
**BANK OF LATVIA
ANNUAL REPORT
2003**



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The Latvian economy continued to grow rapidly in 2003. The growth was ensured by the strong domestic and external demand as well as by successful performance of the Latvian businesses in major export markets; in addition, exports to countries of the European Union (EU) grew at an even higher pace than total exports. Real gross domestic product (GDP) increased by 7.5% in the reporting year. The average annual inflation was 2.9%, mainly determined by the conditions on the supply side. Unemployment remained broadly unchanged, and real wages went up. The rapidly growing domestic demand and the large financing required for modernisation of the economy determined an increase in the current account deficit of the balance of payments. Services surplus did not change notably, while that of current transfers grew considerably. The ongoing rapid growth of the national economy notwithstanding, the economic developments in the country remained balanced. The Bank of Latvia carefully monitored eventual risks related to the dynamic growth and, having assessed the outlook, did not alter the monetary policy and left interest rates unchanged. Money market interest rates were still low, and their moderate growth in the second half of the year did not substantially affect the average weighted interest rates on loans granted to non-banks.

Banks still accounted for the most essential part of the financial sector. In line with stability of the national currency, growing prosperity of the population and strengthening of the real sector of the economy, banks managed to increase markedly the amount of deposits received from domestic enterprises and private persons. A higher level of return and stronger confidence in the national currency determined a considerably faster growth of deposits in lats than of deposits in foreign currencies. In respect of loans and deposits of domestic non-banks in foreign currencies, the depreciation of the US dollar, the appreciation and strengthening of the euro in foreign trade settlements determined a rise in the share of transactions in euros and a decline in transactions in US dollars. Contracting cash ratio indicated a further development of non-cash payment instruments and expansion of their application.

The sustainability of the economic situation, the growing income of the population, low interest rates, and the reduction of credit risk, supported in part by the creation of the Register of Debtors, fostered growth in loans granted to domestic enterprises and private persons, and long-term lending expanded in all sectors of the economy. Loans to residents were dominated by mortgage loans, commercial credit and industrial credit.

Tax revenue grew in the reporting year. The fiscal deficit of the general government consolidated budget was smaller than projected. Yields on government securities traded in primary tenders declined. The spread between interest rates on Latvia's eurobonds and central governments' debt securities of corresponding maturities in EU countries narrowed.

In 2003, gradual favourable changes in the external economic environment were observed. The announcements of international rating agencies *Fitch Ratings* and *Standard & Poor's* on assigning a higher long-term creditworthiness rating for Latvia's liabilities in foreign currencies and on improving the country's outlook indicated that Latvia's evaluation abroad had become more positive.

The year 2003 was particularly significant for Latvia for several reasons. The tenth anniversary since the first banknote of the restored national currency – 5 lats – was put into circulation was marked on March 5. It was both a historically significant event and an impetus to economic development. The lats has firmly established itself as one of the most significant symbols of Latvia's regained independence.

The positive vote on September 20 at the referendum on Latvia's accession to the EU and hence also to the Economic and Monetary Union (EMU) was a memorable event for the country and its citizens, confirming the desire of the nation to live in a united Europe and to exploit the advantages of a single currency. The Protocol Decision on Latvia's preparation for full-scale participation in the EMU passed by the Government of Latvia on December 9 is an important step towards the introduction of the euro in Latvia. The Bank of Latvia actively conducted public information campaigns on potential gains and risks for the economy upon Latvia becoming an EU member state.

Cooperation with the European Central Bank was expanding and deepening. Representatives of the Bank of Latvia were involved in the committees and working groups of the European System of Central Banks as observers, contributing to the exchange of information related to central banking.





GLOBAL ECONOMIC ENVIRONMENT

In 2003, the recovery of economic activity was ongoing in several parts of the globe. Acceleration of the growth rate in the US and many Asian countries indicated that the global economy had become sustainable. In European countries, recovery was on its way despite a rather weak domestic demand and imbalances persisting in some economies.

Likewise, the financial market uncertainties diminished, indicated by both market participants' investing in more risk-exposed securities, and more optimistic forecasts and better key performance indicators of the economy. In 2003, major US investment funds recorded a notable growth – for the first time after three subsequent years of losses. The US stock market index S&P 500 increased by 26%, DJIA by 25%, and NASDAQ – an index predominantly for the stock of technology corporations – by 50%. Indices for securities quoted at the stock exchanges of Asia also increased despite the still-felt discouraging effects of SARS. Shortly before the outbreak of the war in Iraq, i.e. on March 11, stock market indices fell to the lowest level in 2003, to commence a rapid recovery again in mid-April.

Since the middle of 2003, the demand for fixed-income debt securities had been declining; hence the yield on them increased. Yields on the US government 10-year bonds rose from 3.1% to 4.3%, while those on Japan's government bonds of the same maturity went up from 0.5% to 1.4%. By contrast, yields on 2-year bonds increased by 26 basis points in the US, 64 basis points in the United Kingdom, and 5 basis points in Japan.

To a certain extent, imbalances of the global economy were corrected by exchange rate changes: in 2003, the US dollar sharply depreciated against all major currencies of the world (due, in part, to the growing US twin deficit and also differences in capital yield rates). The US dollar depreciated against the euro. Despite massive interventions conducted by the Government of Japan, the US dollar depreciated also against the Japanese yen.

The growth rate of economic activity in the US had been accelerating since the spring of 2003. GDP growth rate increased in the second quarter, rose to its high in the last 10 years in the third quarter, but somewhat slowed in the fourth quarter. Tax cuts supported the growth of real disposable income; hence private consumption strengthened notably. Domestic demand was also fostered by a record low federal fund target rate set by the Federal Reserve System, which in June was reduced by 25 basis points and remained anchored at 1% until the end of the year. Due to tax cuts and the growing military expenditure, the government budget balance deteriorated substantially in 2003. The manufacturing sector showed positive signs, with capital expenditure growing, industrial production expanding and business confidence strengthening notably. The labour market, by contrast, remained sluggish.

In Japan, the recovery that had started in 2002 continued. It was largely driven by investment growth and rapid acceleration of exports (particularly to countries in East Asia). However, the recovery was not smooth, with improvements observed only in some sectors of industry and without much effect on unemployment trends; though deflation persisted, it diminished at the end of the year.

Following a three-quarter long stagnation in the euro area, real GDP growth revived in the third quarter. Since the beginning of summer, business confidence indicators had been implying certain progress of the economic activity. In line

with simultaneous growth in a number of world regions, the external economic environment became more favourable for economic activities in the euro area. A decline in competitiveness notwithstanding, the economic growth in the euro area accelerated (mainly owing to export growth) at the end of 2003 in line with the appreciation of the euro against the US dollar.

The European Central Bank lowered the base interest rate on two occasions in 2003 (by a total of 75 basis points) and left it at a historical low of 2.0% until the end of the year. The low interest rates in the countries of the euro area, however, failed to push up the domestic demand essentially, and it was still weak in 2003. Since the beginning of 2003, inflation in the euro area had been fluctuating close to 2%. With the budget balance worsening in several countries of the euro area in 2003, excessive budget deficit procedure was implemented.

The economic development trends of 2003 in different countries of Central and East Europe were uneven. GDP of Poland, the Czech Republic and Lithuania grew faster than in 2002. By contrast, the economic activity in Slovenia and Hungary continued to decline, particularly in the first half of 2003, with the situation moderately improving only in the third and fourth quarters. To a great extent, the economic growth in the region was driven by the domestic demand, yet with terms of trade improving, the economic activity was enhanced also by the expansion of exports. Unemployment rates remained broadly unchanged but were still comparatively high across the region, whereas inflation continued to follow a downward trend in the majority of countries. As the domestic demand still was the major driving factor behind the growth, the current account of a number of countries deteriorated.

In Poland, the economic growth accelerated notably in 2003, with GDP increasing by 3.7%. Both private consumption and export growth had a positive effect on the economic development. The decline in gross fixed capital formation gradually slowed down, and in the second half of 2003 expenditure for investment exceeded the level of the previous period and also that of the corresponding period of 2002. GDP increased by 2.9% also in the Czech Republic. Both private consumption and exports grew more rapidly than in 2002, and a decline in the growth of the Government expenditure was, in part, offset by increasing investment. The economy of Lithuania recorded a particularly notable pick-up, with GDP increasing by 8.9% year-on-year. It was mainly determined by private consumption and investment growth. Progress in exports of goods and services was considerably less notable than in 2002.

The economies of Slovenia and Hungary recorded similar growth trends. GDP growth rate in these countries dropped to 2.3% and 2.9%, respectively, mainly due to a weak external demand. The domestic demand in these countries, on the other hand, strengthened at a rapid rate. With real personal income increasing, the domestic demand in Hungary was driven by stronger household consumption, whereas growing investment figured as the driving force in Slovenia. The amount of inventories increased notably both in Hungary and Slovenia. As to Slovakia, the slow household consumption growth determined by a steep rise in prices was an impediment to its economic progress. The decline in domestic demand was, in part, offset by a marked expansion of exports, and GDP increased by 4.2%. Economic growth slowed down also in Estonia (mainly as a result of a slower growth in private consumption). Exports of goods went up by 9.7%, yet the expansion of imports caused deterioration of the trade balance and a higher current account deficit. Estonia's GDP increased by 4.7% in 2003.

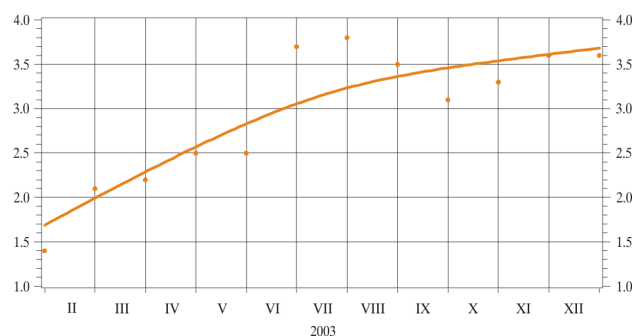
The economic growth in Russia accelerated notably in comparison with 2002. It was determined by both the robust domestic demand and exports, attributed to a favourable situation on the global energy and non-ferrous metals market. The rapid growth in the real income of the population notwithstanding, private consumption was strengthening at a slightly slower (by 7.3%) pace than in 2002 due to channelling of an increasingly growing share of income into savings. Nevertheless, the steep rise in investment (12.9%) fostered the domestic demand, and Russia's GDP grew by 7.3% in 2003.

INFLATION AND PRICES

In 2003, the annual average inflation in Latvia was 2.9% (1.9% in 2002), including 3.2% for goods and 2.1% for services. In December 2003, the consumer price index increased by 3.6% year-on-year (see Chart 1).

Chart 1

CHANGES IN THE CONSUMER PRICE INDEX
(year-on-year basis; %)



Source: Central Statistical Bureau of Latvia.

Factors contributing to the rise in prices changed several times during the year. At the beginning of 2003, low inflation persisted (in part determined by the high base of the previous year). In the second quarter, the euro appreciated markedly, and with the high previous base effect ceasing to exist, inflation rose to 3.7% in June. Due to a poor harvest and hence also a modest domestic supply in the summer months, prices of unprocessed food notably influenced total inflation. This influence was reinforced by poor harvests also in Latvia's major trade partner countries and the considerably stronger euro in comparison with the year 2002. In July, following a decision of the Public Utility Commission, gas supply charges were increased. Higher gas tariffs, in turn, caused a rise in heat tariffs as well, when the new heating season set in. In 2003, population's spending on health care increased substantially (by 5.9%). It was determined mainly by a rise in prices for medical products (7.9%), influenced since spring by the appreciation of the euro.

In 2003, the effects of changes in food prices (measuring 0.8 percentage points) on total inflation weakened; in addition, inflation growth was slightly slowed down by falling prices for some particular foodstuffs (e.g. meat and meat product prices dropped 3.1%). At the same time, the influence of non-food product and service prices increased. In 2003, the contribution of administered prices to total inflation increased and reached 0.5 percentage points. The contribution of fuel prices to the average annual inflation also grew, reaching 0.3 percentage points.

The average monthly gross wage and salary of persons employed in the national economy was LVL 192.49 and the average monthly net wage and salary LVL 138.07 in 2003. In comparison with the previous year, the average gross wage and salary increased by 11.4% and the average net wage and salary by 10.9%. The rise in wages and salaries exceeded the annual inflation rate; hence the annual real gross wage rose 8.3% and the real net wage 7.8% year-on-year. This real wage growth

in 2003 was the fastest in the last five years, caused, to an extent, by a large increase in the public sector's wages.

In line with an increasing demand for industrial output accompanied by improved sales, producer prices continued to pick up. In comparison with 2002, the producer price index grew by an average 3.2% in 2003. The largest price rise was registered for manufacture of wearing apparel (14.8%), basic metals (9.6%), and furniture and manufacturing n.e.c. (8.4%). Producer prices dropped, by contrast, for manufacture of electrical machinery and apparatus (1.8%), and manufacture of fabricated metal products (except machinery and equipment; 0.4%). The construction cost index dropped 1.3%.

The export unit value increased by 7.9% in 2003 (by 2.7% in 2002). The price rise for products of the chemical and allied industries (18.7%), miscellaneous manufactured articles (mainly furniture; 14.9%), textiles and textile articles (14.0%), wood and articles of wood (8.2%), and base metals and articles of base metals (6.7%) was the highest. A moderate decrease in prices was registered for machinery and mechanical appliances, electrical equipment (1.7%), transport vehicles (1.5%), and pulp of wood, paper and paperboard (0.5%). Overall, real exports grew by 8.6%, with machinery and mechanical appliances, electrical equipment, wood and articles of wood, and transport vehicles showing the largest increase. The growth in exports was associated with an increase in both export volume and prices.

The import unit value grew by 6.9% (5.8% in the previous year). The growth was a result of noticeably higher prices for base metals and articles of base metals (14.1%), mineral products (10.1%), transport vehicles (8.5%), and the output of the chemical and allied industries (4.8%). Real imports grew by 12.0%, with transport vehicles, base metals and articles of base metals, machinery and mechanical appliances, electrical equipment, mineral products, and the chemical and allied industries accounting for the largest share.

With the export unit value growing at a somewhat faster pace than the import unit value, terms of trade improved by 0.9% in 2003.

GROSS DOMESTIC PRODUCT

In 2003, the rapid growth of the national economy was a result of high domestic and external demand. Growth was particularly significant in the first quarter, with the year-on-year GDP increase of 8.8% and the overall annual growth of 7.5% (see Table 1). GDP at current prices totalled 5 872.2 million lats.

Table 1

GROSS DOMESTIC PRODUCT AND GROSS VALUE ADDED

(at constant prices; year-on-year basis; %)

	2001	2002	2003
GDP	7.9	6.1	7.5
Goods-producing sector	8.3	7.0	8.4
Service sector	8.3	5.9	7.0

Source: Central Statistical Bureau of Latvia.

In 2003, the goods-producing sector grew at a noticeably higher rate than the services sector. Construction (a 13.7% growth), mainly driven by a strong domestic demand, and manufacturing (a 9.1% growth) with an increasing volume of

new orders, both in foreign and domestic markets, were major contributors to this growth in goods sector.

The rise in construction led to an increase in the output of a number of manufacturing sectors such as manufacture of other non-metallic mineral products, fabricated metal products (except machinery and equipment), and rubber and plastics products. Growth in manufacturing of wood and products of wood and cork (except furniture), basic metals, radio, television and communication equipment and apparatus, and machinery and equipment n.e.c. was driven mainly by the external demand. Strengthening of both the external and the domestic demand determined growth in manufacture of electrical machinery and apparatus n.e.c., food products and beverages, furniture, manufacturing n.e.c., and some other manufacturing branches.

The development of the services sector was mainly determined by trade, with its real contribution to total value added increasing by 11.3%. Retail trade turnover (a rise of 12.8%) grew most rapidly (by 35.6%) at stores trading textile articles, clothing, footwear and leather goods. Expansion of the supermarket network notwithstanding, sales volumes increased in non-specialised stores predominantly trading foodstuffs, while retailing outside stores narrowed.

Hotels and restaurants posted a remarkably rapid development (an increase of 16.4%). The turnover at constant prices of public catering grew by 15.8%.

Despite the oil main standing idle all year, transport, storage and communications also developed successfully (a 7.9% increase year-on-year). Transit cargoes (including crude oil) transported to Latvian ports by rail picked up 25.8%. The oil product pipeline operated efficiently, with the volume of transported diesel oil increasing by 10.6%. Overall, freight turnover at Latvian ports expanded by 5.0% in comparison with 2002.

At the beginning of 2003, the methodology of calculating the unemployment rate was changed, and the data of the previous year were re-calculated according to it. The number of the unemployed registered with the State Employment Service in 2003 remained broadly unchanged and accounted for 8.6% of the total number of economically active population (8.5% at the end of 2002). The average unemployment rate, in turn, was 0.3 percentage points below the 2002 level. Regional disparities continued to persist. In 2003, unemployment declined substantially in almost all cities, except Ventspils (Daugavpils and Rēzekne recording the largest decline by 1.3 and 1.2 percentage points, respectively). In the majority of districts, on the other hand, the level of registered unemployment rose and was most pronounced in the districts of Rēzekne and Daugavpils (an increase of 2.8 and 2.2 percentage points, respectively).

In 2003, the share of long-term unemployed remained broadly unchanged. In line with the growing number of registered job vacancies, the ratio of unemployment to vacancies decreased markedly.

FOREIGN TRADE AND THE BALANCE OF PAYMENTS

Latvia's foreign trade turnover reached 4 639.8 million lats in 2003. In comparison with 2002, exports of goods increased by 17.2% and imports of goods by 19.7%. Foreign trade deficit was 1 338.5 million lats (see Table 2).

A somewhat sluggish economic growth across Europe notwithstanding, the demand for Latvia's commodities in external markets grew and competitiveness was

not impaired. The strengthening domestic demand and the export growth determined the rise in imports. Imports of capital and intermediate goods expanded most pronouncedly (by 30.9% and 19.0%, respectively). Overall, the growth in both exports and imports of goods was more sizable than in the preceding years, in part resulting also from a price rise under the impact of the strong euro.

Table 2

LATVIA'S FOREIGN TRADE

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

	2001	2002	2003
Exports	1 256.4	1 408.8	1 650.6
Imports	2 201.6	2 497.4	2 989.2
Balance	-945.2	-1 088.6	-1 338.5

Source: Central Statistical Bureau of Latvia.

The largest increase in trade deficit was registered for machinery and mechanical appliances, electrical equipment, transport vehicles, mineral products, and the chemical and allied industries, as imports of these products grew noticeably. With exports of wood and articles of wood expanding rapidly, the surplus of this group of goods increased. It covered 38.2% of the total foreign trade deficit (39.6% in 2002).

In 2003, wood and articles of wood (35.2% of total exports), textiles and textile articles (12.6%), base metals and articles of base metals (12.6%), and machinery and mechanical appliances, electrical equipment (7.1%) were the most important Latvian export goods. Of wood and articles of wood, a substantial increase in exports was registered for sawn wood, woodwork and fuel wood. Articles of apparel, not knitted or crocheted, determined the growth in exports of textiles and textile articles. Exports of food industry (including alcoholic and non-alcoholic beverages and tobacco; by 6.7 million lats) declined, as did exports of pulp of wood, paper and paperboard (by 9.9 million lats). Although the share of capital goods in total exports was not sizable, in 2003, exports of these goods grew by 25.3% indicating that production and exports of goods with a higher value added were generally on the rise.

Latvia's principal export partners were the EU countries whose export share grew from 60.4% in 2002 to 61.8% in 2003. The increase in exports to EU countries (20.0%) was even larger than that in total exports. Exports to EU countries were dominated by wood and articles of wood (47.0%), textiles and textile articles (15.3%), and base metals and articles of base metals (12.8%). The most notable rise in exports was registered for the United Kingdom, Germany and Sweden. Exports of metals and wood increased notably to the United Kingdom, of textile articles, furniture and wood to Germany, and of wood, equipment and textile articles to Sweden. The United Kingdom was the major export market for Latvia's wood and articles of wood (34.7% of total exports of these goods). Exports to other countries, mainly to Estonia, Lithuania and Norway, rose markedly as well. As to Estonia, the largest growth was recorded in exports of wood, textiles, machinery, and optical instruments and apparatus; Lithuania increased purchases of metals, pharmaceutical products and foodstuffs, while of exports to Norway wood and metals posted the largest increase. Of exports to the CIS countries, foodstuffs, products of the chemical and allied industries, and machinery and mechanical appliances, electrical equipment were the most important export goods. In the group of CIS countries, exports rose to Ukraine (wood and articles of wood) and Russia (base metals, plastics and products thereof, and pharmaceutical products).

Latvia's major export partners were the United Kingdom (15.5% of total exports), Germany (14.9%), Sweden (10.6%), Lithuania (8.2%), Estonia (6.6%) and Denmark (6.0%). Exports to a number of recently explored markets in China, Japan, Peru, Spain, Portugal and Iceland continued to strengthen substantially.

In 2003, Latvia increased imports of all principal groups of goods, and the largest growth was recorded in imports of machinery and mechanical appliances, electrical equipment (21.1% of total imports), transport vehicles (10.5%), products of the chemical and allied industries (10.1%), mineral products (9.9%), and base metals and articles of base metals (9.3%). In the group of transport vehicles, the largest growth was registered in imports of passenger cars; pharmaceutical products accounted for the most sizable increase in the group of the chemical and allied industries, while larger imports of diesel fuel, natural gas and motor spirit dominated the group of mineral products.

Latvia's principal import partners were Germany (16.1% of total imports), Lithuania (9.7%), Russia (8.7%), Finland (7.4%), Estonia (6.4%) and Sweden (6.3%). Imports from the EU countries (51.0% of total imports; 53.0% in 2002) were dominated by machinery and mechanical appliances, electrical equipment, transport vehicles, and products of the chemical and allied industries. Major import goods from the CIS countries were mineral products, and base metals and articles of base metals; machinery and mechanical appliances, electrical equipment, products of the chemical and allied industries, mineral products and food-stuffs, including alcoholic and non-alcoholic beverages and tobacco, dominated imports from other countries. The largest growth in imports was recorded for Germany (transport vehicles, metals, machinery, and plastics), Estonia (transport vehicles, mineral products, and metals), and three CIS countries – Russia, Belarus (mineral products, metals, and wood) and Ukraine (transport vehicles and metals).

In foreign trade transactions of 2003, the share of the euro continued to grow (reaching 53.5%; 47.7% in 2002), whereas the share of transactions in the US dollars contracted (to 26.7%; 32.1% in 2002).

The real effective exchange rate index of the lats continued to fall in 2003 and had a positive effect on the income from exports. The decline of the real effective exchange rate index of the lats, measured against currencies of 13 major trade partners of Latvia, was primarily a result of a drop in the nominal exchange rate of the lats (6.4% on average annually), which, in turn, was essentially affected by the strong appreciation of the euro. In comparison with 2002, the real effective exchange rate index of the lats dropped 6.0% in 2003 (4.4% against the currencies of developing countries and 6.8% against those of developed countries). In line with a slow-down in the appreciation pace of the euro and with the index of relative price changes growing, the real effective exchange rate index of the lats became stable.

The current account deficit of the balance of payments in 2003 was 9.2% of GDP (7.6% of GDP in 2002). Growth in the goods deficit (by 249.4 million lats), with imports growing more steadily than exports, determined a rise in the current account deficit.

The services surplus remained broadly unchanged in comparison with 2002; income posted a growing deficit, while the current transfers surplus increased markedly. The services and current transfers surplus covered 55.3% of the goods deficit. The moderate decline in the services surplus resulted from an increase in the travel services deficit, as in comparison with 2002, the spending of Latvian travel-

lers increased by 17.9 million lats more than increased that of non-residents. The surplus of transportation services and other services grew, mainly owing to expanding transportation services rendered by road and rail, as well as a larger volume of construction and financial services. In line with non-residents' growing income from direct investment, income deficit posted a 29.1 million lats increase.

In 2003, inflows of capital were sufficient to cover the current account deficit almost in full, and reserve assets increased by 38.5 million lats year-on-year. The foreign direct investment balance (187.4 million lats) covered 34.5% of the current account deficit.

