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BANK DEPOSITS IN LATVIA: RECENT TRENDS AND DEVELOPMENT

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Abstract. Bank deposits occupy an important place in the sources of the formation of banking resources, and in many European banks reach 70%. However, recently, due to unstable economic policies, the amount and share of total deposits in the banking system has been declining, which leads to a shortage of long-term banking resources. In this article, the author examines the trends in the development of bank deposits in Latvia, identify patterns in the process of their formation in conjunction with active operations that generate income. The problem of turning deposits into bank assets in terms of the timing, scale, expediency and efficiency of the use of attracted funds was highlighted. The purpose of the study is to analyse and assess the trends in deposit operations in Latvia, as well as their forecasting until 2030. Author used such methods as economic analysis, comparison method, economic grouping, statistical methods, extrapolation method and others. The results of the study can be used by both commercial banks and their customers.

Key words: Bank Deposits, Liabilities, Bank Resources Transformation, Forecast Trends.

Introduction. As is well known, the main source of bank funds are customer deposits. However, with the development of the banking system, the composition of accumulated bank resources has changed. The reason for this was the emergence of new methods that are not traditional for the previous banking system to attract temporarily free cash funds [1].

In modern banking practice, all attracted finance resources are divided into deposits and non-deposit attracted funds by the method of their accumulation. The bulk of attracted resources are bank deposits, that is, funds deposited by bank clients for storage in certain accounts and used by them in accordance with the account regime and banking legislation [2]. Non-deposit funds are considered to be funds that banks receive in the form of loans in order to maintain their liquidity and expand the resource base [3]. The deposit represents the economic relationship between the bank and its client in relation to the transfer of funds to the bank for temporary use. The amount of income (profit) on a deposit depends directly on its type, term and volume [4]. By categories of owners, bank deposits are divided into deposits of legal entities and deposits of individuals. In Latvian banks, deposits of individuals amount for approximately 40% of all liabilities of the banking sector, and this share is steadily growing. The share of deposits of legal entities is about 30% of all liabilities and tends to decrease.

As for demand deposits, in Latvia and other European countries, demand deposits account for more than 70% of all attracted customer deposits. And this means that the share of transformation of current resources into long-term investments is quite high. All this requires new approaches and methods for managing deposits to meet the needs of clients in borrowed funds and ensure the stability of banks.

Concept of Bank Deposits: Literature Review. Commercial banks in their activities attract free funds from customers through deposit operations. By attracting deposits, banks assume obligations and responsibilities for the payment of deposits within the deadlines established in accordance with deposit agreements. Consider the points of view of various authors on the concept of “deposits” and “deposit operations.” Deposit operations are operations of banks to attract free funds of clients to deposit accounts in order to form banking resources [5]. The funds attracted to deposit accounts are used by banks mainly for lending to entrepreneurial activities and consumer purposes of those clients who need additional funds [6]. A number of scientists and economists (Begenau, J., Stafford, E., Choi M., Rocheteau G., Andolfatto D., Berentsen A., Martin F.M. and others) define the deposit as follows. Deposit is the amount of money that a client (individual or legal entity) placed with a bank

on a deposit account [1-5]. Customers can use funds placed on deposit in accordance with the rules of deposit accounts established by banks. Deposits can be issued for a specific period – term deposits and without specifying a specific period – demand deposits [7, 8].

Consider the signs of term deposits and demand deposits. Characterizing term deposits, it should be noted that they are issued for a specific predetermined period, when issuing a deposit agreement, deposit interest is charged [9,10]. Term deposits provide clients with interest income and are classified as stable resources of a commercial bank. In turn, term deposits can be simple and special [11]. A simple term deposit is a deposit, interest on which is accrued only on the principal amount of the deposit and is paid to the depositor according to the terms of the deposit agreement. A special term deposit is a deposit, accrued interest on which is attached to the principal amount of the deposit and subsequent interest is accrued on the amount increased by the attached interest of the deposit [12].

