

# MONETARY BULLETIN 2010

## 12

In the last months of 2010, the Latvian economy continued to grow progressively: external demand remained steady and domestic demand also returned to the growth path, albeit in the presence of some risks to the outlook. The latter are primarily associated with a potential drop in the euro area demand due to sovereign debt crisis and a rise in the tax burden likely to weaken the domestic demand and economic competitiveness.

In Latvia, the gap between import and export growth widened in November due to seasonal factors and base effects as well as on account of decelerating growth of economic activity in Latvia's export partners. Exports of goods increased by 29.4%, while the annual rise in imports was steeper (38.3%); hence the deficit on trade in goods rose. Exports of base metals, plastic products, machinery and mechanical appliances, and wood recorded the highest annual growth. In addition to the steady external demand, the pickup in exports of these respective sectors was supported by improvements in Latvia's competitiveness.

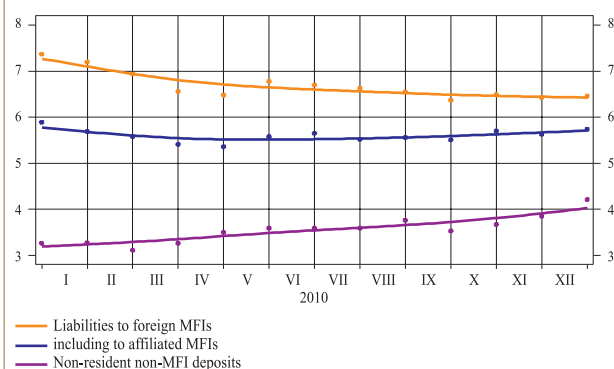
Industrial growth was somewhat losing momentum, with manufacturing output contracting by 0.6% in November against October and its annual rise slowing down to 12.4% due to base effects. Monthly and annual increases in the retail trade turnover, by 0.2% and 8.3% respectively, mirrored the expansion of consumption. Port performance indicators continued to improve in December: with freight flows expanding, the overall freight turnover at Latvian ports increased by 1.3% year-on-year. Meanwhile, freight transport by rail in Latvia contracted by 12.4%.

Even though the number of registered unemployed rose somewhat in December, the registered unemployment rate remained unchanged, at 14.3% of economically active population.

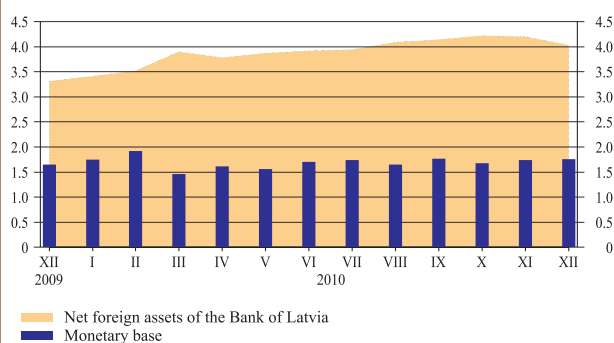
Consumer prices retained the previous upward trend. The drop of 1.1% in consumer prices in 2010 on average notwithstanding, in December prices went up both month-on-month and year-on-year by 0.1% and 2.5% respectively. Fuel prices rose by 4.0% within a month due to soaring global oil prices. Seasonal effects were responsible for a sharp uplift of fruit and vegetable prices, with other food prices also climbing notably. The 12-month average harmonised index of consumer prices (HICP) used for the Maastricht criterion was -1.2% in December. Consumer price core inflation also remained in the negative territory, at -0.3%.

In December 2010, the consolidated general government budget deficit stood at 362.7 million lats, while the deficit accumulated in the course of the year was 802.7 million lats (892.1 million lats in 2009). Both the central government basic budget and the central government social security budget ran deficits, whereas the consolidated local government budget recorded a surplus. The year-on-year rise of 15.7% in the consolidated general government budget revenue was fuelled by both higher tax revenue (8.3%) on account of growing revenue from personal income tax and social security contributions, and received foreign financial aid. In December, budget expenditure grew by 17.3% year-on-year due to bigger spending on subsidies and grants, goods and services, and remuneration. The general government debt amounted to 5 069.5 million lats in December. The pickup in the central government debt was mainly on account of the Treasury bill issuance.

