

MONETARY BULLETIN 2006

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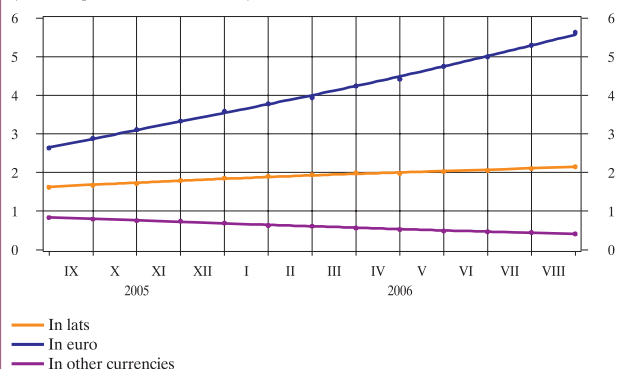
In the second quarter of 2006, the strong and persistent domestic demand continued to boost economic growth in Latvia. GDP posted a year-on-year increase of 11.1% with the robust expansion of retail trade turnover behind it (value added in trade grew by 18.7%). The growth in manufacturing was more modest (4.3%).

In August, consumer prices fell by 0.2%; the annual inflation, on the other hand, still soared high (6.8%). The annual core inflation declined to 4.8%. In monthly terms, inflation diminished due to an overall 1.7% drop in food prices, which was most pronounced for vegetables (21.1%), potatoes (18.1%) and fruit (5.1%). As to annual inflation, it was most affected by rises in prices of catering, heat and fuel.

The growth in retail trade turnover (including transport vehicle sales and automotive fuel retailing) at constant prices in July exceeded the level of the respective period of the previous year by 25.2%. In July, the seasonally adjusted volume index of industrial output in manufacturing increased by 2.5%. The total real annual industrial growth amounted to 4.0%. In August, freight transported by rail shrank by 4.4%, whereas the total freight turnover at Latvian ports expanded by 13.0%. Unemployment rate remained unchanged at 6.9% in August.

Loans granted to resident financial institutions, non-financial corporations and households increased by 344.5 million lats, and their annual growth rate accelerated by 0.6 percentage point (to 60.9%). An increase in loans in euro (334.9 million lats; 2.1 times more year-on-year) was behind almost the entire growth. Loans in lats also posted a modest increase (32.8% year-on-year), while loans in other currencies were on a downward trend. The overall growth in loans was determined by the expansion in mortgage lending (252.3 million lats; including 145.1 million lats to households for house purchase). Nevertheless, the annual pace of growth for these loans decelerated somewhat (to 91.6% and 87.6% respectively). In August, commercial credit, industrial credit and consumer credit to households increased in similar amount (approximately by 20 million lats). Over a half of all loans went to households, with the amount rising by 195.0 million lats and growth rate accelerating to 80.6%.

**LOANS TO RESIDENT FINANCIAL INSTITUTIONS,
NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**
(at end of period; in billions of lats)

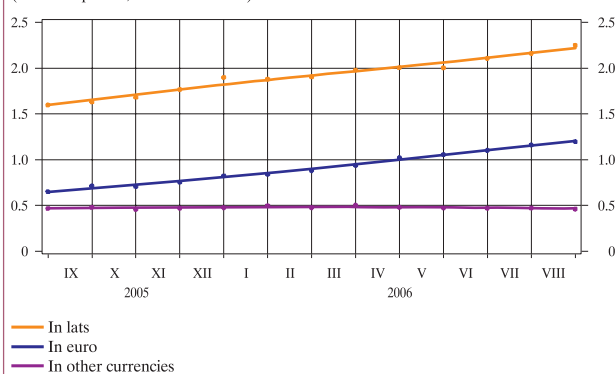


In August 2006, the general government consolidated budget had a financial surplus of 33.0 million lats, which for the first eight months of 2006 totalled 261.7 million lats (149.9 million lats for the first eight months of 2005). Surpluses in August and the first eight months of the year were incurred in the central government basic budget and the social security fund as well as in the local government consolidated budget.

