

Latvijas Banka
Annual Report
1992

Riga 1993

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Introduction

In the world economy, 1992 was a difficult year. The decline of the United States economy took longer because of the large federal budget deficit and the high rate of unemployment. Although a rapid expansion seemed to have started in the second half of the year, the relatively low exchange rate of the dollar in the international currency markets slowed sales of imported goods.

In Japan, the second largest trading country, prices in the stock and real estate markets decreased rapidly, and the future prospects appeared to be quite gloomy as compared to the recent past.

Although western Europe had placed high expectations on the common market in 1992, unemployment increased in many countries. In Germany the situation was aggravated by the problems of reunification. Late in the year, the European Monetary System (EMS) experienced a serious crisis, when several important countries decided to leave the agreed upon exchange rate system.

At the same time, disintegration of the trading system of the former USSR (FSU) and the countries under its influence (the so-called socialist countries) continued. Many large enterprises that were purposefully isolated from market forces and world prices were unable to compete under free market conditions. Factories specializing in producing goods for the Soviet war machine became completely redundant. However, it was difficult to let them go bankrupt.

The economic and political situation in Russia and the Ukraine had unfavourable impact on the Baltic States which exported more than half of their gross domestic product, mainly to the East. Although the export of goods to these countries continued also last year, it was extremely difficult to agree on prices and to obtain payments.

Many central banks of the republics of the FSU acted quite irresponsibly, continuing to provide subsidized credits to all enterprises and organizations. This forced Latvia to separate itself from the so-called ruble zone.

In May 1992, when Latvia put into circulation its own monetary unit – the Latvian ruble, many financial experts predicted disastrous consequences. However, purchasing power of the Latvian ruble soon surpassed the value of the Russian ruble, and by the end of the year the exchange rate of the Latvian ruble stabilized against the so-called hard currencies.

The monetary policy of Latvijas Banka received a favorable response from the International Monetary Fund as well as from many experts in Latvia and abroad. The transition to the Lats, the national monetary unit, will take place in 1993¹.

It is very important to note that the transition period has been difficult for the population. These hardships would have been endured in vain, if Latvia were not able to maintain a stable currency. Devaluation of currency may bring short-lived popularity to the politicians; however, Latvijas Banka rigorously rejected such monetary policy in 1992.

¹ A gradual introduction of the Latvian national currency – the Lats (in plural – Lati) – will be begun in March 1993.

Renewal of the Activities of Latvijas Banka – Main Tasks and Objectives

Latvijas Banka was founded on July 31, 1990 by a resolution of the Supreme Council (Parliament) of the Republic of Latvia. However, the Bank could begin its real activities only after the declaration of independence of Latvia. The resolution of the Supreme Council of September 3, 1991 authorized Latvijas Banka to take over the branches of the FSU specialized state banks (i.e., Agricultural Bank, Industry and Construction Bank, Housing and Social Development Bank and Foreign Trade Bank) and the branch of the USSR State Bank located in Latvia. Thus, Latvijas Banka performed the functions of both a central bank and a commercial bank.

Both laws "On Banks" and "On the Bank of Latvia" were passed in May 1992. According to the latter, Latvijas Banka cannot participate in commercial activities.

To eliminate this divergence of legislation, the Supreme Council of the Republic of Latvia formed a Commission of Reorganization and Privatization of Latvijas Banka in December 1992. The mission of this Commission is to manage the branches of Latvijas Banka engaged in commercial banking until their privatization. At the end of 1992, Latvijas Banka became the central bank of Latvia with characteristic central banking functions, and thus it is the sole legal successor to the rights of Latvijas Banka, which was founded in 1922 and existed de facto until the occupation of Latvia in 1940.

Our own currency, the Latvian ruble, was introduced in 1992. Subsequently it was successfully separated from the monetary system of the FSU. It is under full control of Latvijas Banka. We believe that the monetary reform will be completed in 1993 with the introduction of the Latvian national currency – the Lats.

The Latvian banking and monetary system underwent a reform based on market economy principles. Credit and deposit interest rates as well as cash withdrawal procedures have been liberalized. These were the necessary prerequisites to begin attracting money to banks in the form of deposits.

The stabilization of the Latvian ruble has begun. At the end of 1992, the rate of inflation of domestic prices declined and reached 2.6% in December, down significantly from 12.0% in November.

To stabilize the exchange rate of the Latvian ruble, Latvijas Banka actively participated in the convertible currency markets. At the end of December, Latvijas Banka sold US dollars to banks at the exchange rate 167 Latvian rubles per dollar.

A new domestic clearing system has been introduced saving considerable time in settling accounts within Latvia. Also, a new settlement system has been introduced with the ruble zone countries based on market exchange rates. Latvijas Banka supported development of trading non-convertible currencies. After initial difficulties, the new settlement procedures provided for automatic adjustment of currency exchange rates based on real economic developments in the countries

of both involved parties. Thus, the potential export of inflation to Latvia was made much more difficult. Formal settlement agreements between Latvijas Banka and other central banks of the FSU have been or are in the process of being signed. To accelerate decentralized settlements, all Latvian commercial banks have been allowed and advised to establish direct correspondent relationships with commercial banks in the FSU.

The most important future activities of Latvijas Banka will be:

- to replace administrative methods of credit distribution with a competitive interest rate policy,
- to stabilize the Latvian ruble by participating actively in the foreign exchange market,
- to continue the anti-inflation program in cooperation with the International Monetary Fund,
- to improve the domestic payments system by introducing a computerized communications network and electronic transfer of payment documents,
- to improve supervision and control of commercial banks and their activities with the help of foreign experts.

Separation of Commercial Bank Functions from Latvijas Banka

From September 1991 to December 1992, Latvijas Banka performed functions of both a commercial bank and a central bank. This assumption of the dual function was necessary at the time immediately after the recognition of the independence of the Republic of Latvia on September 3, 1991 in order to coordinate the activities of the banking system. All 49 branches of Latvijas Banka were branches of specialized state banks of the FSU. These branches were actually the only banking institutions in rural areas. The monopoly situation of these branches was not influenced by the existence of the branches of the State Savings Bank, as the latter actually did not grant credits to business, but only accepted deposits of the local population. By the end of 1991 the credit portfolios of the 49 branches constituted 83% of the total credit amount in the banking sector. Furthermore, these branches held 3/4 of the demand deposits of business enterprises.

