

MONETARY BULLETIN 2008

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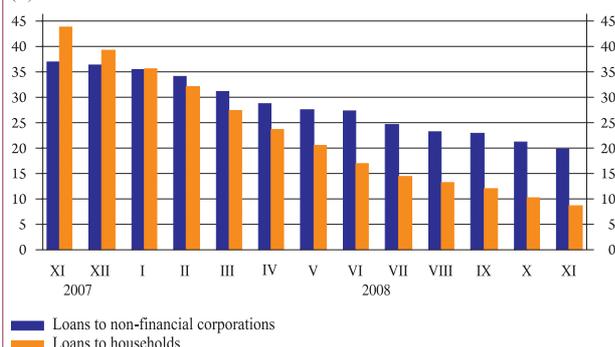
The situation in Latvia's financial system became aggravated in November. In order to ensure stability of the system, the government took over the world-financial-crisis-hit *AS Parex banka*, Latvia's second largest bank. At the same time, the Bank of Latvia supported the financial system by enhancing bank liquidity via collateralised loans and interventions in the foreign exchange market (selling euro). Economic downturn, tight liquidity conditions and deteriorating confidence of depositors were reflected through decreasing amounts of bank deposits and contracting money supply. Recent statistical data point to unfavourable trends also in the economy. A substantial rise in the general government consolidated budget deficit was observed. The amount of loans granted in November did not increase for the first time since 1999 due to a negative future outlook of consumers and businesses, and more restrained bank funding.

The data released by the Central Statistical Bureau of Latvia on contracting GDP were in line with the forecasts. Against the backdrop of weakening domestic demand and decelerating economic growth the third quarter GDP decreased by 4.6% year-on-year. According to preliminary statistical estimates for October and November, the shrinking of private consumption is expected to continue also in the fourth quarter. The retail trade turnover recorded a sharp decline of 19.7% in October; the number of cars newly registered with the Road Traffic Safety Department dropped substantially in November. Moreover, with the unemployment rate rising in November to 6.1% of the economically active population, an ongoing deterioration in consumer confidence indicators was observed. In October, the working day adjusted volume index of industrial output in manufacturing fell by 11.1% year-on-year. In November, when the volume of transit cargoes through Latvian ports increased, freight transportation indicators improved markedly: freight transportation by rail and at Latvian ports grew by 15.0% and 11.4% respectively. Exports increased somewhat in October (2.8% annual growth rate), while imports shrank by 9.3%.

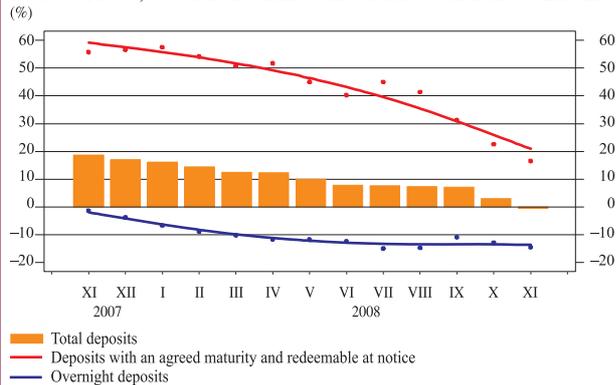
The economic slowdown and weakening demand underpinned a pronounced easing of inflationary pressures, with inflation expectations abating and favourable global oil price changes taking place simultaneously. In November, consumer price inflation dropped 2.0 percentage points on an annual basis (to 11.8%) and 0.4% on a monthly basis. The annual core inflation lowered to 9.8% primarily due to moderating price rises for processed food and other tradable goods. With oil prices declining, fuel became 12.8% cheaper. In November, a drop in some food prices (vegetables, fruit and cheese in particular) was recorded; however overall, they grew by 0.2% on average. Heating tariffs increased markedly (by 6.0%).

In November, when the general government consolidated budget revenue contracted by 16.9% year-on-year and expenditure grew by 14.9%, the financial deficit of the respective budget stood at 192.8 million lats. As a result, its eleven-months-financial deficit amounted to 285.4 million lats. In November, both the central government basic budget and the local government consolidated budget recorded financial deficits (203.1 million lats and 6.8 million lats respectively), not offset by an insignificant surplus in the social security fund (14.8 million lats). All revenue items of the general government consolidated budget posted a decrease, including a 6.1% contraction in tax revenue. Generally, the revenue from all taxes (excluding from corporate and personal income) fell below the year-on-year level. Consequently in November, the central government basic budget revenue collection accounted

ANNUAL CHANGES IN LENDING
(%)



ANNUAL GROWTH IN DEPOSITS OF RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS (%)



