q1-Q3 2021 vs Q1-Q3 2020, %)



Comments

- In the Baltics service sectors remain the weakest link in the economy, however export of IT, business and professional services continued to grow strongly in 2021.
- In Latvia export of services has lagged behind Lithuania and Estonia mostly due to losing Russian commodity transit cargoes and associated servicing of non-resident financial flows.
- Activity parts of transport and tourism sector remains well below pre COVID-19 levels, however in Latvia longer lasting and more widespread COVID-19 related restrictions have caused even further decline in tourism sector in 2021.

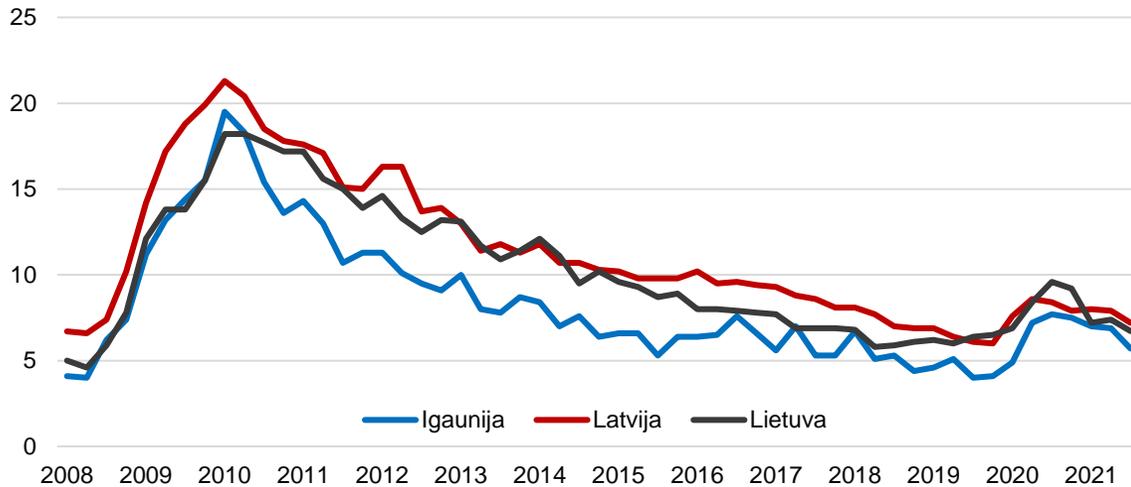
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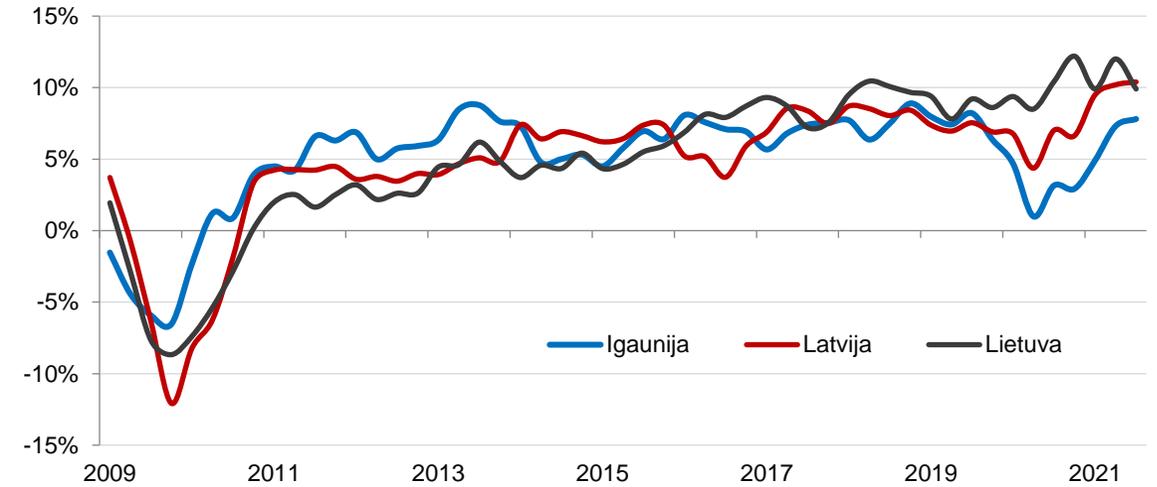
Labour market

