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## INTRODUCTION

In many ways 1997 was an outstanding year for Latvian economy, a year memorable for the beginning of an economic upturn. A stable national currency, a relatively low inflation, a balanced state budget and considerable growth in GDP were the major achievements during 1997.

The Bank of Latvia's main ambition for 1997 was single-digit inflation. Due to the Bank of Latvia's commitment to its monetary policy and the Government's tight fiscal policy whose main objective was a balanced budget, inflation decreased from 13.1% in 1996 to 7.0% in 1997. Latvia had the lowest inflation in the Baltic countries and the third lowest in Eastern Europe. For the first time after the restoration of independence, inflation in Latvia fell to a level that was not much higher than in industrially developed countries. This is an event of economic and political significance that gives grounds to anticipate positive future developments.

The remarkable event for Latvian economy in 1997 was significant growth in GDP (6.5%) promoted by rapid developments in the main sectors of the economy. The increase experienced by value added in the goods-producing sector also was important; moreover, it was the highest since the beginning of the reform process. A significant contribution to the growth in GDP was made by high productivity and macroeconomic stability reflected in falling inflation that promoted capital inflow and long-term lending to the goods-producing sector. Latvia, like other major Central and Eastern European countries, experienced a large influx of direct foreign investment. Exports continued to increase rapidly.

The stability of the lats was ensured through the peg to the XDR<sup>1</sup> basket of currencies. Fluctuations in the exchange rates of foreign currencies against the lats were prompted by developments in the global foreign exchange market. At the end of 1997, the world foreign exchange markets were affected by the East Asian financial crisis, during which the countries that had been considered a model of development experienced a rapid fall in stock prices causing a foreign exchange crisis. This influenced strongly the financial markets of Eastern Europe (including those of Estonia and Russia), yet had but a slight impact on major world currencies, which determine the exchange rate of the lats. In the reporting year, the US dollar appreciated against three currencies of the XDR basket: the German mark, the French franc and the Japanese yen, and hence, it appreciated also against the lats. There was high demand for lats in the domestic foreign exchange market, and the Bank of Latvia sold lats to banks, thus increasing its foreign currency reserves. The Bank of Latvia's foreign reserves amounted to 484.2 million lats at the end of 1997. The national currency was fully ed by gold and foreign currency reserves.

As a result of the Government's tight fiscal policy, the general government budget was balanced and interest rates fell. Since inflation was low and discount rates on government securities as well as interbank market rates fell, the Bank of Latvia was able to gradually reduce the refinancing rate from 9.5% to 4.0%. This facilitated a decline in deposit and lending rates.

With the introduction of currency swaps in July 1997, the Bank of Latvia had a full range of monetary policy instruments at its disposal to operate as stipulated by law.

The previous year was very successful for Latvian credit institutions. Their stable and safe development was supported by macroeconomic stabilization and stringent supervision

<sup>1</sup> The code for Special Drawing Rights in accordance with the International Standard ISO 4217 (Codes for the Representation of Currencies and Funds).

by the Bank of Latvia. The number of banks entitled to accept private person deposits increased. The quality of credit institutions' assets (including credits) improved considerably, and so did their indicators. The professional qualifications of bank managers improved. The regulatory framework was developed further, stipulating that each bank should set up an efficient internal control system.

At the end of 1997, the assets of credit institutions totalled 1.7 billion lats, and their equity reached 219.6 million lats. In 1997, deposits of domestic enterprises and private persons raised by credit institutions grew rapidly, and so did credits. The analysis of credit structure revealed a positive tendency: credits with a maturity exceeding one year accounted for over half of total credits.

In the reporting year, Latvian legislative acts pertaining to the financial sector continued to be harmonized with EU requirements. At the end of the year, the Law "On the Prevention of Laundering of Proceeds Derived from Criminal Activity", developed with the participation of the Bank's experts, was adopted. The Law "On Private Person Deposit Guarantee Scheme" was drafted and submitted to the Saeima of the Republic of Latvia.

In June 1997, the Saeima adopted amendments to the Law "On the Bank of Latvia". To provide for the functions of the Bank of Latvia, the Bank's nominal capital was raised to 25 million lats.

The Saeima of the Republic of Latvia voiced its support of the Bank of Latvia's policy by re-electing the Bank's Governor Einars Repse for another six-year term.

In May 1997, the Bank of Latvia looked at the first stage of the monetary reform enacted five years ago. The introduction of the Latvian ruble was the first step towards the restoration of the national currency, the lats. In September, the Bank of Latvia commemorated its 75th anniversary, marking it with an exhibition at the History Museum of Latvia.

In January 1997, Latvia's reform-oriented economic policy was recognized internationally: Standard & Poor's rated Latvia as an investment-grade country (BBB) with reasonable and acceptable risk on investments.

Moody's also recognized Latvia as a country safe for investment; moreover, it acknowledged that the Latvian banking system was one of the most developed among transition economies and had good prospects.

The adoption of a balanced budget for 1998 at the end of the reporting year, a stable national currency, low inflation, a safe banking system, foreign investment, export growth are those factors that allow us to expect further growth in Latvian economy.

# THE NATIONAL ECONOMY AND BANK OF LATVIA'S MONETARY POLICY

## INFLATION AND PRICES

1997 was a year of rapid upturn in the macroeconomic situation. The monetary policy implemented by the Bank of Latvia and the Government's tight fiscal policy ensured stability of the lats; the inflation rate and the level of interest rates decreased substantially. With manufacturing and the sector of transport and communication developing, GDP showed substantial growth.

An increase in the consumer price index (7.0%; see Chart 1) was considerably smaller in 1997 than in 1996 (13.1%). The highest rise in the index was recorded in January (1.9%), while the increase in other months did not exceed a 1.0% level. On average, the consumer price index rose by 8.4% in 1997 compared with 1996 (by 17.6% in 1996 compared with 1995).

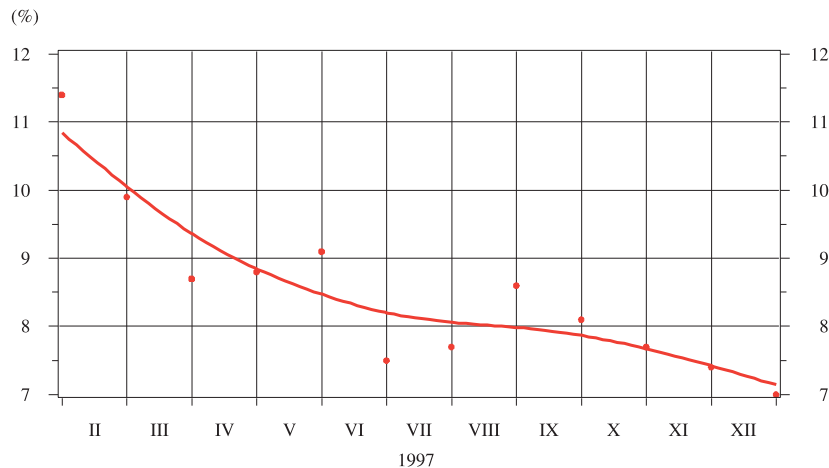
As before, inflation was mainly a result of a rise in administered (i.e., monopoly) prices and administrative decisions. The largest increase was registered for rent (77.5%), communication charges (19.1%), the prices of water supply, sewerage and refuse collection (17.8%), gas charges (15.6%) and electricity price (10.1%). A substantial rise in consumer prices was also effected by changes in various tax rates: excise tax on fuel, alcoholic beverages and tobacco as well as land tax were raised.

In 1997, the prices of services rose much more rapidly than the prices of goods (by 18.2% and 4.2%, respectively). The prices of the largest commodity group, food products, increased by only 2.3% over the year.

In 1997, the average calculated (gross) monthly wage in the public sector (excluding social and religious organizations) increased by 8.7% year-on-year, amounting to LVL 124.43 (USD 214.17). The gross wage increased more rapidly than the annual inflation. Hence, the

Chart 1

CHANGES IN CONSUMER PRICE INDEX (YEAR-ON-YEAR BASIS)



Source: Central Statistical Bureau of Latvia.



real gross wage rose by 10.7% year-on-year. The average net wage, however, totalled only LVL 91.41 or 73.5% of the gross wage, which increased more rapidly because social tax payments made by employers increased at the beginning of 1997. The increase in the net real wage (0.7%) during the year was a signal of positive change. (In 1996, the net real wage decreased by 7.8%.)

In 1997, the producer price index rose by only 3.6% (by 7.7% in 1996), as the index showed a small increase in manufacturing (2.6%). Producer prices in mining and quarrying as well as electricity, gas and water supply experienced a substantially higher rise (8.3% and 7.7%, respectively). In manufacturing, the highest price rise was registered for recycling (22.9%), sawmilling, planing and impregnating of wood (13.2%), as well as for building and repairing of ships and boats (10.1%). In the reporting period, the producer price index fell in the manufacture of textiles (by 1.8%), the manufacture of pulp, paper and paper products (by 1.9%), as well as in the manufacture of radio, television and communication equipment and apparatus (by 2.6%).

The construction and installation price index rose by 7.9% in 1997 (by 8.0% in 1996).

Export prices rose by only 1.6% in 1997 (by 6.2% in 1996). The highest increase was recorded for export prices of products of the chemical and allied industries (10.8%) and wood and articles of wood (7.4%), while the most significant fall was experienced by export prices of prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco products), and live animals and animal products (27.3% and 2.5%, respectively).

## GROSS DOMESTIC PRODUCT

In 1997, GDP<sup>1</sup> amounted to 3 211.2 million lats, increasing by 6.5% year-on-year at constant prices. In 1997, gross value added (at basic current prices) amounted to 2 796.0 million lats (for its structure, see Table 1). Both the service sector and goods-producing sector contributed to the increase. Gross value added (at basic average prices of 1995) in these sectors rose by 7.4% and 5.4%, respectively. In the service sector, substantial growth was experienced by trade as well as transport and communication (12.9% and 7.4%,

Table 1  
STRUCTURE OF GROSS VALUE ADDED AT BASIC CURRENT PRICES  
(in millions of lats)

	1995		1996*		1997	
		%		%		%
Total	2 033.8	100.0	2 468.8	100.0	2 796.0	100.0
Services	1 139.7	56.0	1 479.1	59.9	1 731.2	61.9
Manufacturing	456.4	22.4	516.2	20.9	591.5	21.2
Agriculture, hunting and forestry	210.8	10.4	213.9	8.7	201.4	7.2
Electricity, gas and water supply	112.0	5.5	130.9	5.3	122.2	4.4
Construction	102.9	5.1	116.5	4.7	140.9	5.0
Mining and quarrying	3.2	0.2	4.0	0.2	2.8	0.1
Fishing	8.9	0.4	8.2	0.3	5.9	0.2

\* Data have been revised.

Source: Central Statistical Bureau of Latvia.

<sup>1</sup> Gross value added plus turnover tax, customs duties and excise tax (except subsidies).

respectively). Value added in the goods-producing sector rose due to growth in the sector's main areas: manufacturing (7.0%), agriculture, hunting and forestry (4.9%) and construction (8.2%).

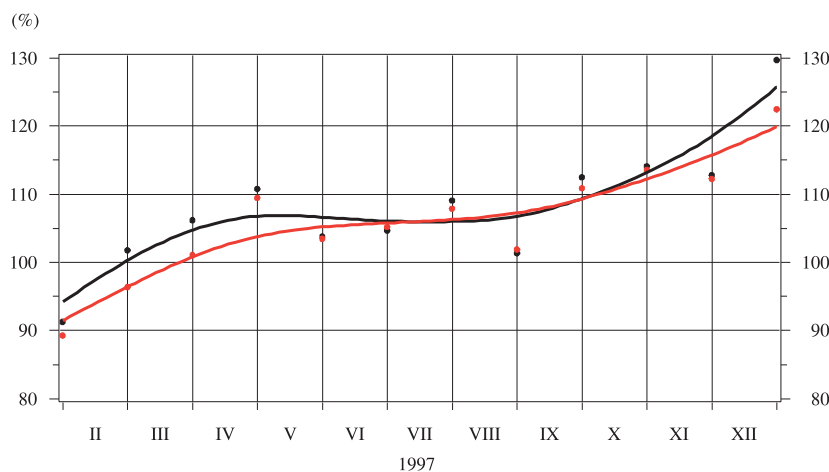
1997 was remarkable for the largest growth experienced by real industrial output since the restoration of independence of the Republic of Latvia (a 6.1% growth, including 8.1% in manufacturing; for the dynamics of the volume index of industrial output, see Chart 2). Twelve sectors of manufacturing experienced a year-on-year growth. In seven of these, industrial output grew throughout the year due to a stable increase in demand both in the foreign and domestic markets. The increase in the manufacture of the following product groups was particularly rapid: food products and beverages (10.7%), wearing apparel, dressing and dyeing of fur (18.2%) wood and products of wood and cork (11.1%), pulp, paper and paper products (79.1%) and fabricated metal products (16.9%).

Value added grew in agriculture, hunting and forestry due to an increase in the output of some products (50.3%, sugar beets; 7.7%, cereals and pulses; 7.0%, milk). Meat and egg production showed a year-on-year decline (6.4% and 1.3%, respectively).

The transport sector's contribution to the upturn of the economy was significant. Cargoes loaded and unloaded at Latvia's ports grew by 12.6%, as the indicator showed an increase at the Riga, Ventspils and Liepaja ports and small ports (50.4%, 2.9%, 42.7% and 78.8%, respectively). Railway was another area of the transport sector showing positive developments. With transit as well as export and import transportation increasing (by 12.9%, 84.5% and 26.3%, respectively), transportation by rail grew by 16.3%. Transportation by pipeline was particularly active. In the reporting year, the transportation of oil and oil products by pipeline increased by 8.7% and 9.3%, respectively.

Chart 2

**VOLUME INDEX OF INDUSTRIAL OUTPUT (YEAR-ON-YEAR BASIS)**



Volume index of industrial output  
 Volume index of industrial output in manufacturing

Source: Central Statistical Bureau of Latvia.

In 1997, the turnover of domestic trade (at constant prices) showed a year-on-year growth of 12.9% (including a 14.3% rise in retail trade turnover), indicating an increase in private consumption. Concurrently, the turnover of public catering declined by 4.0%. In the period since April 1997, retail trade turnover showed a more rapid increase than purchasing power.

At the end of 1997, the number of persons registered at the State Employment Service totalled 84 934 or 7.0% of the economically active population (7.2% at the end of 1996). Changes in legislation governing the right to unemployment benefits and an upturn in the economic activity, resulted in a 6.5% decrease in the number of unemployed during the year.

The number of persons registered as long-term unemployed continued to follow an upward trend (a year-on-year increase of 6.6%), and their share in the total number of unemployed reached 62.0%.

At the end of 1997, unemployment was lowest in Riga and Ventspils (3.0% and 3.2%, respectively). The highest unemployment rate, exceeding significantly the overall unemployment level in the country, was in Rezekne and Kraslava districts (27.9% and 21.6%, respectively).

## FOREIGN TRADE

The turnover of Latvian foreign trade amounted to 2 554.1 million lats in 1997, increasing by 23.2% year-on-year. Both exports and imports rose over the previous year's level (by 22.2% and 23.8%, respectively). The largest increase was registered in the trade turnover of base metals and articles of base metals (52.0%), wood and articles of wood (49.0%) and transport vehicles (40.4%). A decrease in trade turnover was observed for mineral products (22.2%).

The negative foreign trade balance increased, reaching 610.7 million lats (see Table 2) or 19.0% of GDP (17.1% in 1996). The main contributors to the negative balance were the following product groups: machinery, mechanical appliances and electrical equipment, mineral products, transport vehicles, and products of the chemical and allied industries.

In 1997, Latvia had trade transactions with 143 countries. Its major trading partners were the EU countries, whose share in foreign trade turnover increased from 47.5% in 1996 to 51.5% in 1997. The share of the CIS countries decreased from 29.5% in 1996 to 23.5% in 1997. The largest trade turnover Latvia had was with Russia, Germany, Sweden, the United Kingdom, Lithuania and Finland. In the second and third quarters of 1997, imports from Germany exceeded imports from Russia for the first time. This was mainly a result of

Table 2

### FOREIGN TRADE TURNOVER

(exports – in FOB prices; imports – in CIF prices; in millions of lats)

	1995	1996	1997
Eksports	688.4	795.2	971.7
Imports	959.6	1 278.2	1 582.4
Balance	-271.2	-483.0	-610.7

Source: Central Statistical Bureau of Latvia.

expanding imports of mechanical appliances and transport vehicles. The volume of transactions with Germany and the United Kingdom was on the rise, whereas that of transactions with Russia, Ukraine and Belarus declined. Exports of wood and articles of wood to the United Kingdom grew. In transactions with Russia, a decrease was observed for exports of meat and fish products, electric appliances and equipment as well as for imports of mineral products.

In the reporting year, the most significant of Latvia's export goods were wood and articles of wood (29.7% of total exports), textiles and textile articles (15.6%), prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco; 10.1%), as well as machinery, mechanical appliances and electrical equipment (9.0%). During the year, the share of wood and articles of wood, and base metals and articles of base metals in total exports increased, while that of transport vehicles (due to output decline), prepared foodstuffs (due to decreasing export prices), and textiles and textile articles contracted. Within the group of wood and articles of wood, exports of sawn wood experienced the most rapid growth (58.4%). Within the group of base metals and articles of base metals, exports of iron and non-alloy steel increased by 49.6%.

