

# MONETARY BULLETIN 2009

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With the impact of shrinking domestic demand on consumer price inflation stronger than that of value added and excise tax increases, the annual rate of inflation continued on a downward trend, dropping to 9.6% in February, the lowest level since July 2007. Deteriorating external environment, declining confidence of economic agents and decelerating rate of lending all underpinned a further downside in the economic activity. It was confirmed by available indicators of the operation of the real economy and the contraction of tax revenue. The economic downturn triggered certain easing of external imbalances, with a current account surplus replacing the deficit in the balance of payments in January. Unemployment continued to soar, rising to 9.5% in February. The situation in financial markets remained stable. It was supported by the EU loan of 1 billion euro transferred to the government toward the end of February.

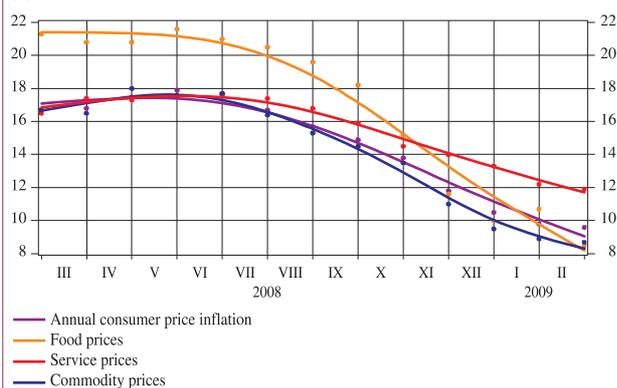
In February, the raising of excise tax rate resulted in higher prices for fuel, alcoholic and non-alcoholic beverages, and coffee (recording rises of 12.4%, 8.4%, 5.3% and 10.1% respectively). When cigarettes with higher excise tax came into circulation, prices on tobacco products in the market also went up by 13.2%. As the demand fell sharply, overall food prices dropped 0.7%, the decrease being stronger for dairy products (4.5%) and vegetables (4.2%). The annual consumer price core inflation was 6.6%.

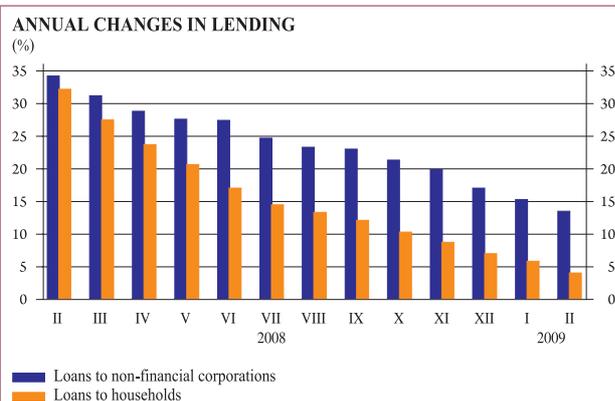
Given the progressive weakening of the domestic and foreign demand, the downturn in the output of manufacturing was gaining momentum. In January, the working day adjusted volume index of industrial output in manufacturing decreased by 27.2% year-on-year, with almost all manufacturing sub-sectors recording substantial slowdowns. Retail trade continued to record a sharp downside, with its turnover, including sales of motor vehicles and retailing in automotive fuel, narrowing by 29.9% at constant prices in January. Exports shrank significantly by 25.3% and imports recorded an even sharper drop of 36.1%. The transport sector was more resilient, with freight transportation by rail in February decreasing by a mere 0.7% year-on-year, while freight turnover at Latvian ports declined by 0.8%.

In February, when the general government consolidated budget revenue dropped 3.5% year-on-year but expenditure picked up 11.4%, the financial deficit of this budget amounted to 51.8 million lats, while the surplus accumulated since the beginning of the year declined to 6.8 million lats. Tax collections of the general government consolidated budget were down 21.1% year-on-year. The steep fall in private consumption triggered a 35.5% drop in the value added tax revenue. Budget revenues from employment taxes also diminished notably, with personal income tax revenue decreasing by 23.2% and social security contributions by 29.0%. Despite the cuts in a number of expenditure items (wages and salaries, goods and services, capital expenditure), the growth in total expenditure was triggered by expanding social benefit expenditure (by 40.3%) and increasing subsidies and grants (by 21.1%). The general government debt totalled 3 308.8 million lats at the end of February. Its monthly growth was on account of the rise in external debt due to the EU loan to the government.