FISCAL POLICY

In 2003, the general government consolidated budget posted a fiscal deficit of 103.2 million lats or 1.8% of GDP, which was considerably lower than in 2002 (2.5% of GDP) and below the projections; it was achieved due to a better outcome of budget revenues and the policy restricting Government expenditure.

In the first 10 months of 2003, the general government consolidated budget recorded a fiscal surplus, resulting, in part, from the restricting effects on expenditure under the interim budget at the beginning of the year (January–March). The deficit of the general government consolidated budget posted a marked rise only in December when the expenditure of both the central government basic budget and the central government special budget was sharply increased. Such an increase in December resulted from the majority of projected payments (including payments for services and investment) being made only at the close of the year. Despite an increase in the minimum wage and salary from 60 lats to 70 lats and in remuneration for various social groups such as medical staff, teachers, and workers in the interior system in 2003, the government budget expenditure reached only 97.1% of the projected (regular expenditure 97.7%, capital expenditure 92.0% and expenditure for investment 88.6%). At the same time, the government budget revenue exceeded the projected amount by 1.1%. Year-on-year, the revenue of the general government consolidated budget posted a more rapid growth than its expenditure (11.3% and 9.2%, respectively).

In comparison with 2002, tax revenue increased by 12.3% in 2003. Revenue from excise tax grew by 19.5% (its share reaching 11.8% of total tax revenue), this growth primarily resulting from higher excise tax revenue on oil products. The relatively sharp increase in imports enhanced revenue from value added tax (by 19.9%; a share of 25.6%) and customs duties (by 24.4%; a share of 1.0%). Revenue from personal income tax (a share of 20.5%) went up 14.9% year-on-year. Although the overall social security contribution rate was lowered by 2.0 percentage points as of January 1, 2003, revenue from state compulsory social security contributions (a share of 32.0%) rose by 6.8%. The growth in revenue from the two taxes was determined by higher labour remuneration. Revenue from corporate income tax dropped 14.4% primarily as a result of a 3.0 percentage points lower tax rate. Consequently, the share of corporate income tax in total tax revenue contracted from 6.9% in 2002 to 5.2% in 2003.

The fiscal deficit of the general government consolidated budget was offset by the fiscal surplus (18.8 million lats) of the central government special budget. In comparison with 2002, revenue of the central government special budget increased by 10.4% and expenditure by 8.4% in 2003. The performance of the social insurance budget was exceptionally good, and its fiscal surplus in the amount of 18.3 million lats indicated positive results of the pension reform.

The central government basic budget deficit was 110.9 million lats in 2003. Total expenditure rose 13.7% and total revenue 14.6% year-on-year. Expenditure increased in almost all major expenditure groups.

The fiscal deficit of the local government consolidated budget (22.3 million lats) primarily resulted from the deficit of the Riga city local government basic budget, which in 2003 was substantially smaller than in 2002. Likewise, fiscal indicators of the local government consolidated budget were better than in 2002 (e.g. revenue increased by 11.5% and expenditure by 9.1%).

In 2003, the Government's debt increased by 90.1 million lats (reaching 846.3 million lats). The budget deficit was financed by the Government borrowings from the domestic market; hence the share of the Government's domestic debt in total debt rose substantially (from 38.6% at the end of 2002 to 50.4% at the end of 2003). The Government's domestic debt was 426.7 million lats at the end of 2003 (an increase of 135.1 million lats against the end of 2002). The domestic debt denominated in the national currency grew by 82.4 million lats as a result of a bond issue, whereas the domestic debt denominated in foreign currencies increased due to refinancing of several comparatively expensive foreign loans by borrowing from the domestic banks. This brought about a 9.7% reduction (to 419.6 million lats) in the Government's foreign debt.

BANKING SECTOR

At the end of 2003, 22 banks, 28 credit unions and the Latvia branch of *Nordea Bank Finland Plc* were registered in the Republic of Latvia. Likewise, representative offices of *Dresdner Bank AG*, *HSH Nordbank AG* and joint-stock commercial banks *AsiaUniversalBank*, *Nadra Bank* and *East Bridge Bank* operated in Riga.

Nearly the whole banking industry is in private hands in Latvia. At the end of the reporting year, the Government's stake in the banking sector's paid-up share capital was a mere 6.7%. The Latvian State is the sole owner of the joint-stock company *Latvijas Hipotēku un zemes banka*. The Government also has a 7.1% holding in the joint-stock company *Latvijas Krājbanka*, a bank whose privatisation has not yet been completed.

At the end of 2003, the total paid-up share capital of banks was 307.9 million lats (a year-on-year increase of 8.5%), with no essential change in the share of foreign investment (53.9% at the end of 2003).

In 2003, all major bank performance indicators continued to improve at a rapid rate: assets (excluding trust assets) expanded by 29.3% (to 5 716.7 million lats), loans (including transit credit) and deposits grew by 41.2% (to 3 001.0 million lats) and 21.5% (to 3 730.5 million lats), respectively. The banking sector's profit was 71.5 million lats (after taxes; 27.0% higher than in 2002). A rise of 25.6% (to 482.0 million lats) was recorded in banks' equity.

In 2003, loans continued to gain importance in the structure of banks' assets, reaching 52.4% (including a 13.3% rise in loans to households (private persons and non-profit institutions servicing them)), whereas the share of claims on credit institutions shrank somewhat (to 23.2%).

At the end of 2003, banks' liquid assets (vault cash and deposits with the Bank of Latvia, claims on credit institutions and foreign central banks, securities issued by central governments) accounted for 33.5% of total assets, ensuring adequate liquidity. Of liquid assets, 47.1% were claims on credit institutions of the OECD countries.

Compared to the end of 2002, the share of long-term loans to non-banks with original maturity of over 5 years increased from 36.9% to 41.6% of loan portfolio. The share of short-term loans (maturity of up to 1 year) also recorded a slight rise (from 18.7% to 20.3%), whereas that of medium-term loans (maturity of 1 to 5 years) decreased (from 44.4% to 38.1%).

In 2003, the share of non-bank deposits in the banks' liabilities shrank by 4.2 percentage points (to 65.3%), whereas liabilities to credit institutions picked up by 4.5 percentage points (to 18.9%).

Non-bank deposits received by banks grew slower than loans granted to non-banks in 2003. With the share of short-term deposits in total deposits attracted by banks decreasing slightly (from 21.3% to 20.1%), that of demand deposits increased (by 1.3 percentage points, to 73.2%). The share of medium-term deposits (maturity of 1 to 5 years) remained almost unchanged (6.0%).

Although credit unions develop rapidly in Latvia, they do not play a significant role in the financial sector. In 2003, their assets grew 44.2% (to 3.9 million lats), loans and deposits increased by 53.7% (to 3.2 million lats) and 47.4% (to 2.6 million lats), respectively. Credit unions' profit was 58.6 thousand lats (a year-on-year drop of 1.6%). Their paid-up capital and equity expanded by 37.1% (to 0.7 million lats) and 34.4% (to 0.9 million lats), respectively.

In 2003, the Bank of Latvia, in close cooperation with the Financial and Capital Market Commission, prepared and published the first issue of the *Financial Stability Report*. It will be published semi-annually. The goal of the Report is to assess the potential adverse factors and risks, which might affect the Latvian financial system, paying particular attention to the banking sector and the performance of leasing companies. The Report does not cover the financial position of individual financial institutions; it provides a macro-prudential analysis with the aim to assess the stability and vulnerability of the financial system in the context of the overall macroeconomic situation. The Report concluded that, in general, the situation in the banking sector remained stable under favourable economic conditions, maintaining high profitability, liquidity and capital adequacy indicators. Nevertheless, the rapid growth in lending in recent years, particularly in lending to households, pushes banks to be more prudent when applying their credit policies to limit the potential credit risk and maintain high quality of the loan portfolio. Banks' growing dependence on foreign funding is another potential risk factor.

MONEY SUPPLY

The principal monetary aggregates of the Latvian banking system and the Bank of Latvia are reflected in Appendix 1 of the Report. In 2003, broad money M2X¹ increased by 21.1%, amounting to 2 258.7 million lats at the end of the year (see Chart 2). The robust growth of the Latvian national economy resulted in an almost unchanged growth rate in the money supply for the third consecutive year (M2X increase was 20.8% in 2001 and 21.0% in 2002). Broad money grew at a more rapid rate in the second half of the year, particularly so in the fourth quarter (in the first half of 2003, M2X expanded by 7.6%, in the second half it grew 12.6%, whereas in the fourth quarter the increase was 9.2%), showing a minor seasonal drop only in January (0.9%). In December, the growth in broad money reached a record high (99.4 million lats or 4.6%), when both lending to domestic enterprises and private persons, as well as the demand for cash recorded a marked increase.

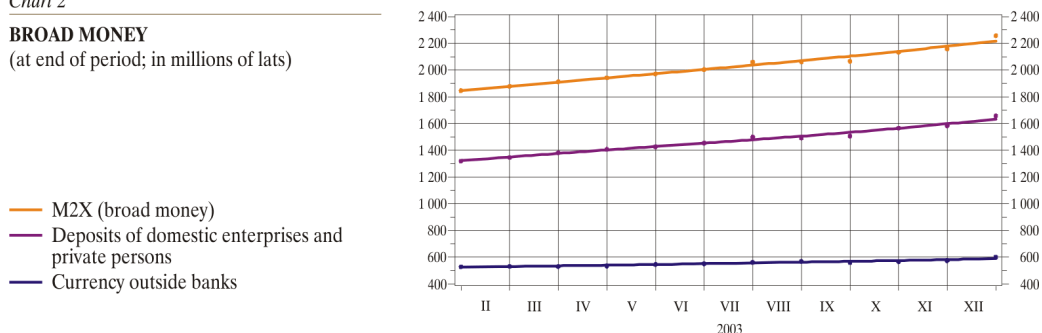
¹ Currency outside banks + deposits of domestic enterprises and private persons in the national and foreign currencies.

With lending expanding rapidly, the money multiplier continued to rise in 2003, reaching 2.80 in December (2.47 in December 2002). Economic stability and growing savings facilitated a decrease in the velocity of money circulation from 2.8 in 2002 to 2.6 in 2003.

Chart 2

BROAD MONEY

(at end of period; in millions of lats)

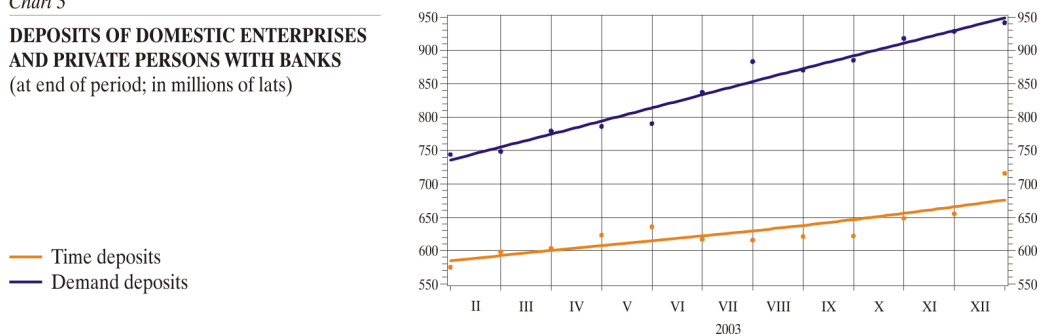


The stable macroeconomic environment and rising household income enabled the banking sector to attract more deposits from domestic enterprises and private persons than in 2002 (by 335.9 million lats or 25.4%; for monthly dynamics of such time deposits and demand deposits, see Chart 3). Currency outside banks posted an increase of 58.0 million lats (almost the same amount as in 2002) or 10.7% (11.9% in 2002). The most rapid seasonal growth in this component was observed in December (4.6%). Currency outside banks in broad money shrank to 26.6% (29.1% at the end of 2002), reflecting the development of non-cash payment instruments in Latvia. The share of demand deposits in broad money remained unchanged (41.7%), whereas that of time deposits grew by 2.5 percentage points, to 31.7%. The share of private person deposits in domestic deposits posted a slight increase, amounting to 57.2% (56.8% at the end of 2002). The share of private person deposits in time deposits and demand deposits accounted for 64.4% and 51.7%, respectively.

Chart 3

DEPOSITS OF DOMESTIC ENTERPRISES AND PRIVATE PERSONS WITH BANKS

(at end of period; in millions of lats)



Higher return and confidence in the national currency ensured a more rapid rise in deposits in lats than those in foreign currency (32.3% and 15.5%, respectively). One of the reasons for the decline in deposits in foreign currency was the prolonged depreciation of the US dollar, the most popular foreign currency with the depositors up to now. Thus, the resident non-bank deposits in US dollars posted a slight drop (0.8%) in 2003, whereas the appreciation of the euro and its growing importance in Latvia's foreign trade determined a considerable increase (62.0%) in the share of deposits in euro. At the end of 2003, deposits received in lats accounted for the largest share of total deposits (62.4%; 59.1% at the end of 2002).

With the share of the national currency in the money supply growing, the domestic money supply M2D expanded by 23.4%, recording a higher growth than the total money supply. M1, the most liquid component of M2X, increased by 16.2%.

Although the Bank of Latvia's foreign reserves increased, net foreign assets of the banking system declined by 276.7 million lats in 2003. It was determined by the increasing trend to invest part of funds borrowed from non-residents in domestic assets. In 2003, foreign liabilities of the banking sector grew by 732.0 million lats, including a pickup of 378.9 million lats in liabilities to foreign banks (of them, liabilities to associated and affiliated credit institutions rose by 245.9 million lats) and an increase of 331.2 million lats in non-resident non-bank deposits (mostly demand deposits). A rise in the banking sector's foreign assets was lower (409.1 million lats), with claims on foreign banks expanding by 304.8 million lats (including an increase of 245.3 million lats and 157.9 million lats in demand deposits and debt securities, respectively). Claims on foreign non-banks grew by 86.3 million lats, with a slight decrease in investment in debt securities of foreign governments as well as private companies.

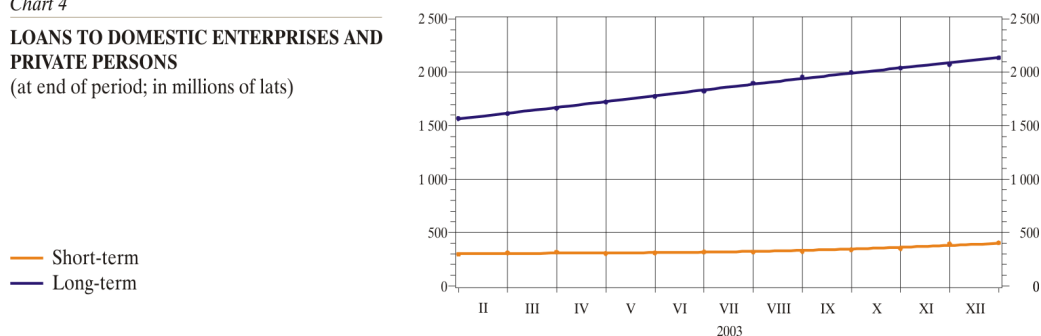
The sustained growth in money supply was determined by an increase in domestic loans (793.4 million lats or 39.1%; 570.5 million lats or 39.8% in 2002), including an increase of 693.1 million lats or 37.5% in loans to domestic enterprises and private persons (494.8 million lats or 36.5% in 2002). At the end of 2003, exposure to domestic enterprises and private persons reached 45.0% in credit institutions' assets (42.6% at the end of 2002). The banking system's net claims on the central government grew 1.6 times, amounting to 250.2 million lats.

The stable economic situation, growing income, as well as low interest rates on the global financial markets and hence an increase in credit institutions' funds, and also reduced credit risks promoted further growth in lending to domestic enterprises and private persons. With the real estate market expanding and a more efficient system of ownership rights and collateral registration, mortgage lending grew more important. In 2003, the long-term loans granted to domestic enterprises and private persons increased by 578.7 million lats or 37.1%, whereas the same short-term loans expanded by 114.4 million lats or 39.3% (for monthly amounts outstanding, see Chart 4). At the end of 2003, long-term loans accounted for 84.1% of total loans granted (84.3% at the end of 2002).

Chart 4

LOANS TO DOMESTIC ENTERPRISES AND PRIVATE PERSONS

(at end of period; in millions of lats)



Mortgage loans grew 1.9 times year-on-year, amounting to 772.6 million lats. Commercial credit and industrial credit posted a more moderate growth (98.5 million lats or 14.7% and 92.1 million lats or 21.2%, respectively), and so did consumer credit (55.0 million lats or 62.0%) and overdraft (27.0 million lats or 41.8%); other types of lending also expanded. At the end of 2003, mortgage loans, commercial credit and industrial credit accounted for the largest amounts outstanding (30.4%, 30.3% and 20.7% of total loans granted, respectively).

Lending to private persons still retained the highest growth (76.3%), largely due to a considerable increase in housing loans (2.1 times; at the end of December, 487.5 million lats or 64.0% of loans to private persons were granted for house

purchases). In 2003, loans to enterprises grew by 25.6% (to 363.3 million lats), exceeding the growth in loans to private persons by 33.7 million lats.

Long-term loans (an increase of 269.1 million lats or 22.9%) accounted for the largest share of growth in lending to domestic enterprises. They increased across all sectors of the economy, with the highest growth in real estate, renting and business activities (89.8 million lats or 1.8 times), construction (28.3 million lats or 37.3%), hotels and restaurants sector (21.5 million lats or 1.7 times), agriculture, hunting and forestry (21.2 million lats or 37.0%) and other community, social and personal service activities (20.9 million lats or 1.9 times). Short-term loans increased mostly in trade (by 40.4 million lats or 1.5 times), financial intermediation (by 16.6 million lats or 1.7 times) and manufacturing (by 14.2 million lats or 27.7%).

At the end of 2003, the largest share of loans was granted to trade (20.3% of lending to domestic enterprises), financial intermediation (15.8%) and manufacturing (14.8%; an annual drop across all the above sectors was 1.6 percentage points).

More favourable lending rates facilitated a somewhat higher growth in loans granted in foreign currencies (391.0 million lats or 38.9%), although a considerable increase in loans in lats was also retained (302.0 million lats or 35.8%). Thus, the share of loans granted in lats decreased by 0.5 percentage points (to 45.1%) in 2003. Of loans to resident non-banks in foreign currencies, the share of lending in euros gradually increased and that in the US dollars decreased.

LENDING AND DEPOSIT RATES

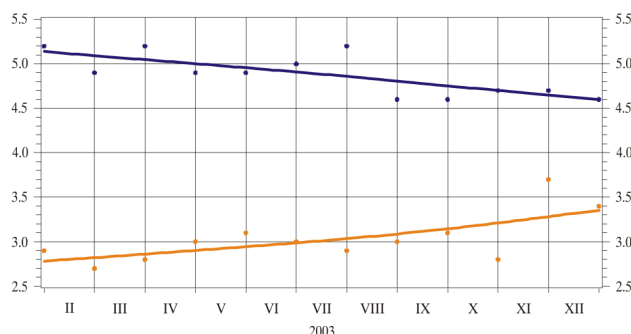
In 2003, interest rates on deposits attracted from domestic enterprises and private persons as well as on loans granted to this group of customers for all maturity and currency spectrum (particularly on loans granted in the OECD currencies) were lower on average than in 2002. They reached historic lows, though the decline was slower. It was determined by interbank interest rates on longer-term loans (rates on loans with a floating rate are pegged to them), posting lower rates on average than in 2002, but still showing an upward trend in the second half of 2003. Thus, lending rates increased for some maturity groups and currencies, while in others the downward trend observed for several years continued.

In 2003, the weighted average interest rates on deposits received from domestic enterprises and private persons remained as stable as they were in the second half of 2002. The weighted average interest rate on deposits in lats fluctuated between 2.7% and 3.7% for short-term deposits and between 4.6% and 5.2% for long-term deposits (see Chart 5). In December, due to fluctuations the weighted average interest rate on short-term deposits in lats grew by 0.3 percentage point year-on-year, whereas that on long-term deposits in lats shrank by 0.6 percentage point.

Chart 5

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

— Short-term
— Long-term



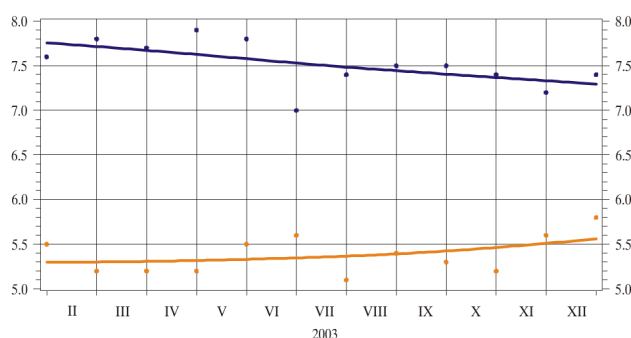
The weighted average interest rates on deposits in lats were higher than those on deposits in foreign currencies with the same maturity, being the driving factor behind a more pronounced growth in deposits received from domestic enterprises and private persons in lats. Moreover, the gap gradually expanded, as the weighted average interest rates on deposits in foreign currencies continued to decrease due to the downward trend in interest rates of major currencies: in December 2003, the weighted average interest rate spreads for short-term and long-term loans reached 1.7 percentage points and 1.9 points, respectively (in December 2002, 1.1 percentage points and 1.8 percentage points). In December 2003, the weighted average interest rates on short-term and long-term deposits received in the OECD currencies decreased year-on-year (by 0.3 percentage point (to 1.7%) and by 0.6 percentage point (to 2.8%), respectively).

Changes in the weighted average interest rates on loans granted to domestic enterprises and private persons in lats were minor over the year (interest rates were between 5.1% and 5.8% for short-term loans and between 7.0% and 7.9% for long-term loans; see Chart 6). In December 2003, the weighted average interest rate on short-term loans in lats reached 5.8% (a year-on-year increase of 0.4 percentage point). The weighted average interest rate on long-term loans in lats remained unchanged year-on-year (7.4%) as a result of increasing competition, growth in the amount of loans and decrease in banks' profit margin, as money market indexes for longer-term lats transactions increased in this period.

Chart 6

WEIGHTED AVERAGE INTEREST RATES ON LOANS IN LATS GRANTED TO DOMESTIC ENTERPRISES AND PRIVATE PERSONS (%)

— Short-term
— Long-term



In December 2003, the weighted average interest rates on loans in the OECD currencies were lower than those on loans granted in lats with the same maturity. It was mostly determined by lower base rates of foreign currencies (the US dollar and the euro). The weighted average interest rate on short-term loans in the OECD currencies rose by 0.3 percentage point (to 4.5%), whereas that on long-term loans dropped by 1.6 percentage points (to 4.2%).

In 2003, with growing inflation, the real interest rates on short-term and long-term loans fell by 1.8 percentage points (to 2.2%) and by 2.2 percentage points (to 3.8%), respectively. The real interest rates on deposits in lats also posted a decline: 1.9 percentage points (to -0.2%) and 2.8 percentage points (to 1.0%) for short-term and long-term loans, respectively.

INTERBANK MARKET

In 2003, lending on the interbank market continued to expand. The amount of interbank loans granted to domestic banks, like in the previous year, increased 1.5 times (to 9.7 billion lats), whereas that of interbank loans to foreign credit institutions grew by 25.7% (to 105.1 billion lats).

On the domestic interbank market, loans granted both in lats and in the OECD currencies posted a pickup. Loans in the national currency totalled 5.4 billion lats, of which overnight loans accounted for 86.2%.

At the beginning of 2003, the minimum reserve requirement was reduced and the terms for the calculation of and compliance with the bank reserve requirement were amended, resulting in improved bank liquidity. Interest rates on the Bank of Latvia's Lombard loans and time deposits remained unchanged, whereas the interbank market interest rates were in the lower part of the interest rate band set by the Bank of Latvia. Short-term fluctuations of the interbank market interest rates were characteristic of the last days of the reserve maintenance period when banks adjusted the average balance on the reserve account for the reserve maintenance period.

In the first 10 months of 2003, the banking sector enjoyed adequate liquidity, ensuring stable and low interest rates on the lats transactions. The weighted average interest rate on overnight loans in lats was 2.5%–3.1% at that time. However, the rapid increase in lending and the high interbank market demand for lats caused a slight rise in the interest rates on transactions in lats at the end of the year. In November, the average interest rate on overnight loans in lats reached 3.7%, falling to 3.2% in December. Interest rates on interbank loans in foreign currencies were affected by a drop in interest rates on the global money market, and the average interest rate on overnight loans in these currencies was considerably lower throughout the year (1.4%–1.8%).

