

MONETARY BULLETIN 2007

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The available macroeconomic indicators suggest an ongoing presence of excessive domestic demand reflected in the persisting high levels of inflation and import demand. Yet, already for several months in row, the growth of money supply and loans has been stabilizing.

Considering the external and internal imbalances and the need to support the Government's efforts to curb inflation, as well as the rising interest rates in the euro area (the European Central Bank raised its key interest rate to 3.75% as of 14 March), the Bank of Latvia's Council, consistently pursuing a tight monetary policy, raised the refinancing rate by 0.5 percentage point to 5.5% as of 24 March. As a part of launching enhanced monetary policy instruments, the marginal lending facility rate was set at 6.5% as of 24 March, and the deposit facility rate at 2.0%.

In March, consumer prices rose 1.4% over February, and the annual rate of consumer price inflation reached 8.5%. The steep rise of prices on clothing and footwear (6.1%), as well as increase on meat, dairy, bread and cereal product prices had the most notable effect on consumer prices. The annual core inflation rose to 7.7%. The unexpected rocketing of prices testified the need for a consistent implementation of the Government's inflation curbing plan, approved in early March.

In February, the year-on-year growth in manufacturing was slow (1.0%), whereas the industrial output grew by 2.0%, owing to a more energetic increase recorded in mining and quarrying and in energy. The retail trade turnover grew by 31.5%. In March, freight transported by rail increased by 6.7% year-on-year, cargo turnover at Latvian ports by 15.3%, and the amount of oil products transported by pipeline by 13.3%.

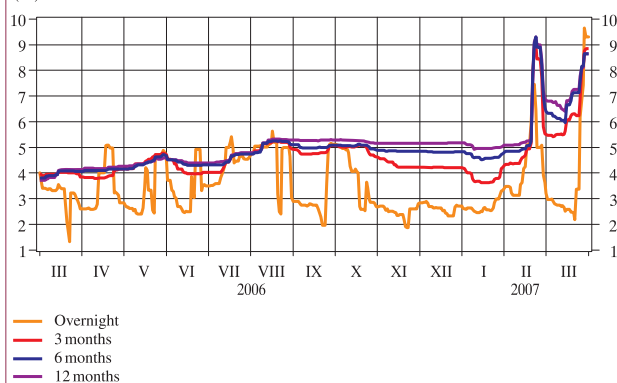
In March, the surplus of the general government consolidated budget amounted to 10.0 million lats. The central government basic budget reported a deficit of 30.3 million lats, whereas the social security fund and local government consolidated budget revenue exceeded expenditure. The growth of tax revenue remained strong (32.1%), with revenue from the social security contributions growing faster and that from value added tax growing at a more contained rate. General government consolidated budget expenditure increased by 37.5% in March. The annual growth of general government consolidated budget revenue dropped to 15.7% as a result of the lower growth rate of inflows from EU structural funds due to the high base.

Standing at 1 166.1 million lats at the end of March, central government's total debt increased somewhat on the account of government debt securities issues. In March, two primary placement competitive multi-price auctions of 12-month Treasury bills and 2-year bonds were held where securities in the amount of 4.8 million lats and 0.1 million lats were sold (weighted average yield 5.105% and 5.959% respectively).

The money supply dynamics remained broadly the same in March. The rise in deposits with MFIs posted an increase over the growth during the previous month. The monthly growth in loans once again was over 400 million lats, however, the year-on-year growth diminished by 0.8 percentage point (to 58.2%) due to the high base.

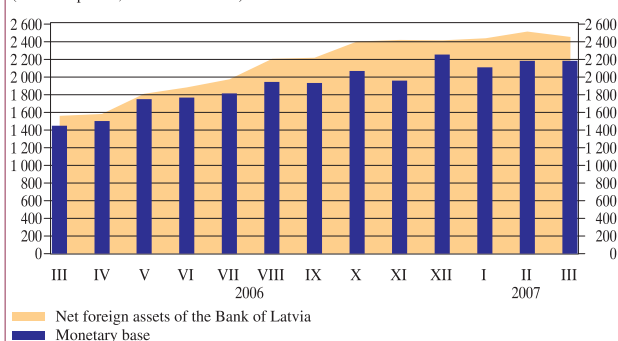
In March, the rise in broad money M3 was higher month-on-month (154.3 million lats). Money supply was pushed up by an

MONEY MARKET INDEX RIGIBOR
(%)



BACKING OF THE NATIONAL CURRENCY

(at end of period; in millions of lats)



