

LATVIJAS BANKA

BANK OF LATVIA

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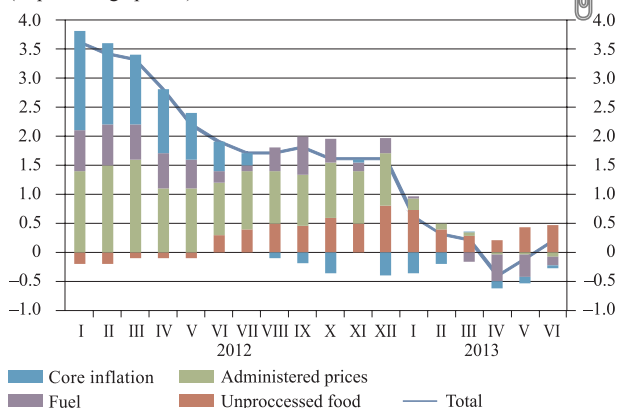
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1. Highlights

Unusually low inflation expected in 2013

Contributions to annual inflation
(in percentage points)



monitoring of consumer prices will work in the opposite direction. Thus this year's average annual inflation will be unusually low in the conditions of positive economic growth.

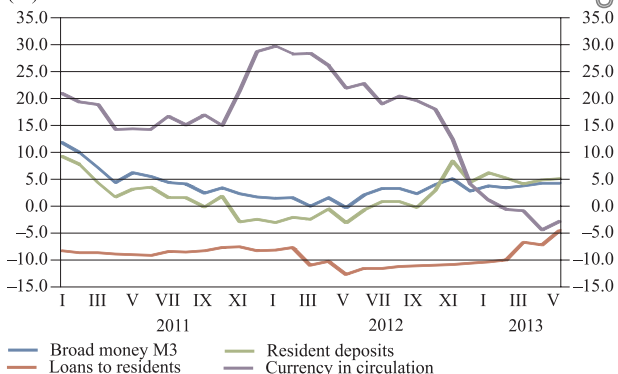
The slightly positive (+0.2%) annual inflation in June 2013 mostly reflected the base effect of the unprocessed food prices, while other factors contributed to a year-on-year drop.

Favourable dynamics of the global food prices persist. Moreover, this year's grain harvest is expected to be better than in the 2012/2013 marketing year, with the price dynamics potentially benefiting from that. At the same time, looking at global prices, the oil price risk has increased.

Meanwhile domestic factors do not point to a substantial pressure on prices. Although the rate of economic growth has been slightly faster than expected at the beginning of the year and one cannot exclude the possible wish of consumers to shop more than usual before euro introduction, the drop of heating tariffs and the

As Latvia moves towards the euro area, demand for cash currency declines

Annual growth of monetary aggregates
(%)



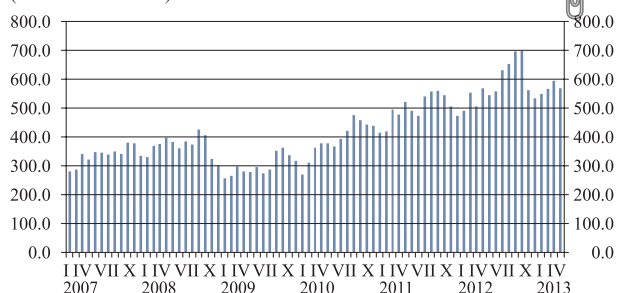
The monetary aggregate M3, which characterizes the amount of cash and non-cash currency in the economy, continued to expand at a moderate 4.2% year-on-year rate. However, in May, as the course towards the euro became more determined, currency in circulation decreased both month-on-month and year-on-year.

In May, the business loan portfolio was only 1.5% smaller year-on-year and the annual rate of decrease for loans granted to households improved to 7.8%.

A decline in the demand for cash currency will probably persist in the coming months as people reduce their cash balances in preparations for the euro changeover. The domestic demand stimulated by growing revenues, however, could compensate the impact of external demand, with the overall money supply remaining close to the current level in the coming months.

Metal sector struggles notwithstanding, exports performing well

Exports of goods
(in millions of lats)








In May, exports of goods grew a mere 0.1% year-on-year. Growth in exports of goods was mainly determined by food products, textile articles, building materials, machinery and electrical equipment. A negative impact was felt by the fall in the exports of base metals and articles of base metal related to JSC "Liepājas metalurģis" halting its operations starting with May. The annual growth of exports of goods, metal working industry output excluded, was at 6.5%, which remains a good indicator.

At the same time, the weak growth of several European Union (EU) countries is beginning to be gradually reflected in Latvian exports, for a drop is observed in exports to all main EU trade partners. However, the good news is that

exports to CIS countries like Russia, Kazakhstan, Uzbekistan and others as well as to the Nordic countries, Sweden and Norway, continue to grow, indicating that Latvian exporters know how to reorient themselves to different export markets.