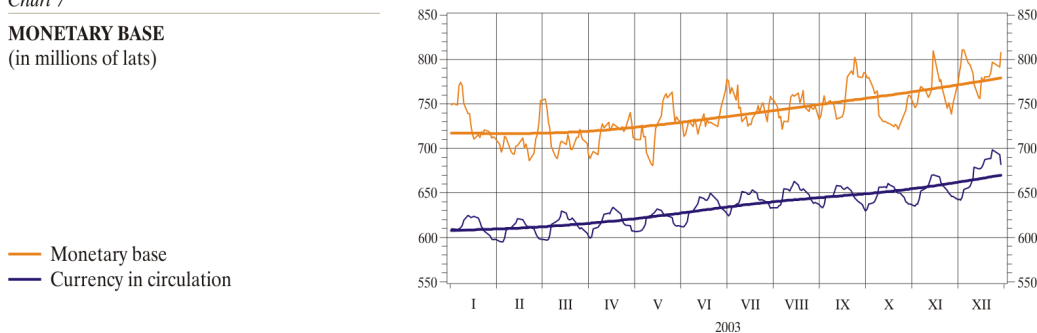
In the second half of 2003, the money market index RIGIBOR (interest rates on loans to non-banks are quite often pegged to this index) somewhat increased, reaching 4.3% on loans with 6-month maturity at the end of the reporting year (4.0% at the beginning of the year).

MONETARY BASE

In 2003, monetary base $M0^1$ grew 6.8% (considerably slower than in 2002), reaching 806.8 million lats at the end of the period (see Chart 7). A more moderate growth was observed in the demand for cash (in 2003, currency in circulation increased by 59.5 million lats or 9.6%; by 12.0% in 2002), whereas demand deposits of banks and other domestic financial institutions with the Bank of Latvia slightly shrank (by 7.9 million lats or 6.0%). The cash component of the monetary base expanded to 84.5% (82.5% at the end of 2002).

Chart 7

MONETARY BASE (in millions of lats)



The growth in the monetary base was mainly effected by an increase in net foreign assets of the Bank of Latvia (46.2 million lats or 5.9%), with the Bank of Latvia

¹ Lats in notes and coins in circulation + demand deposits of domestic banks and other financial institutions with the Bank of Latvia.

purchasing foreign currency (in the reporting year, net total amount of foreign currency purchased was 97.4 million lats). Although the central bank also offered currency swaps, their amount decreased by 77.5 million lats over the year. Thus at the end of 2003, the Bank of Latvia's net foreign assets totalled 824.0 million lats (see Chart 8) and in December covered goods imports of 3.3 months (of 3.7 months in December 2002), while the backing of the national currency with the Bank of Latvia's net foreign assets (see Chart 9) was 102.1% (103.0% at the end of 2002).

Chart 8

NET FOREIGN ASSETS OF THE BANK OF LATVIA

(in millions of lats)

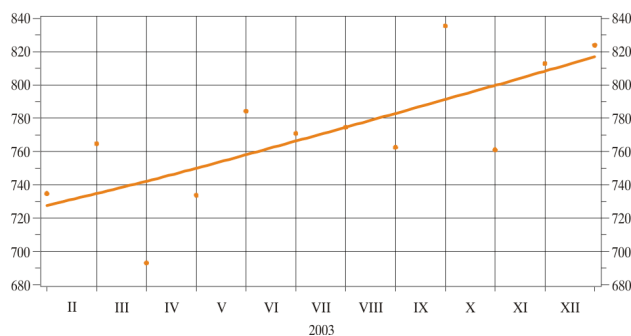
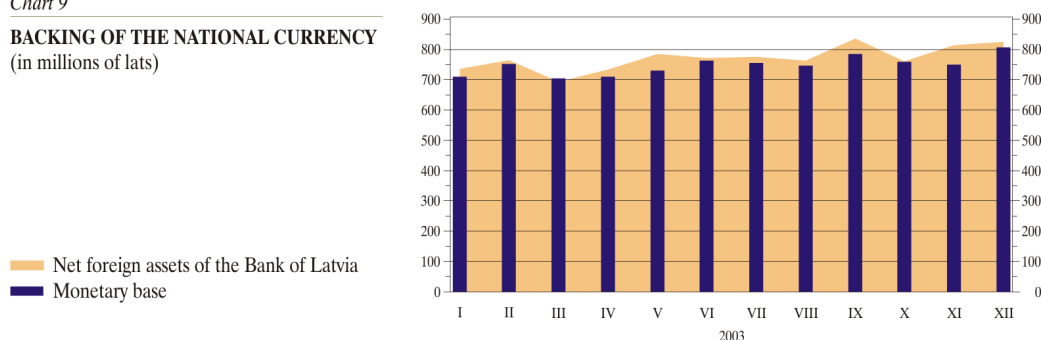


Chart 9

BACKING OF THE NATIONAL CURRENCY

(in millions of lats)



The Bank of Latvia's net domestic assets posted minor changes (an increase of 5.5 million lats), as the domestic credit remained almost unchanged (44.4 million lats at the end of 2003; 44.7 million lats at the end of 2002). However, of total domestic credit, a considerable increase (28.6 million lats) was observed in the Bank of Latvia's credit to banks. The monetary base decreased due to an increase in the Government deposit with the Bank of Latvia (18.2 million lats) and a decrease in the government securities portfolio held by the central bank (2.1 million lats).

Of the Bank of Latvia's credit to banks, repo loans, demand Lombard loans and automatic Lombard loans accounted for 98.8%, 1.1% and 0.1%, respectively (for monthly average amounts outstanding, see Table 3).

Loans under repurchase agreements were predominantly of 7-day maturity; a smaller amount of repo loans were of 28-day maturity. Repo loans of 7-day and 28-day maturity were granted in the amount of 2 515.2 million lats and 94.6 million lats, respectively. The amount of repo loans grew 5.1 times year-on-year; demand Lombard loans and automatic Lombard loans dropped 19.3% (28.5 million lats) and 36.4% (2.1 million lats) year-on-year, respectively.

In the reporting year, the Bank of Latvia's refinancing rate remained unchanged at 3.0% as of September 2002 (see Chart 10). The average weighted interest rate on repo loans changed in line with the interbank market interest rates, generally being considerably lower than in the previous year and increasing only in some months at the end of the year. In the first eight months of 2003, it was 2.8%–2.9%, reaching a high in November (3.6%).

Table 3

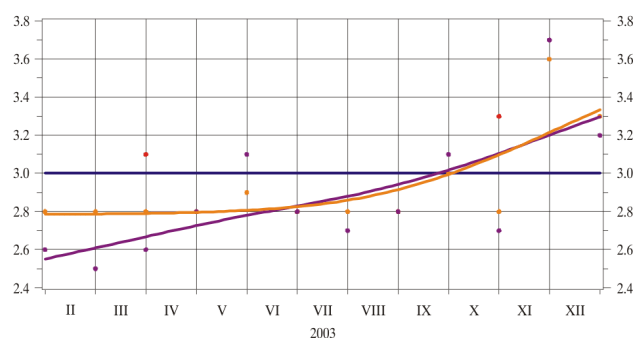
THE BANK OF LATVIA'S CREDIT TO BANKS
(average balances; in millions of lats)

	2001	2002	2003
January	42.5	22.5	23.7
February	74.8	11.3	28.9
March	41.6	7.5	33.9
April	39.6	6.0	55.9
May	66.3	13.9	69.9
June	89.2	13.1	65.9
July	73.2	22.4	56.9
August	63.2	33.0	84.5
September	70.0	32.1	79.3
October	76.8	36.1	41.5
November	69.8	31.0	95.8
December	63.5	34.6	51.7

Chart 10

MONEY MARKET INTEREST RATES
(%)

- The Bank of Latvia's refinancing rate
- Weighted average repo rate
- Weighted average yield on 6-month bills
- Weighted average interest rate on domestic interbank loans in lats



FOREIGN EXCHANGE MARKET AND LATVIA'S EXTERNAL DEBT

In 2003, considerable volatility was observed on the global foreign exchange market, the appreciation of the euro and depreciation of the US dollar against other SDR basket currencies being its main features. The substantial US budget deficit and foreign trade deficit, the slow growth and even slowdown in the national economies of EU countries, as well as Japan's failure to implement economic reforms were the major factors behind the exchange rate fluctuations of the SDR basket currencies. The UK economy, in its turn, demonstrated robust growth, and Bank of England was the only one of the four major central banks to raise the base rate once in 2003.

In the reporting year, the euro appreciated against the US dollar by 20.0% (from 1.0492 at the end of 2002 to 1.2595 at the end of 2003), reaching its high at the very end of the year. The US economic growth indicators considerably improved, except for those of employment and new jobs. In view of the optimistic outlook, a substantial rise in stock prices was observed, despite the accounting scandals. The US Federal Reserve System continued to reduce interest rates. Even the end of the Iraqi conflict and the capture of Saddam Hussein would not solve the problems in the Middle East. The US dollar depreciated against the Japanese yen from 118.79 at the end of 2002 to 107.22 at the end of 2003 (by 9.7%), reaching its low on December 9, 2003 (106.74). The British pound appreciated against the US dollar by 10.9% (from 1.6100 at the end of 2002 to 1.7858 at the end of 2003), reaching its high at the end of the year.

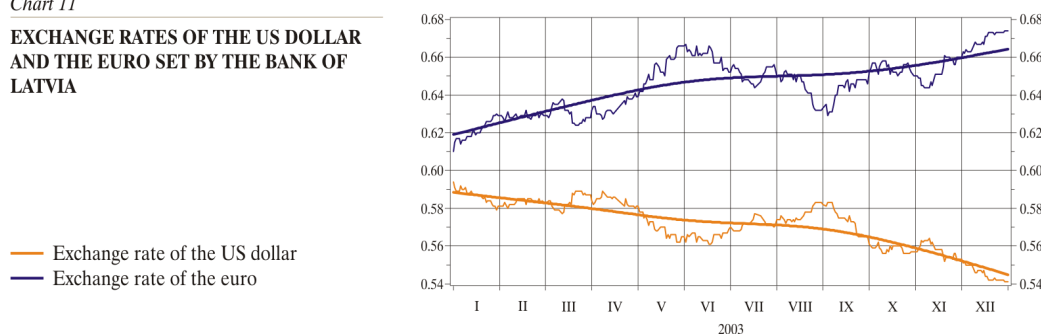
Since the euro strengthened against all other SDR basket currencies in the re-

porting year, it appreciated against the lats from 0.6135 at the end of 2002 to 0.6714 at the end of 2003 (by 9.4%) on the domestic foreign exchange market, reaching a low on January 3, 2003 (0.6094) and a high at the end of 2003 (0.6730).

The US dollar depreciated against other SDR basket currencies. It declined vis-à-vis the lats from 0.5844 at the end of 2002 to 0.5335 at the end of 2003 (by 8.7%). The US dollar exchange rate was at high on January 8, 2003 (0.5905) and at low at the end of 2003 (0.5319; for the evolution of the exchange rates of the US dollar and the euro as set by the Bank of Latvia, see Chart 11).

Chart 11

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



According to the international investment position (classified according to the principle of residency: liabilities of residents, including the Government, to the rest of the world in lats and foreign currencies), Latvia's external debt to non-residents increased by 808.2 million lats, reaching 4 945.2 million lats (84.2% of GDP) at the end of 2003. Foreign assets totalled 3 460.4 million lats and net external debt amounted to 1 484.9 million lats (25.3% of GDP). In 2003, the banking and corporate sectors' debt increased by 729.2 million lats and 108.3 million lats, respectively, whereas the Government debt shrank by 29.3 million lats. As a result, the breakdown of the external debt by sector changed: the Government liabilities, banks' liabilities and enterprises' liabilities accounted for 8.5%, 59.4% and 32.1%, respectively, at the end of the year. No essential changes were observed in the breakdown of the external debt by instrument. At the end of 2003, debt-related direct investment, debt securities and other investment amounted to 11.3%, 5.7% and 83.0% of the external debt, respectively. Long-term and short-term debt totalled 1 898.5 million lats and 3 046.7 million lats, respectively, at the end of the year. Liabilities of the Government and monetary institutions to non-residents were 420.2 million lats.

At the end of 2003, the banking sector's external debt was 2 938.8 million lats (including long-term liabilities of 421.4 million lats and short-term liabilities of 2 517.5 million lats). Of bank short-term liabilities, 75.6% were deposits received by banks. Net external debt of the banking sector amounted to 767.1 million lats at the end of 2003.

Long-term liabilities (1 058.2 million lats or 66.7%) dominated in the external debt of the corporate sector (1 586.2 million lats) at the end of 2003. Liabilities to direct investors constituted a notable share (33.4%) of corporate debt.

According to the data provided by the Treasury, the Government external debt in foreign currencies amounted to 419.6 million lats (7.1% of GDP) at the end of 2003. In 2003, the Government continued to make use of the funds under loan agreements concluded in previous years: the Government received 9.4 million lats from the World Bank and other international institutions. 102.5 million lats, equalling 3.8% of annual exports, were used to service foreign debt in 2003 (in-

cluding 48.5 million lats for prepayments under loans from the World Bank). The Government external debt decreased by 44.9 million lats year-on-year.

SECURITIES MARKET

The Bank of Latvia continued to act as the Government's agent in organising auctions of and accounting for government securities in the primary market of Latvian government securities. In 2003, the Treasury held auctions in the primary market of government securities, and the amount of securities supplied was higher than in 2002. In the reporting year, government securities were supplied in the amount of 199.6 million lats (an increase of 2.7 times) at competitive multi-price auctions. Banks' demand 1.8 times exceeded the supply, and securities in the amount of 138.2 million lats (including Treasury bills in the amount of 35.3 million lats and Treasury bonds in the amount of 102.9 million lats) were sold. The supply of government securities was increased since the Government used part of the receipts from the eurobond issue of 2001 to finance the general government budget deficit for 2002, and thus new securities issues were necessary to finance the 2003 general government budget deficit. However, no eurobonds were issued in the reporting year; therefore, securities issues in the domestic market were used to finance the budget deficit.

In 2003, 17 banks took part in competitive multi-price auctions in the primary market of government securities (18 banks in 2002). High concentration was observed in the primary market of government securities, as the four most active banks bid 70.1% of the total demand. Part of government securities were sold at fixed rate non-competitive auctions at the Latvian Central Depository, using the yield rate of the previous securities auction of the same maturity held at the Bank of Latvia. In the reporting year, government securities in the amount of 38.5 million lats (2.5 times exceeding the amount issued in 2002) were issued in such a way.

At primary auctions, the shortest maturity of government securities auctioned was 6 months. The weighted average discount rate of these bills dropped from 3.52% in 2002 to 3.15% in 2003. The weighted average discount rate of 12-month bills shrank to 3.25% (4.02% in 2002), and the weighted average yield of 5-year bonds fell to 4.64% (5.53% in 2002). After a three-year break, the Latvian Government resumed issuing 3-year bonds (with the average yield of 4.01%) and commenced the issuance of 10-year bonds, the average yield at auctions reaching 5.05%. Since the general government budget deficit was not high, the Treasury was in the position to reduce the hidden rates determined at auction, and banks had to accept them. The decrease in rates was also driven by a drop in the money market interest rates, the robust economic growth and the prospective access to the EU.

In 2003, the stock of government securities outstanding increased by 28.2% (to 375.8 million lats; for the stock of government securities outstanding of all maturity spectrum, see Chart 12). The structure of government securities holders did not show significant changes: at the end of the year, Latvian banks held 46.9% of the stock of government securities outstanding; the Bank of Latvia, other residents and non-residents held 30.6%, 20.0% and 2.5%, respectively.

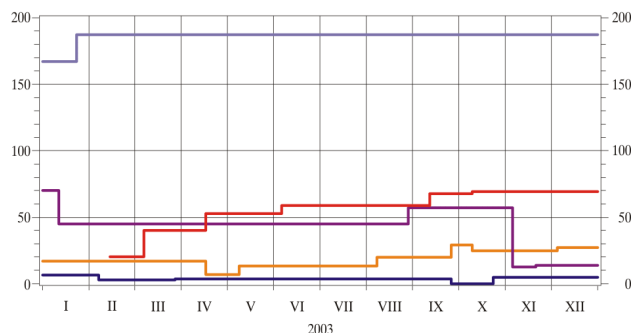
At the end of 2002, the bid and ask rates quoted for Latvian eurobonds (redemption in November 2008) were 4.35% and 4.23%, respectively, shrinking to 3.80% and 3.69% at the end of 2003. At the end of 2002, the spread between Latvian eurobond yields and German government securities yields of the same maturity was approximately 40–60 basis points, falling to 20–30 basis points at the end of

Chart 12

STOCK OF LATVIAN GOVERNMENT
SECURITIES OUTSTANDING

(in millions of lats)

- 6-month bills
- 12-month bills
- 2-year bonds
- 3-year bonds
- 5-year bonds



2003. The spread narrowed mostly due to a rise in German government long-term bond yields.

In 2003, the total turnover of debt securities on the Riga Stock Exchange was 143.2 million lats (24.3% less than in the previous year). Government securities still accounted for the highest turnover (118.3 million lats), whereas the turnover of the Nordic Investment Bank, the joint-stock company *Latvijas Unibanka* and the state joint-stock company *Latvijas Hipotēku un zemes banka* bonds amounted to 11.5 million lats, 8.0 millions of lats and 5.4 millions of lats, respectively. The turnover of private debt securities increased as new issues were made available and investors were encouraged, offering them issues of floating rate debt securities, as the coupon rate might increase. The turnover of government securities declined as the yields had become low but, unlike private securities, coupon rates for the stock of government securities were fixed.

At the end of 2002, the bid and ask rates quoted for 5-year Treasury bonds (redemption in May 2007) on the Riga Stock Exchange were 4.85% and 4.20%, respectively, whereas at the end of 2003 they shrank to 4.05% and 3.85%. On February 17, upon opening trading, the respective yields quoted for 10-year Treasury bonds were 5.40% and 5.00%, dropping to 5.10% and 5.05% at the end of the year. The fall resulted from a decline in yields on government securities at primary auctions as well as from the low money market interest rates.

In 2003, the stock of outstanding publicly traded corporate debt securities denominated in lats, registered with the Latvian Central Depository, increased 2.1 times (to 101.8 millions of lats). New issues amounted to 61.6 millions of lats, whereas the stock redeemed accounted for 7.4 millions of lats. A closed issue of the limited liability company *Lattelekom* bonds in the amount of 25.6 millions of lats was the most significant of them. Three new bond issues were held to grant a syndicated loan to the state joint-stock company *Latvenergo*. The purpose of most new issues with maturity of 5–10 years was definite economic projects. In 2003, coupon rates of a number of the new bond issues were pegged to the money market index (6-month RIGIBOR), making these securities more attractive to investors: low interest rates were observed on the global financial markets, with an outlook for a rise in interest rates in the future, which might result in an increase in interest rates in Latvia as well.

In 2003, the Dow Jones Riga Stock Exchange index (DJRSE) improved by 41.8%, reaching 228.4 points. The stock market capitalisation increased from 418.3 millions of lats to 608.3 millions of lats. A rise in stock prices was driven by the positive vote for Latvia's accession to the EU and improvement in the stock exchange indexes of the developed and the neighbouring countries. One of the key domestic market factors was the buyback of minority shares in several companies.

In 2003, the stock market turnover increased by 6.9% (to 80.4 millions of lats), the shares in the joint-stock companies *Latvijas Gāze*, *Latvijas Balzams* and *Ventspils nafta* being the most liquid ones.

On January 1, 2004, the Law "On the Financial Instruments Market" took effect, superseding the Law "On Securities". The new law strictly distinguishes between the circulation of publicly traded securities and the relevant regulations in a regulated market, and the circulation of securities not traded publicly. By the end of 2003, companies whose shares were traded on the Riga Stock Exchange had to conclude an agreement on further trading of their shares in order to comply with the key requirements of a regulated market. Almost half (20) of the companies on the free list failed to comply with this requirement and were excluded from listing on the Riga Stock Exchange. At the beginning of 2004, shares of 36 companies continued to be quoted on the stock exchange; of them, three companies were listed on the official list, nine companies were included on the second list, and 24 companies made up the free list (at the end of 2002, three, ten and 49 companies were listed on the official, the second and the free lists, respectively).

INTEGRATION INTO THE EUROPEAN UNION

In 2003, the Bank of Latvia continued its participation in the joint activities of the Latvian Government and governmental institutions to promote Latvia's integration into the EU. The Bank of Latvia drafted proposals for amendments to Latvia's legislation in conformity with the EU legislation and updated the Bank of Latvia's regulations related to the operation of payment systems and governing the methodology for drafting statistical reports.

Regular exchange of information and cooperation with the ECB continued. On June 26, 2003, the Governor of the Bank of Latvia participated as an observer at the meeting of the General Council of the ECB for the first time. As of May 2003, representatives of the Bank of Latvia participated as observers in the work of committees and working groups of the European System of Central Banks, as well as the EU Economic and Financial Committee and sub-committees and working groups of the European Commission. Business contacts with the ECB related to core operation of the central banks, integration within the European System of Central Banks and the central bank legislation were maintained.

INTERNATIONAL FINANCIAL INSTITUTIONS

In 2003, Latvia continued its activities as a member of the IMF, the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation and the European Bank for Reconstruction and Development. Likewise, the Bank of Latvia continued its participation in the activities within the Bank for International Settlements.

Pursuant to the Republic of Latvia Cabinet of Ministers Resolution of March 20, 2003, the functions of the authorised representative of the Republic of Latvia in the IMF were delegated to the Governor of the Bank of Latvia, and the Bank of Latvia became the coordinating institution for the IMF affairs in Latvia.

Further cooperation with the IMF was based on consultations under Article IV of the IMF Articles of Agreement. In July 2003, the Mission of the IMF Monetary and Financial Statistics arrived in Latvia to assess the compliance of the statistics compiled by the Bank of Latvia with the methodology incorporated in the *Monetary and Financial Statistics Manual* (issued by the IMF in 2000). In September 2003, an IMF mission worked in Latvia, auditing the compliance of the statistics in Latvia with internationally accepted standards and preparing the *Report on the Observance of Standards and Codes* (ROSC).

COOPERATION WITH FOREIGN CENTRAL BANKS AND TECHNICAL ASSISTANCE

The Bank of Latvia continued its cooperation and exchange of experience and information with the central banks of other countries.

Representatives of the Bank of Latvia participated in the work of the Nordic-Baltic Monetary and Financial Committee. In the reporting year, the Bank of Latvia organised several international meetings (a meeting of the Club of Clearing Houses of the Central and Eastern Europe, a meeting of *Logica*, the real time settlement system users group) and an international workshop for the central banks' internal audit experts. An official delegation of the central bank of China visited the Bank of Latvia.

In the reporting year, technical assistance to the Bank of Latvia was mostly ex-

tended in the form of invitation to participate in the workshops and courses hosted by the relevant of international financial institutions and foreign central banks, as well as advisory services on issues related to the operation of the central banks.

In 2003, cooperation with the central bank of Germany continued, advising the Bank of Latvia on the issues of monetary research and assessment of the fiscal sector's performance. Under technical assistance programmes, the Bank of Latvia's employees participated in a number of training sessions organised by the ECB, the IMF Institute, the World Bank, the European Commission and the Joint Vienna Institute, and also participated in seminars hosted by the central banks of Austria, the Czech Republic, Estonia, France, Germany, Italy, Lithuania, the Netherlands, Switzerland and the UK.

In May 2003, the Bank of Latvia's employees attended the Annual Seminar of Baltic Central Banks in Estonia, discussing issues of financial stability, coordination of external affairs and issues related to personnel policy of central banks.

The Bank of Latvia, in its turn, provided technical assistance to Georgia, advising the specialists of the central bank on the issues of foreign exchange operations and human resource management.

2003 HIGHLIGHTS OF NORMATIVE ACTS ADOPTED IN PURSUIT OF THE BANK OF LATVIA'S MAIN TASKS

January 9

The Executive Board of the Bank of Latvia adopted a new version of the "Regulation for Tenders of Short-Term Currency Swaps" (in effect as of February 17, 2003).

