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**Assessment of the 2017 stability programme for
Latvia**

(Note prepared by DG ECFIN staff)

CONTENTS

1. INTRODUCTION.....	3
2. MACROECONOMIC DEVELOPMENTS	3
3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS.....	5
3.1. DEFICIT DEVELOPMENTS IN 2016 AND 2017	5
3.2. MEDIUM-TERM STRATEGY AND TARGETS	6
3.3. MEASURES UNDERPINNING THE PROGRAMME.....	8
3.4. DEBT DEVELOPMENTS.....	11
3.5. RISK ASSESSMENT	13
4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT	13
5. LONG-TERM SUSTAINABILITY	17
6. FISCAL FRAMEWORK	19
7. SUMMARY	20
8. ANNEXES	21

1. INTRODUCTION

On 20 April 2017, Latvia submitted its 2017 stability programme (hereafter called stability programme), covering the period 2017-2020. The government approved the stability programme on 11 April, which was reviewed by the parliamentary committee on European Affairs on 18 April.

Latvia is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should ensure that the deviation from the adjustment path towards the medium-term budgetary objective in 2016 and 2017 is limited to the allowance linked to the systemic pension reform and the major structural reform in the healthcare sector.

This document complements the Country Report published on 22 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 2017 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 on the basis of 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 pick-up in real GDP growth from 2.0% in 2016 to 3.2% in 2017, to around 4.3% in 2018-2020. The economic growth forecast assumes the implementation of a tax reform in 2018 with a strong positive GDP growth effect thereafter. Investment is expected to be the main driver of economic growth, while imports are projected to rise faster than exports. Real private consumption is projected to decelerate and grow by less than GDP over the forecast horizon while growth of investments in fixed assets is set to accelerate substantially to 5.2% in 2017 and 44.2% in 2018. This upturn in investments is explained by the back-loaded absorption of EU funds from the second half of 2017 and into 2018. Moreover, investment is expected to be supported by a pick-up in lending, the stable external environment and the strong positive effect of the tax reform from 2018. As GDP grows, unemployment is expected to improve from 9.6% in 2016 to 8.2% in 2020 reflecting a modest increase in employment, while the negative dynamics of the working age population are expected to be compensated by a higher participation rate, maintaining a steady labour force. Inflation was particularly low at 0.1% in 2016 in line with low energy prices. However, inflation is expected to increase to 2.3% in 2017 and 2.0% the following years.

The stability programme assumes that the implementation of the tax reform will contribute to real GDP growth by almost 1 percentage point from 2018, relative to the scenario without the reform¹. This assumes a stronger contribution to GDP growth from investment and private consumption, as well as large gross operating surplus gains for the companies.

¹ The stability programme presents two macroeconomic scenarios – (i) without and (ii) with the tax reform. The standard tables of the stability programme show macroeconomic projection not including the reform while the

The Commission has conducted Quest model simulations of the tax reform. The tax reform has been modelled through an increase in consumption tax equivalent to 0.8% of GDP, a decrease in personal income tax equivalent to 1.2% of GDP and a decrease in corporate income tax equivalent to 0.5% of GDP. The simulations differ by the way fiscal sustainability is ensured. The tax reform has a permanent negative effect on the government balance of around 0.8% of GDP, which is assumed to be offset in 3 or 10 years in order to ensure the long term sustainability of public finances. All simulations point to a positive GDP impact of at most 0.2% by 2020, far below the scenario of the stability programme. The consumer response to the reform appears to account for a large difference between the Quest model simulation results and those of the stability programme. Under the Quest model, liquidity constrained households use their income gains for higher consumption, while households without such constraints consume less and save more in anticipation of future fiscal retrenchment and for investment. Overall, consumption gains are estimated to be small and short lived and most of the positive GDP effect is related to the pick-up in investment and employment by at most 2.3% and 0.2%, respectively, by 2020.

Table 1: Comparison of macroeconomic developments and forecasts

	2016		2017		2018		2019	2020
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	2.0	2.0	3.2	3.2	3.5	4.3	4.4	4.3
Private consumption (% change)	3.4	3.4	3.9	3.2	4.9	4.0	2.4	2.3
Gross fixed capital formation (% change)	-11.7	-11.7	14.2	5.2	7.3	43.1	12.3	10.1
Exports of goods and services (% change)	2.8	2.8	3.4	3.3	3.6	3.5	5.0	8.2
Imports of goods and services (% change)	4.6	4.6	6.1	1.4	6.1	9.2	5.8	8.4
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	0.1	0.1	5.5	3.6	5.0	10.2	4.0	4.3
- Change in inventories	3.0	3.0	-0.8	-1.5	0.0	-2.3	1.0	0.5
- Net exports	-1.1	-1.1	-1.5	1.1	-1.5	-3.6	-0.6	-0.5
Output gap ¹	1.6	1.6	1.8	2.7	1.6	1.5	0.5	-0.5
Employment (% change)	-0.1	-0.3	0.3	0.2	0.5	0.2	0.0	0.0
Unemployment rate (%)	9.6	9.6	9.2	9.4	8.7	8.9	8.4	8.2
Labour productivity (% change)	2.0	2.3	2.8	3.0	3.0	3.2	3.2	3.0
HICP inflation (%)	0.1	0.1	2.2	2.3	2.0	2.0	2.0	2.0
GDP deflator (% change)	0.7	0.7	3.1	1.9	2.7	1.8	2.7	2.6
Comp. of employees (per head, % change)	6.9	5.0	6.0	5.5	6.8	5.2	5.3	5.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	3.7	2.0	0.9	3.4	-0.7	0.6	-0.8	-0.8
<i>Note:</i>								
¹ In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.								
<i>Source:</i>								
Commission 2017 spring forecast (COM); Stability Programme (SP).								

The positive output gap, as recalculated by the Commission following the commonly agreed methodology, is estimated to widen from 1.6% of GDP in 2016 to 2.7% in 2017 before gradually closing (1.5% in 2018, 0.5% in 2019) and turning negative in 2020 (-0.5%). The

budgetary projections assume the implementation of the reform. This document shows macroeconomic and fiscal projections including the impact of the reform.

recalculated output gap fluctuates over a wider cycle than the output gap presented by the national authorities².

