

**LATVIJAS BANKA**
EIROSISTĒMA

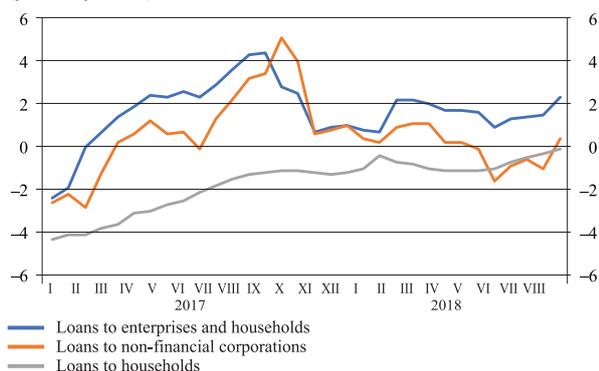


LATVIJAS BANKA
MONTHLY NEWSLETTER

OCTOBER 2018

The ice age in lending is approaching an end

Domestic loans (year-on-year; %)*



Source: Latvijas Banka.

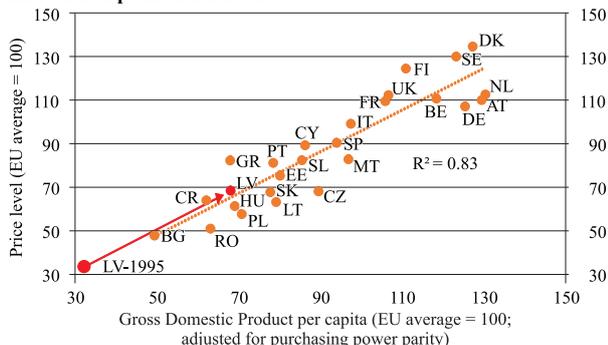
*To ensure comparability, the one-off effects due to the structural changes in the Latvian banking sector are excluded.

In August domestic loans increased, with the loan portfolios of non-financial corporations and households growing somewhat. The volume of new loans granted in August exceeded the level recorded in July by more than one third, with non-financial corporations and households receiving more of them.

Though lending is still quite sluggish, both loan demand and supply remain wary and external risks to Latvia's economic development also do not recede, there is some scope for a more positive assessment. The expansion of the domestic loan portfolio in recent months suggests that the freeze period experienced at the beginning of the year is gradually coming to an end and bank lending could again play an increasing role in financing the much needed investment into the economy.

Inflation about 3% regarded healthy

Income and price levels in 2017



Source: EC.

Latvian inflation hovers around 3% for a second year in a row, slightly exceeding the euro area average.

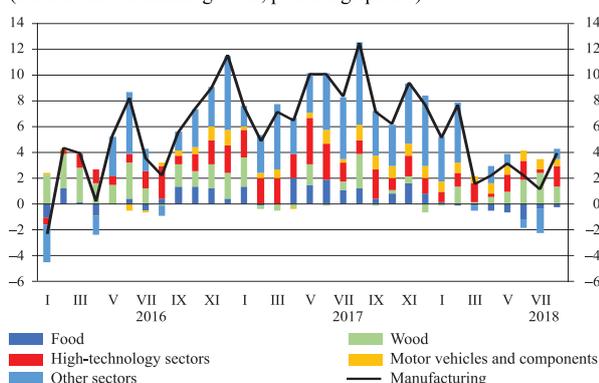
First, higher inflation is a by-product of ongoing income convergence. Strong positive relation between income and price levels means that it is not possible to achieve German welfare with Romanian prices. As long as Latvian GDP per capita continues rising relatively fast, this will be true also for consumer prices.

Second, it reflects the impact of cyclical expansion. Also other euro area economies operating at or somewhat above potential have higher inflation than economies operating substantially below potential.

Third, it reflects a rather high share of energy in the consumption basket. Consequently, an oil price rise from 50 USD per barrel in mid-2017 to the current 85 USD per barrel has a bigger impact on inflation in Latvia vis-à-vis the euro area average inflation.

Latvian economy continues expanding

Manufacturing output (contribution to annual growth; percentage points)



Source: CSB.

Strong economic growth continues in Latvia; however, some moderation across certain sectors of the economy has been observed. Manufacturing has been volatile this year and after a mediocre performance in July it was growing again in August. In sub-sectors, respectable growth rates continue to be reported by the timber industry, and which is particularly pleasing: outstanding growth is seen in the high-technology sectors. Meanwhile, performance of food production moderated.

Against a backdrop of very strong growth in 2017, retail trade developments seem to have temporarily departed from the income trend. Some rebound could be seen in September, as part of the purchases might have been postponed shortly before opening of the largest IKEA in the Baltics at the end of August. Moreover, the consumer confidence remains at a historically high level.

