

# MONETARY BULLETIN 2006

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In September, development trends in Latvia remained broadly unchanged while the annual inflation rate declined substantially. Although consumer prices grew by 0.7% in September, the annual inflation shrank to 5.9% due to the high base and dropped below 6% for the first time since April 2004. The annual core inflation declined to 4.7%. A month-on-month increase in consumer prices resulted mostly from a rise in clothing and footwear prices as well as education service prices in the new academic year and catering service prices (9.2%, 10.3% and 3.3% respectively). A decline in fuel and food prices (7.2% and 0.6% respectively) exerted a dampening effect on inflation, with the prices on potatoes, vegetables and fruit decreasing most notably (by 18.4%, 12.9% and 8.2%). The increase in heating tariffs, catering services as well as vegetable and potato prices had the most pronounced effect on annual inflation.

Retail trade turnover (including sale of motor vehicles and retail trade in automotive fuel) at constant prices posted a year-on-year pickup of 26.1% in August. A rise in the domestic and foreign demand contributed to the expansion of industrial output in manufacturing: the seasonally adjusted volume index of industrial output grew by 8.2% year-on-year and the total annual increase in the industrial output in real terms reached 7.6%.

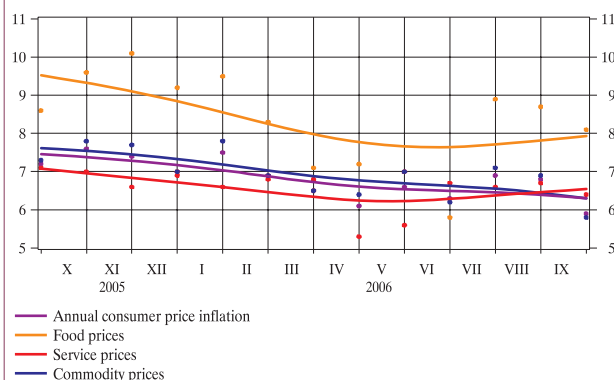
The volume of rail freight decreased substantially year-on-year (by 22.7%) and cargo turnover at Latvian ports posted a minor decline (0.1%) in September. The unemployment rate dropped to 6.8%.

The financial surplus of the general government consolidated budget was 42.8 million lats in September, reaching a record high of 304.5 million lats in the first nine months of 2006. The financial surplus of the central government consolidated budget stood at 44.7 million lats in September. An increase in tax revenue (29.9%), with that of value added tax recording the highest rise (41.7%), contributed to a year-on-year rise in the general government budget revenue (28.4%). The general government consolidated budget expenditure grew by 22.8%, with all most significant expense items increasing, including the expansion of capital investment expenditure (40.9%).

The general government debt grew by 3.3 million lats during the month (1 071.2 million lats at the end of September), with the domestic debt expanding primarily as a result of the issue of 10-year Government bonds.

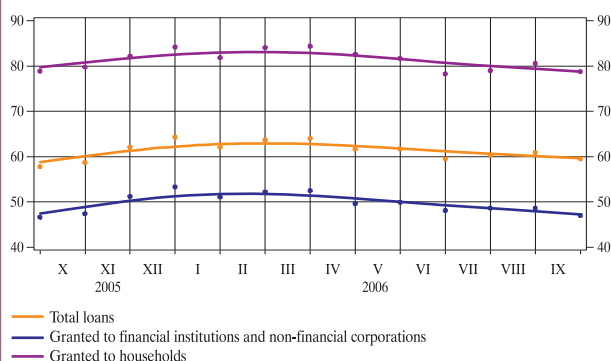
An increase in loans granted to resident financial institutions, non-financial corporations and households in September (335.6 million lats) was almost similar to that of July and August (331.0 million lats and 344.5 million lats respectively). The annual growth rate of lending stabilised at the range of 59–61% (in September – 59.5%) over the last six months. The increase of 231.9 million lats in mortgage loans was the major contributor to the overall loan expansion, including a rise of lending to households for house purchase (150.9 million lats). The monthly balances of other major loans reported a lower growth. More than a half of the loans were granted to households: in Septem-

ANNUAL CONSUMER PRICE INFLATION (%)



**GROWTH RATE DEVELOPMENTS FOR LOANS GRANTED TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**

(year-on-year changes; %)



MACROECONOMIC INDICATORS	2006	
	VIII	IX
Changes in the volume index of industrial output (year-on-year basis; %)	7.6	*
Changes in the CPI		
Month-on-month basis (%)	-0.2	0.7
Year-on-year basis (%)	6.8	5.9
Annual rate of core inflation <sup>1</sup> (%)	4.8	4.7
Number of registered unemployed persons (at end of period)	73 056	71 704
Unemployment rate (%)	6.9	6.8
General government consolidated budget financial deficit/surplus (in millions of lats)	261.7	304.5
Foreign trade (in millions of lats)		
Exports	284.3	*
Imports	552.9	*
Balance	-268.6	*

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

\* Figure available at a later date.