The signs of demand deposits will be as follows: demand deposits allow customers to freely carry out various transactions for transferring funds, funds can also be credited to demand deposits at any time [13]. Execution of a demand deposit is accompanied by the conclusion of an account agreement or a demand deposit agreement. Demand deposits are not a source of revenue for customers [14]. Speaking of demand deposits, it should be noted that they can be both interest-free and interest-bearing. This is determined by the terms of the contract between the customer and the bank [15].

Along with the main types of deposits – term and demand, overnight accounts can be opened in banks, savings deposits can be issued, and insurance deposits can be used. What are these account types? Overnight is customer money placed with a bank for a period of 1 day/night (the maximum placement period is 24 hours). Given the short-term nature of these accounts, it should be noted that overnight deposits are characterized by large amounts, since only “big money” can earn in a short period of time. Overnight accounts can be opened with a bank not only by business clients, but also by other banks [16]. Thanks to overnight deposits, entrepreneurs whose working day has ended instruct their banks to transfer their money to those banks where the working day begins. Moreover, the banks themselves, having large amounts of funds in their correspondent accounts, transfer them to overnight. Thus, in entrepreneurship, money works around the clock [17].

Continuing to consider the classification of bank deposits, it is also necessary to note the existence of a savings deposit and an insurance deposit.

Savings deposit – a bank deposit intended for continuous accumulation of funds. A feature of this type of deposit is that the account can be replenished with sufficiently small amounts, and partial withdrawal of funds is possible from this account [18].

Insurance (guarantee) deposit – funds deposited in the bank by customers to the insurance (guarantee) deposit account, which are collateral for loans, payment cards and other requirements of the bank. The funds of the insurance (guarantee) deposit are deposited with the bank, as a rule, for the period until the full fulfilment of obligations to the bank, which are secured by this deposit, or for a fixed, predetermined period exceeding the validity of credit and other similar agreements, which are secured by the insurance deposit [14, 15].

In banking practice, in addition to the traditional types of deposits discussed above, deposit forms such as NOW accounts, ATS accounts, SWEEP accounts and others are also used [8, 19]. NOW accounts (negotiable orders of withdrawal) – a type of sets that occupy an intermediate position between savings and current accounts. Holders of such accounts have the right, when notifying the bank 30 days in advance, to issue negotiable orders of withdrawal (NOW) and use them to make payments [8, 20]. ATS (automatic transfer service) account is a combination of a demand account (checking account) with an interest-bearing savings account (term deposit), which allows you to transfer money from a second account to the first when a check is written to it, or its owner accepts payment. As a rule, this account does not provide for the payment by the client of a commission either for its maintenance or for the transfer of funds [8, 21]. SWEEP account – an account with automatic clean-

ing (transfer of funds), the functioning mechanism of which allows the balance of funds available at the end of the day to be automatically invested in interest assets in the interests of the account holder, and at the beginning of the next day the invested funds and accrued interest are returned to the client's account [9, 20]. This type of account allows the client to take advantage of demand deposits (free transfer of funds), and at the same time receive interest income from investing unused cash balances [19, 20]. All the above-mentioned accounts (NOW accounts, ATS accounts, SWEEP accounts) have an important similarity: they all allow the client (account holder) to make payments and settlements from it, and at the same time use it as an accumulative account. That is, all these accounts combine certain properties of both a demand deposit and a term deposit. And by virtue of this property, they are called hybrid accounts.

Bank Deposit Trend Analysis in Latvia. Bank deposit trend analysis shows changes in deposit volumes and their growth/decline rates over a certain period. Figure 1 shows trends in deposits with commercial banks in Latvia from 2014 to 2024. During this period, we see a sharp decline in deposits during 2016-2019. In 2016, the rate of decline was 8.2% compared to 2015, and in 2017-2019 they continued to fall. Thus, the volume of deposits in the banking sector of Latvia for the period from 2015 to 2019 decreased by 4615 million euros, and the decline rate for this period was 20%. This trend is explained by the tightening of requirements for servicing clients of non-residents of Latvia during this period, in connection with which many banks refused to serve non-residents, and non-residents left the Latvian market. Further, the trend is characterized by instability, and after a slight increase in deposits in 2021, there was again a decline in 2023, the reason for which was the lack of free funds from the population and enterprises of Latvia. These trends reflect the instability of the Latvian economy, and the inability of individuals and legal entities to withstand economic and political shocks.

