

MONETARY BULLETIN 2009

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Although the economic growth continues on an overall downward trend, positive signals were also surfacing. The current account of the balance of payments sustained a surplus as imports decelerated faster than exports. Inflation also declined; as a result, macroeconomic imbalances eased. Some industries recorded the beginning of recovery, while the inflow of financing under the second tranche of the IMF's loan in the amount of around 200 million euro rendered the financial market situation more stable.

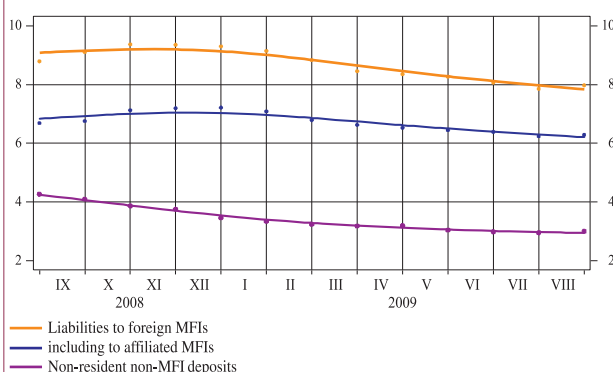
In August, the deficit accrued in the general government consolidated budget contracted somewhat, yet uncertainty surrounded the growth trends of both domestic and external demand. The demand for money continued to shrink modestly, with both broad money and bank deposits and loans diminishing. The unemployment rate went up by 0.5 percentage point (to 12.3%).

In line with population's income falling, the downward pressure on prices intensified; in August compared with the previous period consumer prices went down for the fifth consecutive month (by 1.0%). At the same time, the annual consumer price inflation dropped to 1.8%; nevertheless, the average annual inflation of the last 12 months was still high, at 7.9%. A decline in prices against July was fuelled by the weak demand, lower administered prices, and a seasonal decrease in vegetable and fruit prices. The prices of clothing and footwear, and processed food (milk and meat in particular) continued to fall. The book prices also went down due to the lowering of VAT rate. Meanwhile, the fuel prices rose. The annual consumer price core inflation dropped to 1.0% and contributed 0.8 percentage point to total inflation.

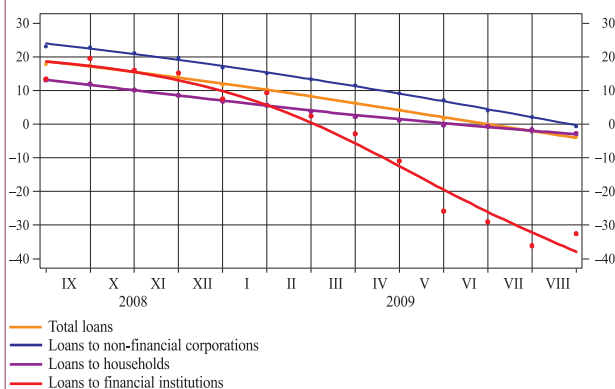
As consumption contracted, retail trade turnover in July was 1.0% smaller than in June, while its year-on-year drop measured 29.5%. In July month-on-month, manufacturing output shrank somewhat (by 0.6%), whereas its annual contraction moderated (-18.8%). In August year-on-year, the situation in freight transport services improved notably, with freight traffic by rail picking up 6.9% and freight turnover at Latvian ports growing by 10.0%.

In August, the surplus in the general government consolidated budget stood at 12.2 million lats, with the deficit accrued since the beginning of the year at 416.7 million lats. The central government social security budget and the local government consolidated budget both recorded minor deficits. The central government basic budget, on the other hand, recorded a surplus of 39.2 million lats. The budget revenue dropped 17.6% year-on-year (26.1% in July) due to foreign financial assistance payments, including a 30.5% decline in tax revenue. The revenue from corporate income tax, personal income tax, and VAT shrank most notably (by 73.0%, 33.3%, and 30.5% respectively). The budget expenditure contracted as well (by 17.5% in August year-on-year), with expenditure on compensation of employees, goods and services decreasing but that on social benefits increasing by 22.3%. The general government debt rose by 149.8 million lats in August (to 4 139.8 mil-

