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Latvia economy: Banking lending continues to fall

Economist Intelligence Unit (EIU)

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The banking sector continues to retrench as banks seek to consolidate their balance sheets ahead of expected large losses from the deep economic downturn in Latvia, following the rapid expansion of credit in the past few years. Total assets fell to LVL21.8bn in March, down by 4.7% from the end of 2008, although this partly reflected syndicated loan repayments by several banks. Lending to private corporations and households has been falling since November 2008, declining in the first quarter by 1.6% and 1.1%, respectively.

The sector remains under considerable pressure. Total deposits, having fallen in January and February, edged up slightly in March, by 1.1%. However, this was mainly owing to a rise in deposits by the government; households' and firms' deposits continued to slip lower, and the total deposit base is down by 6.5% since the middle of 2008. The Latvian banking sector has large holdings of non-resident deposits (NRDs), around 37% of the total at end-March 2009, mainly from residents of countries in the Commonwealth of Independent States (CIS). These deposits have been gradually drawn down owing to the impact of the economic crisis, and have fallen by 22% since mid-2008.

The sector as a whole posted losses of LVL44m in the first quarter of 2009, partly as a result of provisions for bad loans. Loan loss provisions rose by LVL106m in March alone, and now total LVL551m, according to the **Financial and Capital Markets Commission**. The figure is likely to rise further in the coming quarters, as non-performing loans (NPLs) are increasing—loans with payments more than 90 days overdue grew from 3.6% of the total at the end of 2008 to 7.1% at the end of March.

As a result, lending activity is likely to remain subdued. Banks may also have to raise fresh capital in order to meet capital-adequacy requirements. Additional capital injections would probably be provided for foreign-owned banks by their parent institutions, if need be. However, it will be harder for locally owned banks to raise additional capital. The European Bank for Reconstruction and Development (EBRD) has taken a 25% stake in the state-owned lender, **Parex** Bank, and may also buy stakes in some of the smaller Latvian lenders.

SOURCE: Country Report

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