IMF Country Reports 25/272

Republic of Latvia: 2025 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Latvia

INTERNATIONAL MONETARY FUND

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IMF Country Report No. 25/272

REPUBLIC OF LATVIA

September 2025

2025 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF LATVIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2025 Article IV consultation with the Republic of Latvia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 15, 2025, consideration of the staff report that concluded the Article IV consultation with the Republic of Latvia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 15, 2025, following discussions that ended on June 6, 2025, with the officials of the Republic of Latvia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 30, 2025.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Latvia.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Executive Board Concludes 2025 Article IV Consultation with the Republic of Latvia

FOR IMMEDIATE RELEASE

- Latvia’s successful convergence to euro area income levels has slowed. GDP per capita has fallen behind, due to weak total factor productivity and limited capital deepening. The government faces growing fiscal demands from pensions, health care, defense, energy security, and climate transition, requiring preserved fiscal space for future crises.
- The fiscal strategy should focus on mobilizing revenue and improving the efficiency of public spending, to preserve fiscal buffers and address rising medium- and long-term spending pressures. Also, to ensure adequate retirement income, the defined contribution pillars of the pension system should be strengthened.
- Financial sector policies should reassess the solidarity contribution on banks and continue to monitor banks’ exposure to the commercial real estate sector. Structural reforms should target measures to promote investment and allocative efficiency, which are crucial to reignite growth, accelerate convergence, and increase government revenue.

Washington, DC – September 19, 2025: On September 15, 2025, the Executive Board of the International Monetary Fund (IMF) completed the Article IV Consultation for the Republic of Latvia.[1]

Latvia’s growth contracted while inflationary pressures eased. Following strong growth in 2023, Latvia’s economy contracted by 0.4 percent in 2024 largely driven by a decline in private investment. Public investment also contributed negatively, as the government struggled to maintain the unusually high absorption of EU funds. Headline inflation experienced a significant decline due to lower energy and food prices, while strong nominal wage growth kept core inflation elevated. The inflation momentum has begun to reverse in recent months with both headline and core inflation increasing.

Growth is expected to rebound in 2025, despite downside risks. Real GDP growth is projected to recover to about 1 percent, mainly supported by public investment. Headline inflation is projected to rise in 2025 due to higher energy and food prices, while core inflation is anticipated to decrease but remain high due to persistent services inflation. Downside risks to growth dominate and stem mainly from worsening geopolitical tensions, deeper geoeconomic fragmentation, spillovers from new tariffs, slower growth in trading partners, delays in the absorption of EU funds, higher energy and food prices, and increased electricity costs. A strong recovery in Latvia’s main trading partners, a boost in confidence from improved

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

security, a faster-than-expected disbursement of EU funds, and a swift implementation of structural reforms could lead to higher-than-expected growth.

Latvia's government is facing significant medium- and long-term spending pressures, compounded by new near-term challenges. Medium and long-term spending pressures driven by population aging (pensions, health care), defense spending, investments for energy security, and the costs of the green transition pose fiscal challenges. Although direct trade and financial exposures to the U.S. are small, indirect trade and confidence channels may still affect economic and financial stability through financial contagion. Also, an escalation of trade tensions between the EU and its main trading partners could affect Latvia's exports indirectly through weaker demand in key European trading partners and heightened global trade policy uncertainty.

Executive Board Assessment[2]

Executive Directors commended Latvia's track record of prudent policies and strong institutions. Directors cautioned, however, that the economy faces emerging near-term challenges from geopolitical fragmentation and trade tensions, as well as structural headwinds from unfavorable demographic trends and skill mismatches in the labor market that are compounding the obstacles to productivity growth. Directors emphasized the importance of safeguarding macroeconomic stability and advancing structural reforms to reignite growth and accelerate income convergence with euro area peers.

Directors stressed the need to preserve fiscal buffers while addressing the significant medium- and long-term spending pressures from pensions, health care, defense, energy security, and the climate transition. They recommended mobilizing additional revenues, improving the efficiency of public spending, and reprioritizing expenditures. Revenue measures could include strengthening tax compliance, rationalizing exemptions, and broadening the tax base by reducing the informal economy. Directors also encouraged accelerating fiscal reforms, including strengthening public investment management and enhancing the governance of state-owned enterprises. They recommended further strengthening the pension system to improve pension adequacy and sustainability and curb old-age poverty.

Directors welcomed the financial sector's resilience and concurred that the macroprudential stance remains broadly appropriate. They encouraged the authorities to ensure that the existing borrower-based measures to promote energy-efficient housing are carefully designed so that any adjustments do not inadvertently create vulnerabilities in the housing market or the broader financial system. Directors urged the authorities to carefully assess the impact of the solidarity contribution on banks and continue to monitor banks' exposure to the commercial real estate sector. Directors commended the authorities for their progress in strengthening the AML/CFT framework and encouraged them to continue addressing any remaining gaps. Directors emphasized the importance of pursuing growth-enhancing reforms geared toward boosting productivity, strengthening the labor supply and deepening capital markets. They recommended adopting targeted measures to promote investment and the efficient allocation

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[2] At the conclusion of the discussion, the Managing Director, as Chair of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

of resources and addressing labor and skills shortages. Accelerating efforts to support innovation, technology adoption, and the digital transformation by increasing cooperation between the public and private sectors would also be important. Directors encouraged Latvia to enhance its energy security, including by increasing the share of renewable energy and continuing to improve interconnections to other European power grids.

Table 1. Latvia: Selected Economic Indicators, 2020–26

	2020	2021	2022	2023	2024	2025	2026
						Proj.	
National Accounts							
Real GDP	-3.5	6.9	1.8	2.9	-0.4	1.0	2.0
Private consumption	-4.8	8.1	5.1	-1.0	0.5	1.3	2.1
Public consumption	3.9	3.7	2.4	7.0	7.6	1.8	2.0
Gross capital formation	-8.6	23.8	-8.8	16.5	-11.7	4.5	3.9
Gross fixed capital formation	-2.4	6.8	-1.6	9.9	-6.7	4.7	4.0
Exports of goods and services	-0.3	9.1	11.4	-4.7	-1.6	2.0	2.3
Imports of goods and services	-1.1	15.1	9.9	-2.0	-2.3	3.4	3.0
Nominal GDP (billions of euros)	29.2	32.3	36.1	39.4	40.2	42.3	44.6
GDP per capita (thousands of euros)	15.3	17.1	19.2	20.9	21.5	22.6	23.9
Savings and Investment							
Gross national saving (percent of GDP)	25.2	21.7	18.7	20.7	19.0	18.7	18.6
Gross capital formation (percent of GDP)	22.2	25.7	24.2	24.6	21.2	21.4	21.4
Private (percent of GDP)	17.9	21.8	20.7	20.9	17.3	16.9	16.8
HICP Inflation							
Headline, period average	0.1	3.2	17.2	9.1	1.3	3.3	2.5
Headline, end-period	-0.5	7.9	20.7	0.9	3.4	2.2	2.1
Core, period average	1.1	2.0	11.3	9.8	3.8	3.4	2.4
Core, end-period	0.9	4.7	15.2	4.0	4.9	2.2	2.8
Labor Market							
Unemployment rate (LFS; period average, percent)	8.1	7.6	6.9	6.5	6.9	6.7	6.6
Nominal wage growth	6.2	11.7	7.5	11.9	9.7	7.2	6.0
Consolidated General Government 1/							
Total revenue	38.8	38.9	39.6	39.7	42.6	40.8	40.9
Total expenditure	42.6	44.6	43.5	43.1	44.5	44.4	44.4
Basic fiscal balance	-3.8	-5.7	-3.9	-3.4	-1.8	-3.6	-3.5
ESA fiscal balance	-4.1	-7.2	-4.9	-2.4	-1.8	-3.1	-3.5
General government gross debt	44.0	45.9	44.4	44.6	46.8	47.5	48.1
Money and Credit							
Credit to private sector (annual percentage change)	-4.4	11.9	7.1	3.8	3.0	...	...
Broad money (annual percentage change)	13.1	9.2	5.1	2.7	6.6	...	...
Balance of Payments							
Current account balance	3.0	-4.1	-5.5	-3.9	-2.1	-2.7	-2.8
Trade balance (goods)	-5.3	-8.6	-11.4	-9.3	-8.2	-7.3	-7.1
Gross external debt	126.0	114.3	109.4	101.9	98.9	94.4	92.1
Net external debt 2/	14.1	10.4	8.8	8.4	5.6	6.0	9.6
Exchange Rates							
U.S. dollar per euro (period average)	1.14	1.18	1.05	1.08	1.08	...	...
REER (period average; CPI based, 2005=100)	124.5	125.1	130.2	138.9	137.6	...	...
Terms of trade (annual percentage change)	1.9	-1.6	-2.8	3.6	0.8	0.8	1.1

Sources: Latvian authorities; Eurostat; and IMF staff calculations.

1/ National definition. Includes economy-wide EU grants in revenue and expenditure.

2/ Gross external debt minus gross external assets.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LATVIA

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION

July 30, 2025

KEY ISSUES

Context. Latvia's successful convergence to euro area income levels has slowed. GDP per capita has fallen behind, including relative to other Baltic states, due to weak total factor productivity and limited capital deepening since the global financial crisis. Additional pressures include rising labor costs, demographic decline, and geopolitical tensions. Although unemployment remains low and inflation has eased, the economy remains vulnerable to external shocks. At the same time, the government faces growing fiscal demands from pensions, health care, defense, energy security, and climate transition, requiring preserved fiscal space for future crises.

Outlook and Risks. Growth is expected to gradually improve in 2025 and 2026, driven by higher public investment, before converging to its potential level of around 2½ percent in the medium term. Downside risks dominate from worsening geopolitical tensions, deeper geoeconomic fragmentation, spillovers from new tariffs, slower growth in trading partners, delays in the absorption of EU funds, and higher energy and food prices. The financial sector is broadly resilient and systemic risks are contained, but banks' exposure to commercial real estate is a notable share of the corporate loan portfolio.

Key Policy Recommendations

Fiscal Policy. To address its significant medium- and long-term spending pressures and preserve fiscal buffers, Latvia's government should mobilize additional revenue, improve the efficiency of public spending and public investment management, and accelerate structural fiscal reforms. The authorities should also continue to strengthen the defined contribution pillars of Latvia's pension system to ensure adequate retirement income.

Financial Sector Policies. While Latvia's macroprudential stance is broadly appropriate, the borrower-based measures adopted in 2024 to promote energy-efficient housing should be reconsidered. The authorities should reassess the solidarity contribution on banks and continue to monitor banks' exposure to the commercial real estate sector.

Structural Policies. Targeted measures to promote investment and allocative efficiency are crucial to reigniting growth, accelerating convergence, and increasing government revenue. These measures include active labor market policies to boost skilled labor and alleviate labor market shortages, greater support for innovation, technology adoption, and the digital transformation, and efforts to bolster energy security by investing in renewables and grid interconnections.

Approved by
Helge Berger (EUR) and Jarkko Turunen (SPR)

Discussions were held in Riga during May 26–June 6, 2025. The team comprised Luis Brandao-Marques (head), Gianluigi Ferrucci, Bingjie Hu, Keyra Primus (all EUR). Carlos Acosta and Anjum Rosha (all LEG) participated virtually in the meetings. Gundars Davidsons (OED) also joined the discussions. Karen Cerrato and Can Ugur supported the mission. The mission met with Bank of Latvia Governor Kazāks, Minister of Finance Ašeradens, officials from the Ministry of Energy and Climate, Ministry of Economics, Ministry of Justice, other senior officials, and private sector representatives.

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CONTEXT

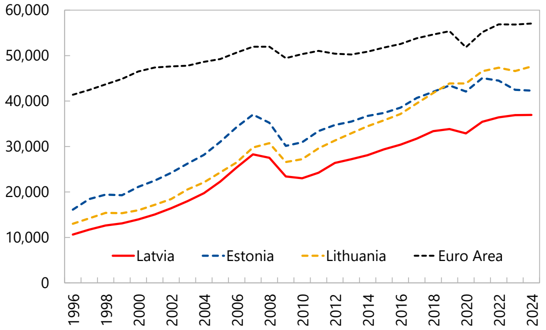
1. **After decades of high growth and convergence towards euro area income levels, Latvia faces structural headwinds with lagging productivity growth.** Latvia's labor productivity continues to lag other Baltics and the euro area (EA), confirming a trend in place since the global financial crisis (GFC)—Text Figure 1. Latvia also faces eroding external competitiveness given recent increases in unit labor costs. Meanwhile, geoeconomic fragmentation, geopolitical tensions, trade policy uncertainty, adverse demographics, and skill mismatches and frictions in the labor market are adding to long-standing challenges to productivity growth.

Text Figure 1. Baltics: Labor Productivity and GDP Per Capita

Latvia's income convergence to the euro area average continues to lag that of other Baltics...

GDP Per Capita

(In PPP 2021 international dollars)

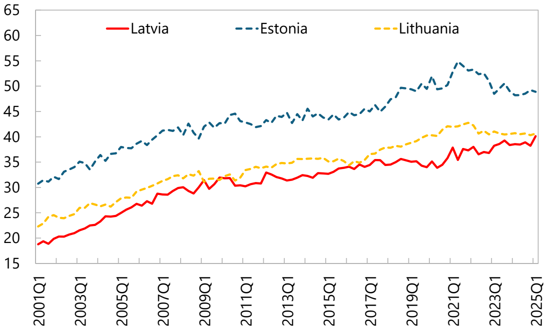


Sources: World Economic Outlook, IMF; and IMF staff calculations.

...amid sluggish labor productivity growth.

Real Labor Productivity Per Hour Worked

(Index; Euro Area = 100)

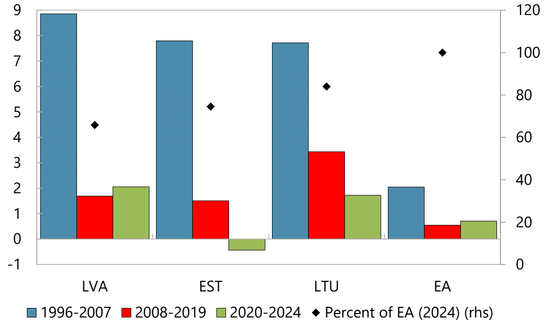


Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Despite a still wide income gap with the EA, Latvia's GDP per capita growth has slowed since the GFC...

GDP Per Capita: Growth Rate and Percent of Euro Area

(LHS: percent, annual average growth rate; RHS: index, Euro Area = 100; based on GDP in 2021 PPP USD)

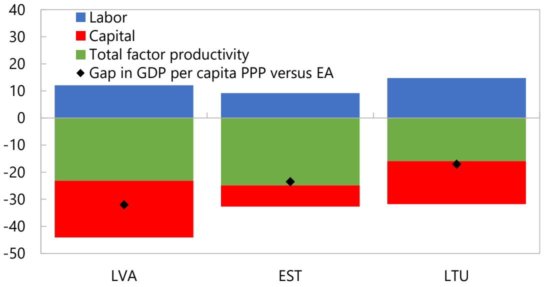


Sources: World Economic Outlook, IMF; and IMF staff calculations.

...because of slower relative TFP growth and capital accumulation.

Decomposition of GDP Per Capita Difference with the Euro Area, 2023

(Percent, in PPP terms)



Sources: European Commission, AMECO database; World Economic Outlook, IMF; and IMF staff calculations.

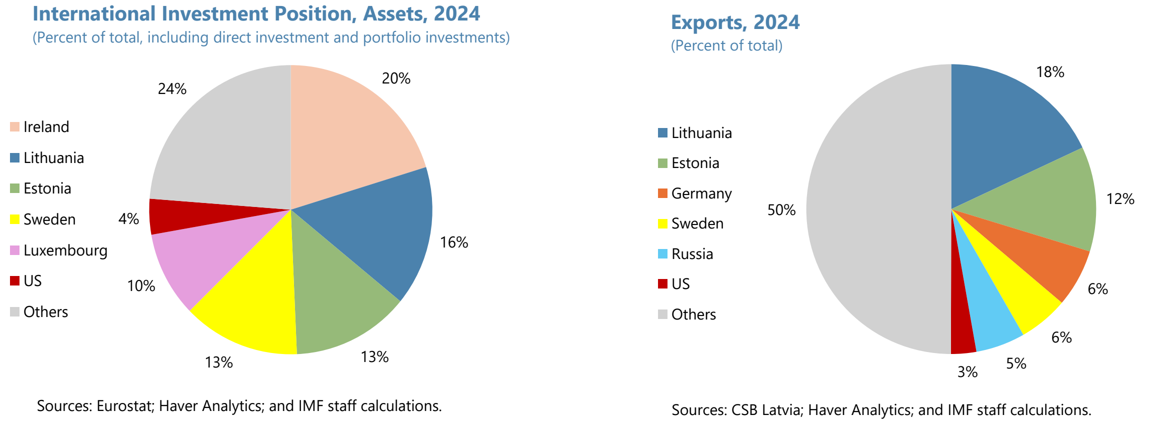
2. **Latvia's growth momentum slowed notably after the global financial crisis.** Since joining the European Union in 2004, Latvia's GDP per capita increased from 20 percent to around 65 percent of the EA average. However, this process has slowed down since the GFC and, at the current rate of convergence, it would take approximately 40 years to close the gap with the rest of the EA. Latvia's large per capita income gap with the EA mainly stems from deficiencies in relative TFP growth and capital deepening (Text Figure 1). Structural reforms to boost investment and to create the conditions

for high-productivity sectors to grow could accelerate the convergence process.

Text Figure 2. Latvia: Short-Term Exposures and Long-Term Spending Pressures

Latvia has a low exposure to the United States through investment…

…and exports.

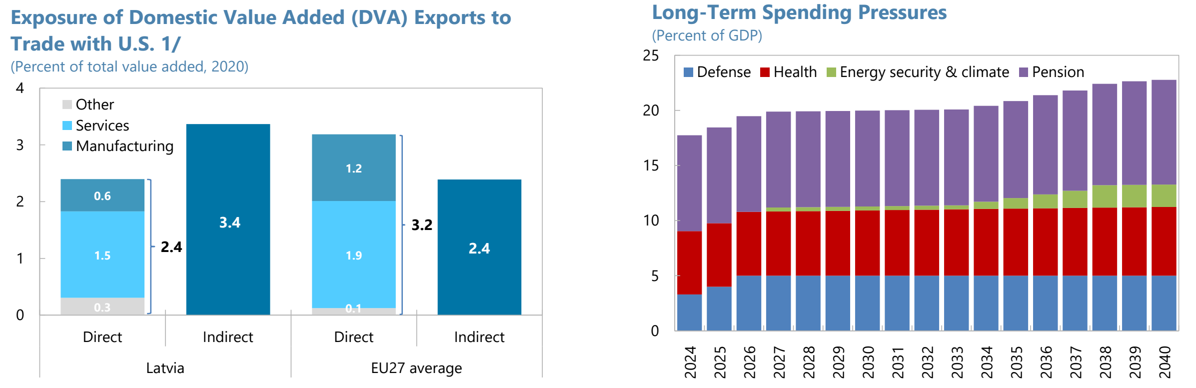


Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Sources: CSB Latvia; Haver Analytics; and IMF staff calculations.

Latvia's direct exposure of exports to the United States is lower than its indirect exposure.

Latvia faces significant long-term spending pressures.



Sources: OECD TiVA, 2023 edition; Eurostat; and IMF staff calculations.

Source: IMF staff projections.

1/ The direct exposure is computed as the product of (i) the share of DVA exports to the U.S. in total DVA exports, and (ii) the share of total DVA exports in total value added. The indirect exposure is computed as (i) the share of EU27's DVA exports to the U.S. in total EU27's DVA exports, (ii) the share of the country's total DVA exports to the EU27 in total DVA exports, and (iii) the share of total DVA exports in total value added.

3. **In addition, new challenges have emerged from geopolitical fragmentation and trade tensions.** Although unemployment is close to historical lows, inflation has declined, and the financial system remains strong, rising geopolitical tensions, geoeconomic fragmentation and uncertainty in trade policies could affect the outlook and hinder the recovery. Direct trade and financial exposures to the U.S. are small (Text Figure 2), but indirect trade and confidence channels may still affect economic and financial stability through financial contagion. Latvia's exposure of domestic value-added exports to trade with the U.S. is only 2.4 percent of total value added, with a significant share coming from services exports that are not subject to tariffs. However, an escalation of trade tensions between the EU and its main trading partners could reduce Latvia's exports indirectly through weaker

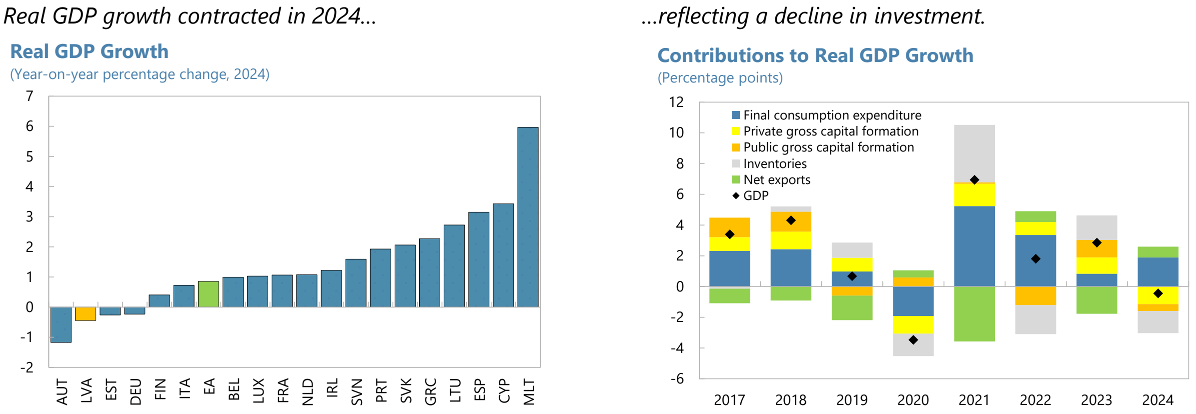
demand in key European trading partners and heightened global trade policy uncertainty (Text Figure 2).

4. **Latvia faces significant medium- and long-term spending pressures.** These include rising costs for pensions and health care, increased defense spending, investments for energy security, and the costs of the climate transition (Text Figure 2). The burden from these expenses will increase over time. At the same time, as the recent experience with the Covid-19 pandemic and Russia's war in Ukraine illustrates, Latvia needs to conserve fiscal space to meet unexpected shocks.

RECENT DEVELOPMENTS

5. **Economic activity contracted in 2024, driven by a decline in investment.** GDP is estimated to have contracted by 0.4 percent in 2024 (Text Figure 3; Figure 1), largely driven by a decline in private investment. Public investment also contributed negatively, as the government struggled to maintain the unusually high absorption of EU funds in 2023. Despite robust real wage growth and improving household purchasing power, private consumption growth remained weak. In Q1 2025, real GDP remained unchanged (0 percent q/q growth rate) driven by a decline in private consumption.

Text Figure 3. Latvia: Economic Activity



Real GDP growth contracted in 2024…

Real GDP Growth

(Year-on-year percentage change, 2024)

Source: World Economic Outlook, IMF.

…reflecting a decline in investment.

Contributions to Real GDP Growth

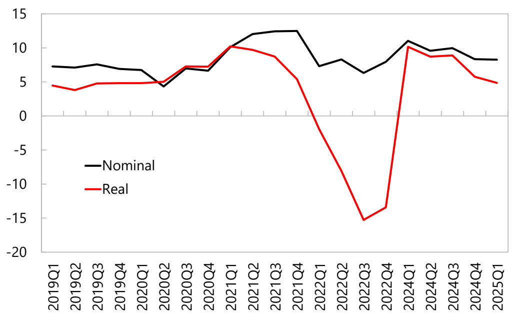
(Percentage points)

Sources: CSB Latvia; Eurostat; Haver Analytics; and IMF staff calculations.

6. **Headline inflation has fallen because of lower energy and food prices while strong nominal wage growth sustained core inflation.** Headline inflation declined to 1.3 percent in 2024, from 9.1 percent in 2023, with core inflation also declining sharply (Text Figure 4). The disinflation momentum has begun to shift recently with headline inflation increasing to 3.7 percent and core inflation rising to 4.9 percent in May 2025, driven by an increase in services inflation and processed food.

