

MONETARY BULLETIN 2008

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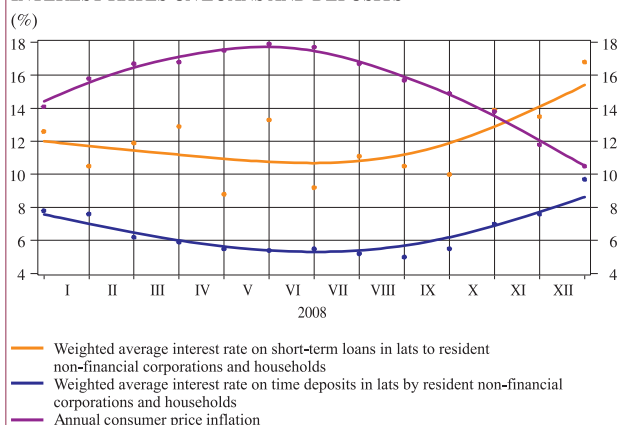
In December, the Latvian financial market steadied owing to the international support extended to Latvia: the Bank of Latvia entered into swap agreements with the central banks of Sweden and Denmark, as well as the first instalment of the IMF loan was received by the government. With the aim to promote the interbank money market, the Bank of Latvia Council revised the interest rate on the marginal lending facility as of 9 December. The previous annual rate of 7.5% remains valid for banks that have resorted to the facility no more than 5 working days within the previous 30 day period. A 15% interest rate is applied in case a bank has resorted to the facility from 6 to 10 working days, and a 30% rate if the facility has been used for over 10 days within the previous 30 day period. The exchange rate of lats stepped back from upper intervention margin, and the Bank of Latvia has not intervened in the foreign exchange market since mid-December, while the money market interest rates have been declining progressively.

December witnessed a further decline of the annual consumer price inflation, down to 10.5%. The inflation diminished on account of the moderating demand reflected in the fast drop of consumer price core inflation as well as the plummeting world energy prices: combined they acted to ease cost pressures. In 2008, the annual average inflation was 15.4%, comprising both the price increase earlier in the year as well as the significant decrease recorded in the second half of the year.

The weakness of both domestic and external demand adversely affected the growth of the national economy; growth slowed down in manufacturing and retail trade. In November, the working day adjusted volume index of industrial output in manufacturing fell by 15.2% year-on-year. With the labour market conditions deteriorating, in December the unemployment rate went up 0.9 percentage point, to 7.0% of the economically active population. In November, the weakening consumer confidence resulted in a 20.4% year-on-year decline in the retail trade turnover (including sales of motor vehicles and automotive fuel). In November, exports declined markedly by 17.6%, while imports shrank at an even faster pace, by 22.1%, thus the foreign trade balance improved further. In December, given the growing transit via Latvian ports, freight transportation by rail and transshipment at Latvian ports increased by 8.5% and 2.3% respectively.

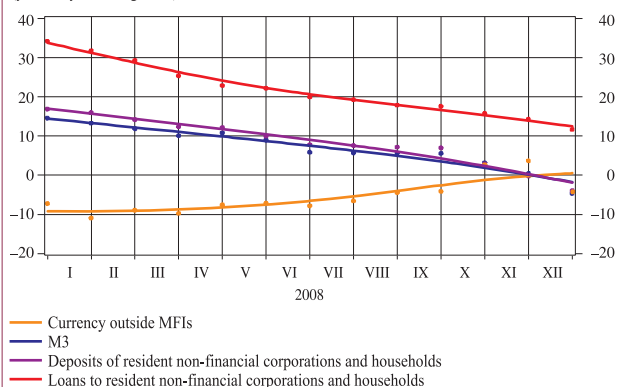
In December, when the general government consolidated budget revenue contracted by 24.2% year-on-year and expenditure by 9.1%, the financial deficit of the respective budget stood at 245.7 million lats. In 2008 overall the deficit had thus reached 531.1 million lats. In December, a deficit was recorded in the central government basic budget, the local government consolidated budget and the central government social security budget. All revenue items of the general government consolidated budget continued to decrease, including a 11.4% contraction in tax revenue. Only corporate income tax, property tax and excise tax revenues continued to move up. In December, the expenditure of the central government basic budget was contained, hence a month-on-month and year-on-year decrease. The expenditure of local government budget, on the contrary, posted a 12.9% year-on-year growth, but revenue remained on the previous level. The general government debt stood at 2 727.7 million lats at the end of 2008. In December, foreign debt increased on account of the first instalment (589.9 million euro) from the IMF loan for economic stabilisation and restoration of growth. Domestic debt augmented because of a government securities issue.