January 16

The Board of Governors of the Bank of Latvia passed "Regulation for the Register of Debtors" (in effect as of June 2, 2003), as well as resolved that by October 1, 2003, banks and branches of foreign banks registered in the Republic of Latvia shall submit data on all debtors to the Register of Debtors (as per June 2, 2003).

May 15

The Board of Governors of the Bank of Latvia adopted the "Regulation for Preparing Interest Rate Reports by Credit Institutions" (in effect as of January 1, 2004).

The Board of Governors of the Bank of Latvia adopted the "Regulation for the Use of the IBAN" (in effect as of January 1, 2004, except for Paragraph 4.2, which is to take effect on January 1, 2005).

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for Credit Transfers" (in effect as of January 1, 2004).

June 26

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Tenders of the Secondary Market for Securities Organised by the Bank of Latvia" (in effect as of August 1, 2003).

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Tenders of Short-Term Currency Swaps" (in effect as of August 1, 2003).

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Repo Tenders of Securities Organised by the Bank of Latvia" (in effect as of August 1, 2003).

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Reverse Repo Tenders of Securities Organised by the Bank of Latvia" (in effect as of August 1, 2003).

July 17

The Board of Governors of the Bank of Latvia passed the "Regulation for Compiling the 'Report on Money Market Transactions' " (in effect as of January 1, 2004).

The Board of Governors of the Bank of Latvia passed the "Regulation for Compiling the 'Report on Net Open Foreign Exchange Position' " (in effect as of January 1, 2004).

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for the Securities Settlement System Organised by the Bank of Latvia", the "Regulation for Granting Lombard Loans" and the "Regulation for Receiving Bank Time Deposits at the Bank of Latvia" (in effect as of August 1, 2003).

The Board of Governors of the Bank of Latvia passed the "Regulation for Receiving a Cash Collection License" (in effect as of August 1, 2003).

September 11

The Board of Governors of the Bank of Latvia passed the "Regulation for Compiling the 'Quarterly Report on Services' " (in effect as of January 1, 2004).

October 9

The Executive Board of the Bank of Latvia passed the "Regulation for Compiling and Submitting Non-Banks' Statistical Documents in Electronic Form" (in effect as of January 1, 2004).

October 16

The Executive Board of the Bank of Latvia passed the resolution "On 'Regulation for Initial Placement of Latvian Government Securities at Competitive Multi-Price Auctions'".

November 6

The Executive Board of the Bank of Latvia approved the "Procedure for Maintaining the Register of Debtors".

November 13

The Board of Governors of the Bank of Latvia approved a new edition of the "Regulation on the Securities Settlement System Organised by the Bank of Latvia" (in effect as of January 9, 2004).

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for Granting Lombard Loans" and the "Regulation for Receiving Bank Time Deposits at the Bank of Latvia" (in effect as of January 9, 2004).

The Board of Governors of the Bank of Latvia approved a new edition of the "Regulation for Compiling the 'Quarterly Report on Transportation and Intermediary Services' " (in effect as of January 1, 2004).

The Board of Governors of the Bank of Latvia passed the "Regulation for Compiling the 'Monthly Report on Natural Person Job Contracts for Working Abroad' " (in effect as of January 1, 2004).

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for Compiling Information on Foreign Settlements by Non-Banks", the "Regulation for Compiling the 'Quarterly Report on Foreign Investment' " and the "Regulation for Compiling the 'Annual Report on Foreign Investment' " (in effect as of January 1, 2004).

In 2003, the global economic environment showed ongoing positive changes, and, in comparison with the beginning of the year, uncertainty in financial markets diminished, providing a stimulus to the economic activity in the euro area in the second half of the year. In the US, encouraging monetary and fiscal policies supported acceleration of the economic growth. Base rates, both in the US and the euro area, were at a record low level, creating a precondition for further sustainable growth of the economy.

Steady growth of the Latvian economy, supported by strong domestic demand and effective performance of Latvian exporters in major export markets continued in 2003. Influenced by supply effects, the average annual inflation was 2.9%. The current account deficit of the balance of payments grew under the impact of the rapidly strengthening domestic demand and the large amount of financing required for modernisation. Nevertheless, a number of factors – higher growth in productivity than in wages in the production sector, sustained ability of Latvian producers to compete on external markets and prevalence of long-term foreign borrowing facility – indicated that the robust growth was still underlying a balanced economic situation without impairing overall macroeconomic stability. Hence the Bank of Latvia did not subject its monetary policy to any adjustments in 2003 and did not change the interest rates it had formerly set. Money market interest rates were still low, and a moderate growth in their level in the latter half of the year was not reflected in changes of average weighted interest rates on loans granted to non-banks.

The year 2003 was particularly significant for Latvia due to several reasons. The tenth anniversary since the first banknote of the restored national currency – 5 lats – was put into circulation was marked on March 5. The positive vote on September 20 at the referendum on Latvia's accession to the European Union (EU) was an exceptionally memorable event for the country and its citizens. Honorable services of the lats notwithstanding, it will be replaced with the euro in compliance with the EU Treaty, which won the support of the nation via the positive vote in the referendum. The Protocol Decision on Latvia's preparation for full-scale participation in the Economic and Monetary Union (EMU) passed by the Government of Latvia on December 9 is an important move towards the introduction of the euro in Latvia.

International rating agencies made announcements on assigning higher rating to Latvia (*Fitch Ratings* in July) and on improving their outlook (*Standard & Poor's* in July and *Fitch Ratings* in November) thereby reflecting Latvia's positive evaluation abroad.

In the reporting year, the Bank of Latvia's Executive Board managed the Bank's business in compliance with the Law "On the Bank of Latvia" and other laws and regulations, as well as decisions of the Bank of Latvia's Board of Governors concerning monetary policy and other activity areas of the central bank. The Bank of Latvia's Executive Board convened 46 meetings and passed 23 resolutions on the usage of monetary policy instruments and 183 resolutions on conducting other daily business of the Bank. The Executive Board of the Bank of Latvia drafted 38 resolutions for the Bank of Latvia's Board of Governors and submitted 16 reports concerning monetary policy and other central banking issues to the Board of Governors.

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

In 2003, the Bank of Latvia did not change its foreign exchange rate policy, retaining the peg of the lats to the SDR basket of currencies (XDR 1 = LVL 0.7997 since 1994). The exchange rate of the lats against individual foreign currencies fluctuated depending on mutual fluctuations of their exchange rates in the global foreign exchange market.

The Bank of Latvia's foreign reserves, which consist of gold, convertible foreign currencies and SDR, amounted to 830.5 million lats at the end of 2003 (788.4 million lats at the end of 2002). In terms of euros, foreign reserves declined to 1 232.2 million euros at the end of 2003 (1 292.5 million euros at the end of 2002), whereas in terms of US dollars they increased (to 1 535.1 million US dollars; 1 327.3 million US dollars at the end of 2002). In 2003, the Bank of Latvia conducted significant currency interventions buying foreign currencies in the net amount of 137.8 million euros (171.6 million US dollars). In December, foreign currencies in the amount of 80.3 million euros or 100.0 million US dollars were bought, of which 90.0 million were US dollars. The Bank of Latvia generated income by investing its foreign reserves in the external financial markets in compliance with the Guidelines approved by the Bank of Latvia's Board of Governors. The amount of foreign reserves in terms of euros shrank due to the appreciation of the euro against the lats from 0.610 to 0.674 (in accord with the exchange rate set by the Bank of Latvia); the depreciation of the US dollar against the lats from 0.594 to 0.541, in turn, resulted in an increase in the amount of foreign reserves in terms of US dollars.

The Bank of Latvia's Board of Governors approved a new edition of the "Guidelines for Managing the Bank of Latvia's Foreign Reserves" in 2003 (in effect as of January 1, 2004). The Guidelines have been improved without amending the core principles of reserve management and with a central focus on risk minimisation. It was possible due to a new financial risk management and performance attribution system introduced at the beginning of 2003. The Bank of Latvia continues to invest its foreign reserves in safe and liquid financial instruments, primarily in securities issued by the governments and government agencies of the US, countries of the euro area, the United Kingdom and Japan. Within the limits stipulated by the Guidelines, the Bank of Latvia's foreign reserves were also invested in high quality debt securities of credit institutions and corporate entities, asset and mortgage backed securities and callable bonds, and interest rate future contracts. The Bank of Latvia's gold reserves were placed in short-term deposits with foreign financial institutions of high credit rating.

Since October 1994, the Bank of Latvia has been employing three external asset managers in the United Kingdom, and the US. At the beginning of 2003, one of the external asset managers was replaced. All external asset managers operate in compliance with the Guidelines approved by the Bank of Latvia's Board of Governors.

THE BANK OF LATVIA'S MONETARY POLICY INSTRUMENTS

The Bank of Latvia continued to pursue a tight monetary policy with the range of the employed monetary policy instruments broadly unchanged.

In 2003, the Bank of Latvia did not change the refinancing rate (3.0%) and the interest rates on the standing facilities, i.e. the interest rate on banks' 7-day time deposits (2.0%), the interest rate on banks' 14-day time deposits (2.25%), the

interest rate on Lombard loans with maturity of up to 10 days (5.0%), from 11 to 20 days (6.0%) and over 20 days (7.0%). This decision was dictated by the situation in Latvia's economy.

In 2003, the Bank of Latvia bought foreign currencies in the net amount of 97.4 million lats via spot transactions, hence at the end of the year the usage of other monetary policy instruments was to be limited.

As of January 24, 2003, the reserve ratio for banks was reduced from 5.0% to 3.0% and vault cash balances excluded from the reserve base. In 2003, the compliance with the reserve requirements was ensured by the average balance of funds on the settlement account of a bank with the Bank of Latvia over the reserve compliance period, which started with the 24th date of the month and ended on the 23rd date of the following month. The reserve base and reserve requirements were calculated based on the average balance of non-bank deposits received and debt securities issued by a bank or a branch of a foreign bank registered in the Republic of Latvia. Non-callable debt securities with the original maturity over 2 years issued by a bank, non-bank deposits received by bank branches opened abroad, non-bank deposits with agreed maturity of over 2 years, non-bank deposits redeemable at notice with the notice period of over 2 years, and repurchase agreements were excluded from the reserve base. At the end of 2003, 22 banks and one branch of a foreign bank were subject to the reserve requirements. With the reserve base increasing and the reserve ratio decreasing, the volume of the reserve requirements reached 106.0 million lats at the end of 2003 (145.1 million lats at the end of 2002).

In 2003, the most often used monetary policy instruments were repurchase agreements and currency swaps. As compared with 2002, the significance of banks' time deposits diminished. Repo transactions were conducted in the amount of 2 609.8 million lats (510.5 million lats in 2002), whereas currency swaps amounted to 1 549.3 million lats (340.8 million lats in 2002).

In 2003, the Bank of Latvia offered repurchase agreements of 7- and 28-day maturity but ceased to offer repurchase agreements of 91-day maturity in such a way continuing to harmonise the usage of monetary policy instruments with the practice of the European Central Bank (ECB). The volume of repo transactions was 5.1 times larger than in 2002 because banks increased their demand for the Bank of Latvia's resources in lats. The average end-of-day balance on repurchase agreements in 2003 was 57.1 million lats or 2.6 times above that in 2002. The weighted average interest rate on 7-day repurchase agreements (96.4% of total repo transactions) dropped from 3.22% in 2002 to 2.97% in 2003. The average rates on repo transactions declined alongside with the Bank of Latvia lowering minimum interest rates set for repo auctions in line with changes in money market interest rates.

As long-term currency swaps of the Bank of Latvia were completely redeemed in the amount of 59.0 million lats in 2003 (the Bank of Latvia has not held long-term currency swap auctions since the end of 2001), banks' demand for the Bank of Latvia's short-term currency swaps considerably increased in the first half of the year. However at the end of the year, when the Bank of Latvia engaged in interventions purchasing foreign currencies, the money market resources in lats increased, pushing down the demand for currency swaps. In 2003, the volume of currency swap deals increased 4.5 times as compared with the previous year. The end-of-day balance on short-term currency swaps averaged 78.3 million lats (28.8 million lats in 2002), while the weighted average interest rate was 2.90% (2.97% in 2002).

The average end-of-day balance on time deposits of banks and other financial institutions was 2.6 million lats in 2003 (7.8 times smaller than in the previous year). Banks and other financial institutions were offered 7- and 14-day deposit facility, but in 2003 they used only the 14-day facility. This instrument was more actively used in the first quarter of 2003, when the reserve ratio was lowered; however in December, the average end-of-day balance of these time deposits was already below 1 million lats.

In 2003, the average end-of-day balance on Lombard loans was 0.3 million lats, of which 97.9% were demand Lombard loans. As compared with 2002, the average end-of-day balance on Lombard loans was 1.9 times larger because some banks, having not demanded the entire volume of lats resources offered in the Bank of Latvia's monetary operations at the beginning of a reserve maintenance period, had to use Lombard loans when the respective period was closing. In 2003, Lombard loans were granted in the amount of 30.6 million lats or 20.9% less than in 2002; however the average Lombard loan maturity period was longer. The weighted average interest rate on Lombard loans was 5.00% in 2003 (23 basis points lower than in 2002). For the purpose of liquidity management, banks actively used the intra-day credit facility (in the amount of 918.3 million lats; 1.7 times more than in 2002) offered by the Bank of Latvia.

In 2003, the Bank of Latvia purchased Latvian government securities (5- and 10-year bonds) in the amount of 17.2 million lats. The Bank of Latvia's interventions in the securities secondary market were conducted in February and were associated with replenishment of the government securities portfolio, which had decreased owing to redemption of securities (in the amount of 11.3 million lats in January and 18.3 million lats in 2003). In 2003, the average end-of-day balance on the government securities portfolio held by the Bank of Latvia, excluding securities pledged under repurchase agreements, was 65.5 million lats (8.6% larger than in 2002).

As in the previous year, no reverse repo transactions with government securities were conducted in 2003 because the Bank of Latvia had no need to limit liquidity of banks.

The Latvian Government continued to deposit funds with the Bank of Latvia. The end-of-day balance of Government's deposits in lats with the Bank of Latvia was 45.8 million lats at the end of 2003, which was 47.3% more than at the end of 2002.

The Bank of Latvia continued to quote two money market indices – RIGIBID (deposit rates in the interbank market) and RIGIBOR (lending rates in the interbank market) in accordance with the Bank of Latvia's "Regulation for the Calculation of RIGIBID and RIGIBOR" basing quotation lists on the quotes of those banks that were active in the interbank market and able to conduct operations at money market rates on transactions in lats also in the conditions of a volatile interbank market. In 2003, the list of the banks whose money market quotes are used in RIGIBID and RIGIBOR calculations (already comprising joint-stock companies *Hansabanka*, *Latvijas Krājbanka*, *Latvijas Unibanka*, *Parekss-banka*, *Vereinsbank Rīga*, the Latvia Branch of *Nordea Bank Finland Plc*) was supplemented with a joint-stock company *Baltijas Tranzītu banka*.

In 2003, amendments were introduced to several regulations of the Bank of Latvia. As of January 9, 2004, due to the extension of operating time of the Bank of Latvia's payment and settlement systems, the time period for receiving Lombard loan and banks' time deposit orders, as well as securities transfer orders at the

Bank of Latvia was also extended. Participants in the short-term currency swap arrangements, on the other hand, were offered to opt for making auction-related settlements in foreign currencies with one-day delay using securities as an appropriate collateral.

CASH MANAGEMENT

In 2003, currency in circulation increased by 9.6% (from 622.6 million lats to 682.1 million lats). Over the last five years, currency in circulation has grown 1.8 times.

Banknotes and coins received from the banking sector were checked for authenticity and fitness for circulation by using automated cash processing systems. The amount of currency processed in 2003 (1 445.0 million lats) exceeded the amount of currency in circulation 2.1 times (1.7 times in 2002). Of the amount processed, 204.0 million lats or 14.1% was withdrawn from circulation (119.0 million lats or 11.4% in 2002). The total nominal value of counterfeits detected in 2003 (6.3 thousand lats) accounted for only 0.001% of currency in circulation.

In 2003, 250 000 new 1-lats coins featuring an ant on coin's reverse were issued (in circulation as of March 25, 2003). The Bank of Latvia continued its participation in the international coin program *Hansa Cities* organised by the Mint of Finland Ltd. Under this program, a silver commemorative coin *Valmiera* was issued (in circulation as of August 28, 2003). Under an international coin program in honor of the 2004 Olympic Games in Athens, a coin dedicated to Graeco-Roman wrestling was struck and put into circulation as of February 20, 2003. By issuing 1-lats silver coin *Kurzeme* (in circulation as of December 9, 2003), the second series *Time* of the program *Latvia. Times and Values* was commenced. To commemorate the tenth anniversary of restoration of the Latvian national currency, a coin preserving the design of the 5-lats silver coin struck before World War II was issued under the international coin program *The Smallest Gold Coins of the World* and put into circulation as of February 28, 2003. In 2003, 10 388 commemorative coins were sold in Latvia and 15 354 abroad.

In November 2003, the reconstruction of the Liepāja Branch building was accomplished, and one more region of Latvia can pride itself on having a modern and secure vault and cash processing premises meeting central banking standards.

BALANCE OF PAYMENTS AND FINANCIAL STATISTICS

In 2003, the methodological work in respect of preparing Latvia's balance of payments and financial statistics continued with the primary focus on data collection and improvement of compliance with international standards.

With a view to obtain more accurate information about services delivered by and received from residents of Latvia, the Bank of Latvia's Board of Governors passed the "Regulation for Compiling the 'Quarterly Report on Services'" (in effect as of January 1, 2004). Following the exchange of opinion with respondents and for the purpose of streamlining the process of report compiling, the Bank of Latvia's Board of Governors approved a new edition of the "Regulation for Compiling the 'Quarterly Report on Transportation and Intermediary Services'" (in effect as of January 1, 2004).

With the Bank of Latvia's Board of Governors passing the "Regulation for Compiling and Submitting Non-Banks' Statistical Documents in Electronic Form", a pilot project on compiling and submitting non-banks' statistical reports to be sub-

mitted in electronic form to the Bank of Latvia for balance of payments statistics was implemented.

With a view to a broader range of collected statistical data, the Bank of Latvia's Board of Governors passed the "Regulation for Compiling Interest Rate Reports of Credit Institutions" (in effect as of January 1, 2004) thus introducing the ECB standards for interest rate statistics, and the "Regulation for Compiling the 'Report on Money Market Transactions' " (in effect as of January 1, 2004). For the purpose of enhancing a uniform approach to compiling of the new reports, the Bank of Latvia developed and placed on its website *Manual for Compiling Interest Rate Reports of Credit Institutions*, which comprises samples of interest rate calculations and provides answers to credit institutions' most often asked questions.

As of July 2003, within the framework of interest rate statistics the Bank of Latvia submits information on Latvia's selected long-term interest rates to the ECB on a regular basis to ensure monitoring of the compliance with the Maastricht convergence criterion.

At the close of the reporting year, a report on flows statistics of credit institutions was compiled thus also managing to incorporate the requirements stipulated under the Regulation (EC) No. 2423/2001 of the European Central Bank concerning the consolidated balance sheet of the monetary financial institutions sector (ECB/2001/13) in relevant regulations.

Having examined the ECB requirements for quarterly financial accounts and government statistics, the Bank of Latvia assumed responsibility for compiling quarterly financial accounts in Latvia, commenced collection of relevant statistical data under a pilot project, and took part in a working group dealing with the quality improvement of government statistics. The working group comprised also representatives of the Ministry of Finance, the State Treasury, the State Revenue Service, and the Central Statistical Bureau of Latvia.

In 2003, representatives of the IMF and the ECB assessed the performance of the Bank of Latvia in the area of statistics. In July, the IMF Monetary and Financial Statistics Mission visited the Bank, and its purpose was to assess the compliance of the Bank of Latvia's statistical information with the methodology incorporated in *Monetary and Financial Statistics Manual* by IMF staff (edition of 2000) and, if required, provide recommendations. Acknowledging general compliance of monetary and financial statistics with the requirements of the Manual, the Mission proposed a number of improvements to statistical information for submission to the IMF. In August, representatives of the ECB provided a positive assessment of the quality of developing Latvia's balance of payments, with attention being drawn to the significance of improving data breakdown by country. In September, the IMF ROSC (*Reports on the Observance of Standards and Codes*) Mission assessed the quality of both the bank and monetary as well as balance of payments statistical data.

The Bank of Latvia proceeded with dissemination of financial and balance of payments statistics through its regular publications, the Bank of Latvia's website and IMF publications *International Financial Statistics* and *Balance of Payments Statistics Yearbook*, with the help of the Bank for International Settlements and Eurostat, and also within the framework of IMF Special Data Dissemination Standard (including publishing, as of June, of quarterly information on the country's external debt in accord with the requirements of IMF publications *Balance of Payments Manual* (5th edition) and *External Debt Statistics: Guide to Compilers and Users* (edition of 2003).

PAYMENT SYSTEMS

In 2003, preparations for implementing the IBAN, the International Bank Account Number standard in Latvia continued.

In May 2003, the Bank of Latvia's Board of Governors approved the "Regulation for the Use of the IBAN" (in effect as of January 1, 2004), stipulating the procedure for assigning, validating and using the IBAN in Latvia to be met by credit institutions and other institutions registered in the Republic of Latvia that perform non-cash payments. The regulation provides for a transition period lasting from January 1, 2004 to December 31, 2004 when banks and the non-profit organisation state joint-stock company *Latvijas pasts* have to ensure transition to the use of the IBAN, replacing the current customer account numbers. Upon receiving a customer's payment document with the beneficiary's Latvian IBAN indicated, the originator's bank will be able to check whether the specified IBAN corresponds to the standard account number at the beneficiary's bank, and erroneous credit transfers will thus be prevented. Banks will notify their customers of the account number replacement by specifying the IBAN in account statements, as well as by disseminating information otherwise. In order to ensure the necessary conditions for implementing the IBAN, amendments were made to the "Regulation for Credit Transfers" (in effect as of January 1, 2004). The amendments stipulate that upon receiving a payment with the Latvian IBAN specified, the receiving bank will be entitled to credit funds to the beneficiary's account on the basis of the specified IBAN only, without checking other banking details of the beneficiary, indicated in the payment document. This provision has been introduced to facilitate straight through processing and to reduce the number of payments which might be rejected or delayed because of any inaccuracy in banking details of the beneficiary (inaccuracies in the registration number of an enterprise, identity number or name).

Upon Latvia's accession to the EU, the Regulation (EC) No 2560/2001 of the European Parliament and of the Council of 19 December 2001 "On cross-border payments in euro" provides for the duty of banks to issue the IBANs to their customers upon their request, should it be necessary for cross-border business transactions in euros; however, beginning with January 1, 2005, the IBAN will be the sole identifier of the account both for the domestic and cross-border payments. The Bank of Latvia has published an informational booklet on the IBAN, and it is available to customers in all banks in Latvia.

In 2003, the Bank of Latvia developed a new version of the electronic clearing system (EKS), and it commenced its operation at the beginning of 2004. The new version of the EKS has an extended operation time till 3.00 p.m. and two clearing cycles, thus increasing settlement speed and efficiency. The introduction of a second clearing cycle in the EKS makes it possible to effect a considerably larger volume of bank customer payments in lats on the day they have been submitted to a bank. The new version of the system was developed in close cooperation with banks to ensure its full compliance with the current market requirements. In order to introduce two clearing cycles in the EKS, amendments were made to the "Regulation for Interbank Settlements Effected by the Bank of Latvia", accordingly extending the operation time of SAMS, the interbank automated payment system, till 4.30 p.m.

A requirement to the system's participants to submit opinions on their capability to fulfil their obligations arising from the participation in the Bank of Latvia's payment systems was also incorporated in the regulation. In addition, banks, which have not been registered in the Republic of Latvia, shall submit an opinion on the

impact of legislation of their country of registration on the bank's capability to fulfil its obligations in the system. The above requirement will help reduce the legal risk in the Bank of Latvia's payment systems. The regulation also provides more detailed criteria for a bank's participation and suspension of its operation in the system, as well as more accurately defines the moments of a payment's acceptance, irrevocability and finality. Procedures for the SAMS and EKS operations in emergency, for cases when any participant in the system encounters technical problems with the connection to the SAMS, or where there are technical problems within the SAMS or communications network disruptions, have been updated and supplemented. The regulation has been amended in accordance with the ECB recommendations for improving the operation of the Latvian payment system, issued in 2002, and the compliance assessment of the Bank of Latvia's interbank payment systems with the Core Principles for Systemically Important Payment Systems as formulated by the Bank of International Settlements, conducted by the Bank of Latvia in 2002.

