

MONETARY BULLETIN 2005

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Data on GDP growth in the third quarter (a year-on-year increase of 11.4%) suggest that Latvia's economy continued to develop buoyantly. Nevertheless, the risks stemming from unbalanced growth still persisted as the growth was driven by domestic demand (the highest rise was reported in trade, housing construction, other community, social and personal service activities). At the same time, growth in manufacturing, transport, storage and communication also picked up. The October and November data continued to indicate growth; the seasonally adjusted volume index of industrial output in manufacturing increased by 9.4%, whereas industry recorded an overall growth of 6.4% year-on-year in October. The volume of freight transported grew significantly in November. Freight carried by rail grew 12.8% year-on-year, whereas cargo turnover at Latvian ports increased by 6.6%. Retail trade turnover soared, rising by 21.6% year-on-year in October. Unemployment rate remained unchanged (7.5%).

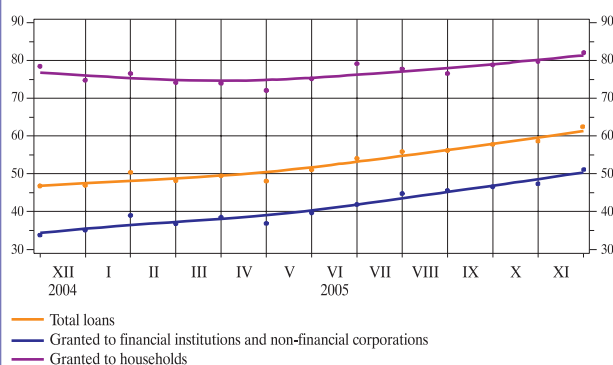
Oil price developments on the global market facilitated a drop in both monthly and annual inflation rate in Latvia (to 0.3% and 7.4%, respectively), with the prices on fuel contracting by 5.9% in November. However, rising prices of bread, fruit and vegetables as well as heating tariffs prevented inflation from shrinking more notably.

Active lending policy of banks (annual growth rate of loans granted to resident financial institutions, non-financial corporations and households amounted to 62.1% in November) continued to fuel domestic demand. In November, the annual growth rates of household loans for house purchase and mortgage loans were 96.2% and 99.5%, respectively. Outstanding loans expanded by 283.0 million lats in November, including mortgage loans by 162.4 million lats. Commercial credit grew significantly (by 81.8 million lats), whereas industrial credit did so only slightly (by 19.7 million lats). Both loans granted in euro as well as in lats increased (by 220.7 million lats and 76.0 million lats, respectively). More than a half of the loans were granted to financial institutions and non-financial corporations. In November, these loans grew by 164.0 million lats, whereas loans granted to households by 119.0 million lats. The annual growth rates of both loans granted to resident financial institutions and non-financial corporations as well as loans granted to households accelerated (51.2% and 82.2% in November, respectively).

To facilitate more balanced economic growth (contain the rapid lending expansion to dampen domestic demand and mitigate inflationary pressures), the Bank of Latvia's Council resolved to raise the reserve ratio for banks from 6% to 8% as of December 24, 2005. Raising of the European Central Bank's key rate to 2.25% could also facilitate a drop in domestic demand, as a significant share of loans has been granted in euro (56.8%). As the lats is pegged to the euro, increasing the euro key rate should trigger off a rise in the lats interest rates as well, overall containing the lending expansion and indirectly decelerating inflation in Latvia.

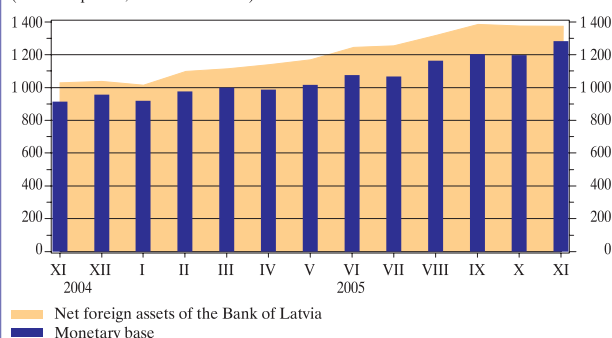
In November 2005, the financial deficit of the general government consolidated budget amounted to 80.2 million lats, with the financial surplus accumulated from the beginning of the year declining to 98.6 million lats, i.e. 2.1 times more than in the first 11 months of 2004. The main contributor was the financial deficit in the central government basic budget totalling 72.9 million lats. The local government consolidated budget

ANNUAL GROWTH RATE DEVELOPMENTS FOR LOANS GRANTED TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS
(year-on-year changes; %)



BACKING OF THE NATIONAL CURRENCY

(at end of period; in millions of lats)



also reported a financial deficit in the amount of 3.6 million lats, whereas the social security budget ran a slight financial surplus of 1.3 million lats. In November, the revenue and the expenditure of the general government consolidated budget grew 30.1% and 38.5% year-on-year, respectively. The rise in budget revenue was mainly underpinned by growing value added tax, personal income tax collections and social insurance contributions as well as funding received from the EU funds. Budget expenditure increased on account of an increase of wages and salaries and budget grants and climbing investment expenditure.