The improvement in the budget revenue in August, compared with August of the previous year when it was 19.0%, was secured by an increase of 28.1% in the tax revenue, primarily as a result of the growing VAT (by 41.6%) and increases in direct taxes and social insurance contributions. Simultaneously, a steep rise in non-tax revenue was recorded. The increase (16.1%) in budget expenditure, in turn, was due to a wage rise in the public

BANK DEPOSITS OF RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS

(at end of period; in billions of lats)



MACROECONOMIC INDICATORS	2006	
	VII	VIII
Changes in the volume index of industrial output (year-on-year basis; %)	4.0	*
Changes in the CPI		
Month-on-month basis (%)	0.6	-0.2
Year-on-year basis (%)	6.9	6.8
Annual rate of core inflation ¹ (%)	4.9	4.8
Number of registered unemployed persons (at end of period)	73 333	73 056
Unemployment rate (%)	6.9	6.9
General government consolidated budget financial deficit/surplus (in millions of lats)	228.6	261.7
Foreign trade (in millions of lats)		
Exports	258.7	*
Imports	503.8	*
Balance	-245.1	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

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

sector, also pension indexation and higher benefits. Capital investment expenditure likewise grew significantly (by 40.4%).

In August, currency outside MFIs increased modestly, yet due to the low base the annual growth rate amounted to 23.7% (the highest since 1998). With overnight deposit expansion accelerating (51.4% year-on-year), money supply M1 picked up 103.7 million lats or 43.4% (an annual increment of 1.4 percentage points). The annual growth in monetary aggregates M2 and M3 was also faster than in July (42.0% and 42.3% respectively).

With time deposits expanding less buoyantly, deposits of resident financial institutions, non-financial corporations and households grew mostly on account of demand deposits that increased by 74.6 million lats. However, the pick-up in deposits in lats was 89.0 million lats (annual growth of 40.9%), whereas deposits in euro grew by 36.8 million lats (85.1%).

In order to ensure credit resources and to meet the reserve requirement, banks attracted additional funding from abroad; hence net negative foreign assets of MFIs (excluding the Bank of Latvia) gained 350.2 million lats in August. On the other hand, with the general government consolidated budget surplus growing, net credit of MFIs to the general government shrank by 21.9 million lats.

The Bank of Latvia's restrictive monetary policy of the recent months together with the resolutions of the European Central Bank on raising interest rates have contributed to a rise in both the short-term and long-term interest rates on the lats money market. Banks managed to overcome the lats liquidity problems through continuous selling of the euro (net of 244.0 million lats in August). Despite regular interventions in the foreign exchange market, the interest rates on interbank market overnight transactions in lats rose to 4.35% in August. RIGIBOR on overnight loans went up, reaching a high of 5.64% in mid-August and recording a temporary decline only at the end of the reserve maintenance period. RIGIBOR on loans with 6- and 12-month maturities also grew, reaching 5.11% and 5.29% respectively at the end of the month.

Banks improved lats liquidity also through repo auctions (loans granted in the amount of 125.9 million lats in August; 1.7 times more than in July) and in smaller amount through foreign exchange swaps.

Interest rates on non-IMF loans also rose in August. Interest rates on loans in lats to households went up by 0.3 percentage point (to 10.2%), including on those for house purchase by 0.2 percentage point (to 6.7%). Interest rates on loans in euro to households increased by 0.2 percentage point (to 5.1%; 5.0% on loans for house purchase). Interest rates on loans to non-financial corporations followed the same trend.

Foreign currency purchases from banks and the growing repo loans to banks boosted the central bank's money supply in August. As a result, the backing of the national currency with Bank of Latvia's net foreign assets was 113.5% at end-August. At the same time, the monetary base was reduced by increasing government deposits with the Bank of Latvia.

In August, the US dollar and the Japanese yen depreciated against the lats (by 1.3% and 2.5% respectively); the British pound sterling, in turn, appreciated against the lats by 1.1%.

MONETARY INDICATORS (at end of period; in millions of lats)	2006	
	VII	VIII
MFIs¹		
M3	4 673.1	4 817.0
Repurchase agreements	0	0
Money market fund shares and units	32.8	31.9
Debt securities issued with maturity of up to 2 years	2.6	2.6
M2	4 637.6	4 782.6
Deposits with agreed maturity of up to 2 years	1 082.3	1 122.5
Deposits redeemable at notice of up to 3 months	135.8	137.0
M1	3 419.5	3 523.2
Currency outside MFIs	859.0	874.6
Overnight deposits	2 560.5	2 648.5
Net external assets	-1 724.1	-1 851.4
Credit to resident financial institutions, non-financial corporations and households	7 856.9	8 201.4
Credit to general government	356.0	340.9
Deposits of central government	271.9	266.8
Longer-term financial liabilities	1 610.4	1 672.2
Bank of Latvia		
M0	1 805.3	1 940.2
Currency in circulation	948.8	961.4
Deposits with the Bank of Latvia in lats	856.4	978.8
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	1 978.6	2 201.5
Net domestic assets	-173.4	-261.4
Credit	-113.1	-196.6
To MFIs	0	10.0
To central government (net)	-113.1	-206.6
Other items (net)	-60.3	-64.8
International reserves (at end of period; in millions of US dollars)	3 604.85	4 020.88
Gold	157.14	153.11
Special Drawing Rights	0.15	0.15
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	3 447.48	3 867.54