In May 1992, the Supreme Council of the Republic of Latvia passed a resolution directing Latvijas Banka to become a full-fledged state central bank. Immediately after this resolution, Latvijas Banka started developing the concepts and drafting the project of reorganization and privatization of its branches. As early as mid-1992, it became more difficult for Latvijas Banka to combine the two diametrically opposed functions. As a central bank, independent of the Government, Latvijas Banka began to follow a strict monetary policy. At the same time, both the Government and business demanded low-interest credits in unlimited amounts from Latvijas Banka in its function as the biggest commercial bank. Thus, an essential conflict of interest became apparent. With the financial situation of the state enterprises and companies worsening daily, the credit portfolio of the branches of Latvijas Banka experienced an unavoidable deterioration of quality. Extension of credit was granted to companies and state enterprises without appropriate auditing of their financial condition, without receiving pledges and guarantee agreements from the clients. Consequently, by privatization of the branches of Latvijas Banka, two dangers could be contained: the tendency to deteriorating credit portfolios in each and every branch of Latvijas Banka and the likelihood that these continually growing losses would eventually have to be covered by general revenues.

In December 1992, the Supreme Council of the Republic of Latvia adopted the resolution "On Reorganization and Privatization of the Structural Units of Latvijas Banka" and formed a special Commission of Reorganization and Privatization of Latvijas Banka. The main task of this Commission is to administer the above mentioned 49 bank branches until the completion of their privatization.

Thus, by the end of the year, there were 51 commercial banks and 49 former branches of Latvijas Banka in Latvia.

Monetary Policy and the Economic Situation in Latvia

The Latvian Ruble versus the Russian Ruble

In the first four months of the year Latvia was adversely affected by the Russian ruble inflation. In addition, the outgoing cash payments surpassed the incoming money amounts by 122 million rubles (5.9%) in February, but in April by 686 million rubles (29.2%), thus causing a very serious shortage of cash.

Since the money was emitted by Russia, Latvijas Banka was unable to improve the cash circulation in the country. The situation fully depended on the possibilities to receive or buy cash and credit resources from the central bank of Russia. It was evident that a crisis could develop by the end of May, when Latvijas Banka would not be able to execute even the most necessary payments.

To resolve the problem, on May 4, 1992 the Monetary Reform Commission¹ of the Republic of Latvia passed a resolution "On Introduction of the Latvian Ruble". From May 7, 1992, Latvian rubles (LVR) were put into circulation in Latvia as a legal tender parallel to the existing ruble notes of the FSU (SUR). It was declared equal in value with the Russian ruble. The nominal values of the Latvian rubles were 1, 5, 20, 50, 200 and 500 (later also 2 and 10) rubles.

The liberalization of cash payments was established and withdrawals from the bank accounts were not limited. Beginning May 7, all cash payments were made in Latvian rubles, in case of necessity allowing their exchange for Russian rubles. The vault cash of Russian rubles in the banks increased rapidly, and they were initially used for stabilization of the Latvian ruble. If the vault cash of the Russian rubles held by banks on May 7 was 349.1 million Russian rubles, on July 15 it was already 9.2 times more.

Russian rubles in circulation were increasingly substituted by Latvian rubles. This process is characterized by the following Tables 1 and 2, and Chart 1.

With the inflation level in Latvia decreasing gradually and hyperinflation beginning to appear in Russia, the exchange rate of the Latvian ruble to the Russian ruble remained at 1 : 1, despite the fact that the demand of the latter was significantly lower than the supply. This led to a disadvantageous situation for the circulation of the Latvian money. To prevent this, on July 6, 1992 the Monetary Reform Commission adopted the resolutions "On the Determination of the Latvian ruble as the Only Legal Tender in the Republic of Latvia" and "On the Determination of the Ruble as the Minimum Payment Unit".

¹ The Monetary Reform Commission was established on November 26, 1991, according to the law of the Republic of Latvia to administer the process of monetary reform and introduce the Latvian currency Lats. The Commission consists of the Chairman of the Council of Ministers, the President of Latvijas Banka and the Chairman of the Economic Commission of the Supreme Council of the Republic of Latvia.

In accordance with these resolutions, on July 20, 1992 the Latvian ruble became the only acceptable tender in Latvia. The circulation of the small change of the FSU was discontinued on July 13. On July 20, the existing ruble accounts in the banks became Latvian ruble accounts. Since the Russian ruble became a foreign currency, the Russian ruble customers had to open separate Russian ruble accounts. From July 7 to July 15 every client was entitled to unlimited exchange of Russian rubles for Latvian rubles at the exchange rate 1 : 1.

Table 1. Circulation of Latvian Rubles in 1992
(million LVR)

Period	Disbursed by banks	Received by banks	Emission
May (from 07.05.)	3 084.5	1 415.3	2 023.4
June	4 689.7	2 711.6	2 094.9
July	6 175.9	2 913.0	3 423.5
August	5 576.7	4 383.7	1 394.5
September	6 792.8	5 076.5	1 662.5
October	7 412.7	6 567.0	866.2
November	8 326.5	5 980.7	2 534.8
December	9 596.7	7 839.1	1 493.6
Total in 1992	51 655.5	36 886.9	15 493.4
Average per month	6 456.9	4 610.9	1 936.7

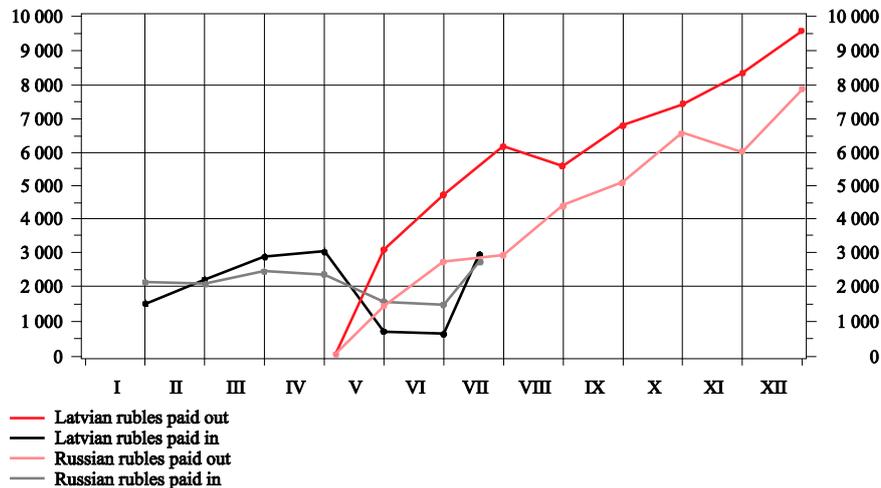
Table 2. Circulation of Russian Rubles in 1992
(million SUR)

Period	Disbursed by banks	Received by banks	Emission
January	1 494.9	2 128.8	-170.2
February	2 201.9	2 080.3	471.2
March	2 874.7	2 440.1	-188.3
April	3 034.3	2 348.5	438.6
May	671.1	1 543.9	-1 053.4
June	579.9	1 444.7	-750.5
July	2 948.6	2 726.8	378.1
August ¹

Total in 1992	13 805.4	14 713.1	-874.5
Average per month	1 972.2	2 101.9	-124.9

¹ Beginning July 20, the Russian ruble was regarded as a foreign currency.