DYNAMICS OF THE MAIN COMPONENTS OF FOREIGN LIABILITIES OF LATVIAN MFIs (EXCLUDING THE BANK OF LATVIA)
(at end of period; in billions of lats)



ANNUAL CHANGES IN BANK LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS (%)



| MACROECONOMIC INDICATORS | 2009 | |
|----------------------------------------------------------------------------------------|---------|---------|
| | VII | VIII |
| Volume index of industrial output (working-day adjusted annual rate of change; %) | -17.7 | * |
| Changes in the CPI | | |
| Month-on-month basis (%) | -0.6 | -1.0 |
| Average annual inflation rate (HCPI) of last 12 months (%) | 9.1 | 7.9 |
| Year-on-year basis (%) | 2.5 | 1.8 |
| Annual rate of core inflation ¹ (%) | 1.8 | 1.0 |
| Number of registered unemployed persons (at end of period) | 132 519 | 137 586 |
| Unemployment rate (%) | 11.8 | 12.3 |
| General government consolidated budget financial deficit/surplus (in millions of lats) | -428.9 | -416.7 |
| Foreign trade (in millions of lats) | | |
| Exports | 258.8 | * |
| Imports | 354.5 | * |
| Balance | -95.7 | * |

¹ Source: Bank of Latvia.

* Figure available at a later date.

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

lion lats, with the IMF's loan tranche received and Treasury bills issued).

While banks proceeded with their prudent lending policies, credit extended to resident financial institutions, non-financial corporations and households decreased somewhat in August against July (by 54.9 million lats; the smallest monthly drop since January), at the same time recording a 3.7% year-on-year contraction. Loans to households decreased by 21.1 million lats or 0.3% and those to non-financial corporations by 63.8 million lats or 0.9%; meanwhile, loans to financial institutions increased by 30.0 million lats or 4.6%. The annual pace of change in loans to non-financial corporations and households decelerated, to -0.6% and -2.7% respectively. The deceleration in commercial credit was comparatively more dynamic (0.8%), while loans to households for house purchase and consumer credit contracted slightly (by 0.3% and 0.2% respectively). At the same time, industrial credit grew by 0.4%.

In August, M1, M2, and M3 decreased by 57.8 million lats, 67.9 million lats, and 63.0 million lats respectively. The annual deceleration in these monetary aggregates became more pronounced and was -22.1%, -12.5%, and -13.2% respectively. The demand for cash dropped somewhat, while the decline in deposits was slower than in July. Overnight deposits, deposits with an agreed maturity of up to two years, and deposits redeemable at notice decreased by 2.2%, 0.1%, and 2.6% respectively. As in July, the decline in lats deposits was smaller than that in euro deposits. Deposits of resident financial institutions, non-financial corporations and households went down by 8.4% year-on-year.

In August, foreign financing of the banking sector expanded for the first time since October 2008. The liabilities of Latvian banks to foreign banks grew by 120.9 million lats or 1.5% (including by 46.5 million lats or 0.7% to affiliated banks). Non-resident non-bank deposits picked up 51.0 million lats or 1.7%. The negative net foreign assets of MFIs (except the Bank of Latvia) shrank by 7.7 million lats.

In August, the monetary base, underpinned by improved liquidity of lats, excess reserves and growing demand deposits with the Bank of Latvia, expanded by 6.5 million lats. Year-on-year, demand deposits with the central bank, currency in circulation, and the monetary base decreased by 41.0%, 25.7%, and 34.5% respectively. Net foreign assets of the central bank increased by 284.5 million lats or 9.9%, while the backing of issued national currency with the Bank of Latvia net foreign assets was 200.8% at the end of August. This rise in the central bank's reserves was on account of the second tranche of the IMF's loan and Bank of Latvia's interventions (buying euro). Both a fall in credit to banks (20.0 million lats) and an increase in government's deposit in lats with the Bank of Latvia (20.9 million lats) contributed to the reduction in the central bank's money supply.