In the reporting year, representatives of the Bank of Latvia participated in the status of observers in the discussions of the Payment and Settlement Systems Committee of the European System of Central Banks (ESCB) and its working groups on various issues concerning payment systems. With Latvia's accession to the EU, the issue on its participation in TARGET (Trans-European Automated Real-time Gross settlement Express Transfer system) has become topical for Latvia. When Latvia joins the EMU and introduces settlements in euros, the connection to TARGET will ensure infrastructure for settlements in the euro area, and the Bank of Latvia will need it for implementing the monetary policy. To provide banks a possibility to effect real-time cross-border payments in euros, the EU candidate countries were offered an opportunity to join TARGET before their membership in the EMU. In view of the potential costs and the already existing settlement system infrastructure in Latvia, banks did not express willingness and necessity to participate in TARGET prior to joining the euro area, therefore the Bank of Latvia, like most of the central banks of the EU candidate countries, is expected to join TARGET only after joining the EMU. At the same time a project of a new TARGET version was developed, discussing the system's operational principles, management and operational issues and the Bank of Latvia having an opportunity to participate in planning the system already during its project stage and study the compatibility of the systems and infrastructure. The new payment statistics methodology developed by the ECB was agreed, oversight principles for retail payment systems were developed, oversight guidelines for large-value euro payment systems were set forth, and other issues related to the payment systems policy were addressed.

Within the framework of payment system oversight, the Bank of Latvia, in cooperation with the Financial and Capital Market Commission, continued auditing banks' payment systems in 2003. As a result of the audit it was concluded that none of the banks audited would cause additional risks to the Bank of Latvia's payment systems. Cooperation with the limited liability company *Banku servisa centrs* was also commenced to assess the operation of the payment card payment system and the associated risks.

In order to assess banks' compliance with the Bank of Latvia's "Recommendations for Transactions Effected by Means of Electronic Payment Instruments", a survey on the compliance with the recommendations was conducted at the end of the year. The results of the survey indicate that the recommendations are largely complied with; nevertheless, it was established that banks had not put into practice several requirements thereof.

In 2003, the total amount of payments processed by the SAMS increased by 56.0%, reaching 33.5 billion lats. Such an increase in payments was determined by the amount of interbank operations as well as operations between banks and the Bank of Latvia, which in turn was facilitated by a high demand for lats resources in 2003. The volume of processed payments reached 127.7 thousand (16.3% higher than in 2002). In 2003, the share of interbank payments in the SAMS grew 4.9%, reaching 40.3% of total payments processed by the SAMS.

In the reporting year, the EKS processed 14.8 million payments in the amount of 5.6 billion lats (a year-on-year drop of 8.0% and 10.3%, respectively). The reason for the decline in the volume and amount was an agreement between several banks to perform their mutual payments outside the EKS. In 2003, the average amount per payment in the EKS was 377.50 lats (2.5% less than in 2002).

INFORMATION SYSTEMS

On June 2, 2003, the information system of the Debtors' Register started its operation. There, the Republic of Latvia credit institutions register information on their debtors who fail to make their contractual payments, or have made breaches stated in the Law "On Credit Institutions", or other essential contractual breaches.

The new version of the EKS and the related information systems, developed with the aim of ensuring the possibility of having several clearing cycles and the introduction of the IBAN, was accomplished successfully. In 2003, the development of the information system enabling non-banks to submit electronically the information required for compiling the state balance of payments was completed.

The development of the new securities settlement system was also completed and its use was commenced in the Bank of Latvia. The new system ensures considerably enhanced level of automation and security. Substantial changes have been made in a number of Bank of Latvia's information systems to ensure their integration with the securities settlement system.

A new bookkeeping system for fixed assets, intangible assets and inventories was introduced at the Bank of Latvia, ensuring a uniform and centralised compiling and use of the relevant information.

The Bank of Latvia successfully completed the introduction of the intrusion detection and prevention system, thus increasing the overall security of its information systems. A centralised server administration system was also introduced successfully, ensuring uniform administration of the operations of all essential servers systems, including performance analysis, problem compilation and other important operations.

The Bank of Latvia Executive Board approved the revised "Regulation for the Security of the Bank of Latvia's Information Systems". Essential amendments have been made to the regulation with respect to assigning responsibility for the information systems and their usage, the issues of privacy have been stated accurately, and all relevant updates have been made in line with changes in the technologies used.

Pursuant to the regulation approved by the Executive Board of the Bank of Latvia at the close of 2002, a complex analysis of all operational risks was conducted at the Bank of Latvia. The Executive Board of the Bank of Latvia approved its results, informing the Board of Governors thereof. An in-depth risk analysis of all essential information systems of the Bank of Latvia was conducted on the basis of adapted *Information Security Forum's* methodology.

The Bank of Latvia took part in the *Information Security Forum's* Information Security Status Survey, conducted every two years and assessing the compliance of the information systems environment of the members of the above organisation with sound operational and security requirements. The Bank received a very high evaluation.

Active cooperation continued with the ECB to ensure the Bank's ability to join the uniform information systems of the ESCB and the telecommunications environment.

INFORMATION TO THE PUBLIC

In the reporting year, the Bank's own publications as well as the Internet, the press, television and radio were the media used by the Bank of Latvia to inform the public about its activities and developments in the Latvian economy.

At the beginning of 2003, the Bank of Latvia published its *Bank of Latvia: Annual Report 2002* to reflect its operation and financial performance results, as well as provide a comprehensive review of the developments in the Latvian economy for that year. The Bank of Latvia's *Monetary Review*, *Monetary Bulletin*, *Latvia's Balance of Payments* and *Latvia's Balance of Payments (Key Items)* informed about the key economic and monetary indicators. The bulletin *Averss un Reverss* analysed economic developments in Latvia and abroad and provided information on resolutions by the Bank's Board of Governors and Executive Board. In a series of working papers, several studies by the Bank of Latvia's experts were published and made available to professionals in economics and finance: *Transmission of Monetary Shocks in Latvia*, *Interest Rate Term Structure in Latvia in the Monetary Policy Context* and *Measuring Output Gap in Latvia*.

Mass media received information on resolutions passed by the Bank's Board of Governors and Executive Board and the Bank's activities on a regular basis. The Bank's employees prepared materials discussing issues falling within the competency of the central bank to be published in the press both in Latvia and abroad.

The Bank of Latvia's Governor held regular press conferences to inform the media about resolutions passed by the Bank's Board of Governors and developments in the national economy, followed by question and answer sessions.

At the beginning of 2003, on the eve of the tenth anniversary of the lats restoration, the Bank of Latvia initiated a public discussion on the importance of the national currency for the development of the national economy. On March 5, 2003, the day when the first lats banknotes were put into circulation, the Bank of Latvia invited economists, banking experts, businessmen, journalists and other representatives of the public to a conference and discussion at the Big Hall of the University of Latvia to analyse the monetary policy implemented by the Bank of Latvia and its impact on the national economy. At the Riga Gallery, people had a possibility to attend an exhibition displaying the coins and banknotes, including commemorative coins, issued by the Bank of Latvia.

In September 2003, in view of the upcoming people's vote on Latvia's membership in the EU, the Bank of Latvia prepared a wide range of informational materials, comprising analysis of economic benefits and risks associated with Latvia's accession to the EU. Via media, the prospective voters could acquire exhaustive information for making an informed choice. Each household in Latvia received a booklet published by the Bank of Latvia, containing answers to the most essential questions regarding the introduction of the euro in Latvia.

In September 2003, the Bank of Latvia made it possible for the general public to attend a travelling photo exhibition "The Making of the Euro", commissioned by the ECB, at the Riga Stock Exchange building. Several thousand people visited it.

All Bank of Latvia's publications, regularly updated information on the Bank of Latvia, the regulations adopted by the Bank, financial statistics, payment and settlement systems, Latvian money, and other areas of interest were available on the Bank's website (www.bank.lv). The comprehensive information on the EMU and Latvia's participation in it, available on the Bank of Latvia's website, was particularly frequently searched for.

The official exchange rates quoted and regulations developed by the Bank as well as other official information were disseminated through *Latvijas Vēstnesis*, the official newspaper of the Republic of Latvia.

The Bank's employees provided lectures on the activities of the Bank of Latvia and developments in the national economy to students, teachers of economics and students of secondary schools.

The Bank of Latvia participated in the production of the TV broadcast *Kā bankā* and the radio broadcast *Lata spoguļi*, which reflect and analyse economic and financial developments in Latvia and abroad.

QUALITY MANAGEMENT AT THE BANK OF LATVIA

The quality management system has been functioning at the Bank of Latvia since 2000.

In 2003, one internal quality audit of the Bank's quality management system was conducted. The limited liability company *Bureau Veritas Latvia* performed a certification audit of the Bank's quality management system in compliance with the requirements of the standard ISO 9001:2000. During the certification audit, no serious deficiencies and major non-compliance with the standard ISO 9001:2000 were detected in the Bank's quality management system.

Since November 2003, the maintenance and updating of the Bank's quality management system is performed by the limited liability company *Zygon Baltic Consulting* on a contractual basis.

MANAGEMENT OF THE BANK OF LATVIA'S BUDGET

In the reporting year, expenses were incurred and long-term investments made in accordance with the 2003 budget as approved by the Bank of Latvia's Board of Governors. The Bank of Latvia's Executive Board, together with the heads of the relevant Bank's organisational units, made sure, on a regular basis, that the expenses were incurred and long-term investments made in accordance with the approved budget, and reported to the Bank's Board of Governors and Budgetary Commission on the execution of the 2003 budget.

The management of the Bank of Latvia's budget for the year 2003 proceeded in compliance with the "Regulation for Managing the Bank of Latvia's Budget" approved by the Board of Governors of the Bank of Latvia. The regulation provides for the procedure of drafting, approving and monitoring the execution of the Bank's budget.

The Bank of Latvia's Executive Board drafted the 2004 budget in accordance with the "Regulation for Managing the Bank of Latvia's Budget" and taking into ac-

count the income, expenditure and long-term investment projections of the Bank's organisational units. They were prepared observing the Bank of Latvia's tasks, as laid down in the Law "On the Bank of Latvia", one of the key goals being a successful integration of the Bank of Latvia within the ESCB, and taking into account the working plans of the Bank's organisational units for 2004, the outlook for the economy and financial market in Latvia and the issuing countries of the SDR basket currencies, as well as the expenditure projections for long-term investments prior approved by the Bank of Latvia's Board of Governors for several consecutive years.

FINANCIAL RESULTS OF THE BANK OF LATVIA

In 2003, the Bank of Latvia earned 11 908 thousand lats in profit (14 434 thousand lats in 2002). The Bank of Latvia's net interest income amounted to 30 652 thousand lats in 2003 (32 497 thousand lats in 2002). The net interest income was mainly derived from investing gold and convertible foreign currency reserves in secure financial instruments of high liquidity, and income from the Latvian government securities and money market transactions. A decrease in yields on foreign debt securities and money market interest rates had a continuous negative effect on the interest income from foreign operations (27 327 thousand lats in 2003; 30 762 thousand lats in 2002). A higher banks' demand for the lats resources mostly underlay an increase in interest income from loans granted to banks registered in the Republic of Latvia (961 thousand lats); as a result, the amount of repo transactions recorded a year-on-year growth. Interest income from Latvian government debt securities (4 216 thousand lats; 4 725 thousand lats in 2002) slightly shrank, since the yield on these securities dropped in 2003, without substantial changes in the amount of investment made in the Latvian government debt securities. The Bank of Latvia's interest expense (2 659 thousand lats; 3 815 thousand lats in 2002) was largely comprised of interest on the Government's deposits.

THE BANK OF LATVIA'S ORGANISATIONAL STRUCTURE

The composition of the Board of Governors of the Bank of Latvia, as at the end of 2003, was as follows:

– Governor	Ilmārs Rimšēvičs;
– Deputy Governor	Andris Ruselis;
– Members of the Board of Governors:	Harry Bush, Valentīna Kolotova, Vīta Pilsuma, Arvils Sautiņš, Varis Zariņš, Valentīna Zeile.

The Executive Board of the Bank of Latvia, as at the end of 2003, was as follows:

– Chairperson of the Executive Board	Māra Raubiško;
– Deputy Chairmen of the Executive Board:	Reinis Jakovļevs, Helmūts Ancāns;
– Members of the Executive Board:	Roberts L. Grava, Māris Kālis, Harijs Ozols.

At the end of 2003, the number of the Bank of Latvia's employees was 743, of which 26 were employees having a job contract for a definite period (721 and 14 employees at the end of 2002, respectively). Of the Bank's staff, as at the end of 2003, 59% were males and 41% were females.

To optimise the Bank of Latvia's operation and approximate its organisational structure to the arrangement set up by the ECB to discharge its respective functions, the Bank of Latvia continued to improve its organisational structure.

In cooperation with the ECB and Eurostat, new trends were developed in the sphere of compiling statistics (compiling statistics of financial accounts, financial services sector and foreign branches). As a result, General Economic and Financial Statistics Division was established on the basis of the former Statistics Analysis Division of the Statistics Department.

New employees studying financial system's stability issues and doing in-depth research were recruited for the Macroeconomic Analysis Division of the Monetary Policy Department.

To ensure a uniform performance and control of the Bank's financial transactions, the Monetary Policy Department and the Foreign Exchange Department were restructured: the domestic market operations, formerly within the competence of the Monetary Policy Department, were included in the functions of the Foreign Exchange Department. As of August 1, 2003, the Foreign Exchange Department was renamed the Market Operations Department.

As of April 1, 2003, two divisions were established on the basis of the former System Security and Quality Assurance Division of the Information Systems Department: Information Systems Security Division and Information Systems Quality Assurance Division.

HUMAN RESOURCES DEVELOPMENT

In the reporting year, the Bank of Latvia employees continued their academic studies, as well as additional professional training, participating in seminars, workshops and conferences in Latvia and abroad to improve their expertise and follow the latest developments in the fields of monetary policy, macroeconomics, econometrics, foreign exchange operations, payment systems, statistics, bank accounting and information technologies. A number of the Bank's employees successfully participated in international professional certification programmes.

In 2003, 3.8% of total expense on wages, salaries and other personnel costs and social security contributions was used for the needs of personnel training.

In the Bank of Latvia's personnel training, particular attention was paid to improving skills necessary for successful cooperation with the ECB. Those involved in the ECBS committees and working groups as observers since May 2003 had a possibility to develop their skills of business English writing, as well as enhance their international business meeting and presentation skills. The Bank offered the English and French language as well as computer skills training, in-depth studies in the fields of business presentations and effective communication. To improve the expertise of the Bank of Latvia's staff on the global financial markets, a visiting lecturer was invited from *Sensei Inc* (US).

In 2003, the Bank continued cooperation with the ECB's Directorate Human Resources in the field of personnel selection. It is possible for the Bank of Latvia's employees to apply for temporary or permanent employment at the ECB. Four

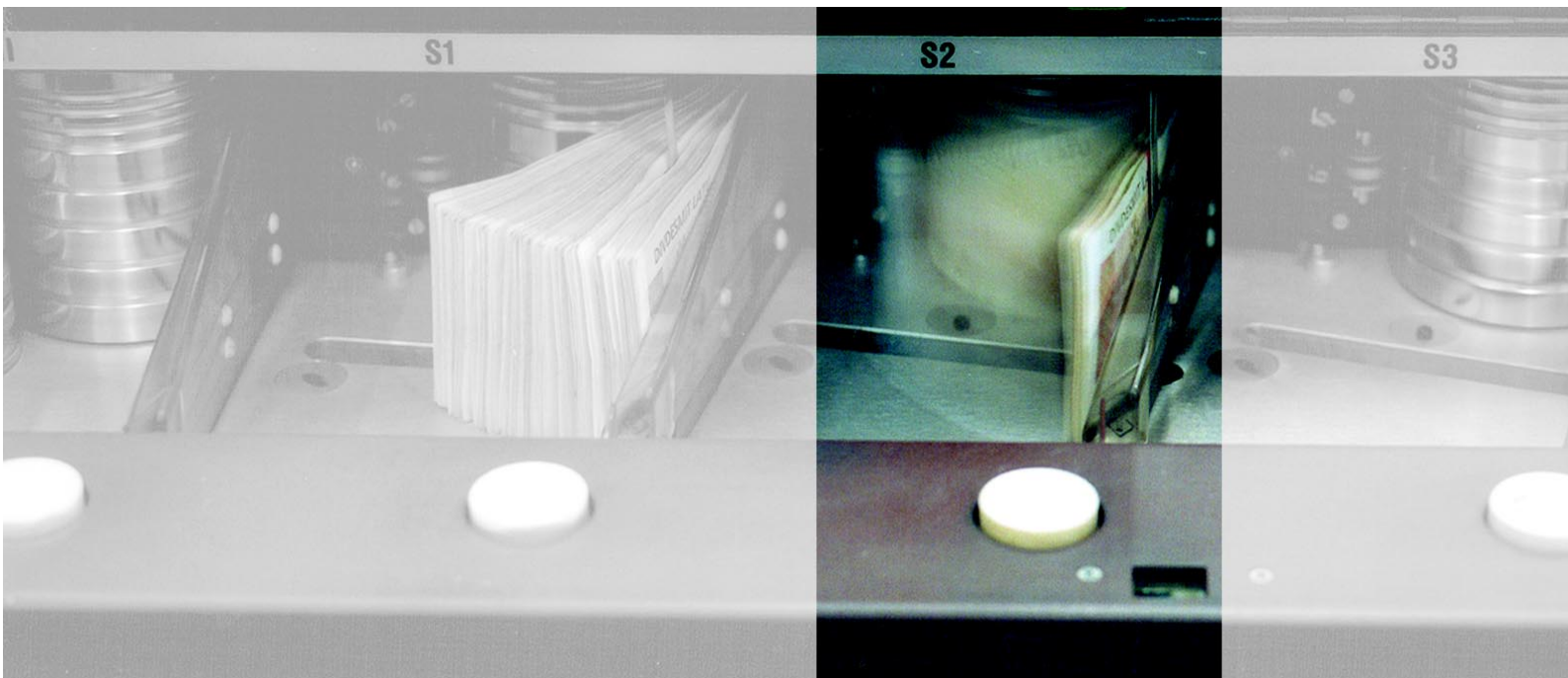
employees of the Bank of Latvia have made use of this opportunity. The cooperation with the ECB is further developed through closer contacts and individual employee exchange programmes organised by the Personnel Department of the Bank of Latvia.

The Bank's cooperation with the Centre for Central Banking Studies of the Bank of England continued as well. Members of the Bank's Board of Governors and Executive Board, and heads of the Bank's organisational units had an opportunity to participate in a workshop in Latvia on the strategic management processes, as well as in an international seminar on strategic management, internal control systems and physical security issues. Representatives from the ECB and the central banks of Austria, Denmark, Estonia, Iceland, Lithuania, Malta and Norway also took part in the seminar.

It has already become a tradition for the Bank of Latvia's professionals to share their expertise with their colleagues. Special seminars were held for recently hired employees to inform them about the Bank's tasks and its organisational units' fulfilling these tasks, whereas representatives of the Monetary Policy Department and Payment Systems Department told their colleagues about the essence and areas of their work.

The Bank of Latvia conducted job performance and development appraisal meetings between an employee and his/her direct supervisor in 2003 as well. The process of job performance and development appraisal is still further elaborated. The attitude of employees and supervisors towards these meetings is positive in most cases.

**THE BANK OF LATVIA'S FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2003**



THE BANK OF LATVIA'S BALANCE SHEET

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

ASSETS	Notes ¹	2003	2002
FOREIGN ASSETS		937 526	894 613
Gold	4	55 543	51 025
Special Drawing Rights		75	41
Convertible foreign currencies	5	774 834	737 313
International Monetary Fund	6	101 144	101 144
Shares in the Bank for International Settlements	7	1 000	1 197
Other foreign assets	8	4 930	3 893
DOMESTIC ASSETS		162 716	146 321
Loans to credit institutions	9	59 320	30 690
Transit credits	10	3 018	11 749
Government securities	11	62 273	64 382
Fixed assets	12	34 200	32 798
Other domestic assets	13	3 905	6 702
TOTAL ASSETS		1 100 242	1 040 934

¹ The accompanying notes set out on pages 54 to 78 are an integral part of these financial statements.

(cont.)	(at the end of the year; in thousands of lats)		
LIABILITIES, CAPITAL AND RESERVES	Notes	2003	2002
FOREIGN LIABILITIES		113 545	116 778
Convertible foreign currencies		149	–
International Monetary Fund	14	104 423	110 388
Foreign bank deposits in lats		677	679
Non-convertible currencies		36	37
Other foreign liabilities	15	8 260	5 674
LATS IN CIRCULATION	16	682 145	622 632
DOMESTIC LIABILITIES		213 521	209 676
Balances due to credit institutions	17	123 810	134 223
Balances due to the Government		80 254	62 079
Balances due to other financial institutions		1 670	3 012
Other domestic liabilities	18, 19	7 787	10 362
CAPITAL AND RESERVES		91 031	91 848
Nominal capital	20	25 000	25 000
Reserve capital	20	45 787	37 928
Valuation account	21	19 712	28 389
European Union grant		532	531
TOTAL LIABILITIES, CAPITAL AND RESERVES		1 100 242	1 040 934
MEMORANDUM ITEMS	22, 25, 26		

These financial statements, which are set out on pages 48 to 78, were authorised by the Bank of Latvia's Executive Board on March 1, 2004.

BANK OF LATVIA'S EXECUTIVE BOARD

Māra Raubiško
 Reinis Jakovļevs
 Helmūts Ancāns
 Roberts L. Grava
 Māris Kālis
 Harijs Ozols

THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT

(in thousands of lats)

	Notes	2003	2002
INTEREST AND SIMILAR INCOME			
Foreign operations			
Interest on deposits with foreign credit institutions and other foreign financial institutions		1 838	2 507
Income from debt securities		25 395	28 098
Dividends on shares in the Bank for International Settlements		94	157
GROSS foreign interest and similar income		27 327	30 762
Domestic operations			
Interest on loans to credit institutions		1 744	783
Income from transit credits		24	42
Income from government securities		4 216	4 725
GROSS domestic interest and similar income		5 984	5 550
INTEREST EXPENSE			
Foreign operations			
Interest on deposits		8	127
GROSS foreign interest expense		8	127
Domestic operations			
Interest on deposits of credit institutions		29	560
Interest on government deposits		2 590	3 055
Interest on deposits of other financial institutions		32	73
GROSS domestic interest expense		2 651	3 688
NET INTEREST INCOME		30 652	32 497

(cont.)	(in thousands of lats)		
	Notes	2003	2002
OTHER OPERATING INCOME		994	605
OTHER OPERATING EXPENSE			
Salaries, wages and other personnel costs		9 385	8 724 ¹
Social security costs		1 857	1 832
Depreciation and amortisation charges	12, 13	2 302	1 798 ²
Costs of financing the Financial and Capital Market Commission	22	1 200	1 200
Maintenance of information systems		753	769 ³
Renovation and repair costs		425	449
Banknote production and coinage costs		180	84
Other operating expense	23	3 636	3 812 ^{1, 2, 3}
TOTAL other operating expense		19 738	18 668
PROFIT BEFORE APPROPRIATION		11 908	14 434
APPROPRIATION OF PROFIT			
Profit appropriated to the State budget		4 049	5 341
Increase in reserve capital		7 859	9 093

¹ Additionally includes accident insurance, health insurance and life insurance premium payments made by the Bank of Latvia (323 thousand lats), which were reported under the caption "Other operating expense" in the profit and loss statement for 2002.

² Amortisation charges of intangible assets (96 thousand lats), which were reported under the caption "Other operating expense" in the financial statements for 2002, are stated under the caption "Depreciation and amortisation charges".

³ Information system maintenance expense (769 thousand lats), which was reported under the caption "Other operating expense" in the financial statements for 2002, is stated under the caption "Maintenance of information systems".

