

# MONETARY BULLETIN 2006

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The somewhat slower growth of the financial sector in the first two months of 2006 was followed by renewed acceleration in March. The growth in lending to resident financial institutions, non-financial corporations and households surged to a record high (305.4 million lats). A notable rise in domestic deposits triggered a substantial increase in the money supply.

Real sector developments were similar to previous months. In February, the working-day adjusted retail trade turnover at constant prices increased by 15.1% year-on-year. The seasonally adjusted industrial output index in manufacturing grew by 6.2%, and the total industrial output expanded by 7.2%. Freight turnover at Latvian ports and freight traffic by rail shrank (by 3.8% and 10.9%, respectively). The unemployment rate dropped 0.1 percentage point (to 7.4%).

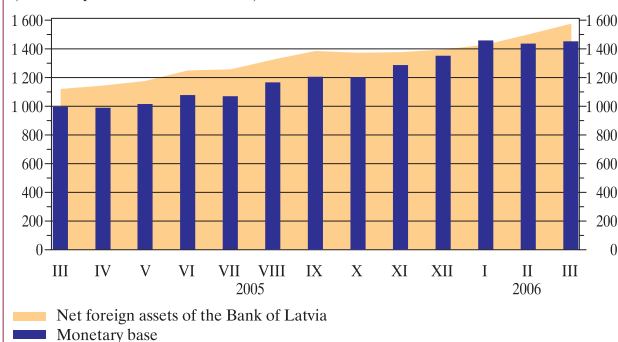
For the second consecutive month, both monthly and annual inflation declined (to 0.2% and 6.5%, respectively). Consumer price developments were determined by somewhat lower food prices (by 0.7%) and fuel prices (by 1.6%), whereas the growth of electricity tariffs (an increase of 6.7%) and higher clothing and footwear prices (an increase of 3.6%) had an upward pressure on inflation.

In March 2006, the financial surplus of the general government consolidated budget stood at 62.1 million lats (29.6 million lats in March 2005). Surpluses were recorded for both the general government consolidated budget (49.8 million lats due to a surplus of 37.1 million lats in the state basic budget and a 12.7 million lats surplus in the social security fund) and the local government consolidated budget (12.2 million lats). The year-on-year improvement of the general government consolidated budget balance was driven by a steep rise in the budget revenue (25.5%), with the budget expenditure going up by 15.3%. The budget revenue increased on account of the rapidly growing tax revenue (by 26.1%) and the EU funding (by 24.4%). Unchanged from the first two months of the year, the personal income tax revenue continued to rise (by 27.1%; despite the increase in non-taxable minimum of personal income tax and tax relief for a dependent person as of January), and the income from social security contributions also grew (by 29.8%). Reflecting strong expansion of private consumption, the revenue from the value added tax surged at a fast pace (28.0%). At the same time, the rise in wages and salaries for persons employed in the public sector, as well as an increase in pensions and social benefits as of 1 January 2006 resulted in growing expenditure from the general government consolidated budget. Transfers to institutions, organisations and enterprises as well as investment grew notably (by 36.5% and 3 times, respectively). This was primarily associated with providing co-financing for the projects funded from the EU Structural Funds.

The total debt of the general government stood at 1 109.8 million lats at the end of March, recording a drop of 21.7 million lats in the course of one month, mainly triggered by a reduction in domestic debt. One auction of 6-month Treasury bills was held on the Government securities market. In a competitive multi-price auction on the primary market, Treasury bills were sold in the amount of 1.3 million lats (32.5% of the amount offered) at the weighted average discount rate of 3.525% (by 1.158 percentage points exceeding the rate at the previous auction in October 2005).

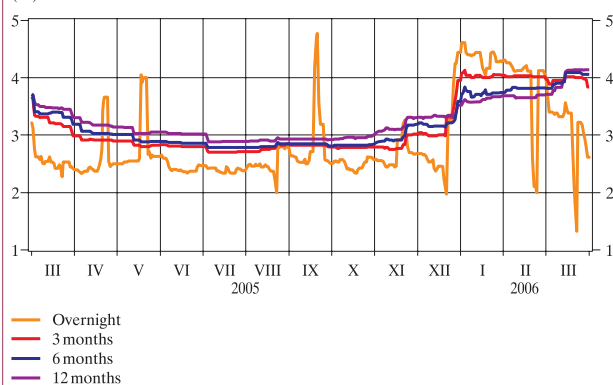
In March, currency outside MFIs remained broadly unchanged, whereas overnight deposits grew fast. Money supply M1 picked up 109.1 million lats or 3.8%. The growth of M2 recorded an

**BACKING OF THE NATIONAL CURRENCY**  
(at end of period; in millions of lats)



### MONEY MARKET INDEX RIGIBOR

(%)



