

LATVIJAS BANKA

**BANK OF LATVIA. ANNUAL REPORT 2002**





# **BANK OF LATVIA: ANNUAL REPORT 2002**

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The national economy of Latvia continued to show stable growth in 2002. As a result of high domestic demand, the rise in GDP surpassed the projections. Although the national economy developed at a rapid pace, inflation rate still remained low. Unemployment rate declined. Increase in real wages reached its high of the last five years. The current account deficit of the balance of payments decreased year-on-year, as a rise in the surplus of services and current transfers almost covered the increase in the deficit of goods and revenue. Following the trend in the global money markets in 2002, the Latvian money market interest rates also decreased considerably.

Significant growth was observed in the banking sector. The stability of the banking sector and the national currency, the population's growing welfare and the consolidation of the real sector of the national economy enabled credit institutions to attract considerably more deposits from domestic enterprises and private persons. Higher profitability, confidence in the national currency and the income and expenditure structure of transactions promoted growth of deposits made in lats that was considerably higher than that of deposits made in foreign currencies. A rise in the euro exchange rate and the growing importance of the euro in foreign trade settlements caused an increase in the share of deposits made in euros against the overall foreign currency non-bank deposits made by residents. Non-cash payment instruments continued to develop and were used ever more widely.

An upward trend in money demand, caused by economic activity, a drop in interest rates on loans and reduced credit risks facilitated a pickup in loans granted to domestic enterprises and private persons. Commercial credit, industrial credit and mortgage loans still dominated domestic lending. Increased lending could be observed in almost all branches of the national economy.

Personal income tax, corporate income tax, excise tax and other tax revenue rose in the reporting year. The general government consolidated budget had a lower fiscal deficit than expected. The yield on government securities at primary auctions declined. The difference between the interest rates on Latvian eurobonds and debt securities of the same term issued by the EU central governments diminished.

In view of Latvia's economic stability and growth, Latvia's rating for long-term obligations in foreign currencies was upgraded from BBB to BBB+ by the international rating agency *Standard & Poor's* and from Baa2 to A2 by *Moody's Investors Service*. At the end of 2002, the ten-year cooperation with the IMF resulted in concluding the Memorandum of the Economic Policy as further evidence of Latvia's capability and skills to develop its economic policy independently.

2002 saw several international developments that will have a significant impact on Latvia's political and economic life. The invitation to join NATO, extended to Latvia in 2002, and the conclusion of the negotiations on the accession to the EU testified to Latvia's successful integration in the global security system and the union of European states. It will ensure greater stability, open up opportunities for more extensive economic cooperation with countries across the globe, and promote more rapid growth of the Latvian national economy.

In early 2002, several structural units of the Bank of Latvia re-launched their operations at a new location, the Riga Branch building. It was awarded first prize in the category *New Public Buildings* at the competition *The Best Building of 2001*, organised by the Latvian Construction Contractors Association. Latvian cash reserves were transferred to a modern and secure vault, and the processing of cash, as well as the interbank settlement systems and the computer centre of the Bank of Latvia were accommodated in premises best suited for the purpose.

The Bank of Latvia expanded and deepened its cooperation with the European Central Bank. The traditionally close cooperation linked experts on monetary policy, settlement systems, information systems, statistics and currency operations. Good cooperation developed in the sphere of public relations and publications.

In 2002, the Saeima of the Republic of Latvia made amendments to the Law "On the Bank of Latvia" to ensure compliance of the legal framework with the requirements stipulated for the laws and regulations governing the operations of central banks in the EU member states.







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

## GLOBAL ECONOMIC ENVIRONMENT

In 2002, the pace of the global economic growth was slightly faster (1.8%) than in the previous year (1.0%). The second half of the year, however, was characterised by instability in the financial and equity markets, low consumer and producer confidence, and aggravation of the geopolitical situation. The United States' inability to overcome the consequences of the slower development in 2001 made a negative impact on the economic growth rate both in separate countries and globally. In view of the unstable economic environment, the central banks of several developed countries reduced their base interest rates to record lows as a means of facilitating recovery of the national economy.

According to provisional data, the US GDP grew by 2.4% (0.3% in 2001). In the first quarter, GDP rose considerably (by 5.0% against the previous quarter) as a result of an increase in the domestic demand and adjustment of reserves, but in the second quarter growth of the national economy slowed down. Nevertheless, the tendency of the production to expand in the first half of 2002 testified to promising developments in the production sector. The improved confidence of producers and consumers in early 2002 proved short-lived, however. In the first half of the year accounting scandals in several large corporations had a negative impact, since they aggravated the situation in securities markets. The level of investment in the production sector remained low, and no new jobs were created. Instability in the labour market had a negative effect on consumer confidence during the entire 2002. The deteriorating geopolitical situation and concerns regarding the possibility of US military action in Iraq added complexity in the second half of the year: the GDP growth rate declined but since there was almost no inflation risk, the Federal Reserve System lowered the federal funds rate by 50 basis points (to 1.25%) to boost the national economy.

In 2002, the growth of the economies in the euro area was slower than in the previous year. The total GDP of the above countries increased by a mere 0.8% (1.4% in 2001). A brief upswing in the economic activity at the beginning of the year, which was characterised by improving industrial production volume as a result of a pickup in the global demand, was followed by slower national economy development in the euro area, as well as in the United States later on.

Private consumption did not facilitate the GDP growth in the euro area; the domestic demand increased in the second half of the year only. The weak economic growth resulted in a decline in tax revenue, thus the fiscal situation grew worse, affected also by other negative factors, e.g., expenditure related to flood relief efforts. Four EU countries had problems in complying with the fiscal discipline. After a considerable pickup in early 2002, resulting mostly from growing food prices due to bad weather in Southern Europe, the CPI in the euro area gradually declined over the year. Inflation rate dropped to 2.2% in the euro area (2.4% in 2001). Inflation pressure eased off, and the ECB reduced the refinancing rate by 50 basis points (to 2.75%).

Recovery of Japan's national economy, facilitated by expanding exports, helped maintain a positive GDP growth rate. According to provisional data, Japan's GDP rose by 0.3% in 2002. Nevertheless, the national economy in Japan still encountered a decline in capital expenditure, low domestic demand and unsolved problems in the banking sector due to the slow pace of structural reforms. Japan faced deflation for the fourth year in succession.

In 2002, economic activity remaining low in the major export markets, several Central and East European countries recorded a slight decline in their GDP growth

rate. Since foreign demand decreased, the rise in GDP was mostly determined by domestic factors. That, against a cyclical decline in the global economic activity, ensured markedly rapid growth in several countries in the region. On the one hand, an increase in real wages, reduced unemployment, development of the banking sector and increased lending underlay the rise in domestic demand; in some countries a drastic upsurge in government expenditure was also a contributing factor. On the other hand, the demand was affected by net capital inflow in the region, facilitated both by stable macroeconomic situation in most of the countries, as well as the EU enlargement process.

Although the economic activity in Poland was stimulated by way of monetary policy, it remained low for the second consecutive year. In 2002, Poland's GDP rose by 1.3% only. Despite a more rapidly increasing private consumption, the domestic demand was low because of declining investment. GDP in the Czech Republic also grew rather slowly (2.0%) as a consequence of both decreased foreign demand and a rise in the exchange rate of the Czech koruna, as well as the flood in August 2002. The Baltic States faced a more rapid growth than the region as a whole. In Estonia, an increase in the domestic demand was facilitated both by a significant expansion of private consumption and a marked increase in investment, resulting in a GDP growth rate of 5.8% (5.0% in 2001). A pickup in goods exports in the second half of the year also facilitated development; nevertheless, the overall goods exports from Estonia declined by 1.6% in 2002. Owing to an increase in goods imports by 5.8%, a rise in the current account deficit was reported. The GDP growth rate in Lithuania reached 6.7% (5.9% in 2001). Both private and government expenditure continued to expand significantly. The level of investment also grew rapidly, and exports of Lithuanian goods increased by 10.6%. Although the economic activity was quite high, consumer prices dropped in the second half of the year, and in December 2002, consumer prices in Lithuania were 1.0% lower than in the previous year. It was largely determined by a rise in the exchange rate of the litas, as well as by a relatively low increase in wages due to rapidly improving productivity.

The growing domestic demand in Russia facilitated the development of other CIS countries as well. Due to an increase in the real income of inhabitants, resulting from a sharp rise in wages and declining unemployment, private consumption expanded substantially. The investment growth rate, however, decelerated for the second consecutive year due to lower enterprise performance results. In 2002, goods exports, expressed in US dollars, rose by 5.3% as a result of rising oil prices, whereas the growing domestic demand caused a more rapid increase in imports. Hence, Russia's current account surplus decreased. According to provisional data of the State Committee of the Russian Federation on Statistics, that country's GDP increased by 4.3% in 2002. The growth rates in industry, construction and agriculture declined, whereas the services sector developed at a more rapid pace than in the previous year.

### **INFLATION AND PRICES**

In Latvia the year-on-year rise in CPI was 1.9% in 2002, including 2.1% for goods and 1.3% for services (in 2001, the year-on-year increase was 2.5%). In December 2002, the year-on-year increase in CPI was 1.4% (see Chart 1).

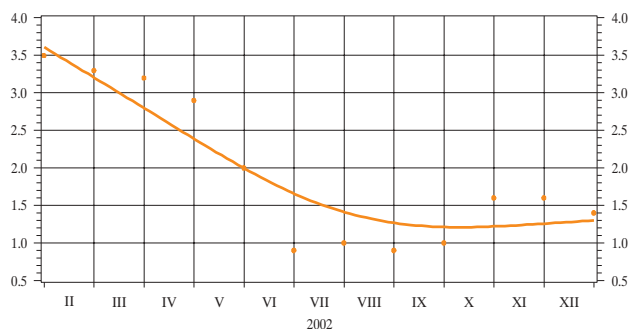
In 2002, inflation reached its low since the restoration of Latvia's independence. The inflation rate was affected by both internal and external factors. Deceleration of the global economy growth rate facilitated a decline in inflation in its trade partner countries, resulting in lower import prices in Latvia. The prices regulated

administratively remained almost constant, but due to fluctuations in the global oil markets the annual average fuel price in Latvia fell by 0.9%. The reduced tariffs for mobile phone services, as well as reduced prices for travel by rail and air, also affected the inflation rate. Inflation increased mostly due to rising prices of food, household goods and transport vehicles, as well as health care and education services.

Chart 1

**CHANGES IN THE CONSUMER PRICE INDEX**

(year-on-year basis; %)



Source: Central Statistical Bureau of Latvia.

The annual average CPI growth (by 1.1 percentage points) was determined mostly by rising food prices (potatoes in particular). Higher prices in transportation, owing to the rise in prices of transport vehicles (by 6.1%), significantly affected the average price level. Tobacco prices and payments related to housing and health care, as well as education also increased. The increase in food prices was mostly due to unfavourable weather conditions and a rise in producer prices set for some groups of food products (7.9% for sugar). Excise tax on tobacco products increased. Housing-related payments rose as a result of administrative decisions on an increase in prices for water supply and sewage services. Also prices of medicine grew significantly (by 5.7%). Fees for financial services and education rose quite rapidly (by 12.8% and 6.3%, respectively, including tuition fees for higher education by 16.9%); however, the share of these in the consumption expenditure structure is not large.

In 2002, prices of several goods and services decreased, thereby slowing the growth rate of the average consumer price level. That was primarily (by 0.2 percentage points) affected by the communications industry (price cuts for mobile phones and services). Meat prices also dropped significantly (on the average by 0.8% over the year; in December the year-on-year decrease was 7.4%) due to imports of subsidised pork from Poland as well as growing competition; nevertheless, the rise in the prices of other food products induced a price increase in this consumption group.

Inflation, administratively regulated prices and fuel prices excluded, declined gradually over the year (a year-on-year decrease of 1.1% in December) in step with overall inflation, yet remained the key component underlying the rise in the average consumer price level. In 2002, the impact of the administratively regulated prices was minor (0.1 percentage points only), as they increased by only 0.6%.

As to the breakdown by month, the CPI reached its high in January (0.9%), whereas in February, June, July and August the price level declined. January also saw the highest annual inflation rate (3.5%); it was the lowest in June and August (0.9%).

In 2002, the average monthly gross wage of persons employed in the national economy reached LVL 172.78 (a year-on-year increase of 8.5%). The average monthly net wage rose by 8.0% over the year (to LVL 124.47 or 72.0% of the average monthly gross wage). The wage rise exceeded the annual inflation rate;



hence the annual growth of the real gross wage was 6.4%, and that of the real net wage 6.0%. 2002 saw the most rapid increase in the real wage in the last five years.

The producer price index was 1.0% higher than in the previous year. The increase was determined by a price rise for exported goods (1.9%) and a moderate pickup in prices of goods sold on the domestic market (0.3%), without a perceptible effect on the inflation rate in Latvia.

Construction costs decreased in all basic groups of resources; hence the construction cost index fell by 2.9% compared to the previous year.

In 2002, the export unit value increased by 2.7% (2.6% in 2001). The price rise for prepared foodstuffs (including alcoholic and non-alcoholic beverages and tobacco products) (14.1%), wood pulp, paper and paperboard (7.4%), and base metals and articles of base metals (5.8%) was the highest. At the same time, the export unit value substantially decreased for the products of the chemical and allied industries, as well as live animals and animal products (by 9.5% and 6.6%, respectively). The volume of exports increased by 9.2%, with exports of prepared foodstuffs (including alcoholic and non-alcoholic beverages and tobacco products), various miscellaneous articles (furniture), machinery and mechanical appliances, electrical equipment, and products of the chemical and allied industries as the main contributors.

The import unit value increased by 5.8% (1.7% in 2001). The gain was determined by a rise in the prices of goods dominant in imports – machinery and mechanical appliances, electrical equipment, base metals and articles of base metals, and transport vehicles (9.8%, 9.5% and 3.6%, respectively). Only the import unit value of mineral products decreased (by 1.4%). The volume of imports increased by 7.2%.

With the import unit value increasing in excess of the export unit value, the terms of trade deteriorated by 2.9% in 2002.

### GROSS DOMESTIC PRODUCT

In 2002, the national economy continued to develop rapidly as a result of high domestic demand and increased exports. Growth was particularly significant in the second half of the year when the year-on-year increase in real GDP reached 7.8% (4.3% in the first half of the year), resulting in an overall annual increase of 6.1% (see Table 1). GDP at current prices totalled 5 194.7 million lats.

Table 1

#### GROSS DOMESTIC PRODUCT AND GROSS VALUE ADDED

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

	2000	2001 <sup>1</sup>	2002
GDP	6.8	7.9	6.1
Goods-producing sector	6.3 <sup>1</sup>	8.3	7.0
Service sector	7.1	8.3	5.9

<sup>1</sup> Data have been revised.

Source: Central Statistical Bureau of Latvia.

In 2002, the most rapid increase was recorded in the trade sector. It accounted for 12.7% in real growth in the total value added, and contributed most to the vigorous rise of the services sector. Also financial intermediation (an increase of 5.1% in the value added), real estate, renting and business activities (5.7%), as well as personal services (4.6%) reported an upward trend.

Slower growth in transport, storage and communications (2.4%) can be explained by a rapid decline in oil transit. In the first quarter, a year-on-year decrease of 1.5% was reported in the volume of oil transported to the port of Ventspils by pipeline, but in the fourth quarter it reached 83.9%. As a result, in 2002 cargoes loaded and unloaded at the port of Ventspils declined by 24.3%. However, the total volume of cargoes loaded and unloaded at the ports of Latvia fell by 8.4% only, since the cargoes handled at the port of Riga and other ports in Latvia increased considerably. The volume of cargoes transported by rail rose by 5.8%.

Development in the goods-producing sector was mainly determined by manufacturing, its most significant branch, whose value added in the total value added growth increased by 7.2%, owing to a high demand both in the domestic and foreign markets at the same time. The production growth in constant prices was most pronounced in machine building, production of building materials, chemical industry, production of wood pulp and prepared foodstuffs. The production output volume grew substantially in construction (by 10.8%), mining and quarrying (by 7.7%), electricity, gas and water supply (by 4.6%), and agriculture, hunting and forestry (by 4.2%).

In 2002, the number of unemployed persons registered with the State Employment Service declined by 2.1%, and the unemployment rate dropped to 7.6% of the economically active population (7.7% at the end of 2001).

With the economic activity in Latvia expanding, the unemployment level declined. Although the unemployment rate rose seasonally to 8.2% in February and March, it had a gradual decrease subsequently and in December was at its lowest since November 2001.

The high rate of unemployment still remained a topical issue in several regions in Latvia. In some districts, towns and cities unemployment decreased (the highest drop, by 1.7 percentage points, was in the Jēkabpils district), while elsewhere it increased (e.g., in the Kuldīga and Limbaži districts, etc.). The highest unemployment rate still persisted in the Rēzekne district (26.2% of the economically active population), as well as in the Balvi and Ludza districts (20.8% and 20.2%, respectively), while the lowest one was in the Saldus and Riga districts (5.5% and 6.4%, respectively). In Riga, the unemployment rate was only 3.7% in December.

#### **FOREIGN TRADE AND THE BALANCE OF PAYMENTS**

In 2002, Latvia's foreign trade turnover amounted to 3 906.2 million lats. Exports grew by 12.1% and imports by 13.4%. Although the economic growth rate in Europe and elsewhere in the world remained low, the demand for Latvian goods increased in several markets. Exports expanded more rapidly in the second half of the year, which, in part, can be explained by the lower base in the second half of 2001. The pickup in domestic and foreign demand resulted in higher imports, and the foreign trade deficit increased by 143.4 million lats (to 1 088.6 million lats; see Table 2). Machinery and mechanical appliances, electrical equipment, mineral products, transport vehicles, and products of the chemical and allied industries accounted for most of the trade deficit. Imports of machinery and mechanical appliances, electrical equipment, transport vehicles, and products of the chemical and allied industries grew more rapidly, leading to a substantial increase in the deficit in these groups of goods. With expanding exports of wood and articles of wood, the surplus of this group of goods rose and covered 39.6% of the total foreign trade deficit (42.1% in 2001). Of Latvia's major partner countries, foreign trade surplus was reported with the United Kingdom (147.6 million lats) and the

United States (20.4 million lats). Increasing exports to Sweden and Denmark, as well as declining imports from Belarus reduced the foreign trade deficit with these countries, whereas rapidly expanding imports from Germany, Finland, Poland and Lithuania resulted in a substantial rise in this indicator for each respective country. The EU countries were Latvia's major trade partners (60.4% of total exports and 53.0% of total imports).

Table 2

**LATVIA'S FOREIGN TRADE**

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

	2000	2001	2002
Exports	1 131.3	1 256.4	<b>1 408.8</b>
Imports	1 933.9	2 201.6	<b>2 497.4</b>
Balance	-802.6	-945.2	<b>-1 088.6</b>

Source: Central Statistical Bureau of Latvia.