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2006	
	VII	VIII
Weighted average interest rate on domestic interbank loans in lats	4.0	4.4
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	6.5	6.8
Loans to households (in lats)	9.9	10.2
incl. for house purchase	6.5	6.7
Loans to non-financial corporations (in foreign currencies)	5.2	5.3
Loans to households (in foreign currencies)	5.1	5.3
incl. for house purchase	4.8	5.0
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	4.2	3.9
Demand deposits of non-financial corporations (in lats)	1.2	1.0
Time deposits of households (in lats)	3.7	3.9
Demand deposits of households (in lats)	0.5	0.6
Time deposits of non-financial corporations (in foreign currencies)	3.3	3.8
Demand deposits of non-financial corporations (in foreign currencies)	1.4	1.5
Time deposits of households (in foreign currencies)	3.8	3.4
Demand deposits of households (in foreign currencies)	1.3	1.3
The Bank of Latvia's refinancing rate (at end of period; %)	4.5	4.5
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5540	0.5470
LVL/GBP	1.0290	1.0400
LVL/100 JPY	0.4800	0.4680
LVL/EUR	0.7028	0.7028

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

	2006	
	VII	VIII
MFI reserves	940.6	1 056.6
Vault cash in national currency	89.8	86.7
Deposits with the Bank of Latvia	850.7	969.9
Foreign assets	3 512.2	3 643.0
Vault cash in foreign currencies	63.3	61.7
Claims on MFIs	2 087.1	2 220.3
Claims on non-MFIs	1 316.7	1 326.5
Other assets	45.0	34.5
Claims on central government	258.8	248.1
Claims on local government	92.6	92.8
Claims on public non-financial corporations	114.6	114.8
Claims on financial institutions and private non-financial corporations	4 432.3	4 583.5
Claims on households	3 357.4	3 552.4
Unclassified assets	782.0	692.1
Fixed assets	144.0	145.0
Items in transit	21.8	15.5
Other assets	89.3	84.7
Claims on resident MFIs (incl. investments)	526.9	446.9
Total assets	13 490.4	13 983.3
<i>Memo item: Trust assets</i>	<i>454.0</i>	<i>523.7</i>
Overnight deposits in lats	1 412.0	1 472.3
Public non-financial corporations	64.7	60.6
Financial institutions and private non-financial corporations	571.6	616.2
Households	775.7	795.6
Time deposits and deposits redeemable at notice in lats	750.3	779.0
Public non-financial corporations	92.7	89.2
Financial institutions and private non-financial corporations	187.6	201.8
Households	469.9	488.0
Foreign currency deposits of residents	1 631.2	1 656.3
Public non-financial corporations	17.8	16.9
Financial institutions and private non-financial corporations	497.9	509.4
Households	1 115.6	1 130.0
Deposits of central government	154.2	60.2
Deposits of local government	141.5	153.5
Transit funds	4.7	4.7
Foreign liabilities	7 214.9	7 695.9
Liabilities to MFIs	4 093.9	4 552.2
Liabilities to non-MFIs	2 870.8	2 900.7
Other liabilities (incl. subordinated liabilities)	250.2	243.0
Liabilities to the Bank of Latvia	0	10.0
Debt securities issued	319.8	318.0
Money market fund shares and units	32.8	31.9
Capital and reserves	1 038.1	1 096.4
Residents	624.8	653.8
Non-residents	413.3	442.6
Provisions	86.1	87.4
Unclassified liabilities	704.8	617.8
Items in transit	141.1	131.2
Other liabilities (incl. subordinated liabilities)	80.7	83.8
Liabilities to resident MFIs	483.0	402.8
Total liabilities	13 490.4	13 983.3
<i>Memo item: Trust liabilities</i>	<i>454.0</i>	<i>523.7</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>).