



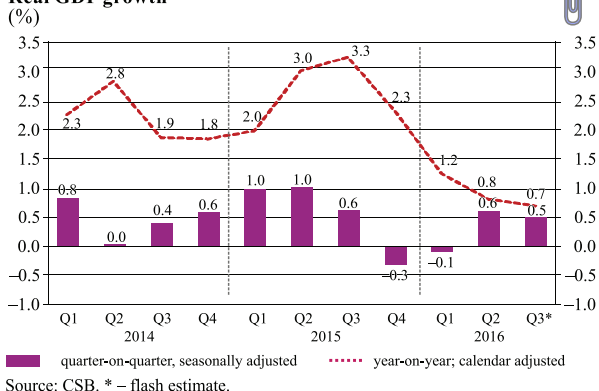
**LATVIJAS BANKA**  
**MONTHLY NEWSLETTER**

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**NOVEMBER 2016**

## Slowdown in GDP growth reflects temporary delay in EU funds' implementation

**Real GDP growth**



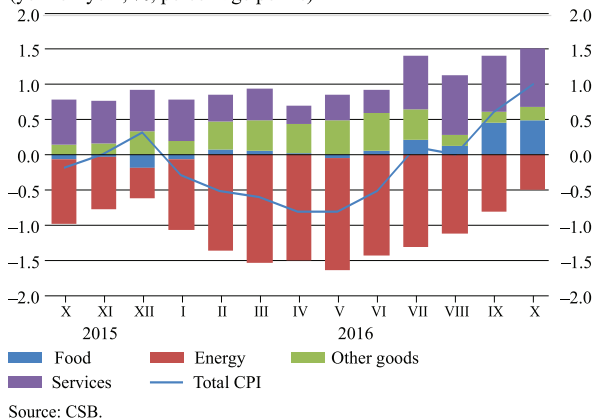
According to the flash estimate, GDP grew by 0.7% year-on-year in the third quarter of 2016 (calendar adjusted data). In the same quarter, manufacturing recorded a 3.8% year-on-year growth in value added. The major impediment to economic growth in the third quarter was a decrease in construction output by 22 % (calendar adjusted data at constant prices), which resulted from a delay in the implementation of EU related investment projects. Recently there has been a marked progress, which is expected to translate into recovering investments in the coming quarters.

However, in 2017, the growth is expected to accelerate. The resumption of the flow of EU funding will positively contribute to construction. Public consumption, along with

the still robust private consumption, is a factor that will foster GDP growth, as the fiscal budget for 2017 foresees an increase in public sector wages and consequently higher consumption of goods and services.

## Inflation is on the rise as expected

**Contribution of main components to HICP inflation**  
(year-on-year, %; percentage points)

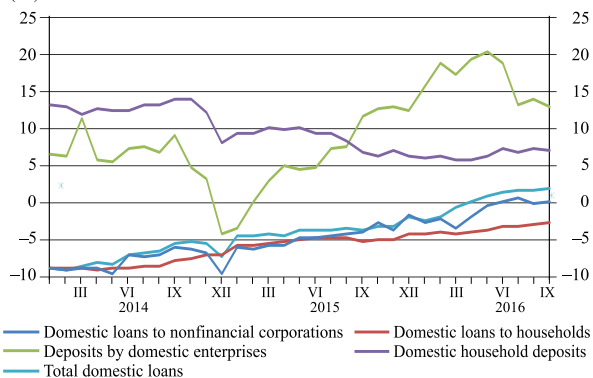


The consumer price level in October grew by 0.8% month-on-month and by 1.0% year-on-year. As indicated by global resource price trends and purchasing price developments of selected agricultural products domestically, inflation increased on account of the impact from oil prices on fuel prices, with the latter picking up 4.2% month-on-month, and the rise in several food product prices. Although the impact on monthly and annual consumer price changes is still largely determined by different supply-side factors affecting consumer prices directly, core inflation is also accelerating, pointing to stronger effects of costs rather than sustainability of the demand. Seasonally volatile prices of such groups of goods and services as wearing apparel, footwear, accommodation services, passenger

transportation services by air, and even fresh vegetables recorded a higher month-on-month increase in October. In the coming months, however, inflation is most likely to continue to rise, as the decreasing effects of commodity prices are fading out.