In the reporting year, wood and articles of wood (33.6% of total exports), base metals and articles of base metals (13.2%), textiles and textile articles (12.8%) and prepared foodstuffs (including alcoholic and non-alcoholic beverages and tobacco; 7.2%) were the most important Latvian export goods. The highest rise was observed in the exports of wood and articles of wood (45.6 million lats); likewise, exports of woodwork, fuel wood and sawn wood expanded considerably. Also reported was an increase in exports of prepared foodstuffs (28.3 million lats; alcoholic and non-alcoholic beverages, tobacco, fish products), base metals and articles of base metals (25.6 million lats), miscellaneous manufactured articles (11.8 million lats; mostly furniture), machinery and mechanical appliances, electrical equipment (11.0 million lats). Exports of textiles and textile articles grew by 2.6 million lats only.

Latvia's principal export partners for wood and articles of wood were the United Kingdom (34.9% of total exports of these goods), Sweden (19.7%) and Germany (12.0%). Exports of wood and articles of wood to Sweden, Japan, the United States and Poland grew considerably. As in previous years, the most significant changes affected the sales of base metals and articles of base metals: there was a considerable year-on-year decrease in exports to Iran and an increase in exports to the Netherlands. As before, Germany accounted for the largest share of exports of base metals and articles of base metals (36.3%). However, exports of base metals and articles of base metals to other countries rose as well. Major markets for textiles and textile articles were Sweden (14.4%), Germany (14.1%) and Denmark (12.9%). The drop in the exports of the above goods to Germany was offset by a rise in exports to Italy, the United States and Russia. Growth in the exports of prepared foodstuffs (including alcoholic and non-alcoholic beverages and tobacco products) was attributable to increased exports of these products to the United States (an increase of 14.9 million lats), as well as Lithuania, Russia, Germany and Cyprus. Exports of machinery and mechanical appliances, electrical equipment continued to expand, including all major markets – Russia, Lithuania and Germany (by 17.4%, 15.8% and 13.3%, respectively), as well as Sweden, France and Estonia. Demand for miscellaneous manufactured articles (mostly furniture) declined in Germany and Finland, but rose in France, the United Kingdom, Estonia and the United States. Exports to the markets established in previous years (Norway, Japan, Algeria, Peru) continued to expand; moreover, manufacturers penetrated new markets as well (Portugal, Cyprus, Greece, Australia), yet sales volumes were not high.



Exports to the EU countries increased by 10.6%, mostly to Sweden (mainly wood and articles of wood). A considerable rise in exports to other countries (16.8%) was observed, primarily to the United States (tobacco, alcoholic and non-alcoholic beverages), Lithuania and Estonia. Exports to Lithuania and Estonia expanded for almost all the principal groups of goods. As to the CIS countries, Russia (stone, plaster and cement articles, machinery and mechanical appliances, fish products) and Ukraine (woodwork and pharmaceutical products) accounted for the growth in exports. Latvia's principal foreign markets were Germany, the United Kingdom, Sweden, Lithuania, Estonia and Russia for exports, Germany, Lithuania, Russia, Finland and Sweden for imports. Imports from the EU (mostly from Germany and Finland) and other countries (mainly from Lithuania) increased (by 14.3% and 17.8%, respectively). Imports from the CIS countries remained almost constant for the third consecutive year.

In 2002, Latvia's most significant import goods were machinery and mechanical appliances, electrical equipment (21.3% of total imports), products of the chemical and allied industries (10.5%), transport vehicles (9.8%), mineral products (9.7%), and base metals and articles of base metals (8.4%). Imports of almost all product groups increased, with mineral products the sole exception (a year-on-year decrease of 0.8%). The largest growth was recorded in imports of machinery and mechanical appliances, electrical equipment (65.8 million lats), transport vehicles (37.8 million lats; mostly cars, trucks and lorries), products of the chemical and allied industries (30.6 million lats; pharmaceutical products), prepared food-stuffs (29.6 million lats; alcoholic and non-alcoholic beverages), and base metals and articles of base metals (28.5 million lats).

Germany, Finland and Sweden accounted for the largest shares in imports of machinery and mechanical appliances, electrical equipment (24.1%, 16.1% and 7.7%, respectively); imports of the goods from Italy and the Netherlands reported the highest growth. Products of the chemical and allied industries were imported mostly from Germany (14.9%), Switzerland, Poland, Russia, Finland and Lithuania. The major countries from which Latvia imported transport vehicles were Germany (33.6%), Sweden (13.0%), Finland (9.6%) and Estonia (8.7%). The largest growth in imports of these goods was observed for Germany, Estonia and Finland. The drop in the imports of mineral products from Belarus (17.0 million lats) was almost offset by a rise in imports from Lithuania. Russia continued to supply significant volumes of mineral products (41.6%). Russia, Germany and Lithuania again accounted for the largest shares in imports of base metals and articles of base metals (16.5%, 14.7% and 11.6%, respectively). The largest growth in imports was observed for Lithuania, Germany, Poland and Finland. Textiles and textile articles were imported predominantly from Germany (16.6%), Sweden (13.4%), Italy (11.0%) and Denmark (10.0%). Imports of these goods from China and Italy increased most markedly.

In foreign trade transactions, the share of transactions in euros increased in 2002, while that of transactions in US dollars decreased. The share of transactions in euros reached 47.7% (in 2001, the proportion of EMU currencies and euro was 40.7%), while that of transactions in US dollars contracted from 38.8% to 32.1%. The proportion of foreign trade transactions in lats grew from 5.6% in 2001 to 6.6% in 2002.

The real effective exchange rate index of the lats, as measured against the currencies of ten Latvia's principal trading partners, fell by 3.7% in 2002, and the nominal exchange rate of the lats against these currencies declined by 2.3%. The decrease in the real effective exchange rate index of the lats, as measured against

the currencies of the developed countries (3.4%) was determined by a drop in the nominal exchange rate of the lats against these currencies, as the differences between the annual average inflation rate in Latvia and the developed countries in 2002 were insignificant. Whereas the real effective exchange rate index of the lats, as measured against the currencies of the developed countries, dropped by 4.5% (primarily as a result of the comparatively higher level of inflation rates in these countries).

In 2002, the current account deficit of the balance of payments was 403.1 million lats or 7.8% of GDP (9.6% in 2001). Growth in exports of goods, services and current transfers exceeded that in imports, and the ratio of goods and current transfers balance against GDP improved.

The services and current transfers surplus was higher than in 2001 and covered 56.0% of the goods deficit. In 2002, the services surplus gain (26.0 million lats) resulted mainly from an increase in the exports of travel services and other services. The decline in the volume of Latvian port services was partly offset by an increase in the provided transportation services. Revenues incurred a deficit of 11.8 million lats, as the revenue gained by non-residents from direct investment grew by 48.2%.

In 2002, the received financial resources and capital transfers fully covered the funds necessary for financing current accounts operations. The foreign direct investment surplus (240.4 million lats) covered 59.6% of the current account deficit. Portfolio investment reported a deficit of 143.3 million lats, but other investment showed a surplus of 326.2 million lats. Reserve assets remained almost unchanged compared to the year before.

### FISCAL POLICY

In 2002, the general government consolidated budget posted a fiscal deficit of 131.1 million lats or 2.5% of GDP (1.8% of GDP in 2001), slightly less than the indicator stipulated by amendments to the general government budget for 2002 (2.8% of GDP).

A considerable rise in the general government consolidated budget deficit was reported in December, when the central government basic budget expenditure rose sharply. That can be partly attributed to the fact that amendments to the Law "On General Government Budget for 2002" took effect as late as 21 November, and all additional expenditure stipulated by the budget amendments was financed in December. Amendments to the Law "On General Government Budget for 2002" provided for additional funding necessary for several urgent measures taken to meet the obligations under several laws and regulations (wage rise for medical staff, stabilisation of the situation in agriculture caused by drought, etc.).

The financial deficit of the general government consolidated budget totalled 146.4 million lats. Year-on-year, the general government consolidated budget revenue increased at a slower pace than expenditure (increases of 10.5% and 13.2%, respectively).

In 2002, the fiscal deficit of the central government basic budget was 103.7 million lats (a year-on-year increase of 33.7 million lats), reaching its highest growth in December (69.4 million lats). Almost all major expenditure items (current expenditure, subsidies and grants, capital expenditure) contributed to higher expenditure. In 2002, the central government basic budget revenue totalled 818.5 million lats (a year-on-year increase of 10.7%) and expenditure, including net lending,

was 922.2 million lats (a year-on-year increase of 13.9%). The central government basic budget tax revenue increased by 6.5%.

In 2002, the fiscal deficit in the local government consolidated budget reached 45.3 million lats (a year-on-year increase of 18.6 million lats; including 26.5 million lats deficit in the basic budget of the City of Riga). It had a significant negative impact on the fiscal balance of the general government consolidated budget. Revenue and expenditure of the general government consolidated budget increased by 9.8% and 11.8%, respectively.

The central government special budget revenue grew at a more rapid pace than expenditure (by 14.2% and 10.3%, respectively), and a fiscal surplus of 2.4 million lats was reported in 2002. Also the balance of the state social security budget was positive, posting a fiscal surplus of 1.7 million lats. Revenue and expenditure from social security contributions rose by 9.6% and 7.2%, respectively.

The record high revenue of all government budgets and the local government basic budget in December (180.5 million lats) slowed down the growth of the fiscal deficit in the general government consolidated budget. All tax revenue increased in comparison with 2001, except for revenue from customs duties. Personal income tax, corporate income tax, excise tax, state compulsory social security contributions and value added tax revenue increased by 12.7%, 11.5%, 10.3%, 9.9% and 9.3%, respectively.

In 2002, the Government's debt increased by 43.5 million lats (to 756.2 million lats). Domestic debt increased by 35.5 million lats, amounting to 291.5 million lats at the end of the year. The rise resulted primarily from the issuance of 5-year government bonds. External debt rose by 8.0 million lats only, totalling 464.7 million lats at the end of the year. The deficit of the general government consolidated budget was financed also by way of reducing government deposits in the banking system.

## BANKING SECTOR

At the end of the reporting year, 22 banks, 26 credit unions and the Latvia branch of *Nordea Bank Finland Plc* were registered in the Republic of Latvia. The representative offices of *Dresdner Bank AG* and *Nadra Bank* also operated in Riga.

The banking industry is almost entirely in private hands in Latvia. At the end of the reporting year, the Government's stake in the banking sector's paid-up share capital was only 7.3%. The Latvian State is the sole owner of the joint-stock company *Latvijas Hipotēku un zemes banka*. The Government also has a holding in the joint-stock company *Latvijas Krājbanka*, a bank whose privatisation has yet to be completed.

At the end of 2002, the total paid-up share capital of credit institutions was 284.2 million lats (a year-on-year increase of 19.7%). As owners of several banks changed, the share of foreign investment in banks' paid-up share capital decreased (by 13.5 percentage points, totalling 54.3% at the end of 2002).

In 2002, continued rapid growth was recorded for all major indicators characterising the industry: assets (excluding trust assets) increased by 27.9% (to 4 425.2 million lats), loans (including transit credit) by 29.9% (to 2 127.2 million lats) and deposits by 31.8% (to 3 072.1 million lats). Credit institutions sector generated profit in the amount of 56.4 million lats (a year-on-year-increase of 13.7%). Credit institutions' equity grew by 24.4% in the reporting year, amounting to 384.3 million lats at the end of the period.



The structure of banks' assets did not experience significant changes in 2002. The share of loans and claims on credit institutions slightly expanded (to 48.1% and 25.2%, respectively).

At the end of 2002, banks' liquid assets (vault cash, claims on the Bank of Latvia and credit institutions, government securities) accounted for 38.0% of total assets, adequate to meet depositors' claims. Of liquid assets, 53.5% were claims on credit institutions in the OECD countries.

Compared to the end of 2001, the share of non-bank long-term loans (maturity of over 5 years) increased from 29.0% to 36.7% of the total loans, but that of short-term loans (maturity to 1 year) decreased from 26.2% to 18.7%. The share of medium-term loans (maturity of 1 to 5 years) remained almost unchanged (44.6%).

Total non-bank deposits with banks reported a slightly faster increase than that of loans in 2002. With a decrease of the share of short-term deposits in total deposits attracted by banks (from 25.4% to 21.1%), the proportion of demand deposits increased by 3.8 percentage points (to 71.9%) and that of medium-term deposits (1 to 5 years) rose by 0.6 percentage points (to 6.1%).

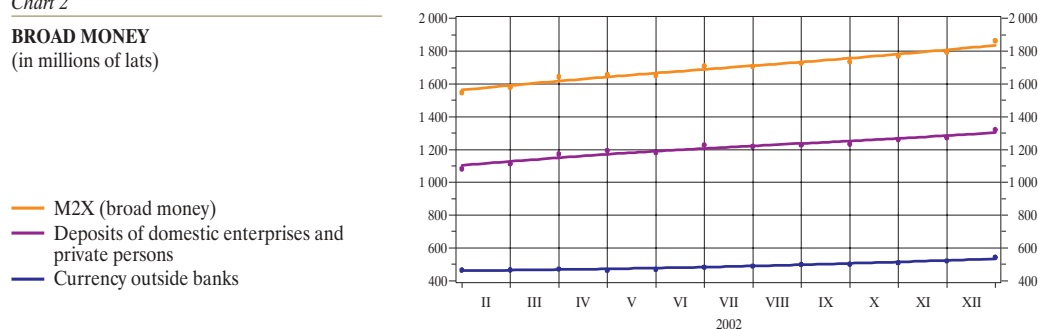
In 2002, the Bank of Latvia continued its close cooperation with the Financial and Capital Market Commission and began drafting the report of the financial sector stability. A database of indicators characterising stability of the financial sector was developed, and the current situation in the financial sector and recommendations for improving the draft report of the financial sector stability were discussed at the meetings of representatives of the Bank of Latvia and the Financial and Capital Market Commission. Cooperation between the Bank of Latvia and the Financial and Capital Market Commission continued in drawing up draft laws and regulations.

### MONEY SUPPLY

The principal monetary indicators of Latvia's banking system and the Bank of Latvia are reflected in Appendix 1 of the Report. Broad money M2X<sup>1</sup> increased by 21.0%, amounting to 1 864.9 million lats at the end of 2002 (see Chart 2). The stable development of the Latvian national economy promoted an almost unchanging rate of growth in the money supply for the second consecutive year (M2X increase was 20.8% in 2001). Broad money increased smoothly throughout the year (by 11.0% in the first half of the year; by 9.0% in the latter half), showing a slight drop only in May and July (0.3% and 0.2%, respectively). The most rapid rise in broad money was recorded in March (4.1%), when bank deposits received

Chart 2

#### BROAD MONEY (in millions of lats)



<sup>1</sup> Currency outside banks + deposits in lats and foreign currencies received from domestic enterprises and private persons.

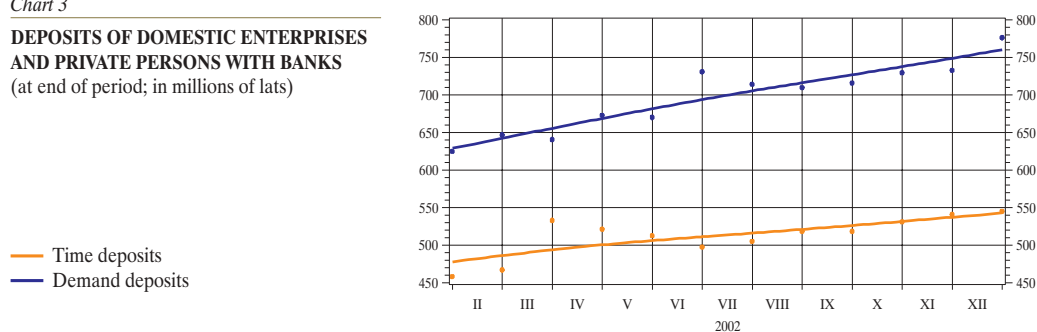
from domestic enterprises and private persons grew sharply, and in December (3.9%), when the demand for cash was also high due to the rising deposit level.

The money multiplier did not change substantially in the reporting year and was 2.47 in December (2.50 in December 2001). Economic stability and growing savings facilitated a decrease in the velocity of money circulation from 3.1 in 2001 to 2.8 in 2002.

The soundness of the banking sector and the national currency, the population's increasing welfare and further consolidation of the real sector of the national economy enabled the banking sector to attract more deposits from domestic enterprises and private persons (by 265.5 million or 25.1%; see Chart 3). Currency outside banks increased by 57.9 million lats or 11.9%, with growth rates slightly falling. The most rapid rise in currency outside banks was recorded in June and December (2.7% and 4.2%, respectively) due to seasonal factors. Non-cash payment instruments continued to evolve, and the cash component of broad money dropped to 29.1% at the end of 2002 (31.5% at the end of 2001). At the same time, the share of demand deposits and the share of time deposits in broad money grew (by 1.3 percentage points to 41.7%, and by 1.0 percentage points to 29.2%, respectively). The growth in saving dictated a rise in the share of time and demand deposits by private persons (up to 70.5% and 47.2%, respectively). Consequently, the share of deposits by private persons continued to grow in the total of domestic deposits, reaching 56.8% (54.4% at the end of 2001).

Chart 3

**DEPOSITS OF DOMESTIC ENTERPRISES  
AND PRIVATE PERSONS WITH BANKS**  
(at end of period; in millions of lats)



Higher yield and confidence in the national currency, as well as the population's income and expenditure structure, determined a more rapid growth of deposits in lats than deposits in foreign currencies (34.6% and 13.6%, respectively). Consequently, the share of deposits received in lats increased and constituted 59.1% of all deposits at the end of 2002 (55.0% at the end of 2001). A rise in the euro exchange rate and growing importance of this currency for Latvia's foreign trade brought about an increase in the share of residents' non-bank foreign currency deposits made in euros at the end of the reporting year (up to 20.0% against 12.2% at the end of 2001), simultaneously reducing the share of deposits in US dollars.

In 2002, quasi-money<sup>1</sup> and M1<sup>2</sup>, the more liquid component of broad money, increased at almost the same rate (by 20.8% and 21.2%, respectively).

Despite the slight increase in the Bank of Latvia's foreign reserves, net foreign assets of the banking system declined by 165.8 million lats in 2002. This reflected a trend observed for two consecutive years: a part of funds received from non-

<sup>1</sup> Time deposits in lats received from domestic enterprises and private persons + deposits in foreign currencies received from domestic enterprises and private persons.

