

MONETARY BULLETIN 2006

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In July, consumer prices increased by 0.6% in Latvia, and the annual consumer price inflation rose to 6.9% (the highest level since March 2006), reflecting both increasing costs and strengthening of domestic demand. As continuing drought negatively affected the harvest, unprocessed food prices grew significantly (the annual price rise for this commodity group reaching 14.5%). Potato prices posted the steepest pickup in July, both month-on-month and year-on-year. Administered (water supply and sewage) prices grew notably. Due to seasonal sales, the prices of clothing and footwear fell. The steady growth of lending and dynamics of wages and employment supported a rise in consumer price core inflation (to 4.9%).

The accelerated expansion of retail trade turnover (including transport vehicle sales and retailing of automotive fuel) pointed to high private consumption, which in June exceeded the level of the respective period of the previous year by 25.6% at constant prices. The pace of industrial growth was more moderate (5.7%, including a 4.8% output growth in manufacturing). In July, freight transported by rail and freight turnover at Latvian ports both shrank year-on-year (by 8.4% and 5.0%, respectively). Unemployment rate continued to decline in July (to 6.9%).

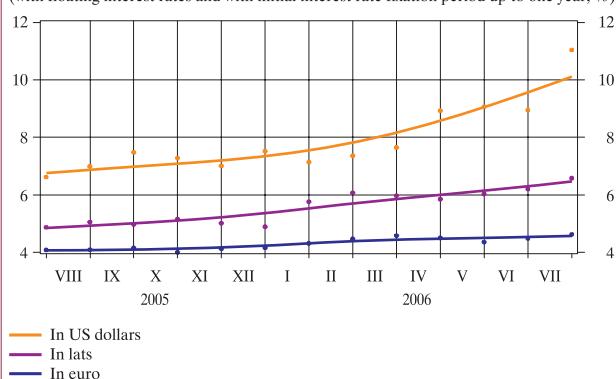
Low real interest rates and the strong competition among banks facilitated further expansion of lending, with loans granted to resident financial institutions, non-financial corporations and households increasing by 331.0 million lats in July and the annual growth rate of loans amounting to 60.3%. The overall growth in loans was determined by the expansion of mortgage lending by 207.1 million lats, with loans to households for house purchase going up by 132.7 million lats. Commercial credit, in turn, increased by 63.4 million lats, consumer credit to households grew by 21.4 million lats, and a 16.7 million lats increase was recorded for industrial credit. Overall, loans to households gained 166.8 million lats, whereas loans to financial institutions and non-financial corporations posted a pickup of 164.2 million lats. The annual growth rate of loans granted to households as well as financial institutions and non-financial corporations accelerated somewhat (to 79.0% and 48.6%, respectively). Unchanged from the previous periods, loans in euro recorded the steepest increase (299.8 million lats), with an upward trend in loans granted in lats also continuing (a 50.2 million lats increase).

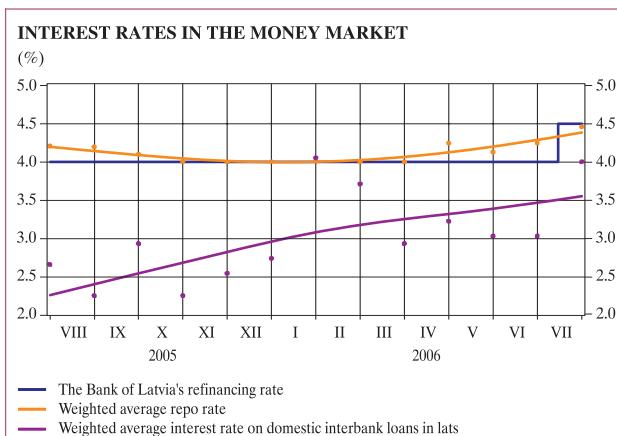
Given the macroeconomic development trends in Latvia, long-sustained negative real interest rates on loans in lats, and the recent regular raising of base rates in the euro area and the US, the Council of the Bank of Latvia in its pursuit of a restrictive monetary policy aimed at containing the pace of lending, raised the refinancing rate by 0.5 percentage point (to 4.5%) as of July 15, 2006. Interest rates on Lombard loans were also raised by 0.5 percentage point.