**DYNAMICS OF THE MAIN COMPONENTS OF FOREIGN LIABILITIES OF LATVIAN MFIs (EXCLUDING THE BANK OF LATVIA)**  
(at end of period; in billions of lats)



**BACKING OF THE NATIONAL CURRENCY**  
(at end of period; in billions of lats)



The growth in money supply continued in December, reaching a monthly high since December 2009. M3 increased by 3.5%, yet its annual growth slowed somewhat down, to 11.5%, due to the base effect. Money supply was substantially enhanced by the seasonally high level of general government budget expenditure and deficit. Deposits of non-financial corporations were under favourable impact of expanding manufacturing and exports as well as rising household consumption, likely to be boosted by the projected consumer tax rate rises. Resident deposits grew by 4.3%, with the increase of 7.9% in non-financial corporation deposits notably outpacing the pickup in household deposits (2.2%). This upward trend in deposits did not testify to a more pronounced saving behaviour, since it was the liquid bank overnight deposit segment and currency outside MFIs that posted a pickup of 8.3% and 4.1% respectively, while, by contrast, household deposits contracted. Recording an annual increase of 26.6%, M1 grew by 7.4% in December, considerably outpacing the growth rates of M2 and M3.

The protracted downturn in lending continued in December as well: loans to resident financial institutions, non-financial corporations and households shrank by 1.6%, while in annual terms the drop in lending amounted to 8.3%. Bank stances toward non-financial corporations became more cautious, with the respective lending decelerating by 2.3%; loans to households decreased only by 0.5%, as, due to rising household expenditure, consumer credit edged up slightly after a longer break.

External financing of the banking sector expanded by 378.4 million lats in December, with non-resident non-MFI deposits growing by 365.2 million lats and liabilities to foreign banks increasing by 26.0 million lats.

The monetary base M0 grew by 11.0 million lats in December due to a sharp seasonal pick-up in the demand for cash and also the reduction in bank demand deposits as banks resorted to deposit facility with the Bank of Latvia more often. The central bank's money supply was somewhat boosted by contracting government deposit in lats with the Bank of Latvia. Meanwhile, the amounts of lats put into circulation as a result of government converting the euro to lats to finance the general budget deficit were largely offset by banks buying the euro from the Bank of Latvia.

Net foreign assets of the Bank of Latvia shrank by 4.1% in December; the backing of the national currency with the Bank of Latvia's net foreign assets at the month's end was 229.7%. The decline in foreign reserves was mainly triggered by banks buying the euro from the Bank of Latvia in the net amount of 184.0 million lats.

In the interbank market, interest rates went down. In December, the average weighted interest rate on overnight loans was 0.23%, and average monthly RIGIBOR on overnight loans stood at 0.50%. 3-, 6-, and 12-month RIGIBOR remained almost unchanged in December, at 0.85%, 1.39%, and 2.24% respectively at its end.

Most interest rates on loans to non-financial corporations and households went up in December, while those on loans to households in foreign currency slid down slightly. At the same time, interest rates on household time deposits increased.

In December, the exchange rates of the US dollar and the Japanese yen set by the Bank of Latvia against the lats appreciated by 0.8% and 3.2% respectively but the British pound sterling depreciated by 0.6%.

| MACROECONOMIC INDICATORS   | 2010    |         |
|--|---------|---------|
|  | XI      | XII     |
| Volume index of industrial output (working-day adjusted annual rate of change; %)      | 11.4    | *       |
| Changes in the CPI   |         |         |
| Month-on-month basis (%)   | 0.2     | 0.1     |
| Average annual inflation rate (HCPI) of last 12 months (%)                             | -1.4    | -1.1    |
| Year-on-year basis (%)   | 1.9     | 2.5     |
| Annual rate of core inflation <sup>1</sup> (%)   | -0.6    | -0.3    |
| Number of registered unemployed persons (at end of period)                             | 161 816 | 162 471 |
| Unemployment rate (%)  | 14.3    | 14.3    |
| General government consolidated budget financial deficit/surplus (in millions of lats) | -440.0  | -802.7  |
| Foreign trade (in millions of lats)  |         |         |
| Exports  | 435.3   | *       |
| Imports  | 557.3   | *       |
| Balance  | -122.0  | *       |