Wage Growth

(Year-on-year percentage change)



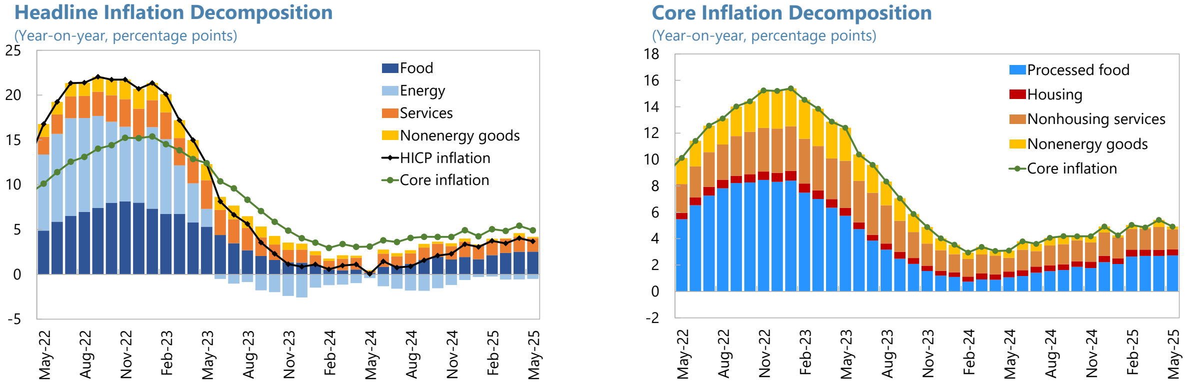
Sources: CSB Latvia; Haver Analytics; and IMF staff calculations.

7. **The labor market has shown signs of cooling.** Weak economic activity moderated real wage growth (Figure 3) and caused a small increase in the unemployment rate from 6.5 percent in 2023 to 6.9 percent in 2024.

Text Figure 4. Latvia: Inflation Developments

Headline inflation declined in 2024, driven by lower food and energy prices.

Core inflation declined but remains elevated, driven by persistent nonhousing services and processed food.

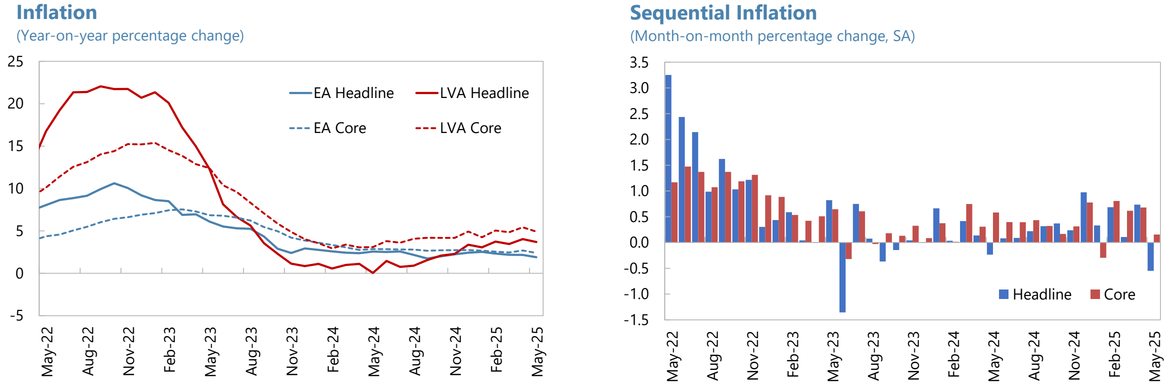


Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Sources: Eurostat; Haver Analytics; and IMF staff calculations.

In recent months both headline and core inflation have increased above the eurozone average.

Month-on-month sequential inflation momentum has accelerated since end-2024.

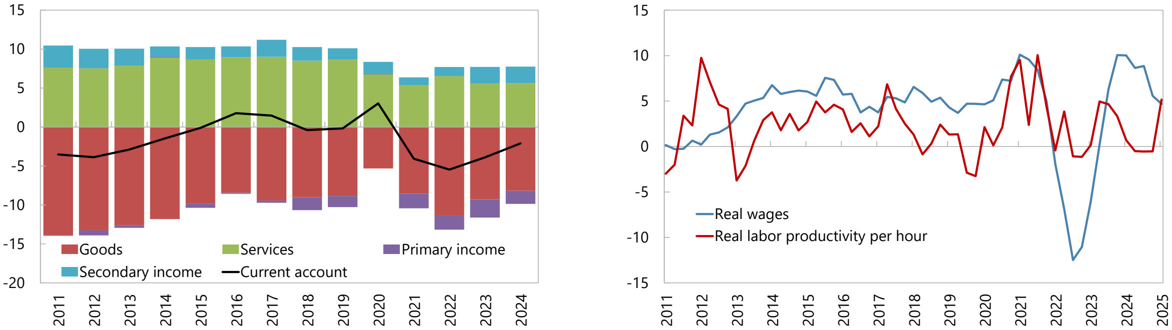


Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Sources: Eurostat; Haver Analytics; and IMF staff calculations.

8. **In 2024, the external position was broadly consistent with that implied by fundamentals and policies at desirable levels (Annex II).** The current account deficit narrowed from 3.9 percent of GDP in 2023 to 2.1 percent of GDP in 2024 (Text Figure 5; Figure 4). Both exports and imports of goods and services declined in real terms in 2024 by 1.6 and 2.3 percent, respectively (y/y). Despite a slight depreciation in the real effective exchange rate of 0.9 percent in 2024, external competitiveness remains weak because real wages grew faster than productivity.

Text Figure 5. Latvia: Current Account and External Competitiveness



The current account deficit narrowed in 2024…

Current Account Balance

(Percent of GDP)

Sources: Bank of Latvia; CSB Latvia; Haver Analytics; and IMF staff calculations.

…but external competitiveness remains under pressure.

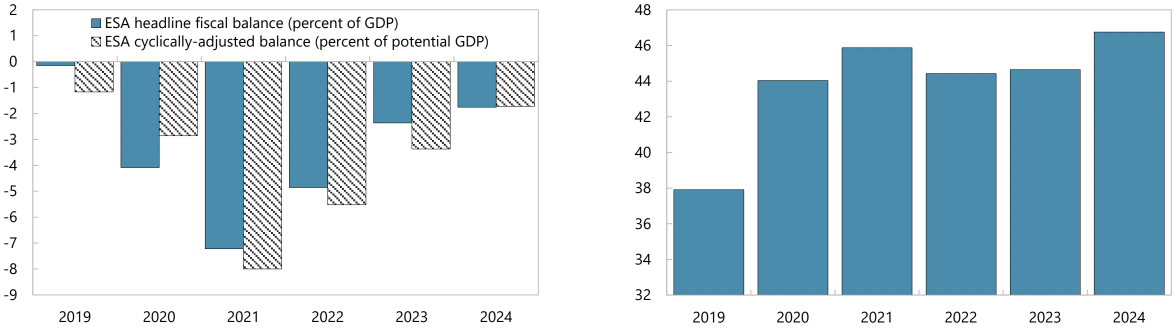
Real Wages and Labor Productivity Growth

(Year-on-year percentage change)

Sources: CSB Latvia; Eurostat; Haver Analytics; and IMF staff calculations.

9. The fiscal performance was stronger than envisaged. The headline ESA fiscal deficit was 1.8 percent of GDP in 2024, below the 2024 budget target of 2.8 percent of GDP, while the debt-to-GDP ratio increased to 46.8 percent in 2024 from 44.6 percent in 2023 (Text Figure 6; Figure 2). The fiscal overperformance is mostly explained by lower-than-anticipated central government expenditure and an under-execution of EU funds. The fiscal stance—measured by the change in the ESA cyclically-adjusted balance as a percent of potential GDP—was contractionary in 2024. Regarding public debt, the overall risk of sovereign stress is assessed to be low (Annex III).

Text Figure 6. Latvia: Headline and Cyclically-Adjusted Fiscal Balances and Public Debt



The ESA cyclically-adjusted balance contracted in 2024…

Headline and Cyclically-Adjusted Fiscal Balances

(Percent)

Sources: Latvian authorities; and IMF staff calculations.

…while public debt increased.

General Government Debt

(Percent of GDP)

Sources: Latvian authorities; and IMF staff calculations.

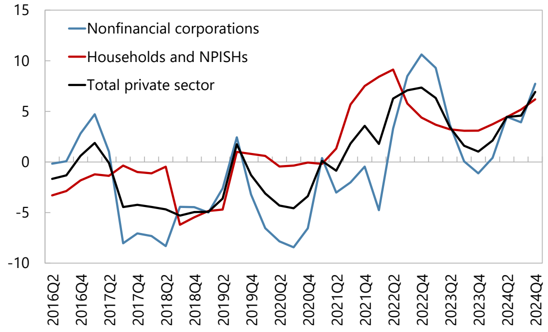
10. Despite the economic downturn and high global uncertainty, the resilience of Latvia's credit institutions is containing systemic risks (Figure 6). Despite the 20 percent annual corporate income tax payment effective from 2024, and a decline in profitability in 2024 as interest rate margins decreased with monetary policy easing, banks have adequate capital (Tier 1 capital ratio of 19.3 percent) and liquidity (liquidity coverage ratio above 200 percent). Asset quality stabilized in 2024 with the nonperforming loan ratio at 2.7 percent (Figure 6). Credit growth picked up in 2024, but bank credit as a share of GDP remained low compared to other economies (Text Figure 7; Figure 7). Lower monetary policy rates have passed through to mortgage rates and, with increased mortgage refinancing, reduced debt servicing costs to households. Despite the economic downturn, firms' capacity to service debt remained resilient. Housing affordability improved as construction costs declined in recent years (Figure 8). The macroprudential policy stance is broadly neutral.

Text Figure 7. Latvia: Financial Sector Developments

Credit growth picked up in 2024…

Bank Domestic Lending to the Private Sector

(Year-on-year percentage change)

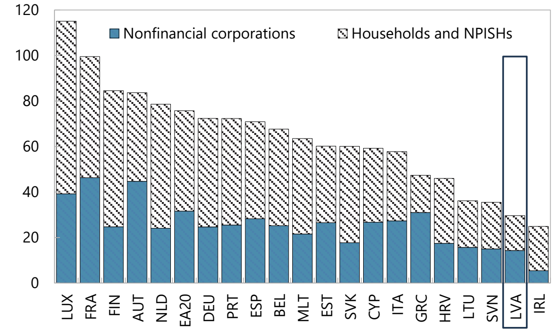


Sources: European Central Bank; Haver Analytics; and IMF staff calculations.

…but credit as a share of GDP remained low.

Bank Loan-to-GDP Ratio, Private Sector, 2024Q4

(Percent of GDP)

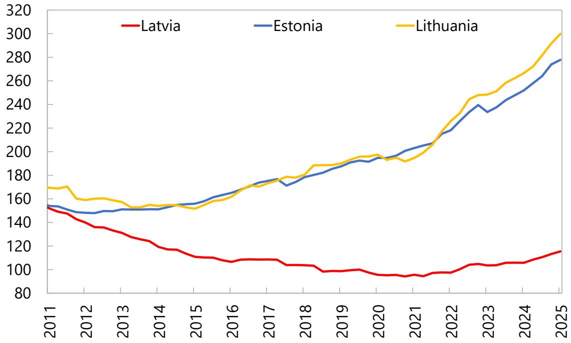


Sources: European Central Bank; Eurostat; Haver Analytics; and IMF staff calculations.

Bank lending has been lagging Baltic peers.

Loans to Households and Nonfinancial Corporations

(Index, 2006=100)

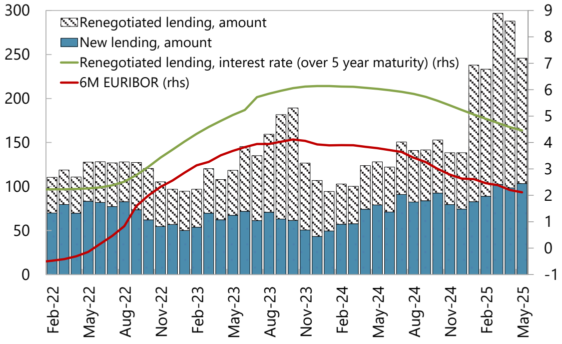


Sources: European Central Bank; Haver Analytics; and IMF staff calculations.

Monetary policy easing is passing through to lower mortgage rates and encouraging mortgage refinancing.

New and Renegotiated Mortgages

(LHS: million euros; RHS: percent)



Sources: Bank of Latvia; Deutsche Bundesbank; and Haver Analytics.

OUTLOOK AND RISKS

11. Growth is projected to rebound in 2025, mainly supported by public investment. Real GDP growth is projected to recover to 1 percent in 2025, underpinned mainly by higher public investment, but also a recovery in private consumption and a gradual recovery of external demand (e.g., from Germany and Scandinavia). The planned increase in the budget deficit to 3.1 percent of

GDP and an increased absorption of EU funds are expected to support growth in 2025. In the medium term, real GDP growth should stabilize at around 2.4 percent (Text Table 1).

12. Core inflation is expected to continue to moderate to 3.4 percent, while headline inflation is projected to increase to 3.3 percent in 2025. The projected increase in headline inflation reflects increases in energy prices in the early months of 2025 and increases in food prices, which will be to some extent mitigated by a stronger euro. Core inflation is expected to remain above 3 percent in 2025 as high nominal wage growth contributes to persistent services inflation. However, these pressures are expected to slowly ease as nominal wage growth decelerates from 9.7 percent in 2024 to 7.2 percent in 2025. Although the fiscal stance is projected to be expansionary in 2025, the higher expected import content of public spending (i.e., imports of military equipment and investment goods) will lessen its impact on inflation. Both headline and core inflation will stabilize at around 2.2 percent over the medium term.

Text Table 1. Latvia: Macroeconomic Projections, 2024–30

	2024	2025	2026	2027	2028	2029	2030
Real GDP growth (percent)	-0.4	1.0	2.0	2.4	2.4	2.4	2.4
Output gap (percent)	-0.1	-0.9	-0.7	-0.4	-0.2	-0.1	0.0
Potential output growth (percent)	2.1	1.9	1.9	2.0	2.2	2.3	2.4
Headline inflation (average)	1.3	3.3	2.5	2.7	2.2	2.2	2.2
Core inflation (average)	3.8	3.4	2.4	2.2	2.2	2.2	2.2
Unemployment rate (LFS, percent)	6.9	6.7	6.6	6.6	6.5	6.5	6.4
Nominal wage growth (percent)	9.7	7.2	6.0	6.0	6.0	6.0	5.0
Current account balance (percent of GDP)	-2.1	-2.7	-2.8	-2.9	-3.1	-3.0	-2.9
ESA fiscal balance (percent of GDP)	-1.8	-3.1	-3.5	-3.5	-3.5	-3.4	-3.4
General government debt (percent of GDP)	46.8	47.5	48.1	48.7	49.3	49.6	50.0

Sources: Latvian authorities; and IMF staff projections.

13. The fiscal and current account deficits are projected to widen in support of the government's priorities, including higher defense spending and capital investment for projects funded by the Recovery and Resilience Fund (RRF). The 2025 budget also includes tax reforms to simplify the personal income tax but expected revenue gains are minimal. Staff projects the headline ESA fiscal deficit to increase to 3.1 percent of GDP in 2025, from 1.8 percent in 2024, due to higher defense and investment spending, and the cyclically-adjusted fiscal deficit to increase to 2.8 percent of potential GDP, from 1.7 percent in 2024. The government has recently committed to gradually increase defense spending to 5 percent of GDP starting in 2026 and fund it with expenditure cuts and a larger deficit. The current account deficit is projected to increase to 2.7 percent of GDP in 2025 and 2.8 percent in 2026, given the expected increase in imports of capital goods and defense equipment.

14. Risks to the outlook are tilted to the downside for growth, and balanced for inflation.

- Key global downside risks to growth include an intensification of geopolitical tensions and deeper geoeconomic fragmentation, spillovers from new tariffs, an escalation of trade tensions between the EU and key trading partners, and a further slowdown in trading partners' growth (which reduces the chances of an export-led recovery).

- On the domestic front, delays in the absorption of EU funds could weigh on growth. Further increases in electricity prices following the desynchronization of Latvia's electrical grid from that of Russia and Belarus could reduce household consumption and put energy-intensive industries at a disadvantage in export markets.
- On the upside, risks to growth include a strong economic recovery in Latvia's main trading partners, a boost in confidence from improved security, a faster-than-expected disbursement of EU funds, and a swift implementation of structural reforms.
- On inflation, new increases in energy and food prices could deteriorate the terms of trade, lower real incomes, and raise inflation. A worsening labor market reduces the risk of a resurgence in inflation but makes a consumption-led recovery less likely.
- Latvia has a strong track record, solid commitment to fiscal discipline, and strong fiscal institutions. Despite that, the fiscal balance is subject to downside risks from higher spending in defense (e.g., should costs rise more than expected), contingent liabilities with state-owned enterprises (SOEs) that could be in excess of the Fiscal Safety Reserve, and higher capital expenditure with large infrastructure projects.

Authorities' Views

15. **The authorities largely concurred with staff's assessment of the economic outlook.** The Bank of Latvia and Ministry of Finance project growth of around 1.1-1.2 percent in 2025 and anticipate that higher energy and food prices will increase headline inflation to slightly above 3 percent in 2025. The authorities saw risks to growth as broadly balanced. While downside risks to growth are related to trade tariffs and geopolitical tensions, upside risks arise from a potentially stronger-than-expected impact of increased defense spending (both in Latvia and in partner countries) and rising household purchasing power. Downside risks to the fiscal balance stem mostly from higher spending needs in defense, with the Fiscal Safety Reserve and a strong commitment to fiscal discipline serving as strong mitigating factors. The authorities agreed that low productivity growth and aging are dampening medium-term growth.

POLICY DISCUSSIONS

Economic policies should continue to focus on long-term goals. The fiscal strategy should focus on mobilizing revenue and improving the efficiency of public spending, to preserve fiscal buffers and address rising medium- and long-term spending pressures. Financial sector supervisors should continue to monitor banks' exposure to commercial real estate (CRE). Structural policies should focus on reigniting growth and accelerating the convergence process. Key measures include improving access to finance to stimulate investment, implementing labor and product market reforms to enhance productivity, and increasing investments in renewable energy sources and grid interconnections to enhance energy security.

A. Fiscal Policy: Addressing Public Spending Pressures

16. Latvia has fiscal space, despite the increase in the structural fiscal deficit and public debt. In the medium term, the structural fiscal deficit (including one-off expenses) is projected to increase to 3.2 percent of GDP on average in the baseline. The public debt ratio is projected to increase to 50 percent of GDP at the end of the decade. Financing higher defense spending—expected to gradually increase to 5 percent of GDP starting in 2026—is an immediate challenge.

17. The expansionary fiscal stance in the 2025 budget is broadly appropriate given the still negative output gap but, going forward, the government will need to preserve buffers to address spending pressures. In the past, a succession of shocks (e.g., Covid-19, Russia's war in Ukraine), has caused public debt to rise from 37.9 percent to 46.8 percent of GDP between 2019 and 2024. Spending pressures are projected to increase over the long term due to aging-related costs (pensions and health care), defense spending, investments for energy security, and the costs of the green transition. In the absence of measures to increase fiscal revenues and reprioritize government spending, the long-term spending pressures are likely to be financed by higher debt, which will erode the authorities' ability to address large adverse shocks in the future.

18. Latvia's government should mobilize revenue to preserve fiscal buffers and address rising medium- and long-term spending pressures. Reducing public debt to below 40 percent of GDP provides an important fiscal anchor and, if attained, ensures debt sustainability in the long run. In addition to increasing productivity growth, economic policy should be guided by the following priorities:

Mobilizing Revenue and Reorienting Spending

- Revenue and spending measures could deliver up to 0.6 percent of GDP annually over 2026-2030 and reduce public debt to 41.5 percent of GDP in 2030. These measures include: (i) strengthening tax compliance; (ii) broadening the bases of corporate and personal income taxes by reducing the shadow economy; (iii) continuing to improve VAT collection efficiency through further narrowing of the compliance gap; (iv) reducing tax exemptions and fossil fuel subsidies; and (v) raising property tax revenue by updating cadaster values with market prices, reducing property tax exemptions, and raising the property tax rate. Policies to increase the property tax rate should be matched with options to support

Measures to Address Long-term Spending Pressures

Measures	Estimated Impact (by 2030, percent of GDP)
Revenue	**2.7**
Property tax 1/	0.4
Broadening the PIT and CIT bases 2/	0.2
Tax exemptions (incl. fossil fuel subsidies) 3/	1.3
Increasing VAT collection efficiency	0.6
Strengthening tax compliance	0.2
Expenditure	**0.3**
Improving the efficiency of public spending	0.3
Total savings	**3.0**

Source: IMF staff calculations.

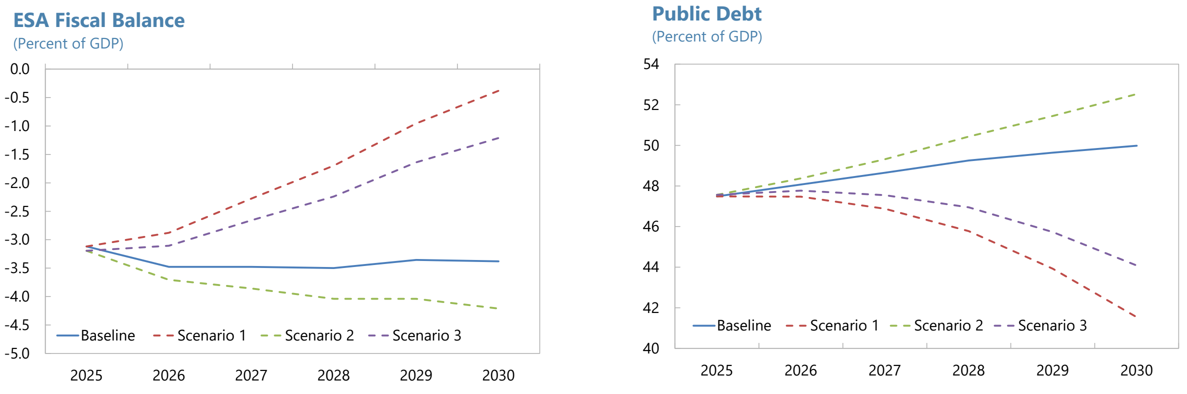
1/ To come closer to the euro area average of 1.1 percent of GDP, we propose an increase in property tax revenue of 0.4 percent of GDP.

2/ Given the high level of the informal sector in Latvia (21.4 percent of GDP in 2024), there is scope to broaden the tax base of PIT and CIT.

3/ Tax exemptions are high in Latvia (7.7 percent of GDP) compared to Estonia (0.9 percent of GDP) and Lithuania (4.2 percent of GDP).

low-income households. In addition, the government should consider improving the efficiency of public spending by further improving procurement, eradicating rent-seeking activities, simplifying regulation, reducing bureaucracy, and increasing the efficiency of public administration. The authorities should also contemplate reorienting spending by reallocating funds away from lower priority spending on goods and services. Proceeds from such measures could be used to relieve both current and medium- and long-term spending pressures and ensure fiscal sustainability (Text Figure 8).

Text Figure 8. Latvia: ESA Fiscal Balance and Public Debt Scenarios, 2025–30



Source: IMF staff projections.

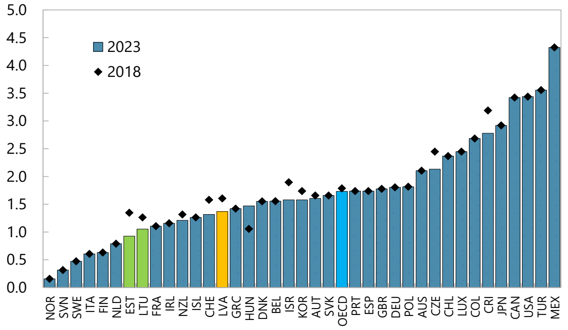
Source: IMF staff projections.

Note: The baseline includes an increase in defense spending from 4 percent of GDP in 2025 to 5 percent of GDP in 2026. Scenario 1 incorporates revenue and expenditure measures of 0.6 percent of GDP per year (2026-2030). Scenario 2 includes higher public spending due to pensions. Scenario 3 combines scenarios 1 and 2 (higher spending on pensions with revenue and expenditure measures).

Accelerating Structural Fiscal Reforms

Governance of State Owned Enterprises

(Index, 0 to 6 (least to most restrictive); lower score means better performance)



Source: OECD, Product Market Regulation Indicators.