The Commission 2017 spring forecast projects an acceleration of the real GDP growth rate from 3.2% in 2017 to 3.5% in 2018. This accounts for the effect of the announced tax reform in 2018 with estimated net cost of 1.1% of GDP, to be financed from the higher government borrowing. The fiscal relaxation in 2018 is estimated to increase domestic demand with positive feedback effects on real GDP growth and public finances, although this effect is estimated to be much lower than assumed by the stability programme. While the GDP growth projections of the stability programme are broadly in line with the Commission forecast for 2017, they appear markedly favourable for 2018. Moreover, the composition of growth is notably different. The stability programme scenario foresees a deceleration of imports from +4.6% in 2016 to +1.4% in 2017, even though domestic demand and exports accelerate. After a sharp drop in investment in 2016 (-11.7%), the national authorities assume a 44.2% surge of investment in 2018. This projected increase appears optimistic compared to the overall GDP growth and only marginally reflected in imports. The Commission forecast assumes a stronger recovery in investment already in 2017 and continuing into 2018. Partially compensating the dynamism of investment, private consumption is less dynamic in the stability programme than in the Commission 2017 spring forecast. This appears to be linked to low wage growth assumptions by the authorities. Considering the announced minimum wage increase by 13% in 2018 and the projected wage increases in the public sector, the Commission projects a higher growth in wages and consumption over the forecast period with further stimulus from the announced measures in 2018. Inflation projections are in line with the Commission forecast, but this is not the case of the GDP deflator. This most likely reflects the different assumptions regarding trade developments. Overall, the programme's GDP growth projections appear plausible for 2017, but markedly favourable for 2018.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2016 AND 2017

The general government recorded a balanced position in 2016, better than the projected deficit of 1% of GDP in the 2016 stability programme. The improvement of the headline government balance reflects higher-than-expected revenue by 0.4% of GDP and lower expenditure by 0.6% of GDP. Revenue benefited from a one-off receipt of confiscated illicit funds of 0.2% of GDP and steady tax revenue growth despite a weaker GDP outcome, due to the fall in investment, which had a lower impact on tax revenues. Strong private consumption and wage growth explain the increase in taxes. The expenditure savings are related to a lower capital spending in view of delays with the rollout of EU co-financed projects and unspent budget allocations by the end of the year. There was a strong increase in social spending in 2016 following the wage dynamics and a pick-up in the use of sick leave and unemployment benefits. This effect was already largely accounted for in the 2016 stability programme.

For 2017, the stability programme targets a deficit of 0.8% of GDP, as compared to 1.1% of GDP of the Draft Budgetary Plan. The improvement reflects a positive tax carry-over from the better-than-planned outturn in 2016 and lower capital spending in 2017 as compared to the

² At face value, the output gaps presented in the programme differ significantly from the recalculated output gaps used for the purpose of the programme assessment, amounting to -0.1% in 2017 and gradually turning positive to 0.7% in 2020.

previous plans. Moreover, the one-off revenue envisaged at the time of the Draft Budgetary Plan of 0.1% of GDP were substituted by other measures during the finalisation of the budget. The 2017 budget is expected to be implemented broadly as planned. An increase in the government deficit in 2017 from a balanced position in 2016 assumes that notable expenditure savings and one-off revenue in 2016 will not be repeated in 2017.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The stability programme targets a headline deficit to increase from 0.8% of GDP in 2017 to 1.6% in 2018, before declining to 1.2% of GDP in 2019 and 0.5% of GDP in 2020. These targets are estimated to be consistent with structural deficit targets of 0.7% of GDP in 2017, 1.7% in 2018, 1.5% in 2019 and 0.8% of GDP in 2020, in line with the MTO of a structural deficit of 1% of GDP³ and the fiscal temporary deviation granted to Latvia. The structural deficit targets are set in a top-down manner, choosing the most stringent target among the requirements of the Stability and Growth Pact and the national fiscal rules. The deficit targets for 2019 and 2020 leave a room of 0.4% of GDP and 0.9% of GDP, respectively, for future budgetary decision relative to the adopted policies.

The stability programme suggests a more flexible interpretation of the fiscal rules. The stability programme foresees that the fiscal loosening in 2018 would imply a risk of non-compliance with the Stability and Growth Pact, based on the Commission forecast and the commonly agreed methodology for estimating the cyclical position of the economy. Therefore, the stability programme argues applying constrained judgment for Latvia, if output gap estimates are identified as uncertain by the plausibility tool (see Box 2). This would allow for a higher fiscal deficit in 2018 and ensure the compliance with the Stability and Growth Pact requirements. For compliance with the national fiscal rules, the stability programme treats the announced tax reform as a one-off measure⁴.

The structural deficit estimates as recalculated by the Commission according to the commonly agreed methodology stand at 1.8% of GDP in 2017 and 2.2% of GDP in 2018, before declining to 0.3% of GDP in 2020. The difference compared to the targets in the stability programme is mostly due to different output gap estimates. The authorities assume the output gap to move from -0.5% of GDP in 2016 to +0.7% in 2020, while the recalculated output gap is projected to increase from +1.6% of GDP in 2016 to +2.7% of GDP in 2017 and to decrease to -0.5% of GDP by 2020 (see Box 2 assessing uncertainty around the output gap estimates).

The deficit path of the stability programme is notably affected by the planned implementation of the tax reform. The planned fiscal deterioration in 2018 is in contrast with the past stability programmes, which had planned broadly unchanged or slightly improving fiscal positions over the programming period (see Figure 1). The tax cutting measures cost around 1.7% of GDP, which is partly compensated by 0.8% of GDP in revenue-increasing measures (including the unspecified tax compliance measures of 0.2% of GDP). Moreover, the stability programme estimates a large positive second round effect of the measures of deficit-improving effect of 0.3% of GDP in 2018, an additional 0.1% of GDP in 2019 and 0.4% of GDP in 2020. The planned increase in the national minimum wage, included in the package,

³ The MTO for Latvia is consistent with the updated minimum MTOs.

⁴ The implementation of the tax reform does not qualify as a one-off measure according to the guidance in the 2015 Public Finance Report: https://ec.europa.eu/info/sites/info/files/file_import/ip014_en_2.pdf

is estimated to increase government expenditure on public sector wages and social benefits by 0.2% of GDP. Overall, the stability programme assumes that the combined negative effect of the tax reform on the government balance of around 0.8% of GDP in 2018 will disappear by 2020 on the back of stronger economic growth and better tax collection.

