

# MONETARY BULLETIN 2007

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In July, the domestic demand remained strong in Latvia although the real estate market showed the first signs of stabilisation and lending lost some momentum as a result of Government's anti-inflation measures. The signs of economic overheating continued to be broadly-based, with the preliminary second quarter real GDP growth indicator (11.3%) released by the Central Statistical Bureau of Latvia and unexpectedly strong upsurge in inflation lending force to the trend. Economic imbalances surfaced in manufacturing where production shrank by 0.2% in June while the rise of energy sector brought about an increase of 1.2% in industrial production overall. Persistent high growth of the retail trade turnover (23.2% in June) suggested that private consumption remained solid, though slowdown in its growth has been observed in recent months. Freight transportation by rail and overall freight turnover at Latvian ports also increased (recording a year-on-year growth of 9.9% and 8.8% respectively in July).

In the month under review, consumer prices rose by 1.2%, with the annual consumer price inflation advancing to 9.5% and the 12-month average annual inflation (the harmonised index of consumer prices) reaching 7.5%. The annual core inflation surged to 9.1%. Notwithstanding a moderate easing, food prices contributed markedly to inflation, and several groups of food products were not affected by seasonal price moderations. Increase in excise tax rates effective as of January had accounted for a gradual upswing in tobacco product prices, whereas the subsequent recurrent increase of this tax rate in July caused a price jump (14.0%). Untypical for July, solid fuel prices and heating tariffs soared, and house maintenance service costs increased.

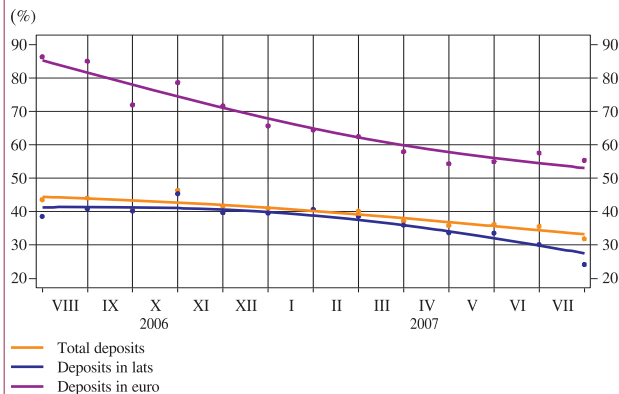
The financial surplus of the general government consolidated budget stood at 36.0 million lats in July, with the surplus since the beginning of the year amounting to 289.6 million lats (228.6 million lats in the respective period of 2006). In July, financial surpluses were recorded in the central government basic budget (17.1 million lats) and the social security fund (26.8 million lats), whereas in the local government consolidated budget a minor financial deficit (6.3 million lats) was observed.

The annual growth of the general government consolidated budget revenue was extremely strong in July (48.5%) primarily on account of tax revenue posting a solid pick-up (38.2%). Non-tax revenue, the amount of EU structural funds received and budget institutions' revenue were likewise higher. The growth in both the social security contributions (to 38.0%) and VAT collections, notwithstanding a slight deceleration of the latter to 29.0%, was essential for improvements in overall tax revenue. At the same time, the general government consolidated budget expenditure also rose at a buoyant pace (by 47.0%, including 45.6% higher costs for wages and salaries and social security contributions, and an 85.2% boost in capital expenditure).

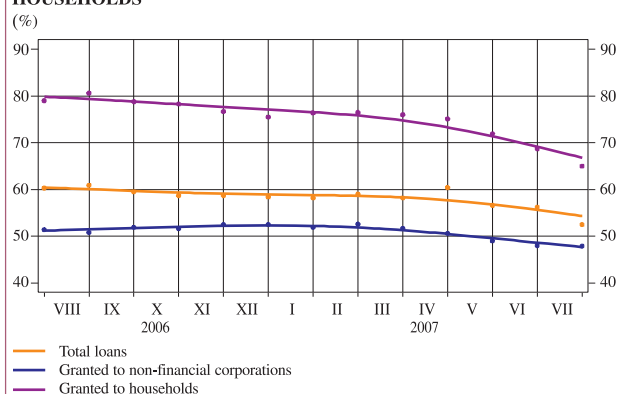
The general government debt, which at the end of July stood at 1 086.8 million lats, decreased by 17.5 million lats within the month due to redemptions of government securities.

In July, broad money M3 rose by mere 20.4 million lats, with the M3 annual growth rate dropping to 32.0% (35.7% in June) and that of monetary aggregates M2 and M1 decelerating to 30.3% and 25.2% respectively. Deposits of resident financial institutions, non-financial corporations and households grew

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



**ANNUAL CHANGES IN LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**



modestly by 11.6 million lats, with the annual growth rate losing 3.7 percentage points (to 31.9%). Currency outside MFIs shrank by 1.8 million lats, and its annual growth rate posted a 2.8 percentage point decrease (to 10.2%).

