

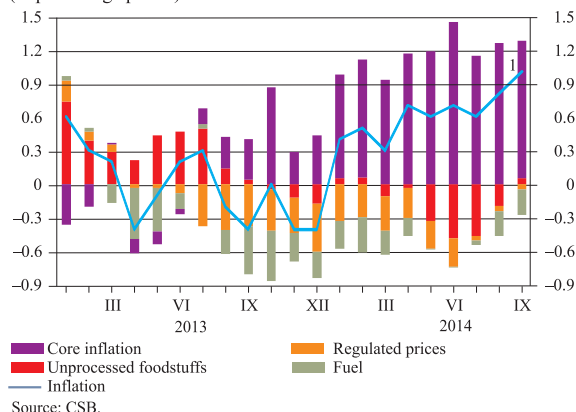


LATVIJAS BANKA
MONTHLY NEWSLETTER

OCTOBER 2014

Inflation in September 1.0%

Contributions to annual inflation
(in percentage points)



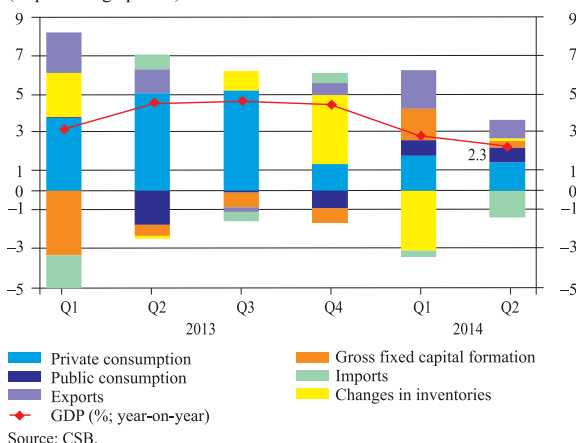
In September, the annual inflation grew slightly reaching 1.0%. The month-on-month rise in prices was 0.5%, which would not be untypical for the season but was somewhat higher than expected taking into account the economic conditions.

The September 2014 inflation trend in Latvia differed from what could have been expected due to factors such as the world oil and food prices, slow growth and low inflation in the euro area countries as well as the Russian trade limitations. In September, the world oil prices fell gradually and consequently the fuel prices dropped slightly, even though the strengthening of the dollar partly offset the moderating influence of oil prices on inflation. The level of prices of foodstuffs also fell only somewhat in Latvia. Despite a 7.3% decrease in the prices of dairy products that may have been the result of the impact of Russian trade sanctions, the prices of several other food

products developed in the opposite direction of the global and seasonal trends. In September, the prices of new seasonal wearing apparel and footwear began to dominate, although a slightly smaller increase than usual was expected taking into account the low inflation of the main trading partners.

GDP growth relatively stable

Contributions to real GDP growth
(in percentage points)



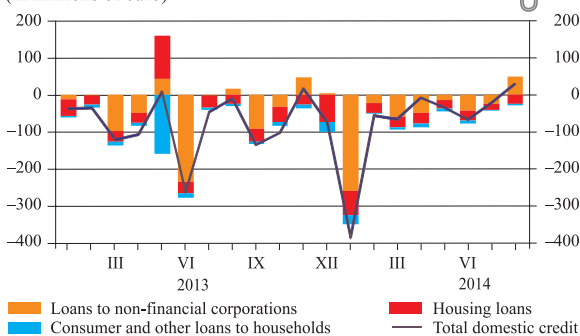
This time, the revised GDP was published later than usual due to the introduction of ESA 2010, the new methodology for the European System of Accounts. In the second quarter GDP grew by 0.9% quarter-on-quarter (excluding seasonal effects); the year-on-year growth slightly decreased to 2.3%. Despite the negative impact of the Russian-Ukrainian conflict and Russian sanctions, GDP growth in Latvia has been relatively stable.

The main driver behind the GDP growth was private consumption which grew by 2.3%. Moreover, there was an increase in investment (+1.8%), exports (+1.7%), and imports (2.3%). Analyzing by branch, the most rapid annual growth was posted by construction (+15.8%). This resulted from mostly short-term factors: the tightening of the Immigration Law (in September stricter requirements for obtaining temporary residence permits took effect, therefore people interested in this issue had purchased real estate and started construction or renovation of buildings

already beforehand) and an increase in the construction of hotels related to higher demand as tourist flows continued to grow. Other branches contributing positively to the GDP growth were trade, transport and storage as well as public administration.

Positive trends in bank lending

Monthly growth of domestic credit stock
(in millions of euro)



As regards lending developments in August, the portfolio of loans granted to businesses increased by 0.8% month-on-month which is the most rapid monthly rise over the past two years. The total bank loan portfolio expanded by 0.2%, with the annual drop rate improving to 6.6%. With both loans to non-financial enterprises and financial intermediaries growing and the household loan portfolio decreasing only slightly, in August the total balance of loans grew for the first time since November 2013. Business and household deposits grew by 0.9%, with the domestic deposit year-on-year growth rate at 10.4%. Both the household and business deposits grew moderately, the former by 0.5% (with the annual growth rate at 13.1%) and the latter by 1.4% (with the annual growth rate at 7.3%).

Since external risks remain, accruals of funds with banks could be increased due to the possible precautionary savings, therefore the overall level of bank deposits will continue to rise gradually. Recovery of lending at the euro area level could be promoted by the ECB's stimulus scheme; investment decisions, however, might be affected by the geopolitical uncertainty.

