



ANNUAL REPORT 1996



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INTRODUCTION

In 1996, as in previous years, tailoring and implementing monetary policy with the aim of achieving price stability, supervising credit institutions, ensuring the operation of payment and settlement systems, and supplying good quality coins and banknotes were the Bank of Latvia's main activities consistent with the Law "On the Bank of Latvia".

The objective of the Bank of Latvia's monetary policy – exchange rate stability – was pursued throughout the year, and the stability of the lats against the SDR was maintained. Fluctuations in the exchange rates of foreign currencies against the lats were prompted by developments in the global foreign exchange market. Foreign reserves grew, amounting to 427.4 million lats at the end of 1996, and the backing of the national currency by net foreign assets reached 105.2%.

A rapid decrease in the annual rate of inflation and a rise in the gross wage and salary of employees in the public sector led to a year-end increase in purchasing power. (In 1996, the rate of inflation was 13.1%, but in 1995, it was 23.1%.) GDP grew by 2.8% in 1996. (In 1995, GDP decreased by 1.6%.) With the privatization process becoming more active, unemployment rose slightly to reach 7.2% at the end of the year. The Central Government basic budget deficit decreased almost four times compared with 1995, and totalled 23.0 million lats in 1996.

Deposits of domestic enterprises and private persons held with credit institutions grew by 15.9% in 1996, whereas credits increased by only 3.5%. Banks were inactive in lending due to several reasons: the market for real estate had not yet developed sufficiently; there was a lack of reliable borrowers; demand deposits dominated in the structure of deposits, accounting for 82.5% of total deposits.

Due to relatively low inflation and a fall in interbank market rates, the Bank of Latvia was able to reduce the refinancing rate.

1996 witnessed stabilization and growth in the Latvian banking sector. Hence, at the end of the year the main indicators characterizing activities in this sector reached the level attained before the 1995 banking crisis. The Law "On Credit Institutions" stipulated a gradual increasing of the minimum initial capital to 5 million ECU by December 31, 1999 for those banks which had begun their activities before the Law took effect. This led to the emergence of planned bank mergers, which are likely to be implemented in the coming years. The fact that the European Bank for Reconstruction and Development, the Swedish investment fund *Swedfund International AB* and other foreign investors acquired stakes in several Latvian banks also indicated the strengthening of the banking sector. After a lapse of over three years, two new banks, the joint stock companies *Maras Banka* and *Vereinsbank Riga*, were granted licences.

The number of banks which were entitled to accept private person deposits increased from 13 to 15 during 1996. Intensified supervision was applied to these banks.

In the reporting year, regulations governing the supervision of credit institutions as well as Latvian legislation relating to the financial sector were developed further to meet EU requirements. A number of the Bank's experts drafted the law on private person deposit guarantee scheme, participated in drafting the law on preventing the use of the financial system for money laundering and in reviewing and amending the Law "On Credit Institutions".

The Bank of Latvia, which was re-established after the Republic of Latvia had regained

its independence, commemorated the fifth anniversary in September 1996. The Bank reviewed its achievements during the period of five years' activity as a full-fledged central bank and sought to evaluate its role in Latvia's development.

The end of 1996 was marked with the adoption of a balanced budget for 1997, which reinforced the recovery of Latvian economy and improvements in the overall living standard in Latvia. In January 1997, Latvia's reform-oriented economic policy was recognized internationally – *Standard & Poor's* rated Latvia as an investment-grade country. The monetary and fiscal policies implemented in Latvia were approved and the Latvian model of its national economy was recognized as effective and sound.

Monetary indicators characterizing the Latvian banking system were communicated to the domestic and international public through the Bank of Latvia's regular publications. In 1996, information on the Bank of Latvia and the banking sector was available also on the Internet. The Bank of Latvia, in collaboration with the Central Statistical Bureau of Latvia and the Ministry of Finance, began and co-ordinated regular preparation of financial indicators for inclusion in *Economic Indicators for Eastern Europe*, the monthly publication of the Bank for International Settlements.

The monetary policy results presented in the Annual Report are derived from the analysis of monetary and banking statistics performed by the Bank of Latvia. The economic situation in the country has been analysed utilizing data provided by the Central Statistical Bureau of Latvia.

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

INFLATION AND PRICES

1996 was characterized by stabilization in the macroeconomic situation, which was reflected in several macroeconomic indicators. The monetary policy implemented by the Bank of Latvia ensured the stability of the lats and also facilitated a decrease in the rate of inflation and the level of interest rates, thus contributing to a further growth in GDP.

In 1996, the consumer price index (CPI) showed a substantially smaller increase than in the preceding year (13.1% in 1996; 23.1% in 1995). Inflation decreased gradually in the reporting year, and no significant month-on-month fluctuations of prices were observed, except for January when the monthly growth in the CPI exceeded 3%. (The highest CPI, 106.9%, was recorded in the first quarter.) In other months (see Chart 1) inflation ranged between -0.5% (in August) and 1.8% (in February), and was 2.6% in the second quarter, 0.5% in the third quarter, 2.6% in the fourth quarter. On average, the CPI rose by 17.6% in 1996 compared with 1995 (by 25.0% in 1995 compared with 1994).

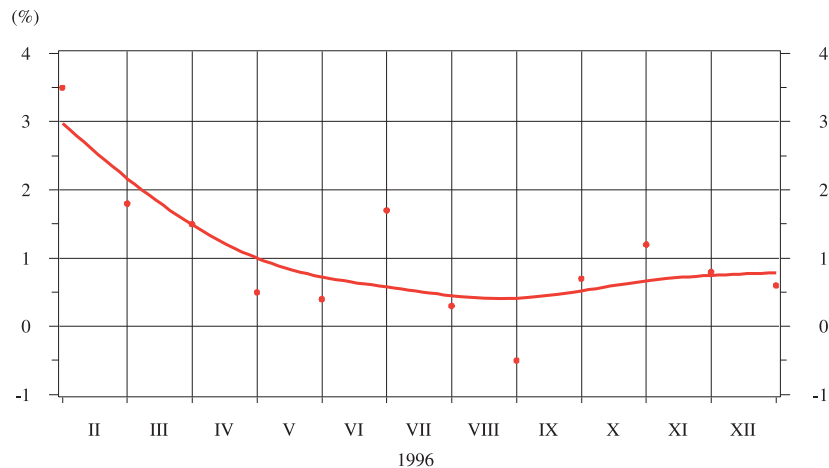
Consumer prices were mainly influenced by an increase in administered (i.e., monopoly) prices (the prices of communication increased by 44.5%, public transport fares rose by 31.5%, housing maintenance costs went up by 18.7%), as well as by administrative actions (influenced by changes in the excise tax, petrol prices rose by 46.9% during the year).

Increases in the consumer prices of goods and services differed. The prices of the largest commodity group – food products – increased by 7.7% over the year (the prices of alcohol and tobacco rose by 8.5%). Rises in the prices of services and non-food goods were considerably higher – 18.6% and 17.4%, respectively.

Until October 1996, the purchasing power of employees in central and local govern-

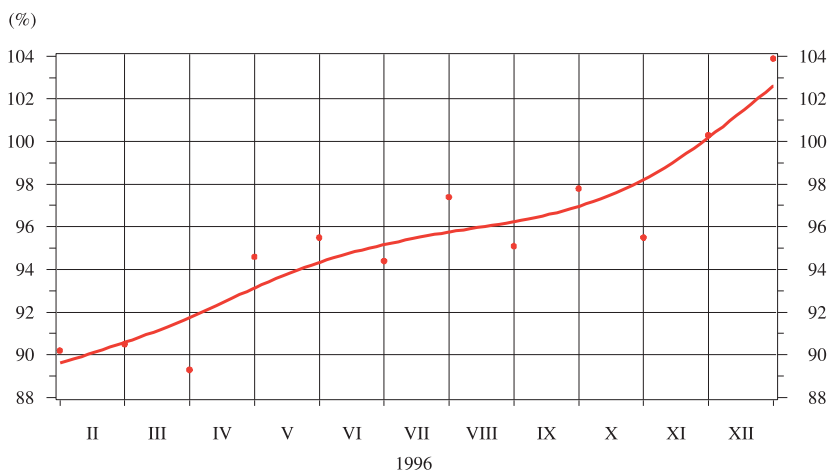
Chart 1

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



Source: Central Statistical Bureau of Latvia.

DYNAMICS OF REAL WAGES IN CENTRAL AND LOCAL GOVERNMENT INSTITUTIONS AND ENTERPRISES (YEAR-ON-YEAR BASIS)



Source: Central Statistical Bureau of Latvia.

ment institutions and enterprises, and companies with central or local government capital participation was lower than in the previous year. Nevertheless, real wage and salary rose (a 3.9% increase in December 1996 compared with December 1995; see Chart 2) due to the rapid decrease in the annual rate of inflation and an increase in gross salary and wage. In the reporting year, the average gross monthly wage and salary of public sector employees totalled LVL 109.96 (USD 199.56), but in December it amounted to LVL 134.33 (USD 241.60), showing an increase compared with the corresponding period of the previous year (11.7% and 17.5%, respectively).

Over the reporting year, the producer price index (PPI) increased by 7.7% (by 15.9% in 1995). The most significant increases were recorded in the producer prices of publishing, ing and reproduction of recorded media (12.2%) and the manufacture of radio, television and communication equipment and apparatus (11.2%). The PPI fell only in the manufacture of paper and paper products (by 1.8%).

The construction and installation price index rose by 8.0% in 1996 (by 40.6% in 1995).

Export prices rose by 6.2% in 1996, showing the lowest increase for three consecutive years. (The export unit value index was 115.2% in 1994 and 116.1% in 1995.) The most substantial increases were recorded for the export prices of transport vehicles (21.9%), machinery and mechanical appliances, and electrical equipment (16.3%), whereas the only product group whose export prices decreased was wood and articles of wood (by 2.4%).

GROSS DOMESTIC PRODUCT

Both the services sector and goods-producing sector (except agriculture, hunting and forestry) showed an upturn in 1996. Total gross value added (at constant prices) increased by 2.8%, amounting to 2 090.3 million lats (see Table 1).

After the restoration of the independence of the Republic of Latvia, 1996 was the first

year when real industrial output showed a year-on-year increase. The volume index of industrial output rose by 1.1%, including a 2.0% growth in manufacturing. Eight branches of manufacturing increased their industrial output due to growing demand in the domestic and foreign markets. The largest increases were observed for the manufacture of the following product groups: other non-metallic mineral products (25.8%), paper and paper products (21.7%), wood and products of wood except furniture (18.2%), fabricated metal products, textiles, food and beverages. In the reporting year, compared with 1995, rapid increases were recorded in exports of several food products (dairy products, chocolate and other food preparations containing cocoa, fish and marine products), as well as veneer sheets and plywood, sawn wood, particle board, knitted or crocheted fabrics, and wearing apparel.

In 1996, the increase in industrial output accounted for a 26.9% increase in the stock of goods produced in the sector of manufacturing. The largest shares in the stock of industrial goods were those of food and beverages, textiles and footwear, but the smallest were those of wood and articles of wood, except furniture, as well as chemicals and chemical products.

There was no upturn in the output of the agricultural sector. With meat imports increasing rapidly (import of beef increased more than three times, and imports of pork more than two times), meat production declined by 38.9%. Milk production also decreased slightly (by 2.5%), whereas egg production grew by 11.8%.

Cargo turnover at ports grew by 15.4%, and total cargo traffic increased by 13.5%. An 8.7% decrease in cargo traffic by sea, however, triggered a slight decrease (0.4%) in total cargo traffic.

In 1996, passenger traffic by main kinds of transport – bus and railway – was equal to 80.3% of the previous years' figure, but passenger turnover to 87.8%. The decrease in passenger turnover by public transport was partly due to two reasons: firstly, the number of private automobiles registered at Road Traffic Safety Directorate in 1996 exceeded by 8.4% the previous year's figure; secondly, public transport fares increased.

In the reporting year, the turnover of domestic trade was lower than in 1995. In 1996, retail trade turnover at constant prices decreased by 11.0%, but that of public catering grew by 4.6%. At the beginning of the year, retail trade turnover fell rapidly; however, with purchasing power increasing, it slowly rebounded to reach the previous year's level and in

Table 1

GROSS DOMESTIC PRODUCT (AT CONSTANT PRICES OF 1995) AND ITS STRUCTURE
(in millions of lats)

	1995		1996	
		%		%
Total	2 033.8	100.0	2 090.3	100.0
Services	1 139.7	56.0	1 193.7	57.1
Manufacturing	456.4	22.4	469.9	22.5
Agriculture, hunting and forestry	210.8	10.4	189.4	9.1
Electricity, gas and water supply	112.0	5.5	114.5	5.5
Construction	102.9	5.1	108.3	5.2
Mining and quarrying	3.1	0.2	4.9	0.2
Fishing	8.9	0.4	9.6	0.4

Source: Central Statistical Bureau of Latvia.

December already exceeded the 1995 figure (100.3% of the figure recorded in December 1995).

At the end of 1996, the number of registered unemployed persons in Latvia was 90 819 or 7.2% of the economically active population (at the end of 1994, unemployment rate was 6.5%). The number of unemployed persons increased by 9.0% during the year (increases were recorded only in January–March, November and December, but in April–October the level of unemployment did not change substantially). The number of persons registered as permanently out of work was 37 452 at the beginning of the year and 49 455 at the end of the year.

FOREIGN TRADE

The turnover of Latvian foreign trade amounted to 2 073.3 million lats in 1996. Compared with the previous year, it increased by 25.8%, including a 15.5% increase in exports and a 33.2% increase in imports. The largest increases were registered in the trade turnover of vegetable products (78.7%), fat and oil (60.6%), as well as pulp of wood, paper and paperboard (47.3%). A decrease in trade turnover was observed only for transport vehicles (10.5%).

The negative foreign trade balance increased (see Table 2), reaching 23.3% of trade turnover (16.5% in 1995) or 17.4% of GDP (11.5% in 1995). The main contributors to the negative foreign trade balance were the following product groups: mineral products; machinery and mechanical appliances, electric equipment; products of the chemical and allied industries. The balances of two groups – base metals and articles of base metals and vegetable products – deteriorated significantly.

In 1996, Latvia had trade transactions with 135 countries, and its major trading partners were the EU and CIS countries. The share of EU countries in total foreign trade turnover did not change (47.5%), but that of CIS countries decreased from 32.4% in 1995 to 29.5% in 1996. The largest trade turnover was with Russia, Germany, Sweden, Lithuania, Finland and the United Kingdom. The volume of trade transactions with Lithuania and Estonia increased in all principal product groups.

In the reporting year, the most significant components in Latvia's exports were wood and articles of wood (24.4% of total exports), textiles and textile articles (16.9%), prepared foodstuffs (including alcoholic and non-alcoholic beverages, and tobacco; 11.8%). During the year, the share of the following products in total exports increased: textiles and textile articles (mainly articles of apparel), pulp of wood, paper and paperboard, as well as machin-

Table 2

FOREIGN TRADE TURNOVER

(exports – in FOB prices; imports from 1995 – in CIF prices; in millions of lats)

	1994	1995	1996
Exports	553.4	688.4	795.2
Imports	694.6	959.6 ¹	1 278.2
Balance	-141.2	-271.2	-483.0

¹ Imports were shown in FOB prices in the 1995 Annual Report.
Source: Central Statistical Bureau of Latvia.

ery and mechanical appliances, and electrical equipment. The shares of transport vehicles (due to output declines) and wood and articles of wood decreased. Within the group of wood and articles of wood, the following changes were registered: exports of wood in the rough declined by 61.4%, but exports of processed products increased (sawn wood by 46.4%, veneer sheets and plywood by 49.7%). Although the export prices of wood fell by 2.4%, real exports of wood increased by 17.8%.