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

ber these loans grew by 201.2 million lats. The annual rate of increase in loans granted to both households and financial institutions and non-financial corporations declined slightly (in September – 78.8% and 47.0% respectively). Loans in euro continued to account mostly for the expansion of lending (in September 304.2 million lats; annual growth – 2.1 times), with loans granted in lats also rising slightly (by 34.8 million lats; annual growth rate – 30.8%).

In September, the increase in broad money M3 (82.9 million lats) was lower than in the previous three months. Thus, the annual growth rate of M3 shrank by 2.4 percentage points (to 39.9%). The money supply was determined by a smaller growth of resident deposits and currency in circulation. Nevertheless, the annual growth rate of currency outside MFIs increased and reached 24.5%. Minor rise in overnight deposits (their annual growth rate diminished by 7.4 percentage points; to 44.0%) accounted for the decline in the annual rate of increase in money supply M1 (4.8 percentage points; to 38.6%). The annual growth rate of monetary aggregate M2 also diminished (to 39.5%).

The annual growth rate of deposits of resident financial institutions, non-financial corporations and households declined to 41.0% in September, reaching its low since October 2005. The pickup in deposits resulted mostly from a rise in time deposits (the annual rate of increase was 35.9%). Deposits made in lats and euro posted a fairly similar expansion, with their annual growth rate declining to 40.2% and 72.0% respectively. Deposits expanded almost entirely on account of household deposits (annual growth rate – 49.6%).

In September, Latvian banks continued to borrow from abroad, hence the negative net foreign assets of MFIs (excluding the Bank of Latvia) grew by 193.4 million lats. With the surplus of general government consolidated budget growing, net credit of MFIs (excluding the Bank of Latvia) to the general government shrank by 14.7 million lats.

The trend of increasing interest rates on loans to non-MFIs continued in September, particularly on loans granted in lats: the weighted average interest rate on household loans for house purchase rose to 7.4%. The weighted average interest rates on loans granted in euro also posted an increase.

As a result of excess liquidity in the banking sector, interest rates on the lats money market shrank by the end of the reserve maintenance period of September. The RIGIBOR on overnight loans was lower than 3% by 23 September. RIGIBOR on loans with maturity of 6 months and 12 months also posted a minor decline. At the end of month, with the beginning of a new reserve maintenance period, money market interest rates rose again.

The excess liquidity resulted in a sharp decline in lats demand: the amount of euro sold by banks to the Bank of Latvia was 26.8 million lats only (9.1 times lower than in August), and the amount of loans granted at the repo tenders (20.8 million lats) was 6.1 times lower month-on-month.

The central bank's money supply remained broadly unchanged in September, as the impact of increase in net foreign assets and loans granted to banks was offset by the expansion of the Government's deposits with the Bank of Latvia. At the end of September, the backing of the national currency with the Bank of Latvia's net foreign assets amounted to 114.6%.

In September, the US dollar, the Japanese yen and the British pound appreciated against the lats (by 0.9%, 0.4% and 0.2%).

MONETARY INDICATORS (at end of period; in millions of lats)	2006	
	VIII	IX
<b>MFIs<sup>1</sup></b>		
M3	4 817.0	4 899.9
Repurchase agreements	0	0
Money market fund shares and units	31.9	31.2
Debt securities issued with maturity of up to 2 years	2.6	2.6
M2	4 782.6	4 866.2
Deposits with agreed maturity of up to 2 years	1 122.5	1 166.4
Deposits redeemable at notice of up to 3 months	137.0	149.9
M1	3 523.2	3 549.9
Currency outside MFIs	874.6	892.5
Overnight deposits	2 648.5	2 657.4
Net external assets	-1 851.4	-2 028.1
Credit to resident financial institutions, non-financial corporations and households	8 201.4	8 537.0
Credit to general government	340.9	339.4
Deposits of central government	266.8	308.8
Longer-term financial liabilities	1 672.2	1 692.0
<b>Bank of Latvia</b>		
M0	1 940.2	1 936.2
Currency in circulation	961.4	983.5
Deposits with the Bank of Latvia in lats	978.8	952.6
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	2 201.5	2 218.3
Net domestic assets	-261.4	-282.1
Credit	-196.6	-212.6
To MFIs	10.0	20.8
To central government (net)	-206.6	-233.4
Other items (net)	-64.8	-69.5
International reserves (at end of period; in millions of US dollars)	4 020.88	4 023.61
Gold	153.11	149.71
Special Drawing Rights	0.15	0.15
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	3 867.54	3 873.67