- Given plans to scale up capital investment, improving public investment management would be essential to enhance efficiency. The authorities should improve the governance of SOEs to increase efficiency, rationalize spending, and contain fiscal risks.[1]

19. The authorities should adopt a comprehensive approach to improve pension adequacy while ensuring the pension system's financial sustainability. The government projects a decline in pension spending driven by the decline in the benefit ratio and the replacement rate of

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[1] The OECD's Product Market Regulation indicator for the governance of SOEs in Latvia is lower than the OECD average and higher than its Baltic peers. The ranking measures relative performance and the *de jure* quality of SOE governance (see Vitale, Cristiana, Rosamaria Bitetti, Isabelle Wanner, Eszter Danitz, and Carlotta Moiso, 2020, "The 2018 Edition of the OECD PMR Indicators and Database: Methodological Improvements and Policy Insights", OECD Economics Department Working Papers, No. 1604, OECD Publishing, Paris).

the public (pay-as-you-go) pillar of the pension system, which raises concerns about the future adequacy of pension income in Latvia.[2] However, the basic pension for those of retirement age who do not receive any other pension income is low. The authorities should focus on three priorities to ensure that Latvia's pension system is able to provide an adequate retirement income and to curb old-age poverty, which is high in Latvia (Figure 5).[3]

- First, pension adequacy could be strengthened by increasing the contribution rates and the returns to the mandatory defined contribution pension pillar. Increasing the payments to the mandatory defined contribution pension pillar could prevent an excessive reduction of pensions compared to salaries without raising fiscal pressures. Also, a prudent increase in the share of equities and alternative investments in the asset composition of retirement savings would increase returns.[4] Though contributing to increasing long-term returns to pension plan holders, recent reforms to cut commission fees for pension fund managers are expected to result in savings of only 0.2 percent of GDP.
- Second, strengthening incentives for higher voluntary savings for retirement through a more flexible and accessible system design could significantly complement the retirement income of future pensioners and, hence, cover a large part of the gap in adequacy. The government could promote enrollment in the voluntary pension pillar by providing tax incentives.
- Finally, pursuing active labor market policies to increase labor force participation could increase the number of workers contributing to the pension system and enhance its sustainability. Policies should be adopted to counteract the expected decline in the labor force, including raising human capital by investing in education, promoting access to childcare to support an increase in labor force participation, and attracting qualified individuals to work in Latvia.

Still, public spending on pensions will likely have to increase in the future. Incentivizing pensioners to work and linking the retirement ages to future life expectancy gains could lessen the increases in public spending to support retirement income.

Authorities' Views

20. The authorities broadly agreed with staff's fiscal policy advice but noted that there was limited scope for revenue mobilization to address spending pressures. Despite forecasts of an erosion of fiscal space amid higher spending needs, there is limited room for revenue mobilization because tax compliance gaps have been closing and raising property taxes could be challenging. Nonetheless, reducing the informal sector could generate additional tax revenue. Reviewing and redirecting public spending and encouraging private sector involvement through

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[2] The benefit ratio is the average pension benefit divided by the average wage. The replacement rate is the ratio of the pension entitlement to the economy-wide average pre-retirement wage.

[3] See SIP on "Ensuring Adequate and Affordable Pensions in Latvia".

[4] Doubling pillar II outlays—either by raising contributions or increasing returns—over the next 10 years would reduce public debt by about 5 percentage points by 2034.

public-private partnerships will be crucial to preserve fiscal buffers while accommodating increased spending with defense and public investment.

21. The authorities are committed to pursuing pension reforms to improve adequacy. The mandatory and voluntary defined-contribution pillars of Latvia's pension system need to be strengthened to guarantee adequate pensions. The authorities noted that recent measures to reduce pension plans' management fees and ongoing reforms to pension enrollment that make a life cycle plan the default option will contribute to higher returns and improve pension adequacy in the future.

B. Financial Sector Policies: Countering Risks and Building Resilience in the Financial Sector

22. Latvia's financial sector is resilient and the macroprudential policy stance remains broadly appropriate, but borrower-based measures to promote energy-efficient housing should be reconsidered. In December 2024, the authorities implemented a positive neutral countercyclical capital buffer requirement of 0.5 percent, which increased to 1 percent in June 2025. Staff welcomes the move because it facilitates the build-up of releasable buffers. Looser DTI and DSTI limits of 8 times and 45 percent were implemented in 2024 to promote loans for the purchase of energy-efficient housing (Text Table 2), but there is limited evidence that the share of these loans has increased. Moreover, it is appropriate for borrower-based measures to differ across loan segments only when the risk profiles differ significantly across such segments (see 2024 Latvia Staff Report).

Text Table 2. Latvia: Macroprudential Instruments in Place

Borrower Based Measures		Capital Based Measures	
2007 May	**90% LTV** (95% for the State guarantee program participants)	2024 December	**O-SII buffer (0.25% – 2%)** (5 banks) **CCyB (0.5%)**
2020 June	**70% LTV** for buy-to-let mortgages* **40% DSTI*** **6 times DTI*** Maturity caps - **30 years*** (mortgages) and **7 years*** (consumer loans)	2025 January	**80%** risk weights on CRE exposures for banks with standardized approach are no more applied. Instead, **standard CRR 3 framework is applied**
2024 January	**45% DSTI*** for energy-efficient housing loans **8 times DTI*** for energy-efficient housing loans	2025 June	**CCyB (1%)**

*10 percent of institutions' total newly issued loans to households in a quarter may exceed relevant limits.
Source: Bank of Latvia.

23. Given that loans to the CRE sector are more than 31 percent of banks' total corporate loan portfolio, CRE developments should be closely monitored. In January 2025, the authorities reduced the risk weight (80 percent) on CRE exposures for banks with the standardized approach to that in the standard Capital Requirements Regulation 3 (CRR3) framework,[5] which is set at 60 percent for the part of the exposure that is up to 55 percent of the property value. Although the total size of banks' exposure to CRE (10 percent of GDP) is not large, the authorities should carefully assess the effect of the new framework on capital requirements.

24. The authorities should reassess the solidarity contribution on banks. From 2025 until 2027, credit institutions are required to pay a solidarity contribution of 60 percent of the net interest income that exceeds its 2018-22 historical average by more than 50 percent (capped at 33 percent of profits).[6] Lenders who meet credit growth targets linked to nominal GDP growth are eligible for a rebate of up to 100 percent. This measure could distort bank lending toward less productive uses such as real estate and reduce lending to corporates, because banks can spread the increased tax costs over the full term of a mortgage, unlike for corporate loans which have shorter maturities (typically three years).

25. Latvia continues making progress in strengthening its AML/CFT framework. The authorities have pursued AML/CFT reforms and improved the effectiveness of its system, including by implementing recommendations from recent Fund technical assistance. The joint FATF/MONEYVAL plenary meeting concluded in June with the adoption of Latvia's 6th Mutual Evaluation Report (MER), which will soon be published. The authorities should continue to address any remaining gaps.

Authorities' Views

26. The authorities agreed with staff's assessment of the macroprudential stance. Latvia's financial system has shown remarkable resilience and its banks have strong capital and liquidity buffers. The authorities assessed the financial risks associated with the CRE sector as limited given the moderate size of the loan exposure. The Bank of Latvia agreed that the effects of the borrower-based macroprudential measures in promoting loans for energy-efficient housing have been limited so far. Still, it sees the macroprudential treatment of those loans as risk neutral, since it considers the positive effects on debt serviceability from lower expenses on energy. The Bank of Latvia was less concerned than staff about the potentially distortionary effect of the solidarity contribution on bank credit but agreed that its effects should be monitored. The Ministry of Finance deemed the solidarity contribution as important to fund the increase in defense spending but acknowledged that it would become less significant as bank profits normalize. The authorities emphasized the strong and effective performance of the AML/CFT framework.

C. Contingent Policy Responses: Softening the Blow of Adverse Shocks

27. Given elevated uncertainty, the authorities should be ready to adjust the policy mix in response to shocks. In a global downside scenario with higher import tariffs, increased global

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[5] CRR3 is the EU's implementation of the Basel III Accord.

[6] The solidarity tax on bank profits is expected to raise 0.3 percent of GDP in revenue. This temporary measure is in addition to the permanent 20 percent annual corporate income tax payment effective from 2024.

uncertainty, and tighter financial conditions, Latvia's growth will be lower. In such a scenario, automatic stabilizers should provide a first line of defense and additional fiscal support to alleviate the impact of adverse shocks should be temporary and targeted to the most vulnerable groups. Also, structural reforms should be accelerated to dampen the adverse impact on potential growth, encourage investment, and boost productivity.

D. Structural Policies: Boosting Investment and Productivity

28. Sluggish capital accumulation and allocative inefficiencies have constrained Latvia's productivity growth since the global financial crisis. Staff's research emphasizes two main reasons for Latvia's low productivity growth: (i) a capital shortfall, in which low capital depresses the marginal product of labor; and (ii) allocative inefficiencies that reduce total factor productivity growth and, hence, labor productivity growth.[7] The low capital stock results from inadequate investment possibly driven by financial constraints and low risk-adjusted expected returns. Allocative inefficiencies in Latvia likely stem from structural bottlenecks that hinder the flow of resources from low- to high-productivity sectors. Shift-share analysis indicates that while productivity gains have been recorded across most sectors in Latvia[8]—particularly real estate, construction, and other nontradable sectors—the movement of labor toward higher productivity sectors has been minimal, both in absolute terms and relative to Estonia and Lithuania (Text Figure 9).

29. Labor and skills shortages pose a significant barrier to investment and productivity in Latvia. These shortages are primarily driven by an aging population and emigration. In 2023, the biggest labor shortages were in science, technology, engineering and mathematics, sectors that are highly relevant for productivity gains.[9]

30. The lack of firm dynamism in Latvia, which hinders productivity growth, may be related to the low level of corporate insolvencies. Corporate insolvency filings in courts have remained below pre-pandemic levels and the time taken for in-court resolution has been declining from its peak reached during the pandemic. Despite significant reforms to Latvia's insolvency framework since 2016, costly insolvency procedures for small firms hinder the reallocation of resources to more productive enterprises. Insolvency reforms that facilitate the exit of nonviable firms could help the reallocation of resources to more viable businesses.

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[7] See SIP on "Allocative Efficiency, Firm Dynamics, and Productivity in Latvia".

[8] See McMillan, Margaret S. and Dani Rodrik, 2011, "Globalization, Structural Change and Productivity Growth", NBER Working Paper 17143.

[9] EC Council Recommendation on the Economic, Social, Employment, Structural and Budgetary Policies of Latvia, 2024.

Text Figure 9. Latvia: Labor Productivity Growth

Latvia's labor productivity growth has declined sharply relative to the frontier since the GFC…

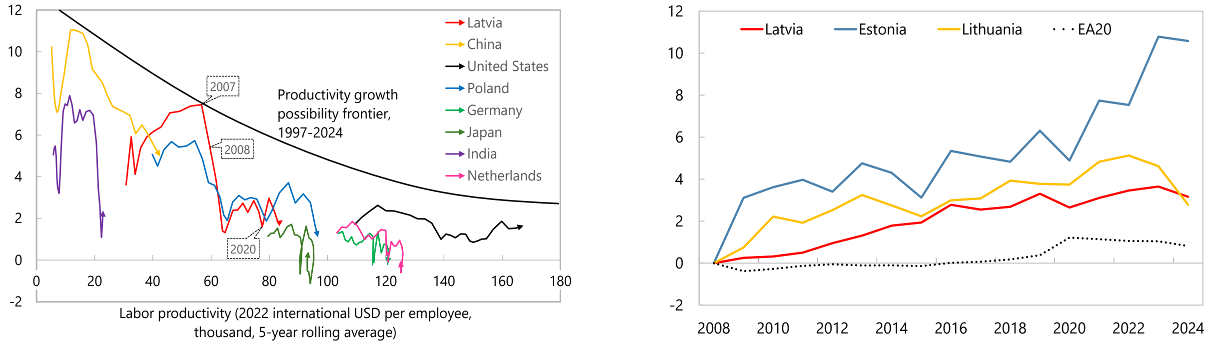
Labor Productivity Growth, 1997-2024

(Percent, 5-year rolling average)

…amid minimal gains from labor reallocation across sectors.

Labor Shift Contribution to Productivity Growth

(Cumulative contribution, percentage points)



Sources: The Conference Board Total Economy Database; and IMF staff calculations.

Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Labor productivity in manufacturing lags peers…

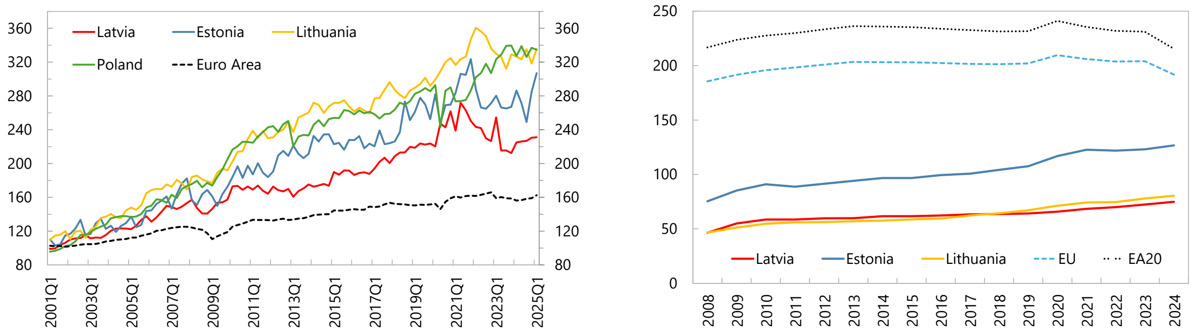
Manufacturing: Real Labor Productivity Per Hour Worked

(Index; 2000 = 100)

…while capital per worker in the total economy is low and rising slowly.

Capital Intensity: Net Capital Stock Per Person Employed

(Thousands of 2020 euros)



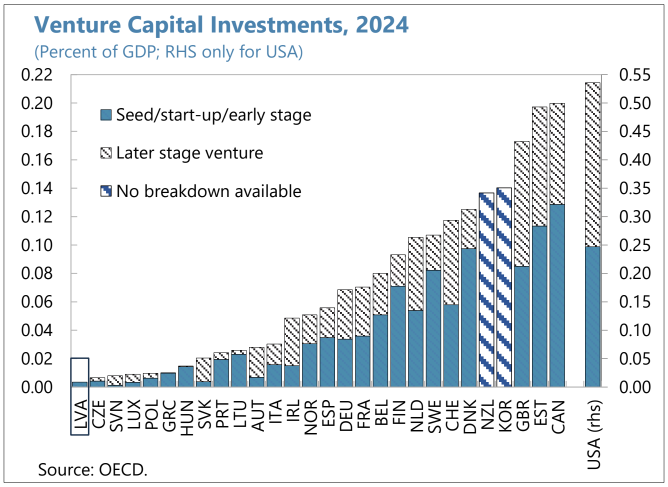
Sources: Eurostat; Haver Analytics; and IMF staff calculations.

Source: European Commission, AMECO database.

Boosting Investment and Efficiency Through Corporate Reforms and Better Access to Finance

31. Targeted measures to promote investment and allocative efficiency will be crucial for reigniting growth and accelerating convergence. The authorities could boost productivity by increasing the quantity and quality of corporate investment, improving the reallocation of labor and capital toward higher value-added products and services, and enhancing digital technology adoption in traditional sectors. Boosting productivity would also help to support higher wage income without pressuring Latvia's external competitiveness.

32. The authorities should continue to address institutional limitations that could be holding back the necessary and timely exit of nonviable firms in Latvia. The current framework could be upgraded by: (i) reducing the high deposit requirement for access to the court-based insolvency procedure; (ii) establishing modalities for resolving cases where the debtor lacks sufficient assets to cover the cost of a court procedure; and (iii) strengthening the limited early warning system, as well as low-cost financial literacy and debt counseling services, particularly for micro and small enterprises (MSE). Data collected on insolvency cases by the authorities could be further refined and disaggregated to identify opportunities to reduce costs and time taken in resolving MSE insolvency.


Venture Capital Investments, 2024
(Percent of GDP; RHS only for USA)

Source: OECD.

33. Corporate reforms could also enhance access to finance. A significant percentage of firms in Latvia perceives finance availability as a major obstacle to investment.[10] Given the large share of small firms, initiatives to develop the domestic capital market could help to improve SMEs' access to finance and reverse Latvia's long-standing pattern of weak investment growth. Progress in the EU's savings and investment union could also contribute to improve Latvian firms' access to finance. Expanding the availability of venture capital, including by facilitating investments by second- and third-pillar pension funds, would improve access to finance and facilitate capital deepening, therefore boosting opportunities for startups to scale up.[11] More broadly, deepening the European single market would particularly benefit small EU member states like Latvia, allowing promising firms to leverage economies of scale to enhance productivity and growth.[12]

Boosting Productivity by Labor and Product Market Reforms and Digitalization

34. Addressing labor and skills shortages is crucial to enhancing productivity. High-quality education and training systems and targeted upskilling and reskilling measures are key to reducing the labor and skills shortages, improving competitiveness, and boosting productivity. The authorities should utilize targeted active labor market policies to boost skilled labor and alleviate labor market shortages. Facilitating skilled migration will also help enhance participation.

35. Product- and service-market reforms can enhance competition and productivity. Latvia's regulatory burden is perceived as higher than in other Baltic countries, with market entry barriers in service sectors dominated by SOEs remaining among the highest in the OECD. The

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[10] See Yashiro, Naomitsu, Caroline Klein, Olga Rastrigina, and Ania Thiemann , 2019, "Policies for Stronger Productivity Growth in Latvia", OECD WP No. 1571.

[11] Although venture capital is not exclusively local, there is a tendency for venture capitalists to invest in companies that are geographically close to them (see Chen, Henry, Paul Gompers, Anna Kovner, and Josh Lerner, 2010, "Buy Local? The Geography of Venture Capital", *Journal of Urban Economics* 67(1): 90-102). Therefore, allowing local pension funds more flexibility in investing in venture capital could help Latvian startups.

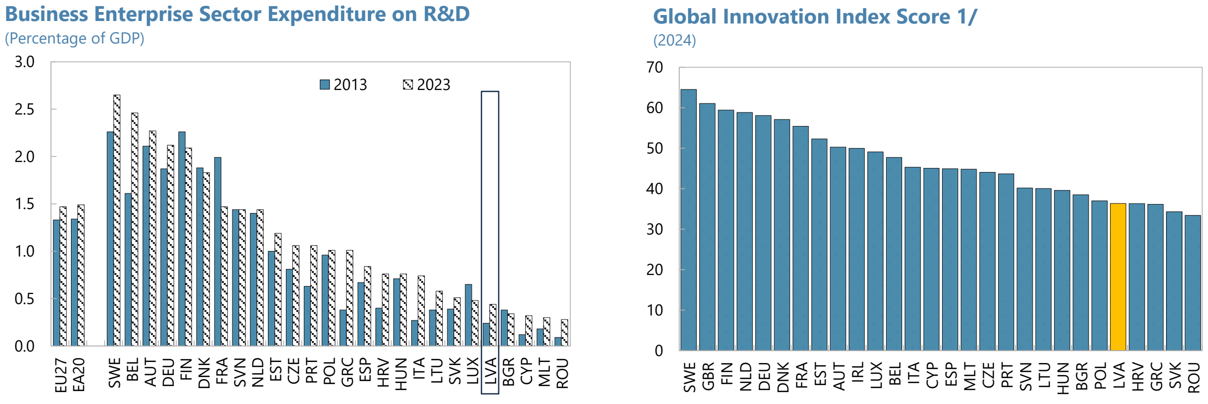
[12] In line with the recommendations made in the reports by Letta and Draghi, which prioritize removing remaining barriers to the free flow of goods, services, and factors of production within the EU.

regulatory framework could be improved by reducing the use of retail price regulation. Despite the ongoing overhaul of administrative procedures and digitalization efforts in the construction sector spearheaded by the authorities, further streamlining spatial planning and construction regulations could benefit the housing market and investment.

36. The authorities should accelerate their efforts to support innovation, technology adoption, and the digital transformation by increasing cooperation between the public and private sectors. Despite a modest rise in the past decade, Latvia's R&D spending as a share of GDP remains among the lowest in Europe, mainly on the back of low R&D spending from the business sector, hampering innovation and productivity growth (Text Figure 10).[13] Reforms to accelerate the digital transformation include centralizing the governance of digital platforms and systems in the public sector, expanding digital training to public employees, advancing digitization in businesses, enhancing broadband infrastructure, and fostering digitalization in the education sector.

Text Figure 10. Latvia: R&D Spending and Global Innovation

Latvia's business sector spending on R&D is low… *…and Latvia scores low on global innovation.*



Business Enterprise Sector Expenditure on R&D
(Percentage of GDP)

Source: Eurostat.

Global Innovation Index Score 1/
(2024)

Source: World Intellectual Property Organization (WIPO).

1/ WIPO's Global Innovation Index rankings reflect relative (and not absolute) performance, and are constructed using more than 70 indicators. For further details, please refer to: Dutta, Lanvin, Rivera León, and Wunsch-Vincent, 2024, "Global Innovation Index 2024: Unlocking the Promise of Social Entrepreneurship", WIPO.

Enhancing Energy Security

37. Latvia should continue to enhance its energy security by increasing the share of renewable energy. Currently, approximately 75 percent of Latvia's power supply is generated through renewable sources. This green energy mix strengthens energy security by easing dependence on imported fossil fuels and supports the green transition by lowering greenhouse gas emissions. However, a high reliance on renewables requires balancing mechanisms to manage the fluctuations in power supply from these sources.

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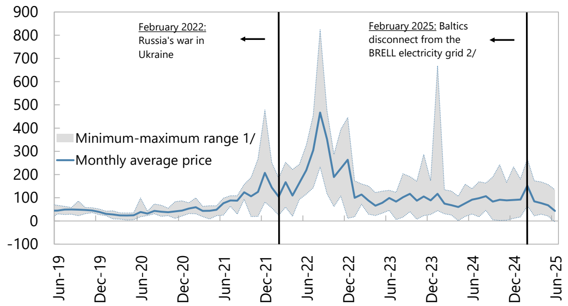
[13] Many firms in Latvia exhibit low productivity due to limited digital adoption and insufficient innovation (OECD Economic Surveys 2024: Latvia).

Latvia: Monthly Wholesale Electricity Prices

(Euros per megawatt-hour equivalent)



Sources: Ember; and IMF staff calculations.
1/ The minimum and maximum price range is based on daily values in the month.
2/ BRELL stands for "Belarus, Russia, Estonia, Latvia, Lithuania".

38. The recent disconnection from Russia's electricity grid is an opportunity to modernize the electricity infrastructure. Although the transition has resulted in higher electricity prices in the short term, it is anticipated to foster risk diversification, ultimately leading to lower volatility and potentially lower prices in the long run. Options to further diversify the country's renewable energy mix include scaling up production of wind and solar power. Among others, this requires streamlining domestic permitting processes to reduce the time and costs associated with building interconnections and more renewables.

39. Latvia should continue to improve interconnections to other European power grids.[14] To unlock the full benefits of a unified European energy market, Latvia must implement a coordinated strategy to strengthen collaboration at the EU and regional levels and make progress at the national level. A closer integration of Europe's electricity markets could increase the level of potential output between 1.5 and 3.5 percent by 2035.[15] In addition to closely coordinating domestic policies and investments with the EU and pooling resources with neighboring countries to develop grid infrastructures, the Latvian authorities should consider streamlining domestic permitting processes.

Authorities' Views

40. The authorities continued to pursue efforts to reduce the regulatory burden, deepen credit and capital markets, address skills shortages, and ensure energy security. They emphasized measures to simplify regulations and streamline processes, including those in real estate development. Such reforms would be more effective if accompanied by the deepening of the EU's single market, allowing Latvian firms to leverage economies of scale and significantly improve access to capital. The authorities agreed with staff's recommendations on using active labor market policies to encourage workforce participation and noted the ongoing initiatives to upgrade technical and digital skills. Energy security requires investing in interconnections and increasing electricity production through renewable sources.

41. The authorities highlighted the importance of Latvia's insolvency reforms, which will facilitate the exit of nonviable firms and reallocate resources to more productive businesses. The authorities emphasized the reforms since 2016 and improvements in Latvia's insolvency framework, such as shortening the duration of the insolvency process and increasing the asset

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[14] See SIP "Modernizing Latvia's Electricity Sector Through Closer EU Integration".

[15] See Arnold, Nathaniel, Allan Dizioli, Alexandra Fotiou, Jan Frie, Burcu Hacibedel, Tara Iyer, Huidan Lin, Malhar Nabar, Hui Tong, and Frederik Toscani, 2025, "Lifting Binding Constraints on Growth in Europe: Actionable Priorities to Deepen the Single Market". IMF Working Paper WP/25/113.

recovery rates. Since its adoption, the new insolvency framework has contributed to reducing the cost and length of insolvency processes. In time, the new framework will contribute to greater business dynamism.

STAFF APPRAISAL

42. **Despite decades of rising per capita GDP, Latvia's economy faces structural headwinds with lagging productivity growth and a deceleration in per capita income convergence.** Latvia's labor productivity continues to lag other Baltics and the euro area. Latvia's growth also slowed over the last decade, driven by deficiencies in capital deepening, which led to a deceleration in per capita income convergence. Unfavorable demographic trends and skill mismatches in the labor market are compounding the challenges to productivity growth and a slowdown in income convergence.