The principal imports were mineral products (22.2% of total imports), machinery and mechanical appliances, electrical equipment (16.7%), products of the chemical industry and allied industries (11.0%), as well as textiles and articles of textiles (8.0%). The share of prepared foodstuffs (especially fresh meat, coffee, sugar and cigarettes) in total imports increased, while the share of transport vehicles (tractors and passenger cars) decreased.

The US dollar and German mark were the currencies used most frequently in foreign trade transactions. Transactions in German marks accounted for 20.4% of foreign trade transactions. The share of transactions in US dollars increased from 48.5% in 1995 to 53.4% in 1996, but the shares of other principal currencies declined slightly.

The balance of payments for the first nine months showed that the current account deficit was covered with capital inflows. The continuous growth in reserve assets allows us to project that the balance of payments for 1996 will be in surplus despite the current account deficit.

FISCAL POLICY

As the Government tightened its fiscal policy, the results achieved in 1996 were considerably better than in the previous year. The Central Government budget deficit was equal to 1.2% of GDP and totalled 32.2 million lats (in 1995, 69.9 million lats or 3.0% of GDP). The Central Government budget deficit was comprised of the basic budget deficit (23.0 million lats) and the special budget deficit (9.2 million lats). In 1995, only the basic budget was in deficit (89.9 million lats), whereas in 1996, the social security budget, which is the principal constituent part of the special budget, was also in deficit, and the basic budget deficit decreased considerably. The basic budget deficit was fully financed with proceeds from sales of Treasury bills, but the special budget deficit was covered with the previous year's surplus of this budget.

Compared with the previous year, the Central Government basic budget revenue increased by 29.1% and expenditure by 8.2%. A 23.9% increase in revenue from indirect taxes (excise tax, value added tax and customs duties) accounted for the increase in the basic budget revenue, which was comprised mainly of tax revenue (88.7%). The increase in tax revenue was due to an upturn in the economic activity, an increase in the excise tax, improved tax administration, and the fact that settlements in cash were limited and the number of wholesale companies trading in goods subject to the excise tax was reduced. The shares of excise tax revenue and non-tax revenue increased (from 9.9% and 9.4% in 1995 to 13.2% and 11.5% in 1996, respectively). Although value added tax revenue grew by 21.7%, its share in total revenue of the basic budget contracted slightly and was 58.2%. The shares of enterprise income tax and customs duties also continued to decrease.

The amount of tax arrears to the basic budget decreased by 16.6%, and totalled 89.6 million lats at the end of the year. The decrease occurred because the consequences of the financial crisis had been overcome, tax administration had improved, government institu-

tions had capitalized and written-off the arrears of several enterprises as well as stopped an increase resulting from the failure to pay the arrears. The Central Government basic budget expenditure decreased because in real terms wages and salaries were reduced, but expenditure on goods and services was unchanged. A real increase was recorded only for interest payments on government domestic debt. Of total basic budget expenditure, 94.4% were made up of current expenditure. The share of investments in total basic budget expenditure constituted only 3.0% in 1996.

Government domestic debt increased by 20.9 million lats over the year. The debt was financed with proceeds from sales of Treasury bills.

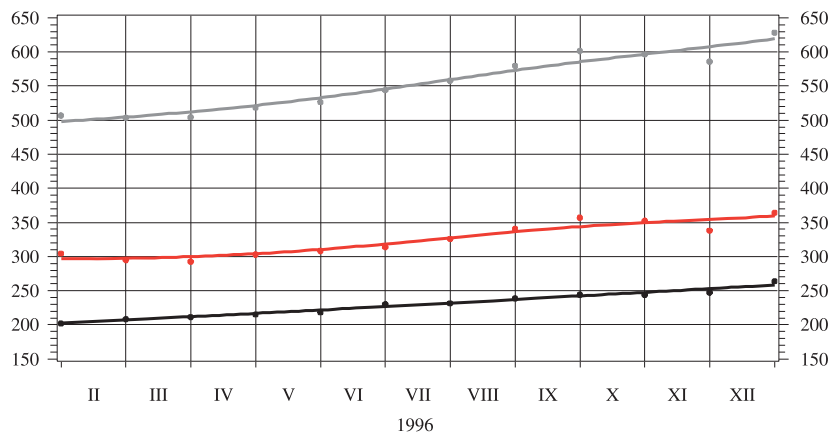
MONEY SUPPLY

The monetary indicators of the Latvian banking system and the Bank of Latvia have been included in Appendix 1 to the Annual Report. Broad money, M2X¹, increased from 524.0 million lats at the end of 1995 to 628.3 million lats at the end of 1996 (by 19.9%; see Chart 3). Broad money was on a steady upward trend throughout the reporting year, and showed a monthly average increase of 1.7%. The growth in broad money was more rapid in the second half of the year due to macroeconomic stabilization processes as well as the growth in GDP. (In the first half of the year, M2X grew by 3.9%, and in the second half of the year, it already showed a 15.4% growth.) Due to the restored confidence in the banking sector, economic upturn and increase in the purchasing power, banks raised more deposits of domestic enterprises and private persons (a 15.9% growth in the second half of the year). Currency outside banks increased more rapidly (by 26.0%). The structure of broad money did not change substantially: the share of currency outside banks reached 42.0% at

Chart 3

BROAD MONEY

(in millions of lats)



M2X (broad money)

Deposits of domestic enterprises and private persons

Currency outside banks

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

the end of 1996, the shares of demand and time deposits decreased slightly during the period, and at the end of 1996 they were 47.8% and 10.2%, respectively. In the reporting year, both demand and time deposits of domestic enterprises and private persons grew, amounting to 300.5 million lats and 63.8 million lats at the end of the year, respectively (see Chart 4). Deposits of private persons still dominated in the structure of time deposits (81.7%), whereas deposits of enterprises still comprised the largest part of demand deposits (74.2%).

Although growth was observed in both deposits made in lats (13.7%) and deposits made in foreign currency (17.8%) during the reporting period, the share of deposits in lats contracted slightly, and at the end of the period, constituted 46.3% of total deposits.

Latvia's macroeconomic stability facilitated foreign capital inflows, and as a result, net foreign assets of the banking system increased by 145.9 million lats or 47.6% in 1996 (including a 131.2 million lats or 57.7% increase in the Bank of Latvia's net foreign assets).

In the reporting year, the banking sector had more possibilities to invest its assets; however, banks did not change their investment policies substantially. They invested mainly in foreign assets (a 245.8 million increase or by 1.8 times), as well as in securities of the Latvian Government and credits to local governments (net credit of the banking sector to the Government increased by 56.2 million lats or 1.8 times).

In 1996, credits to domestic enterprises and private persons grew by only 7.2 million lats or 3.5%. The slow increase in credits was not only due to a lack of safe borrowers, but also due to the large share of demand deposits in funds raised by banks; hence, issuing of long-term credits was made difficult.

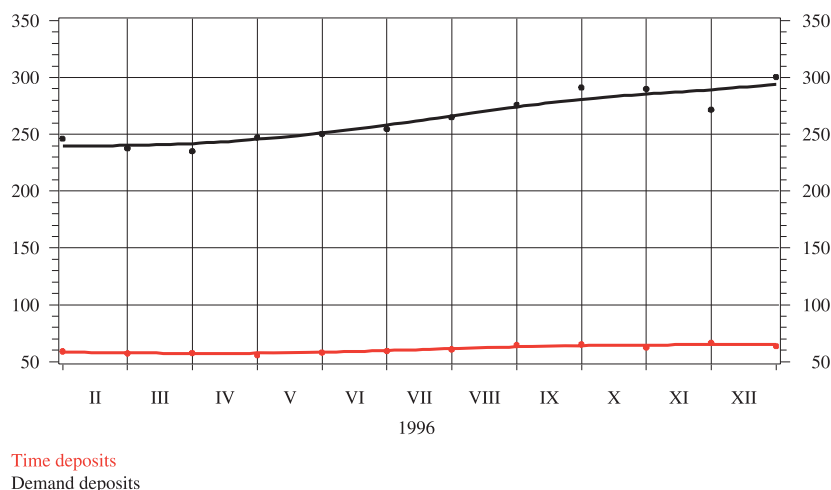
The term structure of credits as at the end of 1996 did not differ much from that a year earlier. Over a half of credits, 55.5%, still were short-term (for changes in short-term and long-term credits granted to domestic enterprises and private persons see Chart 5).

In the reporting period, the share of credits in lats decreased from 44.9% to 39.3%, indicating that banks utilized their resources in lats mainly in the government securities market and the domestic interbank market. Credits to enterprises and private persons were

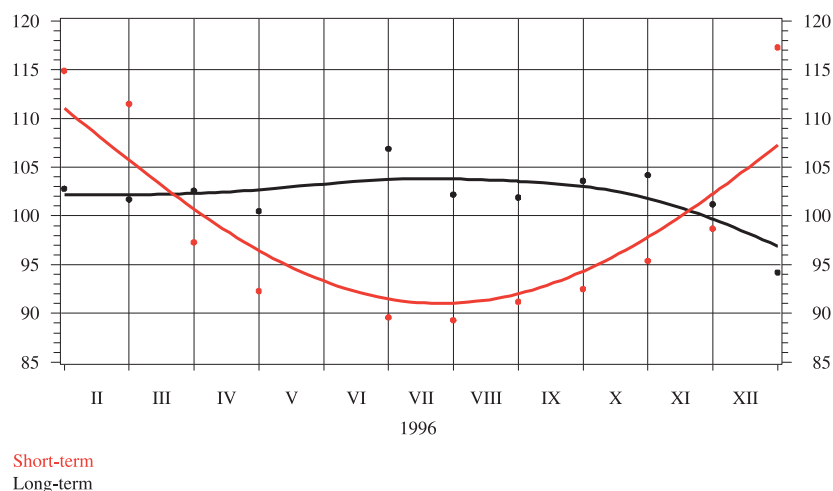
Chart 4

DEPOSITS OF DOMESTIC ENTERPRISES AND PRIVATE PERSONS WITH BANKS

(balances at end of period; in millions of lats)



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



granted mainly in foreign currency. With the share of public sector in the national economy declining, credits extended to public enterprises decreased by 29.6%, whereas credits to the private sector increased by 8.1%.

The main increases were recorded for credits to trade (23.4%) and manufacturing (23.3%). Credits to the above sectors accounted for the largest part of credits to the national economy (38.6% and 28.3%, respectively). Concurrently, credits to two of the most important sectors of the national economy – agriculture and construction – decreased (by 4.0% and 11.9%, respectively), and at the end of the year comprised 6.4% and 6.0% of total credits, respectively.

DEPOSIT AND LENDING RATES

As inflation, interest rates on government securities and interbank market rates followed a downward trend, the fall of deposit and lending rates continued in the reporting year. Although the decrease was not steady and, influenced by some deals, interest rates fluctuated considerably, rates on deposits of all maturities as well as on credits both in lats and foreign currency declined. The most rapid decrease was that of short-term lending rates (10–11 percentage points). Interest rates on short-term deposits fell by 4–5 percentage points, whereas interest rates on long-term credits and deposits fell by 1–4 percentage points.

The average weighted interest rate on long-term deposits in lats decreased from 15.7% at the end of 1995 to 13.6% at the end of 1996 (see Chart 6), and on long-term deposits in foreign currency from 12.0% to 7.7%. A decrease was also registered in interest rates on short-term deposits in lats (from 15.0% in December 1995 to 10.0% in December 1996) and in foreign currency (from 9.8% to 5.7%).

Interest rates on deposits in foreign currency were on average 4–5 percentage points

lower than those on deposits in lats throughout the year.

Interest rates on short-term credits, both in lats and foreign currency, fell over the year. During the year, the average weighted interest rate on short-term credits in lats decreased from 31.1% to 20.3% (see Chart 7), and on credits in foreign currency from 28.2% to 18.0%.

The average weighted interest rates on long-term credits fluctuated in a wider range throughout the year; however, the average weighted interest rate on credits in lats decreased from 23.6% to 21.8%, and on credits in foreign currency from 17.5% to 16.1%.

Chart 6

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

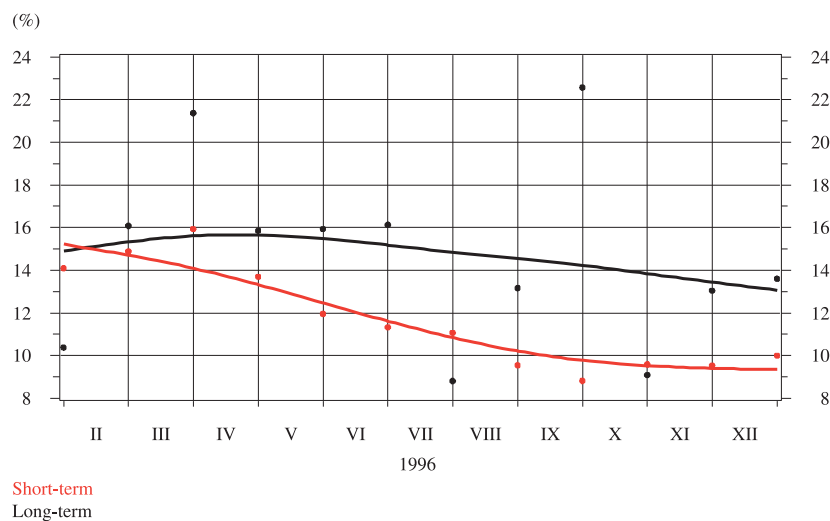
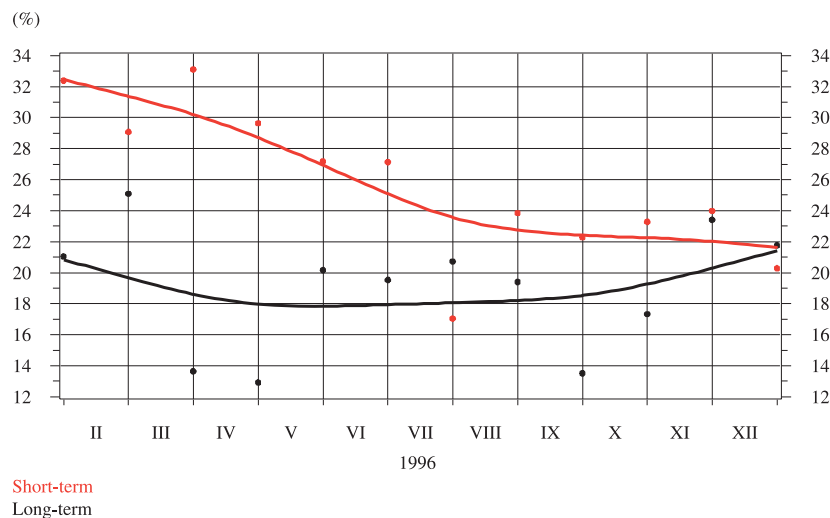


Chart 7

AVERAGE WEIGHTED INTEREST RATES ON CREDITS GRANTED IN LATS



THE INTERBANK MARKET

The activity of banks in the domestic interbank market increased substantially in the reporting year due to several factors: confidence among banks was restored, the amount of bank excess reserves ranged between 2.3 million lats and 8.7 million lats, banks were reluctant to lend to businesses. The number of banks participating in the interbank market increased to nineteen in December 1996, from only seven in December 1995. In 1995, the monthly average turnover of credits to domestic banks was about 15 million lats (approximately 5% of similar investments in foreign banks), but after the second quarter of 1996, the monthly average turnover of such credits increased to 35–50 million lats, exceeding a 100 million lats monthly level (10%–20% of credits to foreign banks) at the end of the year. Most of the credits were either overnight or with a maturity up to one month. The average weighted interest rate on interbank credits in lats declined from 21.1% to 9.7% during 1996.

