LATVIJAS BANKA

ANNUAL REPORT 1999

CONTENTS

INTRODUCTION

In 1999, the recovery of the Latvian economy from the downturn caused by the Russian crisis gave rise to a positive development outlook for Latvia.

In the first two quarters of 1999, the decrease in GDP slowed down gradually, while in the third and fourth quarters, GDP grew year-on-year by 0.2% and 2.8%, respectively (a 0.1% growth for the year as a whole). In the service sector, the most pronounced growth was recorded for trade, and real estate, renting and business activities. The domestic trade turnover rose by 12.0%. Value added grew significantly in construction and fishing. Industrial output contracted in 1999; nevertheless, in the fourth quarter, the volume index of industrial output rose by 2.6%. Output showed year-on-year growth predominantly in the sectors related to western markets (the manufacture of wearing apparel, dressing and dyeing of fur; the manufacture of wood and products of wood and cork, except furniture; and the manufacture of other transport vehicles).

The share of the European Union (EU) member states in Latvia's exports reached 57.5%. With imports outweighing exports less markedly, the foreign trade deficit decreased by 11.9%. The balance-of-payments current account deficit was mainly covered with direct investment and the Government's long-term borrowing by issuing eurobonds. In 1999, Latvia witnessed a larger foreign currency inflow than was needed to finance the current account deficit; therefore, the Bank of Latvia's international reserves grew and the balance of payments was in surplus.

With the business activity in the country expanding and becoming brisker, the situation in the labour market improved. In the reporting year, the number of unemployed persons registered at the State Employment Service declined by 1.7%, and the unemployment rate dropped to 9.1%. Compared with 1998, the average monthly gross wage in the public sector (excluding social and religious organizations) increased by 9.7%, and the real gross wage rose by 7.1%.

Price stability was one of the preconditions for the country's macroeconomic stability and foreign investors' interest. Likewise, it enhanced enterprise competitiveness. On average, the consumer price index (CPI) rose by 2.4% in 1999 compared with the previous year (by 4.7% in 1998).

Although the country's fiscal position deteriorated and the government posted a consolidated budget fiscal deficit, the deficit was below the level provided for by the Law "On the State Budget for 1999".

The Bank of Latvia used monetary policy instruments so as to ensure the stability of the national currency, promote a downward trend in money market rates and provide sufficient liquidity to the banking system. The national currency in circulation was fully backed by gold and convertible foreign currencies. The stability of the lats was maintained through fixing the currency to the SDR[1] basket of currencies. Fluctuations in the exchange rates of foreign currencies against the lats were in line with developments in the global foreign exchange market. Although interbank market rates and yields on government securities fluctuated considerably in 1999, they dropped markedly towards the end of 1999. Interest rates on loans granted to domestic enterprises and private persons in lats fell, while interest rates on deposits received from this group of customers were stable.

The Latvian banking sector was also stable and showed gradual growth. In 1999, all major banking indicators rose. The banking sector's assets grew by 14.2%. Loans to domestic

[1] The code for Special Drawing Rights (SDR) in accordance with the International Standard ISO 4217 (Codes for the Representation of Currencies and Funds) is XDR.

enterprises and private persons increased by 15.3%. With purchasing power on the rise and public confidence in the banking system remaining strong, deposits of domestic enterprises and private persons increased. Several internationally well-known banks acquired qualifying holdings in Latvian banks thus reinforcing the capital base of banks and promoting the development of banking services and growth in the Latvian banking sector. Once the JSC *Rīgas Komercbanka* (the new name, the JSC *Pirmā Latvijas Komercbanka*), which suffered from the Russian crisis, was reopened in October, confidence in the banking sector and the financial system became stronger. Moreover, this was evidence of an efficient collaboration among interested parties to find ways for rehabilitating an insolvent bank.

The introduction of consolidated supervision as of July 1, 1999 marked a qualitatively new stage in supervision of credit institutions. Consolidated supervision will provide for an assessment of risks incurred by a bank as a result of capital ties and for objective decision making with respect to the financial standing of banks. With a view to the introduction of one of the most complex EC directives concerning capital adequacy, the Bank of Latvia continued preliminary work, establishing market risk capital requirements.

In the reporting year, the Bank of Latvia improved the interbank funds transfer system and promoted a smooth operation of settlement and payment systems in Latvia. On April 1, 1999, the transition to electronic settlements in the Bank of Latvia interbank funds transfer systems was completed. The Bank of Latvia continued to develop the real-time gross settlement system, which would ensure better risk management, be an effective means for implementing monetary policy and be in compliance with EU requirements.

The planned accession to the EU continued to be the main priority of Latvian foreign and economic policies. In December 1999, Latvia was invited to begin accession negotiations. This provides additional stimulus for the development of Latvia; however, it also obliges the country to undertake a set of measures in order to meet convergence criteria set forth in the Maastricht Treaty, to harmonize and improve the Latvian legislation and to provide for observance of laws.

The rating agencies *Moody's*, *Fitch IBCA* and *Standard & Poor's* retained the previously assigned ratings, which rank Latvia among countries with a safe investment environment. Announcements made by the above agencies concerning their intentions not to change the previously assigned ratings reflected the country's good future growth prospects and acknowledged that Latvia had an opportunity of achieving compliance with EU requirements and setting up a vigorous and growing economy.

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

GLOBAL ECONOMIC ENVIRONMENT

Global economic conditions improved in 1999. According to forecasts by international institutions, world GDP growth was at a level of about 3% (a year-on-year increase of 0.5 percentage points). Regions affected by the 1997–1998 financial crises (Russia, South East Asia, Brazil) recovered at a more rapid pace than was expected, and the crises did not become global. Confidence in emerging financial markets mounted gradually.

In the United States, domestic demand continued to rise (by 5.3%). For the third consecutive year, growth in domestic demand, economic activity and labour efficiency continued to exceed projections. The prolonged and strong growth in GDP (4.1% in 1999) was partly driven by the increasing fixed investment and capital accumulation. The ongoing expansion in the United States is a combination of strong economic growth, declining unemployment and subdued inflation.

Japan's GDP rebounded in growth in the first half of 1999 after the economic recession, which lasted for a year and a half, but this tendency did not continue in the second half of 1999 (growth projected for 1999 is 0.6%–1.0%; in 1998 a decrease of 2.8%). Growth in Japan's GDP was supported by the Government's fiscal stimulus package and a gradual increase in private demand; however, on the whole, growth in the Japanese economy remained somewhat weak.

Last year was remarkable for the introduction of the single European currency in non-cash settlements. The low exchange rate of the euro favourably influenced exports and employment in the euro area. The unemployment rate in the EU reached the lowest level in seven years (9.2%). Although the euro depreciated and oil prices rose, inflation in the EU member states and the euro area remained low (1.2% and 1.1%, respectively). Growth in Western European countries was underpinned by the increasing private consumption and exports, low interest rates (in the euro area interest rates in real terms reached the lowest point since early 1970s), and improving situation in foreign markets.

The rebounding economic activity in Western Europe was a positive stimulus for exports and economic growth in Central and Eastern Europe. In 1999 a decade had passed since this region began the transition to a market economy; however, in only three countries (Poland, Slovakia and Slovenia), out of ten candidates for accession to the EU, GDP exceeded the level achieved in 1989. Average GDP for all ten countries was at 84% of the 1989 level. Last year was remarkable because the European Commission expressed its readiness to start accession negotiations with all applicant countries. In 1999, overall GDP growth for all ten countries averaged 0.5%.

In Lithuania and Estonia, growth recorded for industrial output and exports in the fourth quarter of 1999 indicated that recovery from the 1998 Russian crisis was under way.

The Russian economy continued to send mixed signals. On the one hand, growth tendencies started emerging and inflation fell; on the other hand, the living standard continued to deteriorate, and consumption and savings were stagnant. Russia's GDP increased by 3.2% in 1999. A number of factors promoted the growth. Developments in world markets for raw materials and energy resources were benign. The devaluation of the Russian ruble promoted expansion of the domestic industry, which started producing goods for export and to substitute for similar imported goods (industrial output rose by 8.1%). The positive trends in the real sector, however, did not lead to growth in consumption, savings, exports and investment. The inflation rate rose almost at the same pace as the exchange rate of the Russian ruble decreased.

The global foreign exchange market was somewhat volatile due to the introduction of the euro as of January 1, 1999, economic and political difficulties in the EU, a recovery in the Japanese economy during the first half of 1999, and the prolonged growth of the US economy. This explains fluctuations in exchange rates of the currencies of the SDR basket.

In the reporting year, the euro depreciated against the US dollar (by 14.4%; from 1.1800 to 1.0095), reaching a low of 1.0025 on December 6. The appreciation of the US dollar was driven by the good performance of the US economy, and the sustainability of the trend was supported by principal economic indicators. The strength of the US economy was also manifested in a rapid expansion of the US stock market. The US dollar depreciated against the Japanese yen (by 9.7%; from 113.00 to 102.00). Interventions undertaken by the Bank of Japan kept the exchange rate of the US dollar against the Japanese yen above a level of 102. The British pound fell slightly against the US dollar (by 2.7%; from 1.660 to 1.615).

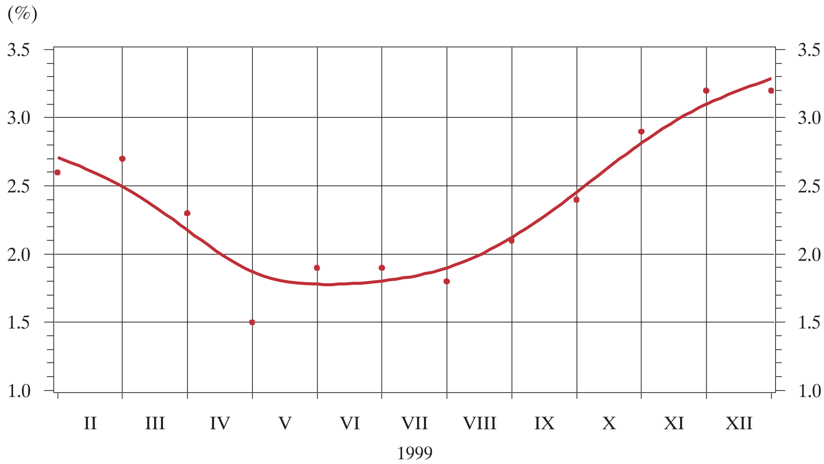
INFLATION AND PRICES

The CPI rose by 3.2% in Latvia in 1999 (see Chart 1). The increase in the index was slightly more pronounced than in 1998, when the CPI rose by 2.8%. A higher consumer price level could be attributable to the increasing oil product prices in world markets and an upswing in economic activity in the second half of the year. On average, the CPI rose by 2.4% in 1999 compared with 1998 (by 4.7% in 1998 compared with 1997).

The upward trend in oil product prices in world markets led to a 28.3% rise in fuel prices in Latvia. The first half of the year was still marked by the influence of the 1998 Russian crisis: sales of products in foreign markets contracted and the saturation of the domestic market led to a decline in food prices. Towards the end of the year, food prices

Chart 1

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



Source: Central Statistical Bureau of Latvia.

again rose because of the mounting economic activity and the influence of the rising fuel prices. In 1999, as before, inflation was largely a result of a rise in administered (i.e., monopoly) prices and of administrative decisions. The most pronounced price increases related to housing maintenance (prices of water supply and sewerage, thermal energy and refuse disposal increased by 10.4%, 3.2% and 3.4%, respectively), telephone services (by 16.5%) and public transport services (by 6.6%). In 1999, the rise in the CPI was also facilitated by the Government's fiscal policy (tax rates and customs duties were changed). At the beginning of the year, the tax rate was raised for diesel oil and petrol. The tax rate for tobacco products and alcoholic beverages was raised twice during the year. In 1999, import duties were increased for a number of goods. Subsequently, the prices of imported goods, also of those used to calculate the CPI (cigarettes, margarine, pork), were increased.

In 1999, the prices of services rose at a more rapid pace than those of goods (by 5.1% and 2.6%, respectively). The most substantial increase in the CPI was observed in January (1.2%). Consumer prices decreased in April, July and August.

In 1999, the average monthly gross wage in the public sector (excluding social and religious organizations) showed a year-on-year increase of 9.7%, amounting to LVL 156.77 (USD 267.98). Since the rise in the gross wage exceeded the rate of annual inflation, the real net wage and the real gross wage were higher than in the previous year (by 6.5% and 7.1%, respectively). The average net wage totalled LVL 113.57 or 72.4% of the average gross wage.

Difficulties in sales of products caused deflation of producer prices. In 1999, the average year-on-year decrease in the index was 4.0% (a year-on-year increase of 1.9% in 1998), including a 5.2% decrease in manufacturing. Producer prices rose in mining and quarrying as well as electricity, gas and water supply (by 6.1% and 1.2%, respectively).

The construction price index rose by 4.4% in the reporting year (by 11.0% in 1998).

Export prices fell by 3.6% in 1999 (by 0.2% in 1998). The most substantial export price decreases were recorded for miscellaneous manufactured articles (including furniture and toys; 9.1%), pulp of wood, paper and paper board (7.9%), prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco products; 7.2%), and wood and articles of wood (3.6%). Export prices of live animals and animal products, and products of the chemical and allied industries rose (by 2.6% and 2.2%, respectively). Exports at current prices declined (by 5.7%), while in real terms, exports fell by only 2.1%.

Import prices decreased by 5.3% in 1999 (by 2.0% in 1998). They fell in all major import product groups, except mineral products (a price increase of 4.3%). The largest import price decreases were recorded for base metals and articles of base metals (14.8%), transport vehicles (9.6%), prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco products; 9.0%), plastics and articles thereof, rubber and articles thereof (7.9%), and products of the chemical and allied industries (7.8%). The decrease in imports in real terms (3.2%) was smaller than the decrease in imports at current prices (8.4%).

GROSS DOMESTIC PRODUCT

In 1999, Latvia's GDP (at constant prices) amounted to 2 741.0 million lats, showing a year-on-year increase of 0.1%. As in previous years, value added increased in the service sector (by 5.0%). At the same time, value added declined in the goods-producing sector (by 6.4%). The rate of decrease in GDP slowed from 1.5% in the first quarter to 1.1% in the second quarter, while in the third and fourth quarters, GDP increased by 0.2% and 2.8%, respectively (see Table 1). In the service sector, value added showed the largest growth in trade (10.4% in 1999), real estate, renting and business activities (17.8%), and other community, social and personal service activities (7.9%). The domestic trade turnover (at constant prices) amounted to 1 233.6 million lats in 1999 (a 12.0% increase over the 1998 level). Some of the indicators of the service sector fell. With oil and other transit declining, cargoes loaded and unloaded at the Ventspils and Riga ports decreased by 5.3% and 9.8%, respectively. Cargoes loaded and unloaded at Latvian ports decreased by 6.2%. Decreases in transit, export, import and domestic transportation by rail (6.2%, 34.9%, 23.0% and 20.3%, respectively) led to a decline in cargo traffic by rail (12.3%). Oil transportation by pipeline decreased by 13.7%, while the transportation of oil products by pipeline increased by 11.9%.

In the goods-producing sector, value added increased significantly in construction (by 8.1%), fishing (by 27.9%), and mining and quarrying (by 9.9%). At the same time, value added decreased in agriculture, hunting and forestry (by 8.3%), electricity, gas and water supply (by 5.2%) and manufacturing (by 9.8%).

The volume index of industrial output dropped rapidly in the first and second quarters; in the third quarter, the rate of decrease slowed; and in the fourth quarter, the index rose by 2.6%. In 1999, the volume index of industrial output decreased by 9.8%. Year-on-year growth was recorded mainly for sectors aimed at western markets: the manufacture of wearing apparel, dressing and dyeing of fur (2.6%), the manufacture of wood and products of wood and cork (except furniture; 6.0%), and the manufacture of other transport vehicles (5.3%). In the fourth quarter, output rose rapidly in the manufacture of pulp, paper and paper products (21.3%) and the manufacture of fabricated metal products (except machinery and equipment; 51.4%). The decline in output of other sectors of industry slowed down considerably.

The value added of agriculture declined as a result of a decrease in the size of the sown area and the declining production of milk, meat and eggs (by 15.0%, 12.8% and 9.0%, respectively).

The number of unemployed persons decreased by 1.7% during 1999, and at the end of the year, 109 497 unemployed persons were registered at the State Employment Service. The unemployment rate was 9.1% (9.2% at the end of 1998). In the first four months of the year, the number of unemployed persons rose as the Russian crisis continued to influence the economic activity of enterprises. In the following months, the unemployment rate embarked on a falling trend. The number of unemployed persons decreased also due to seasonal factors; however, the main influence was the rebounding enterprises' activity and increasing economic activity. At the end of the year, the lowest unemployment rate was registered in Riga and the Saldus district (4.8% and 6.1%, respectively), while the highest, in the Rēzekne and the Balvi districts (27.2% and 22.9%, respectively).

Table 1

GROSS DOMESTIC PRODUCT AND GROSS VALUE ADDED AT CONSTANT PRICES (YEAR-ON-YEAR BASIS)

(%)

	Q1	Q2	Q3	Q4	1999
GDP	–1.5	–1.1	0.2	2.8	0.1
Goods-producing sector	–10.4	–10.8	–3.9	–0.3	–6.4
Service sector	4.9	6.5	3.6	5.1	5.0

Source: Central Statistical Bureau of Latvia.

FOREIGN TRADE

The turnover of Latvia's foreign trade amounted to 2 732.2 million lats in 1999 (a year-on-year decrease of 7.4%). Both exports and imports declined (by 5.7% and 8.4%, respectively), and imports outweighed exports to a lesser extent (76.0% in 1998; 71.0% in 1999). Exports increased by 4.9% and imports decreased by 7.8% in August–December compared with the corresponding period of 1998 (the beginning of the Russian crisis).

The foreign trade deficit decreased by 96.8 million lats, totalling 715.6 million lats (see Table 2). The largest trade deficit was recorded for machinery, mechanical appliances and electrical equipment, mineral products, products of the chemical and allied industries, and transport vehicles. Due to declining imports, the trade balance of transport vehicles as well as base metals and articles of base metals improved considerably. With exports decreasing, the trade balance of prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco products) deteriorated. Only a few product groups had a positive trade balance: wood and articles of wood, textiles and textile articles, and miscellaneous manufactured articles. The positive trade balance of wood and articles of wood covered half of the foreign trade deficit.

Latvia's principal trading partners were the EU member states, whose share in the foreign trade turnover expanded from 55.7% in 1998 to 57.5% in 1999. Latvia's exports to these countries increased by 26.2 million lats, while imports decreased considerably. The share of the CIS countries decreased from 17.1% to 13.9%, respectively. The balance of trade with Russia deteriorated as Latvia's exports to that country declined by 48.5%. The most significant partners in terms of export were Germany, the United Kingdom, Sweden, Lithuania and Russia, whereas in terms of import, Germany, Russia, Finland, Lithuania and Sweden. Substantial growth was recorded for exports to the United States (ferrous metals), Puerto Rico (ferrous metals), Slovakia (glass and articles thereof) and Canada (ferrous metals). This was indicative of expanding markets for Latvia's goods.

In the reporting year, Latvia's principal export goods were wood and articles of wood (37.3% of total exports), textiles and textile articles (15.4%), base metals and articles of base metals (11.5%), and products of the chemical and allied industries (6.0%). Although total exports declined, exports of wood and articles of wood (sawn wood), base metals and articles of base metals (in particular, non-ferrous metals and articles thereof), mineral products (products of mineral oils distillation), miscellaneous manufactured articles (furniture) and other less significant commodity groups rose. Prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco products), machinery, mechanical appliances and electrical equipment, live animals and animal products, and textiles and textile articles were product groups, whose exports showed the largest decline.

