

# MONETARY BULLETIN 2006

## 10

Latvia's economy continued to develop buoyantly, persistently driven by the high domestic demand. With consumer prices growing by 0.5% month-on-month, October was the second month in succession when the annual inflation decreased significantly, to 5.6%, but the annual core inflation climbed to 4.8%. Inflation eased primarily on account of a drop in fuel prices by 6.3%, whereas an upward pressure on inflation was exerted by a rise of vegetable prices by 16.3% and several other foodstuffs with the overall increase of food prices at 1.2%, and that of clothing and footwear prices at 2.7%. Latvia's inflation rate lost its leading position in the EU for the first time in 26 months, to Hungary.

As a result of shrinking wood production output in real terms and an insignificant increase in food production output, the seasonally adjusted volume index of industrial output in manufacturing grew merely by 2.2% year-on-year in September. Although the increase in mining and quarrying and energy was more significant, the overall industrial output grew by only 3.8%. Retail trade turnover (including sale of motor vehicles and retail trade in automotive fuel) expanded by 30.3% at constant prices.

In October, the volume of rail freight and cargo turnover at Latvian ports continued to shrink by 20.9% and 5.8% respectively. Oil products transported by pipeline grew by 8.5%. The unemployment rate dropped to 6.6%.

The financial surplus of the general government consolidated budget amounted to 1.7 million lats in October, with the respective figure for the first 10 months of 2006 being 306.1 million lats. In October, the central government consolidated budget recorded a financial surplus of 1.8 million lats as a result of a 4.9 million lats surplus in the social security fund. The central government basic budget and local government consolidated budget reported a small deficit. The year-on-year growth of the general government consolidated budget revenue by 25.4% was underpinned by a rapid rise of tax collections by 33.1%, with the value added tax growth slightly moderating to 34.2% and that of the social insurance contributions and direct taxes accelerating.

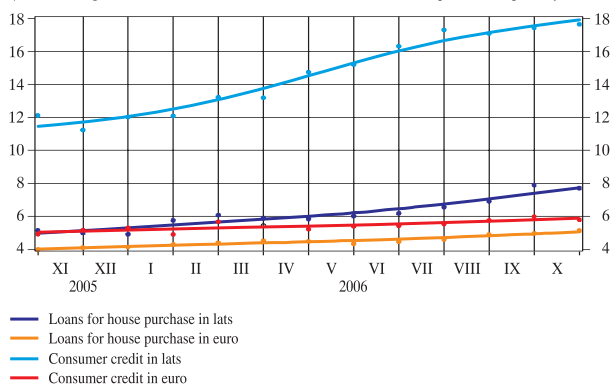
The general government consolidated budget expenditure grew by 27.5% supported by several factors, including raising the teaching staff salaries from 1 September and the old-age pension indexation conducted in October. Capital investment expenditure also increased.

The general government debt increased slightly to stand at 1 091.9 million lats at the end of October due to growing short-term domestic debt. One auction of 6-month and one auction of 12-month Treasury bills were held on the domestic government securities market in October. 6-month and 12-month Treasury bills totalling 17.5 million lats at the weighted average discount rate of 4.722% and 4.603% or 120 and 76 basis points higher than at the previous auctions respectively were sold at competitive multi-price auctions on the primary market.

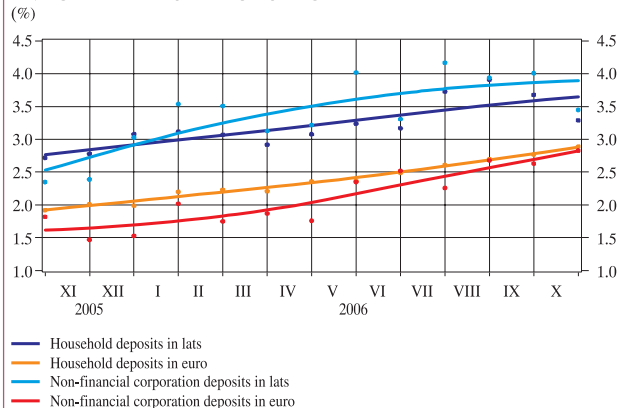
In October, the growth rate of loans granted to resident financial institutions, non-financial corporations and households remained unchanged, whereas the annual growth rate of lending decreased to 58.7%, which is the lowest level since October 2005. The highest growth was reported by mortgage lending, with the annual growth rate reaching 90.7%, including that of household

### INTEREST RATES ON LOANS TO RESIDENT HOUSEHOLDS

(with floating interest rates and with initial interest rate fixation period of up to 1 year; %)