Chart 1. *Turnover of Latvian Rubles and Russian Rubles in Banks, 1992*
(million rubles)



The above mentioned rate was maintained also after July 20, but the uncontrollable non-cash emissions in different ruble zone territories threatened to flood Latvia with valueless money. For example, the Ukraine, in particular, put 6 billion rubles into circulation in Latvia during the period from June 1 to July 20. The existing accounting system practically provided no defense against this practice. Effective July 24, it was required that payments with each republic of the FSU could be effected through a specific correspondent account opened for this purpose. This gave Latvijas Banka an opportunity to separate individual republic non-cash money flows. Effective August 4, it was prohibited to transfer funds between accounts of different non-convertible currencies.

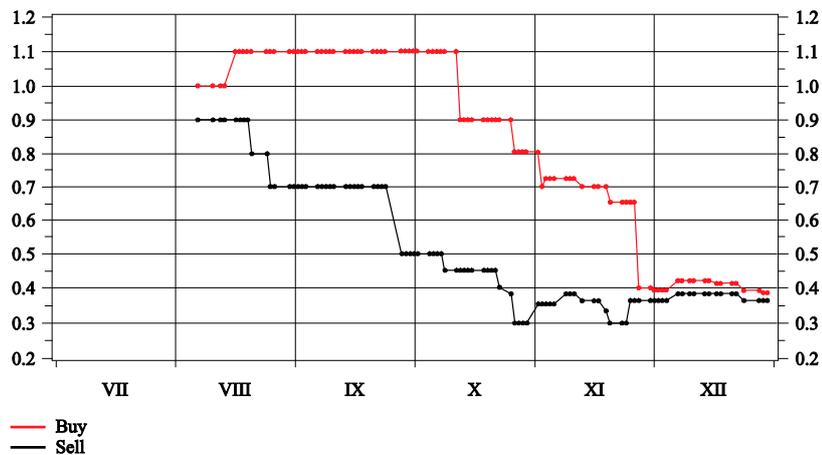
Stabilization of the Latvian Ruble

Beginning August 7, 1992, Latvijas Banka started to buy and sell non-convertible currencies in non-cash using fixed buying and selling rates in Latvian rubles for currencies of the various republics of the FSU (except the Estonian crown). The buying and selling rates of the non-convertible currencies were not regulated for commercial banks. Between August 17, 1992 and November 27, 1992, Latvijas Banka required that its branches buy non-convertible currencies for non-cash at the rate not lower than that fixed by Latvijas Banka but to sell at

the rate not higher than that fixed by Latvijas Banka. After November 27, 1992, the selling rate was not fixed, but the buying rate could not be lower than that fixed by Latvijas Banka.

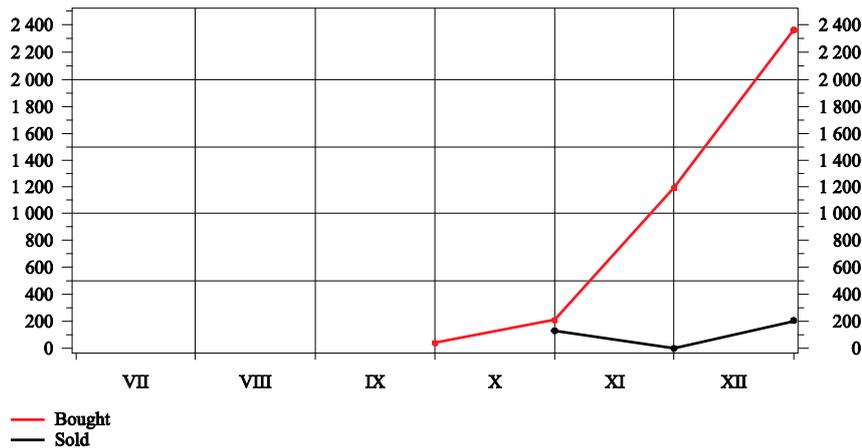
As a result of the above mentioned activities, the value of the Latvian ruble in relation to monetary units of the ruble zone countries was increasing constantly: while on August 7 the middle point of the rate for buying and selling the Russian ruble was 0.95 Latvian rubles, on August 31 it was 0.90 LVR, on September 30 – 0.80 LVR, on October 30 – 0.55 LVR, on November 30 – 0.38 LVR, but on December 30 – 0.37 LVR (see Chart 2). Primarily the determination of the rate was based on the outstanding balances in the correspondent accounts with Latvijas Banka, but later – on the exchange rate of the ruble of the respective republic to the US dollar.

Chart 2. Buying and Selling Rates of the Russian Ruble by Latvijas Banka in the Second Half of 1992
(exchange rate in LVR)



The purchased amounts from all the ruble zone republics significantly surpassed the non-convertible currency amounts sold. For example, Chart 3 shows the purchases and sales of Russian rubles in Latvijas Banka.

Chart 3. *Purchase and Sale of Russian Rubles by Latvijas Banka in the Second Half of 1992*
(million SUR)



To stabilize the Latvian ruble, on September 1, 1992 Latvijas Banka began to sell US dollars to banks for the exchange rate a little less than the market rate (the buying was begun at the end of August). The average selling rate set by Latvijas Banka during September-December 1992 was 174.11 LVR per US dollar, but the buying rate – 167.50 LVR per US dollar (see Chart 4). As a result of buying and selling convertible currencies, the amount of Latvian rubles in circulation has increased by 3.2 billion LVR.

In November 1992, Latvijas Banka began to buy and sell in non-cash also other convertible currencies – British pounds sterling, French francs, Deutsche marks, Japanese yen and Estonian crowns (see Chart 5). For the needs of book-keeping and tax calculations, Latvijas Banka established and published weekly the official exchange rate for convertible (from February 1992) and non-convertible (from September 1992) currencies. These exchange rates were based on the current market exchange rates and data of international currency markets.

On August 31, 1992, the Monetary Reform Commission adopted the resolution "On the Guarantees During Transition to the National Currency – the Lats" which stated that during the transition period all Latvian rubles will be exchanged into lats at a uniform exchange rate, thus strengthening trust in the Latvian currency.