In 1999, the following product groups dominated imports: machinery and mechanical

Table 2

LATVIA'S FOREIGN TRADE TURNOVER

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

	1997	1998	1999
Exports	971.7	1 068.9	1 008.3
Imports	1 582.4	1 881.3	1 723.9
Balance	–610.7	–812.4	–715.6

Source: Central Statistical Bureau of Latvia.

appliances, electrical equipment (21.9% of total imports), products of the chemical and allied industries (12.0%), mineral products (11.4%), transport vehicles (8.3%), and textiles and textile articles (7.7%). Of total imports, the most substantial decreases were recorded for transport vehicles, base metals and articles of base metals, prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco products; due to a particularly pronounced decrease in imports of sugar and non-alcoholic beverages), and textiles and textile articles. An increase in imports was observed for few product groups, which accounted for a small part of the total.

The currencies used most frequently in foreign trade transactions were the US dollar (44.3% of foreign trade turnover) and the German mark (22.9%). The shares of the US dollar, the German mark, the Finnish mark and the Russian ruble contracted, while those of the lats, the British pound and the Danish crown expanded. Of all foreign trade transactions, 3.4% was in euros.

In 1999, the balance-of-payments current account deficit was 372.0 million lats or 10.2% of GDP (10.6% in 1998). The positive balance of services increased, while the balance of income deteriorated. The positive balance of services covered 33.4% of the foreign trade deficit. The current account deficit was mainly covered with foreign direct investment and the Government's long-term borrowing in world eurobond markets. The country witnessed a larger foreign currency inflow than was needed to finance the current account deficit, and the Bank of Latvia's international reserves increased and the balance of payments was in surplus.

FISCAL POLICY

At the end of the year, the fiscal deficit in the general government consolidated budget (147.0 million lats or 4.0% of GDP) was below the level prescribed by the Law "On the State Budget for 1999" (4.5% of GDP).

The general government consolidated budget was in deficit as a result of growing expenditure (mainly for social security and welfare, and defence) and lower-than-projected revenue from taxes and privatization of state property. In 1999, the general government consolidated budget revenue and expenditure increased over the previous year's level (by 0.3% and 10.0%, respectively). In the general government consolidated budget, the financial deficit was 140.1 million lats, net lending was 6.9 million lats and fiscal deficit was 147.0 million lats. The budget's revenue equalled 43.2% of the country's GDP (44.1% in 1998), expenditure 47.0% (43.8% in 1998), and financial deficit 3.8% (in 1998, the financial surplus was 0.3% of GDP).

The share of tax revenue in GDP did not decrease; however, its structure was different. Revenue from social security contributions and the personal income tax increased compared with 1998 (by 5.9% and 9.7%, respectively), while other tax revenue decreased. Revenue from the value added tax was only 0.03% lower than in the previous year. Revenue from the excise tax, corporate income tax, customs duties and property tax decreased below the 1998 level (by 8.4%, 0.2%, 18.6% and 3.7%).

In 1999, the central government basic budget revenue was 648.1 million lats (a year-on-year decrease of 4.7%), expenditure totalled 692.0 million lats (a year-on-year increase of 4.7%), and net lending was 71.4 million lats. Capital expenditure remained at approximately the same level as in the previous year (9.3% of expenditure; 9.1% in 1998).

In the reporting year, the revenue and expenditure of the central government special budget exceeded the 1998 level (by 7.2% and 17.6%, respectively). The budget's fiscal deficit was 89.6 million lats. The largest deficit was in the social security budget (57.6 million lats), whose expenditure, due to larger expenditure for pensions and unemployment benefits, showed a year-on-year increase of 16.2% or 72.3 million lats (almost half of the increase in the general government consolidated budget expenditure). The revenue of the State Property Privatization Fund amounted to only 6.2 million lats (37.0 million lats in 1998). The fiscal deficit in the central government special budget mainly was financed by borrowing from the central government basic budget. Revenue and expenditure of the local government consolidated budget increased over the 1998 level (by 4.1% and 7.7%, respectively). The budget's fiscal deficit was 14.4 million lats, and it was financed by borrowing from the central government basic budget and the banking sector.

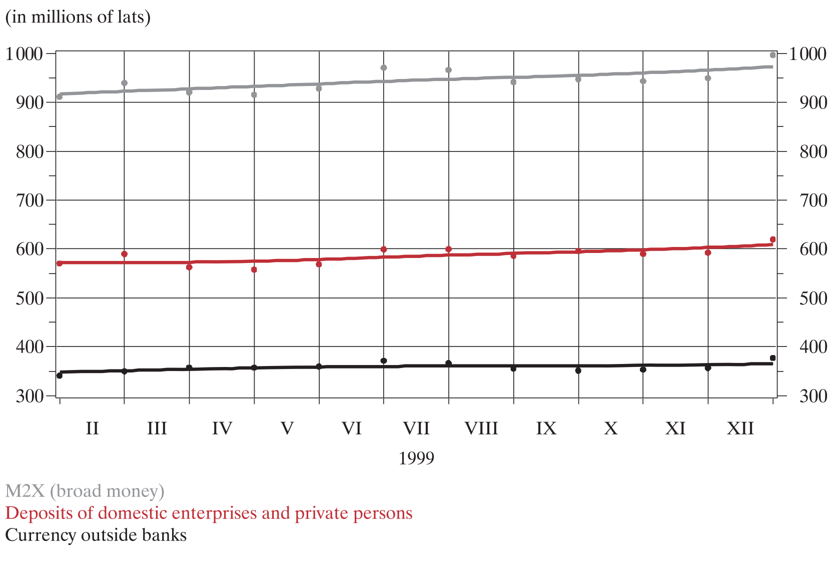
The fiscal deficit in the general government consolidated budget (147.0 million lats) was mainly financed by government borrowing: the government debt increased by 138.1 million lats in 1999 (including 130.1 million lats as a result of the issue of eurobonds).

MONEY SUPPLY

The monetary indicators of the Latvian banking system and the Bank of Latvia are included in Appendix 1 to the Annual Report. Broad money M2X[1] grew by 8.0% during 1999, amounting to 997.2 million lats at the end of the year (see Chart 2). The growth rate of broad money rose by 2.1 percentage points in 1999 compared with 1998. In the first half of the year, broad money increased more rapidly (by 5.2%; the monthly average increase of 0.9%) than in the second half of the year, when, due to the growing demand for foreign currencies and the Bank of Latvia's interventions in the foreign exchange market (particularly

Chart 2

BROAD MONEY



[1] Currency outside banks plus deposits of domestic enterprises and private persons in the national and foreign currencies.

in August and September), it showed a less rapid increase (2.7%; the monthly average increase of 0.5%). The increased money supply was caused by the mounting economic activity, seasonal factors, and high year-end money demand, which rose because banks increased their liquid assets in preparation for increased demand for cash during the Year 2000 rollover period. Growth in broad money was also promoted by the growing private persons' demand for cash as well as bank loans, which increased as banks placed funds attracted outside Latvia in the domestic market.

The stable economic situation and increasing savings were the factors facilitating a decrease in the velocity of money from 4.09 in 1998 to 3.84 in 1999.

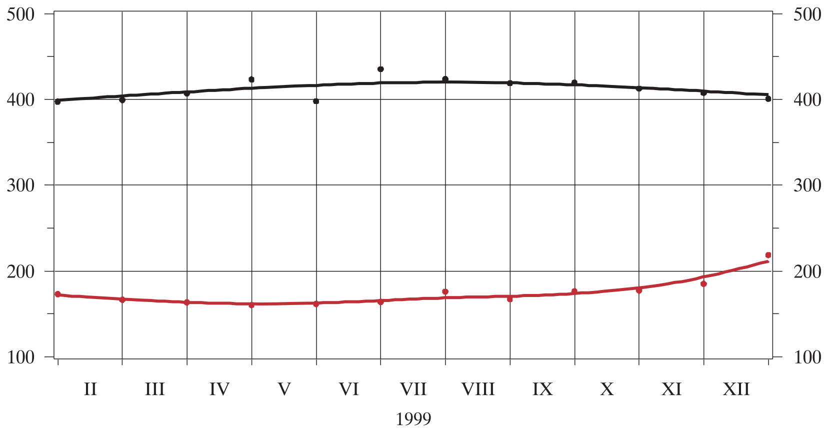
Although several sectors of the national economy were subject to short-lived shocks as well as rises and falls in the economic activity, and some banks experienced difficulties, the banking system continued to enjoy public confidence; therefore, with purchasing power increasing, deposits of domestic enterprises and private persons grew by 6.3% (see Chart 3); however, an increase of 8.2% observed in 1998 was more marked. Currency outside banks increased more rapidly (by 10.9%; by 2.3% in 1998). This was facilitated by seasonal factors and the December increase in currency outside banks (5.7%; 4.9% in January–November) due to the potential Year 2000 problem. The share of currency outside banks in broad money reached 37.8% at the end of 1999 (36.9% at the end of 1998). At the same time, the share of demand deposits in broad money decreased from 44.3% at the end of 1998 to 40.2% at the end of the reporting year. The increasing share of time deposits (from 18.9% to 21.9%, respectively) was indicative of a long-term economic stability. Deposits of private persons continued to dominate in time deposits (53.9%). Deposits of enterprises accounted for the largest part of demand deposits (64.7%).

Deposits in lats increased at a less rapid pace than deposits in foreign currencies (by 1.4% and 12.3%, respectively). This led to a decrease in the share of deposits in lats to 51.8% of total deposits (54.4% at the end of 1998).

Chart 3

DEPOSITS OF DOMESTIC ENTERPRISES AND PRIVATE PERSONS WITH BANKS

(at end of period; in millions of lats)



Time deposits
Demand deposits

Quasi-money, a less liquid component of broad money, increased more rapidly than its more liquid component M1 (by 12.5% and 5.4%, respectively).

In the reporting year, the banking sector used funds attracted outside Latvia for issuing loans to domestic enterprises and private persons and for investing in Latvian government securities. As a result, the banking system's net foreign assets decreased during the year (by 54.2 million lats or 13.0%, including an increase of 110.4 million lats in net foreign liabilities of the banking sector). The banking sector's foreign assets increased by 135.6 million lats or 16.6%, and foreign liabilities, by 246.0 million lats or 28.3%. In foreign assets, demand and short-term deposits with foreign credit institutions increased by 47.6% (to 416.0 million lats), investment in debt securities of banks and the private sector, 2.1 times (to 90.4 million lats), loans to foreign non-banks, by 12.5% (to 178.5 million lats). At the same time, investment in foreign enterprise shares, investment in foreign government securities and trust assets decreased (by 4.9 times, 15.6% and 15.9%, respectively).

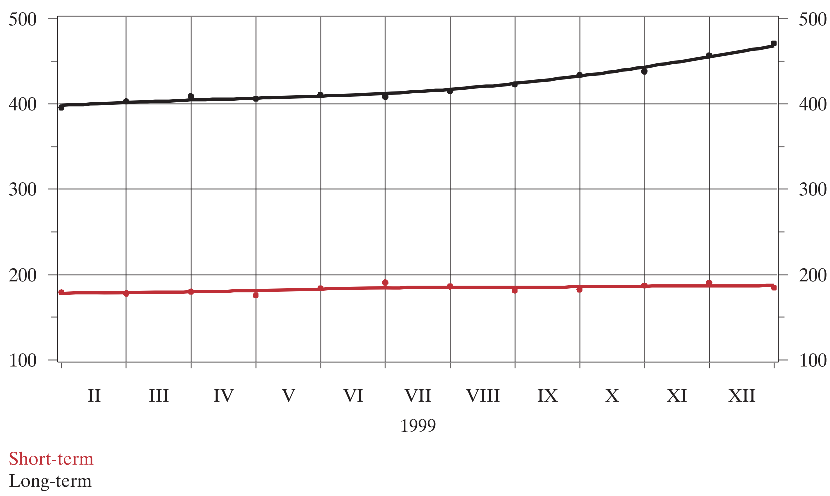
Loans to domestic enterprises and private persons increased by 87.2 million lats or 15.3%, while the banking sector's net claims on the central government, by 57.3 million lats or 2.5 times (to 95.9 million lats). Loans to domestic enterprises and private persons increased as a result of lessening credit risk, falling interest rates, increasing funds attracted by banks and a longer maturity of the funds, which allowed banks to issue loans of longer maturity. In the reporting year, long-term loans to domestic enterprises and private persons grew by 89.3 million lats or 23.4%, while short-term loans decreased by 2.1 million lats or 1.1% (see Chart 4). At the end of 1999, the maturity profile of loans was as follows: short-term loans accounted for 28.2% (32.9% at the end of 1998), loans with a maturity of 1 to 5 years for 55.3% (54.1%) and loans with a maturity over 5 years for 16.5% (13.0%). The demand for loans in lats was lower than the demand for loans in foreign currencies, and at the end of the year, loans in lats accounted for 41.4% of total loans (45.3% at the end of 1998).

Loans showed growth in most sectors of the national economy, the largest of which,

Chart 4

LOANS TO DOMESTIC ENTERPRISES AND PRIVATE PERSONS IN NATIONAL AND FOREIGN CURRENCIES

(at end of period; in millions of lats)



manufacturing, showed a substantial increase of 12.2%. More rapid increases were recorded for electricity, gas and water supply (2.6 times), hotels and restaurants (2.6 times) and construction (24.4%). At the end of 1999, manufacturing had received 148.4 million lats (26.4% of loans to domestic enterprises), trade 139.4 million lats (24.8%), and transport, storage and communication 73.0 million lats (13.0%).

DEPOSIT AND LENDING RATES

The improving country's macroeconomic indicators after the Russian crisis, declining business risks, growing bank competition and falling interest rates in the securities and interbank markets promoted a decrease of 2.7–3.9 percentage points in interest rates for loans granted in lats. Interest rates on loans in the currencies of the OECD countries fluctuated slightly during the year. Changes in the weighted average interest rates of deposits in lats and the currencies of the OECD countries ranged from 0.7 to 2.3 percentage points.

At the end of 1999, the weighted average interest rate of long-term deposits in lats was 7.8% (see Chart 5), and that of long-term deposits in the currencies of the OECD countries was 6.6%. The weighted average interest rates of short-term deposits in lats and in the currencies of the OECD countries were considerably lower (4.2% and 4.8%, respectively).

At the end of 1999, the weighted average interest rates of short-term and long-term loans in lats decreased to 12.5% and 12.6%, respectively (see Chart 6). In December, the weighted average interest rates of short-term and long-term loans in the currencies of the OECD countries were 11.5% and 10.6%, respectively.

In the reporting year, the weighted average interest rates on deposits received and loans granted in the currencies of the OECD countries were lower than on deposits received and loans granted in lats.

As in 1998, the real weighted average interest rates of time deposits were positive;

Chart 5

WEIGHTED AVERAGE INTEREST RATES ON LATS DEPOSITS OF DOMESTIC ENTERPRISES AND PRIVATE PERSONS

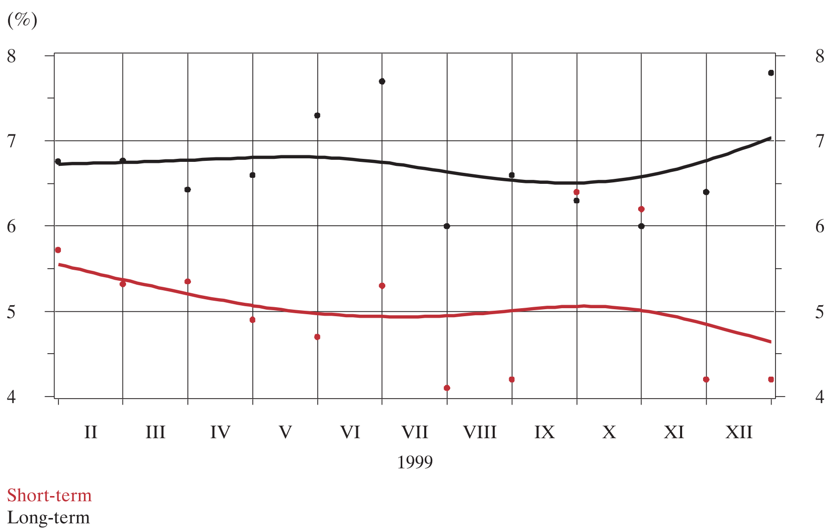
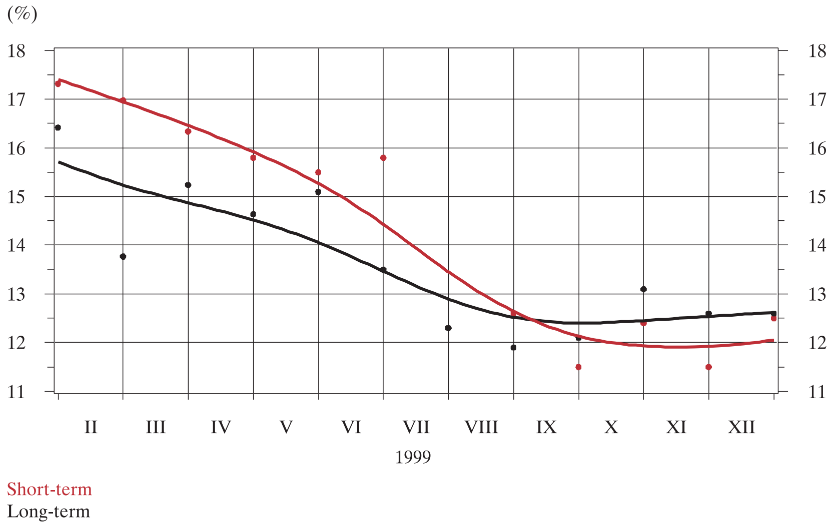


Chart 6

WEIGHTED AVERAGE INTEREST RATES ON LOANS GRANTED IN LATS



however, they gradually declined during the year (to 1.2%; 3.7% in December 1998), slowing down growth in residents' deposits.

During the year, the interest-rate spread decreased for short-term and long-term transactions in lats (from 9.9 percentage points to 8.4 percentage points and from 8.6 percentage points to 4.7 percentage points, respectively) and for short-term and long-term transactions in the currencies of the OECD countries (from 9.7 percentage points to 6.6 percentage points and from 4.8 percentage points to 4.0 percentage points, respectively).

THE INTERBANK MARKET

In the reporting year, the domestic interbank market was influenced by the rebounding confidence among banks and their increasing activity. At the beginning of the year, market turnover continued to decrease due to caution among banks caused by liquidity difficulties in some of the banks and restrictions imposed on some banks' activity. (The lowest monthly value of transactions, 140.6 million lats, was registered in April.) With the year in progress, banks' results for 1998 were released and their liquidity improved. This resulted in brisk activity in the interbank market, where the highest monthly value of transactions was recorded in August (258.8 million lats). In the last months of the year, loans granted in the interbank market again decreased slightly, because in September and October bank liquidity declined due to the increasing demand for foreign currencies and banks' borrowing funds in lats at the Bank of Latvia in November and December. The number of interbank market participants increased from 19 to 24 during the reporting year.

In 1999, the average monthly amount of interbank loans was 201.9 million lats (307.2 million lats in 1998). The bulk of interbank loans was overnight and with a maturity up to one month (86.9% and 12.4%, respectively). The demand for interbank loans in lats was higher (68.6% of total domestic interbank loans).

The higher activity and stronger liquidity of banks were the reasons that promoted a fall in interbank market rates. The weighted average interest rate of overnight loans in lats decreased from 5.5% in January to 3.4% in August, rose to 7.2% in September and October, and dropped rapidly in the last months of the year. Interest rates on interbank loans in the currencies of the OECD countries followed a different pattern. The weighted average interest rate of overnight loans in the currencies of the OECD countries ranged from 4.5% to 5.4%.

