

Latvia

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IN A NUTSHELL

- The economy recovered, the government continued to provide Covid-related support to help preserve employment and stabilise household income.
- House prices increased due to buoyant market activity and low new building construction rates.
- Rising housing demand supported residential lending, the outstanding amount of mortgage loans held by banks increased moderately.
- Domestic deposits continue to dominate bank funding.

MACROECONOMIC OVERVIEW

Despite the recurring waves of the pandemic, the economy largely recovered. GDP grew by 4.5% (s.a.) exceeding the pre-pandemic level, with mainly the contact-intensive services lagging whereas manufacturing benefited from a return of foreign demand. Exports of goods and services grew by 6.2% in real terms (s.a.). The global economic recovery led to supply-side bottlenecks motivating businesses to increase inventories boosting imports of goods by 12.1% (s.a.) in real terms. As containment measures rendered many services unavailable periodically, despite the income growth the private consumption in the year as a whole remained below the 2019 level, growing by 4.5% in 2021 after a 7.4% drop in 2020.

The recovery of global demand caused price increases in various industrial inputs including construction materials and energy weighing on investment decisions in Latvia and contributing to inflation. Gross fixed capital formation grew by 2.3%, mainly investment in machinery and equipment, while investment in dwellings as well as other buildings and structures dropped considerably (by 14.7% and 4.8% respectively, s.a.). The annual increase in consumer prices reached 3.2% in 2021 overall as measured by HICP, and ranged from a negative rate in January to 7.9% in December.

The increase in economic activity resulted in unemployment falling to 7.6% in 2021 on average. Government policies continued to provide pandemic related support to preserve jobs and stabilise disposable income. By the end of the year some small government support become available to mitigate the impact of growing energy prices on vulnerable household purchasing power.

The general government budget deficit widened to 7.3% as the pandemic support package more than doubled from 2020 as allowed by the General Escape Clause of the Stability and Growth pact. Government debt remained at sustainable level of 44.8% of GDP.

HOUSING MARKETS

Real estate market activity was high in 2021 and the first quarter of 2022. The activity was broad-based, as the number of real estate purchases increased for existing and new apartments and residential houses. The number of purchases of land units for the individual residential houses also increased. The conflict in

Ukraine affected activity in the real estate market temporarily but not significantly. In March 2022, the number of purchases was 3.4% lower than in March 2021, but 14.4% higher than in March 2019. Activity was boosted by the increase in income and savings for many households and state support for families with children.

The supply side was weaker. Construction of new dwellings continued to slow. According to the Central Statistical Bureau's of Latvia data, the total area of the new dwellings commissioned was 23.2% less than in 2020. According to Colliers estimates¹, the number of available completed new apartments in Riga and Riga region had fallen to its lowest level in the last 10 years. As elsewhere in Europe, construction activity was hampered by a sharp rise in construction costs and supply chain bottlenecks on building materials.

House prices are growing more rapidly due to the imbalance between supply and demand. According to the CSB data, house prices increased by 11.0% in 2021. The rate of price growth accelerated over the year, with prices in the fourth quarter being 16.5% higher than in the fourth quarter of 2020. It should be noted that the dynamics of the house price index in countries with a relatively small and heterogeneous real estate market (such as the Latvian market) may be affected by changes in the structure of market transactions. In the fourth quarter of 2021, the share of transactions with larger existing dwellings and private houses in areas with higher house prices increased significantly, which may have contributed to the growth rate of the index. The impact of changes in the structure of market transactions is smaller if price growth is calculated within individual market segments. According to the information published by real estate companies, price growth in the largest market segments has been more moderate - in the fourth quarter of 2021 the prices of standard-type apartments in Riga were 11.1% higher than in fourth quarter of 2020.

The conflict in Ukraine and sanctions are having a negative impact on the supply of construction materials (most importantly, the availability of metals) and construction costs, so the availability of new housing will continue to deteriorate. Slow construction of new housing implies that house price growth is likely to remain significant in 2022.

MORTGAGE MARKETS

The outstanding amount of residential and commercial mortgage loans held by banks increased moderately in 2021 – by 3.7%. Residential mortgages outstanding increased by 7.8% partly explained by the acquisition of the loan portfolio of a non-bank (excluding this one-off effect by 4.1%). Moderate growth of residential lending is explained by rising demand for housing on account of households wishing to improve their living conditions or use the option of working remotely more extensively as well as better-off individuals looking for investment opportunities.

New origination continues to be facilitated by low interest rates and the state housing guarantee programme² (in 2021, 44% of new residential mortgages were issued within this scheme).

¹ <https://www.colliers.com/en-lv/news/the-number-of-completed-new-apartments-available-on-the-market-in-riga-has-decreased>

² Within the programme, a guarantee for a bank loan for purchase or construction of the housing for the families with children or young specialists with regular income but not enough savings to make the down payment is provided. The LTV requirement for these state-guaranteed loans is set at a maximum of 95% (the general maximum LTV requirement is 90%). More details on the programme available here: <https://www.altum.lv/en/services/individuals/housing-guarantee-programme/about-the-programme/> and here: <https://www.altum.lv/en/services/individuals/housing-guarantee-programme-1/about-the-programme-of-housing-guarantees/>

After a period of lending standard volatility at the start of the pandemic, the LTV of new residential mortgage loans remained stable in 2021. LTVs for 27% of new loans volume exceeded 90% in 2021, mainly related to the state housing guarantee programme. Total residential mortgage loans are only 13% of GDP and overall household indebtedness is low. Interest rates on residential mortgage loans has decreased somewhat – from 2.62% in 2020 to 2.38% in 2021.

