Government revises updated macroeconomic and fiscal forecasts

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On Tuesday 15 August, the Cabinet of Ministers considered the informative report by the Ministry of Finance on the projections for macroeconomic indicators, revenue and general government budget balance in 2024, 2025 and 2026. The Ministry of Finance has updated the general government budget balance for the medium-term at unchanged policy, based on the data on the implementation of the general budget in the first half of this year provided by the Treasury. In addition, forecasts of tax and non-tax revenue, base expenditure of state basic and special budget for the medium-term were updated.

The updated budget balances are based on projected macroeconomic indicators approved in June this year, which provide that Latvia's gross domestic product (GDP) at constant prices will increase by 1.0 % in 2023 and by 2.5 % in 2024, while consumer prices will increase by 10.0 % in 2023 and 2.2 % in 2024. In the medium-term, economic growth is projected to accelerate to 2.9 % in 2025 and 2026, while consumer price growth will stabilise between 2.3 % and 2.5 %.

According to estimates by the Ministry of Finance, the general government budget deficit is estimated at 2.7 % of GDP this year, which is 1.5 percentage points below the planned in the budget and by 1.3 percentage points lower than projected when preparing the Stability Programme for 2023-2026. A lower deficit at unchanged policy is also projected over the whole medium-term at 2.2 % of GDP in 2024, 1.3 % of GDP in 2025 and a surplus of 0.1 % of GDP in 2026.

The decrease in the deficit compared to the previous forecast was mainly due to higher tax and non-tax revenues, which were revised taking into account the actual execution in the first half of the year, as well as the renewed macro forecasts, for instance, the higher average salary contributed to higher social security contributions and personal income tax revenues. It should be noted that the increase in tax revenue in the medium-term is forecast to be equal in both the state and local-government budgets.

The balance is also improved in the medium-term compared to the spring forecast by lower state budget expenditure on social benefits, when the Ministry of Welfare mainly reduces the projected amount of expenditure for the payment of sickness benefits on the basis of the assumption of a sharp decrease in the number of beneficiaries in the post-COVID-19 period. In addition, expenditure on pensions (age, disability, retirement, etc.) has been reduced by adjusting the indexation rates. As inflation decreases, on 1 October this year a coefficient of 1,064 will be applied to the indexation of state pensions while it was 1,2287 last year.

It should be noted that the extending of retirement age will conclude in 2025, according to demographics, an increase in the number of old-age pension recipients is forecasted already by 2026. Overall, budgetary expenditure on pensions and social benefits will increase over the medium-term, with the average benefit rising affected by wage growth.

Based on the data on the aid disbursed in the first half of the year, the Ministry of Finance has reduced the budget expenditure forecast for 2023 for energy support and support to the Ukrainian civilian population, as well as currently does not foresee expenditure for the coming years, as the government has not yet decided on further support. In the first half of this year, the aid amounted to EUR 479 million or 1.1 % of GDP, of which energy support amounted to EUR 417 million and support to Ukrainian refugees to EUR 34 million.

The Ministry of Finance has also updated the fiscal space calculation based on updated macroeconomic and fiscal forecasts under unchanged policies, in line with the national fiscal discipline framework and the Fiscal Policy Strategy approved by the Cabinet of Ministers on 12 April 2022. Taking into account the defined fiscal conditions and structural balance objectives in line with the provisions of the Fiscal Discipline Law, the available fiscal space is EUR 148.4 million in 2024, EUR 450.3 million in 2025 and EUR 684.3 million in 2026. Accoring to the fiscal policy strategy, it is possible to finance the one-off internal and external security measures stemming from the war in Ukraine, support to Ukraine and its civilian population in Latvia, as well as compensation for the significant increase in energy prices, outside the fiscal space.

According to Treasury's assessment that takes into account the need to refinance debt of EUR 5.5 billion over next three years, the general government debt could amount to around 39.7 % of GDP by the end of 2023 and 40.5 % of GDP by the end of 2024. Given that euro interest rates have increased significantly since the beginning of 2022, with a direct impact on borrowing costs, debt servicing costs will increase over the medium-term.

The informative report is available at: Portal of Draft Legal Acts

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