

MONETARY BULLETIN 2010

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A number of factors pointed to an ongoing recovery of the Latvian economy. The resilient financial market situation, a positive assessment of Latvia's achievements in coping with the economic crisis by the European Commission and the IMF, and the recent announcement of the rating agency Standard & Poor's on upgrading its outlook on Latvia from negative to stable all were supportive of benign environment for the restoration of confidence. In the initial months of 2010, both business and household confidence indicators improved, contractions in retail trade turnover eased, export expansion underpinned the growth in a number of manufacturing branches, and the cold winter determined an upturn in the energy sector. Meanwhile, the unemployment rate continued to rise, albeit less dynamically than in the previous months, amounting to 17.1% at the end of February.

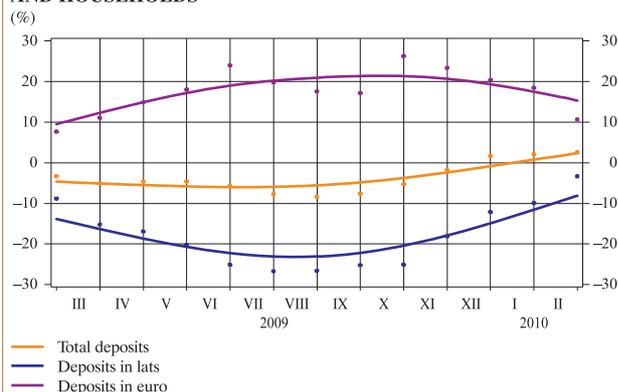
In January, the retail trade turnover increased by 4.0% month-on-month (seasonally adjusted data), whereas its year-on-year decrease stood at 16.0% (working day adjusted data). In January against December, the seasonally adjusted volume of industrial output in manufacturing decreased by 3.9%, while on an annual basis and according to the working day adjusted data output decreased by a mere 0.1%. Freight transport performance deteriorated in February. With transit via Latvian ports contracting, rail freight posted a 5.6% decline. Total freight turnover at Latvian ports shrank by 7.3%.

In February, consumer prices remained broadly unchanged month-on-month. The weak demand and competition continued to exert a downward pressure on the prices of clothing, footwear, and various non-administered services. This drop in prices was, however, offset by higher excise tax on alcoholic beverages; fuel prices were on a continuous upward trend and seasonal factors pushed vegetable prices up as well. Year-on-year, the drop in consumer prices was 4.2%, and annual core inflation stood at -5.6%. The factors on both the demand and supply sides were the drivers behind the recorded price drops, whereas deflation was constrained by an 18.4% year-on-year fuel price hike. Despite annual deflation persisting for the fifth consecutive month, the 12-month average inflation was still positive, at 1.3%, while the 12-month average growth in harmonised index of consumer prices used in assessing inflation convergence under Maastricht criteria went down to 1.1%.

In February, the general government consolidated budget posted a deficit in the amount of 87.8 million lats; the deficit accrued since the beginning of the year stood at 17.2 million lats. A surplus was recorded only in the local government budget, with deficits building up in the central government basic budget and central government social security budget. Although tax revenues did not fall as sharply as in the previous month (by 14.2%), the inflows of foreign financial aid contracted notably, with the drop in total revenues reaching 19.1%. The shrinkage in corporate income tax and excise tax collections was substantial, whereas revenues from personal income tax, value added tax, and social security contributions contracted only slightly. Budget expenditure decreased by 9.6% in February mainly on account of reduced compensation and capital expenditure, whereas interest expenditure grew. The general government debt increased by 109.4 million lats (primarily due to financing received from international lenders) and in February amounted to 4 467.4 million lats.

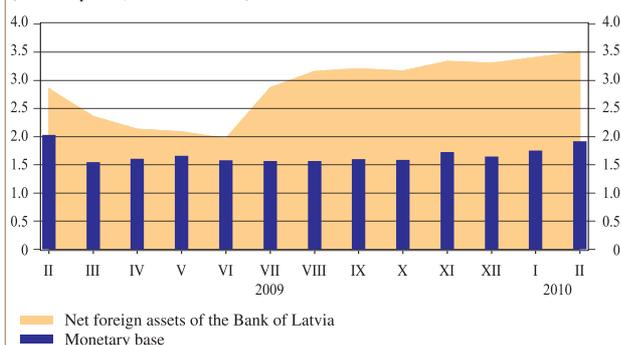
Following a minor decrease due to seasonal factors in January, currency in circulation returned to growth in February, with

ANNUAL CHANGES IN DEPOSITS OF RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS



BACKING OF THE NATIONAL CURRENCY

(at end of period; in billions of lats)



the majority of monetary aggregates rising above the seasonally high December level. Monetary aggregate M3 picked up 2.4% but the negative rate of annual change in M3 decelerated from -2.3% in January to -0.7% in February. Improving consumer and business confidence combined with a more favourable economic environment triggered a rise in both the deposits of resident financial institutions, non-financial corporations and households (2.0%) and currency outside MFIs (2.1%). The growth in deposits, both overall and in the sector of non-financial corporations and households, was on account of increasing deposits in lats (by 5.5%); meanwhile, deposits in euro contracted somewhat (by 1.0%). The annual growth in resident deposits continued to accelerate, to 2.6% at the end of February.