Table 2: Composition of the budgetary adjustment⁵

(% of GDP)	2016	2017		2018		2019	2020	Change: 2016-2020
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	36.4	36.5	36.8	35.8	36.2	36.2	36.0	-0.4
<i>of which:</i>								
- Taxes on production and imports	13.3	13.7	13.6	14.4	14.5	14.6	14.6	1.3
- Current taxes on income, wealth, etc.	8.4	8.3	8.5	6.6	6.7	6.6	6.9	-1.5
- Social contributions	8.7	8.7	8.8	9.0	9.4	9.4	9.4	0.7
- Other (residual)	6.0	5.7	5.9	5.8	5.6	5.6	5.1	-0.9
Expenditure	36.3	37.3	37.6	37.5	37.8	37.5	36.6	0.3
<i>of which:</i>								
- Primary expenditure	35.2	36.2	36.6	36.6	36.9	36.5	35.7	0.5
<i>of which:</i>								
Compensation of employees	10.2	10.4	10.6	10.5	10.5	10.3	10.0	-0.2
Intermediate consumption	5.9	6.1	6.3	6.2	6.7	6.6	6.5	0.6
Social payments	11.7	11.7	11.7	11.8	12.0	12.1	12.3	0.6
Subsidies	0.5	0.5	0.6	0.5	0.5	0.5	0.4	-0.1
Gross fixed capital formation	3.5	3.8	3.7	4.0	4.2	3.9	3.6	0.1
Other (residual)	3.4	3.7	3.8	3.6	3.0	3.2	2.8	-0.6
- Interest expenditure	1.1	1.1	1.0	1.0	0.9	1.0	0.9	-0.2
General government balance (GGB)	0.0	-0.8	-0.8	-1.8	-1.6	-1.2	-0.5	-0.5
Primary balance	1.1	0.3	0.2	-0.8	-0.7	-0.2	0.4	-0.7
One-off and other temporary	0.2	0.0	0.0	0.0	0.0	0.0	0.0	-0.2
GGB excl. one-offs	-0.1	-0.8	-0.8	-1.8	-1.6	-1.2	-0.5	-0.4
Output gap ¹	1.6	1.8	2.7	1.6	1.5	0.5	-0.5	-2.1
Cyclically-adjusted balance ¹	-0.6	-1.4	-1.8	-2.4	-2.2	-1.4	-0.3	0.3
Structural balance²	-0.8	-1.4	-1.8	-2.4	-2.2	-1.4	-0.3	0.5
Structural primary balance ²	0.4	-0.4	-0.8	-1.4	-1.3	-0.4	0.6	0.2
Notes:								
¹ 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.								
² Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
Source:								
Stability Programme (SP); Commission 2017 spring forecasts (COM); Commission calculations.								

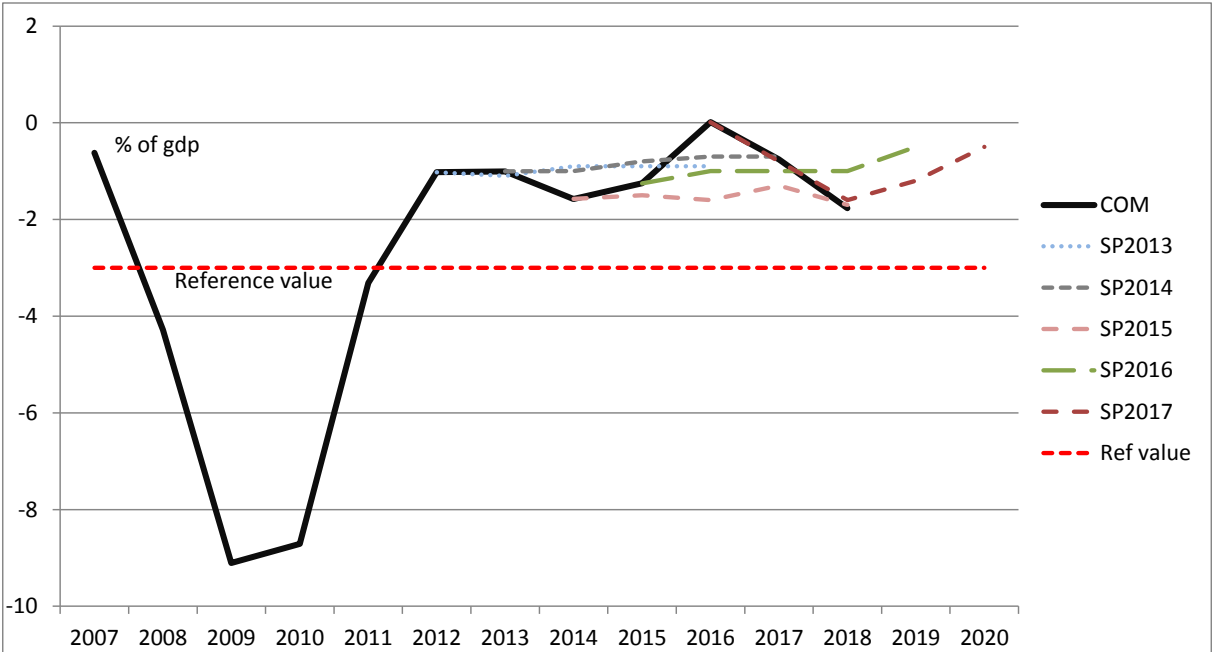
Revenues are estimated to decline by 0.8 percentage points of GDP between 2017 and 2020 at face value, following the implementation of the tax reform and the decrease in dividend payments from public corporations. In 2018, the stability programme assumes a drop in direct tax revenue by 1.8 percentage points to be largely compensated by higher indirect tax (+0.9 pp. of GDP) and social contribution revenue (+0.6 pp of GDP). This implies a reduction in the

⁵ By reflecting GDP growth projections that do not include the tax reform, the ratios to GDP based on the stability programme (SP) are overestimated.

tax burden by 0.3 percentage point to 30.4% of GDP. The Commission spring forecast projects lower gains in indirect tax and social contribution revenues and the tax burden is estimated to drop just below 30% of GDP in 2018.

The government expenditure share in GDP is projected to increase by 0.2 percentage points of GDP in 2018, but to decline by 0.3 pp. and 0.9 pp. of GDP in 2019 and 2020, respectively. In 2018, the expenditure increases are concentrated in capital spending, purchases of goods and services and social expenditure, while the share of other expenditure is projected to contract. The expenditure dynamics in 2018 are broadly similar to those of the Commission spring forecast. In 2019 and 2020, the stability programme projects a contraction in all major expenditure items, except for social expenditure. The main savings are expected in capital spending and in compensation of employees of ½ pp. of GDP in each. This corresponds to an annual reduction of capital expenditure of around 2% and growth in public sector wage bill of around 3%. Such expenditure restraint is not accompanied by efficiency increasing measures, which would allow to maintain unchanged the level of public services.

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



– Source: Commission 2017 spring forecast; stability and convergence programmes

3.3. MEASURES UNDERPINNING THE PROGRAMME

The stability programme lists measures adopted in the budget for 2017 and announces the draft tax reform measures for 2018-2020 (see below).

In 2017, the main revenue-increasing measures include the increase in the micro enterprise tax rate and improvements in tax collection, in particular stricter requirements for cash registers. A change in the tax payment date for vehicles has been postponed to 2020. The share of dividend payments from the public companies to the government has been regularly revised upwards in order to generate revenue. However, this share is set to decrease over the programme period from 90% in 2016 to 50% in 2020, decreasing government revenue by around 0.2% of GDP over the period. On the expenditure side, the stability programme confirms the increase in defence spending to the NATO target of 2% of GDP, as well as higher spending on internal security, healthcare and education as budgeted for 2017. A large

share of these measures account for increased spending on the compensation of employees and purchases of goods and services. Part of the expenditure-increasing measures is financed by the savings identified in the 2016 expenditure review, which is set to be part of the annual budgetary process.

Latvia avails of the structural reform clause for the healthcare reform from 2017. In 2017, a package of three measures totalling 0.1% of GDP has been presented: (i) early diagnosis and treatment of oncological patients, (ii) improved access to specialists, examinations, day care, rehabilitation and (iii) improved access to medicine for hepatitis C virus patients. The stability programme provides estimates of the long-term positive effect of the implementation of the measures. These measures are assessed to reduce the number of preventable deaths⁶, improving the health status of population and limiting incidences of contagious diseases. The improvement in the number of working age population is estimated to have a positive effect on GDP and public finances in the long run, which appears plausible.