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

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		(in thousands of lats)	
	Notes	2003	2002
RESULT ON REVALUATION			
Increase arising from revaluation of gold reserves	4	4 531	6 582
Result on revaluation of assets and liabilities denominated in foreign currencies	21	570	-11 860 ^{1,2}
Increase/decrease (-) in fair value of non-traded financial derivative contracts	21	-3 119	9 366 ²
Result on revaluation of securities	21	-10 659	3 734
NET RESULT ON REVALUATION		-8 677	7 822
PROFIT BEFORE APPROPRIATION		11 908	14 434
TOTAL		3 231	22 256

¹ Revaluation on shares in the Bank for International Settlements (154 thousand lats), which was reported under the caption "Increase arising from revaluation of gold and shares in the Bank for International Settlements" in the financial statements for 2002, is reported as a result on revaluation of assets and liabilities denominated in foreign currencies.

² Increase in fair value of non-traded financial derivative contracts (9 366 thousand lats) was included in the caption "Result on revaluation of assets and liabilities denominated in foreign currencies" in the financial statements for 2002.

THE BANK OF LATVIA'S CASH FLOW STATEMENT

		(in thousands of lats)	
	Notes	2003	2002
Net cash and cash equivalents inflow arising from operating activities	24 (1)	32 242	2 965 ¹
Acquisition of fixed assets		-3 198	-1 687
Acquisition of intangible assets		-386	-905
Net cash and cash equivalents inflow	24 (2)	28 658	373

¹ Additionally includes repayment of the credit facility provided by the International Monetary Fund (6 098 thousand lats), which was reported as a separate caption "Repayment of the credit facility provided by the International Monetary Fund" in the cash flow statement for 2002.

1. 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;
- management of foreign currency and gold reserves;
- issue of the national currency, both banknotes and coins;
- organisation and management of the interbank settlement system and promotion of a smooth functioning of the payment system in Latvia;
- compiling and publishing of financial statistics and Latvia's balance of payments;
- representation of the Republic of Latvia in foreign central banks and international financial institutions;
- acting as a financial agent for the Government of the Republic of Latvia.

2. RISK MANAGEMENT

The main risks associated with the Bank of Latvia's activities are financial risks and the operational risk arising from activities in pursuit of the Bank's primary functions. Therefore, the Bank of Latvia's Executive Board has established a risk management framework under the principles and guidelines set forth by the Board of Governors of the Bank of Latvia, which is continuously upgraded in line with financial markets and the Bank of Latvia's operational developments. Financial risks of the Bank of Latvia are managed by the Investment Committee and the Market Operations Department. At the Bank of Latvia, management of operational risk is coordinated by the Risk Management Working Group of the Bank of Latvia headed by the security manager of information systems. Monitoring of the given risk management systems is in the competence of the Bank of Latvia's Executive Board. The risk management framework is subject to review by the Internal Audit Department personnel on a regular basis. At least quarterly, the Bank of Latvia's Auditing Committee, which comprises three members of the Board of Governors of the Bank of Latvia, reviews auditors' findings and recommendations, as well as improvements in the risk management framework made by the Bank of Latvia.

FINANCIAL RISKS

Market (price, interest rate and currency risks), credit and liquidity risks are among the most significant financial risks to which the Bank of Latvia is exposed in its daily activities.

The Bank of Latvia manages financial risks related to foreign currency and gold reserves (hereinafter, foreign reserves) in accordance with the "Guidelines for Managing the Bank of Latvia's Foreign Reserves" (hereinafter, the Guidelines), as approved by the Board of Governors of the Bank of Latvia. Managing of foreign reserves proceeds in compliance with the basic principles set out in the Guidelines, including preserving the value of foreign reserves, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting to the Bank of Latvia's monetary policy objectives.

Foreign reserves are managed by classifying them into different investment portfolios. Portfolios of borrowed reserves are comprised of foreign reserves, which correspond to the Bank of Latvia's liabilities in foreign currencies to other institutions. Gold reserves, foreign currency reserves managed by the Bank of Latvia and foreign currency reserves managed by external asset managers are managed as separate investment portfolios.

Parameters for a benchmark portfolio reflecting the return target and acceptable level of financial risks, as well as the structure of investments are set out for each portfolio type in the Guidelines. On a daily basis, the Risk Management Division of the Market Operations Department monitors the compliance of foreign reserves with the requirements set out in the Guidelines.

For the purpose of financial risk management, the Bank of Latvia has established the Investment Committee that develops the investment management strategy, approves the investment tactics and sets detailed limits for financial risks in accordance with the Guidelines. The Investment Committee reviews the investment strategy once a quarter. Once a week, the Investment Committee reviews reports and forecasts for developments in financial markets, which are prepared by foreign reserves investment portfolio managers, and approves the investment management tactics for the forthcoming week.

MARKET RISK

Market risk is exposure to losses due to adverse changes in financial markets (for example, movements in interest rates or exchange rates). The Bank of Latvia manages interest rate risk inherent mainly in financial instruments sensitive to interest rate fluctuations by using a modified duration limit set individually for each investment portfolio.

The Bank of Latvia monitors the currency risk by determining open currency position limits. For foreign currency reserves portfolios, except for portfolios of borrowed reserves, the foreign currency profile of the net position on financial instruments, which corresponds to the structure of the SDR basket of currencies, is taken as a benchmark. For portfolios of borrowed reserves, the currency structure is formed in compliance with parameters of respective liabilities. Deviations from the benchmark currency structure give rise to the open currency position. Every day, the Risk Management Division of the Market Operations Department monitors the compliance of the modified duration limits and open currency positions with the Guidelines and the related resolutions passed by the Investment Committee.

The aggregated market risk of foreign reserves portfolios, except for portfolios of borrowed reserves, is managed by determining the portfolio tracking error limit. It is calculated as the annualised standard deviation of the difference in return between the investment portfolio and a respective benchmark portfolio.

The Bank of Latvia manages interest rate risk by investing only in financial instruments denominated in the currencies of the countries of the Organisation of Economic Cooperation and Development (OECD).

The Bank of Latvia does not hedge interest rate risk, which is related to domestic financial assets in order to avoid a conflict with the monetary policy objectives pursued by the Bank.

Exposure of the Bank of Latvia to market risk (as at the end of 2003) is provided in Notes 27 and 28.

CREDIT RISK

Credit risk is exposure to losses resulting from a counterparty's default. The Bank of Latvia's exposure to credit risk results from investments in foreign debt securities and short-term cash and gold deposits, as well as short-term lending to domestic credit institutions.

The Bank of Latvia manages exposure to credit risk related to investments made in foreign debt securities and short-term cash and gold deposits by establishing limits on investments of different credit quality in the Guidelines. Credit quality is evaluated on the basis of ratings assigned by the international rating agencies *Fitch Ratings*, *Moody's Investors Service* and *Standard & Poor's*. Limits are set also on the maximum investment in financial instruments of the same asset class and with one counterparty. In order to monitor Bank's exposure to credit risk associated with its foreign operations, the Risk Management Division of the Market Operations Department is involved in daily monitoring of the Bank of Latvia's compliance with the Guidelines.

Short-term loans granted to domestic credit institutions are secured by collateral of Latvian government securities and such private sector debt securities, which have been included on the list of securities approved by the Chairperson of the Bank of Latvia's Executive Board and whose issuers' ratings assigned by international rating agencies are not below the rating thresholds established by the Bank of Latvia's Board of Governors in respect of long-term liabilities in foreign currencies. The Monetary Policy Department reviews the compliance of securities on the list referred above with the requirements of the Bank of Latvia's Board of Governors and monitors the adequacy of collateral on a regular basis. Exposure of the Bank of Latvia to credit risk (as at the end of 2003) is provided in Notes 29 to 31.

LIQUIDITY RISK

Liquidity risk is associated with a failure to meet liabilities timely and to dispose of assets close to fair value. The Bank of Latvia manages liquidity risk by investing foreign exchange reserves in liquid debt securities and other financial instruments issued by international institutions, foreign governments and corporates, while investing its gold reserves in short-term deposits with foreign financial institutions. Investments are made so as to ensure timely meeting of the Bank of Latvia's liabilities. The structure of the Bank of Latvia's cash and its equivalents is provided in Note 24.

The Bank of Latvia manages liquidity risk also by setting limits on the maximum investment in financial instruments of the same group. The Bank of Latvia's asset structure by sector of issuer or counterparty is provided in Note 29.

OPERATIONAL RISK

Operational risk is exposure to financial and non-financial losses resulting from unexpected interruption of operation, unauthorised use of information, non-compliance with security requirements and other internal or external factors related to inadequate internal control system. To minimise operational risk inherent in security and information systems, the Bank of Latvia has established the Committee for Managing the Development of the Bank of Latvia's Complex Security Strategy and the Committee for Managing the Bank of Latvia's Information Systems, which review, on a regular basis, the operational risk management system. The Bank of Latvia's Board of Governors has adopted "The Bank of Latvia's Security Guidelines", which specifies the set of documents necessary for risk management and defines responsibilities in respect of managing risks. The Bank of Latvia's Executive Board has adopted the "Regulation for Managing the Bank of Latvia's Risks", which lays down the procedure for identifying, documenting, assessing and minimising risks. The Bank of Latvia has established the Risk Management Working Group, which evaluates and summarises risk reports prepared by the Bank's organisational units and identifies and classifies risks by maintaining and improving the Bank of Latvia's risk matrix.

In order to minimise operational risk, the Bank of Latvia has developed adequate regulations for the improvement of the internal control system, and the Bank of Latvia's Executive Board monitors abidance by them jointly with heads of organisational units. Under the internal control system, information and relevant technical resources are classified to ensure confidentiality, availability and integrity of information. The Bank of Latvia has appointed owners of information and information systems who are responsible for classification, risk analysis and protection of particular information or information systems, and determination of the access rights and usage procedure.

From time to time, the Bank of Latvia's management reviews the adequacy and availability of resources for ensuring the continuity of the Bank's operations in case of emergency.

In order to improve the organisation of the Bank of Latvia's operational activities and to minimise operational risk, the Bank of Latvia has designed and is continuously upgrading a quality management system. In 2003, the quality management system was improved, and since May 2003 it complies with the quality management system standard ISO 9001:2000.

Within the framework of measures for minimising total operational risk, the Bank of Latvia has insured certain operational risks.

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 adopted accounting policies have been applied consistently in the financial statements for the years ended December 31, 2003 and December 31, 2002.

BASIS OF PRESENTATION

These financial statements have been prepared in accordance with the historical cost basis of accounting, modified for 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 exchange rates 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 exchange rates set by the Bank of Latvia at the end of the year. The official exchange rates of the lats against foreign currencies as quoted by the Bank of Latvia are calculated taking into account the peg of the lats to the SDR on the basis of the exchange rate of the US dollar against the SDR, and the exchange rates of other currencies against the US dollar as quoted in the information system *Reuters*. Gains and losses resulting from the translation of monetary assets and liabilities denominated in foreign currencies are credited or charged to the balance sheet caption "Valuation account".

The principal exchange rates of foreign currencies and gold set by the Bank of Latvia and used in compiling the balance sheet are as follows:

	(at the end of the year)	
	2003	2002
XDR	0.7997	0.7997
USD	0.541	0.594
EUR	0.674	0.61
GBP	0.96	0.946
JPY	0.00506	0.00494
XAU	223.44	205.21

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount at which financial assets could be exchanged, or financial liabilities settled on an arm's length basis between knowledgeable, willing parties.

Fair value of the Bank of Latvia's financial assets and liabilities at the end of 2003 and 2002 did not differ materially from the reported book value of respective assets and liabilities.

OFFSETTING FINANCIAL ASSETS AND LIABILITIES

Financial assets and liabilities are offset and the net amount reported in the financial statements when there is only 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 reserves are recorded at market value in the balance sheet. Any surplus or deficit arising from the revaluation of gold reserves is credited or charged to the balance sheet caption "Valuation account".

SECURITIES

Debt securities of foreign issuers and the Latvian government securities are stated at fair value in the balance sheet. Adjustments to the value of securities arising from revaluation of these financial instruments are reported in the balance sheet caption "Valuation account" until their disposal. Upon disposal of such securities, the accumulated revaluation adjustment is transferred from the balance sheet caption "Valuation account" to the relevant profit and loss statement caption.

LOANS TO CREDIT INSTITUTIONS, DEPOSITS AND SIMILAR FINANCIAL CLAIMS AND LIABILITIES

Loans granted to credit institutions, deposits and similar financial claims and liabilities are recorded at nominal value.

REVERSE REPURCHASE AGREEMENTS

Reverse repurchase agreements are accounted for as financing transactions. Securities purchased under reverse repurchase agreements are not included in the Bank of Latvia's balance sheet. The related funding provided to the counterparty is included in the balance sheet of the Bank of Latvia at nominal value as claims

on domestic credit institutions or foreign credit institutions and other foreign financial institutions, as appropriate.

The difference between the purchase and resale price of securities is treated as interest income and recognised in the profit and loss statement over the term of the agreement.

REPURCHASE AGREEMENTS

Repurchase agreements are accounted for as financing transactions. Securities sold under repurchase agreements are retained in the Bank of Latvia's balance sheet along with other securities that are not involved in these transactions. Funding received from such sales is included in the balance sheet at nominal value as a liability to the counterparty.

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

FINANCIAL DERIVATIVES

The Bank of Latvia enters into commitments involving forward exchange rate contracts, currency and interest rate swap arrangements and interest rate future contracts, which are reported in off-balance sheet accounts at their contract or notional amount. Subsequent to initial recognition and measurement, financial assets and liabilities arising from these derivative financial instruments are revalued on a regular basis and reported in the balance sheet at fair value. Fair value of respective financial assets and financial liabilities is obtained from quoted market prices or discounted cash flows. Discounted cash flows are modeled on the basis of financial instruments' quoted market prices and money market interest rates.

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

ACCRUED INTEREST INCOME AND EXPENSE

Accrued interest income on debt securities of foreign issuers and Latvian government securities are reported under the balance caption "Convertible foreign currencies" or "Government securities". Accrued interest income and expense on other financial instruments are reported under relevant balance sheet captions of other assets and liabilities.

FIXED ASSETS

Fixed assets are tangible long-term investments costing not less than 50 lats and with the useful life over one year. These assets are used in the provision of services as well as in the maintenance of other fixed assets and for the Bank of Latvia's administrative purposes.

Fixed assets are recorded at historical cost less accumulated depreciation. If the recoverable amount of a fixed asset is lower than its carrying amount, the carrying amount of the fixed asset is reduced to the asset's recoverable amount.

Depreciation is provided using the straight-line method over the useful life of the

asset estimated by the Bank of Latvia. Assets under construction or development, land and works of art are not depreciated.

The following depreciation rates have been applied on an annual basis:

	(percentage)
Buildings	1–3
Transport vehicles	20
Office furniture	10
Computer equipment	25–33
Other office equipment	20
Cash processing equipment	20
Tools	50
Other fixed assets	14–20

In accordance with generally accepted principles for hedge accounting, the cost of individual fixed assets includes an effective result arising from financial instruments designated as hedges of exchange risk associated with their development.

Costs associated with the maintenance and repairs of fixed assets are recognised in the profit and loss statement when incurred.

Loss on disposal of fixed assets is determined on the basis of the carrying amount of the fixed assets as at the time of disposal and is reported under the profit and loss statement caption "Other operating expense".

INTANGIBLE ASSETS

Intangible assets include costs related to the acquisition of rights to use specialised software for information systems, adjusted for accrued amortisation. Acquisition costs of such software are amortised over the period of the licensed software use as specified in the relevant agreements; however, this period may not exceed 10 years.

Costs related to software development by the Bank of Latvia are recognised in the profit and loss statement as expense on the maintenance of information systems when incurred. Expense on the maintenance of information systems software is recognised in the profit and loss statement for the relevant period.

IMPAIRMENT OF ASSETS

Relevant Bank of Latvia's organisational units assess the quality the Bank of Latvia's assets on a regular basis. If an impairment of an asset has occurred, adequate specific provisions for a relevant asset are established. Such provisions are not included in the book value of the asset and are recognised in the profit and loss statement.

LATS IN CIRCULATION

Lats banknotes and coins in circulation issued by the Bank of Latvia, except for gold circulation coins, are included in the balance sheet caption "Lats in circulation" at nominal value. The balance sheet caption "Lats in circulation" reports the Bank of Latvia's liabilities to holders of the respective banknotes and coins.

GOLD CIRCULATION COINS

Gold circulation coins (fineness .999) held in the vaults of the Bank of Latvia are included in the balance sheet caption "Other domestic assets", as 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 excluded from the balance sheet caption "Other domestic assets". The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", as their nominal value is directly supported by their content of gold.

COMMEMORATIVE COINS

The issued commemorative coins that represent the Bank of Latvia's liability to holders of these coins are included in the balance sheet caption "Lats in circulation". The issued commemorative coins that are not circulation coins are not included in the balance sheet caption "Lats in circulation".

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, demand deposits with foreign credit institutions and other foreign financial institutions, foreign debt securities, which are readily convertible to cash close to their fair value within twenty-four hours, excluding demand deposits from foreign financial institutions, domestic credit institutions, Latvian Government and other domestic financial institutions.

INTEREST AND SIMILAR INCOME AND EXPENSE

Interest income and expense are recognised in the profit and loss statement on an accrual basis.

Interest income includes interest on bonds purchased, loans granted and deposits made, as well as similar income, i.e., the result on disposal of debt securities, the result on changes in the fair value of interest rate future contracts and dividends on shares in the Bank for International Settlements.

Interest expense includes interest on time deposits attracted from credit institutions, deposits from the Government and other financial institutions and loans of foreign financial institutions.

FEES

Fees are charged or credited to the profit and loss statement on an accrual basis.

BANKNOTE PRODUCTION AND COINAGE COSTS

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

4. GOLD

Movements in gold reserves during 2003 were as follows:

	Troy ounces	Amount in thousands of lats
As at December 31, 2002	248 647	51 025
Net changes resulting from gold deposits and their withdrawals	-64	-13
Increase in gold market value	-	4 531
As at December 31, 2003	248 583	55 543

5. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency assets of the Bank of Latvia are invested primarily in short-term cash deposits and debt 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 (9 095 thousand lats at the end of 2003 and 8 769 thousand lats at the end of 2002).

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

	(in thousands of lats)	
	2003	2002
Debt securities of foreign governments, financial institutions and corporate entities	695 518	583 043
Demand deposits with foreign central banks, credit institutions and international institutions	52 911	88 092
Time deposits with foreign credit institutions and other foreign financial institutions	25 710	65 389
Foreign currency in cash	695	789
Total	774 834	737 313

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 SDR and recognised in the balance sheet assets. The IMF holdings in lats and the Systemic Transformation Facility (STF) granted by the IMF are stated as a balance sheet liability (see Note 14).

At the end of 2003 and 2002, the Republic of Latvia's quota in the IMF was 126 478 thousand SDR (101 144 thousand lats).

At the end of 2003 and 2002, the Republic of Latvia's total quota in the IMF was 126 800 thousand SDR.

7. SHARES IN THE BANK FOR INTERNATIONAL SETTLEMENTS

The Bank of Latvia owns 1 000 shares in the Bank for International Settlements (BIS). As at December 31, 2002, these shares were denominated in the gold equiva-

lent (5 834 Troy ounces). On March 10, 2003 the Bank for International Settlements re-denominated shares in the SDR. As a result of this re-denomination, nominal value of the Bank of Latvia's share holding in the BIS was 1 250 thousand SDR on December 31, 2003.

As a result of changes in gold market value and the BIS share re-denomination, the value of the Bank of Latvia's shares in the BIS decreased by 197 thousand lats during 2003, and at the end of 2003 the value of the BIS shares owned by the Bank of Latvia was 1 000 thousand lats (1 197 thousand lats at the end of 2002). This adjustment of the change in share value is reported under the balance sheet caption "Valuation account".

8. OTHER FOREIGN ASSETS

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

	(in thousands of lats)	
	2003	2002
Non-traded financial derivative contracts with foreign financial institutions	4 628	3 319
Accrued interest income on deposits with foreign credit institutions and other foreign financial institutions	118	216
Other foreign assets	184	358
Total	4 930	3 893

9. LOANS TO CREDIT INSTITUTIONS

At the end of the year, credit facilities provided to domestic credit institutions were as follows:

	(in thousands of lats)	
	2003	2002
Repo loans by original maturity	59 320	30 545
7-day maturity	45 000	14 140
28-day maturity	14 320	16 405
Credit facilities provided under the European Union grant	–	145
Total	59 320	30 690

10. TRANSIT CREDITS

The Bank of Latvia acts as an agent for the Government of the Republic of Latvia for distribution of funds received from various international institutions. This caption states credit facilities granted under the Republic of Latvia's Government foreign borrowings to support the government investment programs (3 018 thousand lats; 11 749 thousand lats at the end of 2002). 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	2003	2002
Within 3 months	1 707	13 044
3 to 6 months	51	70
6 to 12 months	–	6 955
1 to 3 years	43 608	19 379
Over 3 years	16 907	24 934
Total	62 273	64 382

12. FIXED ASSETS

The following changes in fixed assets took place in 2003:

	(in thousands of lats)					
	Buildings and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
As at December 31, 2002						
Cost	29 097	5 674	2 068	960	3 503	41 302
Accumulated depreciation	–887	–3 295	–1 719	–756	–1 847	–8 504
Net book value	28 210	2 379	349	204	1 656	32 798
During 2003						
Additions	1 345	513	110	520	777	3 265
Adjustments	–67	–	–	–	–	–67
Disposals	–	–361	–16	–38	–7	–422
Net change in cost	1 278	152	94	482	770	2 776
Depreciation charge	–364	–759	–130	–83	–448	–1 784
Depreciation on disposals	–	349	16	38	7	410
Net change in accumulated depreciation	–364	–410	–114	–45	–441	–1 374
As at December 31, 2003						
Cost	30 375	5 826	2 162	1 442	4 273	44 078
Accumulated depreciation	–1 251	–3 705	–1 833	–801	–2 288	–9 878
Net book value	29 124	2 121	329	641	1 985	34 200

13. OTHER DOMESTIC ASSETS

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

	(in thousands of lats)	
	2003	2002
Intangible assets	2 891	3 023
Currency swap arrangements with domestic credit institutions	567	2 800
Accrued interest income on loans to domestic credit institutions	36	81
Gold circulation coins in vault	32	147
Other domestic assets	379	651
Total	3 905	6 702

Intangible assets include the rights to use specialised software for information systems acquired by the Bank of Latvia.

In 2003, the following movements were observed in intangible assets:

	(in thousands of lats)	
As at December 31, 2002		
Cost		3 240
Accumulated amortisation		-217
Net book value		3 023
During 2003		
Additions		386
Amortisation charge		-518
As at December 31, 2003		
Cost		3 626
Accumulated amortisation		-735
Net book value		2 891

14. INTERNATIONAL MONETARY FUND

At the end of 2003, liabilities to the IMF were comprised of the 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 2003 were as follows:

	(in thousands of lats)		
	STF	Holdings in lats	Total
As at December 31, 2002	9 146	101 242	110 388
Increase in holdings in lats	-	132	132
Repayment	-6 097	-	-6 097
As at December 31, 2003	3 049	101 374	104 423

15. OTHER FOREIGN LIABILITIES

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

	(in thousands of lats)	
	2003	2002
Non-traded financial derivative contracts with foreign financial institutions	7 929	5 444
Accrued expense	300	188
Other foreign liabilities	31	42
Total	8 260	5 674

16. 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	
	2003	2002	2003	2002	2003	2002
Banknotes						
LVL 500	97 328	82 082	195	164	14.3	13.2
LVL 100	140 369	119 859	1 404	1 199	20.6	19.2
LVL 50	50 717	54 140	1 014	1 083	7.4	8.7
LVL 20	237 391	211 495	11 870	10 575	34.8	34.0
LVL 10	71 866	73 908	7 187	7 391	10.5	11.9
LVL 5	53 194	52 822	10 639	10 564	7.8	8.5
Total banknotes	650 865	594 306	–	–	95.4	95.5
Coins						
LVL 100	326	302	3	3	0	0
LVL 10	139	137	14	14	0	0
LVL 5	77	–	15	–	0	–
LVL 2	6 504	6 640	3 252	3 320	1.0	1.1
LVL 1	11 768	9 751	11 768	9 751	1.7	1.6
50 s	4 980	4 731	9 961	9 461	0.7	0.8
20 s	2 627	2 417	13 133	12 085	0.4	0.4
10 s	1 655	1 477	16 547	14 770	0.3	0.2
5 s	1 227	1 122	24 532	22 447	0.2	0.2
2 s	1 095	957	54 777	47 874	0.2	0.1
1 s	882	792	88 247	79 196	0.1	0.1
Total coins	31 280	28 326	–	–	4.6	4.5
Total lats in circulation	682 145	622 632	–	–	100.0	100.0

In 2003, 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 1 870 thousand lats at the end of 2002 to 1 980 thousand lats at the end of 2003. The respective coins in circulation are not in-

cluded in the balance sheet caption "Lats in circulation", since their nominal value is directly supported by their content of gold.