Chart 4. *Buying and Selling Rates of the US Dollar by Latvijas Banka in the Second Half of 1992*
(exchange rate in LVR)

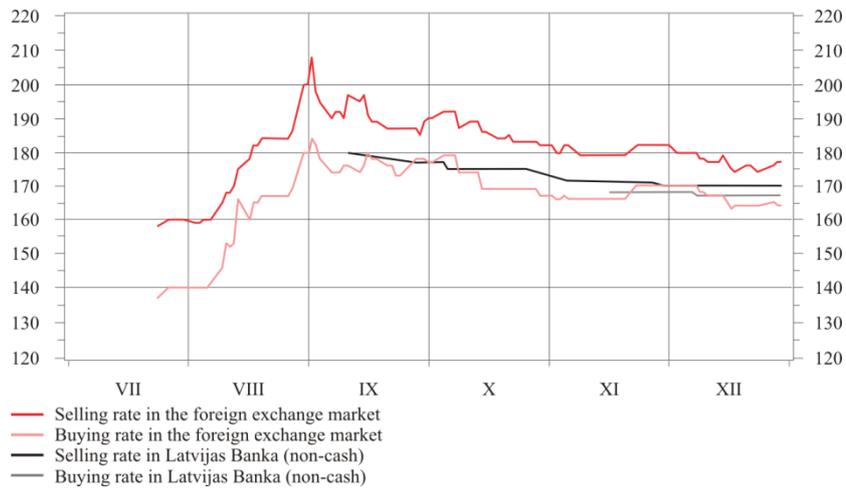
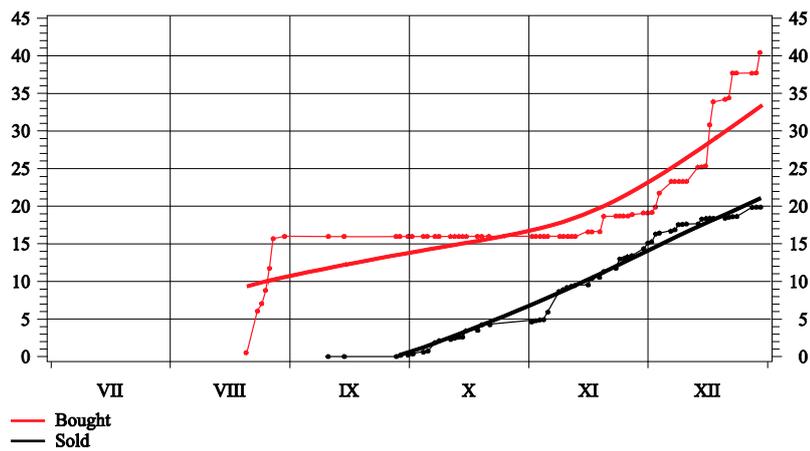


Chart 5. *Turnover of Convertible Currency in Latvijas Banka, 1992*
(million USD)

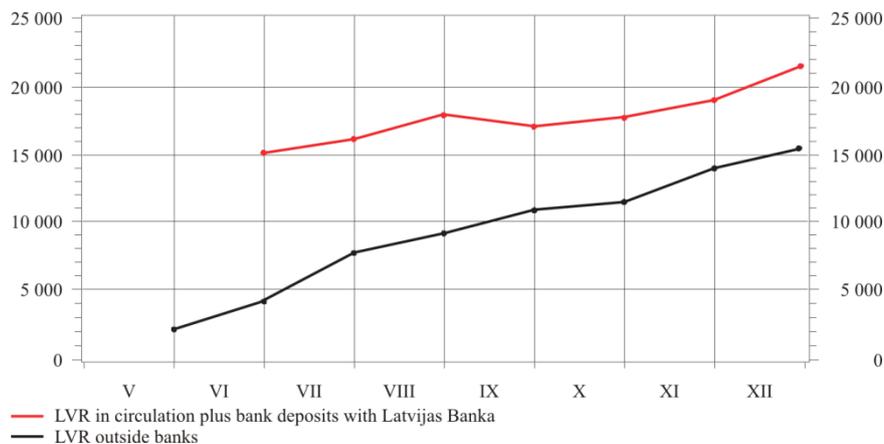


Monetary Policy

The main goal of monetary policy after the introduction of the Latvian ruble was to achieve the stabilization of inflation, prices and currency.

In cooperation with the International Monetary Fund, Latvijas Banka had agreed on maximum emission targets in 1992. The monetary base, which is regarded as the most important policy target, has increased in this period by 34% or at an average rate of 6.8% monthly. On the other hand, M2 (the amount of money in circulation, i.e., money outside banks + non-bank deposits in banks) has increased by 40.5% or at the average rate of 8.1% monthly. The increase of M2 was mainly based on the growth of money in circulation, because interest rates offered by banks for deposits did not attract funds from the public. Since the Latvian ruble had become the only legal tender, the amount of cash rose sharply. By the end of the year, it increased 2.1 times, or at the average rate of 21.1% monthly (see Chart 6).

Chart 6. Emission of the Latvian Ruble in 1992
(million LVR)



In 1992, velocity of money in circulation increased. While for several years the velocity had fluctuated from 1.8 to 3.0 times annually (according to Prof. J. Neimanis), in 1992 it had reached 5.58 times (according to IMF estimates). Gross domestic product was growing more rapidly than the monetary aggregate M2.

Latvijas Banka with its monetary policy has been able to prevent hyperinflation and to stabilize the Latvian ruble. While in the first half of 1992 the inflation rate was 146% quarterly, in the two last quarters it decreased to 55.6%. By December, the inflation was reduced to 2.6%.

To enforce its monetary policy, Latvijas Banka limited emission, began unlimited sales of US dollars and influenced activities of commercial banks by changing obligatory reserve requirements and interest rates of refinancing.

Table 3. Monetary Survey During the Second Half of 1992¹

	1992, the end of period					
	Jul	Aug	Sept	Oct	Nov	Dec
1. Currency in circulation (million LVR)	7 542	8 936	10 599	11 465	14 002	15 493
% to previous month	...	18.0	18.6	8.2	22.1	10.6
of which:						
1.1. Vault cash (million LVR)	811	928	833	819	1071	838
1.2. Currency outside banks (million LVR)	6 731	8 008	9 766	10 646	12 931	14 665
2. Bank deposits in Latvijas Banka (million rubles)	8 551	9 017	11 763	11 867	9 041	9 590
% to previous month	...	5.4	30.5	0.9	-23.8	6.1
2.1. of which in millions of LVR	8 551	9 017	6 473	6 304	5 054	6 066
% to previous month	...	5.4	-28.8	-2.6	-19.8	20.0
3. Reserve money (million rubles)	16 093	17 953	22 362	23 332	23 043	25 083
4. Reserve money (million LVR)	16 093	17 953	17 072	17 769	19 056	21 559
% to previous month	...	11.6	-4.9	4.1	7.2	13.1
5. Non-bank deposits (million rubles)	16 466	21 589	22 272	22 413	19 505	17 948
% to previous month	...	31.1	3.2	0.6	-13.0	-8.0
6. Broad money – M2 (million rubles)	23 197	29 597	32 038	33 059	32 436	32 613
% to previous month	...	27.6	8.2	3.2	-1.9	0.5

Credits of Latvijas Banka to Commercial Banks

At the beginning of the year, Latvijas Banka established a credit plan for its former branches.

Given the growing needs for money resources in the second quarter, Latvijas Banka decided to emit additional credits of 4 billion LVR. The extra credit resources in the second and third quarters were granted with maturity of 3 to 6 months, but beginning October 1 – only for 1 month. The annual refinancing rate

¹ Used exchange rate of the Latvian ruble to the currencies of the FSU – 1 : 1.

for extra credits was 25% in April and May, 50% in June, 80% in July-September, and 120% in October-December.