43. **New near-term challenges emerge from geopolitical fragmentation and trade tensions that may dampen the recovery.** Although direct trade and financial exposures to the U.S. are small, weaker demand in key European trading partners and lower consumer and business confidence could affect economic and financial stability through financial contagion. Also, an escalation of trade tensions between the EU and its main trading partners could affect Latvia's exports indirectly through weaker demand in key European trading partners and heightened global trade policy uncertainty.

44. **Growth is projected to rebound in 2025 driven by higher public investment, but risks are tilted to the downside.** Downside risks to growth stem mainly from further slowing of growth in Latvia's trading partners, delays in absorption of EU funds, new increases in global energy and food prices, and increased electricity costs. Inflation is projected to continue to moderate.

45. **Latvia's government faces significant medium- and long-term spending pressures.** These include rising costs for pensions and health care, increased defense spending, investments for energy security, and the costs of the green transition. The government's recent commitment to increasing defense spending in the near term will increase spending pressures over time. In the absence of measures to increase fiscal revenues and reprioritize government spending, the medium- and long-term spending pressures are likely to be financed by higher debt, which will erode the authorities' ability to address large adverse shocks in the future.

46. **The government should mobilize revenue and reorient spending to preserve fiscal buffers, address rising medium- and long-term spending pressures, and ensure fiscal sustainability.** Revenue measures could include strengthening tax compliance; broadening the bases of corporate and personal income taxes by reducing the shadow economy; and raising property tax revenue. Measures to improve the efficiency of public spending should also be considered. The government should also accelerate structural fiscal reforms to build buffers. Importantly, the authorities should continue to strengthen the second and third pillars of the pension system to improve pension adequacy and sustainability.

47. Latvia's external position is currently in line with that implied by fundamentals and desirable policies, but staff expects the current account deficit to widen in the medium term given the spending increases. Fiscal adjustment and structural reform measures to boost productivity should help the external sector maintain a balanced position.

48. Latvia's financial sector is resilient with systemic risks contained. The authorities should allow the solidarity contribution levied on banks to expire in 2027 when the sunset clause comes into effect and monitor loan exposure to CRE. The solidarity contribution could distort bank lending toward less productive uses such as real estate and reduce lending to corporates. Considering structural changes in the office CRE segment globally, CRE developments should be closely monitored. Although the macroprudential policy stance remains broadly appropriate, the borrower-based measures implemented in 2024 to promote loans for the purchase of energy-efficient housing should be reconsidered.

49. Latvia continues making progress in strengthening its AML/CFT framework. The authorities are encouraged to continue addressing any remaining gaps.

50. As Latvia continues to grapple with low productivity growth, targeted improvements to investment and resource allocation are essential to reignite growth and accelerate convergence. Latvia's low productivity growth is driven by sluggish capital accumulation and allocative inefficiencies. The authorities should consider measures to boost productivity including increasing the quantity and quality of corporate investment, improving the reallocation of labor and capital toward higher value-added products and services, and enhancing digital technology adoption in traditional sectors.

51. Corporate reforms can improve capital allocation and enhance access to finance. Insolvency reforms with a focus on micro companies could help to reallocate resources to more viable businesses. Initiatives to develop the domestic capital market (including expanding venture capital) and deepening the EU's single market could help to improve access to finance for Latvia's SMEs and enable them to grow.

52. Labor and skills shortages pose a major obstacle to investment and productivity growth in Latvia. Strengthening high-quality education and training systems, along with focused upskilling and reskilling initiatives, is essential to addressing these shortages, enhancing competitiveness, and boosting productivity gains. The authorities should utilize targeted active labor market policies and support skilled migration to boost skilled labor and address labor market shortages.

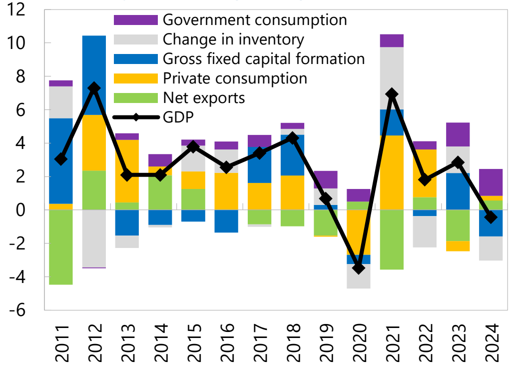
53. Reforms in product and service markets can enhance competition and boost productivity. The regulatory framework could be improved by reducing the use of retail price regulation, streamlining spatial planning and construction regulations, further simplifying administrative procedures, and digitalization efforts in the construction sector.

54. The authorities should enhance support for innovation, technology adoption, and digital transformation, while strengthening energy security. Despite a modest rise in the past decade, Latvia's R&D spending as a share of GDP remains among the lowest in Europe, hampering innovation and productivity growth. Finally, Latvia should continue to enhance its energy security by increasing the share of renewable energy and improving interconnections to other European power grids.

55. It is recommended that the next Article IV consultation take place on the regular 12-month cycle.

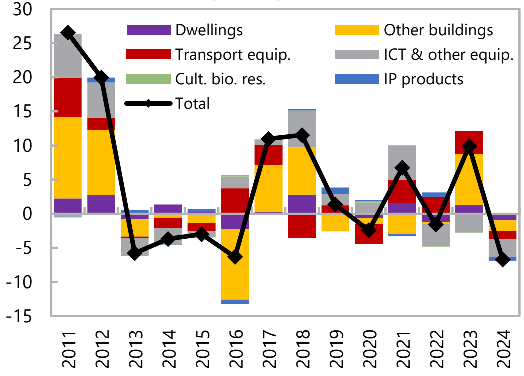
Figure 1. Latvia: Real Sector and Inflation Developments

GDP shrunk in 2024…


GDP Growth and Contributions

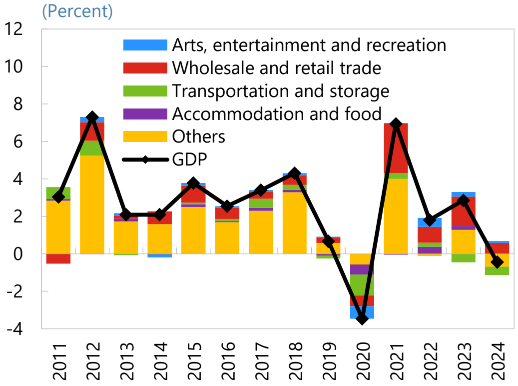
(Year-on-year percentage change)

…driven by a decline in investment.


Gross Fixed Capital Formation

(Year-on-year percentage change)

Growth contribution of wholesale and retail trade declined but remained positive…


Contribution to GDP Growth

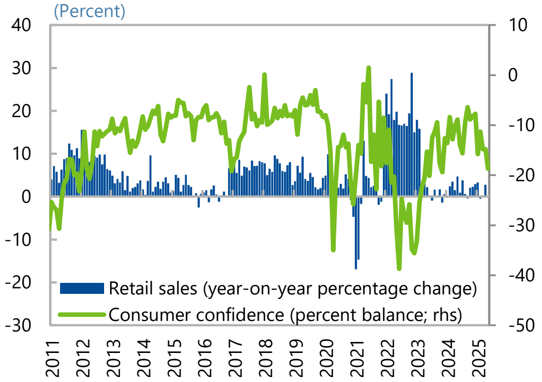
(Percent)

…while its share in gross value added in the economy is large.


Share in Gross Value Added, 2024

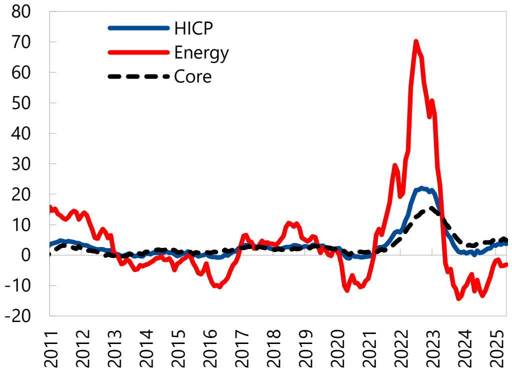
(Percent)

Retail sales have been growing but at a slower pace than previous highs.


Retail Sales

(Percent)

A decline in energy prices caused inflation to decelerate.

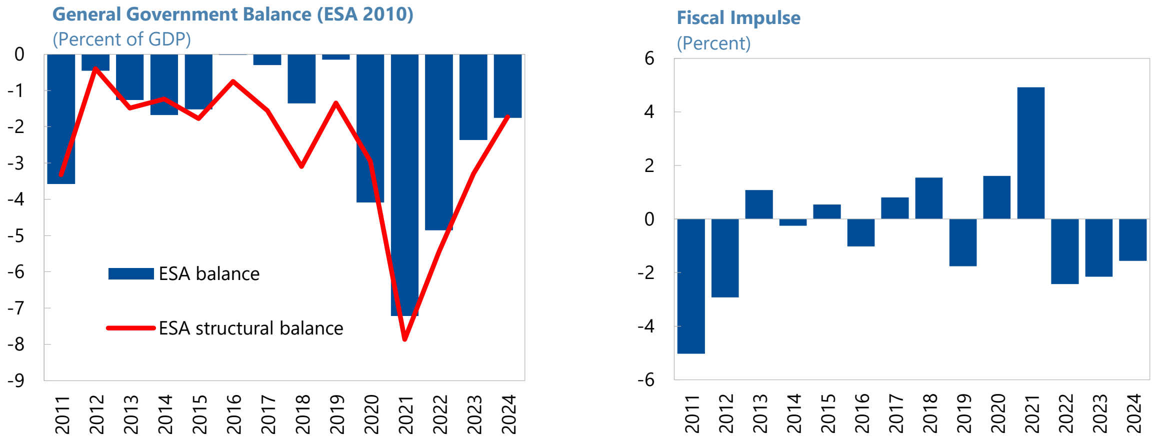

HICP Inflation

(Year-on-year, percent)

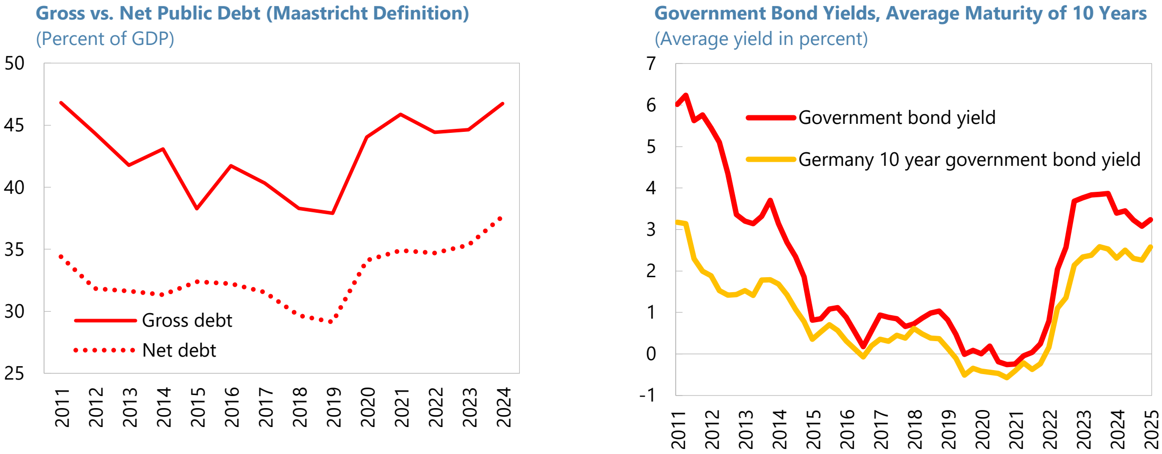
Sources: Latvian Central Statistical Bureau; Haver Analytics; and IMF staff calculations.

Figure 2. Latvia: Fiscal Sector Developments

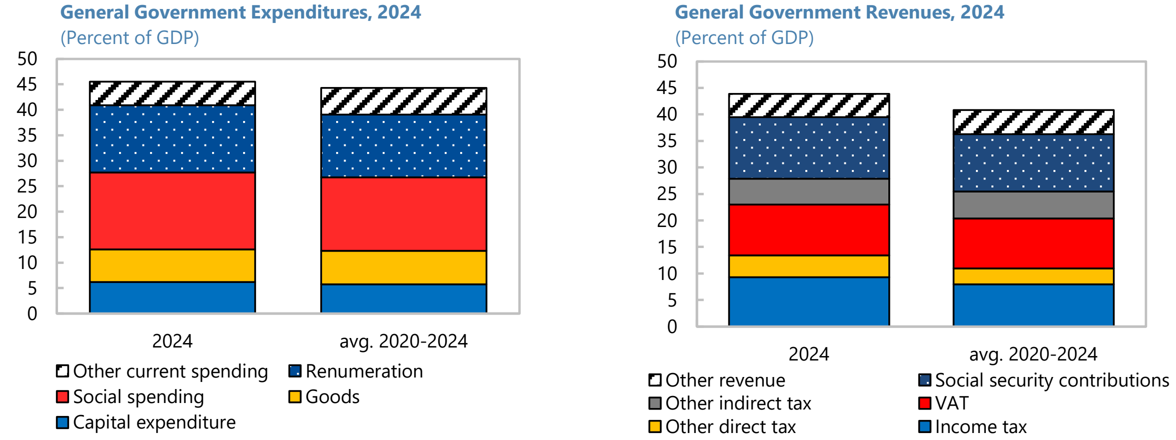
The structural balance improved… *…as significant crisis relief measures were scaled back.*



Public debt has increased. *As financial conditions eased, bond yields declined.*



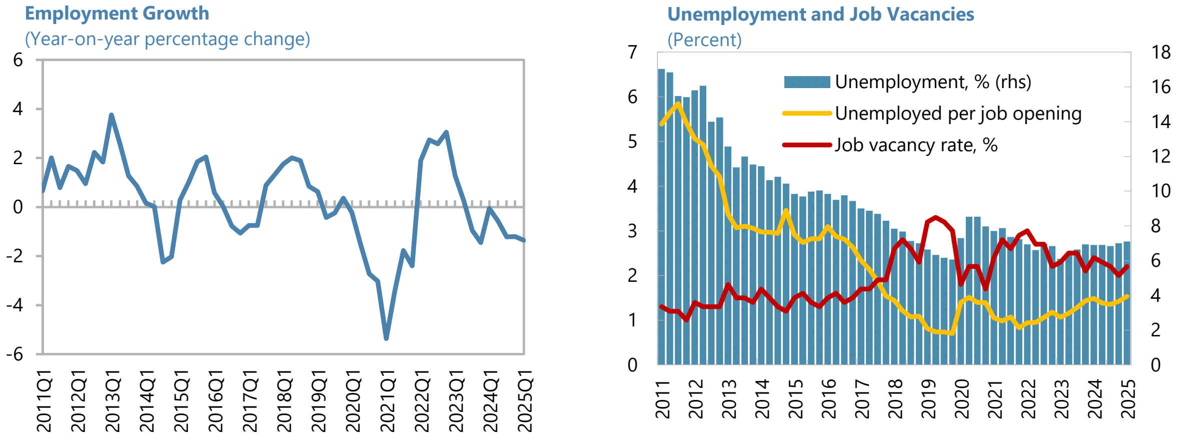
Social spending remained relatively unchanged… *…while revenue sources held up.*



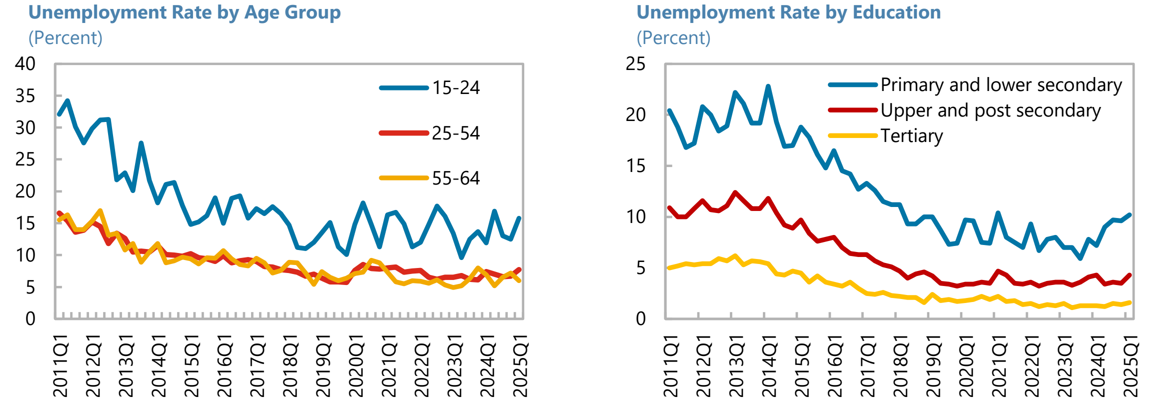
Sources: Latvian authorities; Eurostat; Haver Analytics; and IMF staff calculations.

Figure 3. Latvia: Labor Market Developments

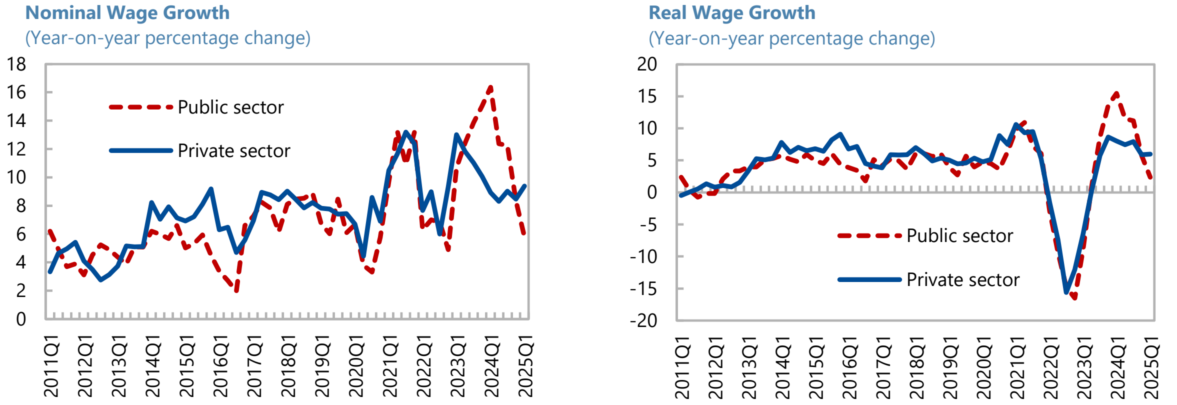
Employment growth decreased recently… *…and the unemployment rate increased in 2024.*



The unemployment rate is higher among the young… *…and those with lower education.*



Nominal wage growth was higher in the public sector in 2024. *High nominal wage growth sustained positive real wage growth.*

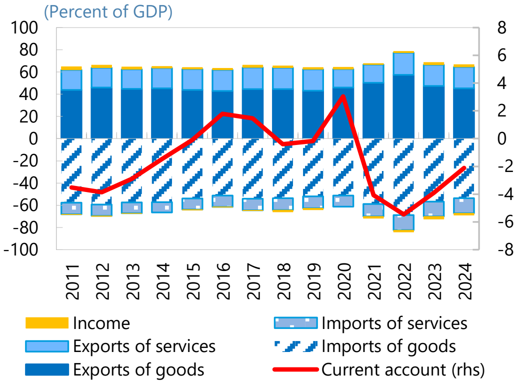


Sources: Latvian Central Statistical Bureau; Eurostat; Haver Analytics; and IMF staff calculations.

Figure 4. Latvia: External Sector Developments

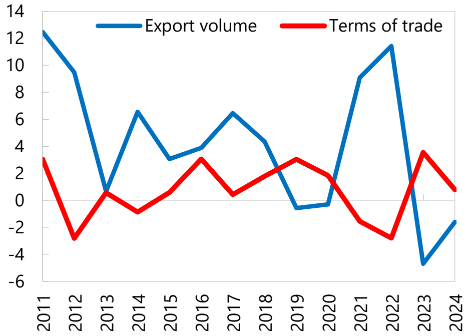
The current account deficit narrowed in 2024…

Current Account
(Percent of GDP)



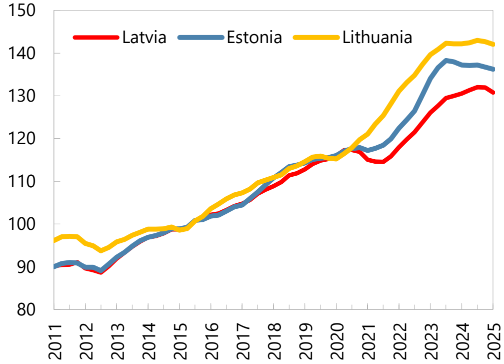
…as export volume growth improved.

Terms of Trade and Export Volume
(Year-on-year percent change)



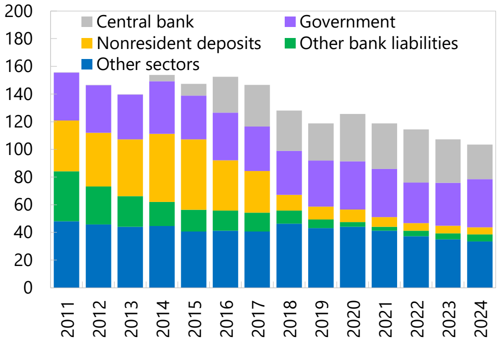
REER appreciation led to the erosion of price competitiveness in 2024.

Real Effective Exchange Rates 1/
(Index, 2015=100)



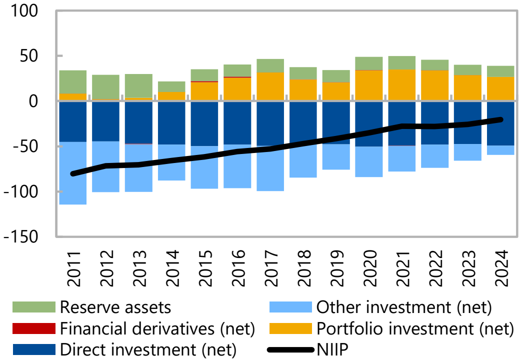
The total external debt burden decreased.

Composition of External Debt
(Percent of GDP)



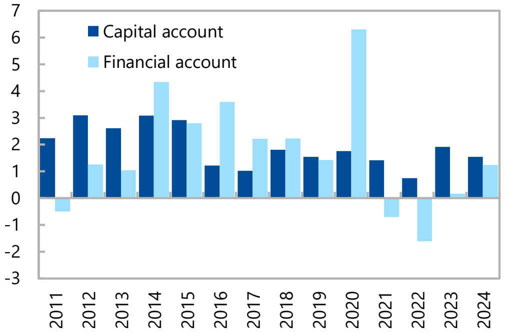
The NIIP continued its long-term improvement…

Net International Investment Position
(Percent of GDP)



…while the financial and capital account balances remained positive.

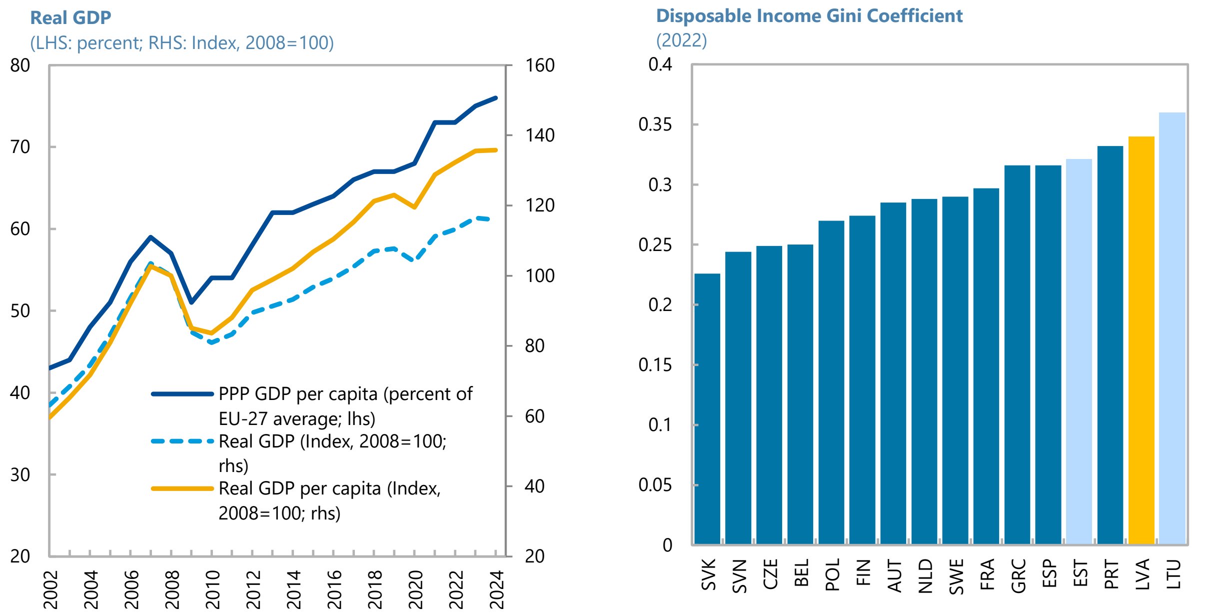
Capital and Financial Account Balance
(Percent of GDP)



Sources: Bank of Latvia; Latvian Central Statistical Bureau; European Commission; and IMF staff calculations.