At the end of November, the debt of central and local governments debt totalled 993.8 million lats. The decline was secured by the redemption of Latvian government securities. In November, a competitive multi-price auction of 10-year Treasury bonds was held on the government securities market, and all offered bonds in the amount of 12.0 million lats were allotted, with the average yield of 3.621% (1.2 basis points lower than in the previous auction in September 2004).

Credit expansion was financed by the growth of domestic deposits which was also reflected in a significant boost of the monetary aggregates. In November, broad money M3 grew by 167.2 million lats. The increase was mainly driven by a rise in overnight deposits (110.6 million lats). Deposits with an agreed maturity of up to 2 years and currency outside MFIs also expanded quite notably (by 38.4 million lats and 14.6 million lats, respectively). Hence, the annual growth rate of all monetary aggregates (M1, M2 and M3) accelerated (to 41.0%, 37.2% and 37.8%, respectively).

The vigorous lending expansion was also partly driven by rising foreign borrowing of banks, resulting in an increase in the negative net foreign assets of MFIs by 163.1 million lats. In November, MFI (excluding the Bank of Latvia) assets expanded by 298.3 million lats. Profit amounted to 177.8 million lats in the first eleven months of 2005 (1.7 times higher than in the respective period of 2004).

With the demand for cash strengthening and banks' demand deposits with the Bank of Latvia growing, the monetary base M0 increased by 85.8 million lats in November. The central bank's net foreign assets remained broadly unchanged, as the amount of foreign currency purchased by the Bank of Latvia was small. Money supply was primarily pushed up by a decline in the Government deposits with the Bank of Latvia by 73.2 million lats and a decrease in banks' time deposits with the central bank by 11.3 million lats.

Liquidity remained high, and in November the Bank of Latvia granted repo loans only in the amount of 11.6 million lats, whereas time deposits received from banks amounted to 128.6 million lats.

RIGIBOR on overnight loans was 2.5%–2.7%, increasing to 3.3% only at the end of the reserve maintenance period. RIGIBOR for loans with a 6- and 12-month maturity grew by 0.3 percentage point during the month (reaching 3.2% and 3.3% at the end of the period, respectively). Interest rates on lending to non-financial corporations also grew (by 0.1–0.2 percentage point; to 5.5% on lending in lats and 4.9% on lending in foreign currencies). Interest rate on household loans for house purchase granted in lats declined by 0.2 percentage point, whereas that on the respective loans granted in foreign currencies increased by 0.1 percentage point to stand at 5.1% and 4.3%, respectively.

In November, the US dollar appreciated against the lats by 2.6%, whereas the Japanese yen and the British pound sterling depreciated by 0.6% and 0.9%, respectively.

MACROECONOMIC INDICATORS	2005	
	X	XI
Changes in the volume index of industrial output (year-on-year basis; %)	6.4	*
Changes in the CPI		
Month-on-month basis (%)	0.8	0.3
Year-on-year basis (%)	7.6	7.4
Annual rate of core inflation ¹ (%)	6.0	5.8
Number of registered unemployed persons (at end of period)	80 044	79 392
Unemployment rate (%)	7.5	7.5
General government consolidated budget fiscal deficit/surplus (in millions of lats)	197.4	119.6
Foreign trade (in millions of lats)		
Exports	257.9	*
Imports	468.7	*
Balance	-210.8	*