The total amount of Latvijas Banka credits to banks is shown in Table 4.

Table 4. Outstanding Credits of Latvijas Banka to Banks in 1992
(million LVR)

End of period (1992)	Total credits outstanding	Of which					
		Branches of Latvijas Banka				Commercial banks	
		Planned credits	Interest rate per year (%)	Extra credits	Interest rate per year (%)	Amount	Interest rate per year (%)
January	2 741.9	2 692.9	10	x	x	49.0	10
February	3 818.9	3 769.9	10	x	x	49.0	10
March	4 156.2	3 586.0	15	521.2	25	49.0	25
April	4 187.5	3 481.0	15	657.5	25	49.0	25
May	4 421.5	3 375.0	15	963.5	50	84.0	50
June	7 136.5	3 269.0	15	3 773.5	80	94.0	80
July	9 731.6	3 269.0	15	5 877.6	80	585.0	80
August	9 820.5	3 269.0	15	6 036.0	80	545.5	80
September	8 491.2	3 213.0	15	4 664.2	120	514.0	120
October	10 505.7	3 213.0	15	6 160.7	120	707.0	120
November	11 140.4	3 213.0	15	7 180.4	120	747.0	120
December	10 642.2	3 015.0	15	6 959.2	120	668.0	120

At the end of December 1992, the amount of credits extended to banks, in comparison with the respective period of 1991, has increased 4.08 times. At the end of the year, the former branches of Latvijas Banka had received 93.7%, and commercial banks – 6.3% of the total credits granted by Latvijas Banka. Although commercial banks had access to Latvijas Banka credits, their use was limited by insufficient amount of commercial bank capital. At the end of the year, commercial banks increased their deposit interest rates in order to attract deposits from individuals and enterprises.

Some of the credits extended by Latvijas Banka to its branches were used to settle their customer payments. Effective July 1, 1992, the obligatory reserves were increased from 15% to 20%.

Fiscal Policy

During 1991 and in the first half of 1992, the budget of the Republic of Latvia was balanced. Predominantly, its revenue consisted of turnover, excise, and enterprise profit taxes (in the first half of the year – 23%, 20% and 22%, respectively).

With the worsening liquidity crisis – when "everybody owes everybody" – the solvency of enterprises was low and consequently payments of tax liabilities were unsatisfactory. For this reason, the 3 792 million rubles budget deficit planned for 1992 increased to 4 592 million rubles.

The law "On the Bank of Latvia" authorized Latvijas Banka to grant to the Government short-term credits up to 1/12 of the revenues of the current budget year. During the year under review, Latvijas Banka exercised this right, and at the end of the year, the loan to the Government amounted to 1 200 million rubles.

According to the data released by the Ministry of Finance of the Republic of Latvia, the following foreign institutions and international organizations have decided to grant credits to the Latvian Government:

1. Canada – 10 million CAD (1 320 million LVR);
2. Finland – 50 million FIM (1 616 million LVR);
3. Germany – 15.6 million DEM (1 647 million LVR);
4. USA – 10 million USD (1 670 million LVR);
5. World Bank – 45 million USD (7 515 million LVR);
6. IMF – 54.9 million SDR (12 736 million LVR);
7. EBRD – 30.8 million ECU (6 327 million LVR).

The total amount of these loans is 195.8 million USD (32 830 million LVR) of which 110.9 million USD (18 590 million LVR) have actually been received.

Each of these loans has been granted for a specific purpose such as stabilization of the national currency, rehabilitation, procurement of agricultural machinery, grain, and energy resources.

Development of National Economy

Although Latvijas Banka succeeded in stabilizing the Latvian ruble, the national economy did not improve. Most industrial activities were still carried out by state-owned enterprises and the speed of privatization has been unacceptably slow. The share of the state or local government-owned as well as public organization capital in the total charter capital of enterprises (except agricultural) in Latvia at the end of September was 88.7% and the total production volume – 80.6%.

Gross domestic product (GDP) in Latvia in real prices reached 182 billion rubles in 1992 which is 6.3 times more than in 1991. However, it must be noted that in comparison to 1990 prices, it had considerably decreased – by 43.9%, constituting 6.4 billion rubles. The biggest reductions were in capital construction – by 65.4%, in industry – 47.1%, in agriculture and forestry – 27.7%.

Gross industrial output in 1992 in comparison with the previous year in base prices (1990) has decreased by 36.7 billion rubles or 35.1%. This reduction has

touched all branches of industry, but most of all machine building (9.3 billion rubles) and the food industry (8.7 billion rubles). More than 485 companies or 76.5% of the total have decreased their industrial output and of those 142 (22.4%) companies – by more than a half. This was mainly caused by price increase for raw materials but also by the lack of markets.

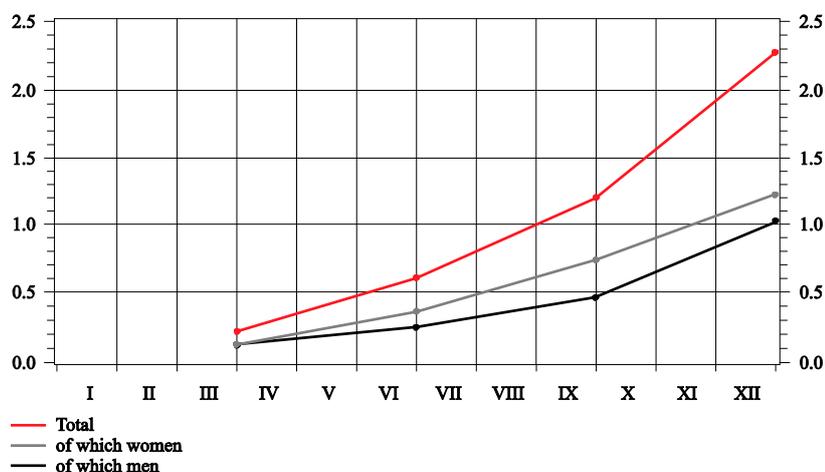
As a result of the above mentioned problems, considerable amounts of finished products had been accumulating. At the end of November, their value was 13.5 billion rubles or 80.8% of the production output in November, and at the end December – 13.1 billion rubles or 79% of the production output in December. The biggest stocks had been created in machine building and metal processing, as well as in food-processing enterprises (3.7 and 2.6 billion rubles, respectively).

Volumes of agricultural production also continued their decrease in 1992 – milk by 12%, meat by 15%, eggs by 20%, of which in collective and state farms 32%, 25% and 26%, respectively.

Investments have fallen to a minimum. Fixed assets in the amount of 4 billion rubles were put into operation, which is equal to only 28% of the level in 1991.

