

MONETARY BULLETIN 2004

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At the end of December 2004, the lats was repegged from the SDR to the single European currency at the rate of EUR 1 = LVL 0.702804 (in effect as of January 1, 2005), bringing Latvia closer to membership in the Economic and Monetary Union. As of January 2005, the Bank of Latvia unilaterally ensures the euro rate fluctuations within $\pm 1\%$ of the central or peg rate, preserving the previous width of the fluctuation band and a fixed exchange rate regime, which is well-suited for Latvia as a small and open economy.

In December, the euro appreciated significantly on the global foreign exchange market, whereas the US dollar continued to depreciate, with the exchange rates set by the Bank of Latvia changing accordingly: the euro and British pound sterling appreciated by 1.6% and 0.9%, whereas the US dollar and Japanese yen depreciated by 1.1% and 1.6% against the lats, respectively. As the change of the lats peg and its mechanism were announced more than a year in advance, there was no turbulence on Latvia's financial market at the turn of the year. The money market had accumulated high liquidity, the lats' money market interest rates were low and exchange rates were stable.

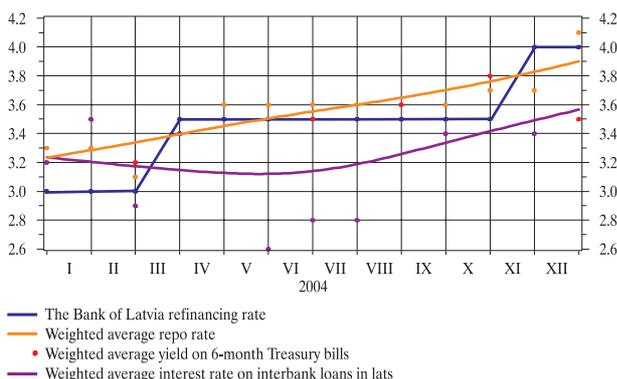
Persistently high inflation reflected supply side effects and robust domestic demand. In December, the annual growth rate of consumer prices remained broadly unchanged, and the annual inflation stood at 7.3%. Average annual inflation of 2004 reached 6.2%. Prices increased by 0.3% month-on-month, fuelled by a rise in food prices (primarily vegetables and fruit) by 1.6% and liquefied gas by 34.2%.

Inflation growth was curbed by the tight fiscal policy. Although under the impact of seasonal factors the general government consolidated budget deficit was high in December (155.0 million lats), its annual fiscal deficit of 2004 was only 79.0 million lats (about 1.1% of GDP). It was more than twice lower than provided in the law and the lowest in the last six years. In 2004, the fiscal surplus of the central government special social insurance budget was 51.1 million lats, whereas the central government basic budget and the local government consolidated budget ran a fiscal deficit of 133.8 million lats and 7.3 million lats, respectively.

In December, Government debt remained broadly unchanged and totalled 975.0 million lats at the end of the period. Due to exchange rate fluctuations, the Government external debt slightly increased, whereas the Government domestic debt shrunk, as only 6-month Treasury bills in the amount of 4.0 million lats were issued, while the amount of maturing government securities was larger. Against the background of high bank liquidity, the weighted average discount rate of the issued 6-month Treasury bills was 3.43%, i.e., 27 basis points lower than at the previous tender in October.

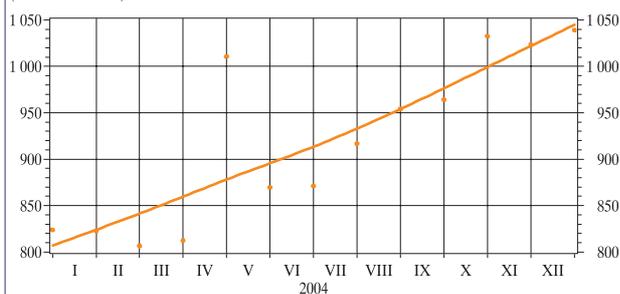
In December, broad money and deposits by domestic enterprises and private persons posted a record-high increase of 148.7 million lats and 123.3 million lats, respectively. The seasonal growth of currency outside banks by 25.4 million lats was smaller year-on-year, albeit remaining the highest in 2004. Therefore, the annual growth rate of broad money increased

INTEREST RATES IN THE MONEY MARKET
(%)



NET FOREIGN ASSETS OF THE BANK OF LATVIA

(in millions of lats)



by 1.1 percentage points month-on-month, reaching 27.0%. The annual growth rate of deposits was even higher, at 34.1%, whereas that of cash declined to 7.4%. Hence, the cash component of the broad money continued to shrink, amounting to only 22.5% in December.

