

# MONETARY BULLETIN 2007

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Considering the macroeconomic developments in Latvia and in support of the Government's anti-inflationary measures, the Bank of Latvia's Council raised the refinancing rate by 0.5 percentage point (to 6.0%) as of 18 May, 2007. The interest rate of marginal lending facility was raised by 1.0 percentage point (to 7.5%), while the rate of deposit facility remained unchanged (2.0%). The Bank of Latvia's Council passed this resolution with the purpose of containing the excessive growth of domestic demand that is among the most significant factors causing inflation.

In May, the year-on-year consumer price inflation dropped by 0.7 percentage point (to 8.2%). Year-on-year core inflation declined less (by 0.2 percentage point, to 7.9%). In May, the rising fuel prices (by 3.5%) as well as meat and fruit prices (by 1.7% and 4.6% respectively) had the strongest impact on inflation. Tariffs on natural gas went up by 16.7%. For the time being, it is paramount that the anti-inflationary measures approved by the Saeima (Parliament) of the Republic of Latvia be implemented consistently and fully, and, if necessary, be expanded.

Domestic demand continued to be high. The rapid increase of value added in trade (15.7%) accounted for most of the GDP growth in the first quarter (11.2%). The growth of the sector continued in April – the retail trade (including sale of motor vehicles and retail trade in automotive fuel) turnover increased by 22.8%. At the same time, the value added in manufacturing increased only by 2.4% during the first quarter, whereas in April the seasonally adjusted volume index of industrial output decreased by 0.9%.

The performance indicators in the transport sector improved in May. The volume of rail freight and cargo turnover at Latvian ports rose by 11.9% and 5.3% year-on-year respectively.

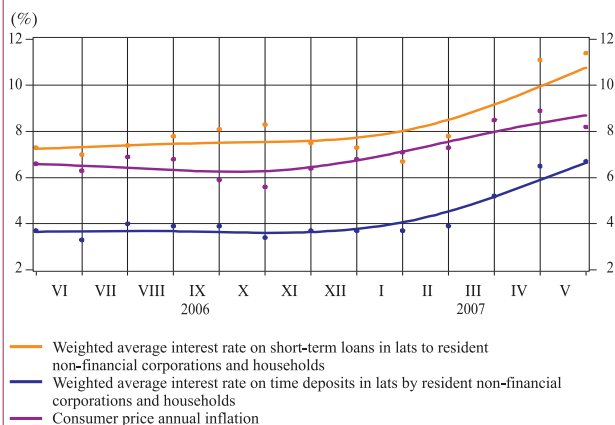
The buoyant economic growth supported a considerable increase in tax revenues; as a result, in May the financial surplus of the general government consolidated budget was 100.2 million lats; since the beginning of 2007 it has accumulated to 275.0 million lats (230.6 million lats in the first five months of 2006). Surpluses were recorded in the central government consolidated budget, social security fund and local government consolidated budget.

The general government debt, which stood at 1 092.8 million lats at the end of May, decreased by 65.2 million lats within the month because government securities were redeemed on maturity.

In May, the increase of broad money M3 (64.3 million lats) was somewhat slower than a month ago, whereas the M3 annual increase rate speeded up to 35.4% (35.2% in April). Domestic deposits grew moderately across the maturity spectrum. The demand in cash decreased, and the annual growth rate of currency outside MFIs dropped to 15.5%. The annual growth rate of deposits with MFIs by financial institutions, non-financial corporations and households increased to 36.2%, with deposits in lats remaining virtually unchanged. Deposits in euro increased by 60.5 million lats, posting an annual growth rate of 55.0%. The increase of household deposits accounted for nearly all of the overall growth of deposits.

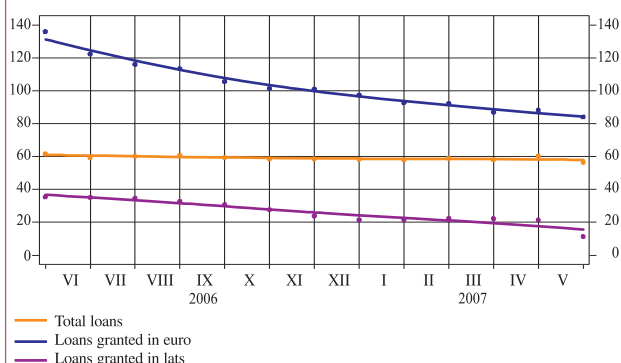
The first trend changes on the real estate market and an inten-

CONSUMER PRICE ANNUAL INFLATION AND WEIGHTED AVERAGE INTEREST RATES OF LOANS AND DEPOSITS



**GROWTH RATE DEVELOPMENTS FOR LOANS GRANTED TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS**

(year-on-year changes; %)



**MACROECONOMIC INDICATORS**

	2007	
	IV	V
Changes in the volume index of industrial output (year-on-year basis; %)	-0.9	*
Changes in the CPI		
Month-on-month basis (%)	0.9	0.6
Year-on-year basis (%)	8.9	8.2
Annual rate of core inflation <sup>1</sup> (%)	8.1	7.9
Number of registered unemployed persons (at end of period)	65 118	62 833
Unemployment rate (%)	6.1	5.9
General government consolidated budget financial deficit/surplus (in millions of lats)	174.8	275.0
Foreign trade (in millions of lats)		
Exports	324.7	*
Imports	623.3	*
Balance	-298.6	*

<sup>1</sup> Source: Bank of Latvia.