Among coins in circulation, there were also commemorative coins that did not represent any liability of the Bank of Latvia to holders of these coins, and their total nominal value was 963 thousand lats at the end of 2003 (930 thousand lats at the end of 2002). These coins are not included in the balance sheet caption "Lats in circulation".

17. BALANCES DUE TO CREDIT INSTITUTIONS

Balances due to credit institutions include balances on the settlement accounts of banks and other credit institutions opened with the Bank of Latvia, as well as time deposits in lats received from the above financial institutions. Credit institutions place their funds with the Bank of Latvia in order to comply with its minimum reserve requirement for banks, as well as to effect interbank and customer payments, the Bank of Latvia's monetary policy operations and other settlements in the Bank of Latvia's payment systems.

At the end of 2003, demand deposits of credit institutions amounted to 123 810 thousand lats (131 793 thousand lats at the end of 2002). Credit institutions had placed no time deposits with the Bank of Latvia at the end of 2003 (they totalled 2 430 thousand lats at the end of 2002).

18. OTHER DOMESTIC LIABILITIES

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

	(in thousands of lats)	
	2003	2002
Profit appropriated to the State budget	4 049	5 341
Currency swap arrangements with domestic credit institutions	1 074	1 148
Accrued expenditure on completed construction works	–	734
Deferred liabilities to constructors	640	813
Accrued interest expense on government deposits	256	215
Other accrued expense	1 088	824
Deferred income	5	400
Tax liabilities	14	139
Other domestic liabilities	661	748
Total	7 787	10 362

19. TAXES

In 2003, the Bank of Latvia calculated and paid the following taxes:

(in thousands of lats)

	Liabilities	Paid	Increase deferred liabilities	Calculation	Claims (-)	Liabilities
	2003				2002	
Personal income tax	-	2 008	-	2 007	-	1
Compulsory social security contributions (by employer)	6	1 834	22	1 857	-	5
Compulsory social security contributions (by employee)	2	687	-	687	-	2
Tax on real estate	-	391	-	423	-32	-
Value added tax	6	288	-	172	-	122
Other taxes	-	11	-	2	-	9
Total	14	5 219	22	5 148	-32	139

In addition to the tax payments indicated herein, the Bank of Latvia transfers a part of the profit earned in the reporting year and the payment for the usage of State capital (4 049 thousand lats in 2003; 5 341 thousand lats in 2002; see Note 20) to the State budget.

20. NOMINAL CAPITAL AND RESERVE CAPITAL

The nominal capital of the Bank of Latvia is comprised of the State allotted resources and the Bank of Latvia's profit allocations. The authorised nominal capital of the Bank of Latvia amounts to 25 million lats as prescribed by the Law "On the Bank of Latvia".

The Law "On the Bank of Latvia" establishes that a 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", and a payment in the amount of 15 per cent of the profit earned during the reporting year for the usage of State capital shall be transferred to the State budget. On December 31, 2003, the enterprise income tax rate applicable to residents of the Republic of Latvia was 19 per cent (22 per cent and 15 per cent in 2002 and in 2004, respectively). Hence, 34 per cent of the Bank of Latvia's profit earned during the year ended December 31, 2003 shall be transferred to the State budget.

The Bank of Latvia's profit remaining after making the above deductions shall be transferred to the reserve capital. The reserve capital shall be formed to cover possible losses.

21. VALUATION ACCOUNT

At the end of the year, the valuation account comprised the following items:

	(in thousands of lats)	
	2003	2002
Surplus on revaluation of assets and liabilities in foreign currency and gold	26 612	21 511
Deficit on revaluation of forward exchange rate contracts	-4 258	-2 892
Deficit on revaluation of currency swap arrangements	-507	-707
Surplus on revaluation of interest rate swap arrangements	946	2 899
Deficit (-)/surplus on revaluation of securities	-3 081	7 578
Total	19 712	28 389

22. FINANCING OF THE FINANCIAL AND CAPITAL MARKET COMMISSION

Pursuant to Article 5 of the Transition Rules of the Law "On the Financial and Capital Market Commission", the operation of the Financial and Capital Market Commission shall be financed from payments made by financial and capital market participants, the State budget and the Bank of Latvia. In 2003, the Bank of Latvia covered expenses pertaining to the supervision of credit institutions in the amount of 1 200 thousand lats. The Bank of Latvia is to make such payments also from 2004 until 2006 according to the following schedule: 960 thousand lats in 2004, 600 thousand lats in 2005, and 240 thousand lats in 2006.

23. OTHER OPERATING EXPENSE

Other operating expense was as follows:

	(in thousands of lats)	
	2003	2002
Tax on real estate	423	102
Business travel	395	374
Maintenance of buildings, territory and equipment	360	354
Municipal services and rent of premises	344	361
Communications services	341	360
Acquisition of low value office supplies	301	378
Publications (including publications in mass media)	276	206
Personnel training	224	177
Insurance	195	144
Maintenance of transport vehicles	118	120
Legal and other professional fees	46	106
Transportation of valuables	-	530
Other operating expense	613	600
Total	3 636	3 812

24. CASH FLOW STATEMENT

(1) Reconciliation of profit before appropriation to net cash and cash equivalents inflow

	(in thousands of lats)	
	2003	2002
Profit before appropriation	11 908	14 434
Adjustments:		
Depreciation of fixed assets and amortisation of intangible assets	2 302	1 798
Loss on disposal of fixed assets	12	6
Net surplus/deficit (-) arising from revaluation and financial instruments' market value adjustment	-12 881	1 555
Net change in balance sheet items:		
Net decrease in gold	13	-
Net increase (-)/decrease in Special Drawing Rights	-34	13
Net increase (-)/decrease in foreign debt securities and other foreign investments	-11 702	63 162
Net increase in other foreign assets	-1 037	-1 887
Net increase in loans to domestic credit institutions	-28 630	-11 857
Decrease in transit credits	8 731	6 863
Net increase (-)/decrease in government securities	2 109	-39 667
Net increase (-)/decrease in other domestic assets	2 665	-2 751
Net decrease in liabilities to the IMF	-6 097	-6 098 ¹
Net increase in lats deposits of foreign banks	-	257
Net increase/decrease (-) in other foreign liabilities	2 586	-125
Net increase in lats in circulation	59 513	66 629
Net decrease in time deposits of domestic credit institutions	-2 430	-19 570
Net increase/decrease (-) in the Government's time deposits	13 317	-53 462
Net decrease in time deposits of other financial institutions	-1 480	-450
Net decrease in other domestic liabilities	-6 624	-15 892
Increase in European Union grant	1	7
Net cash and cash equivalents inflow arising from operating activities	32 242	2 965

¹ Including repayment of the credit facility (6 098 thousand lats) provided by the IMF, which was reported under the caption "Repayment of the credit facility provided by the International Monetary Fund" in the cash flow statement for 2002.

(2) Analysis of cash and cash equivalents

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

	2003	Change	2002
Assets			
Convertible foreign currencies in cash	695	-94	789
Demand deposits with foreign credit institutions and other foreign financial institutions	52 911	-35 181	88 092
Foreign debt securities, which are readily convertible to cash within twenty-four hours	191 102	61 094	130 008
Liabilities			
Demand deposits from foreign financial institutions	-460	-148	-312
Demand deposits from domestic credit institutions	-123 810	7 983	-131 793
Demand deposits from Latvian Government	-15 679	-4 858	-10 821
Demand deposits from other domestic financial institutions	-800	-138	-662
Total	103 959	28 658	75 301

25. CONTRACTED CAPITAL OFF-BALANCE SHEET COMMITMENTS

At the end of 2003, the Bank of Latvia had capital off-balance sheet commitments in the amount of 33 thousand lats in respect of the acquisition of fixed assets (1 045 thousand lats at the end of 2002).

26. FINANCIAL INSTRUMENTS' OFF-BALANCE SHEET ACCOUNTS

The Bank of Latvia enters into forward and spot exchange rate contracts, interest rate swap arrangements and interest rate future contracts in order to manage interest rate and exchange risks associated with its 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 spot exchange rate and financial derivative contracts:

(in thousands of lats)

	Contract or notional amount		Fair value			
			Assets		Liabilities	
	2003	2002	2003	2002	2003	2002
Spot exchange rate contracts						
with foreign financial institutions	7 522	37	-	-	-	-
Derivative exchange rate contracts						
Forward exchange rate contracts						
with foreign financial institutions	237 427	248 127	3 671	2 484	7 929	5 376
Currency swap arrangements						
with domestic credit institutions	75 707	185 521	567	2 800	1 074	1 148
Gold interest rate swap arrangements						
with foreign financial institutions	28 600	26 267	946	540	-	-
Other non-traded financial derivative interest rate contracts						
with foreign financial institutions	3 679	25 483	11	295	-	68
Total non-traded financial derivative contracts and spot exchange rate contracts						
with foreign financial institutions	x	x	4 628	3 319	7 929	5 444
with domestic credit institutions	x	x	567	2 800	1 074	1 148
Interest rate future contracts						
with foreign financial institutions	35 572	56 467	183	516	52	250

27. CURRENCY PROFILE

At the end of 2003 and 2002, the net position of the Bank of Latvia's assets, liabilities and memorandum items within the limits stipulated by the Guidelines corresponded to the currency profile of the SDR basket of currencies. At the end of the year, the currency profile of the Bank of Latvia's assets, liabilities and memorandum items, as well as that of the SDR basket of currencies was as follows:

(in thousands of lats)

	LVL	XDR	USD	EUR	GBP	JPY	Gold	Other	Total
As at December 31, 2003									
Foreign assets									
Gold	–	–	–	–	–	–	55 543	–	55 543
Special Drawing Rights	–	75	–	–	–	–	–	–	75
Convertible foreign currencies	–	–	307 740	347 781	76 881	38 693	–	3 739	774 834
International Monetary Fund	–	101 144	–	–	–	–	–	–	101 144
Shares in the BIS	–	1 000	–	–	–	–	–	–	1 000
Other foreign assets	4 628	–	47	127	111	–	12	5	4 930
Domestic assets									
Loans to credit institutions	59 320	–	–	–	–	–	–	–	59 320
Transit credits	–	–	3 018	–	–	–	–	–	3 018
Government securities	62 273	–	–	–	–	–	–	–	62 273
Fixed assets	34 200	–	–	–	–	–	–	–	34 200
Other domestic assets	3 901	–	4	–	–	–	–	–	3 905
TOTAL ASSETS	164 322	102 219	310 809	347 908	76 992	38 693	55 555	3 744	1 100 242
Foreign liabilities									
Convertible foreign currencies	–	–	–	149	–	–	–	–	149
International Monetary Fund	101 374	3 049	–	–	–	–	–	–	104 423
Foreign bank deposits in lats	677	–	–	–	–	–	–	–	677
Non-convertible currencies	–	–	–	–	–	–	–	36	36
Other foreign liabilities	7 959	–	98	202	–	–	–	1	8 260
Lats in circulation	682 145	–	–	–	–	–	–	–	682 145
Domestic liabilities									
Balances due to credit institutions	123 810	–	–	–	–	–	–	–	123 810
Balances due to the Government	45 753	75	818	33 608	–	–	–	–	80 254
Balances due to other financial institutions	1 648	–	20	2	–	–	–	–	1 670
Other domestic liabilities	6 898	–	5	884	–	–	–	–	7 787
TOTAL LIABILITIES	970 264	3 124	941	34 845	–	–	–	37	1 009 211
Net position on balance sheet	–805 942	99 095	309 868	313 063	76 992	38 693	55 555	3 707	91 031
Net position on financial instruments' off-balance sheet accounts	69 075	–	–32 061	–46 319	6 836	56 982	–55 445	–2 876	–3 808
Net position on balance sheet and off-balance sheet accounts	–736 867	99 095	277 807	266 744	83 828	95 675	110	831	87 223

	LVL	XDR	USD	EUR	GBP	JPY	Gold	Other	Total
Conformity with the currency profile of the SDR basket of currencies									
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts (%)	x	x	38.32	36.79	11.56	13.20	0.02	0.11	100.0
Currency profile of the SDR basket of currencies (%)	x	x	39.00	35.94	11.78	13.28	x	x	100.0
As at December 31, 2002									
TOTAL ASSETS	137 590	101 185	376 043	288 081	57 509	18 251	52 421	9 854	1 040 934
TOTAL LIABILITIES	907 410	9 187	420	32 032	–	–	–	37	949 086
Net position on balance sheet	–769 820	91 998	375 623	256 049	57 509	18 251	52 421	9 817	91 848
Net position on financial instruments' off-balance sheet accounts	148 391	–	–112 765	–49 743	10 460	57 672	–51 338	–3 150	–473
Net position on balance sheet and off-balance sheet accounts	–621 429	91 998	262 858	206 306	67 969	75 923	1 083	6 667	91 375
Conformity with the currency profile of the SDR basket of currencies									
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts (%)	x	x	42.35	33.23	10.95	12.23	0.17	1.07	100.0
Currency profile of the SDR basket of currencies (%)	x	x	42.77	32.64	11.64	12.95	x	x	100.0

28. REPRICING MATURITY OF ASSETS AND LIABILITIES

75

	Interest bearing					Non-	Total
	Within 3 months	3-6 months	6-12 months	1-3 years	Over 3 years	interest bearing	
(in thousands of lats)							
As at December 31, 2003							
Foreign assets							
Gold	12 296	14 367	-	-	-	28 880	55 543
Special Drawing Rights	75	-	-	-	-	-	75
Convertible foreign currencies	183 079	17 813	49 979	356 434	156 235	11 294	774 834
International Monetary Fund	-	-	-	-	-	101 144	101 144
Shares in the BIS	-	-	-	-	-	1 000	1 000
Other foreign assets	-	-	-	-	-	4 930	4 930
Domestic assets							
Loans to credit institutions	59 320	-	-	-	-	-	59 320
Transit credits	-	-	-	-	-	3 018	3 018
Government securities	1 707	51	-	43 608	16 907	-	62 273
Fixed assets	-	-	-	-	-	34 200	34 200
Other domestic assets	-	-	-	-	-	3 905	3 905
TOTAL ASSETS	256 477	32 231	49 979	400 042	173 142	188 371	1 100 242
Foreign liabilities							
Convertible foreign currencies	-	-	-	-	-	149	149
International Monetary Fund	-	-	-	-	-	104 423	104 423
Foreign bank deposits in lats	367	-	-	-	-	310	677
Non-convertible currencies	-	-	-	-	-	36	36
Other foreign liabilities	-	-	-	-	-	8 260	8 260
Lats in circulation	-	-	-	-	-	682 145	682 145
Domestic liabilities							
Balances due to credit institutions	-	-	-	-	-	123 810	123 810
Balances due to the Government	75 683	4 485	-	-	-	86	80 254
Balances due to other financial institutions	870	-	-	-	-	800	1 670
Other domestic liabilities	-	-	-	-	-	7 787	7 787
TOTAL LIABILITIES	76 920	4 485	-	-	-	927 806	1 009 211
Net position on balance sheet	179 557	27 746	49 979	400 042	173 142	x	x
Assets on financial instruments' off-balance sheet accounts	318 277	1 002	-	29 576	-	x	x
Liabilities on financial instruments' off-balance sheet accounts	351 651	1 012	-	-	-	x	x
As at December 31, 2002							
TOTAL ASSETS	322 231	29 590	113 103	226 206	184 757	165 047	1 040 934
TOTAL LIABILITIES	62 746	-	935	2 722	-	882 683	949 086
Net position on balance sheet	259 485	29 590	112 168	223 484	184 757	x	x
Assets on financial instruments' off-balance sheet accounts	425 376	15 337	18 805	13 401	13 409	x	x
Liabilities on financial instruments' off-balance sheet accounts	454 279	14 458	18 064	-	-	x	x

The table above reflects the sensitivity of the Bank of Latvia's assets and liabilities 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 residual maturity dates.

In accordance with interest rate future contracts dealing requirements, the Bank of Latvia has pledged securities in the amount of 3 121 thousand lats (3 228 thousand lats at the end of 2002), which are included in the balance sheet caption "Convertible foreign currencies". All other balances included in the balance sheet caption "Convertible foreign currencies" represent investments of high liquidity, which are subject to disposal at the Bank of Latvia's discretion.

29. SECTORAL PROFILE OF ASSETS

The sectoral profile of the Bank of Latvia's assets at the end of the year was as follows:

	Amount (in thousands of lats)		Percentage	
	2003	2002	2003	2002
Claims				
Foreign central governments and other governmental institutions	407 786	292 475	37.2	28.1
Foreign local governments	25 216	13 869	2.3	1.3
Foreign central banks and credit institutions	233 734	269 830	21.2	25.9
Other foreign financial institutions	90 341	113 100	8.2	10.9
Foreign corporate entities	33 410	34 760	3.0	3.3
International institutions	142 408	167 120	12.9	16.1
Latvian central government	124 651	106 757	11.3	10.3
Domestic credit institutions	29	145	0	0
Unclassified assets	42 667	42 878	3.9	4.1
Total	1 100 242	1 040 934	100.0	100.0

For the purposes of credit risk analysis, claims arising from securities purchased under repurchase agreements are classified herein according to the issuer of the security. As a result, claims arising from Latvian government securities purchased under agreements to resell to domestic credit institutions in the amount of 59 320 thousand lats (30 545 thousand lats at the end of 2002) and the related accrued interest income in the amount of 36 thousand lats (80 thousand lats at the end of 2002) are reported as exposure to the Latvian central government.

30. FOREIGN ASSETS BY THEIR LOCATION OR THE COUNTERPARTY'S DOMICILE

At the end of the year, the Bank of Latvia's foreign assets broken down by their location or the counterparty's domicile were as follows:

	Amount (in thousands of lats)		Percentage	
	2003	2002	2003	2002
European Union	450 800	432 605	48.1	48.4
United States of America	208 008	197 990	22.2	22.1
Japan	23 441	26 106	2.5	2.9
Other countries	112 869	70 792	12.0	7.9
International institutions	142 408	167 120	15.2	18.7
Total	937 526	894 613	100.0	100.0

31. ASSETS BY CREDIT RATINGS ASSIGNED TO THE COUNTERPARTY

At the end of the year, the Bank of Latvia's assets broken down by categories of credit ratings assigned to the counterparty were as follows:

	Credit rating	Amount (in thousands of lats)		Percentage	
		2003	2002	2003	2002
FOREIGN ASSETS					
Gold	AAA	33 761	11 293	3.1	1.1
	AA+	7 217	13 210	0.7	1.3
	AA	14 565	19 915	1.3	1.9
	AA-	-	6 607	0	0.6
Special Drawing Rights	AAA	75	41	0	0
Foreign debt securities	AAA	529 921	386 495	48.2	37.2
	AA+	23 593	52 680	2.1	5.1
	AA	56 700	42 109	5.1	4.0
	AA-	26 714	52 413	2.4	5.0
	A+	16 864	11 492	1.5	1.1
	A	33 705	20 965	3.1	2.0
Deposits with foreign credit institutions and other foreign financial institutions	A-	8 021	16 889	0.7	1.6
	AAA	39 017	71 449	3.4	7.0
	AA+	1 799	19 826	0.2	1.9
	AA	8 831	9 905	0.8	1.0
	AA-	22 576	25 479	2.0	2.4
	A+	1 473	12 106	0.1	1.2
	A	2 789	14 675	0.3	1.4
Foreign currency in cash	A-	2 136	41	0.2	0
	AAA	695	789	0.1	0.1
International Monetary Fund	AAA	101 144	101 144	9.2	9.7

(cont.)

	Credit rating	Amount (in thousands of lats)		Percentage	
		2003	2002	2003	2002
Shares in the BIS	AAA	1 000	1 197	0.1	0.1
Derivative financial instruments	AAA	11	–	0	–
	AA+	42	264	0	0
	AA	634	761	0.1	0.1
	AA–	799	1 517	0.1	0.1
	A+	2 563	647	0.2	0.1
	A	–	130	0	0
	A–	579	–	0.1	–
Accrued interest income	Different	118	216	0	0
Other foreign assets	Different	184	358	0	0
DOMESTIC ASSETS					
Loans to credit institutions	Different	59 320	30 690	5.4	2.9
Transit credits	BBB+ ¹	3 018	11 749	0.3	1.1
Government securities	A–	62 273	64 382	5.7	6.2
Other	Different	38 105	39 500	3.5	3.8
TOTAL		1 100 242	1 040 934	100.0	100.0

At the end of the year, the Bank of Latvia's foreign assets broken down by major categories of credit ratings assigned to the counterparty were as follows:

	Credit rating category	Amount (in thousands of lats)		Percentage	
		2003	2002	2003	2002
Foreign assets	AAA	705 624	572 408	75.3	63.9
	AA	163 470	244 686	17.4	27.4
	A	68 130	76 945	7.3	8.6
	Different	302	574	0	0.1
Total		937 526	894 613	100.0	100.0

Based on *Standard & Poor's* credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above tables show the breakdown of the Bank of Latvia's assets as at the end of the year. The rating "AAA" is the highest possible long-term creditworthiness rating, which indicates an extremely strong capacity of the counterparty to meet its financial commitments. The rating "AA" confirms the counterparty's very strong capacity and the rating "A" the counterparty's strong capacity to meet its financial commitments. Ratings below "AAA" are modified by marks "+" or "-" to show the relative standing within the major categories of an agency's ratings.

¹ The Bank of Latvia is not exposed to the credit risk arising from transit credits.

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

We have audited the balance sheet of the Bank of Latvia as at 31 December 2003, and the related statements of profit and loss, total recognised gains and losses, and cash flows for the year then ended and the accompanying notes (hereinafter, the financial statements). These financial statements, which are set out on pages 48 to 78, are the responsibility of the Bank of Latvia's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank of Latvia as at 31 December 2003, and the results of its operations and its cash flows for the year then ended in conformity with the accounting principles adopted by the Bank of Latvia and the Law "On the Bank of Latvia".

ERNST & YOUNG

Riga
1 March 2004

THE STATE AUDIT OFFICE
OF THE REPUBLIC OF LATVIA

RESOLUTION OF THE BANK OF LATVIA'S BOARD OF GOVERNORS

On March 24, 2004, the Bank of Latvia's Board of Governors passed Resolution No. 111/1 "On the Bank of Latvia's Annual Report for 2003".

Having reviewed the results of the audit of the Bank of Latvia's economic activity in 2003, the Bank of Latvia's Board of Governors resolves:

1 To approve the Bank of Latvia's Annual Report for 2003, including the balance sheet, profit and loss statement, statement of recognised gains and losses and cash flow statement.

2 To appropriate the Bank of Latvia's profit for 2003 in the following way.

2.1 4 049 thousand lats to be transferred to the state revenue.

2.2 7 859 thousand lats to be transferred to the Bank's reserve capital.

