

MONETARY BULLETIN 2007

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In September, the deceleration of growth became more pronounced, particularly in lending, real estate market and retail trade. However, the brisk economic development in the previous periods accounted for a steep upsurge of inflation in September. It was driven by the cost pressures, price developments on the global markets, inflation expectations and the high domestic demand.

The price increase in September (1.9%) pushed up the annual inflation rate to 11.4%, with the 12-month annual inflation (HICP) reaching 8.2%. The prices on clothing and footwear and on educational services grew due to seasonal factors, yet steeper than usually. Also the swelling prices on catering services and food, as well as the increase of heating tariffs boosted the overall price level significantly.

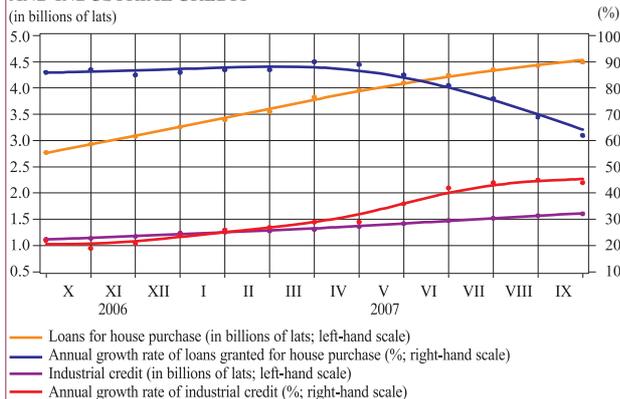
The previous development trends persisted in real sector: the growth was small in manufacturing (1.0% year-on-year in August), whereas industry reported overall annual growth of 3.3%, with a more pronounced development of the energy sector and mining and quarrying. In August, retail trade experienced a notably slower annual growth (turnover – 17.5%). Cargo transportation indicators improved in September, with the volume of rail freight and cargo turnover at Latvian ports increasing. Unemployment continued to shrink rapidly, hitting a low of 5.1% in September.

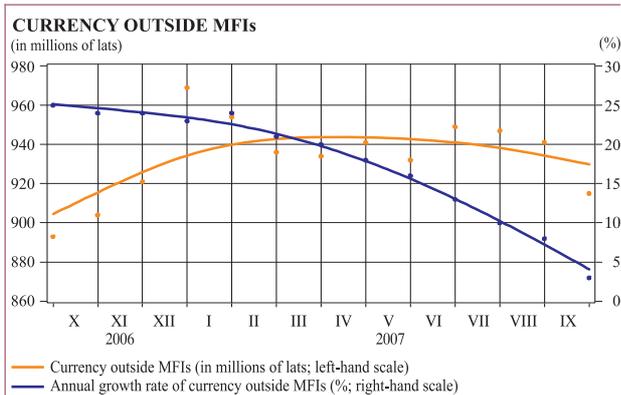
In September, general government consolidated budget financial surplus amounted to 3.6 million lats, standing at 351.2 million lats after the first nine months of the year. Social security fund posted a financial surplus, whereas the central government basic budget and local government consolidated budget had a financial deficit. The growth of general government consolidated budget revenue was comparatively slower in September (20.0%) due to the lower growth of tax revenue (to 28.8%); also, the amount of received EU funds as well as budget institutions' revenue and non-tax revenue decreased year-on-year. General government consolidated budget expenditure increased at a quicker pace (by 36.0%) mainly on account of growing public sector wages and salaries and social security contributions, as well as an increase in capital expenditure (by 48.0% and 44.1% respectively). General government total debt shrank somewhat during the month, to 1 085.8 million lats at the end of September.

With the inflation curtailment plan affecting the banking business, a further slowdown of lending and a decline in money supply was observed over the last few months. In September, broad money M3 diminished by 116.6 million lats. Both the decline in lats domestic deposits as well as currency outside MFIs told on money supply. Thus, M3 annual growth rate dropped to 23.4%. Money aggregates M2 and M1, too, shrank in September, reporting an annual growth of 22.3% and 11.8% respectively. Time deposits and savings deposits expanded together with the increase of respective interest rates, whereas the deposit facility and currency outside MFIs contracted. The year-on-year increase rate of currency outside MFIs dropped to 2.5%, and that of deposit facility to 15.0%. The overall decline in deposits was due to a decrease in lats deposits (by 102.1 million lats), with euro deposits rising by 20.2 million lats.

