

# MONETARY BULLETIN 2008

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In August, the decline of inflation became more pronounced because of the base effect and the loosening domestic demand pressure. The decrease was confirmed by the contracting retail trade turnover and output in manufacturing industry, as well as by the deteriorating producer and consumer confidence indicators. At the same time, however, the external imbalances continued to decrease – in the second quarter, with the lasting moderate growth of exports (9.3% in July in annual terms) coupled with a decline in imports (by 12.6% in July), the current account deficit of the balance of payments stood at 15.6% of GDP (the lowest since 2005). The dampening economic activity continued to push up the unemployment rate – in August it increased by another 0.1 percentage point (to 5.2%).

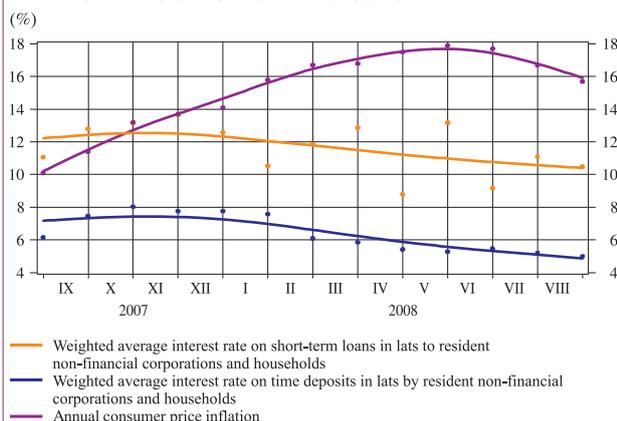
In July, the working day adjusted volume index of industrial output in manufacturing decreased by 9.1% year-on-year, and the retail trade turnover (including sales of motor vehicles and automotive fuel) contracted by 10.3%. In August, freight turnover at Latvian ports and rail freight turnover shrank by 12.1% and 0.6% year-on-year respectively.

In August, consumer price annual inflation went down 1.0 percentage point (to 15.7%), while, month-on-month, consumer prices declined by 0.4% (the steepest fall since August 2003). Vegetable and fuel prices decreased by 27.6% and 4.3% respectively, exerting the most significant dampening effect on overall prices. The prices on clothing and catering services experienced the highest surge. The annual core inflation decreased to 13.4%, while the 12-month average annual inflation increased to 15.6%.

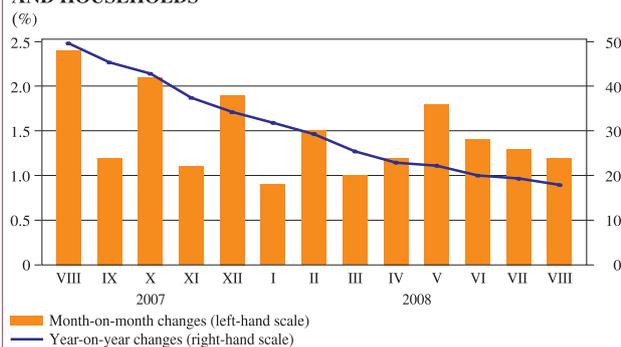
In August, general government consolidated budget financial surplus amounted to 15.4 million lats, standing at 116.5 million lats after the first eight months of 2008. In August, the central government basic budget and the local government consolidated budget deficits (6.5 million lats and 9.0 million lats respectively) were offset by the 29.6 million lats surplus in the central government social security budget. In August, the general government consolidated budget revenue and expenditure grew by 7.3% and 19.1% year-on-year respectively. Tax revenue increased by 8.3% (including corporate income tax revenue by 41.6% and excise tax revenue by 23.7%). The growth rates of personal income tax and social security contributions continued to slow down, reporting an increase of 9.9% and 18.0% respectively. The rest of taxes contributed less to the central government basic budget revenue than a year ago. Foreign financial assistance increased by 57.0% on account of the financing from the EU funds. Expenditure increased on account of both higher current and capital expenditure. With the government launching the issues of Treasury bills and bonds, in August the general government debt grew by 15.4 million lats (amounting to 1 506.8 million lats outstanding).

M3 and resident deposits dropped somewhat in August, whereas loans continued their moderate albeit steady growth. M3 shrank by a mere 3.1 million lats, with its annual growth rate remaining 5.7%, while M2 and M1 contracted a little more, with the annual growth rate standing at 5.5% and –11.3% respectively. Overnight deposits and deposits redeemable at notice of up to three months dropped by 58.8 million lats and 12.2 million lats respectively, while deposits with an agreed maturity of up to two years grew by 40.9 million lats. Currency outside MFIs increased by 14.0 million lats. With the declining deposits by resident financial institutions, non-financial corporations and households, the annual growth rate slowed down by 0.4 percentage point (to 7.2%). The deposits by households, however,

ANNUAL CONSUMER PRICE INFLATION AND WEIGHTED AVERAGE INTEREST RATES ON LOANS AND DEPOSITS



**DYNAMICS OF LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**



increased by 16.5 million lats or 0.5% (5.0% year-on-year).