Unemployment in the Baltics is approaching pre-pandemic levels

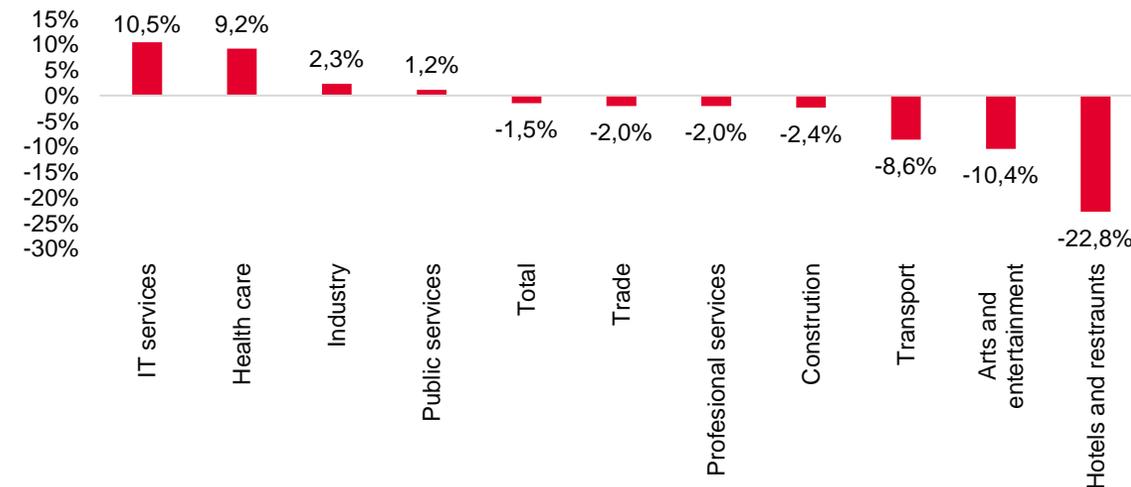
Unemployment rate (%)



Average gross wage (% YoY)



Employment by sectors in Latvia (Q3 2021 vs Q3 2019, %)



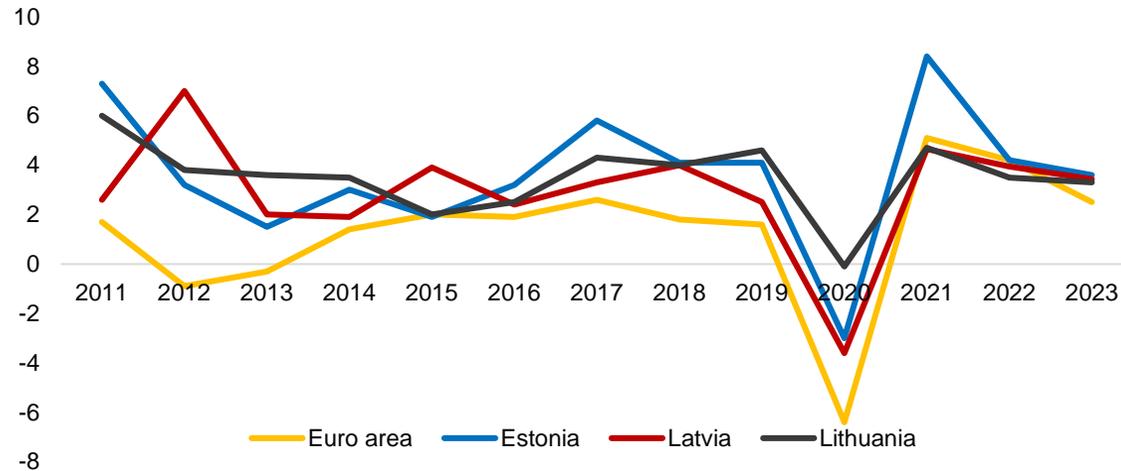
Comments

- Unemployment in the Baltics increased during the COVID-19 pandemic, but in November 2022 unemployment in Estonia fell to 5%, while in Latvia and Lithuania it was 7.3% and 6.0%, respectively.
- Average wages in the Baltics in the first three quarters of 2021 has grown by 6.7% in Estonia and by more than 10% in Lithuania and Latvia.
- In the near future, labour shortages are most likely to be felt in the service sectors, as workers have left for other sectors that have grown during the COVID-19 pandemic.

