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**Assessment of the 2019 Stability Programme for  
Latvia**

*(Note prepared by DG ECFIN staff)*

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## CONTENTS

EXECUTIVE SUMMARY .....	<b>ERROR! BOOKMARK NOT DEFINED.</b>
1. INTRODUCTION.....	3
2. MACROECONOMIC DEVELOPMENTS .....	4
3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS.....	6
3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018.....	6
3.2. MEDIUM-TERM STRATEGY AND TARGETS .....	6
3.3. MEASURES UNDERPINNING THE PROGRAMME.....	8
3.4. DEBT DEVELOPMENTS.....	9
3.5. RISK ASSESSMENT .....	11
4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT .....	12
5. FISCAL SUSTAINABILITY .....	<b>ERROR! BOOKMARK NOT DEFINED.</b>
6. FISCAL FRAMEWORK .....	18
7. SUMMARY .....	19
8. ANNEXES .....	20

## **EXECUTIVE SUMMARY**

In 2018, real GDP growth reached 4.8%, Latvia's highest growth rate since 2011, marking the peak of the recent investment-driven upturn in the economic cycle. Investment growth is projected to slow considerably over the next two years and as a result, the GDP growth will moderate to around 3% in both 2019 and 2020. The macroeconomic scenario presented in the Stability Programme is plausible for 2019 and somewhat optimistic for 2020.

The favourable economic conditions are confirmed by the estimates for the output gap, which peaked in 2018 and is expected to gradually close by 2022.

In 2018 the nominal general government balance deteriorated to -1.0% of GDP from -0.5% of GDP in 2017. The nominal balance outcome confirmed by Eurostat was also 0.3 percentage points of GDP lower than forecast in the updated 2019 Draft Budgetary Plan from February 2019. The negative surprise was almost entirely due to higher than-projected public investment linked to EU fund implementation, in particular by companies classified within the general government.

The Stability Programme projects the nominal balance to improve to -0.5% of GDP in 2019 and to -0.4% of GDP in 2020, as the deficit-increasing surprise in 2018 should not persist and expenditure growth is restrained under the 2019 budget and the policy plans for 2020. The Commission forecast is slightly more cautious and projects the balance at -0.6% of GDP in both years. In 2019, the budget improvement is due to expenditure restraint, while for 2020 budgetary plans have not yet been fully developed.

The Stability Programme projects the general government debt ratio to increase slightly from 35.9% of GDP in 2018 to 36.1% of GDP in 2020. According to the Commission's spring forecast, the government debt is expected to fall to 33.5% of GDP by 2020. This assumes no change in stock-flow adjustments in 2019-2020, while the authorities' forecast assumes an accumulation of financial assets during this period.

The fiscal sustainability analysis suggests Latvia's long-term fiscal risks are low and would decrease further if the Stability Programme were implemented as presented.

In 2019 and 2020, based on the Commission 2019 spring forecast, Latvia's structural balance is projected to be close to the medium-term-objective in both years, if the allowance linked to the implementation of the structural reforms for which a temporary deviation is granted is taken into account. The current assessment indicates a risk of some deviation in both 2019 and 2020.

## **1. INTRODUCTION**

Latvia submitted its 2019 Stability Programme on 17 April 2019 and amendments to the programme on 14 May 2019. The government approved the programme on 15 April and its amendments on 14 May. The amendments updated the Stability Programme in line with the EDP notification data for 2018, which became available after the submission of the Stability Programme. Hereafter, the amended 2019 Stability Programme is called Stability Programme. The Stability Programme covers the period 2019-2022.

Latvia is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its medium-term budgetary objective (MTO) taking into account the allowances linked to the implementation of the systemic pension reform and of the structural reforms for which a temporary deviation is granted.

This document complements the Country Report published on 27 February and updates it with the information included in the Stability Programme

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2019 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium-term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including based on the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

## **2. MACROECONOMIC DEVELOPMENTS**

The Stability Programme projects a gradual slowdown in real GDP growth from 4.8% in 2018 to 3.2% in 2019, to 3.0% in 2020 and to around 3% in 2021-2022. According to the programme, GDP growth in 2019 is set to slow down due to maturing of the investment cycle, which had carried the rapid GDP growth over the previous two years. Private consumption is expected to slow slightly due to lower employment growth, but continuously rapid wage growth will ensure it remains solid. Export growth is forecast to recover slightly compared to 2018. On the one hand, the recovery from adverse one-off events from the previous year will have a positive effect; on the other hand, slowing European growth will dampen the demand for exports. In 2020, investment and private consumption are set to slow further, but export growth is expected to pick up slightly in line with the currently projected European growth dynamic.

HICP inflation is forecast at 2.5% in 2019, the same as it was in 2018. It is then expected to slow down to just above 2% over 2020-2022. The inflation drivers will change slightly in 2019 as the energy price inflation is expected to recede and food prices to accelerate due to excise tax increases. The inflation rate is expected to moderate in 2020 as the energy price increases level off and the impact of excise tax increases is projected to be lower than in the previous year. Moreover, the slowing wage growth is also expected to ease the pressure on prices.

Employment growth is forecast to gradually slow as labour supply wears increasingly thin. The unemployment rate of 7.0% in 2019 and 6.5% in 2020 approaches historical lows. However, wage growth is expected to remain brisk at 6.5% in 2019 and 5.5% in 2020, as the falling labour supply will continue to put pressure on wages.

The positive output gap, as recalculated by the Commission following the commonly agreed methodology, is estimated to shrink from 2.9% of GDP in 2018 to 2.1% in 2019 and to 0.9% in 2020, before reaching around zero in 2021 and 2022. The output gap estimate of the Stability Programme at face value is around 1 percentage point lower in 2018, ½ percentage point lower in 2019, but similar in 2020-2022. The largest difference between the recalculated output gap and the face value output gap of the Programme concerns the initial position in 2018. Notably it results from an accumulation of differences in the potential growth rate in

years up to 2016, when recalculated potential growth is estimated to have been lower than assumed by the authorities.