As a result of the reduction in production, in 1992 unemployment appeared in the country. In the course of the year, 75 500 people applied for work and at the end of the year 33 200 unemployed were registered, which is equal to 2.3% of population of working age (see Chart 7). 25 200 people were granted unemployment benefits. 3 300 people were out of work for more than 6 months. There also exists hidden unemployment (estimated at about 40 000 people monthly).

Chart 7. *Unemployed as Percent of the Total Available Labour Force in Latvia Population*
(percentage)

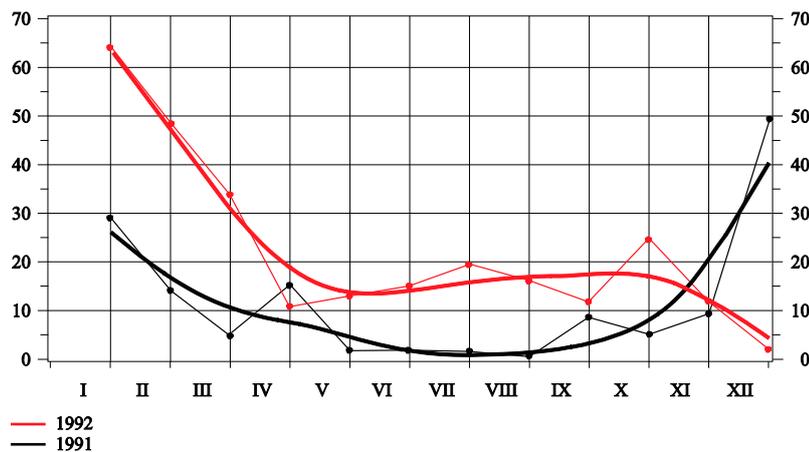


Inflation and Prices

The average monthly inflation rate in the first quarter of 1992 equalled 148.8%, in the second quarter – 113.1%, in the third – 116%, in the fourth – 113.2%. The annual inflation of retail prices in 1992 – as compared to 1991 – was 1 051%. The inflation of wholesale prices was even faster. Year-to-year, it rose 14.1 times.

The first tangible results of the strict monetary policy of Latvijas Banka could be observed in the statistics on retail prices. Inflation in December 1992, compared to November, was 2.6%, but in comparison to November 1991 – 958.1% (see Chart 8).

*Chart 8. Retail Price Index in Latvia (% to the previous month)
(percentage)*

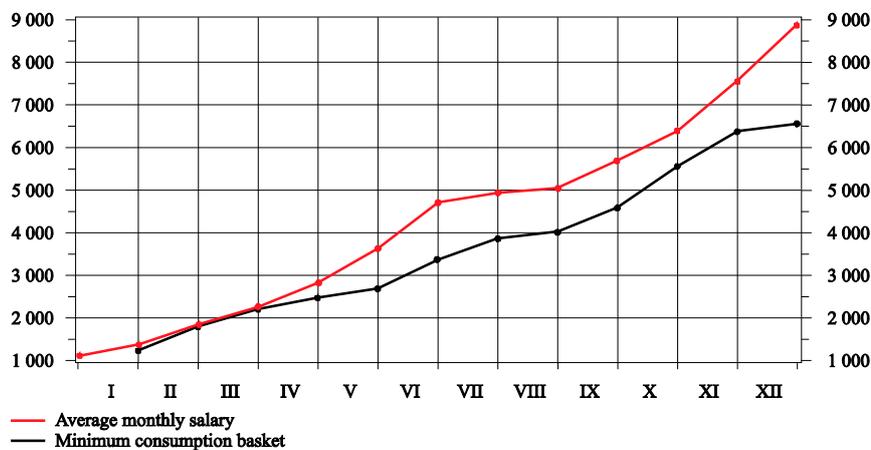


The average salary increases for the state sector employees in 1992 were considerably lower than inflation. While the price index increased 10.5 times within 12 months, the average salary – 7.8 times which resulted in lowered purchasing power of employees by 26.4%.

Turnover of retail goods in 1992 amounted to 47 345 million rubles and in actual prices grew 3.9 times in comparison with previous year. In comparative prices, however, the turnover decreased by 51%. The turnover in the service sector in 1992 reached 9 971 million rubles, but in comparative prices the turnover in 1992 decreased by 79%.

The minimum salary in December 1992 was 1 500 rubles per month, i.e., 3.3 times higher than in January 1992, but it purchased only 23% of the minimum consumption basket (37% in January 1992). The average salary in the state sector of the national economy was 8 845 rubles per month, i.e. 7.9 times more than in December 1991 (see Chart 9).

Chart 9. Average Monthly Salary in the State Sector of the National Economy and the Minimum Consumption Basket in 1992 (in LVR)



Balance of Payments

In 1992, the State Statistics Committee began to compile information on the balance of payments in Latvia corresponding to world standards.

Preliminary estimates showed a negative balance of 4.7 billion LVR in commodity trade with eastern countries in 1992, whereas trade balance with western countries was positive by 11.6 billion LVR.

The most important position in external economic relations of Latvia was occupied by trade with Eastern countries, with 50% and 57.5% of the total volume of Latvian exports and imports respectively. Of the CIS countries, the most active trade relations were with Russia and the Ukraine.

Difficulties in economic relations with the CIS, as well as the desire to earn convertible currency forced Latvian manufacturers to look to western markets as possible areas of expansion. The most active trade was carried out with Germany, the Netherlands and Sweden.

Securities Market

The first rudiments of a financial market, including the securities market, appeared in Latvia in 1992. New stock exchanges were founded, and the network of commercial banks expanded. However, due to the general crisis in the national economy, the majority of the created stock exchanges were not able to start real operations. By the end of 1992, only 5 stock exchanges appeared to be in operation.

Turnover of Latvian securities in 1992 was rather insignificant, and some Russian securities also circulated in stock exchanges in rather small quantities. Promissory notes and commercial bank registered shares practically did not appear in open markets.

Monetary Policy Calendar in Latvia

January-March

Latvijas Banka granted credits to its former branches and credits to commercial banks at the rate of 10% per year.

April-May

Latvijas Banka granted extra credits to its former branches and credits to commercial banks at the rate of 25% per year.

May 4

The Monetary Reform Commission of the Republic of Latvia passed its Resolution No. 1 "On Introduction of the Latvian Ruble".

May 7

The Latvian ruble was introduced.

May 19

The Supreme Council of the Republic of Latvia passed laws "On Banks" and "On the Bank".

June

Latvijas Banka granted extra credits to its former branches and credits to commercial banks at the rate of 50% per year.

July

Latvijas Banka stopped to keep accounts of inter-enterprise non-payments (card file No. 2 was annulled).

July-September

Latvijas Banka granted extra credits to its former branches and credits to commercial banks at the rate of 80% per year.

July 1

Latvijas Banka increased the ratio of obligatory reserves from 15% to 20%.

July 2

The Supreme Council of the Republic of Latvia approved Members of the Council of Latvijas Banka.

