

MONETARY BULLETIN 2010

1

Against the backdrop of a broadly unchanged macroeconomic environment in Latvia, positive developments were more and more pronounced and associated with stabilisation of financial markets and money supply dynamics as well as with improving key economic confidence indicators and recovering exports. According to the flash estimate of the Central Statistical Bureau of Latvia, in the fourth quarter GDP posted a year-on-year contraction of 17.7% (19.0% in the third quarter). Yet, adverse trends in economy continued to persist as well: in January, the registered unemployment rate climbed to 16.6%, retail trade turnover dropped still further.

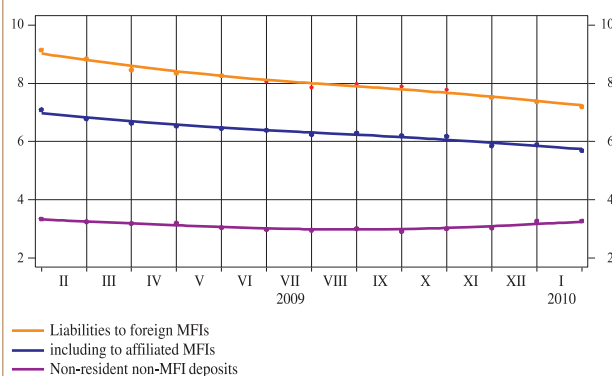
The weak domestic demand in December accounted for a sustained contraction of retail trade, the turnover falling by 1.9% month-on-month (seasonally adjusted), while the year-on-year decline (working-day adjusted) was 30.2%. After expanding strongly in November, the seasonally adjusted volume index of industrial output in manufacturing posted a 5.7% decline in December, while the year-on-year decline (working-day adjusted) was 5.3%. The performance of the freight transportation business continued to deteriorate in January. With freight transit through Latvian ports decreasing, rail freight declined by 6.0% year-on-year. Total cargo turnover at Latvian ports went down 10.4%.

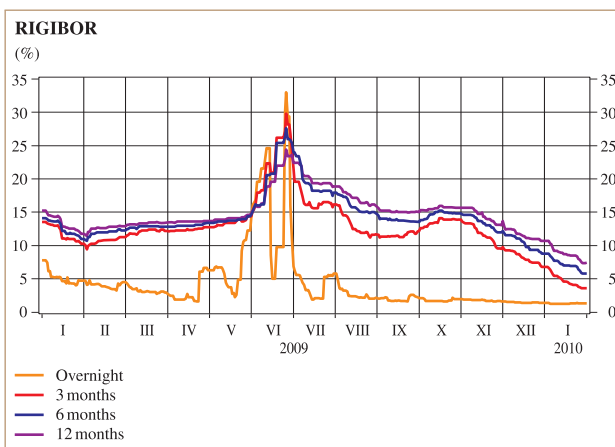
In January – the month when prices traditionally are on a steeper rise than at the end of the year due to a number of factors – a weak demand and cost decrease accounted for a price decline for the majority of goods and services, the upward effect was insignificant and consumer prices gained a mere 0.2%. The rise was triggered mainly by an increase in food prices due to seasonal factors as well as a marked climb of fuel prices. The annual deflation of consumer prices stood at 3.1%, while annual consumer price core inflation was –5.0%. In spite of the fact that annual deflation was recorded for the fourth consecutive month, the average 12-month inflation continued to be in the positive area (2.5%), but the 12-month average growth in the harmonised index of consumer prices (HICP) used for the Maastricht criterion dropped to 2.2%.

In January, the surplus of the general government consolidated budget amounted to 70.7 million lats, posting a 20.6% year-on-year increase. The central government basic budget and local government consolidated budget recorded a surplus, whereas the central government social security budget registered a small deficit. A 20.3% decline in tax revenue was offset by inflows of foreign financial assistance and from trading greenhouse gas emission surplus, thus total decrease in revenue amounted to 0.2%. The revenue from corporate income tax, personal income tax and value added tax posted the sharpest falls of 56.5%, 25.3% and 17.3% respectively. In January, the budget expenditure decreased by 3.7%. The largest contribution to the decrease was a smaller expenditure for compensation to employees, whereas capital expenditure, expenditure for social benefits and interest expense had risen. The general government debt went up by 93.0 million lats, to reach 4 358.1 million lats outstanding, prevailingly as a result of a government Treasury bill issue.

