

Latvia

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IN A NUTSHELL

- The economy grew by 2.8%, supported by the post-pandemic recovery of service industries but restrained by a decrease in purchasing power.
- Overall transactions in the real estate market decreased driven by deteriorating household purchasing power and rising interest rates, but price growth started to slow down.
- Outstanding amount of residential and commercial mortgage loans held by banks continued to grow moderately, while household lending witnessed clear-cut signs of deceleration, due to interest rate hikes. Domestic deposits continue to dominate bank funding.

MACROECONOMIC OVERVIEW

The political conflict in Ukraine led to elevated uncertainty and price increases. Against that the economy grew by 2.8% due to service industries recovering from pandemic, while the growth was held back by a reduction in purchasing power. The uncertainty provoked stockpiling, pushing up real import growth to 11.8%, while growth of real exports was also strong at 9.2%.

The gross-fixed capital formation growth slowed to 0.8%, due to the higher construction material prices and economic uncertainty, which made investors reconsider upcoming projects. However, private consumption increased by 8.3% due to the end of Covid restrictions at the beginning of the year, the government support during the high inflation period and a higher spending of savings among households.

Although, there was an increase in the number of people participating in the labour market, it remained tight, and the unemployment rate dropped to 6.9%. However, starting in the second half of 2022, the number of job openings began to decline, indicating a decreasing but still significant demand for labour. Although the annual growth rate of wages was near 9% in 2022, the real compensation per employee plummeted due to high HICP inflation which reached 17.2%.

The general government budget deficit reached 4.4% of GDP due to support measures such as Covid support, energy support including partial compensation of price increase and refugee support. The government debt-to-GDP ratio dropped by 2.9 pps compared to 2021 due to the growth of nominal GDP and remained at 40.8%.

HOUSING MARKETS

Hampered by deteriorating household purchasing power, rising interest rates and worsening affordability of newly built dwellings, activity in the real

estate market has been decreasing since the second half of 2022. In April 2023, the number of transactions in the real estate market was 15.2% smaller than a year ago. The decline in activity was particularly sharp in the region near the capital, where the number of purchases in February 2023 fell to the lows seen in 2020. Transactions with private houses and land for residential construction fell significantly, while the activity in the apartment segment fell only moderately.

Supply remained weak as the construction of new apartments was constrained by the rapid increase in construction costs. According to Central Statistical Bureau's data, the total area of new dwellings commissioned in 2022 increased by 23.0% compared to the record low figure in 2021 but was 5.6% and 19.4% lower than in 2020 and 2019, respectively. As the number of new projects and projects actual under construction has decreased in 2022, fewer new apartments will be available to the market in 2023.

The overall growth in house prices is slowing but vary considerably by segment. In the 4th quarter of 2022, the Central Statistical Bureau's house price index was 9.1% higher than a year ago, but in quarterly terms prices decreased by 0.2%. Due to growing supply of standard series apartments in the secondary market and overall lower demand in this segment, the annual growth rate of existing dwelling prices has been slowing. Yet the growth of newly built dwelling prices has been accelerating, supported by rapid increase in construction costs.

Affordability of existing dwellings overall remained good, but the affordability of new housing worsened significantly in 2022. The increase in wages significantly lags the increase in the prices of new housing, while rising interest rates on housing loans harm the creditworthiness of potential borrowers.

There are no signs of a sharp price correction currently, as the imbalances in the housing market have not grown significantly since the pandemic. Lending for house purchases has been cautious and household debt is low. Prices of newly built housing are set to continue to increase, as construction cost growth remains elevated. The ability of developers to throughput construction costs to new house prices overall has been strong thus far, as the housing construction volume has been small and supply is lagging demand for a prolonged time already.

MORTGAGE MARKETS

The outstanding amount of residential and commercial mortgage loans held by banks continued to grow moderately (by 4.5%). Residential mortgages outstanding increased by 4.9% facilitated by the state support programme¹ for house purchase. However, already in late 2022, following substantial interest rate hikes, household lending witnessed clear-cut signs of deceleration.

¹ Within the programme, a guarantee for a bank loan for purchase or construction of the housing for the families with children, young specialists or the National armed forces soldiers with regular income but not enough savings to make the downpayment 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-guarantees-for-families/> <https://www.altum.lv/en/services/individuals/housing-guarantees-for-young-professionals/> <https://www.altum.lv/en/services/individuals/for-the-armed-forces-soldiers/>

The LTVs of new residential mortgage loans remained stable. LTVs for 26% of new loans volume exceeded 90%, mainly related to the state housing guarantee program. Total residential mortgage loans are still low at 12% of GDP at yearend, and overall household indebtedness remains low. Interest rates on residential mortgage loans have increased significantly in line with EURIBOR growth – from 2.4% in 2021 to 2.9% in 2022 (or from 2.2% in December 2021 to 4.3% in December 2022).

The quality of bank loan portfolios still continues to improve – the share of NPLs reached 1.7% of the total domestic loans and 1.0% of the residential mortgage loans at the end of 2022.

MORTGAGE FUNDING

Credit institutions obtain funding mostly from domestic retail and non-financial corporations' deposits. Some banks participated in TLTRO III operations, but half of the amount has already been repaid. Credit institutions are not active in the financial markets for funding. Domestic deposits continued to grow and reached 68.2% at the end of 2022 (compared to 66.4% the year before) of banks' total liabilities, while the share of liabilities to foreign parent MFIs (mostly Nordic parent banks) was 4.3% (2.8% in 2021), as only small foreign branches used parent bank funding and the banking sector domestic loan to deposit ratio was still low – 72.0% (74.8% in 2021). In 2022, there were no mortgage covered bonds issued by Latvian banks. However, an Estonian bank's Latvian branch mortgages were included in an Estonian covered bond programme.

	LATVIA 2021	LATVIA 2022	EU 27 2022
MACROECONOMIC VARIABLES			
Real GDP growth (%) (1)	4.3	2.8	3.5
Unemployment Rate (LSF), annual average (%) (1)	7.6	6.9	6.2
HICP inflation (%) (1)	3.2	17.2	9.2
HOUSING MARKET			
Owner occupation rate (%) (1)	83.2	83.1	69.1
Gross Fixed Investment in Housing (annual change)(1)	-15.4	-11.2	1.5
Building Permits (2015=100) (2)	135.3	134.1	125.8
House Price Index – country (2015=100) (2)	162.1	184.5	164.6*
House Price Index – capital (2015=100) (2)	n/a	n/a	163.8*
Nominal house price growth (%) (2)	11.2	13.9	10.6*
MORTGAGE MARKET			
Outstanding Residential Loans (mn EUR) (2)	4,505	4,713	6,743,197
Outstanding Residential Loans per capita over 18 (EUR) (2)	2,935	3,103	18,433
Outstanding Residential Loans to disposable income ratio (%) (2)	21.8	19.4	71.5
Gross residential lending, annual growth (%) (2)	n/a	n/a	-6.5
Typical mortgage rate, annual average (%) (2)	2.4	2.9	3.1

* Please note that this value is a simple average of the available values in 2022.

Sources:

(1) Eurostat

(2) European Mortgage Federation - Hypostat 2023, 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 the 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 21 years.

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

What is the level of costs associated with house purchase in your country (taxes and other transaction costs)? 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).

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.