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2006	
	VIII	IX
Weighted average interest rate on domestic interbank loans in lats	4.4	2.7
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	6.8	7.1
Loans to households (in lats)	10.2	10.8
incl. for house purchase	6.7	7.4
Loans to non-financial corporations (in foreign currencies)	5.3	5.5
Loans to households (in foreign currencies)	5.3	5.4
incl. for house purchase	5.0	5.1
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	3.9	4.0
Demand deposits of non-financial corporations (in lats)	1.0	1.3
Time deposits of households (in lats)	3.9	3.7
Demand deposits of households (in lats)	0.6	0.6
Time deposits of non-financial corporations (in foreign currencies)	3.8	3.8
Demand deposits of non-financial corporations (in foreign currencies)	1.5	1.5
Time deposits of households (in foreign currencies)	3.4	3.6
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	0.5470	0.5520
LVL/GBP	1.0400	1.0420
LVL/100 JPY	0.4680	0.4700
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	
	VIII	IX
MFI reserves	1 056.6	1 040.6
Vault cash in national currency	86.7	91.0
Deposits with the Bank of Latvia	969.9	949.5
Foreign assets	3 643.0	3 590.3
Vault cash in foreign currencies	61.7	61.2
Claims on MFIs	2 220.3	2 162.2
Claims on non-MFIs	1 326.5	1 320.6
Other assets	34.5	46.3
Claims on central government	248.1	243.9
Claims on local government	92.8	95.5
Claims on public non-financial corporations	114.8	115.1
Claims on financial institutions and private non-financial corporations	4 583.5	4 722.7
Claims on households	3 552.4	3 753.6
Unclassified assets	692.1	739.0
Fixed assets	145.0	133.7
Items in transit	15.5	19.2
Other assets	84.7	102.9
Claims on resident MFIs (incl. investments)	446.9	483.3
<b>Total assets</b>	<b>13 983.3</b>	<b>14 300.6</b>
<i>Memo item: Trust assets</i>	523.7	448.9
Overnight deposits in lats	1 472.3	1 493.4
Public non-financial corporations	60.6	63.5
Financial institutions and private non-financial corporations	616.2	621.7
Households	795.6	808.2
Time deposits and deposits redeemable at notice in lats	779.0	795.5
Public non-financial corporations	89.2	83.1
Financial institutions and private non-financial corporations	201.8	207.6
Households	488.0	504.7
Foreign currency deposits of residents	1 656.3	1 691.5
Public non-financial corporations	16.9	19.4
Financial institutions and private non-financial corporations	509.4	505.3
Households	1 130.0	1 166.8
Deposits of central government	60.2	75.4
Deposits of local government	153.5	151.5
Transit funds	4.7	4.7
Foreign liabilities	7 695.9	7 836.6
Liabilities to MFIs	4 552.2	4 634.6
Liabilities to non-MFIs	2 900.7	2 889.4
Other liabilities (incl. subordinated liabilities)	243.0	312.6
Liabilities to the Bank of Latvia	10.0	20.8
Debt securities issued	318.0	318.0
Money market fund shares and units	31.9	31.2
Capital and reserves	1 096.4	1 115.1
Residents	653.8	672.6
Non-residents	442.6	442.6
Provisions	87.4	85.3
Unclassified liabilities	617.8	681.6
Items in transit	131.2	145.9
Other liabilities (incl. subordinated liabilities)	83.8	97.3
Liabilities to resident MFIs	402.8	438.4
<b>Total liabilities</b>	<b>13 983.3</b>	<b>14 300.6</b>
<i>Memo item: Trust liabilities</i>	523.7	448.9

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>).