## Encouraging situation in credit market

**12-month changes in some money indicators**  
(%)










In September, the total domestic loan portfolio, including newly granted loans, and lending to non-financial corporations both grew. With finances in bank accounts of enterprises on the rise, the balance of deposits attracted by banks also grew. The annual rate of change of domestic loans in September increased by 2.0%. Domestic deposits attracted by banks in September grew by 9.7% year-on-year, but enterprise deposits went up by 13.0% year-on-year.

The resumption of lending growth and moderately maintained rise in deposits will foster further stability of the economy and investments necessary for continued economic growth. The survey of bank lending conducted in September also points to an encouraging situation in

the loan market. The overall mood of market participants remains positive, and the impact of the supporting monetary policy of the Eurosystem on low interest rates will continue, therefore there are grounds to expect a further recovery of the lending indicators.



	Reporting period	Data (%)
<b>Gross domestic product (GDP)</b>		
Real GDP (year-on-year growth)	2016 Q3 <i>flash estimate</i>	<b>0.7</b>
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2016 Q3 <i>flash estimate</i>	<b>0.5</b>
02.11.2016 <a href="#">GDP still without notable growth</a> 		
<b>Public finances</b>		
General government budget expenditure (since the beginning of the year; year-on-year growth)	2016 X	<b>0.5</b>
Tax revenue (since the beginning of the year; year-on-year growth)	2016 X	<b>5.6</b>
<b>Consumer price changes</b>		
Consumer Price Index (CPI; year-on-year growth)	2016 X	<b>0.1</b>
Harmonised Index of Consumer Prices (HICP; year-on-year growth)	2016 X	<b>1.7</b>
12-month average inflation (HICP)	2016 X	<b>-0.1</b>
10.11.2016 <a href="#">Inflation is on the rise, as expected</a> 		
<b>Foreign trade</b>		
Exports (year-on-year growth)	2016 IX	<b>-2.7</b>
Imports (year-on-year growth)	2016 IX	<b>-3.2</b>
11.11.2016 <a href="#">Latvia's exports will hardly keep afloat without investment</a> 		
<b>Balance of payments</b>		
Current account balance (ratio to GDP)	2016 Q2	<b>-0.6</b>
Foreign direct investment in Latvia (net flows; ratio to GDP)	2016 Q2	<b>-2.7</b>
<b>Industrial output</b>		
Working day-adjusted manufacturing output index (year-on-year growth)	2016 IX	<b>5.6</b>
04.11.2016 <a href="#">Manufacturing finishes the third quarter on an optimistic note</a> 		
<b>Retail trade turnover</b>		
Retail trade turnover at constant prices (year-on-year growth)	2016 IX	<b>0.5</b>
31.10.2016 <a href="#">Retail trade keeps stalling</a> 		
<b>Labour market</b>		
Registered unemployment (share in working age population)	2016 X	<b>7.9</b>
Jobseekers rate (share in working age population)	2016 Q3	<b>9.5</b>
17.11.2016 <a href="#">Inflow of low-skilled workforce would deteriorate the standard of living</a> 		
<b>Monetary indicators</b>		
Resident deposits (year-on-year growth)	2016 IX	<b>9.7</b>
28.10.2016 <a href="#">To the hungry soul every bitter thing is sweet</a> 		

Sources: Treasury, CSB and Latvijas Banka.

## Lending to businesses – the driver of economic growth regains momentum



**Vilnis Purviņš,**  
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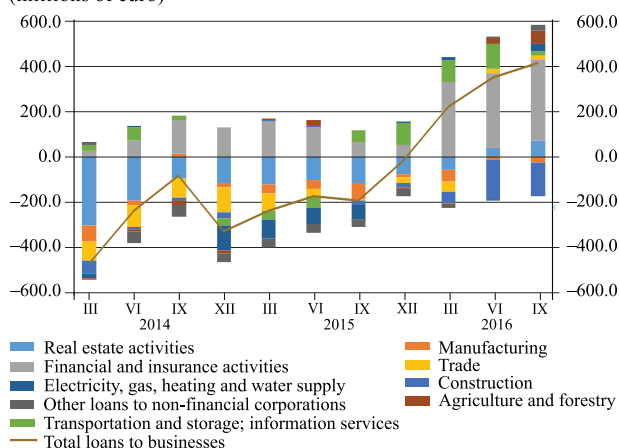
Lending to non-financial corporations has posted stable growth in the last nine months of 2016, and this is reflected in the increase in the total domestic loan portfolio. Both bank and business sentiments in the lending market are positive, and the impact of the Eurosystem's accommodative monetary policy with its low interest rates also continues; hence, there is a reason to expect a further pick-up in lending growth which, in turn, will contribute to a further strengthening of the economic stability and investment required for future economic growth.