Overnight credits and credits with a maturity up to one month were also the most common credits in foreign convertible currency granted to foreign banks. Interest rates on these credits fluctuated between 5% and 6% during the year. Banks' activity in this type of transactions peaked in the third quarter, when the monthly average of these credits exceeded 800 million lats. At the end of the year, the volume of transactions in the interbank market increased, whereas credits issued to foreign banks declined.

MONETARY BASE

At the end of 1996, the monetary base, M0¹, totalled 340.7 million lats (see Chart 8). It increased by 24.5% during the year, mainly due to an increase in purchases of foreign currency. As an increase in currency issue (25.1% during the year) exceeded an increase in bank deposits held with the Bank of Latvia (21.8% during the year), the share of currency in circulation relative to the monetary base grew to 82.9% at the end of 1996 (82.6% at the end of 1995).

The Bank of Latvia's net foreign assets grew 1.6 times. They exceeded the highest level recorded before the 1995 banking crisis already in April, and were 358.5 million lats at the end of 1996 (see Chart 9). Net foreign assets covered 3.4 months' imports (3.0 at the end of 1995), and the backing of the national currency by net foreign assets reached 105.2% (83.1% at the end of 1995). The net amounts of foreign currency purchased as well as the increase in net foreign assets were relatively stable throughout the year.

During the reporting year, net domestic assets of the Bank of Latvia declined by 64.1 million lats because net credit of the central bank to the Government decreased substantially (from 56.9 million lats at the beginning of the year to 13.3 million lats at the end of the year) due to improvements in the fiscal situation. The Government repaid the extra credit which it had received from the Bank of Latvia during the 1995 banking crisis, as well as increased its deposits with the central bank.

The highest banks' demand for the Bank of Latvia's credits was recorded in the first quarter when discount rates on Treasury bills were relatively high. (Credits granted through repo auctions totalled 34.4 million lats in the first quarter.) Notwithstanding the supply,

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

banks' demand for the Bank of Latvia's credits was rather low in the second and third quarters, and banks were more active in borrowing in the interbank market. In the fourth quarter, mainly in October, credits granted through repo auctions increased; however, they did not reach the figure recorded at the beginning of the year. The Bank of Latvia's credit to banks amounted to 108.8 million lats in 1996, 2.4 times exceeding the 1995 figure. Of this amount, 77.4% were credits issued through repo auctions, 12.2% were demand collateralized (lombard) credits, 10.2% were automatic collateralized credits and 0.2% credits issued to prevent extraordinary situation (for the monthly average balances of these credits see Table 3).

Chart 8

MONETARY BASE

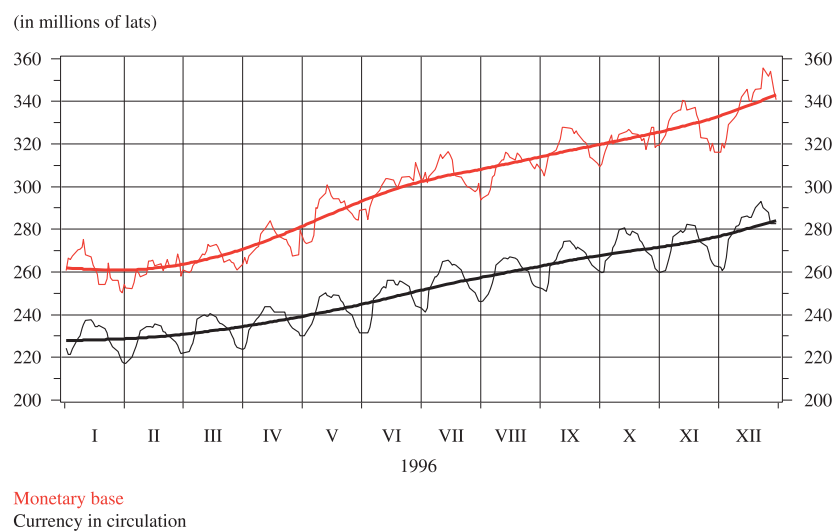
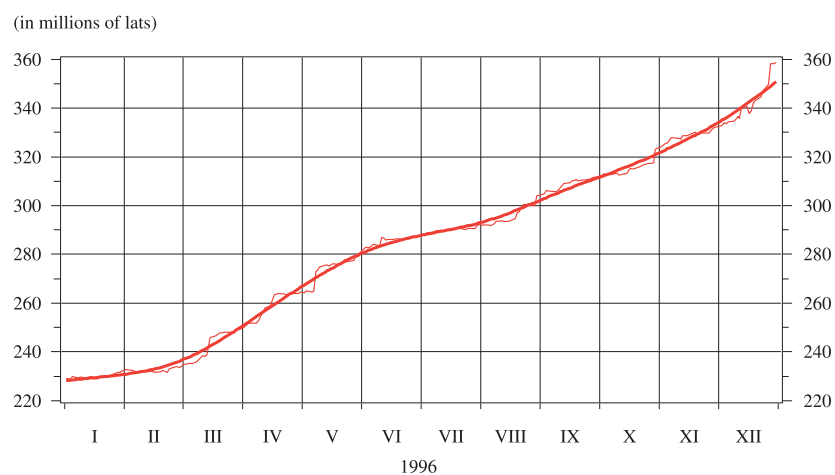


Chart 9

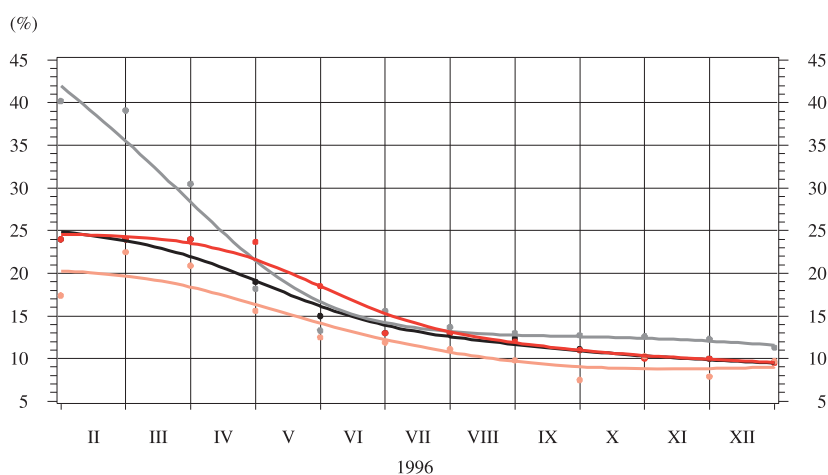
NET FOREIGN ASSETS OF THE BANK OF LATVIA



Due to relatively low inflation as well as a rapid decline in both discount rates on government securities and interbank market interest rates, the Bank of Latvia was able to reduce the refinancing rate from 24% at the beginning of 1996 to 9.5% at the end of 1996 (see Monetary Policy Calendar and Chart 10) thus enhancing a more rapid growth of the national economy. In 1996, the rates on credits issued through repo auctions and collateralized credits fell in line with the decrease in the refinancing rate: from 25.6% and 27.1% in the first quarter to 10.0% and 12.0% in the fourth quarter, respectively.

Chart 10

INTEREST RATES IN THE MONEY MARKET



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

Table 3

THE BANK OF LATVIA'S CREDITS TO BANKS

(average balances; in millions of lats)

	1994	1995	1996
January	6.1	1.3	3.4
February	5.9	1.8	5.7
March	2.3	2.2	6.3
April	2.3	2.3	5.0
May	3.0	2.7	0.5
June	2.5	3.9	0.6
July	1.8	4.2	2.4
August	1.7	4.2	2.1
September	1.6	3.8	2.0
October	1.9	6.2	2.6
November	1.6	8.1	4.6
December	1.9	7.4	3.2

In the reporting year, the Bank of Latvia accepted 10 deposits in lats for the total amount of 2.0 million lats with a maturity of one month at the average interest rate of 10.0% from four banks.

THE FOREIGN EXCHANGE MARKET

Foreign currency reserves increased from 587.2 million US dollars at the end of 1995 to 768.7 million US dollars at the end of 1996. In 1996, the net amount of foreign currency purchased by the Bank of Latvia from banks totalled 148.5 million US dollars. (In 1995, the net amount of foreign currency sold by the Bank of Latvia totalled 67.5 million US dollars.) The Bank purchased large amounts of foreign currency in March and April, but the largest monthly total, in the amount of 53.4 million US dollars, was recorded in December. This was due to the stabilization of the macroeconomic situation and greater confidence in the national currency.

The increase in foreign reserves was in part also due to income gained from managing foreign reserves in accordance with the guidelines approved by the Bank of Latvia's Board of Governors. Foreign reserves are invested in safe and liquid financial instruments, mainly in government securities issued by the United States of America, Germany, Japan, the United Kingdom and France. Changes in the exchange rate of the US dollar against the lats, which resulted from differences in the year-end exchange rates for 1995 and 1996, also contributed to the growth in foreign reserves. A part of the IMF credit (17.5 million SDR) received under the Stand-By Arrangement was repaid in 1996.

The Bank continually invests in improved technology. The Bank of Latvia leased a *Telerate* terminal in 1996 and used it alongside *Reuters* and *Bloomberg* systems. These systems allow the Bank to receive information in a timely manner and to analyse financial markets more efficiently, thus leading to better results in foreign currency reserves management. A new information system for the Foreign Exchange Department, which foresees the handling of all transactions and payments electronically, has been partly installed. The information system is designed to evaluate the foreign reserves portfolio, calculate accrued interest and prepare reports.

The Bank of Latvia's "Provisions on Purchasing and Selling of Non-Cash Foreign Currency" (in effect from March 1, 1996) improved procedures of the Bank of Latvia's transactions with Latvian banks, isolating the Bank from credit risk. The regulations stipulate the following transaction procedures: 1) both parties transact on the same day, but until the time of settlement the commercial bank pledges Treasury bills owned by the bank; or 2) transaction value dates are set so that the bank with whom the Bank of Latvia has entered into a transaction is the first to settle its obligations.

The foreign exchange rate policy implemented by the Bank of Latvia did not change, and stability of the lats against the basket of SDR currencies was maintained. The exchange rate of the lats against the SDR has not changed since February 1994 (1 SDR = 0.7997 LVL). During the reporting year, the Bank of Latvia continued to purchase from and sell to banks and the Government the five SDR basket currencies (the US dollar, German mark, French franc, British pound, Japanese yen), quoting buying and selling rates of these currencies daily. In 1996, the Bank of Latvia set the exchange rates of twenty foreign convertible currencies, the SDR, ECU and troy ounce of gold against the lats daily for the next working day. From September, the Bank of Latvia began to set daily exchange rates

for six additional foreign convertible currencies – the Czech koruna, Hungarian forint, Russian ruble, Moldova lev, Polish zloty and Slovak koruna. Once a week the Bank of Latvia also set exchange rates of foreign non-convertible currencies. The exchange rate of foreign currencies against the lats fluctuated in line with the fluctuations of the exchange rates of SDR basket currencies in the global foreign exchange market (see Appendix 5).

Information on the Bank of Latvia's exchange rates has become more widely accessible as it is disseminated through the Internet, *Reuters* and *Telerate* systems, and is available by electronic mail.

GOVERNMENT FOREIGN DEBT

Government foreign debt is managed by the Ministry of Finance of the Republic of Latvia, but the Bank of Latvia acts as the Government's fiscal agent in receiving and distributing foreign credits.

Government foreign debt totalled 227.4 million lats at the end of 1996, and the Government issued guarantees in the amount of 12.9 million lats to enterprises for the receipt of foreign credits (at the end of 1995, 216.7 million lats and 13.6 million lats, respectively). By the end of 1996, the Latvian Government had concluded loan agreements and issued guarantees in the total amount of 422.0 million lats.

In 1996, 35.7 million lats were spent to service government foreign debt. This amount is equal to 4.5% of the annual volume of exports.

GOVERNMENT SECURITIES MARKET

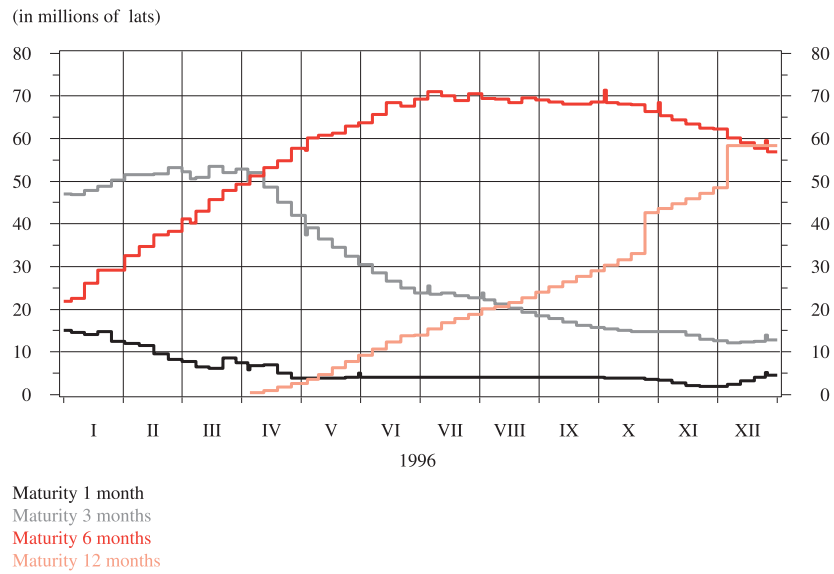
The government securities market, in which the Bank of Latvia acted as the Government's agent in organizing auctions of and accounting for Treasury bills, expanded considerably in 1996. In April, the Government started issuing 12-month bills. With the fiscal situation improving, the supply of Treasury bills declined by 32.3% compared with 1995; however, banks' demand for Treasury bills increased 1.9 times and sales of bills grew by 9.4%. Bills with a shorter maturity (1- and 3-month, in the second half of the year also 6-month bills) gradually lost their importance in the market, whereas the stock of 12-month bills outstanding grew (see Chart 11). The average residual maturity of bills outstanding was 64 days in January 1996 and 151 days in December 1996. The stock of Treasury bills outstanding increased by 44.1 million lats or 1.5 times over the year, and totalled 132.6 million lats at the end of 1996. At the end of the year, the term structure of Treasury bills was the following: 12-month bills comprised 44.1% of Treasury bills outstanding, 6-month bills 43.0%, 3-month bills 9.6% and 1-month bills 3.3%.

The development of the securities market was rather smooth in 1996. In the first months of the year, the demand for Treasury bills was facilitated not only by the safety of such investments, but also by high interest rates (in the first quarter, average weighted discount rates fluctuated within the range of 23.0%–30.8%). In March, a rapid fall started in Treasury bill discount rates (see Chart 12), and in the second quarter, the average weighted discount rates of Treasury bills were within the range of 12.4%–14.5%. This fall continued also in the second half of the year, and the rates were at the average level of 9.8%–12.7% in the fourth quarter. The demand for Treasury bills remained high even after discount rates had

been reduced, because banks preferred safe investments at low rates to higher-risk lending to businesses. The demand was high also due to non-residents' interest in securities of the Latvian Government. In the reporting year, the share of Treasury bills owned by Latvian banks in the stock of Treasury bills outstanding decreased, but that of bills held by non-residents increased (17.3% at the end of the year).

