

MONETARY BULLETIN 2005

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On April 29, 2005, the Economic and Financial Committee of the EU Council of Ministers decided to include the Latvian lats in the Exchange Rate Mechanism II (ERM II), and on May 2, 2005 Latvia joined ERM II (the central rate of the lats is set at 1 EUR = 0.702804 LVL). Though the standard fluctuation band around the central rate within ERM II is $\pm 15\%$, Latvia has undertaken a unilateral commitment to maintain the exchange rate of the lats at the central rate against the euro with a fluctuation band of $\pm 1\%$, thus preserving the lats exchange rate fluctuation band that has existed since 1994. Participation in the ERM II is another important step towards introduction of the euro in Latvia, with the stability of the lats exchange rate as one of the five economic criteria to be met.

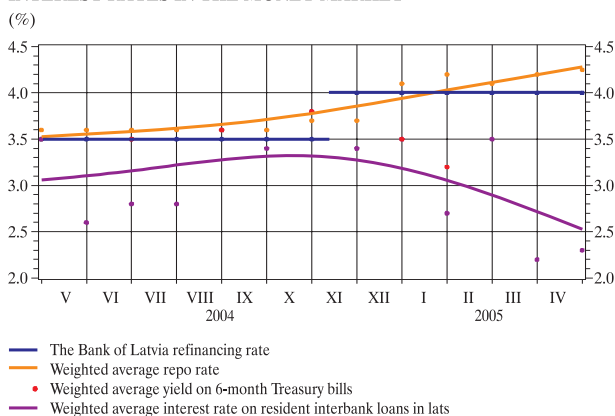
The industrial sector resumed growth in March (the seasonally adjusted industrial volume index grew by 2.0% in manufacturing, 20.9% in mining and quarrying, and 6.0% in electricity, gas and water supply, resulting in an overall 3.2% rise in the industrial volume index), and the pickup in retail trade turnover was notable (14.9%). In April, freight transportation by rail increased by 6.3%, freight turnover at Latvian ports grew by 3.4%, and the volume of oil products transported by pipeline expanded by 10.5%. The unemployment rate dropped 0.2 percentage point (down to 8.4%).

Consumer prices in April rose by 1.0% month-on-month, with their annual growth rate accelerating to 6.9%. In line with sustained high oil prices in the global market, fuel prices continued to go up (by 6.1% in April; the largest increase since the excise tax rise in May 2004). Medical services became more costly (a notable 13.9% pickup) as a result of increased patient contribution payments; likewise, rent increased due to a rise of the price ceiling. Prices were on the rise for a major part of food products.

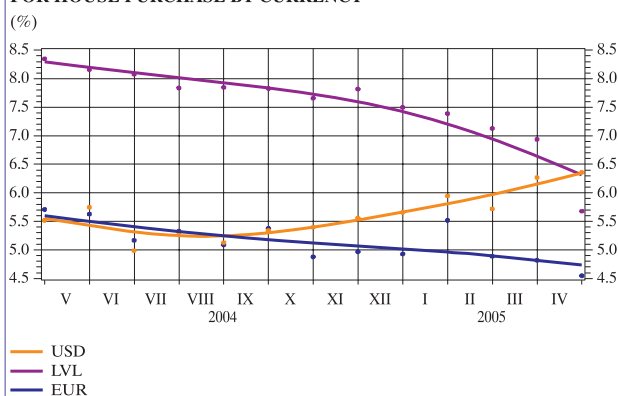
In April for the first time in 2005 a financial deficit (5.4 million lats) caused by the central government basic budget shortfall (13.2 million lats) was recorded in the general government consolidated budget, with both the central government special budget and the local government consolidated budget recording financial surpluses (6.7 million lats and 1.6 million lats, respectively). Deterioration of the general government consolidated budget was a result of a relatively slow revenue increase (4.9% year-on-year in April) due to moderating growth of foreign financial assistance. However, tax revenue continued to grow, and, against the background of the high basis, a slight decrease was recorded only for the revenue from the value added tax. The general government consolidated budget expenditure increased by 12.6% year-on-year. In the first four months of 2005, the general government consolidated budget recorded a financial surplus (37.6 million lats), which resulted from surpluses in both the central government consolidated budget (14.3 million lats) and the local government consolidated budget (28.0 million lats). The positive financial balance of the central government consolidated budget was determined by a financial surplus in the central government basic budget (16.7 million lats), whereas the central government special budget posted a narrow deficit (1.7 million lats).