The banking sector's credit to foreign banks increased 1.4 times (to 25.6 billion lats).

MONETARY BASE

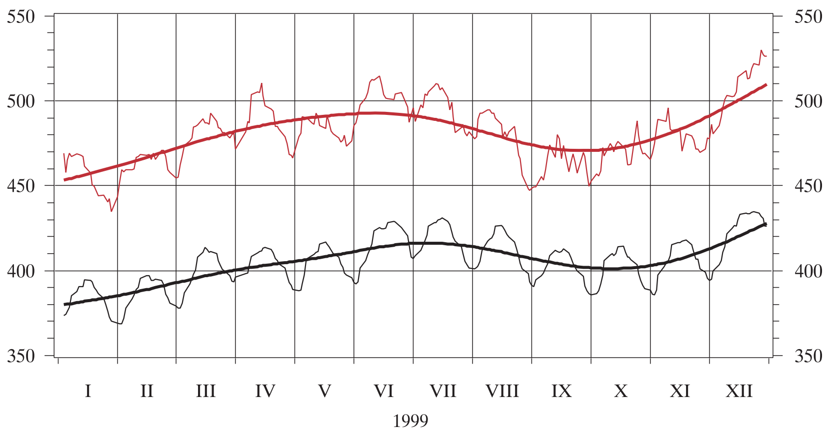
The monetary base M0[1] increased by 11.6%, amounting to 526.2 million lats at the end of 1999 (see Chart 7). Changes in the monetary base were prompted by the economic upturn at the end of the year and activities undertaken by banks in order to meet the possibly high demand for cash during the Year 2000 rollover period. As banks increased their liquid assets, bank deposits with the Bank of Latvia grew significantly (in December, the monetary base grew by 10.0%, currency in circulation by 7.8%, and bank deposits with the Bank of Latvia by 20.7%). In 1999, an increase in the issue of currency (13.8%) outweighed the growth in deposits with the Bank of Latvia (3.2%). At the end of the year, currency in circulation accounted for 81.0% of the monetary base (79.4% at the end of 1998).

In 1999, a net amount of 31.9 million lats was sold under currency swap arrangements (the largest amounts were recorded in October, November and March; currency swaps as at the end of a year increased 2.1 times compared with 1998). This along with funds received from the sales of eurobonds in May and October (225.0 million euro) led to growth in the Bank's net foreign assets (by 56.3 million lats or 12.1%, to 521.6 million lats at the end of the year; see Chart 8). The Bank's net foreign assets equalled 3.6 months' imports (3.0 at the end

Chart 7

MONETARY BASE

(in millions of lats)



Monetary base
Currency in circulation

[1] Currency in circulation plus deposits with the Bank of Latvia.

of 1998). The backing of the national currency with the Bank's net foreign assets was 99.1% (98.7% at the end of the previous year). In several months (mostly in August and September) the Bank of Latvia intervened in the market by selling foreign currencies.

The Bank of Latvia's net domestic assets decreased by 1.5 million lats, because an 11.3 million lats increase in credit to banks and a 44.3 million lats increase in net other assets were offset by a decrease in net claims on the Government (57.1 million lats). The demand for the Bank of Latvia's credit peaked in August, September and October, when the banking sector's liquidity, due to the central bank's interventions in the foreign exchange market, was less strong. Of the annual amount of the Bank of Latvia's credit, 61.5% was granted in the second half of the year. Of total credit, 74.2% was loans under repo agreements, 23.1% was demand Lombard loans, and 2.7% was automatic Lombard loans (for the monthly average credit, see Table 3).

Chart 8

NET FOREIGN ASSETS OF THE BANK OF LATVIA

(in millions of lats)

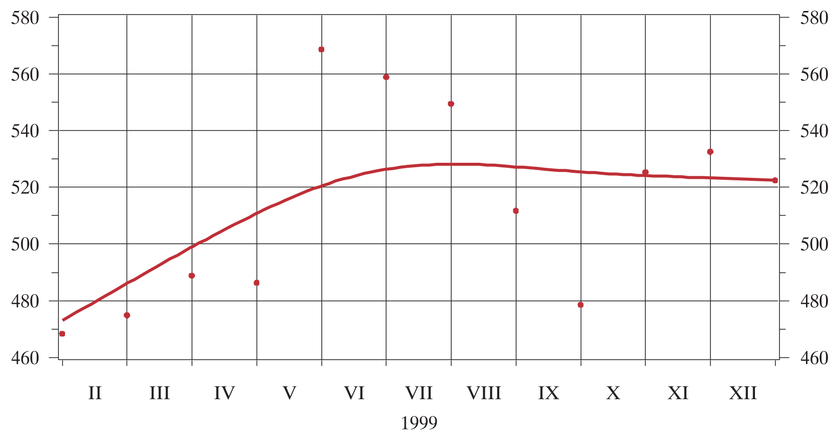


Table 3

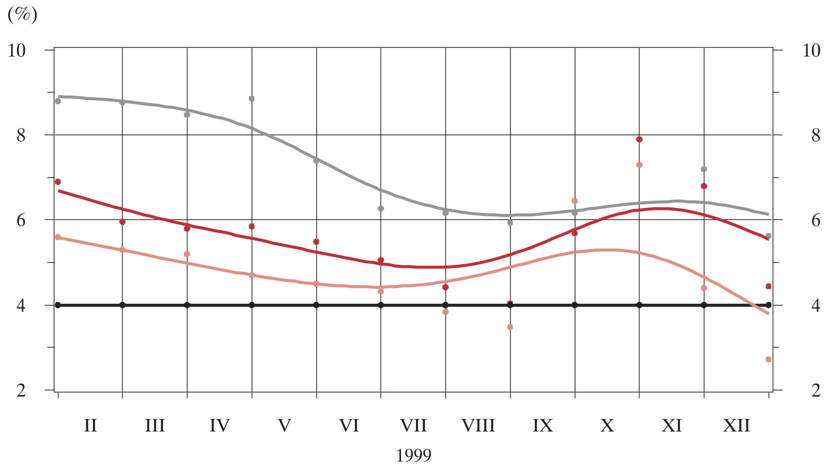
THE BANK OF LATVIA'S CREDIT TO BANKS

(average balances; in millions of lats)

	1997	1998	1999
January	2.7	8.5	42.5
February	0.7	11.9	60.7
March	1.8	14.4	74.9
April	1.8	13.4	71.0
May	7.3	15.8	55.7
June	6.8	10.1	48.7
July	9.0	17.2	42.4
August	4.2	17.4	37.9
September	0.3	33.1	48.1
October	3.2	34.2	38.2
November	6.9	33.9	40.0
December	8.3	37.5	53.1

Chart 9

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 domestic interbank loans in lats

Loans issued under repo agreements were of 7-, 28- and 91-day maturity. Loans issued under repo agreements showed the following totals by maturity: 310.8 million lats with 7-day maturity, 99.9 million lats with 28-day maturity, and 95.1 million lats with 91-day maturity. Compared with 1998, the amount of repo loans and demand Lombard loans increased (by 3.9%, to 505.8 million lats; by 4.2%, to 157.6 million lats, respectively). At the same time, the amount of automatic Lombard loans decreased (by 4.2%, to 18.1 million lats).

The Bank of Latvia's refinancing rate remained at a level of 4.0% in 1999. The repo rate changed in line with the fluctuations of interbank market rates: it fell from 6.9% in January to 4.0% in August, then rose reaching 7.9% in October, and finally dropped to 4.4% in December (see Chart 9).

Growth in the monetary base was smaller because of a decrease in the Bank of Latvia's net credit to the Government, which occurred because of a 33.6 million lats increase in the Government's deposit with the Bank of Latvia and a 19.3 million lats decrease in the Bank's portfolio of government securities.

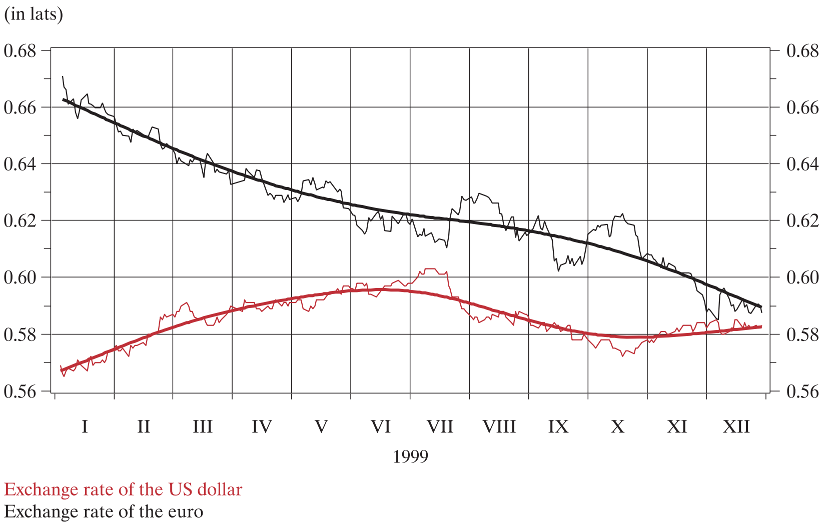
THE FOREIGN EXCHANGE MARKET AND GOVERNMENT FOREIGN DEBT

In the global foreign exchange market, the US dollar depreciated only against the Japanese yen, while appreciating against the other currencies of the SDR basket (the euro and the British pound) and the lats (from 0.5690 to 0.5830; by 2.5%; see Chart 10 and Appendix 5). The lowest level, 0.6075, was observed on July 12. On several occasions, the exchange rate of the lats in the domestic foreign exchange market was close to the selling rate of the US dollar quoted by the Bank of Latvia; therefore, the Bank intervened in the market by selling US dollars and buying lats.

At the end of 1999, the Government's foreign borrowing totalled 359.0 million lats or 9.8%

Chart 10

EXCHANGE RATES OF THE US DOLLAR AND THE EURO SET BY THE BANK OF LATVIA



of GDP. Foreign borrowing by enterprises in the amount of 66.6 million lats was backed by government guarantees. In 1999, total foreign borrowing increased by 127.4 million lats (the Latvian Government issued eurobonds in the amount of 225.0 million euro or 132.2 million lats). The Government's guarantees increased by 23.7 million lats. By the end of 1999, the Latvian Government had signed loan agreements and issued guarantees in the total amount of 565.2 million lats.

In 1999, 28.2 million lats was spent to service the government foreign debt (37.0 million lats in 1998). This amount is equal to 2.8% of the annual volume of exports. Under the Stand-By Arrangement, the Bank of Latvia repaid 3.4 million XDR (2.7 million lats) to the International Monetary Fund (IMF). Payments in the amount of 7.6 million XDR (6.1 million lats) were made for 45.8 million XDR received under the IMF's Systemic Transformation Facility.

GOVERNMENT SECURITIES AND STOCK MARKETS

The Bank of Latvia acted as the Government's agent in organizing auctions of and accounting for government securities in the primary market for Latvian government securities. The placement of government securities was ensured through auctions.

The lowest banks' demand for government securities was registered in March, September and November, when due to various reasons banks' liquidity decreased and the demand/supply ratio in government securities auctions did not rise above 1.0. The demand/supply ratio, however, increased from 1.2 in 1998 to 1.8 in 1999, because in several months (May, August, October and December) demand exceeded supply more than twofold.

Although the state budget was in deficit, the Ministry of Finance reduced the supply of government securities by 10.0% (to 232.2 million lats). This was possible due to the successful placement of eurobonds in world securities markets. Auctions of 1- and 3-month Treasury bills were held once a week, and auctions of 6-month bills, once a fortnight. Treasury bills with a maturity of 12-months and 2-year Treasury bonds were auctioned less frequently, but their issues were larger. Several auctions of 1-, 3- and 6-month bills failed to take place as there was no demand. In the reporting year, 40 auctions of 1-month bills, 43 of 3-month bills, 22 of 6-month bills and 11 of 12-month bills were held. Two issues of 2-year bonds were sold in four auctions.

The stock of government securities outstanding increased by 14.8% during the year, totalling 145.8 million lats at the end of the year. At the end of 1999, the maturity profile of securities outstanding revealed a year-on-year increase in the shares of all Treasury bills: 12-month bills accounted for 41.3% of the total, 6-month bills for 8.3%, 3-month bills for 2.7% and 1-month bills for 1.0%. At the same time, the share of 2-year bonds decreased to 46.7% of the total (for the stock of government securities outstanding during the year, see Chart 11).

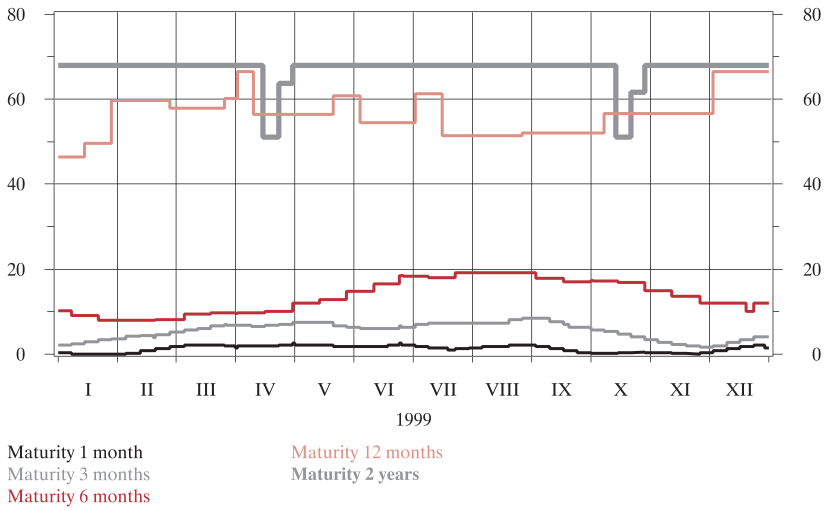
Yields on government securities were dependent on the supply. At the beginning of the year, the weighted average discount rates of Treasury bills ranged from 6.4% (for 1-month bills) to 10.6% (for 12-month bills), while in the summer, with bank liquidity becoming stronger, they fell to the range of 4.1%–7.3%. In October and November, when the demand for foreign currencies was high, the weighted average discount rates of Treasury bills rose, while falling to the range of 4.6%–7.6% in December (see Chart 12). The fixed income rate of 2-year bonds decreased from 13.50% in April to 12.25% in October.

In the secondary market the Bank of Latvia bought government securities in the amount of 31.2 million lats, but did not enter into any selling transactions. (In 1998, the Bank bought securities in the amount of 89.9 million lats and sold securities in the amount of 19.6 million lats.) The share of the Bank's transactions in the secondary market for government securities decreased to 7.5% (15.6% in 1998), and that of government securities held by the Bank, to 20.9% of the total (38.7% in 1998). The Bank's largest transactions were recorded in July and

Chart 11

STOCK OF LATVIAN GOVERNMENT SECURITIES OUTSTANDING

(in millions of lats)



December, when the Bank bought government securities in the amount of 11.2 million lats and 9.4 million lats, respectively.

In 1999, the value of transactions in the secondary market for government securities decreased by 40.8% (to 417.4 million lats). The share of transactions between banks and resident non-banks declined from 78.0% in 1998 to 70.6% in the reporting year; concurrently, the shares of transactions between banks and non-residents and transactions among banks increased (from 2.3% to 11.8% and from 4.1% to 10.2%, respectively). At the end of 1999, resident banks and non-banks held a large amount of government securities (71.9% and 5.5% of the total, respectively).

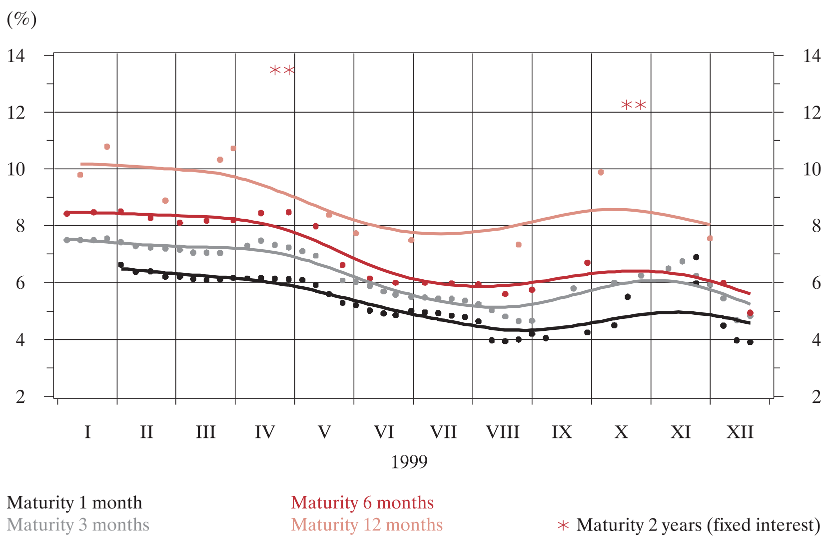
In 1999, activity in the Latvian stock market was somewhat low. The Dow Jones Riga Stock Exchange Index fell by 10.4% in the reporting year (to 87.8). The index fell from the beginning of the year until October, reaching a low of 69.8 on October 1. In the last months of the year, the index rose. The change was brought about by the recovery of Eastern Europe from the aftermath of the Russian crisis and growth tendencies in the Latvian economy. In the last months of the year, foreign investors' activity in the Latvian stock market increased because the Riga Stock Exchange, as stock exchanges in other Baltic States, made a decision to join the NOREX. This made Latvian enterprises' shares more attractive to investors from the Nordic area.

The privatization slowed down somewhat, and the Riga Stock Exchange started quoting the shares of only one large enterprise, the JSC *Latvijas Gāze*.

In 1999, the market capitalization increased by 5.0%, reaching 229.2 million lats (about 6% of GDP). Turnover on the stock exchange was 27.9 million lats (a 41.9% decrease over the 1998 level).

Chart 12

WEIGHTED AVERAGE DISCOUNT RATES OF GOVERNMENT SECURITIES



1999 HIGHLIGHTS OF NORMATIVE ACTS ADOPTED IN PURSUIT OF THE BANK OF LATVIA'S MAIN TASKS

January 14
The Board of Governors of the Bank of Latvia adopted amendments to the "Regulation for Calculating Credit Institution Performance Indicators" (in effect as of January 31, 1999).
The Board of Governors of the Bank of Latvia passed a resolution "On Auditing Annual Financial Statements of Credit Institutions".

March 10
The Executive Board of the Bank of Latvia adopted the new version of the "Regulation for Interbank Settlements Effected by the Bank of Latvia" (in effect as of April 1, 1999).

March 11
The Board of Governors of the Bank of Latvia adopted the "Regulation for Consolidated Annual Financial Statements of Banks" (in effect as of May 1, 1999).
The Board of Governors of the Bank of Latvia adopted the "Regulation for Consolidated Supervision of Banks" (in effect as of May 1, 1999).
The Board of Governors of the Bank of Latvia adopted amendments to the "Regulation for Annual Financial Statements of Credit Institu-tions" (in effect as of May 1, 1999).
The Board of Governors of the Bank of Latvia adopted amendments to the "Regulation for Preparing the Monthly Financial Position Report of Credit Institutions and Appendices to the Report" and amendments to the "Monthly Financial Position Report" and its appendices (in effect as of September 1, 1999).
The Board of Governors of the Bank of Latvia adopted amendments to the "Regulation for Receiving a Cash Collection Licence".
The Board of Governors of the Bank of Latvia adopted the "Regulation for Receiving Bank of Latvia Permits Governing Credit Institution Operations" (in effect as of May 1, 1999; article 7.4 in effect as of May 1, 2001).