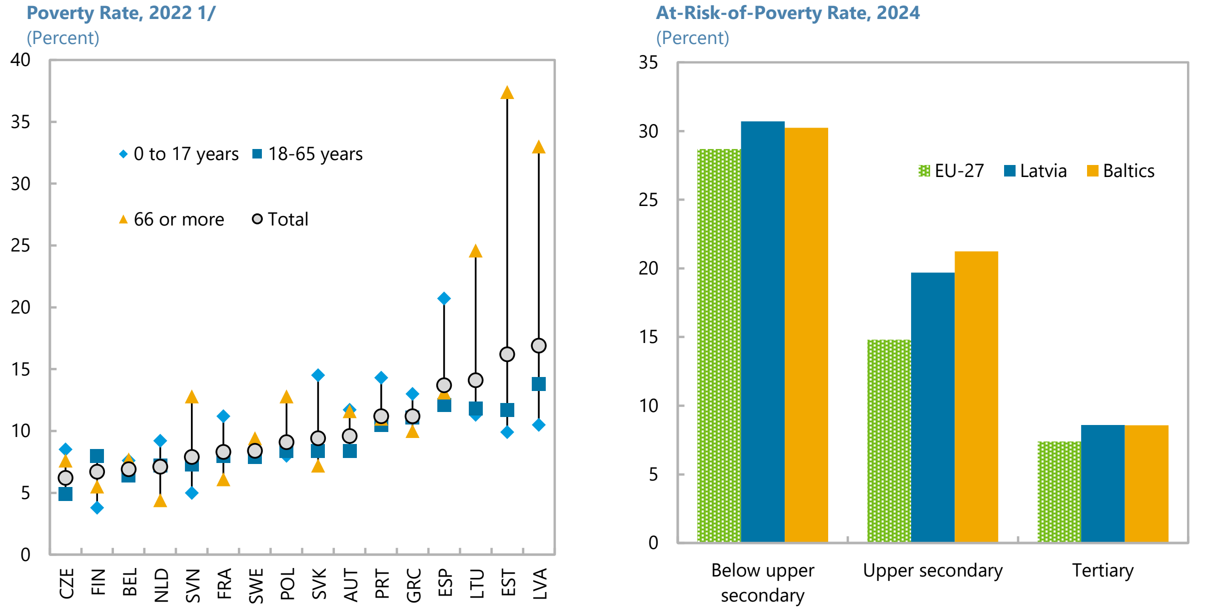
1/ Real effective exchange rates are based on IC–37 countries for ULC.

Figure 5. Latvia: Inequality and Poverty Indicators



GDP per capita remains below that of Western Europe.

Income inequality is one of the highest in the EU.



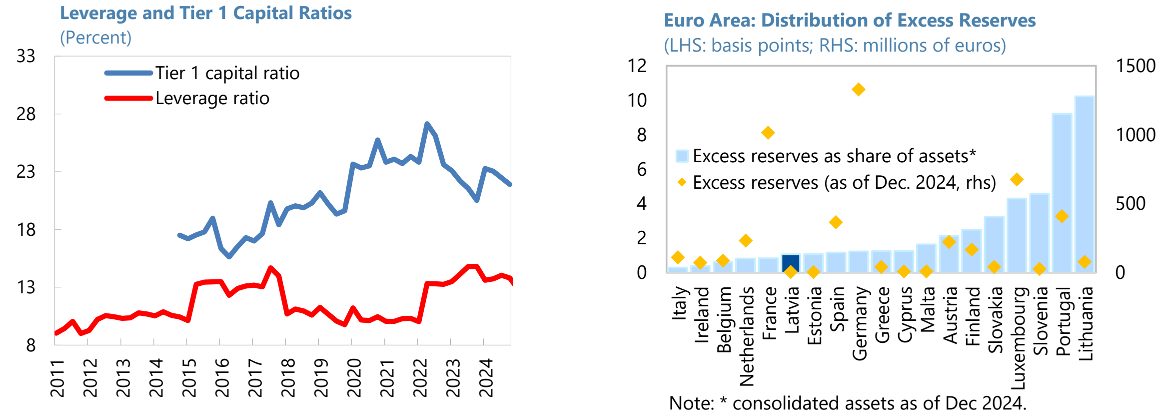
Poverty rates are among the highest in the EU, especially among the elderly…

…and those with lower education.

Sources: OECD; Eurostat; and IMF staff calculations.

1/ Poverty rate based on 50 percent of the national median disposable income.

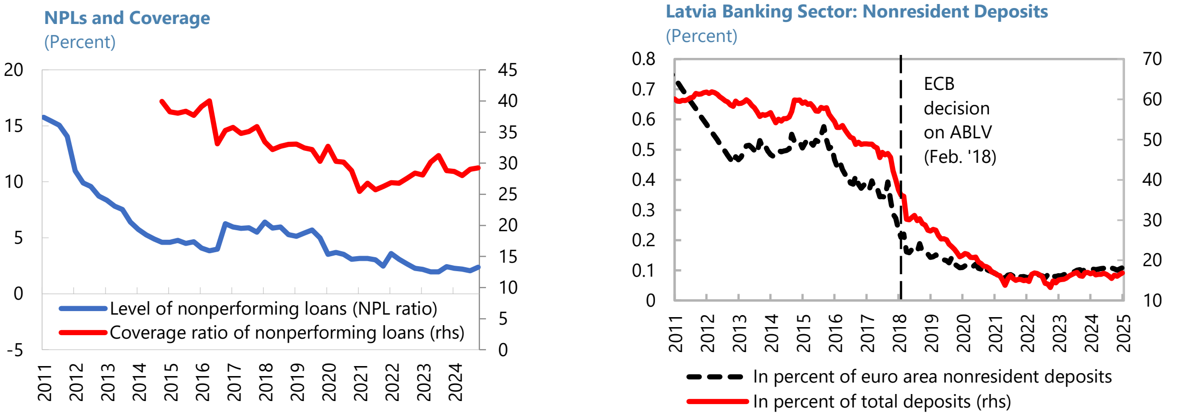
Figure 6. Latvia: Banking Sector Developments



Banks hold adequate capital buffers.

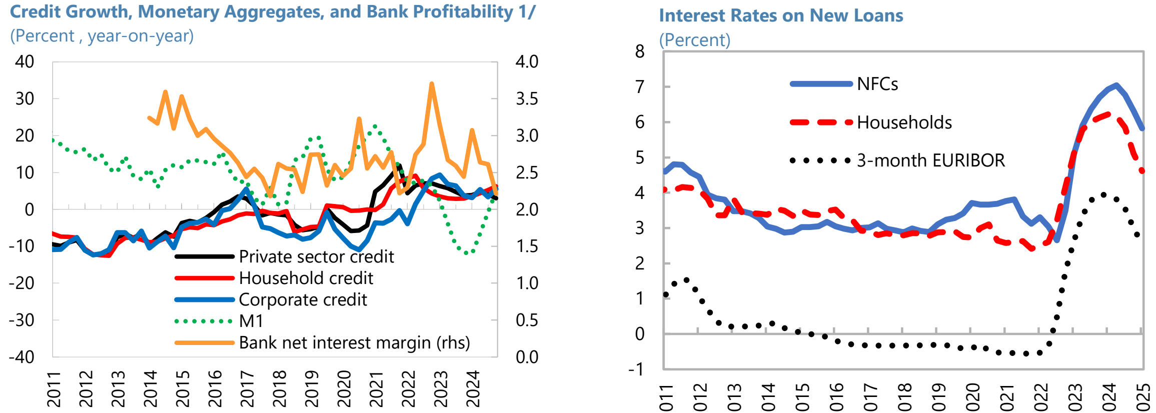
Excess reserves are lower than in some euro area countries.

Note: * consolidated assets as of Dec 2024.



The NPL ratio remained low.

The retrenchment of nonresident deposits points to a lower risk of money laundering.



Interest margins declined…

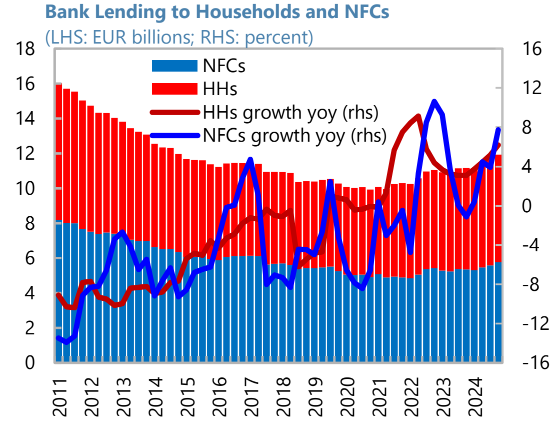
…but lending rates remain well above the cost of funding.

Sources: Bank of Latvia; ECB; Haver Analytics; and IMF staff calculations.

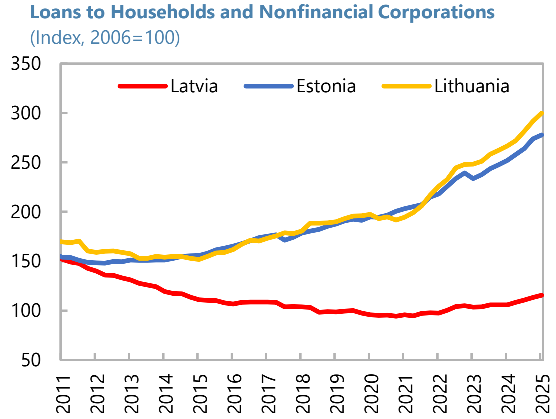
1/ Data from March 2012 onwards exclude Parex Bank and from May 2012 exclude Latvijas Krajbanka.

Figure 7. Latvia: Indicators of Financial System's Credit

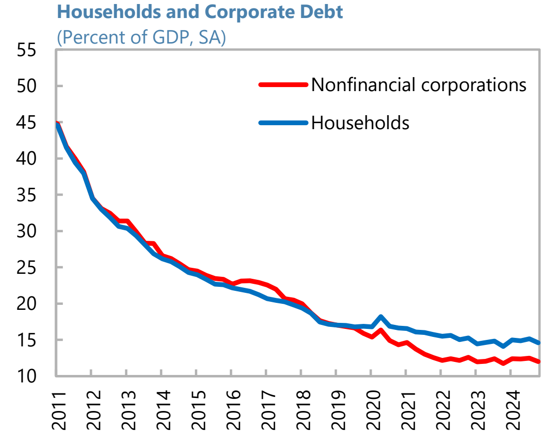
Bank lending remains relatively unchanged in Latvia…


Bank Lending to Households and NFCs
(LHS: EUR billions; RHS: percent)

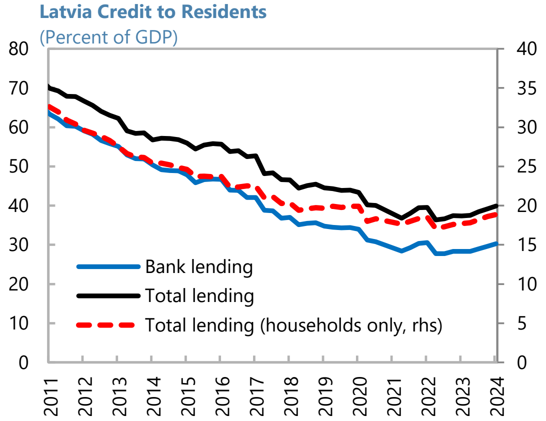
…and still lags that of Baltic peers.


Loans to Households and Nonfinancial Corporations
(Index, 2006=100)

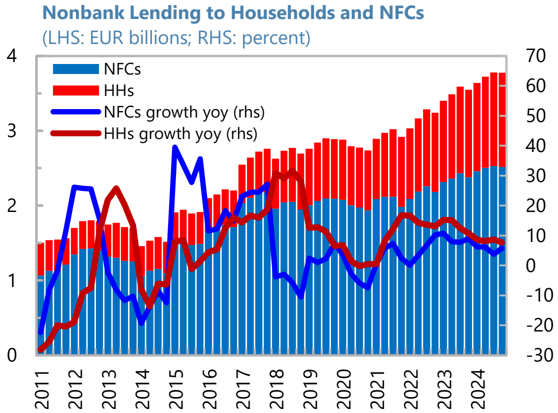
Household debt remains above that of nonfinancial corporates.


Households and Corporate Debt
(Percent of GDP, SA)

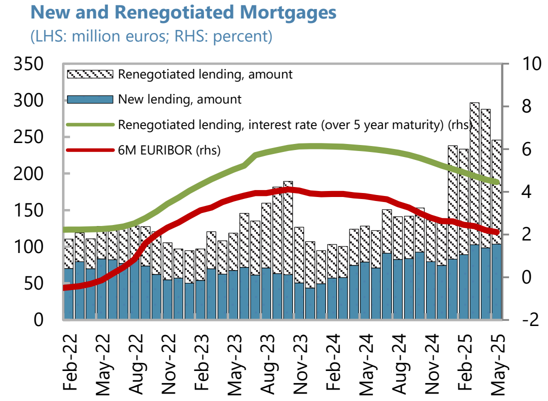
Total lending to residents increased in line with lower interest rates.


Latvia Credit to Residents
(Percent of GDP)

Nonbank lending to households and NFCs increased.


Nonbank Lending to Households and NFCs
(LHS: EUR billions; RHS: percent)

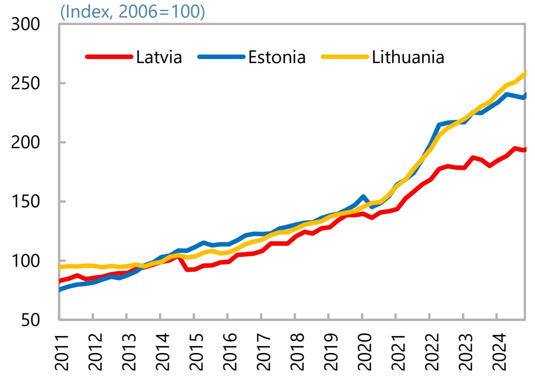
Monetary policy easing is passing through to lower mortgage rates and encouraging mortgage refinancing.


New and Renegotiated Mortgages
(LHS: million euros; RHS: percent)

Sources: Bank of Latvia; ECB; Deutsche Bundesbank; OECD; Haver Analytics; and IMF staff calculations.

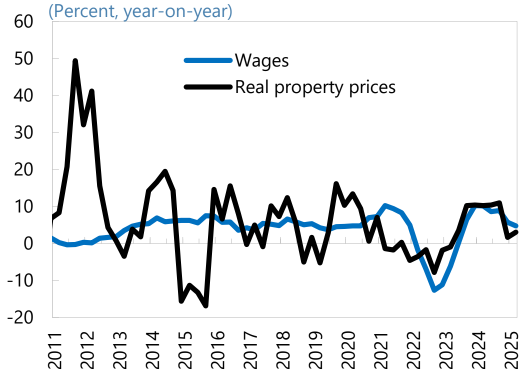
Figure 8. Latvia: Housing Market Indicators

Increases in Latvia's house prices have been slower than those for its Baltic neighbors…



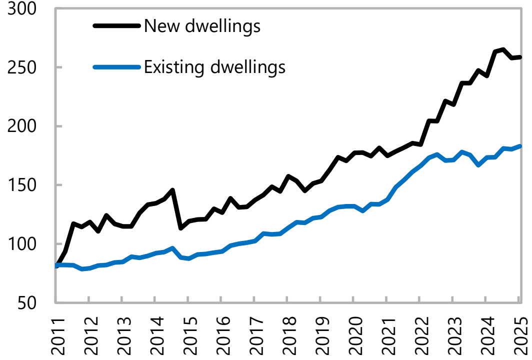
Housing Price Index
(Index, 2006=100)

…and on average in line with wage growth.



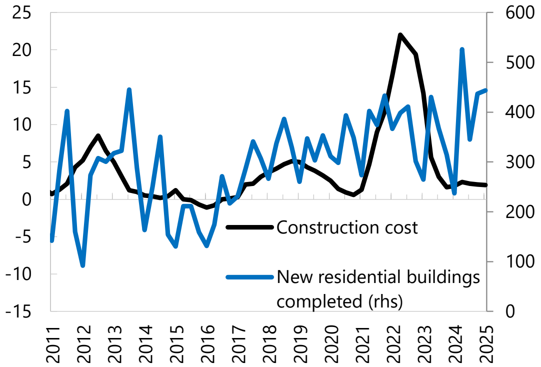
Real Average Gross Monthly Wages and Real Property Prices
(Percent, year-on-year)

Prices for new dwellings rose rapidly as compared to those for existing dwellings.



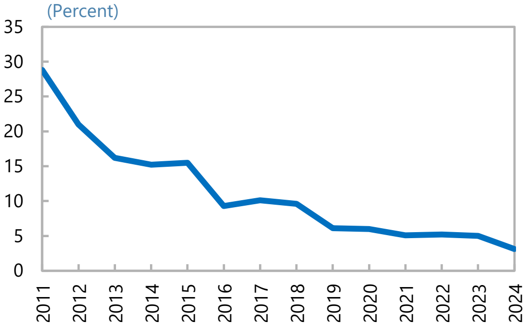
Residential Property Prices
(Index, 2006=100)

…despite the decline in construction costs.



Construction Activity
(LHS: percent, year-on-year; RHS: sqm, index, 2010Q1=100)

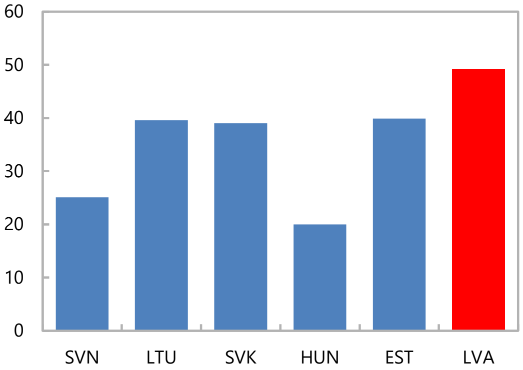
Housing is gradually becoming more affordable…



Housing Cost Burden Rate
(Percent)

Note: The share of population living in HH that spent 40% or more of their disposable income on housing.

…but the loan-to-value ratio is still higher than that for peers.



Household Loan-to-Value Ratio
(Percent, 2021)

Sources: Latvian Central Statistics Bureau; Eurostat; ECB; Haver Analytics; and IMF staff calculations.

Table 1. Latvia: Selected Economic Indicators, 2020–26

	2020	2021	2022	2023	2024	2025	2026
						Proj.	
National Accounts	(Percentage change, unless otherwise indicated)						
Real GDP	-3.5	6.9	1.8	2.9	-0.4	1.0	2.0
Private consumption	-4.8	8.1	5.1	-1.0	0.5	1.3	2.1
Public consumption	3.9	3.7	2.4	7.0	7.6	1.8	2.0
Gross capital formation	-8.6	23.8	-8.8	16.5	-11.7	4.5	3.9
Gross fixed capital formation	-2.4	6.8	-1.6	9.9	-6.7	4.7	4.0
Exports of goods and services	-0.3	9.1	11.4	-4.7	-1.6	2.0	2.3
Imports of goods and services	-1.1	15.1	9.9	-2.0	-2.3	3.4	3.0
Nominal GDP (billions of euros)	29.2	32.3	36.1	39.4	40.2	42.3	44.6
GDP per capita (thousands of euros)	15.3	17.1	19.2	20.9	21.5	22.6	23.9
Savings and Investment							
Gross national saving (percent of GDP)	25.2	21.7	18.7	20.7	19.0	18.7	18.6
Gross capital formation (percent of GDP)	22.2	25.7	24.2	24.6	21.2	21.4	21.4
Private (percent of GDP)	17.9	21.8	20.7	20.9	17.3	16.9	16.8
HICP Inflation							
Headline, period average	0.1	3.2	17.2	9.1	1.3	3.3	2.5
Headline, end-period	-0.5	7.9	20.7	0.9	3.4	2.2	2.1
Core, period average	1.1	2.0	11.3	9.8	3.8	3.4	2.4
Core, end-period	0.9	4.7	15.2	4.0	4.9	2.2	2.8
Labor Market							
Unemployment rate (LFS; period average, percent)	8.1	7.6	6.9	6.5	6.9	6.7	6.6
Nominal wage growth	6.2	11.7	7.5	11.9	9.7	7.2	6.0
Consolidated General Government 1/	(Percent of GDP, unless otherwise indicated)						
Total revenue	38.8	38.9	39.6	39.7	42.6	40.8	40.9
Total expenditure	42.6	44.6	43.5	43.1	44.5	44.4	44.4
Basic fiscal balance	-3.8	-5.7	-3.9	-3.4	-1.8	-3.6	-3.5
ESA fiscal balance	-4.1	-7.2	-4.9	-2.4	-1.8	-3.1	-3.5
General government gross debt	44.0	45.9	44.4	44.6	46.8	47.5	48.1
Money and Credit							
Credit to private sector (annual percentage change)	-4.4	11.9	7.1	3.8	3.0	…	…
Broad money (annual percentage change)	13.1	9.2	5.1	2.7	6.6	…	…
Balance of Payments							
Current account balance	3.0	-4.1	-5.5	-3.9	-2.1	-2.7	-2.8
Trade balance (goods)	-5.3	-8.6	-11.4	-9.3	-8.2	-7.3	-7.1
Gross external debt	126.0	114.3	109.4	101.9	98.9	94.4	92.1
Net external debt 2/	14.1	10.4	8.8	8.4	5.6	6.0	9.6
Exchange Rates							
U.S. dollar per euro (period average)	1.14	1.18	1.05	1.08	1.08	…	…
REER (period average; CPI based, 2005=100)	124.5	125.1	130.2	138.9	137.6	…	…
Terms of trade (annual percentage change)	1.9	-1.6	-2.8	3.6	0.8	0.8	1.1

Sources: Latvian authorities; Eurostat; and IMF staff calculations.

1/ National definition. Includes economy-wide EU grants in revenue and expenditure.

2/ Gross external debt minus gross external assets.