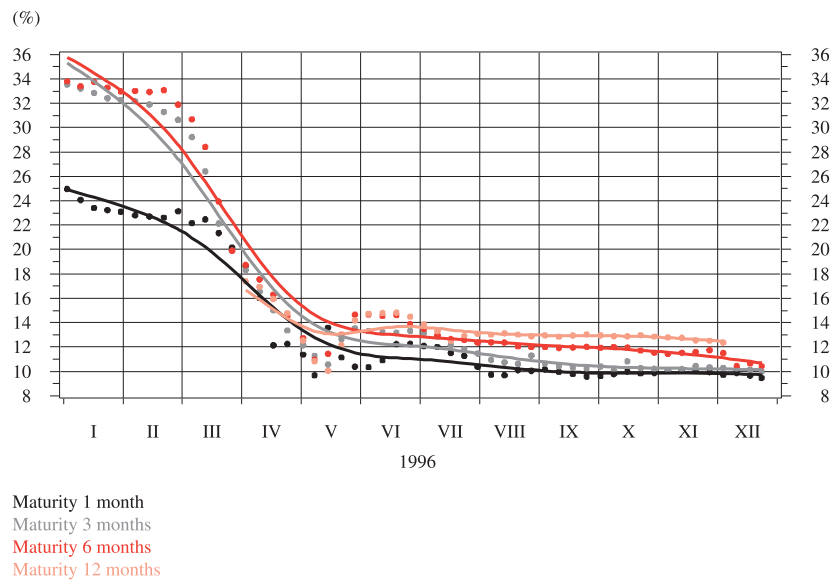
TREASURY BILLS OUTSTANDING

Chart 11



AVERAGE WEIGHTED DISCOUNT RATES OF TREASURY BILLS

Chart 12



In 1996, 52 auctions of Treasury bills with maturities of 1, 3 and 6 months and 36 auctions of Treasury bills with a maturity of 12 months were held. Total supply of Treasury bills amounted to 388.9 million lats. Of this amount, 20.2% were 1-month bills, 28.5% were 3-month bills, 35.6% were 6-month bills and 15.7% were 12-month bills. Unlike in the previous year, when the demand for Treasury bills was lower than the supply, banks' demand exceeded 1.8 times the supply in 1996. During the year, sales of Treasury bills totalled 357.4 million lats, of which bills with a maturity of 1 month were 19.0%, bills with a maturity of 3 months were 29.4%, bills with a maturity of 6 months were 35.3% and bills with a maturity of 12 months were 16.3%.

Quarterly figures for the turnover on the secondary market for Treasury bills registered at the Bank of Latvia showed a decrease, which occurred due to a fall in discount rates. The turnover increased to 370.6 million lats in 1996 (exceeding 2.6 times the 1995 figure); however, in the second half of the year, it reached only one third of the figure registered in the first half of the year.

To pursue the goals of the monetary policy and to provide for the liquidity of government securities, the Bank of Latvia continued its activity in the secondary market for Treasury bills. The volume of the Bank's activities (114.1 million lats) exceeded by 22.4% the figure recorded in 1995.

MONETARY POLICY HIGHLIGHTS – 1996

January 11	The Board of Governors of the Bank of Latvia approved "Provisions on Accounting Income and Expenses of Credit Institutions".
January 15	The Board of Governors of the Bank of Latvia approved "Guidelines on Depositing the Bank of Latvia's Gold Reserves".
January 17	The Board of Governors of the Bank of Latvia approved "Provisions on Evaluation of Credits and Off-Balance-Sheet Liabilities".
February 9	The Governor of the Bank of Latvia approved "Provisions Governing Auctions of Treasury Bills of the Republic of Latvia".
March 14	The Board of Governors of the Bank of Latvia approved "Regulations on Issuing Licences (Permissions) to Credit Institutions".
March 15	The Board of Governors of the Bank of Latvia approved "Regulations on Amending the Charter, Changing the Shareholders, the Initial Capital, the Management, the Chief Accountant, the Legal Address, the Name of Credit Institutions, and Undertaking Merger or Split-Up of Credit Institutions".
April 12	The Bank of Latvia reduced the refinancing rate from 24% to 22% per year.
April 25	The Executive Board of the Bank of Latvia approved "Regulations on Accounting of Treasury Bills of the Republic of Latvia". The Executive Board of the Bank of Latvia approved "Regulations Governing Reverse Repo Auctions of Treasury Bills".
April 30	The Bank of Latvia reduced the refinancing rate from 22% to 19% per year.
May 10	The Bank of Latvia reduced the refinancing rate from 19% to 17% per year.
May 16	The Board of Governors of the Bank of Latvia passed a Resolution "On Establishing Standards to Activities of Credit Institutions".
May 17	The Board of Governors of the Bank of Latvia approved "Regulations on Calculating the Indicators that Characterize Activities of Credit Institutions". The Board of Governors of the Bank of Latvia passed a Resolution "On Reserve Requirements to a Credit Institution". The Board of Governors of the Bank of Latvia approved "Procedure of Calculating Reserve Requirements to a Credit Institution".
May 31	The Bank of Latvia reduced the refinancing rate from 17% to 15% per year.

June 6	The Executive Board of the Bank of Latvia passed a resolution on amendments to "The Bank of Latvia Provisions on Granting Extraordinary Credits to Credit Institutions".
June 13	The Executive Board of the Bank of Latvia approved "Report on Transactions with Treasury Bills of the Republic of Latvia in the Secondary Securities Market". The Executive Board of the Bank of Latvia approved "Report on Treasury Bills of the Republic of Latvia".
June 2	The Bank of Latvia reduced the refinancing rate from 15% to 13% per year.
July 11	The Board of Governors of the Bank of Latvia approved "Regulations on Information Systems of Banks". The Board of Governors of the Bank of Latvia approved amendments to "Regulations on Issuing Licences (Permissions) to Credit Institutions".
August 9	The Bank of Latvia reduced the refinancing rate from 13% to 12% per year.
August 15	The Executive Board of the Bank of Latvia approved "The Bank of Latvia Provisions on Performing Settlements."
September 16	The Bank of Latvia reduced the refinancing rate from 12% to 11% per year.
October 8	The Bank of Latvia reduced the refinancing rate from 11% to 10% per year.
November 14	The Board of Governors of the Bank of Latvia approved "Regulations on Annual Financial Statements of Credit Institutions". The Board of Governors of the Bank of Latvia passed a Resolution "On Monthly Financial Position Report of Credit Institutions" and approved "Provisions on Preparing of Credit Institutions' Monthly Financial Position Report and Appendixes to the Report". The Board of Governors of the Bank of Latvia passed a Resolution "On Auditing Annual Financial Statements of Credit Institutions for 1996". The Board of Governors of the Bank of Latvia passed a Resolution "On Determining the Bank of Latvia's Interest Rates".
November 21	The Executive Board of the Bank of Latvia passed a Resolution "On Determining the Bank of Latvia's Interest Rates".
December 6	The Bank of Latvia reduced the refinancing rate from 10% to 9.5% per year.

SUPERVISION OF CREDIT INSTITUTIONS

SYSTEM OF CREDIT INSTITUTIONS

At the end of the reporting year, there were 39 credit institutions licensed in the Republic of Latvia, of which 34 banks, 4 credit unions, the Riga Branch of *Societe Generale*, as well as the representative office of *Dresdner Bank*.

The Bank of Latvia granted licences for conducting banking operations (transactions) to two new banks: the joint-stock company *Maras Banka* and the subsidiary of the German bank *Vereins- und Westbank AG* in Riga – the joint-stock company *Vereinsbank Riga*. Licences were also issued to three credit unions of Cesis region: the Taurene Credit Union, the Veselava Credit Union and the credit union *Ligatnes Druva*.

The Bank of Latvia revoked licences for conducting banking operations (transactions) of 8 banks: the joint-stock company *Talsu Komerbanka*, the joint-stock company *Tukuma Banka*, the joint-stock company commercial bank *Dinastija*, the joint-stock company *Ako Banka*, the joint-stock company *Daugavas Banka*, the joint-stock commercial bank *Jelgava*, the joint-stock company *Bauskas Banka* and the joint-stock company *Banka Atmoda*.

The Latvian state was the sole owner of the joint-stock company *Latvijas Hipoteku un Zemes Banka*. The state joint-stock company *Latvijas Krajbanka* was taken over by the non-profit institution state joint-stock company *Latvijas Privatizācijas Agentūra* on February 26, 1996. The privatization of the joint-stock company *Latvijas Unibanka* was successfully continued during the reporting year, and as a result, the Government's holding in this bank contracted to 33.3% of the bank's share capital.

STABILIZATION OF THE BANKING SECTOR

In 1996, the Latvian banking sector stabilized after the 1995 banking crisis: the bank capital base strengthened, banks' profitability increased, the quality of assets improved and creditors' confidence in banks grew.

Twenty-two banks received permission to increase their share capital in 1996. At the end of 1996, the total paid-up share capital of banks amounted to 115.5 million lats, increasing by 25.7%. This increase was facilitated partly by the requirement of the Law "On Credit Institutions" stipulating that the minimum initial capital of those banks which had started their lawful activities before the adoption of the Law was not to be less than 1 million lats as from April 1, 1996. Six banks made additional payments into their share capital in order to comply with the Law; however, four banks failed to meet this requirement, and the Bank of Latvia revoked their licences for conducting banking operations. Several Latvian banks were successful in attracting foreign investments. The European Bank for Reconstruction and Development invested 5.5 million lats and the Swedish investment fund *Swedfund International AB* 3.3 million lats in share capital of Latvian banks. Due to profit, the capital base of the banking sector increased by 9.7 million lats in 1996.

In the reporting year, banks' total equity increased from 103.1 to 148.7 million lats or by 44.2%. According to unaudited annual financial statements, the total profit of credit institutions for 1996 was 30.3 million lats or 5.5 times larger than in 1995. Profit was gained mainly from investments in securities and from foreign exchange transactions.

The increase in deposits, especially those of private enterprises, during the reporting year indicated that customers' confidence had been restored after the 1995 banking crisis. At the end of the reporting year, deposits of the Government, enterprises and private persons held with credit institutions amounted to 686.0 million lats, exceeding by 29.5% the figure at the end of 1995. The private sector's deposits with credit institutions exceeded the pre-crisis level (623.8 million lats at the end of 1994).

In 1996, the assets of credit institutions increased by 36.2%, amounting to 1 137.3 million lats. The assets were comprised mainly of claims on foreign credit institutions (31.7%), loans to the Government, enterprises and private persons (23.4%), and securities of the Latvian Government and governments of other countries (17.1%). With investments in securities of central and local governments increasing, risk on banks' asset portfolios decreased. A decrease in the proportion of loan loss provisions to the total assets of credit institutions evidenced improved asset quality: at the end of 1995, this ratio was 6.0%, whereas in the reporting year, it decreased to 4.6%. Another indicator showing the quality of assets, capital adequacy, was 20% at the end of 1995, but at the end of the reporting year, it was 25%.

Loans granted to the Government, enterprises and private persons increased by 27.1% during the reporting year, and totalled 266.6 million lats at the end of the year. Banks paid more attention to the analysis of borrowers' financial standing and the quality of collateral; hence, more conservative lending policies were applied. In 1996, the total loan portfolio of banks increased by only 38.9% of total deposits raised during the reporting year. Lending in Latvia still was quite risky due to the following factors: there was a lack of business history and information on how borrowers had previously settled their obligations; the market for real estate was not yet well-developed, and could not serve as an effective source for collateral. At the same time, interest of enterprises and private persons in borrowing increased due to a fall in lending rates which during 1996 reached a level favourable enough for the realization of long-term projects and development of businesses.

EXAMINATIONS OF THE ACTIVITIES OF CREDIT INSTITUTIONS

The Bank of Latvia's examiners performed 123 on-site inspections in 1996, covering the entire system of licensed credit institutions. As in previous years, attention was mainly directed to the assessment of credits and other risk assets. In several banks, a necessity to establish additional loan loss provisions was detected. The principal criteria in assessing credits were the borrower's financial standing, business potential and timeliness in meeting debt obligations. When examining the performance of internal auditing departments, shortcomings were detected in several banks. The Bank of Latvia oversees how such problems are being rectified and how control systems are being improved.

Trust operations, foreign exchange, financial contracts, securities and other financial instruments were those banking operations which developed rapidly during the reporting year. Therefore, during on-site inspections it was important to identify those policies and procedures that need to be drafted for the operation of banks in order to enable their managements to control risks.

The number of banks which were entitled to take private person deposits increased from 13 to 15 during 1996. Intensified supervision was applied to these banks, and alongside

the Bank of Latvia's examinations, the auditing companies *Arthur Andersen*, *Coopers & Lybrand*, *Deloitte & Touche*, *Price Waterhouse* and *KPMG* performed special audits on behalf of the Bank of Latvia, evaluating the quality of banks' financial statements, loan portfolios, and internal controls and management. The compliance of interim financial statements for the first half of 1996 with International Standards on Auditing was assessed.

REGULATIONS GOVERNING THE ACTIVITIES OF CREDIT INSTITUTIONS

In the reporting year, the Bank of Latvia's Board of Governors approved several regulations and provisions governing the activities of credit institutions. The new normative documents were harmonized with the Law "On Credit Institutions" passed in 1995, EU directives and International Accounting Standards, and, in many cases, they replaced documents that had been in use previously.

"Provisions on Accounting Income and Expenses of Credit Institutions" (approved on January 11, 1996) ensure that the results of credit institutions' activities are evaluated according to the accrual principle in accordance with International Accounting Standards.

"Provisions on Evaluation of Credits and Off-Balance-Sheet Liabilities" (approved on January 17, 1996; in effect from February 1, 1996), which were adopted in the reporting year, improved procedures of assessing credits and off-balance-sheet liabilities and making loan loss provisions, as well as harmonized these with the supervision standards used by central banks in developed countries. The new regulations made banks review their lending policies, be more demanding in respect of their borrowers, and assess carefully the borrower's financial standing and capacity to repay the loan.

"Regulations on Issuing Licences (Permissions) to Credit Institutions" (approved on March 14, 1996) and "Regulations on Amending the Charter, Changing the Shareholders, the Initial Capital, the Management, the Chief Accountant, the Legal Address, the Name of Credit Institutions, and Undertaking Merger or Split-Up of Credit Institutions" (approved on March 15, 1996) improved the procedures of licensing credit institutions, and procedures to be observed when changing the activities, organization or shareholders of a credit institution. The regulations incorporate criteria utilized by the Bank of Latvia in deciding whether to authorize the merger or split-up of credit institutions.

The reviewed and amended "Regulations on Calculating the Indicators that Characterize Activities of Credit Institutions" came into effect on September 1, 1996. Procedures for calculating capital adequacy, exposures and restrictions on open foreign exchange position were amended, and new liquidity requirements were established. Previously, in order to control liquidity management, banks used indicators characterizing short-term and long-term liquidity of assets and liabilities, which were calculated according to original maturities of assets and liabilities. With these regulations taking effect, banks have to tailor special policies to manage their liquidity, evaluate the term structure of assets and liabilities by residual maturity, and plan how to attract financial resources. It has been stipulated that a credit institution has to maintain liquid assets in the amount sufficient to meet its liabilities, but not below 30% of total current liabilities (liquidity indicator). The Bank of Latvia introduced this requirement in accordance with the recommendations of the Basle Committee on Banking Supervision.