The pace of lending decelerated progressively; nevertheless, the annual rate of credit growth remained positive (8.4% in February). The inflow of financing saved the money supply

ANNUAL CONSUMER PRICE INFLATION (%)





from drying up. In February, M3 increased by 42.9 million lats, with its annual rate of decrease at  $-4.2\%$ . M2 and M1 also grew, with their annual rate of decrease at  $-4.3\%$  and  $-14.4\%$  respectively. The money supply was still adversely affected by a weaker demand for cash (currency outside MFIs decreased by  $3.4\%$ ). At the same time, deposits rose (overnight deposits by  $1.8\%$ , deposits with agreed maturity of up to 2 years by  $0.7\%$ , and deposits redeemable at notice of up to 3 months by  $4.6\%$ ). Overall deposits of resident financial institutions, non-financial corporations and households expanded, with their annual rate of decrease at  $-3.3\%$ . Deposits of households declined somewhat, while those of financial institutions and non-financial corporations increased. Deposits in lats shrank by  $1.7\%$ , whereas those in euro went up  $5.9\%$ .

In February, loans to resident financial institutions, non-financial corporations and households decreased by 60.3 million lats or  $0.4\%$ . The annual rate of growth in loans to households, financial institutions and non-financial corporations decelerated somewhat (to  $3.9\%$ ,  $2.5\%$  and  $13.4\%$  respectively). Commercial credit, industrial credit, loans to households for house purchase and consumer credit all shrank somewhat within the month (by  $0.8\%$ ,  $0.5\%$ ,  $0.2\%$  and  $0.7\%$  respectively). The decrease was 49.5 million lats for loans in lats and 16.5 million lats for loans in euro.

In February, foreign liabilities of Latvian banks, those to parent banks in particular, continued on a downward trend (a 308.2 million lats decrease). Contractions in non-resident non-MFI deposits, on the other hand, were less pronounced than in the previous months. In line with less contracting foreign assets, negative net foreign assets of MFIs (excluding the Bank of Latvia) shrank by 201.1 million lats.

The monetary base M0 increased in February on account of growing bank deposits with the Bank of Latvia. With the reserve requirement almost unchanged and the lats liquidity becoming ample, excess reserves on bank accounts with the Bank of Latvia rose. The growth rate of currency in circulation and that of monetary base remained negative in February ( $-4.9\%$  and  $-16.1\%$  respectively).

In February, the lats exchange rate temporarily came close to the upper intervention margin and the Bank of Latvia engaged in some interventions in the foreign exchange market selling foreign currencies in the net amount of 24.7 million lats. Net foreign assets of the Bank of Latvia grew by  $26.7\%$ ; at the end of the month, the backing of the national currency with the Bank of Latvia's net foreign assets was  $140.5\%$ . The recorded steep rise in the central bank's reserves was on account of rising government foreign currency funds due to the transfer of the EU loan. A decrease in the government deposit in lats with the Bank of Latvia (150.1 million lats) and a slight increase in the currency swap balance contributed positively to the money supply of the central bank; at the same time, loans to banks remained broadly unchanged.

In February, the interbank market average weighted interest rate on overnight loans and average RIGIBOR on overnight loans were  $3.2\%$  and  $4.1\%$  respectively or 0.3 and 1.2 percentage points lower month-on-month. RIGIBOR on 3-, 6- and 12-month loans rose slightly and at the end of February were  $11.30\%$ ,  $12.30\%$  and  $12.90\%$  respectively. Interest rates on loans to non-financial corporations in lats and foreign currency as well as to households in foreign currency and in lats for house purchase increased somewhat. For the second consecutive month, interest rates on time deposits recorded substantial declines.

In February, exchange rates of the US dollar and British pound sterling set by the Bank of Latvia appreciated against the lats (by  $3.2\%$  and  $3.7\%$  respectively), while that of the Japanese yen depreciated (by  $5.0\%$ ).

MACROECONOMIC INDICATORS	2009	
	I	II
Volume index of industrial output (working-day adjusted annual rate of change; %)	-23.9	*
Changes in the CPI		
Month-on-month basis (%)	2.2	1.1
Average annual inflation rate (HCPI) of last 12 months (%)	14.9	14.3
Year-on-year basis (%)	9.8	9.6
Annual rate of core inflation <sup>1</sup> (%)	6.1	6.6
Number of registered unemployed persons (at end of period)	90 436	103 731
Unemployment rate (%)	8.3	9.5
General government consolidated budget financial deficit/surplus (in millions of lats)	58.6	6.8
Foreign trade (in millions of lats)		
Exports	246.2	*
Imports	393.5	*
Balance	-147.3	*

<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)