Despite the slight decrease in the amount of broad money registered in January, with monetary aggregate M3 shrinking by 1.1%, the annual growth rate of money supply remained broadly unchanged to stand at –2.3% (–2.8% in December). Currency outside MFIs decreased by 2.1% and deposits of

DYNAMICS OF THE MAIN COMPONENTS OF FOREIGN LIABILITIES OF LATVIAN MFIs (EXCLUDING THE BANK OF LATVIA)
(at end of period; in billions of lats)





resident financial institutions, non-financial corporations and households contracted by 1.4%; yet, these indicators as well as broad money, overall, were well above the levels recorded in November 2009.

With domestic financial markets remaining steady, deposits in lats shrank by an immaterial 0.8% and those in euro by 2.1%. The deposits made by households, financial institutions and non-financial corporations decreased at a similar rate, while non-resident non-MFI deposits increased somewhat. The annual growth rate of domestic deposits continued to accelerate, and at the end of January deposits of households and non-financial corporations posted a 2.1% year-on-year increase.

Given the deteriorating quality of loan portfolios, banks continued to be reserved in their lending policies, domestic demand was weak, and lending to private sector continued to shrink in January (–0.5%); nevertheless, this decline was the smallest in the last four months. Yet, industrial credit demonstrated a rise of 0.6%, the highest since December 2008.

With decreasing funding from foreign parent banks, foreign liabilities of the banking sector to affiliated MFIs declined by 197.6 million lats in January. During the month, with foreign assets of the banking sector declining only by 84.5 million lats, the negative net foreign assets of MFIs (except the Bank of Latvia) decreased by 94.1 million lats.

In January, the monetary base M0 increased by 100.5 million lats and its negative annual growth rate decelerated to 7.9% and was the smallest year-on-year fall recorded since December 2008. The increase of M0 was the result of the expanding bank demand deposits with the Bank of Latvia, while the recourse to deposit facility moderated. At the same time, demand for cash and lending to banks contracted due to seasonal factors, but the government deposits with the Bank of Latvia surged. Net foreign assets of the Bank of Latvia picked up 3.0% to peak at 3.4 billion lats, mainly contributed by changes in government foreign currency funds. At the end of the month, the backing of the national currency with the Bank of Latvia's net foreign assets was 195.4%.

The banking sector continued to enjoy ample liquidity, and interest rates remained on their downward trend in interbank market. In January, RIGIBOR on overnight loans dropped to 1.31% on average (1.46% in December). Longer-term RIGIBOR was subject to an even more pronounced decrease: at the end of January, 3-month, 6-month and 12-month RIGIBOR went down to 3.6%, 5.8% and 7.4% respectively (6.8%, 8.8% and 10.7% at the end of December). In January, interest rates on lats loans granted to households increased notably, mainly due to interest rate hikes on consumer credit, whereas interest rates on loans for house purchase decreased further. Interest rates on loans to non-financial corporations moved up. The month-on-month increase of interest rates was also the effect of the untypically low interest rates in December. Since banks decreased their seasonal activities in raising domestic funds, interest rates on deposits decreased somewhat, nevertheless hovering around relatively high levels, e.g. the weighted average interest rate on time deposits in lats made by households was 9.9%.

