

# MONETARY BULLETIN 2010

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The second quarter and the first month of the third witnessed increasingly more signs of economic stabilisation. Industry continued to regain competitiveness on foreign markets, with both output in manufacturing and exports of goods increasing. In June, the seasonally adjusted industrial output grew by 0.2% month-on-month, with the annual increase (working day unadjusted) amounting to 13.8% and that of the exports to 23.3%. The future outlook of economic agents improved, the number of newly-registered cars grew and there was some evidence of retail stabilisation. Retail trade turnover (including sales of motor vehicles) went up by 0.7% month-on-month in June according to seasonally adjusted data, while the year-on-year increase was 0.5%. July was the fourth consecutive month witnessing a decline in registered unemployment, to stand at 15.3% of the economically active population at the end of the month. Overall freight turnover at Latvian ports grew by 1.5% year-on-year, the volume of oil products transported by pipeline expanded significantly, while freight transportation by rail continued to decrease. The tax revenue dynamics of the government budget became more positive resulting in a significant year-on-year decrease of the budgetary deficit.

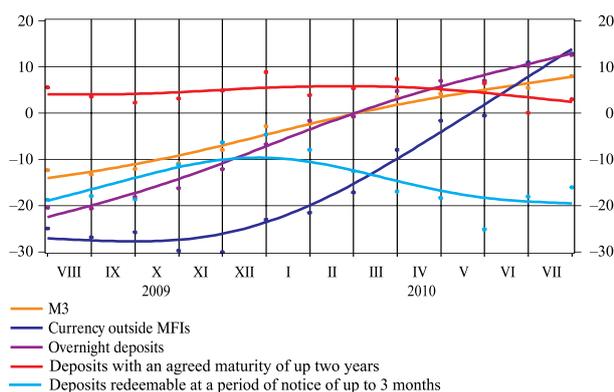
Gross domestic product posted an increase already for the second consecutive quarter: according to the flash estimate of the Central Statistical Bureau of Latvia, the seasonally adjusted GDP grew by 0.1% in the second quarter, while the year-on-year decline during the quarter amounted to a mere 3.0% (two times smaller than in the previous quarter).

Consumer prices climbed by 0.2% in June on account of higher natural gas tariffs and food prices. The prices on clothing and footwear, by contrast, posted a decline as a result of seasonal factors. Thus the annual deflation retreated to -0.6%; nevertheless, the prices on most goods and services in the consumer basket were still lower than in the corresponding period of the previous year. Global energy price movements and rising vegetable prices due to unfavourable weather conditions continued to be the main contributors to the diminishing of the deflation. Service prices experienced the steepest decline (4.8% year-on-year) as a result of the weak demand. In July, average inflation of the last 12 months was -1.6%, whereas the 12-month average harmonised index of consumer prices (HICP) used for the Maastricht criterion decreased by 1.8%.

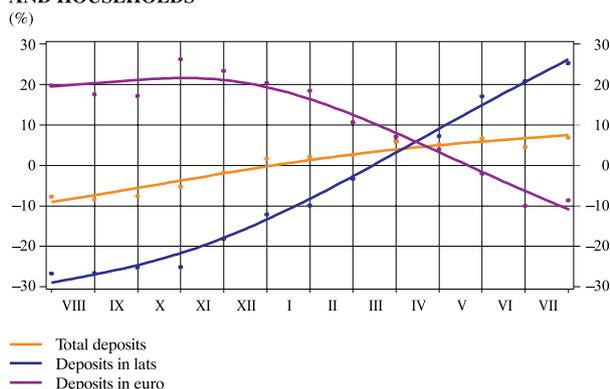
The consolidated general government budget ran a 12.9 million lats deficit in June. Consequently, the deficit accumulated from the beginning of the year grew to 186.5 million lats (in the seven months of the previous year the deficit of the consolidated general government budget amounted to 428.9 million lats). The local government consolidated budget and central government social security budget recorded a deficit in July, while the central government basic budget was in a surplus. With the non-tax revenue shrinking and foreign financial assistance funding inflows growing, the aggregate budget revenue declined by 11.0% year-on-year in July, whereas the tax revenue shrank by a mere 3.4%, with almost all major tax-type revenue with the exception of the personal income tax revenue posting a decline. In July, budget expenditure was 13.6% higher than a year ago mainly as a result of the low base, as the expenditure continued to shrink in comparison with June. The general government debt decreased to 4 816.9 million lats in July.