July 6

The Monetary Reform Commission of the Republic of Latvia passed its Resolution No. 2 "On the Determination of the Latvian ruble as the Only Legal Tender in the Republic of Latvia".

July 6

The Monetary Reform Commission of the Republic of Latvia passed its Resolution No. 3 "On the Determination of the Ruble as the Minimum Payment Unit".

July 13

Circulation of USSR's small change was stopped in Latvia.

July 20

Latvian ruble became the only legal tender in Latvia.

August 7

Latvijas Banka started to establish buying and selling rates for non-convertible, non-cash transfer currencies.

August 26

The Supreme Council of the Republic of Latvia passed the law "On Restoring the Power of the Law on Promissory Notes and Cheques Adopted on September 27, 1938".

August 31

The Monetary Reform Commission of the Republic of Latvia passed its Resolution No. 4 "On Guarantees During Transition to the National Currency – the Lats".

September 22

Latvijas Banka started unlimited sale of US dollars in non-cash.

October 9

Latvijas Banka granted extra credits to its former branches and credits to commercial banks at the rate of 120% per year.

October 30

The Council of Latvijas Banka approved Members of the Board of Latvijas Banka.

November 4

Latvijas Banka started unlimited sale of US dollars in cash to banks and private persons.

November 5

The Council of Latvijas Banka approved economic requirements of commercial banks and other credit institutions including obligatory reserve standards which will come into force on July 1, 1993.

November 10

The Council of Latvijas Banka adopted a resolution on introduction of monthly balance statistics of credit institutions in Latvia, beginning with January 1993.

December 2

The Supreme Council of the Republic of Latvia passed the resolution "On Reorganization of Latvijas Banka, Transformation of its Structural Units and Privatization" in accordance with which the Commission of Reorganization and Privatization of Latvijas Banka was created.

International Cooperation

1. International Monetary Fund (IMF)

Latvia became a member of the IMF in May 1992. In accordance with the law of the Republic of Latvia "On Acceptance of Membership by the Republic of Latvia in the IMF", Latvijas Banka became the depositary of the IMF for the currency holdings of Latvia. Mr. Einars Repse, the President of Latvijas Banka, was appointed as Alternate Governor of the IMF.

Latvia joined the Baltic-Nordic Group in order to represent our interests in the IMF administration.

In September 1992, the IMF accepted the program of financial and economic development in 1992 and the first six months of 1993, which was worked out by the Government of Latvia and Latvijas Banka. Based on terms of this programme, Latvia received a Stand-By Arrangement from the IMF.

2. Bank for International Settlements

In June 1992 Latvijas Banka renewed its participation in the Bank for International Settlements, which had been suspended since 1940.

3. Technical assistance

Beginning November 1991, Latvijas Banka has received technical assistance from the IMF, foreign governments and central banks.

In 1992, Latvijas Banka was visited by two IMF technical assistance missions which comprised not only employees from the IMF but also representatives from Finland, Sweden, Denmark, Norway, and other countries.

The main directions of technical assistance continue to be:

- supervision of commercial banks and other credit institutions,
- monetary policy and management,
- foreign exchange operations,
- central bank accounting.

Latvijas Banka received technical assistance on monetary policy, legislation, accounting, banking statistics, securities market policy and other issues from the representatives of the Deutsche Bundesbank on regular basis. The opportunity to visit Bundesbank and its branch was given to some Council members of Latvijas Banka.

The assistance of two consultants (Mr. U. Klauss as long-term advisor and Mr. J. Viksnins as short-term advisor) in Latvia was financed by the US Treasury. Their task is to advise the President of Latvijas Banka on macroeconomics, monetary policy, bank supervision and other topics of everyday activities of a central bank.

During the second part of 1992, a consulting group, financed by the Swiss Government, valued the credit portfolios of the former state specialized banks' branches.

Negotiations with the European Community were started to seek a possibility in obtaining a long-term advisor on central bank accounting.

The Structure of Latvijas Banka and Training of Personnel

During 1992, the staff of Latvijas Banka increased by 14 employees (from 178 employees at the end of 1991 to 192 employees at the end of 1992). Several structural changes have occurred; new departments have been created, such as the Monetary Policy Department, the Foreign Exchange Department, the Security Department. Departments, the functions of which were not typical for a central bank, such as the Investment and Crediting Departments, were closed.

Since August 1, 1992 the Riga Accounting and Credit School was transformed into the Latvian Banking College, where the training program "On Banking" was worked out in cooperation with Swedish experts.

Since October 15, 1992 two recreation centres of Latvijas Banka were consolidated.

Ilmars Rimsevics was appointed as Vice-President of Latvijas Banka by the resolution of July 2, 1992 of the Supreme Council of the Republic of Latvia, and as Council members of Latvijas Banka:

Gaļina Aļijeva ¹ ,	Bruno Reinholds Rubess,
Valentīna Kolotova,	Varis Zarins,
Harijs Bušs,	(one vacancy) ² .

The following Board members of Latvijas Banka were appointed by the Council:

Ilmārs Rimšēvičs, Chairman of the Board (from August 27, 1992),
 Antonija Sileniece (from October 30, 1992),
 Silvija Lejniece (from October 30, 1992),
 Ēriks Blūms (from October 30, 1992),
 Laila Rūse (from January 21, 1993).

Several courses and seminars were conducted by foreign experts in 1992 (32 employees participated) on the most topical subjects:

the International Monetary Fund – macroeconomics and finance, supervision of commercial banks;

Danmarks Nationalbank – foreign exchange operations of a central bank;

the Bank of England – reserve management, functions of a central bank, macroeconomics, administration of a central bank;

Schweizerische Nationalbank (National Bank of Switzerland) – monetary and financial policy;

Oesterreichische Nationalbank (National Bank of Austria) – payments, management and supervision;

the World Bank – an orientation seminar on the World Bank approaches and practices for new World Bank member countries.

Two members of the staff have participated in Master's Degree course in Banking and Finance of the Stockholm University.

The staff members of Latvijas Banka have improved their knowledge of English and German.

¹ Retired on March 5, 1993.

² Guntis Ulmanis and Vita Pilsuma were approved on March 31, 1993.