<sup>2</sup> Currency outside banks + demand deposits in lats received from domestic enterprises and private persons.

residents was invested in domestic assets, i.e., loans to domestic enterprises and private persons. Consequently, at the end of 2002, net foreign assets of the banking sector fell behind those of 2001 by 184.4 million lats. The rise in foreign liabilities of the banking sector (528.4 million lats) considerably exceeded the increase in foreign assets (344.0 million lats): at the end of the year they accounted for 51.1% and 41.3% of liabilities and assets of the consolidated balance sheet of credit institutions, respectively (48.9% and 41.9% at the end of 2001).

Regarding foreign assets, claims on foreign banks (mostly short-term ones) grew significantly (by 31.1%, to 1 160.0 million lats). Claims on foreign non-banks went up 15.7% (to 580.0 million lats, including 1.7 times increased investment in foreign debt securities). The only decrease, and a slight one at that, was observed in banks' vault cash in foreign currencies and investment in equity of foreign enterprises. The volume of non-resident non-bank deposits reported a particularly swift rise (459.9 million lats or 38.1%, mainly demand deposits); so did liabilities to foreign banks (72.0 million lats or 17.1%).

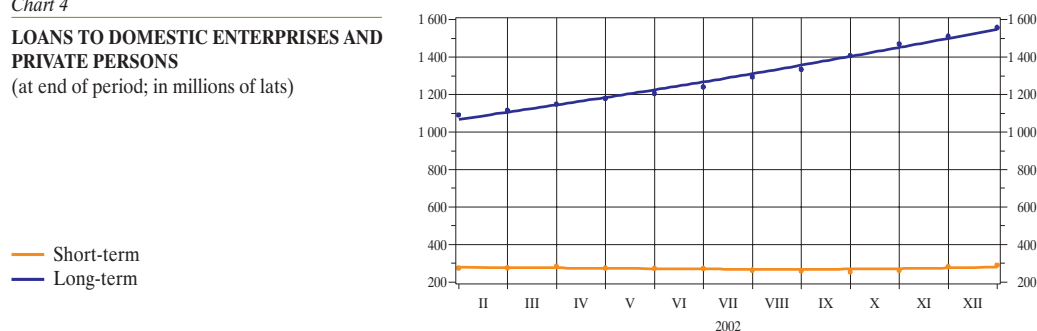
As in 2001, the growth in money supply was determined by an increase in domestic loans (570.5 million lats or 39.8%; 376.5 million lats or 35.6% in 2001), including an increase of 494.8 million lats or 36.5% in loans to domestic enterprises and private persons. As a result, the share of loans to domestic enterprises and private persons in the assets of the consolidated balance sheet of credit institutions accounted for 42.6% at the end of 2002 (39.9% at the end of 2001). The banking system's net claims on the central government grew twofold and amounted to 154.7 million lats.

A more dynamic increase in loans was fostered by a growing real demand for money because of booming economic activity and expansion of the resources base of credit institutions as well as falling interest rates and diminishing credit risk. Low interest rates on loans and ever-increasing mortgage lending was a particularly important factor in promoting the growth of long-term loans to domestic enterprises and private persons. In 2002, long-term loans issued to domestic enterprises and private persons increased by 478.7 million lats or 44.3%, while short-term lending grew by 16.1 million lats or 5.9% (see Chart 4 for loans at the end of each month). At the end of 2002, long-term loans accounted for 84.3% of total loans (79.7% at the end of 2001).

Chart 4

**LOANS TO DOMESTIC ENTERPRISES AND PRIVATE PERSONS**

(at end of period; in millions of lats)



Mortgage loans increased by 169.0 million lats or 1.7 times (to 404.9 million lats). Rapid growth was also observed in commercial credit (171.9 million lats or 34.5%), credit for purchases of consumer goods (29.2 million lats or 49.1%) and industrial credit (69.4 million lats or 19.0%). Other types of loans also grew. In loans to residents, commercial credit (36.3% of total loans), industrial credit (23.5%) and mortgage loans (21.9%) preserved their dominating position.



The substantial increase (191.5 million lats or 79.6%) in loans issued to private persons (growth of credit to enterprises amounted to 303.4 million lats or 27.2%) was due to a notable rise (113.8 million lats or 91.9%) in loans to households for house purchases.

The currency structure of borrowers' income and the favorable lending rates facilitated a more rapid growth of loans in lats (261.5 million lats or 44.9%); yet loans in foreign currencies also continued to grow vigorously (by 233.3 million lats or 30.2%). Hence, the share of loans in lats increased by 2.6 percentage points (to 45.6%) in 2002. Loans in foreign currencies were still dominated by the US dollar (66.6% and 67.1% at the end of 2002 and 2001, respectively), but the share of loans in euros also increased (by 30.0% and 28.4%, respectively).

Loans increased in almost all sectors of the national economy. In accord with the structure of the total value added, the largest growth was observed in loans extended to the service sector: other services (79.5 million lats or 66.9%), financial intermediation (57.0 million lats or 30.0%), trade (53.8 million lats or 20.9%), as well as transport, storage and communications (27.3 million lats or 23.8%). Loans increased in all branches of the goods-producing sector, with the largest increase in manufacturing (34.5 million lats or 17.4%), electricity, gas and water supply (30.8 million lats or 50.3%), and agriculture, hunting and forestry (15.1 million lats or 29.2%). By the end of 2002, the largest credit resources had been invested in trade (21.9% of all loans to domestic enterprises; a yearly decline of 1.2 percentage points), financial intermediation (17.4%; a rise of 0.4 percentage points), and manufacturing (16.4%; a fall of 1.4 percentage points). During the reporting year, short-term loans went mostly to trade (32.0% of all short-term loans) and manufacturing (21.0%), while long-term loans were extended mainly to trade, financial intermediation and manufacturing (19.8%, 19.1% and 15.4% of total loans, respectively).

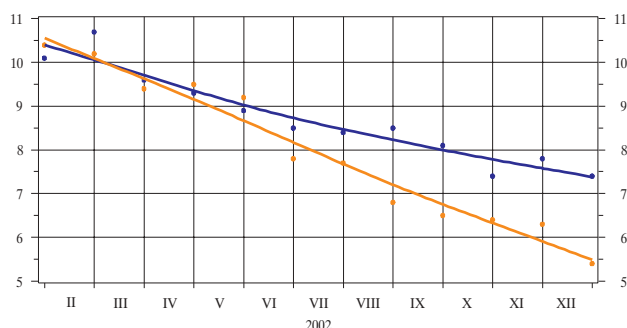
### LENDING AND DEPOSIT RATES

Lending rates fell rapidly in 2002. Interest rates on loans in lats reported the most marked decline. The weighted average interest rates on loans in lats to domestic enterprises and private persons decreased for both short-term and long-term transactions (by 4.5 percentage points, from 9.9% to 5.4%, for short-term, and by 2.4 percentage points, from 9.8% to 7.4%, for long-term loans; see Chart 5), with lending rates decreasing notably for enterprises as well as private persons. Such a downslide in lending rates resulted from the Bank of Latvia's monetary policy, competition among the banks, and a gradual reduction in the money market interest rates in 2002, to which the interest rates of bank loans with a floating rate are pegged. Lower interest rates were also determined by the changing time structure of newly granted loans (the share of loans with maturity up to 1 month in-

Chart 5

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

— Short-term  
— Long-term



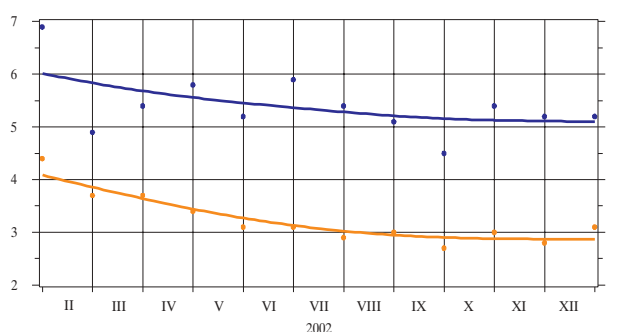
creased in the structure of short-term credit) and the improving quality of collateral. Decreasing interest rates in the world money markets, mainly those of the US dollars and the euro, also contributed to the downward movement of the weighted average interest rates of loans in lats. The weighted average interest rate of short-term loans in the currencies of the OECD countries dropped from 7.1% to 4.1%, while the weighted average interest rate of long-term loans rose slightly (from 5.6% to 5.8%) in comparison with its comparatively low level in December 2001.

The weighted average interest rates of deposits by domestic enterprises and private persons dropped less than the weighted average interest rates of relevant loans. The weighted average interest rate of short-term deposits in lats (see Chart 6) declined from 5.7% to 3.1% in 2002, whereas the weighted average interest rate of long-term deposits was down from 6.8% to 5.2%. The interest rates of deposits in the currencies of the OECD countries also reported a year-on-year decrease. The weighted average interest rate of short-term deposits in these currencies decreased from 3.0% at the end of 2001 to 2.0% at the end of 2002, whereas the fall of the weighted average interest rate of long-term deposits was even more marked – from 4.8% to 3.4%, respectively.

Chart 6

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

— Short-term  
— Long-term



Interest rates on loans and deposits in the currencies of the OECD countries were lower than interest rates on transactions in lats (by 1.1–1.2 percentage points on short-term and 1.7–1.8 percentage points on long-term transactions). Though the lending rates on loans in foreign currencies were lower in 2002, the demand for loans in lats went up under the impact of decreasing interest rates and the reluctance of the borrowers to assume foreign currency risks. Higher interest rates on deposits in lats, in turn, contributed to the attraction of such deposits.

The drop in the lending interest rates was more marked than that of inflation, and in 2002 the real interest rate on short-term loans was down 2.7 percentage points (to 4.0%), while the real interest rate on long-term loans fell 0.6 percentage points (to 6.0%). The real interest rate on short-term deposits in lats declined (by 0.8 percentage points to 1.7%), whereas the real interest rate on long-term deposits rose slightly (to 3.8%).

#### THE INTERBANK MARKET

The amount of loans granted on the interbank market continued to grow during the reporting year. The amount of interbank loans extended to domestic banks increased 1.5 times (to 6.5 billion lats); however, the banks placed the funds mainly abroad. The amount of interbank loans granted to foreign credit institutions increased 1.2 times (to 83.6 billion lats). Loans in lats accounted for 57.7% of the total loans extended on the domestic interbank market, including 82.6% overnight loans and 16.4% loans with maturity up to 1 month. Loans to foreign credit

institutions were mainly extended in the currencies of the OECD countries (98.6%), of which overnight loans accounted for 92.7%.

In 2002, high bank liquidity was observed; it promoted a decline of the interest rates on transactions in lats and also a decrease of the interest rate spread on transactions in lats and the currencies of the OECD countries. At the beginning of the reporting year, the reserve ratio was reduced, and the terms for the calculation and maintenance of the minimum bank reserves were changed. This enabled banks to manage liquidity more efficiently and to ensure smoother compliance with the reserve requirements. The weighted average interest rate of overnight loans in lats dropped from 3.8% in January to 2.7% in December. Falling interest rates in the world money markets had an impact upon the interest rates of loans in the currencies of the OECD countries, and the weighted average interest rate of overnight loans extended in these currencies decreased from 2.7% in January to 2.0% in December.

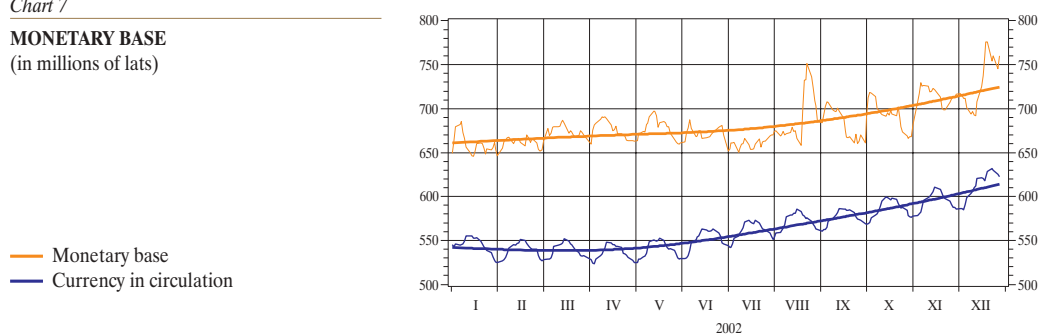
Financial stability and economic growth of Latvia had a greater impact upon interest rates of the loans with maturity over 3 months. The money market index RIGIBOR on 6-month loans (interest rates on loans extended to non-bank institutions are often pegged to this index) dropped from 6.6% to 4.0% in 2002, thus pushing up the demand for loans in lats.

### MONETARY BASE

Monetary base M0<sup>1</sup> grew at a slightly higher pace than in 2001 and increased by 22.4% (to 755.1 million lats; see Chart 7). The demand for cash grew less rapidly (in 2002, cash in circulation increased by 66.6 million lats or 12.0%; in 2001, by 15.3%), unlike the demand deposits of domestic banks and other financial institutions with the Bank of Latvia, which grew by 71.4 million lats or 2.2 times. The cash component of the monetary base decreased to 82.5% (90.1% at the end of 2001).

Chart 7

#### MONETARY BASE (in millions of lats)



The growth in the monetary base was mainly effected by an increase in net domestic assets of the Bank of Latvia (119.4 million lats), with net lending to the Government growing substantially. The Government's deposit with the Bank of Latvia decreased (by 57.5 million lats), and the Bank's portfolio of government securities increased (by 39.7 million lats). The amount of the Bank of Latvia's credit to banks also increased (by 11.9 million lats); however, the total amount of credit extended by the Bank of Latvia (549.2 million lats) in 2002 was 5.9 times smaller than in 2001. More effective management of bank liquidity was a determinative factor for this decline – banks conducted transactions in the interbank market and

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

used currency swaps of the Bank of Latvia to offset liquidity fluctuations and to meet the reserve requirement.

Of the Bank of Latvia's credit to banks, 93.0% was loans under repurchase agreements, 6.4% was demand Lombard loans and 0.6% was automatic Lombard loans (for monthly average balances on the Bank's credit, see Table 3).

Table 3

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

	2000	2001	2002
January	54.9	42.5	<b>22.5</b>
February	41.5	74.8	<b>11.3</b>
March	39.6	41.6	<b>7.5</b>
April	38.6	39.6	<b>6.0</b>
May	46.3	66.3	<b>13.9</b>
June	43.2	89.2	<b>13.1</b>
July	43.5	73.2	<b>22.4</b>
August	36.1	63.2	<b>33.0</b>
September	37.0	70.0	<b>32.1</b>
October	36.6	76.8	<b>36.1</b>
November	31.5	69.8	<b>31.0</b>
December	38.7	63.5	<b>34.6</b>

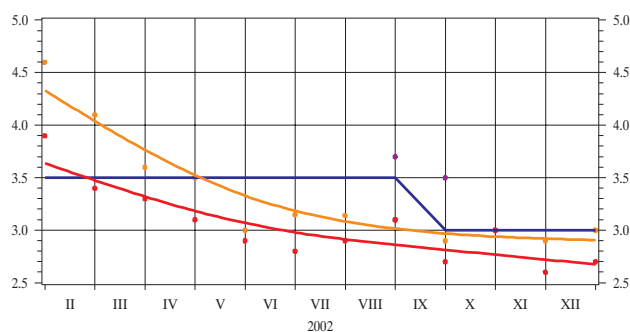
Loans under repurchase agreements were predominantly of 7-day maturity; a smaller number of repo loans were of 28-day and 91-day maturity. Repo loans of 7-day maturity were issued in the total amount of 419.3 million lats, of 28-day and 91-day maturity in the amount of 42.3 million lats and 48.9 million lats, respectively. In repo loans, a year-on-year decrease of 41.8% was observed; the amount of demand Lombard loans fell 66.2 times (to 35.3 million lats) and that of automatic Lombard loans 5.9 times (to 3.3 million lats).

As of September 2002, the Bank of Latvia's refinancing rate was reduced to 3.0% (see Chart 8). The interest rate on repo loans was considerably lower than in the previous year. It was lowest in September and November (2.9%) and highest in January (4.6%).

Chart 8

**INTEREST RATES IN THE MONEY MARKET**  
(%)

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



The growth in the monetary base was also effected by an increase in net foreign assets of the Bank of Latvia (18.6 million lats or 2.4%), which resulted from the Bank of Latvia's currency swaps (an increase of 19.2 million lats) and purchase of foreign currencies in small amounts (in the reporting year, the net amount of foreign currencies bought was 4.7 million lats). As a result, the Bank's net foreign assets reached 777.6 million lats at the end of 2002 (see Chart 9) and in December covered goods imports of 3.7 months (of 4.0 months in December 2001), while the



backing of the national currency with the Bank's net foreign assets reached 103.0% (see Chart 10; 123.0% at the end of 2001).

Chart 9

### NET FOREIGN ASSETS OF THE BANK OF LATVIA (in millions of lats)

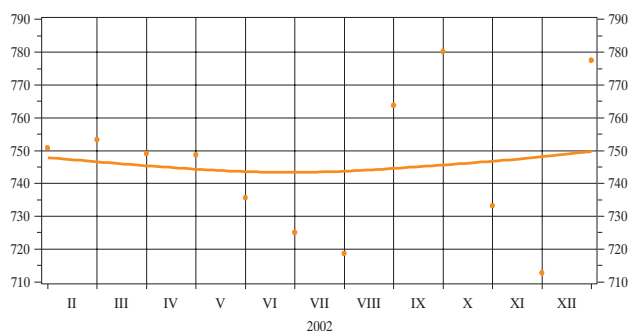
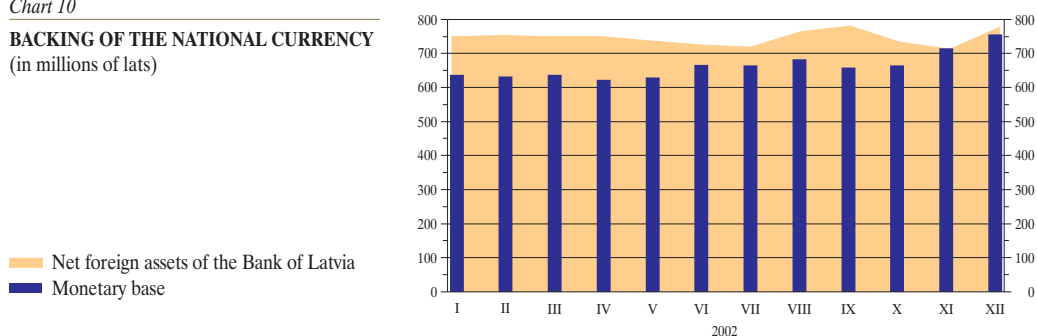


Chart 10

### BACKING OF THE NATIONAL CURRENCY (in millions of lats)

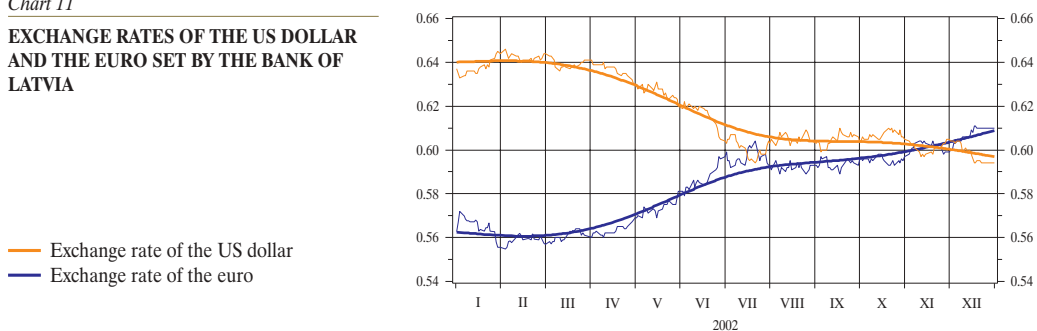


## THE FOREIGN EXCHANGE MARKET AND LATVIA'S EXTERNAL DEBT

In the reporting year, foreign reserves increased, amounting to 1 327.3 million US dollars at the end of the year. In 2002, the Bank of Latvia did not intervene substantially in the foreign exchange market. The growth of 66.0 million US dollars resulted from currency swap arrangements with credit institutions of Latvia. The growth in the foreign reserves resulting from fluctuating exchange rates was determined by a drop from 0.638 to 0.594 (see Chart 11) in the Bank of Latvia's exchange rate of the US dollar against the lats and by income from investing foreign reserves in foreign financial markets in accordance with the guidelines adopted by the Bank of Latvia's Board of Governors. During the year, deposits in foreign currencies of the Ministry of Finance held with the Bank of Latvia decreased.