Government debt remained broadly unchanged and was 951.5 million lats at the end of April (including the Government internal debt in the amount of 406.1 million lats). The new issues of government securities were in balance with the redemptions in April. At a competitive multi-price auction of the primary market, 12-month Treasury bonds in the amount of 8.0 million lats were sold at a low average weighted discount rate (2.42%), the latter dropping 1.2 percentage points from the previous auction of 12-month bonds

INTEREST RATES IN THE MONEY MARKET



INTEREST RATES ON LENDING TO RESIDENT HOUSEHOLDS FOR HOUSE PURCHASE BY CURRENCY



in October 2004. Confidence of financial market participants in declining state risk premium and the ample bank liquidity were the main factors behind the fall in interest rates on securities in lats.

In April, broad money M3 grew by 69.8 million lats. The money supply was primarily affected by an increase in overnight deposits (30.2 million lats), with the growth in currency in circulation (21.2 million lats) also playing a role. A more moderate increase in less liquid components resulted in a decline of M3 annual growth rate to 28.1% (29.0% in March). At the same time, an increase in M1 annual growth rate from 29.7% in March to 30.2% in April was observed due to accelerating growth of more liquid components.

The overall annual growth of deposits by resident financial institutions, non-financial corporations and households slowed in April (down to 31.2%); however, deposits of households, both in lats and foreign currencies, continued to rise vigorously.

Due to the relatively high base, lending to resident financial institutions, non-financial corporations and households decreased somewhat (from 49.5% in March to 48.1% in April). The observed strengthening of lending in April was primarily due to an increase of 76.3 million lats in mortgage lending, including a 53.0 million lats rise in lending to households for house purchase. Growth in industrial credit (22.3 million lats) and commercial credit (14.7 million lats) was moderate. As before, the overall increase in loans was due to loans in euros. The increase in loans to households was 78.9 million lats, whereas those to financial institutions and non-financial corporations rose by 56.0 million lats. Though the annual growth rate of loans to households continued to decline, it remained notably higher than that of loans to financial institutions and non-financial corporations (72.1% and 36.9%, respectively).

With the budget surplus narrowing, loans to the general government in April increased by 3.8%, rising 6.2% over the level of the corresponding period of the previous year.

In the first four months of 2005, banks' profit was 62.9 million lats or 2.0 times more year-on-year.

As a result of the strong bank competition, interest rates on loans to households fell notably in April. As to loans in lats, the fall measured 1.6 percentage points (to 7.7%), including a 1.3 percentage point decrease (to 5.7%) in interest rates on loans for house purchase. Interest rates on the same types of loans in euros also fell (to 4.7% and 4.5%, respectively). Changes in interest rates on loans to non-financial corporations and deposits attracted by MFIs were less pronounced.

Despite a substantial strengthening in the demand for cash in April, the monetary base M0 declined by 9.3 million lats. Such weakening was brought about by a decrease in banks' demand deposits with the central bank caused by their more active use of the time deposit facility with the Bank of Latvia due to ample liquidity. Thus, the money supply of the central bank decreased, notwithstanding either the upward pressure of the shrinking Government deposit with the Bank of Latvia (by 5.0 million lats) or the growth in the central bank's net foreign assets (by 19.6 million lats) resulting from the Bank of Latvia's foreign currency purchases.

In April, the exchange rate of the US dollar against the lats remained unchanged, whereas exchange rates of the British pound sterling and the Japanese yen appreciated by 2.0% and 1.4%, respectively.

MACROECONOMIC INDICATORS	2005	
	III	IV
Changes in the volume index of industrial output (year-on-year basis; %)	3.2	*
Changes in the CPI		
Month-on-month basis (%)	0.6	1.0
Year-on-year basis (%)	6.4	6.9
Annual rate of core inflation ¹ (%)	5.4	5.4
Number of registered unemployed persons (at end of period)	91 590	89 375
Unemployment rate (%)	8.6	8.4
General government consolidated budget fiscal deficit/surplus (in millions of lats)	61.0	56.8
Foreign trade (in millions of lats)		
Exports	237.4	*
Imports	388.9	*
Balance	-151.5	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

Source: Central Statistical Bureau of Latvia.