The annual growth in loans to resident financial institutions, non-financial corporations and households slowed down to 52.5% in July, the lowest level since the spring of 2005. In July, loans to non-financial corporations and households grew (by 184.0 million lats and 156.1 million lats respectively), while those to financial institutions shrank (by 114.2 million lats), decelerating the annual growth rate of lending to 47.9%, 65.0% and 19.0% respectively. Mortgage lending to households moderated, but industrial credit to non-financial corporations edged up. The monthly increase in lending to households for house purchase continued to shrink (107.6 million lats in July against 141.7 million lats in June), with the annual growth in lending for house purchase losing 5.3 percentage points and dropping to 75.6%. Industrial credit expanded by 44.2 million lats, and its annual pace of growth strengthened (43.9%).

The rising interest rates triggered a downward trend in loans in lats, and loans in euro accounted for 80.0% of total loans. However, the annual growth in loans in euro kept on decelerating (to 80.6% in July), whereas the stock of loans in lats for the first time lagged 3.3% behind the level of the respective period of the previous year.

External financing was the main source of lending. Syndicated loans caused notably higher liabilities to unrelated MFIs, whereas an increase in liabilities to parent banks in July moderated month-on-month (133.3 million lats). Non-resident non-bank deposits also surged. The negative net foreign assets of MFIs (except the Bank of Latvia) grew by 122.6 million lats.

In July, liquidity remained high. Banks met the demand for lats by selling foreign currency to the central bank (the Bank of Latvia bought euro in the net amount of 34.0 million lats), and there was no demand for central bank loans and currency swaps. Net foreign assets of the Bank of Latvia increased by 2.1%, and the backing of the national currency with the central bank's net foreign assets stood at 116.2% at end-July. The money supply decreased as a result of an increase in the Government deposit with the Bank of Latvia by 62.1 million lats. In July, the monetary base M0 shrank by 42.9 million lats and its annual growth rate decelerated to 25.7%.

The high liquidity triggered a further decrease in RIGIBOR. In July, RIGIBOR on overnight loans decreased by 165 basis points (to 3.30%), in mid-month dropping even to 2.55%, whereas that on 3- and 6-month loans lost 142 and 115 basis points (decreasing to 6.21% and 7.20%) respectively. This drop in RIGIBOR supported the lowering of the weighted average interest rate on loans in lats to non-financial corporations (8.4%); the same rate on loans in lats to households soared to 16.5% (10.0% on loans for house purchase), with bank interest rate margins growing. The increase in EURIBOR contributed to a higher weighted average interest rate on loans in foreign currencies to households and non-financial corporations, which rose to 6.3% (to 6.0% on loans for house purchase) and 6.5% respectively. The weighted average interest rate on time deposits in lats of non-financial corporations and households dropped notably (by 1.4 and 0.8 percentage point, to 4.1% and 4.6% respectively).

In July, the US dollar and the British pound sterling depreciated against the lats by 1.3% and 0.1% respectively, but the Japanese yen appreciated by 2.4%.

MACROECONOMIC INDICATORS	2007	
	VI	VII
Changes in the volume index of industrial output (year-on-year basis; %)	1.2	*
Changes in the CPI		
Month-on-month basis (%)	0.9	1.2
Average annual inflation rate (HCPI) of last 12 months (%)	7.2	7.5
Year-on-year basis (%)	8.8	9.5
Annual rate of core inflation <sup>1</sup> (%)	8.1	9.1
Number of registered unemployed persons (at end of period)	62 287	60 635
Unemployment rate (%)	5.8	5.7
General government consolidated budget financial deficit/surplus (in millions of lats)	253.6	289.6
Foreign trade (in millions of lats)		
Exports	340.9	*
Imports	649.6	*
Balance	-308.7	*