### MACROECONOMIC INDICATORS

	2006	
	II	III
Changes in the volume index of industrial output (year-on-year basis; %)	7.2	*
Changes in the CPI		
Month-on-month basis (%)	0.4	0.2
Year-on-year basis (%)	6.9	6.5
Annual rate of core inflation <sup>1</sup> (%)	5.4	5.3
Number of registered unemployed persons (at end of period)	79 625	78 759
Unemployment rate (%)	7.5	7.4
General government consolidated budget financial deficit/surplus (in millions of lats)	62.3	124.3
Foreign trade (in millions of lats)		
Exports	228.2	*
Imports	416.3	*
Balance	-188.1	*

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

\* Figure available at a later date.

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

acceleration (168.1 million lats of 4.2%), with deposits with an agreed maturity of up to 2 years climbing significantly. Broad money M3 increased by 169.5 million lats or 4.2%. Thus, the annual growth rate of M1, M2 and M3 accelerated (to 44.7%, 40.1% and 41.6%, respectively).

In March, deposits of resident financial institutions, non-financial corporations and households increased by 156.3 million lats, with the annual growth rate standing at 44.0%. More than a half of the overall growth in deposits was on account of overnight deposits, though time deposits also posted a rather notable pickup (54.9 million lats). The rise in deposits in lats and foreign currencies was similar (74.0 million lats and 82.3 million lats, respectively). The increase in deposits of households (92.8 million lats) dominated the overall growth of deposits.

The growth in loans granted to resident financial institutions, non-financial corporations and households continued on a robust upward trend (64.0% annual growth rate in March). The growth in loans was record-high (305.4 million lats) and was determined by the expansion of mortgage lending by 161.5 million lats, with the commercial credit also growing substantially (by 80.0 million lats). Unchanged from the previous period, the growth in loans was still driven by an increase in loans granted in euro (304.2 million lats); loans in lats continued to expand (by 48.6 million lats) but loans in other currencies contracted. Slightly more than a half of total loans went to financial institutions and non-financial corporations, with lending to this group of customers growing by 171.6 million lats in March.

In March, the negative net foreign assets of MFIs increased by 78.9 million lats. MFI (excluding the Bank of Latvia) assets grew by 225.4 million lats in March, whereas their profit amounted to 61.9 million lats in the first three months of 2006 (a year-on-year increase of 48.4%).

The money supply of the central bank increased due to foreign currency purchases from banks. As a result of this increase and the growth in Government foreign currency deposits with the central bank, net foreign assets of the Bank of Latvia picked up 85.7 million lats or 5.8%. The backing of the national currency with the Bank of Latvia net foreign assets was 107.4% at the end of March. At the same time, the money supply was reduced due to an increase in Government deposits in lats with the Bank of Latvia (5.3 million lats). Given the moderate growth in bank overnight deposits with the Bank of Latvia, the monetary base M0 recorded a month-on-month expansion of 18.1 million lats at the end of March.

With banks ensuring sufficient liquidity in lats by foreign currency sales to the Bank of Latvia and interbank market transactions (those in lats rose to 854.2 million lats, a record-high of the last 12 months), in March the Bank of Latvia granted repo loans in the amount of only 5.2 million lats (8.5 times below the February level), with the time deposits attracted standing at 2.1 million lats (6.1 times less).

With ample liquidity persisting, in March RIGIBOR on overnight loans gradually declined from 4.0% at the beginning of the month to 1.3% at the end of the reserve maintenance period. In turn, RIGIBOR on loans with 6- and 12-month maturities grew by 0.2–0.4 percentage point within a month (4.06% and 4.14%, respectively, at the end of the month). However, the rise in interest rates on non-MFI loans that was observed in the previous months had ceased, and interest rates on loans in lats to households even dropped slightly (by 0.1 percentage point to 8.0%), while those on loans in foreign currencies remained unchanged (4.9%). Interest rates on loans to non-financial corporations also decreased by 0.2–0.4 percentage point.

With the euro appreciating on the global currency markets, the US dollar, Japanese yen and British pound sterling depreciated against the lats (by 1.9%, 2.7% and 1.9%, respectively).