A further decline in RIGIBOR was spurred by improved lats liquidity. At the beginning of August, RIGIBOR on overnight loans was 5.8%, standing at 2.1%–2.7% in the second half of the month (2.83% monthly average; 4.08% in July). 3-, 6-, and 12-month RIGIBOR dropped 3–4 percentage points (to 12%–16%). This stable situation in the lats money market underpinned the lending and depositing rate dynamics for non-financial corporations and households, which was less pronounced than in the previous months.

In August, the exchange rates of the US dollar, British pound sterling, and Japanese yen set by the Bank of Latvia against the lats depreciated by 2.0%, 2.8%, and 0.6% respectively.

| MONETARY INDICATORS (at end of period; in millions of lats) | 2009 | |
|--------------------------------------------------------------------------------------|----------|----------|
| | VII | VIII |
| MFIs¹ | | |
| M3 | 5 717.7 | 5 654.7 |
| Repurchase agreements | 0 | 0 |
| Money market fund shares and units | 60.7 | 65.6 |
| Debt securities issued with maturity of up to 2 years | 1.7 | 1.7 |
| M2 | 5 655.3 | 5 587.4 |
| Deposits with agreed maturity of up to 2 years | 2 424.8 | 2 422.1 |
| Deposits redeemable at notice of up to 3 months | 277.5 | 270.2 |
| M1 | 2 953.0 | 2 895.2 |
| Currency outside MFIs | 664.9 | 658.3 |
| Overnight deposits | 2 288.1 | 2 236.9 |
| Net external assets | -3 976.0 | -3 683.8 |
| Credit to resident financial institutions, non-financial corporations and households | 13 976.5 | 13 921.5 |
| Credit to general government | 710.7 | 685.8 |
| Deposits of central government | 1 973.2 | 2 221.2 |
| Longer-term financial liabilities | 2 274.0 | 2 224.7 |
| Bank of Latvia | | |
| M0 | 1 566.8 | 1 573.3 |
| Currency in circulation | 767.1 | 756.7 |
| Deposits with the Bank of Latvia in lats | 792.0 | 809.0 |
| Deposits with the Bank of Latvia in foreign currencies | 7.7 | 7.6 |
| Net foreign assets | 2 873.9 | 3 158.4 |
| Net domestic assets | -1 307.1 | -1 585.2 |
| Credit | -1 053.3 | -1 323.5 |
| To MFIs | 255.0 | 235.0 |
| To central government (net) | -1 308.3 | -1 558.5 |
| Other items (net) | -253.7 | -261.7 |
| International reserves (at end of period; in millions of euro) | 4 093.17 | 4 494.90 |
| Gold | 164.56 | 164.53 |
| Special Drawing Rights | 0.46 | 103.37 |
| Reserve position in the IMF | 0.06 | 0.06 |
| Foreign convertible currencies | 3 928.09 | 4 226.94 |
| International reserves (at end of period; in millions of US dollars) | 5 753.39 | 6 447.02 |
| Gold | 231.30 | 235.99 |
| Special Drawing Rights | 0.64 | 148.26 |
| Reserve position in the IMF | 0.09 | 0.09 |
| Foreign convertible currencies | 5 521.36 | 6 062.68 |

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

| EXCHANGE RATES SET BY THE BANK OF LATVIA AND INTEREST RATES | 2009 | |
|-------------------------------------------------------------------------------|--------|--------|
| | VII | VIII |
| Weighted average interest rate on domestic interbank loans in lats | 2.8 | 2.2 |
| Interest rates on loans to resident non-financial corporations and households | | |
| Loans to non-financial corporations (in lats) | 14.6 | 10.6 |
| Loans to households (in lats) | 17.7 | 18.1 |
| incl. for house purchase | 8.4 | 8.4 |
| Loans to non-financial corporations (in foreign currencies) | 5.6 | 4.3 |
| Loans to households (in foreign currencies) | 5.4 | 5.5 |
| incl. for house purchase | 4.4 | 4.3 |
| Interest rates on deposits of non-financial corporations and households | | |
| Time deposits of non-financial corporations (in lats) | 8.5 | 5.9 |
| Demand deposits of non-financial corporations (in lats) | 1.1 | 0.6 |
| Time deposits of households (in lats) | 12.0 | 9.9 |
| Demand deposits of households (in lats) | 0.9 | 0.9 |
| Time deposits of non-financial corporations (in foreign currencies) | 1.2 | 1.4 |
| Demand deposits of non-financial corporations (in foreign currencies) | 0.3 | 0.3 |
| Time deposits of households (in foreign currencies) | 3.0 | 2.7 |
| Demand deposits of households (in foreign currencies) | 0.8 | 0.9 |
| 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 | 0.5000 | 0.4900 |
| LVL/GBP | 0.8200 | 0.7970 |
| LVL/100 JPY | 0.5260 | 0.5230 |
| LVL/EUR | 0.7028 | 0.7028 |