**INTEREST RATES ON DEPOSITS FROM RESIDENTS WITH AN AGREED MATURITY OF UP TO 1 YEAR (%)**



loans for house purchase 86.5%. Domestic consumption was fuelled also by the significant annual growth of consumer credit by 64.9% and by credit card credit increasing 2.0 times. Lending to companies grew at a more modest pace, with the growth rates of industrial credit and commercial credit reaching 19.3% and 22.3% respectively in October. The annual growth of both lending to households and lending to financial institutions and non-financial corporations slightly decelerated to 78.3% and 45.8% respectively. Lending growth was driven by euro loans increasing by 335.4 million lats in October or 2.0 times year-on-year, whereas the amount of outstanding lats loans remained broadly unchanged and their annual growth rate dropped to 27.8%.

Broad money M3 increased by 210.8 million lats in October, which is considerably higher than in the previous months. Money supply was affected by a rapid rise in resident deposits, with currency in circulation growing rather moderately. The annual growth rate of M3 went up from 39.9% in September to 44.3% in October and that of overnight deposits from 44.0% to 54.1% respectively. The annual growth rate of currency outside MFIs decreased by 0.7 percentage point to 23.8%, that of deposits with an agreed maturity of up to 2 years declined by 1.8 percentage points to 39.2% and that of deposits redeemable at notice by 9.4 percentage points to 42.7%. The annual growth of monetary aggregates M1 and M2 also increased significantly to stand at 45.5% and 43.9% respectively.

In October, the annual growth rate of deposits by resident financial institutions, non-financial corporations and households climbed to 46.4%, which is the highest level since 1997. Moreover, the growth of lats deposits was considerably higher than that of deposits in foreign currencies.

Latvian banking sector continued to borrow abroad, hence the negative net foreign assets of MFIs (excluding the Bank of Latvia) grew by 281.8 million lats in October. Net credit of MFIs (excluding the Bank of Latvia) to the general government grew by a mere 0.4 million lats.

Interest rates on non-MFI loans, particularly those on lats loans, continued on an upward trend. For example, the weighted average interest rate on household loans grew by 0.5 percentage point, reaching 11.3% in October. Nevertheless, the interest rates on household loans for house purchase in lats remained unchanged at 7.4%, whereas those in euro grew only by 0.1 percentage point, reaching 5.2%.

In October, the banking sector's liquidity was ample, and RIGIBOR on overnight loans declined from 5.12% to 2.69%, whereas that on 6- and 12-month loans decreased by 18 and 14 basis points, to 4.90% and 5.15% respectively.

Banks increased their lats liquidity by selling euro in the net amount of 176.0 million lats to the Bank of Latvia. On the first days of the month, they also resorted to repo loans amounting to 35.0 million lats. Foreign currency supply was also boosted by purchasing lats for the privatisation needs of the JSC *Ventspils Nafta*. With the reserve requirements growing and accumulation of significant excess reserves, demand deposits of banks with the Bank of Latvia increased by 114.5 million lats. Demand for cash also continued to grow, and monetary base M0 expanded by 128.9 million lats, with its annual growth reaching 72.3%. At the end of October, the backing of the national currency with the Bank of Latvia's net foreign assets was 116.1%. Money supply was decreased by growing government deposits with the Bank of Latvia and shrinking repo loans granted by the central bank.

In October, the US dollar, the Japanese yen and the British pound sterling appreciated against the lats by 0.2%, 0.2% and 0.6% respectively.

MACROECONOMIC INDICATORS	2006	
	IX	X
Changes in the volume index of industrial output (year-on-year basis; %)	3.8	*
Changes in the CPI		
Month-on-month basis (%)	0.7	0.5
Year-on-year basis (%)	5.9	5.6
Annual rate of core inflation <sup>1</sup> (%)	4.7	4.8
Number of registered unemployed persons (at end of period)	71 704	70 045
Unemployment rate (%)	6.8	6.6
General government consolidated budget financial deficit/surplus (in millions of lats)	304.5	306.1
Foreign trade (in millions of lats)		
Exports	283.6	*
Imports	567.5	*
Balance	-283.9	*