In 1997, the principal imports were machinery, mechanical appliances and electrical equipment (19.3% of total imports), mineral products (14.1%), products of the chemical industry and allied industries (10.9%), as well as transport vehicles (8.4%). The product groups whose share in total imports increased were machinery, mechanical appliances and electrical equipment (especially mechanical appliances and parts thereof, and ing equipment), transport vehicles (cars and trucks), base metals and articles of base metals. A substantial decrease was recorded for the share of mineral products. Moreover, since the entire stock of such products imported in 1996 had not been utilized and electric energy production in Latvia increased in 1997, imports of all mineral products, except natural gas declined.

The US dollar and the German mark were the currencies used most frequently in foreign trade transactions. The share of transactions in US dollars decreased from 53.4% in 1996 to 50.7% in 1997, while that of transactions in German marks increased from 20.4% to 22.0%.

In the reporting year, the deficit in the balance-of-payments current account totalled 257.1 million lats. The negative balance of foreign trade increased, and the positive balance of current transfers decreased slightly. Services extended and received experienced a decline, and the surplus earned from services covered 40.2% of the negative trade balance. Direct foreign investment covered a large part of the current account deficit. The reserve assets of the Bank of Latvia increased, and this is indicative of a surplus in the balance of payments in 1997.

## **FISCAL POLICY**

The Government was committed to a tight fiscal policy. In the reporting year, the general government budget showed a considerable surplus, which was mainly composed of a surplus in the Central Government basic and special budgets. The deficit in the local government basic budget was small, and was financed by borrowing from the Central Government. The fiscal surplus equalled 1.1% of GDP. (The 1996 fiscal deficit was equal to 1.8% of GDP.)

In 1996, the Government had begun to curb current expenditure growth and to increase revenue by amending tax-related legislation and improving tax administration. These measures, continued in 1997, led to a substantial surplus in the Central Government basic budget (38.4 million lats) and the social security budget (21.0 million lats), which is the principal constituent part of the Central Government special budget.

Total tax revenue increased approximately at the same rate as in 1996 (by 22.2%, including a 16.6% increase in the tax revenue of the Central Government basic budget). As a result of redistributing revenue from private person income tax, the Central Government tax revenue increased, reaching 84.0% of total tax revenue (79.3% in 1996).

The share of tax revenue in GDP continued to increase. The largest growth was experienced by direct taxes (social, private person income and enterprise income taxes). This reflected the rise in the average gross wage and improvement of enterprise performance indicators. Influenced by the increase in excise tax rates and domestic consumption, revenue from excise and value added taxes was on the rise; however, the increase in these two largest indirect taxes was slower than in 1996, and accounted for only one-fourth of the increase in total tax revenue (over a half of the total increase in revenue in 1996).

Since the privatization of state property was actively continued, privatization-related revenue was high, and an amount of 21.4 million lats was transferred to the Central Government basic budget.

The current expenditure of the Central Government basic budget was 4.1% lower than projected, saving over 22 million lats. Capital expenditure, however, was not reduced.

The social security budget was in surplus because the monthly increase in its revenue (due to the rise in wages) exceeded that in the expenditure, which was composed mainly of spending for pensions.

## **MONEY SUPPLY**

The monetary indicators of the Latvian banking system and the Bank of Latvia have been included in Appendix 1 to the Annual Report. Broad money, M2X<sup>1</sup>, increased from 628.3 million lats at the end of 1996 to 871.3 million lats at the end of 1997 (by 38.7%; see Chart 3). In 1996, growth in money supply was two times slower (19.9%) than in 1997, and M2X increased mainly in the second half of the year. In 1997, money supply grew rather steadily throughout the year (by 15.4% in the first half-year and by 20.2% in the second half-year), showing a monthly average increase of 3.2%. This growth was a result of the economic upturn in the country, foreign capital inflow and the activity of domestic banks in lending.

The velocity of money turnover fell in 1997 (from 4.41 in 1996 to 4.32 in the third quarter of 1997), indicating that money holders believed in the economic stability and increased their cash balances. Due to this, no additional pressures on the rate of inflation arose.

Strengthening confidence in the banking sector, the economic upturn and an increase in purchasing power were the factors enabling credit institutions to raise more deposits from domestic enterprises and private persons. Such deposits showed a year-on-year growth of 47.8% (15.9% in 1996). As in 1996, currency outside banks increased by 26.0%. The cash component in broad money decreased from 42.0% at the end of 1996 to 38.2% at the end of

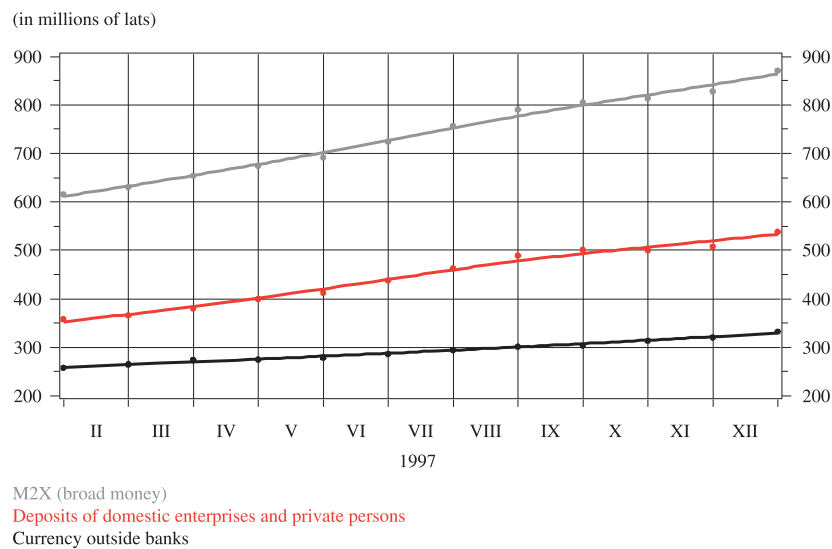
<sup>1</sup> Currency outside banks plus deposits of domestic enterprises and private persons in both national and foreign currencies.

the reporting year, reflecting an increase in the share of non-cash transactions. The share of demand and time deposits in broad money showed an increase (from 47.8% to 48.2% and from 10.2% to 13.6%, respectively; for demand and time deposits, see Chart 4). Private person deposits accounted for 64.6% of time deposits, while enterprise deposits (72.3%) dominated demand deposits.

Deposits in lats showed a more rapid increase than deposits in foreign currency (53.9%)

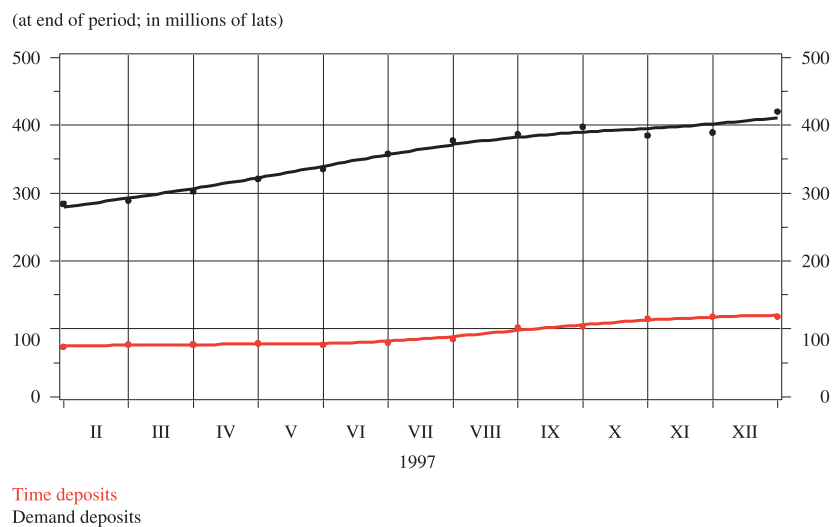
### BROAD MONEY

Chart 3



### DEPOSITS OF DOMESTIC ENTERPRISES AND PRIVATE PERSONS WITH BANKS

Chart 4



and 42.7%, respectively), indicating a decline in dollarization. The share of lats deposits in total deposits expanded slightly (to 48.2% at the end of the period).

Quasi-money<sup>1</sup>, the less liquid component of M2X, increased slightly more rapidly than its most liquid component, M1<sup>2</sup>, (by 44.2% and 35.7%, respectively).

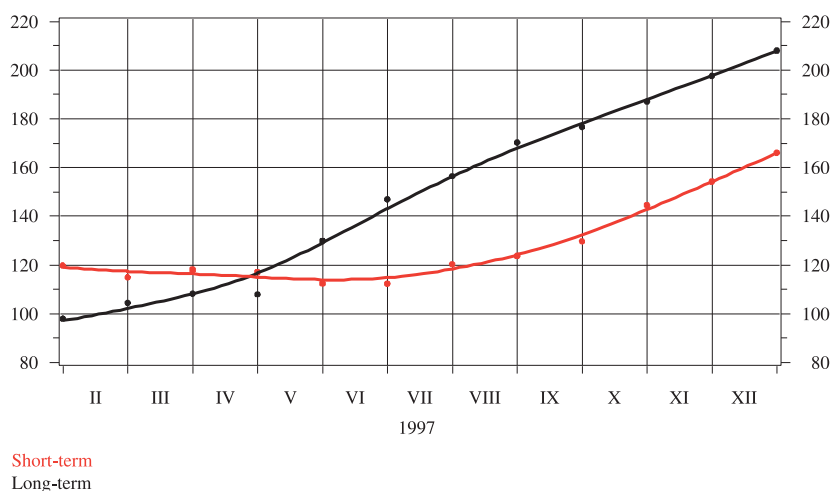
Macroeconomic stability, enterprise privatization, and the development of the domestic securities market promoted foreign capital inflow. Due to investment abroad, the net foreign assets of the banking system increased (by 150.1 million lats or 33.2% during the year).

Although the banking sector continued to invest mainly in foreign assets (an increase of 494.2 million lats or 1.9 times), lending to domestic enterprises and private persons showed about an equally rapid increase (162.8 million lats or 1.8 times). In foreign assets, investment in foreign government securities trebled to 199.6 million lats, and credit to non-resident enterprises and private persons increased more than two times (to 125.0 million lats). The claims of Latvian banks on foreign banks reached 498.7 million lats at the end of 1997, while their investment in foreign enterprises amounted to 69.1 million lats. The favourable fiscal situation led to an 87.1 million lats decrease in the banking sector's net credit to the Central Government and local governments (it amounted to 39.6 million lats at the end of 1997).

Lending to enterprises and private persons grew rapidly because credit risks decreased, interest rates fell, funds raised by banks increased and the maturity of deposits became longer. The latter factor facilitated long-term lending. The term structure of credits changed drastically in 1997. At the end of 1996, over a half of the credits, 55.5%, were short-term, but at the end of 1997, their share decreased to 44.4%. Long-term credits increased correspondingly (see Chart 5). Funds drawn from credit lines opened by foreign banks also made a contribution to the increase in long-term lending.

Chart 5

**CREDITS TO DOMESTIC ENTERPRISES AND PRIVATE PERSONS IN NATIONAL AND FOREIGN CURRENCIES**



<sup>1</sup> Time deposits in the national currency and deposits in foreign currency made by domestic enterprises and private persons.  
<sup>2</sup> Currency outside banks plus deposits of domestic enterprises and private persons in the national currency.

As funds were mainly raised in lats and domestic enterprises and private persons increasingly demanded loans in lats, the share of credits in lats increased from 39.3% at the end of 1996 to 46.5% at the end of 1997.

Lending to the national economy was on the increase. The largest growth was recorded for credits to transport, storage and communications (5 times), manufacturing (74.2%), agriculture (58.7%) and trade (43.9%). Although credits to financial intermediation rose tenfold, this sector accounted still for a small part of total credits (only 4.1%). Of credits to enterprises, 70.9% were utilized for transport, storage and communication, manufacturing and trade. Credits to agriculture dominated transit credits (43.1%).

## DEPOSIT AND LENDING RATES

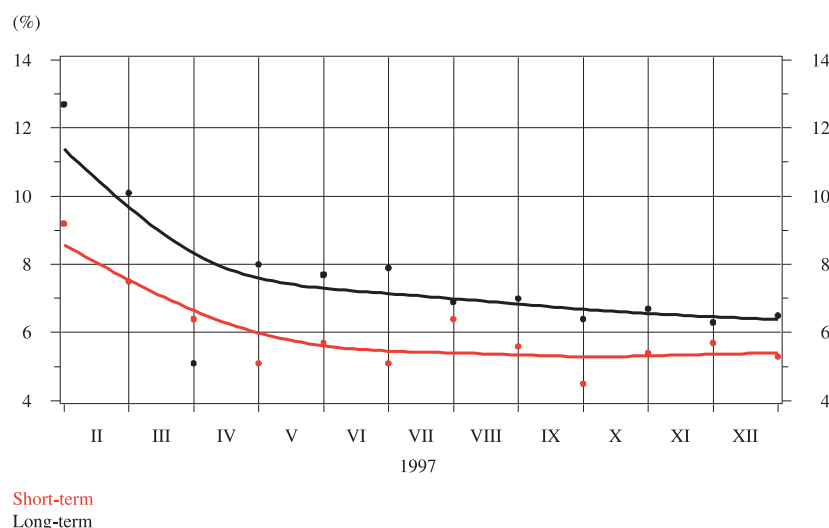
A further decrease in inflation, falling interest rates in the securities and interbank markets, macroeconomic stability and lower credit risk were the factors contributing to a fall in deposit and lending rates. The decrease in interest rates, which affected deposits of all maturities and credits in lats (in particular) and in foreign currency, was steady throughout the year, and there were fewer instances of rapid fluctuations arising from individual transactions. Lending rates showed the most rapid decrease (by 6-9 percentage points), whereas deposit rates fell by 4-5 percentage points.

At the end of the reporting year, the weighted average interest rate on long-term deposits in lats was 6.5% (see Chart 6), while that of long-term deposits in the currencies of the OECD countries was 5.1%. The weighted average interest rate for short-term deposits both in lats and foreign currency fell to a 5.3% level.

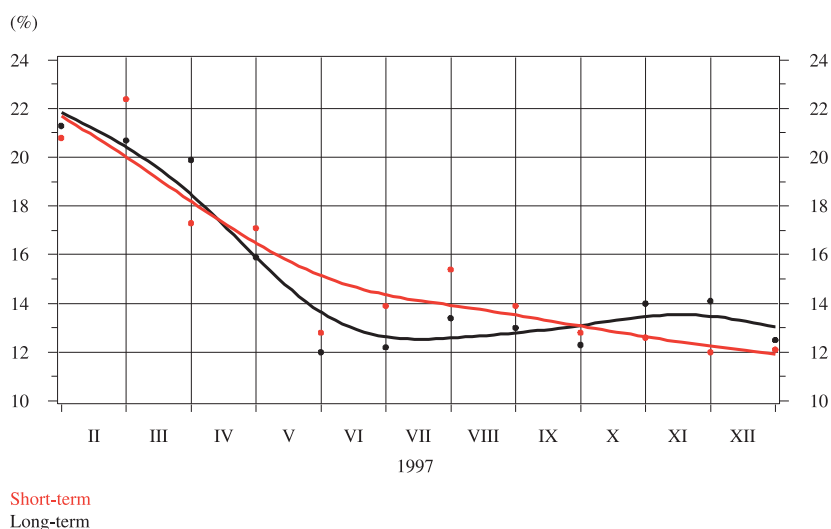
At the end of 1997, the weighted average interest rate of short-term credits in lats decreased to 12.1% (see Chart 7), and that of short-term credits in the currencies of the OECD countries fell to 12.3%.

Chart 6

### WEIGHTED AVERAGE INTEREST RATES ON LATS DEPOSITS OF DOMESTIC ENTERPRISES





**WEIGHTED AVERAGE INTEREST RATES ON CREDITS GRANTED IN LATS**

The fall in the weighted average interest rate of long-term credits was lower. It decreased to 12.5% on credits in lats and to 10.5% on credits granted in the currencies of the OECD countries.

In 1997, interest rates on deposits and credits both in the currencies of OECD countries and lats were approximately at the same level. This proved that financial market participants considered the lats as safe as major world currencies.

With inflation falling more rapidly than deposit rates, the negative margin of real interest rates on time deposits decreased from 3.0% in December 1996 to 1.6% in December 1997.

During the year, interest-rate margin decreased from 9–10 percentage points to 5–6 percentage points, which is probably indicative of tougher competition and faster information flow in the financial sector.

**THE INTERBANK MARKET**

The domestic interbank market grew significantly in the reporting year. Both the turnover on the market and the number of market participants (17–25 banks) increased. Banks could borrow in the interbank market at a relatively low interest rate. In 1996, domestic interbank credits totalled 617.5 million lats, whereas in 1997, they reached 2.6 billion lats. The bulk of credits were overnight (83.8%) and with a maturity up to one month (15.1%). On the whole, the demand for interbank credits in lats was higher (78.6% of total domestic interbank credits); however, due to disturbances in the stock market, the demand for credits in foreign currency increased during the last months of the year. (In November, these credits amounted to 35.3% of total domestic interbank credits.)