Chart 11

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



In 2002, the global foreign exchange market showed considerable volatility, with the fall in the exchange rate of the US dollar against other currencies of the SDR basket the main contributor. In the reporting year, the exchange rate of the euro against the US dollar increased by 18.0% (from 0.8895 at the end of 2001 to 1.0492 at the end of 2002), reaching its high at the end of 2002. The US dollar fell against the Japanese yen from 130.89 at the end of 2001 to 118.61 at the end of 2002

(down by 9.4%) and reached its low (115.85) on July 19. The British pound appreciated against the US dollar by 10.7% (from 1.4546 at the end of 2001 to 1.6100 at the end of 2002), reaching its high at the end of 2002.

Since the US dollar weakened against the other currencies of the SDR basket in the reporting year, its exchange rate dropped against the lats in the domestic foreign exchange market from 0.6305 at the end of 2001 to 0.5844 at the end of 2002 (down by 7.3%, reaching its high on January 29 (0.6479) but its low at the end of 2002).

According to the international investment position (classified according to the principle of residency: liabilities of residents, including the Government, to the rest of the world in lats and foreign currencies), Latvia's external debt to non-residents increased by 587.9 million lats, totaling 4 140.9 million (79.7% of GDP) at the end of 2002 and testifying to Latvia's capacity to attract funds from the global financial markets. At the end of 2002, breakdown of external debt by sector was as follows: liabilities of the Government 10.8%, of banks 53.4% and of enterprises 35.8%. As compared to 2001, the share of the banking sector in total external debt increased, while that of the Government and enterprises declined. Government liabilities amounted to 449.6 million lats. At the end of the year, foreign assets amounted to 2 976.2 million lats, and net external debt was 1 164.7 million lats (22.4% of GDP). Long-term debt was 1 642.1 million lats, and short-term debt, 2 498.8 million lats.

At the end of 2002, the banking sector's external debt was 2 209.6 million lats (including long-term liabilities in the amount of 262.6 million lats and short-term liabilities in the amount of 1 947.0 million lats). Deposits received accounted for the bulk of the banking sector's short-term liabilities. The banking sector's net external debt was 450.7 million lats at the end of 2002.

Long-term liabilities dominated in the external debt of the enterprise sector (48.1% of long-term liabilities were loans from affiliated enterprises). At the end of 2002, enterprises' foreign liabilities totalled 1 481.6 million lats, of which 930.8 million lats (62.8% of enterprises' debt) was long-term liabilities and 550.8 million lats short-term liabilities (mainly trade credit).

According to the State Treasury data, the Government's external debt (including all eurobonds issued by the Government) to residents and non-residents in foreign currencies was 464.7 million lats (8.9% of GDP) at the end of 2002. The Government received foreign loans in the amount of 12.7 million lats in 2002. 44.9 million lats, equalling 1.9% of annual exports, went to service foreign debt in 2002. Loans received from international financial institutions were repaid gradually. Repayments totalling 7.0 million lats and 7.6 million XDR (6.1 million lats) were made under the loans from the World Bank and the IMF Systemic Transformation Facility, respectively.

### THE SECURITIES MARKET

The Bank of Latvia continued to act as the Government's agent in organising auctions of and accounting for government securities in the primary market for Latvian government securities. In 2002, the State Treasury held fewer trading sessions in the primary market for government securities and the volume of offered securities was lower than in the previous years.

The State Treasury supplied government securities in the total amount of 74.2 million lats (3.5 times less than in 2001; lowest since 1994) at competitive multi-price auctions.

In comparison with the previous years, the demand by banks was higher in 2002 exceeding the supply 2.7 times; nevertheless, 68.2% of the supplied government securities were sold. Under the conditions of favorable liquidity of the money market, lower sales were a result of the State Treasury's determination to borrow funds at the lowest possible interest rate, attributable to a stable state budget almost throughout the year and income resources still available from the issuance of eurobonds in November 2001. In the reporting year, an average of nine banks participated in a single auction of government securities, which was more than in the previous years (four banks in 2001). In 2002, eighteen banks participated in the auctions of government securities (fifteen in the previous year).

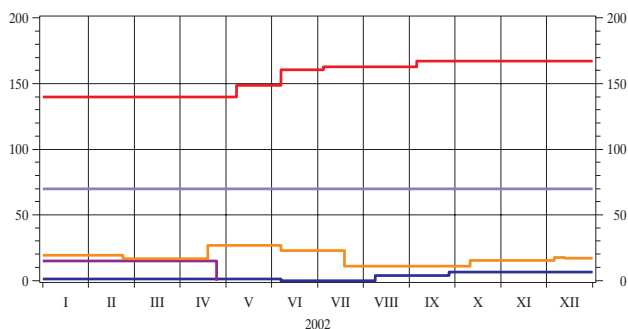
Starting in May 2002, a part of government securities were sold at fixed rate (non-competitive) auctions of the Latvian Central Depository using the discount (yield) rate set for the previous auction of respective securities at the Bank of Latvia.

In 2002, the stock of government securities outstanding grew by 13.7% (the slowest growth rate in last four years) and amounted to 293.1 million lats. The stock of bills outstanding grew at a more rapid pace, hence their ratio in the total stock of securities increased from 11.6% to 13.4% (for the stock of individual government securities outstanding, see Chart 12).

Chart 12

**STOCK OF LATVIAN GOVERNMENT  
SECURITIES OUTSTANDING**  
(in millions of lats)

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



Yields on government securities at primary auctions decreased. At the September 2002 auction, the weighted average discount rate of 6-month bills was 3.50% or 173 basis points lower than in December 2001, and the weighted average discount rate of 12-month bills dropped to 3.35% or 263 basis points against December 2001. The weighted average yield rate of 5-year bonds issued in September 2002 was 5.38% (240 basis points lower than in April 2001). Such decrease in rates was determined by a small volume of government securities placed in the primary market and the high liquidity persisting in the money market. The movement of rates was positively affected by higher rating assigned to Latvia by international rating agencies and by falling rates on debt securities in global markets.

The breakdown of government securities by holder revealed that the Bank of Latvia's share in the total grew (from 15.9% to 29.4%) in 2002, whereas those of non-resident non-banks and the Latvian banking sector decreased (from 9.2% to 1.9% and from 55.8% to 50.4%, respectively). The share of the resident non-banks remained almost unchanged.

At the Riga Stock Exchange, the turnover of debt securities, including those sold at auctions, was 200.0 million lats in 2002 (a year-on-year decrease of 2.1 times).

At the end of 2001, quoted buying and selling rates of the 2001 bonds with 5-year maturity at the Riga Stock Exchange were 6.85% and 7.00%, respectively, whereas at the end of 2002 they were 4.10% and 4.80%, the movement of rates on the secondary market being determined by a fall in the rates of the primary market.

In 2002, the Government of Latvia did not issue eurobonds (the first issue took place in 1999, the second in 2001). The yield rate of the Latvian eurobonds continued to decline. The quoted buying and selling rates of the first issue of eurobonds (redemption in 2004) was 4.30% and 4.70% at the end of 2001, but 2.97% and 3.15% at the end of 2002. The quoted buying and selling rates of the second issue of eurobonds (redemption in 2008) declined from 5.52% and 5.69% to 4.35% and 4.23%, respectively. In 2002, the spread between the rates of the Latvian eurobonds and relevant German securities narrowed. This was promoted by higher credit rating assigned to Latvia and the invitation to join the EU and NATO.

Regarding stock market developments in 2002, the most important event was the sale of the shares in the Riga Stock Exchange and the Latvian Central Depository to the *HEX Group*. In the future, integration of the *HEX Group's* stock exchanges and depositories as well as their further integration with associations of European stock exchanges is projected. This will contribute to the increase in the number of investors with an easier access to Latvia's securities market and simplify the operation of Latvia's financial institutions on international financial markets. The fact that the Latvian Central Depository joined *Euroclear*, the system for international securities transactions and storage, was also of great significance.

Market capitalisation of the public shares increased by 4.0% (to 366.0 million lats). The total nominal value of public shares rose from 286.6 million lats to 479.3 million lats. The growth was mainly determined by registration of the shares of the joint-stock company *Latvijas kuģniecība* with the Latvian Central Depository.

Capitalisation of the enterprises' stock quoted on the Riga Stock Exchange went down by 4.6% (to 418.3 million lats). *The Dow Jones Riga Stock Exchange Index* (DJRSE) fell to 161.1 points (by 19.6%). Stock market turnover on the Riga Stock Exchange declined by 12.6% year-on-year (to 75.2 million lats; excluding auctions of shares).

In 2002, shares in the joint-stock companies *Latvijas Gāze* and *Latvijas kuģniecība* were offered for privatisation vouchers. Of the greatest significance were two trading sessions of the shares in the joint-stock company *Latvijas kuģniecība* (32% was sold for vouchers and 51% for cash) and the subsequent quoting on the Riga Stock Exchange. The public offering of the shares in the joint-stock company *Latvijas Gāze* was for vouchers, but the amount of shares supplied was comparatively small (3% of the total), since more important public offerings of the shares in the company had been held in the previous years.

In 2002, private fixed income securities registered with the Latvian Central Depository were issued in the amount of 58.2 million lats, of which securities of up to 12-month maturity accounted for 20.2 million lats. The issuance of 3-year bonds in the amount of 9.9 million lats by the joint-stock company *Latvijas Unibanka* was a notable event. For the second time, the state joint-stock company *Latvijas Hipotēku un zemes banka* issued 10-year mortgage bonds in the amount of 5 million lats. Fixed income long-term securities in lats were issued by *Norddeutsche Landesbank Girozentrale*. The total of private debt securities registered with the Latvian Central Depository grew from 48.2 million lats to 74.2 million lats.

The turnover of private debt securities on the Riga Stock Exchange remained at approximately the same level as in 2001 (22.7 million lats). The bulk of the private debt securities' turnover was made up of transactions with mortgage bonds of the state joint-stock company *Latvijas Hipotēku un zemes banka* (43.7% of traded private debt securities).



## 2002 HIGHLIGHTS OF NORMATIVE ACTS ADOPTED IN PURSUIT OF THE BANK OF LATVIA'S MAIN TASKS

### January 17

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for the Securities Settlement System Organised by the Bank of Latvia" (in effect as of February 1, 2002).

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for Receiving Bank Time Deposits at the Bank of Latvia" (in effect as of February 15, 2002).

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for Granting Lombard Loans" (in effect as of February 15, 2002).

### February 14

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Tenders of Short-Term Currency Swaps" (in effect as of February 15, 2002).

The Executive Board of the Bank of Latvia adopted the "Regulation for Preparing and Submitting Non-Bank's Statistical Documents in Electronic Form" (in effect as of February 14, 2002).

The Executive Board of the Bank of Latvia adopted the "Regulation for Managing the Flow of Non-Banks' Statistical Reports" (in effect as of February 14, 2002).

### February 21

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Tenders of the Secondary Market for Securities Organised by the Bank of Latvia" (in effect as of March 1, 2002).

### March 14

The Board of Governors of the Bank of Latvia made amendments to the "Regulation for Buying and Selling Cash Foreign Currency" (in effect as of April 1, 2002).

### May 16

The Board of Governors of the Bank of Latvia passed a resolution "On Interest Rates" (in effect as of May 17, 2002), decreasing interest rates on bank deposits with the Bank of Latvia by 0.5 percentage points (2.5% per annum on 7-day deposits; 2.75% per annum on 14-day deposits).

### July 11

The Board of Governors of the Bank of Latvia passed a resolution "On Approving the 'Regulation for Credit Transfers'" (in effect as of January 1, 2003).

### September 13

The Board of Governors of the Bank of Latvia passed a resolution "On Interest Rates" (in effect as of September 16, 2002), by 0.5 percentage points cutting the refinancing rate (to 3.0% per annum), interest rates on bank deposits with the Bank of Latvia (to 2.0% per annum on 7-day deposits and to 2.25% per annum on 14-day deposits), and the Lombard rates (to 5.0% per annum, where the Lombard loan balance has been maintained for up to 10 days in the last 30 days, to 6% per annum, where the Lombard loan balance has been maintained for 11 to 20 days in the last 30 days, and to 7.0% per annum, where the Lombard loan balance has been maintained for 21 days or longer in the last 30 days).

The Board of Governors of the Bank of Latvia passed a resolution "On Amendments to the 'Regulation for the Securities Settlement System Organised by the Bank of Latvia'" (in effect as of October 1, 2002).

The Board of Governors of the Bank of Latvia passed a resolution "On Amendments to the 'Regulation for Receiving Bank Time Deposits at the Bank of Latvia'" (in effect as of October 1, 2002).

The Board of Governors of the Bank of Latvia passed a resolution "On Amendments to the 'Regulation for Granting Lombard Loans by the Bank of Latvia'" (in effect as of October 1, 2002).

#### **October 24**

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Tenders of the Secondary Market for Securities Organised by the Bank of Latvia" (in effect as of November 1, 2002).

The Executive Board of the Bank of Latvia made amendments to the "Regulation for Reverse Repo Tenders of Securities at the Bank of Latvia" (in effect as of November 1, 2002).

#### **November 14**

The Board of Governors of the Bank of Latvia set the reserve ratio of 3% for banks and branches of foreign banks registered in the Republic of Latvia (in effect as of January 24, 2003).

The Board of Governors of the Bank of Latvia made amendments to its September 13, 2001 Resolution No. 89/4 "On Minimum Reserve Requirement for Banks" (in effect as of January 24, 2003).

The Board of Governors of the Bank of Latvia passed the "Regulation for Issuance and Maintaining of Electronic Money" (in effect as of January 1, 2003).

#### **December 12**

The Executive Board of the Bank of Latvia resolved that repo tenders of securities would be held each working day, with repurchase period being 7 and 28 days (in effect as of January 1, 2003).

## INTEGRATION IN THE EUROPEAN UNION

In 2002, the Bank of Latvia continued its participation in the joint activities of the Government and governmental institutions of Latvia to promote Latvia's integration in the European Union. In accession negotiations concerning issues that fall, in part or in full, within the Bank of Latvia's competency (the Economic and Monetary Union, free movement of capital, freedom to provide services, and statistics) both parties have reached a consensus and negotiations in respect of these chapters have been closed.

The Bank of Latvia developed proposals for amendments to Latvia's legislation in conformity with the EU legislation and updated regulations of the Bank of Latvia governing the movement of electronic money and the operation of payment systems.

A regular exchange of information and cooperation with the ECB was continued. On December 5, 2002, the Governor of the Bank of Latvia took part in the meeting for central bankers from the EU accession countries in Brussels, organised by the ECB.

Business contacts with the ECB related to core operation of central banks and central bank legislation were maintained. Representatives of the Bank of Latvia have been nominated as observers in the committees of the European System of Central Banks.

## INTERNATIONAL FINANCIAL INSTITUTIONS

In 2002, Latvia continued its activities as a member of the IMF, the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation and the European Bank for Reconstruction and Development. The Bank of Latvia, likewise, continued its participation in the activities within the Bank for International Settlements.

The Memorandum of Economic Policy was concluded with the IMF at the end of the reporting year; the IMF acknowledged by it that a decade long cooperation with Latvia had been very successful; in the future, partnership with this international organization will enter a new and qualitatively different stage of development, with cooperation being based on consultations under Article IV of the IMF Articles of Agreement. The Stand-By Arrangement signed between Latvia and the IMF in support of the economic program of Latvia's Government was effective until December 19, 2002; in the reporting year, however, the Arrangement was not utilized. At the end of 2002, Latvia's total quota in the IMF was 126.8 million XDR.

## COOPERATION WITH FOREIGN CENTRAL BANKS AND TECHNICAL ASSISTANCE

The Bank of Latvia continued to cooperate and exchange expertise and information with the central banks of other countries.

Representatives of the Bank of Latvia took part in the work of the Nordic-Baltic Monetary and Financial Committee.

In the reporting year, technical assistance to Latvia mostly took the form of invitation to participate in the workshops and courses hosted by the relevant international financial institutions and foreign central banks, and advisory services on issues related to the operation of central banks.

Under technical assistance programs, the Bank of Latvia's employees attended a number of training sessions organised by the IMF Institute, the World Bank, the European Commission and the Joint Vienna Institute, and also participated in seminars hosted by the central banks of Austria, Estonia, France, Germany, Italy, Lithuania, the Netherlands, Switzerland and the United Kingdom. 2002 saw widening of the contacts with the central bank of Germany that advised the Bank of Latvia on a number of issues related to central banking. In May, a group of the Bank of Latvia's employees attended a seminar in Lithuania, held annually for the staff of the central banks of the Baltic countries. The seminar focused on payment systems, accounting and information technologies.

The Bank of Latvia, in its turn, provided technical assistance to Azerbaijan and Georgia, advising the specialists of the central banks on vault and cash issues as well as the operation of payment systems.



The Latvian economy was characterised by continued steady growth in 2002. Driven by high domestic demand, GDP growth was higher than projected. The rapid economic growth notwithstanding, inflation remained low. The unemployment rate dropped. Deficit in the current account of the balance of payments was lower than in the previous year, with growth in the services and current transfers surpluses almost fully offsetting an increase in the goods and income deficit.