<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)                          | 2010     |          |
|--|----------|----------|
|  | XI       | XII      |
| MFI <sup>1</sup>   |          |          |
| M3   | 6 326.2  | 6 547.6  |
| Repurchase agreements  | 0        | 0        |
| Money market fund shares and units   | 88.7     | 81.4     |
| Debt securities issued with maturity of up to 2 years                                | 20.6     | 20.6     |
| M2   | 6 216.9  | 6 445.6  |
| Deposits with an agreed maturity of up to 2 years                                    | 2 449.8  | 2 430.6  |
| Deposits redeemable at notice of up to 3 months                                      | 255.2    | 244.4    |
| M1   | 3 511.9  | 3 770.6  |
| Currency outside MFIs  | 775.5    | 807.4    |
| Overnight deposits   | 2 736.4  | 2 963.2  |
| Net external assets  | -1 266.0 | -1 219.0 |
| Credit to resident financial institutions, non-financial corporations and households | 12 596.6 | 12 399.3 |
| Credit to general government   | 530.2    | 563.8    |
| Deposits of central government   | 2 048.5  | 1 792.8  |
| Longer-term financial liabilities  | 2 295.1  | 2 295.6  |
| Bank of Latvia   |          |          |
| M0   | 1 744.2  | 1 755.2  |
| Currency in circulation  | 888.9    | 937.9    |
| Deposits with the Bank of Latvia in lats   | 839.0    | 797.3    |
| Deposits with the Bank of Latvia in foreign currencies                               | 16.2     | 20.0     |
| Net foreign assets   | 4 203.5  | 4 032.3  |
| Net domestic assets  | -2 459.4 | -2 277.0 |
| Credit   | -1 326.8 | -1 081.0 |
| To MFIs  | 0        | 0        |
| To central government (net)  | -1 326.8 | -1 081.0 |
| Other items (net)  | -1 132.5 | -1 196.0 |
| International reserves (at end of period; in millions of euro)                       | 6 067.93 | 5 789.25 |
| Gold   | 255.92   | 266.33   |
| Special Drawing Rights   | 141.89   | 141.37   |
| Reserve position in the IMF  | 0.06     | 0.06     |
| Foreign convertible currencies   | 5 670.06 | 5 381.49 |
| International reserves (at end of period; in millions of US dollars)                 | 8 031.20 | 7 605.07 |
| Gold   | 338.72   | 349.87   |
| Special Drawing Rights   | 187.79   | 185.71   |
| Reserve position in the IMF  | 0.09     | 0.08     |
| Foreign convertible currencies   | 7 504.60 | 7 069.41 |

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

| EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES                   | 2010   |        |
|---|--------|--------|
|   | XI     | XII    |
| Weighted average interest rate on domestic interbank loans in lats            | 0.5    | 0.2    |
| Interest rates on loans to resident non-financial corporations and households |        |        |
| Loans to non-financial corporations (in lats)                                 | 5.0    | 5.2    |
| Loans to households (in lats)   | 13.9   | 16.5   |
| incl. for house purchase  | 4.8    | 5.7    |
| Loans to non-financial corporations (in foreign currencies)                   | 4.2    | 4.7    |
| Loans to households (in foreign currencies)                                   | 5.2    | 5.1    |
| incl. for house purchase  | 3.7    | 4.0    |
| Interest rates on deposits of non-financial corporations and households       |        |        |
| Time deposits of non-financial corporations (in lats)                         | 0.5    | 0.4    |
| Demand deposits of non-financial corporations (in lats)                       | 0.2    | 0.2    |
| Time deposits of households (in lats)   | 1.9    | 2.1    |
| Demand deposits of households (in lats)                                       | 0.5    | 0.3    |
| Time deposits of non-financial corporations (in foreign currencies)           | 0.7    | 0.7    |
| Demand deposits of non-financial corporations (in foreign currencies)         | 0.2    | 0.2    |
| Time deposits of households (in foreign currencies)                           | 1.6    | 2.3    |
| Demand deposits of households (in foreign currencies)                         | 0.4    | 0.4    |
| The Bank of Latvia's refinancing rate (at end of period; %)                   | 3.5    | 3.5    |
| Exchange rates of foreign currencies (at end of period)                       |        |        |
| LVL/USD   | 0.5310 | 0.5350 |
| LVL/GBP   | 0.8290 | 0.8240 |
| LVL/100 JPY   | 0.6310 | 0.6510 |
| LVL/EUR   | 0.7028 | 0.7028 |