The end of recession in Latvia is marked by the growth of several real economy sector indicators as well as currency in circulation. Following a marginal contraction in the previous two months, the monetary aggregate M3 grew by 0.4% in

**THE ANNUAL GROWTH RATE OF M3 AND ITS COMPONENTS (%)**



**ANNUAL CHANGES IN DEPOSITS OF RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**



MACROECONOMIC INDICATORS	2010	
	VI	VII
Volume index of industrial output (working-day adjusted annual rate of change; %)	13.3	*
Changes in the CPI		
Month-on-month basis (%)	0.4	0.2
Average annual inflation rate (HCPI) of last 12 months (%)	-1.4	-1.6
Year-on-year basis (%)	-1.4	-0.6
Annual rate of core inflation <sup>1</sup> (%)	-3.6	-3.5
Number of registered unemployed persons (at end of period)	176 879	173 301
Unemployment rate (%)	15.6	15.3
General government consolidated budget financial deficit/surplus (in millions of lats)	-173.7	-186.5
Foreign trade (in millions of lats)		
Exports	364.5	*
Imports	448.2	*
Balance	-83.7	*

<sup>1</sup> Source: Bank of Latvia.

\* Figure available at a later date.

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

July, with the annual growth of M3 amounting to 8.0%. Funds were still concentrated in M1, the most liquid component of the money supply, reporting a month-on-month increase of 0.7%, with the year-on-year growth accelerating to 12.6%.

Higher demand for cash associated with the summer season was the main contributor to the expansion of currency in circulation in July: currency outside MFIs expanded by 2.3%. Overnight deposits and deposits with an agreed maturity of up to 2 years placed with banks increased slightly by 0.2%. At the same time, deposits redeemable at notice contracted; therefore, the aggregate deposits by resident financial institutions, non-financial corporations and households remained broadly unchanged month-on-month in July. Nevertheless, the deposits exceeded the level of the corresponding period of the previous year by 6.9%.

Loans granted to resident financial institutions, non-financial corporations and households continued to shrink at the previous rate in July. The month-on-month decline amounted to 0.9%, with loans to households shrinking more modestly in comparison with the average rate. The annual rate of decrease in loans was 7.7%. In order to motivate the banks to channel their free liquidity to economic development, the Bank of Latvia decreased the interest rates on the 7-day deposit facility and overnight deposit facility to 0.5% and 0.375% respectively as of 24 June.

Foreign financing of the banking sector diminished slightly in July as the liabilities to foreign banks shrank by 67.8 million lats (including borrowing from MFIs by 129.9 million lats) and aggregate foreign liabilities of banks by 66.4 million lats. As the decrease of the banks' foreign assets was more moderate, the negative net foreign assets of MFIs (except the Bank of Latvia) continued to shrink.

Monetary base M0 grew by 40.8 million lats in July, with the lats liquidity remaining ample and both demand deposits with the central bank and demand for cash increasing. As a result, the annual rate of change of M0 and its components continued to improve: the annual rate of change of M0 amounted to 11.1% at the end of July representing the highest level since March 2008. The annual rate of change of currency in circulation reached the level of the summer 2007 to stand at 11.6%, and demand deposits with the central bank were already 10.6% above the level of the corresponding period of the previous year. A decrease in the government deposit in lats with the Bank of Latvia had an upward effect on the money supply of the central bank. Net foreign assets of the Bank of Latvia grew by 0.5% due to an increase in foreign currency funds deposited by the government, whereas the backing of the national currency with the Bank of Latvia's net foreign assets was 226.2%.

Interbank market rates remained low: the weighted average rate on overnight loans edged down to 0.87% in July as compared to 0.90% in June, while the average RIGIBOR on overnight loans was 1.02% during the month (1.09% in June). 3-month, 6-month and 12-month RIGIBOR decreased at a more significant rate by 61, 41 and 42 basis points, to 1.38%, 2.31% and 3.88% respectively.

The interest rates on lats loans granted to households and non-financial corporations (except loans for house purchase) declined in July, whereas the lending rates in foreign currencies went up reflecting the pass-through of the rising EURIBOR to euro lending rates. The lats lending rates declined as a result of falling interest rates on the lats money market. The interest rates on time deposits in lats also contracted reflecting the shrinking RIGIBID, whereas the rates on foreign currency deposits remained broadly unchanged.

In July, the exchange rate of the US dollar, the British pound sterling and the Japanese yen set by the Bank of Latvia decreased against the lats by 5.8%, 2.4% and 4.0% respectively.