The Latvian economy was also influenced by global economic trends: global economic growth was slightly more pronounced in 2002 than in the previous year, even though there was some instability in the financial market, consumer and producer confidence was low, and the geopolitical situation deteriorated in the latter half of the year. Interest rates on the Latvian money market reflected global trends, falling significantly. Besides, the dynamics of interest rates on foreign currency loans followed interest rate movements on major world financial markets. The downward trend of money market rates was fostered by the Bank of Latvia's decision of September 2002 to lower interest rates. Changes in the money market and escalating competition on the domestic market accounted for a pronounced decline in the weighted average interest rates of loans granted to non-banks.

In view of stability and growth in the Latvian economy, the international rating agency *Standard & Poor's* upgraded Latvia's sovereign rating in respect of liabilities in foreign currency from BBB to BBB+, and *Moody's Investors Service* upgraded Latvia's similar rating from Baa2 to A2, aligning it with the previously assigned sovereign rating in respect of liabilities in lats. The politically significant events that marked the end of 2002—the official invitation to begin negotiations for joining NATO and the official invitation to join the European Union (EU) in 2004, which followed the successfully completed accession negotiations—are seen as a confirmation that Latvia has developed the preconditions for long-term growth and a benign climate for foreign investment. The interaction of the above factors shaped Latvia's macroeconomic environment so as to promote development.

In the reporting year, the Bank of Latvia's Executive Board managed the Bank's business, following the requirements of the Law "On the Bank of Latvia" and other laws and regulations in force in the Republic of Latvia, as well as decisions of the Bank of Latvia's Board of Governors concerning monetary policy and other activities of the Bank. The Bank of Latvia's Executive Board convened 51 meetings and passed 25 resolutions on the utilisation of monetary policy instruments and 177 resolutions on conducting other day-to-day business of the Bank. The Executive Board drafted 36 resolutions for the Bank's Board of Governors and submitted 23 reports concerning monetary policy and central banking to the Board of Governors.

## **THE BANK OF LATVIA'S FOREIGN EXCHANGE RATE POLICY AND FOREIGN RESERVES**

In 2002, the Bank of Latvia did not change its foreign exchange rate policy, retaining the peg of the lats to the SDR basket of currencies (XDR 1 = LVL 0.7997 since 1994). Fluctuations in the exchange rates of foreign currencies against the lats reflected trends in the global foreign exchange market.

The Bank of Latvia's foreign reserves, which consist of gold and convertible foreign currencies, amounted to 788.4 million lats at the end of 2002 (777.3 million lats at the end of 2001).

The Bank of Latvia's foreign reserves were managed in accordance with the guide-

lines adopted by the Bank's Board of Governors and invested in safe and liquid financial instruments, predominantly in government and government agency debt securities of the United States, the euro area countries and Japan, as well as in debt securities of international institutions. Pursuant to the guidelines, the Bank's foreign reserves were invested in high quality debt securities issued by credit institutions and enterprises, in asset-backed debt securities, revocable bonds and interest rate future contracts.

The Bank's gold reserves were placed as short-term deposits with foreign credit institutions with high credit ratings. Since October 1994, the Bank of Latvia has been employing three fund managers in the United Kingdom and the United States. The fund managers operate in compliance with the guidelines established by the Bank of Latvia's Board of Governors.

### **THE BANK OF LATVIA'S MONETARY POLICY INSTRUMENTS**

While pursuing tight monetary policy, the Bank of Latvia, as in previous years, continued to approximate the usage of monetary policy instruments to the practice of the European Central Bank (ECB).

The Bank of Latvia amended its regulations for granting Lombard loans and repurchase agreements, to the effect that the Bank of Latvia will enter into such transactions only with those participants in the Bank of Latvia's securities settlement system that have been registered in Latvia. The Bank of Latvia lowered the rating threshold for private sector securities eligible for monetary policy operations, which previously was equal to Latvia's sovereign rating, establishing new requirements for such securities' ratings as assigned by international rating agencies. This was done to reach conformity with the ECB practice to accept in monetary policy operations private sector debt securities with a certain rating that is not linked to the sovereign rating.

As of September 16, 2002, the Bank of Latvia lowered, by 50 basis points, the refinancing rate. Likewise, the Bank decreased the interest rates on the standing facilities: the interest rates of Lombard loans were cut by 50 basis points as of September 16, and those of banks' time deposits were lowered by 50 basis points on two occasions (as of May 17 and as of September 16). Hence, at the end of 2002, the interest rates were as follows: the refinancing rate was 3.0%; the Lombard rate was 5.0% during the first ten days of the use of the credit facility, 6.0% from the 11th to the 20th day, and 7.0% from the 21st day; and the interest rate on the time deposit facility was 2.0% per annum on 7-day deposits and 2.25% per annum on 14-day deposits.

The interest rates were lowered in view of both internal and external factors. The latter were more ample money market liquidity for lats transactions and lower interest rates on foreign currency transactions on the money market. At the beginning of 2002, money market rates on lats transactions declined significantly, because the banking sector's liquidity was ample. This could be attributed to both the Bank of Latvia's outright purchases of foreign currencies at the end of 2001 and the slow growth rate of currency in circulation in the first five months of 2002. As a result, money market rates on lats transactions dropped to the level of the interest rates on the Bank of Latvia's time deposit facility. The lowering of the interest rates on the time deposit facility undertaken by the Bank of Latvia fostered an overall downward trend in the interest rate level on the domestic market and the narrowing of the spread between interest rates on lats loans and interest rates on foreign currency loans, thus promoting the lending business.

The most notable external factor underlying the downward trend of interest rates was the lowering of official interest rates by the central banks of the industrialised countries. The ECB reduced the refinancing rate and the Federal Reserve System cut the federal funds rate by 50 basis points. This also promoted a decline in interest rates on the Latvian money market.

As of January 1, 2002, the reserve ratio for banks was reduced to 5%, and the maximum level of the cash component was decreased to 30%. The reserve requirements were calculated based on the average balance on funds received by a bank or a branch of a foreign bank licensed in Latvia (irrespective of currency and maturity, and excluding liabilities to credit institutions, the State budget and funds received by foreign branches of Latvian banks). As of December 23, 2002, non-bank deposits with agreed maturity of over two years, deposits with over two years' notice and repurchase agreements were excluded from the reserve base. In 2002, compliance with the reserve requirements was ensured by the average end-of-day balance on the reserve account at the Bank of Latvia and the average balance of vault cash (in lats), which could not exceed the established percentage of the calculated minimum reserve requirements. At the end of 2002, 22 banks and one branch of a foreign bank were subject to the reserve requirements. With the reserve base (funds received) increasing, the volume of the reserve requirements reached 145.1 million lats in December 2002, growing by 28.4% during the year. In November 2002, the Bank of Latvia's Board of Governors resolved to lower the reserve ratio to 3%, excluding vault cash balances from meeting the reserve requirements (in effect as of January 24, 2003).

In 2002, the most often used monetary policy instruments were repurchase agreements and banks' time deposits. Repo transactions were in the amount of 510.5 million lats, whereas banks' time deposits were received in the amount of 527.3 million lats.

In 2002, the Bank of Latvia offered repurchase agreements of 7-, 28- and 91-day maturity. In December 2002, the Bank of Latvia's Executive Board resolved to cease to offer repurchase agreements of 91-day maturity as of 2003. The turnover of repurchase agreements was lower than in 2001, owing to banks' lower demand for additional funds in ample liquidity conditions. In 2002, the average end-of-day balance on repurchase agreements was 22.1 million lats (a decline of 11.7% compared with 2001). The weighted average repo rate of 7-day repurchase agreements (82.1% of all repurchase agreements) dropped from 5.41% in 2001 to 3.22% in 2002.

The end-of-day balance on banks' time deposits averaged 20.3 million lats in 2002 (a year-on-year increase of 5.9 times). Banks' time deposits were with maturity of seven and fourteen days. Banks used the time deposit facility very actively in the first half of the year, whereas later their demand diminished.

The average end-of-day balance on Lombard loans amounted to only 149.0 thousand lats (22.2 million lats in 2001). Lombard loans were issued in the amount of 38.6 million lats (2 356.4 million lats in 2001), and their weighted average interest rate dropped from 5.89% to 5.23%. The bulk of such loans were demand Lombard loans.

To manage liquidity, banks actively used the Bank of Latvia's daylight credit facility (532.4 million lats; 619.9 million lats in 2001).

Demand in the Bank of Latvia's short-term currency swap tenders rose in the latter half of 2002, when the Bank of Latvia lowered interest rates and increased

the supply of currency swap deals to follow market trends. The amount allotted under short-term currency swap tenders was 340.8 million lats (a year-on-year increase of 128.1 million lats), and the currency swap end-of-day balance averaged 17.3 million lats (a year-on-year decrease of 2.6 times). The weighted average interest rate of short-term currency swaps was 2.97% (6.41% in 2001).

In the first three months of 2002, the Bank of Latvia purchased government securities in the amount of 40.7 million lats, increasing its portfolio of government securities, which had decreased significantly, to only 24.7 million lats at the beginning of the year, owing to redemption of securities. The Bank purchased mostly 5-year bonds, as liquidity conditions on the market for shorter maturity securities were tighter. In 2002, the average end-of-day balance on government securities held by the Bank of Latvia, excluding securities pledged under repurchase agreements, was 60.3 million lats.

No reverse repo transactions were conducted in 2002, as the Bank of Latvia had no need to limit the banking sector's liquidity. Interbank market rates were low, and banks used the time deposit facility offered by the Bank of Latvia.

The Latvian Government placed its available funds with the Bank of Latvia as demand deposits and time deposits. The end-of-year stock of the Government's deposits with the Bank of Latvia declined by 57.5 million lats or 1.9 times compared with the previous year.

The Bank of Latvia continued to quote two money market indices—RIGIBID (deposit rates in the interbank market) and RIGIBOR (lending rates in the interbank market)—in accordance with its "Regulation for Calculating RIGIBID and RIGIBOR". The indices are based on the quotes of those banks that are active in the interbank market and are able to conduct their market operations at money market rates that they quote for operations in lats, even if the interbank market is volatile. (At the end of the reporting year, as at end-2001, the following credit institutions were included on the list: the joint-stock companies *Hansabanka*, *Latvijas Krājbanka*, *Latvijas Unibanka*, *Parekss-banka*, *Vereinsbank Rīga* and the Latvia Branch of *Nordea Bank Finland Plc.*)

### CASH MANAGEMENT

In 2002, currency in circulation increased by 12.0% (from 556.0 million lats to 622.6 million lats). Over the last five years, currency in circulation has grown 1.7 times.

Banknotes and coins received from the banking sector were checked for authenticity and fitness for circulation by using automated cash processing machines. In 2002, the amount of processed cash (1 044.4 million lats) exceeded that of currency in circulation 1.7 times (1.4 times in 2001). Of the amount of cash processed, 119.0 million lats or 11.4% was withdrawn from circulation (203.5 million lats or 25.5% in 2001). In 2002, the total nominal value of counterfeit banknotes and coins (8.0 thousand lats) accounted for only 0.001% of currency in circulation.

In 2002, the Bank of Latvia continued its participation in the international coin program *Hansa Cities* organised by the Mint of Finland Ltd., issuing a silver commemorative coin *Kuldīga* (in circulation as of July 10, 2002). To continue the first series *Roots* of the program *Latvia. Times and Values*, the 1-lats silver coin *Destiny* was issued (in circulation as of December 2, 2002). The coin *National Library of Latvia*, which is a dedication to the Riga of the 21st century and Latvian culture,

features a sketch of the new building of the library as it has been conceived by Gunnar Birkerts (in circulation as of April 9, 2002).

### BALANCE OF PAYMENTS AND FINANCIAL STATISTICS

In the reporting year, the methodological work in respect of the coverage and improvement of balance of payments statistics was enhanced. A package of programs has been developed for grossing up of the survey data on enterprises' foreign investment to the whole enterprise population, which also allows the Bank to estimate the precision of the obtained indicators, improve the quality of data input and determine an optimum allocation of the sample for the next survey. With the introduction of the procedure for preliminary assignment of non-bank external payment codes, it is possible to classify payments reported by banks in accordance with the External Payment Codes in force and to improve the accuracy of data on large-value payments. This has improved the quality of non-bank external payments statistics. Likewise, to capture foreign direct investment more precisely, the relevant data have been compared with the data of other countries.

With a view to non-banks' wish to submit statistical surveys to the Bank of Latvia electronically, the Bank launched a pilot project in 2002, involving a selected number of non-banks, which submitted part of data for balance of payments statistics in electronic form. This was done to create a prerequisite for reducing the scope of data processed manually and speeding up data processing in the near future thus increasing the time allowed for controlling the quality of data. The pilot project will be continued, and the non-banks involved in it will be offered a possibility of submitting the other statistical surveys to the Bank of Latvia electronically.

The Bank of Latvia improved the "Regulation for Compiling the Monthly Financial Position Report of Credit Institutions and Its Appendices" (amendments in effect as of January 1, 2002), introducing a more precise institutional breakdown, a wider range of financial instruments and their maturity breakdown. Thus the following was attained: the quality of banking and money statistics was improved; the relevant requirements of the ECB were fulfilled; and calculations regarding the banking sector's transactions for the needs of the country's balance of payments and international investment position could be done with greater precision.

The Bank of Latvia remained committed to integration in the EU in respect of financial and balance of payments statistics, and its employees participated in seminars and meetings of the relevant working groups organised by the ECB and the Eurostat. The Bank of Latvia revised information on the methodology pursued in compiling banking and money statistics, contained in Latvia's chapter in Part I of the ECB's publication *Money and Banking Statistics in the Accession Countries: Methodological Manual*. The Bank of Latvia also prepared information for Part II of the Manual, which deals with the accession countries' legal framework for statistics on other financial intermediaries, the financial market and interest rates. The Bank of Latvia provided a description of liquidity in the Latvian primary and secondary securities markets for inclusion in the new version of the ECB's publication *Bond Markets and Long-term Interest Rates in European Union Accession Countries*. The Bank of Latvia maintained the list of Latvian monetary financial institutions, which is included in the Provisional List of Monetary Financial Institutions of the Accession Countries, published on the ECB's website.

In the reporting year, the Bank of Latvia started to submit, on a regular basis, Latvia's balance of payments and international investment position and statistics on monetary indicators, interest rates and government bonds to the ECB.



The Bank of Latvia disseminated financial and balance of payments statistics through its regular publications and Internet site, as well as the Dissemination Standards Bulletin Board of the International Monetary Fund (IMF), the IMF publications *International Financial Statistics* and *Balance of Payments Statistics Yearbook*, as well as with the help of the Bank for International Settlements (BIS) and the Eurostat.

### PAYMENT SYSTEMS

On July 11, 2002, the Bank of Latvia adopted the new "Regulation for Credit Transfers" (in effect as of January 1, 2003; whereas certain obligations of Latvian institutions vis-à-vis institutions of the member states of the European Economic Area regarding retail credit transfers incoming from such institutions will take effect upon Latvia's accession to the EU), which supersedes the previous regulation. The new regulation incorporates more precisely the requirements of Directive 97/5/EC of the European Parliament and of the Council on cross-border credit transfers, making them applicable to participants in any credit transfer, where a customer's retail credit transfer (equivalent to 50 000 euros) is effected in Latvia and the European Economic Area. This regulation applies to all those institutions that effect credit transfers on behalf of customers, i.e., to credit institutions, the Bank of Latvia and the non-profit organisation state joint-stock company *Latvijas pasts*.

There is a new requirement that the originator's institution is to assume responsibility for the funds of a credit transfer to be placed at the disposal of the beneficiary's institution within the time limit the originator and the originator's institution have agreed upon. Likewise, the regulation specifies more exactly the institution's responsibility for executing the credit transfer in compliance with the payment order, including a requirement to avoid multiple commission fees, and defines the obligations of participants in a credit transfer that is not completed. Institutions are required to provide for effective redress and complaints procedures for the settlement of disputes between themselves and their customers, as well as to notify customers of the procedure for initiating such procedures.

On November 14, 2002, the Bank of Latvia adopted the "Regulation for Issuance and Maintenance of Electronic Money" (in effect as of January 1, 2003), which contains the requirements of Directive 2000/46/EC of the European Parliament and of the Council on the taking up, pursuit of and prudential supervision of the business of electronic money institutions with regard to the issuance and redemption of electronic money. The minimum requirements for institutions issuing electronic money, as set forth by the European System of Central Banks (ESCB), have also been included.

In 2002, the Bank of Latvia, in cooperation with banks, developed the basis for introducing the International Bank Account Number (IBAN) standard in Latvia, which will be used to identify the beneficiaries not only of foreign, but also domestic payments. Banks are scheduled to begin assigning IBANs in 2004, and as of 2005, the Bank of Latvia's payment systems will handle only those payment orders that contain the beneficiary's IBAN. As a result, a unified structure of customer accounts will be introduced at Latvian banks, thereby attaining a high level of standardisation in Latvia's payment system. The introduction of the IBAN standard in Latvia will enhance the automated processing of payments, reduce the number of erroneously prepared payment orders, as well as lower the costs relating to the execution of payments and investigation and correction of errors. Once the IBAN standard is introduced, the Latvian financial system will be well

prepared for compliance with Regulation No. 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euros.

In June 2002, the ECB, in cooperation with the central banks of the EU member states and accession countries, conducted an assessment of the infrastructure of payment and securities settlement systems and the related oversight function in the accession countries. It was recognised that in the EU enlargement context Latvia's payment and securities settlement systems would not pose additional risks to the single EU payment system. At the same time, recommendations to further enhance the functioning of payment systems were provided. The Bank of Latvia has started to implement these recommendations.

In addition to the assessment of the payment system infrastructure conducted by the ECB in the reporting year, the Bank of Latvia assessed the compliance of its interbank payment systems with the Core Principles for Systemically Important Payment Systems, as formulated by the Bank for International Settlements, evaluating compliance with each of the ten principles separately. The assessment covered the legal aspects of the system, the inherent financial risks and their management, operational activity, including activity in crisis situations, as well as issues relating to the efficiency and management of the systems. It was acknowledged that the interbank automated payment system (SAMS) and the electronic clearing (net settlement) system (EKS) functioned in compliance with international standards. Several propositions were made with regard to improvements to the systems' legal framework and risk management procedures in emergencies. Likewise, it was proposed to change the business hours for the EKS to meet market requirements.