**Table 1: Comparison of macroeconomic developments and forecasts**

	2018		2019		2020		2021	2022
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	4.8	4.8	3.1	3.2	2.8	3.0	2.9	2.9
Private consumption (% change)	4.5	4.6	3.7	4.3	3.6	3.6	3.6	3.6
Gross fixed capital formation (% change)	16.4	16.2	2.8	7.7	1.7	6.0	6.0	6.0
Exports of goods and services (% change)	1.8	2.5	2.2	3.2	2.4	4.1	4.0	3.9
Imports of goods and services (% change)	5.1	6.8	2.0	5.7	2.3	5.2	5.0	4.9
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	6.8	6.9	3.1	5.0	2.8	4.2	4.0	4.1
- Change in inventories	-0.1	0.7	0.0	0.0	0.0	-0.2	-0.2	-0.2
- Net exports	-2.0	-2.9	0.1	-1.8	0.1	-1.0	-1.0	-1.0
Output gap <sup>1</sup>	2.8	2.9	2.2	2.1	1.3	0.9	0.2	-0.2
Employment (% change)	1.6	1.6	0.3	0.5	0.0	0.1	-0.1	-0.1
Unemployment rate (%)	7.4	7.4	6.9	7.0	6.7	6.5	6.3	5.6
Labour productivity (% change)	3.1	2.9	2.8	2.7	2.8	2.9	3.0	3.0
HICP inflation (%)	2.6	2.5	2.8	2.5	2.4	2.2	2.1	2.0
GDP deflator (% change)	4.2	3.9	2.7	3.1	2.0	2.8	2.5	2.5
Comp. of employees (per head, % change)	7.8	8.4	6.2	6.5	5.0	5.5	5.0	5.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.3	0.1	1.7	-0.7	1.9	-1.6	-2.1	-3.1

Note:

<sup>1</sup>In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission 2019 spring forecast (COM); Stability Programme (SP).

The Commission 2019 spring forecast projects a deceleration of the real GDP growth rate from 4.8% in 2018 to 3.1% in 2019 and to 2.8% in 2020. The growth forecast for both years is broadly in line with the Stability Programme. GDP components in 2019 differ somewhat between the Commission forecast and the Stability Programme – the Stability Programme is more optimistic about the growth of both domestic demand and exports than the Commission forecast. This difference is balanced by correspondingly higher imports projected in the Stability Programme to arrive at broadly the same GDP growth as in the Commission forecast. In 2020, the differences in components' growth forecast are smaller, with investment being a notable exception – the Stability Programme assumes significantly higher investment growth than the Commission forecast. The GDP deflator forecast in the Stability Programme is broadly in line with the Commission for 2019 and somewhat higher for 2020. The wage growth projections are close to those of the Commission, but the employment growth is more optimistic than assumed by the Commission. Overall, the Stability Programme's GDP growth projections are plausible for 2019 and somewhat more favourable for 2020.

### **3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS**

#### **3.1. DEFICIT DEVELOPMENTS IN 2018 AND 2019**

The government deficit in 2018 stood at 1.0% of GDP, worse than the estimated 0.7% of GDP in the updated 2019 Draft Budgetary Plan (DBP) submitted in February 2019. The deterioration in balance came mostly from (i) significantly higher-than-estimated investment by companies classified within the general government, (ii) a lower co-financing rate for the EU-funded projects, and (iii) a negative accrual adjustment to tax revenue. Overall, 2018 showed strong expenditure growth for investment, public sector wages and for goods and services, while revenue were supported by solid wage and consumption growth, which mitigated the effect of tax cutting measures.

For 2019, the Stability Programme targets a deficit of 0.5% of GDP, the same as in the updated Draft Budgetary Plan, which was submitted in February 2019. This target includes a security reserve of 0.1% of GDP. Revenue and expenditure growth is planned to decelerate relative to 2018 and to be lower than the nominal GDP growth. Revenues will be supported by still dynamic consumption and wage growth, while covering the costs of the tax-cutting measures adopted in 2017. Expenditure plans for 2019 have changed little since the updated Draft Budgetary Plan; however, a higher expenditure outturn in 2018 than envisaged in the updated Draft Budgetary Plans results in lower expenditure growth rates in 2019. The deficit-increasing surprises in 2018 are assumed to have no effect on the plans for 2019. However while the relevant budgetary items will be closely reviewed and monitored. Expenditure growth is driven by higher public sector wages and social benefits, which mirror buoyant wage developments in the private sector, as well as wage increases to medical personnel, government employees in the judicial and public safety sectors. Other expenditure items are planned to remain broadly unchanged in nominal terms and to shrink relative to GDP. In particular, purchases of goods and services and interest expenditure are set to decrease, and public investment is assumed to have peaked after the rush in 2017 and 2018.

#### **3.2. MEDIUM-TERM STRATEGY AND TARGETS**

The Stability Programme targets the headline deficit to fall to 0.5% of GDP in 2020 and to 0.2% and 0.3% in 2021 and 2022, respectively. The planned deficit reduction is consistent with plans in the previous Stability Programmes (see Figure 1). The structural deficit taken at face value is estimated to decline from 1.7% of GDP in 2018 to 1.1% in 2019, to 0.8% in 2020 and 0.5% in both 2021 and 2022. The top-down structural deficit targets are established by the most binding requirements under the Stability and Growth Pact and the national fiscal rules (see Section 6). The latter are more binding for 2020-2022.<sup>1</sup>

Latvia reconfirms its medium-term budgetary objective (MTO) of the structural deficit of 1% of GDP. This MTO reflects the objectives of the Stability and Growth Pact. Moreover, Latvia benefits from the temporary deviation allowance for the healthcare reform granted in 2017. It allows for the deviation of 0.5% of GDP in 2019 and will expire in 2020. From 2020, no