Bank excess reserves were high throughout the year, and the average level of interbank market rates followed a falling trend. The most significant fall was experienced by the weighted average interest rate of overnight credits in lats (from 4.3% in January to 2.2% in September).

Turbulence in the global securities market in October–November influenced the Latvian interbank market. The number of banks supplying funds to the market decreased significantly, leading to a rapid rise in interest rates. (In November, interest rates on overnight credits in lats rose to as much as 5.0% and on overnight credits in the currencies of the OECD countries to 6.5%.)

Lending to foreign banks was still an important activity of the banking sector (the most common types of credit were overnight and with a maturity up to one month). Credits to foreign banks increased 1.5 times over the 1996 level, amounting to 12.4 billion lats.

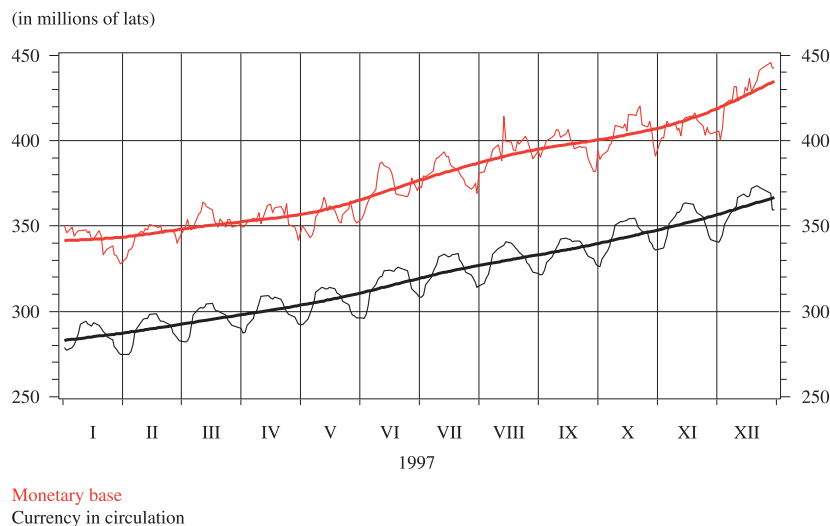
## MONETARY BASE

At the end of 1997, the monetary base, M0<sup>1</sup>, totalled 441.7 million lats (see Chart 8). It increased by 29.6% during the year, showing a slightly more rapid increase than in 1996. In previous years, the increase in the monetary base occurred largely because of growth in the Bank of Latvia's foreign assets. In 1997, a significant contributor to the growth was the increase in the Bank's net domestic assets (credits to banks and to the Government). Since the increase in currency issue (27.2%) was lower than the increase in bank deposits held with the Bank of Latvia (41.9%), the share of currency in circulation in the monetary base decreased to 81.4% at the end of 1997 (83.9% at the end of 1996).

The Bank of Latvia's net foreign assets grew by 78.7 million lats or 22.0%, reaching 437.2 million lats at the end of the year (see Chart 9). The Bank's net foreign assets covered 3.3 months' imports (3.4 months' imports at the end of 1996), and the ing of the national currency by the Bank of Latvia's net foreign assets was 99.0% (105.2% at the end of 1996).

Chart 8

## MONETARY BASE



<sup>1</sup> Currency in circulation plus deposits of banks and other financial institutions held with the Bank of Latvia.

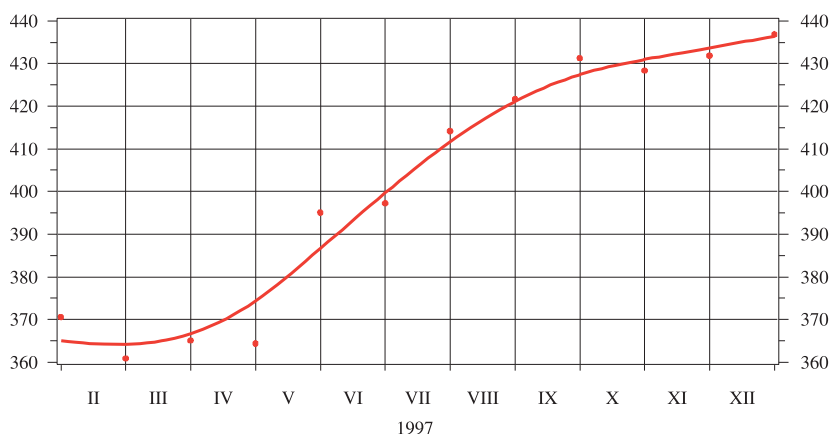
The Bank's net foreign currency purchases were high in May and July (21.1 million lats and 13.1 million lats, respectively), when funds in foreign currency intended for utilization in privatization process were exchanged for lats. Changes in the net foreign assets were also effected by the Bank's currency swap deals, the Government's foreign borrowings and fluctuations in the exchange rate of the US dollar.

In the reporting year, the net domestic assets of the Bank of Latvia grew by 22.4 million lats because the Bank's net credit to the Government increased substantially (from 13.3 million lats to 75.5 million lats). This was a result of the following factors: the Bank of Latvia increased its government securities portfolio (by 26.9 million lats) in order to offset the

Chart 9

**NET FOREIGN ASSETS OF THE BANK OF LATVIA**

(in millions of lats)



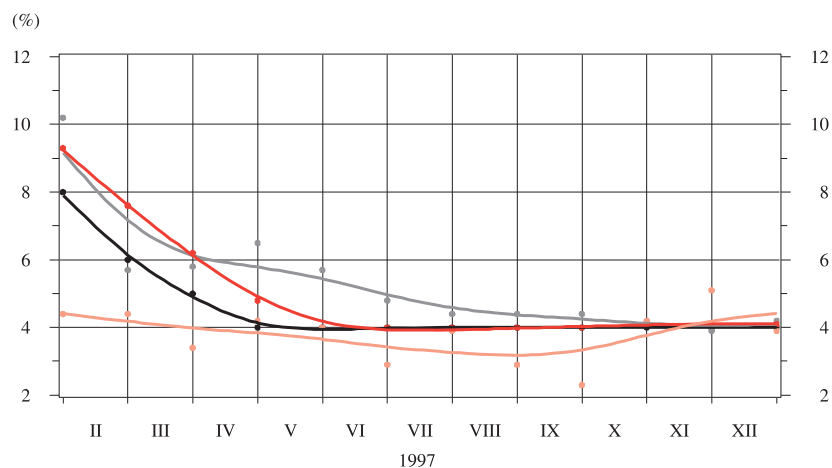
**THE BANK OF LATVIA'S CREDITS TO BANKS**

Table 3

(average balances; in millions of lats)

	1996	1997	1998
January	1.3	3.4	2.7
February	1.8	5.7	0.7
March	2.2	6.3	1.8
April	2.3	5.0	1.8
May	2.7	0.5	7.3
June	3.9	0.6	6.8
July	4.2	2.4	9.0
August	4.2	2.1	4.2
September	3.8	2.0	0.3
October	6.2	2.6	3.2
November	8.1	4.6	6.9
December	7.4	3.2	8.3

## INTEREST RATES IN THE MONEY MARKET



The Bank of Latvia's refinancing rate  
 Weighted average interest rate in Treasury bill repo auctions  
 Weighted average yield on 6-month Treasury bills sold in auctions  
 Weighted average interest rate on credits in lats granted in the interbank market

influence that the rise in government deposit in lats could have had on money supply; the Government assumed the foreign credit obligations in the amount of 19.7 million lats of those banks whose licences had been revoked; and the Government disbursed foreign loans to domestic borrowers.

Since in the fourth quarter bank liquidity was relatively low and interbank market rates were considerably higher than the Bank of Latvia's refinancing rate, the demand for the Bank's credits rose substantially, and the Bank of Latvia's credit to banks totalled 58.8 million lats or 52.2% of the Bank's total credits in 1997. In the first nine months of the year, the demand for the Bank of Latvia's credits was moderate, as banks utilized interbank credits, which were cheaper. In 1997, the Bank of Latvia's credit to banks totalled 112.6 million lats, exceeding by 3.5% the 1996 level. Repo credits accounted for 83.9% of the total, automatic Lombard credits for 14.8% and demand Lombard credits for 1.3% (for monthly average credit balances, see Table 3).

In the reporting year, repo credits with a maturity of seven days totalled 55.7 million lats, those with a maturity of 28 days totalled 33.1 million lats, and those with a maturity of 91 days totalled 5.7 million lats.

The repo rate fell (from 9.3% in January to 4.0% in May; see Chart 10) in line with the Bank of Latvia's refinancing rate.

## THE FOREIGN EXCHANGE MARKET

The Bank's foreign currency reserves increased from 772.6 million US dollars at the end of 1996 to 820.7 million US dollars at the end of 1997. In 1997, the net amount of foreign currency purchased by the Bank of Latvia from banks totalled 97.6 million US dollars; of these, 19.4 million US dollars was acquired in currency swaps. The Bank purchased the largest amounts of foreign currency in May and July (37.4 million US dollars and 24.0 million US dollars, respectively). Part of the increase in the foreign reserves was due to net interest income from investing foreign reserves in foreign financial markets in accordance with the guidelines approved by the Bank's Board of Governors. The Bank's foreign reserves were decreased as a result of repaying a part of the IMF credit received under the Stand-by Arrangement and by fluctuations in the US dollar exchange rate.

The Bank of Latvia did not change its foreign exchange rate policy in 1997, and stability of the lats against the basket of XDR currencies was maintained. The exchange rate of the lats against the XDR has not changed since February 1994 (XDR 1 = LVL 0.7997). Foreign currencies fluctuated against the lats in line with developments in the global foreign exchange market.

In 1997, the global foreign exchange market was somewhat volatile. The main events affecting major world currencies were the creation of the European Monetary Union scheduled for 1999, a crisis in the Japanese economy, certain developments in the US economy, and the East Asian financial crisis.

In the reporting year, the US dollar appreciated against the German mark by 15.9% (from 1.5360 to 1.7800), peaking at 1.8910 in early August. This process was a consequence of the approaching EMU and improvements in the US economy. The US dollar also appreciated against the French franc (by 14.9%; from 5.1700 to 5.9400) and the Japanese yen. The latter increase was less pronounced: by 11.8%, from 115.4 to 129.0. Throughout the year, the US dollar was stronger than the Japanese yen because of interest-rate differentials between these countries (interest rates of US government securities ranged between 5% and 6%, those of Japanese government securities between 0.5% and 2%).

The May 1997 elections and the United Kingdom's decision to abstain from joining the European Monetary Union at its outset in 1999 were the main reasons for the fluctuations in the exchange rate of the British pound.

The US dollar appreciated against major currencies of the XDR basket—the German mark, the French franc and the Japanese yen; and hence, also against the lats. The lats, however, was influenced not only by the US dollar fluctuations but also by the demand in the domestic foreign exchange market. In 1997, the exchange rate of the lats in the domestic foreign exchange market was close to the US dollar buying rate set by the Bank of Latvia, reflecting the demand for lats. The Bank of Latvia issued lats, thus increasing the foreign reserves. Since the Ministry of Finance had to repay a loan arranged by the financial corporation *Nomura International plc*, the supply of lats outweighed the demand in August 1997; nevertheless, the domestic foreign exchange market successfully absorbed the supplied lats.

## GOVERNMENT FOREIGN DEBT

Since 1997, the government foreign debt has been managed by the State Treasury, which is subordinated to the Minister of Finance. The Bank of Latvia acts as the Government's fiscal agent in servicing foreign debt.

The government foreign debt totalled 218.4 million lats or 6.8% of GDP at the end of 1997. The Government issued guarantees in the amount of 31.4 million lats to enterprises for the receipt of foreign credits. During 1997, total foreign debt was reduced by 9.0 million lats, while the Government's guarantees increased by 17.9 million lats. By the end of 1997, the Latvian Government had signed loan agreements and issued guarantees in the total amount of 399.1 million lats.

In accordance with the Stand-by Arrangement, the Bank of Latvia repaid 26.7 million XDR (21.3 million lats) to the IMF. The Latvian Government redeemed government securities in the amount of 20.5 million lats (4 billion Japanese yen) that had been arranged by the financial corporation *Nomura International plc*; it also repaid, before the maturity date, the credit received from *Finnish Export Credit* (4.2 million US dollars or 2.5 million lats) for stabilization of the balance-of-payments, and the remainder (12.9 million lats) of the 30 million XEU<sup>1</sup> credit issued by the European Bank for Reconstruction and Development for the energy sector.

In 1997, 72.7 million lats was spent to service the government foreign debt (32.1 million lats in 1996). This amount is equal to 7.5% of the annual volume of exports.

## THE SECURITIES MARKET

The primary market for Latvian government securities, in which the Bank of Latvia acted as the Government's agent in organizing auctions of and accounting for government securities, expanded in 1997. In April, the Government started issuing 2-year Treasury bonds. In the reporting year, 52 auctions of 1-month Treasury bills, 52 auctions of 3-month bills, 34 auctions of 6 month-bills, 8 auctions of 12-month bills and 2 auctions of 2-year bonds were held. With the fiscal situation improving, the number of auctions decreased by 45 as compared with the previous year and the supply of securities declined 1.5 times. Nevertheless, banks' demand decreased less (by 14.3%), and the demand/supply ratio rose to 2.3 (1.8 in 1996). Treasury bills of shorter maturity (1-, 3- and 6-month) gradually lost their dominance in the market, whereas 12-month bills and 2-year bonds assumed greater importance in the market (see Chart 11). The Ministry of Finance issued securities of longer maturity fairly rarely, but in larger amounts, making them more attractive for investors. The decrease in the stock of short-term government securities improved the structure of the government domestic debt, promoted fiscal stability, and reduced servicing costs of the government domestic debt.

The stock of government securities outstanding grew by 17.3% in 1997, totalling 155.6 million lats by the end of the year. At the end of the reporting year, the term structure of outstanding securities was as follows: 12-month bills 55.3%, 2-year bonds 21.9%, 6-month bills 15.9%, 3-month bills 5.7% and 1-month bills 1.2%.

<sup>1</sup> The code for the European Currency Unit in accordance with the International Standard ISO 4217 (Codes for the Representation of Currencies and Funds).

At the beginning of 1997, the weighted average discount rates on securities underwent a rapid fall that was associated with the favourable credit rating assigned to Latvia. Foreign investors' participation in auctions enhanced competition, leading to a decrease in discount rates. In January, discount rates still ranged between 9.6% (on 1-month bills) and 10.4% (on 6-month bills), whereas in February–March, they fell to a 3.7%–5.3% level. In the following

Chart 11

**STOCK OF LATVIAN GOVERNMENT SECURITIES OUTSTANDING**

(in millions of lats)

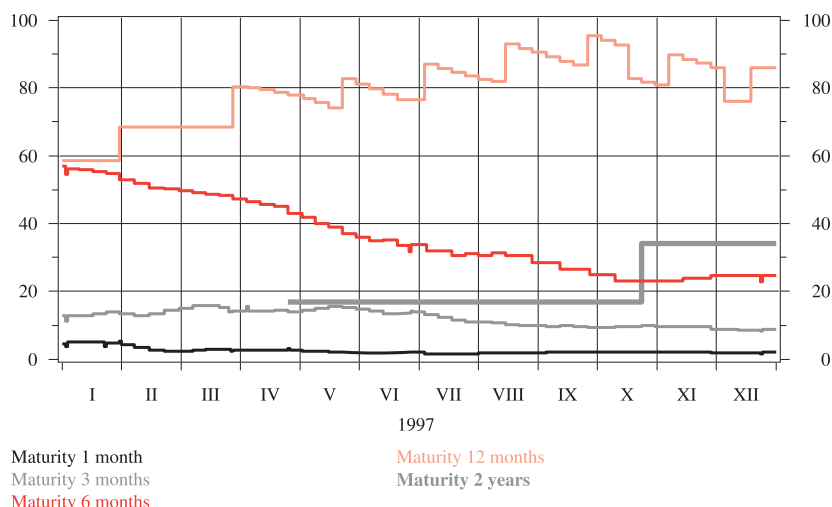
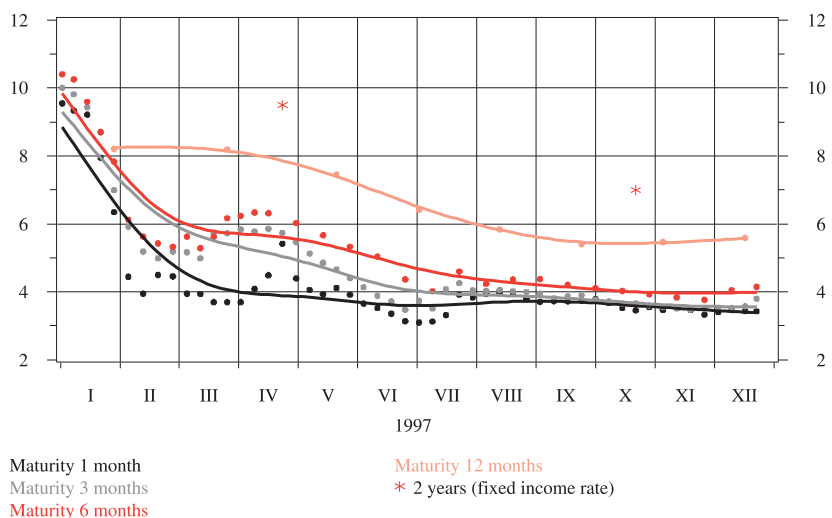


Chart 12

**WEIGHTED AVERAGE DISCOUNT RATES OF LATVIAN GOVERNMENT SECURITIES**

(%)



months, foreign investors' activity ebbed; however, discount rates were stable throughout the rest of the year, showing a slight decrease (see Chart 12). The dynamics of the discount rate of 12-month bills and the fixed income rate of 2-year bonds was similar: they decreased from 8.2% to 5.6% and from 9.5% to 7.0%, respectively.