2. Macroeconomic Data

	Reporting period	Data (%)
Gross Domestic Product (GDP) (quarter-on-quarter growth; seasonally adjusted)	2013 Q1	1.4
State budget		
Tax revenue (current month; year-on-year growth)	2013 VI	0.3
General government expenditure (since the beginning of the year, year-on-year growth)	2013 VI	7.0
Consumer price changes		
Consumer Price Index CPI (month-on-month growth)	2013 VI	0.2
12-month average annual inflation (to comply with the Maastricht Criteria)	2013 VI	0.9
08.07.2013 The short period of deflation is over, yet this year, unusually low inflation is expected 		
Foreign trade		
Exports (year-on-year growth)	2013 V	0.1
Imports (year-on-year growth)	2013 V	-0.9
10.07.2013 In external trade, the negative impact of AS "Liepājas metalurģis" and external environment is felt 		
Balance of payments		
Current account balance (ratio to GDP)	2013 Q1	-1.4
Foreign direct investment in Latvia (net flows; % of GDP)	2013 Q1	2.7
Industrial output		
Working day-adjusted industrial output index (year-on-year growth)	2013 V	-0.2
04.07.2013 A small rise in manufacturing in May 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2013 V	8.0
28.06.2013 The pulse of trade stable, immunity good 		
Employment and unemployment		
Registered unemployment (share in working age population)	2013 VI	9.6
Monetary indicators		
Broad money M3 (year-on-year)	2013 VI	3.3
18.07.2013 A moderate rise in money supply continues 		

Source: Treasury, Central Statistical Bureau of the Republic of Latvia, and Bank of Latvia data.

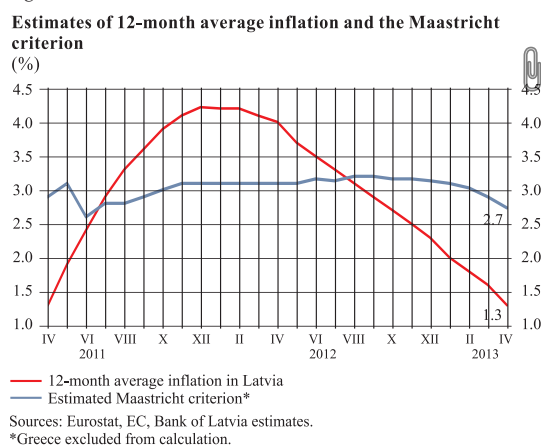
3. In Focus

Latvia to join the euro area as of January 2014

With the ECOFIN decision of 9 July Latvia has been invited to join the euro area as its 18th full-fledged member on 1 January 2014. The current exchange rate of the lats to the euro, set by the Bank of Latvia already in 2005, i.e. 0.702804, has been approved to be the irrevocably fixed exchange rate for the euro changeover. Consequently, as the Bank of Latvia has already notified before, the changeover to the euro as of 1 January 2014 will be based on the current exchange rate of the lats to the euro.

On 5 June in its Convergence Report the EC had already acknowledged that Latvia complied with all the Maastricht criteria (see Figure 1).

Figure 1



Commending Latvia's efforts towards sustainable economic policy made in recent years, some challenges of future economic policy were mentioned in the report, such as maintaining price stability and fiscal consolidation. In this respect it must be mentioned that in the recent past Latvia has been able to maintain a credible economic policy, which is already reflected in the improving credit ratings in recent years. This counter-cyclical fiscal policy that was absent before crisis is now well established by the ratification of the Fiscal Compact and, moreover, is reflecting its principles in the Fiscal Discipline Law adopted in 2013. These legal acts will serve as a source of price stability. Furthermore, the inflation sustainability is underpinned by the labour market flexibility which can be characterized by a decentralized wage setting mechanism as well as the flexible reallocation of labour between sectors and trend decline in NAIRU. The financial sector policies, such as setting up of a macroprudential institutional framework in line with the ESRB Recommendation on a macroprudential mandate of national authorities, are also among measures towards maintaining price stability which will remain the main monetary policy goal also after joining the EMU.

Figure 2

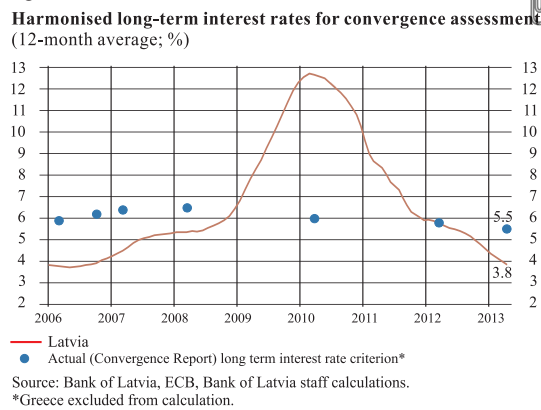


Figure 3

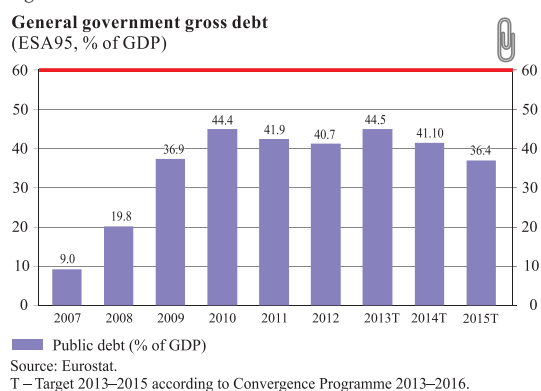


Figure 4