March 31
The Executive Board of the Bank of Latvia adopted the "Regulation for Accepting Time Deposits from Banks at the Bank of Latvia" (in effect as of April 12, 1999).

April 29
The Executive Board of the Bank of Latvia adopted the "Regulation for Compiling Credit Institution Statistical Reports for Electronic Transmission" (in effect as of July 1, 1999).

May 13
The Board of Governors of the Bank of Latvia adopted the "Regulation for Year 2000 Compliance".
The Board of Governors of the Bank of Latvia adopted the "Regulation for Compiling Credit Institution Payment Statistics" (in effect as of July 1, 1999).

July 15	The Board of Governors of the Bank of Latvia adopted the "Regulation for Compiling 'Report on Country Risk' " (in effect as of October 1, 1999). The Board of Governors of the Bank of Latvia adopted the "Regulation for Assessing Assets and Off-Balance-Sheet Liabilities" (in effect as of January 1, 2000). The Board of Governors of the Bank of Latvia adopted amendments to the "Regulation for Preparing the Monthly Financial Position Report of Credit Institutions and Appendices to the Report" (in effect as of January 1, 2000; the transition period will end on June 30, 2000).
September 16	The Board of Governors of the Bank of Latvia adopted the "Regulation for Compiling the 'Report on Natural Person Job Contracts for Working Abroad' " (in effect as of January 1, 2000).
October 28	The Executive Board of the Bank of Latvia adopted the new version of the "Regulation for Encrypting and Digitally Signing Information" (in effect as of November 5, 1999). The Executive Board of the Bank of Latvia adopted the new version of the "Regulation for Using the Interbank Network" (in effect as of November 5, 1999).
November 17	The Board of Governors of the Bank of Latvia reduced the reserve requirement for credit institutions by 1.0 percentage points (to 7%; in effect as of December 1, 1999). The Board of Governors of the Bank of Latvia adopted the new version of the "Regulation for Receiving Bank Time Deposits at the Bank of Latvia" (in effect as of December 1, 1999). The Board of Governors of the Bank of Latvia adopted the new version of the "Regulation for Granting Bank of Latvia Lombard Loans" (in effect as of December 1, 1999).
December 10	The Board of Governors of the Bank of Latvia established the following maturities and interest rates for bank time deposits held with the Bank of Latvia (in effect as of December 13, 1999): 7 days, 2.0% per year; and 14 days, 2.25% per year. The Board of Governors of the Bank of Latvia established the following Lombard rates (in effect as of December 13, 1999): 6% per year if credit is utilized for a period up to 10 days during 30 consecutive days; 7% per year if credit is utilized for 11 to 20 days during 30 consecutive days; and 8% per year if credit is utilized for 21 or more days during 30 consecutive days.

SUPERVISION OF CREDIT INSTITUTIONS

SYSTEM OF CREDIT INSTITUTIONS

At the end of the reporting year, there were 33 licensed credit institutions in the Republic of Latvia, comprising 23 banks, 9 credit unions, the Riga Branch of *Société Générale* (France), and the representative office of *Dresdner Bank AG* (Germany).

In 1999, the Bank of Latvia issued credit institution operating licences to four credit unions: *Raunas Kooperatīvā krājaizdevu sabiedrība*, *Pūņu Kooperatīvā krājaizdevu sabiedrība*, *Jūrnieku forums* and *Zosēnu Kooperatīvā krājaizdevu sabiedrība*. By the end of the year, the latter two had not been registered at the State Enterprise Register and had not started operating.

The Bank of Latvia revoked the credit institution operating licence of the JSC bank *Land* for the failure to meet the requirements for own funds as stipulated in the Law "On Credit Institutions" and a regular non-compliance with the requirements governing the activity of credit institutions as stipulated in the said law. The Bank issued permits to reorganize a number of banks: the JSC *Latvijas Industriālā banka*, which was insolvent, was merged with the JSC *Baltijas Starptautiskā banka*, the JSC *Rīgas Naftas un ķīmijas banka* was merged with the joint-stock commercial bank *Baltijas Tranzītu banka*; the JSC *Latvijas Kredītbanka* was reorganized into an undertaking other than a credit institution. The licences of the banks that ceased to exist as a result of a reorganization were revoked.

In 1999, two banks, whose insolvency had been recognized, were rehabilitated in accordance with the rehabilitation plans approved by the Bank of Latvia. During the rehabilitation of the JSC *Rīgas Komercbanka*, most of creditors' claims were capitalized, additional funds were attracted from shareholders and the number of shareholders was increased thereby restoring the bank's solvency. The bank's name was changed for the JSC *Pirmā Latvijas Komercbanka*. When rehabilitating the JSC *Latvijas Industriālā banka*, the bank was reorganized by merging it with the JSC *Baltijas Starptautiskā banka*, to which all the bank's liabilities and rights were transferred.

At the end of 1999, the total paid-up share capital of credit institutions amounted to 208.6 million lats (a 4.3% increase over the end-1998 level). Fourteen banks received the Bank of Latvia's permission to increase their share capital in 1999. The share of foreign investment in banks' share capital declined, to 66.2% of the share capital at the end of 1999. Foreign investment was made in twenty banks; in twelve of these, foreign shareholders owned over 50% of the share capital, and six banks were the subsidiaries of foreign banks. The Latvian Government was the sole owner of the JSC *Latvijas Hipotēku un zemes banka*.

DEVELOPMENT OF THE BANKING SECTOR

In 1999, the ongoing positive development of Latvian banks and credit unions was reflected in strong performance indicators of credit institutions: assets (excluding trust assets) increased by 16.4%, reaching 1 962.9 million lats, the largest amount since the restoration of Latvia's independence; loans issued to and deposits received from resident non-banks grew by 16.1% and 23.8%, respectively.

In the reporting year, credit unions became more active. Their assets grew by 24.9%; however, they still accounted for only 0.03% of total credit institutions' assets.

In 1999, the banking sector recovered from the consequences of the Russian financial crisis, and the profit earned during the year amounted to 12.5 million lats. At the end of the year, the equity of credit institutions totalled 186.3 million lats.

The capital adequacy ratio of the banking sector, which in accordance with the Law "On Credit Institutions" may not fall below 10%, was at 16% at the end of the year.

Latvian banks' assets (excluding trust assets) increased by 16.4%. The structure of assets as at the end of 1999 did not show any substantial year-on-year changes. In view of possible Year 2000 compliance disturbances and to be able to meet depositors' claims, banks increased, by 3.5%, their liquid assets (vault cash, claims on the Bank of Latvia and credit institutions, government securities). As a result of this, the share of such assets reached 42.8% of total assets. Of liquid assets, 45.1% was claims on credit institutions in the OECD countries. At the end of 1999, the ratio of banks' liquid assets to current liabilities was 64% (the Bank of Latvia's regulations stipulate that this ratio may not fall below 30%).

Of total loans, 77.1% was issued to domestic enterprises and private persons. Loans were mainly granted to manufacturing, trade, and transport, storage and communication.

The maturity profile of the loan portfolio continued to show positive development trends. The share of medium-term loans (1 year to 5 years) increased from 46.9% to 49.5%, as did that of long-term loans (over 5 years), from 12.7% to 15.3%. The share of short-term loans declined from 40.4% to 35.2%. These changes are indicative of a gradual transition from short-term lending to trade to lending to the goods-producing sector and the service sector.

At the end of 1999, total non-bank deposits received by banks amounted to 1 290.8 million lats, the all-time highest level recorded for Latvian banks. This confirms public confidence in the Latvian banking sector. The maturity profile of deposits tends to show positive changes. The share of demand deposits declined to 68.3% (74.9% at the end of 1998), and short-term deposits increased by 65.2% (28.1% of total deposits).

An increase registered for loans granted to and deposits received from residents shows that Latvian banks increasingly seek to be active in the domestic market.

EXAMINATIONS OF THE ACTIVITY OF CREDIT INSTITUTIONS

In 1999, the Bank of Latvia's staff conducted 56 on-site inspections, of which 49 were in banks. As in previous years, attention was mainly directed at the evaluation of risk assets, analysis of internal control systems and internal audit.

The growing lending activity of banks throughout 1999 led to an increase in loans granted and the introduction of new types of credit. Hence, in bank examinations attention was increasingly paid to the assessment of borrowers' financial standing and solvency so as to timely detect difficulties that might arise in repaying loans.

As credit institutions expanded their activity and introduced new financial services, the focus was on the improvement of the internal control systems at banks to provide for a prudent management of traditional and new risks.

Cognizant of the possible effect of the Year 2000 problem on financial institutions, the Credit Institutions Supervision Department monitored whether banks took adequate measures to avoid the Year 2000 problem and, in collaboration with the Information Systems Audit Division of the Internal Audit Department, conducted the relevant audits.

The auditing companies *Arthur Andersen*, *Deloitte & Touche* and *PricewaterhouseCoopers* performed interim reviews on behalf of the Bank of Latvia, assessing selected banks' financial statements for the first half of 1999 in accordance with International Standards on Auditing. Banks' internal control systems and the Year 2000 compliance also were assessed.

REGULATIONS GOVERNING THE ACTIVITY OF CREDIT INSTITUTIONS

In the reporting year, the Bank of Latvia continued to harmonize banking regulations with the requirements of EC directives and the Basle Core Principles for Effective Banking Supervision.

The Bank's Board of Governors approved amendments to the "Regulation for Calculating Credit Institution Performance Indicators". The definition of Zone A countries has been altered in view of the evolution of the global economy. The procedure to be used for calculating the open foreign exchange position after the introduction of the euro is established. Likewise, the amendments reflect changes in the Law "On Credit Institutions".

The "Regulation for Receiving Bank of Latvia Permits Governing Credit Institution Operations" came into effect on May 1, 1999, replacing the "Regulation for Amending the Charter, Changing the Shareholders, the Initial Capital, the Management, the Chief Accountant, the Legal Address, the Name of Credit Institutions, and Undertaking Merger or Split-up of Credit Institutions", which was approved by the Bank of Latvia Board of Governors on March 15, 1996. In the new regulation, the requirements concerning the identification of credit institutions' shareholders, their financial standing and qualifying holdings in other undertakings or business ventures are set out more explicitly and are expanded, in particular distinguishing whether said undertakings or business ventures include credit institutions, financial institutions or financial holding companies. The regulation lists the relevant documents to be submitted. Another new requirement establishes that should a credit institution intend to render new financial services, it must inform the Bank of Latvia 30 days in advance and concurrently submit to the Bank of Latvia a description of policies and procedures for managing inherent risks.

Pursuant to the amendments to the Law "On Credit Institutions", consolidated supervision was introduced in Latvia as of January 1, 1999. In view of this, the Bank of Latvia developed the "Regulation for Consolidated Supervision of Banks" (in effect as of May 1, 1999). The regulation establishes procedures for the preparation of financial statements and information for the purposes of consolidated supervision, determines enterprises to be included in the consolidated financial statements, and describes the procedure for calculating performance indicators on a consolidated basis.

When preparing annual financial statements for 1999 and the subsequent years, credit institutions will have to comply with the "Regulation for Consolidated Financial Statements of Banks". Consolidated annual financial statements must disclose information about the financial standing and activity results of the group consisting of a bank (a parent undertaking) and its subsidiaries to any person or investor wishing to obtain such information.

Within the framework of the continued harmonization of laws and regulations with the EC directives, the Bank's Board of Governors approved amendments to the "Regulation for Annual Financial Statements of Credit Institutions" (in effect as of May 1, 1999). The amendments relate to the disclosure of additional information in the notes to the annual financial statements about the average number of a credit institution's employees, salaries of its board and executive board members and total amounts of their advances, loans, guarantees and other their transaction amounts, as well as information about subordinated claims, liabilities and claims on associated and related companies to be included in the balance sheet.

The "Regulation for Compiling 'Report on Country Risk' " (in effect as of October 1, 1999) will regularly provide the Bank of Latvia, the credit institutions supervisory body, with information that will enable it to evaluate country risk inherent in credit institutions' operations.

The development of the "Regulation for Assessing Assets and Off-Balance-Sheet

Liabilities" (in effect as of January 1, 2000) was prompted by considerable qualitative changes in lending and credit risk management practices of Latvian banks. The regulation replaced the "Provisions for Evaluating Credits and Off-Balance-Sheet Items" approved by the Board of Governors on January 17, 1996. The regulation was worked out in accordance with the consultative paper of the Basle Committee on Banking Supervision "Sound Practices for Loan Accounting and Disclosure", and provides guidelines for evaluating the quality of assets and off-balance-sheet liabilities, their classification in accordance with the determined degree of credit risk, as well as for disclosing changes in their quality in financial statements.

In the reporting year, work on a number of regulatory documents was begun to complete the harmonization of the Latvian banking legislation with the EU legislation and to introduce the EC directives establishing the capital adequacy requirement with respect to market risks.

INTERNATIONAL COOPERATION

INTERNATIONAL FINANCIAL INSTITUTIONS

In 1999 Latvia, as a member country, continued its activity within the 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 its participation in the Bank for International Settlements.

The Stand-By Arrangement in the amount of 33.0 million XDR (available for 16 months) signed between Latvia and the IMF to support the Latvian Government's economic policy came into effect on December 10, 1999. The credit facility, however, was not utilized in the reporting year.

Latvia's quota in the IMF totalled 126.8 million XDR at the end of 1999.

COOPERATION WITH FOREIGN CENTRAL BANKS

In 1999, the Bank of Latvia continued cooperation and exchange of expertise and information with central banks in other countries. The Bank's employees visited the Bank of Ireland, *Banque de France*, *Českį Nįrodnķ Banka*, *Danmarks Nationalbank*, *Deutsche Bundesbank*, *Eesti Pank*, *Suomen Pankki* and the European Central Bank (ECB). Authorities from *Danmarks Nationalbank* and *Deutsche Bundesbank* visited the Bank of Latvia.

In May 1999, the Bank's employees participated in the sixth seminar for the central banks of the Baltic countries in Vilnius to discuss issues of monetary policy, statistics and payment systems. In 1999, Deputy Governors of the central banks of the Baltic states agreed to convene regular meetings.

TECHNICAL ASSISTANCE

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

The IMF Technical Assistance Mission provided consultations to the Credit Institutions Supervision Department on the introduction of capital adequacy requirement as consistent with EC directives and other requirements.

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 *Österreichische Nationalbank*.

Five of the Bank's employees received scholarships from the Nordic Council of Ministers for working at central banks and public institutions in Denmark, Finland, Iceland, Norway and Sweden.

In the reporting year, the Bank of Latvia also provided technical assistance by participating in seminars and providing consultations to the employees of the National Bank of Ukraine on issues relating to banking legislation and credit institutions supervision.

PREPARATION FOR THE EUROPEAN UNION

In 1999, the Bank of Latvia continued its cooperation with the Latvian Government and governmental institutions to promote Latvia's accession to the EU. The Bank's employees participated in screening Latvian legislation pertaining to capital mobility, financial services, the European Monetary Union and statistics at the European Commission.

In the reporting year, the Bank prepared amendments to Latvian laws and normative documents as well as reviewed and amended regulations governing the activities of Latvian credit institutions so as to harmonize them with the requirements of EC directives.

In 1999, a regular exchange of information and cooperation with the ECB was begun. The Bank of Latvia Governor and Deputy Governor participated in a meeting of central bankers from EU applicant countries in Helsinki, which was organized by the ECB. Working contacts between the ECB and the Bank of Latvia were established in the field of statistics and payment systems.

REPORT OF THE BANK OF LATVIA EXECUTIVE BOARD

Economic developments in Latvia were closely related with major tendencies in the global economic environment and world financial markets. On the international scale, last year was remarkable for the strong performance of the US economy, a rebounding economic activity in Western Europe and also in Japan (in the first half of the year), the introduction of the single European currency, reviving confidence in financial markets of transition economies, and rising interest rates in major world economies. The domestic situation was marked by the election of a new government in the summer of 1999, debates about the country's fiscal position, economic reforms and a further structural reform of the national economy, as well as preparations for accession to the EU. The intricate pattern of reciprocal relationships among the above factors shaped Latvia's macroeconomic position. Much effort was expended to cope with the consequences of the 1998 Russian financial crisis and to achieve year-end growth in industrial output and exports. Monetary policy implemented by the Bank of Latvia reinforced the stability and gradual growth of the Latvian financial sector.

The Bank of Latvia Executive Board conducted the daily activities of the Bank, following the requirements of the Laws "On the Bank of Latvia" and "On Credit Institutions", and directives of the Board of Governors on monetary policy, credit institutions supervision and other activities of the Bank. The Executive Board developed draft resolutions for the Bank's Board of Governors to provide for a better organization of the financial market and improved supervision of credit institutions. In the reporting year, the Bank of Latvia Executive Board convened 66 meetings and passed 130 resolutions on credit institutions supervision, 11 resolutions on the utilization of monetary policy instruments and 274 resolutions on conducting other day-to-day business of the Bank.

THE BANK OF LATVIA'S FOREIGN EXCHANGE POLICY AND INTERNATIONAL RESERVES

The country witnessed a larger foreign currency inflow than was needed to finance the current account deficit; therefore, the Bank of Latvia's international reserves increased by 10.9%, amounting to 550.6 million lats at the end of 1999. Growth in international reserves resulted from the issue of eurobonds successfully enacted by the Government in May and October, currency swap arrangements entered into by the Bank of Latvia and profitable investments in foreign financial markets. It offset the influence exerted by fluctuations of foreign exchange and interest rates, as well as the Bank's interventions in the interbank market.

In 1999, the Bank of Latvia did not change its foreign exchange rate policy, retaining the stability of the lats against the SDR basket of currencies (XDR 1 = LVL 0.7997 since 1994). The exchange rate of the lats against other currencies changed in line with developments on the global foreign exchange market.

THE BANK OF LATVIA'S MONETARY POLICY INSTRUMENTS

The Bank of Latvia used monetary policy instruments in accordance with market economy principles, approximating the ECB practice.

The low inflation rate and monetary policy aimed at the stabilization of money market and exchange rates were the key factors enabling the Bank of Latvia to retain the refinancing rate at the level of 4.0% throughout the reporting period; the refinancing rate had been at this level since April 25, 1997. To follow trends in the money market and to lower interbank market rates, the Bank of Latvia decreased the Lombard rates by 1.0 percentage points as of December 13. At the end of the reporting year, the Lombard rate was at 6.0% per year for the first ten days of credit utilization, at 7.0% per year as from the eleventh to the twentieth day of credit utilization, and at 8.0% per year as from the twenty-first day of credit utilization.

In the reporting year, the Bank of Latvia continued to quote two money market indices: RIGIBID and RIGIBOR. The indexes were based on the quotes of six banks, which were the most active money market participants.

The Bank of Latvia offered to banks repurchase agreements of 7-, 28- or 91-day maturity and Lombard loans. The amount of credit granted by the Bank to the domestic banking sector was considerable and it increased from 52.0 million lats at the beginning of the year to 63.3 million lats at the end of the year.

To restrict the money supply, the Bank of Latvia continued to attract bank time deposits of 7- and 15-day maturity (as from December, with 7- and 14-day maturity). At the beginning of 1999, 7-day deposits were received at an interest rate of 6.0% and 15-day deposits at an interest rate of 6.5%. Interest rates on time deposits were decreased gradually, to 2.0% for 7-day deposits and 2.25% for 14-day deposits at the end of the year. In the reporting year, the Bank of Latvia received 7-day time deposits in the amount of 209.8 million lats, 14-day deposits in the amount of 9.3 million lats, and 15-day deposits in the amount of 180.3 million lats (the weighted average interest rate was 4.2%).