In January, the exchange rate of the US dollar, the British pound sterling and the Japanese yen set by the Bank of Latvia increased against the lats by 2.7%, 3.7% and 4.3% respectively.

| MACROECONOMIC INDICATORS | 2009 | 2010 |
|--|---------|---------|
| | XII | I |
| Volume index of industrial output (working-day adjusted annual rate of change; %) | –3.6 | * |
| Changes in the CPI | | |
| Month-on-month basis (%) | –0.5 | 0.2 |
| Average annual inflation rate (HCPI) of last 12 months (%) | 3.5 | 2.5 |
| Year-on-year basis (%) | –1.2 | –3.1 |
| Annual rate of core inflation ¹ (%) | –2.0 | –5.0 |
| Number of registered unemployed persons (at end of period) | 179 235 | 186 295 |
| Unemployment rate (%) | 16.0 | 16.6 |
| General government consolidated budget financial deficit/surplus (in millions of lats) | –892.1 | 70.7 |
| Foreign trade (in millions of lats) | | |
| Exports | 315.8 | * |
| Imports | 385.5 | * |
| Balance | –69.7 | * |

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)

| | 2009 | 2010 |
|--|----------|----------|
| | XII | I |
| MFIs¹ | | |
| M3 | 5 873.1 | 5 806.3 |
| Repurchase agreements | 0 | 0 |
| Money market fund shares and units | 76.1 | 91.4 |
| Debt securities issued with maturity of up to 2 years | 0.9 | 0.9 |
| M2 | 5 796.2 | 5 714.1 |
| Deposits with agreed maturity of up to 2 years | 2 565.2 | 2 542.8 |
| Deposits redeemable at notice of up to 3 months | 251.6 | 249.9 |
| M1 | 2 979.3 | 2 921.4 |
| Currency outside MFIs | 667.3 | 653.0 |
| Overnight deposits | 2 312.0 | 2 268.4 |
| Net external assets | -3 021.6 | -2 827.8 |
| Credit to resident financial institutions, non-financial corporations and households | 13 514.9 | 13 444.6 |
| Credit to general government | 590.8 | 642.0 |
| Deposits of central government | 1 932.2 | 2 089.1 |
| Longer-term financial liabilities | 2 224.4 | 2 242.0 |
| Bank of Latvia | | |
| M0 | 1 645.8 | 1 746.3 |
| Currency in circulation | 788.2 | 752.4 |
| Deposits with the Bank of Latvia in lats | 837.7 | 984.1 |
| Deposits with the Bank of Latvia in foreign currencies | 19.9 | 9.8 |
| Net foreign assets | 3 313.1 | 3 412.9 |
| Net domestic assets | -1 667.3 | -1 666.6 |
| Credit | -1 151.5 | -1 316.6 |
| To MFIs | 140.4 | 131.7 |
| To central government (net) | -1 291.9 | -1 448.3 |
| Other items (net) | -515.8 | -350.0 |
| International reserves (at end of period; in millions of euro) | 4 805.37 | 4 910.21 |
| Gold | 191.18 | 193.41 |
| Special Drawing Rights | 129.82 | 132.70 |
| Reserve position in the IMF | 0.06 | 0.06 |
| Foreign convertible currencies | 4 484.31 | 4 584.04 |
| International reserves (at end of period; in millions of US dollars) | 6 906.44 | 6 874.36 |
| Gold | 274.78 | 270.78 |
| Special Drawing Rights | 186.58 | 185.78 |
| Reserve position in the IMF | 0.09 | 0.09 |
| Foreign convertible currencies | 6 444.99 | 6 417.71 |

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES

| | 2009 | 2010 |
|---|--------|--------|
| | XII | I |
| Weighted average interest rate on domestic interbank loans in lats | 1.4 | 1.1 |
| Interest rates on loans to resident non-financial corporations and households | | |
| Loans to non-financial corporations (in lats) | 6.7 | 10.1 |
| Loans to households (in lats) | 12.2 | 18.9 |
| incl. for house purchase | 9.1 | 8.2 |
| Loans to non-financial corporations (in foreign currencies) | 4.2 | 5.0 |
| Loans to households (in foreign currencies) | 5.8 | 5.4 |
| incl. for house purchase | 4.5 | 3.9 |
| Interest rates on deposits of non-financial corporations and households | | |
| Time deposits of non-financial corporations (in lats) | 5.4 | 4.1 |
| Demand deposits of non-financial corporations (in lats) | 0.5 | 0.6 |
| Time deposits of households (in lats) | 11.4 | 9.9 |
| Demand deposits of households (in lats) | 1.1 | 1.1 |
| Time deposits of non-financial corporations (in foreign currencies) | 1.3 | 1.4 |
| Demand deposits of non-financial corporations (in foreign currencies) | 0.2 | 0.2 |
| Time deposits of households (in foreign currencies) | 3.1 | 2.4 |
| Demand deposits of households (in foreign currencies) | 0.8 | 0.6 |
| 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 | 0.4890 | 0.5020 |
| LVL/GBP | 0.7830 | 0.8120 |
| LVL/100 JPY | 0.5330 | 0.5560 |
| LVL/EUR | 0.7028 | 0.7028 |