The increase in the turnover on the secondary securities market (especially in the fourth quarter) was a result of transactions entered into by the Ministry of Finance and the Bank of Latvia. To pursue monetary policy objectives more efficiently and to ensure the transparency of the securities market, the Bank of Latvia abandoned trading at a fixed price and started organizing secondary market auctions. The Bank of Latvia mainly bought government securities.

In 1997, the stock market was promoted by further privatization of state property. Capitalization on the Riga Stock Exchange (RSE) increased from 82 million lats to 199 million lats (6.2% of GDP) during the year, with a number of new companies being listed on the Stock Exchange.

The RSE started organizing trading sessions every day, and as of November, introduced continuous trading. In June, the RSE, in collaboration with the agency *Dow Jones Telerate*, introduced the DJRSE index. The index stood at 247.7 at the end of 1996, and rose to 345.9 by the end of 1997. Share prices rose rapidly at the beginning of the year, reflecting a fall in the overall interest rate level in the country. However, by mid-1997, share prices embarked a falling trend, which accelerated in October as a result of turbulence in the global securities market caused by problems experienced by the East Asian financial sectors. The Latvian stock market appeared to be particularly sensitive to the activity of Estonian and Russian investors.

The number of RSE members increased, as several Latvian banks and also Estonian and Lithuanian brokerage companies joined the RSE.

At the end of 1997, the Saeima of the Republic of Latvia adopted the Law "On Investment Companies" (effective as of July 1, 1998).



## MONETARY POLICY HIGHLIGHTS–1997

- January 10      The Bank of Latvia reduced the refinancing rate from 9.5% to 9% per year.
- January 31      The Bank of Latvia reduced the refinancing rate from 9% to 8% per year.
- February 14     The Bank of Latvia reduced the refinancing rate from 8% to 7% per year.
- February 28     The Bank of Latvia reduced the refinancing rate from 7% to 6% per year.
- March 13        The Board of Governors of the Bank of Latvia passed a Resolution "On Amendments to Resolution No. 33/2 passed by the Board of Governors of the Bank of Latvia on May 16, 1996 'On Establishing Standards to Credit Institution Performance' ".  
The Board of Governors of the Bank of Latvia passed a Resolution "On Amendments to 'Regulation on Calculating Credit Institution Performance Indicators' ".  
The Board of Governors of the Bank of Latvia passed a Resolution "On Amendments to 'Provisions for Evaluating Credits and Off-Balance-Sheet Items' ".  
The Board of Governors of the Bank of Latvia passed a Resolution "On Amendments to 'Provisions for Accounting Income and Expenses of Credit Institutions' ".  
The Board of Governors of the Bank of Latvia passed a Resolution "On Amendments to 'Procedure for Calculating a Credit Institution's Reserve Requirements' ".  
The Board of Governors of the Bank of Latvia passed a Resolution "On Auditing Annual Financial Statements of Credit Institutions".
- March 27        The Executive Board of the Bank of Latvia passed a Resolution "On Maturity of Repo Agreements".  
The Executive Board of the Bank of Latvia approved "Provisions for Secondary Market Auctions of the Republic of Latvia Treasury Bills Held at the Bank of Latvia".
- March 28        The Bank of Latvia reduced the refinancing rate from 6% to 5% per year.
- April 22         The Governor of the Bank of Latvia approved "Provisions for Initial Placement of Latvian Government Securities".
- April 24         The Executive Board of the Bank of Latvia approved "Provisions for Currency Swap Auctions".  
The Executive Board of the Bank of Latvia passed a Resolution "On Statistical Reports on Interest Rates".  
The Executive Board of the Bank of Latvia passed a Resolution "On 'Report on Buying and Selling of Foreign Currency' ".

April 25	The Bank of Latvia reduced the refinancing rate from 5% to 4% per year.
April 30	The Executive Board of the Bank of Latvia passed a Resolution "On 'Report on Transactions with Republic of Latvia 2-Year Treasury Bonds in the Secondary Market for Bonds' and 'Report on Republic of Latvia Treasury Bonds' ".
July 17	The Board of Governors of the Bank of Latvia passed a Resolution "On 'Guidelines for Establishing Internal Control System in Credit Institutions' ".
July 24	The Executive Board of the Bank of Latvia passed a Resolution "On Maturity of Repo Credits".
August 21	The Executive Board of the Bank of Latvia passed a Resolution "On Approving 'Provisions for Accounting of Latvian Government Securities' ".
October 2	The Executive Board of the Bank of Latvia approved "Regulation on Repo Auctions of Latvian Government Securities Held at the Bank of Latvia".
November 20	The Executive Board of the Bank of Latvia approved "Regulation on Reverse Repo Auctions of Latvian Government Securities Held at the Bank of Latvia". The Executive Board of the Bank of Latvia passed a Resolution "On Amending 'Regulation on Repo Auctions of Latvian Government Securities Held at the Bank of Latvia' ".
December 4	The Executive Board of the Bank of Latvia approved "Regulation on Secondary Market Auctions of Latvian Government Securities Held at the Bank of Latvia".

## **SUPERVISION OF CREDIT INSTITUTIONS**

### **SYSTEM OF CREDIT INSTITUTIONS**

At the end of the reporting year, there were 37 licensed credit institutions in the Republic of Latvia, of which 31 banks, 5 credit unions, the Riga Branch of *Société Générale* (France), as well as the representative office of *Dresdner Bank* (Germany).

In 1997, the Bank of Latvia issued a licence to the credit union *Skolu Krājaizdevu Sabiedrība*.

The Bank of Latvia revoked two licences for conducting banking operations (transactions): that of the Latvian commercial bank JSC<sup>1</sup> *Sakaru Banka* and that of the joint-stock commercial bank *Latvijas Privātbanka*.

The Latvian state was the sole owner of the JSC *Latvijas Hipotēku un Zemes Banka*. The privatization of the JSC *Latvijas Unibanka* and the JSC *Latvijas Krājbanka* was continued during the reporting year. In 1997, the shares held by the Government in the JSC *Latvijas Unibanka* were sold under the Global Depository Receipt program through the RSE. As a result, the government investment in this bank contracted from 33.3% at the beginning of the year to 7.6% at the end of the year. In February 1997, the joint-stock commercial bank *Rīgas Apvienotā Baltijas Banka* merged with the JSC *Latvijas Krājbanka*. This merger reduced the government interest in the JSC *Latvijas Krājbanka* to 74.5%. In May and June 1997, the JSC *Latvijas Krājbanka* shares were sold in public offering for privatization vouchers. After approving the results of privatization in September, the government interest in the bank decreased to 52.8%. In October 1997, there was a new issue of the JSC *Latvijas Krājbanka* shares, and the Government exchanged funds invested in the bank's subordinated capital for shares; therefore, its investment in the bank increased to 54.3%.

### **DEVELOPMENT OF THE BANKING SECTOR**

In 1997, the Latvian banking sector was characterized by movement toward stability: the bank capital base strengthened, the quality of assets improved, banks' profitability increased and creditors' confidence in banks grew.

At the end of 1997, the total paid-up share capital of credit institutions amounted to 154.4 million lats, increasing by 33.7%. Nineteen banks received permission to increase their share capital in 1997.

In the reporting year, the total equity of credit institutions increased from 148.7 million lats to 219.6 million lats or by 47.7%. According to unaudited annual financial statements, the total profit of credit institutions for 1997 was 46.0 million lats or 51.9% higher than in 1996. The banking sector's efficiency increased considerably: the return on assets amounted to 3.3% and the return on equity was 24.9%. The main source of profit was fees for trust operations, money transfers, foreign exchange and other banking transactions (23.7% of credit institutions' total income), interest income on debt securities (19.6%) and loans (19.5%).

<sup>1</sup> Joint-stock company.

At the end of the reporting year, deposits of enterprises and private persons as well as the Government held with credit institutions amounted to 1 080.4 million lats, exceeding by 57.5% the figure at the end of 1996. The increase was mainly achieved by attracting funds from private enterprises (a 245.7 million lats increase) and from private persons (a 79.5 million lats increase). The term structure of deposits did not change substantially in the reporting year. At the end of 1997, demand deposits accounted for 82.5% of total deposits at Latvian credit institutions. To compensate for the lack of long-term funds, several banks borrowed from foreign banks.

In 1997, the assets of credit institutions increased 1.5 times, amounting to 1 690.7 million lats. Claims on credit institutions in the OECD countries, and securities of the Latvian Government and governments of other countries accounted for a rather large share of the assets (17.7% and 17.7%, respectively). Due to this, bank liquidity was high and credit risk on assets was low.

Loans granted to enterprises and private persons as well as the Government increased 1.7 times during the reporting year, totalling 501.6 million lats at the end of the year. Hence, the share of these loans in credit institutions' assets increased (from 25.3% to 29.7%). The increase in lending was promoted by improvement in the economic situation and a fall in the discount rates of Latvian government securities. The main types of loans were commercial credit (40.7% of the credit portfolio) and industrial credit which reached 28.0%. Financial leasing and mortgage lending began to develop as well.

The term structure of credit institutions' loans changed substantially. At the end of 1996, loans with a maturity over one year accounted for 34.0% of credit institutions' credit portfolio, whereas at the end of 1997, such loans constituted 43.4% of the total. In 1997, the balance of loans with a maturity over one year increased 2.4 times, and that of short-term loans (including loans on demand) grew 1.5 times. These changes showed that banks gradually decreased short-term lending primarily to the trading sector, and began making funds available to the goods-producing and service sectors.

In 1997, the quality of credit institutions' loans improved since banks were much more careful in assessing potential borrowers. Of total loans, 86.6% were assessed as standard and 9.8% were classified as non-performing loans. The latter mainly were comprised of loans issued in previous years and had not yet been written-off. At the end of 1996, the above indicators had been 72.0% and 20.4%, respectively. Specific provisions for losses decreased from 15.5% to 7.4% of the credit portfolio. Non-performing loans were almost completely provided for, and the experience of developed countries shows that only a small part of such loans may cause problems to a credit institution.

## **EXAMINATIONS OF THE ACTIVITIES OF CREDIT INSTITUTIONS**

In 1997, the Bank of Latvia's staff performed 148 on-site inspections, of which 140 were in banks. As in previous years, attention was mainly directed at evaluation of loans and other risk assets. The principal criteria in assessing credits were the borrower's financial standing, business potential and timeliness in meeting debt obligations. In view of banks' activity in the Latvian and foreign securities markets, greater attention was paid to the assessment of banks' securities portfolio risks.

Trust operations, foreign exchange, dealing in future contracts, securities and other

financial instruments continued to develop during the reporting year. As new banking services developed and bank assets grew, the focus of attention moved on the assessment of banks' risk management policy and procedures as well as their efficiency.

The number of banks that were prohibited from accepting private person deposits decreased from 19 to 12 during 1997. Intensified supervision was applied to these banks; in addition to examinations by the Bank of Latvia's staff, the auditing companies *Arthur Andersen*, *Coopers & Lybrand*, *Deloitte & Touche*, KPMG and *Price Waterhouse* performed interim reviews on behalf of the Bank of Latvia, assessing the compliance of banks' financial statements for the first half of 1997 with the International Standards on Auditing.

#### **REGULATIONS GOVERNING THE ACTIVITIES OF CREDIT INSTITUTIONS**

The Bank of Latvia focused special attention on the efficiency of internal control systems at credit institutions. This was done with the aim of reinforcing the present achievements of the banking sector and providing for stable development in the future. As of July 1997, the Bank of Latvia required that each credit institution set up an effective internal control system. This requirement will have to be met by April 1, 1998. The Bank of Latvia Board of Governors approved "Guidelines on Establishing an Internal Control System in Credit Institutions". These guidelines were based on the experience of banks and supervisory authorities in developed countries.

## **INTERNATIONAL COOPERATION**

### **INTERNATIONAL FINANCIAL INSTITUTIONS**

In 1997 Latvia, as a member country, continued its activity within the International Monetary Fund (IMF), the International Bank for Reconstruction and Development, the International Development Association and the International Finance Corporation, as well as the European Bank for Reconstruction and Development. The Bank also continued to participate in the Bank for International Settlements.

After the memorandum on the economic policy of the Latvian Government was developed, on October 10, 1997 an agreement on a Stand-by Arrangement (33 million XDR) was signed between Latvia and the IMF for the period until April 9, 1999. This is to provide support for the Government's economic policy for the period 1997–1999. The credit facility, however, was not utilized in the reporting year.

Latvia's quota in the IMF totals 91.5 million XDR, which comprises 0.06% of the financial resources of the IMF.

### **COOPERATION WITH FOREIGN CENTRAL BANKS**

During the reporting year, the Bank of Latvia continued cooperation and exchange of expertise and information with central banks in other countries.

Employees of the Bank of Latvia visited Ceska Narodni Banka, the National Bank of Hungary, Deutsche Bundesbank and Narodna Banka Slovenska with the aim of exchanging experience in different areas of central banking. Representatives from the National Bank of Ukraine visited the Bank of Latvia.

In May 1997, the Bank of Latvia organized a seminar for the central banks of the Baltic countries on the topic "Secure Cash Today and Tomorrow".

In June 1997, a number of the Bank of Latvia's employees participated in the 4th seminar of central banks of the Baltic countries held in Estonia. Issues concerning strategy and organizational structure, monetary policy and supervision of credit institutions were on the agenda.

### **TECHNICAL ASSISTANCE**

During the reporting year, the Bank of Latvia continued to receive technical assistance from international financial organizations and foreign central banks.

This year technical assistance received by the Bank of Latvia was directed towards implementation of various specific projects. In mid-1997, three resident advisors financed by the EU Phare program, the IMF and the US Agency for International Development, finished their work at the Bank of Latvia.

In the reporting year, with financial support from the EU Phare program, the project of on-call audit assistance was continued and the initial stage of the interbank payment system development project was accomplished.

Regular technical assistance was provided by Deutsche Bundesbank. Within the framework of technical assistance programs, the Bank of Latvia's employees participated in

several courses organized at the IMF Institute and the Joint Vienna Institute, as well as in seminars organized by the Bank of England, Banca d'Italia, Banque de France, Banque Nationale Suisse, Deutsche Bundesbank, the Federal Reserve System and Oesterreichische Nationalbank.

Four Bank employees received scholarships from the Nordic Council of Ministers which granted them the opportunity of working at the central banks and public institutions of Denmark, Finland, Norway and Sweden.

The Bank of Latvia was represented at the regular meetings held by the Bank for International Settlements, which were devoted to issues relating to planning and coordination of technical assistance.

### **PARTICIPATION IN INTERNATIONAL AGREEMENTS**

To meet the obligations envisaged by the Association Agreement between the Republic of Latvia and the European Union, the Bank of Latvia reviewed and amended regulations governing the activities of Latvian credit institutions so as to harmonize them with the requirements of EU directives. The Bank of Latvia was represented on working groups drafting the Laws "On the Prevention of Laundering of Proceeds Derived from Criminal Activity" (adopted in December 1997) and "On Private Person Deposit Guarantee Scheme".

The Bank of Latvia participated in preparing the National Program for the Adoption of the Acquis, Accession Partnership documentation, as well as the Medium-Term Economic Policies Associated with the pre-Accession Strategy of Latvia. The Bank delegated a number of its employees to joint EU-Latvia working groups on economic and financial issues and financial services.

### **COOPERATION IN THE AREA OF INTERNATIONAL STATISTICS**

To furnish financial market participants with timely and comprehensive information, the IMF elaborated Special Data Dissemination Standards in 1996. In the reporting period, the Bank of Latvia, in collaboration with the Central Statistical Bureau of Latvia and the Ministry of Finance, prepared metadata characteristics and the dissemination format for data on the financial, real, external and fiscal sectors. As of December 18, 1997, the Dissemination Standards Bulletin Board of the IMF provides key information about economic and financial data. Information on the monetary indicators of the Bank of Latvia and the banking system, Latvia's foreign reserves, exchange and interest rates is disseminated in accordance with the release calendars approved by the IMF. It is readily available for all participants of the financial market at the Bank of Latvia's Internet WWW site (<http://www.bank.lv>).

## **REPORT OF THE BANK OF LATVIA'S EXECUTIVE BOARD**

### **PRINCIPAL ACTIVITIES OF THE BANK OF LATVIA**

In accordance with the Republic of Latvia Law "On the Bank of Latvia", the main tasks of the Bank of Latvia are as follows:

- determining and implementing monetary policy with the aim of maintaining price stability in the country;
- determining the foreign exchange policy;
- issuing the national currency;
- organizing and ensuring the functioning of settlement and payment systems in the country;
- supervising credit institutions with the aim of facilitating soundness, stability and development of the banking system;
- issuing licences (permits) to credit institutions for conducting banking operations (transactions), as well as licences for foreign exchange operations;
- collecting, processing and publishing of financial statistics reflecting the development of the banking system and macroeconomic environment;
- managing foreign assets;
- acting as the Government's financial agent.