	Reporting period	Data (%)
Gross domestic product (GDP)		
Real GDP (year-on-year growth, seasonally and calendar adjusted)	2018 Q2	4.4
Real GDP (quarter-on-quarter growth, seasonally adjusted)	2018 Q2	0.9
Public finances		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2018 IX	10.3
Tax revenue (since the beginning of the year; year-on-year growth)	2018 IX	8.7
Consumer price changes		
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2018 IX	3.3
12-month average inflation (HICP)	2018 IX	2.5
Consumer Price Index (CPI; year-on-year growth)	2018 IX	3.2
11.10.2018 Why inflation rate of close to 3% is healthy for Latvia at this stage 		
Foreign trade		
Exports (year-on-year growth)	2018 VIII	7.8
Imports (year-on-year growth)	2018 VIII	14.0
Balance of payments		
Current account balance (ratio to GDP)	2018 Q2	0.5
Foreign direct investment in Latvia (net flows; ratio to GDP)	2018 Q2	0.4
Sectoral performance		
Working day-adjusted manufacturing output index (year-on-year growth)	2018 VIII	3.9
Retail trade turnover at constant prices (year-on-year growth)	2018 VIII	1.4
Labour market		
Average monthly wage (year-on-year growth)	2018 Q2	8.4
Jobseekers rate (share in working age population)	2018 Q2	7.7
Monetary indicators		
Resident deposits (year-on-year growth)	2018 VIII	3.6
Loans to residents (year-on-year growth)	2018 VIII	-7.6
01.10.2018 The ice age in lending is approaching an end 		

Sources: Treasury, CSB and Latvijas Banka.

An era of instant payments



Deniss Filipovs,
Head of Payment
Systems Policy
Division,
Latvijas Banka

Instant payments provide a good notion of what modern financial services should be like. The 21st century consumer expects any service to be available online, here and now. Paying invoices, making purchases or transferring funds to a friend's or relative's account can take place at any hour of the day or night and from any location with internet access. It only takes a couple of clicks and seconds for the money to reach the recipient. Instant payments are quick, convenient, secure and user-friendly.

28 August of 2018 marks one year since Latvijas Banka started the era of instant payments (instant interbank transfers executed within a matter of seconds 24/7/365) in the euro area. Understanding the substantial benefits that instant payments can bring to the economy and people in Latvia, Latvijas Banka initiated a challenging project to develop an instant payments processing infrastructure in Latvia. Timely action and close cooperation with market participants ensured that on 28 August 2017 Latvijas Banka was the first in the euro area to introduce the instant payments infrastructure based on the so-called SEPA Inst scheme – common rules for euro instant payments in the EU.

Since November 2017, the customers of the banks "Citadele" and "SEB banka" and as of 9 October 2018 "Swedbank" customers as well have already been benefitting from the advantages of instant payments by making both mutual transfers and transfers to more than 1000 euro area banks. Those three commercial banks service nearly 90% of all customer accounts in Latvia. At this point of time, more than 80% of the customer payments between "Citadele" and "SEB banka" are already made via the so-called instant payments channel, i.e. they are executed instantly 24/7/365. Over the past ten months, more than 1.6 million instant payments totalling 350 million euro were processed in Latvijas Banka's system. Absolute majority of instant payments processed by Latvijas Banka's infrastructure are executed in less than a second (on average 0.4 seconds). The project is a great example of how a small central bank can create a new and innovative infrastructure with its own resources adopting the state-of-art IT technologies quickly.

Instant payments serve the needs of the public perfectly: they are available 24/7, every day and night, including weekends and holidays.

They significantly save the consumers' time and provide various opportunities for better management of their funds. Smartphone is currently the most convenient device for making instant payments, but

they can also be executed via internet banking. Those who do not use smartphones but for whom it is important to receive money on their account at any time, including weekends and holidays, can also benefit from the advantages of instant payments. The infrastructure for instant payments is universal, and it will be accessible on any other devices in the future, in the age of the Internet of Things in particular.

To meet the needs of the general public, commercial banks, creative FinTech companies and merchants need to introduce more and more creative settlement solutions. The future of instant payments lies in their closer integration with the opportunities provided by smartphones and other mobile devices to enable people to use this settlement method when making purchases at stores or paying for various everyday services, e.g. catering and transportation services, etc.

Instant payments have the obvious potential of not only significantly accelerating the speed of processes, but also facilitating lower fees, simpler payment processes, alternatives for retail traders and service providers and, eventually, also strengthening consumer confidence.

It becomes a new normal to settle an invoice or transfer funds to a friend's account from a smartphone by touching its screen just a few times and making the payment in a couple of seconds.