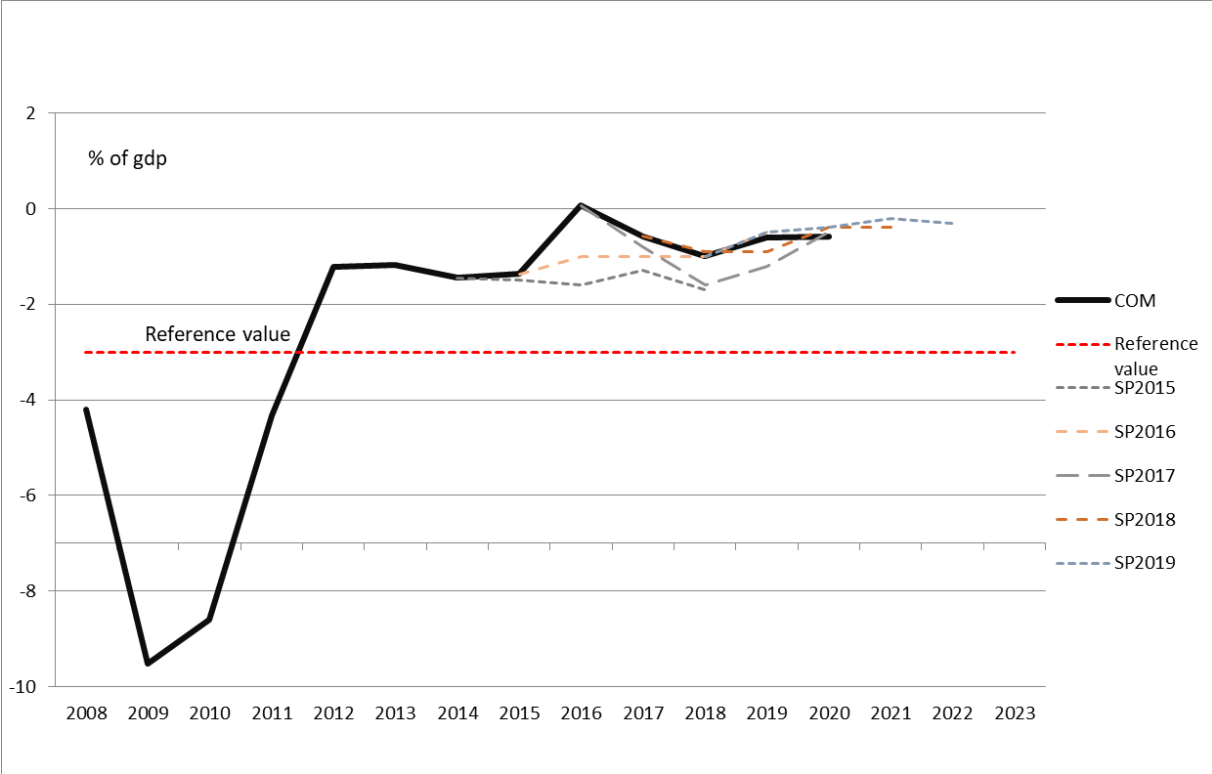
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<sup>1</sup> The targets for 2019-2022 are consistent with the national MTO of -0.5% of GDP, under an assumption that the transitional costs of the 2017 tax reform of 0.5% of GDP in 2019 and 0.3% of GDP in 2020 are one-off measures. The Stability Programme recognises that the Commission (see Table 2) does not treat those discretionary policy measures as one-off measures.

reform clauses have been applied for. Overall, this amounts to a structural deficit limit of 1.5% of GDP in 2019, taking into account the temporary allowance from an adjustment path, and the MTO of 1% of GDP thereafter.

The recalculated structural balance<sup>2</sup> stands at 1.4% of GDP in 2019, 0.8% of GDP in 2020 and then converging with the Stability Programme’s estimates in 2021-2022. The fiscal policy stance is projected to change from pro-cyclical to counter-cyclical in 2019 as the structural balance is set to improve at a time of a positive output gap.

**Figure 1: Government balance projections in successive programmes (% of GDP)**



Source: Commission 2019 spring forecast; Stability Programmes

Government revenue as a share of GDP is estimated to decline in 2020 and thereafter. This reflects the undeveloped revenue and expenditure plans for those years and the impact of rising nominal GDP. While tax revenue growth broadly follows that of GDP, non-tax revenue ratio to GDP is set to decline on the back of lower transfers from the EU, which is related to the ending of the 2014-2020 planning period, as well as lower projected dividends from state-owned enterprises, notably AS “Latvenergo”.

The Stability Programme projects the government expenditure share in GDP to decrease by 1.5 percentage points between 2019 and 2022. This too reflects the undeveloped budgetary plans for 2020-2022 and the impact of rising nominal GDP. As a result, the Stability Programme includes only few items that are known to impact expenditure developments in 2020 and beyond: (i) the rapid wage growth is expected to sustain the growth of expenditure on social assistance; (ii) the government’s commitment to meeting the NATO 2% target will ensure defence spending is increased in line with nominal GDP; (iii) the right to inherit

<sup>2</sup> The structural balance of the Stability Programme is recalculated by the Commission using information in the Programme and in line with the commonly agreed methodology.

accumulated pension capital starting from 2020 will increase the social spending; and (iv) the capital expenditure related to EU-funded projects is expected to decline after 2020.

**Table 2: Composition of the budgetary adjustment**

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	SP	COM	SP	SP	SP	SP
<b>Revenue</b>	<b>37.5</b>	<b>37.2</b>	<b>36.2</b>	<b>36.8</b>	<b>35.9</b>	<b>35.4</b>	<b>34.9</b>	<b>-2.6</b>
<i>of which:</i>								
- Taxes on production and imports	14.1	14.3	14.1	14.4	14.3	14.2	14.0	-0.1
- Current taxes on income, wealth, etc.	7.3	6.7	6.5	6.7	6.6	6.6	6.6	-0.7
- Social contributions	9.3	9.4	9.4	9.4	9.4	9.4	9.4	0.1
- Other (residual)	6.8	6.8	6.2	6.3	5.6	5.2	4.9	-1.9
<b>Expenditure</b>	<b>38.5</b>	<b>37.8</b>	<b>36.7</b>	<b>37.4</b>	<b>36.4</b>	<b>35.6</b>	<b>35.2</b>	<b>-3.3</b>
<i>of which:</i>								
- Primary expenditure	37.8	37.1	36.0	36.7	35.6	34.8	34.4	-3.4
<i>of which:</i>								
Compensation of employees	10.2	10.5	10.3	10.5	9.9	9.6	9.3	-0.9
Intermediate consumption	5.9	5.3	5.5	5.2	5.2	5.1	4.9	-1.0
Social payments	11.5	11.6	11.6	11.7	11.8	11.7	11.9	0.4
Subsidies	1.0	0.9	1.6	0.9	1.5	1.4	1.4	2.1
Gross fixed capital formation	5.4	5.3	5.1	5.2	4.9	4.7	4.4	4.4
Other (residual)	3.8	3.5	1.9	3.3	2.3	2.4	2.5	-1.3
- Interest expenditure	0.7	0.7	0.7	0.6	0.8	0.8	0.8	0.1
<b>General government balance (GGB)</b>	<b>-1.0</b>	<b>-0.6</b>	<b>-0.5</b>	<b>-0.6</b>	<b>-0.4</b>	<b>-0.2</b>	<b>-0.3</b>	<b>0.7</b>
<b>Primary balance</b>	<b>-0.3</b>	<b>0.1</b>	<b>0.2</b>	<b>0.1</b>	<b>0.4</b>	<b>0.5</b>	<b>0.5</b>	<b>0.8</b>
One-off and other temporary	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0
<b>GGB excl. one-offs</b>	<b>-1.0</b>	<b>-0.8</b>	<b>-0.6</b>	<b>-0.6</b>	<b>-0.4</b>	<b>-0.2</b>	<b>-0.3</b>	<b>0.7</b>
Output gap <sup>1</sup>	2.8	2.2	2.1	1.3	0.9	0.2	-0.2	-3.1
Cyclically-adjusted balance <sup>1</sup>	-2.1	-1.4	-1.3	-1.1	-0.8	-0.3	-0.2	1.9
<b>Structural balance<sup>2</sup></b>	<b>-2.1</b>	<b>-1.6</b>	<b>-1.4</b>	<b>-1.1</b>	<b>-0.8</b>	<b>-0.3</b>	<b>-0.2</b>	<b>1.9</b>
Structural primary balance <sup>2</sup>	-1.4	-1.0	-0.7	-0.4	0.0	0.5	0.6	1.9

Notes:

<sup>1</sup>Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

<sup>2</sup>Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2019 spring forecasts (COM); Commission calculations.