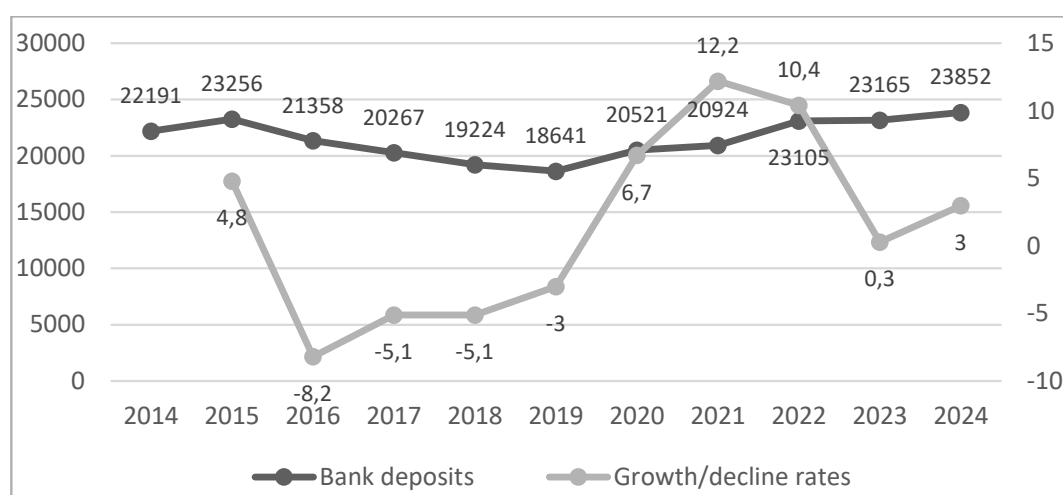


Fig. 1. The total amount of customer bank deposits and growth/decline rates (created by the author based on [22-23]).

The following graph (fig.2) shows that the most vulnerable to external economic conditions were legal entities (private companies), which were forced to withdraw their funds from Latvian banks. The decline in deposits of private companies for the period from 2015 to 2019 amounted to more than 50%. At the same time, household deposits, on the contrary, tended to grow. Figure 2 shows that starting from 2014, household deposits have a gradual upward trend until 2021. During this period, the total growth rate of household deposits amounted to 59%. However, with the increase in prices for energy and other goods, starting in 2022, the growth rate of household deposits slowed down.

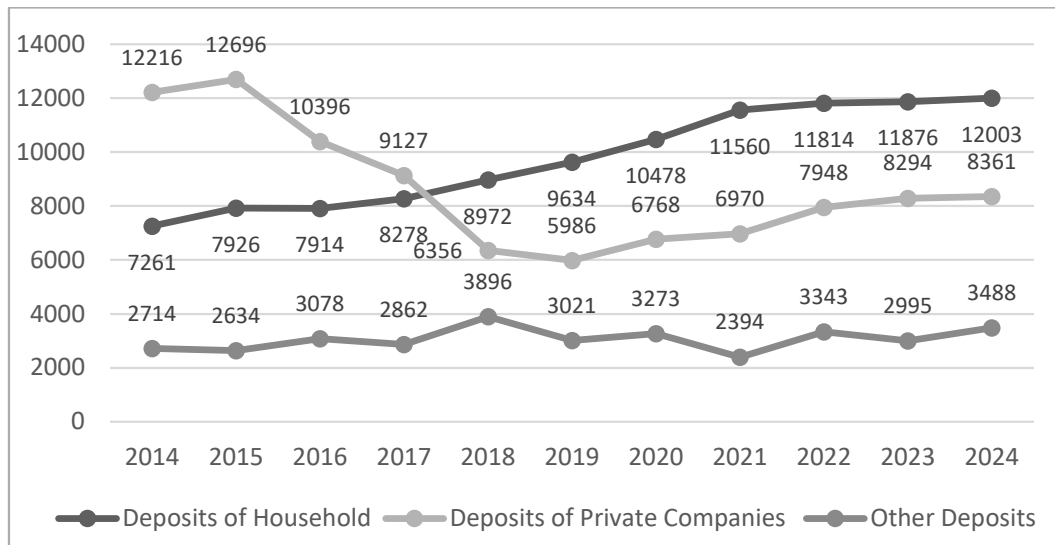


Fig. 2. Trends of bank deposits in Latvia by groups of customers in millions of euros (created by the author based on [22-23])