Table 2. Latvia: Macroeconomic Framework, 2019–30

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
							Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Percentage change, unless otherwise indicated)												
National Accounts												
Real GDP	0.7	-3.5	6.9	1.8	2.9	-0.4	1.0	2.0	2.4	2.4	2.4	2.4
Consumption	1.3	-2.5	6.8	4.4	1.1	2.5	1.4	2.1	2.3	2.3	2.3	2.2
Private consumption	-0.1	-4.8	8.1	5.1	-1.0	0.5	1.3	2.1	2.4	2.4	2.4	2.3
Public consumption	5.6	3.9	3.7	2.4	7.0	7.6	1.8	2.0	2.2	2.2	2.2	2.0
Gross capital formation	5.8	-8.6	23.8	-8.8	16.5	-11.7	4.5	3.9	3.9	3.9	3.9	3.2
Gross fixed capital formation	1.3	-2.4	6.8	-1.6	9.9	-6.7	4.7	4.0	4.0	4.0	4.0	3.3
Exports of goods and services	-0.6	-0.3	9.1	11.4	-4.7	-1.6	2.0	2.3	2.5	2.5	2.5	2.5
Imports of goods and services	2.0	-1.1	15.1	9.9	-2.0	-2.3	3.4	3.0	3.0	3.0	3.0	2.6
Contributions to growth												
Domestic demand	2.3	-3.9	10.5	1.1	4.6	-1.1	2.2	2.6	2.8	2.8	2.8	2.6
Net exports	-1.5	0.5	-3.6	0.8	-1.9	0.6	-1.0	-0.6	-0.4	-0.5	-0.5	-0.2
HICP Inflation												
Headline, period average	2.7	0.1	3.2	17.2	9.1	1.3	3.3	2.5	2.7	2.2	2.2	2.2
Headline, end-period	2.1	-0.5	7.9	20.7	0.9	3.4	2.2	2.1	3.1	2.5	2.3	2.9
Core, period average	2.7	1.1	2.0	11.3	9.8	3.8	3.4	2.4	2.2	2.2	2.2	2.2
Core, end-period	1.9	0.9	4.7	15.2	4.0	4.9	2.2	2.8	2.1	2.9	2.3	2.1
Labor Market												
Unemployment rate (LFS, percent)	6.3	8.1	7.6	6.9	6.5	6.9	6.7	6.6	6.6	6.5	6.5	6.4
Employment (period average, percent)	0.1	-1.9	-3.2	2.6	-0.2	-0.8	0.1	0.1	0.1	0.1	0.1	0.1
Nominal wage growth	7.2	6.2	11.7	7.5	11.9	9.7	7.2	6.0	6.0	6.0	6.0	5.0
(Percent of GDP)												
Consolidated General Government 1/												
Total revenue	38.6	38.8	38.9	39.6	39.7	42.6	40.8	40.9	40.7	40.8	40.7	40.7
Total expenditure	39.0	42.6	44.6	43.5	43.1	44.5	44.4	44.4	44.1	44.3	44.1	44.1
ESA fiscal balance	-0.2	-4.1	-7.2	-4.9	-2.4	-1.8	-3.1	-3.5	-3.5	-3.5	-3.4	-3.4
ESA structural fiscal balance	-1.3	-2.9	-7.9	-5.4	-3.3	-1.7	-2.8	-3.2	-3.3	-3.4	-3.3	-3.4
General government gross debt	37.9	44.0	45.9	44.4	44.6	46.8	47.5	48.1	48.7	49.3	49.6	50.0
Saving and Investment												
Gross national saving	23.2	25.2	21.7	18.7	20.7	19.0	18.7	18.6	18.4	18.3	18.6	18.6
Foreign saving	0.2	-3.0	4.1	5.5	3.9	2.1	2.7	2.8	2.9	3.1	3.0	2.9
Gross capital formation	23.3	22.2	25.7	24.2	24.6	21.2	21.4	21.4	21.4	21.4	21.5	21.5
External Sector												
Current account balance	-0.2	3.0	-4.1	-5.5	-3.9	-2.1	-2.7	-2.8	-2.9	-3.1	-3.0	-2.9
Net IIP	-41.4	-35.0	-27.9	-28.2	-25.8	-20.5	-27.0	-33.3	-38.1	-41.3	-45.6	-49.1
Gross external debt	121.3	126.0	114.3	109.4	101.9	98.9	94.4	92.1	89.6	86.8	84.8	82.7
Net external debt 2/	18.9	14.1	10.4	8.8	8.4	5.6	6.0	9.6	11.7	12.1	13.7	14.7
Memorandum Items:												
Nominal GDP (billions of euros)	29.6	29.2	32.3	36.1	39.4	40.2	42.3	44.6	47.1	49.5	51.9	54.5
Output gap (percent of potential GDP)	2.6	-3.0	1.7	1.5	2.4	-0.1	-0.9	-0.7	-0.4	-0.2	-0.1	0.0
Potential output growth (percent)	2.6	2.1	2.0	2.0	2.0	2.1	1.9	1.9	2.0	2.2	2.3	2.4
Terms of trade (annual percentage change)	3.0	1.9	-1.6	-2.8	3.6	0.8	0.8	1.1	0.3	0.2	0.1	0.1

Sources: Latvian authorities; and IMF staff calculations.

1/ National definition. Includes economy-wide EU grants in revenue and expenditure.

2/ Gross external debt minus gross external assets.

Table 3. Latvia: General Government Operations, 2019–30 1/

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
							Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percent of GDP, unless otherwise indicated)											
Revenue	38.6	38.8	38.9	39.6	39.7	42.6	40.8	40.9	40.7	40.8	40.7	40.7
Taxes	20.8	20.9	20.3	21.8	21.9	22.8	22.0	22.0	21.9	22.0	21.9	21.9
Personal income tax	6.5	6.2	6.0	6.3	6.4	7.0	6.8	6.8	6.8	6.8	6.8	6.8
Corporate income tax	0.2	0.7	0.9	1.0	1.4	1.8	1.6	1.5	1.5	1.5	1.5	1.5
Property tax	0.8	0.8	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Value-added tax	9.0	8.7	8.6	9.9	9.9	9.7	9.4	9.4	9.4	9.4	9.4	9.4
Excise tax	3.6	3.6	3.4	3.1	2.9	3.0	2.9	2.9	2.9	2.9	2.9	2.9
Other taxes	0.8	0.8	0.8	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Social Contributions	9.8	10.0	9.7	10.2	10.2	10.9	10.7	10.7	10.7	10.7	10.7	10.7
Grants	4.5	4.5	4.2	4.1	3.8	4.5	4.3	4.5	4.2	4.2	4.2	4.2
Other Revenue	3.5	3.5	4.6	3.6	3.8	4.4	3.7	3.7	3.8	3.8	3.8	3.8
Expenditure	39.0	42.6	44.6	43.5	43.1	44.5	44.4	44.4	44.1	44.3	44.1	44.1
Expense	34.9	38.4	40.7	40.0	39.4	40.6	40.0	39.9	39.8	39.9	39.7	39.7
Compensation of employees	8.8	9.3	9.1	8.6	9.1	10.2	9.9	10.1	10.1	10.2	10.2	10.2
Use of goods and services	5.1	5.0	4.8	6.4	5.9	5.3	5.9	6.1	6.2	6.2	6.2	6.2
Interest	0.9	0.9	0.8	0.5	0.6	0.9	1.1	1.3	1.4	1.5	1.5	1.5
Subsidies 2/	7.9	9.5	11.2	10.6	10.3	10.1	9.6	9.0	8.6	8.5	8.3	8.3
Grants	1.2	1.3	1.4	1.2	1.2	1.2	1.2	1.1	1.3	1.3	1.3	1.3
Payments to EU budget	1.0	1.1	1.2	1.1	1.0	0.9	0.9	0.8	1.0	1.0	1.0	1.0
International organizations	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social support	11.0	12.4	13.3	12.5	12.3	13.0	12.2	12.2	12.1	12.1	12.1	12.1
Pensions	7.5	8.7	7.9	7.9	10.0	8.7	8.7	8.7	8.7	8.7	8.7	8.7
Other	3.5	3.7	5.4	4.6	2.2	4.2	3.5	3.5	3.4	3.4	3.4	3.4
Net Acquisition of Nonfinancial Assets	4.1	4.3	3.9	3.5	3.7	3.9	4.4	4.5	4.4	4.4	4.4	4.4
Gross Operating Balance	3.7	0.4	-1.8	-0.4	0.3	2.0	0.8	1.0	0.9	0.9	1.0	1.0
Net Lending/Borrowing	-0.4	-3.8	-5.7	-3.9	-3.4	-1.8	-3.6	-3.5	-3.5	-3.5	-3.4	-3.4
Domestic financing	-3.1	1.5	-16.8	-18.6	-13.9	0.1	2.9	2.4	2.4	2.4	2.3	2.4
External financing	3.5	2.3	22.5	22.6	17.2	1.7	0.7	1.0	1.0	1.0	1.0	1.0
Errors and omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items												
ESA fiscal balance 3/, 4/	-0.2	-4.1	-7.2	-4.9	-2.4	-1.8	-3.1	-3.5	-3.5	-3.5	-3.4	-3.4
ESA structural fiscal balance (percent of GDP) 4/	-1.3	-2.9	-7.9	-5.4	-3.3	-1.7	-2.8	-3.2	-3.3	-3.4	-3.3	-3.4
ESA cyclically-adjusted fiscal balance (percent of potential GDP) 4/	-1.2	-2.9	-8.0	-5.5	-3.4	-1.7	-2.8	-3.2	-3.3	-3.4	-3.3	-3.4
ESA structural fiscal balance (percent of potential GDP) 4/	-1.4	-2.9	-8.0	-5.5	-3.4	-1.7	-2.8	-3.2	-3.3	-3.4	-3.3	-3.4
ESA structural fiscal primary balance (percent of GDP) 4/	-0.5	-2.0	-7.1	-4.9	-2.7	-0.8	-1.7	-1.9	-1.9	-1.9	-1.8	-1.9
Cyclically-adjusted fiscal balance (percent of potential GDP) 5/	-1.4	-2.6	-6.5	-4.6	-4.4	-1.8	-3.3	-3.2	-3.3	-3.4	-3.3	-3.4
General government debt	37.9	44.0	45.9	44.4	44.6	46.8	47.5	48.1	48.7	49.3	49.6	50.0
Nominal GDP (billions of euros)	29.6	29.2	32.3	36.1	39.4	40.2	42.3	44.6	47.1	49.5	51.9	54.5

Sources: Latvian authorities; and IMF staff calculations.

1/ Fiscal accounts are on a cash basis as provided by the authorities.

2/ Changes in subsidies are driven by higher subsidies and grants to businesses and institutions, which are supported by EU funds.

3/ ESA refers to European System of Accounts.

4/ The decline in the ESA deficit in 2023 is mainly due to the correction of EU funds' revenue in 2023.

5/ Cash basis.

Table 4. Latvia: Medium-Term Balance of Payments, 2019–30

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
							Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Percent of GDP, unless otherwise indicated)												
Current Account	-0.2	3.0	-4.1	-5.5	-3.9	-2.1	-2.7	-2.8	-2.9	-3.1	-3.0	-2.9
Goods and services (fob)	-0.2	1.4	-3.2	-4.9	-3.7	-2.6	-2.9	-2.5	-2.6	-2.7	-2.9	-2.8
Goods (fob)	-8.9	-5.3	-8.6	-11.4	-9.3	-8.2	-7.3	-7.1	-7.0	-7.1	-7.1	-7.0
Exports	43.2	46.0	50.2	57.4	47.4	45.4	46.0	44.5	43.1	42.3	41.6	40.9
Imports	52.0	51.4	58.8	68.8	56.7	53.6	53.3	51.6	50.2	49.3	48.7	47.9
Services	8.7	6.8	5.4	6.5	5.6	5.6	4.5	4.6	4.4	4.3	4.2	4.2
Credit	19.4	16.6	16.6	20.1	19.1	19.2	16.9	17.0	16.8	16.5	16.3	16.0
Debit	10.7	9.9	11.2	13.6	13.5	13.6	12.4	12.4	12.4	12.2	12.1	11.9
Primary income	-1.4	0.0	-1.9	-1.8	-2.4	-1.7	-1.9	-2.0	-2.0	-2.0	-1.8	-1.8
Compensation of employees	1.7	1.4	1.2	1.1	0.9	0.9	1.1	1.0	1.1	1.0	1.1	1.1
Investment income	-4.5	-2.8	-4.2	-3.9	-4.2	-3.8	-4.1	-3.9	-3.8	-3.7	-3.6	-3.6
Secondary income	1.5	1.6	1.0	1.2	2.2	2.1	2.0	1.8	1.7	1.7	1.7	1.7
Capital and Financial Account	3.0	8.1	0.7	-0.9	2.1	2.8	0.2	0.7	-0.3	-0.5	-0.6	-0.6
Capital account	1.5	1.8	1.4	0.7	1.9	1.5	1.4	1.7	1.3	1.3	1.2	1.2
Financial account	1.4	6.3	-0.7	-1.6	0.2	1.2	-1.3	-1.0	-1.6	-1.8	-1.8	-1.8
Direct investment	-3.1	-2.2	-2.6	-3.6	-1.6	-2.4	-2.4	-2.3	-2.2	-2.2	-2.1	-2.0
Portfolio investment and financial derivatives	-1.8	13.5	-0.8	3.8	-4.3	-4.6	-2.3	1.4	1.9	2.0	2.0	2.2
of which: general government net issuance	3.4	-1.1	1.9	2.2	4.8	4.1	4.7	1.1	0.4	0.4	0.3	0.2
Other investment	6.7	-6.5	2.3	-0.7	5.4	8.3	3.4	-0.1	-1.3	-1.6	-1.7	-1.9
Reserve assets	-0.3	1.5	0.4	-1.2	0.6	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omissions	0.1	1.5	1.9	3.1	2.2	1.8	0.0	0.0	0.0	0.0	0.0	0.0
(Percent change, unless otherwise indicated)												
Goods and Services												
Export value (fob)	2.8	-1.0	17.8	29.7	-6.4	-0.7	2.3	3.2	2.8	3.1	3.3	3.4
Import value (fob)	2.4	-3.6	26.3	31.6	-7.1	-2.2	2.9	2.8	3.0	3.4	3.7	3.3
Export volume	-0.6	-0.3	9.1	11.4	-4.7	-1.6	2.0	2.3	2.5	2.5	2.5	2.5
Import volume	2.0	-1.1	15.1	9.9	-2.0	-2.3	3.4	3.0	3.0	3.0	3.0	2.6
Gross reserves (billions of euros)	4.0	4.3	4.8	4.2	4.5	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Gross external debt (billions of euros)	35.9	36.8	36.9	39.5	40.1	39.8	39.9	41.1	42.2	42.9	44.0	45.1
Medium and long term (billions of euros)	21.6	20.9	20.7	20.0	22.2	24.3	27.0	28.0	28.8	29.5	30.5	31.4
Short term (billions of euros)	14.3	15.9	16.2	19.5	17.9	15.5	13.0	13.2	13.4	13.4	13.5	13.7
Net External Debt (billions of euros) 1/	5.6	4.1	3.4	3.2	3.3	2.3	2.5	4.3	5.5	6.0	7.1	8.0
Gross External Debt (percent of GDP)	121.3	126.0	114.3	109.4	101.9	98.9	94.4	92.1	89.6	86.8	84.8	82.7
Medium and long term (percent of GDP)	72.9	71.6	64.1	55.3	56.5	60.4	63.8	62.6	61.2	59.7	58.7	57.5
Short term (percent of GDP)	48.4	54.3	50.2	54.1	45.4	38.4	30.6	29.5	28.4	27.0	26.0	25.1
Net External Debt (percent of GDP) 1/	18.9	14.1	10.4	8.8	8.4	5.6	6.0	9.6	11.7	12.1	13.7	14.7
Memo Items												
Nominal GDP (billions of euros)	29.6	29.2	32.3	36.1	39.4	40.2	42.3	44.6	47.1	49.5	51.9	54.5
U.S. dollar per euro (period average)	1.12	1.14	1.18	1.05	1.08	1.08	…	…	…	…	…	…

Sources: Latvian authorities; and IMF staff calculations. Methodologies are based on BPM6.

1/ Gross external debt liabilities minus gross external debt assets.

Table 5. Latvia: Financial Soundness Indicators, 2018–24

(In percent, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023	2024
Core FSIs							
Regulatory capital to risk-weighted assets	22.3	21.7	26.8	25.3	23.0	21.0	21.2
Tier 1 capital to risk-weighted assets	20.6	20.6	26.0	24.6	22.1	20.4	19.4
Nonperforming loans net of provisions to capital	23.2	26.8	15.7	12.5	7.3	7.4	7.6
Capital to assets (leverage ratio)	11.1	8.5	9.3	9.0	9.4	9.6	9.2
Nonperforming loans to total gross loans	5.3	5.0	3.1	2.5	2.3	2.4	2.4
Provisions to nonperforming loans	39.7	44.4	40.3	45.1	59.8	59.6	55.8
Return on assets	1.1	0.6	0.8	1.3	1.2	2.8	2.4
Return on equity	9.0	4.9	7.5	12.3	12.3	21.0	18.4
Interest margin to gross income	46.4	48.2	51.4	50.3	56.4	72.8	71.8
Noninterest expenses to gross income	67.9	69.8	70.2	64.7	61.1	45.2	54.1
Liquid assets to total assets	28.8	25.1	27.9	29.5	24.0	28.1	28.9
Liquid assets to short-term liabilities	37.1	41.4	43.6	50.2	35.0	42.5	43.3
Net open position in foreign exchange to capital	1.0	5.2	1.3	0.5	0.9	0.2	0.2
Additional FSIs							
Large exposures to capital	102.8	83.8	78.5	71.7	88.2	93.3	99.4
Gross asset position in financial derivatives to capital	2.8	4.7	2.1	4.8	5.1	1.4	1.5
Gross liability position in financial derivatives to capital	2.7	4.6	2.5	4.3	4.3	1.4	0.9
Trading income to total income	5.4	9.5	5.4	6.6	5.0	2.4	3.7
Personnel expenses to noninterest expenses	40.3	40.3	41.5	41.8	39.5	38.3	34.8
Customer deposits to total (noninterbank) loans	86.0	88.1	94.2	89.8	125.5	126.7	129.6
Residential real estate loans to total gross loans	22.6	23.2	23.4	23.0	28.1	28.6	28.5
Commercial real estate loans to total gross loans	18.4	19.7	19.8	18.6	22.1	23.0	23.9

Source: IMF Financial Soundness Indicators.

Table 6. Latvia: Summary of Monetary Accounts, 2015–24

(Millions of euros, unless otherwise specified)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Central Bank										
Net foreign assets	5,373	4,416	5,369	5,779	6,286	6,111	7,302	3,964	5,785	7,932
Net domestic assets	3,566	4,150	4,932	4,944	5,174	6,493	6,156	8,137	8,045	7,059
Net domestic claims	592	806	1,102	724	887	2,050	1,690	2,850	2,497	1,521
Claims on central government (net)	328	549	857	685	875	790	1,073	2,327	2,404	1,521
Claims on state and local government	0	0	0	0	0	0	0	0	0	0
Claims on public nonfinancial corporations	0	0	0	0	0	0	0	0	0	0
Claims on private sector	0	0	0	0	0	0	0	0	0	0
Claims on other depository corporations	264	257	245	39	12	1,260	617	523	93	0
Claims on other financial corporations	0	0	0	0	0	0	0	0	0	0
Other items net	2,974	3,344	3,830	4,220	4,287	4,443	4,466	5,287	5,548	5,538
Monetary base	8,937	8,568	10,301	10,722	11,458	12,604	13,456	12,100	13,830	14,992
Other Depository Corporations										
Net foreign assets	-3,675	-2,500	-3,482	-1,534	-295	1,597	765	3,031	1,439	1,565
Net domestic assets	15,133	14,851	16,012	14,194	13,979	16,344	17,619	16,777	17,672	18,835
Net domestic claims	18,789	18,167	19,492	17,359	17,458	18,256	20,290	19,713	21,649	22,921
Claims on central government (net)	638	221	405	40	42	715	778	299	253	-86
Claims on state and local government	36	29	26	17	15	104	197	188	179	172
Claims on public nonfinancial corporations	0	0	0	0	0	0	0	0	0	0
Claims on private sector	11,870	11,849	11,366	10,672	10,561	10,150	10,477	11,187	11,301	11,922
of which: private sector credit	11,688	11,700	11,145	10,561	10,421	10,024	10,354	11,088	11,165	11,776
Claims on central bank	4,984	4,383	5,946	4,913	5,157	5,815	6,436	5,355	7,188	8,402
Claims on other depository corporations	1,261	1,685	1,749	1,717	1,683	1,472	2,402	2,684	2,728	2,511
Other items net	-3,656	-3,316	-3,480	-3,165	-3,479	-1,912	-2,671	-2,936	-3,977	-4,086
Liabilities to the central bank	264	257	245	39	12	1,260	617	523	93	0
Liquid liabilities	10,250	11,081	11,486	12,131	13,183	15,058	16,656	18,261	18,473	19,932
Transferable deposits	8,231	9,025	9,595	10,332	11,486	13,856	15,591	16,933	14,864	15,758
Other deposits	1,984	2,034	1,865	1,799	1,697	1,202	1,065	1,328	3,609	4,164
Securities other than shares	35	22	26	0	0	0	0	0	0	10
Non-liquid liabilities	945	1,016	801	490	489	1,627	1,115	1,024	544	464
Depository Corporations										
Net foreign assets	1,698	1,916	1,887	4,245	5,991	7,708	8,067	6,995	7,224	9,497
Net domestic assets	12,506	13,345	13,952	13,348	12,783	13,685	15,412	17,930	17,774	16,892
Net domestic claims	14,133	14,333	14,403	13,131	13,176	13,231	14,927	16,685	16,865	16,040
Claims on central government (net)	966	770	1,262	725	917	1,505	1,851	2,626	2,657	1,435
Claims on state and local government	36	29	26	17	15	104	197	188	179	172
Claims on public nonfinancial corporations	0	0	0	0	0	0	0	0	0	0
Claims on private sector	11,870	11,849	11,366	10,672	10,561	10,150	10,477	11,187	11,301	11,922
of which: private sector credit	11,688	11,700	11,145	10,561	10,421	10,024	10,354	11,088	11,165	11,776
Claims on other financial corporations	1,261	1,685	1,749	1,717	1,683	1,472	2,402	2,684	2,728	2,511
Other items net	-1,627	-988	-451	217	-393	454	485	1,245	909	852
Broad money 1/	11,469	12,242	12,614	14,287	15,435	17,462	19,063	20,041	20,582	21,940
Memorandum Items										
Year-on-year growth (percent)										
Monetary base	38.4	-4.1	20.2	4.1	6.9	10.0	6.8	-10.1	14.3	8.4
Broad money 1/	8.2	6.7	3.0	13.3	8.0	13.1	9.2	5.1	2.7	6.6
Claims on private sector										
Depository corporations, claims on private sector	-2.1	-0.2	-4.1	-6.1	-1.0	-3.9	3.2	6.8	1.0	5.5
Depository corporations, credit to private sector	-2.7	0.1	-4.7	-5.2	-1.3	-3.8	3.3	7.1	0.7	5.5
Broad money multiplier (ratio) 1/	1.3	1.4	1.2	1.3	1.3	1.4	1.4	1.7	1.5	1.5

Sources: Bank of Latvia; European Central Bank; and IMF staff calculations.

1/ The broad money measure uses Bank of Latvia's M3 monetary aggregate.

Annex I. Risk Assessment Matrix[1]

Risks	Likelihood	Impact on Latvia	Recommended Policy Response
Conjunctural Risks			
Trade policy and investment shocks. Higher trade barriers or sanctions reduce external trade, disrupt FDI and supply chains, and trigger further U.S. dollar appreciation, tighter financial conditions, and higher inflation.	**High**	**Medium** Trade policy uncertainty affects economic and financial stability mostly through confidence and indirect channels as direct trade and financial exposures are low. Latvia's exposure of domestic value-added exports to trade with the U.S. is only 2.4 percent of total value added, with a large share from services exports that are not subject to tariffs. Latvia faces challenges to external competitiveness.	Allow automatic stabilizers to work and supplement with temporary and targeted support to the most vulnerable. Accelerate structural reforms to strengthen competitiveness and build resilience.
Tighter financial conditions and systemic instability. Higher-for-longer interest rates and term premia amid looser financial regulation, rising investments in cryptocurrencies, and higher trade barriers trigger asset repricing, market dislocations, weak bank and NBFI distress, and further U.S. dollar appreciation, which widens global imbalances, worsens debt affordability, and increases capital outflow from EMDEs.	**Medium**	**Medium** Banks are well capitalized and liquid and appear resilient. However, given the large share of variable interest rate loans, a sharp increase in interest rates could have implications for borrowers. A sudden correction in house prices could affect banks' profits.	Banks could restructure loans if sharp changes to interest rates affect borrowers' ability to repay loans. Intensified monitoring of banks' capital positions and risk management practices could help to contain systemic risk.
Regional conflicts. Intensification of conflicts (e.g., in the Middle East, Ukraine, Sahel, and East Africa) or terrorism disrupt trade in energy and food, tourism, supply chains, remittances, FDI and financial flows, payment systems, and increase refugee flows.	**Medium**	**Medium** Trade with Russia has diminished significantly since the annexation of Crimea. Nonetheless, the sanctions against Russia and Belarus could lead to some disruptions in Latvia's trade and finance. The war could further increase risks to economic and investor confidence, reduce foreign direct investment, make the inflow of refugees disorderly, affect the economy via indirect spillovers, and rekindle inflation from higher commodity prices.	Automatic stabilizers should be allowed to operate. More active support, if necessary to cushion the impact on the most vulnerable groups, should be well-targeted, also prioritizing key security-related areas and the integration of refugees. Address structural issues to encourage investment. Energy support, if any, should preserve price signals to foster savings.
Commodity price volatility. Supply and demand volatility (due to conflicts, trade restrictions, OPEC+ decisions, advanced economies' energy policies, or green transition) increases commodity price volatility, external and fiscal pressures, social discontent, and economic instability.	**Medium**	**High** Much of the increase in inflation in Latvia has been driven by high international energy and food prices (because of their high share in the consumer price index basket). An escalation of the war could result in renewed increases in energy prices; however, their volatility is likely to be smaller than in 2022.	Keep participating in European policy responses. Continue to enhance energy security. Provide incentives to boost domestic food production. Energy support, if any, should preserve price signals to foster savings, be limited in scope to preserve fiscal buffers and be offset by adjustment in other areas to avoid rekindling inflation.

