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Causality between Price and Wage Inflation in the Latvian Economy

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Abstract

This paper investigates the relationship between price inflation and wage inflation in the Latvian economy. Several specifications of Granger causality tests are applied in two approaches. The first approach investigates relationship between price inflation and productivity-adjusted wage inflation. The second approach investigates relationship between inflation of components of price index and productivity-adjusted wage inflation. The main findings are as follows. Firstly, changes in productivity-adjusted wages lead to changes in the price index. Secondly, labour cost-intensive good prices, in contrast to labour cost-intensive service prices, do not respond to changes in productivity-adjusted wages. In conclusion, implications for policy are drawn based on these findings and suggestions for further research are offered.