MACROECONOMIC INDICATORS

	2007	
	II	III
Changes in the volume index of industrial output (year-on-year basis; %)	2.0	*
Changes in the CPI		
Month-on-month basis (%)	0.5	1.4
Year-on-year basis (%)	7.3	8.5
Annual rate of core inflation ¹ (%)	6.5	7.7
Number of registered unemployed persons (at end of period)	68 943	*
Unemployment rate (%)	6.5	*
General government consolidated budget financial deficit/surplus (in millions of lats)	141.1	151.1
Foreign trade (in millions of lats)		
Exports	277.5	*
Imports	555.2	*
Balance	-277.7	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

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

expansion of deposits, with currency outside MFIs remaining broadly unchanged. However, given the high base, the annual growth rate of almost all monetary aggregates declined (M3 to 36.7%). An increase in overnight deposits and deposits with agreed maturity of up to two years shrank, whereas that of deposits redeemable at notice expanded. The annual growth rate of currency outside MFIs dropped to 20.3%.

Deposits by resident financial institutions, non-financial corporations and households posted a pickup of 116.4 million lats, with the rise in deposits by financial institutions and non-financial corporations accounting for more than two thirds of the total expansion of deposits. An increase in lats deposits and euro deposits was broadly similar. Funds received from deposits and borrowings from foreign credit institutions (mainly from the parent banks) accounted for the lending growth. The negative net foreign assets of MFIs (excluding the Bank of Latvia) increased by 208.8 million lats.

The annual growth rate of loans granted both to financial institutions and non-financial corporations and those granted to households moderated somewhat and stood at 46.0% and 76.0% respectively in March. An upsurge in mortgage loans (231.4 million lats) contributed to the growth of lending, with household loans granted for house purchase determining expansion. Commercial credit accounted for the rise in lending to financial institutions and non-financial corporations (a pickup of 91.6 million lats). The largest contribution to the increase came from loans in euro reporting a growth of 360.1 million lats, while loans in lats expanded more moderately (by 57.5 million lats). The annual rate of increase in loans in euro continued to follow a downward trend (87.1% in March), whereas that of the loans in lats remained broadly unchanged (22.3%).

The Bank of Latvia satisfied the increased demand for euro via passive interventions on the foreign exchange market and sold euro in the net amount of 215.7 million lats. The euro interbank market rate remained close to the upper intervention margin set by the Bank of Latvia. Increased selling of the lats to the Bank of Latvia resulted in a liquidity shortage on the money market, causing a substantial rise in RIGIBOR. At the end of March, RIGIBOR on overnight loans reached 9.30%, and on loans maturing in 3 and 6 months 8.85% and 8.65% respectively (335 and 225 basis points higher than at the beginning of the month respectively). Rising interest rates on the lats money market pushed up the interest rates on loans granted to non-MFIs and on deposits received from them. The weighted average interest rate on household loans in lats rose by 1.6 percentage points (to 11.0%), including the increase in the weighted average interest rate on loans granted for house purchase (0.7 percentage point; to 7.5%). Interest rates on loans granted to non-financial corporations in lats as well as those on deposits in lats and euro posted a rise. Interest rates on loans granted in foreign currencies remained broadly unchanged.

The shrinking impact of interventions in the foreign exchange market on the central bank's money supply was partly offset by foreign currency swaps, hence the Bank of Latvia's net foreign assets shrank only by 2.1% and the backing of the national currency with the Bank of Latvia's net foreign assets was 112.6% at the end of March. Money supply expanded somewhat as a result of growing loans to banks (by 39.2 million lats), with banks using both the Bank of Latvia's main refinancing operations and the marginal lending facility.

In March, the exchange rate of the US dollar and the British pound sterling set by the Bank of Latvia depreciated against the lats by 0.9% and 1.1% respectively, whereas the Japanese yen appreciated by 1.4%.