In 2002, the Bank of Latvia continued to cooperate with payment system participants and service providers, addressing a number of issues pertaining to payment systems. The Bank of Latvia, in cooperation with the Association of Latvian Commercial Banks, informed banks about a number of issues, such as the payment system standards adopted by the ECB, introduction of the procedures for out-of-court settlement of disputes, applying commission fees to cross-border transfers in the EU, the Bank of Latvia's payment system policy, outlook for the development of the Bank of Latvia's interbank payment system, new types of S.W.I.F.T. messages, and the IBAN standard.

With regard to compilation of statistics on Latvia's payment and securities settlement systems to be included in the ECB publication *Blue Book* on a regular basis, in 2002 the Bank of Latvia cooperated with banks and institutions to ensure the operation of payment and securities settlement systems.

Within the framework of payment system oversight, the Bank of Latvia, in cooperation with the Financial and Capital Market Commission, began auditing banks' payment systems in the reporting year.

The Bank of Latvia continued to ensure the operation of the SAMS and the EKS. At the end of January 2002, the SAMS and the EKS were launched in the new building of the Bank of Latvia's Riga Branch. This enhanced the security of the payment systems and services rendered to the Bank of Latvia's customers. In 2002, two new participants, the joint-stock companies *Akciju komercbanka "Baltikums"* and *Reģionālā investīciju banka*, joined the SAMS and the EKS.

At the beginning of 2002, changes necessary for the transition to the new S.W.I.F.T. standard (MT103) in the EKS were completed. As the amendments to the "Regulation for Interbank Settlements Effected by the Bank of Latvia" became effec-

tive on February 1, 2002, the limits on the value of a payment handled in the EKS were introduced (the EKS ceased to process payments whose value exceeded 50 thousand lats).

To pinpoint the Bank of Latvia's risks from the point of view of an operator of the interbank payment system, as well as internal factors that could give rise to risks, the Bank carried out identification and evaluation of risks pursuant to its risk assessment procedures. During risk assessment, risks material for the Bank of Latvia in respect of the payment systems were identified. All risks were evaluated in terms of the extent of their impact, summarising and specifying hedges in respect of payment systems.

In the reporting year, the total volume of payments processed by the SAMS increased by 28.8%, reaching 109.8 thousand, while their total value was 21.5 billion lats. The average value of a single SAMS-processed payment was 195.7 thousand lats in 2000.

In 2002, the total volume of payments handled by the EKS rose by 11.3% (to 16.1 million), whereas their total volume was 14.2% lower than in the previous year (6.2 billion lats). The decline in the total volume of payments processed by the EKS may be attributed to the limits in respect of the value of a payment.

The Bank of Latvia continued to upgrade payment services extended to its customers on whose behalf the Bank of Latvia executes payments in the interbank settlement systems. An electronic exchange of payment documents with the Bank of Latvia was provided for the Treasury and the Riga Stock Exchange. A new agreement on account servicing was concluded with the Latvian Central Depository, expanding the range of services. As a result, the Latvian Central Depository could provide for the automation of its payment flows related to the management of the second level pension funds.

### INFORMATION SYSTEMS

The introduction of the Bank's integrated information system *Globus* was completed and the system was launched on December 2, 2002. Improving automation and reducing the inherent risks, the new system also helps to effect the Bank of Latvia's financial transactions and provides for uniform accounting. To facilitate their integration with the system *Globus*, a number of significant changes have been made to the Bank of Latvia's information systems.

In 2002, the infrastructure was developed for a pilot project of receiving balance of payments information from non-banks in electronic form. Work was also begun on developing the new securities settlement system with enhanced automation and security.

The possibilities provided by the system for the management of electronic documents were further enhanced to allow the participants of the Bank's Board of Governors and Executive Board as well as working group meetings to benefit from modern information technologies.

A modern computer centre opened at the new Riga Branch building of the Bank of Latvia at the beginning of 2002. A secure high-speed telecommunications connection with the computer centre at the Bank of Latvia's main building at K. Valdemāra iela 2a has been ensured. The new building also houses a disaster recovery site that ensures the mirroring of all significant Bank's information systems in real time.

The modernisation of the local computer network and the introduction of a centralised system for data storage and management allowed the Bank of Latvia to create a secure high-speed operational environment for the Bank's information systems, in particular, a higher level of uninterrupted functioning of the information systems. For the local network, a convenient and secure infrastructure for wireless connection was created.

In 2002, cooperation with the ECB was developed to ensure the Bank's ability to gradually join the uniform information systems of the ESCB. At the end of 2002, the first joint project was completed successfully, as the Bank of Latvia joined the ESCB system *CebaMail* for information exchange.

On November 14, 2002, the Bank of Latvia's Board of Governors adopted a new version of the "Strategic Development Plan for the Bank of Latvia's Information Systems", laying down the guidelines for further development of the Bank's information systems in the period from 2003 to 2005. It has been planned, inter alia, to significantly enhance the payment and settlement systems, the Bank of Latvia's securities settlement system and the technical facilities for compiling the balance of payments, as well as to ensure the compatibility of the Bank of Latvia's information systems with the ESCB uniform information systems.

#### INFORMATION TO THE PUBLIC

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

In 2002, the Bank of Latvia published its annual report for 2001 to reflect its activity and financial results for that year. The Bank of Latvia's *Monetary Bulletin* and *Monetary Review* informed about the dynamics of economic and monetary indicators. In 2002, the Bank published the monthly *Latvia's Balance of Payments (Principal Items)* and the quarterly *Latvia's Balance of Payments* to meet the ECB requirements. In a series of working papers, two studies by experts from the Monetary Policy Department were published: *Real Exchange Rate in Latvia (1994–2001)* analysing the determinants of the real exchange rate and the implications of changes in the real exchange rate for the Latvian economy, and *Financial Market in Latvia* dealing with the structure of the financial market, its participants and instruments, and development trends. The bulletin *Averss un Reverss* discussed economic developments in Latvia and abroad and provided information on resolutions by the Bank's Board of Governors and Executive Board.

Regular press releases covered information on resolutions passed by the Bank's Board of Governors and Executive Board and the Bank's activities. The Bank's employees prepared materials discussing issues falling within the competency of the central bank for publication in both Latvian and foreign newspapers and journals. The official exchange rates quoted and regulations developed by the Bank as well as other official information were disseminated through the official newspaper *Latvijas Vēstnesis*.

The Bank of Latvia's Governor held regular press conferences to inform the media on developments in the national economy.

The Bank's employees provided lectures on the activities of the central bank and developments in the national economy to students, students of secondary schools and teachers of economics. In the summer of 2002, the Bank organised a visit to the ECB and the *Deutsche Bundesbank* for the secondary school students who

had won the nation-wide competition on essentials of business. The purpose of the visit was to familiarise the students with the concept of the single monetary policy and the implications of the Economic and Monetary Union for the economy of the participating member states.

All Bank of Latvia's publications as well as the schedule for meetings of the Bank's Board of Governors were available on the Bank's Internet site (<http://www.bank.lv>). Information published on the Bank's site covered a wide variety of issues relating to the Bank of Latvia, the regulations adopted by the Bank, financial statistics, payment and settlement systems, Latvian notes and coins, and other areas of interest. The information was continually updated and expanded. At the end of 2002, the Bank of Latvia launched an improved version of its website, offering a wider range of information and improved search facilities. A section containing information for the specific needs of journalists and reporters was formed, comprising materials from the Bank of Latvia Governor's press conferences, commentary and analytical publications.

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

#### QUALITY MANAGEMENT AT THE BANK OF LATVIA

The quality management system has been functioning at the Bank of Latvia since 2000. With the introduction of the Bank's integrated information system *Globus* at the end of 2002, the procedure for conducting the principal Bank of Latvia's operations changed significantly. With a view to this, changes in the procedures of the Bank's departments conducting the core functions of the central bank, i.e., the Monetary Policy Department, the Payment Systems Department, the Accounting Department, the Foreign Exchange Department and the Cashier's and Money Operations Department, were initiated and scheduled for completion in early 2003.

In 2002, two internal quality audits of the Bank's quality management system were conducted. *Bureau Veritas Latvia* conducted two surveillance audits. During the surveillance audits, no serious deficiencies and major non-compliance with the standard ISO 9002:1994 were detected in the Bank's quality management system.

#### MANAGEMENT OF THE BANK OF LATVIA'S BUDGET

In the reporting year, expenses were incurred and long-term investments made in accordance with the 2002 budget as approved by the Bank of Latvia's Board of Governors. The Bank of Latvia's Executive Board, together with the heads of the relevant Bank's organisational units, made sure, on a regular basis, that the expenses were incurred and long-term investments made in accordance with the approved budget for 2002, and reported to the Bank's Board of Governors and Budgetary Commission on the execution of the budget.

On September 13, 2002, the Bank of Latvia's Board of Governors adopted the "Regulation for Managing the Bank of Latvia's Budget". In respect of the preceding procedure for preparing, adopting and executing the Bank of Latvia's budget, this regulation defined more precisely the principles for establishing reserves for expenditures and long-term investment to be included in the budget and the structure of the Bank of Latvia's budget.

The Bank of Latvia's Executive Board drafted the 2003 budget in accordance with the "Regulation for Managing the Bank of Latvia's Budget" and taking into ac-



count the forecasts regarding income, expenditures and long-term investments of the Bank's organisational units. They were prepared observing the Bank of Latvia's tasks, as laid down in the Law "On the Bank of Latvia", the working plans of the Bank's organisational units for 2003, the outlook for the economy and financial market in Latvia and the countries whose currencies are included in the SDR basket of currencies, as well as the expenditure plan for long-term investment projects for several consecutive years, as approved by the Bank of Latvia's Board of Governors.

The Bank's Budgetary Commission reviewed the draft budget of the Bank of Latvia submitted by the Executive Board and forwarded its opinion to the Bank's Executive Board and Board of Governors for approval. Upon receipt of the opinion of the Budgetary Commission, the Bank of Latvia's Executive Board submitted the improved Bank's draft budget for the year 2003 for approval to the Bank's Board of Governors.

### FINANCIAL RESULTS OF THE BANK OF LATVIA

The Bank of Latvia's profit for 2002 totalled 14 434 thousand lats (22 154 thousand lats in 2001). The year-on-year decrease in the profit earned was largely determined by declining interest income on financial instruments acquired in the Latvian and foreign financial markets. In 2002, the Bank of Latvia's net interest income amounted to 32 497 thousand lats (39 484 thousand lats in 2001). The Bank of Latvia's interest income was earned mainly by investing gold and convertible foreign currency reserves in secure financial instruments of high liquidity and conducting transactions in the market for Latvian government securities and the money market. The decrease in interest income on foreign operations could be attributed to lower yields on foreign debt securities and money market rates. Rather ample liquidity of the banking sector and the downward trend of lending rates had a negative impact on interest income on loans granted to banks registered in the Republic of Latvia (such interest income declined by 2 492 thousand lats in the reporting year). Interest income on Latvian government debt securities rose by 1 718 thousand lats as a result of investment made in government bonds at the outset of 2002. The Bank of Latvia's interest expense (3 815 thousand lats; 2 841 thousand lats in 2001) was largely comprised of interest on the Government's deposits.

The Bank of Latvia's financial results should be evaluated taking into account the result on revaluation of financial instruments, recognised under "Capital and reserves" in the caption "Valuation account". The net increase in the value of foreign debt securities and other financial instruments held by the Bank of Latvia during the year 2002 accounted for an increase of 7 822 thousand lats in the Bank's reserves caption (an increase of 313 thousand lats in 2001).

### THE BANK OF LATVIA'S ORGANISATIONAL STRUCTURE

The composition of the Board of Governors of the Bank of Latvia, as at the end of 2002, was as follows:

- |                                      |  |
|--------------------------------------|--|
| – Governor                           | <b>Ilmārs Rimševičs;</b>   |
| – Deputy Governor                    | <b>Andris Ruselis;</b>   |
| – Members of the Board of Governors: | <b>Harry Bush,<br/>Valentīna Kolotova,<br/>Arvils Sautiņš,<br/>Vita Pilsuma,</b> |

**Varis Zariņš,  
Valentīna Zeile.**

The Executive Board of the Bank of Latvia, as at the end of 2002, was as follows:

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

The Republic of Latvia Saeima elected Mr. Andris Ruselis as Deputy Governor of the Bank of Latvia for a period of six years on February 14, 2002. On January 17, 2002, the Bank of Latvia's Board of Governors appointed Ms. Māra Raubiško, Deputy Chairperson of the Executive Board, as Chairperson of the Executive Board of the Bank of Latvia, and concurrently, discharged Mr. Ilmārs Rimšēvičs from office (in effect as of January 21, 2002). On March 14, 2002, the Bank of Latvia's Board of Governors appointed Mr. Reinis Jakovļevs and Mr. Helmūts Ancāns, Members of the Executive Board, as Deputy Chairmen of the Executive Board of the Bank of Latvia, and Mr. Harijs Ozols, Head of Information Systems Department, as Member of the Executive Board of the Bank of Latvia (in effect as of April 1, 2002).

At the end of 2002, the number of the Bank of Latvia's employees was 721, of which 14 were employees having a job contract for a definite period (751 and 19 employees at the end of 2001, respectively). This decrease was a result of two factors: work organisation was optimised, and the technical facilities for ensuring the security regime of the Bank's buildings were modernised, as part of the Bank's functions were transferred to the new building of the Bank's Riga Branch as of January 2002. Of the Bank's staff, as at the end of 2002, 59.6% were males and 40.4% were females.

To approximate the Bank of Latvia's organisational structure to the arrangement set up by the ECB to discharge its respective functions, a Communications Department was created, merging the functions of the General Office, the Publications Department and partly of the Secretariat. The principal functions of the new department are publishing, translation, organisation of record keeping and office work, provision of information services by the archive and the library, provision of business travel services, dealing with organisational and economic issues pertaining to organisation of meetings, events and activities, as well as effecting external communication.

The Governor's Office was created to improve information support for the Bank of Latvia Governor and optimise external communication.

At the end of 2002, the Bank started cooperation with the ECB's Directorate Human Resources in the field of personnel selection. It is possible for the Bank of Latvia's employees to apply for temporary or permanent employment at the ECB.

In 2002, the Bank of Latvia continued a pilot project on job performance and development appraisal, which was started in 2001. After prior preparations and arrangements in respect of the appraisal meeting, each employee talked to his/her direct supervisor. During the appraisal meetings, job performance in the previous period was analysed, tasks for the next period were considered, and the

employee's wishes regarding career and the ways of improving professional skills were discussed. The process of job performance and development appraisal will be further elaborated, taking into account the proposed improvements.

### **PERSONNEL TRAINING**

In the reporting year, the Bank of Latvia employees participated in seminars, workshops and conferences in Latvia and abroad to improve their expertise and follow the latest developments in the fields of monetary policy, macroeconomics, econometrics, foreign exchange operations, payment systems, statistics, bank accounting and information technologies.

In 2002, 2.1% of total expense on salaries, wages and other remuneration to personnel was used for the needs of personnel training.

The Bank's employees broadened their understanding of EU-related issues, upgraded their knowledge of English and French, improved their computer skills, enhanced their presentation, strategy and business relationship skills, and acquired knowledge about creative thinking and effective use of memory. Special seminars were held for recently hired employees to inform them about the Bank's tasks and its organisational units' fulfilling these tasks. A number of Bank of Latvia employees successfully participated in international professional certification programs.

In 2002, the Bank's cooperation with the Centre for Central Banking Studies of the Bank of England was continued. The members of the Bank's Board of Governors and Executive Board, and heads of the Bank's organisational units had an opportunity to participate in seminars on risk management held in Latvia. Regional seminars on financial stability and specific issues pertaining to monetary policy operations were also organised. In addition to the Bank of Latvia's employees, employees from the Financial and Capital Market Commission and the central banks of Estonia and Lithuania also participated in these seminars.

**THE BANK OF LATVIA'S FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2002**



# THE BANK OF LATVIA'S BALANCE SHEET

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

ASSETS	Notes <sup>1</sup>	2002	2001
<b>FOREIGN ASSETS</b>		<b>894 613</b>	881 489
Gold	4	51 025	44 443
Special Drawing Rights		41	54
Convertible foreign currencies	5	737 313	732 799
International Monetary Fund	6	101 144	101 144
Shares in the Bank for International Settlements	7	1 197	1 043
Other foreign assets	8	3 893	2 006
<b>DOMESTIC ASSETS</b>		<b>146 321</b>	98 121
Loans to credit institutions	9	30 690	18 833
Transit credits	10	11 749	18 612
Government securities	11	64 382	24 715
Fixed assets	12	32 798	32 819
Other domestic assets	13	6 702	3 142
<b>TOTAL ASSETS</b>		<b>1 040 934</b>	979 610

<sup>1</sup> The accompanying notes set out on pages 52 to 73 are an integral part of these financial statements.



(cont.)	(at the end of the year; in thousands of lats)		
LIABILITIES, CAPITAL AND RESERVES	Notes	2002	2001
<b>FOEIGN LIABILITIES</b>		<b>116 778</b>	122 306
International Monetary Fund	14	110 388	116 012
Foreign bank deposits in lats		679	454
Non-convertible currencies		37	41
Other foreign liabilities	15	5 674	5 799
<b>LATS IN CIRCULATION</b>	16	<b>622 632</b>	556 003
<b>DOMESTIC LIABILITIES</b>		<b>209 676</b>	226 374
Balances due to credit institutions		134 223	82 433
Balances due to the Government		62 079	119 587
Balances due to other financial institutions		3 012	3 441
Other domestic liabilities	17	10 362	20 913
<b>CAPITAL AND RESERVES</b>		<b>91 848</b>	74 927
Nominal capital	18	25 000	10 100
Reserve capital	18	37 928	5 512
Other reserves	18	–	38 224
Valuation account	19	28 389	20 567
European Union grant		531	524
<b>TOTAL LIABILITIES, CAPITAL AND RESERVES</b>		<b>1 040 934</b>	979 610
MEMORANDUM ITEMS	21, 24, 25		

These financial statements, which are set out on pages 46 to 73, were authorised by the Bank of Latvia's Executive Board on February 27, 2003.