### **FINANCIAL RESULTS OF THE BANK OF LATVIA**

The Bank of Latvia's profit for 1997 totalled 7 820 thousand lats (6 923 thousand lats in 1996).

The successful and effective investment of gold and foreign convertible currency reserves in safe and profitable financial instruments accounted for the largest part of the income.

The Bank of Latvia's interest income from government securities and from servicing the Government foreign borrowing decreased to 3 322 thousand lats (4 170 thousand lats in 1996). The Bank of Latvia's interest expense on government deposits totalled 2 726 thousand lats (2 971 thousand lats in 1996).

Interest income from loans to banks amounted to 204 thousand lats (575 thousand lats in 1996).

### **APPROPRIATION OF THE BANK OF LATVIA'S PROFIT**

Article 18 of the Law "On the Bank of Latvia" stipulates the maximum level of nominal capital, and Article 19 of that Law sets the maximum level of reserve capital. In 1997, the Law was amended, raising the Bank's authorized nominal capital to 25 million lats, and the maximum reserve capital was increased proportionally. Consequently, in 1997 the Bank increased its nominal capital by 1 955 thousand lats and the reserve capital by 782 thousand lats. Pursuant to Article 20 of the Law, other reserves have to be increased. Hence, 5 083 thousand lats of the 1997 profit were transferred to other reserves.



## **THE BANK OF LATVIA'S FOREIGN RESERVES**

The Bank of Latvia's foreign reserves consist of gold, foreign convertible currencies (see Note 2) and XDRs. The Bank's foreign reserves amounted to 484.2 million lats at the end of 1997 (429.5 million lats at the end of 1996).

The Bank of Latvia managed the foreign reserves in accordance with the guidelines approved by the Bank's Board of Governors. Preserving value, maintaining liquidity and ensuring return are the core of the Bank's foreign currency reserves management strategy.

The Bank of Latvia invests its foreign currency reserves in safe and liquid financial instruments. The Bank may invest its foreign currency reserves in bank accounts and time deposits with the International Bank for Reconstruction and Development, the Bank for International Settlements, the European Investment Bank, the European Bank for Reconstruction and Development, the Nordic Investment Bank and other international institutions. The Bank may also invest in government, government agency and bank securities of the following countries: the United States of America, Germany, Japan, the United Kingdom, France, Sweden, Denmark, the Netherlands and Canada. The foreign currency reserves may not be invested in equity instruments of any kind. (This restriction does not apply to the long-term investment in the Bank for International Settlements.) Investment in financial instruments of international institutions, government agencies and banks may not exceed 20% of foreign currency reserves.

Investments may be made in US dollars, German marks, Japanese yen, British pounds, French francs, Swedish kronas, Danish kroner, Dutch guilders, Swiss francs, Canadian dollars, XDR and XEU. The proportion of each currency that may be held is similar to the spread of currencies within the XDR basket of currencies. The Bank uses forward contracts to hedge any deviation from the prescribed allocation.

The Bank of Latvia employed three fund managers in New York and London to manage a part of the foreign currency reserves. The fund managers have the same objectives and operate under the same restrictions as the Bank's own foreign reserves portfolio managers.

Limits to the volume and maturity of gold deposits are set out in the guidelines on investment of the Bank of Latvia's gold reserves approved by the Bank's Board of Governors.

To keep up with developments on financial markets and to have access to qualitative and varied information, in 1997 the Bank purchased the Datastream system and enhanced the systems it had been using (Reuters, Bloomberg, Telerate). The information system of the Foreign Exchange Department was upgraded. The system envisages entering all transactions and payments related to foreign exchange into the system's database, electronic data flow and generating partly automatic SWIFT messages. New methods are used to calculate indexes for return on foreign reserves portfolio and interest rate risks.

The Investment Committee reviews and amends the Bank of Latvia's investment strategies every week. The Committee consists of the following bank officers and employees: the Chairman of the Bank's Executive Board, the Head of Foreign Exchange Department, and the Heads of this Department's Analysis, Risk Control, Trading and Investment Divisions, as well as the foreign reserves portfolio managers and dealers.

## THE BANK OF LATVIA'S FINANCIAL INSTRUMENTS

The financial instruments used by the Bank of Latvia to implement its monetary policy correspond to the market economy principles and the monetary policy to be implemented by the European Central Bank.

The Bank of Latvia sets the refinancing rate, which serves as a reference rate for the entire Latvian financial system. As the annual inflation rate decreased and discount rates on Treasury bills and interbank market rates fell, the Bank of Latvia was able to gradually lower the refinancing rate from 9.5% to 4.0% per year in 1997.

In order to implement its monetary policy more effectively and to develop the money market, the Bank of Latvia started organizing currency swap auctions in July 1997. Thus banks could obtain lats without entering into exchange operations and with lower exchange risks. Banks' interest in the new monetary instrument was rather high and swap deals totalled 22.3 million lats in July–December (maturity 91 days; the weighted average interest rate 5.2%).

To ensure the availability of long-term funds, in 1997 the Bank extended the maturity of government securities repo agreements. In April 1997, the Bank extended the maturity from 7 to 28 days, and starting with August 1997, it stipulated three maturities: 7, 28 and 91 days.

In 1997, the Bank of Latvia's Executive Board amended regulations on repo and reverse repo auctions of government securities. There was, however, no need to utilize reverse repo in the reporting year.

Another important interest rate is the Lombard rate, which sets the upper interest rate limit in the interbank market. The Bank of Latvia extended to banks demand and automatic Lombard credits secured by Treasury bills. Demand Lombard credits are granted for a definite time period, which may not exceed fourteen consecutive days, and are subject to a special agreement concluded with the bank upon its request. Bank of Latvia automatic Lombard credits are extended overnight and may not exceed the debit balance of the bank's correspondent account with the Bank of Latvia.

The Bank of Latvia's credits to the banking sector decreased from 10.0 million lats at the beginning of the year to 7.6 million lats at the end of the year.

Banks could also make time deposits with the Bank of Latvia.

The Bank of Latvia purchased from and sold to banks foreign convertible currency for lats in non-cash transactions; payments for such transactions were effected within two working days or, upon mutual agreement, in a shorter period of time. The net amount of foreign convertible currency purchased by the Bank of Latvia in 1997 totalled 97.6 million US dollars (148.5 million US dollars in 1996). Of this amount, 19.4 million US dollars were raised from currency swaps.

The Bank of Latvia's reserve requirement for banks was 8% of the average deposits acquired by the respective bank (irrespective of currency and maturity, and excluding liabilities to domestic credit institutions, the balance of the State Treasury's consolidated account, subordinated capital and funds raised by foreign branches of Latvian banks). Amendments to "Procedure for Calculating Credit Institution Reserve Requirement" came into force on April 1, 1997. The amendments stipulated that bank liabilities to foreign credit institutions were exempt from reserve requirement. The reserve requirement was met with balances on correspondent accounts of credit institutions with the Bank of Latvia and average vault cash balances in lats (the cash component was not to exceed 50% of the required reserves). The

cash component of the required reserves slightly increased (from 30.7% at the beginning of the year to 31.4% at the end of the year).

Bank excess reserves fluctuated within the range of 5.7 million lats (8.7% of reserve requirement) in November and 17.3 million lats (27.2%) in August. Banks were more and more efficient in managing their liquidity. In the first half of the year, excess reserves were over 5% of the reserve requirement in two-thirds of the banks, whereas in the last months of the year, they exceeded 5% of the reserve requirement in one-fifth of the banks.

The Bank of Latvia organizes sales of Latvian government securities through auctions in accordance with the following normative acts: Resolution No. 163 "On Authorizing the Bank of Latvia" passed by the Republic of Latvia Cabinet of Ministers on April 9, 1997; Resolution No. 285 "On Short-, Medium- and Long-Term Securities of Latvian Government" and "Regulation on Issuing Latvian Government Securities" passed by the Ministry of Finance on April 11, 1997. Auctions are organized by an auction commission formed jointly by the Bank of Latvia and the Ministry of Finance. Any bank or branch of a foreign bank, provided they have been licensed in the Republic of Latvia, as well as any foreign bank or an international financial institution holding a correspondent account in lats with the Bank of Latvia may participate in these auctions.

To implement the monetary policy more efficiently, the Bank of Latvia participated in the secondary market for government securities. The volume of the Bank of Latvia's transactions on the market totalled 89.7 million lats in 1997, down 21.4% from the 1996 level.

As the Government implemented tighter fiscal policy, it deposited excess funds with the Bank of Latvia. To lessen the impact of the Government's deposit on money supply, the Bank increased its portfolio of government securities.

Monetary indicators of the Latvian banking system were communicated to the domestic and international audience through regular Bank publications. This and other information was available on the Internet.

To coordinate and harmonize problems related to payment and settlement systems, the Consultative Committee of Latvian Settlement System was set up in April 1997. The Bank of Latvia and the twelve largest Latvian banks are represented on the Committee.

## **MONEY CIRCULATION**

The exclusive rights of currency issue are vested with the Bank of Latvia. Banknotes in the denominations of 5, 10, 20, 50 and 100 lats, and coins of lats and santims were in circulation. The supply of cash to the banking system was ensured through five branches of the Bank of Latvia in Riga, Liepaja, Daugavpils, Rezekne and Valmiera. Work on plans for building the Bank's new Riga Branch was continued in view of the need to ensure a safe storage, processing and security of the Bank of Latvia notes and coins and the electronic database in accordance with standards applied by other central banks.

The Riga Branch of the Bank of Latvia checked cash received from the banking system for authenticity and fitness for circulation. During the reporting year, the amount of processed cash (430.2 million lats, of which 94.3 million lats were destroyed banknotes) exceeded that of currency in circulation by a factor of 1.3. The banking system, therefore, received only good quality notes and coins. In the reporting year, counterfeit banknotes and coins only

slightly exceeded the amount of 12 thousand lats. This testified to the fact that the security features ensured the reliability of the Latvian currency.

Within the framework of international coin programs, in 1997 the Bank of Latvia issued the silver 10-lats coin "Corncrake" dedicated to endangered wildlife (in circulation since May 7, 1997), the 10-lats coin "Gaff-Sail Schooner Julia Maria" issued within the program "The Smallest Gold Coins of the World" (in circulation since July 9, 1997), the gold 20-lats coin "Frigate Gekroente Ehrendt" dedicated to the history of seafaring (in circulation since September 24, 1997). The series of eight silver 10-lats coins commemorating the 800th Anniversary of Riga was continued by issuing the coins dedicated to the 15th century (in circulation since January 6, 1997), the 16th century (in circulation since July 1, 1997), the 17th century (in circulation since October 1, 1997), and the 18th century (in circulation since December 12, 1997). The designs and models of the last two series' coins were prepared. In the reporting year, 16.7 thousand collector coins were sold abroad through distributor companies and 8.6 thousand coins were sold in Latvia.

#### **THE BANK OF LATVIA'S ORGANIZATIONAL STRUCTURE**

The composition of the Board of Governors of the Bank of Latvia did not change in the reporting year, and at the end of 1997, it was as follows:

- Chairman of the Board of Governors, Governor Einars Repše;
- Deputy Governor Ilmārs Rimšēvičs;
- members of the Board of Governors: Harry Bush,  
Valentīna Kolotova,  
Vita Pilsuma,  
Bruno R. Rubess,  
Varis Zariņš,  
Valentīna Zeile.

On August 28, 1997, the Saeima of the Republic of Latvia elected the Bank's Governor Einars Repše for a second term.

The Bank of Latvia's Executive Board at the end of 1997 was as follows:

- Chairman of the Executive Board Ilmārs Rimšēvičs;
- Deputy Chairperson of the Executive Board Māra Raubiško;
- members of the Executive Board: Helmūts Ancāns,  
Roberts L. Grava,  
Reinis Jakovļevs,  
Antonija Sileniece.

The Bank of Latvia's Executive Board managed the day-to-day work of the Bank, implemented the Board of Governors' directives on money circulation and credit institutions supervision, as well as developed draft resolutions for the Bank's Board of Governors. In the reporting year, the Bank of Latvia's Executive Board convened 52 meetings and passed 139 resolutions on credit institutions supervision, 23 resolutions on the utilization of monetary policy instruments and 151 resolutions on conducting other day-to-day business of the Bank.

At the end of 1997, 710 persons were employed by the Bank of Latvia.

In the reporting year, the organizational structure of two departments, the Foreign Exchange Department and the Credit Institutions Supervision Department, was expanded.

On January 3, 1996, the Republic of Latvia Ministry of Education licensed the Latvian Banking College. In accordance with Resolution No. 675 passed by the Republic of Latvia Cabinet of Ministers on December 30, 1997, the Banking Institution of Higher Education was formed. It assumed the rights and obligations of the Latvian Banking College.

## **PERSONNEL TRAINING**

During 1997, employees of the Bank of Latvia improved their professional knowledge on the issues of monetary policy, techniques of macroeconomic and monetary analyses, foreign exchange transactions, bank supervision and accounting by taking part in seminars, courses and conferences in Latvia and abroad.

In May 1997, the Personnel Department polled the bank's employees to identify their priorities in studies. Afterwards, it worked out a study program, based on the results of the poll and international experience. The working group for coordinating studies continued its work.

Information on study centres and professors in Latvia and abroad was gathered and assessed with the aim of selecting partners for future cooperation that would meet the needs of a central bank.

In 1997, seminars were held on main issues of central banking and a course "Getting Acquainted with the Bank of Latvia".

The Bank of Latvia supported graduate and post-graduate projects of students from the Riga School of Economics and Erlangen-Nürnberg University (Germany).

**THE BANK OF LATVIA'S FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 1997**

**THE BANK OF LATVIA'S BALANCE SHEET AS AT  
31 DECEMBER 1997**

(in thousands of lats)

ASSETS	Notes <sup>1</sup>	1997	1996
FOREIGN ASSETS		562 202	506 904
Gold	1	43 725	43 746 <sup>2</sup>
Special Drawing Rights		1 201	1 251
Convertible currencies	2	439 292	384 549
International Monetary Fund	3	72 929	72 929
Shares in the Bank for International Settlements	4	1 024	1 024 <sup>3</sup>
Other foreign assets	5	2 667	2 019
Non-convertible currencies	6	1 364	1 386
DOMESTIC CREDITS		107 943	74 309
To banks	7	7 551	9 950
To the Government	8	59 394	30 575
Government securities	9	40 998	14 077
Other credits	10	–	19 707
OTHER ASSETS	11	6 991	5 620
FIXED ASSETS	12	6 274	6 086
<b>TOTAL ASSETS</b>		<b>683 410</b>	<b>592 919</b>

<sup>1</sup> The accompanying notes are an integral part of these financial statements.

<sup>2</sup> The 1996 value of gold includes the increase in gold value (2 168 thousand lats) after reinstating the value of gold in lats in accordance with the new valuation policy adopted in 1997 (see Notes 1 and 18).

<sup>3</sup> The 1996 value of shares in the Bank for International Settlements, which is stated in gold equivalent, includes the increase (51 thousand lats) arising after reinstating the value of gold in lats in 1997 (see Notes 1, 4 and 18).

(cont.)

(in thousands of lats )

LIABILITIES	Notes	1997	1996
FOREIGN LIABILITIES		124 622	145 805
International Monetary Fund	13	124 134	145 497
Other foreign liabilities		6	6
Foreign bank deposits in lats		251	67
Non-convertible currencies	6	231	235
LATS IN CIRCULATION	14	359 353	282 602
DOMESTIC DEPOSITS		152 077	131 653
From banks		80 531	52 780
From the Government		24 702	31 017
Government foreign borrowings	15	44 780	42 197
Humanitarian aid deposits		207	364
Other deposits		1 857	5 295
OTHER LIABILITIES	16	2 938	5 350
CAPITAL AND RESERVES		44 420	27 509
Nominal capital	17	4 455	2 500
Reserve capital	17	1 407	625
Other reserves	17	18 577	13 494
Valuation account	18	19 542	10 463 <sup>1</sup>
European Union grant	19	439	427
<b>TOTAL LIABILITIES</b>		<b>683 410</b>	<b>592 919</b>

<sup>1</sup> The 1996 value of gold includes the increase (2 219 thousand lats) arising after reinstating the value of gold in lats in accordance with the new valuation policy adopted in 1997 (see Notes 1, 4 and 18).



**THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 1997**

(in thousands of lats )

	Notes	1997	1996
<b>INTEREST INCOME</b>			
Foreign operations			
Interest on bank deposits		2 613	2 207
Income from securities		20 567	16 941
Other foreign income		30	59
Dividends on BIS shares		184	115
GROSS foreign interest income		23 394	19 322
Domestic operations			
Interest on loans to banks		204	575
Interest on Government securities		1 398	1 538
Interest on loans to the Government		1 924	2 632
Other domestic income		32	197
GROSS domestic interest income		3 558	4 942
<b>INTEREST EXPENSE</b>			
Foreign operations			
Interest on loans		1 198	1 978
Other foreign expense		331	294
GROSS foreign interest expense		1 529	2 272
Domestic operations			
Interest on bank deposits		24	17
Interest on Government deposits		2 726	2 971
GROSS domestic interest expense		2 750	2 988
<b>NET INTEREST INCOME</b>		<b>22 673</b>	<b>19 004</b>

(cont.)

