

MONETARY BULLETIN 2008

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With the aggravation of the global financial crisis, the liquidity conditions of the Latvian financial sector also tightened. As the deposits attracted by banks shrank, the money supply decreased. The general government consolidated budget reported a deficit. The low demand for loans and tighter lending standards resulted in slower loan growth. The economic downturn was more pronounced than expected: according to the flash estimate in the third quarter GDP fell 4.2% year-on-year. In October, the unemployment rate posted a more rapid rise than in previous months (0.3 percentage point, to 5.6%). In September, exports expanded notably (by 23.5% year-on-year) and imports grew only somewhat (by 7.0%).

As a result of a stronger-than-expected downturn in the economic activity, the impact of inflation expectations and external imbalances moderated. Price changes of oil and food products on the global markets also had a favourable effect, and in October the annual and the annual core inflation in Latvia shrank by 1.1 percentage points (to 13.8%) and 1.4 percentage points (to 11.2%) respectively, although consumer prices rose by 1.2% over the month. The price rise in October resulted from changes in regulated prices which accounted for almost 1 percentage point of the overall monthly inflation after the heating tariffs had increased by 16.5% and the natural gas price had surged by 68.9%. At the same time fuel prices dropped significantly (by 4.6%).

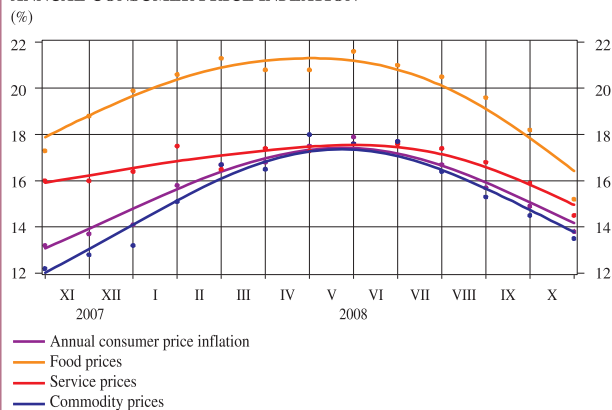
The persistent decrease in the retail trade turnover (including sales of motor vehicles and automotive fuel) pointed to a further decline in domestic demand: in September, the turnover shrank by 12.6% year-on-year, mostly as a result of the contracting retail trade turnover of motor vehicles, food products and beverages, as well as furniture and household appliances.

In September, the 8.6% year-on-year decrease in the working-day-adjusted volume index of industrial output in manufacturing was smaller than in the previous month. In October, rail freight turnover and freight turnover at Latvian ports expanded by 9.2% and 3.2% respectively.

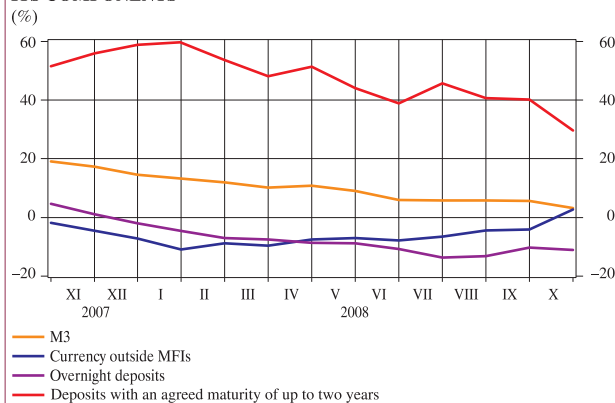
In view of a stronger-than-expected decrease of inflation due to weaker economic activity, slower lending growth and a substantially declining role of banks in maintaining domestic demand, the Council of the Bank of Latvia continued to unwind the tight monetary conditions, releasing extra funding for lending to banks and thus creating more favourable environment for economic growth. The reserve ratio for bank liabilities with maturity of over two years was reduced from 5% to 3%, and from 7% to 5% for the rest of the liabilities included in the reserve base (a respective decline of 1.0 percentage point as of 24 November and 24 December).

In October, the general government consolidated budget revenue shrank by 3.6% and expenditure grew by 29.2%, resulting in a financial deficit of 228.5 million lats in the general government consolidated budget. In the first ten months of 2008, the financial deficit totalled 92.6 million lats in comparison with 292.2 million lats of financial surplus in the corresponding period of 2007. In October, expenditure exceeded revenue in all budgets, resulting in a financial deficit in the central government basic budget, central government social security budget and local government consolidated budget (202.0 million lats, 7.3 million lats and 20.3 million lats respectively). Revenue decreased mostly on account of a reduction in funds received from the EU while a slight increase in tax revenue (5.0%) was maintained. Excise tax and corporate income tax revenues posted the highest increases whereas the

ANNUAL CONSUMER PRICE INFLATION



THE ANNUAL GROWTH RATE OF BROAD MONEY M3 AND ITS COMPONENTS



revenue growth from personal income tax and social security contributions moderated; value added tax revenue also continued on a downward trend. The rise in expenditure resulted from an increase in grants and subsidies. In October, the central government debt expanded due to an issue of Treasury bills in the amount of 65.0 million lats.