### 3.3. MEASURES UNDERPINNING THE PROGRAMME

The Stability Programme presents the measures adopted since the submission of the updated Draft Budgetary Plans in February 2019. In total, for 2019 the Stability Programme presents 0.4% of GDP worth of revenue-increasing measures and 0.6% of GDP worth of expenditure-increasing measures. The measures presented for 2020 and 2021 do not exceed 0.2% of GDP (see table below on the main budgetary measures of the Stability Programme).

In order to reach the deficit targets, the Stability Programme assumes a consolidation effort of less than 0.1% of GDP in 2020 and 0.2% of GDP in 2021, which is yet to be specified in the annual budgets. For 2019, the budgetary position is improved by one-off revenue of 0.2% of GDP linked to the sale of an exceptionally large amount of greenhouse gas emission



allowances in 2018. The Stability Programme's estimate of the one-off revenue effect is lower, at 0.1% of GDP, as it excludes the impact of the large market price increase in 2018.

### Main budgetary measures

Revenue	Expenditure
<b>2019</b>	
<ul style="list-style-type: none"> <li>• Increase of dividend pay-out from state-owned forest management company (+0.1% of GDP)</li> <li>• Other revenue measures (+0.3% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Continuation of the health reform clause (+0.2% of GDP)</li> <li>• Length of service awards to public officials on special duty (+0.1% of GDP)</li> <li>• Other expenditure measure (revisions, EU fund reallocations and others) (+0.3% of GDP)</li> </ul>
<b>2020</b>	
<ul style="list-style-type: none"> <li>• Decrease of dividend pay-out from state-owned forest management company (-0.1% of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>• Length of service awards to public officials on special duty (-0.1% of GDP)</li> <li>• Other expenditure measure (revisions, EU fund reallocations and others) (-0.1% of GDP)</li> </ul>
<b>2021</b>	
	<ul style="list-style-type: none"> <li>• Other expenditure measure (revisions, EU fund reallocations and others) (+0.1% of GDP)</li> </ul>
<p><u>Note:</u> The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

### 3.4. DEBT DEVELOPMENTS

Government debt declined to 35.9% of GDP at the end of 2018 — lower than expected previously (Figure 2). The reduction was caused by large financial operations by companies included in the government sector, which increased the government debt level in 2017 and reduced it in 2018. The Stability Programme projects a slight increase in debt in 2019 to 37% of GDP before declining to 33% of GDP by 2022. The increase in 2019 is linked to the planned borrowing exceeding the refinancing needs with the aim of taking advantage of the low interest rate environment. The decline of the debt from 2020 onwards is driven by nominal GDP growth exceeding the growth in primary borrowing. The Commission projects the debt ratio to decline already in 2019, under the assumption that new debt issues will satisfy the refinancing needs, but without accumulation financial assets.

**Table 3: Debt developments**

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	SP	COM	SP	SP	SP
<b>Gross debt ratio<sup>1</sup></b>	<b>39.5</b>	<b>35.9</b>	<b>34.5</b>	<b>37.4</b>	<b>33.5</b>	<b>36.1</b>	<b>33.5</b>	<b>33.1</b>
Change in the ratio	-0.3	-4.0	-1.4	1.5	-1.0	-1.3	-2.6	-0.4
<i>Contributions<sup>2</sup>:</i>								
<b>1. Primary balance</b>	<b>-0.3</b>	<b>0.3</b>	<b>-0.1</b>	<b>-0.2</b>	<b>-0.1</b>	<b>-0.4</b>	<b>-0.5</b>	<b>-0.5</b>
<b>2. “Snow-ball” effect</b>	<b>-0.4</b>	<b>-2.6</b>	<b>-1.3</b>	<b>-1.4</b>	<b>-0.9</b>	<b>-1.3</b>	<b>-1.2</b>	<b>-0.9</b>
<i>Of which:</i>								
Interest expenditure	1.2	0.7	0.7	0.7	0.6	0.8	0.8	0.8
Growth effect	-1.1	-1.7	-1.1	-1.1	-0.9	-1.1	-1.0	-0.9
Inflation effect	-0.6	-1.6	-0.9	-1.0	-0.6	-1.0	-0.9	-0.8
<b>3. Stock-flow adjustment</b>	<b>0.4</b>	<b>-1.7</b>	<b>0.0</b>	<b>3.1</b>	<b>0.0</b>	<b>0.4</b>	<b>-0.9</b>	<b>1.0</b>
<i>Of which:</i>								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