What types of deposits by maturity prefer to have customers of Latvian banks? As is well-known, in European banking practice, according to the criterion of maturity, deposits are usually divided into the following groups: demand deposits, short-term deposits (up to 1 year), medium-term deposits (from 1 to 5 years), and long-term deposits (over 5 years). The structure of customer deposits in Latvian banks is shown in the figure 3.

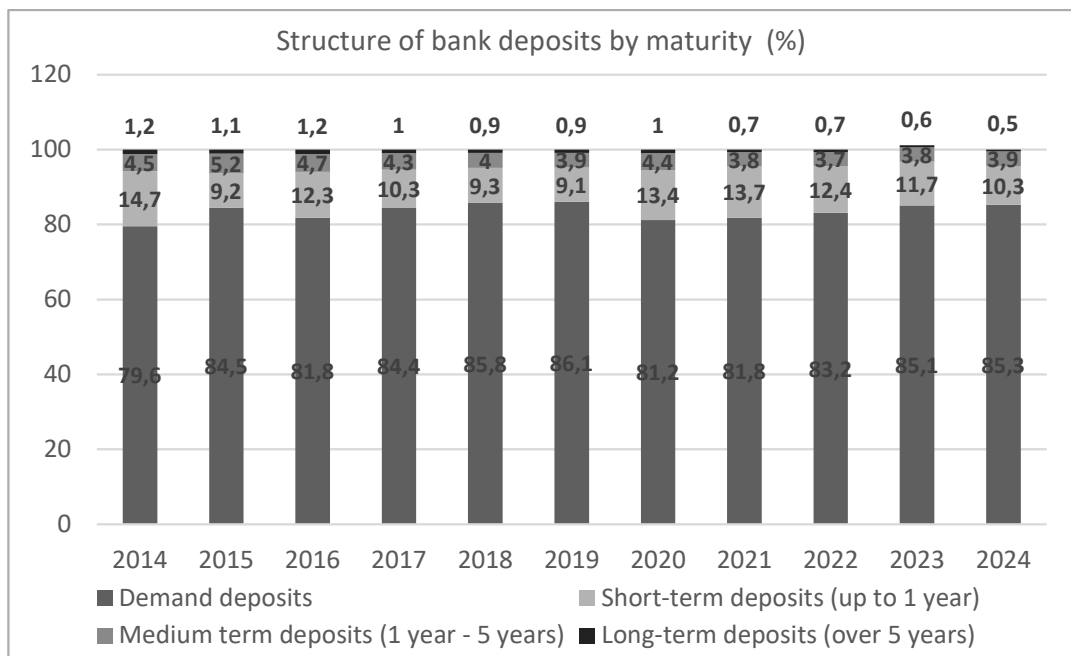


Fig. 3. Structure of bank deposits by maturity (created by the author based on [22-23])

Since household and private company deposits occupy a predominant share in the sources of banking resources in Latvia, author considers how the trends of these types of resources change over time

(figure 4). For the analysed period from 2014 to 2024, there is both a sharp drop and a slight increase in deposits of private companies. The sharp decline in deposits of private companies in the Latvian banking system in 2018 is explained by the withdrawal of non-resident clients from the Latvian market due to tightening requirements of supervisory authorities and the policy of restricting work with the non-resident market segment. Since a significant share of non-resident clients were private companies, their withdrawal from the Latvian market led to a sharp decrease in deposits. In 2018, the rate of decline in deposits of private companies amounted to more than 30%. This negatively affected the total volume of banking resources, and commercial banks in Latvia were forced to look for resources in the non-deposit market. As for household deposits, this market segment continued to develop in Latvia from 2016 to 2020, and their growth rates during this period ranged from 4.6% to 8.8%. But starting in 2021, the growth rate of household deposits slowed down significantly due to rising prices and lower real incomes of the individuals.