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



DYNAMICS OF BROAD MONETARY AGGREGATE AND ITS COMPONENTS

(year-on-year changes: %)



MACROECONOMIC INDICATORS

	2008	
	XI	XII
Volume index of industrial output (working-day adjusted annual rate of change; %)	-13.9	*
Changes in the CPI		
Month-on-month basis (%)	-0.4	-0.5
Average annual inflation rate (HCPI) of last 12 months (%)	15.7	15.4
Year-on-year basis (%)	11.8	10.5
Annual rate of core inflation ¹ (%)	9.8	8.7
Number of registered unemployed persons (at end of period)	67 065	76 435
Unemployment rate (%)	6.1	7.0
General government consolidated budget financial deficit/surplus (in millions of lats)	-285.4	-531.1
Foreign trade (in millions of lats)		
Exports	310.6	*
Imports	521.1	*
Balance	-210.5	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

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

Further downturn in economic activity, decline in lending growth rate, and decelerating income were reflected in shrinking household and local government deposits with banks and contracting money supply. In December, M3 declined by 101.6 million lats, with the annual growth rate turning negative (-4.3%). Monetary aggregates M1 and M2 shrank as well. Money supply was affected by the contracting demand for cash (currency outside MFIs diminished by 47.1 million lats in December) and by a seasonal decline of local government deposits. At the same time, the deposits of resident financial institutions and non-financial corporations went up. Overnight deposits were the ones to post a decline (by 3.7%) while deposits with an agreed maturity of up to two years grew by 2.5%. Household overnight deposits shrank by 6.8% because of pre-holiday shopping; also, retail investors opted for time deposits with higher returns. As a result, household time deposits increased by 1.7% and those of financial institutions and non-financial corporations by 4.9%. Deposits in lats were 0.4% up in December, while deposits in euro grew by 4.8%.

The moderation in lending was determined both by the contracting demand for loans as well as tighter lending policies pursued by banks in the wake of the global financial crisis. Loans to resident financial institutions, non-financial corporations and households decreased by 65.3 million lats or 0.4%, with the annual growth rate going up 2.6 percentage points (to 11.7%). Though loans to households and financial institutions contracted, the loans granted to non-financial corporations were pushed up by a notable increase of industrial credit (by 51.9 million lats or 2.9%). The loans to households declined both on account of decrease in loans for house purchase and consumer credit.

In December, the financing from foreign banks declined somewhat (by 54.0 million lats), though loans from affiliated banks continued to grow (by 20.1 million lats). Non-resident non-MFI deposits shrank by 291.7 million lats, and the negative net foreign assets of MFIs decreased by 270.2 million lats, since the foreign assets declined less.

In December, the monetary base M0 narrowed by 156.1 million lats due to a decrease in bank demand deposits with the Bank of Latvia, with the central bank engaging in outright sales of foreign currency and lowering the reserve ratio, and with the reserve base diminishing. Net foreign assets of the Bank of Latvia decreased by 1.4% in December, and the backing of the national currency with the central bank's net foreign assets stood at 110.5% at the end of the month. Net foreign assets decreased as a result of the interventions by the Bank of Latvia, continuing to sell euro in the first half of the month, while the rise in the government deposits in foreign currency following the instalment of the IMF loan had an increasing effect. An increase in lending to banks and a decrease in the government deposit with the Bank of Latvia in lats contributed positively to the central bank's money supply.

The subsiding tensions in financial markets had an effect on RIGIBOR: in the middle of the month it dropped to 6.5% on overnight loans, while RIGIBOR for longer maturities (3, 6 and 12 months) moved up somewhat, standing at 13.54%, 14.10%, and 15.24% respectively at the end of December. In December, the interest rates on loans in lats extended to non-financial corporations and to households for house purchases surged drastically, while interest rates on the same type of loans in foreign currency followed a downward trend, subsequent to the euro base rate reduction by the European Central Bank.

According to the exchange rate set by the Bank of Latvia, in December the US dollar, the Japanese yen and the British pound sterling depreciated against the lats by 9.0%, 4.2% and 13.1% respectively.