The main measures for 2018-2020 are related to the introduction of the tax reform. The most costly measures are the reduction of the standard personal income tax rate from 20% to 23% (0.9% of GDP) and change in corporate tax regime with a 0% tax rate on reinvested profits (0.7 of GDP). Moreover, non-taxable allowance and the applicable income brackets of the personal income tax and the allowance for pensioners are increased, both benefiting more the low and middle income households. The solidarity tax on high incomes is cancelled and partly replaced by a higher ceiling on social security contributions. A personal income tax rate at 23% is retained for high incomes (well within the 10th income decile). The tax cutting measures are partly compensated by changes in VAT administration improving compliance and increases in excise duties on a range of products beyond already announced increases. However, the stability programme also relies on unspecified tax compliance measures (0.2% of GDP).

The tax reform measures reduce the relatively high tax wedge on low income earners to around the EU average level. This is mostly achieved by an increase in the maximum non-applicable minimum and to a lesser extent by the reduction of the standard personal income tax rate. The personal income tax measures benefit more medium and high income households (see Figure 2). A large share of nominal income gains is handed to the richest households, while the poorest 30% account for 10% of the reform costs (see Figure 3). Moreover, the introduction of the 0% tax rate on reinvested profits benefits the business owners at the expense of lower public revenue. Given very unequal wealth distribution and a higher reliance of lower income groups on public services, this measure is expected to be highly regressive. Finally, the tax reform is partly financed from higher public borrowing with high uncertainty over fiscal adjustment and its impact across income groups.

⁶ The Latvian authorities measure an improvement in the indicator of 'years of potential life lost', for assessment of the effectiveness of the health reforms.

Figure 2: Distributional effect of the personal income tax measures for each income group

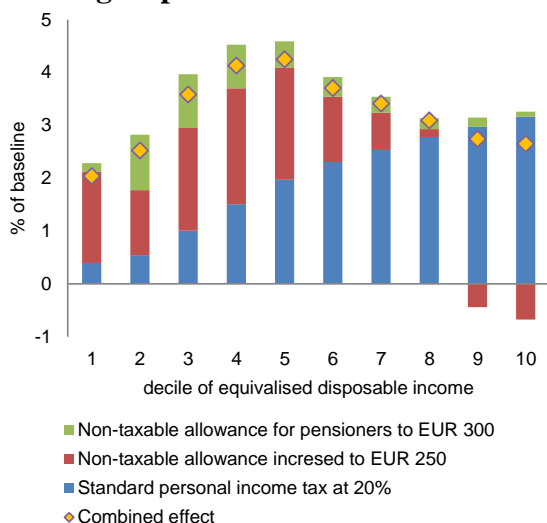
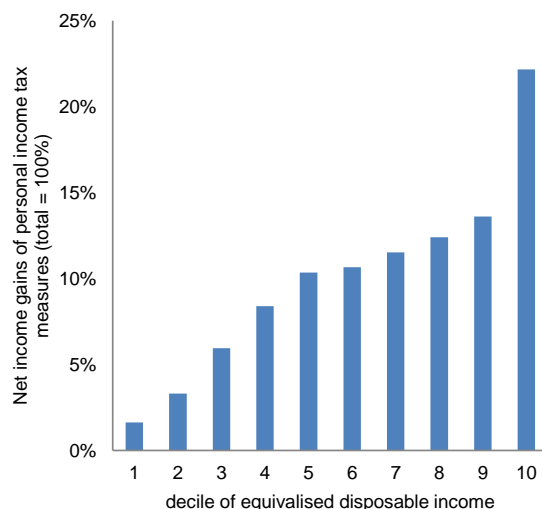


Figure 3: Nominal gains of the personal income tax measures across income groups



Source: European Commission (Euromod)

The impact of the discretionary measures as presented in the stability programme appears plausible and has been taken on board in the Commission spring forecast, except for the unspecified tax compliance measures. Moreover, the second round effect of the increase in the national minimum wage on tax revenue is not considered as a discretionary tax measure, but is part of the Commission forecast.

Main budgetary measures (in % of GDP)

Revenue	Expenditure
2017	
<ul style="list-style-type: none"> • Micro enterprise tax increased (+0.2% of GDP) • Stricter requirements for cash registers (+0.1% of GDP) 	<ul style="list-style-type: none"> • Increased defence capacity (+0.2% of GDP) • Increased spending on internal security (+0.2% of GDP) • Increased health spending (+0.2% of GDP, including +0.1% of GDP under the structural reform clause) • Increased salaries for teachers (+0.1% of GDP) • Expenditure review savings (-0.2% of GDP)
2018	
<ul style="list-style-type: none"> • Standard rate of personal income tax reduced from 23% to 20% (-0.9% of GDP) • Personal income tax non-taxable minimum increased (-0.2% of GDP) • Non-taxable minimum for pensioners 	<ul style="list-style-type: none"> • Increased defence capacity (+0.2% of GDP) • Increase in public sector wages in line with minimum wage increase (+0.1% of GDP)

<p>increased (-0.1% of GDP)</p> <ul style="list-style-type: none"> • Cancellation of the solidarity tax (-0.2% of GDP) • Ceilings on social security contributions increased (+0.1% of GDP) • Corporate income tax on reinvested profit set at 0% and standard rate increased to 20%, tax on accounted dividends to be cancelled after a transition period (-0.7% of GDP) • Capital taxes increased to standard rate of 20% (+0.1% of GDP) • Lowering VAT registration threshold, applying standard rate for hospitality services, extending used of reverse charging (+0.3% of GDP) • Increases in excise duties (+0.2% of GDP) • Unspecified tax compliance measures (+0.2% of GDP) 	<ul style="list-style-type: none"> • Increase in social spending in line with minimum wage increase (+0.1% of GDP)
2019	
<ul style="list-style-type: none"> • Personal income tax non-taxable minimum increased (-0.1% of GDP) 	
2020	
<ul style="list-style-type: none"> • Increases in excise duties (+0.1% of GDP) • Shift in tax payment date for commercial vehicles (-0.1% of GDP) 	
<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 increased from 36.5% of GDP in 2015 to 40.1% of GDP at the end of 2016. This increase represents mostly a large build-up of financial reserves, including for settling the maturing government bonds. In 2017, the level of financial buffers is assumed to be broadly maintained, while the reduction in the growth debt ratio to GDP by around 1 percentage point is estimated to be driven by the nominal GDP growth excess over the government's net borrowing. In 2018, the increase in government borrowing is estimated to be still lower than the nominal GDP growth effect on debt ratio and some reduction of cash buffers is estimated to reduce the ratio by 1 percentage point. In 2019 and 2020, an increase and stabilisation of the debt ratio assume further build-up of financial resources. The Commission forecast of the debt ratio to decline to 36% of GDP by 2018, assuming a reduction in part of the cash resources.