| AGGREGATED BALANCE SHEET OF MFIs (EXCLUDING THE BANK OF LATVIA) (at end of period; in millions of lats) | 2010     |          |
|---|----------|----------|
|   | XI       | XII      |
| MFI reserves  | 1 776.2  | 1 817.3  |
| Vault cash in national currency   | 113.4    | 130.6    |
| Deposits with the Bank of Latvia  | 1 662.7  | 1 686.7  |
| Foreign assets  | 4 962.9  | 5 559.6  |
| Vault cash in foreign currencies  | 66.9     | 76.2     |
| Claims on MFIs  | 2 771.7  | 3 309.9  |
| Claims on non-MFIs  | 1 993.0  | 2 045.5  |
| Other assets  | 131.4    | 128.0    |
| Claims on central government  | 467.8    | 502.3    |
| Claims on local government  | 62.5     | 61.5     |
| Claims on public non-financial corporations   | 450.9    | 474.5    |
| Claims on financial institutions and private non-financial corporations                                 | 6 600.3  | 6 430.5  |
| Claims on households  | 5 771.1  | 5 740.9  |
| Unclassified assets   | 920.3    | 954.8    |
| Fixed assets  | 119.0    | 121.0    |
| Items in transit  | 21.9     | 15.5     |
| Other assets  | 499.0    | 512.2    |
| Claims on resident MFIs (incl. investments)   | 280.3    | 306.2    |
| Total assets  | 21 011.9 | 21 541.4 |
| <i>Memo item: Trust assets</i>  | 472.7    | 408.5    |
| Overnight deposits in lats  | 1 494.5  | 1 662.7  |
| Public non-financial corporations   | 81.8     | 87.1     |
| Financial institutions and private non-financial corporations   | 699.9    | 805.0    |
| Households  | 712.9    | 770.5    |
| Time deposits and deposits redeemable at notice in lats   | 1 175.2  | 1 112.1  |
| Public non-financial corporations   | 201.1    | 156.4    |
| Financial institutions and private non-financial corporations   | 476.7    | 472.4    |
| Households  | 497.4    | 483.3    |
| Foreign currency deposits of residents  | 2 684.0  | 2 807.9  |
| Public non-financial corporations   | 84.7     | 114.5    |
| Financial institutions and private non-financial corporations   | 926.9    | 1 001.4  |
| Households  | 1 672.4  | 1 692.0  |
| Deposits of central government  | 721.6    | 711.8    |
| Deposits of local government  | 218.4    | 202.0    |
| Foreign liabilities   | 10 432.5 | 10 810.9 |
| Liabilities to MFIs   | 6 432.2  | 6 458.2  |
| Liabilities to non-MFIs   | 3 848.3  | 4 213.5  |
| Other liabilities (incl. subordinated liabilities)  | 151.9    | 139.2    |
| Liabilities to the Bank of Latvia   | 0        | 0        |
| Debt securities issued  | 175.4    | 175.9    |
| Money market fund shares and units  | 89.1     | 81.8     |
| Capital and reserves  | 1 658.8  | 1 640.5  |
| Residents   | 356.7    | 338.4    |
| Non-residents   | 1 302.1  | 1 302.2  |
| Provisions  | 1 779.1  | 1 741.5  |
| Unclassified liabilities  | 583.2    | 594.4    |
| Items in transit  | 95.2     | 74.2     |
| Other liabilities (incl. subordinated liabilities)  | 229.5    | 234.6    |
| Liabilities to resident MFIs  | 258.5    | 285.6    |
| Total liabilities   | 21 011.9 | 21 541.4 |
| <i>Memo item: Trust liabilities</i>   | 472.7    | 408.5    |

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>).