MONETARY INDICATORS (at end of period; in millions of lats)	2008	
	XI	XII
MFIs¹		
M3	6 141.0	6 039.4
Repurchase agreements	0	0
Money market fund shares and units	79.2	70.2
Debt securities issued with maturity of up to 2 years	4.5	4.4
M2	6 057.3	5 964.8
Deposits with agreed maturity of up to 2 years	2 299.5	2 356.1
Deposits redeemable at notice of up to 3 months	270.3	263.7
M1	3 487.5	3 345.0
Currency outside MFIs	913.2	866.1
Overnight deposits	2 574.3	2 478.9
Net external assets	-6 184.8	-5 914.6
Credit to resident financial institutions, non-financial corporations and households	14 643.0	14 577.7
Credit to general government	949.6	1 182.0
Deposits of central government	812.1	1 354.2
Longer-term financial liabilities	2 432.5	2 323.5
Bank of Latvia		
M0	2 267.6	2 111.5
Currency in circulation	1 044.5	1 018.1
Deposits with the Bank of Latvia in lats	1 213.1	1 068.8
Deposits with the Bank of Latvia in foreign currencies	10.0	24.6
Net foreign assets	2 367.1	2 332.3
Net domestic assets	-99.5	-220.7
Credit	106.6	1.2
To MFIs	554.6	639.3
To central government (net)	-448.0	-638.1
Other items (net)	-206.1	-222.0
International reserves (at end of period; in millions of euro)	3 442.51	3 696.52
Gold	156.91	155.09
Special Drawing Rights	0.13	0.27
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	3 285.41	3 541.10
International reserves (at end of period; in millions of US dollars)	4 447.44	5 248.34
Gold	202.71	220.20
Special Drawing Rights	0.17	0.38
Reserve position in the IMF	0.08	0.09
Foreign convertible currencies	4 244.48	5 027.67

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2008	
	XI	XII
Weighted average interest rate on domestic interbank loans in lats	5.0	5.7
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	10.4	13.4
Loans to households (in lats)	18.2	17.5
incl. for house purchase	12.0	16.2
Loans to non-financial corporations (in foreign currencies)	7.8	6.7
Loans to households (in foreign currencies)	6.8	7.5
incl. for house purchase	7.0	6.5
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	7.4	9.8
Demand deposits of non-financial corporations (in lats)	2.4	1.6
Time deposits of households (in lats)	8.0	9.6
Demand deposits of households (in lats)	1.1	0.9
Time deposits of non-financial corporations (in foreign currencies)	3.2	3.0
Demand deposits of non-financial corporations (in foreign currencies)	1.3	0.9
Time deposits of households (in foreign currencies)	3.6	3.6
Demand deposits of households (in foreign currencies)	1.4	1.2
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	0.5440	0.4950
LVL/GBP	0.8380	0.7280
LVL/100 JPY	0.5710	0.5470
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	
	XI	XII
MFI reserves	1 356.2	1 246.2
Vault cash in national currency	131.3	151.9
Deposits with the Bank of Latvia	1 224.9	1 094.3
Foreign assets	5 065.9	4 925.9
Vault cash in foreign currencies	67.0	77.4
Claims on MFIs	2 787.6	2 801.8
Claims on non-MFIs	2 038.5	1 938.4
Other assets	172.8	108.3
Claims on central government	870.8	1 105.4
Claims on local government	78.9	76.6
Claims on public non-financial corporations	342.1	381.2
Claims on financial institutions and private non-financial corporations	7 931.4	7 866.1
Claims on households	6 432.9	6 402.4
Unclassified assets	1 024.2	908.0
Fixed assets	195.8	196.7
Items in transit	26.4	36.0
Other assets	281.2	287.8
Claims on resident MFIs (incl. investments)	520.8	387.5
Total assets	23 102.3	22 911.9
<i>Memo item: Trust assets</i>	<i>345.4</i>	<i>354.8</i>
Overnight deposits in lats	1 402.4	1 385.1
Public non-financial corporations	93.4	111.9
Financial institutions and private non-financial corporations	612.2	607.7
Households	696.8	665.5
Time deposits and deposits redeemable at notice in lats	1 189.7	1 216.6
Public non-financial corporations	168.2	167.3
Financial institutions and private non-financial corporations	394.7	408.4
Households	626.8	641.0
Foreign currency deposits of residents	2 421.7	2 463.4
Public non-financial corporations	31.9	32.0
Financial institutions and private non-financial corporations	722.3	794.2
Households	1 667.6	1 637.2
Deposits of central government	364.1	716.1
Deposits of local government	273.9	197.8
Transit funds	3.5	3.5
Foreign liabilities	13 617.8	13 172.8
Liabilities to MFIs	9 360.5	9 306.5
Liabilities to non-MFIs	3 755.0	3 463.3
Other liabilities (incl. subordinated liabilities)	502.3	403.0
Liabilities to the Bank of Latvia	554.6	639.3
Debt securities issued	178.4	178.9
Money market fund shares and units	79.2	70.2
Capital and reserves	1 879.3	1 740.7
Residents	1 143.4	1 004.6
Non-residents	735.9	736.1
Provisions	224.7	373.1
Unclassified liabilities	913.0	754.3
Items in transit	168.4	139.2
Other liabilities (incl. subordinated liabilities)	267.3	271.5
Liabilities to resident MFIs	477.3	343.7
Total liabilities	23 102.3	22 911.9
<i>Memo item: Trust liabilities</i>	<i>345.4</i>	<i>354.8</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>).