Table 3: Debt developments

(% of GDP)	Average 2011-2015	2016	2017		2018		2019	2020
			COM	SP	COM	SP	SP	SP
Gross debt ratio¹	40.1	40.1	38.5	39.2	36.0	38.2	39.4	40.4
Change in the ratio	-2.2	3.6	-1.6	-0.9	-2.5	-1.0	1.2	1.0
<i>Contributions²:</i>								
1. Primary balance	0.1	-1.1	-0.3	-0.2	0.8	0.7	0.2	-0.4
2. “Snow-ball” effect	-1.0	0.2	-1.3	-1.0	-1.3	-1.3	-1.5	-1.6
<i>Of which:</i>								
Interest expenditure	1.5	1.1	1.1	1.0	1.0	0.9	1.0	0.9
Growth effect	-1.4	-0.7	-1.2	-1.2	-1.3	-1.6	-1.6	-1.6
Inflation effect	-1.1	-0.3	-1.2	-0.7	-1.0	-0.6	-0.9	-1.0
3. Stock-flow adjustment	-1.2	4.6	0.0	0.3	-2.0	-0.3	2.5	3.1
<i>Of which:</i>								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

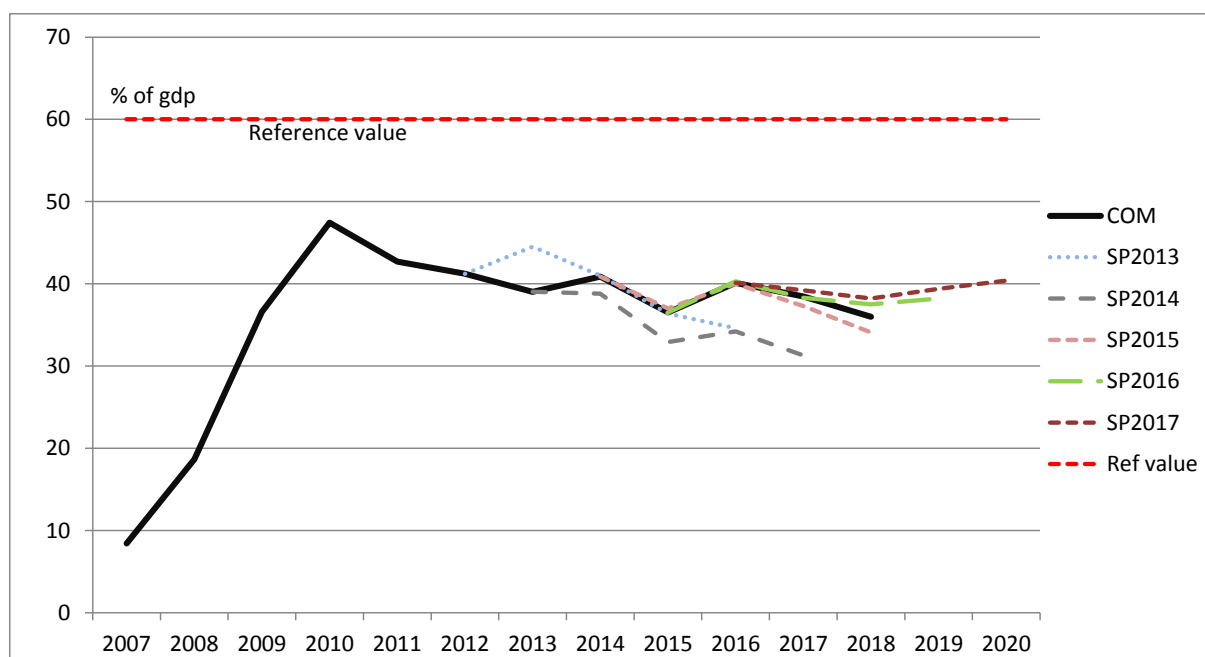
¹ End of period.

² 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 2017 spring forecast (COM); Stability Programme (SP), Commission calculations.

Figure 4: Government debt projections in successive programmes (% of GDP)



Source: Commission 2015 spring forecast; stability and convergence programmes

3.5. RISK ASSESSMENT

The Commission 2017 spring forecast accounts for the tax reform measures announced in the stability programme (excluding the unspecified tax compliance measures) and projects the government deficit to increase from 0.8% of GDP in 2017 to 1.8% of GDP in 2018. This is broadly similar to the planned deficit increase from 0.8 % of GDP in 2017 to 1.6% of GDP in 2018 in the stability programme. The Commission forecast assumes a lower second round effect on GDP and public finances of the tax reform measures. This is also supported by the Quest model simulations, which suggests a small positive effect on GDP and a permanent negative effect on public finances of the tax reform (see Section 1). Nevertheless, the Commission spring forecast is more positive on private consumption and wage growth, which are important tax bases. Overall, the fiscal projections of the stability programme seem to be overly optimistic regarding the second round effects of the tax reform, while at the same time being cautious on the underlying developments on the tax-rich growth components.

Other risks to the fiscal targets are related to implementation of the budgetary plans. Unexpected delays with the investment projects may produce short-term savings, while an increased demand for construction from EU-funded projects may push up construction costs in case of supply constraints.

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

As from 2013, Latvia is benefiting from the pension reform clause, which allows for a deviation from the structural adjustment path towards the MTO (set at -1% of GDP) of 0.6% of GDP in 2016 and 2017 and 0.3% of GDP in 2018. Latvia is also eligible for an additional deviation of 0.1% of GDP in 2017 and 0.4% of GDP in 2018 under the structural reform clause in view of a healthcare reform, which is limited by the constraint posed by the minimum benchmark⁷.

In 2016, the structural deficit is estimated to have improved by 0.9% of GDP and to have reached 0.8% of GDP, above the MTO. Government expenditure, net of discretionary revenue measures and one-offs, is estimated to have increased by 4.0% and to have exceeded the expenditure benchmark by 0.2% of GDP. This calls for an overall assessment. The 10 year reference rate of potential growth used for the computation of the expenditure benchmark (1.5% of GDP) reflects the notable economic adjustment with negative potential growth rates in 2010-2011 and is therefore considered to underestimate the relevant medium-term potential growth rate at the current juncture. Therefore, the structural balance pillar is more appropriate for the assessment of 2016. Overall, Latvia is assessed to have been compliant with the preventive arm requirements in 2016, based on the structural balance pillar.

In 2017, according to the information provided in the programme, the recalculated structural balance and the net expenditure growth are estimated to be in line with the requirements.

