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August 25, 2021

Statement by Mr. Dresse and Mr. Tevdovski on Republic of Latvia
(Preliminary)
Executive Board Meeting
August 27, 2021

We thank staff for the insightful report, and Mr. Pösö and Ms. Skrivere for their informative Buff statement. We commend the authorities for their past prudent policies and effective police response that helped to mitigate the economic and social impact of pandemic. We agree with staff that the main challenges in the medium term are to address the long-standing structural issues and the transformation towards a greener, digital, and more inclusive economy.

We broadly share staff's appraisal. We associate ourselves with Mr. Palotai's statement and offer the following comments for emphasis:

Although we agree with staff's short-term outlook, the pandemic remains the main source of uncertainty. A strong recovery is expected, driven by pent-up consumption demand, continued strong foreign demand for manufactured goods, and capital spending supported by EU funds. However, virus mutations and the slow pace of vaccination remain key downward risks. We note the authorities' commitment to ramp up mass vaccination to 60 - 70 percent of the population by fall, despite the high observed vaccine hesitancy till June. *Could staff comment on the possible effects on the outlook if the downside risks materialized due to a new COVID-19 wave or a slower pace of vaccination?*

While fiscal policy should remain supportive until a sustained recovery takes hold, it is important to rebuild fiscal buffers over the medium-term. The budget for 2021 appropriately maintains temporary support to fight the COVID-19 crisis. We support the authorities to ring-fence COVID-19-related spending to avoid using it to respond to spending pressures from the political cycle. This, together with maintaining high governance standards, is key in managing emergency spending. In the medium term, gradual restoration of fiscal space once the recovery is well-established should continue to be supported by fiscal rules.

Risk-based supervision should continue, amid the resilience of the financial sector. Further improvement of the insolvency framework, together with recapitalization of viable corporations with restructuring needs, is important for exiting from the support measures.

Regarding the AML/CFT framework, while we welcome the authorities significant progress since the last Article IV report, we emphasize the need to further strengthen AML/CFT, including by implementation risk-mitigation measures that are elaborated in National ML/FT Risk Assessment.

The structural transformation is key for achieving a sustainable economy. We support staff's recommendations for scaring mitigation in the labor market due to the uneven impact of the pandemic across population groups. However, we emphasize the need for a more in deep analysis of the unfavorable demographic trends and its impact on the long-term growth and social systems. *Staff comments are welcomed.* Investment in digital transformation and green economy are steps in right direction to support long-term productivity growth. They should be based on a robust project selection and management and, where appropriate, in coordination with the private sector. We positively note the authorities' commitment to deliver ambitious goals under the Paris Agreement. We would welcome more broad discussions of climate policies in future work of staff.

With these remarks, we wish the authorities success in their future endeavors.