Lending to businesses prevailed, with lending to households increasing somewhat less. In August, loans to resident financial institutions, non-financial corporations and households increased by 169.8 million lats or 1.2%, yet the annual growth rate dropped by 1.4 percentage points (to 17.9%). Loans to non-financial corporations expanded by 132.1 million lats or 1.9%, with the annual growth rate dropping by 1.4 percentage points (to 23.2%). Mortgage loans, commercial and industrial credit continued to demonstrate the fastest growth – by 32.4%, 20.2% and 10.1% respectively. Household loans expanded by 48.1 million lats or 0.8%, with the annual growth rate dropping by 1.2 percentage points (to 13.2%). The loans in lats increased marginally (by a mere 3.9 million lats), whereas those in euro and other currencies grew by 138.3 million lats and 27.6 million lats respectively.

With the continuous growth of foreign bank financing, the liabilities to foreign banks expanded by 169.9 million lats, including liabilities to parent banks by 38.5 million lats. Non-resident non-MFI deposits surged as well. In August, the negative net foreign assets of MFIs increased by 99.5 million lats.

Considering the adjustments in the financial sector, a further growth of lending and a decrease of funding to businesses is highly undesirable; furthermore, inflation is on a downward path. Therefore, the Bank of Latvia resolved, as of 24 October, to reduce the reserve ratio (raised earlier in the situation of high inflation rates) for bank liabilities with a maturity of over 2 years from 6% to 5%, and from 8% to 7% for all other liabilities included in the reserve base. This means releasing extra funds that can be channelled for lending, thus facilitating the availability of loans in support of economic growth. Moreover, a simultaneous reduction in the reserve ratio for liabilities with various maturities is expected to even out the effect on the liquidity in the lats money market and stimulate banks to attract long-term funding.

Since the reserve base contracted, the bank demand deposits with the Bank of Latvia declined, and at the end of August the monetary base M0 was 28.5 million lats smaller than in the previous month, with M0 annual growth rate falling to 1.0% (7.1% in July). The central bank's money supply shrank on account of an increase in the government deposit in lats with the Bank of Latvia. Net foreign assets of the Bank of Latvia remained broadly unchanged, and the backing of the national currency with the central bank's net foreign assets stood at 120.3% at the end of August.

Excess liquidity persisted on the Latvian money market, hence banks refrained from using the funds offered by the Bank of Latvia, while continued resorting to the deposit facility with the central bank. Thus, RIGIBOR on overnight loans remained within the range of 3.4%–3.7%. RIGIBOR on loans with a 3-month, 6-month and 12-month maturity also did not change much, standing at 6.21%, 7.15% and 8.47% respectively.

In August, the interest rates on loans granted to households in foreign currencies remained unchanged, whereas those on loans in lats posted an overall decline, though the weighted average interest rate on loans to households for house purchase in national currency increased by 0.2 percentage point, to 9.3%. Interest rates on time deposits made by households declined somewhat, while on those made by non-financial corporations moved up.

According to the exchange rate set by the Bank of Latvia, in August the US dollar and the Japanese yen appreciated against the lats (by 5.3% and 4.3% respectively), whereas the British pound sterling depreciated by 2.3%.

MACROECONOMIC INDICATORS	2008	
	VII	VIII
Volume index of industrial output (working-day adjusted annual rate of change; %)	-6.9	*
Changes in the CPI		
Month-on-month basis (%)	0.3	-0.4
Average annual inflation rate (HCPI) of last 12 months (%)	15.2	15.6
Year-on-year basis (%)	16.7	15.7
Annual rate of core inflation <sup>1</sup> (%)	14.3	13.4
Number of registered unemployed persons (at end of period)	55 436	56 333
Unemployment rate (%)	5.1	5.2
General government consolidated budget financial deficit/surplus (in millions of lats)	101.1	116.5
Foreign trade (in millions of lats)		
Exports	369.9	*
Imports	642.5	*
Balance	-272.6	*