The Bank of Latvia held regular currency swap auctions, thus providing banks with opportunities for obtaining funds in lats without entering into foreign exchange operations and with lower foreign exchange risk. Currency swaps were of 7- and 28-day and 3-month maturity (in November and December, also of 6-month maturity). In the reporting year, funds involved in currency swaps totalled 237.4 million lats (an increase of 3.0 times over the 1998 level). Of all currency swap arrangements, 49.5% was with 3-month maturity, 31.0% with 28-day maturity, 15.9% with 7-day maturity and 3.6% with 6-month maturity. In 1999, the weighted average interest rate of currency swaps was 6.7% (7.7% in 1998).

In accordance with the rights delegated by the Law "On the Bank of Latvia" and to follow tendencies in the Latvian money market and the dynamics of monetary indicators, to gradually reach the level for the respective indicator as set by the ECB, the Bank of Latvia reduced the reserve requirement for credit institutions from 8.0% to 7.0% as of December 1. The reserve requirement is applicable to the average funds received by a credit institution (irrespective of currency and maturity, and excluding liabilities to credit institutions, the state budget and funds received by foreign branches of Latvian banks). The reserve requirement was met with balances on accounts of credit institutions with the Bank of Latvia and average vault cash balances in lats (the cash component was not to exceed 50%). The cash component of the required reserves did not change substantially (38.7% in December 1999).

The Government deposited excess funds as demand and time deposits in lats with the Bank of Latvia, including 411.0 million lats placed in deposits with a maturity of two weeks and 20.0 million lats in deposits with a maturity of three months. The opening of a consolidated account for the State Treasury with the Bank of Latvia resulted in better management of governmental funds and a larger government deposit with the Bank. (In the reporting year, the government deposit increased by 33.7 million lats or 1.8 times.) To offset the impact of the government deposit on the money supply, the Bank increased its portfolio of government securities. The value of the Bank's transactions in the secondary market for government securities amounted to 31.2 million lats in 1999.

BALANCE-OF-PAYMENTS AND FINANCIAL STATISTICS

On August 10, 1999, the Bank of Latvia and the Central Statistical Bureau of Latvia concluded an agreement "On Compiling the Balance of Payments" with the aim of speeding up and improving the compilation of the balance of payments, ensuring that EU requirements with regard to the periodicity of disseminating the balance of payments are met and following the experience of other countries. The agreement stipulates that the Bank of Latvia will start compiling the balance of payments as from the first quarter of 2000.

To receive proper balance-of-payments statistics, the Bank of Latvia concluded agreements with a number of respondents, who had been reporting to the Central Statistical Bureau of Latvia. According to the agreements, reporting forms to be submitted by respondents will cover a wider scope of data.

The Bank of Latvia, in collaboration with other institutions in the Republic of Latvia, continued to seek for and investigate new data sources. As of 2000, apart from data on non-bank external payments, monthly information will be gathered from enterprises who render intermediation services that relate to concluding job contracts between resident natural persons and non-resident employers on employment abroad.

Before taking over the compilation of the country's balance of payments, the Bank of Latvia tested the specially designed system so as to detect and avoid deficiencies and drawbacks in time. The software developed for the balance-of-payments purposes was tested and improved, and the quality of balance-of-payments statistics compared to the respective balance of payments compiled by the Central Statistical Bureau of Latvia.

As Latvia plans its accession to the EU, new financial reporting forms in the field of banking and monetary statistics were introduced so as to show the currency and country profile of credit institutions' transactions. These reporting forms meet ECB requirements in respect of banking and monetary statistics, provide a basis for investigation and analysis of financial markets by region and facilitate management of country risk.

In 1999, the Bank of Latvia, to comply with the requirements of the "Regulation for Compiling Credit Institution Statistical Reports for Electronic Transmission" worked out instructions for preparing reports on credit institution payment statistics and the credit institution monthly financial position as well as software for receiving these data in an electronic format.

In 1999, the Bank of Latvia disseminated financial statistics through its regular publications and the Bank's Internet site, as well as the IMF's Dissemination Standards Bulletin Board and the IMF publication *International Financial Statistics*. The Bank also supplied financial information to the Bank for International Settlements and the Eurostat.

SETTLEMENT AND PAYMENT SYSTEMS

In the reporting year, the Bank of Latvia continued to improve payment systems to promote a reliable and efficient operation of interbank funds transfer systems. On April 1, 1999, the transition to electronic settlements in the Bank of Latvia interbank funds transfer systems was completed.

The electronic clearing system (EKS) of the Bank of Latvia, which is used for processing retail payments, replaced the previous, paper-based clearing system. The EKS is an automated clearing house system, which processes bulk payments submitted in electronic form.

The Bank of Latvia's two gross settlement systems (one for paper-based payment orders and the other for electronic payment orders) were consolidated into the electronic funds transfer system (EFTS). This system is intended for large-value interbank market transactions and the settlement of monetary policy operations of the Bank of Latvia. Settlements in the system are effected by using the S.W.I.F.T. technology.

To facilitate and ensure the usage of electronic settlement in the Bank of Latvia interbank funds transfer systems, a new version of the "Regulation for Interbank Settlements Effected by the Bank of Latvia" was adopted.

The EFTS processed 0.1 million payment instructions with the total value of 13.5 billion lats, and the EKS, 6.9 million payment instructions with the total value of 4.6 billion lats. Thus 7.0 million payment instructions with the value of 18.1 billion lats were processed by the Bank of Latvia funds transfer systems.

In the reporting year, the Bank of Latvia continued to implement the project on the interbank automatic funds transfer system (SAMS). The SAMS is the largest and the most important project in the area of payment systems undertaken by the Bank of Latvia with the assistance of the EU PHARE program. The SAMS is a real-time gross settlement system. The system will enhance risk control and will be effective means for implementing monetary policy. The SAMS is intended for large-value and urgent payments relating to money market transactions, and it will replace the EFTS. The establishment of such system is also in line with EU requirements.

The international invitation to tender announced by the Bank of Latvia for the right to develop the SAMS expired in 1999. Once the Bank of Latvia had signed the contract in November 1999, work at the implementation of the SAMS project started. It is planned that the new system will go live at the end of 2000.

On November 12, 1999, the Bank of Latvia started processing budgetary payments in an electronic form through the account of the State Treasury opened with the Bank of Latvia. The State Treasury also receives complete information about budgetary payments electronically.

To collect statistics necessary for the oversight of payment systems in Latvia and implementing monetary policy, the Bank of Latvia adopted the "Regulation for Compiling Credit Institution Payment Statistics". Pursuant to the regulation, the Bank has started to gather information about payment instruments maintained by banks and settlement environment.

The Bank of Latvia, in collaboration with banks, the Central Depository of Latvia and other institutions, compiled a report on payment and settlement systems in Latvia. The report was included in the ECB publication *Blue Book: Payment systems in countries that have applied for membership of the European Union*.

To continue the harmonization of legislation and to incorporate the requirements of

Directive 98/26/EC "On Settlement Finality in Payment and Securities Settlement Systems", a number of the Bank of Latvia regulations regarding the interbank funds transfer systems of the Bank of Latvia were amended.

SOLUTION TO THE YEAR 2000 PROBLEM

To get a timely, comprehensive and safe assurance that the Bank's information and other systems will be capable of smooth operation throughout the Year 2000 rollover period, a working group for coordinating solutions to the Year 2000 problem was formed on October 15, 1998 upon the Bank of Latvia Governor's instruction. The Bank of Latvia carefully monitored the banking sector to see whether measures taken to address the potential Year 2000 problem were adequate and whether banks complied with the requirements set forth by the "Regulation for Year 2000 Compliance". The Bank of Latvia collaborated with banks and other Latvian and foreign financial institutions and participated in similar working groups formed by the Government.

The coordination centre for all Latvian financial institutions, which was established by the Bank of Latvia, gathered information on the readiness of these institutions for the Year 2000 and any deficiencies detected. The Common Coordination Centre for Solving the Year 2000 Problem in Latvia and mass media were informed about the situation in the Latvian financial sector.

As the Bank of Latvia and the Latvian financial sector prevented the potential disturbances in the functioning of information systems at their disposal in time, a normal business activity of the infrastructure was ensured.

MONEY CIRCULATION

In the reporting year, the Bank of Latvia introduced a new 2-lats circulation coin. A modern technological solution was applied in minting the new coins: coins were produced of two different alloys. The introduction of the new bimetallic coin will enhance the security of the Latvian currency.

In the reporting year, currency in circulation increased by 13.8% (from 374.4 million lats to 426.1 million lats). Over a period of five years, the indicator grew 1.9 times. The share of banknotes of larger denominations expanded at a more rapid pace, both in terms of number and value.

Banknotes and coins received from the banking system were checked for authenticity and fitness for circulation by using automated cash processing machines. In the reporting year, the amount of processed cash (538.6 million lats, of which 137.8 million lats or 25.6% were worn and destroyed notes and coins) exceeded that of currency in circulation 1.3 times (1.5 times in 1998). Counterfeit banknotes and coins totalled 8.4 thousand lats or only 0.002% (0.004% in 1998) of currency in circulation.

In 1999, within the framework of three international coin programs, the Bank of Latvia issued three commemorative coins. The 10-lats gold coin *Javelin Thrower* (in circulation as of June 21, 1999) commemorates the Year 2000 Sydney Olympic Games. The series *Endangered Wildlife* was supplemented by the 1-lats silver coin *European Mink* (in circulation as of December 1, 1999). The Bank of Latvia also participated in the program

Millennium. Masterpiece Collection undertaken by the British Royal Mint. The Bank issued the 1-lats silver coin shaped as a button (in circulation as of December 1, 1999). In 1999, 9 900 commemorative coins were sold in Latvia, and 6 600 coins, outside Latvia.

FINANCIAL RESULTS OF THE BANK OF LATVIA

Although interest rate movements in the global securities market were not favourable and yields on securities fell, the Bank of Latvia earned 22 138 thousand lats as interest income in 1999 (25 834 thousand lats in 1998). This was achieved by investing international reserves in highly liquid financial instruments. As a result of its transactions in the domestic money market and the secondary market for government securities, the Bank of Latvia's income amounted to 6 096 thousand lats (5 588 thousand lats in 1998).

In 1999, interest expense totalled 5 270 thousand lats (5 837 thousand lats in 1998). Interest paid on government demand deposits and time deposits accounted for the bulk of the total.

In 1999, net interest income amounted to 22 964 thousand lats (25 585 thousand lats in 1998).

In the reporting year, the Bank of Latvia's income covered its expense.

THE BANK OF LATVIA'S ORGANIZATIONAL STRUCTURE

The composition of the Board of Governors of the Bank of Latvia at the end of 1999 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,
	Arvils Sautiņš,
	Varis Zariņš,
	Valentīna Zeile.

The Bank of Latvia Executive Board at the end of 1999 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.

At the end of 1999, 708 persons were employed by the Bank of Latvia (703 at the end of 1998).

In the reporting year, the organizational structure of the Statistics Department was expanded to pursue the Bank's new task, compilation of the balance of payments as from 2000. To optimize the fulfillment of the Bank's tasks related to payment systems, the Accounting and Settlements Department and Information Systems Department were restructured, and the Payment Systems Department was established.

PERSONNEL TRAINING

Employees of the Bank of Latvia participated in seminars, courses and conferences in Latvia and abroad to improve expertise in monetary policy, techniques of macroeconomic and monetary analyses, foreign exchange transactions, credit institutions supervision and accounting.

In the reporting year, 169 employees upgraded their knowledge of English, German and French, 236 employees improved their computer skills, and 107 employees advanced their skills in personnel management, communication psychology, psychology of negotiations and efficient work organization. The Bank of Latvia organized special seminars aimed at familiarizing recently hired employees with the Bank's tasks and their fulfillment.

THE BANK OF LATVIA'S FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 1999

THE BANK OF LATVIA'S BALANCE SHEET

ASSETS	Notes[1]	1999	1998
FOREIGN ASSETS		656 304	576 205
Gold	4	42 215	40 651
Special Drawing Rights		1 788	165
Convertible foreign currencies	5	506 582	455 729
International Monetary Fund	6	101 144	72 929
Shares in the Bank for International Settlements	7	988	951
Non-convertible currencies		276	346
Other foreign assets	8	3 311	5 434[2]
DOMESTIC ASSETS		165 104	166 112
Loans to credit institutions	9	63 322	52 040
Transit credits	10	50 110	54 344
Government securities	11	30 156	49 416
Investment in associate	12	4 726	–
Fixed assets	13	15 635	9 243
Other domestic assets	14	1 155	1 069[2]
TOTAL ASSETS		821 408	742 317

[1] The accompanying notes set out on pages 46 to 65 are an integral part of these financial statements.
[2] Restated in accordance with the revised accounting policy for unsettled forward contracts and swap arrangements to report the surplus arising from the respective unsettled financial instruments on a gross basis.

(cont.) (at the end of the year; in thousands of lats)

LIABILITIES, CAPITAL AND RESERVES	Notes	1999	1998
FOREIGN LIABILITIES		134 653	110 784
International Monetary Fund	15	128 699	109 418
Foreign bank deposits in lats		321	250
Non-convertible currencies		42	53
Other foreign liabilities	16	5 591	1 063[1]
LATS IN CIRCULATION	17	426 101	374 448
DOMESTIC LIABILITIES		214 333	202 601
Balances due to credit institutions		95 765	95 669
Balances due to the Government		110 278	101 639
Balances due to other financial institutions		4 341	1 336
Other domestic liabilities	18	3 949	3 957[1]
CAPITAL AND RESERVES		46 321	54 484
Nominal capital	19	4 750	4 750
Reserve capital	19	2 181	2 181
Other reserves	19	25 243	25 243
Valuation account	20	13 632	21 864
European Union grant		515	446
TOTAL LIABILITIES, CAPITAL AND RESERVES		821 408	742 317
MEMORANDUM ITEMS	24, 25		

[1] Restated in accordance with the revised accounting policy for unsettled forward contracts and swap arrangements to report the deficit arising from the respective unsettled financial instruments on a gross basis.

THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT

	Notes	1999	1998
INTEREST INCOME			
Foreign operations			
Interest on deposits with foreign banks and other foreign financial institutions		3 618	2 245
Income from securities		18 384	23 418
Dividends on shares in the Bank for International Settlements		125	119
Other income		11	52
GROSS foreign interest income		22 138	25 834
Domestic operations			
Interest on loans to credit institutions		2 605	1 024
Interest on transit credits		1 664	1 778
Income from government securities		1 742	2 750
Other income		85	36
GROSS domestic interest income		6 096	5 588
INTEREST EXPENSE			
Foreign operations			
Interest on deposits		33	363
Other expense		367	361
GROSS foreign interest expense		400	724
Domestic operations			
Interest on credit institutions' deposits		526	59
Interest on government deposits		4 344	5 054
GROSS domestic interest expense		4 870	5 113
NET INTEREST INCOME		22 964	25 585

	Notes	1999	1998
SPECIFIC PROVISIONS	21	10 748	3 000
OTHER OPERATING INCOME	22	3 884	482
OTHER OPERATING EXPENSE			
Salaries, wages and other personnel costs		7 515	6 578
Social security		1 799	1 395
Banknote production and coinage costs		311	310
Depreciation charge		1 424	1 470
Renovation and repair costs		1 371	2 280
Other operating expense		3 680	3 299
TOTAL other operating expense		16 100	15 332
PROFIT BEFORE APPROPRIATION		–	7 735
APPROPRIATION OF PROFIT			
Nominal capital		–	295
Reserve capital		–	774
Other reserves		–	6 666

THE BANK OF LATVIA'S STATEMENT OF RECOGNISED GAINS AND LOSSES

	1999	1998
RESULT ON REVALUATION		
Increase/decrease (–) arising from revaluation of gold and shares in the Bank for	1 618	–2 590
Increase/decrease (–) in financial instruments' market value	–5 737	3 791
Decrease (–) arising from revaluation of assets and liabilities denominated in foreign currency	–4 113	–50
NET RESULT ON REVALUATION	–8 232	1 151
PROFIT BEFORE APPROPRIATION	–	7 735
TOTAL	–8 232	8 886

THE BANK OF LATVIA'S CASH FLOW STATEMENT

	Notes	1999	1998
Net cash and cash equivalents inflow arising from operating activities	23 (i)	53 035	31 472
Cash transferred to the Deposit Guarantee Fund		–	–500
Investment in associate	12	–15 474	–
Acquisition of fixed assets		–7 833	–4 446
Decrease in balance due to the International		–8 841	–14 716
Net cash and cash equivalents inflow	23 (ii)	20 887	11 810

These financial statements, which are set out on pages 40 to 65, were approved by the Executive Board on March 9, 2000.

THE EXECUTIVE BOARD

Ilmārs Rimšēvičs
Māra Raubiško
Helmūts Ancāns Roberts L. Grava Reinis Jakovļevs Antonija Sileniece

NOTES TO THE BANK OF LATVIA'S FINANCIAL STATEMENTS

1. FOUNDATION AND PRINCIPAL ACTIVITIES

The Bank of Latvia was established on July 31, 1990. The Bank of Latvia operates under the Law "On the Bank of Latvia" and its primary objectives are as follows:

– implementation of monetary policy by controlling the amount of money in circulation;

– facilitation of free competition and stability of the financial system;

– licensing and supervision of credit institutions;

– issue of the national currency, both banknotes and coins;

– organisation and management of the inter-bank settlement system and promotion of a smooth functioning of payment systems in Latvia.

2. RISK MANAGEMENT

The main risks associated with the Bank of Latvia's activities are financial and operational risks arising from a range of activities in pursuit of the Bank's responsibility for monetary and financial stability in the country. As a result, the Bank of Latvia has designed and implemented a framework of controls to identify, monitor and manage these risks. The risk management framework has been established by the Executive Board and is implemented by the management of relevant business areas under the principles and guidelines established by the Board of Governors of the Bank of Latvia. This framework is continuously upgraded in line with market and operational developments and is subject to review by internal audit function on a regular basis.

INTEREST RATE AND FOREIGN EXCHANGE RISKS

As a result of its activities, the Bank of Latvia incurs interest rate risk principally in the form of exposure to adverse changes in the interest received on its foreign and domestic assets and paid on its domestic liabilities.

The Bank of Latvia has adopted appropriate policies to minimise its exposure to interest rate risk. For the purposes of interest rate risk management, the Board of Governors and the Investment Committee, which involves senior management of the Bank, have set appropriate duration limits for the Bank of Latvia's investment activities. A separate Risk Control Division deals with the daily monitoring of the Bank of Latvia's interest risk exposures based on these limits.

In order to avoid losses arising from adverse changes in the rates of exchange, the Risk Control Division monitors, on a real-time basis, the Bank's compliance with the limits established for foreign currency positions.

CREDIT RISK

The Bank of Latvia is exposed to credit risk as a result of the provision of short-term loans to domestic credit institutions and investments made in foreign debt securities and short-term money and gold deposits.

Short-term loans granted to domestic credit institutions are fully secured by collateral in the form of the Latvian government debt securities and other liquid assets whose value is monitored by the management on a regular basis.

Credit risk associated with investments in foreign debt securities and short-term money and gold deposits is evaluated on the basis of the ratings accorded by the international rating agencies *Fitch IBCA*, *Standard & Poor's* and *Moody's*. In order to minimise the Bank's exposure to credit risk associated with its foreign operations, the Risk Control Division is also involved in the daily monitoring of the Bank of Latvia's compliance with the investment limits established for individual countries.

OPERATIONAL RISK

The Bank of Latvia incurs operational risk in the form of exposure to unexpected losses attributed to human error, information system failures, fraud or inadequate internal controls and procedures. The management of each business area is responsible for detailed management of their operational risk. The Bank of Latvia maintains contingency facilities to support its operations in case of any emergency.

3. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by the Bank of Latvia in the preparation of these financial statements is set out below. The respective accounting policies have been applied consistently, unless otherwise stated, throughout the years ended December 31, 1999 and December 31, 1998.

BASIS OF PRESENTATION

These financial statements have been prepared in accordance with the historical cost basis of accounting, modified for the revaluation of certain assets and liabilities as referred to in the accompanying notes.

FOREIGN CURRENCY TRANSLATION

Transactions denominated in foreign currencies are recorded in lats at the rates of exchange as quoted by the Bank of Latvia for the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into lats at the rates of exchange set forth by the Bank of Latvia at the end of the year. Gains and losses resulting from the translation of monetary assets and liabilities denominated in foreign currencies are credited or charged directly to the balance sheet caption "Valuation account".

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount at which a financial asset could be exchanged or a financial liability settled on an arm's length basis. Where the fair values of financial assets and financial liabilities differ materially from their book values, such fair values are separately disclosed in the notes to the financial statements.

OFFSETTING FINANCIAL ASSETS AND LIABILITIES

Financial assets and liabilities are offset and the net amount reported in the financial statements when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

GOLD

Gold is recorded in the balance sheet at its market value. Any surplus or deficit arising from the revaluation of gold is credited or charged to the valuation account.

FINANCIAL INSTRUMENTS DENOMINATED IN FOREIGN CURRENCIES

Financial instruments denominated in foreign currencies are marked to market. Any surplus or deficit arising on valuation is credited or charged to the valuation account. On the disposal of financial instruments, the market value adjustment is transferred from the valuation account to the profit and loss statement.

The Bank of Latvia enters into commitments involving forward foreign exchange rate contracts, currency and interest rate swap arrangements and interest rate future contracts, which are carried in off-balance-sheet accounts. Subsequent to initial recognition and measurement, financial assets and financial liabilities arising from these derivative financial instruments are re-valued on a regular basis and reported at their fair value. Fair values are obtained from quoted market prices and discounted cash flow models as appropriate.

Any surplus or deficit arising from a change in the fair value of forward foreign exchange rate contracts and currency and interest rate swap arrangements is credited or charged to the valuation account. Realised gains and losses arising from a change in the fair value of interest rate future contracts upon settlement are transferred to the profit and loss statement.

LOANS TO CREDIT INSTITUTIONS AND THE PROVISIONS FOR LOAN IMPAIRMENT

Loans to credit institutions are recorded in the balance sheet at the outstanding principal balance, adjusted for specific credit risk provisions for loan impairment.

Loans to credit institutions are reassessed on a regular basis and specific credit risk provisions for loan impairment are established to provide for the management's estimate of credit losses as soon as the recovery of an exposure is identified as doubtful. These provisions for loan impairment are reported in the profit and loss statement as specific provisions. Loans to credit institutions are maintained in the balance sheet until they are recovered or written off. The outstanding loan balances are written off only after all the necessary legal measures to recover them have been taken and the amount of loss has been finalised.

LATVIAN GOVERNMENT SECURITIES

Latvian government securities held by the Bank of Latvia include Latvian Treasury bills and bonds.

Until March 31, 1999, Latvian government bonds held by the Bank of Latvia were carried in the balance sheet at cost. The Bank of Latvia has revised its policy, and as of April 1, 1999, started recognising these bonds at cost adjusted for the amortisation of discounts or premiums. The net effect of this change in accounting policy is not material to the financial statements.

Latvian Treasury bills are stated in the balance sheet at cost adjusted for amortised discount.

The discounts or premiums arising on purchases of Latvian government securities are amortised to interest income on a straight-line basis over the term to maturity. Interest earned on Latvian government bonds is recognised as interest income on an accrual basis.

REPURCHASE AGREEMENTS

These agreements are accounted for as financing transactions. Securities sold under repurchase agreements are retained in the Bank of Latvia's balance sheet, with the related borrowing included in the balance sheet as a liability owed to the counterparty. Securities purchased under reverse repurchase agreements are not included in the Bank of Latvia's balance sheet, but the related funding provided to the counterparty is included in the balance sheet as deposits with foreign banks and other financial institutions or loans to domestic credit institutions.

The difference between the sale and repurchase prices is treated as interest income or expense and recognised in the profit and loss statement over the term of the agreement.

INVESTMENT IN ASSOCIATE

In August 1999, the Bank of Latvia established a subsidiary—*Latvijas Bankas bezpeļņas organizācija SIA "Rīgas Komercbankas rehabilitācijas aģentūra"*, in which it holds 100 per cent of the share capital. The subsidiary was established for the sole purpose of assisting in the re-structuring of a credit institution registered in the Republic of Latvia. In October 1999, this special purpose subsidiary acquired a 6.6 per cent investment in the shares of the JSC[1] *Rīgas Komercbanka* (the JSC *Pirmā Latvijas Komercbanka* as of October 13, 1999). No other activities are conducted by this subsidiary.

The investment of 6.6 per cent acquired in the credit institution carries effective voting rights of 37 per cent and therefore enables the Bank of Latvia to exercise, indirectly through the subsidiary company, significant influence but not control over the operations of that credit institution. This investment was acquired exclusively to assist in the restructuring of the credit institution and is held for the short term with a view to its disposal.

For the purposes of these financial statements, the subsidiary has not been consolidated. The Bank of Latvia has taken the view that because of the special nature of the subsidiary, it is appropriate to reflect only the underlying investment in the credit institution. Although significant influence is exercised, the fact that the investment in the credit institution is held for the short term has determined accounting for this investment at cost, adjusted for a provision for any permanent diminution in value.

FIXED ASSETS

Fixed assets are recorded at historical cost less accumulated depreciation. If the fair value of a fixed asset is lower than its carrying amount, due to circumstances not considered to be temporary, the fixed asset is written down to its fair value.

Depreciation is provided using the straight-line method over the estimated useful life of the asset. Assets under construction and works of art are not depreciated. The following depreciation rates have been applied on an annual basis:

buildings	1–3%
furniture and fittings	10%
transport vehicles	20%
computer equipment and information systems	20%

Costs associated with developing internal computer software programmes are recognised as an expense when incurred. Maintenance and repairs are charged to the profit and loss statement as the related expenditure is incurred.

[1] Joint-stock company.

GOLD CIRCULATION COINS

Gold circulation coins (fineness .999) held in the vault of the Bank of Latvia are included in the balance sheet caption "Other domestic assets", since their nominal value is directly supported by their content of gold. These coins are stated in the balance sheet at the market value of their content of gold.

When gold circulation coins are issued, they are written off the balance sheet. The respective coins in circulation are treated as off-balance-sheet items and are not included under the balance sheet caption "Lats in circulation", as their nominal value is directly supported by their content of gold.

CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents are defined as the amounts comprising convertible foreign currency in cash, short-term deposits with foreign banks and other foreign financial institutions less balances due to domestic credit institutions with a residual maturity of 90 days and less.

INTEREST INCOME AND EXPENSE RECOGNITION

Interest income and expense arising from investments in securities, loans and deposits are recognised in the profit and loss statement on an accrual basis.

COMMISSIONS AND FEES

Commissions and fees are charged or credited to the profit and loss statement as incurred or earned.

BANKNOTE PRODUCTION AND COINAGE COSTS

Banknote production and coinage costs are charged to the profit and loss statement as incurred.

4. GOLD

At the end of 1999 and 1998, the gold reserves were placed in gold short-term deposits.

Movements in gold reserves during 1999 were as follows:

	Troy ounces	Amount in thousands of lats
As at December 31, 1998	249 345	40 651
Net changes resulting from gold deposits and	–86	–17
Surplus arising from revaluation of gold	–	1 581
As at December 31, 1999	249 259	42 215

5. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency assets are invested primarily in foreign banks and other foreign financial institutions as cash deposits and securities of high liquidity.

Interest bearing debt securities include both interest income purchased at the date of acquisition and interest income accrued subsequent to the date of acquisition of the securities (6 618 thousand lats at the end of 1999 and 6 394 thousand lats at the end of 1998).

At the end of the year, the balance sheet caption "Convertible foreign currencies" was comprised of the following assets:

(in thousands of lats)

	1999	1998
Debt securities of foreign governments	226 657	237 305
Debt securities of foreign banks	99 280	56 267
Debt securities of foreign corporate entities	64 736	64 621
Other debt securities	31 391	39 190
Short-term deposits with foreign banks and other foreign financial institutions	81 660	56 527
Foreign currency in cash	2 858	1 819
Total	506 582	455 729

The following table discloses the country-of-issue profile of assets included in the balance sheet caption "Convertible foreign currencies" at the end of the year:

(percentage)

	1999	1998
European Union	56	57
United States of America	29	32
Japan	3	2
Other countries	5	5
International institutions	7	4
Total	100	100

6. INTERNATIONAL MONETARY FUND

The Republic of Latvia's quota in the International Monetary Fund (IMF), secured by promissory notes issued by the Government of Latvia, is recorded as an asset denominated in XDR. The IMF holdings in lats are stated as a liability (see Note 15).

During 1999, the Republic of Latvia increased, by 35 283 thousand XDR, its quota in the IMF, which is secured by promissory notes issued by the Government of Latvia. At the end of 1999, the Republic of Latvia's quota in the IMF, secured by promissory notes issued by the Government of Latvia, was 126 478 thousand XDR (101 144 thousand lats).

As at December 31, 1999, the Republic of Latvia's total quota in the IMF was 126 800 thousand XDR (91 500 thousand XDR as at December 31, 1998).

7. SHARES IN THE BANK FOR INTERNATIONAL SETTLEMENTS

The Bank of Latvia owns one thousand shares in the Bank for International Settlements (BIS). These shares are denominated in the gold equivalent (5 834 troy ounces).

As a result of changes in gold market value, the value of the shares in the BIS increased by 37 thousand lats during 1999.

8. OTHER FOREIGN ASSETS

At the end of the year, other foreign assets consisted of the following items:

(in thousands of lats)

	1999	1998
Accrued interest income on deposits with foreign banks and other foreign financial institutions	848	776
Gold held at a foreign mint	–	1 130
Surplus arising from unsettled forward contracts and swap arrangements with non-residents	2 249	3 502
Other foreign assets	214	26
Total	3 311	5 434

9. LOANS TO CREDIT INSTITUTIONS

At the end of the year, credit facilities provided to credit institutions registered in the Republic of Latvia were as follows:

(in thousands of lats)

	1999	1998
Loans under repo agreements	52 182	20 246
Lombard loans	–	19 500
Refinancing credit facilities	11 000	12 000
Long-term loans	–	198
Credit facilities provided in respect of the European Union grant	140	96
Total	63 322	52 040

10. TRANSIT CREDITS

The Bank of Latvia acts as agent for the Government of the Republic of Latvia for distribution of funds received from various international institutions. These funds are used to finance the state owned enterprises and to support the state investment programmes. As the Bank of Latvia is exposed to currency risk associated with these funds, both transit credits and related funding are included in the balance sheet. The Bank of Latvia is not exposed to any credit risk arising from transit credits.

11. GOVERNMENT SECURITIES

At the end of the year, the Bank of Latvia held the following Latvian government securities:

(in thousands of lats)

Residual maturity	1999	1998
Within 1 month	4 830	3 995
1–3 months	3 215	6 968
3–6 months	16 924	12 313
6–12 months	5 187	13 788
Over 1 year	–	12 352
Total	30 156	49 416

12. INVESTMENT IN ASSOCIATE

In August 1999, the Bank of Latvia established a subsidiary—*Latvijas Bankas bezpeļņas organizācija SIA "Rīgas Komercbankas rehabilitācijas aģentūra"*, in which it holds 100 per cent of the share capital. The subsidiary was established for the sole purpose of assisting in the re-structuring of a credit institution registered in the Republic of Latvia. In October 1999, this special purpose subsidiary acquired a 6.6 per cent investment in the shares of the JSC *Rīgas Komercbanka* (the JSC *Pirmā Latvijas Komercbanka* as of October 13, 1999) exclusively with a view to its disposal in the near future. The initial cost of the respective investment amounted to 15 474 thousand lats.

A provision of 10 748 thousand lats was established in the financial statements for the year ended December 31, 1999 for impairment, deemed to be permanent, in the value of the respective short-term investment, resulting in its carrying amount of 4 726 thousand lats at the end of 1999. The impairment charge is recorded in the profit and loss statement as a specific provision.

13. FIXED ASSETS

The following changes in fixed assets took place in 1999:

(in thousands of lats)

	Construction in progress	Buildings	Furniture and fittings	Transport vehicles	Other	Total
As at December 31, 1998						
Cost	2 217	3 158	5 322	994	2 407	14 098
Accumulated depreciation	–	–220	–2 740	–681	–1 214	–4 855
Net book value	2 217	2 938	2 582	313	1 193	9 243
During 1999						
Additions	6 242	457	775	98	261	7 833
Disposals	–	–	–120	–110	–72	–302
Net change in cost	6 242	457	655	–12	189	7 531
Depreciation charge	–	–81	–818	–121	–404	–1 424
Depreciation on disposals	–	–	111	110	64	285
Net change in accumulated	–	–81	–707	–11	–340	–1 139
As at December 31, 1999						
Cost	8 459	3 615	5 977	982	2 596	21 629
Accumulated depreciation	–	–301	–3 447	–692	–1 554	– 5 994
Net book value	8 459	3 314	2 530	290	1 042	15 635

14. OTHER DOMESTIC ASSETS

At the end of the year, other domestic assets consisted of the following items:

(in thousands of lats)

	1999	1998
Gold circulation coins in vault	416	4
Accrued interest income on Latvian government bonds	154	286
Other accrued interest income	283	102
Surplus arising from unsettled currency swap arrangements with residents	16	309
Other domestic assets	286	368
Total	1 155	1 069

15. INTERNATIONAL MONETARY FUND

During 1999, the Bank of Latvia entirely reimbursed credit facilities previously provided by the IMF under the Stand-By Arrangement (SBA). Accordingly, at the end of 1999, liabilities to the IMF were comprised of the Systemic Transformation Facility (STF) and IMF holdings in lats (see Note 6).

The credit facility under the STF has been provided to the Republic of Latvia with the aim of supporting the Government's economic and financial programme. The respective facility is scheduled for repayment in instalments until July 2004.

Movements in liabilities to the IMF during 1999 were as follows:

(in thousands of lats)

	SBA	STF	Holdings in lats	Total
As at December 31, 1998	2 744	33 537	73 137	109 418
Increase in holdings in lats	–	–	28 215	28 215
Revaluation	–	–	–93	–93
Repayment	–2 744	–6 097	–	–8 841
As at December 31, 1999	–	27 440	101 259	128 699

16. OTHER FOREIGN LIABILITIES

At the end of the year, other foreign liabilities consisted of the following items:

(in thousands of lats)

	1999	1998
Deficit arising from unsettled forward contracts and swap arrangements with non-residents	5 089	894
Other foreign liabilities	502	169
Total	5 591	1 063

17. LATS IN CIRCULATION

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

Nominal	Amount (in thousands of lats)		Number (in thousands of units)		Percentage	
	1999	1998	1999	1998	1999	1998
Banknotes						
LVL 500	20 262	6 269	41	13	4.8	1.7
LVL 100	60 491	47 434	605	474	14.2	12.7
LVL 50	55 501	57 040	1 110	1 141	13.0	15.2
LVL 20	132 331	108 089	6 617	5 404	31.1	28.9
LVL 10	86 598	86 874	8 660	8 687	20.3	23.2
LVL 5	48 375	47 764	9 675	9 553	11.4	12.7
Total banknotes	403 558	353 470	–	–	94.8	94.4
Coins						
LVL 2	6 196	5 826	3 098	2 913	1.4	1.5
LVL 1	7 137	6 366	7 137	6 366	1.7	1.7
50 s	3 695	3 590	7 390	7 180	0.9	1.0
20 s	1 768	1 733	8 840	8 662	0.4	0.5
10 s	1 182	1 138	11 826	11 380	0.3	0.3
5 s	870	776	17 399	15 520	0.2	0.2
2 s	666	589	33 318	29 470	0.1	0.2
1 s	594	521	59 381	52 127	0.1	0.1
Sub-total	22 108	20 539	–	–	5.1	5.5
Commemorative coins						
LVL 100	302	306	3	3	0.1	0.1
LVL 10	133	133	13	13	0.0	0.0
Sub-total	435	439	–	–	0.1	0.1
Total coins	22 543	20 978	–	–	5.2	5.6
Total lats in circulation	426 101	374 448	–	–	100.0	100.0

In 1999, the Bank of Latvia continued to issue gold circulation coins (fineness .999) with a nominal value of LVL 100. As a result, the total nominal value of such coins in circulation increased from 670 thousand lats at the end of 1998 to 1 534 thousand lats at the end of 1999. The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", since their nominal value is directly supported by their content of gold.

18. OTHER DOMESTIC LIABILITIES

At the end of the year, other domestic liabilities consisted of the following items:

(in thousands of lats)

	1999	1998
Accrued interest expense on deposits from the Government	380	710
Other accrued expense	2 302	2 008
Deficit arising from unsettled currency swap arrangements with residents	400	207
Tax liabilities	47	297
Other domestic liabilities	820	735
Total	3 949	3 957

19. NOMINAL CAPITAL, RESERVE CAPITAL AND OTHER RESERVES

The Law "On the Bank of Latvia" prescribes the authorised nominal capital of the Bank of Latvia at 25 million lats.

The nominal capital is comprised of the State allotted resources and the Bank of Latvia's profit allocation. 10 per cent of the Bank of Latvia's profit is annually appropriated to the reserve capital, which is established to cover potential losses, until one-fourth of the authorised nominal capital is reached. The amendments to the Law "On the Bank of Latvia", effective from November 24, 1999, establish that part of the Bank of Latvia's annual profit, calculated by applying the tax rate set for residents by the Law "On Enterprise Income Tax", shall be transferred to the state revenue. As at December 31, 1999, the rate of enterprise income tax applicable to residents of the Republic of Latvia was 25 per cent.

Other reserves are comprised of net profit after the aforementioned appropriations to the reserve capital and the state revenue. Other reserves may be used to finance construction in progress and fixed assets purchase.