#### BANK OF LATVIA'S EXECUTIVE BOARD

Māra Raubiško

Reinis Jakovļevs

Helmūts Ancāns

Roberts L. Grava

Māris Kālis

Harijs Ozols

# THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENT

(in thousands of lats)

Notes	2002	2001
<b>INTEREST AND SIMILAR INCOME</b>		
Foreign operations		
Interest on deposits with foreign credit institutions and other foreign financial institutions	2 507	3 056
Income from debt securities	28 098	32 805
Dividends on shares in the Bank for International Settlements	157	124
<b>GROSS foreign interest and similar income</b>	<b>30 762</b>	35 985
Domestic operations		
Interest on loans to credit institutions	783	3 275
Income from transit credits	42	58
Income from government securities	4 725	3 007
<b>GROSS domestic interest and similar income</b>	<b>5 550</b>	6 340
<b>INTEREST EXPENSE</b>		
Foreign operations		
Interest on deposits	127	44
<b>GROSS foreign interest expense</b>	<b>127</b>	44
Domestic operations		
Interest on credit institutions' deposits	560	32
Interest on government deposits	3 055	2 709
Interest on other financial institutions' deposits	73	56
<b>GROSS domestic interest expense</b>	<b>3 688</b>	2 797
<b>NET INTEREST INCOME</b>	<b>32 497</b>	39 484

(cont.)		(in thousands of lats)	
	Notes	<b>2002</b>	2001
<b>OTHER OPERATING INCOME</b>	20	<b>605</b>	520
<b>OTHER OPERATING EXPENSE</b>			
Salaries, wages and other personnel costs		8 401	8 794
Social security costs		1 832	1 910
Costs of financing the Financial and Capital Market Commission	21	1 200	1 288
Depreciation charge	12	1 702	1 244
Renovation and repair costs		449	568
Banknote production and coinage costs		84	79
Other operating expense	22	5 000	3 967
<b>TOTAL other operating expense</b>		<b>18 668</b>	17 850
<b>PROFIT BEFORE APPROPRIATION</b>		<b>14 434</b>	22 154
<b>APPROPRIATION OF PROFIT</b>			
Profit appropriated to the State budget		5 341	8 862
Nominal capital		–	5 350
Reserve capital		9 093	2 215
Other reserves		–	5 727

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

		(in thousands of lats)		
		Notes	2002	2001
<b>RESULT ON REVALUATION</b>				
	Increase arising from revaluation of gold and shares in the Bank for International Settlements	19	6 736	2 606
	Increase/decrease (-) in financial instruments' market value	19	3 734	-1 176
	Decrease (-) arising from revaluation of assets and liabilities denominated in foreign currency	19	-2 648	-1 117
<b>NET RESULT ON REVALUATION</b>			<b>7 822</b>	313
<b>PROFIT BEFORE APPROPRIATION</b>			<b>14 434</b>	22 154
<b>TOTAL</b>			<b>22 256</b>	22 467

## THE BANK OF LATVIA'S CASH FLOW STATEMENT

		(in thousands of lats)	
	Notes	2002	2001
Net cash and cash equivalents inflow arising from operating activities	23 (1)	<b>9 063</b>	92 112
Acquisition of fixed assets		<b>-1 687</b>	-11 455
Acquisition of intangible assets		<b>-905</b>	-463
Repayment of the credit facility provided by the International Monetary Fund		<b>-6 098</b>	-6 098
Net cash and cash equivalents inflow	23 (2)	<b>373</b>	74 096

## 1. FOUNDATION AND PRINCIPAL ACTIVITIES

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

- implementation of monetary policy;
- issue of the national currency, both banknotes and coins;
- organisation and management of the interbank settlement system and promotion of a smooth functioning of the payment system in Latvia;
- compiling and publishing of financial statistics and the country's balance of payments.

## 2. RISK MANAGEMENT

The main risks associated with the Bank of Latvia's activities are financial and operational risks arising from a range of activities in pursuit of the Bank's primary functions. Therefore, the Bank of Latvia's Executive Board has established a risk management framework under the principles and guidelines established by the Board of Governors of the Bank of Latvia. At the Bank of Latvia, the process of risk analysis is coordinated by the manager of the security of the Bank of Latvia's information systems. The risk management framework is continuously upgraded in line with financial market and the Bank of Latvia's operational developments and is subject to review by the Internal Audit Department personnel on a regular basis. At least quarterly, the Bank of Latvia's Auditing Committee, which is comprised of three members of the Board of Governors of the Bank of Latvia and Head of Internal Auditing Department, reviews auditors' findings and recommendations, as well as improvements to the risk management framework made by the Bank of Latvia.

### FINANCIAL RISKS

Price (interest rate and exchange risks), credit and liquidity risks are among the most significant financial risks. The Bank of Latvia manages these risks in accordance with the "Principles and Guidelines for Investing the Bank of Latvia's Gold and Foreign Reserves" (hereinafter, the Guidelines), as approved by the Board of Governors of the Bank of Latvia.

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

#### *PRICE RISK*

Price risk is exposure to losses due to adverse changes in the financial markets (for example, movements in interest rates or exchange rates). The Bank of Latvia manages interest rate risk inherent mainly in foreign assets sensitive to interest rate fluctuations by using modified duration limits. To avoid losses resulting from adverse changes in exchange rates, the Bank of Latvia monitors exchange risks by applying limits to open foreign exchange positions. Every day the Risk Control Division of the Foreign Exchange Department monitors the compliance of the modified duration limits and open foreign exchange positions with the Guidelines and the respective resolutions passed by the Investment Committee.



The analysis of the Bank of Latvia's price risk, as at December 31, 2002, is provided in Notes 26 and 27.

#### *CREDIT RISK*

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

The Bank of Latvia minimises exposure to credit risk related to investments made in foreign debt securities and short-term cash and gold deposits by establishing limits on investments with different credit quality. Credit quality is evaluated on the basis of the ratings set by the international rating agencies *Fitch Ratings*, *Moody's Investors Service* and *Standard & Poor's*. In order to minimise the Bank's exposure to credit risk associated with its foreign operations, the Risk Control Division of the Foreign Exchange Department is involved in the daily monitoring of the Bank of Latvia's compliance with the Guidelines.

Short-term loans granted to domestic credit institutions are secured by collateral of either Latvian government securities or private sector securities, which have been included on the list of securities approved by the Chairperson of the Bank of Latvia's Executive Board and whose issuers' ratings assigned by international rating agencies are not below the rating thresholds established by the Bank of Latvia's Board of Governors in respect of long-term liabilities in foreign currencies. The Monetary Policy Department of the Bank of Latvia reviews these ratings and monitors the adequacy of collateral on a regular basis.

The analysis of the Bank of Latvia's credit risk, as at December 31, 2002, is provided in Notes 28 to 30.

#### *LIQUIDITY RISK*

Liquidity risk is associated with inability to meet liabilities timely and efficiently. The Bank of Latvia manages liquidity risk by investing its foreign exchange reserves in liquid debt securities and other financial instruments issued by international institutions, foreign governments, credit institutions and corporate entities, while investing its gold reserves in short-term deposits with foreign financial institutions.

#### *OPERATIONAL RISK*

Operational risk is exposure to losses resulting from unexpected interruption of operation, unauthorised use of information, non-compliance with security requirements, theft of assets, fraud and other circumstances related to inadequate internal controls or external factors. To minimise operational risk inherent in security and information systems, the Bank of Latvia has established the Committee for Managing the Development of the Bank of Latvia's Complex Security Strategy and the Committee for Managing the Bank of Latvia's Information Systems, which review, on a regular basis, the operational risk management system. In September 2002, the Bank of Latvia's Board of Governors adopted the new version of "The Bank of Latvia's Security Guidelines", which specifies the set of documents necessary for risk management and defines responsibilities in respect of managing and minimising risks. In December 2002, the Bank of Latvia's Executive Board adopted the "Regulation for Managing the Bank of Latvia's Risks", which lays down the procedure for identifying, documenting, assessing and containing risks. The Bank of Latvia has established the Standing Working Group for Risk Management, which evaluates and summarises risk reports, prepared by the Bank's organisational

units, and identifies and classifies risks to maintain and improve the Bank of Latvia's risk matrix.

The Bank of Latvia's management reviews, on a regular basis, the adequacy and availability of resources for ensuring the continuity of the Bank's operations in case of emergency.

In order to improve the organisation of the Bank of Latvia's operational activities and to mitigate operational risk, the Bank of Latvia has designed a quality management system in accordance with the quality management system standard ISO 9002:1994. This system is improved on a continuous basis. Until May 2003, it is planned to upgrade the Bank of Latvia's quality management system to reach compliance with the quality management system standard ISO 9001:2000.

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

### 3. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by the Bank of Latvia in the preparation of these financial statements is set out below. The adopted accounting policies have been applied consistently in the financial statements for the years ended December 31, 2002 and December 31, 2001.

#### BASIS OF PRESENTATION

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

#### FOREIGN CURRENCY TRANSLATION

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

The principal Bank of Latvia exchange rates, used in compiling the balance sheet, are as follows.

	(at the end of the year)	
	2002	2001
XDR	<b>0.7997</b>	0.7997
USD	<b>0.594</b>	0.638
EUR	<b>0.61</b>	0.560856
GBP	<b>0.946</b>	0.924
JPY	<b>0.00494</b>	0.00485
XAU	<b>205.21</b>	178.74

#### FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the amount at which a financial asset could be exchanged or a financial liability settled on an arm's length basis between knowledgeable, willing par-

ties. Where the fair values of financial assets and liabilities differ materially from their book values, such fair values are separately disclosed in the notes to the financial statements.

The fair value of the Bank of Latvia's financial assets and liabilities did not differ materially from the reported book value of the respective assets and liabilities for the years ended December 31, 2002 and December 31, 2001.

#### OFFSETTING FINANCIAL ASSETS AND LIABILITIES

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

#### GOLD

Gold reserves are recorded in the balance sheet at their market value. Any surplus or deficit arising from the revaluation of gold reserves is credited or charged to the balance sheet caption "Valuation account".

#### FINANCIAL INSTRUMENTS DENOMINATED IN FOREIGN CURRENCIES

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

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

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

In order to offset the effect of exchange risk associated with contracted commitments, the Bank of Latvia establishes a hedging financial instrument portfolio. Gains or losses on the respective hedging instruments are initially recognised in the balance sheet caption "Valuation account". When the hedged commitments result in recognition of an asset, the associated gains or losses on the financial instruments, which are considered to be an effective hedge, are removed from the balance sheet caption "Valuation account" and included in the amount of the corresponding asset.

#### SECURITIES

Securities are stated in the balance sheet at their fair value. Adjustments to the fair value of securities arising from revaluation of these financial instruments are

reported in the balance sheet caption "Valuation account" until their disposal. Upon disposal of such securities, the accumulated revaluation adjustment is transferred from the balance sheet caption "Valuation account" to the relevant profit and loss statement captions.

#### LOANS TO CREDIT INSTITUTIONS

Loans granted to credit institutions are reported in the balance sheet at their net value.

The Bank of Latvia's management reassesses the quality of loans granted to credit institutions on a regular basis. As soon as the recovery of an exposure or any part thereof is identified as doubtful, adequate specific credit risk provisions for loan impairment are established to provide for credit losses. These provisions for loan impairment are reported in the profit and loss statement as specific provisions.

#### REVERSE REPURCHASE AGREEMENTS

Reverse repurchase agreements are accounted for as financing transactions. Securities purchased under reverse repurchase agreements are not included in the Bank of Latvia's balance sheet. The related funding provided to the counterparty is included in the balance sheet as claims on domestic credit institutions, foreign credit institutions and other foreign financial institutions, as appropriate.

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

#### REPURCHASE AGREEMENTS

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

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

#### FIXED ASSETS

Fixed assets are recorded at historical cost less accumulated depreciation. If the net selling price or value in use of a fixed asset is lower than its carrying amount, the carrying amount of the fixed asset is reduced to the higher of the asset's net selling price or its value in use accordingly.

Depreciation is provided using the straight-line method over the estimated useful life of the asset. Assets under construction or development, land and works of art are not depreciated.

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

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

In accordance with generally accepted principles for hedge accounting, construction costs include a result arising from financial instruments designated as effective hedges of exchange risk associated with the paid for construction works.

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

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

#### INTANGIBLE ASSETS

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

Other costs related to the acquisition of the rights to use software and to software developed by the Bank of Latvia are recognised in the profit and loss statement as expense on the maintenance of information systems when incurred. Expense on the maintenance of information systems software is recognised in the profit and loss statement for the relevant period.

#### LATS IN CIRCULATION

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

#### GOLD CIRCULATION COINS

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

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

## COMMEMORATIVE COINS

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

## CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents are defined as the amounts comprising convertible foreign currency in cash, demand deposits with foreign credit institutions and other foreign financial institutions, foreign debt securities, which are readily convertible to cash within twenty-four hours, excluding demand deposits from foreign financial institutions, domestic credit institutions, Latvian Government and other domestic financial institutions.

## INTEREST AND SIMILAR INCOME AND INTEREST EXPENSE

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

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

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

## FEES

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

## BANKNOTE PRODUCTION AND COINAGE COSTS

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

## 4. GOLD

At the end of 2002 and 2001, the Bank of Latvia's gold reserves were placed in gold short-term deposits.

Movements in gold reserves during 2002 were as follows.

	Troy ounces	Amount in thousands of lats
As at December 31, 2001	248 647	44 443
Surplus arising from revaluation of gold	–	6 582
<b>As at December 31, 2002</b>	<b>248 647</b>	<b>51 025</b>

## 5. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency assets of the Bank of Latvia are invested primarily in short-term cash deposits and debt securities of high liquidity.



Interest bearing debt securities include both interest income purchased at the date of acquisition and interest income accrued subsequent to the date of acquisition of the securities (8 769 thousand lats at the end of 2002 and 9 768 thousand lats at the end of 2001).

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

	(in thousands of lats)	
	2002	2001
Debt securities of foreign central governments and other governmental institutions	291 686	293 139
Debt securities of foreign local governments	13 869	14 256
Debt securities of foreign central banks and credit institutions	141 054	144 261
Debt securities of other foreign financial institutions	101 805	110 723
Debt securities of foreign corporate entities	34 629	63 425
Short-term deposits with foreign credit institutions and other foreign financial institutions	65 389	70 926
Demand deposits with foreign central banks, credit institutions and international institutions	88 092	35 512
Foreign currency in cash	789	557
<b>Total</b>	<b>737 313</b>	<b>732 799</b>

## 6. INTERNATIONAL MONETARY FUND

The Republic of Latvia's quota in the International Monetary Fund (IMF), secured by promissory notes issued by the Government of Latvia, is recorded as an asset denominated in XDR and recognised in the balance sheet assets. The IMF holdings in lats and the Systemic Transformation Facility (STF) granted by the IMF are stated as a balance sheet liability (see Note 14).

At the end of 2002 and 2001, the Republic of Latvia's quota in the IMF was 126 478 thousand XDR (101 144 thousand lats).

As at December 31, 2002 and 2001, the Republic of Latvia's total quota in the IMF was 126 800 thousand XDR.

## 7. SHARES IN THE BANK FOR INTERNATIONAL SETTLEMENTS

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

As a result of changes in gold market value, the value of the shares in the BIS increased by 154 thousand lats during 2002. As at December 31, 2002, the value of the BIS shares owned by the Bank of Latvia was 1 197 thousand lats (1 043 thousand lats at the end of 2001).

## 8. OTHER FOREIGN ASSETS

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

	(in thousands of lats)	
	2002	2001
Non-traded financial derivative contracts with foreign financial institutions	3 319	1 554
Accrued interest income on deposits with foreign credit institutions and other foreign financial institutions	216	420
Other foreign assets	358	32
<b>Total</b>	<b>3 893</b>	<b>2 006</b>

## 9. LOANS TO CREDIT INSTITUTIONS

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

	(in thousands of lats)	
	2002	2001
Claims under repurchase agreements	30 545	18 700
Credit facilities provided in respect of the European Union grant	145	133
<b>Total</b>	<b>30 690</b>	<b>18 833</b>

## 10. TRANSIT CREDITS

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

## 11. GOVERNMENT SECURITIES

At the end of the year, the Bank of Latvia held the following Latvian Government securities.

	(in thousands of lats)	
	2002	2001
Residual maturity		
Within 3 months	13 044	640
3–6 months	70	490
6–12 months	6 955	1 450
1–3 years	19 379	13 677
Over 3 years	24 934	8 458
<b>Total</b>	<b>64 382</b>	<b>24 715</b>

Latvian Treasury bills and bonds held by the Bank of Latvia are stated at their fair value.

## 12. FIXED ASSETS

The following changes in fixed assets took place in 2002.

	(in thousands of lats)					
	Buildings and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other	Total
<b>As at December 31, 2001</b>						
Cost	29 295	5 458	1 965	1 031	2 806	40 555
Accumulated depreciation	-533	-2 987	-1 606	-826	-1 784	-7 736
<b>Net book value</b>	<b>28 762</b>	<b>2 471</b>	<b>359</b>	<b>205</b>	<b>1 022</b>	<b>32 819</b>
<b>During 2002</b>						
Additions	650	710	107	87	227	1 781
Adjustments	-94	-	-	-	-	-94
Result on reclassifications of fixed assets	-754	-	-	-	754	0
Disposals	-	-494	-4	-158	-284	-940
<b>Net change in cost</b>	<b>-198</b>	<b>216</b>	<b>103</b>	<b>-71</b>	<b>697</b>	<b>747</b>
Depreciation charge	-354	-796	-116	-88	-348	-1 702
Depreciation on disposals	-	488	3	158	285	934
<b>Net change in accumulated depreciation</b>	<b>-354</b>	<b>-308</b>	<b>-113</b>	<b>70</b>	<b>-63</b>	<b>-768</b>
<b>As at December 31, 2002</b>						
Cost	29 097	5 674	2 068	960	3 503	41 302
Accumulated depreciation	-887	-3 295	-1 719	-756	-1 847	-8 504
<b>Net book value</b>	<b>28 210</b>	<b>2 379</b>	<b>349</b>	<b>204</b>	<b>1 656</b>	<b>32 798</b>

## 13. OTHER DOMESTIC ASSETS

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

	(in thousands of lats)	
	2002	2001
Intangible assets	3 023	2 214
Gold circulation coins in vault	147	179
Currency swap arrangements with domestic credit institutions	2 800	43
Spot exchange rate contracts with domestic credit institutions	-	15
Accrued interest income on loans to domestic credit institutions	81	20
Other domestic assets	651	671
<b>Total</b>	<b>6 702</b>	<b>3 142</b>

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

In 2002, the following movements were observed in intangible assets.

	(in thousands of lats)
<hr/>	
As at December 31, 2001	
Cost	2 335
Accumulated amortisation	-121
<hr/>	
Net book value	2 214
<hr/>	
During 2002	
Additions	905
Amortisation charge	-96
<hr/>	
<b>As at December 31, 2002</b>	
Cost	3 240
Accumulated amortisation	-217
<hr/>	
<b>Net book value</b>	<b>3 023</b>

#### 14. INTERNATIONAL MONETARY FUND

At the end of 2002, liabilities to the IMF were comprised of the STF and IMF holdings in lats (see Note 6).

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

Movements in liabilities to the IMF during 2002 were as follows.

