

# MONETARY BULLETIN 2009

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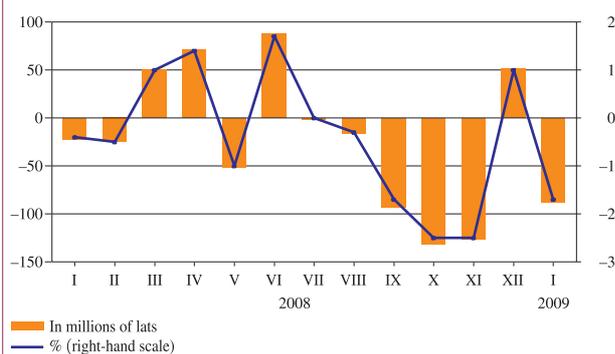
In January, the situation in Latvia's financial market was stable. In the context of appreciating lats exchange rate that fluctuated around the central parity, the Bank of Latvia did not intervene in the foreign exchange market. With the lats liquidity becoming ample, lats money market interest rates dropped notably. Nonetheless, the pace of lending continued to decelerate despite substantial lowering of the bank reserve ratio by the Bank of Latvia in the previous months and expanding resources available for lending. In order to boost the activity in the lats money market and to enhance the inflow of banks' financial resources into the economy, the Bank of Latvia cut the marginal deposit facility rate by 1.0 percentage point (to 2.00%) as of 24 January.

The economic downturn continued, the domestic demand contracted sharply, and the annual inflation rate dropped to one-digit level in January for the first time since July 2007 (9.8%). However, the monthly rise in consumer prices was substantial (2.2%) primarily due to a higher VAT rate (from 18% to 21% for the standard rate; from 5% to 10% for the reduced rate; in effect as of 1 January). Inflation was pushed up also by an increasing weight of housing-related costs in the consumption basket. As a result of increased tax rates the housing-related spending soared notably (by 16.3% for water supply, 16.6% for waste collection, and 16.8% for sewage), and food prices increased (by 3.5% for bread, 3.6% for fish, and 2.1% for meat and meat products). In January, annual consumer price core inflation continued dynamically on a downward trend, dropping to 6.1%.

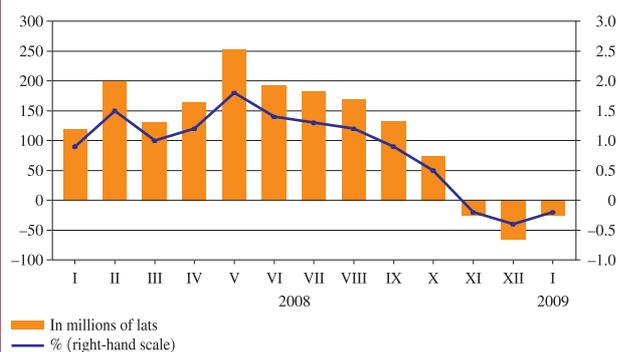
According to the flash estimate of the Central Statistical Bureau of the Republic of Latvia, GDP posted a year-on-year contraction of 10.5% in the fourth quarter of 2008. In December, when the domestic demand and foreign demand were on sustained downward trends, the downturn in the output of manufacturing intensified. The working day adjusted volume index of industrial output in manufacturing decreased by 18.2%. The retail trade turnover (including sales of motor vehicles and retailing in automotive fuel) contracted buoyantly (by 17.5% at constant prices). Exports shrank significantly by 11.1% in December, while imports recorded an even sharper drop of 15.2%. In January, freight transportation indicators deteriorated somewhat due to a slowdown in the economic activity. Freight transportation by rail decreased by 3.0%, while freight turnover at Latvian ports declined by 0.9% year-on-year. At the same time, unemployment surged record high, with its rate elevated by 1.3 percentage points in January (to 8.3% of economically active population).