MACROECONOMIC INDICATORS	2008	
	X	XI
Volume index of industrial output (working-day adjusted annual rate of change; %)	-9.0	*
Changes in the CPI		
Month-on-month basis (%)	1.2	-0.4
Average annual inflation rate (HCPI) of last 12 months (%)	15.9	15.7
Year-on-year basis (%)	13.8	11.8
Annual rate of core inflation ¹ (%)	11.2	9.8
Number of registered unemployed persons (at end of period)	61 049	67 065
Unemployment rate (%)	5.6	6.1
General government consolidated budget financial deficit/surplus (in millions of lats)	-92.6	-285.4
Foreign trade (in millions of lats)		
Exports	390.8	*
Imports	645.6	*
Balance	-254.8	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

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

only for 54.6% of the monthly target. The recorded rise in the general government consolidated budget expenditure resulted from an increase of 48.2% in subsidies and grants. In November, the central government debt expanded notably due to the issue of Treasury bills in the amount of 451.0 million lats.

Reflecting the slowdown in economic activity, increasing euroisation and weakening confidence of depositors, the money supply narrowed. In November, M3 contracted by 136.7 million lats, with the annual growth rate slowing to 0.5%. Monetary aggregates M2 and M1 also shrank (at 0.5% and -8.8% annual growth rates respectively). The dynamics of the demand for cash did not affect the money supply, because currency outside MFIs in November increased by mere 0.8 million lats. At the same time, the deposits of resident financial institutions, non-financial corporations and households decreased by 2.5%, with the annual rate of change becoming negative (-0.2%). Although overnight deposits that diminished by 2.9% were primarily behind the overall contraction of deposits, time deposits were also down. Household deposits posted the largest contraction (3.7%), whereas those of financial institutions and non-financial corporations shrank only by 0.5%. Deposits in lats went down by 5.4%, while deposits in euro grew by 2.0% in November.

Loans to resident financial institutions, non-financial corporations and households decreased by 25.9 million lats or 0.2%, with the annual growth rate going up 1.5 percentage points (to 14.3%). Overall, loans (primarily commercial credit) to non-financial corporations narrowed, with increasing industrial credit an exception. Lending to households, in turn, remained broadly unchanged, and the slight fall in consumer credit was offset by expanded lending for house purchase. Loans in lats remained broadly unchanged, while those in euro and other currencies contracted somewhat.

Liabilities to foreign banks decreased slightly (by 14.0 million lats), whereas those to parent banks grew by 70.4 million lats. Deposits of non-resident non-MFIs diminished by 111.2 million lats. Given the increasing bank deposits with foreign banks, the negative net foreign assets of MFIs grew by 233.3 million lats.

In November, the monetary base M0 was by 115.8 million lats or 4.9% smaller primarily due to a decrease in bank demand deposits with the Bank of Latvia, with the central bank engaging in outright sales of foreign currency and lowering the reserve ratio as well as with the decreasing of the reserve base. In addition, the diminishing of the central bank's money supply was on account of the increasing government lats deposit with the Bank of Latvia, while its expansion, was a result of a sharp increase in lending to banks.

In an environment of mutual distrust in the global and Latvian financial markets, the functioning of the interbank market was limited and banks actively made use of the Bank of Latvia's main refinancing operations and marginal lending facility, engaging also in currency swaps. With the financial market tensions aggravating, RIGIBOR also continued on an upward trend, exceeding 11% on overnight loans and standing at 13.40%, 13.70% and 13.54% on 3-, 6- and 12-month loans respectively at the end of the month. In November, the weighted average interest rate on household loans in lats was still on the rise, picking up 1.1 percentage points, whereas that on non-financial corporation loans in lats dropped 1.3 percentage points. The euro base rate reduction by the European Central Bank underpinned a downward trend in the weighted average interest rate on both household and non-financial loans in foreign currency.

In November, the exchange rates of the US dollar and the Japanese yen set by the Bank of Latvia against the lats appreciated by 1.9% and 5.4% respectively, while that of the British pound sterling depreciated by 5.3%.