Based on the Commission spring forecast, the structural balance is projected to deteriorate by 0.7% of GDP, compared with an allowed deterioration of 1.0% of GDP. In turn, the growth of government expenditure, net of discretionary revenue measures and one-offs, is expected to

⁷ 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 can be used in full in 2019.

exceed the expenditure benchmark by 0.1% of GDP in 2016 and 0.2% over 2016-2017 on average. This calls for an overall assessment. The nominal expenditure benchmark of 4.0% for 2016 is lower than the potential growth rate of 3% together with the projected GDP deflator of 3.1%. The 10 year reference rate of potential growth used for the computation of the expenditure benchmark is set to increase from 1.5% in 2016 to 2.0% in 2017, but still being affected by the negative potential GDP growth in 2011 and appears to be too restrictive for the current economic situation. Inflation dynamics are projected to be stronger than the 2016 forecast used for setting the requirements. This is related to the pick-up in the global energy prices and this effect is underestimated by the expenditure benchmark. This suggests the structural balance pillar is a more appropriate indicator for the assessment. The overall assessment points to compliance with the preventive arm requirements in 2017, based on the structural balance pillar.

In 2018, the recalculated structural balance based on the information provided in the programme is estimated to deteriorate by 0.4% of GDP, exceeding the requirement by 0.1% of GDP. The expenditure benchmark is estimated to be met. The excess on the structural balance pillar requires an overall assessment. The items to be excluded from the expenditure benchmark, as presented in the stability programme, are notably different from the estimates used by the Commission. In particular, the stability programme assumes only a small negative effect of the discretionary revenue measures, while the implementation of the tax reform is assumed to have large fiscal costs under the Commission forecast. Moreover, the stability programme projects a strong pick-up in nationally financed capital expenditure by 2018 and rather stable expenditure financed by the EU funds. The inverse development is expected by the Commission. The expenditure effort based on the information provided in the stability programme seems to be overstated in view of the assumptions used by the Commission. Therefore, the structural balance appears to be a more appropriate indicator for the assessment of the fiscal stance. Overall, the recalculated structural balance points at a risk of some deviation in 2018.

Based on the 2017 spring forecast, the structural balance is projected to deteriorate by 0.9% of GDP, exceeding the corrected requirement of a deterioration of 0.3% of GDP by 0.7% of GDP. The growth of government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the expenditure benchmark by 1.3% of GDP. This points to a risk of significant deviation and necessitates an overall assessment. The worsening of the structural balance and the excessive net expenditure growth reflects the costs of the tax reform. This is assessed to be a structural deterioration. The distance between the two indicators is largely explained by an acceleration of potential growth to 3.7%, while the 10 year reference rate of potential growth used for the computation of the expenditure benchmark increases to 2.5% in 2018. However, while Latvia is flagged by the plausibility tool with respect to the output gap estimate for 2016, the extrapolation of those results to 2018 involve a high degree of uncertainty. The uncertainty over the output gap estimates and the need to be prudent in case of fiscal relaxation warrants no departure from the common methodology in the ex-ante assessment of the Latvia's fiscal position in 2018 (see Box 2). Overall, Latvia is assessed at a risk of significant deviation in 2018.

Box 1. Council recommendations addressed to Latvia

On 18 May 2016, 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 Latvia to ensure that the deviation from the adjustment path towards the medium-term budgetary objective in 2016 and 2017 is limited to the allowance linked to the systemic pension reform and the major structural reform in the healthcare sector; reduce the tax wedge

for low-income earners by exploiting a growth-friendly tax shift towards environmental and property taxes and improving tax compliance.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2016	2017		2018	
Initial position¹					
Medium-term objective (MTO)	-1.0	-1.0		-1.0	
Structural balance ² (COM)	-0.8	-1.4		-2.4	
Structural balance based on freezing (COM)	-0.7	-1.4		-	
Position vis-a-vis the MTO³	Not at MTO	At or above the MTO		Not at MTO	
(% of GDP)	2016	2017		2018	
	COM	SP	COM	SP	COM
Structural balance pillar					
Required adjustment ⁴	0.6	0.0		0.4	
Required adjustment corrected ⁵	0.0	-1.0		-0.3	
Change in structural balance ⁶	0.9	-1.1	-0.7	-0.4	-0.9
One-year deviation from the required adjustment ⁷	0.9	0.0	0.3	-0.1	-0.7
Two-year average deviation from the required adjustment ⁷	0.5	0.4	0.6	-0.1	-0.2
Expenditure benchmark pillar					
Applicable reference rate ⁸	1.3	4.8		6.0	
One-year deviation adjusted for one-offs ⁹	-0.2	0.2	-0.1	0.2	-1.3
Two-year deviation adjusted for one-offs ⁹	-0.1	0.0	-0.2	0.2	-0.7
PER MEMORIAM: One-year deviation ¹⁰	0.0	0.2	-0.3	0.2	-1.3
PER MEMORIAM: Two-year average deviation ¹⁰	0.2	0.0	-0.2	0.2	-0.8
Conclusion					
Conclusion over one year	Compliance	Compliance	Overall assessment	Overall assessment	Significant deviation
Conclusion over two years	Compliance	Compliance	Overall assessment	Overall assessment	Overall assessment
Notes					
¹ 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 points (p.p.) is allowed in order to be evaluated as having reached the MTO.					
² Structural balance = cyclically-adjusted government balance excluding one-off measures.					
³ Based on the relevant structural balance at year t-1.					
⁴ 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, page 38.).					
⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.					
⁶ Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.					
⁷ The difference of the change in the structural balance and the corrected required adjustment.					
⁸ 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.					
⁹ 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.					
¹⁰ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law 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.					
<i>Source:</i>					
<i>Stability Programme (SP); Commission 2017 spring forecast (COM); Commission calculations.</i>					

Box 2: Implementation of the "constrained judgement" approach and its impact in the context of the fiscal surveillance

The April 2016 Amsterdam Informal ECOFIN Council requested that improvements be made to the commonly agreed methodology for the estimation of potential growth and the output gap. In response to this mandate from the Council, two concrete decisions were taken in agreement with the Member States in October 2016.

First, it was agreed that a revised methodology for the estimation of the non-accelerating wage rate of unemployment (NAWRU) would be introduced in the commonly agreed methodology. Second, it was agreed to introduce a "constrained judgement" approach for cases where the commonly agreed methodology appears to produce "counterintuitive" output gap results for individual Member States. Both changes have already been implemented in the assessment of 2017 Draft Budgetary Plans.

The objective of the "constrained judgement" approach is to have a transparent and economically grounded tool to statistically test the plausibility of the output gap estimates for individual Member States estimated on the basis of the common method. To this end, the Commission developed an objective screening tool - based on a set of cyclically relevant indicators as well as thresholds/ranges - to signal cases when the outcomes of the commonly agreed methodology could be interpreted as being subject to a large degree of uncertainty and therefore deserving of further investigation on the part of the Commission. If this plausibility tool identifies possibly "counterintuitive" results from the common methodology, the Commission carries out an "in depth" analysis which could lead to the application of a "constrained" degree of judgement in conducting Member States' budgetary assessments.