In January, when the general government consolidated budget revenue recorded a 6.2% drop year-on-year and its expenditure soared by 1.7%, the surplus of the general government consolidated budget stood at 58.6 million lats. The central government basic budget, local government consolidated budget and central government social security budget all recorded surpluses. Given a drop in overall tax collection, excluding the corporate income tax, the general government consolidated budget recorded a year-on-year tax revenue contraction of 12.6%. With a dynamic weakening in private consumption going on, VAT collections shrank by 25.5%. Collections of the personal income tax and social insurance contributions dropped 5.1% and 11.8% respectively on account of the smaller number of employed and subdued growth in wages and salaries in the concluding months of 2008. At the same time, the growth in budgetary expenditure was restricted by a set

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



**MONTHLY CHANGES IN LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**



| MACROECONOMIC INDICATORS   | 2008   | 2009   |
|--|--------|--------|
|  | XII    | I      |
| Volume index of industrial output (working-day adjusted annual rate of change; %)      | -14.2  | *      |
| Changes in the CPI   |        |        |
| Month-on-month basis (%)   | -0.5   | 2.2    |
| Average annual inflation rate (HCPI) of last 12 months (%)                             | 15.4   | 14.9   |
| Year-on-year basis (%)   | 10.5   | 9.8    |
| Annual rate of core inflation <sup>1</sup> (%)   | 8.7    | 6.1    |
| Number of registered unemployed persons (at end of period)                             | 76 435 | 90 436 |
| Unemployment rate (%)  | 7.0    | 8.3    |
| General government consolidated budget financial deficit/surplus (in millions of lats) | -531.1 | 58.6   |
| Foreign trade (in millions of lats)  |        |        |
| Exports  | 296.3  | *      |
| Imports  | 523.1  | *      |
| Balance  | -226.8 | *      |

<sup>1</sup> Source: Bank of Latvia.

\* Figure available at a later date.

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

of broad-based measures aimed at cutting it. The general government debt amounted to 2 765.5 million lats at the end of January on account of a 55.7 million lats rise in foreign debt in the course of the month.

The money supply narrowed reflecting the slowdown in the economic activity and moderation in bank lending. In January, M3 shrank by 97.4 million lats, with the annual pace of change decelerating (by 0.9 percentage point) and declining to -5.2%. Likewise, M2 and M1 contracted (the annual pace of change -5.4% and -16.8% respectively). The money supply was affected by the weakening demand for cash (currency outside MFIs decreased by 3.9% in January) and a marked fall in overnight deposits (7.0%). Deposits with an agreed maturity of up to 2 years increased by 3.9% and deposits redeemable at notice with a notice period of up to 3 months expanded by 2.8%, both supporting higher interest rates as a factor encouraging longer term savings. Overall, deposits of resident financial institutions, non-financial corporations and households posted a decrease of 1.7% (annual rate of 5.2%). In January, the deposits of households and non-financial corporations as well as financial institutions declined by 1.3% and 2.4% respectively. In January, deposits in lats contracted by 3.3% and those in euro by 0.6%.

With banks pursuing more prudent lending policies, loans to resident financial institutions, non-financial corporations and households decreased by 25.5 million lats or 0.2% within a month, while the rate of loan growth decelerated by 1.2 percentage points, to 10.5%. Loans to households and financial institutions contracted, whereas those to non-financial corporations picked up somewhat (13.2 million lats or 0.2%).

Liabilities to foreign banks decreased in January by 156.6 million lats, including bank liabilities to parent banks by 124.7 million lats. Non-resident deposits with non-MFIs declined by 127.4 million lats, whereas negative net foreign assets of MFIs shrank by 43.3 million lats reflecting less contracting foreign assets.

M0 narrowed by 215.6 million lats in January on account of a decrease in bank demand deposits with the Bank of Latvia due to a lower reserve base and also as a result of the cash demand dynamics. Bank of Latvia's net foreign assets were by 3.7% smaller in January. At the end of the month, the backing of the national currency with the Bank of Latvia's net foreign assets was 118.5%. The latter amount resulted from the withdrawal of government's foreign currency deposit utilising international institutions' lending. The money supply of the central bank decreased also due to the drop in loans to banks and expansion in the government deposit in lats with the Bank of Latvia.

When the financial market conditions stabilised, RIGIBOR on overnight loans declined from 7.8% at the beginning of the month to 4.7% at its end. Following an upsurge in the run of several months, longer term RIGIBOR also started to go down. RIGIBOR on loans with 3-, 6- and 12-month maturities dropped 3-4 percentage points and stood at 10.28%, 11.02% and 11.80% respectively at the end of the month. In January, the weighted average interest rate on loans to non-financial corporations in lats and on those to households in foreign currency declined. The weighted average interest rate on loans in lats and foreign currency to households for house purchase also went down. Interest rates on deposits (particularly in the corporate sector) started to slide down.