MONETARY INDICATORS (at end of period; in millions of lats)	2006	
	II	III
<b>MFIs<sup>1</sup></b>		
<b>M3</b>	4 028.7	4 198.2
Repurchase agreements	0	0
Money market fund shares and units	41.4	42.8
Debt securities issued with maturity of up to 2 years	3.6	3.6
<b>M2</b>	3 983.7	4 151.8
Deposits with agreed maturity of up to 2 years	958.0	1 014.6
Deposits redeemable at notice of up to 3 months	117.0	119.4
<b>M1</b>	2 908.7	3 017.8
Currency outside MFIs	775.5	775.9
Overnight deposits	2 133.2	2 241.9
Net external assets	-1 460.6	-1 539.5
Credit to resident financial institutions, non-financial corporations and households	6 501.2	6 806.6
Credit to general government	391.7	385.7
Deposits of central government	160.6	216.1
Longer-term financial liabilities	1 275.8	1 285.3
<b>Bank of Latvia</b>		
<b>M0</b>	1 433.3	1 451.4
Currency in circulation	862.1	865.1
Deposits with the Bank of Latvia in lats	571.2	586.3
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	1 473.5	1 559.2
Net domestic assets	-40.2	-107.8
Credit	21.8	-49.4
To MFIs	2.0	1.0
To central government (net)	19.8	-50.4
Other items (net)	-62.0	-58.4
International reserves (at end of period; in millions of US dollars)	2 504.56	2 690.41
Gold	138.27	142.44
Special Drawing Rights	0.15	0.15
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	2 366.06	2 547.74

<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	
	II	III
Weighted average interest rate on domestic interbank loans in lats	3.7	2.9
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	6.5	6.3
Loans to households (in lats)	8.1	8.0
incl. for house purchase	6.1	6.0
Loans to non-financial corporations (in foreign currencies)	5.1	4.7
Loans to households (in foreign currencies)	4.9	4.9
incl. for house purchase	4.6	4.6
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	3.5	3.1
Demand deposits of non-financial corporations (in lats)	1.0	0.7
Time deposits of households (in lats)	3.1	3.0
Demand deposits of households (in lats)	0.5	0.5
Time deposits of non-financial corporations (in foreign currencies)	2.4	2.9
Demand deposits of non-financial corporations (in foreign currencies)	1.1	1.4
Time deposits of households (in foreign currencies)	3.0	3.1
Demand deposits of households (in foreign currencies)	1.1	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	0.5930	0.5820
LVL/GBP	1.0330	1.0130
LVL/100 JPY	0.5100	0.4960
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	
	II	III
MFI reserves	656.1	673.7
Vault cash in national currency	86.5	89.2
Deposits with the Bank of Latvia	569.5	584.5
Foreign assets	3 443.0	3 300.4
Vault cash in foreign currencies	59.7	56.7
Claims on MFIs	2 144.1	1 946.5
Claims on non-MFIs	1 200.4	1 255.6
Other assets	38.7	41.6
Claims on central government	241.1	235.8
Claims on local government	89.3	88.9
Claims on public non-financial corporations	109.4	116.2
Claims on financial institutions and private non-financial corporations	3 801.8	3 967.8
Claims on households	2 625.9	2 759.6
Unclassified assets	490.1	539.6
Fixed assets	140.3	141.9
Items in transit	13.1	16.8
Other assets	73.4	73.8
Claims on resident MFIs (incl. investments)	263.3	307.2
<b>Total assets</b>	<b>11 456.6</b>	<b>11 682.0</b>
<i>Memo item: Trust assets</i>	<i>391.7</i>	<i>431.6</i>
Overnight deposits in lats	1 219.6	1 242.7
Public non-financial corporations	53.5	53.7
Financial institutions and private non-financial corporations	540.3	532.3
Households	625.8	656.7
Time deposits and deposits redeemable at notice in lats	686.1	737.0
Public non-financial corporations	61.4	81.2
Financial institutions and private non-financial corporations	200.9	226.6
Households	423.8	429.2
Foreign currency deposits of residents	1 357.1	1 439.3
Public non-financial corporations	14.5	17.8
Financial institutions and private non-financial corporations	444.6	467.0
Households	898.0	954.5
Deposits of central government	119.1	104.7
Deposits of local government	93.9	106.5
Transit funds	4.9	4.9
Foreign liabilities	6 377.1	6 399.0
Liabilities to MFIs	3 125.4	3 397.3
Liabilities to non-MFIs	3 054.7	2 778.5
Other liabilities (incl. subordinated liabilities)	197.1	223.3
Liabilities to the Bank of Latvia	2.0	1.0
Debt securities issued	162.8	160.9
Money market fund shares and units	41.4	42.8
Capital and reserves	880.8	894.8
Residents	552.1	565.6
Non-residents	328.7	329.1
Provisions	90.6	85.2
Unclassified liabilities	421.2	463.1
Items in transit	113.5	106.2
Other liabilities (incl. subordinated liabilities)	72.4	78.5
Liabilities to resident MFIs	235.3	278.4
<b>Total liabilities</b>	<b>11 456.6</b>	<b>11 682.0</b>
<i>Memo item: Trust liabilities</i>	<i>391.7</i>	<i>431.6</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>).