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[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and the overall level of concern as of the time of discussions with the authorities. Nonmutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Risks	**Likelihood**	**Impact on Latvia**	**Recommended Policy Response**
		Structural Risks	
Deepening geoeconomic fragmentation. Persistent conflicts, inward-oriented policies, protectionism, weaker international cooperation, labor mobility curbs, and fracturing technological and payments systems lead to higher input costs, hinder green transition, and lower trade and potential growth.	**High**	**High** Geopolitical tensions are high due to Latvia's border with Russia. A prolonged war in Ukraine would weigh on activity in trading partners causing external demand to fall or fluctuate around a lower level, keep inflation elevated, worsen supply chain disruptions, and weaken confidence.	Ensure that support and spending in security-related areas are adequate. Seek alternative markets and products for exports.
Cyberthreats. Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	**High**	**Medium** Possible disruptions in economic activity, as Latvia is susceptible to cyber-attacks from Russia's war in Ukraine and this risk could rise given the planned increases in reliance on ICT processes and innovation. Weaker confidence may also lead to capital outflows.	Continue to enhance preparedness for cyberattacks through extensive risk monitoring in cooperation with private and public sector stakeholders. Participate in global and European defenses against cyber-attacks.
Climate change. Extreme climate events driven by rising temperatures cause loss of life, damage to infrastructure, food insecurity, supply disruptions, lower growth, and financial instability.	**Medium**	**Medium** Latvia's National Energy and Climate Plan identifies agriculture and forestry as the sectors most affected by climate change and the extreme variability of weather conditions, such as the replacement of long-lasting rainfall or floods with long-lasting droughts and heat.	Swiftly adopt the amendments to the existing law on pollution and the law of economic sustainability and implement the revised National Energy and Climate Plan to facilitate the green transition.
		Domestic Risks	
Financial sector risks are accentuated by multiple transitions. These include transitions related to climate change and energy.	**Medium**	**Medium** The main risks stem from corporates' and households' weakening capacity to repay their debt due to higher energy prices and interest costs; imbalances in the residential and commercial real estate markets; and liquidity and interest rate risks in the nonbank financial sector. However, the authorities assess these risks to be moderate.	Measures for financially distressed vulnerable households should be targeted. Corporate reforms to facilitate resource allocation should be accelerated to promote productivity growth. To resolve imbalances in the real estate market, measures to increase supply of new housing units and renovate energy-inefficient properties should be implemented. Nonbank financial institutions should be monitored closely.
Skilled labor shortages.	**Medium**	**Medium** Ambitious investment and reform agenda to address multiple transitions (security, climate, aging, digitalization) can be compromised in the absence of skilled labor.	Implement policies to reduce labor market shortages and facilitate structural transformation of labor markets towards new sectors. Target training and skills-building in areas of expected labor pressures (digitalization, green transition).
Inefficient execution of the increase in EU-financed public investment.	**Medium**	**Medium** Inefficient execution of the increase in EU-financed public investment could delay climate and energy transition, and digitalization, weighing on potential output and denting Latvia's economic competitiveness.	Improve the efficiency of EU financed investment. Ensure all EU funds are utilized by the required time frame. Utilize IMF's Public Investment Management Assessment (PIMA) technical assistance to help strengthen public investment management.

Annex II. External Sector Assessment

Overall Assessment: *The external position of Latvia in 2024 was broadly in line with the level implied by fundamentals and desirable policies. The current account deficit narrowed from 3.9 percent of GDP in 2023 to 2.1 percent in 2024, mainly driven by import compression during the economic downturn. The goods trade deficit narrowed while the services trade surplus stayed unchanged. The primary income deficit narrowed due to the increase in investment income. In the near term, the current account deficit is expected to widen as defense spending and investment increase. Over the medium term, the current account deficit is expected to be wider than the norm, reflecting anticipated import increases and concerns over external competitiveness. Both the current account and real effective exchange rate (REER) models indicate a broadly fair valuation of REER.*

Potential Policy Responses: *Given the improving growth outlook, the fiscal policy stance should become neutral in the coming years. It should be tighter in the medium term to preserve buffers and address future spending needs including an increase in defense spending. Macroprudential policies should mitigate financial vulnerabilities. Structural reforms to boost productivity growth, including measures to address high-skilled labor shortage, promote allocative efficiency of capital and labor, and facilitate the green and digital transformation should be prioritized. The abovementioned policies will help Latvia retain its external sector balance.*

Foreign Assets and Liabilities: Position and Trajectory

Background. Gross assets slightly increased from 132 percent of GDP in 2023 to 138 percent of GDP in 2024, and gross liabilities went up slightly to 159 percent of GDP. The asset increase was mainly driven by the expansion in portfolio- and other investments abroad. The NIIP increased to -21 percent of GDP in 2024 by 5 percentage points. Gross external debt decreased from 102 percent of GDP in 2023 to 99 percent of GDP at end-2024, remaining below the medium-term downward path that was observed since the peak of 153 percent of GDP in 2016.

Assessment. The current NIIP does not imply risks to external sustainability. However, the NIIP is projected to decrease in the medium term as current account deficit widens due to increase in investment.

2024 (% GDP)	NIIP: -21	Gross Assets: 138	Debt Assets: 44	Gross Liab.: 159	Debt Liab.: 99

Current Account

Latvia: EBA-lite Model Results, 2024

	CA model 1/	**REER model** 1/
	(in percent of GDP)	
CA-Actual	**-2.1**	
Cyclical contributions (from model) (-)	-0.1	
Adjusted CA	**-2.0**	
CA Norm (from model) 2/	**-2.0**	
Adjusted CA Norm	**-2.0**	
CA Gap	**0.0**	**0.7**
o/w Relative policy gap	2.4	
Elasticity	-0.5	
REER Gap (in percent)	**0.0**	**-1.5**

1/ Based on the EBA-lite 3.0 methodology

2/ Cyclically adjusted, including multilateral consistency adjustments.

Background. The current account deficit narrowed from 3.9 percent of GDP in 2023 to 2.1 percent in 2024, due in part to import compression and a smaller primary income deficit. The goods trade balance narrowed by a percentage point, while the services surplus stayed stable. The shrinkage in primary income deficit to -1.7 percent was driven by the increase in investment and other primary income. Secondary income decreased slightly to 2.1 percent of GDP in 2024.

Assessment. Overall, the current account position is assessed to be broadly in line with the levels implied by fundamentals and desirable policies. The EBA-lite CA model results suggest that the current account balance is in line with the norm in 2024, and that the gap attributed to policies amounts to 2.4 percent of GDP. This mainly reflects Latvia's lower public health expenditure and smaller fiscal policy gap compared to the world average. Given the expected increase in imports due to hikes in defense spending and EU-fund-related investment, as well as concerns over external competitiveness, the current account deficit is projected to widen in the near term and remain in a deficit position over the medium term.

Real Exchange Rate

Background. The REER depreciated by 0.9 percent in 2024. During the past decade, the REER appreciated by 25 percent. Competitiveness has gradually declined as wage growth has exceeded productivity growth, against the backdrop of the aging population and labor shortage. The gross wage growth was 10 percent in nominal terms, reflecting rapid wage growth in the public sector, an increase in the minimum wage, and the relatively tight labor market.

Assessment. The preferred EBA-lite CA model suggests a broadly fair valuation of REER. The EBA-lite REER model finds an undervaluation of about 1.5 percent, although this model seems less granular and more constrained in identifying Latvia-specific issues due to the need to partially rely on euro-area-wide indicators of common monetary policy.

Capital and Financial Accounts: Flows and Policy Measures

Background. The capital account balance was 1.5 percent of GDP in 2024, reflecting the transfer of funds from the EU and private sector transfers from abroad. The level is in line with the long-term average. The financial account (BPM6 methodology) balance shows an outflow of 1.2 percent of GDP in 2024. The outflow of other investment abroad (8.3 percent of GDP) more than offsets the FDI and portfolio inflows.

Assessment. Risks related to capital flows are assessed to be small.

FX Intervention and Reserves Level

Background. The Euro has the status of a global reserve currency. Thus, reserves held by euro area economies are typically low by standard metrics (12.3 percent of GDP for Latvia as of end-2024).

Assessment. The reserve level is assessed to be adequate.

Annex III. Sovereign Risk and Debt Sustainability Analysis

Annex III. Figure 1. Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability in the near-and medium-term horizons, and a moderate vulnerability in the long-term horizon.
Near term 1/			
Medium term	Moderate	Low	Medium-term risks are assessed as low against a mechanical moderate signal.
Fanchart	Moderate	...	
GFN	Moderate	...	
Stress test	Comm. Prices Nat. Diast.	...	
Long term	...	Moderate	Long-term risks are moderate as spending pressures from challenges such as aging, defense, energy security and climate change feed into debt dynamics.
Sustainability assessment 2/	...	...	Not required for surveillance countries.
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Latvia is at a low overall risk of sovereign stress. Over the medium and longer term, Latvia should undertake reforms to tackle fiscal pressures (from aging, defense, energy security and climate change) and continue with reforms to address long-standing issues to boost productivity growth.

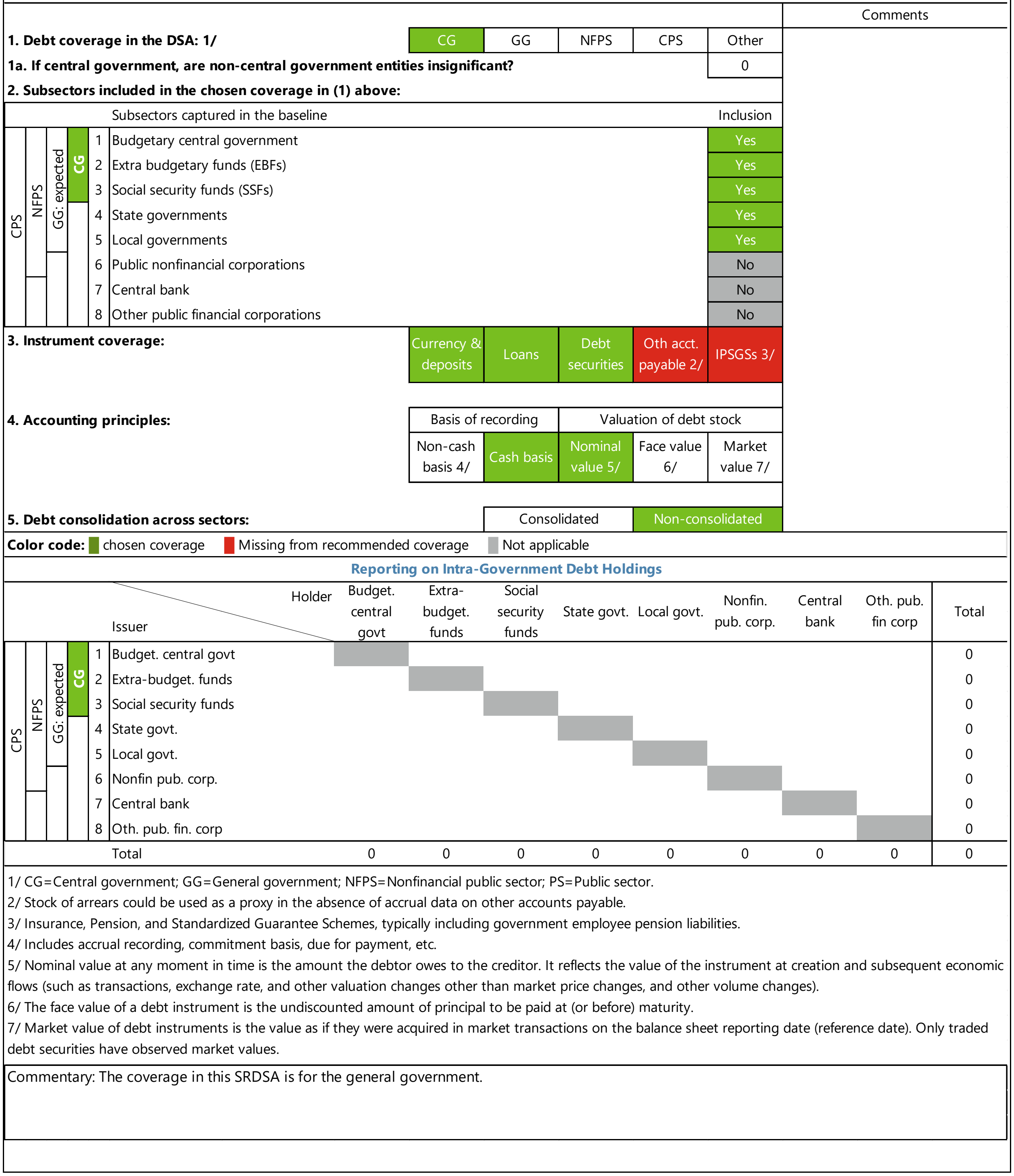
Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex III. Figure 2. Debt Coverage and Disclosures



Comments

1. Debt coverage in the DSA: 1/

CG	GG	NFPS	CPS	Other

1a. If central government, are non-central government entities insignificant? 0

2. Subsectors included in the chosen coverage in (1) above:

					Subsectors captured in the baseline	Inclusion
CPS	NFPS	GG: expected	CG	1	Budgetary central government	Yes
				2	Extra budgetary funds (EBFs)	Yes
				3	Social security funds (SSFs)	Yes
				4	State governments	Yes
				5	Local governments	Yes
				6	Public nonfinancial corporations	No
				7	Central bank	No
				8	Other public financial corporations	No

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:

Consolidated	Non-consolidated

Color code: 🟩 chosen coverage 🟥 Missing from recommended coverage ⬜ Not applicable

Reporting on Intra-Government Debt Holdings

					Holder Issuer	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt									0
				2	Extra-budget. funds									0
				3	Social security funds									0
				4	State govt.									0
				5	Local govt.									0
				6	Nonfin pub. corp.									0
				7	Central bank									0
				8	Oth. pub. fin. corp									0
					Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.

2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.

3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.

4/ Includes accrual recording, commitment basis, due for payment, etc.

5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).

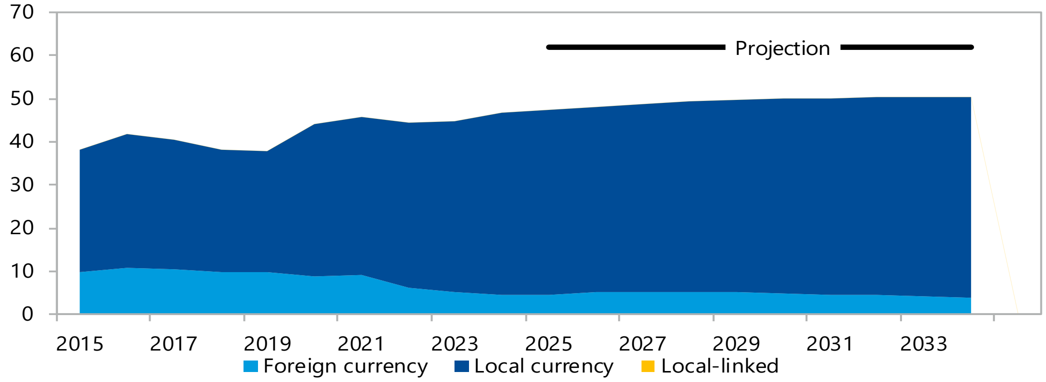
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.

7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The coverage in this SRDSA is for the general government.

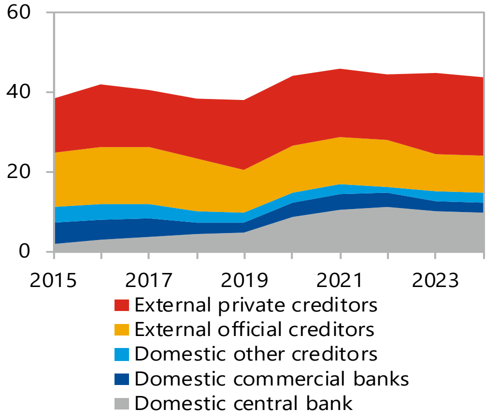
Annex III. Figure 3. Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



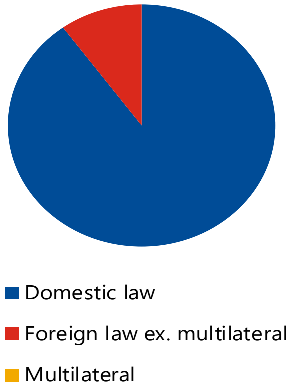
Note: The perimeter shown is central government.

Public Debt by Holder (Percent of GDP)



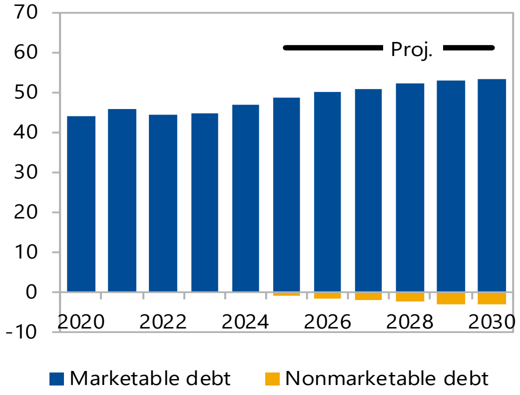
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (Percent)



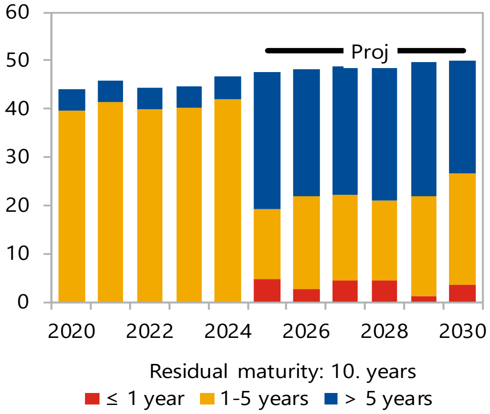
Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (Percent of GDP)



Note: The perimeter shown is general government.

Commentary: Public debt is entirely marketable; and most debt is in domestic currency (EUR) and governed under the domestic law. Currency risks are also minimal for Latvia as it is part of the euro area.

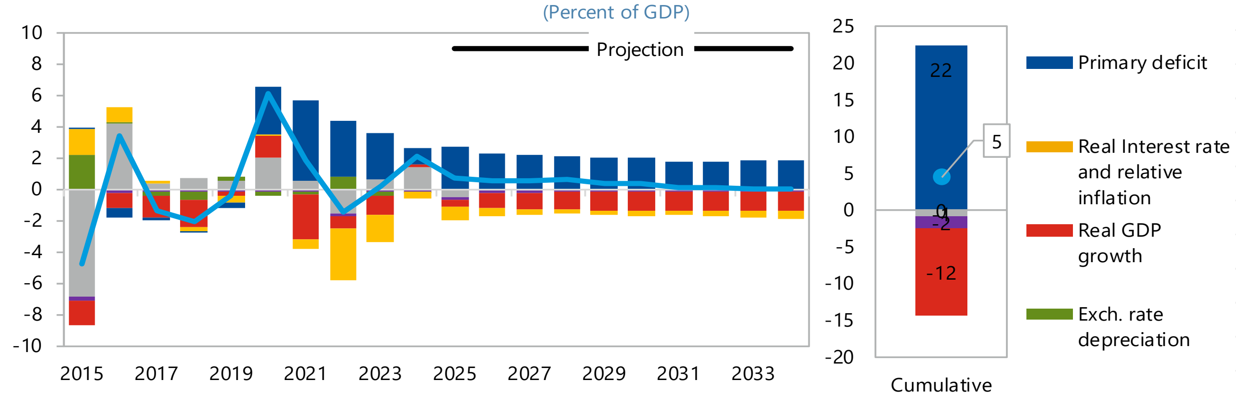
Annex III. Figure 4. Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Public debt	46.8	47.5	48.1	48.7	49.3	49.6	50.0	50.1	50.2	50.3	50.3
Change in public debt	2.1	0.7	0.6	0.6	0.6	0.4	0.3	0.1	0.1	0.1	0.0
Contribution of identified flows	0.7	1.2	0.7	0.6	0.6	0.4	0.4	0.1	0.1	0.1	0.0
Primary deficit	1.0	2.7	2.3	2.2	2.1	2.0	2.0	1.8	1.8	1.8	1.8
Noninterest revenues	42.5	40.6	40.8	40.5	40.6	40.6	40.6	40.6	40.6	40.6	40.6
Noninterest expenditures	43.5	43.3	43.1	42.7	42.7	42.6	42.6	42.3	42.4	42.4	42.4
Automatic debt dynamics	-0.2	-1.3	-1.5	-1.4	-1.3	-1.4	-1.5	-1.5	-1.5	-1.6	-1.7
Real interest rate and relative inflation	-0.4	-0.9	-0.6	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3	-0.4	-0.5
Real interest rate	-0.4	-1.0	-0.6	-0.4	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5
Relative inflation	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	0.2	-0.5	-0.9	-1.1	-1.1	-1.1	-1.2	-1.2	-1.2	-1.2	-1.2
Real exchange rate	0.0	…	…	…	…	…	…	…	…	…	…
Other identified flows	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	1.4	-0.5	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	8.3	8.4	7.7	7.0	9.6	10.1	8.3	10.8	9.6	11.0	12.0
of which: debt service	7.4	5.9	5.5	4.9	7.6	8.2	6.4	9.2	8.0	9.3	10.3
Local currency	6.7	5.7	5.3	4.7	7.2	7.8	6.0	8.7	7.4	8.8	9.9
Foreign currency	0.7	0.2	0.2	0.3	0.4	0.4	0.5	0.5	0.6	0.5	0.4
Memo:											
Real GDP growth (percent)	-0.4	1.0	2.0	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Inflation (GDP deflator; percent)	2.6	4.1	3.4	3.0	2.6	2.6	2.5	2.5	2.5	2.5	2.5
Nominal GDP growth (percent)	2.1	5.2	5.5	5.5	5.1	5.0	5.0	4.9	4.9	5.0	5.0
Effective interest rate (percent)	1.7	2.0	2.0	2.2	2.1	1.9	1.8	1.8	1.7	1.6	1.4

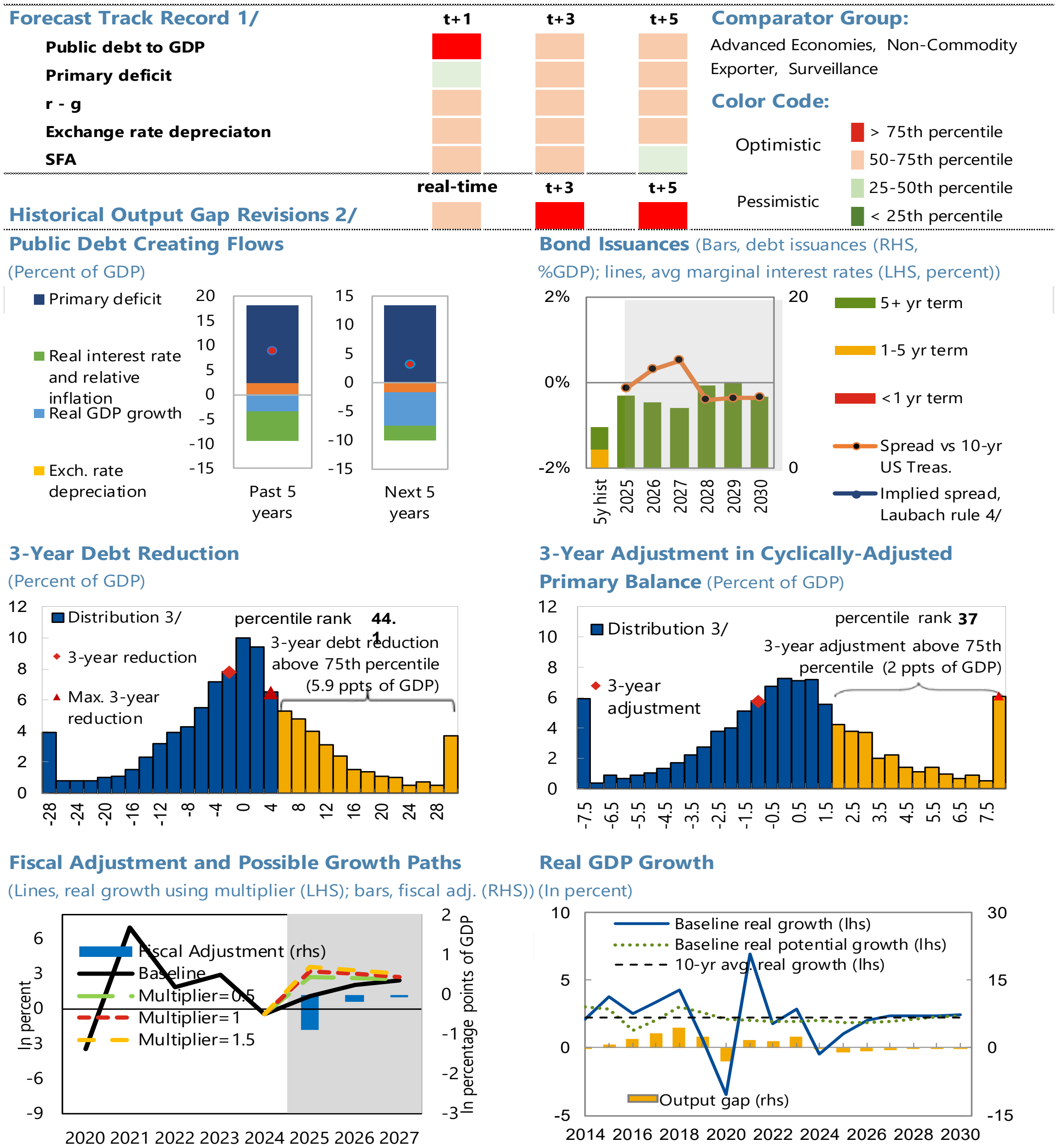
Contribution to Change in Public Debt

(Percent of GDP)



Staff commentary: Public debt will increase due to higher financing needs and long-term spending pressures (aging, defense, energy security, climate).