<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)	2006	
	IX	X
<b>MFIs<sup>1</sup></b>		
<b>M3</b>	4 899.9	5 110.7
Repurchase agreements	0	0
Money market fund shares and units	31.2	31.1
Debt securities issued with maturity of up to 2 years	2.6	4.9
<b>M2</b>	4 866.2	5 074.8
Deposits with agreed maturity of up to 2 years	1 166.4	1 183.1
Deposits redeemable at notice of up to 3 months	149.9	138.8
<b>M1</b>	3 549.9	3 752.8
Currency outside MFIs	892.5	904.4
Overnight deposits	2 657.4	2 848.4
Net external assets	-2 028.1	-2 131.0
Credit to resident financial institutions, non-financial corporations and households	8 537.0	8 873.7
Credit to general government	339.4	345.3
Deposits of central government	308.8	315.3
Longer-term financial liabilities	1 692.0	1 729.5
<b>Bank of Latvia</b>		
<b>M0</b>	1 936.2	2 065.1
Currency in circulation	983.5	998.0
Deposits with the Bank of Latvia in lats	952.6	1 067.1
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	2 218.3	2 397.1
Net domestic assets	-282.1	-332.1
Credit	-212.6	-258.5
To MFIs	20.8	0
To central government (net)	-233.4	-258.5
Other items (net)	-69.5	-73.6
International reserves (at end of period; in millions of US dollars)	4 023.61	4 349.15
Gold	149.71	149.95
Special Drawing Rights	0.15	0.15
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	3 873.67	4 198.97

<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	
	IX	X
Weighted average interest rate on domestic interbank loans in lats	2.7	3.7
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	7.1	7.3
Loans to households (in lats)	10.8	11.3
incl. for house purchase	7.4	7.4
Loans to non-financial corporations (in foreign currencies)	5.5	5.9
Loans to households (in foreign currencies)	5.4	5.5
incl. for house purchase	5.1	5.2
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	4.0	3.5
Demand deposits of non-financial corporations (in lats)	1.3	1.1
Time deposits of households (in lats)	3.7	3.3
Demand deposits of households (in lats)	0.6	0.5
Time deposits of non-financial corporations (in foreign currencies)	3.8	3.4
Demand deposits of non-financial corporations (in foreign currencies)	1.5	1.5
Time deposits of households (in foreign currencies)	3.6	3.5
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	0.5520	0.5530
LVL/GBP	1.0420	1.0480
LVL/100 JPY	0.4700	0.4710
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	
	IX	X
MFI reserves	1 040.6	1 156.6
Vault cash in national currency	91.0	93.5
Deposits with the Bank of Latvia	949.5	1 063.0
Foreign assets	3 590.3	3 531.7
Vault cash in foreign currencies	61.2	58.7
Claims on MFIs	2 162.2	2 073.9
Claims on non-MFIs	1 320.6	1 360.3
Other assets	46.3	38.8
Claims on central government	243.9	252.1
Claims on local government	95.5	93.2
Claims on public non-financial corporations	115.1	116.1
Claims on financial institutions and private non-financial corporations	4 722.7	4 870.7
Claims on households	3 753.6	3 942.0
Unclassified assets	739.0	809.8
Fixed assets	133.7	137.2
Items in transit	19.2	22.9
Other assets	102.9	105.5
Claims on resident MFIs (incl. investments)	483.3	544.2
<b>Total assets</b>	<b>14 300.6</b>	<b>14 772.2</b>
<i>Memo item: Trust assets</i>	<i>448.9</i>	<i>455.0</i>
Overnight deposits in lats	1 493.4	1 624.0
Public non-financial corporations	63.5	138.2
Financial institutions and private non-financial corporations	621.7	648.5
Households	808.2	837.4
Time deposits and deposits redeemable at notice in lats	795.5	817.1
Public non-financial corporations	83.1	77.0
Financial institutions and private non-financial corporations	207.6	219.9
Households	504.7	520.2
Foreign currency deposits of residents	1 691.5	1 724.2
Public non-financial corporations	19.4	20.6
Financial institutions and private non-financial corporations	505.3	536.9
Households	1 166.8	1 166.7
Deposits of central government	75.4	56.9
Deposits of local government	151.5	164.5
Transit funds	4.7	4.6
Foreign liabilities	7 836.6	8 059.9
Liabilities to MFIs	4 634.6	4 808.0
Liabilities to non-MFIs	2 889.4	3 016.4
Other liabilities (incl. subordinated liabilities)	312.6	235.4
Liabilities to the Bank of Latvia	20.8	0
Debt securities issued	318.0	323.5
Money market fund shares and units	31.2	31.1
Capital and reserves	1 115.1	1 146.3
Residents	672.6	696.7
Non-residents	442.6	449.6
Provisions	85.3	91.0
Unclassified liabilities	681.6	729.1
Items in transit	145.9	133.7
Other liabilities (incl. subordinated liabilities)	97.3	98.4
Liabilities to resident MFIs	438.4	497.1
<b>Total liabilities</b>	<b>14 300.6</b>	<b>14 772.2</b>
<i>Memo item: Trust liabilities</i>	<i>448.9</i>	<i>455.0</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>).