In September, the annual growth rate of loans declined to 45.3%, the lowest since September 2004; the month-on-month increase was the slackest since April 2006. Both the monthly

**LOANS GRANTED TO HOUSEHOLDS FOR HOUSE PURCHASE
AND INDUSTRIAL CREDIT**





increase of loans granted for house purchase as well as their annual growth moderated (to 62.0% for the latter). The annual growth rate of consumer credit went down to 28.5%. The growth of industrial credit (43.5% year-on-year in September) continued to dominate in the increase of lending to non-financial corporations. The increase in lending to non-financial corporations was the largest (114.3 million lats), while loans granted to households grew by 87.2 million lats. The annual growth rate for the said groups of borrowers slowed down (to 45.4% and 52.5% respectively in September).

The currency composition of the loans did not change – the entire increase was on account of growth in loans granted in euro (a 183.2 million lats increase), whereas the loans granted in lats contracted. However, the annual growth in loans in euro kept on decelerating (to 69.6% in September), while the stock of loans in lats continued to be lower than a year ago.

With the domestic deposits declining and non-resident deposits with non-MFIs remaining almost unchanged, the banks continued to raise additional funding from foreign credit institutions – both from parent banks as well as in the form of syndicated loans, albeit somewhat less than in the previous month. The negative net foreign assets of MFIs (except the Bank of Latvia) grew by 169.6 million lats in September (by 341.0 million lats in August).

The amount of required reserves went up notably, and the banks' demand deposits with the central bank continued to pick up. At the end of September, the monetary base M0 had gained 45.9 million lats over the end of August, with the annual growth rate moving up to 25.1%. The increase of the central bank's money supply was largely on account of the expanding lending to banks in order to meet their demand for lats. Government deposits with the Bank of Latvia piled up, somewhat reducing the money stock.

In September, the Bank of Latvia did not undertake any interventions on the foreign exchange market, and the central bank's net foreign assets remained nearly unchanged. At the end of September, the backing of the national currency with the Bank of Latvia's net foreign assets was 112.1%.

Tight liquidity conditions were behind the relatively high inter-bank rates: RIGIBOR on overnight loans was 7.06–9.09%, while on 3- and 6-month loans it went up to 12.74% and 12.20% respectively mainly due to the rising inflation. The climb of RIGIBOR was responsible for the increase of the weighted average interest rate on loans in lats to non-financial corporations to 11.1%, and to 11.6% on loans to households for house purchase. Weighted average interest rate on loans in foreign currencies granted to non-financial corporations moved up slightly (to 7.3%), but remained unchanged on loans to households for house purchase. The weighted average interest rates on time deposits in lats increased significantly (by 1.0–1.4 percentage points) in September.

The volatility on the financial markets in the USA, the underperforming USA economy and the decision of the Federal Reserve System to reduce the base rate to 4.75% were the reasons behind a substantial depreciation of the US dollar against the euro. In September, according to the exchange rate set by the Bank of Latvia, the US dollar depreciated by 3.5% against the lats, the British pound sterling by 3.4%, and the Japanese yen by 3.6%.

MACROECONOMIC INDICATORS	2007	
	VIII	IX
Changes in the volume index of industrial output (year-on-year basis; %)	3.3	*
Changes in the CPI		
Month-on-month basis (%)	0.4	1.9
Average annual inflation rate (HCPI) of last 12 months (%)	7.8	8.2
Year-on-year basis (%)	10.1	11.4
Annual rate of core inflation ¹ (%)	10.1	10.8
Number of registered unemployed persons (at end of period)	57 940	54 690
Unemployment rate (%)	5.4	5.1
General government consolidated budget financial deficit/surplus (in millions of lats)	347.6	351.2
Foreign trade (in millions of lats)		
Exports	335.7	*
Imports	641.7	*
Balance	-306.0	*

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)	2007	
	VIII	IX
MFIs¹		
M3	6 161.2	6 044.6
Repurchase agreements	0	0
Money market fund shares and units	62.2	49.9
Debt securities issued with maturity of up to 2 years	51.8	41.2
M2	6 047.2	5 953.5
Deposits with agreed maturity of up to 2 years	1 660.8	1 656.2
Deposits redeemable at notice of up to 3 months	195.3	327.9
M1	4 191.1	3 969.4
Currency outside MFIs	940.6	914.7
Overnight deposits	3 250.6	3 054.7
Net external assets	-3 995.7	-4 175.8
Credit to resident financial institutions, non-financial corporations and households	12 265.3	12 406.6
Credit to general government	303.1	322.4
Deposits of central government	313.4	322.4
Longer-term financial liabilities	2 179.4	2 231.4
Bank of Latvia		
M0	2 376.6	2 422.4
Currency in circulation	1 057.5	1 029.4
Deposits with the Bank of Latvia in lats	1 319.0	1 393.0
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	2 725.6	2 715.1
Net domestic assets	-349.1	-292.7
Credit	-241.2	-177.8
To MFIs	46.8	121.8
To central government (net)	-288.0	-299.6
Other items (net)	-107.9	-114.9
International reserves (at end of period; in millions of US dollars)	5 293.94	5 423.43
Gold	165.53	181.18
Special Drawing Rights	0.17	0.17
Reserve position in the IMF	0.08	0.09
Foreign convertible currencies	5 128.16	5 241.99

