

MONETARY BULLETIN 2008

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In September, the ongoing financial turmoil escalated further, following the insolvency of a number of the US major financial institutions and resulting in an adverse effect on the already shaken confidence in the financial sector and liquidity of the financial markets. Confidence crisis aggravated in Europe as well. The loss of confidence among financial institutions and the shrivelled liquidity heightened risk perception, thus fuelling a surge in risk premiums also on the Latvian market. The developments in global financial markets and reassessment of the related risks was reflected by the decisions of rating agencies – *Moody's* downgraded the outlook for Latvia and *Fitch Ratings* did so for all Baltic states.

The annual inflation of consumer prices continued to decline, and external imbalances eased along with the slowdown in economic activity. The decrease in inflation for the most part was a reflection of the base effect and shrinking domestic demand. In September, inflation went down 0.8 percentage point (to 14.9%), while core inflation dropped to 12.6% (with a 1.1% consumer price increase during the month). The prices of clothing and footwear increased notably, by 9.8%. With the launch of the new academic year tuition fees went up 18.8%. Catering services (by 1.9%) and some food products (bread by 1.6%, meat and meat products by 1.4%) also witnessed price rises in September.

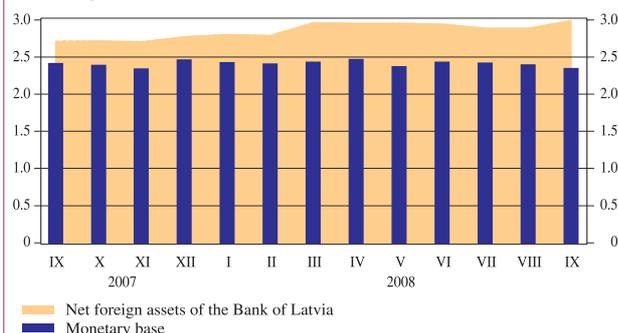
The fall of retail sales (including sales of motor vehicles and automotive fuel) was an evidence of a decline in domestic demand. In August, the year-on-year decrease was 14.7%. The fall in the demand for motor vehicles accounted for a half of the decline. The retail trade turnover also shrunk considerably regarding food, furniture, and household appliances. The retail trade turnover is expected to develop along similar lines in September. In September, the number of cars newly registered with the Road Traffic Safety Department dropped by 50%; also, the consumer confidence indicators deteriorated.

In August, with exports growing moderately (at a 4.2% rate in annual terms) and imports at the same time declining by 11.1%, foreign trade deficit narrowed. The slackened economic activity resulted in an increase of unemployment rate in September by 0.1 percentage point, to 5.3%. In August, the working-day-adjusted volume index of industrial output in manufacturing shrank by 12.7% year-on-year. Rail freight turnover contracted only a little in September (by 0.3%), whereas cargo turnover at Latvian ports posted a 6.1% year-on-year increase.

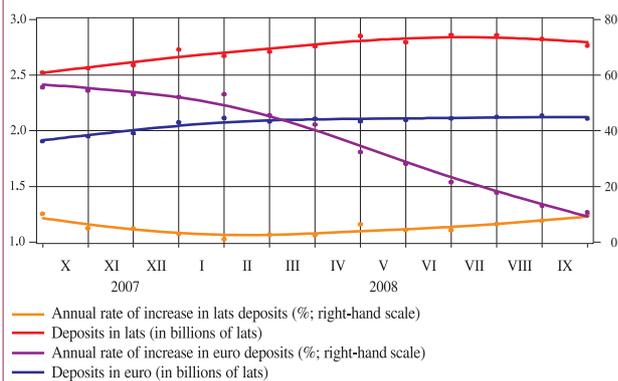
In September, the general government consolidated budget financial surplus increased by 19.4 million lats, standing at 135.9 million lats after the first nine months of the year. The surplus in the central government social security budget was gradually melting away. The central government basic budget reported a surplus, while the local government consolidated budget ran a small deficit. In September, the general government consolidated budget revenue went up 23.6% year-on-year (including a 13.3% pickup in tax revenue), while expenditure (mainly current expenditure) increased by 20.0%. The growth of the budget revenue was facilitated by the received EU funds and non-tax revenue. Tax revenue grew mostly on account of an increase in collections of corporate income tax and social security contributions (43.8% and 28.1% respectively). The collections of excise tax contracted notably (to 5.0%), while value added tax collections dropped by 7.1% year-on-year. In September, with borrowings from credit institutions increasing, the general government debt expanded to 1 587.9 million lats.