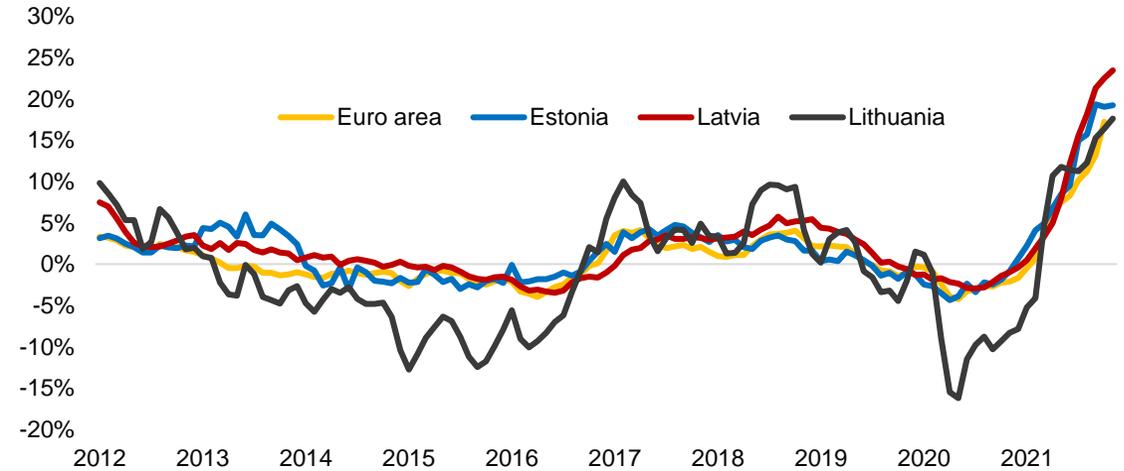
Forecasts

The Baltics have good preconditions for continued strong economic growth in 2022

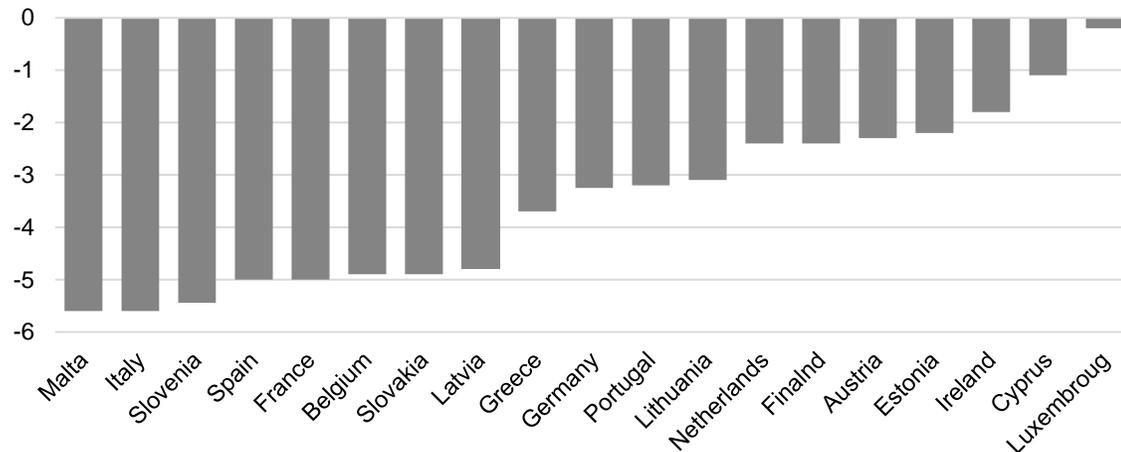
Real GDP (% YoY)



Producer prices (% YoY)



Budget balance in 2022 (% of GDP)



Comments

- Global demand for goods remains strong, inventory levels are relatively low in many sectors, and production and supply chains remain highly congested. In 2022 GDP in the Baltics will grow by 3.5-5%, while inflation is likely to exceed 6-7% as companies will continue to pass on to consumers rising costs.
- IT, professional and business services should continue to grow in 2022 while EU's economic recovery funds will start to flow into construction in 2022, and there is considerable potential for recovery in various service sectors, which are still affected by COVID-19 restrictions.
- In Latvia 2022 is an election year and economic growth will be supported by higher government spending.

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