The downturn in the economic activity and the related low income growth was reflected in the declining money supply. In October, M3 contracted by 103.0 million lats, with the annual growth rate decelerating to 3.2%. M2 and M1 also shrank, posting an annual growth rate of 3.0% and -8.0% respectively. The decrease in money supply moderated on account of changes in the demand for cash. The financial market instability resulted in a higher demand for cash, and currency outside MFIs increased by 35.5 million lats. At the same time, the deposits of resident financial institutions, non-financial corporations and households shrank by 2.5%, with their annual growth rate dropping to 2.9%. A fall of 3.3% in overnight deposits accounted for the overall decrease in deposits. Household deposits posted a more pronounced decline (3.6%) while those of financial institutions and non-financial corporations shrank by a mere 0.7%. The drop in deposits made in euro (5.5%) considerably exceeded that of deposits in lats (1.0%).

In October, bank loans continued to expand, albeit at a notably slower rate than in previous months. Moderate lending growth continued in the corporate sector, whereas loans granted to households posted only a minor increase. Loans to resident financial institutions, non-financial corporations and households expanded by 74.9 million lats or 0.5%, yet the annual growth rate dropped by 1.8 percentage points, to 15.8%. Loans granted to non-financial corporations expanded by 54.8 million lats or 0.8%, with the annual growth rate contracted by 1.7 percentage points, to 21.2%. Industrial credit recorded the highest increase (1.3%). Household loans grew by a mere 0.3%, with the annual growth rate slowing down to 10.2%. Loans granted to households for house purchase and consumer credit moved up by 0.6% and 0.2% respectively.

In October, financing from foreign banks expanded considerably, and the liabilities to foreign banks grew by 262.7 million lats, including loans from affiliated banks by 367.8 million lats. At the same time, non-resident non-MFI deposits shrank by 229.0 million lats, and the negative net foreign assets of MFIs increased by 259.4 million lats.

In October, the monetary base M0 grew by 28.9 million lats or 1.2%. The central bank's money supply expanded due to an increase in lending to banks and a drop in the government deposits in lats with the Bank of Latvia, while the central bank's interventions of purchasing lats had a decreasing effect.

In October, bank liquidity conditions tightened, and individual banks actively resorted to the Bank of Latvia's main refinancing operations and marginal lending facility. With tensions on the financial markets mounting, RIGIBOR continued on its upward trend: on overnight loans, it mostly exceeded 7% throughout the month, and 3-, 6- and 12-month RIGIBOR surged 460 basis points (to 11.78%), 445 basis points (to 12.46%) and 440 basis points (to 13.12%) respectively. Hence, a notable pickup was recorded in interest rates on loans both in lats (0.4–4.0 percentage points) and foreign currency (0.3–0.6 percentage point), as well as on time deposits in lats.

According to the exchange rates set by the Bank of Latvia, in October the US dollar and the Japanese yen appreciated against the lats (by 9.9% and 18.6% respectively), whereas the British pound sterling depreciated by 0.2%.

MACROECONOMIC INDICATORS	2008	
	XI	X
Volume index of industrial output (working-day adjusted annual rate of change; %)	-5.4	*
Changes in the CPI		
Month-on-month basis (%)	1.1	1.2
Average annual inflation rate (HCPI) of last 12 months (%)	15.9	15.9
Year-on-year basis (%)	14.9	13.8
Annual rate of core inflation ¹ (%)	12.6	11.2
Number of registered unemployed persons (at end of period)	57 644	61 049
Unemployment rate (%)	5.3	5.6
General government consolidated budget financial deficit/surplus (in millions of lats)	135.9	-92.6
Foreign trade (in millions of lats)		
Exports	419.6	*
Imports	690.9	*
Balance	-271.3	*