On November 14, 1996, the Bank of Latvia's Board of Governors approved the reviewed and amended "Regulations on Annual Financial Statements of Credit Institutions". These

regulations were elaborated so that they would comply with the Law "On Credit Institutions", International Accounting Standards and the EU directive 86/635/EEC "On the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions". The principles of evaluating balance sheet and off-balance-sheet items have been improved, and the procedures of accounting and revaluating of short-term and long-term assets have been set out. Information to be included in the notes to the annual financial statements has also been specified.

On November 14, 1996, the Bank of Latvia's Board of Governors also approved new statistical forms included with the monthly financial position report of credit institutions and with appendixes to the report, as well as "Provisions on Preparing Credit Institutions' Monthly Financial Position Report and Appendixes to the Report" (in effect from April 1, 1997). Additional information included in the monthly financial position report of credit institutions and appendixes to the report is necessary for the Bank of Latvia to implement its monetary policy and supervise credit institutions. This information is important also for the statistics of the balance of payments.

Information derived from the new statistical forms will allow to achieve several important goals: to improve compilation of the balance of payments because data on transactions of the Latvian financial system with partners in regions with different degrees of development will be available (transactions in the currencies of OECD countries are segregated); to analyse more successfully the macroeconomic situation in Latvia and identify credit institutions' relationship with the real (producing) sector and non-bank financial (intermediation) sector; to receive signals about the development of new transactions and services offered by credit institutions in the market; to follow the term structure of the Latvian securities market. This statistical information will also meet EU requirements in respect of financial statistics.

INTERNATIONAL CO-OPERATION

INTERNATIONAL FINANCIAL INSTITUTIONS

In 1996 Latvia, as a member country, continued its activity within the International Monetary Fund (IMF), the International Bank for Reconstruction and Development, the International Development Association and the International Finance Corporation, as well as the European Bank for Reconstruction and Development. The Bank of Latvia continued to participate in the Bank for International Settlements.

Latvia's quota in the IMF totals 91.5 million SDR, which comprises 0.06% of the financial resources of the IMF. Pursuant to the IMF Articles of Agreement, in 1996 the IMF Mission held annual consultations with the Latvian Government and the Bank of Latvia about the fulfilment of Article IV of the IMF Articles of Agreement.

After the memorandum on the economic policy of the Latvian Government had been elaborated, on May 24, 1996 a stand-by arrangement (30 million SDR) was signed between Latvia and the IMF for the period until August 23, 1997; however, the credit facility was not utilized in the reporting year.

CO-OPERATION WITH FOREIGN CENTRAL BANKS

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

Employees of the Bank of Latvia visited the Bank of England, the Central Bank of Ireland, Narodni Bank Polski and Deutsche Bundesbank with the aim of studying and exchanging experience on different areas of central banking. The Governor of Narodna Banka Slovenska and representatives from the Central Bank of the Republic of Armenia visited the Bank of Latvia.

In June 1996, a number of the Bank of Latvia's employees participated in the 3rd seminar of central banks of the Baltic states held in Lithuania. Issues concerning monetary policy, credit institutions supervision, bank accounting and statistics were on the agenda.

TECHNICAL ASSISTANCE

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

During 1996, three resident advisors continued or began their work at the Bank of Latvia. They were financed by the EU PHARE program (advisor on bank accounting and reporting issues), the US Agency for International Development (advisor on credit institution insolvency and liquidation issues) and the IMF (advisor on supervisory issues).

In the reporting year, with financial support from the EU PHARE program, the project on-call audit assistance was continued and the project on the interbank payments system development was begun.

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

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

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

PARTICIPATION IN INTERNATIONAL AGREEMENTS

To meet the obligations envisaged by the Association Agreement between the Republic of Latvia and the European Union, the Bank of Latvia reviewed and amended regulations governing the activities of Latvian credit institutions so as to harmonize them with the requirements of EU directives. The law on preventing the use of the financial system for money laundering and the law on private person deposit guarantee scheme were drafted and submitted to the Government.

To establish a regular exchange of information and views between the European Commission and the Republic of Latvia, the Bank delegated a number of its employees to the working group on economic and financial issues, which was established jointly by the EU and Latvia.

Within the working group, the Bank of Latvia's representatives participated in talks on joining of the Republic of Latvia to the World Trade Organization, and formulated their recommendations concerning Latvia's commitments in the field of banking and financial services.

REPORT OF THE BANK OF LATVIA'S EXECUTIVE BOARD

The composition of the Board of Governors of the Bank of Latvia did not change in the reporting year, and at the end of 1996, it was as follows:

- Chairman of the Board of Governors, Governor Einars Repse;
- Chairman of the Executive Board, Deputy Governor Ilmars Rimsevics;
- members of the Board of Governors: Harry Bush,
Valentina Kolotova,
Vita Pilsuma,
Bruno R. Rubess,
Varis Zarins,
Valentina Zeile.

The Bank of Latvia's Executive Board at the end of 1996 was as follows:

- Chairman of the Executive Board Ilmars Rimsevics;
- Deputy Chairperson of the Executive Board Mara Raubisko;
- members of the Executive Board: Helmut Ancans,
Roberts L. Grava,
Reinis Jakovlevs,
Antonija Sileniece.

The Bank of Latvia's Executive Board managed the day-to-day work of the Bank, implemented the directives of the Bank of Latvia's Board of Governors on monetary policy and credit institutions supervision, as well as elaborated draft resolutions for the Bank's Board of Governors. In the reporting year, the Bank of Latvia's Executive Board convened 57 meetings and passed 183 resolutions on credit institutions supervision, 18 resolutions on the utilization of monetary policy instruments and 124 resolutions on conducting other practical day-to-day activities of the Bank.

PRINCIPAL ACTIVITIES OF THE BANK OF LATVIA

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

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

FINANCIAL RESULTS OF THE BANK OF LATVIA

The Bank of Latvia's profit for 1996 totalled 6 923 thousand lats (6 433 thousand lats in 1995).

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

Due to the Government's tight fiscal policy, the Bank of Latvia's interest income from credits to the Government and from Republic of Latvia Treasury bills decreased to 4 170 thousand lats (7 089 thousand lats in 1995), whereas the Bank of Latvia's interest expense on government deposits totalled 2 917 thousand lats (3 138 thousand lats in 1995).

Interest income from loans to banks remained at the previous year's level, and was 575 thousand lats.

APPROPRIATION OF THE BANK OF LATVIA'S PROFIT

Article 18 of the Republic of Latvia Law "On the Bank of Latvia" stipulates the maximum level of nominal capital, and Article 19 of the same Law sets the maximum level of reserve capital. In 1993, the Bank of Latvia reached the levels provided for in the Law. Accordingly, no transfers from the 1996 profit had to be made to nominal and reserve capitals. Pursuant to Article 20 of the mentioned law, other reserves have to be increased by transferring 4 400 thousand lats of the profit for 1996. The reserve for the deposit guarantee fund has to be established in the amount of 500 thousand lats. The remaining profit for 1996 in the amount of 2 023 thousand lats is to be transferred to the state budget.

THE BANK OF LATVIA'S FOREIGN RESERVES

The Bank of Latvia's foreign reserves consist of gold, foreign convertible currencies (see Note 2) and the SDR. The Bank's foreign reserves amounted to 427.4 million lats at the end of 1996 (315.3 million lats at the end of 1995).

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

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

Investments may be made in US dollars, German marks, Japanese yens, British pounds, French francs, Swedish kronas, Danish kroner, Dutch guilders, Swiss francs, Canadian dollars, SDR and ECU. The proportion of each currency that can be held is similar to the spread of currencies within the SDR basket of currencies. Forward contracts are used to hedge any deviation from the prescribed allocation.

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

On January 15, 1996, the Bank of Latvia's Board of Governors approved the guidelines governing investment of the Bank of Latvia's gold reserves and setting limits on the volume and maturity of gold deposits.

The Investment Committee reviews and amends the Bank of Latvia's investment strategies every week. The Committee consists of the Chairman of the Bank of Latvia's Executive Board, the Head of Foreign Exchange Department and the staff of this Department's Trading and Investment Division.

THE BANK OF LATVIA'S FINANCIAL INSTRUMENTS

The Bank of Latvia sets the refinancing rate, which serves as a reference rate for the entire Latvian financial system. As the annual rate of inflation decreased and the financial system stabilized, the Bank of Latvia lowered the refinancing rate from 24% to 9.5% per year during 1996.

The Bank of Latvia intervenes in the interbank money market in two ways: by participating in the secondary market for Treasury bills and by entering into repurchase agreements. The Bank of Latvia's Executive Board approved "Regulations Governing Reverse Repo Auctions of Treasury Bills" in 1996. There was, however, no need to utilize this monetary policy instrument in the reporting year.

The other important interest rate is the collateralized credit rate, which sets the upper limit to interbank market interest rates. The Bank of Latvia extended demand and automatic collateralized credits to banks against collateral of Treasury bills. Demand collateralized credits are granted for a definite time period, which may not exceed fourteen consecutive days, and are subject to a special agreement concluded with the bank. Automatic collateralized credits are extended overnight and may not exceed the debit balance of the bank's correspondent account. The Bank of Latvia's credits to the banking sector decreased from 24.6 million lats at the beginning of the year to 10.0 million lats at the end of the year.

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

The Bank of Latvia purchased from and sold to banks foreign convertible currency for lats in non-cash transactions; payments for such transactions were effected within two working days or, upon mutual agreement, in a shorter period of time. The net amount of foreign convertible currency purchased by the Bank of Latvia in 1996 totalled 148.5 million US dollars (67.5 million US dollars in 1995).

The Bank of Latvia's reserve requirement for banks remained at the same level as in the previous year – 8% of the average deposits acquired by the respective bank (irrespective of currency and maturity, and excluding liabilities to domestic credit institutions and the state budget, as well as deposits raised by foreign branches of Latvian banks). The reserve requirement was met with balances on correspondent accounts of credit institutions with

the Bank of Latvia and average vault cash balances in lats (the cash component was not to exceed 50% of the required reserves). The cash component of the required reserves decreased from 34.9% at the beginning of the year to 30.7% at the end of the year.

With funds raised by banks increasing, deposits that banks were obliged to hold on their correspondent accounts with the Bank of Latvia also grew. At the beginning of the reporting year, such deposits totalled 39.0 million lats, and at the end of the year, 48.5 million lats.

Pursuant to the regulations "On Realization of Government Domestic Borrowing" passed by the Cabinet of Ministers of the Republic of Latvia on November 30, 1993, the Bank of Latvia organizes the sales of Treasury bills through auctions. The auctions are organized by an auction commission, which is formed by the Bank of Latvia and the Ministry of Finance. Any bank or branch of a foreign bank, provided they have been licensed in the Republic of Latvia, as well as any foreign bank holding a lats correspondent account with the Bank of Latvia may participate in these auctions.

To implement the monetary policy and maintain the liquidity of Government securities, the Bank of Latvia participated in the secondary Treasury bill market. The volume of the Bank of Latvia's transactions on the market totalled 114.1 million lats in 1996, exceeding by 22.4% the previous year's figure.

With implementation of tighter fiscal policy, the Bank of Latvia's lending to the Government declined substantially. The Government could also deposit the available resources with the Bank of Latvia.

MONEY CIRCULATION

The exclusive rights of currency issue are vested with the Bank of Latvia. Lats banknotes in the denominations of 5, 10, 20, 50 and 100 lats, and coins of lats and santims were in circulation. The supply of cash to the banking system was ensured through five branches of the Bank of Latvia in Riga, Liepaja, Daugavpils, Rezekne and Valmiera.

The Riga Branch of the Bank of Latvia checked cash received from the banking system for authenticity and fitness for circulation. During the reporting year, the amount of processed cash (370.0 million lats, of which 88.4 million lats were destroyed) 1.3 times exceeded that of currency in circulation. The banking system, therefore, received only good quality notes. In the reporting year, counterfeit banknotes and coins only slightly exceeded the amount of 5 thousand lats. This testified to the fact that the security features incorporated in lats banknotes ensured the reliability of the Latvian currency.

COMMEMORATIVE COINS

Within the framework of international coin programs, in 1996 the Bank of Latvia issued a silver 1-lats coin commemorating the 50th Anniversary of the United Nations (in circulation since January 10, 1996) and a silver 10-lats coin dedicated to the world history of seafaring (in circulation since March 20, 1996). The first two coins of the series of eight silver 10-lats coins commemorating the 800th Anniversary of Riga were issued: the coin dedicated to the 13th century (dated 1995; in circulation since July 5, 1996) and the coin dedicated to the 14th century (dated 1995; in circulation since September 18, 1996). The

designs and models of the next three series' coins were prepared. In the reporting year, 20.0 thousand collector coins were sold abroad through distributor companies.

THE BANK OF LATVIA'S ADMINISTRATION AND PERSONNEL TRAINING

At the end of 1996, 696 persons (26 more than in the previous year) were employed by the Bank of Latvia.

In the reporting year, two new departments were established: the Construction Department, the main task of which is to ensure building of the Bank's Riga Branch, and the Public Relations Department, the task of which is to inform the public about the implementation of the Bank of Latvia's policy.

The fact that the Bank of Latvia has begun analytical and research work on the balance of payments determined changes in the organization of the Statistics Department and the Monetary Policy Department.

During 1996, employees of the Bank of Latvia improved their professional knowledge on the issues of monetary policy, techniques of macroeconomic and monetary analyses, foreign exchange transactions, foreign reserves management, bank supervision and accounting by taking part in seminars, courses and conferences in Latvia and abroad.

In 1996, a working group for coordination of studies was formed to organize training programs for the Bank of Latvia's employees in Latvia and abroad.

The Study Centre of the Bank of Latvia was established in 1996. Forty-five employees of the Bank supplemented their knowledge of personnel management, presentation skills and communicative psychology; seventy employees improved their computer skills, and one hundred and forty employees upgraded their knowledge of foreign languages.

In 1996, two new courses for the Bank of Latvia's employees were begun: one concerning issues of monetary policy, credit institutions supervision and accounting, and the other "Getting Acquainted with the Bank of Latvia". Eighteen senior staff specialists participated in the program on macroeconomic and finance theory, organized jointly by the Bank of Latvia and the Riga School of Economics.

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

In 1996, the Latvian Banking College offered education in banking and finance in both day and correspondence departments, qualifying bank managers and tax inspectors for the needs of the State Revenue Service. In 1996, the college enrolled 297 students, and the number of graduates receiving certificates was 195. To raise theoretical knowledge and professional skills, about 1 100 specialists attended various courses and workshops organized by the Latvian Banking College during the year. The activities of the Latvian Banking College were supervised by the Committee of Trustees.

**THE BANK OF LATVIA'S FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 1996**

**THE BANK OF LATVIA'S BALANCE SHEET AS OF
DECEMBER 31, 1996**

				(in thousands of lats)	
ASSETS	Notes	1996	1995		
FOREIGN ASSETS		504 685	392 548		
Gold	1	41 578	40 150		
Special Drawing Rights		1 251	1 195		
Convertible currencies	2	384 549	273 971 ¹		
International Monetary Fund	3	72 929	72 929		
Shares in the Bank for International Settlements	4	973	940		
Other foreign assets	5	2 019	2 556		
Non-convertible currencies	6	1 386	807		
DOMESTIC CREDITS		74 309	100 818		
To banks	7	9 950	24 579		
To the Government	8	30 575	51 585		
Government securities	9	14 077	5 774		
Other credits	10	19 707	18 880		
OTHER ASSETS	11	5 620	9 011 ²		
FIXED ASSETS	12	6 086	4 453		
TOTAL ASSETS		590 700	506 830		

¹ Comparative figures for 1995 have been increased by 3 061 thousand lats to reflect the accounting policy of 1996 for investments marked to market (see Notes 2 and 17).