Deposits by private persons expanded significantly by 80.8 million lats due to rising personal income and marketing campaigns of banks. The increase in enterprise and private person bank account balances in December was also affected by the steep rise in the central government budget expenditure at the end of the year.

Lending growth rate remained high in December (47.0%), and the growth rate of loans to domestic enterprises and private persons (113.1 million lats) was also broadly similar to that of the preceding months. Loans to enterprises grew by 60.6 million lats in December, slightly more than loans to private persons. The expansion of loans to private persons and total loans to domestic enterprises and private persons was underpinned by an increase in mortgage lending by 59.3 million lats, including loans to private persons for house purchase by 40.4 million lats. Increase in loans to enterprises was mainly comprised of a rise in commercial credit and industrial credit by 34.1 million lats and 18.6 million lats, respectively. Foreign currency loans prevailed, and the outstanding loans reached 77.4 million lats in December.

After a longer pause, the increase in domestic deposits exceeded that of the loans granted to enterprises and private persons. With net credit to government expanding significantly, domestic loans increased. Non-resident non-bank deposits grew by 172.5 million lats, whereas the banking sector's net foreign assets decreased by 88.2 million lats.

In 2004, banks' profit stood at 116.1 million lats (1.6 times higher than in 2003).

The weighted average interest rate on foreign currency loans to enterprises rose noticeably (by 0.5 percentage point), reaching 5.3% in December. Interest rates on lats loans and foreign currency loans to private persons remained broadly unchanged. Changes in deposit rates were minor.

In December, the interbank market RIGIBOR for overnight loans fluctuated from 2.8% to 4.5%, whereas that of longer term loans decreased (for 6-month loans from 4.43% at the beginning of the month to 4.28% at the end of the month and for 12-month loans from 4.35% to 4.26%, respectively).

The seasonal demand for cash in December resulted in expansion of the monetary base (42.5 million lats). Growth of the Bank of Latvia's money supply was determined by a decline in the government deposits with the Bank of Latvia by 55.0 million lats due to the seasonally high central government budget expenditure as well as an increase in the central bank's net foreign assets by 15.7 million lats, as the Bank of Latvia purchased foreign currency. The backing of the national currency with the Bank of Latvia's net foreign assets was 108.6% in December. With inflows of the government funds into the banking sector, banks' demand for the Bank of Latvia loans and outstanding central bank loans to banks shrank by 24.4 million lats. Bank of Latvia's repo loans to banks decreased 1.5 times to 92.2 million lats, and no Lombard loans were granted. Foreign exchange swaps amounted to only 2.3 million lats.

In December, the volume of cargo transportation by rail decreased by 8.0% year-on-year, whereas the freight turnover at Latvian ports grew by 4.8% and oil products transportation by pipeline posted an increase of 33.5%. In November, the industrial output index was 5.0%, with the growth in manufacturing reaching 5.1%. The retail trade turnover at constant prices grew by 13.7%.

MACROECONOMIC INDICATORS	2004	
	XI	XII
Changes in the volume index of industrial output (year-on-year basis; %)	5.0	*
Changes in the CPI		
Month-on-month basis (%)	0.5	0.3
Year-on-year basis (%)	7.2	7.3
Annual rate of core inflation ¹ (%)	7.4	7.0
Number of registered unemployed persons (at end of period)	90 637	90 800
Unemployment rate (%)	8.5	8.5
General government consolidated budget fiscal deficit/surplus (in millions of lats)	76.0	-79.0
Foreign trade (in millions of lats)		
Exports	193.2	*
Imports	340.7	*
Balance	-147.5	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

Source: Central Statistical Bureau of Latvia.