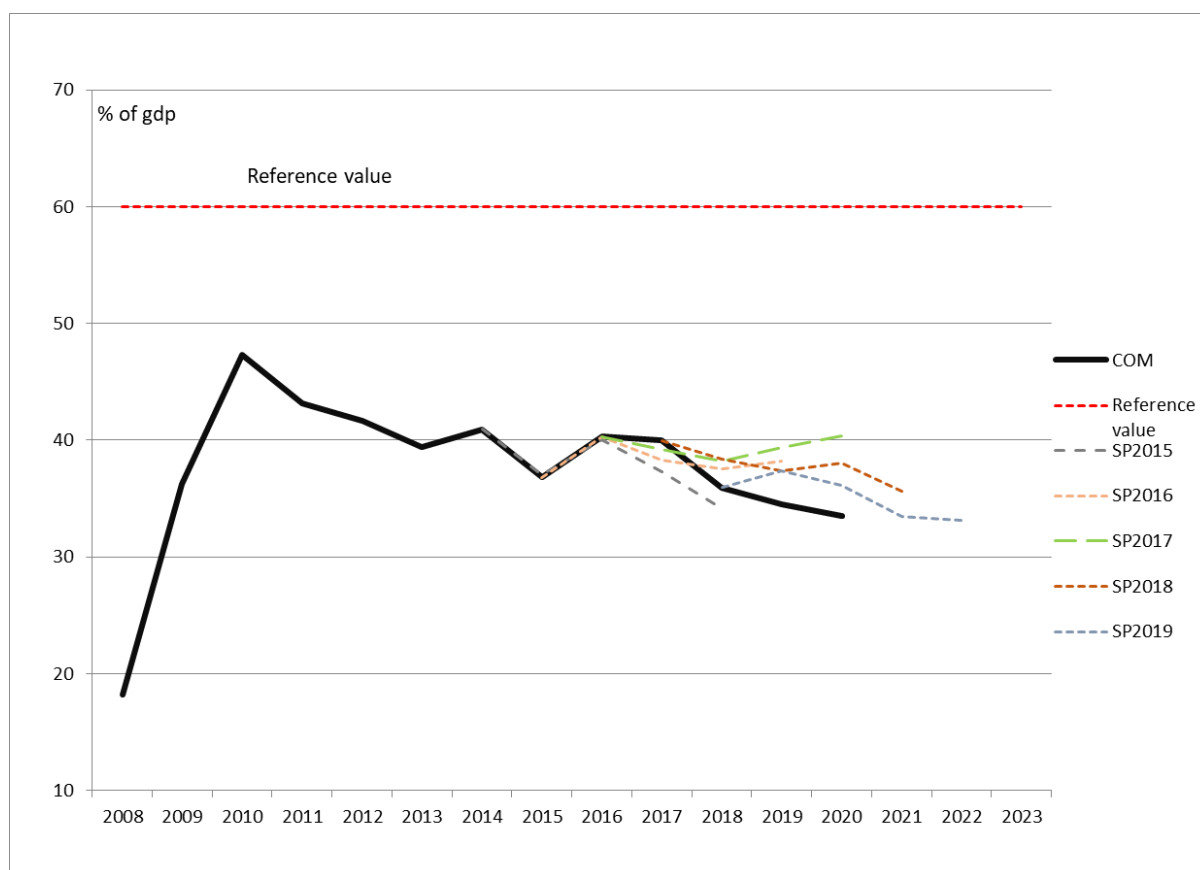
<sup>1</sup> End of period.

<sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Commission 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

**Figure 2: Government debt projections in successive programmes (% of GDP)**



Source: Commission 2019 spring forecast; Stability Programmes

### 3.5. RISK ASSESSMENT

The Commission 2019 spring forecast projects a government deficit of 0.6% of GDP in both 2019 and 2020, which is above the deficit target of the Stability Programme of 0.5% for 2019 and 0.4% for 2020. Revenue projections are broadly similar, while there are diverging views on the yield of revenue-increasing tax compliance measures. Moreover, the Commission forecast is somewhat more cautious on revenues from corporate income tax in 2020 and thereafter since the corporate income tax reform created an incentive to delay dividend payout. The Commission no-policy change forecast for 2020 assumes a higher expenditure growth for public sector wages and investment, while the Stability Programme shows a higher growth in other expenditure in Table 2, which appear to include yet unspecified expenditure envelopes. Overall, the risks to the budgetary position are balanced.

#### 4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

##### **Box 1. Council Recommendations addressed to Latvia**

*On 15 June 2018, the Council addressed recommendations to Latvia in the context of the European Semester. In particular, in the area of public finances the Council recommended to achieve the medium-term budgetary objective in 2019, taking into account the allowances linked to the implementation of the structural reforms for which a temporary deviation is granted.*

*The Council noted that based on the Commission 2019 spring forecast, this was consistent with a maximum nominal growth rate of net primary government expenditure of 4.8 % in 2019, corresponding to improvement in the structural balance of 0.2 % of GDP.*

##### **Assessment of requests for deviating from SGP requirements**

Latvia has been allowed to temporarily increase its structural deficit limit to finance the healthcare reform. The implementation of this health reform allows the government deficit to deviate from the MTO by 0.1% of GDP in 2017, 0.4% of GDP in 2018 and 0.5% of GDP in 2019.<sup>3</sup>

The Stability Programme reports on the implementation of the healthcare sector reform in 2018 and plans for 2019. The implementation in 2018 broadly follows the announced plans to increase the provision of public health services, to reduce waiting times, to improve the quality of primary care, to reduce the spread of infectious diseases and to improve prevention and care quality for cardiovascular diseases. In some areas, a greater efficiency than planned has been achieved in terms of the number of patients treated and the average costs, while in other areas costs were higher due to a larger than planned number of difficult medical cases. Waiting times for cancer patients have been decreased from 30 days to 10 days. The efficiency of treatment of infectious diseases has also improved as larger number of patients were treated. The measures for 2019 are broadly outlined in the Stability Programme with more details provided in national documents. The measures launched in 2017 are continued and expanded in 2019 and four new measures are included: (i) reform of healthcare institutions, (ii) strategic procurement of rehabilitation services, (iii) improvements to mental healthcare, and (iv) improvements of accessibility of healthcare institutions and efficiency of healthcare infrastructure. The increased financing is used to increase service provision, but also includes higher remuneration for medical personnel, coverage for rising costs of medical supplies and purchase of new equipment, all necessary for the planned delivery of services. The Stability Programme reconfirms a positive effect of the reform measures on economic growth, employment and public finances in the long run, which appears plausible.

##### **Adjustment towards the MTO**

Based on the Commission 2019 spring forecast and the 2018 outturn data validated by Eurostat, in 2018, the growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, exceeded the applicable expenditure benchmark of 6.6%, leading to a deviation of 1.4% of GDP from the fiscal requirement in 2018 and over

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<sup>3</sup> The structural reform clause for the healthcare sector reform of 0.5% of GDP was granted to Latvia as from 2017, but the existing allowance for the pension reform and the minimum benchmark of a structural deficit of 1.7% of GDP limit the deviation granted under the structural reform clause to 0.1% of GDP in 2017 and 0.4% in 2018. The allowed deviation of 0.5% of GDP is used in full in 2019.