On the backdrop of low demand for credits, banks kept to their precautionary lending policies, hence loans to resident financial institutions, non-financial corporations and households were on a moderate downward trend in February, with the annual rate of decrease at 7.9%. However, this downward trend in lending has already come to an end in some areas, and the progressively more pronounced expansion of industrial credit portfolio, e.g. by 0.8% in February, can be viewed as a factor with a potential to boost the business activity, which is well-confirmed by the already recorded year-on-year growth in this credit type.

Liabilities to foreign banks decreased by 262.5 million lats or 3.6% in February mainly on account of the repayment of syndicated loans; meanwhile, non-resident non-MFI deposits contracted by 153.5 million lats or 4.7%. As foreign assets of the banking sector declined by 270.0 million lats within a month, the negative net external assets of MFIs (except the Bank of Latvia) improved by 164.5 million lats in February.

Monetary base M0 increased by 177.2 million lats in February, and demand deposits with the central bank expanded substantially due to rising minimum reserves and ample liquidity of the lats. As a result, the annual rate of change in the monetary base and its components continued to improve: at the end of February, M0 was only by 5.0% and currency in circulation by 16.7% below the year-on-year level, whereas demand deposits with the central bank by 4.8% exceeded those in the corresponding month of the previous year.

Net foreign assets of the Bank of Latvia increased by 111.4 million lats or 3.3% in February, and the backing of the national currency with the Bank of Latvia net foreign assets was 183.2% at the month-end. The increase in net foreign assets was primarily driven by the inflow of the second disbursement of the IMF loan into the government account with the Bank of Latvia. The expansion in the monetary base on the backdrop of slightly contracting lending to banks was facilitated by a 113.4 million lats decline in the government deposit in lats with the Bank of Latvia.

With surplus liquidity persisting, the interbank market interest rates went on decreasing. RIGIBOR on overnight loans declined to an average 1.27% in February (1.31% in January). The downward trend in longer term RIGIBOR was even steeper, and 3-, 6-, and 12-month RIGIBOR, dropping 81, 186, and 203 basis points respectively, stood at 2.78%, 3.94%, and 5.37% in February. The interest rates on loans to households also went down notably, and so did the interest rates on loans in lats to non-financial corporations. With seasonal depositing campaigns expiring, the interest rates on deposits in both lats and foreign currencies dropped markedly.

In February, the exchange rates of the US dollar and the Japanese yen set by the Bank of Latvia against the lats appreciated by 4.0% and 5.0% respectively, whereas the British pound sterling depreciated by 1.5%.

MACROECONOMIC INDICATORS	2010	
	I	II
Volume index of industrial output (working-day adjusted annual rate of change; %)	5.7	*
Changes in the CPI		
Month-on-month basis (%)	0.2	0.0
Average annual inflation rate (HCPI) of last 12 months (%)	2.5	1.3
Year-on-year basis (%)	-3.1	-4.2
Annual rate of core inflation ¹ (%)	-5.0	-5.6
Number of registered unemployed persons (at end of period)	186 295	192 032
Unemployment rate (%)	16.6	17.1
General government consolidated budget financial deficit/surplus (in millions of lats)	70.7	-17.2
Foreign trade (in millions of lats)		
Exports	269.4	*
Imports	346.2	*
Balance	-76.9	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

Source: Central Statistical Bureau of Latvia and Ministry of Finance.

MONETARY INDICATORS (at end of period; in millions of lats)

	2010	
	I	II
MFIs¹		
M3	5 806.3	5 944.5
Repurchase agreements	0	0
Money market fund shares and units	91.4	101.8
Debt securities issued with maturity of up to 2 years	0.9	0.9
M2	5 714.1	5 841.8
Deposits with agreed maturity of up to 2 years	2 542.8	2 596.1
Deposits redeemable at notice of up to 3 months	249.9	248.2
M1	2 921.4	2 997.5
Currency outside MFIs	653.0	666.5
Overnight deposits	2 268.4	2 331.0
Net external assets	-2 827.8	-2 551.9
Credit to resident financial institutions, non-financial corporations and households	13 444.6	13 352.9
Credit to general government	642.0	644.0
Deposits of central government	2 089.1	2 046.4
Longer-term financial liabilities	2 242.0	2 301.6
Bank of Latvia		
M0	1 746.3	1 923.5
Currency in circulation	752.4	767.7
Deposits with the Bank of Latvia in lats	984.1	1 144.9
Deposits with the Bank of Latvia in foreign currencies	9.8	10.9
Net foreign assets	3 412.9	3 524.3
Net domestic assets	-1 666.6	-1 600.8
Credit	-1 316.6	-1 216.8
To MFIs	131.7	117.6
To central government (net)	-1 448.3	-1 334.4
Other items (net)	-350.0	-384.0
International reserves (at end of period; in millions of euro)	4 910.21	5 066.17
Gold	193.41	201.71
Special Drawing Rights	132.70	137.54
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	4 584.04	4 726.86
International reserves (at end of period; in millions of US dollars)	6 874.36	6 820.93
Gold	270.78	271.58
Special Drawing Rights	185.78	185.17
Reserve position in the IMF	0.09	0.08
Foreign convertible currencies	6 417.71	6 364.10

¹ In accordance with the methodology of the European Central Bank.