In July 2006, the general government consolidated budget had a 21.4 million lats financial surplus, recording a 228.6 million lats surplus for the first seven months of the year. Though the central government basic budget posted a financial deficit of 10.4 million lats in July, it was offset by financial surpluses in the social security fund (28.3 million lats) and the local government consolidated budget (3.4 million lats). The improvement of the budget revenue continued and was on account of the

INTEREST RATES ON LOANS TO RESIDENT HOUSEHOLDS GRANTED FOR HOUSE PURCHASE

(with floating interest rates and with initial interest rate fixation period up to one year; %)





increasing tax revenue, which compared to July 2005 went up by 24.6% and was determined by the growing VAT, social security contributions and personal income tax revenues (increases of 31.4%, 30.3% and 24.4%, respectively). With current expenditure going up by 22.9%, budgetary transfers and subsidies increasing by 22.8% and capital expenditure expanding by 23.5%, the increase in the budget expenditure stood at 21.3% in July.

The total debt of the general government picked up 3.8 million lats (totalling 1 093.9 million lats), such pickup being driven by an increase in the local government borrowing (9.5 million lats).

In July, the growth in currency outside MFIs (19.5 million lats) lagged behind that in June. Overnight deposits expanded by 84.3 million lats, bringing about a 103.8 million lats or 3.1% increase in money supply M1 (5.0% in the previous month). The increase in monetary aggregates M2 and M3 was more moderate (146.6 million lats or 3.3% against 4.0% in June, and 145.0 million lats or 3.2% against 3.9% in June, respectively). The annual rate of M1, M2 and M3 growth accelerated in July (reaching 42.0%, 40.7% and 41.1%, respectively).

Deposits of resident financial institutions, non-financial corporations and households expanded mostly on account of growing demand deposits in July (by 66.5 million lats). Deposits in lats and euro went up by 54.7 million lats and 58.4 million lats, respectively. At the same time, the growth in household deposits was much above that in deposits of financial institutions and non-financial corporations (94.2 million lats and 19.9 million lats, respectively).

In order to ensure credit resources and to meet the reserve requirement, banks attracted additional funding from abroad, therefore negative net foreign assets of MFIs (excluding the Bank of Latvia) increased by 232.7 million lats in July.

The central bank's money supply in July grew mainly on account of foreign currency purchases from banks, as a result of which net foreign assets of the Bank of Latvia grew by 98.7 million lats or 5.3%. The backing of the national currency with the Bank of Latvia's net foreign assets was 109.6% at the end of July. At the same time, the monetary base was reduced by the Bank of Latvia's interventions in the secondary market of government securities (the portfolio of government securities held by the central bank shrank by 45.3 million lats), as well as an increase in the government deposits with the central bank and the decline in the Bank of Latvia's repo loans to banks (nevertheless, monthly repo loans in the amount of 75.4 million lats 10.6 times exceeded those granted in June).

The restrictive monetary policy pursued by the Bank of Latvia was reflected by RIGIBOR, which on overnight loans increased from 3.50% at the beginning of July to 4.62% at the end of the month. RIGIBOR on 6- and 12-month maturities went up by 0.4 percentage point and stood at 4.74% and 4.79% at the end of July, respectively.

A surge in money market interest rates triggered higher interest rates on non-MFI loans, and those on loans in lats to households went up to 9.9%, including a rise to 6.5% on loans for house purchase. Interest rates on loans granted to households in euro also rose (to 4.9%, including to 4.8% on loans for house purchase). Likewise, interest rates on loans to non-financial corporations increased, albeit modestly.

In July, the US dollar and the Japanese yen depreciated against the lats (by 1.1% and 0.2%, respectively), while the British pound sterling appreciated by 1.1%.

MACROECONOMIC INDICATORS	2006	
	VI	VII
Changes in the volume index of industrial output (year-on-year basis; %)	5.7	*
Changes in the CPI		
Month-on-month basis (%)	0.3	0.6
Year-on-year basis (%)	6.3	6.9
Annual rate of core inflation ¹ (%)	4.7	4.9
Number of registered unemployed persons (at end of period)	74 387	73 333
Unemployment rate (%)	7.0	6.9
General government consolidated budget financial deficit/surplus (in millions of lats)	207.2	228.6
Foreign trade (in millions of lats)		
Exports	285.4	*
Imports	493.5	*
Balance	-208.1	*

¹ Source: Bank of Latvia.

* Figure available at a later date.

MONETARY INDICATORS (at end of period; in millions of lats)