BACKING OF THE NATIONAL CURRENCY

(at end of period; in billions of lats)



RESIDENT FINANCIAL INSTITUTION, NON-FINANCIAL CORPORATION AND HOUSEHOLD DEPOSITS WITH BANKS



In September, with the continuing influx of funds from foreign banks, loans outstanding posted a moderate albeit robust growth. M3 contracted by 133.6 million lats, with the annual growth rate decelerating to 5.6%. M2 increased at an annual rate of 5.2% and M1 dropped 8.9%. The decline in the overnight deposits by 76.4 million lats was responsible for the overall contraction of deposits. Currency outside MFIs shrank by 22.7 million lats. The deposits of resident financial institutions, non-financial corporations and households declined, with the annual rate of increase dropping to 7.0%. The decrease in household as well as financial institution and non-financial corporation deposits followed a very similar pattern, with deposits in lats shrinking more than those in euro.

Lending to businesses continued to predominate. In September, loans to resident financial institutions, non-financial corporations and households increased by 133.4 million lats or 0.9%, with the annual growth rate dropping by 0.3 percentage point (to 17.6%). Loans to non-financial corporations grew by 121.4 million lats or 1.7%, with the annual growth rate falling to 22.9%. Lending to financial institutions contracted somewhat. The increases in commercial credit (1.6%) and industrial credit (1.8%) were the main contributors to the growth of corporate loans. Household loans increased by 30.1 million lats or 0.5%, with the annual growth rate dropping to 12.0%. Loans for house purchase expanded by 17.9 million lats or 0.4%, posting a 12.1% annual growth. While loans in lats decreased somewhat, overall expansion of lending was on account of the growth in loans granted in euro and other foreign currencies (125.2 million and 11.2 million lats respectively).

Banks' liabilities to foreign banks increased by 314.5 million lats (of this, liabilities to parent banks by 69.9 million lats). The deposits of non-residents with non-MFIs declined by 170.2 million lats. The negative net foreign assets of MFIs rose by 195.5 million lats in September.

In September, the demand for cash and banks' demand deposits with the Bank of Latvia diminished, and at the end of September the monetary base M0 was 46.7 million lats smaller than in August. The central bank's money supply was reduced by the growth in the government deposit in lats with the Bank of Latvia, while the increase in lending to banks had an expanding effect. The Bank of Latvia's net foreign assets increased on account of a rise in the government deposits in foreign currency. At the end of September, the backing of the national currency with the Bank of Latvia's net foreign assets was 127.0%.

In the first half of the month, banks continued to resort to the deposit facility with the central bank. At the end of September, the tensions regarding the liquidity conditions of the Latvian money market aggravated due to the increase in the government deposits with the Bank of Latvia and turmoil in global financial markets. Following a several months' pause, late in September banks again resumed their use of the resources offered by the Bank of Latvia, borrowing 10.0 million lats through the main refinancing operations. RIGIBOR went up along with the growing tensions in the financial markets, to 6.5% at the end of the month (up from 3.6% at the beginning of month) on overnight loans. RIGIBOR on loans with a 3-month, 6-month and 12-month maturity increased as well (by 97, 86 and 25 basis points respectively, to 7.18%, 8.01%, and 8.72%). In September, the interest rates on loans granted to households in lats and foreign currency moved up; so did the interest rates on loans to non-financial corporations in foreign currency. The interest rates on loans granted to non-financial corporations in lats, on the contrary, went down.

According to the exchange rate set by the Bank of Latvia, in September the US dollar, the Japanese yen and the British pound sterling appreciated against the lats (by 2.3%, 4.8% and 1.6% respectively).

MACROECONOMIC INDICATORS	2008	
	VIII	IX
Volume index of industrial output (working-day adjusted annual rate of change; %)	-11.1	*
Changes in the CPI		
Month-on-month basis (%)	-0.4	1.1
Average annual inflation rate (HCPI) of last 12 months (%)	15.6	15.9
Year-on-year basis (%)	15.7	14.9
Annual rate of core inflation ¹ (%)	13.4	12.6
Number of registered unemployed persons (at end of period)	56 333	57 644
Unemployment rate (%)	5.2	5.3
General government consolidated budget financial deficit/surplus (in millions of lats)	116.5	135.9
Foreign trade (in millions of lats)		
Exports	362.9	*
Imports	589.1	*
Balance	-226.2	*