MONETARY INDICATORS (at end of period; in millions of lats)	2005	
	III	IV
MFIs¹		
M3	2 973.8	3 043.6
Repurchase agreements	0	0
Debt securities issued with maturity of up to 2 years	9.6	23.8
M2	2 964.1	3 019.8
Deposits with agreed maturity of up to 2 years	800.4	801.3
Deposits redeemable at notice of up to 3 months	77.6	80.8
M1	2 086.1	2 137.6
Currency outside MFIs	640.0	661.2
Overnight deposits	1 446.2	1 476.4
Net external assets	-397.6	-485.2
Credit to resident financial institutions, non-financial corporations and households	4 150.7	4 285.6
Credit to general government	394.9	410.1
Deposits of central government	212.0	203.4
Longer-term financial liabilities	966.0	989.0
Bank of Latvia		
M0	997.7	988.4
Currency in circulation	717.8	736.7
Deposits with the Bank of Latvia in lats	279.9	251.7
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	1 120.6	1 140.2
Net domestic assets	-122.9	-151.9
Credit	-32.3	-26.9
To MFIs	8.5	8.5
To central government (net)	-40.8	-35.4
Other items (net)	-90.6	-124.9
International reserves (at end of period; in millions of US dollars)	2 088.46	2 123.74
Gold	105.93	107.63
Special Drawing Rights	0.15	0.15
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	1 982.30	2 015.88

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2005	
	III	IV
Weighted average interest rate on domestic interbank loans in lats	2.2	2.3
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	7.0	6.5
Loans to households (in lats)	9.3	7.7
incl. for house purchase	7.0	5.7
Loans to non-financial corporations (in foreign currencies)	5.1	5.2
Loans to households (in foreign currencies)	5.1	4.9
incl. for house purchase	5.2	4.7
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	2.7	2.6
Demand deposits of non-financial corporations (in lats)	0.7	0.7
Time deposits of households (in lats)	3.5	3.4
Demand deposits of households (in lats)	0.5	0.5
Time deposits of non-financial corporations (in foreign currencies)	2.2	1.9
Demand deposits of non-financial corporations (in foreign currencies)	0.9	0.9
Time deposits of households (in foreign currencies)	2.4	2.5
Demand deposits of households (in foreign currencies)	1.4	1.1
The Bank of Latvia's refinancing rate (at end of period; %)	4.0	4.0
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5430	0.5430
LVL/GBP	1.0200	1.0400
LVL/100 JPY	0.5060	0.5130
LVL/EUR	0.7028	0.7028

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

	2005	
	III	IV
MFI reserves	386.8	385.0
Vault cash in national currency	77.8	75.5
Deposits with the Bank of Latvia	309.0	309.6
Foreign assets	3 108.2	2 994.1
Vault cash in foreign currencies	57.6	56.2
Claims on MFIs	1 996.4	1 851.1
Claims on non-MFIs	1 019.4	1 038.3
Other assets	34.8	48.5
Claims on central government	220.8	231.4
Claims on local government	75.4	79.6
Claims on public non-financial corporations	109.1	108.4
Claims on financial institutions and private non-financial corporations	2 570.6	2 627.4
Claims on households	1 496.8	1 575.7
Unclassified assets	475.6	423.0
Fixed assets	129.3	129.2
Items in transit	12.5	15.2
Other assets	64.8	66.4
Claims on resident MFIs (incl. investments)	269.1	212.2
Total assets	8 443.2	8 424.7
<i>Memo item: Trust assets</i>	764.2	637.8
Overnight deposits in lats	826.6	841.6
Public non-financial corporations	46.7	44.6
Financial institutions and private non-financial corporations	382.1	380.9
Households	397.8	416.2
Time deposits and deposits redeemable at notice in lats	638.3	637.8
Public non-financial corporations	70.7	81.6
Financial institutions and private non-financial corporations	207.1	195.9
Households	360.5	360.4
Foreign currency deposits of residents	908.9	925.3
Public non-financial corporations	14.6	15.9
Financial institutions and private non-financial corporations	288.5	287.7
Households	605.7	621.7
Deposits of central government	72.5	68.9
Deposits of local government	74.4	81.4
Transit funds	5.4	5.3
Foreign liabilities	4 626.4	4 619.6
Liabilities to MFIs	1 604.5	1 698.7
Liabilities to non-MFIs	2 873.9	2 743.7
Other liabilities (incl. subordinated liabilities)	148.0	177.2
Liabilities to the Bank of Latvia	8.5	8.5
Debt securities issued	90.3	90.3
Capital and reserves	665.3	692.9
Residents	390.2	383.8
Non-residents	275.1	309.1
Provisions	93.1	92.3
Unclassified liabilities	433.4	360.7
Items in transit	112.5	107.5
Other liabilities (incl. subordinated liabilities)	64.0	60.1
Liabilities to resident MFIs	256.9	193.2
Total liabilities	8 443.2	8 424.7
<i>Memo item: Trust liabilities</i>	764.2	637.8

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>).