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2007	
	VIII	IX
Weighted average interest rate on domestic interbank loans in lats	6.7	8.0
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	9.2	11.1
Loans to households (in lats)	15.4	16.4
incl. for house purchase	11.4	11.6
Loans to non-financial corporations (in foreign currencies)	6.7	7.3
Loans to households (in foreign currencies)	6.4	6.4
incl. for house purchase	6.2	6.2
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	6.3	7.7
Demand deposits of non-financial corporations (in lats)	2.6	2.8
Time deposits of households (in lats)	6.0	7.0
Demand deposits of households (in lats)	0.6	0.7
Time deposits of non-financial corporations (in foreign currencies)	4.2	4.0
Demand deposits of non-financial corporations (in foreign currencies)	1.9	1.8
Time deposits of households (in foreign currencies)	4.1	4.2
Demand deposits of households (in foreign currencies)	1.8	1.8
The Bank of Latvia's refinancing rate (at end of period; %)	6.0	6.0
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5150	0.4970
LVL/GBP	1.0370	1.0020
LVL/100 JPY	0.4460	0.4300
LVL/EUR	0.7028	0.7028

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

	2007	
	VIII	IX
MFI reserves	1 429.2	1 499.4
Vault cash in national currency	116.9	114.7
Deposits with the Bank of Latvia	1 312.2	1 384.7
Foreign assets	4 458.3	4 757.1
Vault cash in foreign currencies	61.1	53.6
Claims on MFIs	2 620.8	2 928.3
Claims on non-MFIs	1 706.9	1 700.2
Other assets	69.5	75.0
Claims on central government	236.2	236.3
Claims on local government	66.9	86.1
Claims on public non-financial corporations	199.4	190.1
Claims on financial institutions and private non-financial corporations	6 487.5	6 546.5
Claims on households	5 636.7	5 724.0
Unclassified assets	877.5	921.3
Fixed assets	153.3	158.4
Items in transit	23.9	26.1
Other assets	145.5	156.2
Claims on resident MFIs (incl. investments)	554.8	580.6
Total assets	19 391.7	19 960.7
<i>Memo item: Trust assets</i>	<i>616.0</i>	<i>454.6</i>
Overnight deposits in lats	1 697.6	1 564.2
Public non-financial corporations	94.1	89.2
Financial institutions and private non-financial corporations	711.6	675.5
Households	891.9	799.5
Time deposits and deposits redeemable at notice in lats	927.6	958.9
Public non-financial corporations	147.4	164.4
Financial institutions and private non-financial corporations	207.5	211.3
Households	572.8	583.3
Foreign currency deposits of residents	2 380.3	2 402.0
Public non-financial corporations	28.2	27.4
Financial institutions and private non-financial corporations	697.0	693.4
Households	1 655.1	1 681.3
Deposits of central government	25.4	22.8
Deposits of local government	267.5	273.6
Transit funds	4.2	4.2
Foreign liabilities	11 179.7	11 648.0
Liabilities to MFIs	7 352.1	7 500.0
Liabilities to non-MFIs	3 533.5	3 564.6
Other liabilities (incl. subordinated liabilities)	294.1	583.5
Liabilities to the Bank of Latvia	46.8	121.8
Debt securities issued	350.1	339.8
Money market fund shares and units	62.2	49.9
Capital and reserves	1 569.3	1 619.5
Residents	858.1	886.5
Non-residents	711.2	733.1
Provisions	108.1	110.2
Unclassified liabilities	772.8	845.7
Items in transit	152.1	172.9
Other liabilities (incl. subordinated liabilities)	132.3	164.7
Liabilities to resident MFIs	488.4	508.0
Total liabilities	19 391.7	19 960.7
<i>Memo item: Trust liabilities</i>	<i>616.0</i>	<i>454.6</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>).