¹ 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)	2008	
	IX	X
MFIs¹		
M3	6 380.7	6 277.7
Repurchase agreements	0	0
Money market fund shares and units	113.0	97.3
Debt securities issued with maturity of up to 2 years	7.1	4.5
M2	6 260.5	6 175.9
Deposits with agreed maturity of up to 2 years	2 322.7	2 324.5
Deposits redeemable at notice of up to 3 months	320.5	289.2
M1	3 617.3	3 562.2
Currency outside MFIs	876.9	912.4
Overnight deposits	2 740.4	2 649.8
Net external assets	-5 692.1	-5 951.5
Credit to resident financial institutions, non-financial corporations and households	14 594.0	14 668.9
Credit to general government	490.5	543.8
Deposits of central government	617.2	555.6
Longer-term financial liabilities	2 392.0	2 428.9
Bank of Latvia		
M0	2 354.5	2 383.4
Currency in circulation	998.9	1 037.0
Deposits with the Bank of Latvia in lats	1 348.1	1 336.5
Deposits with the Bank of Latvia in foreign currencies	7.5	9.9
Net foreign assets	2 990.2	2 888.3
Net domestic assets	-635.7	-504.9
Credit	-471.8	-313.6
To MFIs	10.0	187.9
To central government (net)	-481.8	-501.5
Other items (net)	-163.9	-191.3
International reserves (at end of period; in millions of euro)	4 314.99	4 248.93
Gold	150.66	144.81
Special Drawing Rights	0.12	0.13
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	4 164.15	4 103.93
International reserves (at end of period; in millions of US dollars)	6 239.90	5 592.06
Gold	217.86	190.58
Special Drawing Rights	0.18	0.17
Reserve position in the IMF	0.09	0.08
Foreign convertible currencies	6 021.77	5 401.23

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2008	
	IX	X
Weighted average interest rate on domestic interbank loans in lats	3.7	6.5
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	7.7	11.7
Loans to households (in lats)	16.7	17.1
incl. for house purchase	9.4	10.9
Loans to non-financial corporations (in foreign currencies)	7.9	8.2
Loans to households (in foreign currencies)	7.0	7.6
incl. for house purchase	6.8	7.1
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	5.2	6.8
Demand deposits of non-financial corporations (in lats)	2.2	2.6
Time deposits of households (in lats)	6.6	7.5
Demand deposits of households (in lats)	1.3	1.3
Time deposits of non-financial corporations (in foreign currencies)	4.1	3.8
Demand deposits of non-financial corporations (in foreign currencies)	1.8	1.7
Time deposits of households (in foreign currencies)	4.2	4.1
Demand deposits of households (in foreign currencies)	1.8	1.6
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	0.4860	0.5340
LVL/GBP	0.8870	0.8850
LVL/100 JPY	0.4570	0.5420
LVL/EUR	0.7028	0.7028

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

	2008	
	XI	X
MFI reserves	1 475.3	1 468.5
Vault cash in national currency	122.0	124.6
Deposits with the Bank of Latvia	1 353.2	1 343.9
Foreign assets	4 913.2	4 918.0
Vault cash in foreign currencies	58.2	67.3
Claims on MFIs	2 654.3	2 587.8
Claims on non-MFIs	2 081.1	2 078.8
Other assets	119.5	184.2
Claims on central government	417.5	467.8
Claims on local government	73.0	76.0
Claims on public non-financial corporations	337.4	345.2
Claims on financial institutions and private non-financial corporations	7 908.4	7 955.3
Claims on households	6 411.3	6 432.2
Unclassified assets	981.7	962.6
Fixed assets	194.6	190.8
Items in transit	34.0	31.3
Other assets	207.5	244.1
Claims on resident MFIs (incl. investments)	545.6	496.3
Total assets	22 517.7	22 625.7
<i>Memo item: Trust assets</i>	<i>364.2</i>	<i>361.8</i>
Overnight deposits in lats	1 539.8	1 510.2
Public non-financial corporations	84.0	74.0
Financial institutions and private non-financial corporations	653.8	654.3
Households	802.1	781.9
Time deposits and deposits redeemable at notice in lats	1 225.8	1 228.4
Public non-financial corporations	192.3	179.5
Financial institutions and private non-financial corporations	381.5	406.8
Households	652.0	642.0
Foreign currency deposits of residents	2 506.3	2 401.6
Public non-financial corporations	19.6	19.7
Financial institutions and private non-financial corporations	716.5	699.0
Households	1 770.2	1 683.0
Deposits of central government	135.4	54.1
Deposits of local government	256.4	264.1
Transit funds	3.7	3.7
Foreign liabilities	13 595.4	13 757.8
Liabilities to MFIs	9 111.8	9 374.5
Liabilities to non-MFIs	4 095.2	3 866.2
Other liabilities (incl. subordinated liabilities)	388.4	517.1
Liabilities to the Bank of Latvia	10.0	187.9
Debt securities issued	183.2	175.5
Money market fund shares and units	113.0	97.3
Capital and reserves	1 873.7	1 891.6
Residents	1 135.6	1 155.6
Non-residents	738.1	735.9
Provisions	171.2	188.0
Unclassified liabilities	903.7	865.4
Items in transit	154.8	140.2
Other liabilities (incl. subordinated liabilities)	245.2	273.9
Liabilities to resident MFIs	503.6	451.4
Total liabilities	22 517.7	22 625.7
<i>Memo item: Trust liabilities</i>	<i>364.2</i>	<i>361.8</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>).