Due to the experienced economic crisis, the instability of the external demand, the poor state of legal environment and other factors, banks had significantly restricted granting of new loans for several years. Moreover, the borrowers' demand was also relatively low. If 2015 saw the first weak signs of recovery of corporate lending with a minor increase in the loan portfolio recorded in some months, 2016 shows very clear positive trends in lending to businesses. As of April, the portfolio of loans granted to non-financial corporations has shown monthly increases, while that of loans granted to businesses from the non-bank financial sector – already starting with February. Loans granted to businesses have increased by 443 million euro in the first nine months of this year (compared to a rise of only 50 million euro in the corresponding period of 2015), while the annual growth rate of loans reached 5.6% at the end of September. New loans have even recorded a more rapid increase, with new loans (excluding revised loans) to non-financial corporations totalling 1.2 billion euro in January–September 2016 and constituting a year-on-year rise of 36%.

**If 2015 saw the first weak signs of recovery of corporate lending with a minor increase in the loan portfolio recorded in some months, 2016 shows very clear positive trends in lending to businesses.**

As can be seen in the chart below, the increase in the portfolio of loans granted to businesses across sectors has been largely spurred by credit inflows in the financial and insurance sectors. Bank loans have been mostly used by the financial services sector, including the financial leasing sector, as the growing leasing and factoring market requires financing. It should be noted that the amount of funds obtained by non-financial corporations via leasing and factoring exceeds 1 billion euro, equalling 17% of the portfolio of bank loans granted to non-financial corporations in June 2016. On the other hand, the financing of leasing companies to non-financial corporations almost equals bank loans to non-bank financial institutions in terms of volume. Namely, also loans granted to financial institutions via leasing companies largely flow into the real economy sector to support the financing of the purchases of equipment and transport vehicles.

**Structure of annual changes in the loan portfolio of the domestic enterprises**  
(millions of euro)



Source: Latvijas Banka.

By contrast to 2015, when a moderate growth in lending to financial sector businesses was only complemented by credit inflows in the transportation sector, 2016 can be characterised by positive lending growth in most economic sectors. At the same time, agriculture, particularly crop production and, to a small extent, also forestry, energy, and trade (wholesale) likewise recorded an increase in loans in the first nine months of this year. With the real estate market gradually recovering, real estate mirrored the same trend. Although loan investment in manufacturing has contracted even further, it has recorded increases in sub-sectors such as the manufacture of food products, textiles, wood, fabricated metal products, furniture and the pharmaceutical industry. Construction is the only sector where lending has declined considerably; however, it could expect significant loan investment inflows to ensure co-financing already in the near future, along with the more efficient absorption of European Union funds.

Under the current circumstances, further growth in lending to businesses is vital for long-term economic growth. Investment supporting competitiveness, exports and capitalisation, co-financing necessary for the absorption of European Union funds, loans for the construction of commercial objects, involvement in financing private and public partnership projects and the state-supported programme for heat insulation of multi-apartment houses are good goals to benefit from the Eurosystem's accommodative monetary policy and the low level of interest rates. A particularly rapid rise in loans cannot be expected since various contrary factors affecting lending will play a role simultaneously. Among the factors which support lending are, for instance, increased activity in the real estate market, construction of selected infrastructure objects, bank savings of businesses to ensure a higher level of self-financing and support provided by the European Investment Fund to grant loans to small enterprises, etc. Meanwhile, the factors restricting lending include, e.g. uncertainty that is more related to global, yet also domestic developments. However, lending growth will continue.