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

| | 2009 | |
|-------------------------------------------------------------------------|-----------------|-----------------|
| | VII | VIII |
| MFI reserves | 894.1 | 911.1 |
| Vault cash in national currency | 102.2 | 98.4 |
| Deposits with the Bank of Latvia | 791.9 | 812.7 |
| Foreign assets | 4 444.3 | 4 622.7 |
| Vault cash in foreign currencies | 72.0 | 68.1 |
| Claims on MFIs | 2 479.3 | 2 719.3 |
| Claims on non-MFIs | 1 786.2 | 1 732.6 |
| Other assets | 106.8 | 102.8 |
| Claims on central government | 634.4 | 611.1 |
| Claims on local government | 76.3 | 74.7 |
| Claims on public non-financial corporations | 382.9 | 382.5 |
| Claims on financial institutions and private non-financial corporations | 7 523.2 | 7 491.1 |
| Claims on households | 6 232.9 | 6 211.8 |
| Unclassified assets | 951.7 | 944.4 |
| Fixed assets | 164.8 | 160.0 |
| Items in transit | 19.1 | 22.9 |
| Other assets | 375.6 | 394.0 |
| Claims on resident MFIs (incl. investments) | 392.2 | 367.4 |
| Total assets | 21 139.8 | 21 249.3 |
| <i>Memo item: Trust assets</i> | <i>349.5</i> | <i>327.5</i> |
| Overnight deposits in lats | 1 042.5 | 1 015.3 |
| Public non-financial corporations | 66.7 | 60.9 |
| Financial institutions and private non-financial corporations | 455.2 | 454.5 |
| Households | 520.6 | 499.8 |
| Time deposits and deposits redeemable at notice in lats | 1 052.7 | 1 060.5 |
| Public non-financial corporations | 163.5 | 175.1 |
| Financial institutions and private non-financial corporations | 375.8 | 378.0 |
| Households | 513.4 | 507.5 |
| Foreign currency deposits of residents | 2 871.5 | 2 838.3 |
| Public non-financial corporations | 45.2 | 43.8 |
| Financial institutions and private non-financial corporations | 1 012.4 | 1 008.4 |
| Households | 1 813.8 | 1 786.1 |
| Deposits of central government | 664.9 | 662.8 |
| Deposits of local government | 180.1 | 175.6 |
| Transit funds | 3.2 | 3.2 |
| Foreign liabilities | 11 294.2 | 11 465.0 |
| Liabilities to MFIs | 7 862.2 | 7 983.0 |
| Liabilities to non-MFIs | 2 951.2 | 3 002.1 |
| Other liabilities (incl. subordinated liabilities) | 480.9 | 479.8 |
| Liabilities to the Bank of Latvia | 255.0 | 235.0 |
| Debt securities issued | 160.7 | 157.7 |
| Money market fund shares and units | 60.7 | 65.6 |
| Capital and reserves | 1 669.2 | 1 615.8 |
| Residents | 758.9 | 704.1 |
| Non-residents | 910.3 | 911.7 |
| Provisions | 1 105.1 | 1 178.8 |
| Unclassified liabilities | 780.1 | 775.7 |
| Items in transit | 74.4 | 86.3 |
| Other liabilities (incl. subordinated liabilities) | 346.7 | 353.8 |
| Liabilities to resident MFIs | 359.0 | 335.6 |
| Total liabilities | 21 139.8 | 21 249.3 |
| <i>Memo item: Trust liabilities</i> | <i>349.5</i> | <i>327.5</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>).