Annex III. Figure 5. Realism of Baseline Assumptions



Commentary: The 3-year adjustment in the cyclically-adjusted primary balance is within the highest 75-percentile. Previously, some forecast track record was in the top quartile.

Source : IMF Staff.

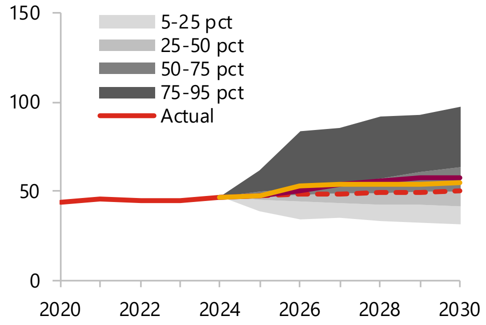
1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

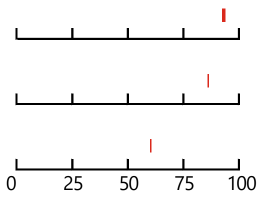
3/ Data cover annual observations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex III. Figure 6. Medium-Term Risk Assessment

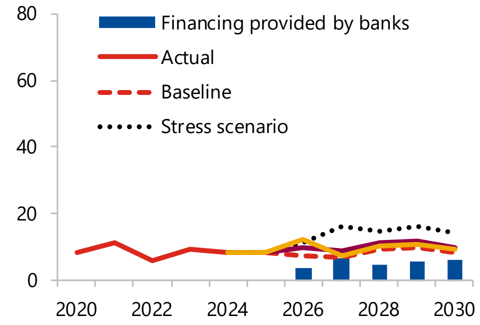
Final Fanchart (Percent of GDP)



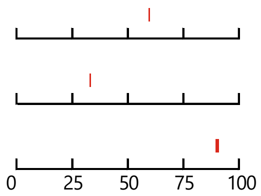
Debt fanchart module	Value	Contrib 1/	Percentile in peer group 2/
Fanchart width *(percent of GDP)*	66.3	1.0	
Probability of debt non-stabilizaiton *(percent)*	60.2	0.5	
Terminal debt-to-GDP x institutions index	15.9	0.3	
Debt fanchart index (DFI)		1.8	
Risk signal: 3/		**Moderate**	



Gross Financing Needs (Percent of GDP)



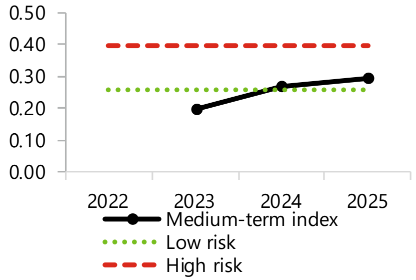
Gross financing needs (GFN) module	Value	Contrib 1/	Percentile in peer group 2/
Average baseline GFN *(percent of GDP)*	8.5	2.9	
Initial Banks' claims on th gen. govt *(pct bank assets)*	3.4	1.1	
Chg. In banks' claims in stress *(pct banks' assets)*	17.2	5.8	
GFN financeability index (GFI)		9.8	
Risk signal: 4/		**Moderate**	



Triggered stress tests (stress tests not activated in gray)

Banking crisis 🟥 Commodity prices Exchange rate Contingent liab. 🟧 Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	(normalized)	Weight	Contribution
Debt fanchart index	1.8	0.4	0.5	0.2
GFN finaceability index	9.8	0.2	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		**Moderate**		
Final assessment:		**Low**		

Prob. of missed crisis, 2025-2030, if stress not predicted: 18.2 pct.

Prob. of false alarms, 2025-2030, if stress predicted: 30.7 pct.

Commentary: While the fanchart width is high, debt-to-GDP is low; so the fanchart risk score is moderate. Gross financing needs are not large and banks do not hold high levels of debt. Banks are well capitalized and highly liquid. Given strong banks and low gross financing needs, the overall risk of gross financing needs is moderate.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.

2/ The comparison group is advanced economies, non-commodity exporter, surveillance.

3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.

4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.

5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

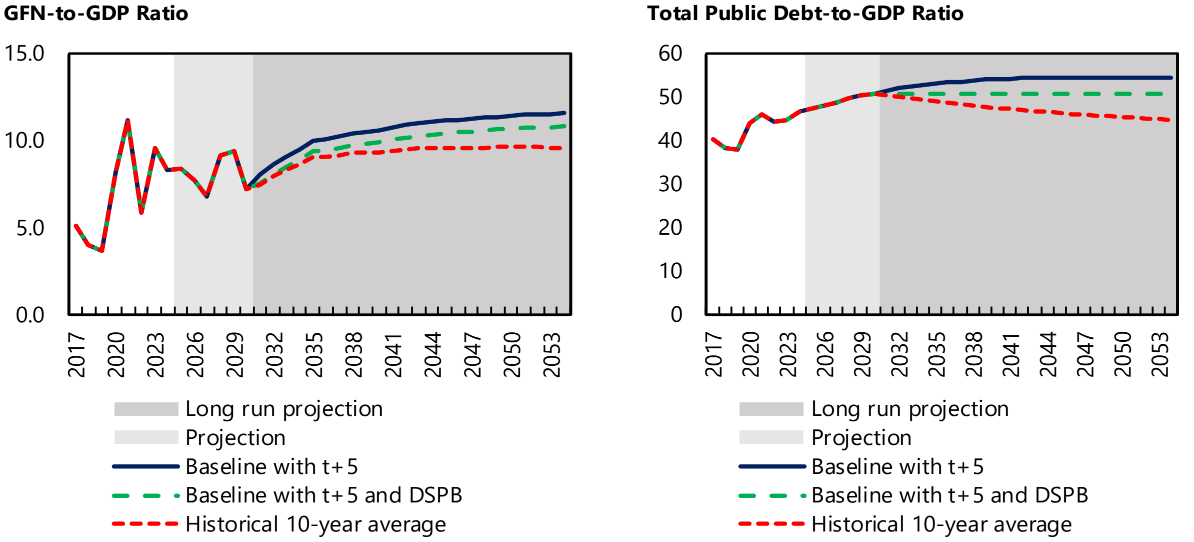
Annex III. Figure 7. Long-Term Risk Assessment: Large Amortization

Latvia: Triggered Modules

Large amortizations
Pensions
Health
Climate change: Adaptation
Climate change: Mitigation
Natural Resources

Latvia: Long-Term Risk Assessment: Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	🟥
	Amortization-to-GDP ratio	🟥
	Amortization	🟥
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	🟥
	Amortization-to-GDP ratio	🟥
	Amortization	🟥
Historical average assumptions	GFN-to-GDP ratio	🟩
	Amortization-to-GDP ratio	🟩
	Amortization	🟥
Overall Risk Indication		🟥


GFN-to-GDP Ratio

Total Public Debt-to-GDP Ratio

Commentary: Under the Baseline with t+5, both GFN- and public debt-to-GDP ratios increase over the long-term as spending pressures (aging, defense, energy security, and climate change) rise. The Baseline with t+5 and DSPB scenario shows an increase in the long-term GFN-to-GDP ratio and stabilization of the public debt ratio at lower levels than staff's baseline. Overall, the long run modules for demographics and climate were not triggered for Latvia.

Annex IV. Data Issues

Annex IV. Table 1. Latvia: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/

A

Questionnaire Results 2/

Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A

Detailed Questionnaire Results

Data Quality Characteristics						
Coverage	B	A	A	A	A	
Granularity 3/	A		A	A	A	
			A		A	
Consistency			A	B		A
Frequency and Timeliness	A	A	A	A	A	

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.

1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.

2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).

3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund are adequate for surveillance.
B	The data provided to the Fund have some shortcomings but are broadly adequate for surveillance.
C	The data provided to the Fund have some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund have serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data provided to the Fund are adequate for surveillance. (1) There are discrepancies between the GDP estimates based on production and those based on expenditure. The statistical discrepancy is included in changes in inventories on the expenditure side (which is a common practice). (2) There are statistical discrepancies between GDP by expenditure and the sum of expenditure components. (3) The external sector accounts have large errors and omissions, greater than 1 percent of GDP in recent years.

Changes since the last Article IV consultation. The magnitude of GDP data revisions increased over the last year. These revisions are driven by updates based on improved data sources and methodological changes in the compilation of intermediate consumption.

Corrective actions and capacity development priorities. Staff recommends to address the issues raised above to improve national accounts and external sector statistics. During the mission, staff suggested that the authorities consider IMF TA to improve GDP estimates and BoP compilations. The authorities are liaising with STA to discuss their approach to estimate GDP.

Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff. Staff also uses data from Eurostat, most importantly for price data – Eurostat produces harmonized price indices that allow for within EU comparisons.

Other data gaps. No macro-critical data gaps.

Annex IV. Table 2. Latvia: Data Standards Initiative

Latvia adheres to the Special Data Dissemination Standard (SDDS) Plus since August 2018 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Annex IV. Table 3. Latvia: Common Indicators Required for Surveillance

As of June 30, 2025

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Latvia[8]	Expected Timeliness[6,7]	Latvia[8]
Exchange Rates	30-Jun-25	30-Jun-25	D	D	D	...	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May-25	Jun-25	M	M	M	M	1W	3W
Reserve/Base Money	May-25	Jun-25	M	M	M	M	2W	2W
Broad Money	May-25	Jun-25	M	M	M	M	1M	20D
Central Bank Balance Sheet	May-25	Jun-25	M	M	M	M	2W	2W
Consolidated Balance Sheet of the Banking System	May-25	Jun-25	M	M	M	M	1M	20D
Interest Rates[2]	30-Jun-25	30-Jun-25	D	D	D	...	...	...
Consumer Price Index	May-25	Jun-25	M	M	M	M	1M	NLT 6WD
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Dec-24	Apr-25	Q	Q	A/Q	...	2Q/12M	...
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Dec-24	Apr-25	Q	Q	M	M	1M	3W
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec-24	Apr-25	Q	Q	Q	M	1Q	3W
External Current Account Balance	Mar-25	Jun-25	Q	Q	Q	M	1Q	30D
Exports and Imports of Goods and Services	Apr-25	Jun-25	M	M	M	M	8W	NLT 8W
GDP/GNP	Mar-25	May-25	Q	Q	Q	Q	1Q	70D
Gross External Debt	Mar-25	Jun-25	Q	Q	Q	Q	1Q	65D
International Investment Position	Mar-25	Jun-25	Q	Q	Q	Q	1Q	65D

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex V. Past IMF Policy Recommendations

IMF 2024 Article IV Recommendations	Implementation
Fiscal Policy	
Support fiscal consolidation by (i) broadening the bases of corporate income tax and personal income tax; (ii) broadening the base of property taxes; (iii) reducing tax exemptions and fossil fuel subsidies; and (iv) rationalizing spending on goods and services.	The government undertook tax reforms (effective January 2025) to simplify the tax system and reduce the labor tax wedge. However, these reforms did not generate sufficient revenue to support fiscal consolidation.
Improve public investment management to mitigate fiscal risks from large projects.	The authorities are considering resorting to the IMF's Public Investment Management Assessment (PIMA) technical assistance to strengthen public investment management.
Link both the official and early retirement ages to future life expectancy gains to encourage longer work lives once the retirement age reaches 65.	No reforms were introduced to link the official and early retirement ages to future life expectancy gains.
Financial Sector Policies	
The mortgage borrower protection fees (MBPF) and subsidies for the mortgage interest expenses should be phased out. The authorities should refrain from further initiatives to increase tax on bank profits.	The MBPF was phased out by end-2024. The authorities implemented a solidarity contribution at 60 percent of banks' net interest income (NII) that is more than 150 percent of the average NII of 2018-2022. The solidarity contribution is capped at 33 percent of profits and effective for 2025-27.
The looser debt-service-to-income (DSTI) and debt-to-income (DTI) limits for mortgage loans collateralized by energy-efficient housing units should be reconsidered.	No measures were taken to remove the differential DSTI and DTI limits for mortgage loans secured by energy-efficient housing units.
Structural Reforms	
Alleviate labor market shortages by: (i) promoting training and labor mobility toward priority sectors; (ii) strengthening migration processes; and (iii) reducing employment protection.	The authorities are utilizing active labor market policies to alleviate labor market shortages, including training programs and mobility subsidies for regions with high unemployment.
Improve labor force participation for women between 25 and 44 years old to further reduce gender inequality.	The authorities introduced general reforms to improve labor force participation, but no specific policies were targeted to women.
Enhance energy security, including by increasing renewable energy and boosting investment in clean energy and connections.	The authorities have made attempts to increase the share of renewables in the energy mix. However, there is scope to further diversify the country's renewable energy mix.

INTERNATIONAL MONETARY FUND

REPUBLIC OF LATVIA

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 30, 2025

Prepared by The European Department

CONTENTS

FUND RELATIONS 2

FUND RELATIONS

(As of June 30, 2025)

Membership Status: Joined May 19, 1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	332.30	100.00
Fund holdings of currency (Exchange Rate)	280.24	84.33
Reserve Tranche Position	52.39	15.76

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	439.32	100.00
Holdings	441.52	100.50

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Dec 23, 2008	Dec 22, 2011	1,521.63	982.24
Stand-By	Apr 20, 2001	Dec 19, 2002	33.00	0.00
Stand-By	Dec 10, 1999	Apr 09, 2001	33.00	0.00

Projected Payments to Fund:

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming		
	2026	**2027**	**2028**
Principal	0.00	0.00	0.00
Charges/Interest	0.00	0.00	0.00
Total	0.00	0.00	0.00

Exchange Rate Arrangement:

As of January 1, 2014, the currency of Latvia is the euro. The exchange rate arrangement of the euro area is free floating. Latvia participates in a currency union (EMU) with 19 other members of the EU and has no separate legal tender. The euro, the common currency, floats freely and independently against other currencies. Latvia has accepted the obligations under Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions, with the exception of restrictions notified to the Fund in accordance with decision No.144 (52/51) resulting from UN Security Council Resolutions and EU Council Regulations.

Previous Article IV Consultation:

Latvia is on the 12-month consultation cycle. The last Article IV consultation was concluded on September 5, 2024 (IMF Country Report No. 24/285). The Executive Board assessment is available https://www.imf.org/en/Publications/CR/Issues/2024/09/05/Republic-of-Latvia-2024-Article-IV-Consultation-Press-Release-and-Staff-Report-554553.

Safeguards Assessment:

The safeguards assessment completed on July 8, 2009 concluded that the Bank of Latvia (BoL) operates robust internal audit and control systems. The assessment recommended clarifying the respective roles of the BoL and the Treasury in holding, managing, and reporting to the Fund audited international reserves data. It also recommended amendments to the mandate of the BoL's audit committee and improvements to the financial statements' disclosures. The authorities have already taken steps to implement these recommendations, notably by establishing a formal arrangement between the BoL and the Treasury, revising the audit committee charter and expanding the existing accounting framework.

FSAP Participation and ROSCs:

A joint World Bank-International Monetary Fund mission conducted an assessment of Latvia's financial sector as part of the Financial Sector Assessment Program (FSAP) during February 14–28, 2001. The Financial Sector Stability Assessment (FSSA) report was discussed at the Board on January 18, 2002, together with the 2001 Article IV staff report (Country Report No. 02/10). An AML/CFT assessment mission took place during March 8–24, 2006, and the report was sent to the Board on May 23, 2007. A joint IMF-World Bank mission conducted an FSAP update during February 27–March 9, 2007. A World Bank mission conducted an FSAP development module during November 8–18, 2011.

ROSC Modules

Standard/Code Assessed	Issue date
Code of Good Practices on Fiscal Transparency	March 29, 2001
Code of Good Practices on Transparency in Monetary and Financial Policies	January 2, 2002
Basel Core Principles for Effective Banking Supervision	January 2, 2002
CPSS Core Principles for Systemically Important Payment Systems	January 2, 2002
IOSCO Objectives and Principles of Securities Regulation	January 2, 2002
IAIS Core Principles	January 2, 2002
OECD Corporate Governance Principles	January 2, 2002
Data Module	June 23, 2004

Table 1. Latvia: Technical Assistance, 2009–22

Dept.	Project	Action	Timing	Counterpart
FAD	Revenue Administration	Mission	January 2009	Ministry of Finance
MCM	Bank Resolution	Mission	January 2009	FCMC, Bank of Latvia
FAD	Public Financial Management	Mission	March 2009	Ministry of Finance
MCM/ LEG	Debt Restructuring	Mission	March 2009	Ministry of Finance, FCMC
LEG	Legal Aspects of P&A Transactions	Mission	Feb–March 2009	FCMC
MCM	Bank Intervention Procedures and P&A	Mission	March 2009	FCMC
FAD	Public Financial Management	Mission	April-May 2009	Ministry of Finance
FAD	Revenue Administration	Mission	July 2009	Ministry of Finance
FAD	Public Financial Management	Resident Advisor	July 2009–June 2010	Ministry of Finance
FAD	Cash Management	Mission	July–Aug. 2009	Ministry of Finance
MCM	Mortgage and Land Bank	Mission	Sept. 2009	Ministry of Finance
MCM	Deposit Insurance	Mission	Sept. 2009	FCMC
MCM	Liquidity Management	Mission	November 2009	Bank of Latvia
LEG	Bank Resolution Legal Framework	Mission	January 2010	FCMC
FAD	Tax Policy	Mission	February 2010	Ministry of Finance
LEG	Bank Resolution Legal Framework	Mission	February 2010	FCMC
LEG	Corporate and Personal Insolvency Law	Mission	March 2010	Ministry of Justice
FAD	Public Financial Management	Mission	April 2010	Ministry of Finance

Table 1. Latvia: Technical Assistance, 2009–22 (concluded)

LEG	Corporate and Personal Insolvency Law	Mission	April 2010	Ministry of Justice
MCM	Stress Testing	Mission	June 2010	Bank of Latvia
FAD	Expenditure Policy	Mission	August 2010	Ministry of Finance
FAD	Revenue Administration	Mission	Sept. 2010	Ministry of Finance
LEG	Legal Framework for Foreclosure Procedures	Mission	November 2010	Ministry of Justice
FAD	Public Financial Management	Mission	Feb–March 2011	Ministry of Finance
FAD	Tax Administration	Mission	June 2011	Ministry of Finance
MCM	Bank Resolution	Mission	July 2012	FCMC
FAD	Expenditure Rationalization	Mission	October 2012	Ministry of Finance
LEG	Insolvency Reform	Mission	May-Dec. 2018	Ministry of Justice
LEG	Insolvency Reform	Mission	February 2019	Ministry of Justice
LEG	AML/CFT Supervision and Financial Flows Analysis	Mission	June 2022	FIU; Bank of Latvia; FCMC

Statement by Mr. Vitas Vasiliauskas, Executive Director for the Republic of Latvia and Mr. Gundars Davidsons, Advisor to Executive Director

September 15, 2025

On behalf of the Latvian authorities, we thank the IMF Latvia mission team, led by Mr. Brandao Marques, for their analysis and policy advice. The authorities highly value staff's constructive engagement and contributions to policy discussions. The Latvian authorities broadly agree with staff's views on the outlook and the challenges the economy is facing.

Despite a series of shocks, Latvia has demonstrated a considerable degree of resilience over the last decade. After years of successful convergence to euro area average income levels, the deep recession during the global financial crisis marked the beginning of a period when a series of consecutive global shocks, such as the pandemic and the cost-of-living crisis, compounded the effect of existing structural challenges, including aging population and sluggish productivity growth. Russia's war against Ukraine further contributed to the slowdown of Latvia's recovery. Currently, to address emerging challenges, the authorities have been focusing on strengthening energy security, increasing defense spending, and contributing to the security of the Baltic Sea region within the NATO alliance.

The Latvian authorities broadly concur with staff on the near-term output projections, although they consider the risks to the outlook to be balanced. After an output contraction of 0.4 percent in 2024, largely driven by reduced private investment, the economy shows a tentative recovery in early 2025. Growth remained modest, with the second quarter of 2025 posting a 0.4 percent QoQ increase (following close to zero growth in the first quarter), confirming the expectations of subdued expansion throughout the year. The authorities view the risks as balanced, as the considerable downside risks are counterweighted by a possible stronger rebound in private consumption and external demand, as increased defense spending in Latvia and Europe may bolster confidence and thereby contribute to growth.

Fiscal Policy

In response to the shift in the security landscape in Europe, the authorities are significantly increasing defense spending. Latvia's defense spending is projected to be close to 4 percent of GDP in 2025, and starting from 2026, a gradual further increase aiming to raise the spending to 5 percent of GDP is planned. The adjustment in the 2026 budget will focus on spending rationalization measures and the authorities are committed to continuing this work in 2027. In addition to spending reprioritization, encouraging public-private partnerships will be instrumental in preserving fiscal buffers while accommodating spending needs on public investment. Also, reducing the informal sector could generate additional tax revenue. Although currently, the focus will remain on expenditure cuts, the authorities appreciate staff's discussion on possible revenue measures. The authorities will weigh them carefully, although the likelihood of raising significant revenue from some of the proposed tax measures, such as property tax, is low. It should be noted that Latvia already raises significant revenues from the property tax: the revenues (as percentage of GDP), while below the euro area average, is at the higher end of the distribution of EU Eastern European countries and the highest in the Baltic states.

Financial Sector Policy

Latvia's financial sector remains resilient, profitable, and characterized by strong capital and liquidity buffers, and macroprudential stance remains appropriate. Lending to both non-financial corporations and households continued to grow in 2024 and the 1st half of 2025, as the strong growth momentum, following a decade of declining credit to GDP ratio, continued. While we agree with staff that close monitoring of risks stemming from commercial real estate (CRE) is warranted, the authorities consider that these risks remain modest, as the loan exposure to the sector is rather limited. Regarding the effects of the borrower-based macroprudential measures, the authorities recognize that the effect on promoting loans for energy-efficient housing has been limited. At the same time, the authorities also see the macroprudential treatment of those loans as risk neutral, since they also consider the positive effects on debt serviceability from lower expenses on energy. The solidarity contribution on bank credit is a significant measure to finance the increase in defense spending. The authorities are not currently observing any distortional effect related to the contributions but are committed to closely monitoring the effects going forward.

In the last few years, the authorities have continued to implement further improvements in the already well-developed AML/CFT framework. In June, a joint FATF-MONEYVAL plenary meeting adopted Latvia's 6th Mutual Evaluation Report (MER), which was the first evaluation under a new round of mutual evaluations. The report, which will be published by the end of the year, will provide a valuable assessment of the current situation and serve as guidance for the way forward.

Structural Policies

The authorities will continue working on boosting productivity and addressing other structural challenges. While further efforts are needed, the Latvian authorities have recently implemented reforms to improve the health and education system, and reduce administrative burden, in particular, regarding building regulation. Work is ongoing on promoting labor market participation and enhancing digital and technical skills, including through active labor market policies. Staff's analysis in the Selected Issues paper on allocative efficiency and firm entry and exit is a valuable contribution to the productivity discussion. In recent years, the authorities have implemented significant reforms facilitating the exit of unviable firms. The recovery rates and the duration of the insolvency process have considerably improved, but further actions in this field could be considered. This year Latvia, together with the other Baltic states, successfully disconnected from the BRELL power grid, strengthening its energy independence. In this regard, the authorities agree with staff that Latvia would further benefit from a more interconnected electricity infrastructure in Europe. Similarly, a more integrated and developed capital market union in EU would be beneficial for Latvian firms.

While important pension reforms have been implemented, the authorities concur with staff that further efforts are needed to ensure pension adequacy and sustainability. In 2025, Latvia has finalized some notable pension reforms, including increasing the retirement age to 65 years and the minimum contribution required for a pension from 15 to 20 years (effective as of January 2025). Latvia's three-pillar pension framework has recently been reinforced through substantive Pillar II reforms, notably the reduction of management fees and the introduction of life cycle-related plans as the default option for new participants. Pillar III has also exhibited sustained expansion, with contributions increasing by 19 percent in 2024 and assets approaching one billion euros, equivalent to approximately one-ninth of Pillar II. Notwithstanding these advances, further policy measures will be required to mitigate old-age poverty, for which staff's analysis in the Selected Issues paper provides an important basis.