The plausibility tool indicates that the output gap estimate for 2016 of +1.6% of GDP on the basis of the common methodology may be subject to a large degree of uncertainty in the case of Latvia. This estimate is outside the confidence interval of the plausibility tool at the 68% confidence level⁸ and well above the central estimate of the plausibility tool of the output gap of 0.2% of GDP (see Figure 5). At the stricter 90% confidence level, a second criterion adopted by the plausibility tool, the commonly agreed methodology does not overestimate the output gap and the two estimations (however different) can be considered broadly in line with one another given the available information. Over time, the cyclical indicators included in the plausibility tool provide a good fit with the output gap estimates, with few outliers (2009, 2015 and 2016) (see Figure 6). However, since 2012 the plausibility tool has suggested small negative output gaps with the cyclical variables included in the tool being close to their respective averages. This is consistent with the subdued growth experienced in Latvia since the crisis, in the context of tensions on labour supply and deleveraging of the private sector. A further specific issue impacts upon 2016, when a temporary trough in investment in line with delays in EU funds altered the potential growth based on the production function methodology, while actual growth benefited from mitigating factors. This increases the corresponding output gap in 2016, even though the shock to investment is by nature more cyclical than structural. Therefore, there is economic evidence to suggest that the output gap is less than the +1.6% of GDP in 2016 given by the commonly agreed methodology.

⁸ There is broadly a 2/3 probability that the outcome of the commonly agreed methodology is an overestimation of the output gap if it is larger than 1.1%, and a 1/3 probability to wrongfully say that it is an overestimation in this case.

However, application of the plausibility tool results for the assessment of fiscal compliance in 2016 and 2017 would not lead to any change to the conclusions, as Latvia is assessed to be in compliance with the requirements in both years.

The plausibility tool does not provide results for future years. Mechanical extrapolation of the plausibility tool results for 2016 for the coming years increases the uncertainty of the process as it depends on non-predicted cyclical variables. In addition, the plausibility tool's results in 2016 are particularly impacted by the drop in investment in this year. The normalisation of investment growth in 2017 and 2018 suggests a pick-up in potential growth and narrowing of the positive output gap in the commonly agreed methodology. Hence, the output gap estimates in the coming years may fall within the confidence interval of the plausibility tool. Therefore, given the large uncertainties involved in the extrapolation from 2016, including the expected normalisation of investment growth, a departure from the common methodology which allows for a fiscal relaxation in 2018 would not be prudent.

Figure 5: Confidence intervals around the output gap estimates

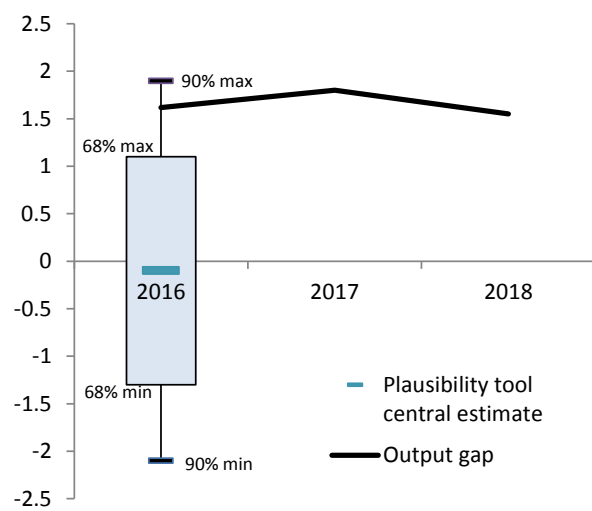
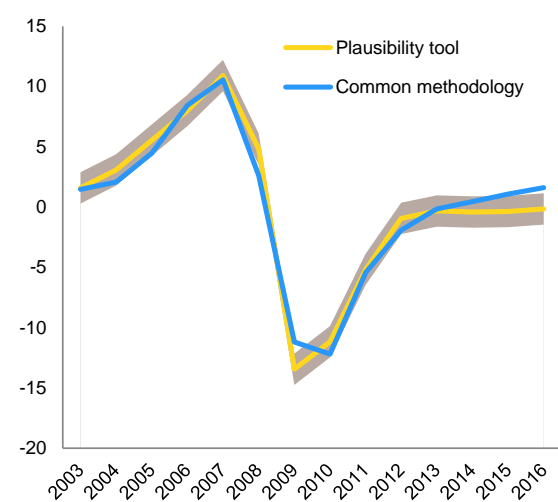


Figure 6: Output gap estimates and plausibility range.



Source: European Commission

5. LONG-TERM SUSTAINABILITY

Latvia's public finances are assessed to face low sustainability risks under the baseline scenarios (see Table 5). However, the fiscal sustainability is subject to risk related to low adequacy of pensions and demand for better healthcare services as discussed in the country report for Latvia published on 22 February⁹.

Based on Commission forecasts and a no-fiscal policy change scenario beyond forecasts, the medium-term sustainability gap indicator (S1) at -1.5 pps of GDP reflects primarily the distance between the current government debt level and the benchmark ratio of 60% of GDP, as well as the projected decline in ageing costs until 2030. The full implementation of the stability programme would put the sustainability risk indicator S1 at -3.5 pps. of GDP, leading to even lower medium-term risk.

⁹ https://ec.europa.eu/info/publications/2017-european-semester-country-reports_en

Table 5: Sustainability indicators

<i>Time horizon</i>	No-policy Change Scenario		Stability / Convergence Programme Scenario	
Short Term	LOW risk			
S0 indicator ^[1]	0.2			
Fiscal subindex	0.0	LOW risk		
Financial & competitiveness subindex	0.3	LOW risk		
Medium Term	LOW risk			
DSA ^[2]	LOW risk			
S1 indicator ^[3]	-1.5	LOW risk	-3.5	LOW risk
<i>of which</i>				
Initial Budgetary Position	0.7		-1.7	
Debt Requirement	-1.9		-1.8	
Cost of Ageing	-0.3		0.0	
<i>of which</i>				
Pensions	-0.8		-0.3	
Health-care	0.2		0.1	
Long-term care	0.0		0.0	
Other	0.2		0.2	
Long Term	LOW risk		LOW risk	
S2 indicator ^[4]	1.4		-0.2	
<i>of which</i>				
Initial Budgetary Position	1.8		-0.1	
Cost of Ageing	-0.4		-0.1	
<i>of which</i>				
Pensions	-1.5		-1.0	
Health-care	0.4		0.4	
Long-term care	0.1		0.1	
Other	0.5		0.5	
Source: Commission services; 2017 stability/convergence programme.				
Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2017 forecast covering until 2018 included. 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 2015 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 2031. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2019 for No-policy Change 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 2015 and Debt Sustainability Monitor 2016.				

The long-term sustainability indicator (S2), which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is at 1.4pps of GDP. In the long-term therefore Latvian public finances appear to face low fiscal sustainability risks, with projected ageing costs contributing with -0.4 pps of GDP. Full implementation of the stability programme would nonetheless put the S2 indicator at -0.2 pps. of GDP, leading to a lower long-term risk.

Based on Commission forecasts and a no-fiscal policy change scenario beyond forecasts, government debt, at 40.1% of GDP in 2016, is expected to decrease to 37.4% in 2027, thus remaining below the 60% of GDP Treaty threshold. The full implementation of the stability programme would also put debt on a decreasing path, reaching 30.1% of GDP by 2027.