(in thousands of lats )

	Notes	1997	1996
SPECIFIC PROVISIONS	20	2 658	1 142
OPERATING INCOME		622	611
OPERATING EXPENSE			
Salaries, wages and other personnel costs		5 473	4 541
Social security		1 500	1 543
Coinage costs		109	294
Depreciation		1 656	1 478
Other operating expense		4 079	3 694
TOTAL operating expense		12 817	11 550
PROFIT BEFORE APPROPRIATION		7 820	6 923
APPROPRIATION OF PROFIT			
Nominal capital		1 955	–
Reserve capital		782	–
Other reserves		5 083	4 400
Reserve for deposit guarantee fund		–	500
Remaining profit appropriated to the State budget		–	2 023

**THE BANK OF LATVIA'S CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 DECEMBER 1997**

(in thousands of lats )

	Notes	1997	1996
Net cash inflow/outflow (–) from operating activities	21	–15 841	31 057
Remaining profit appropriated to the State budget		–2 023	–1 500
Purchase of fixed assets		–2 148	–3 145
Decrease in balance due to the International Monetary Fund		–21 363	–13 666
Cash inflow/outflow (–) for the period	21	–41 375	12 746

THE EXECUTIVE BOARD

I. Rimšēvičs  
M. Raubiško  
H. Ancāns R. L. Grava R. Jakovļevs A. Sileniece

## **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 1997**

### **FORM OF PRESENTATION OF FINANCIAL STATEMENTS**

The Bank of Latvia's financial statements have been prepared in accordance with the Law "On the Bank of Latvia" and the Law "On Accounting". International Accounting Standards have been used where they are appropriate and applicable to the activities of a central bank.

The Financial Statements have been prepared in accordance with the historical cost basis of accounting modified to include the revaluation of certain assets as referred to in the notes. A summary of the principal accounting policies is set out below.

#### **GOLD**

On the repatriation of the Bank of Latvia's gold in 1992–1993, it was valued at 300 US dollars per troy ounce. This valuation and subsequently realised gains and losses were included in the valuation account. To reduce the impact of US dollar exchange rate differences on the valuation of gold, the Bank of Latvia reviewed its gold valuation policy in 1997. On 28 April 1997, the value of gold (300 US dollars per troy ounce) was restated in lats at the US dollar rate of exchange set by the Bank of Latvia on that date (USD 1 = LVL 0.5850). Accordingly, the Bank of Latvia's revised policy is to value its long-term investment in gold at 175.50 lats per troy ounce. The 31 December 1996 balance sheet value of the Bank of Latvia's gold has been restated correspondingly.

#### **FOREIGN CONVERTIBLE CURRENCIES**

Foreign convertible currency investments are marked to market and translated into lats at the exchange rates set by the Bank of Latvia at the year end. Any surplus or deficit arising on valuation is transferred to the valuation account. On the disposal of the investment, the market value adjustment is transferred from the valuation account to the profit and loss account.

#### **LATVIAN GOVERNMENT SECURITIES**

The discount arising on purchase of Treasury bills is amortised to interest income on a straight-line basis over the term to maturity. Treasury bills are stated at cost plus amortised discount. Government bonds are stated at cost.

#### **FIXED ASSETS**

Fixed assets are recorded at historical cost less accumulated depreciation. Depreciation is calculated using the straight-line method. The following depreciation rates have been applied:

Buildings	1%–2%
Furniture and office equipment	10%
Transport vehicles	20%
Computer equipment and information systems	20%

Bank note production costs are included in the fixed assets. The costs are depreciated over the estimated period of useful life, i.e., 2 years. Costs of coinage are expensed in the year when incurred.

#### INTEREST INCOME AND EXPENSE RECOGNITION

Interest income and expenses are recognised on an accrual basis.

#### FOREIGN CURRENCY TRANSLATION

Assets and liabilities denominated in foreign currencies are translated into lats at the rates set by the Bank of Latvia at the year end. Gains and losses on translation are credited or charged to the valuation account.

### NOTES TO THE BALANCE SHEET, PROFIT AND LOSS STATEMENT AND CASH FLOWS STATEMENT

#### 1. GOLD

Movements in gold reserves in 1997 were as follows:

	Troy ounces	Amount in thousands of lats
Gold at 31 December 1996	249 269	43 746
Changes resulting from deposits and withdrawals	-126	-21
Gold at 31 December 1997	249 143	43 725

The value of gold included in the balance sheet as at 31 December 1996 has been revalued due to the changes in the valuation policy in 1997. As a result the value of gold as at 31 December 1996 has increased by 2 168 thousand lats.

#### 2. CONVERTIBLE CURRENCIES

The Bank of Latvia's foreign convertible currency assets are invested mainly in foreign banks and other financial institutions as cash deposits and securities of high liquidity.

At the end of 1997, debt securities include interest income purchased at the date of acquisition which amounts to 3 142 thousand lats (3 284 thousand lats at the end of 1996). Interest income accrued after the date of acquisition is recorded in other assets.

At the end of 1997, the foreign convertible currency reserves of the Bank of Latvia translated into lats were as follows:

	(in thousands of lats)	
	1997	1996
Short-term deposits with foreign banks and other financial institutions	27 373	41 050
Short-term government securities	122 286	90 876
Short-term securities of banks	24 121	5 151
Short-term securities of other financial institutions	24 571	–
Long-term government securities	219 979	233 331
Long-term securities of banks	11 066	9 676
Long-term securities of other financial institutions	8 512	3 134
Foreign currency in cash	1 384	1 331
<b>Total</b>	<b>439 292</b>	<b>384 549</b>

The following table provides the currency profile of the foreign convertible currency reserves of the Bank of Latvia as at 31 December 1997:

	(percentage)	
	1997	1996
US dollars	48	40
German marks	24	20
British pounds	14	12
Japanese yen	6	16
French francs	5	11
Other foreign currencies	3	1
<b>Total</b>	<b>100</b>	<b>100</b>

The convertible currency assets are held in a spread of currencies that approximate the spread of currencies in the XDR. Deviations from the XDR spread are hedged by the purchase and sale of forward foreign exchange contracts.

### 3. INTERNATIONAL MONETARY FUND

The Republic of Latvia participation in the International Monetary Fund (IMF), which is secured by a promissory note issued by the Government of Latvia, is recorded as an asset and denominated in XDR. The IMF holdings of Latvian national currency are accordingly stated as a liability (see Note 13). The quota of the Republic of Latvia in the IMF is 91 500 thousand XDR.

#### 4. SHARES IN THE BANK FOR INTERNATIONAL SETTLEMENTS

The Bank of Latvia owns one thousand shares in the Bank for International Settlements (BIS). The shares are denominated in the gold equivalent (5 834 troy ounces). The value of this investment included in the balance sheet as at 31 December 1996 has been revalued due to the changes in the valuation policy in 1997. As a result, the value of the investment as at 31 December 1996 has increased by 51 thousand lats.

#### 5. OTHER FOREIGN ASSETS

This item represents deposits with foreign financial institutions made on the behalf of the Government in the amount of 2 641 thousand lats and other foreign assets in the amount of 26 thousand lats.

#### 6. NON-CONVERTIBLE CURRENCIES

This item is comprised of the net book value of the balances of the accounts (opened during 1991 and 1992 in order to settle payments between the CIS countries).

#### 7. DOMESTIC CREDITS TO BANKS

This item represents repo loans secured with Latvian government securities in the amount of 6 746 thousand lats, long-term loans issued to banks in 1992 in the amount of 198 thousand lats, foreign loans issued to banks for further distribution as loans to final borrowers in the amount of 513 thousand lats, as well as loans issued within the framework of the grant received from the European Union in the amount of 94 thousand lats.

#### 8. DOMESTIC CREDITS TO THE GOVERNMENT

This item represents foreign credits utilised by the Government to finance state enterprises and to ensure the state investment programmes, as well as G-24 credits that were granted by the banks whose licences have been revoked and that have been taken over by the Ministry of Finance.

#### 9. GOVERNMENT SECURITIES

The Bank of Latvia is a market maker for government securities issued by the Ministry of Finance. At 31 December 1997 the Bank of Latvia held the following securities:

	(in thousands of lats)	
Original maturity of government securities	1997	1996
Within 1 month	250	527
Within 3 months	3 596	1 021
Within 6 months	9 975	3 249
Within 12 months	24 421	9 280
Within 2 years	2 756	–
Total	40 998	14 077

The value of securities with remaining maturity within 30 days is 6 214 thousand lats, within 90 days – 8 456 thousand lats, within 180 days – 9 519 thousand lats, within 360 days – 14 053 thousand lats and with remaining maturity exceeding 360 days – 2 756 thousand lats.

#### 10. OTHER CREDITS

The G-24 credits granted by the banks whose licences have been revoked, which were included in the financial statements for 1996 as other credits, are stated in the financial statements for 1997 as domestic credits to the Government (see Note 8).

#### 11. OTHER ASSETS

This item is comprised of accrued interest in the amount of 6 482 thousand lats, prepayments for purchase of fixed assets in the amount of 266 thousand lats and other assets in the amount of 243 thousand lats.

#### 12. FIXED ASSETS

Changes in fixed assets in 1997:

	(in thousands of lats)				
	Buildings	Furniture and office equipment	Transport vehicles	Other, including bank notes	Total
Net book value as at 31 December 1996	1 923	2 359	456	1 348	6 086
Additions	869	909	71	299	2 148
Disposals	-212	-74	-9	-9	-304
Depreciation charge	-10	-755	-202	-689	-1 656
Net book value as at 31 December 1997	2 570	2 439	316	949	6 274

#### 13. INTERNATIONAL MONETARY FUND

Liabilities to the IMF comprise three separate balances: credits under the Stand-by Arrangement (SBA) and the Systemic Transformation Facility (STF), and the liability arising from the country's participation in the IMF (see Note 3).

Credits under the SBA and the STF have been issued to the Republic of Latvia with the aim of supporting the Government's economic and financial programmes, and are scheduled for repayment by instalments by July 1999 and by July 2004, respectively.



Movements in liabilities to the IMF in 1997 were as follows:

(in thousands of lats)

	SBA	STF	Participation	Total
Balance as at 31 December 1996	35 672	36 586	73 239	145 497
Revaluation	–	–	–21	–21
Repayment	–21 342	–	–	–21 342
Balance as at 31 December 1997	14 330	36 586	73 218	124 134

#### 14. LATS IN CIRCULATION

At the end of 1997, the following units of lats (LVL) and santims (s) were in circulation:

Nominal	Amount (in thousands lats)		Number (in thousands of units)		Percentage	
	1997	1996	1997	1996	1997	1996
<b>BANK NOTES</b>						
LVL 100	35 795	19 827	358	198	10.0	7.0
LVL 50	53 787	27 357	1 076	547	15.0	9.7
LVL 20	97 224	73 395	4 861	3 670	27.1	26.0
LVL 10	98 128	84 821	9 813	8 482	27.3	30.1
LVL 5	54 930	59 472	10 986	11 893	15.3	21.1
AMOUNT	339 864	264 872	–	–	94.7	93.9
<b>COINS</b>						
LVL 2	5 233	5 018	2 617	2 509	1.5	1.8
LVL 1	6 092	5 467	6 092	5 467	1.7	1.9
50 s	3 415	3 093	6 830	6 187	1.0	1.1
20 s	1 557	1 328	7 785	6 637	0.4	0.5
10 s	996	895	9 959	8 951	0.3	0.3
5 s	708	634	14 169	12 670	0.2	0.2
2 s	493	414	24 645	20 703	0.1	0.2
1 s	451	369	45 070	36 892	0.1	0.1
AMOUNT	18 945	17 218	–	–	5.3	6.1
<b>TOTAL</b>	<b>358 809</b>	<b>282 090</b>	<b>–</b>	<b>–</b>	<b>100.0</b>	<b>100.0</b>

At the end of 1997, silver 10-lats collector coins and gold 100-lats collector coins were in circulation along with souvenir sets of coins with a total nominal value of 544 thousand lats (512 thousand lats at the end of 1996).

#### 15. GOVERNMENT FOREIGN BORROWINGS

This item is comprised of the G-24 credits received by the Government of Latvia.

#### 16. OTHER LIABILITIES

Other liabilities include accrued expense in the amount of 838 thousand lats, interest payments on Government foreign borrowings in the amount of 526 thousand lats, tax payables in the amount of 282 thousand lats, reserve for the deposit guarantee fund in the amount of 500 thousand lats and other liabilities in the amount of 792 thousand lats.

#### 17. NOMINAL CAPITAL, RESERVE CAPITAL AND OTHER RESERVES

The Law "On the Bank of Latvia" states the amount of authorised nominal and reserve capital. The amendments to the Law "On the Bank of Latvia" made in 1997 prescribe an increase in the amount of the authorised nominal capital to 25 million lats and the reserve capital.

The nominal capital is composed of the State allotted resources and the annual Bank of Latvia profit allocation that may not be less than 25% of the Bank's profit. 10% of the Bank's profit is annually appropriated to the reserve capital until it reaches one-fourth of the nominal capital. Other reserves are comprised of net profit after the above mentioned appropriations. Net profit should be included in the nominal capital until the amount defined by the Law is reached. After this provision is met, net profit is transferred to the State budget.

The financial statements for the year ended 31 December 1997 disclose the increases in the nominal capital, reserve capital and other reserves as stated by paragraphs 18, 19 and 20 of the Law "On the Bank of Latvia".

#### 18. VALUATION ACCOUNT

Movements in the valuation account in 1997 were as follows:

	(in thousands of lats)				Total
	Gold	Foreign currencies			
		Conver- tible	Non- convertible	Market value of investments	
Valuation account as at 31 December 1996 (as previously reported)	47 879	-14 467	-25 975	807	8 244
Adjustments	2 168	51	-	-	2 219
Valuation account as at 31 December 1996 (as restated)	50 047	-14 416	-25 975	807	10 463
Movement in Investment Revaluation Reserve	-	-	-	-2 029	-2 029
Revaluation	-	8 520	2 588	-	11 108
Valuation account as at 31 December 1997	50 047	-5 896	-23 387	-1 222	19 542

#### 19. EUROPEAN UNION GRANT

This item represents a grant by the European Union to the Bank of Latvia for the purpose of supporting the development of small and medium-size business in Latvia.

#### 20. SPECIFIC PROVISIONS

The following specific provisions were made in 1997:

	(in thousands of lats)	
	1997	1996
On loans issued to banks whose licences have been revoked	-	11
On receivables regarding settlements of balances with CIS countries in 1992	2 658	1 131
Total	2 658	1 142

#### 21. CASH FLOWS STATEMENT

(i) Reconciliation of operating profit to net cash inflow/outflow (-) from operating activities:

	(in thousands of lats)	
	1997	1996
Profit before appropriation	7 820	6 923
Increase (-)/decrease in gold	21	-6
Increase (-)/decrease in XDR	50	-56
Increase (-) in BIS shares	-	-33
Increase (-) in foreign government securities and other foreign investments	-68 367	-91 958
Revaluation and investments market value adjustment	9 079	-1 664
Increase (-)/decrease in other foreign assets	-648	537
Increase (-)/decrease in non-convertible currency	22	-579
Increase (-)/decrease in domestic credits	-33 634	26 509
Increase (-)/decrease in other assets	-1 371	3 390
Depreciation	1 656	1 478
Loss on disposals of fixed assets	304	34
Increase/decrease (-) in foreign bank deposits in lats	184	-131
Decrease in non-convertible currency deposits	-4	-20
Increase in lats in circulation	76 751	56 731
Increase/decrease (-) in other deposits	-7 327	33 365
Decrease in other liabilities	-389	-3 463
Increase in European Union grant	12	-
Net cash inflow/outflow (-) from operating activities	-15 841	31 057

Cash and cash equivalents include foreign currencies in cash, balances due from foreign banks and other credit institutions with remaining maturity of 90 days or less.

(ii) Analysis of the balances of cash and cash equivalents:

	(in thousands of lats)		
	1997	Change	1996
Short-term deposits with foreign banks and other financial institutions	27 373	-13 677	41 050
Foreign currency in cash	1 384	53	1 331
Short-term deposits from domestic banks	-80 531	-27 751	-52 780
Total	-51 774	-41 375	-10 399

## **REPORT OF THE AUDIT COMMISSION TO THE BOARD OF GOVERNORS OF THE BANK OF LATVIA**

We have audited the balance sheet of the Bank of Latvia as at 31 December 1997 and the related profit and loss and cash flows statements for the year then ended as well as the accompanying notes. These financial statements are the responsibility of the Bank of Latvia's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We have conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank of Latvia as at 31 December 1997 and the results of its operations and cash flows for the year then ended in conformity with the accounting principles adopted by the Bank of Latvia and the Law "On the Bank of Latvia".

ARTHUR ANDERSEN

THE REPUBLIC OF LATVIA STATE CONTROL

Riga  
6 March 1998

## **RESOLUTION OF THE BANK OF LATVIA'S BOARD OF GOVERNORS**

On March 24, 1998, the Bank of Latvia's Board of Governors passed Resolution No. 46/1 "On the Bank of Latvia's Annual Report and Financial Statements for 1997".