20. VALUATION ACCOUNT

Movements in the valuation account during 1999 were as follows:

(in thousands of lats)

	Surplus from revaluation of gold and shares in the BIS	Surplus/ deficit (–) from change in financial instruments'	Deficit (–) from revaluation of assets and liabilities in foreign	Total
As at December 31, 1998	46 865	1 774	–26 775	21 864
Increase/decrease (–)	1 618	–5 737	–4 113	–8 232
As at December 31, 1999	48 483	–3 963	–30 888	13 632

21. SPECIFIC PROVISIONS

The following specific provisions were made during the year:

(in thousands of lats)

	1999	1998
On impairment in the value of the investment in the associate	10 748	–
On credit facilities granted to credit institutions	–	3 000
Total	10 748	3 000

22. OTHER OPERATING INCOME

Other operating income consisted of the following items:

(in thousands of lats)

	1999	1998
Release of previously established specific provisions due to	3 000	–
Other operating income	884	482
Total	3 884	482

23. CASH FLOW STATEMENT

(i) Reconciliation of profit before appropriation to net cash and cash equivalents inflow arising from operating activities:

(in thousands of lats)

	1999	1998
Profit before appropriation	–	7 735
Depreciation of fixed assets	1 424	1 470
Loss on disposal of fixed assets	17	7
Increase in specific provisions	7 748	3 000
Net surplus/deficit (–) arising from revaluation and financial instruments' market value adjustment	–9 884	4 581
Net increase (–)/decrease in gold	17	–35
Net increase (–)/decrease in Special Drawing Rights	–1 623	1 036
Net increase (–)/decrease in foreign debt securities and other foreign investments	–29 870	18 537
Net increase (–)/decrease in other foreign assets	2 123	–365
Net increase (–) in loans to credit institutions	–8 282	–47 489
Decrease in transit credits	4 234	5 050
Net increase (–)/decrease in government securities	19 260	–8 418
Net increase (–) in other domestic assets	–86	–212
Net increase/decrease (–) in foreign bank deposits in lats	71	–1
Net increase/decrease (–) in other foreign liabilities	4 528	–1 336
Net increase in lats in circulation	51 653	15 095
Net increase in balances due to the Government	8 639	31 950
Net increase/decrease (–) in balances due to other financial institutions	3 005	–21
Net increase/decrease (–) in other domestic liabilities	–8	881
Increase in European Union grant	69	7
Net cash and cash equivalents inflow arising from operating activities	53 035	31 472

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

(in thousands of lats)

	1999	Change	1998
Convertible foreign currency in cash	2 858	1 039	1 819
Short-term deposits with foreign banks and other foreign financial institutions (residual maturity of 90 days and less)	76 471	19 944	56 527
Short-term balances due to Latvian credit institutions	–95 765	–96	–95 669
Total	–16 436	20 887	–37 323

24. FINANCIAL DERIVATIVE INSTRUMENTS

The Bank of Latvia enters into forward foreign exchange rate contracts, foreign currency interest rate swap arrangements and interest rate future contracts in order to manage interest rate and foreign exchange risks associated with the Bank's foreign reserves. As part of its monetary policy, the Bank of Latvia also engages in currency swap arrangements.

At the end of the year, the Bank of Latvia had entered into the following unlisted financial derivative instruments:

(in thousands of lats)

	Contract/notional amount		Fair values	
	1999	1998	1999	1998
Foreign exchange rate derivatives				
Claims arising from forward foreign exchange rate contracts	232 390	209 304	231 107	207 959
Liabilities arising from forward foreign exchange rate contracts	232 662	208 046	231 471	206 952
Forward foreign exchange rate contracts (net)	x	x	–364	1 007
Claims arising from currency swap arrangements	60 618	39 891	60 187	39 701
Liabilities arising from currency swap arrangements	61 253	39 773	60 686	39 517
Currency swap arrangements (net)	x	x	–499	184

(cont.)

(cont.) (in thousands of lats)

	Contract/notional amount		Fair values	
	1999	1998	1999	1998
Interest rate derivatives				
Claims arising from interest rate swap arrangements	23 501	26 760	23 501	26 760
Liabilities arising from interest rate swap arrangements	25 862	25 241	25 862	25 241
Interest rate swap arrangements (net)	x	x	–2 361	1 519
Total claims arising from unlisted financial derivatives	316 509	275 955	314 795	274 420
Total liabilities arising from unlisted financial derivatives	319 777	273 060	318 019	271 710
Unlisted financial derivatives (net)	x	x	–3 224	2 710

The Bank of Latvia had the following interest rate future contracts outstanding at the end of the year:

(in thousands of lats)

	Contract amount		Market values	
	1999	1998	1999	1998
Interest rate future contracts bought	1 528	–	1 591	–
Interest rate future contracts sold	13 105	13 074	14 416	15 534

25. CONTRACTED CAPITAL COMMITMENTS

At the end of 1999, the Bank of Latvia had contracted capital commitments of 16 208 thousand lats (at the end of 1998 – 519 thousand lats) in respect of building and equipment acquisition.

26. CURRENCY PROFILE

The currency profile of the Bank of Latvia's assets, liabilities and memorandum items at the end of the year was as follows:

(in thousands of lats)

	LVL	USD	XDR	EUR	Gold	Other	Total
As at December 31, 1999							
Foreign assets							
Gold	–	–	–	–	42 215	–	42 215
Special Drawing Rights	–	–	1 788	–	–	–	1 788
Convertible foreign currencies	–	283 675	–	121 274	–	101 633[1]	506 582
International Monetary Fund	–	–	101 144	–	–	–	101 144
Shares in the BIS	–	–	–	–	988	–	988
Non-convertible currencies	–	–	–	–	–	276	276
Other foreign assets	2 249	786	–	245	–	31	3 311
Domestic assets							
Loans to credit institutions	63 182	–	–	–	–	140	63 322
Transit credits	–	49 209	–	901	–	–	50 110
Government securities	30 156	–	–	–	–	–	30 156
Investment in associate	4 726	–	–	–	–	–	4 726
Fixed assets	15 635	–	–	–	–	–	15 635
Other domestic assets	739	–	–	–	416	–	1 155
TOTAL ASSETS	116 687	333 670	102 932	122 420	43 619	102 080	821 408

(cont.)

[1] The balance includes financial instruments denominated in British pounds and Japanese yen. Their lats equivalents are 45 239 thousand and 12 935 thousand, respectively.

(cont.)							(in thousands of lats)
	LVL	USD	XDR	EUR	Gold	Other	Total
Foreign liabilities							
International Monetary Fund	101 259	–	27 440	–	–	–	128 699
Foreign bank deposits in lats	321	–	–	–	–	–	321
Non-convertible currencies	–	–	–	–	–	42	42
Other foreign liabilities	5 089	500	–	2	–	–	5 591
Lats in circulation	426 101	–	–	–	–	–	426 101
Domestic liabilities							
Balances due to credit institutions	95 765	–	–	–	–	–	95 765
Balances due to the Government	21 520	24 084	1 782	62 892	–	–	110 278
Balances due to other financial institutions	3 858	472	–	2	–	9	4 341
Other domestic liabilities	3 489	352	–	97	–	11	3 949
TOTAL LIABILITIES	657 402	25 408	29 222	62 993	–	62	775 087
Net position on balance sheet	–540 715	308 262	73 710	59 427	43 619	102 018	46 321
Net position on financial derivatives	60 187	–107 829	–	46 842	–42 118	39 694	–3 224
Net position on capital commitments	5 857	–	–	10 351	–	–	16 208
As at December 31, 1998							
TOTAL ASSETS	115 198	287 643	73 094	5 211	42 736	218 435	742 317
TOTAL LIABILITIES	579 549	13 929	36 302	31 934	–	26 119	687 833
Net position on balance sheet	–464 351	273 714	36 792	–26 723	42 736	192 316	54 484
Net position on financial derivatives	17 942	–61 391	–	26 760	–39 779	59 178	2 710
Net position on capital commitments	519	–	–	–	–	–	519

27. REPRICING MATURITY

The table below analyses the sensitivity of the Bank of Latvia's financial position to a change in interest rates.

Assets and liabilities reported in this table are stated at carrying amounts, categorised by the earlier of contractual interest re-fixing or maturity dates. The carrying amounts of derivative financial instruments are included in the balance sheet captions "Other foreign assets", "Other domestic assets", "Other foreign liabilities" and "Other domestic liabilities", respectively, under the heading "Non-interest bearing". The financial derivatives interest sensitivity gap represents the net fair values of all interest sensitive derivative financial instruments.

(in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Within 1 month	1–3 months	3–6 months	6–12 months	Over 1 year		
As at December 31, 1999							
Foreign assets							
Gold	11 090	20 170	10 955	–	–	–	42 215
Special Drawing Rights	–	–	–	–	–	1 788	1 788
Convertible foreign currencies	128 575	68 214	20 441	22 774	263 359	3 219	506 582
International Monetary Fund	–	–	–	–	–	101 144	101 144
Shares in the BIS	–	988	–	–	–	–	988
Non-convertible currencies	–	–	–	–	–	276	276
Other foreign assets	–	–	–	–	–	3 311	3 311
Domestic assets							
Loans to credit institutions	23 568	28 614	11 000	–	140	–	63 322
Transit credits	–	15 417	–	–	–	34 693	50 110
Government securities	4 830	3 215	16 924	5 187	–	–	30 156
Investment in associate	–	–	–	–	–	4 726	4 726
Fixed assets	–	–	–	–	–	15 635	15 635
Other domestic assets	–	–	–	–	–	1 155	1 155
TOTAL ASSETS	168 063	136 618	59 320	27 961	263 499	165 947	821 408

(cont.)

(cont.) (in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Within	1–3	3–6	6–12	Over		
Foreign liabilities							
International Monetary Fund	–	–	–	–	–	128 699	128 699
Foreign bank deposits in lats	–	–	–	–	–	321	321
Non-convertible currencies	–	–	–	–	–	42	42
Other foreign liabilities	–	–	–	–	–	5 591	5 591
Lats in circulation	–	–	–	–	–	426 101	426 101
Domestic liabilities							
Balances due to credit institutions	1 000	–	–	–	–	94 765	95 765
Balances due to the Government	72 260	23 470	2 682	–	–	11 866	110 278
Balances due to other financial institutions	2 950	–	–	–	–	1 391	4 341
Other domestic liabilities	–	–	–	–	–	3 949	3 949
TOTAL LIABILITIES	76 210	23 470	2 682	–	–	672 725	775 087
On balance sheet interest sensitivity gap	91 853	113 148	56 638	27 961	263 499	x	x
Financial derivatives interest sensitivity gap	397	–2 781	–764	–	–	x	x
As at December 31, 1998							
TOTAL ASSETS	145 833	119 593	38 462	55 863	252 415	130 151	742 317
TOTAL LIABILITIES	76 162	29 408	–	–	–	582 263	687 833
On balance sheet interest sensitivity gap	69 671	90 185	38 462	55 863	252 415	x	x
Financial derivatives interest sensitivity gap	402	1 854	568	33	–	x	x

All balances included under the balance sheet caption "Convertible foreign currencies" represent investments of high liquidity, which are subject to disposal at the Bank of Latvia's discretion.

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 December 31, 1999 and the related statements of profit and loss, recognised gains and losses, and cash flows for the year then ended (hereinafter, "the financial statements") prepared in accordance with the accounting policies adopted by the Bank of Latvia and the Law "On the Bank of Latvia". These financial statements, which are set out on pages 40 to 65, 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. The financial statements of the Bank of Latvia for the year ended December 31, 1998 were audited by an audit commission, which consisted of representatives from another firm of independent auditors and the State Audit Office of the Republic of Latvia. The audit commission's report dated March 4, 1999 expressed an unqualified opinion on those statements.

We 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 present fairly, in all material respects, the financial position of the Bank of Latvia as at December 31, 1999 and the results of its operations and cash flows for the year then ended in accordance with the accounting policies adopted by the Bank of Latvia and the Law "On the Bank of Latvia".

KPMG LATVIA SIA	KPMG	STATE AUDIT OFFICE OF
RĪGA	LONDON	THE REPUBLIC OF LATVIA

Riga
March 9, 2000

RESOLUTION OF THE BOARD OF GOVERNORS OF THE BANK OF LATVIA

On March 24, 2000, the Bank of Latvia's Board of Governors passed Resolution No. 73/1 "On the Bank of Latvia's Annual Report for 1999".

Having reviewed the results of the audit of the Bank of Latvia's economic activity in 1999, the Bank of Latvia's Board of Governors resolves:

To approve the Bank of Latvia's annual report for 1999, including the balance sheet, profit and loss statement, statement of recognised gains and losses and cash flow statement.

Einars Repše
Governor
Bank of Latvia

APPENDICES

Appendix 1

MONETARY INDICATORS IN 1999

	I	II	III	IV	V	VI
BANK OF LATVIA						
Monetary base M0	434.5	457.7	481.0	466.7	476.3	491.5
Currency in circulation	370.1	380.7	393.4	388.7	395.9	407.9
Deposits with the Bank of Latvia	64.5	77.0	87.6	77.9	80.4	83.7
Currency vs monetary base (%)	85.2	83.2	81.8	83.3	83.1	83.0
Net foreign assets	468.4	474.9	488.9	486.4	568.7	558.9
Net domestic assets	-33.8	-17.3	-7.8	-19.7	-92.3	-67.3
Credits	77.9	94.2	100.8	88.1	13.6	17.6
To banks	46.3	64.3	84.0	59.8	53.5	44.8
To the Government (net)	31.6	29.9	16.8	28.3	-39.9	-27.2
Other items (net)	-111.7	-111.5	-108.6	-107.8	-105.9	-84.9
BANKING SYSTEM						
Broad money M2X	911.8	940.1	920.7	915.8	928.7	971.3
Currency outside banks	341.1	350.0	357.6	357.5	359.9	371.8
Non-bank[1] deposits	570.7	590.1	563.1	558.2	568.9	599.6
In foreign currencies	259.2	283.4	260.6	255.7	252.8	272.7
Domestic money supply M2D[2]	652.6	656.7	660.1	660.1	675.9	698.6
Net foreign assets	442.0	455.8	416.7	398.7	475.3	496.5
Net domestic assets	469.8	484.3	504.0	517.1	453.5	474.9
Credits	575.3	581.3	589.3	582.2	594.9	599.1
Bank of Latvia refinancing rate (at end of month; %)	4.0	4.0	4.0	4.0	4.0	4.0
Weighted average interest rates (%)						
In the interbank market	5.6	5.3	5.2	4.7	4.5	4.3
In the non-bank sector						
Short-term loans in lats	17.3	17.0	16.3	15.8	15.5	15.8
Time deposits in lats	5.7	5.4	5.4	4.9	4.7	5.3
LVL vs USD (at end of month)	0.574	0.586	0.590	0.591	0.597	0.598
LVL vs EUR (at end of month)	0.657	0.647	0.633	0.627	0.624	0.619

[1] Enterprises and private persons.
[2] Currency outside banks plus deposits of domestic enterprises and private persons in the national currency.

Appendix 1

VII	VIII	IX	X	XI	XII	
						BANK OF LATVIA
481.7	447.2	449.8	469.4	478.2	526.2	Monetary base M0
401.4	393.4	386.5	389.3	395.3	426.1	Currency in circulation
80.3	53.8	63.3	80.0	82.9	100.1	Deposits with the Bank of Latvia
83.3	88.0	85.9	82.9	82.7	81.0	Currency vs monetary base (%)
549.5	511.8	478.6	525.4	532.6	521.6	Net foreign assets
-67.8	-64.6	-28.8	-56.1	-54.4	4.6	Net domestic assets
16.2	21.4	54.3	12.7	14.4	68.0	Credits
38.1	36.3	39.1	36.3	49.0	63.3	To banks
-21.9	-15.0	15.2	-23.6	-34.6	4.6	To the Government (net)
-84.1	-86.0	-83.1	-68.7	-68.8	-63.3	Other items (net)
						BANKING SYSTEM
966.6	941.9	947.6	943.7	949.7	997.2	Broad money M2X
366.7	355.6	351.5	353.5	356.9	377.4	Currency outside banks
600.0	586.3	596.1	590.2	592.8	619.8	Non-bank[1] deposits
275.6	279.5	295.1	294.4	291.5	298.6	In foreign currencies
691.0	662.4	652.5	649.2	658.2	698.7	Domestic money supply M2D[2]
469.2	437.6	418.0	419.5	387.6	362.2	Net foreign assets
497.4	504.2	529.6	524.1	562.2	635.1	Net domestic assets
601.7	604.6	616.8	625.7	647.6	656.3	Credits
4.0	4.0	4.0	4.0	4.0	4.0	Bank of Latvia refinancing rate (at end of month; %)
						Weighted average interest rates (%)
3.8	3.5	6.5	7.3	4.4	2.7	In the interbank market
						In the non-bank sector
12.3	12.6	11.5	12.4	11.5	12.5	Short-term loans in lats
4.2	4.2	6.4	6.2	4.2	4.4	Time deposits in lats
0.588	0.587	0.579	0.577	0.584	0.583	LVL vs USD (at end of month)
0.627	0.615	0.610	0.606	0.592	0.588	LVL vs EUR (at end of month)

Appendix 2

THE BANK OF LATVIA'S MONTH-END BALANCE SHEETS FOR 1999

	I	II	III	IV	V	VI
ASSETS						
FOREIGN ASSETS	573 618	610 875	629 534	624 918	708 168	697 143
Gold	40 573	41 992	41 155	41 657	40 308	38 877
Special Drawing Rights	685	314	314	599	292	288
Convertible foreign currencies	455 021	461 995	480 567	475 750	560 409	548 760
International Monetary Fund	72 929	101 158	101 144	101 144	101 144	101 144
Shares in the BIS	949	982	964	976	943	910
Non-convertible currencies	321	329	305	311	311	317
Other foreign assets[1]	3 140	4 105	5 085	4 481	4 761	6 847
DOMESTIC ASSETS	156 889	169 613	188 641	155 392	150 475	138 838
Loans to credit institutions	46 307	64 253	83 971	59 798	53 453	44 764
Transit credits	54 766	55 875	55 559	55 606	56 153	54 715
Government securities	45 492	38 596	38 671	29 621	29 645	28 527
Investment in associate	–	–	–	–	–	–
Fixed assets	9 134	9 035	9 017	8 987	9 187	9 509
Other domestic assets[1]	1 190	1 854	1 423	1 380	2 037	1 323
TOTAL ASSETS	730 507	780 488	818 175	780 310	858 643	835 981
LIABILITIES, CAPITAL AND RESERVES						
FOREIGN LIABILITIES	108 400	137 633	140 588	138 440	139 416	138 187
International Monetary Fund	106 979	135 208	135 194	134 280	134 187	132 662
Foreign bank deposits in lats	248	255	256	236	246	225
Non-convertible currencies	49	50	47	47	47	48
Other foreign liabilities[2]	1 124	2 120	5 091	3 877	4 936	5 252
LATS IN CIRCULATION	370 078	380 685	393 397	388 712	395 941	407 853
DOMESTIC LIABILITIES	197 486	205 975	229 843	197 987	269 097	237 686
Balances due to credit institutions	63 383	74 792	83 471	74 475	77 238	80 638
Balances due to the Government	127 504	122 828	135 575	113 427	180 988	146 039
Balances due to other financial institutions	1 088	2 199	4 176	3 474	3 168	3 030
Other domestic liabilities[2]	5 511	6 156	6 621	6 611	7 703	7 979
CAPITAL AND RESERVES	54 543	56 195	54 347	55 171	54 189	52 255
Nominal capital	4 750	4 750	4 750	4 750	4 750	4 750
Reserve capital	2 181	2 181	2 181	2 181	2 181	2 181
Other reserves	25 243	25 243	25 243	25 243	25 243	25 243
Valuation account	21 923	23 574	21 726	22 550	21 568	19 634
European Union grant	446	447	447	447	447	447
TOTAL LIABILITIES, CAPITAL AND RESERVES	730 507	780 488	818 175	780 310	858 643	835 981

[1] Restated in accordance with the accounting policy for unsettled forward contracts and swap arrangements, revised in 1999, to report the surplus arising from the respective unsettled financial instruments on a gross basis.
[2] Restated in accordance with the accounting policy for unsettled forward contracts and swap arrangements, revised in 1999, to report the deficit from the respective unsettled financial instruments on a gross basis.