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	
	X	XI
MFIs¹		
M3	3 542.7	3 709.9
Repurchase agreements	0	0
Money market fund shares and units	13.3	14.4
Debt securities issued with maturity of up to 2 years	3.5	3.5
M2	3 525.9	3 692.0
Deposits with agreed maturity of up to 2 years	850.0	888.4
Deposits redeemable at notice of up to 3 months	97.3	99.8
M1	2 578.6	2 703.8
Currency outside MFIs	730.5	745.1
Overnight deposits	1 848.1	1 958.7
Net external assets	-995.0	-1 158.1
Credit to resident financial institutions, non-financial corporations and households	5 592.5	5 875.5
Credit to general government	377.3	378.8
Deposits of central government	266.0	194.8
Longer-term financial liabilities	1 174.6	1 197.2
Bank of Latvia		
M0	1 198.5	1 284.3
Currency in circulation	813.7	830.8
Deposits with the Bank of Latvia in lats	384.7	453.5
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	1 372.6	1 373.4
Net domestic assets	-174.1	-89.1
Credit	-72.3	-0.3
To MFIs	3.0	2.9
To central government (net)	-75.3	-3.2
Other items (net)	-101.8	-88.8
International reserves (at end of period; in millions of US dollars)	2 387.02	2 356.60
Gold	117.83	124.38
Special Drawing Rights	0.14	0.14
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	2 268.97	2 232.00

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2005	
	X	XI
Weighted average interest rate on domestic interbank loans in lats	2.2	2.5
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	5.3	5.5
Loans to households (in lats)	6.8	6.8
incl. for house purchase	5.3	5.1
Loans to non-financial corporations (in foreign currencies)	4.8	4.9
Loans to households (in foreign currencies)	4.5	4.7
incl. for house purchase	4.2	4.3
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	2.4	2.4
Demand deposits of non-financial corporations (in lats)	0.7	0.7
Time deposits of households (in lats)	2.8	2.8
Demand deposits of households (in lats)	0.4	0.4
Time deposits of non-financial corporations (in foreign currencies)	2.2	2.6
Demand deposits of non-financial corporations (in foreign currencies)	1.0	0.9
Time deposits of households (in foreign currencies)	2.7	2.8
Demand deposits of households (in foreign currencies)	1.6	1.3
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	0.5790	0.5940
LVL/GBP	1.0330	1.0240
LVL/100 JPY	0.5020	0.4990
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	
	X	XI
MFI reserves	503.3	562.5
Vault cash in national currency	83.3	85.6
Deposits with the Bank of Latvia	420.0	476.9
Foreign assets	3 238.6	3 151.4
Vault cash in foreign currencies	64.0	63.1
Claims on MFIs	1 957.9	1 811.7
Claims on non-MFIs	1 147.4	1 191.5
Other assets	69.2	85.2
Claims on central government	203.1	204.6
Claims on local government	75.0	76.0
Claims on public non-financial corporations	116.3	115.3
Claims on financial institutions and private non-financial corporations	3 299.7	3 466.2
Claims on households	2 210.4	2 329.4
Unclassified assets	401.8	441.0
Fixed assets	124.9	130.8
Items in transit	15.6	17.2
Other assets	73.2	71.8
Claims on resident MFIs (incl. investments)	188.0	221.3
Total assets	10 048.1	10 346.4
<i>Memo item: Trust assets</i>	<i>458.6</i>	<i>473.1</i>
Overnight deposits in lats	1 038.2	1 109.5
Public non-financial corporations	42.8	54.7
Financial institutions and private non-financial corporations	475.7	497.8
Households	519.7	557.0
Time deposits and deposits redeemable at notice in lats	643.6	657.7
Public non-financial corporations	57.5	57.0
Financial institutions and private non-financial corporations	199.0	207.4
Households	387.2	393.3
Foreign currency deposits of residents	1 162.6	1 223.4
Public non-financial corporations	17.5	17.7
Financial institutions and private non-financial corporations	383.7	414.8
Households	761.3	790.9
Deposits of central government	91.4	93.4
Deposits of local government	93.7	98.6
Transit funds	5.1	4.9
Foreign liabilities	5 606.1	5 682.9
Liabilities to MFIs	2 659.0	2 817.7
Liabilities to non-MFIs	2 743.2	2 656.3
Other liabilities (incl. subordinated liabilities)	203.9	208.8
Liabilities to the Bank of Latvia	3.0	2.9
Debt securities issued	172.0	174.3
Money market fund shares and units	13.3	14.4
Capital and reserves	771.9	792.9
Residents	455.6	476.6
Non-residents	316.3	316.3
Provisions	100.6	99.1
Unclassified liabilities	346.5	392.3
Items in transit	108.0	119.1
Other liabilities (incl. subordinated liabilities)	74.4	76.2
Liabilities to resident MFIs	164.1	197.0
Total liabilities	10 048.1	10 346.4
<i>Memo item: Trust liabilities</i>	<i>458.6</i>	<i>473.1</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>).