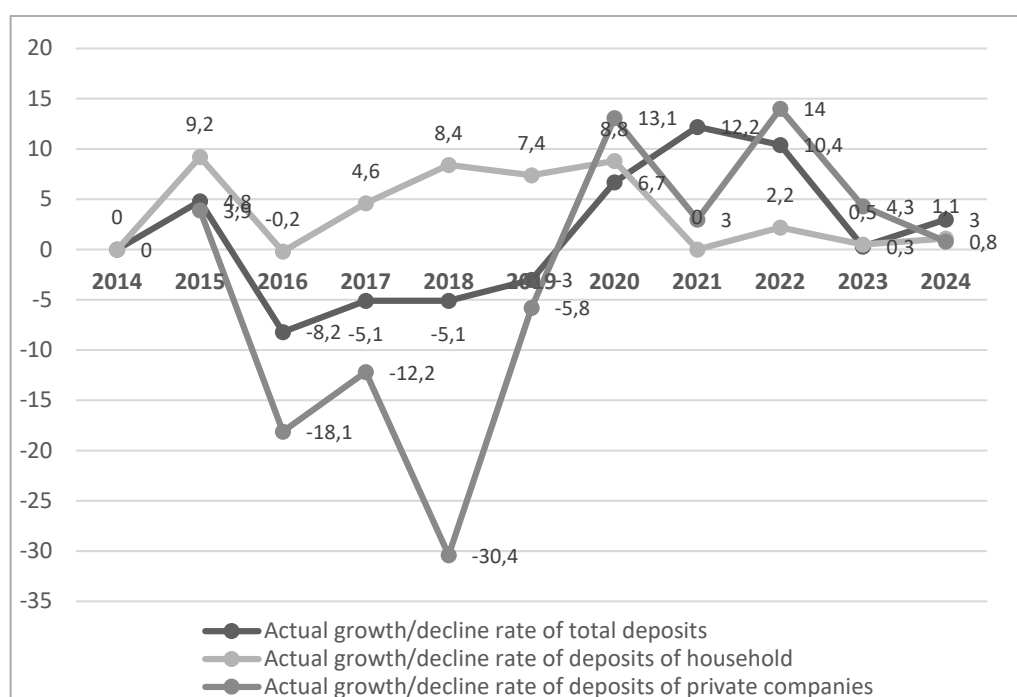


Fig. 4. Actual growth / decline rate in total deposits and in deposits of household and of private companies (created by the author based on [22-23])

Forecast of Deposit Growth Rate in Latvian Banking System. At present, forecasting is becoming an integral part of the management of any company, helping it to keep a certain course, change direction or confidently move forward even in conditions of economic instability. Prediction is the prediction of the future based on accumulated experience and current assumptions regarding it. Forecasting is a complex process in which a large number of different issues need to be addressed. To implement it, various forecasting methods can be used. The most popular forecasting methods are the expert assessment method, extrapolation method, modelling, economic forecasting method, balance method. To predict the growth rate of deposits, we will use the extrapolation method. The extrapolation method consists in studying the persistent trends of the enterprise development that have developed both in the past and in the present and transferring them to the future. Distinguish between predictive and formal extrapolation. Formal extrapolation is based on the assumption that past and present trends will continue in the future; in the forecast case, the present development is linked to

hypotheses about the dynamics of the enterprise, taking into account the fact that in the future the influence of various factors on it will change.

We will make a forecast of the growth rate of deposits in Latvian commercial banks, taking into account historical actual trends over a 10-year period and possible changes in the influence of internal and external factors. Thus, possible trends in deposit growth rates are presented on the graph (Fig. 5).