\* Figure available at a later date.

Source: Central Statistical Bureau of Latvia and Ministry of Finance.

tion of major banks to subject the borrowers' financial situation to closer scrutiny have been observed on the credit market. In May, the month-on-month increase in loans to resident financial institutions, non-financial corporations and households was 271.1 million lats (the smallest in the last 11 months), while the annual growth rate shrank to 56.6% (a low since August 2005). The pickup in mortgage loans was the major contributor to the overall loan expansion, with a lending to households for house purchase rising by 140.9 million lats. The growth in industrial credit (55.8 million lats) accounted for the rise in lending to financial institutions and non-financial corporations. In May, the annual growth rate of mortgage loans, lending to households for house purchase and commercial credit posted a month-on-month decrease, whereas the rate of increase in industrial credit and consumer credit accelerated.

Lending to households expanded more buoyantly, nevertheless, the annual growth rate of loans granted to financial institutions and non-financial corporations and households decelerated (in May, 45.6% and 71.9% respectively).

Loans granted in euro accounted for almost the entire lending expansion (the annual rate of increase was 84.2%) supported by a transfer from loans in lats to loans in euro due to the high lats interest rates (loans granted in lats diminished by 147.8 million lats in May, and their annual growth rate shrank to 11.4%).

In May, borrowings from foreign banks recorded a lower rise – liabilities to foreign banks increased by 88.4 million lats (including those to parent banks – by 61.1 million banks), whereas the negative net foreign assets of MFIs (excluding the Bank of Latvia) grew by 265.3 million lats.

The situation on the Latvian foreign exchange market was stable in May. The banks increased their lats liquidity mainly by selling foreign currency to the central bank. Exercising its passive interventions on the foreign exchange market, the Bank of Latvia bought euro in the net amount of 125.2 million lats, and the exchange rate of the euro on the interbank market was close to the lower limit of the intervention band set by the Bank of Latvia. Hence, net foreign assets of the Bank of Latvia grew by 6.0% in May, and the backing of the national currency with the central bank's net foreign assets stood at 113.8% at the end of the month.

At the same time, the central bank's money supply declined due to a decrease in loans granted to banks (117.6 million lats), a rise in the Government deposits with the Bank of Latvia and a drop in currency swap balance. Overall, at the end of May the monetary base M0 remained at the level of April, with its annual growth rate slowing down to 28.9% (a low of the last two years).

Higher lats liquidity accounted for a decline in RIGIBOR at the end of May. RIGIBOR on overnight loans shrank to 7.57% and that on loans with a 3-month and 6-month maturity decreased to 9.30% and 9.65% respectively. The weighted average interest rate on household loans in lats continued to increase, reaching 14.9% (including that on loans for house purchase – 9.6%). The weighted average interest rate on loans to non-financial corporations granted in lats and euro moderated somewhat. The weighted average interest rate on the lats time deposits made by non-financial corporations and households grew by 0.1 percentage point and 0.4 percentage point respectively (to 7.0% and 6.0%).

The exchange rate of the US dollar and the British pound sterling set by the Bank of Latvia appreciated against the lats in May (by 1.6% and 0.4% respectively), whereas the Japanese yen depreciated by 0.9%.

MONETARY INDICATORS (at end of period; in millions of lats)	2007	
	IV	V
<b>MFIs<sup>1</sup></b>		
<b>M3</b>	5 835.7	5 900.0
Repurchase agreements	0	0
Money market fund shares and units	49.2	45.6
Debt securities issued with maturity of up to 2 years	31.5	33.2
<b>M2</b>	5 754.9	5 821.2
Deposits with agreed maturity of up to 2 years	1 529.4	1 566.2
Deposits redeemable at notice of up to 3 months	166.7	175.9
<b>M1</b>	4 058.9	4 079.1
Currency outside MFIs	940.6	932.3
Overnight deposits	3 118.3	3 146.7
Net external assets	-3 387.4	-3 508.2
Credit to resident financial institutions, non-financial corporations and households	11 113.8	11 384.9
Credit to general government	358.4	317.6
Deposits of central government	239.9	271.7
Longer-term financial liabilities	2 040.5	2 060.5
<b>Bank of Latvia</b>		
<b>M0</b>	2 244.8	2 245.0
Currency in circulation	1 049.6	1 034.1
Deposits with the Bank of Latvia in lats	1 195.2	1 210.8
Deposits with the Bank of Latvia in foreign currencies	0	0
Net foreign assets	2 409.6	2 554.0
Net domestic assets	-164.8	-309.0
Credit	-77.8	-224.5
To MFIs	140.6	23.0
To central government (net)	-218.4	-247.5
Other items (net)	-86.9	-84.6
International reserves (at end of period; in millions of US dollars)	4 637.73	4 874.80
Gold	170.64	163.37
Special Drawing Rights	0.16	0.16
Reserve position in the IMF	0.08	0.08
Foreign convertible currencies	4 466.85	4 711.19