2017-2018. At the same time, the Latvia's structural balance reached a deficit of 2.1% of GDP, exceeding the MTO and the allowed temporary deviation related to the implementation of the pension reform and structural reform in the healthcare sector by 0.4% of GDP (Table 4). Over 2017-2018 on average, the structural balance pillar is met, pointing to compliance. The reading of the indicators calls for an overall assessment. The tighter requirement of the expenditure benchmark is explained mainly by the differences in potential GDP growth estimates and in the different GDP deflators<sup>4</sup> used for the structural balance rule and the expenditure benchmark rule. These factors together account for the entire 0.9 percentage point difference between the assessed deviations by the two indicators. The impact of revenue windfalls and savings on interest expenditure, which flatter the structural balance reading is cancelled out by the effect of the current structural upturn in investment, which is reflected in the structural balance, but is smoothed out from the expenditure benchmark. While the indicators used to assess compliance with the requirements of the preventive arm therefore point to a significant deviation from the adjustment path towards the medium-term budgetary objective in 2018, Latvia was 0.4% of GDP away from its MTO of -1.0% of GDP and the temporary deviation allowance of 0.7% of GDP granted in relation to structural and pension reform implementation, and is projected to move even closer to the MTO by 2020 (gap of 0.1% of GDP). The general government deficit was well below the Treaty reference value of 3% of GDP in 2018 and is projected to remain well below 3% of GDP over the forecast horizon. Moreover, Latvia's general government debt ratio is below 60% of GDP and further declining over the forecast horizon. Overall, the fiscal policy of Latvia does not represent a clear and persistent challenge to the principles of the Stability and Growth Pact. Taking into account these considerations, there is currently no sufficient ground to conclude on the existence of an observed significant deviation in 2018.

For 2019, the recalculated structural deficit of 1.4% of GDP complies with the structural deficit limit of 1.5% of GDP, which reflects the MTO and the allowed temporary deviation for the healthcare sector reform.

Based on the Commission 2019 spring forecast, Latvia's structural deficit of 1.6% of GDP in 2019 is expected to be close to the MTO, taking into account the allowance linked to healthcare reform (gap of 0.1% of GDP). At the same time, Latvia has a requirement that the nominal growth rate of net primary government expenditure should not exceed 4.8% in 2019. The Commission forecast points to a risk of some deviation from the expenditure benchmark in 2019 and to a risk of significant deviation in 2018-2019 taken together. Taking into account the distance to the MTO, the current assessment points to a risk of some deviation in 2019. If the structural balance is no longer projected to be close to the MTO, taking into account the allowance linked to healthcare reform, future assessments would need to take into account a possible deviation from the requirement.

For 2020, the recalculated structural deficit of 0.8% of GDP complies with the MTO (overachievement of 0.1% of GDP). At the same time, the expenditure benchmark points to a significant deviation of 1.2% of GDP. The different reading of the indicators is largely explained by different potential growth and investment assumptions. The 10-year average GDP growth rate used for the expenditure benchmark is lower than the estimate for 2020 used for the structural balance (gap of 0.4% of GDP). The 4-year average investment used for the

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<sup>4</sup> The GDP deflator for 2018 was forecast at 2.7% in spring 2017 (used for the expenditure benchmark rule), while the actual deflator outturn for 2018 was 4.2% (implicitly used for the balance rule as the government revenue depend on the actual nominal GDP growth rate).

expenditure benchmark is estimate to be still catching up with planned investment for 2020, which tightens the expenditure benchmark relative to the structural balance by 0.4 percentage points of GDP. If compliance with the MTO can no longer be established in future assessments, an overall assessment would need to take into account a possible deviation from the requirement.

Based on the Commission 2019 spring forecast, Latvia's structural deficit of 1.1% of GDP in 2020 is expected to be close to the MTO (gap of 0.1% of GDP). At the same time, Latvia has a requirement that the nominal growth rate of net primary government expenditure should not exceed 3.5% in 2020. The Commission forecast points to a risk of significant deviation from the expenditure benchmark in 2020. Taking into account the distance to the MTO, the current assessment points to a risk of some deviation in 2020. If the structural balance is no longer projected to be close to the MTO, future assessments would need to take into account a possible (significant) deviation from the requirement.

**Table 4: Compliance with the requirements under the preventive arm**

(% of GDP)	2018	2019	2020		
<b>Background budgetary indicators<sup>1</sup></b>					
Medium-term budgetary objective (MTO)	-1.0	-1.0	-1.0		
Structural balance <sup>2</sup> (COM)	-2.1	-1.6	-1.1		
<b>Setting the required adjustment to the MTO</b>					
Structural balance based on freezing (COM)	-1.7	-1.6	-		
Position vis-à-vis the MTO <sup>3</sup>	At or above the MTO	Not at MTO	Not at MTO		
Required adjustment <sup>4</sup>	0.0	0.6	0.5		
Required adjustment corrected <sup>5</sup>	-0.5	0.2	0.5		
Corresponding expenditure benchmark <sup>6</sup>	6.6	4.8	3.5		
<b>Compliance with the required adjustment to the MTO</b>					
	COM	SP	COM	SP	COM
<b>Structural balance pillar</b>					
Change in structural balance <sup>7</sup>	-0.8	0.7	0.4	0.6	0.6
One-year deviation from the required adjustment <sup>8</sup>	-0.4	0.5	0.2	0.1	0.1
Two-year average deviation from the required adjustment <sup>8</sup>	0.0	0.1	-0.1	0.3	0.1
<b>Expenditure benchmark pillar</b>					
Net public expenditure annual growth corrected for one-offs <sup>9</sup>	10.8	2.5	6.0	7.3	5.8
One-year deviation adjusted for one-offs <sup>10</sup>	-1.4	0.7	-0.4	-1.2	-0.8
Two-year deviation adjusted for one-offs <sup>10</sup>	-0.8	-0.3	-0.9	-0.2	-0.6
<b>Finding of the overall assessment</b>	no sufficient ground*	Compliance	Some deviation	Compliance	Some deviation

**Legend**

'Compliance' - the recommended structural adjustment or a higher adjustment is being observed.

'Some deviation' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'Significant deviation' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

'Irrelevant for the Significant Deviation Procedure' - a SDP would not be opened only based on the two-year deviation if the MTO has reached (at the time of the freezing or on the base of the last storage) in one of the two years.



**Notes**

\*There is currently not sufficient ground to conclude on the existence of an observed significant deviation in Latvia in 2018.

<sup>1</sup> The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage point is allowed in order to be evaluated as having reached the MTO.

<sup>2</sup> Structural balance = cyclically-adjusted government balance excluding one-off measures.

<sup>3</sup> Based on the relevant structural balance at year t-1.

<sup>4</sup> Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

<sup>5</sup> Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

<sup>6</sup> Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

<sup>7</sup> Change in the structural balance compared to year t-1. Ex post assessment (for 2018) is carried out on the basis of Commission 2019 spring forecast.