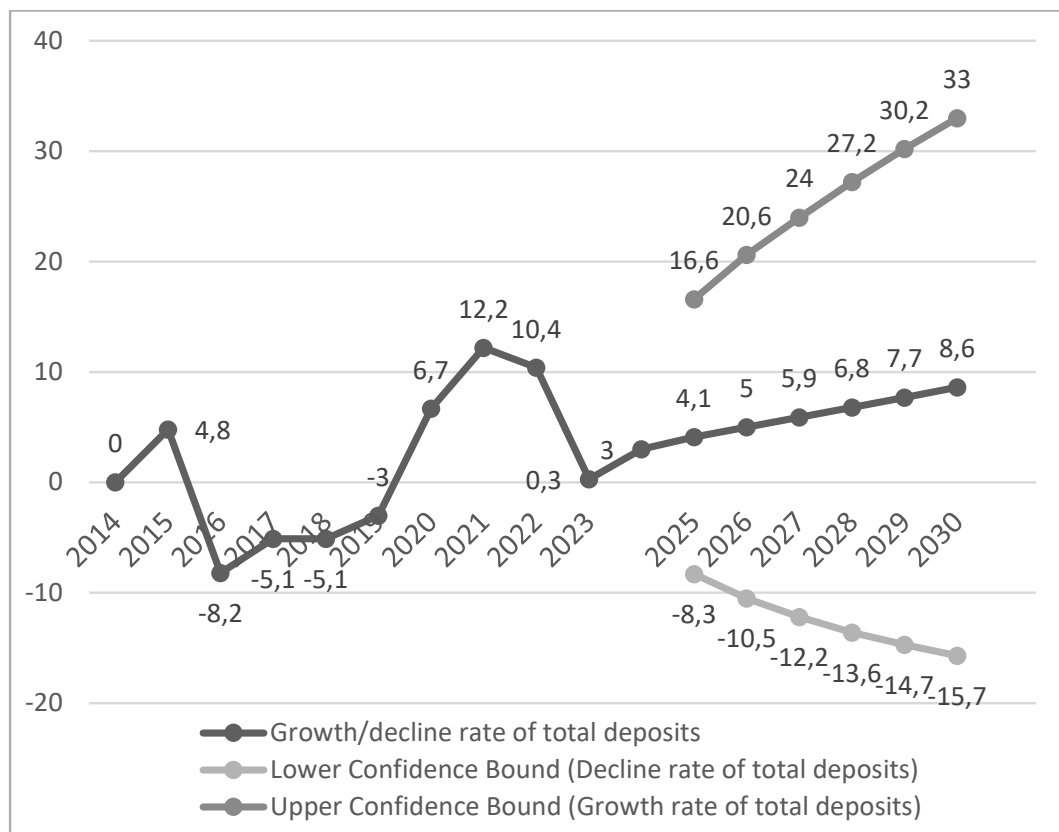


Fig. 5. Forecast of total deposits in Latvia (created by the author based on [22-25])

As can be seen, the average trend has a stable upward trend with an annual increase of 0.9%. While maintaining this trend, the growth rate of total customer deposits by 2030 may reach 8.6%.

The author also made an optimistic and pessimistic forecast of total deposits. According to the optimistic forecast, the annual growth may reach 3-4% and reach 33% by 2030. The pessimistic forecast shows negative trends in terms of total deposits, namely, an annual decline of 1% to 2.2%. Given this trend, the rate of decline in client deposits can range from 8.3% in 2025 to 15.7% in 2030.

Since deposits of households and private companies make up a significant share of total deposits, consider the forecast trends for these types of deposits.

The figure 6 shows that, according to the extrapolation method, the average trends in household deposits, deposits of private companies and total deposits may tend to increase in the future. Thus, the growth rate of deposits of private companies in the absence of financial shocks in the next 5 years may increase with an annual growth of 2.2-2.3%, and by 2030 reach the growth rate of 16.5%. The growth rate of household deposits in the next 5 years may slow down due to continued price growth and inflation. It is assumed that the annual slowdown in the growth rate of household deposits in the next 5 years will be at the level of 0.1%. These trends will affect the total volume of deposits in Latvian commercial banks. According to the forecast based on the extrapolation method, the annual average growth of total deposits in Latvian banks may be 0.8-0.9% and reach 8.6% by 2030.