<sup>1</sup> 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)	2008	
	VII	VIII
<b>MFIs<sup>1</sup></b>		
M3	6 517.4	6 514.3
Repurchase agreements	0	0
Money market fund shares and units	110.7	123.8
Debt securities issued with maturity of up to 2 years	7.6	7.8
M2	6 399.0	6 382.8
Deposits with agreed maturity of up to 2 years	2 296.2	2 337.1
Deposits redeemable at notice of up to 3 months	341.5	329.3
M1	3 761.2	3 716.4
Currency outside MFIs	885.6	899.6
Overnight deposits	2 875.6	2 816.8
Net external assets	-5 397.1	-5 496.6
Credit to resident financial institutions, non-financial corporations and households	14 290.9	14 460.6
Credit to general government	401.0	407.3
Deposits of central government	457.3	478.6
Longer-term financial liabilities	2 390.0	2 429.7
<b>Bank of Latvia</b>		
M0	2 429.7	2 401.2
Currency in circulation	1 003.2	1 018.1
Deposits with the Bank of Latvia in lats	1 417.3	1 375.2
Deposits with the Bank of Latvia in foreign currencies	9.1	7.9
Net foreign assets	2 891.0	2 887.7
Net domestic assets	-461.3	-486.5
Credit	-336.3	-344.7
To MFIs	0	0
To central government (net)	-336.3	-344.7
Other items (net)	-125.0	-141.9
International reserves (at end of period; in millions of euro)	4 098.52	4 156.96
Gold	146.31	140.21
Special Drawing Rights	0.12	0.12
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	3 952.03	4 016.57
International reserves (at end of period; in millions of US dollars)	6 386.81	6 150.60
Gold	228.01	207.46
Special Drawing Rights	0.18	0.18
Reserve position in the IMF	0.09	0.09
Foreign convertible currencies	6 158.53	5 942.87

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2008	
	VII	VIII
Weighted average interest rate on domestic interbank loans in lats	3.4	3.4
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	8.1	8.0
Loans to households (in lats)	16.9	16.3
incl. for house purchase	9.1	9.3
Loans to non-financial corporations (in foreign currencies)	7.5	7.3
Loans to households (in foreign currencies)	6.9	6.9
incl. for house purchase	6.7	6.7
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	4.1	4.4
Demand deposits of non-financial corporations (in lats)	1.3	1.2
Time deposits of households (in lats)	6.7	6.6
Demand deposits of households (in lats)	1.1	1.2
Time deposits of non-financial corporations (in foreign currencies)	4.0	4.1
Demand deposits of non-financial corporations (in foreign currencies)	1.9	1.9
Time deposits of households (in foreign currencies)	4.5	4.3
Demand deposits of households (in foreign currencies)	1.7	1.7
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	0.4510	0.4750
LVL/GBP	0.8940	0.8730
LVL/100 JPY	0.4180	0.4360
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	
	VII	VIII
MFI reserves	1 536.7	1 493.9
Vault cash in national currency	117.6	118.4
Deposits with the Bank of Latvia	1 419.1	1 375.5
Foreign assets	4 844.8	5 005.3
Vault cash in foreign currencies	65.5	64.9
Claims on MFIs	2 724.9	2 797.6
Claims on non-MFIs	1 977.5	2 044.8
Other assets	76.9	98.0
Claims on central government	328.0	334.0
Claims on local government	73.0	73.3
Claims on public non-financial corporations	294.5	307.1
Claims on financial institutions and private non-financial corporations	7 725.3	7 832.9
Claims on households	6 333.1	6 381.2
Unclassified assets	1 057.5	1 184.2
Fixed assets	194.5	195.2
Items in transit	34.9	37.0
Other assets	183.5	205.1
Claims on resident MFIs (incl. investments)	644.6	746.9
<b>Total assets</b>	<b>22 192.8</b>	<b>22 611.8</b>
<i>Memo item: Trust assets</i>	<i>331.1</i>	<i>338.7</i>
Overnight deposits in lats	1 614.0	1 590.9
Public non-financial corporations	67.9	76.0
Financial institutions and private non-financial corporations	699.7	691.4
Households	846.4	823.5
Time deposits and deposits redeemable at notice in lats	1 245.8	1 235.2
Public non-financial corporations	220.6	210.9
Financial institutions and private non-financial corporations	369.8	364.5
Households	655.4	659.7
Foreign currency deposits of residents	2 521.4	2 539.4
Public non-financial corporations	32.0	24.1
Financial institutions and private non-financial corporations	732.0	722.8
Households	1 757.3	1 792.4
Deposits of central government	121.1	134.0
Deposits of local government	270.5	261.5
Transit funds	3.7	3.7
Foreign liabilities	13 132.8	13 389.6
Liabilities to MFIs	8 627.4	8 797.3
Liabilities to non-MFIs	4 178.1	4 265.4
Other liabilities (incl. subordinated liabilities)	327.3	326.9
Liabilities to the Bank of Latvia	0	0
Debt securities issued	226.9	225.3
Money market fund shares and units	110.7	123.8
Capital and reserves	1 868.9	1 892.4
Residents	1 130.8	1 154.2
Non-residents	738.1	738.1
Provisions	145.1	152.4
Unclassified liabilities	931.9	1 063.7
Items in transit	137.5	162.9
Other liabilities (incl. subordinated liabilities)	221.4	233.9
Liabilities to resident MFIs	573.1	666.9
<b>Total liabilities</b>	<b>22 192.8</b>	<b>22 611.8</b>
<i>Memo item: Trust liabilities</i>	<i>331.1</i>	<i>338.7</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>).