<sup>8</sup> The difference of the change in the structural balance and the corrected required adjustment.

<sup>9</sup> Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

<sup>10</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

**Source :**

Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.

## 5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS'

Latvia does not appear to face fiscal sustainability risks in the short, medium or long run. Nonetheless, addressing the currently low pension adequacy and the underfinancing of the healthcare services might lead to higher public spending in the medium to long term<sup>5</sup>.

Based on Commission 2019 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, at 35.9% of GDP in 2018, is expected to fall to 32.4% in 2029), thus remaining below the 60% of GDP Treaty threshold. Sensitivity analysis shows similar results.<sup>6</sup> Overall, this highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would also lead to a decline in the debt ratio from current levels, thus remaining below the 60% of GDP reference value in 2029.

The medium-term fiscal sustainability risk indicator S1<sup>7</sup> is at -2.2 percentage points of GDP, thus indicating low risks in the medium term, as a result of the low level of government debt. The full implementation of the Stability Programme would put the S1 indicator at -3.7 percentage points of GDP. Overall risks to fiscal sustainability over the medium term are, therefore, low. Fully implementing the fiscal plans in the Stability Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 stands at 0.6 percentage points of GDP. In the long term, Latvia therefore appears to face low fiscal sustainability risks, primarily related to the projected decline in ageing costs, in particular for pension expenditure. Full implementation of the programme would put the S2 indicator at -0.3 percentage points of GDP, pointing to a similar long-term risk.<sup>8</sup> The S2 indicator thus points in the same direction as the debt sustainability analysis discussed above, leading to the overall conclusion that Latvia faces low fiscal sustainability risks in the long term.

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<sup>5</sup> See the 2019 country report for Latvia for more details: [https://ec.europa.eu/info/sites/info/files/file\\_import/2019-european-semester-country-report-latvia\\_en.pdf](https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-latvia_en.pdf).

<sup>6</sup> Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

<sup>7</sup> See the note to Table 5 for a definition of the indicator.

<sup>8</sup> The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.



**Table 5: Sustainability indicators**

Time horizon		Commission Scenario		Stability / Convergence Programme Scenario		
<b>Short-term</b>		<b>LOW risk</b>				
<b>S0 indicator</b> <sup>[1]</sup>		0.2				
Fiscal subindex		0.1	LOW risk			
Financial & competitiveness subindex		0.3	LOW risk			
<b>Medium-term</b>		<b>LOW risk</b>				
<b>DSA</b> <sup>[2]</sup>		LOW risk				
<b>S1 indicator</b> <sup>[3]</sup>		-2.2	LOW risk	-3.7	LOW risk	
of which	Initial Budgetary Position	-0.3		-1.5		
	Debt Requirement	-2.1		-2.5		
	Cost of Ageing	0.2		0.3		
	of which	Pensions	-0.5		-0.3	
		Health care	0.2		0.1	
		Long-term care	0.0		0.0	
		Other	0.5		0.5	
<b>Long-term</b>		<b>LOW risk</b>				
<b>DSA</b> <sup>[2]</sup>		LOW risk				
<b>S2 indicator</b> <sup>[4]</sup>		0.6	LOW risk	-0.3	LOW risk	
of which	Initial Budgetary Position	0.8		-0.1		
	Cost of Ageing	-0.3		-0.2		
	of which	Pensions	-1.4		-1.2	
		Health care	0.4		0.3	
		Long-term care	0.1		0.1	
		Other	0.7		0.6	
Source: Commission services; 2019 stability/convergence programme.						
Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.						
[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.						
[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.						
[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.						
[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.						
* For more information see Fiscal Sustainability Report 2018.						

## 6. FISCAL FRAMEWORK

The Fiscal Discipline Council (FDC), which is an independent monitoring body established on the basis of the Fiscal Discipline Law (FDL), monitors the application of the national fiscal rules. The FDC published its interim report on Latvia's Stability Programme on 23 April<sup>9</sup>, with an addendum published on 13 May<sup>10</sup>.

According to the authorities' calculations presented in the programme, the structural balance was -1.7% in 2018, deviating by 0.8% of GDP from the -0.9% of GDP minimum balance permissible under the strictest of the three rules set by the FDL.

The deficit targets for 2019-2022 of the Stability Programme are assessed by the FDC to deviate from the fiscal rules in 2019 and 2020 by 0.5% of GDP and 0.3% of GDP, respectively, and to be in line with the rules in 2021 and 2022. The deviations are due to the FDC's disagreement to treat the transitional costs of the 2017 tax reform as one-off measures, contrary to the budgetary authorities' approach. According to the FDC, the adopted revenue-decreasing measures are discretionary and should be matched by offsetting expenditure-decreasing measures, ensuring a lower structural deficit than currently planned in the Stability Programme.

Moreover, the FDC finds that the accrued deviation over the period 2013-2018, calculated ex post taking into account the strictest of the three fiscal rules set by the FDL on annual basis, amounted to 2.6% of GDP. The FDC's interim report also highlights conflicting provisions between the laws governing fiscal framework of Latvia, which have led to numerous irregularity reports from the FDC over the past years. Namely, the FDL prevents increasing expenditure subject to expenditure ceiling using savings in budgetary positions that are allowed to fluctuate, while the Budget and Financial Management Law makes no such distinction between different types of expenditure.

The macroeconomic forecast underlying the stability programme was endorsed by the FDC on 15 February 2019<sup>11</sup>. The FDC considered the macroeconomic forecasts of the Ministry of Finance to be realistic, while highlighting that the economic conditions remain favourable as the output gap is assessed to be positive. It cautioned the government about the need to pursue fiscal policy that is appropriate in the current economic conditions and that would better prepare the public finances in case of unfavourable economic developments.

The FDC reports on a high administrative burden for the small workforce of its secretariat, which limits time for the core tasks. The FDC would prefer routine support tasks to be outsourced to the Ministry of Finance, while keeping the strategic functions. Moreover, the FDL provides for only one permanent position in the FDC secretariat, while the positions of other experts are only temporary — established by annual budget laws from 2018.

The Stability Programme points out that the document also serves as the national medium-term fiscal plan in the meaning of the Regulation 473/2013.