ILMĀRS RIMŠĒVIČS
GOVERNOR
BANK OF LATVIA

APPENDICES



Appendix 1

MONETARY INDICATORS IN 2003

(at end of month; in millions of lats)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
BANK OF LATVIA												
Monetary base M0	709.2	751.5	703.5	710.3	730.6	763.3	754.6	746.7	784.0	758.2	749.7	806.8
Currency in circulation	597.8	598.1	604.9	606.8	613.3	628.8	633.4	639.4	632.4	637.7	646.3	682.1
Deposits with the Bank of Latvia	111.4	153.3	98.6	103.6	117.3	134.5	121.2	107.3	151.6	120.5	103.5	124.6
Currency vs monetary base (%)	84.3	79.6	86.0	85.4	83.9	82.4	83.9	85.6	80.7	84.1	86.2	84.5
Net foreign assets	734.8	764.8	693.1	733.8	784.3	771.0	774.7	762.6	835.6	761.1	813.0	824.0
Net domestic assets	-25.6	-13.4	10.4	-23.5	-53.7	-7.8	-20.1	-15.9	-51.6	-2.9	-63.3	-17.2
Credits	40.6	56.3	73.5	39.9	13.6	59.3	41.4	44.7	11.4	55.6	-2.8	44.4
To banks	27.9	29.2	60.8	64.7	63.5	102.3	80.2	103.9	73.6	88.4	50.0	59.3
To the Government (net)	12.6	27.0	12.6	-24.8	-49.8	-43.0	-38.8	-59.2	-62.2	-32.8	-52.8	-15.0
Other items (net)	-66.2	-69.6	-63.0	-63.4	-67.3	-67.0	-61.5	-60.6	-63.0	-58.5	-60.6	-61.6
BANKING SYSTEM												
Broad money M2X	1 847.8	1 879.1	1 914.0	1 944.0	1 972.3	2 005.9	2 061.4	2 061.9	2 067.8	2 134.5	2 159.3	2 258.7
Currency outside banks	528.3	531.9	531.0	534.2	545.8	551.1	561.9	570.0	560.3	567.5	574.8	601.1
Deposits of domestic enterprises and private persons	1 319.5	1 347.2	1 383.0	1 409.7	1 426.5	1 454.8	1 499.5	1 491.9	1 507.5	1 567.1	1 584.4	1 657.7
In foreign currencies	549.5	548.6	570.1	580.4	579.9	587.4	628.2	612.1	613.1	638.3	634.4	623.9
Domestic money supply M2D ¹	1 298.3	1 330.5	1 343.8	1 363.6	1 392.4	1 418.5	1 433.2	1 449.7	1 454.7	1 496.2	1 524.9	1 634.9
Net foreign assets	336.8	307.6	312.3	299.0	281.6	297.4	242.0	193.5	205.8	194.6	138.6	75.4
Net domestic assets	1 511.0	1 571.5	1 601.6	1 644.9	1 690.7	1 708.4	1 819.4	1 868.4	1 861.9	1 939.9	2 020.6	2 183.4
Loans of domestic enterprises and private persons	1 865.1	1 926.7	1 982.2	2 027.9	2 083.7	2 143.7	2 217.9	2 281.7	2 338.4	2 391.2	2 469.0	2 542.6
Bank of Latvia refinancing rate (at end of month; %)	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Weighted average interest rates on transactions in lats (%)												
Interbank loans	2.6	2.5	2.6	2.8	3.1	2.8	2.7	2.8	3.1	2.7	3.7	3.2
Long-term loans to enterprises and private persons	7.6	7.8	7.7	7.9	7.8	7.0	7.4	7.5	7.5	7.4	7.2	7.4
Time deposits of enterprises and private persons	2.9	2.8	2.9	3.1	3.2	3.1	3.0	3.0	3.1	2.9	3.8	3.5
LVL vs USD (at end of month)	0.581	0.583	0.587	0.581	0.565	0.569	0.571	0.583	0.565	0.557	0.553	0.541
LVL vs EUR (at end of month)	0.629	0.629	0.628	0.639	0.664	0.652	0.654	0.632	0.646	0.650	0.660	0.674

¹ Currency outside banks + deposits of domestic enterprises and private persons in the national currency.

THE BANK OF LATVIA'S MONTH-END BALANCE SHEETS FOR 2003

(in thousands of lats)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
FOREIGN ASSETS	849 952	877 552	805 252	851 936	903 273	886 170	887 237	875 080	949 853	873 399	924 206	937 526
Gold	52 850	51 431	48 201	48 136	50 931	48 805	51 264	53 681	53 485	53 557	54 422	55 543
Special Drawing Rights	116	53	53	213	56	56	61	25	25	25	0	75
Convertible foreign currencies	691 110	720 457	649 010	695 892	743 627	729 674	729 595	715 160	788 550	711 213	765 211	774 834
International Monetary Fund	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144
Shares in the BIS	1 240	1 207	1 131	1 129	1 195	1 000	1 000	1 000	1 000	1 000	1 000	1 000
Other foreign assets	3 492	3 260	5 713	5 422	6 320	5 491	4 173	4 070	5 649	6 460	2 429	4 930
DOMESTIC ASSETS	130 997	148 656	179 185	183 140	181 674	218 688	192 469	216 220	185 864	200 495	155 006	162 716
Loans to credit institutions	27 921	29 249	60 841	64 657	63 468	102 302	80 165	103 890	73 580	88 355	50 000	59 320
Transit credits	9 981	10 015	10 084	9 981	9 706	8 231	4 778	4 878	4 728	4 661	4 627	3 018
Government securities	52 301	69 479	69 305	69 412	69 352	69 866	69 373	69 573	68 838	68 940	61 981	62 273
Fixed assets	32 657	32 848	32 871	32 770	32 844	32 831	32 861	33 302	33 960	34 012	33 873	34 200
Other domestic assets	8 137	7 065	6 084	6 320	6 304	5 458	5 292	4 577	4 758	4 527	4 525	3 905
TOTAL ASSETS	980 949	1 026 208	984 437	1 035 076	1 084 947	1 104 858	1 079 706	1 091 300	1 135 717	1 073 894	1 079 212	1 100 242
FOREIGN LIABILITIES	115 183	112 721	112 149	118 118	118 997	115 154	112 507	112 474	114 224	112 269	111 158	113 545
Convertible foreign currencies	240	679	50	2 127	76	88	112	142	199	171	216	149
International Monetary Fund	108 864	108 864	108 864	108 864	108 996	107 472	105 947	105 947	105 947	105 947	105 947	104 423
Foreign bank deposits in lats	595	569	552	549	696	675	658	631	629	547	720	677
Non-convertible currencies	36	36	37	37	36	37	37	37	36	37	36	36
Other foreign liabilities	5 448	2 573	2 646	6 541	9 193	6 882	5 753	5 717	7 413	5 567	4 239	8 260
LATS IN CIRCULATION	597 788	598 104	604 892	606 778	613 334	628 810	633 363	639 391	632 417	637 744	646 268	682 145
DOMESTIC LIABILITIES	174 986	221 662	177 310	220 742	260 305	271 426	250 652	257 619	303 650	243 806	241 779	213 521
Balances due to credit institutions	110 810	151 833	98 312	99 893	116 395	133 690	118 656	106 360	150 757	119 321	102 383	123 810
Balances due to the Government	49 637	52 491	66 776	104 161	128 886	121 145	112 964	133 613	135 773	106 390	119 376	80 254
Balances due to other financial institutions	3 147	3 994	2 585	5 798	2 436	1 901	3 664	2 036	1 948	2 211	2 022	1 670
Other domestic liabilities	11 392	13 344	9 637	10 890	12 588	14 690	15 368	15 610	15 172	15 884	17 998	7 787
CAPITAL AND RESERVES	92 992	93 721	90 086	89 438	92 311	89 468	83 184	81 816	85 426	80 075	80 007	91 031
Nominal capital	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000	25 000
Reserve capital	37 928	37 928	37 928	37 928	37 928	37 928	37 928	37 928	37 928	37 928	37 928	45 787
Valuation account	29 532	30 261	26 626	25 978	28 851	26 008	19 724	18 356	21 966	16 615	16 547	19 712
European Union grant	532	532	532	532	532	532	532	532	532	532	532	532
TOTAL LIABILITIES, CAPITAL AND RESERVES	980 949	1 026 208	984 437	1 035 076	1 084 947	1 104 858	1 079 706	1 091 300	1 135 717	1 073 894	1 079 212	1 100 242

THE BANK OF LATVIA'S YEAR-END BALANCE SHEETS FOR THE YEARS 1999–2003

(in thousands of lats)

	1999	2000	2001	2002	2003
FOREIGN ASSETS	656 304	669 551	881 489	894 613	937 526
Gold	42 215	41 917	44 443	51 025	55 543
Special Drawing Rights	1 788	3	54	41	75
Convertible foreign currencies	506 582	521 512	732 799	737 313	774 834
International Monetary Fund	101 144	101 144	101 144	101 144	101 144
Shares in the BIS	988	983	1 043	1 197	1 000
Non-convertible currencies	276	–	–	–	–
Other foreign assets	3 311	3 992	2 006	3 893	4 930
DOMESTIC ASSETS	165 181	143 859	98 121	146 321	162 716
Loans to credit institutions	63 322	42 530	18 833	30 690	59 320
Transit credits	50 110	23 835	18 612	11 749	3 018
Government securities	30 387 ^{1,2}	51 725 ^{1,2}	24 715	64 382	62 273
Investment in associate	4 726	–	–	–	–
Fixed assets	15 117	22 657	32 819	32 798	34 200
Other domestic assets	1 519 ^{2,3}	3 112 ²	3 142	6 702	3 905
TOTAL ASSETS	821 485	813 410	979 610	1 040 934	1 100 242
FOREIGN LIABILITIES	134 653	129 053	122 306	116 778	113 545
Convertible foreign currencies	–	–	–	–	149
International Monetary Fund	128 699	122 014	116 012	110 388	104 423
Foreign bank deposits in lats	321	158	454	679	677
Non-convertible currencies	42	42	41	37	36
Other foreign liabilities	5 591	6 839	5 799	5 674	8 260
LATS IN CIRCULATION	426 101	482 314	556 003	622 632	682 145
DOMESTIC LIABILITIES	214 333	140 723	226 374	209 676	213 521
Balances due to credit institutions	95 765	80 453	82 433	134 223	123 810
Balances due to the Government	110 278	45 926	119 587	62 079	80 254
Balances due to other financial institutions	4 341	3 950	3 441	3 012	1 670
Other domestic liabilities	3 949	10 394	20 913	10 362	7 787
CAPITAL AND RESERVES	46 398	61 320	74 927	91 848	91 031
Nominal capital	4 750	4 750	10 100	25 000	25 000
Reserve capital	2 181	3 297	5 512	37 928	45 787
Other reserves	25 243	32 497	38 224	–	–
Valuation account	13 709 ⁴	20 254 ⁴	20 567	28 389	19 712
European Union grant	515	522	524	531	532
TOTAL LIABILITIES, CAPITAL AND RESERVES	821 485	813 410	979 610	1 040 934	1 100 242

¹ Latvian government securities, which in the financial statements for 1999 and 2000 were reported at amortised acquisition cost, are stated at their fair value, applying the current Latvian government securities valuation policy retrospectively.

² Restated to include accrued interest income on Latvian government bonds, which was reported under the caption "Other domestic assets" in the financial statements for 1999 and 2000.

³ Restated to include intangible assets, which were reported under "Fixed assets" in the financial statements for 1999.

⁴ Restated to include the revaluation result arising after retrospectively revaluing Latvian government securities in accordance with the current Latvian government securities valuation policy.

Appendix 4

**THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENTS
FOR THE YEARS 1999–2003**

(in thousands of lats)

	1999	2000	2001	2002	2003
INTEREST INCOME					
Foreign operations ¹	21 771	28 075	35 985	30 762	27 327
Domestic operations	6 096	5 496	6 340	5 550	5 984
INTEREST EXPENSE					
Foreign operations ¹	33	55	44	127	8
Domestic operations	4 870	3 754	2 797	3 688	2 651
NET INTEREST INCOME	22 964	29 762	39 484	32 497	30 652
SPECIFIC PROVISIONS	10 748	290	–	–	–
LOSS ON DISPOSAL OF INVESTMENT IN ASSOCIATE	–	2 030	–	–	–
OTHER OPERATING INCOME	3 884	527	520	605	994
OTHER OPERATING EXPENSE	16 100	16 809	17 850	18 668	19 738
PROFIT BEFORE APPROPRIATION	–	11 160	22 154	14 434	11 908

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)

2003	EUR			GBP			100 JPY			USD		
	Maximum	Average	Minimum	Maximum	Average	Minimum	Maximum	Average	Minimum	Maximum	Average	Minimum
I	0.6300	0.6216	0.6140	0.9560	0.9462	0.9410	0.4970	0.4934	0.4900	0.5920	0.5862	0.5790
II	0.6320	0.6289	0.6260	0.9600	0.9424	0.9190	0.4980	0.4883	0.4820	0.5850	0.5834	0.5800
III	0.6380	0.6303	0.6240	0.9330	0.9243	0.9190	0.4960	0.4925	0.4880	0.5890	0.5837	0.5770
IV	0.6410	0.6335	0.6270	0.9250	0.9195	0.9130	0.4930	0.4876	0.4820	0.5890	0.5842	0.5800
V	0.6660	0.6556	0.6420	0.9260	0.9208	0.9130	0.4910	0.4846	0.4760	0.5780	0.5685	0.5620
VI	0.6670	0.6612	0.6520	0.9480	0.9367	0.9220	0.4820	0.4774	0.4750	0.5690	0.5645	0.5610
VII	0.6560	0.6507	0.6440	0.9480	0.9301	0.9100	0.4880	0.4817	0.4750	0.5770	0.5717	0.5680
VIII	0.6530	0.6444	0.6320	0.9270	0.9205	0.9140	0.4960	0.4850	0.4770	0.5830	0.5767	0.5720
IX	0.6480	0.6421	0.6290	0.9360	0.9213	0.9110	0.5080	0.4972	0.4890	0.5830	0.5740	0.5650
X	0.6580	0.6535	0.6500	0.9470	0.9356	0.9260	0.5150	0.5094	0.5040	0.5620	0.5585	0.5560
XI	0.6610	0.6518	0.6440	0.9500	0.9422	0.9360	0.5150	0.5109	0.5070	0.5640	0.5581	0.5520
XII	0.6740	0.6680	0.6600	0.9600	0.9526	0.9460	0.5090	0.5059	0.5040	0.5530	0.5463	0.5410

¹ The amounts reported under the interest income caption "Foreign operations" for the period from 1999 until 2000 have been reduced by including expense on transactions with foreign debt securities, which were reported under the interest expense caption "Foreign operations" in the financial statements for 1999 and 2000.

*Appendix 6***THE BANK OF LATVIA'S ORGANISATIONAL UNITS AT THE END OF 2003****1 ACCOUNTING DEPARTMENT**

(Head of Department, Chief Accountant – Māris Kālis; Deputy Chief Accountants – Jānis Caune, Antonija Sileniece)

1.1 Central Accounting Division (Head of Division – Maija Kurpniece)

1.2 Internal Banking Operations Division (Head of Division – Anita Jakāne)

2 CASHIER'S AND MONEY OPERATIONS DEPARTMENT

(Head of Department – Veneranda Kausa; Deputy Head of Department – Vilnis Kepe)

2.1 Cash Operations Division (Head of Division – Oskars Zaltans)

2.2 Money Operations Division (Head of Division – Alite Grobiņa)

2.3 Coin Division (Head of Division – Maruta Brūkle)

2.4 Money Expertise and Equipment Maintenance Division (Head of Division – Andris Tauriņš)

3 COMMUNICATIONS DEPARTMENT

(Head of Department – Aina Raņķe)

3.1 Publications Division (Head of Division, Deputy Head of Department – Aija Grīnfelde)

3.2 Library (Manager of Library, Deputy Head of Department – Dace Gasiņa)

3.3 Archive (Manager of Archive – Baiba Blese)

3.4 Clerical Office (Head of Clerical Office – Svetlana Petrovska)

3.5 Division for Translation and Protocol (Head of Division – Gundega Vizule)

4 CONSTRUCTION DEPARTMENT

(Acting Head of Department – Dijs Okolovičs)

5 GENERAL SERVICE DEPARTMENT

(Head of Department – Einārs Cišs)

5.1 Building Maintenance Division (Head of Division – Arnis Bērziņš)

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

5.3 Transport Division (Head of Division – Imants Vācietis)

5.4 Division of Riga Branch (Head of Division – Jānis Kreicbergs)

6 GOVERNOR'S OFFICE

(Head of Office – Guntis Valujevs)

7 INFORMATION SYSTEMS DEPARTMENT

(Head of Department – Harijs Ozols; Deputy Head of Department – Ivo Oditis)

7.1 System Design and Programming Division (Head of Division – Ilgvars Apinis)

7.2 Computer Network and Server Systems Division (Head of Division, Deputy Head of Department – Egons Bušs)

7.3 Information Systems Security Division (Head of Division – Ilona Etmane)

7.4 Information Systems Quality Assurance Division (Head of Division – Askolds Kālis)

7.5 Systems Maintenance Division (Head of Division – Edvins Mauriņš)

8 INTERNAL AUDIT DEPARTMENT

(Head of Department – Modris Briedis)

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(cont.)

8.1 Operational Audit Division (Head of Division, Deputy Head of Department – Anita Hāznere)

8.2 Information System Audit Division (Head of Division – Juris Ziediņš)

9 INTERNATIONAL DEPARTMENT

(Head of Department – Juris Kravalis; Deputy Head of Department – Aleksandra Bambale)

10 LEGAL DEPARTMENT

(Head of Department – Pēteris Putniņš; Deputy Heads of Department – Edvards Kušners, Bruno Mačš)

11 MARKET OPERATIONS DEPARTMENT

(Head of Department – Roberts L. Grava)

11.1 Trading and Investment Division (Head of Division – Kārlis Bauze)

11.2 External Debt Management Division (Head of Division – Agita Birka)

11.3 Risk Management Division (Head of Division – Daira Brunere)

11.4 Analysis Division (Head of Division, Deputy Head of Department – Aigars Egle)

11.5 Payments and Settlements Division (Head of Division – Una Ruka)

12 MONETARY POLICY DEPARTMENT

(Head of Department – Helmūts Ancāns; Deputy Heads of Department – Ēriks Āboliņš, Zoja Medvedevskiha)

12.1 Macroeconomic Analysis Division (Head of Division – Vilnis Purviņš)

12.2 Financial Market Analysis Division (Head of Division – Mārtiņš Prūsis)

12.3 Monetary Research and Forecasting Division (Head of Division – Mārtiņš Bitāns)

12.4 Securities Settlement Division (Head of Division – Anda Kalniņa)

13 PAYMENT SYSTEMS DEPARTMENT

(Head of Department – Egons Gailītis; Deputy Head of Department – Agnija Hāzenfuss)

13.1 Payment Systems Policy Division (Head of Division – Anda Zalmane)

13.2 Payment Systems Operations Division (Head of Division – Aigars Tatarčuks)

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 Lukina)

15 PUBLIC RELATIONS DEPARTMENT

(Head of Department, Press Secretary¹; Deputy Head of Department – Kristaps Otersons)

16 SECURITY DEPARTMENT

(Head of Department – Romualds Namnieks; Deputy Heads of Department – Igors Fleitmanis, Oļegs Rītiņš)

16.1 Analytical Unit (Head of Unit – Juris Jansons)

¹ Vacancy. As of January 1, 2004, Mr. Mārtiņš Grāvītis.

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(cont.)

16.2 Engineering and Technical Unit (Head of Unit – Vilnis Gābers)

16.3 Armament Unit (Head of Unit – Juris Kušķis)

16.4 Central Division (Head of Division – Eduards Bukovskis)

16.5 Riga Division (Head of Division – Andis Bērziņš)

16.6 Daugavpils Division (Head of Division – Ilmārs Suhockis)

16.7 Liepāja Division (Head of Division – Gints Liepiņš)

16.8 Rēzekne Division (Head of Division – Andrejs Gugāns)

16.9 Valmiera Division (Head of Division – Aldis Zimmers)

17 STATISTICS DEPARTMENT

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

17.1 Banking and Monetary Statistics Division (Head of Division – Zigrīda Aušta)

17.2 Balance-of-Payments Statistics Division (Head of Division –
Daiga Gaigala-Ližbovska)

17.3 General Economic and Financial Statistics Division (Head of Division –
Iveta Salmiņa)

18 RIGA BRANCH

(Branch Manager – Jānis Strēlnieks; Deputy Branch Manager – Gunārs Viksne)

19 DAUGAVPILS BRANCH

(Branch Manager – Jolanda Mateša; Deputy Branch Manager –
Bernarda Kezika)

20 LIEPĀJA BRANCH

(Branch Manager – Gundars Lazdāns; Deputy Branch Manager –
Ieva Ratniece)

21 RĒZEKNE BRANCH

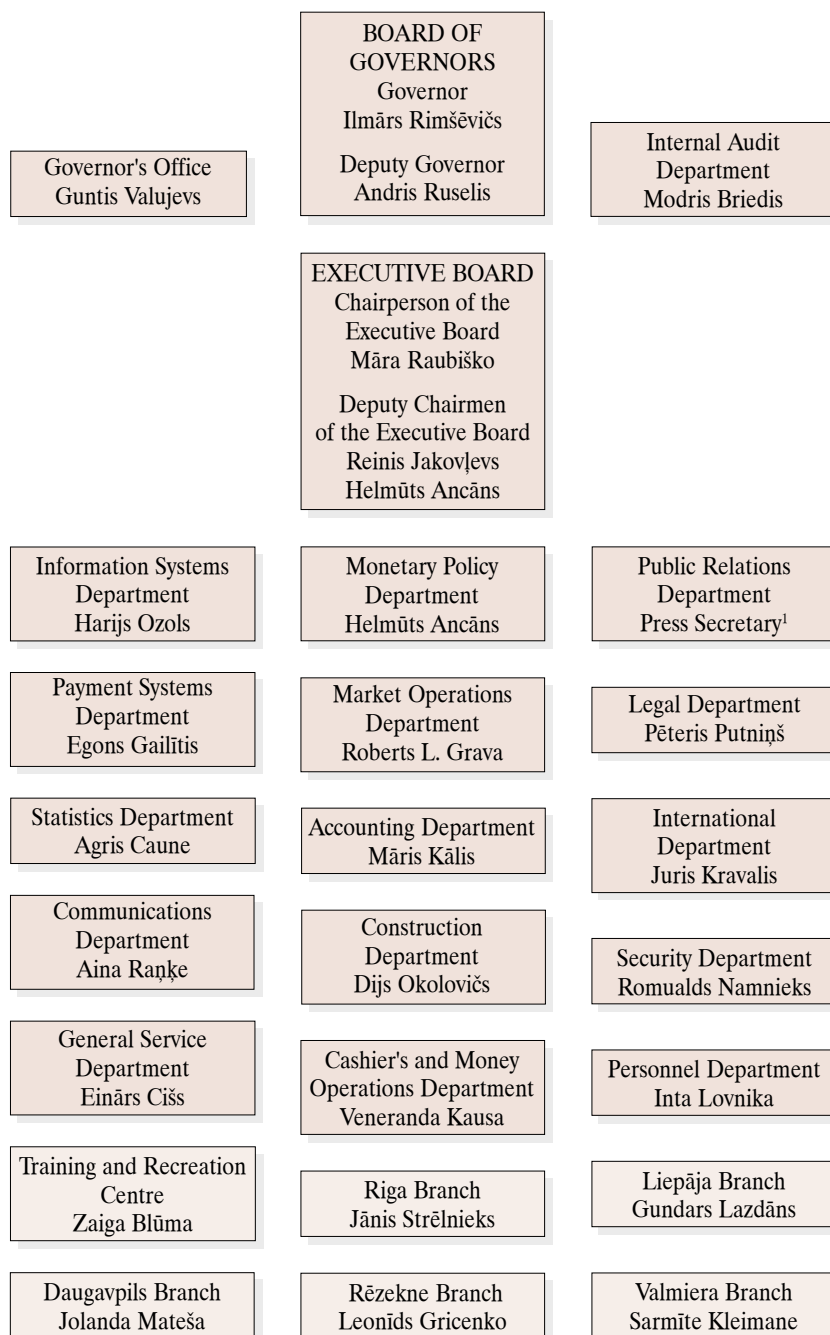
(Branch Manager – Leonīds Gricenko; Deputy Branch Manager –
Anna Matisāne)

22 VALMIERA BRANCH

(Branch Manager – Sarmīte Kleimane; Deputy Branch Manager –
Anna Grigorjeva)

23 TRAINING AND RECREATION CENTRE

(Director – Zaiga Blūma)



¹ Vacancy. As of January 1, 2004, Mr. Mārtiņš Grāvītis.

Bank of Latvia: Annual Report 2003

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