In January, the exchange rates set by the Bank of Latvia for the US dollar, Japanese yen and British pound sterling appreciated against the lats (by 8.3%, 9.0% and 4.1% respectively).

| MONETARY INDICATORS (at end of period; in millions of lats)                          | 2008                 | 2009     |
|--|----------------------|----------|
|  | XII                  | I        |
| <b>MFIs<sup>1</sup></b>  |                      |          |
| M3   | 6 039.5 <sup>2</sup> | 5 942.1  |
| Repurchase agreements  | 0                    | 0        |
| Money market fund shares and units   | 70.2                 | 82.1     |
| Debt securities issued with maturity of up to 2 years                                | 4.4                  | 3.1      |
| M2   | 5 964.9 <sup>2</sup> | 5 856.8  |
| Deposits with agreed maturity of up to 2 years                                       | 2 356.1              | 2 447.7  |
| Deposits redeemable at notice of up to 3 months                                      | 263.7                | 271.1    |
| M1   | 3 345.1 <sup>2</sup> | 3 138.0  |
| Currency outside MFIs  | 866.1                | 832.2    |
| Overnight deposits   | 2 479.0 <sup>2</sup> | 2 305.9  |
| Net external assets  | -5 914.6             | -5 871.3 |
| Credit to resident financial institutions, non-financial corporations and households | 14 577.7             | 14 552.2 |
| Credit to general government   | 1 182.0              | 1 160.3  |
| Deposits of central government   | 1 354.2              | 1 398.9  |
| Longer-term financial liabilities  | 2 306.1 <sup>2</sup> | 2 361.7  |
| <b>Bank of Latvia</b>  |                      |          |
| M0   | 2 111.5              | 1 895.9  |
| Currency in circulation  | 1 018.1              | 949.7    |
| Deposits with the Bank of Latvia in lats   | 1 068.8              | 930.3    |
| Deposits with the Bank of Latvia in foreign currencies                               | 24.6                 | 15.8     |
| Net foreign assets   | 2 332.3              | 2 246.8  |
| Net domestic assets  | -220.7               | -351.0   |
| Credit   | 1.2                  | -118.6   |
| To MFIs  | 639.3                | 595.3    |
| To central government (net)  | -638.1               | -713.9   |
| Other items (net)  | -222.0               | -232.4   |
| International reserves (at end of period; in millions of euro)                       | 3 696.52             | 3 581.38 |
| Gold   | 155.09               | 167.64   |
| Special Drawing Rights   | 0.27                 | 2.01     |
| Reserve position in the IMF  | 0.06                 | 0.06     |
| Foreign convertible currencies   | 3 541.10             | 3 411.67 |
| International reserves (at end of period; in millions of US dollars)                 | 5 248.34             | 4 695.92 |
| Gold   | 220.20               | 219.81   |
| Special Drawing Rights   | 0.38                 | 2.64     |
| Reserve position in the IMF  | 0.09                 | 0.08     |
| Foreign convertible currencies   | 5 027.67             | 4 473.39 |

<sup>1</sup> In accordance with the methodology of the European Central Bank.

<sup>2</sup> Data have been revised.

| EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES                   | 2008   | 2009   |
|---|--------|--------|
|   | XII    | I      |
| Weighted average interest rate on domestic interbank loans in lats            | 5.7    | 3.6    |
| Interest rates on loans to resident non-financial corporations and households |        |        |
| Loans to non-financial corporations (in lats)                                 | 13.4   | 12.0   |
| Loans to households (in lats)   | 17.5   | 20.3   |
| incl. for house purchase  | 16.2   | 11.1   |
| Loans to non-financial corporations (in foreign currencies)                   | 6.7    | 6.1    |
| Loans to households (in foreign currencies)                                   | 7.5    | 7.1    |
| incl. for house purchase  | 6.5    | 6.2    |
| Interest rates on deposits of non-financial corporations and households       |        |        |
| Time deposits of non-financial corporations (in lats)                         | 9.8    | 5.7    |
| Demand deposits of non-financial corporations (in lats)                       | 1.6    | 1.1    |
| Time deposits of households (in lats)   | 9.6    | 8.7    |
| Demand deposits of households (in lats)                                       | 0.9    | 1.0    |
| Time deposits of non-financial corporations (in foreign currencies)           | 3.0    | 2.4    |
| Demand deposits of non-financial corporations (in foreign currencies)         | 0.9    | 0.5    |
| Time deposits of households (in foreign currencies)                           | 3.6    | 3.1    |
| Demand deposits of households (in foreign currencies)                         | 1.2    | 1.0    |
| The Bank of Latvia's refinancing rate (at end of period; %)                   | 6.0    | 6.0    |
| Exchange rates of foreign currencies (at end of period)                       |        |        |
| LVL/USD   | 0.4950 | 0.5360 |
| LVL/GBP   | 0.7280 | 0.7580 |
| LVL/100 JPY   | 0.5470 | 0.5960 |
| LVL/EUR   | 0.7028 | 0.7028 |