Profit and Loss Account for the Year Ended December 31, 1992

(thousand LVR)

	1992	1991
Interest income		
Foreign:		
Interest on bank deposits	60 242	0
Income from securities	10 771	0
Other income	9 339	0
Share dividend, BIS	28 687	0
Gross foreign interest income	109 039	0
Domestic		
Interest on loans to banks	2 178 899	120 059
Interest on other loans	274 313	0
Interest on forward transactions in foreign currency	0	0
Gross domestic interest income	2 453 212	120 059
Interest expenses		
Foreign:		
Interest on bank credits	0	0
Other expenses	57 815	0
Gross foreign interest expenses	57 815	0
Domestic:		
Interest on bank deposits	0	0
Other expenses	6 217	153
Gross domestic interest expenses	6 217	153
Net interest income, domestic and foreign	2 498 219	119 906
Valuation adjustments		
Net foreign exchange gain/losses	-1 052 284	0
Net gain/losses on securities	0	0
Net valuation adjustments	-1 052 284	0
Net interest income and valuation adjustments	1 445 935	119 906
Operating income		
Commission income	0	0
Other operating income	2 106	305
Total operating income	2 106	305
Operating expenditure		
Wages, salaries and other personnel costs	17 709	1 114
Social security	7 483	0
Money printing	899 405	0
Investments	0	0
Depreciation	2 036	215
Other operating expenses	34 244	2 776
Total operating expenses	960 877	4 105
Net operating expenses	958 771	3 800

Profit for the year before loan losses	487 164	116 106
Loan losses	0	0
Profit for the year before transfers	487 164	116 106
Transfers		
Capital	267 776	18 800
Reserve capital	48 716	7 500
State budget, donations	170 672	40 870
Operational capital	0	48 936

Balance Sheet of Latvijas Banka on December 31, 1992

(million LVR)

ASSETS	1992	1991
Foreign assets	21 695	2 694
Gold	3 380	0
Convertible currencies	11 812	0
Estonian correspondent account	8	0
Shares	292	0
Non-convertible currencies	4 573	2 694
Cash	57	404
Correspondent accounts after 1992	2 506	0
Correspondent accounts before 1992	1 479	2 290
Cash-blocked SUR	531	0
Credits to other republics	1 630	0
Cash in LVR	8	0
Domestic credits	12 411	5 059
Commercial banks	670	0
Savings Bank	0	0
Branches of Latvijas Banka	10 541	5 056
Companies and cooperatives	0	3
Government	1 200	0
Valuation account for non-convertible currencies	4 425	0
Other assets	2 523	11
Total	41 062	7 764
LIABILITIES	1992	1991
Foreign liabilities	7 319	0
Convertible currencies	5 916	0
IMF accounts	79	0
Obligations to the IMF	5 837	0
Non-convertible currencies	1 403	0
Correspondent accounts	1 403	0
LVR in circulation	15 493	0
Domestic deposits	7 953	7 511
Commercial banks	1 144	904
Branches of Latvijas Banka	5 948	6 583
Savings Bank	223	21
Companies and cooperatives	0	3
Government	96	0
Humanitarian aid, social insurance	542	0
Capital	366	93
Reserve capital	58	30
Valuation account for convertible currencies	7 428	0
Other liabilities	2 445	130
Total	41 062	7 764

Notes to the Accounts

1. In March 1992, the Supreme Council of the Republic of Latvia acknowledged that Latvijas Banka is a legal successor to the rights of Latvijas Banka, which was founded in 1922 and which had existed de facto until the 1940 occupation. Thus, Latvijas Banka was granted the right to take over possession of Latvijas Banka deposits and other property located abroad, which had existed until 1940, as well as the gold and other valuables located abroad which until 1940 belonged to the Ministry of Finance.

The balance sheet shows gold holdings which were actually transferred to the accounts of Latvijas Banka. The book value of the gold holding is calculated at 300 US dollars per ounce. This corresponds to 1 610 725 LVR per kilogram.

The gold holdings consisted of 2 099 kilograms in bars.

The official fixing on December 30, 1992 in London was 333.05 US dollars per ounce.

2. Foreign currency.

Assets and liabilities in convertible foreign currencies are converted in LVR as on December 31, 1992 in accordance with exchange rates Latvijas Banka publishes weekly for the book-keeping and tax calculation purposes. The same principle is applied for converting assets and liabilities in non-convertible currencies.

The asset item of the balance sheet "Valuation account of non-convertible currencies" and the liability item "Valuation account of convertible currencies" reflect valuation adjustments of the balance sheet items according to changes in the exchange rates.

3. Foreign securities are accounted at their face amount.

4. Shares in the Bank for International Settlements (BIS).

Latvijas Banka holds 1 000 shares in the BIS at a value of 312.5 gold francs. 500 shares were allotted in December 1930 and, in addition, 500 shares in December 1969. The shares are entered in the balance sheet at a value of 292 million LVR (paid-in).

5. Percentage distribution of Latvijas Banka's foreign exchange reserves by currency at the end-1992 is shown below:

Currency	1992 (%)
US dollar	78
Deutsche mark	22
Total	100

6. Claims and liabilities with the CIS and Lithuania are shown as non-convertible items of balance sheet. The item "Credits to other republics" shows credits which were granted to several CIS countries to perform

settlements with Latvia. The item "Cash-blocked SUR" shows the FSU rubles which were withdrawn from circulation when the Latvian ruble was introduced as the only legal tender and which were blocked according to agreement with the IMF.

7. Latvian rubles in circulation as of the end of December 1992.

Nominal	Amount ¹ (thousands LVR)	Number (thousands notes)	Percentage distribution (%)
1 LVR	18 853	18 853	0.12
2 LVR	15 383	7 691	0.10
5 LVR	115 139	23 027	0.74
10 LVR	151 510	15 151	0.98
20 LVR	427 416	21 370	2.76
50 LVR	1 059 495	21 189	6.84
200 LVR	3 898 300	19 491	25.16
500 LVR	987 300	19 614	63.30
Total	15 493 396		100.00

8. The property of Latvijas Banka is entered under the item "Other assets" at a historical cost of 2 137 million LVR.

¹ In whole thousands LVR.

Report of the Audit Commission

on the Inspection and Audit of Documents and Economic Activity of Latvijas Banka in 1992

We, 7 members of the Audit Commission confirmed by the Republic of Latvia State Control, have accomplished the inspection and audit of economic activities and documents of Latvijas Banka for the year 1992.

The annual report and accounts which comprise the balance sheet, the profit and loss account and notes to the accounts were presented by the Board of Latvijas Banka.

We have examined the correctness of the annual report, accounts, profit and loss account and other documents.

Our inspection was performed according to the law of the Republic of Latvia "On the Bank of Latvia" as well as to generally adopted auditing standards which are in force in Latvia.

We have implemented the required procedure in order to confirm the documentary accuracy of the annual report of the Bank and the accounts. We have examined selected parts of evidence supporting the accounts, content and presentation of the annual report and the accounts, as well as have assessed accounting principles applied. In the framework of generally accepted auditing standards we have inspected the lawfulness of the economic activities of Latvijas Banka.

We consider that the annual report and accounts of Latvijas Banka, which show profit for the year of 487 164 thousand LVR, have been prepared in conformity with generally accepted principles for drawing up annual reports.

On the basis of the above mentioned inspected documents, we acknowledge the correctness of the annual report, balance sheet and profit and loss account for 1992 and consider them to be ready to present to the Council of Latvijas Banka for confirmation.

Audit Commission

March 17, 1993

STRUCTURE OF LATVIJAS BANKA JANUARY 1, 1993