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES

	2010	
	I	II
Weighted average interest rate on domestic interbank loans in lats	1.1	1.0
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	10.1	7.2
Loans to households (in lats)	18.9	12.7
incl. for house purchase	8.2	9.4
Loans to non-financial corporations (in foreign currencies)	5.0	5.1
Loans to households (in foreign currencies)	5.4	4.9
incl. for house purchase	3.9	3.9
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	4.1	3.6
Demand deposits of non-financial corporations (in lats)	0.6	0.5
Time deposits of households (in lats)	9.9	6.8
Demand deposits of households (in lats)	1.1	1.0
Time deposits of non-financial corporations (in foreign currencies)	1.4	0.7
Demand deposits of non-financial corporations (in foreign currencies)	0.2	0.2
Time deposits of households (in foreign currencies)	2.4	1.8
Demand deposits of households (in foreign currencies)	0.6	0.6
The Bank of Latvia's refinancing rate (at end of period; %)	4.0	4.0
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5020	0.5220
LVL/GBP	0.8120	0.8000
LVL/100 JPY	0.5560	0.5840
LVL/EUR	0.7028	0.7028

AGGREGATED BALANCE SHEET OF MFIs (EXCLUDING THE BANK OF LATVIA) (at end of period; in millions of lats)

	2010	
	I	II
MFI reserves	1 171.9	1 359.8
Vault cash in national currency	99.4	101.3
Deposits with the Bank of Latvia	1 072.4	1 258.5
Foreign assets	4 770.4	4 500.4
Vault cash in foreign currencies	68.1	67.4
Claims on MFIs	2 892.5	2 601.0
Claims on non-MFIs	1 702.1	1 724.3
Other assets	107.7	107.6
Claims on central government	572.0	574.4
Claims on local government	70.0	69.6
Claims on public non-financial corporations	405.5	405.8
Claims on financial institutions and private non-financial corporations	7 131.5	7 065.6
Claims on households	6 065.5	6 045.3
Unclassified assets	907.9	913.0
Fixed assets	146.7	144.9
Items in transit	14.0	16.3
Other assets	462.5	460.0
Claims on resident MFIs (incl. investments)	284.7	291.9
Total assets	21 094.7	20 934.0
<i>Memo item: Trust assets</i>	<i>405.1</i>	<i>430.2</i>
Overnight deposits in lats	1 095.0	1 147.5
Public non-financial corporations	76.6	73.1
Financial institutions and private non-financial corporations	501.8	532.7
Households	516.6	541.7
Time deposits and deposits redeemable at notice in lats	1 172.3	1 244.6
Public non-financial corporations	231.9	245.6
Financial institutions and private non-financial corporations	390.8	445.6
Households	549.6	553.4
Foreign currency deposits of residents	2 814.5	2 792.7
Public non-financial corporations	34.6	34.2
Financial institutions and private non-financial corporations	1 029.4	1 022.3
Households	1 750.5	1 736.1
Deposits of central government	640.8	711.9
Deposits of local government	135.0	147.1
Transit funds	3.0	3.0
Foreign liabilities	11 011.1	10 576.5
Liabilities to MFIs	7 202.4	6 939.9
Liabilities to non-MFIs	3 267.1	3 113.6
Other liabilities (incl. subordinated liabilities)	541.6	523.0
Liabilities to the Bank of Latvia	131.7	118.1
Debt securities issued	150.2	158.6
Money market fund shares and units	91.4	101.8
Capital and reserves	1 636.5	1 677.4
Residents	391.6	432.5
Non-residents	1 244.8	1 244.8
Provisions	1 559.2	1 604.9
Unclassified liabilities	654.0	649.9
Items in transit	95.1	84.6
Other liabilities (incl. subordinated liabilities)	304.8	298.7
Liabilities to resident MFIs	254.1	266.5
Total liabilities	21 094.7	20 934.0
<i>Memo item: Trust liabilities</i>	<i>405.1</i>	<i>430.2</i>

The IMF's Dissemination Standards Bulletin Board (<http://dsbb.imf.org>) disseminates the release dates for monetary indicators of the Latvian banking system, monetary indicators of the Bank of Latvia and international reserves. The data are first made available on the Bank of Latvia's website (<http://www.bank.lv>).