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

| | 2009 | 2010 |
|---|-----------------|-----------------|
| | XII | I |
| MFI reserves | 1 233.0 | 1 171.9 |
| Vault cash in national currency | 120.8 | 99.4 |
| Deposits with the Bank of Latvia | 1 112.2 | 1 072.4 |
| Foreign assets | 4 854.9 | 4 770.4 |
| Vault cash in foreign currencies | 63.4 | 68.1 |
| Claims on MFIs | 2 983.3 | 2 892.5 |
| Claims on non-MFIs | 1 712.5 | 1 702.1 |
| Other assets | 95.7 | 107.7 |
| Claims on central government | 519.1 | 572.0 |
| Claims on local government | 71.8 | 70.0 |
| Claims on public non-financial corporations | 395.7 | 405.5 |
| Claims on financial institutions and private non-financial corporations | 7 195.0 | 7 131.5 |
| Claims on households | 6 088.2 | 6 065.5 |
| Unclassified assets | 943.5 | 907.9 |
| Fixed assets | 148.5 | 146.7 |
| Items in transit | 16.4 | 14.0 |
| Other assets | 460.4 | 462.5 |
| Claims on resident MFIs (incl. investments) | 318.2 | 284.7 |
| Total assets | 21 301.1 | 21 094.7 |
| <i>Memo item: Trust assets</i> | <i>391.5</i> | <i>405.1</i> |
| Overnight deposits in lats | 1 114.9 | 1 095.0 |
| Public non-financial corporations | 70.4 | 76.6 |
| Financial institutions and private non-financial corporations | 487.0 | 501.8 |
| Households | 557.5 | 516.6 |
| Time deposits and deposits redeemable at notice in lats | 1 171.3 | 1 172.3 |
| Public non-financial corporations | 201.6 | 231.9 |
| Financial institutions and private non-financial corporations | 426.4 | 390.8 |
| Households | 543.3 | 549.6 |
| Foreign currency deposits of residents | 2 866.8 | 2 814.5 |
| Public non-financial corporations | 50.6 | 34.6 |
| Financial institutions and private non-financial corporations | 1 044.2 | 1 029.4 |
| Households | 1 771.9 | 1 750.5 |
| Deposits of central government | 640.2 | 640.8 |
| Deposits of local government | 133.3 | 135.0 |
| Transit funds | 3.0 | 3.0 |
| Foreign liabilities | 11 189.7 | 11 011.1 |
| Liabilities to MFIs | 7 374.2 | 7 202.4 |
| Liabilities to non-MFIs | 3 261.7 | 3 267.1 |
| Other liabilities (incl. subordinated liabilities) | 553.8 | 541.6 |
| Liabilities to the Bank of Latvia | 140.4 | 131.7 |
| Debt securities issued | 153.5 | 150.2 |
| Money market fund shares and units | 76.1 | 91.4 |
| Capital and reserves | 1 624.7 | 1 636.5 |
| Residents | 392.8 | 391.6 |
| Non-residents | 1 231.8 | 1 244.8 |
| Provisions | 1 526.7 | 1 559.2 |
| Unclassified liabilities | 660.6 | 654.0 |
| Items in transit | 77.1 | 95.1 |
| Other liabilities (incl. subordinated liabilities) | 298.6 | 304.8 |
| Liabilities to resident MFIs | 284.9 | 254.1 |
| Total liabilities | 21 301.1 | 21 094.7 |
| <i>Memo item: Trust liabilities</i> | <i>391.5</i> | <i>405.1</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>).