² Receivables regarding settlements with CIS countries have been included.

(cont.)		(in thousands of lats)	
LIABILITIES	Notes	1996	1995
FOREIGN LIABILITIES		145 805	159 622
International Monetary Fund	13	145 497	159 163
Other foreign liabilities		6	6
Foreign bank deposits in lats		67	198
Non-convertible currencies	6	235	255
LATS IN CIRCULATION	14	282 602	225 871
DOMESTIC DEPOSITS		131 653	92 416
From banks		52 780	46 908
From the Government		31 017	2 623
Government foreign borrowings	15	42 197	41 049
Humanitarian aid accounts		364	996
Other deposits		5 295	840
OTHER LIABILITIES	19	5 350	7 790 ¹
CAPITAL AND RESERVES		25 290	21 131
Nominal capital	16	2 500	2 500
Reserve capital	16	625	625
Other reserves	16	13 494	9 093
Valuation account	17	8 244	8 486 ²
EU grant	18	427	427
TOTAL LIABILITIES		590 700	506 830

¹ Provisions for receivables regarding settlements with CIS countries have been included.

² Comparative figures for 1995 have been increased by 3 061 thousand lats to reflect the accounting policy of 1996 for investments marked to market (see Notes 2 and 17).

**THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1996**

		(in thousands of lats)	
	Notes	1996	1995
INTEREST INCOME			
Foreign operations			
Interest on bank deposits		2 207	1 306
Income from securities		16 941	19 907
Other foreign income		59	268
Dividends on BIS shares		115	111
GROSS foreign interest income		19 322	21 592
Domestic operations			
Interest on loans to banks		575	561
Interest on Government securities		1 538	845
Interest on loans to Government		2 632	6 244
Other domestic income		197	2 403
GROSS domestic interest income	20	4 942	10 053
INTEREST EXPENSE			
Foreign operations			
Interest on loans		1 978	2 700
Other foreign expense		294	260
GROSS foreign interest expense		2 272	2 960
Domestic operations			
Interest on banks' deposits		17	21
Interest on Government deposits		2 971	3 138
GROSS domestic interest expense		2 988	3 159
NET INTEREST INCOME		19 004	25 526

		(in thousands of lats)	
	Notes	1996	1995
Special provisions	21	1 142	7 825
OPERATING INCOME		611	604
OPERATING EXPENSES			
Salaries, wages and other personnel costs		4 541	3 438
Social security		1 543	1 258
Costs of coin production		294	23
Depreciation		1 478	837
Other operating expenses		3 694	6 316 ¹
TOTAL operating expenses		11 550	11 872
PROFIT BEFORE APPROPRIATION		6 923	6 433
PROPOSED APPROPRIATION OF PROFIT			
Reserve for deposit guarantee fund		500	–
Other reserves		4 400	4 933
Remaining profit appropriated to the State budget		2 023	1 500

¹ Net foreign exchange loss has been segregated in the 1995 financial statements.

**THE BANK OF LATVIA'S CASH FLOW STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1996**

		(in thousands of lats)	
	Notes	1996	1995
Net cash inflow (outflow)	22(i)	31 057	(194 095)
Profit transferred to the Central Government general budget in accordance with Article 20 of the Law "On the Bank of Latvia"		(1 500)	–
Purchase of fixed assets		(3 145)	(1 507)
Repayment of IMF credit		(13 666)	(2 750)
Increase (decrease) in cash and cash equivalents	22(ii)	12 746	(198 352)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 1996

FORM OF PRESENTATION OF ACCOUNTS

The Financial Statements have been prepared in accordance with the Law "On the Bank of Latvia" and the Law "On Accounting". International Accounting Standards have been adopted where they are appropriate and applicable to the activities of a central bank.

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

GOLD

On the repatriation of the Bank of Latvia's gold in 1992–1993, it was valued at USD 300 per troy ounce. This valuation and subsequent realized gains and losses are included within the valuation account.

FOREIGN CONVERTIBLE CURRENCY INVESTMENTS

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

This is a change of accounting policy from that adopted in previous financial statements when the foreign convertible currency investments were maintained in the accounting records at their historic cost. The change of accounting policy has been introduced to present the foreign convertible currency investment portfolio in a way more consistent with the management's valuation of these investments on a day-to-day bases. The previous year's adjustment associated with this change of accounting policy has been included in the valuation account. The December 31, 1995 balance sheet value of foreign convertible currency investments has been presented on a consistent basis.

LATVIAN GOVERNMENT SECURITIES

The discount to nominal value at purchase of Treasury bills is amortized to interest income on a straight line basis over the period from purchase to maturity. The Treasury bills are stated in the balance sheet at purchase cost plus the amortized discount.

FIXED ASSETS

Fixed assets are recorded at acquisition cost less accumulated depreciation. Depreciation is calculated using the straight-line method at the following depreciation rates:

Buildings	1%–2%
Furniture and fittings	10%
Motor vehicles	20%
Computer equipment and information systems	20%

The cost of producing bank notes are capitalized and expensed over their estimated useful life of 2 years. Costs of coin production are expensed at year when costs were incurred.

INCOME AND EXPENSE RECOGNITION

Interest income and expenses are recognized on an accruals basis. Interest income is recognized on doubtful loans, simultaneously making provisions for such loans and interest income.

FOREIGN CURRENCY TRANSLATION

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

NOTES TO THE BALANCE SHEET AND PROFIT AND LOSS STATEMENT

1. GOLD

Movements in gold reserves in 1996 were as follows:

	Ounces	Amount in thousands of lats
Gold at December 31, 1995	249 223	40 150
Changes resulting from deposits and withdrawals	46	6
Exchange rate difference	–	1 422
Gold at December 31, 1996	249 269	41 578

During the year gold has been deposited with foreign commercial banks, thus earning interest.

The official fixing of the gold price in London on December 30, 1996 was USD 369.25 per troy ounce.

2. CONVERTIBLE CURRENCIES

The Bank of Latvia's assets in foreign convertible currencies invested in foreign banks and other financial institutions consisted of cash deposits and securities of high liquidity.

At the end of 1996 the foreign convertible currency reserves of the Bank of Latvia translated into lats were as follows:

	(in thousands of lats)	
	1996	1995
Deposits with foreign banks and other financial institutions	41 050	22 386
Government short-term securities	90 876	44 593
Government bonds	233 331	179 810
Other securities	17 961	25 806
Foreign currency in cash	1 331	1 376
Total	384 549	273 971

Investments held at December 31, 1995 have been restated to their market value at that date in accordance with the new accounting policy adopted in 1996. This has resulted in investments being valued at 3 061 thousand lats higher than the stated amount in the 1995 annual report.

The convertible currency assets are held in a spread of currencies that approximate to the spread of currencies in the SDR. Deviations from the SDR spread are hedged by the purchase and sale of forward foreign exchange contracts. Therefore, on December 31, 1996 forward foreign contracts were concluded in the total amount of 114.6 thousand lats.

The analysis by currency of the foreign convertible currency reserves of the Bank of Latvia at December 31, 1996 was as follows:

	(percentage)	
	1996	1995
US dollars	46	47
German marks	27	37
British pounds	10	5
Japanese yen	6	6
French francs	7	4
Other foreign currencies	4	1
Total	100	100

3. INTERNATIONAL MONETARY FUND

The Republic of Latvia participation in the International Monetary Fund (IMF) is recorded as an asset denominated in SDRs, which is secured by a promissory note issued by the Latvian Government. The Latvian national currency holdings of the IMF are stated as a liability (see Note 13). The quota of the Republic of Latvia in the IMF is SDR 91 500 000.

4. SHARES IN THE BANK FOR INTERNATIONAL SETTLEMENTS

The Bank of Latvia owns 1 000 shares in the Bank for International Settlements (BIS).

The shares are denominated in the gold equivalent (5 834 troy ounces) and are valued at USD 300 per troy ounce. The movement in the investment value during the year arises as a consequence of the historic value being denominated in US dollars.

5. OTHER FOREIGN ASSETS

This item represents deposits with foreign financial institutions made on the behalf of the Government in the amount of 1 993 thousand lats and other foreign assets in the amount of 26 thousand lats.

6. NON-CONVERTIBLE CURRENCIES

This item comprises balances of the accounts (opened during 1991 and 1992 in order to settle payments between CIS countries) after establishing special provisions.

7. Domestic credits to banks

The Bank of Latvia acted as an agent for the distribution of a large part of foreign loans received by the Republic of Latvia. This item includes foreign loans for 5 632 thousand lats that were distributed to banks for further distribution of these funds as loans to final borrowers, 4 109 thousand lats issued to banks against collateral of Treasury bills and 209 thousand lats of long-term loans to banks issued during 1992.

8. DOMESTIC CREDITS TO THE GOVERNMENT

This item consists of the foreign credits for 30 575 thousand lats utilized by the Government to finance enterprises in the public sector and to ensure the government investment programs.

9. GOVERNMENT SECURITIES

The Bank of Latvia is a market-maker for Treasury bills issued by the Ministry of Finance. At December 31, 1996, the Bank of Latvia held the following Treasury bills.

	(in thousands of lats)	
Original maturity of Treasury bills	1996	1995
Within 1 month	527	–
Within 3 months	1 021	3 450
Within 6 months	3 249	2 324
Within 12 months	9 280	–
Total	14 077	5 774

10. OTHER CREDITS

Other credits represent G-24 loans granted to the banks whose licenses have been revoked. No provisions have been established for these loans due to the fact that the Government has guaranteed to repay the loan balances outstanding in case the collection of these loans is not possible.

11. OTHER ASSETS

This item comprises accrued interest in the amount of 4 933 thousand lats, prepayments for purchase of fixed assets in the amount of 309 thousand lats and other assets in the amount of 378 thousand lats.

12. FIXED ASSETS

Changes in fixed assets in 1996:

	(in thousands of lats)				
	Buildings	Furniture and fittings	Motor vehicles	Other including bank notes	Total
Net book value as at December 31, 1995	845	2 518	324	766	4 453
Additions	1 121	510	352	1 162	3 145
Items transferred to the State Property Fund	(34)	–	–	–	(34)
Depreciation charge	(9)	(669)	(220)	(580)	(1 478)
Net book value as at December 31, 1996	1 923	2 359	456	1 348	6 086

13. INTERNATIONAL MONETARY FUND

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

Credits under the SBA and the STF have been issued to the Republic of Latvia with an aim of supporting the economic and financial program of the Government, and are scheduled for repayment by installments through the periods to July 1999 and July 2004, respectively.

Movements in liabilities to the IMF in 1996 were as follows:

	(in thousands of lats)			
	SBA	STF	Partici- pation	Total
Balance as at December 31, 1995	49 697	36 586	72 880	159 163
Exchange gain	–	–	359	359
Repayment	(14 025)	–	–	(14 025)
Balance as at December 31, 1996	35 672	36 586	73 239	145 497

14. LATS IN CIRCULATION

At the end of 1996 the following units of lats (Ls) and santims (s) were in circulation:

Nominal	Amount (in thousands lats)		Number (in thousands of units)		Percentage (%)	
	1996	1995	1996	1995	1996	1995
BANK NOTES						
Ls 100	19 827	14 186	198	142	7.0	6.3
Ls 50	27 357	17 745	547	355	9.7	7.9
Ls 20	73 395	56 779	3 670	2 839	26.0	25.2
Ls 10	84 821	63 514	8 482	6 351	30.1	28.2
Ls 5	59 472	56 953	11 893	11 390	21.1	25.3
AMOUNT	264 872	209 177	–	–	93.9	92.9
COINS						
Ls 2	5 018	4 839	2 509	2 420	1.8	2.1
Ls 1	5 467	5 131	5 467	5 130	1.9	2.3
50 s	3 093	2 910	6 187	5 820	1.1	1.3
20 s	1 328	1 190	6 637	5 951	0.5	0.5
10 s	895	848	8 951	8 476	0.3	0.4
5 s	634	566	12 670	11 324	0.2	0.2
2 s	414	366	20 703	18 286	0.2	0.2
1 s	369	306	36 892	30 572	0.1	0.1
AMOUNT	17 218	16 156	–	–	6.1	7.1
TOTAL	282 090	225 333	–	–	100.0	100.0

At the end of 1996, silver 10 lats collector coins and gold 100 lats collector coins were in circulation along with souvenir sets of coins with total value of 512 thousand lats.

15. GOVERNMENT FOREIGN BORROWINGS

This item comprises the G-24 loans received by the Government of the Republic of Latvia. The loans have been distributed to banks for further distribution of these funds in the form of loans to commercial borrowers. The loans are guaranteed by the Government of Latvia.

16. NOMINAL CAPITAL, RESERVE CAPITAL, OTHER RESERVES

The Law "On the Bank of Latvia" sets a maximum level of nominal and reserve capital.

The Bank of Latvia achieved the maximum levels in 1993. Accordingly, nominal and reserve capital remained unchanged in 1996.

Pursuant to Article 20 of the Law "On the Bank of Latvia", other reserves were increased in 1996.

17. VALUATION ACCOUNT

Movements in the valuation account in 1996 were as follows:

(in thousands of lats)

	Gold	Foreign currencies			Total
		Conver- tible	Non- convertible	Market value of investments	
Valuation account at December 31, 1995 as previously reported	46 457	(13 434)	(27 598)	–	5 425
Previous year adjustment	–	–	–	3 061	3 061
Valuation account at December 31, 1995 as restated	46 457	(13 434)	(27 598)	3 061	8 486
Movement in Investment Revaluation Reserve	–	–	–	(2 254)	(2 254)
Revaluation	1 422	(1 033)	1 623	–	2 012
Valuation account at December 31, 1996	47 879	(14 467)	(25 975)	807	8 244

The previous year adjustment relates to the change in accounting policy for the valuation of foreign convertible currency investments.

18. EU GRANT

This item comprises a grant by the EU to the Bank of Latvia for the purpose of supporting the development of small and medium size businesses in Latvia. The loans were distributed through three commercial banks in Latvia selected by the EU.

19. OTHER LIABILITIES

Other liabilities include accrued expenses in the amount of 1 561 thousand lats, the remaining profit in the amount of 2 023 thousand lats of profit appropriation to be transferred to the state budget revenue, the remaining profit in the amount of 500 thousand lats to be transferred to the reserve for the deposit guarantee fund, interest payments on foreign credits in the amount of 719 thousand lats and other liabilities in the amount of 547 thousand lats.

20. INTEREST INCOME AND EXPENSES

In 1996 interest income from domestic operations decreased as the Government repaid the extra credit it had received from the Bank of Latvia.

21. SPECIAL PROVISIONS

Special provisions represent provisions on loans issued in 1992 to a bank, whose licence has been revoked, which were not guaranteed by the Government and for the related interest. The Bank of Latvia also provided for receivables regarding settlements of balances with CIS countries in 1992.

The following special provisions have been made.

	(in thousands of lats)	
	1996	1995
On loans issued to banks whose licences have been revoked	11	3 434
On receivables regarding settlements of balances with CIS countries in 1992	1 131	4 391
Total	1 142	7 825

22. CASH FLOW STATEMENT

(i) Reconciliation of operating profit to net cash inflow (outflow) from operating activities.