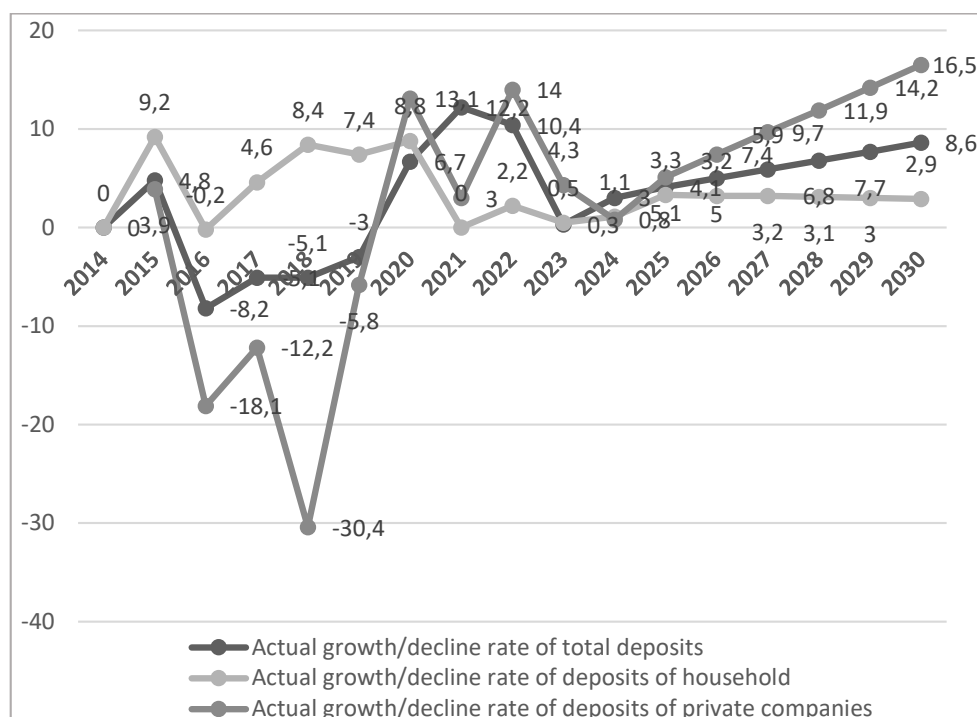


Fig. 6. Forecast of total deposits, household deposits and private companies' deposits in Latvia (created by the author based on [22-25])

Conclusions. As a result of the study, the author made the following conclusions.

The main type of attracted resources in commercial banks in Latvia are demand deposits, which make up 80-85%. The share of deposit sources attracted for specific periods is very small and amounts to less than 20%. Clients of Latvian banks prefer not to invest in banks for specific periods due to economic instability and lack of free funds. Of the deposits attracted for terms, the most popular are deposits up to 1 year.

Latvian banks are transforming current and short-term resources into long-term investments, because of which they are exposed to the risk of unbalanced liquidity.

The growth rate of household deposits has slowed in recent years due to rising prices and rising inflation. Also, a slowdown in the growth rate for this segment is expected in the future, as indicated by forecasts made using the extrapolation method.

Until 2018, non-resident legal entities accounted for a fairly large share of deposits in the Latvian banking sector. But with the tightening of requirements for servicing non-residents, many non-resident accounts were closed, resulting in a significant outflow of deposits from private non-resident companies. However, the forecast results indicate that in the future, in the absence of financial shocks, deposits may grow due to clients of the resident market, as well as due to the reorientation from eastern non-residents to western ones.

Based on the study, the author made several proposals to strengthen the deposit base in the banking sector of Latvia.

- 1) With a high share of transformation of current and short-term deposits into medium-term and long-term loans and other assets, exercise strict control over the transformation process.
- 2) Ensure interconnection between assets and liabilities of the bank in maturity and amounts.
- 2) To strengthen the deposit and resource base, banks need to find opportunities to attract alternative forms of long-term and medium-term funds, such as issuing debt obligations.
- 3) Expand the possibilities of using subordinated liabilities in Latvian commercial banks.

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