MONETARY INDICATORS (at end of period; in millions of lats)	2010	
	VI	VII
<b>MFI<sup>1</sup></b>		
M3	6 147.4 <sup>2</sup>	6 173.7
Repurchase agreements	0	0
Money market fund shares and units	98.1	97.5
Debt securities issued with maturity of up to 2 years	20.6	20.6
M2	6 028.7 <sup>2</sup>	6 055.6
Deposits with agreed maturity of up to 2 years	2 491.5 <sup>2</sup>	2 496.4
Deposits redeemable at notice of up to 3 months	233.7	233.1
M1	3 303.5 <sup>2</sup>	3 326.1
Currency outside MFIs	733.6	750.8
Overnight deposits	2 569.9 <sup>2</sup>	2 575.3
Net external assets	-1 720.4	-1 658.0
Credit to resident financial institutions, non-financial corporations and households	13 007.8	12 893.7
Credit to general government	553.8	543.1
Deposits of central government	2 199.6	2 046.2
Longer-term financial liabilities	2 237.9 <sup>2</sup>	2 197.6
<b>Bank of Latvia</b>		
M0	1 700.4	1 741.2
Currency in circulation	838.3	856.4
Deposits with the Bank of Latvia in lats	837.8	869.9
Deposits with the Bank of Latvia in foreign currencies	24.2	14.9
Net foreign assets	3 920.4	3 939.4
Net domestic assets	-2 220.0	-2 198.2
Credit	-1 400.8	-1 347.0
To MFIs	0	0
To central government (net)	-1 400.8	-1 347.0
Other items (net)	-819.2	-851.2
International reserves (at end of period; in millions of euro)	5 590.93	5 582.63
Gold	251.75	222.83
Special Drawing Rights	146.89	141.80
Reserve position in the IMF	0.07	0.06
Foreign convertible currencies	5 192.22	5 217.94
International reserves (at end of period; in millions of US dollars)	6 857.47	7 265.74
Gold	308.78	290.01
Special Drawing Rights	180.17	184.55
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	6 368.44	6 791.10

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

<sup>2</sup> Data have been revised.

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2010	
	VI	VII
Weighted average interest rate on domestic interbank loans in lats	0.9	0.9
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	7.0	3.5
Loans to households (in lats)	18.1	16.0
incl. for house purchase	8.3	10.1
Loans to non-financial corporations (in foreign currencies)	3.5	4.6
Loans to households (in foreign currencies)	4.9	5.4
incl. for house purchase	3.8	4.3
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	1.0	0.7
Demand deposits of non-financial corporations (in lats)	0.3	0.3
Time deposits of households (in lats)	3.6	3.2
Demand deposits of households (in lats)	0.6	0.8
Time deposits of non-financial corporations (in foreign currencies)	0.8	0.8
Demand deposits of non-financial corporations (in foreign currencies)	0.2	0.2
Time deposits of households (in foreign currencies)	1.9	2.0
Demand deposits of households (in foreign currencies)	0.5	0.5
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	0.5730	0.5400
LVL/GBP	0.8650	0.8440
LVL/100 JPY	0.6460	0.6200
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	
	VI	VII
MFI reserves	1 526.4	1 567.7
Vault cash in national currency	104.7	105.7
Deposits with the Bank of Latvia	1 421.7	1 462.0
Foreign assets	4 765.9	4 742.8
Vault cash in foreign currencies	74.1	70.0
Claims on MFIs	2 617.6 <sup>1</sup>	2 579.2
Claims on non-MFIs	1 955.7 <sup>1</sup>	1 998.0
Other assets	118.5	95.6
Claims on central government	489.6	479.9
Claims on local government	64.2	63.2
Claims on public non-financial corporations	407.7	410.8
Claims on financial institutions and private non-financial corporations	6 854.1	6 776.1
Claims on households	5 952.1	5 914.5
Unclassified assets	821.6	806.6
Fixed assets	93.9	92.8
Items in transit	15.2	14.5
Other assets	490.0	479.7
Claims on resident MFIs (incl. investments)	222.4	219.6
<b>Total assets</b>	<b>20 881.5</b>	<b>20 761.6</b>
<i>Memo item: Trust assets</i>	<i>533.5</i>	<i>414.5</i>
Overnight deposits in lats	1 352.4	1 389.6
Public non-financial corporations	93.6	93.5
Financial institutions and private non-financial corporations	589.0	613.5
Households	669.8	682.5
Time deposits and deposits redeemable at notice in lats	1 239.8 <sup>1</sup>	1 235.8
Public non-financial corporations	209.4	207.7
Financial institutions and private non-financial corporations	487.7	485.8
Households	542.7	542.4
Foreign currency deposits of residents	2 720.7	2 685.0
Public non-financial corporations	44.4	43.5
Financial institutions and private non-financial corporations	951.0	952.3
Households	1 725.3	1 689.2
Deposits of central government	798.8	699.2
Deposits of local government	185.0	186.7
Foreign liabilities	10 406.6	10 340.2
Liabilities to MFIs	6 696.9	6 629.1
Liabilities to non-MFIs	3 590.1	3 588.4
Other liabilities (incl. subordinated liabilities)	119.6	122.7
Liabilities to the Bank of Latvia	0	0
Debt securities issued	192.2	191.8
Money market fund shares and units	98.5	97.9
Capital and reserves	1 577.9	1 536.9
Residents	313.0 <sup>1</sup>	272.1
Non-residents	1 264.9 <sup>1</sup>	1 264.9
Provisions	1 816.0	1 852.9
Unclassified liabilities	493.6	545.7
Items in transit	102.2	69.9
Other liabilities (incl. subordinated liabilities)	196.0	181.1
Liabilities to resident MFIs	195.3	294.7
<b>Total liabilities</b>	<b>20 881.5</b>	<b>20 761.6</b>
<i>Memo item: Trust liabilities</i>	<i>533.5</i>	<i>414.5</i>

<sup>2</sup> Data have been revised.

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>).