The quality of bank loan portfolios continues to improve – NPLs comprised 2.4% of the total domestic loans and 1.6% of the residential mortgage loans as of end-2021.

MORTGAGE FUNDING

Credit institutions in Latvia obtain funding mostly from domestic retail and non-financial corporations deposits and some banks participated in TLTRO III operations. Latvian credit institutions are not active in the financial markets as a source of funding. Domestic deposits as a source of funding continued to grow and at the end of 2021 was 66.4% (compared to 62.7% the year before) of banks' total liabilities, while the share of liabilities to foreign parent MFIs (mostly Nordic parent banks) was 2.8% (3.1% in 2020) as only small foreign branches used parent banks funding and the banking sector domestic loan to deposit ratio was still low – 74.8% (73.8% in 2020). In 2021, there were no mortgage covered bonds issued by Latvian MFIs (however, one of Estonian bank's Latvian branch mortgages were included Estonian covered bond programme).

	LATVIA 2020	LATVIA 2021	EU 27 2021
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	-3.8	4.5	5.4
Unemployment Rate (LSF), annual average (%) (1)	8.1	7.6	7.0
HICP inflation (%) (1)	0.1	3.2	3.0
HOUSING MARKET			
Owner occupation rate (%) (1)	81.2	83.2	70.0
Gross Fixed Investment in Housing (annual change)(1)	-1.9	-15.4	6.6
Building Permits (2015=100) (2)	121.8	135.3	134.0
House Price Index – country (2015=100) (2)	145.8	162.1	145.2*
House Price Index – capital (2015=100) (2)	n/a	n/a	146.1*
Nominal house price growth (%) (2)	4.2	11.2	10.3*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	4,178	4,505	6,508,621
Outstanding Residential Loans per capita over 18 (EUR) (2)	2,699	2,935	17,782
Outstanding Residential Loans to disposable income ratio (%) (2)	21.5	21.8	62.8*
Gross residential lending, annual growth (%) (2)	0.0	0.0	12.2
Typical mortgage rate, annual average (%) (2)	2.6	2.4	2.0

* Please note that this value is the simple average of the available values in 2021.

Sources:

(1) Eurostat

(2) European Mortgage Federation - Hypostat 2022, Statistical Tables.

LATVIA FACT TABLE

Which entities can issue mortgage loans in your country? Credit institutions, credit unions and non-bank financial institutions can issue mortgage loans in Latvia.

What is the market share of new mortgage issuances between these entities? Not available

Which entities hold what proportion of outstanding mortgage loans in your country? The mortgage market is significantly dominated by mortgage loans issued by banks.

What is the typical LTV ratio on residential mortgage loans in your country? According to Latvian legislation, LTV cannot exceed 90%. For the participants of the state support programme for house purchase and construction, the upper LTV limit is 95%.

How is the distinction made between loans for residential and non-residential purposes in your country? The distinction is based on the loan issuing purpose (defined by Latvijas Banka's Regulation Compiling the Monthly Financial Position Report of Monetary Financial Institutions and Regulation for the Credit Register).

What is/are the most common mortgage product(s) in your country? Housing loans

What is the typical/average maturity for a mortgage in your country? The typical maturity of a new issued mortgage is 22 years.

What is/are the most common ways to fund mortgage lending in your country? See section on Mortgage funding.

A stamp duty of 0.5-1.5% of the home price applies when registering the purchase. Regularly, the 1.5% fee applies, and the stamp duty is reduced to 0.5% under the support programme for house purchase. The reduced cost is applied only to families with children, and not for young specialists (please see question 10 on the overview of the support programmes).

What is the level of costs associated with house purchase in your country (taxes and other transaction costs)? In addition to the stamp duty, 0.1% of the mortgage loan amount should be paid for the registration of the mortgage. These are the main fees associated with house purchase, there are also some additional registration fees, but they are usually small, and their amount is fixed (does not depend on the loan amount or real estate price).

For home purchases under the state guarantee programme buyers face additional costs:

- for families with children, the one-time fee is applied -2.5% of the outstanding amount of the guarantee;
- for young specialists, the guarantee fee of 4.8% per annum (of outstanding amount) applies.

It is possible to obtain a state guarantee up to 30% of the loan amount, but not exceeding EUR 30,000 for families with children (the exact amount of the guarantee depending on the number of children). In addition, an extra 5% increase in the guarantee (but not exceeding the amount of EUR 30,000) is possible if the dwelling corresponds to the "A" energy efficiency class of buildings or is nearly zero energy building. Moreover, families with at least three children that have applied for a mortgage in the largest commercial banks in Latvia starting from July 1st 2020 are eligible as of second half of November 2020 to receive a state subsidy in the amount of 8 to 12 thousand euro (the exact amount depending on the number of children in the family and energy efficiency of the housing to be purchased/built). Although approved 17th of November, it applies retroactively to mortgages granted since 1 July 2020, and was announced already before 1 July 2020.

For young specialists (individuals up to 35 years old who have acquired the vocational secondary or higher education) it is possible to obtain a guarantee up to EUR 50,000.