	(in thousands of lats)	
	1996	1995
Profit before appropriation	6 923	6 433
Increase in gold	(6)	–
Increase in SDR	(56)	(1 021)
Increase in foreign government securities and other investments	(91 958)	(159 237)
Revaluation and investments market value adjustment	(1 664)	9 000
Decrease in other foreign assets	537	1 463
(Increase) decrease in foreign non-convertible currency	(579)	459
(Increase) decrease in domestic credits	26 509	(32 839)
Decrease (increase) in other assets	3 390	(3 085)
Depreciation	1 478	837
Loss on disposal of fixed assets	34	–
Decrease in foreign banks' deposits made in lats	(131)	(3 082)
Decrease in foreign non-convertible currency deposits	(20)	(144)

(cont.)	(in thousands of lats)	
	1996	1995
Increase (decrease) in lats in circulation	56 731	(6 229)
Decrease in other liabilities	(3 463)	(797)
(Increase) decrease of BIS shares	(33)	19
Increase (decrease) in non-bank deposits	33 365	(5 872)
Net cash inflow (outflow)	31 057	(194 095)

Cash and cash equivalents include foreign currencies in cash, claims on foreign banks and other credit institutions with a remaining period of maturity of three months or less.

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

	(in thousands of lats)		
	1996	Change	1995
Short-term deposits with foreign banks and other financial institutions	41 050	18 663	22 387
Foreign currency in cash	1 331	(45)	1 376
Short-term deposits from domestic banks	(52 780)	(5 872)	(46 908)
Total	(10 399)	12 746	(23 145)

REPORT OF THE AUDIT COMMISSION

We have audited the balance sheet of the Bank of Latvia as at 31 December 1996 and the related statements of profit and loss and cash flows for the year then ended together with the notes. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based upon our audit.

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

In our opinion, the financial statements present fairly in all material respects the financial position of the Bank of Latvia as at 31 December 1996 and the results of its operations and cash flows for the year then ended in accordance with the accounting principles adopted by the Bank of Latvia and the Law "On the Bank of Latvia".

SIA Coopers & Lybrand Latvia

The Republic of Latvia State Control

Riga, 28 February 1997

RESOLUTION OF THE BANK OF LATVIA'S BOARD OF GOVERNORS

On March 13, 1997, the Bank of Latvia's Board of Governors passed Resolution No. 39/9 "On the Bank of Latvia's Annual Report and Financial Statements for 1996".

Having reviewed the results of the audit of the Bank of Latvia's economic activity in 1996, the Bank of Latvia's Board of Governors resolves:

1. To approve the Bank of Latvia's annual report for 1996, including the balance sheet, profit and loss statement and cash flow statement.
2. To appropriate the Bank of Latvia's profit for 1996 in the following way.
 - 2.1. 500 thousand lats to be transferred to the private person deposit guarantee fund reserve.
 - 2.2. 4 400 thousand lats to be transferred to the Bank of Latvia's other reserves.
 - 2.3. 2 023 thousand lats to be transferred to the state budget.
3. The Bank of Latvia's Executive Board ensures that the Bank of Latvia's annual report for 1996, including the balance sheet, profit and loss statement and cash flow statement, are published in Latvian and English and are sent to respective institutions.

E. Repše
Governor
Bank of Latvia

APPENDIXES

Appendix 1

MONETARY INDICATORS IN 1996

(at end of month; in millions of lats)

	I	II	III	IV	V	VI
Bank of Latvia						
Monetary base M0	251.3	258.9	261.4	280.5	288.9	311.3
Currency in circulation	217.9	221.7	224.7	230.1	231.5	244.0
Deposits with the Bank of Latvia	33.4	37.2	36.8	50.4	57.4	67.3
Currency vs reserve money (%)	86.7	85.6	86.0	82.0	80.1	78.4
Net foreign assets	229.6	231.2	245.6	260.6	278.9	283.5
Net domestic assets	21.7	27.7	15.9	19.9	10.0	27.7
Credits	79.3	83.3	73.2	76.4	69.7	86.9
To banks	25.8	29.9	27.0	22.2	17.6	20.6
To Central Government (net)	34.7	34.1	26.6	34.5	32.3	46.5
Other credits	18.9	19.4	19.6	19.7	19.8	19.8
Other items (net)	-57.7	-55.7	-57.4	-56.5	-59.7	-59.2
Banking system						
Broad money M2X	507.1	503.7	504.4	518.6	526.8	544.4
Currency in circulation ¹	202.2	208.5	211.6	215.4	218.3	230.2
Nonbank ² deposits (total)	304.9	295.2	292.9	303.3	308.4	314.2
In foreign currencies	164.8	158.6	161.7	165.0	168.0	174.7
Domestic money supply M2D ³	342.4	345.1	342.7	353.6	358.7	369.7
Net foreign assets	285.3	291.4	324.8	349.6	364.6	371.6
Net domestic assets	221.8	212.3	179.6	169.0	162.2	172.8
Credits	219.0	213.1	196.5	192.8	196.7	196.4
Bank of Latvia refinancing rate (%)	24.0	24.0	24.0	19.0	15.0	13.0
Average weighted interest rates (%)						
In the interbank market	17.4	22.5	20.9	15.6	12.5	11.9
In the nonbank sector						
Short-term credits granted in lats	32.4	29.1	33.1	29.7	27.2	27.1
Long-term deposits in lats	13.9	15.0	16.4	13.8	12.2	11.6
LVL vs USD	0.549	0.542	0.549	0.552	0.555	0.554

¹ Less vault cash balances.

² Enterprises and private persons.

³ Currency outside banks plus deposits of domestic enterprises and private persons in national currency.

Appendix 1

(cont.)

(at end of month; in millions of lats)

	VII	VIII	IX	X	XI	XII
Bank of Latvia						
Monetary base M0	301.6	310.5	310.8	319.3	316.1	340.7
Currency in circulation	246.3	252.8	261.0	260.6	262.8	282.6
Deposits with the Bank of Latvia	55.3	57.7	49.8	58.8	53.3	58.1
Currency vs reserve money (%)	81.7	81.4	84.0	81.6	83.1	82.9
Net foreign assets	288.5	301.0	311.1	324.5	332.2	358.5
Net domestic assets	13.1	9.5	-0.3	-5.2	-16.1	-17.8
Credits	71.6	68.2	59.0	58.0	45.7	42.9
To banks	13.1	13.2	10.9	17.6	10.6	10.0
To Central Government (net)	38.9	35.5	28.3	20.7	15.5	13.3
Other credits	19.6	19.6	19.8	19.8	19.6	19.7
Other items (net)	-58.5	-58.7	-59.3	-63.2	-61.9	-60.7
Banking system						
Broad money M2X	558.4	580.4	601.5	596.6	586.0	628.3
Currency in circulation ¹	231.7	239.0	244.4	243.9	247.6	264.0
Nonbank ² deposits (total)	326.7	341.4	357.1	352.6	338.3	364.3
In foreign currencies	183.6	193.3	200.8	198.8	185.4	195.5
Domestic money supply M2D ³	374.8	387.1	400.7	397.8	400.6	432.7
Net foreign assets	379.2	399.8	410.1	428.7	421.8	452.2
Net domestic assets	179.2	180.6	191.4	167.9	164.2	176.0
Credits	191.5	193.1	196.1	199.6	200.0	211.5
Bank of Latvia refinancing rate (%)	13.0	12.0	11.0	10.0	10.0	9.5
Average weighted interest rates (%)						
In the interbank market	11.1	9.8	7.5	10.3	7.9	9.7
In the nonbank sector						
Short-term credits granted in lats	17.1	23.9	22.3	23.3	24.0	20.3
Long-term deposits in lats	11.0	9.7	13.2	9.6	9.9	10.1
LVL vs USD	0.548	0.548	0.555	0.554	0.552	0.556

Appendix 2

THE BANK OF LATVIA'S MONTH-END BALANCE SHEETS

(in thousands of lats)

	1996					
	I	II	III	IV	V	VI
ASSETS						
FOREIGN ASSETS	391 941	394 124	406 152	422 135	440 756	442 816
Gold	41 040	40 517	41 041	41 265	41 489	41 428
Special Drawing Rights	1 195	2 633	118	1 073	146	141
Convertible currencies	272 656	273 566	287 365	301 176	320 158	322 291
International Monetary Fund	72 929	72 929	72 929	72 929	72 929	72 929
Shares in the Bank for International Settlements	961	949	961	966	971	970
Other foreign assets	2 352	2 742	2 955	3 423	3 763	3 772
Non-convertible currencies	808	788	783	1 303	1 300	1 285
DOMESTIC CREDITS	95 269	98 833	98 145	84 642	84 817	90 305
To banks	25 783	29 922	26 998	22 187	17 637	20 606
To the Government	45 918	44 634	44 020	34 281	34 408	34 142
Government securities	4 688	4 915	7 515	8 455	12 945	15 770
Other credits	18 880	19 362	19 612	19 719	19 827	19 787
OTHER ASSETS ¹	4 488	3 853	5 394	5 263	5 754	6 215
FIXED ASSETS	4 592	4 596	4 664	4 633	4 601	4 772
TOTAL ASSETS	496 290	501 406	514 355	516 673	535 928	544 108
LIABILITIES						
FOREIGN LIABILITIES	159 504	159 706	157 185	157 723	157 646	155 087
International Monetary Fund accounts	159 163	159 163	156 647	157 006	157 006	154 491
Other foreign liabilities	6	6	6	6	6	6
Foreign bank deposits in lats	80	288	285	466	393	352
Non-convertible currencies	255	249	247	245	241	238
LATS IN CIRCULATION	217 874	221 693	224 670	230 092	231 540	243 992
DOMESTIC DEPOSITS	93 606	97 600	106 786	104 009	118 351	116 782
From banks	32 612	36 359	36 314	49 930	56 842	66 764
From the Government	18 277	18 212	27 828	11 677	18 830	7 160
Government foreign borrowings	40 872	41 173	41 277	41 077	41 268	41 749
Humanitarian aid accounts	1 005	980	878	706	705	593
Other deposits	840	876	489	619	706	516
OTHER LIABILITIES ¹	4 762	4 278	6 370	6 258	7 059	8 004
CAPITAL AND RESERVES	20 544	18 129	19 344	18 591	21 332	20 243
Nominal capital	2 500	2 500	2 500	2 500	2 500	2 500
Reserve capital	625	625	625	625	625	625
Other reserves	9 094	9 094	9 094	9 094	9 094	9 094
Valuation account	7 898	5 483	6 698	5 945	8 686	7 597
EU grant	427	427	427	427	427	427
TOTAL LIABILITIES	496 290	501 406	514 355	516 673	535 928	544 108

¹ Data in the balance sheets for January–November 1996 have been revised and provisions made for receivables regarding settlements with CIS countries have been excluded.

Appendix 2

(cont.)

(in thousands of lats)

	1996					
	VII	VIII	IX	X	XI	XII
ASSETS						
FOREIGN ASSETS	446 559	458 669	463 599	474 359	482 078	504 685
Gold	40 980	40 980	41 503	41 428	41 279	41 578
Special Drawing Rights	1 149	214	98	115	1 238	1 251
Convertible currencies	325 569	338 869	343 562	354 912	362 204	384 549
International Monetary Fund	72 929	72 929	72 929	72 929	72 929	72 929
Shares in the Bank for International Settlements	959	959	971	970	966	973
Other foreign assets	3 712	3 271	3 111	2 601	2 077	2 019
Non-convertible currencies	1 261	1 447	1 425	1 404	1 385	1 386
DOMESTIC CREDITS	90 513	78 805	77 569	84 748	72 145	74 309
To banks	13 113	13 176	10 917	17 592	10 621	9 950
To the Government	41 431	37 154	37 087	35 599	31 413	30 575
Government securities	16 401	8 915	9 763	11 795	10 522	14 077
Other credits	19 568	19 560	19 802	19 762	19 589	19 707
OTHER ASSETS ¹	6 709	6 870	6 124	6 079	6 955	5 620
FIXED ASSETS	4 749	4 759	4 833	4 790	4 853	6 086
TOTAL ASSETS	548 530	549 103	552 125	569 976	566 031	590 700
LIABILITIES						
FOREIGN LIABILITIES	153 953	154 027	152 041	149 406	149 459	145 805
International Monetary Fund accounts	153 500	153 500	150 985	149 003	149 003	145 497
Other foreign liabilities	6	6	6	6	6	6
Foreign bank deposits in lats	214	294	827	159	215	67
Non-convertible currencies	233	227	223	238	235	235
LATS IN CIRCULATION	246 322	252 762	261 035	260 559	262 778	282 602
DOMESTIC DEPOSITS	120 325	113 786	110 123	127 636	121 615	131 653
From banks	54 803	57 257	48 920	54 571	52 349	52 780
From the Government	22 590	13 827	18 060	26 324	25 968	31 017
Government foreign borrowings	41 849	41 734	41 783	42 094	41 898	42 197
Humanitarian aid accounts	584	511	513	455	456	364
Other deposits	499	457	847	4 192	944	5 295
OTHER LIABILITIES ¹	9 440	9 477	9 276	9 183	11 444	5 350
CAPITAL AND RESERVES	18 490	19 051	19 650	23 192	20 735	25 290
Nominal capital	2 500	2 500	2 500	2 500	2 500	2 500
Reserve capital	625	625	625	625	625	625
Other reserves	9 094	9 094	9 094	9 094	9 094	13 494
Valuation account	5 844	6 405	7 004	10 546	8 089	8 244
EU grant	427	427	427	427	427	427
TOTAL LIABILITIES	548 530	549 103	552 125	569 976	566 031	590 700

Appendix 3

THE BANK OF LATVIA'S YEAR-END BALANCE SHEETS FOR 1992–1996

(in thousands of lats)

	1992	1993	1994	1995	1996
ASSETS					
FOREIGN ASSETS	108 476	385 358	416 177	392 548	504 685
Gold	16 902	43 268	40 972	40 150	41 578
Special Drawing Rights	22 419	58 359	174	1 195	1 251
Convertible currencies	36 636	201 543	298 919	273 971 ¹	384 549
International Monetary Fund	–	74 853	72 929	72 929	72 929
Shares in the Bank for International Settlements	1 461	1 040	959	940	973
Other foreign assets	–	2 053	958	2 556	2 019
Correspondent accounts	41	467	10	–	–
Credits to CIS countries	8 152	145	–	–	–
Non-convertible currencies	22 865	3 630	1 256	807	1 386
CASH	42	–	–	–	–
DOMESTIC CREDITS	62 055	54 357	67 979	100 818	74 309
To banks	56 055	51 981	54 468	24 579	9 950
To the Government	6 000	2 376	13 126	51 585	30 575
Government securities	–	–	385	5 774	14 077
Other credits	–	–	–	18 880	19 707
OTHER ASSETS	12 366	3 040	5 926	9 011 ²	5 620
FIXED ASSETS	249	1 563	3 172	4 453 ³	6 086
TOTAL ASSETS	183 188	444 318	493 254	506 830	590 700

¹ In the 1995 balance sheet foreign assets in convertible currency have been recorded at their historic cost.

² Receivables regarding settlements with CIS countries have been included.

³ In the 1995 balance sheet, as in previous year-end balance sheets, fixed assets have been included in the item "Other Assets".

Appendix 3

(cont.)