Appendix 2

VII	VIII	IX	X	XI	XII	
						ASSETS
682 437	645 975	613 743	660 332	668 336	656 304	FOREIGN ASSETS
37 344	37 132	44 096	42 900	42 858	42 215	Gold
568	256	256	256	9	1 788	Special Drawing Rights
534 701	496 631	462 622	512 037	519 770	506 582	Convertible foreign currencies
101 144	101 144	101 144	101 144	101 144	101 144	International Monetary Fund
874	869	1 032	1 004	1 003	988	Shares in the BIS
312	305	298	286	286	276	Non-convertible currencies
7 494	9 638	4 295	2 705	3 266	3 311	Other foreign assets[1]
133 303	154 288	156 488	135 145	148 269	165 104	DOMESTIC ASSETS
38 123	36 338	39 096	36 260	49 002	63 322	Loans to credit institutions
52 173	52 067	51 375	51 180	51 725	50 110	Transit credits
31 476	37 128	35 863	23 459	23 134	30 156	Government securities
–	15 546	15 546	9 546	9 546	4 726	Investment in associate
9 829	11 635	12 860	13 337	13 893	15 635	Fixed assets
1 702	1 574	1 748	1 363	969	1 155	Other domestic assets[1]
815 740	800 263	770 231	795 477	816 605	821 408	TOTAL ASSETS
						LIABILITIES, CAPITAL AND RESERVES
132 798	134 064	135 097	134 815	135 661	134 653	FOREIGN LIABILITIES
130 223	130 223	130 223	130 223	130 223	128 699	International Monetary Fund
495	461	353	312	310	321	Foreign bank deposits in lats
48	46	45	43	43	42	Non-convertible currencies
2 032	3 334	4 476	4 237	5 085	5 591	Other foreign liabilities[2]
401 415	393 377	386 476	389 340	395 307	426 101	LATS IN CIRCULATION
230 740	223 824	200 005	224 361	238 107	214 333	DOMESTIC LIABILITIES
77 204	51 295	61 308	75 646	78 429	95 765	Balances due to credit institutions
141 315	143 311	110 828	136 527	146 859	110 278	Balances due to the Government
3 083	18 077	17 520	4 390	4 433	4 341	Balances due to other financial institutions
9 138	11 141	10 349	7 798	8 386	3 949	Other domestic liabilities[2]
50 787	48 998	48 653	46 961	47 530	46 321	CAPITAL AND RESERVES
4 750	4 750	4 750	4 750	4 750	4 750	Nominal capital
2 181	2 181	2 181	2 181	2 181	2 181	Reserve capital
25 243	25 243	25 243	25 243	25 243	25 243	Other reserves
18 166	16 377	16 032	14 272	14 841	13 632	Valuation account
447	447	447	515	515	515	European Union grant
815 740	800 263	770 231	795 477	816 605	821 408	TOTAL LIABILITIES, CAPITAL AND RESERVES

Appendix 3

THE BANK OF LATVIA'S YEAR-END BALANCE SHEETS FOR THE YEARS 1995–1999

	1995	1996	1997	1998	1999
ASSETS					
FOREIGN ASSETS	407 528	518 240	572 038	576 205	656 304
Gold[1]	51 753[2]	51 176[2]	43 147[2]	40 651	42 215
Special Drawing Rights	1 195	1 251	1 201	165	1 788
Convertible foreign currencies	279 579[3, 4]	389 826[4]	447 318[4]	455 729	506 582
International Monetary Fund	72 929	72 929	72 929	72 929	101 144
Shares in the BIS[5]	1 211[6]	1 198[6]	1 010[6]	951	988
Non-convertible currencies	807	1 386	1 364	346	276
Other foreign assets	54[7]	474[7]	5 069[7, 8]	5 434[8]	3 311
DOMESTIC ASSETS	111 176	82 283	115 074	166 112	165 104
Loans to credit institutions	24 579	9 950	7 551	52 040	63 322
Transit credits	51 585[9]	30 575	59 394	54 344	50 110
Other loans	18 880	19 707	–	–	–
Government securities	5 774	14 077	40 998	49 416	30 156
Investment in associate	–	–	–	–	4 726
Fixed assets	4 453	6 086	6 274	9 243	15 635
Other domestic assets	5 905[10]	1 888	857	1 069[8]	1 155
TOTAL ASSETS	518 704	600 523	687 112	742 317	821 408

[1] In the financial statements for 1995–1996, gold reserves were valued at USD 300 per troy ounce. In the financial statements for 1997, gold reserves were valued at LVL 175.50 per troy ounce.
[2] Gold reserves were valued at market rate by applying the current gold valuation policy retrospectively.
[3] In the financial statements for 1995, foreign assets in convertible foreign currencies were recorded at their historial cost.
[4] Restated to include accrued interest income on foreign securities and funds held on behalf of the Government, which were reported in the financial statements for 1995–1997 under the captions "Other assets" and "Other foreign assets".
[5] In the financial statements for 1995–1996, the value of the shares was stated at gold equivalent (USD 300 per troy ounce). In the financial statements for 1997, the value of the shares was stated at gold equivalent (LVL 175.50 per troy ounce).
[6] The shares were valued at the market rate of gold by applying the current gold valuation policy retrospectively.
[7] Restated to include accrued interest income on deposits with foreign banks and other foreign financial institutions, which was reported in the financial statements for 1995–1997 under the caption "Other assets".
[8] Restated in accordance with the accounting policy for unsettled forward contracts and swap arrangements, revised in 1999, to report the surplus arising from the respective unsettled financial instruments on a gross basis.
[9] Including the Bank of Latvia's credit to the Government (15 750 thousand lats).
[10] In the financial statements for 1995, fixed assets were included in the caption "Other assets".

	1995	1996	1997	1998	1999
LIABILITIES, CAPITAL AND RESERVES					
FOREIGN LIABILITIES	159 622	145 805	127 015	110 784	134 653
International Monetary Fund	159 163	145 497	124 134	109 418	128 699
Foreign bank deposits in lats	198	67	251	250	321
Non-convertible currencies	255	235	231	53	42
Other foreign liabilities	6	6	2 399[1]	1 063[1]	5 591
LATS IN CIRCULATION	225 871	282 602	359 353	374 448	426 101
DOMESTIC LIABILITIES	100 206	137 003	155 153	202 601	214 333
Balances due to credit institutions	46 908	52 780	80 531	95 669	95 765
Balances due to the Government[2]	44 668	73 578	69 689	101 639	110 278
Balances due to other financial institutions	840	5 295	1 857	1 336	4 341
Other domestic liabilities	7 790	5 350	3 076	3 957[1]	3 949
CAPITAL AND RESERVES	33 005	35 113	45 591	54 484	46 321
Nominal capital	2 500	2 500	4 455	4 750	4 750
Reserve capital	625	625	1 407	2 181	2 181
Other reserves	9 093	13 494	18 577	25 243	25 243
Valuation account	20 360[3, 4]	18 067[3]	20 713[3, 5]	21 864	13 632
European Union grant	427	427	439	446	515
TOTAL LIABILITIES, CAPITAL AND RESERVES	518 704	600 523	687 112	742 317	821 408

[1] Restated in accordance with the accounting policy for unsettled forward contracts and swap arrangements, revised in 1999, to report the deficit from the respective unsettled financial instruments on a gross basis.
[2] In the financial statements for 1995–1997, the Government's foreign borrowings and humanitarian aid deposits were stated separately.
[3] Restated to account for the change in the value of gold reserves and in the shares in the Bank for International Settlements as a result of retrospectively valuing gold at market rate in accordance with the current gold valuation policy.
[4] Restated to account for the increase in the value of investments in accordance with the revised accounting policies.
[5] Restated in accordance with the revised accounting policy for unsettled forward contracts and swap arrangements to report the net surplus arising from the respective unsettled financial instruments.

Appendix 4

THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENTS FOR THE YEARS 1995–1999

(in thousands of lats)

	1995	1996	1997	1998	1999
INTEREST INCOME					
Foreign operations	21 592	19 322	23 394	25 834	22 138
Domestic operations	10 053	4 942	3 558	5 588	6 096
INTEREST EXPENSE					
Foreign operations	2 960	2 272	1 529	724	400
Domestic operations	3 159	2 988	2 750	5 113	4 870
NET INTEREST INCOME	25 526	19 004	22 673	25 585	22 964
SPECIFIC PROVISIONS	7 825	1 142	2 658	3 000	10 748
OTHER OPERATING INCOME	604	611	622	482	3 884
OTHER OPERATING EXPENSE	11 872	11 550	12 817	15 332	16 100
PROFIT BEFORE APPROPRIATION	6 433	6 923	7 820	7 735	–

Appendix 5

THE BANK OF LATVIA'S EXCHANGE RATES FOR THE EURO, THE BRITISH POUND, THE JAPANESE YEN AND THE US DOLLAR

(LVL vs foreign currency)

	Maximum	Average	Minimum	Maximum	Average	Minimum
1999	EUR			GBP		
I	0.6710	0.6620	0.6559	0.9560	0.9417	0.9300
II	0.6566	0.6503	0.6452	0.9520	0.9433	0.9350
III	0.6448	0.6399	0.6327	0.9560	0.9509	0.9380
IV	0.6384	0.6325	0.6264	0.9540	0.9498	0.9400
V	0.6351	0.6305	0.6243	0.9640	0.9573	0.9500
VI	0.6231	0.6196	0.6152	0.9610	0.9534	0.9470
VII	0.6285	0.6183	0.6104	0.9480	0.9400	0.9350
VIII	0.6296	0.6225	0.6127	0.9490	0.9422	0.9330
IX	0.6218	0.6105	0.6021	0.9540	0.9416	0.9340
X	0.6225	0.6167	0.6064	0.9610	0.9539	0.9490
XI	0.6084	0.6022	0.5917	0.9500	0.9439	0.9360
XII	0.5962	0.5898	0.5849	0.9460	0.9395	0.9320
1999	100 JPY			USD		
I	0.5140	0.5021	0.4930	0.5740	0.5695	0.5650
II	0.5120	0.4970	0.4810	0.5870	0.5786	0.5720
III	0.4980	0.4902	0.4810	0.5910	0.5865	0.5830
IV	0.5000	0.4925	0.4870	0.5920	0.5901	0.5880
V	0.4960	0.4868	0.4780	0.5970	0.5926	0.5880
VI	0.5010	0.4940	0.4890	0.5990	0.5966	0.5930
VII	0.5090	0.4983	0.4910	0.6030	0.5978	0.5880
VIII	0.5290	0.5165	0.5080	0.5880	0.5862	0.5830
IX	0.5570	0.5425	0.5270	0.5860	0.5815	0.5780
X	0.5540	0.5420	0.5350	0.5780	0.5758	0.5720
XI	0.5640	0.5535	0.5470	0.5840	0.5810	0.5770
XII	0.5740	0.5678	0.5630	0.5850	0.5826	0.5800

Appendix 6

LIST OF CREDIT INSTITUTIONS AT THE END OF 1999

BANKS

1. JSC *Aizkraukles banka*
2. JSC *Baltijas Starptautiskā banka*
3. Joint-Stock Commercial Bank *Baltijas Tranzītu banka*
4. JSC *Hansabank*
5. JSC *Latvijas Biznesa banka*
6. JSC *Latvijas Ekonomiskā komercbanka*
7. State JSC *Latvijas Hipotēku un zemes banka*
8. JSC *Latvijas Krājbanka*
9. JSC *Latvijas tirdzniecības banka*
10. JSC *Latvijas Unibanka*
11. JSC *Māras banka*
12. JSC *MeritaNordbanken Latvia*
13. JSC *Multibanka*
14. JSC *Ogres komercbanka*
15. JSC *Parekss-banka*
16. JSC Bank *Paritāte*
17. JSC *Pirmā Latvijas Komercbanka*
18. JSC *Rietumu Banka*
19. JSC *Saules banka*
20. JSC *Trasta komercbanka*
21. JSC *VEF banka*
22. JSC Commercial Bank *Ventspils Apvienotā Baltijas Banka*
23. JSC *Vereinsbank Rīga*

CREDIT UNIONS

1. *Dzelzceļnieks KS*
2. *Jūrnieku forums*
3. *Līgatnes Druva*
4. *Pūņu Kooperatīvā krājaizdevu sabiedrība*
5. *Raunas Kooperatīvā krājaizdevu sabiedrība*
6. *Rucavas krājaizdevu sabiedrība*
7. *Rūjienas Kooperatīvā krājaizdevu sabiedrība*
8. *Skolu krājaizdevu sabiedrība*
9. *Taurenes Kooperatīvā krājaizdevu sabiedrība*
10. *Veselavas Kooperatīvā krājaizdevu sabiedrība*
11. *Zosēnu Kooperatīvā krājaizdevu sabiedrība*

BRANCH OF FOREIGN BANK

1. Riga Branch of *Société Générale* (France)

Appendix 7

THE BANK OF LATVIA'S ORGANIZATIONAL UNITS AT THE END OF 1999

1. ACCOUNTING AND SETTLEMENTS DEPARTMENT[1]
(Head of Department, Chief Accountant – Antonija Sileniece; Deputy Chief Accountants – Māris Kālis, Maija Kurpniece)
1.1. Internal Banking Operations Division (Head of Division – Anita Jakāne)
1.2. Central Accounting Division (Head of Division – Jānis Caune)

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 Grobiņa)
2.3. Coin Division (Head of Division – Maruta Brūkle)

3. CONSTRUCTION DEPARTMENT
(Head of Department – Juris Kozlovskis; Deputy Head of Department – Jānis Komisars)

4. CREDIT INSTITUTIONS SUPERVISION DEPARTMENT
(Head of Department – Armands Šteinbergs; Deputy Head of Department [Legal Issues and Licensing] – Jānis Brazovskis; Deputy Head of Department [Credit Institutions Supervision and Methodology] – Jānis Placis)
4.1. Supervision Division (Head of Division – Jeļena Ļebedeva)
4.2. Banking Regulations and Analysis Division (Head of Division – Ludmila Vojevoda)
4.3. Licensing and Legal Division (Head of Division – Valda Bidiņa)

5. FOREIGN EXCHANGE DEPARTMENT
(Head of Department – Roberts L. Grava)
5.1. Payments and Settlements Division (Head of Division – Una Ruka)
5.2. Trading and Investment Division (Head of Division, Deputy Head of Department – Arvīds Sīpols)
5.3. External Debt Management Division (Head of Division – Agita Birka)
5.4. Analysis Division (Head of Division, Deputy Head of Department – 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 – Elvīra Kulberga)
7.1. Division for Guest Reception and Translation Services (Head of Division – Leons Brunavs)
7.2. Clerical Office (Head of Clerical Office – Dace Mūrniece)
7.3. Library (Manager of Library, Deputy Head of Department – Dace Gasiņa)

[1] As of February 1, 2000, the Accounting Department.

Appendix 7

(cont.)

8. GENERAL SERVICE DEPARTMENT
(Head of Department – Einārs Cišs)
8.1. Communications and Service Division (Head of Division, Deputy Head of Department – Juris Liepa)
8.2. Building Exploitation Division (Head of Division – Arnis Bērziņš)
8.3. Transport Division (Head of Division – Imants Vācietis)

9. INFORMATION SYSTEMS DEPARTMENT
(Head of Department – Harijs Ozols; Deputy Head of Department – Ivo Odītis)
9.1. System Design and Programming Division (Head of Division – Gunārs Dišlers)
9.2. System Maintenance Division (Head of Division – Edvīns Mauriņš)
9.3. System Security and Quality Assurance Division (Head of Division – Ilona Etmane)
9.4. Computer Network and Server Systems Division (Head of Division – Egons Bušs)

10. INTERNAL AUDITING DEPARTMENT
(Head of Department – Modris Briedis)
10.1. Bank Audit Division (Head of Division, Deputy Head of Department – Anita Hāznere)
10.2. Information Systems Audit Division (Head of Division – Andris Brieze)

11. LEGAL DEPARTMENT
(Head of Department – Reinis Jakovļevs; Deputy Head of Department – Bruno Mačs)

12. MONETARY POLICY DEPARTMENT
(Head of Department – Helmūts Ancāns; Deputy Heads of Department – Zoja Medvedevskiha, Laila Rūse)
12.1. Macroeconomic Analysis Division (Head of Division – Vilnis Purviņš)
12.2. Open Market Operations Division (Head of Division – Uldis Paukšens)
12.3. Financial Market Analysis Division (Head of Division – Jeļena Zubkova)
12.4. Monetary Research and Forecasting Division (Head of Division – Ēriks Āboliņš)

13. PAYMENT SYSTEMS DEPARTMENT
(Head of Department – Egons Gailītis)
13.1. Payment Systems Policy Division (Head of Division – Anda Zalmane)
13.2. Payment Systems Operations Division
13.3. Account Service and Maintenance Division (Head of Division – Natālija Popova)

14. PERSONNEL DEPARTMENT
(Head of Department – Inta Lovnika; Deputy Head of Department – Elita Ošmucniece)

15. PUBLIC RELATIONS DEPARTMENT (Head of Department, Press Secretary – Edžus Vējiņš; Deputy Head of Department – Kristaps Otersons)

16. PUBLICATIONS DEPARTMENT
(Head of Department – Aina Raņķe; Deputy Head of Department – Aija Grīnfelde)

Appendix 7

(cont.)

17. SECURITY DEPARTMENT
(Head of Department – Armands Šteinbergs; Deputy Head of Department – Aldis Liekniņš; Head of Security Headquarters – Didzis Nīmants)
17.1. Daugavpils Division (Head of Division – Ilmārs Suhockis)
17.2. Liepāja Division (Head of Division – Gints Liepiņš)
17.3. Rēzekne Division (Head of Division – Arnis Stirna)
17.4. Valmiera Division (Head of Division – Aldis Zemmers)

18. STATISTICS DEPARTMENT
(Head of Department – Agris Caune; Deputy Head of Department – Ilmārs Skarbnieks)
18.1. Statistics Division (Head of Division – Zigrīda Aušta)
18.2. Statistics Analysis Division (Head of Division – Inta Gaile)
18.3. External Payment Statistics Division (Head of Division – Anna Petska)

19. RIGA BRANCH
(Branch Manager – Jānis Strēlnieks)

20. DAUGAVPILS BRANCH
(Branch Manager – Jolanda Mateša)

21. LIEPĀJA BRANCH
(Branch Manager – Gundars Lazdāns)

22. RĒZEKNE BRANCH
(Branch Manager – Vilhelmīne Landsberga)

23. VALMIERA BRANCH
(Branch Manager – Sarmīte Kleimane)

24. STUDY AND RECREATION CENTRE
(Director – Igors Strokins)

THE BANK OF LATVIA'S STRUCTURE AT THE END OF 1999

BOARD OF GOVERNORS
Chairman of the Board of Governors
Governor
Einars Repše
Deputy Governor
Ilmārs Rimšēvičs

Internal Auditing Department
Modris Briedis

EXECUTIVE BOARD
Chairman of the Executive Board
Ilmārs Rimšēvičs
Deputy Chairperson of the Executive Board
Māra Raubiško

Information Systems Department
Harijs Ozols

Payment Systems Department
Egons Gailītis

Statistics Department
Agris Caune

Publications Department
Aina Raņķe

General Office
Elvīra Kulberga

General Service Department
Einārs Cišs

Study and Recreation Centre
Igors Strokins

Rēzekne Branch
Vilhelmīne Landsberga

Monetary Policy Department
Helmūts Ancāns

Credit Institutions Supervision Department
Armands Šteinbergs

Foreign Exchange Department
Roberts L. Grava

Accounting and Settlements Department[1]
Antonija Sileniece

Construction Department
Juris Kozlovskis

Cashier's and Money Operations Department
Uldis M. Klauss

Riga Branch
Jānis Strēlnieks

Public Relations Department
Edžus Vējiņš
Press Secretary

Legal Department
Reinis Jakovļevs

Foreign Relations Department
Guntis Valujevs

Security Department
Armands Šteinbergs

Personnel Department
Inta Lovnika

Daugavpils Branch
Jolanda Mateša

Liepāja Branch
Gundars Lazdāns

Valmiera Branch
Sarmīte Kleimane

[1] As of February 1, 2000, the Accounting Department.

Latvijas Banka. Annual Report 1999

Latvijas Banka (Bank of Latvia)
K. Valdemāra ielā 2a, Riga, LV-1050, Latvia
Tel.: (371) 702 2300 Fax: (371) 702 2420
http://www.bank.lv
Printed by "Premo"