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<sup>9</sup> [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_393\\_20190423\\_Interim\\_report.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_393_20190423_Interim_report.pdf)

<sup>10</sup> [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_479\\_20190513\\_Interim\\_report\\_addendum.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_479_20190513_Interim_report_addendum.pdf)

<sup>11</sup> [http://fiscalcouncil.lv/files/uploaded/FDP\\_1\\_08\\_215\\_20190215\\_macroecomic\\_forecasts\\_opinion.pdf](http://fiscalcouncil.lv/files/uploaded/FDP_1_08_215_20190215_macroecomic_forecasts_opinion.pdf)

## 7. SUMMARY

Based on the Commission 2019 spring forecast and the 2018 outturn data validated by Eurostat, the growth of government expenditure, net of discretionary revenue measures and one-offs, was well above the applicable expenditure benchmark rate in 2018, pointing to a significant deviation from the required structural adjustment (deviation of 1.4% of GDP). Moreover, the structural balance deteriorated from -1.2% of GDP in 2017 to -2.1% of GDP in 2018, exceeding the allowed temporary deviation related to the implementation of the pension reform and structural reform in the healthcare sector by 0.4% of GDP, thus pointing to some deviation. Following an overall assessment, both indicators point to a significant deviation from the adjustment path towards the medium-term budgetary objective in 2018. However, taking into account further considerations, regarding in particular the distance to the MTO, the headline deficit and debt reduction, there is currently no sufficient ground to conclude on the existence of an observed significant deviation in 2018.

In 2019, Latvia is projected to be close to its MTO taking into account the allowance linked to the health care reform, based on the Stability Programme and the Commission 2019 spring forecast. However, the expenditure benchmark points to a risk of significant deviation from the requirement in 2019, based on the Commission forecast. Taking into account the distance to the MTO, the current assessment points to a risk of some deviation in 2019. If the structural balance is no longer projected to be close to the MTO, taking into account the allowance linked to healthcare reform, future assessments would need to take into account a possible deviation from the requirement.

In 2020, Latvia is projected to be close to its MTO, based on the Stability Programme and the Commission 2019 spring forecast. However, the expenditure benchmark points to a risk of significant deviation from the requirement in 2020, based on the Stability Programme and the Commission forecast. Taking into account the distance to the MTO, the current assessment points to a risk of some deviation in 2020. If the structural balance is no longer projected to be close to the MTO, future assessments would need to take into account a possible deviation from the requirement.

## 8. ANNEXES

**Table I. Macroeconomic indicators**

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
<b>Core indicators</b>								
GDP growth rate	8.2	0.0	3.5	2.1	4.6	4.8	3.1	2.8
Output gap <sup>1</sup>	0.6	0.1	-1.8	0.2	1.7	2.8	2.2	1.3
HICP (annual % change)	4.1	6.8	1.5	0.1	2.9	2.6	2.8	2.4
Domestic demand (annual % change) <sup>2</sup>	9.6	-1.1	3.4	2.1	6.2	6.8	3.1	2.8
Unemployment rate (% of labour force) <sup>3</sup>	11.9	11.6	12.8	9.6	8.7	7.4	6.9	6.7
Gross fixed capital formation (% of GDP)	27.4	28.9	23.1	19.6	20.9	22.8	22.7	22.2
Gross national saving (% of GDP)	21.0	22.4	21.9	22.3	22.9	23.7	23.7	23.2
<b>General Government (% of GDP)</b>								
Net lending (+) or net borrowing (-)	-1.4	-4.7	-1.9	0.1	-0.6	-1.0	-0.6	-0.6
Gross debt	13.2	23.9	40.4	40.3	40.0	35.9	34.5	33.5
Net financial assets	8.0	-2.4	-14.5	-19.1	-20.5	n.a	n.a	n.a
Total revenue	33.0	34.9	36.6	37.0	37.2	37.5	37.2	36.8
Total expenditure	34.4	39.5	38.5	37.0	37.8	38.5	37.8	37.4
<i>of which: Interest</i>	0.7	0.9	1.5	1.0	0.9	0.7	0.7	0.6
<b>Corporations (% of GDP)</b>								
Net lending (+) or net borrowing (-)	-5.0	-1.8	7.0	2.4	3.4	2.6	2.3	1.7
Net financial assets; non-financial corporations	-90.9	-117.0	-121.3	-118.0	-115.7	n.a	n.a	n.a
Net financial assets; financial corporations	-1.4	3.0	2.3	-1.3	0.7	n.a	n.a	n.a
Gross capital formation	24.5	20.8	16.2	13.8	14.5	14.9	14.8	14.4
Gross operating surplus	33.8	28.0	31.4	26.4	26.6	25.8	24.7	24.3
<b>Households and NPISH (% of GDP)</b>								
Net lending (+) or net borrowing (-)	-2.8	-0.9	-4.7	0.1	-1.3	-0.8	0.1	0.8
Net financial assets	39.7	28.3	58.8	79.8	79.4	n.a	n.a	n.a
Gross wages and salaries	33.8	39.5	37.1	40.8	40.5	40.8	41.1	41.1
Net property income	11.0	5.5	4.3	4.3	3.1	2.5	2.3	2.6
Current transfers received	17.5	18.1	16.9	16.6	16.8	16.4	16.5	16.7
Gross saving	0.7	4.4	-1.4	3.3	2.0	3.1	4.0	4.7
<b>Rest of the world (% of GDP)</b>								
Net lending (+) or net borrowing (-)	-9.2	-7.3	0.5	2.6	1.5	1.3	1.7	1.9
Net financial assets	44.6	88.0	74.7	58.6	56.1	n.a	n.a	n.a
Net exports of goods and services	-12.6	-11.1	-3.0	1.2	0.1	-0.6	-0.5	-0.5
Net primary income from the rest of the world	-0.6	0.3	-0.4	-0.3	-0.7	-0.8	-0.8	-0.8
Net capital transactions	0.7	1.7	2.7	1.0	0.8	1.8	2.0	2.1
Tradable sector	51.5	44.7	45.1	43.8	44.7	44.2	n.a	n.a
Non tradable sector	38.2	44.5	43.1	43.4	42.7	42.8	n.a	n.a
<i>of which: Building and construction sector</i>	5.7	7.4	5.7	4.7	5.3	6.2	n.a	n.a
Real effective exchange rate (index, 2000=100)	75.8	107.9	104.5	117.2	120.3	124.3	124.7	124.2
Terms of trade goods and services (index, 2000=100)	96.5	99.6	100.7	102.9	103.6	105.6	105.6	105.6
Market performance of exports (index, 2000=100)	82.0	95.2	104.8	104.9	104.5	102.6	101.4	100.2

Notes:

<sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

<sup>2</sup> The indicator on domestic demand includes stocks.

<sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source:

AMECO data, Commission 2019 spring forecast

## **Mandatory variables not included in the Stability Programme**

The Stability Programme contains all mandatory variables.