<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)	2007	
	VI	VII
<b>MFIs<sup>1</sup></b>		
<b>M3</b>	6 146.6	6 167.0
Repurchase agreements	0	0
Money market fund shares and units	59.6	70.4
Debt securities issued with maturity of up to 2 years	51.8	52.1
<b>M2</b>	6 035.3	6 044.5
Deposits with agreed maturity of up to 2 years	1 642.5	1 576.2
Deposits redeemable at notice of up to 3 months	178.5	187.7
<b>M1</b>	4 214.3	4 280.7
Currency outside MFIs	948.6	946.8
Overnight deposits	3 265.7	3 333.8
Net external assets	-3 675.5	-3 744.3
Credit to resident financial institutions, non-financial corporations and households	11 754.6	11 980.5
Credit to general government	325.6	297.5
Deposits of central government	210.4	274.2
Longer-term financial liabilities	2 104.2	2 156.7
<b>Bank of Latvia</b>		
<b>M0</b>	2 311.8	2 268.9
Currency in circulation	1 056.1	1 054.7
Deposits with the Bank of Latvia in lats	1 255.7	1 214.2
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	2 582.3	2 636.1
Net domestic assets	-270.5	-367.2
Credit	-186.0	-248.1
To MFIs	23.0	0
To central government (net)	-186.0	-248.1
Other items (net)	-84.6	-119.1
International reserves (at end of period; in millions of US dollars)	4 928.46	5 109.27
Gold	160.32	164.70
Special Drawing Rights	0.16	0.16
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	4 767.90	4 944.33

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2007	
	VI	VII
Weighted average interest rate on domestic interbank loans in lats	3.6	2.7
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	9.8	8.4
Loans to households (in lats)	15.4	16.5
incl. for house purchase	9.1	10.0
Loans to non-financial corporations (in foreign currencies)	6.4	6.5
Loans to households (in foreign currencies)	6.2	6.3
incl. for house purchase	5.9	6.0
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	5.5	4.1
Demand deposits of non-financial corporations (in lats)	1.7	1.0
Time deposits of households (in lats)	5.4	4.6
Demand deposits of households (in lats)	0.6	0.5
Time deposits of non-financial corporations (in foreign currencies)	3.9	4.0
Demand deposits of non-financial corporations (in foreign currencies)	1.9	1.9
Time deposits of households (in foreign currencies)	4.0	4.0
Demand deposits of households (in foreign currencies)	1.6	1.7
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	0.5220	0.5150
LVL/GBP	1.0440	1.0430
LVL/100 JPY	0.4250	0.4350
LVL/EUR	0.7028	0.7028

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

	2007	
	VI	VII
MFI reserves	1 363.1	1 337.0
Vault cash in national currency	107.5	107.9
Deposits with the Bank of Latvia	1 255.6	1 229.0
Foreign assets	4 148.0	4 641.9
Vault cash in foreign currencies	60.8	61.0
Claims on MFIs	2 371.7	2 838.8
Claims on non-MFIs	1 655.7	1 676.1
Other assets	59.8	66.0
Claims on central government	245.5	230.4
Claims on local government	80.1	67.0
Claims on public non-financial corporations	170.6	180.6
Claims on financial institutions and private non-financial corporations	6 260.2	6 320.3
Claims on households	5 382.2	5 538.3
Unclassified assets	970.3	971.4
Fixed assets	144.5	148.2
Items in transit	27.7	29.5
Other assets	128.7	133.7
Claims on resident MFIs (incl. investments)	669.3	660.0
<b>Total assets</b>	<b>18 619.9</b>	<b>19 286.8</b>
<i>Memo item: Trust assets</i>	<i>521.2</i>	<i>601.6</i>
Overnight deposits in lats	1 772.0	1 758.3
Public non-financial corporations	105.6	101.5
Financial institutions and private non-financial corporations	714.2	721.7
Households	952.1	935.1
Time deposits and deposits redeemable at notice in lats	971.3	927.5
Public non-financial corporations	173.8	149.4
Financial institutions and private non-financial corporations	217.4	196.6
Households	580.0	581.5
Foreign currency deposits of residents	2 247.6	2 316.6
Public non-financial corporations	26.2	30.1
Financial institutions and private non-financial corporations	665.0	685.4
Households	1 556.3	1 601.1
Deposits of central government	24.4	26.1
Deposits of local government	266.0	262.6
Transit funds	4.2	4.2
Foreign liabilities	10 405.8	11 022.3
Liabilities to MFIs	6 721.9	7 060.6
Liabilities to non-MFIs	3 378.5	3 676.6
Other liabilities (incl. subordinated liabilities)	305.4	285.1
Liabilities to the Bank of Latvia	0	0
Debt securities issued	357.6	359.1
Money market fund shares and units	59.6	70.4
Capital and reserves	1 512.2	1 547.5
Residents	808.3	837.0
Non-residents	703.8	710.4
Provisions	100.9	102.5
Unclassified liabilities	898.4	889.7
Items in transit	165.0	161.5
Other liabilities (incl. subordinated liabilities)	125.4	131.7
Liabilities to resident MFIs	608.0	596.5
<b>Total liabilities</b>	<b>18 619.9</b>	<b>19 286.8</b>
<i>Memo item: Trust liabilities</i>	<i>521.2</i>	<i>601.6</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>).