MONETARY INDICATORS (at end of period; in millions of lats)	2007	
	II	III
MFIs¹		
M3	5 582.6	5 736.9
Repurchase agreements	0	0
Money market fund shares and units	49.4	51.5
Debt securities issued with maturity of up to 2 years	4.8	22.1
M2	5 528.4	5 663.2
Deposits with agreed maturity of up to 2 years	1 393.8	1 469.8
Deposits redeemable at notice of up to 3 months	157.0	160.7
M1	3 977.6	4 032.7
Currency outside MFIs	935.7	933.6
Overnight deposits	3 041.9	3 099.1
Net external assets	-3 032.8	-3 293.6
Credit to resident financial institutions, non-financial corporations and households	10 340.2	10 767.2
Credit to general government	374.6	364.3
Deposits of central government	258.0	245.9
Longer-term financial liabilities	1 867.6	1 882.5
Bank of Latvia		
M0	2 185.5	2 180.8
Currency in circulation	1 031.0	1 030.0
Deposits with the Bank of Latvia in lats	1 154.5	1 150.8
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	2 507.8	2 455.8
Net domestic assets	-322.3	-275.0
Credit	-234.9	-183.6
To MFIs	2.7	41.9
To central government (net)	-237.6	-225.5
Other items (net)	-87.4	-91.5
International reserves (at end of period; in millions of US dollars)	4 710.77	4 644.31
Gold	170.64	165.31
Special Drawing Rights	0.16	0.16
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	4 539.89	4 478.76

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2007	
	II	III
Weighted average interest rate on domestic interbank loans in lats	3.7	3.4
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	7.5	8.0
Loans to households (in lats)	9.4	11.0
incl. for house purchase	6.8	7.5
Loans to non-financial corporations (in foreign currencies)	6.2	6.0
Loans to households (in foreign currencies)	5.8	5.8
incl. for house purchase	5.7	5.6
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	3.9	5.6
Demand deposits of non-financial corporations (in lats)	1.3	2.3
Time deposits of households (in lats)	3.7	4.4
Demand deposits of households (in lats)	0.5	0.6
Time deposits of non-financial corporations (in foreign currencies)	3.8	3.9
Demand deposits of non-financial corporations (in foreign currencies)	1.6	1.6
Time deposits of households (in foreign currencies)	3.5	3.6
Demand deposits of households (in foreign currencies)	1.4	1.5
The Bank of Latvia's refinancing rate (at end of period; %)	5.0	5.5
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5330	0.5280
LVL/GBP	1.0470	1.0360
LVL/100 JPY	0.4440	0.4500
LVL/EUR	0.7028	0.7028

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

	2007	
	II	III
MFI reserves	1 249.9	1 247.7
Vault cash in national currency	95.3	96.5
Deposits with the Bank of Latvia	1 154.6	1 151.2
Foreign assets	3 878.9	4 052.2
Vault cash in foreign currencies	53.4	51.9
Claims on MFIs	2 425.5	2 478.5
Claims on non-MFIs	1 359.9	1 471.8
Other assets	40.1	50.0
Claims on central government	299.7	289.6
Claims on local government	74.9	74.7
Claims on public non-financial corporations	119.5	119.8
Claims on financial institutions and private non-financial corporations	5 645.2	5 847.7
Claims on households	4 634.6	4 857.8
Unclassified assets	860.4	799.0
Fixed assets	137.0	134.2
Items in transit	17.3	18.5
Other assets	113.0	124.3
Claims on resident MFIs (incl. investments)	593.1	521.9
Total assets	16 763.1	17 288.5
<i>Memo item: Trust assets</i>	<i>1 337.4</i>	<i>514.4</i>
Overnight deposits in lats	1 737.0	1 756.5
Public non-financial corporations	99.8	122.4
Financial institutions and private non-financial corporations	713.0	708.7
Households	924.2	925.5
Time deposits and deposits redeemable at notice in lats	903.5	935.8
Public non-financial corporations	99.5	106.4
Financial institutions and private non-financial corporations	233.6	267.3
Households	570.5	562.1
Foreign currency deposits of residents	1 935.1	1 999.7
Public non-financial corporations	26.7	26.0
Financial institutions and private non-financial corporations	554.2	579.2
Households	1 354.2	1 394.5
Deposits of central government	20.4	20.4
Deposits of local government	176.1	196.1
Transit funds	4.4	4.4
Foreign liabilities	9 419.5	9 801.6
Liabilities to MFIs	6 029.2	6 264.1
Liabilities to non-MFIs	3 107.8	3 038.4
Other liabilities (incl. subordinated liabilities)	282.4	499.1
Liabilities to the Bank of Latvia	2.7	41.9
Debt securities issued	327.2	343.7
Money market fund shares and units	49.4	51.5
Capital and reserves	1 266.8	1 280.3
Residents	809.5	822.1
Non-residents	457.4	458.1
Provisions	95.4	97.2
Unclassified liabilities	825.5	759.3
Items in transit	164.2	166.7
Other liabilities (incl. subordinated liabilities)	121.6	119.6
Liabilities to resident MFIs	539.7	473.0
Total liabilities	16 763.1	17 288.5
<i>Memo item: Trust liabilities</i>	<i>1 337.4</i>	<i>514.4</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>).