Having reviewed the results of the audit of the Bank of Latvia's economic activity in 1997, the Bank of Latvia's Board of Governors resolves:

1. To approve the Bank of Latvia's annual report for 1997, including the balance sheet, profit and loss statement and cash flow statement.

2. To appropriate the Bank of Latvia's profit for 1997 in the following way.

2.1. 1 955 thousand lats to be transferred to the Bank's nominal capital.

2.2. 782 thousand lats to be transferred to the Bank's reserve capital.

2.3. 5 083 thousand lats to be transferred to the Bank's other reserves.

3. The Bank of Latvia's Executive Board ensures that the Bank of Latvia's annual report for 1997, including the balance sheet, profit and loss statement and cash flow statement, are published in Latvian and English and are sent to respective institutions.

E. Repse  
Governor  
Bank of Latvia



## **APPENDIXES**



**MONETARY INDICATORS IN 1997**

(at end of month; in millions of lats)

	I	II	III	IV	V	VI
<b>Bank of Latvia</b>						
Monetary base M0	327.7	342.9	350.9	341.6	351.7	370.9
Currency in circulation	274.7	282.9	291.8	292.3	296.3	310.0
Deposits with the Bank of Latvia	53.0	60.0	59.1	49.2	55.4	60.9
Currency vs monetary base (%)	83.8	82.5	83.2	85.6	84.2	83.6
Net foreign assets	370.6	361.1	365.1	364.9	395.1	397.2
Net domestic assets	-42.8	-18.2	-14.1	-23.3	-43.4	-26.3
Credits	22.1	45.6	49.9	41.1	29.7	48.1
To banks	8.1	4.8	8.2	6.4	16.0	6.3
To the Government (net)	-6.2	20.7	21.5	14.4	13.7	41.8
Other credits	20.3	20.1	20.2	20.3	0	0
Other items (net)	-65.0	-63.8	-64.0	-64.4	-73.1	-74.4
<b>Banking system</b>						
Broad money M2X	616.1	631.1	654.4	675.0	692.1	724.8
Currency in circulation <sup>1</sup>	257.9	264.9	274.0	275.0	279.2	286.4
Non-bank <sup>2</sup> deposits	358.1	366.2	380.4	400.0	412.9	438.4
In foreign currencies	197.5	200.8	213.3	219.3	216.6	234.3
Domestic money supply M2D <sup>3</sup>	418.6	430.3	441.1	455.7	475.6	490.5
Net foreign assets	446.0	441.0	461.7	491.7	524.5	533.0
Net domestic assets	170.0	190.1	192.7	183.3	167.6	191.8
Credits	217.8	219.5	226.5	225.1	242.4	259.5
Bank of Latvia refinancing rate (%)	8.0	6.0	5.0	4.0	4.0	4.0
Weighted average interest rates (%)						
In the interbank market	4.4	4.4	3.4	4.2	4.0	2.9
In the non-bank sector						
Short-term credits granted in lats	20.8	22.4	17.3	17.1	12.8	13.9
Long-term deposits in lats	9.6	7.8	6.5	5.2	5.8	5.2
LVL vs USD	0.573	0.577	0.580	0.586	0.575	0.574

<sup>1</sup> Less vault cash balances.<sup>2</sup> Enterprises and private persons.<sup>3</sup> Currency outside banks plus deposits of domestic enterprises and private persons in national currency.

(cont.)

(at end of month; in millions of lats)

VII	VIII	IX	X	XI	XII	
Bank of Latvia						
369.0	389.3	382.3	391.2	404.0	441.7	Monetary base M0
313.8	322.9	327.7	336.1	342.1	359.4	Currency in circulation
55.2	66.4	54.7	55.1	61.9	82.4	Deposits with the Bank of Latvia
85.0	82.9	85.7	85.9	84.7	81.4	Currency vs moneraty base (%)
414.2	422.7	431.3	428.4	431.9	437.2	Net foreign assets
-45.2	-33.4	-48.9	-37.2	-28.0	4.6	Net domestic assets
33.7	45.3	30.4	40.5	56.5	83.0	Credits
11.0	0.8	1.1	4.3	9.5	7.6	To banks
22.7	44.5	29.3	36.2	47.0	75.5	To the Government (net)
0	0	0	0	0	0	Other credits
-78.9	-78.7	-79.3	-77.7	-84.5	-78.5	Other items (net)
Banking system						
757.6	791.2	805.6	814.2	828.7	871.3	Broad money M2X
294.5	301.5	303.9	313.8	320.8	332.7	Currency in circulation <sup>1</sup>
463.0	489.7	501.7	500.4	507.9	538.6	Non-bank <sup>2</sup> deposits
247.7	262.7	272.3	272.4	275.6	279.0	In foreign currencies
509.9	528.5	533.3	541.8	553.1	592.3	Domestic money supply M2D <sup>3</sup>
573.5	592.1	613.5	609.1	591.7	602.3	Net foreign assets
184.1	199.0	192.1	205.1	237.0	269.0	Net domestic assets
277.0	294.2	306.6	331.8	352.1	374.3	Credits
4.0	4.0	4.0	4.0	4.0	4.0	Bank of Latvia refinancing rate (%)
						Weighted average interest rates (%)
3.9	2.9	2.3	4.2	5.1	3.9	In the interbank market
						In the non-bank sector
15.4	13.9	12.8	12.6	12.0	12.1	Short-term credits granted in lats
5.5	5.6	4.6	5.4	5.7	5.4	Long-term deposits in lats
0.589	0.588	0.586	0.578	0.587	0.590	LVL vs USD

**THE BANK OF LATVIA'S MONTH-END BALANCE SHEETS**

(in thousands of lats)

	1997					
	I	II	III	IV	V	VI
<b>ASSETS</b>						
FOREIGN ASSETS	514 899	504 355	505 787	503 617	533 772	532 602
Gold	42 849	43 127	43 351	43 725	43 725	43 725
Special Drawing Rights	932	1 678	762	780	1 012	128
Convertible currencies	393 666	382 117	384 237	380 983	410 977	410 710
International Monetary Fund	72 929	72 929	72 929	72 929	72 929	72 929
Shares in the Bank for International Settlements	1 003	1 010	1 015	1 024	1 024	1 024
Other foreign assets	2 115	2 086	2 089	2 764	2 726	2 710
Non-convertible currencies	1 405	1 408	1 404	1 412	1 379	1 376
DOMESTIC CREDITS	75 213	85 204	90 777	92 644	96 157	82 869
To banks	8 073	4 806	8 212	6 379	16 008	6 302
To the Government	31 365	42 362	42 350	40 961	60 071	59 817
Government securities	15 504	17 965	20 057	24 990	20 078	16 750
Other credits	20 271	20 071	20 158	20 314	–	–
OTHER ASSETS	6 807	6 041	6 249	5 327	5 262	5 826
FIXED ASSETS	6 132	6 339	6 143	6 136	6 335	6 255
TOTAL ASSETS	603 051	601 939	608 956	607 724	641 526	627 552
<b>LIABILITIES</b>						
FOREIGN LIABILITIES	143 934	142 812	140 298	138 310	138 282	134 956
International Monetary Fund	143 515	142 524	140 009	138 027	138 006	134 500
Other foreign liabilities	6	6	6	6	6	6
Foreign bank deposits in lats	175	44	45	38	37	217
Non-convertible currencies	238	238	238	239	233	233
LATS IN CIRCULATION	274 745	282 904	291 827	292 344	296 288	310 036
DOMESTIC DEPOSITS	148 097	141 122	141 588	142 578	173 473	146 506
From banks	51 536	57 559	55 698	48 154	54 584	60 056
From the Government	52 709	39 302	40 540	51 255	66 108	34 472
Government foreign borrowings	42 056	41 477	41 583	41 745	51 604	50 800
Humanitarian aid deposits	363	348	347	336	335	332
Other deposits	1 433	2 436	3 420	1 088	842	846
OTHER LIABILITIES	11 639	12 470	7 385	6 006	6 910	8 350
CAPITAL AND RESERVES	24 636	22 631	27 858	28 486	26 573	27 704
Nominal capital	2 500	2 500	2 500	2 500	2 500	2 500
Reserve capital	625	625	625	625	625	625
Other reserves	9 094	9 094	13 494	13 494	13 494	13 494
Valuation account	11 990	9 985	10 812	11 440	9 527	10 656
EU grant	427	427	427	427	427	429
TOTAL LIABILITIES	603 051	601 939	608 956	607 724	641 526	627 552

(cont.)

(in thousands of lats)

1997						
VII	VIII	IX	X	XI	XII	
						<b>ASSETS</b>
547 597	556 051	561 103	555 467	559 024	562 202	FOREIGN ASSETS
43 725	43 725	43 725	43 725	43 725	43 725	Gold
866	1 185	238	781	1 104	1 201	Special Drawing Rights
424 872	433 442	439 129	433 068	435 487	439 292	Convertible currencies
72 929	72 929	72 929	72 929	72 929	72 929	International Monetary Fund
						Shares in the Bank for International Settlements
1 024	1 024	1 024	1 024	1 024	1 024	
2 777	2 350	2 677	2 582	3 384	2 667	Other foreign assets
1 404	1 396	1 381	1 358	1 371	1 364	Non-convertible currencies
92 823	81 721	77 655	83 328	103 429	107 943	<b>DOMESTIC CREDITS</b>
10 992	824	1 112	4 295	9 481	7 551	To banks
61 174	61 070	60 669	59 575	59 934	59 394	To the Government
20 657	19 827	15 874	19 458	34 014	40 998	Government securities
–	–	–	–	–	–	Other credits
6 178	7 091	7 042	5 835	5 693	6 991	<b>OTHER ASSETS</b>
5 805	5 959	5 879	6 297	6 335	6 274	<b>FIXED ASSETS</b>
652 403	650 822	651 679	650 927	674 481	683 410	<b>TOTAL ASSETS</b>
						<b>LIABILITIES</b>
132 969	132 943	129 428	126 684	126 680	124 622	<b>FOREIGN LIABILITIES</b>
132 518	132 518	129 012	126 116	126 116	124 134	International Monetary Fund
6	6	6	6	6	6	Other foreign liabilities
207	183	176	332	326	251	Foreign bank deposits in lats
238	236	234	230	232	231	Non-convertible currencies
313 825	322 891	327 675	336 118	342 087	359 353	<b>LATS IN CIRCULATION</b>
164 517	153 574	153 073	149 436	160 375	152 077	<b>DOMESTIC DEPOSITS</b>
54 345	65 547	53 880	54 398	60 969	80 531	From banks
58 829	36 067	47 009	42 563	46 694	24 702	From the Government
50 162	50 784	51 149	51 504	51 607	44 780	Government foreign borrowings
328	307	265	264	209	207	Humanitarian aid deposits
853	869	770	707	896	1 857	Other deposits
10 191	12 577	12 089	12 624	12 873	2 938	<b>OTHER LIABILITIES</b>
30 901	28 837	29 414	26 065	32 466	44 420	<b>CAPITAL AND RESERVES</b>
2 500	2 500	2 500	2 500	2 500	4 455	Nominal capital
625	625	625	625	625	1 407	Reserve capital
13 494	13 494	13 494	13 494	13 494	18 577	Other reserves
13 852	11 788	12 364	9 014	15 413	19 542	Valuation account
430	430	431	432	434	439	EU grant
652 403	650 822	651 679	650 927	674 481	683 410	<b>TOTAL LIABILITIES</b>

**THE BANK OF LATVIA'S YEAR-END BALANCE SHEETS FOR 1993–1997**

(in thousands of lats)

	1993	1994	1995	1996	1997
<b>ASSETS</b>					
FOREIGN ASSETS	385 358	416 177	392 548	506 904	562 202
Gold	43 268	40 972	40 150	43 746 <sup>1</sup>	43 725
Special Drawing Rights	58 359	174	1 195	1 251	1 201
Convertible currencies	201 543	298 919	273 971 <sup>2</sup>	384 549	439 292
International Monetary Fund	74 853	72 929	72 929	72 929	72 929
Shares in the Bank for International Settlements	1 040	959	940	1 024 <sup>3</sup>	1 024
Other foreign assets	2 053	958	2 556	2 019	2 667
Correspondent accounts	467	10	–	–	–
Credits to the CIS countries	145	–	–	–	–
Non-convertible currencies	3 630	1 256	807	1 386	1 364
DOMESTIC CREDITS	54 357	67 979	100 818	74 309	107 943
To banks	51 981	54 468	24 579	9 950	7 551
To the Government	2 376	13 126	51 585	30 575	59 394
Government securities	–	385	5 774	14 077	40 998
Other credits	–	–	18 880	19 707	–
OTHER ASSETS	3 040	5 926	9 011 <sup>4</sup>	5 620	6 991
FIXED ASSETS	1 563	3 172	4 453 <sup>5</sup>	6 086	6 274
TOTAL ASSETS	444 318	493 254	506 830	592 919	683 410

<sup>1</sup> In the 1996 balance sheet, gold has been valued at 300 US dollars per troy ounce.

<sup>2</sup> In the 1995 balance sheet, foreign assets in convertible currency have been recorded at their historic cost.

<sup>3</sup> In the 1996 balance sheet, the shares denominated in the gold equivalent have been valued at 300 US dollars per troy ounce.

<sup>4</sup> Receivables regarding settlements with the CIS countries have been included.

<sup>5</sup> In the 1995 balance sheet, as in previous year-end balance sheets, fixed assets have been included in the item "Other Assets".

(cont.)

(in thousands of lats)

	1993	1994	1995	1996	1997
<b>LIABILITIES</b>					
<b>FOREIGN LIABILITIES</b>	149 585	161 913	159 622	145 805	124 622
International Monetary Fund	146 042	161 289	159 163	145 497	124 134
Other foreign liabilities	6	6	6	6	6
Foreign bank deposits in lats	2 421	219	198	67	251
Non-convertible currencies	1 116	399	255	235	231
<b>LATS IN CIRCULATION</b>	179 132	232 100	225 871	282 602	359 353
<b>DOMESTIC DEPOSITS</b>	91 342	88 706	92 416	131 653	152 077
From banks	46 423	37 326	46 908	52 780	80 531
From the Government	2 377 <sup>1</sup>	10 105	2 623	31 017	24 702
Government foreign borrowings	41 842	40 604	41 049	42 197	44 780
Humanitarian aid deposits	700	671	996	364	207
Other deposits	–	–	840	5 295	1 857
<b>OTHER LIABILITIES</b>	9 557	2 515	7 790 <sup>2</sup>	5 350	2 938
<b>CAPITAL AND RESERVES</b>	14 702	8 020	21 131	27 509	44 420
Nominal capital	2 500	2 500	2 500	2 500	4 455
Reserve capital	625	625	625	625	1 407
Other reserves	–	4 160	9 093	13 494	18 577
Valuation account	10 904	4	8 486	10 463	19 542
EU grant	673	731	427	427	439
<b>TOTAL LIABILITIES</b>	444 318	493 254	506 830	592 919	683 410

<sup>1</sup> Government risk fund has been segregated in the 1993 balance sheet.

<sup>2</sup> Provisions for receivables regarding settlements with the CIS countries have been included.

**THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT  
FOR THE YEARS 1993–1997**

(in thousands of lats)

	1993	1994	1995	1996	1997
<b>INTEREST INCOME</b>					
Foreign operations					
Interest on bank deposits	3 938	5 706	1 306	2 207	2 613
Income from securities	915	4 639	19 907	16 941	20 567
Other foreign income	620	1 540	268	59	30
Dividends on BIS shares	105	99	111	115	184
GROSS foreign interest income	5 578	11 984	21 592	19 322	23 394
Domestic operations					
Interest on loans to banks	18 876	1 748	561	575	204
Interest on Government securities	–	88	845	1 538	1 398
Interest on loans to the Government	3 596	1 542	6 244	2 632	1 924
Other domestic income	239	1 168	2 403	197	32
GROSS domestic interest income	22 711	4 546	10 053	4 942	3 558
<b>INTEREST EXPENSE</b>					
Foreign operations					
Interest on loans	1 991	2 909	2 700	1 978	1 198
Other foreign expense	54	73	260	294	331
GROSS foreign interest expense	2 045	2 982	2 960	2 272	1 529
Domestic operations					
Interest on bank deposits	–	–	21	17	24
Interest on Government deposits	49	1 348	3 138	2 971	2 726
Other domestic expense	2	407	–	–	–
GROSS domestic interest expense	51	1 755	3 159	2 988	2 750
<b>NET INTEREST INCOME</b>	26 193	11 793	25 526	19 004	22 673
Net foreign exchange profit/loss	-185	-2 354	– <sup>1</sup>	–	–
<b>SPECIFIC PROVISIONS</b>	–	–	7 825	1 142	2 658

<sup>1</sup> Beginning with 1995, net foreign exchange loss is included in the item "Other Operating Expense".

## Appendix 4

(cont.)