	2006	
	VI	VII
MFIs¹		
M3	4 528.1 ²	4 673.1
Repurchase agreements	0	0
Money market fund shares and units	34.4	32.8
Debt securities issued with maturity of up to 2 years	2.6	2.6
M2	4 491.0 ²	4 637.6
Deposits with agreed maturity of up to 2 years	1 049.8 ²	1 082.3
Deposits redeemable at notice of up to 3 months	125.5	135.8
M1	3 315.7	3 419.5
Currency outside MFIs	839.5	859.0
Overnight deposits	2 476.2	2 560.5
Net external assets	-1 590.1	-1 724.1
Credit to resident financial institutions, non-financial corporations and households	7 525.9	7 856.9
Credit to general government	368.7	356.0
Deposits of central government	271.4 ²	271.9
Longer-term financial liabilities	1 571.0	1 610.4
Bank of Latvia		
M0	1 766.0	1 805.3
Currency in circulation	927.9	948.8
Deposits with the Bank of Latvia in lats	838.1	856.4
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	1 879.9	1 978.6
Net domestic assets	-113.9	-173.4
Credit	-58.9	-113.1
To MFIs	1.2	0
To central government (net)	-60.1	-113.1
Other items (net)	-55.0	-60.3
International reserves (at end of period; in millions of US dollars)	3 374.16	3 604.85
Gold	144.50	157.14
Special Drawing Rights	0.15	0.15
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	3 229.43	3 447.48

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

²Data have been revised.

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES

	2006	
	VI	VII
Weighted average interest rate on domestic interbank loans in lats		
	3.0	4.0
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	6.4	6.5
Loans to households (in lats)	9.8	9.9
incl. for house purchase	6.3	6.5
Loans to non-financial corporations (in foreign currencies)	5.2	5.2
Loans to households (in foreign currencies)	4.9	5.1
incl. for house purchase	4.7	4.8
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	3.3	4.2
Demand deposits of non-financial corporations (in lats)	1.0	1.2
Time deposits of households (in lats)	3.2	3.7
Demand deposits of households (in lats)	0.5	0.5
Time deposits of non-financial corporations (in foreign currencies)	3.4	3.3
Demand deposits of non-financial corporations (in foreign currencies)	1.5	1.4
Time deposits of households (in foreign currencies)	3.5	3.8
Demand deposits of households (in foreign currencies)	1.2	1.3
The Bank of Latvia's refinancing rate (at end of period; %)	4.0	4.5
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5600	0.5540
LVL/GBP	1.0180	1.0290
LVL/100 JPY	0.4810	0.4800
LVL/EUR	0.7028	0.7028

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

	2006	VI	VII
MFI reserves	924.4	940.6	
Vault cash in national currency	88.4	89.8	
Deposits with the Bank of Latvia	836.1	850.7	
Foreign assets	3 509.5	3 512.2	
Vault cash in foreign currencies	64.9	63.3	
Claims on MFIs	2 046.1	2 087.1	
Claims on non-MFIs	1 346.8	1 316.7	
Other assets	51.7	45.0	
Claims on central government	230.2	258.8	
Claims on local government	88.6	92.6	
Claims on public non-financial corporations	114.9	114.6	
Claims on financial institutions and private non-financial corporations	4 260.6	4 432.3	
Claims on households	3 190.6	3 357.4	
Unclassified assets	737.5	782.0	
Fixed assets	145.0	144.0	
Items in transit	22.2	21.8	
Other assets	87.8	89.3	
Claims on resident MFIs (incl. investments)	482.4	526.9	
Total assets	13 056.3	13 490.4	
<i>Memo item: Trust assets</i>	453.0	454.0	
Overnight deposits in lats	1 369.2	1 412.0	
Public non-financial corporations	55.8	64.7	
Financial institutions and private non-financial corporations	561.9	571.6	
Households	751.5	775.7	
Time deposits and deposits redeemable at notice in lats	738.3 ¹	750.3	
Public non-financial corporations	103.5 ¹	92.7	
Financial institutions and private non-financial corporations	179.8	187.6	
Households	455.0	469.9	
Foreign currency deposits of residents	1 571.8	1 631.2	
Public non-financial corporations	17.3	17.8	
Financial institutions and private non-financial corporations	494.1	497.9	
Households	1 060.5	1 115.6	
Deposits of central government	161.3 ¹	154.2	
Deposits of local government	128.6 ¹	141.5	
Transit funds	4.7	4.7	
Foreign liabilities	6 979.5	7 214.9	
Liabilities to MFIs	3 875.0	4 093.9	
Liabilities to non-MFIs	2 870.3 ¹	2 870.8	
Other liabilities (incl. subordinated liabilities)	234.3	250.2	
Liabilities to the Bank of Latvia	1.2	0	
Debt securities issued	319.0	319.8	
Money market fund shares and units	34.4	32.8	
Capital and reserves	1 010.4	1 038.1	
Residents	597.0	624.8	
Non-residents	413.3	413.3	
Provisions	86.2	86.1	
Unclassified liabilities	651.6	704.8	
Items in transit	130.1	141.1	
Other liabilities (incl. subordinated liabilities)	82.9	80.7	
Liabilities to resident MFIs	438.6	483.0	
Total liabilities	13 056.3	13 490.4	
<i>Memo item: Trust liabilities</i>	453.0	454.0	

¹Data have been revised.

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>).