	Reporting period	Data (%)
Gross Domestic Product (GDP)		
Real GDP (year-on-year growth)	2014 Q2	2.3
Real GDP (quarter-on-quarter growth; seasonally adjusted)	2014 Q2	0.9
30.09.2014 "Construction" of gross domestic product and construction as the fastest growing industry in the second quarter 		
Public Finances		
Tax revenue (since the beginning of the year; year-on-year growth)	2014 IX	2.4
General government budget expenditure (since the beginning of the year, year-on-year growth)	2014 IX	4.0
Consumer price changes		
Consumer Price Index CPI (year-on-year growth)	2014 IX	1.0
Consumer Price Index HICP (year-on-year growth)	2014 IX	1.2
12-month average inflation (HICP)	2014 IX	0.5
08.10.2014 September inflation data bring surprises 		
Foreign trade		
Exports (year-on-year growth)	2014 VIII	-3.7
Imports (year-on-year growth)	2014 VIII	-9.3
10.10.2014 Exports of Latvian goods slightly down in August as a result of weaker demand 		
Balance of payments		
Current account balance (ratio to GDP)	2014 Q2	-3.7
Foreign direct investment in Latvia (net flows; ratio to GDP)	2014 Q2	1.2
Industrial output		
Working day-adjusted manufacturing output index (year-on-year growth)	2014 VIII	-0.9
06.10.2014 In August, Latvian manufacturing did not feel the impact of Russian sanctions 		
Retail trade turnover		
Retail trade turnover at constant prices (year-on-year growth)	2014 VIII	3.9
Labour market		
Registered unemployment (share in working age population)	2014 IX	8.2
Job seekers rate (share in working age population)	2014 Q2	10.7
Monetary indicators		
Resident deposits (year-on-year growth)	2014 VII	10.4
26.09.2014 Positive trends emerge in lending 		

Sources: Treasury, Central Statistical Bureau of the Republic of Latvia, and Latvijas Banka data.

Three pillars to support economic growth: recap of Latvijas Banka's annual conference



Andris Strazds
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On 17 October the annual conference of Latvijas Banka gathered three members of the Governing Council of the ECB and a number of prominent academics and policy makers who sought to answer the question "Have we learned anything from the crisis?" In addition to performing an autopsy of the crisis, however, a substantial part of the discussion was devoted to trying to figure out the way forward. Monetary policy was discussed; however, the most frequently heard words and expressions were "competitiveness", "productivity" and "structural reforms".

The Governor of Latvijas Banka, Mr. Ilmārs Rimšēvičs, during his opening remarks reminded participants of the recent experience of Latvia and stressed the importance of sound fiscal policy and structural reforms as two important pillars of growth in addition to monetary policy.

This was supported by Benoît Cœuré, Member of the ECB Executive Board, who in his keynote address stressed that supply side policies were as important as boosting demand to ensure a sustainable economic recovery. He also emphasized the importance of speeding up the structural reforms as "countries that have enacted a more frontloaded reform strategy have, on the whole, seen better outcomes than those that have applied a more staggered approach". Mr. Cœuré went on contrasting the recovery in Latvia and Ireland, where fiscal adjustment and structural reforms had largely been frontloaded, with the less fast and comprehensive reform effort in Greece, Portugal and Spain. In his view, this contrasting experience, among other things, disproved the political

economy view that reforms should be staggered because the political capital was scarce. The subsequent panel discussion mostly echoed the line taken by Mr. Rimšēvičs and Mr. Cœuré and developed it further. Professor Michael Haliassos from the Goethe University Frankfurt am Main stressed that in case of Greece the supply side policies also had to include investment in raising the production capacity as the production sector had been small before the crisis. Professor Philip Lane from the Trinity College Dublin generalized that crises were costly and more effort should be made in the future to limit excesses during times of economic boom, inter alia, by avoiding structural budget deficits.

The second part of the conference started with a keynote address by Dr. Jens Weidmann, the Governor of the Deutsche Bundesbank. He praised the economic reform effort recently undertaken by Latvia, emphasized the risks associated with further accommodative monetary policy steps and outlined a number of measures required to reignite growth in the euro area including completion of the EU single market, structural shift of government expenditure from consumption to investment without allowing public deficits to rise, as well as concluding the Transatlantic Trade and Investment Partnership. In the panel discussion following the second keynote speech also Mr. Jörg Asmussen, Permanent State Secretary of the Federal Ministry of Labour and Social Affairs (Germany), argued for structural reforms and sticking to the agreed rules. Moreover, he pointed out the importance of drawing the right conclusions from the Russian-Ukrainian conflict and agreeing on a common EU energy policy to ensure sustainable growth. Mr. Leszek Balcerowicz, a prominent former Polish policymaker and now professor at the Warsaw School of Economics, voiced the opinion that an overly accommodative monetary policy risked delaying the necessary fiscal consolidation and reform effort. This view was echoed by Professor Christian de Boissieu of the University of Paris adding that the pace of reform in France during the last two years has been too slow.

The main conclusion of the conference is that accommodative monetary policy alone cannot ensure sustainable growth if it is not supported by sound fiscal policies and structural improvements aimed at raising productivity.



Speeches and presentations from the conference are now available at <http://www.macroconomics.lv/conference-have-we-learnt-anything-crisis>