(in thousands of lats)

	1993	1994	1995	1996	1997
OPERATING INCOME	393	2 379	604	611	622
OPERATING EXPENSE					
Salaries, wages and other personnel costs	1 010	2 429	3 438	4 541	5 473
Social security	373	890	1 258	1 543	1 500
Costs of coin and bank note production	5 686	599	23 <sup>1</sup>	294	109
Depreciation	43	311	837	1 478	1 656
Other operating expense	1 821	3 429	6 316	3 694	4 079
TOTAL operating expense	8 933	7 658	11 872	11 550	12 817
Exceptional items	9 497	–	–	–	–
PROFIT BEFORE APPROPRIATION	7 971	4 160	6 433	6 923	7 820
APPROPRIATION OF PROFIT					
Nominal capital	–	–	–	–	1 955
Reserve capital	58	–	–	–	782
Other reserves	–	4 160	4 933	4 400	5 083
Reserve for deposit guarantee fund	–	–	–	500	–
Remaining profit appropriated to the State budget	7 913	–	1 500	2 023	–

<sup>1</sup> Beginning with 1995, only coinage costs.



**THE BANK OF LATVIA'S EXCHANGE RATES FOR GERMAN MARK, BRITISH POUND, FRENCH FRANC, US DOLLAR, JAPANESE YEN AND XEU**

(in lats)

	Maximum	Average	Minimum	Maximum	Average	Minimum	Maximum	Average	Minimum
1997	DEM			GBP			FRF		
I	0.3600	0.3533	0.3470	0.9490	0.9401	0.9260	0.1069	0.1047	0.1030
II	0.3510	0.3459	0.3420	0.9490	0.9387	0.9200	0.1039	0.1025	0.1013
III	0.3450	0.3422	0.3380	0.9430	0.9339	0.9230	0.1024	0.1014	0.1003
IV	0.3450	0.3412	0.3380	0.9540	0.9499	0.9430	0.1025	0.1013	0.1003
V	0.3420	0.3391	0.3360	0.9560	0.9435	0.9330	0.1014	0.1006	0.0997
VI	0.3380	0.3335	0.3320	0.9570	0.9440	0.9360	0.1001	0.0988	0.0983
VII	0.3310	0.3248	0.3190	0.9800	0.9707	0.9560	0.0982	0.0963	0.0946
VIII	0.3260	0.3202	0.3160	0.9680	0.9488	0.9340	0.0970	0.0950	0.0936
IX	0.3320	0.3286	0.3240	0.9530	0.9414	0.9340	0.0990	0.0977	0.0961
X	0.3350	0.3319	0.3280	0.9680	0.9513	0.9440	0.1001	0.0989	0.0979
XI	0.3400	0.3361	0.3330	0.9880	0.9803	0.9650	0.1014	0.1004	0.0994
XII	0.3340	0.3324	0.3310	0.9920	0.9822	0.9670	0.0999	0.0993	0.0988
1997	USD			100 JPY			XEU		
I	0.5750	0.5631	0.5540	0.4860	0.4803	0.4720	0.6950	0.6855	0.6740
II	0.5820	0.5775	0.5730	0.4770	0.4686	0.4640	0.6790	0.6714	0.6640
III	0.5830	0.5802	0.5770	0.4790	0.4736	0.4670	0.6680	0.6645	0.6590
IV	0.5870	0.5829	0.5760	0.4700	0.4648	0.4610	0.6720	0.6655	0.6600
V	0.5860	0.5781	0.5690	0.5050	0.4826	0.4610	0.6650	0.6612	0.6570
VI	0.5770	0.5751	0.5710	0.5150	0.5029	0.4940	0.6610	0.6514	0.6480
VII	0.5890	0.5796	0.5740	0.5110	0.5046	0.4980	0.6500	0.6406	0.6310
VIII	0.5950	0.5905	0.5870	0.5120	0.5012	0.4940	0.6410	0.6304	0.6220
IX	0.5930	0.5882	0.5850	0.4950	0.4876	0.4790	0.6510	0.6444	0.6370
X	0.5870	0.5844	0.5780	0.4860	0.4827	0.4790	0.6610	0.6519	0.6470
XI	0.5870	0.5814	0.5780	0.4820	0.4665	0.4580	0.6710	0.6646	0.6580
XII	0.5930	0.5903	0.5870	0.4630	0.4561	0.4520	0.6620	0.6575	0.6550

## Appendix 6

### LIST OF CREDIT INSTITUTIONS AT THE END OF 1997

#### BANKS

1. Joint-Stock Company "Aizkraukles Banka"
2. Joint-Stock Company "Baltijas Starptautiska Banka"
3. Joint-Stock Commercial Bank "Baltijas Tranzitu Banka"
4. Joint-Stock Commercial Bank "Doma Banka"
5. Joint-Stock Company "Hansabank – Latvija"
6. Joint-Stock Company Bank "Land"
7. Joint-Stock Company "Latvijas Biznesa Banka"
8. Joint-Stock Company "Latvijas Ekonomiska Komercbanka"
9. State Joint-Stock Company "Latvijas Hipoteku un Zemes Banka"
10. Joint-Stock Company "Latvijas Industriala Banka"
11. Joint-Stock Company "Latvijas Investiciju Banka"
12. Joint-Stock Company "Latvijas Kapital-Banka"
13. Joint-Stock Company "Latvijas Krajbanka"
14. Joint-Stock Company "Latvijas Kreditbanka"
15. Joint-Stock Company "Latvijas Tirdzniecibas Banka"
16. Joint-Stock Company "Latvijas Unibanka"
17. Joint-Stock Company "Latvijas Zemes Banka"
18. Joint-Stock Company "Maras Banka"
19. Joint-Stock Company "Multibanka"
20. Joint-Stock Company "Ogres Komercbanka"
21. Joint-Stock Company "Parekss-Banka"
22. Joint-Stock Company Bank "Paritate"
23. Joint-Stock Company "Rietumu Banka"
24. Joint-Stock Company "Rigas Komercbanka"
25. Joint-Stock Company "Rigas Naftas un Kimijas Banka"
26. Joint-Stock Company "Saules Banka"
27. Joint-Stock Company "Trasta Komercbanka"
28. Joint-Stock Company Commercial Bank "VEF Banka"
29. Joint-Stock Company Commercial Bank "Ventspils Apvienota Baltijas Banka"
30. Joint-Stock Company "Vereinsbank Riga"
31. Joint-Stock Company Commercial Bank "Viktorija"

#### CREDIT UNIONS

1. Credit Union "Dzelzcelnieks KS"
2. Credit Union "Ligatnes Druva"
3. Credit Union "Skolu Krajaizdevu Sabiedriba"
4. Taurene Credit Union
5. Veselava Credit Union

Appendix 6

(cont.)

BRANCH OF FOREIGN BANK

1. Riga Branch of Societe Generale (France)

## Appendix 7

### THE BANK OF LATVIA'S ORGANIZATIONAL UNITS AT THE END OF 1997

1. Accounting and Settlements Department  
(Head of Department, Chief Accountant – Antonija Sileniece; Deputy Chief Accountant – Maija Kurpniece)
  - 1.1. Internal Banking Operations Division (Head of Division – Anita Jakane)
  - 1.2. Central Accounting Division (Head of Division – Iveta Polka)
  - 1.3. Settlements Division (Head of Division – Natalija Popova)
2. CASHIER'S AND MONEY OPERATIONS DEPARTMENT  
(Head of Department – Uldis M. Klauss; Deputy Head of Department – Oskars Zaltans)
  - 2.1. Cash Operations Division (Head of Division – Veneranda Kausa)
  - 2.2. Money Operations Division (Head of Division – Alite Grobina)
  - 2.3. Collector Coin Division (Head of Division – Maruta Brukle)
3. CONSTRUCTION DEPARTMENT  
(Head of Department – Normunds Eglitis)
4. CREDIT INSTITUTIONS SUPERVISION DEPARTMENT  
(Head of Department – Armands Steinbergs; Deputy Head of Department (Credit Institutions Supervision and Methodology) – Janis Placis; Deputy Head of Department (Legal Issues and Licensing) – Janis Brazovskis)
  - 4.1. Supervision Division (Head of Division – Jelena Lebedeva)
  - 4.2. Licensing Division (Head of Division – Galina Sproge)
  - 4.3. Methodological and Analytical Division (Head of Division – Ludmila Vojevoda)
  - 4.4. Legal Division (Head of Division – Valda Bidina)
5. FOREIGN EXCHANGE DEPARTMENT  
(Head of Department – Roberts L. Grava)
  - 5.1. Payments and Settlements Division (Head of Division, Deputy Head of Department – Una Ruka)
  - 5.2. Trading and Investment Division (Head of Division, Deputy Head of Department – Arvids Sipols)
  - 5.3. External Debt Management Division (Head of Division – Agita Birka)
  - 5.4. Analysis Division (Head of Division – Aigars Egle)
  - 5.5. Risk Control Division (Head of Division – Daira Brunere)
6. FOREIGN RELATIONS DEPARTMENT  
(Head of Department – Guntis Valujevs; Deputy Head of Department – Juris Kravalis)
7. GENERAL OFFICE  
(Head of Department – Guntis Didrihsons)
  - 7.1. Division for Guests Reception and Translation Services (Head of Division – Leons Brunavs)
  - 7.2. Clerical Office (Head of Clerical Office – Ilga Strasburga)
  - 7.3. Library (Manager of Library, Deputy Head of Department – Dace Gasina)

## Appendix 7

(cont.)

### 8. GENERAL SERVICE DEPARTMENT

(Head of Department – Einars Ciss)

8.1. Communications and Service Division (Head of Division, Deputy Head of Department – Juris Liepa)

8.2. Building Exploitation Division (Head of Division – Arnis Berzins)

8.3. Transport Division (Head of Division – Imants Vacietis)

### 9. INFORMATION SYSTEMS DEPARTMENT

(Head of Department – Harijs Ozols; Deputy Head of Department – Egons Gailitis)

9.1. System Design and Programming Division (Head of Division – Gunars Dislers)

9.2. System Maintenance Division (Head of Division – Edvins Maurins)

9.3. System Security and Quality Assurance Division (Head of Division – Ilona Etmane)

9.4. Payment System Division (Head of Division – Juris Putrins)

### 10. INTERNAL AUDITING DEPARTMENT

(Head of Department – Modris Briedis; Deputy Head of Division – Anita Haznere)

10.1. Information Systems Audit Division (Head of Division – Andris Brieze)

### 11. LEGAL DEPARTMENT

(Head of Department – Reinis Jakovlevs; Deputy Head of Department – Bruno Macs)

### 12. MONETARY POLICY DEPARTMENT

(Head of Department – Helmut Ancans; Deputy Heads of Department – Laila Ruse, Zoja Medvedevskiha)

12.1. Macroeconomic Analysis Division (Head of Division – Vilnis Purvins)

12.2. Open Market Operations Division (Head of Division – Uldis Pauksens)

12.3. Financial Market Analysis Division (Head of Division – Jelena Zubkova)

12.4. Monetary Research and Forecasting Division (Head of Division – Eriks Abolins)

### 13. PERSONNEL DEPARTMENT

(Head of Department – Inta Lovnika; Deputy Head of Department – Elita Osmuciece)

### 14. PUBLIC RELATIONS DEPARTMENT

(Head of Department, Press Secretary – Edzus Vejins; Deputy Head of Department – Kristaps Otersons)

### 15. PUBLICATIONS DEPARTMENT

(Head of Department – Aina Ranke; Deputy Head of Department – Andris Petersons)

### 16. SECURITY DEPARTMENT

(Head of Department – Armands Steinbergs; Deputy Head of Department – Aldis Lieknins; Head of Security Headquarters – Laimonis Veinsteins)

16.1. Daugavpils Division (Head of Division – Ilmars Suhockis)

## Appendix 7

(cont.)

16.2. Liepaja Division (Head of Division – Ivars Vilcans)

16.3. Rezekne Division (Head of Division – Arnis Stirna)

16.4. Valmiera Division (Head of Division – Aldis Zemmers)

### 17. STATISTICS DEPARTMENT

(Head of Department – Agris Caune; Deputy Head of Department – Ilmars Skarbnieks)

17.1. Statistics Division (Head of Division – Zigrīda Austa)

17.2. Statistics Analysis Division (Head of Division – Inta Gaile)

17.3. Foreign Payment Statistics Division (Head of Division – Anna Petska)

### 18. RIGA BRANCH

(Branch Manager – Janis Strelnieks)

### 19. DAUGAVPILS BRANCH

(Branch Manager – Jolanda Matesa)

### 20. LIEPAJA BRANCH

(Branch Manager – Gundars Lazdans)

### 21. REZEKNE BRANCH

(Branch Manager – Vilhelmine Landsberga)

### 22. VALMIERA BRANCH

(Branch Manager – Sarmite Kleimane)

### 23. LATVIAN BANKING COLLEGE<sup>1</sup>

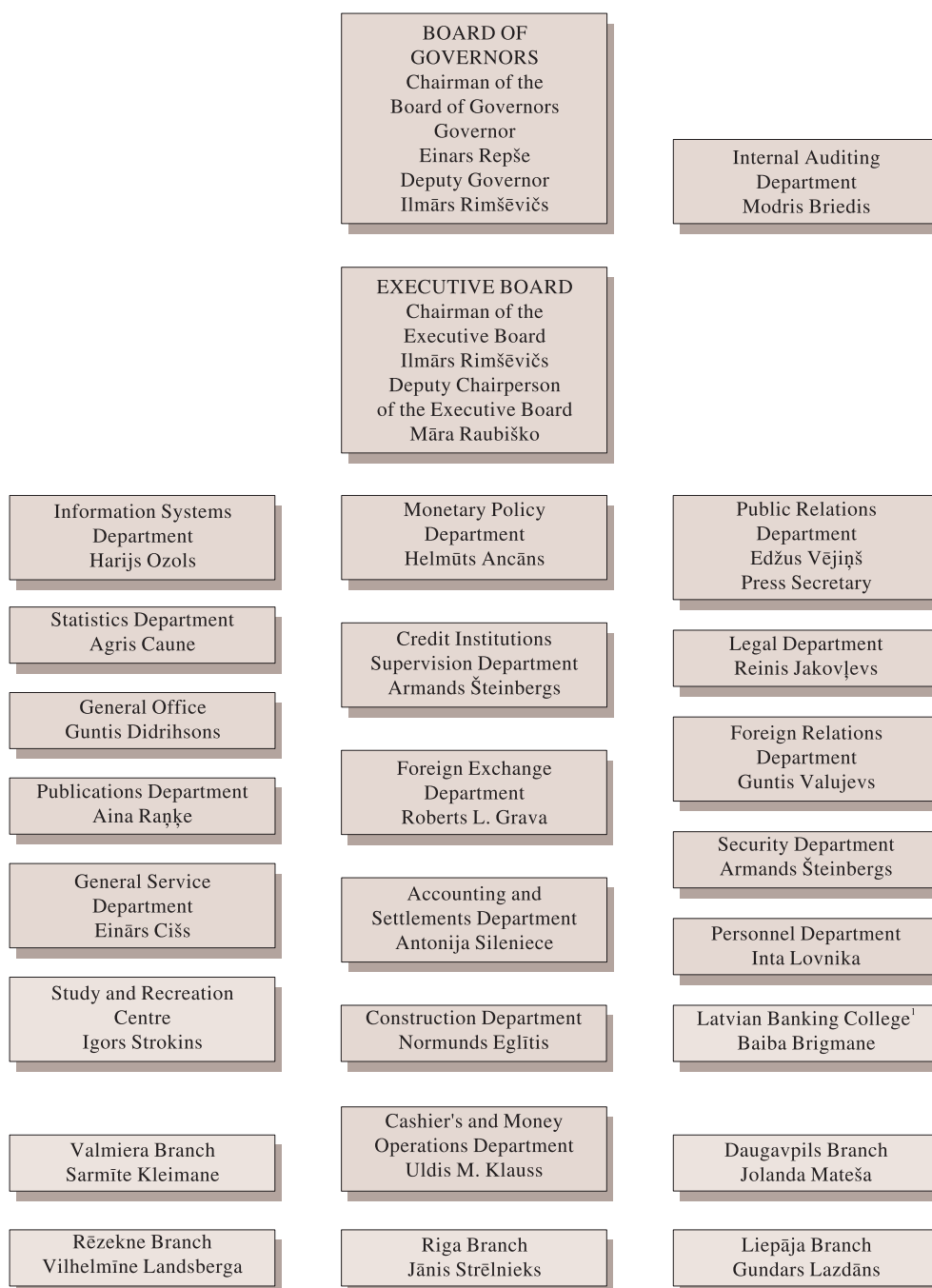
(Principal – Baiba Brigmane; Vice Principal – Inese Vingre)

### 24. STUDY AND RECREATION CENTRE

(Director – Igors Strokins)

<sup>1</sup> The Banking Institution of Higher Education, which assumed the rights and obligations of the Latvian Banking College, was established in accordance with Resolution No. 675 passed by the Cabinet of Ministers on December 30, 1997.

## THE BANK OF LATVIA'S STRUCTURE AT THE END OF 1997



<sup>1</sup> The Banking Institution of Higher Education, which assumed the rights and obligations of the Latvian Banking College, was established in accordance with Resolution No. 675 passed by the Cabinet of Ministers on December 30, 1997.

## Bank of Latvia. Annual Report 1997

Latvijas Banka (Bank of Latvia)  
K. Valdemāra ielā 2a, Rīga, LV-1050, Latvia  
Tel.: (371) 702 2300 Fax: (371) 702 2420  
<http://www.bank.lv>  
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