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)	2008	
	VIII	IX
MFIs¹		
M3	6 514.3	6 380.7
Repurchase agreements	0	0
Money market fund shares and units	123.8	113.0
Debt securities issued with maturity of up to 2 years	7.8	7.1
M2	6 382.8	6 260.5
Deposits with agreed maturity of up to 2 years	2 337.1	2 322.7
Deposits redeemable at notice of up to 3 months	329.3	320.5
M1	3 716.4	3 617.3
Currency outside MFIs	899.6	876.9
Overnight deposits	2 816.8	2 740.4
Net external assets	-5 496.6	-5 692.1
Credit to resident financial institutions, non-financial corporations and households	14 460.6	14 594.0
Credit to general government	407.3	490.5
Deposits of central government	478.6	617.2
Longer-term financial liabilities	2 429.7	2 392.0
Bank of Latvia		
M0	2 401.2	2 354.5
Currency in circulation	1 018.1	998.9
Deposits with the Bank of Latvia in lats	1 375.2	1 348.1
Deposits with the Bank of Latvia in foreign currencies	7.9	7.5
Net foreign assets	2 887.7	2 990.2
Net domestic assets	-486.5	-635.7
Credit	-344.7	-471.8
To MFIs	0	10.0
To central government (net)	-344.7	-481.8
Other items (net)	-141.9	-163.9
International reserves (at end of period; in millions of euro)	4 156.96	4 314.99
Gold	140.21	150.66
Special Drawing Rights	0.12	0.12
Reserve position in the IMF	0.06	0.06
Foreign convertible currencies	4 016.57	4 164.15
International reserves (at end of period; in millions of US dollars)	6 150.60	6 239.90
Gold	207.46	217.86
Special Drawing Rights	0.18	0.18
Reserve position in the IMF	0.09	0.09
Foreign convertible currencies	5 942.87	6 021.77

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

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2008	
	VIII	IX
Weighted average interest rate on domestic interbank loans in lats	3.4	3.7
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	8.0	7.7
Loans to households (in lats)	16.3	16.7
incl. for house purchase	9.3	9.4
Loans to non-financial corporations (in foreign currencies)	7.3	7.9
Loans to households (in foreign currencies)	6.9	7.0
incl. for house purchase	6.7	6.8
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	4.4	5.2
Demand deposits of non-financial corporations (in lats)	1.2	2.2
Time deposits of households (in lats)	6.6	6.6
Demand deposits of households (in lats)	1.2	1.3
Time deposits of non-financial corporations (in foreign currencies)	4.1	4.1
Demand deposits of non-financial corporations (in foreign currencies)	1.9	1.8
Time deposits of households (in foreign currencies)	4.3	4.2
Demand deposits of households (in foreign currencies)	1.7	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	0.4750	0.4860
LVL/GBP	0.8730	0.8870
LVL/100 JPY	0.4360	0.4570
LVL/EUR	0.7028	0.7028

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

	2008	
	VIII	IX
MFI reserves	1 493.9	1 475.3
Vault cash in national currency	118.4	122.0
Deposits with the Bank of Latvia	1 375.5	1 353.2
Foreign assets	5 005.3	4 913.2
Vault cash in foreign currencies	64.9	58.2
Claims on MFIs	2 797.6	2 654.3
Claims on non-MFIs	2 044.8	2 081.1
Other assets	98.0	119.5
Claims on central government	334.0	417.5
Claims on local government	73.3	73.0
Claims on public non-financial corporations	307.1	337.4
Claims on financial institutions and private non-financial corporations	7 832.9	7 908.4
Claims on households	6 381.2	6 411.3
Unclassified assets	1 184.2	981.7
Fixed assets	195.2	194.6
Items in transit	37.0	34.0
Other assets	205.1	207.5
Claims on resident MFIs (incl. investments)	746.9	545.6
Total assets	22 611.8	22 517.7
<i>Memo item: Trust assets</i>	338.7	364.2
Overnight deposits in lats	1 590.9	1 539.8
Public non-financial corporations	76.0	84.0
Financial institutions and private non-financial corporations	691.4	653.8
Households	823.5	802.1
Time deposits and deposits redeemable at notice in lats	1 235.2	1 225.8
Public non-financial corporations	210.9	192.3
Financial institutions and private non-financial corporations	364.5	381.5
Households	659.7	652.0
Foreign currency deposits of residents	2 539.4	2 506.3
Public non-financial corporations	24.1	19.6
Financial institutions and private non-financial corporations	722.8	716.5
Households	1 792.4	1 770.2
Deposits of central government	134.0	135.4
Deposits of local government	261.5	256.4
Transit funds	3.7	3.7
Foreign liabilities	13 389.6	13 595.4
Liabilities to MFIs	8 797.3	9 111.8
Liabilities to non-MFIs	4 265.4	4 095.2
Other liabilities (incl. subordinated liabilities)	326.9	388.4
Liabilities to the Bank of Latvia	0	10.0
Debt securities issued	225.3	183.2
Money market fund shares and units	123.8	113.0
Capital and reserves	1 892.4	1 873.7
Residents	1 154.2	1 135.6
Non-residents	738.1	738.1
Provisions	152.4	171.2
Unclassified liabilities	1 063.7	903.7
Items in transit	162.9	154.8
Other liabilities (incl. subordinated liabilities)	233.9	245.2
Liabilities to resident MFIs	666.9	503.6
Total liabilities	22 611.8	22 517.7
<i>Memo item: Trust liabilities</i>	338.7	364.2

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>).