MONETARY INDICATORS (at end of period; in millions of lats)	2008	
	X	XI
MFIs¹		
M3	6 277.7	6 141.0
Repurchase agreements	0	0
Money market fund shares and units	97.3	79.2
Debt securities issued with maturity of up to 2 years	4.5	4.5
M2	6 175.9	6 057.3
Deposits with agreed maturity of up to 2 years	2 324.5	2 299.5
Deposits redeemable at notice of up to 3 months	289.2	270.3
M1	3 562.2	3 487.5
Currency outside MFIs	912.4	913.2
Overnight deposits	2 649.8	2 574.3
Net external assets	-5 951.5	-6 184.8
Credit to resident financial institutions, non-financial corporations and households	14 668.9	14 643.0
Credit to general government	543.8	949.6
Deposits of central government	555.6	812.1
Longer-term financial liabilities	2 428.9	2 432.5
Bank of Latvia		
M0	2 383.4	2 267.6
Currency in circulation	1 037.0	1 044.5
Deposits with the Bank of Latvia in lats	1 336.5	1 213.1
Deposits with the Bank of Latvia in foreign currencies	9.9	10.0
Net foreign assets	2 888.3	2 367.1
Net domestic assets	-504.9	-99.5
Credit	-313.6	106.6
To MFIs	187.9	554.6
To central government (net)	-501.5	-448.0
Other items (net)	-191.3	-206.1
International reserves (at end of period; in millions of euro)	4 248.93	3 442.51
Gold	144.81	156.91
Special Drawing Rights	0.13	0.13
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	4 103.93	3 285.41
International reserves (at end of period; in millions of US dollars)	5 592.06	4 447.44
Gold	190.58	202.71
Special Drawing Rights	0.17	0.17
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	5 401.23	4 244.48

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2008	
	X	XI
Weighted average interest rate on domestic interbank loans in lats	6.5	5.0
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	11.7	10.4
Loans to households (in lats)	17.1	18.2
incl. for house purchase	10.9	12.0
Loans to non-financial corporations (in foreign currencies)	8.2	7.8
Loans to households (in foreign currencies)	7.6	6.8
incl. for house purchase	7.1	7.0
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	6.8	7.4
Demand deposits of non-financial corporations (in lats)	2.6	2.4
Time deposits of households (in lats)	7.5	8.0
Demand deposits of households (in lats)	1.3	1.1
Time deposits of non-financial corporations (in foreign currencies)	3.8	3.2
Demand deposits of non-financial corporations (in foreign currencies)	1.7	1.3
Time deposits of households (in foreign currencies)	4.1	3.6
Demand deposits of households (in foreign currencies)	1.6	1.4
The Bank of Latvia's refinancing rate (at end of period; %)	6.0	6.0
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5340	0.5440
LVL/GBP	0.8850	0.8380
LVL/100 JPY	0.5420	0.5710
LVL/EUR	0.7028	0.7028

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

	2008	
	X	XI
MFI reserves	1 468.5	1 356.2
Vault cash in national currency	124.6	131.3
Deposits with the Bank of Latvia	1 343.9	1 224.9
Foreign assets	4 918.0	5 065.9
Vault cash in foreign currencies	67.3	67.0
Claims on MFIs	2 587.8	2 787.6
Claims on non-MFIs	2 078.8	2 038.5
Other assets	184.2	172.8
Claims on central government	467.8	870.8
Claims on local government	76.0	78.9
Claims on public non-financial corporations	345.2	342.1
Claims on financial institutions and private non-financial corporations	7 955.3	7 931.4
Claims on households	6 432.2	6 432.9
Unclassified assets	962.6	1 024.2
Fixed assets	190.8	195.8
Items in transit	31.3	26.4
Other assets	244.1	281.2
Claims on resident MFIs (incl. investments)	496.3	520.8
Total assets	22 625.7	23 102.3
<i>Memo item: Trust assets</i>	<i>361.8</i>	<i>345.4</i>
Overnight deposits in lats	1 510.2	1 402.4
Public non-financial corporations	74.0	93.4
Financial institutions and private non-financial corporations	654.3	612.2
Households	781.9	696.8
Time deposits and deposits redeemable at notice in lats	1 228.4	1 189.7
Public non-financial corporations	179.5	168.2
Financial institutions and private non-financial corporations	406.8	394.7
Households	642.0	626.8
Foreign currency deposits of residents	2 401.6	2 421.7
Public non-financial corporations	19.7	31.9
Financial institutions and private non-financial corporations	699.0	722.3
Households	1 683.0	1 667.6
Deposits of central government	54.1	364.1
Deposits of local government	264.1	273.9
Transit funds	3.7	3.5
Foreign liabilities	13 757.8	13 617.8
Liabilities to MFIs	9 374.5	9 360.5
Liabilities to non-MFIs	3 866.2	3 755.0
Other liabilities (incl. subordinated liabilities)	517.1	502.3
Liabilities to the Bank of Latvia	187.9	554.6
Debt securities issued	175.5	178.4
Money market fund shares and units	97.3	79.2
Capital and reserves	1 891.6	1 879.3
Residents	1 155.6	1 143.4
Non-residents	735.9	735.9
Provisions	188.0	224.7
Unclassified liabilities	865.4	913.0
Items in transit	140.2	168.4
Other liabilities (incl. subordinated liabilities)	273.9	267.3
Liabilities to resident MFIs	451.4	477.3
Total liabilities	22 625.7	23 102.3
<i>Memo item: Trust liabilities</i>	<i>361.8</i>	<i>345.4</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>).