<sup>1</sup>In accordance with the methodology of the European Central Bank.

EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES	2007	
	IV	V
Weighted average interest rate on domestic interbank loans in lats	7.7	7.6
Interest rates on loans to resident non-financial corporations and households		
Loans to non-financial corporations (in lats)	10.4	10.1
Loans to households (in lats)	13.3	14.9
incl. for house purchase	9.4	9.6
Loans to non-financial corporations (in foreign currencies)	6.6	6.3
Loans to households (in foreign currencies)	6.0	6.0
incl. for house purchase	5.8	5.8
Interest rates on deposits of non-financial corporations and households		
Time deposits of non-financial corporations (in lats)	6.9	7.0
Demand deposits of non-financial corporations (in lats)	2.4	2.0
Time deposits of households (in lats)	5.6	6.0
Demand deposits of households (in lats)	0.7	0.7
Time deposits of non-financial corporations (in foreign currencies)	3.6	3.7
Demand deposits of non-financial corporations (in foreign currencies)	1.7	1.6
Time deposits of households (in foreign currencies)	3.7	3.8
Demand deposits of households (in foreign currencies)	1.5	1.6
The Bank of Latvia's refinancing rate (at end of period; %)	5.5	6.0
Exchange rates of foreign currencies (at end of period)		
LVL/USD	0.5150	0.5230
LVL/GBP	1.0320	1.0360
LVL/100 JPY	0.4340	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	
	IV	V
MFI reserves	1 304.2	1 312.6
Vault cash in national currency	109.0	101.8
Deposits with the Bank of Latvia	1 195.1	1 210.8
Foreign assets	4 074.6	3 986.9
Vault cash in foreign currencies	53.0	55.1
Claims on MFIs	2 479.5	2 290.1
Claims on non-MFIs	1 487.9	1 583.2
Other assets	54.2	58.5
Claims on central government	283.7	239.3
Claims on local government	74.6	78.3
Claims on public non-financial corporations	120.2	123.3
Claims on financial institutions and private non-financial corporations	6 015.1	6 099.5
Claims on households	5 037.8	5 218.6
Unclassified assets	870.0	830.7
Fixed assets	138.5	139.5
Items in transit	25.7	22.4
Other assets	135.8	125.1
Claims on resident MFIs (incl. investments)	570.1	543.7
<b>Total assets</b>	<b>17 780.2</b>	<b>17 889.2</b>
<i>Memo item: Trust assets</i>	486.6	548.3
Overnight deposits in lats	1 713.9	1 690.2
Public non-financial corporations	115.2	107.8
Financial institutions and private non-financial corporations	670.4	669.1
Households	928.3	913.3
Time deposits and deposits redeemable at notice in lats	968.8	988.6
Public non-financial corporations	117.4	165.8
Financial institutions and private non-financial corporations	279.7	236.6
Households	571.7	586.2
Foreign currency deposits of residents	2 083.6	2 133.4
Public non-financial corporations	26.7	25.2
Financial institutions and private non-financial corporations	620.9	608.9
Households	1 436.1	1 499.3
Deposits of central government	21.5	24.2
Deposits of local government	210.7	243.7
Transit funds	4.4	4.2
Foreign liabilities	9 871.5	10 049.1
Liabilities to MFIs	6 486.0	6 574.4
Liabilities to non-MFIs	3 050.9	3 148.8
Other liabilities (incl. subordinated liabilities)	334.7	325.9
Liabilities to the Bank of Latvia	140.6	23.0
Debt securities issued	352.4	338.8
Money market fund shares and units	49.2	45.6
Capital and reserves	1 437.6	1 471.8
Residents	738.4	772.6
Non-residents	4699.2	699.2
Provisions	93.2	97.7
Unclassified liabilities	832.8	778.9
Items in transit	175.7	166.3
Other liabilities (incl. subordinated liabilities)	139.6	125.1
Liabilities to resident MFIs	517.5	487.5
<b>Total liabilities</b>	<b>17 780.2</b>	<b>17 889.2</b>
<i>Memo item: Trust liabilities</i>	486.6	548.3

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>).