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

|   | 2008                        | 2009            |
|---|-----------------------------|-----------------|
|   | XII                         | I               |
| MFI reserves  | 1 246.2                     | 1 063.9         |
| Vault cash in national currency   | 151.9                       | 117.6           |
| Deposits with the Bank of Latvia  | 1 094.3                     | 946.3           |
| Foreign assets  | 4 925.9                     | 4 766.1         |
| Vault cash in foreign currencies  | 77.4                        | 69.0            |
| Claims on MFIs  | 2 801.8                     | 2 610.5         |
| Claims on non-MFIs  | 1 938.4                     | 1 937.3         |
| Other assets  | 108.3                       | 149.3           |
| Claims on central government  | 1 105.4                     | 1 081.5         |
| Claims on local government  | 76.6                        | 78.7            |
| Claims on public non-financial corporations                             | 381.2                       | 377.4           |
| Claims on financial institutions and private non-financial corporations | 7 866.1                     | 7 863.0         |
| Claims on households  | 6 402.4                     | 6 385.2         |
| Unclassified assets   | 910.3 <sup>1</sup>          | 986.0           |
| Fixed assets  | 196.7                       | 195.4           |
| Items in transit  | 36.0                        | 27.9            |
| Other assets  | 290.0 <sup>1</sup>          | 299.6           |
| Claims on resident MFIs (incl. investments)                             | 387.5                       | 463.1           |
| <b>Total assets</b>   | <b>22 914.1<sup>1</sup></b> | <b>22 601.9</b> |
| <i>Memo item: Trust assets</i>  | 354.8                       | 382.6           |
| Overnight deposits in lats  | 1 385.2 <sup>1</sup>        | 1 259.0         |
| Public non-financial corporations                                       | 111.9                       | 84.8            |
| Financial institutions and private non-financial corporations           | 607.7                       | 546.0           |
| Households  | 665.6 <sup>1</sup>          | 628.2           |
| Time deposits and deposits redeemable at notice in lats                 | 1 216.6                     | 1 257.5         |
| Public non-financial corporations                                       | 167.3                       | 154.2           |
| Financial institutions and private non-financial corporations           | 408.4                       | 459.8           |
| Households  | 641.0                       | 643.6           |
| Foreign currency deposits of residents                                  | 2 463.4                     | 2 461.3         |
| Public non-financial corporations                                       | 32.0                        | 41.7            |
| Financial institutions and private non-financial corporations           | 794.2                       | 785.1           |
| Households  | 1 637.2                     | 1 634.5         |
| Deposits of central government  | 716.1                       | 685.0           |
| Deposits of local government  | 197.8                       | 207.7           |
| Transit funds   | 3.5                         | 3.5             |
| Foreign liabilities   | 13 172.8                    | 12 884.2        |
| Liabilities to MFIs   | 9 306.5                     | 9 149.9         |
| Liabilities to non-MFIs   | 3 463.3                     | 3 335.9         |
| Other liabilities (incl. subordinated liabilities)                      | 403.0                       | 398.5           |
| Liabilities to the Bank of Latvia                                       | 639.3                       | 595.3           |
| Debt securities issued  | 178.9                       | 179.8           |
| Money market fund shares and units                                      | 70.2                        | 82.1            |
| Capital and reserves  | 1 723.3 <sup>1</sup>        | 1 760.7         |
| Residents   | 987.2 <sup>1</sup>          | 1 024.6         |
| Non-residents   | 736.1                       | 736.1           |
| Provisions  | 394.9 <sup>1</sup>          | 430.5           |
| Unclassified liabilities  | 752.2 <sup>1</sup>          | 795.2           |
| Items in transit  | 139.2                       | 96.9            |
| Other liabilities (incl. subordinated liabilities)                      | 269.3 <sup>1</sup>          | 277.4           |
| Liabilities to resident MFIs  | 343.7                       | 420.9           |
| <b>Total liabilities</b>  | <b>22 914.1<sup>1</sup></b> | <b>22 601.9</b> |
| <i>Memo item: Trust liabilities</i>                                     | 354.8                       | 382.6           |

<sup>1</sup> Data have been revised.

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>).