6. FISCAL FRAMEWORK

The national fiscal rules are set in the Fiscal Discipline Law (FDL) adopted in 2013. The law establishes the structural balance rule, which requires that the annual structural budget balance target should not be lower than -0.5% of GDP, and which is supplemented by the expenditure rule. In the multi-annual budgetary planning the most stringent expenditure ceilings established on the basis of the applicable rules are applied. The ex-post deviations are corrected through the debt brake rule. In addition, the debt rule requires that the general government debt does not exceed 60% of GDP.

The Fiscal Discipline Council (FDC), which is an independent monitoring body established on the basis of the FDL, monitors the application of the national fiscal rules. The FDC published its interim report on Latvia's stability programme on 13 April¹⁰. The FDC considers the pension reform a valid reason for departure from the structural balance target, but the financing of the healthcare reform by government borrowing does not confirm with FDL principles. The FDC disagrees on classifying the tax reform as a one-off measure. As a result, the FDC suggest that the structural balance target for 2018 is set at -0.8% of GDP. The stability programme's structural deficit target of 1.7% of GDP for 2018 exceeds the target suggested by the FDC by 0.9% of GDP.

The FDC expressed its opinion on the tax reform and the healthcare reform. It considers the tax reform to be a welcome attempt to motivate people to join the formal labour force, but the reform should be informed by a detailed cost-benefit analysis and quantitative assessment of the impact on public finances. According to the FDC, the reform proposal falls short on the government's target to reach a tax-to-GDP ratio of 1/3 and on the reduction of income inequality. Furthermore, a lower level of government revenues is expected to restrict the ability of the government to provide public services and alleviate poverty. For the healthcare sector, the reform plans should be based on clear performance indicators and envisage a more efficient use of the available resources.

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. The macroeconomic forecast underlying the stability programme was endorsed by the FDC on 16 February¹¹. The endorsed macroeconomic scenario does not account for the implementation of the tax reform, which makes it different from the main scenario of the stability programme.

¹⁰ <http://fiscalcouncil.lv/13042017-interim-report-opinion>

¹¹ <http://fiscalcouncil.lv/16022017-macroeconomic-forecast-endorsement>

7. SUMMARY

In 2016, Latvia reached a balanced budgetary position, over-achieving the MTO. The increase in government expenditure, net of discretionary revenue and one-off measures, exceeded the applicable expenditure benchmark rate by 0.2% of GDP. Following an overall assessment the requirements of the preventive arm are assessed to be met.

In 2017, the headline government balance is planned to deteriorate to a deficit of 0.8% of GDP. The structural balance requirement is met, but the expenditure benchmark is surpassed by 0.1% of GDP. Based on an overall assessment, Latvia is projected to meet the requirements of the preventive arm.

In 2018, Latvia plans the government deficit to increase to 1.6% of GDP. This implies a deviation of 0.7% of GDP from the required adjustment path towards the MTO in 2018. The significant deviation from the expenditure benchmark is also recorded in 2018. Based on the Commission 2017 spring forecast, and following an overall assessment, there is a risk of significant deviation in 2018.

8. ANNEXES

Table I. Macroeconomic indicators

	1999-2003	2004-2008	2009-2013	2014	2015	2016	2017	2018
Core indicators								
GDP growth rate	6.0	7.5	-1.0	2.1	2.7	2.0	3.2	3.5
Output gap ¹	-0.5	5.6	-6.2	0.5	1.1	1.6	1.8	1.6
HICP (annual % change)	2.4	9.0	1.7	0.7	0.2	0.1	2.2	2.0
Domestic demand (annual % change) ²	6.0	8.6	-2.3	0.1	2.4	3.0	4.7	4.9
Unemployment rate (% of labour force) ³	13.2	8.5	16.0	10.8	9.9	9.6	9.2	8.7
Gross fixed capital formation (% of GDP)	25.0	32.6	22.5	22.6	21.5	18.3	20.3	21.0
Gross national saving (% of GDP)	18.9	20.7	23.6	21.2	21.3	21.8	20.2	19.2
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-2.4	-1.4	-4.6	-1.6	-1.3	0.0	-0.8	-1.8
Gross debt	13.0	12.6	41.4	40.9	36.5	40.1	38.5	36.0
Net financial assets	n.a	3.8	-12.2	-14.4	-17.4	n.a	n.a	n.a
Total revenue	33.9	33.9	35.8	35.9	35.8	36.4	36.5	35.8
Total expenditure	36.3	35.3	40.4	37.5	37.0	36.3	37.3	37.5
<i>of which: Interest</i>	0.8	0.5	1.6	1.4	1.3	1.1	1.1	1.0
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-2.6	-9.3	9.1	8.1	7.0	5.2	3.9	3.5
Net financial assets; non-financial corporations	n.a	-99.2	-127.4	-120.7	-118.5	n.a	n.a	n.a
Net financial assets; financial corporations	n.a	-1.7	6.4	-1.0	0.0	n.a	n.a	n.a
Gross capital formation	22.2	25.7	15.5	15.3	15.0	14.5	15.0	15.4
Gross operating surplus	32.6	29.8	31.3	31.0	29.7	28.2	27.6	26.7
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	-2.4	-4.2	-1.9	-5.3	-3.7	-1.7	-2.2	-2.4
Net financial assets	n.a	28.4	41.8	71.9	78.5	n.a	n.a	n.a
Gross wages and salaries	33.6	37.6	37.2	38.4	39.6	40.7	40.5	40.8
Net property income	11.0	7.1	4.6	3.9	3.7	3.7	3.8	3.9
Current transfers received	17.4	17.1	19.1	16.6	16.5	17.6	17.8	17.8
Gross saving	0.0	2.0	1.0	-2.1	-1.3	0.4	0.1	0.1
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-7.5	-14.8	2.7	1.2	2.0	3.7	0.9	-0.7
Net financial assets	n.a	68.7	91.5	63.9	57.4	n.a	n.a	n.a
Net exports of goods and services	-10.2	-16.5	-3.1	-1.9	-1.1	0.5	-1.6	-3.4
Net primary income from the rest of the world	-0.2	-2.0	1.5	-0.1	-0.2	0.3	-0.3	-0.3
Net capital transactions	0.4	1.3	2.4	3.2	2.8	1.8	1.8	1.9
Tradable sector	51.8	45.9	47.0	44.6	44.0	43.7	n.a	n.a
Non tradable sector	37.9	43.3	42.4	44.0	44.5	44.2	n.a	n.a
<i>of which: Building and construction sector</i>	5.8	7.5	5.6	5.9	5.7	4.5	n.a	n.a
Real effective exchange rate (index, 2000=100)	77.1	96.2	102.5	108.6	111.7	116.1	117.8	119.8
Terms of trade goods and services (index, 2000=100)	96.6	98.8	100.8	99.5	100.2	104.9	103.9	103.1
Market performance of exports (index, 2000=100)	76.3	90.0	102.7	104.4	102.9	101.9	100.7	100.2
Notes:								
¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
² The indicator on domestic demand includes stocks.								
³ 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 2017 spring forecast								