(in thousands of lats)

	1992	1993	1994	1995	1996
LIABILITIES					
FOREIGN LIABILITIES	36 592	149 585	161 913	159 622	145 805
International Monetary Fund accounts	29 581	146 042	161 289	159 163	145 497
Other foreign liabilities	–	6	6	6	6
Foreign bank deposits in lats	–	2 421	219	198	67
Non-convertible currencies	7 011	1 116	399	255	235
LATS IN CIRCULATION	77 467	179 132	232 100	225 871	282 602
DOMESTIC DEPOSITS	39 770	91 342	88 706	92 416	131 653
From banks	36 582	46 423	37 326	46 908	52 780
From the Government	480	2 377 ¹	10 105	2 623	31 017
Government foreign borrowings	–	41 842	40 604	41 049	42 197
Humanitarian aid accounts	2 708	700	671	996	364
Government risk fund	–	–	–	840	5 292
Other deposits	12 225	9 557	2 515	7 790 ²	5 350
CAPITAL AND RESERVES	17 134	14 702	8 020	21 131	25 290
NOMINAL CAPITAL	1 829	2 500	2 500	2 500	2 500
Reserve capital	290	625	625	625	625
Other reserves	–	–	4 160	9 093	13 494
Valuation account	15 015 ³	10 904	4	8 486	8 244
EU grant	–	673	731	427	427
TOTAL LIABILITIES	183 188	444 318	493 254	506 830	590 700

¹ Government risk fund has been segregated in the 1993 balance sheet.

² Provisions for receivables regarding settlements with CIS countries have been included.

³ The valuation account has been shown separately for foreign convertible and non-convertible currencies in the 1992 balance sheet.

Appendix 4

THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT FOR THE YEARS 1992–1996

(in thousands of lats)

	1992	1993	1994	1995	1996
INTEREST INCOME					
Foreign operations					
Interest on bank deposits	301	3 938	5 706	1 306	2 207
Income from securities	54	915	4 639	19 907	16 941
Other foreign income	47	620	1 540	268	59
Dividends on BIS shares	143	105	99	111	115
GROSS foreign interest income	545	5 578	11 984	21 592	19 322
Domestic operations					
Interest on loans to banks	10 894	18 876	1 748	561	575
Interest on Government securities	–	–	88	845	1 538
Interest on loans to Government	1 372	3 596	1 542	6 244	2 632
Other domestic income	–	239	1 168	2 403	197
GROSS domestic interest income	12 266	22 711	4 546	10 053	4 942
INTEREST EXPENSE					
Foreign operations					
Interest on loans	–	1 991	2 909	2 700	1 978
Other foreign expense	289	54	73	260	294
GROSS foreign interest expense	289	2 045	2 982	2 960	2 272
Domestic operations					
Interest on bank deposits	–	–	–	21	17
Interest on Government deposits	31	49	1 348	3 138	2 971
Other domestic expense	–	2	407	–	–
GROSS domestic interest expense	31	51	1 755	3 159	2 988
NET INTEREST INCOME	12 491	26 193	11 793	25 526	19 004
Net foreign exchange profit/loss	–5 261	–185	–2 354	– ¹	– ¹
Special provisions	–	–	–	7 825	1 142

¹ Net foreign exchange loss is included in the item "Other Operating Expenses".

Appendix 4

(cont.)

(in thousands of lats)

	1992	1993	1994	1995	1996
OPERATING INCOME	10	393	2 379	604	611
OPERATING EXPENSES					
Salaries, wages and other personnel costs	89	1 010	2 429	3 438	4 541
Social security	37	373	890	1 258	1 543
Costs of coin and bank note production	4 497	5 686	599	23 ¹	294
Depreciation	10	43	311	837	1 478
Other operating expenses	171	1 821	3 429	6 316	3 694
Reserve for deposit guarantee fund	–	–	–	–	500
Other reserves	–	–	4 160	4 933	4 400
Payments and donations to the state budget	853	–	–	–	–
Remaining profit appropriated to the state budget	–	7 913	–	1 500	2 023

¹ Beginning with 1995, only costs of coin production.

Appendix 5

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

(in lats)

	Maximum	Average	Minimum	Maximum	Average	Minimum	Maximum	Average	Minimum
1996	DEM			GBP			FRF		
I	0.3760	0.3730	0.3690	0.8400	0.8339	0.8270	0.1099	0.1090	0.1073
II	0.3750	0.3722	0.3700	0.8420	0.8377	0.8290	0.1091	0.1082	0.1076
III	0.3710	0.3703	0.3690	0.8420	0.8357	0.8320	0.1085	0.1081	0.1077
IV	0.3710	0.3670	0.3610	0.8400	0.8362	0.8340	0.1088	0.1081	0.1071
V	0.3630	0.3611	0.3600	0.8490	0.8374	0.8260	0.1073	0.1068	0.1064
VI	0.3650	0.3627	0.3610	0.8600	0.8542	0.8490	0.1075	0.1071	0.1068
VII	0.3700	0.3661	0.3630	0.8640	0.8572	0.8470	0.1093	0.1082	0.1074
VIII	0.3710	0.3700	0.3690	0.8540	0.8497	0.8440	0.1093	0.1084	0.1078
IX	0.3710	0.3675	0.3640	0.8660	0.8601	0.8530	0.1084	0.1078	0.1072
X	0.3670	0.3634	0.3610	0.8940	0.8782	0.8670	0.1084	0.1075	0.1068
XI	0.3670	0.3645	0.3620	0.9280	0.9135	0.9020	0.1085	0.1078	0.1067
XII	0.3620	0.3587	0.3560	0.9360	0.9240	0.9080	0.1068	0.1061	0.1050
1996	USD			100 JPY			ECU		
I	0.5510	0.5442	0.5390	0.5230	0.5163	0.5130	0.6990	0.6883	0.6750
II	0.5500	0.5457	0.5420	0.5200	0.5155	0.5120	0.6900	0.6832	0.6770
III	0.5490	0.5469	0.5450	0.5200	0.5170	0.5120	0.6880	0.6860	0.6840
IV	0.5540	0.5511	0.5470	0.5240	0.5130	0.5080	0.6900	0.6860	0.6790
V	0.5570	0.5535	0.5500	0.5280	0.5212	0.5120	0.6830	0.6799	0.6780
VI	0.5560	0.5543	0.5520	0.5130	0.5096	0.5070	0.6890	0.6861	0.6820
VII	0.5560	0.5520	0.5470	0.5110	0.5046	0.5000	0.6980	0.6922	0.6890
VIII	0.5500	0.5482	0.5460	0.5130	0.5085	0.5060	0.6980	0.6956	0.6940
IX	0.5550	0.5516	0.5480	0.5060	0.5032	0.5010	0.6990	0.6955	0.6930
X	0.5570	0.5557	0.5540	0.5000	0.4952	0.4850	0.7020	0.6958	0.6930
XI	0.5540	0.5504	0.5480	0.4930	0.4899	0.4840	0.7030	0.6999	0.6970
XII	0.5580	0.5556	0.5520	0.4940	0.4894	0.4860	0.6970	0.6919	0.6880

Appendix 6

LIST OF CREDIT INSTITUTIONS AT THE END OF 1996

BANKS

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

¹ Since February 24, 1997, joint-stock company "Latvijas Krajbanka".

² Licence was revoked on February 21, 1997.

³ Licence was revoked on February 27, 1997 because the Bank of Latvia gave its consent to the merger of the bank with the state joint-stock company in privatization "Latvijas Krajbanka".

Appendix 6

(cont.)

CREDIT UNIONS

1. Credit Union "Dzelzcelnieks KS"
2. Credit Union "Ligatnes Druva"
3. Taurene Credit Union
4. Veselava Credit Union

BRANCH OF FOREIGN BANK

1. Riga Branch of *Societe Generale* (France)

Appendix 7

THE BANK OF LATVIA'S ORGANIZATIONAL UNITS AT THE END OF 1996

1. ACCOUNTING AND SETTLEMENTS DEPARTMENT

(Head of Department, Chief Accountant – Antonija Sileniece; Deputy Chief Accountant – Maija Kurpniece)

1.1. Internal Banking Operations Division (Head of Division – Anita Jakane)

1.2. Central Accounting Division

1.3. Settlements Division (Head of Division – Natalija Popova)

2. CASHIER'S AND MONEY OPERATIONS DEPARTMENT

(Head of Department – Uldis M. Klauss; Deputy Head of Department – Oskars Zaltans)

2.1. Cash Operations Division (Head of Division – Veneranda Kausa)

2.2. Money Operations Division (Head of Division – Alite Grobina)

2.3. Collector Coin Division (Head of Division – Maruta Balduncika)

3. CONSTRUCTION DEPARTMENT

(Head of Department – Janis Karklins; Deputy Head of Department – Dzintars Taurenis)

4. CREDIT INSTITUTIONS SUPERVISION DEPARTMENT

(Head of Department – Armands Steinbergs; Deputy Head of Department (Credit Institutions Supervision and Methodology) – Janis Placis; Deputy Head of Department (Legal Issues and Licensing) – Janis Brazovskis)

4.1. Supervision Division (Head of Division – Jelena Lebedeva)

4.2. Licensing Division (Head of Division – Galina Sproge)

4.3. Methodological and Analytical Division (Head of Division – Ludmila Vojevoda)

4.4. Legal Division (Head of Division – Valda Bidina)

5. FOREIGN EXCHANGE DEPARTMENT

(Head of Department – Roberts L. Grava; Deputy Head of Department – Daira Brunere)

5.1. Payments and Settlements Division (Head of Division, Deputy Head of Department – Una Ruka)

5.2. Trading and Investment Division (Head of Division – Arvids Sipols)

5.3. External Debt Management Division (Head of Division – Agita Birka)

5.4. Analysis Division (Head of Division – Aigars Egle)

6. FOREIGN RELATIONS DEPARTMENT

(Head of Department – Guntis Valujevs; Deputy Head of Department – Linda Vitola)

7. GENERAL OFFICE

(Head of Department – Guntis Didrihsons)

7.1. Division for Guests Reception and Translation Services (Head of Division – Leons Brunavs)

7.2. Clerical Office (Head of Clerical Office – Ilga Strasburga)

7.3. Library (Manager of Library, Deputy Head of Department – Dace Gasina)

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(cont.)

8. GENERAL SERVICE DEPARTMENT

(Head of Department – Einars Ciss)

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

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

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

9. INFORMATION SYSTEMS DEPARTMENT

(Head of Department – Mara Raubisko; Deputy Head of Department – Harijs Ozols)

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

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

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

10. INTERNAL AUDITING DEPARTMENT

(Head of Department – Modris Briedis)

11. LEGAL DEPARTMENT

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

12. MONETARY POLICY DEPARTMENT

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

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

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

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

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

13. PERSONNEL DEPARTMENT

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

14. PUBLIC RELATIONS DEPARTMENT

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

15. PUBLICATIONS DEPARTMENT

(Head of Department – Aina Ranke)

16. SECURITY DEPARTMENT

(Head of Department – Armands Steinbergs; Deputy Heads of Department – Laimonis Veinsteins, Aldis Lieknins)

16.1. Analytical Division (Head of Division – Alvis Zirins)

16.2. Armament Division (Head of Division – Andris Purmalis)

16.3. Cash Transport Division (Head of Division – Janis Osis)

16.4. Daugavpils Division

Appendix 7

(cont.)

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

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

16.7. Valmiera Division (Head of Division – Aldis Zimmers)

17. STATISTICS DEPARTMENT

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

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

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

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

18. RIGA BRANCH

(Branch Manager – Janis Strelnieks)

19. DAUGAVPILS BRANCH

(Branch Manager – Jolanda Matesa)

20. LIEPAJA BRANCH

(Branch Manager – Gundars Lazdāns)

21. REZEKNE BRANCH

(Branch Manager – Vilhelmine Landsberga)

22. VALMIERA BRANCH

(Branch Manager – Sarmīte Kleimane)

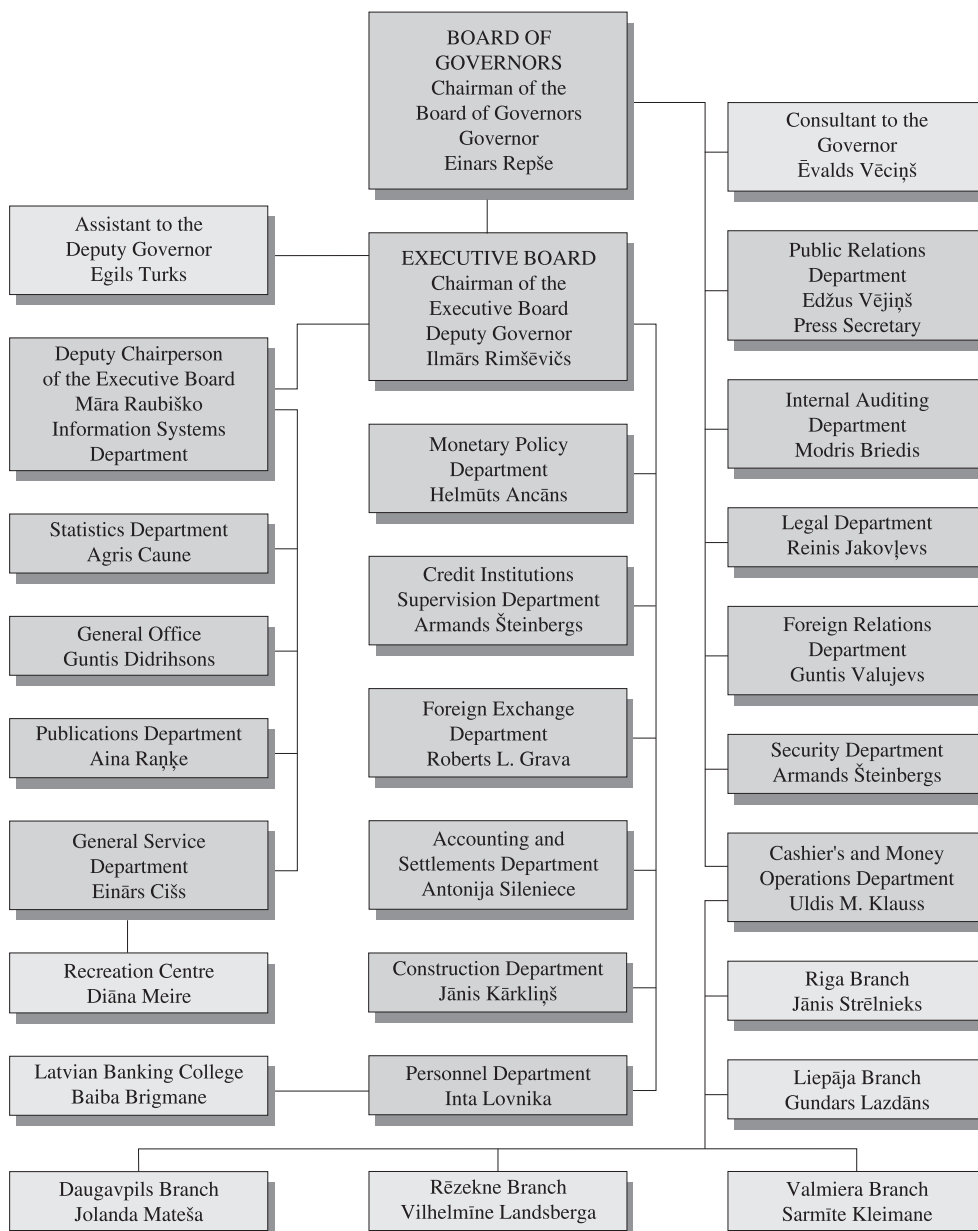
23. LATVIAN BANKING COLLEGE

(Principal – Baiba Brīgmane; Vice Principal – Inese Vīngre)

24. RECREATION CENTRE "PUMPURI"

(Director – Diana Meire)

THE BANK OF LATVIA'S STRUCTURE AT THE END OF 1996



Bank of Latvia. Annual Report 1996

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