	2009	
	I	II
<b>MFIs<sup>1</sup></b>		
M3	5 942.1	5 985.0
Repurchase agreements	0	0
Money market fund shares and units	82.1	83.6
Debt securities issued with maturity of up to 2 years	3.1	3.1
M2	5 856.8	5 898.3
Deposits with agreed maturity of up to 2 years	2 447.7	2 464.3
Deposits redeemable at notice of up to 3 months	271.1	283.6
M1	3 138.0	3 150.4
Currency outside MFIs	832.2	803.9
Overnight deposits	2 305.9	2 346.5
Net external assets	-5 871.3	-5 071.2
Credit to resident financial institutions, non-financial corporations and households	14 552.2	14 491.9
Credit to general government	1 160.3	985.3
Deposits of central government	1 398.9	1 884.9
Longer-term financial liabilities	2 361.7	2 350.6
<b>Bank of Latvia</b>		
M0	1 895.9	2 025.4
Currency in circulation	949.7	922.2
Deposits with the Bank of Latvia in lats	930.3	1 091.8
Deposits with the Bank of Latvia in foreign currencies	15.8	11.4
Net foreign assets	2 246.8	2 845.8
Net domestic assets	-351.0	-820.4
Credit	-118.6	-576.2
To MFIs	595.3	592.8
To central government (net)	-713.9	-1 169.0
Other items (net)	-232.4	-244.2
International reserves (at end of period; in millions of euro)	3 581.38	4 371.58
Gold	167.64	185.40
Special Drawing Rights	2.01	0.53
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	3 411.67	4 185.59
International reserves (at end of period; in millions of US dollars)	4 695.92	5 555.82
Gold	219.81	235.62
Special Drawing Rights	2.64	0.68
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	4 473.39	5 319.44

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

**EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES**

	2009	
	I	II
Weighted average interest rate on domestic interbank loans in lats	3.6	3.3
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	12.0	12.1
Loans to households (in lats)	20.3	19.5
incl. for house purchase	11.1	12.4
Loans to non-financial corporations (in foreign currencies)	6.1	6.9
Loans to households (in foreign currencies)	7.1	7.3
incl. for house purchase	6.2	5.9
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	5.7	5.6
Demand deposits of non-financial corporations (in lats)	1.1	1.2
Time deposits of households (in lats)	8.7	7.4
Demand deposits of households (in lats)	1.0	1.0
Time deposits of non-financial corporations (in foreign currencies)	2.4	1.8
Demand deposits of non-financial corporations (in foreign currencies)	0.5	0.5
Time deposits of households (in foreign currencies)	3.1	2.8
Demand deposits of households (in foreign currencies)	1.0	0.9
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	0.5360	0.5530
LVL/GBP	0.7580	0.7860
LVL/100 JPY	0.5960	0.5660
LVL/EUR	0.7028	0.7028

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

	2009	
	I	II
MFI reserves	1 063.9	1 222.6
Vault cash in national currency	117.6	118.3
Deposits with the Bank of Latvia	946.3	1 104.4
Foreign assets	4 766.1	4 580.7
Vault cash in foreign currencies	69.0	60.7
Claims on MFIs	2 610.5	2 467.5
Claims on non-MFIs	1 937.3	1 933.9
Other assets	149.3	118.6
Claims on central government	1 081.5	905.0
Claims on local government	78.7	80.2
Claims on public non-financial corporations	377.4	389.3
Claims on financial institutions and private non-financial corporations	7 863.0	7 820.7
Claims on households	6 385.2	6 360.2
Unclassified assets	986.0	1 055.1
Fixed assets	195.4	194.1
Items in transit	27.9	24.5
Other assets	299.6	322.4
Claims on resident MFIs (incl. investments)	463.1	514.1
<b>Total assets</b>	<b>22 601.9</b>	<b>22 413.9</b>
<i>Memo item: Trust assets</i>	382.6	365.8
Overnight deposits in lats	1 259.0	1 231.0
Public non-financial corporations	84.8	91.8
Financial institutions and private non-financial corporations	546.0	522.7
Households	628.2	616.5
Time deposits and deposits redeemable at notice in lats	1 257.5	1 241.5
Public non-financial corporations	154.2	173.3
Financial institutions and private non-financial corporations	459.8	441.8
Households	643.6	626.4
Foreign currency deposits of residents	2 461.3	2 578.6
Public non-financial corporations	41.7	33.7
Financial institutions and private non-financial corporations	785.1	886.6
Households	1 634.5	1 658.3
Deposits of central government	685.0	715.8
Deposits of local government	207.7	207.0
Transit funds	3.5	3.5
Foreign liabilities	12 884.2	12 497.7
Liabilities to MFIs	9 149.9	8 843.0
Liabilities to non-MFIs	3 335.9	3 244.5
Other liabilities (incl. subordinated liabilities)	398.5	410.2
Liabilities to the Bank of Latvia	595.3	592.8
Debt securities issued	179.8	178.1
Money market fund shares and units	82.1	83.6
Capital and reserves	1 760.7	1 746.5
Residents	1 024.6	1 008.0
Non-residents	736.1	738.5
Provisions	430.5	474.7
Unclassified liabilities	795.2	863.1
Items in transit	96.9	93.6
Other liabilities (incl. subordinated liabilities)	277.4	299.9
Liabilities to resident MFIs	420.9	469.5
<b>Total liabilities</b>	<b>22 601.9</b>	<b>22 413.9</b>
<i>Memo item: Trust liabilities</i>	382.6	365.8

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>).