MONETARY INDICATORS (at end of period; in millions of lats)	2004	
	XI	XII
Banking system		
M2X	2 719.2	2 867.9
Currency outside banks	620.0	645.4
Deposits of domestic enterprises and private persons	2 099.2	2 222.5
Demand deposits	1 226.0	1 295.6
Time deposits	873.2	926.8
M2D	1 901.1	2 017.9
Net foreign assets	-158.5	-231.0
Net domestic assets	2 877.7	3 098.9
Loans to domestic enterprises and private persons	3 623.9	3 737.0
Short-term loans	540.9	548.7
Long-term loans	3 083.0	3 188.3
Credit to the Government (net)	49.8	173.4
Bank of Latvia		
M0	914.7	957.2
Currency in circulation	694.4	727.4
Deposits with the Bank of Latvia in lats	220.2	229.9
Net foreign assets	1 023.5	1 039.2
Net domestic assets	-108.9	-82.0
Credit	-32.3	-1.1
To banks	37.3	12.9
To the Government (net)	-69.6	-13.9
Other items (net)	-76.6	-80.9
International reserves (at end of period; in millions of US dollars)	1 957.39	2 019.36
Gold	112.21	110.27
Special Drawing Rights	0.15	0.15
Reserve position in the IMF	0.08	0.09
Foreign convertible currencies	1 844.95	1 908.85

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2004	
	XI	XII
Weighted average interest rate on domestic interbank loans in lats	3.4	3.5
Interest rates on loans to domestic enterprises and private persons		
Loans to enterprises (in lats)	7.3	7.3
Loans to private persons (in lats)	9.5	9.6
Loans to enterprises (in foreign currencies)	4.8	5.3
Loans to private persons (in foreign currencies)	5.2	5.3
Interest rates on deposits of domestic enterprises and private persons		
Time deposits of enterprises (in lats)	3.6	3.3
Demand deposits of enterprises (in lats)	1.1	0.9
Time deposits of private persons (in lats)	4.0	4.2
Demand deposits of private persons (in lats)	0.6	0.6
Time deposits of enterprises (in foreign currencies)	1.9	2.1
Demand deposits of enterprises (in foreign currencies)	0.7	0.8
Time deposits of private persons (in foreign currencies)	2.3	2.4
Demand deposits of private persons (in foreign currencies)	0.9	1.0
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	0.5220	0.5160
LVL/GBP	0.9870	0.9960
LVL/100 JPY	0.5070	0.4990
LVL/EUR	0.6920	0.7030

CONSOLIDATED BALANCE SHEET OF CREDIT INSTITUTIONS (at end of period; in millions of lats)

	2004	
	XI	XII
Bank reserves	292.3	310.8
Vault cash in national currency	74.4	81.9
Deposits with the Bank of Latvia	217.9	228.9
Foreign assets	2 956.6	3 001.1
Vault cash in foreign currencies	49.5	51.8
Claims on foreign banks	1 949.7	2 036.2
Claims on foreign non-banks	926.1	892.8
Other assets	31.4	20.4
Claims on the central government (net)	128.0	181.5
Claims on local governments (net)	-8.5	5.9
Claims on public enterprises	90.3	87.7
Claims on private enterprises	2 292.6	2 355.9
Claims on private persons	1 278.5	1 331.1
Unclassified assets	415.6	454.6
Fixed assets	124.5	129.1
Items in transit	15.3	3.9
Other assets	64.4	63.2
Claims on domestic credit institutions (incl. investments)	211.4	258.3
Total assets	7 445.4	7 728.6
<i>Memo item: Trust assets</i>	<i>545.6</i>	<i>616.4</i>
Demand deposits	731.4	804.9
Public enterprises	45.0	37.6
Private enterprises	331.4	390.6
Private persons	355.0	376.8
Time deposits	549.7	567.5
Public enterprises	48.7	48.2
Private enterprises	175.9	183.7
Private persons	325.1	335.7
Foreign currency deposits of residents	818.1	850.0
Public enterprises	19.1	11.8
Private enterprises	272.9	263.5
Private persons	526.2	574.7
Transit funds	5.3	5.4
Foreign liabilities	4 138.7	4 271.4
Liabilities to foreign banks	1 393.3	1 410.7
Liabilities to foreign non-banks	2 576.1	2 748.6
Other liabilities (incl. subordinated liabilities)	169.3	112.1
Liabilities to the Bank of Latvia	37.3	12.9
Debt securities	86.4	90.0
Equity	613.5	630.4
Residents	351.5	360.4
Non-residents	262.0	270.0
Provisions	85.0	88.5
Unclassified liabilities	380.0	407.5
Items in transit	124.9	91.4
Other liabilities (incl. subordinated liabilities)	62.2	67.0
Liabilities to domestic credit institutions	192.9	249.1
Total liabilities	7 445.4	7 728.6
<i>Memo item: Trust liabilities</i>	<i>545.6</i>	<i>616.4</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>).