	(in thousands of lats)		
	STF	Holdings in lats	Total
<hr/>			
As at December 31, 2001	15 244	100 768	116 012
Increase in holdings in lats	-	474	474
Repayment	-6 098	-	-6 098
<hr/>			
<b>As at December 31, 2002</b>	<b>9 146</b>	<b>101 242</b>	<b>110 388</b>

#### 15. OTHER FOREIGN LIABILITIES

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

	(in thousands of lats)	
	2002	2001
<hr/>		
Non-traded financial derivative contracts with foreign financial institutions	5 444	4 585
Accrued expense	188	736
Other foreign liabilities	42	478
<hr/>		
Total	5 674	5 799

## 16. LATS IN CIRCULATION

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

Nominal	Amount (in thousands of lats)		Number (in thousands of units)		Percentage	
	2002	2001	2002	2001	2002	2001
Banknotes						
LVL 500	<b>82 082</b>	54 175	<b>164</b>	108	<b>13.2</b>	9.8
LVL 100	<b>119 859</b>	99 691	<b>1 199</b>	997	<b>19.2</b>	17.9
LVL 50	<b>54 140</b>	58 647	<b>1 083</b>	1 173	<b>8.7</b>	10.6
LVL 20	<b>211 495</b>	183 947	<b>10 575</b>	9 197	<b>34</b>	33.1
LVL 10	<b>73 908</b>	81 354	<b>7 391</b>	8 135	<b>11.9</b>	14.6
LVL 5	<b>52 822</b>	51 931	<b>10 564</b>	10 386	<b>8.5</b>	9.3
Total banknotes	<b>594 306</b>	529 745	–	–	<b>95.5</b>	95.3
Coins						
LVL 100	<b>302</b>	301	<b>3</b>	3	<b>0</b>	0.1
LVL 10	<b>137</b>	137	<b>14</b>	14	<b>0</b>	0
LVL 2	<b>6 640</b>	6 547	<b>3 320</b>	3 274	<b>1.1</b>	1.2
LVL 1	<b>9 751</b>	8 880	<b>9 751</b>	8 880	<b>1.6</b>	1.6
50 s	<b>4 731</b>	4 295	<b>9 461</b>	8 590	<b>0.8</b>	0.8
20 s	<b>2 417</b>	2 173	<b>12 085</b>	10 865	<b>0.4</b>	0.4
10 s	<b>1 477</b>	1 365	<b>14 770</b>	13 650	<b>0.2</b>	0.2
5 s	<b>1 122</b>	1 020	<b>22 447</b>	20 400	<b>0.2</b>	0.2
2 s	<b>957</b>	827	<b>47 874</b>	41 350	<b>0.1</b>	0.1
1 s	<b>792</b>	713	<b>79 196</b>	71 300	<b>0.1</b>	0.1
Total coins	<b>28 326</b>	26 258	–	–	<b>4.5</b>	4.7
Total lats in circulation	<b>622 632</b>	556 003	–	–	<b>100.0</b>	100.0

In 2002, the Bank of Latvia continued to issue gold circulation coins (fineness .999) with a nominal value of LVL 100. As a result, the total nominal value of such coins in circulation increased from 1 813 thousand lats at the end of 2001 to 1 870 thousand lats at the end of 2002. The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", since their nominal value is directly supported by their content of gold.

Among coins in circulation, there were also commemorative coins that did not represent any liability of the Bank of Latvia to holders of these coins, and their total nominal value was 930 thousand lats at the end of 2002 (929 thousand lats in 2001). These coins are not included in the balance sheet caption "Lats in circulation".

## 17. OTHER DOMESTIC LIABILITIES

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

	(in thousands of lats)	
	2002	2001
Profit appropriated to the State budget	5 341	8 862
Currency swap arrangements with domestic credit institutions	1 148	7 093
Accrued expenditure on completed construction works	734	1 559
Deferred liabilities to constructors	813	778
Accrued interest expense on government deposits	215	395
Other accrued expense	824	977
Deferred income	400	429
Tax liabilities	139	21
Other domestic liabilities	748	799
<b>Total</b>	<b>10 362</b>	<b>20 913</b>

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

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

The nominal capital is comprised of the State allotted resources and the Bank of Latvia's profit allocations.

Pursuant to the Amendments of June 20, 2002 to the Law "On the Bank of Latvia", the Bank of Latvia transferred other reserves to the nominal capital, increasing it by 14 900 thousand lats to reach the amount specified in the Law "On the Bank of Latvia", and the remaining part of other reserves in the amount of 23 324 thousand lats was transferred to the reserve capital.

The Law "On the Bank of Latvia" establishes that part of the Bank of Latvia's annual profit, calculated by applying the tax rate set for residents by the Law "On Enterprise Income Tax", and a payment in the amount of 15 per cent of the profit earned during the reporting year for the usage of State capital shall be transferred to the State budget. On December 31, 2002, the enterprise income tax rate applicable to residents of the Republic of Latvia was 22 per cent. Hence, 37 per cent of the Bank of Latvia's profit earned during the year ended December 31, 2002 shall be transferred to the State budget.

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



## 19. VALUATION ACCOUNT

Movements in the valuation account during 2002 were as follows.

	(in thousands of lats)			
	Surplus on revaluation of gold and shares in the BIS	Surplus/deficit (-) on changes in financial instruments' market value	Deficit (-) on revaluation of assets and liabilities in foreign currency	Total
As at December 31, 2001	50 877	3 844	-34 154	20 567
Increase/decrease (-)	6 736	3 734	-2 648	7 822
<b>As at December 31, 2002</b>	<b>57 613</b>	<b>7 578</b>	<b>-36 802</b>	<b>28 389</b>

## 20. OTHER OPERATING INCOME

Other operating income consisted of the following items.

	(in thousands of lats)	
	2002	2001
Income from cash and securities settlement services	316	278
Income from the sales of commemorative coins	105	105
Other operating income	184	137
<b>Total</b>	<b>605</b>	<b>520</b>

## 21. FINANCING OF THE FINANCIAL AND CAPITAL MARKET COMMISSION

Pursuant to Article 5 of the Transition Rules of the Law "On the Financial and Capital Market Commission", the operation of the Financial and Capital Market Commission shall be financed from payments made by financial and capital market participants, the State budget and the Bank of Latvia. In 2002, the Bank of Latvia covered expenses pertaining to the supervision of credit institutions in the amount of 1 200 thousand lats. The Bank of Latvia is to make such payments from 2003 until 2006 according to the following schedule: 1 200 thousand lats in 2003, 960 thousand lats in 2004, 600 thousand lats in 2005, and 240 thousand lats in 2006.

## 22. OTHER OPERATING EXPENSE

Other operating expense was as follows.

	(in thousands of lats)	
	2002	2001
Maintenance of information systems	769	573
Transportation of valuables	530	167
Insurance	467	235
Acquisition of low value office supplies	378	433
Business travel	374	312
Municipal services and rent of premises	361	284
Communications services	360	309
Maintenance of buildings, territory and equipment	354	199
Publications (including publications in mass media)	206	237
Personnel training	177	200

(cont.)	(in thousands of lats)	
Maintenance of transport vehicles	<b>120</b>	123
Legal and other professional fees	<b>106</b>	140
Tax on real estate	<b>102</b>	52
Amortisation charge	<b>96</b>	142
Other operating expense	<b>600</b>	561
<b>Total</b>	<b>5 000</b>	3 967

### 23. CASH FLOW STATEMENT

(1) Reconciliation of profit before appropriation to net cash and cash equivalents inflow or outflow (-) arising from operating activities

	(in thousands of lats)	
	<b>2002</b>	2001
Profit before appropriation	<b>14 434</b>	22 154
Depreciation of fixed assets and amortisation of intangible assets	<b>1 798</b>	1 386
Loss on disposal of fixed assets	<b>6</b>	49
Net surplus/deficit (-) arising from revaluation and financial instruments' market value adjustment	<b>1 081</b>	-2 293
Net decrease in gold	-	3
Net increase (-)/decrease in Special Drawing Rights	<b>13</b>	-51
Net increase (-)/decrease in foreign debt securities and other foreign investments	<b>63 162</b>	-163 816
Net increase (-)/decrease in other foreign assets	<b>-1 887</b>	1 986
Net increase (-)/decrease in loans to domestic credit institutions	<b>-11 857</b>	23 697
Decrease in transit credits	<b>6 863</b>	5 223
Net increase (-)/decrease in government securities	<b>-39 667</b>	27 010
Net increase (-)/decrease in other domestic assets	<b>-2 751</b>	307
Net increase/decrease (-) in lats deposits of foreign banks	<b>257</b>	-26
Net increase in IMF holdings in lats	<b>474</b>	56
Net decrease in other foreign liabilities	<b>-125</b>	-1 040
Net increase in lats in circulation	<b>66 629</b>	73 689
Net increase/decrease (-) in time deposits of domestic credit institutions	<b>-19 570</b>	22 000
Net increase/decrease (-) in the Government's time deposits	<b>-53 462</b>	79 915
Net decrease in time deposits of other financial institutions	<b>-450</b>	-200
Net increase/decrease (-) in other domestic liabilities	<b>-15 892</b>	2 061
Increase in European Union grant	<b>7</b>	2
<b>Net cash and cash equivalents inflow arising from operating activities</b>	<b>9 063</b>	92 112

## (2) Analysis of cash and cash equivalents

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

	2002	Change	2001
<b>Assets</b>			
Convertible foreign currencies in cash	789	232	557
Demand deposits with foreign credit institutions and other foreign financial institutions	88 092	52 527	35 565
Foreign debt securities, which are readily convertible to cash within twenty-four hours	130 008	14 917	115 091
<b>Liabilities</b>			
Demand deposits from foreign financial institutions	-312	32	-344
Demand deposits from domestic credit institutions	-131 793	-71 360	-60 433
Demand deposits from Latvian Government	-10 821	4 046	-14 867
Demand deposits from other domestic financial institutions	-662	-21	-641
<b>Total</b>	<b>75 301</b>	<b>373</b>	<b>74 928</b>

**24. CONTRACTED CAPITAL OFF-BALANCE SHEET COMMITMENTS**

At the end of 2002, the Bank of Latvia had capital off-balance sheet commitments in the amount of 1 045 thousand lats in respect of the acquisition of fixed assets. (The Bank of Latvia had no such commitments at the end of 2001.)

**25. FINANCIAL INSTRUMENTS' OFF-BALANCE SHEET ACCOUNTS**

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

At the end of the year, the Bank of Latvia had entered into the following spot exchange rate and financial derivative contracts.

(in thousands of lats)

	Contract or notional amount		Fair value			
			Assets		Liabilities	
	2002	2001	2002	2001	2002	2001
Spot exchange rate contracts						
with foreign financial institutions	37	85	-	-	-	-
with domestic credit institutions	-	1 512	-	15	-	-
Derivative exchange rate contracts						
Forward exchange rate contracts						
with foreign financial institutions	248 127	220 547	2 484	1 375	5 376	4 585
Currency swap arrangements						
with domestic credit institutions	185 521	127 471	2 800	43	1 148	7 093
Gold interest rate swap arrangements						
with foreign financial institutions	26 267	22 879	540	179	-	-
Other non-traded financial derivative interest rate contracts						
with foreign financial institutions	25 483	-	295	-	68	-
Total derivative exchange rate contracts, and currency and interest rate swap arrangements						
with foreign financial institutions	x	x	3 319	1 554	5 444	4 585
with domestic credit institutions	x	x	2 800	58	1 148	7 093
Interest rate future contracts						
with foreign financial institutions	56 467	66 542	516	62	250	43

## 26. CURRENCY PROFILE

At the end of the year, the currency profile of the Bank of Latvia's assets, liabilities and memorandum items was as follows.

	(in thousands of lats)								
	LVL	XDR	USD	EUR	GBP	JPY	Gold	Other	Total
<b>As at December 31, 2002</b>									
Foreign assets									
Gold	-	-	-	-	-	-	51 025	-	51 025
Special Drawing Rights	-	41	-	-	-	-	-	-	41
Convertible foreign currencies	-	-	364 147	287 726	57 356	18 239	-	9 845	737 313
International Monetary Fund	-	101 144	-	-	-	-	-	-	101 144
Shares in the BIS	-	-	-	-	-	-	1 197	-	1 197
Other foreign assets	3 319	-	140	210	153	12	52	7	3 893
Domestic assets									
Loans to credit institutions	30 545	-	-	145	-	-	-	-	30 690
Transit credits	-	-	11 749	-	-	-	-	-	11 749
Government securities	64 382	-	-	-	-	-	-	-	64 382
Fixed assets	32 798	-	-	-	-	-	-	-	32 798
Other domestic assets	6 546	-	7	-	-	-	147	2	6 702
<b>TOTAL ASSETS</b>	<b>137 590</b>	<b>101 185</b>	<b>376 043</b>	<b>288 081</b>	<b>57 509</b>	<b>18 251</b>	<b>52 421</b>	<b>9 854</b>	<b>1 040 934</b>
Foreign liabilities									
International Monetary Fund	101 242	9 146	-	-	-	-	-	-	110 388
Foreign bank deposits in lats	679	-	-	-	-	-	-	-	679
Non-convertible currencies	-	-	-	-	-	-	-	37	37
Other foreign liabilities	5 466	-	87	121	-	-	-	-	5 674
Lats in circulation	622 632	-	-	-	-	-	-	-	622 632
Domestic liabilities									
Balances due to credit institutions	134 223	-	-	-	-	-	-	-	134 223
Balances due to the Government	31 101	41	281	30 656	-	-	-	-	62 079
Balances due to other financial institutions	2 988	-	22	2	-	-	-	-	3 012
Other domestic liabilities	9 079	-	30	1 253	-	-	-	-	10 362
<b>TOTAL LIABILITIES</b>	<b>907 410</b>	<b>9 187</b>	<b>420</b>	<b>32 032</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>37</b>	<b>949 086</b>
Net position on balance sheet	-769 820	91 998	375 623	256 049	57 509	18 251	52 421	9 817	91 848
Net position on financial instruments' off-balance sheet accounts	148 391	-	-112 765	-49 743	10 460	57 672	-51 338	-3 150	-473
Net position on capital commitments	1 045	-	-	-	-	-	-	-	1 045
<b>As at December 31, 2001</b>									
<b>TOTAL ASSETS</b>	<b>80 741</b>	<b>101 198</b>	<b>418 703</b>	<b>246 777</b>	<b>56 079</b>	<b>15 445</b>	<b>45 665</b>	<b>15 002</b>	<b>979 610</b>
<b>TOTAL LIABILITIES</b>	<b>825 493</b>	<b>15 298</b>	<b>4 958</b>	<b>58 892</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>41</b>	<b>904 683</b>
Net position on balance sheet	-744 752	85 900	413 745	187 885	56 078	15 445	45 665	14 961	74 927
Net position on financial instruments' off-balance sheet accounts	128 196	-	-130 181	-7 083	5 214	43 779	-44 571	-5 420	-10 066

## 27. REPRICING MATURITY OF ASSETS AND LIABILITIES

(in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Within 3 months	3–6 months	6–12 months	1–3 years	Over 3 years		
<b>As at December 31, 2002</b>							
Foreign assets							
Gold	24 641	–	26 384	–	–	–	51 025
Special Drawing Rights	41	–	–	–	–	–	41
Convertible foreign currencies	253 960	29 375	79 764	206 827	159 823	7 564	737 313
International Monetary Fund	–	–	–	–	–	101 144	101 144
Shares in the BIS	–	–	–	–	–	1 197	1 197
Other foreign assets	–	–	–	–	–	3 893	3 893
Domestic assets							
Loans to credit institutions	30 545	145	–	–	–	–	30 690
Transit credits	–	–	–	–	–	11 749	11 749
Government securities	13 044	70	6 955	19 379	24 934	–	64 382
Fixed assets	–	–	–	–	–	32 798	32 798
Other domestic assets	–	–	–	–	–	6 702	6 702
<b>TOTAL ASSETS</b>	<b>322 231</b>	<b>29 590</b>	<b>113 103</b>	<b>226 206</b>	<b>184 757</b>	<b>165 047</b>	<b>1 040 934</b>
Foreign liabilities							
International Monetary Fund	–	–	–	–	–	110 388	110 388
Foreign bank deposits in lats	367	–	–	–	–	312	679
Non-convertible currencies	–	–	–	–	–	37	37
Other foreign liabilities	–	–	–	–	–	5 674	5 674
Lats in circulation	–	–	–	–	–	622 632	622 632
Domestic liabilities							
Balances due to credit institutions	2 000	–	430	–	–	131 793	134 223
Balances due to the Government	58 029	–	505	2 722	–	823	62 079
Balances due to other financial institutions	2 350	–	–	–	–	662	3 012
Other domestic liabilities	–	–	–	–	–	10 362	10 362
<b>TOTAL LIABILITIES</b>	<b>62 746</b>	<b>–</b>	<b>935</b>	<b>2 722</b>	<b>–</b>	<b>882 683</b>	<b>949 086</b>
Net position on balance sheet	259 485	29 590	112 168	223 484	184 757	x	x
Net position on financial instruments' off-balance sheet accounts	–2 093	879	741	–	–	x	x
As at December 31, 2001							
TOTAL ASSETS	220 683	56 199	56 008	294 042	183 016	169 662	979 610
TOTAL LIABILITIES	106 241	25 105	9 214	–	–	764 123	904 683
Net position on balance sheet	114 442	31 094	46 794	294 042	183 016	x	x
Net position on financial instruments' off-balance sheet accounts	–3 368	–495	–3 413	–2 771	–	x	x

The table above analyses the sensitivity of the Bank of Latvia's financial position to a change in interest rates. Assets and liabilities reported in this table are stated at carrying amounts, categorised by the earlier of contractual interest re-fixing or residual maturity dates.



In accordance with interest rate future contracts dealing requirements, the Bank of Latvia has pledged securities in the amount of 3 228 thousand lats (3 330 thousand lats at the end of 2001), which are included in the balance sheet caption "Convertible foreign currencies". All other balances included in the balance sheet caption "Convertible foreign currencies" represent investments of high liquidity, which are subject to disposal at the Bank of Latvia's discretion.

## 28. SECTORAL PROFILE OF ASSETS

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

	Amount (in thousands of lats)		Percentage	
	2002	2001	2002	2001
Foreign central governments and other governmental institutions	292 475	293 139	28.1	29.9
Foreign local governments	13 869	14 256	1.3	1.5
Foreign central banks and credit institutions	269 830	257 997	25.9	26.3
Other foreign financial institutions	113 100	110 723	10.9	11.3
Foreign corporate entities	34 760	63 425	3.3	6.5
International institutions	167 120	141 917	16.1	14.5
Latvian Government	106 757	62 057	10.3	6.3
Domestic credit institutions	145	133	0	0
Others	42 878	35 963	4.1	3.7
<b>Total</b>	<b>1 040 934</b>	<b>979 610</b>	<b>100.0</b>	<b>100.0</b>

For the purposes of credit risk analysis, in the above table claims arising from securities purchased under repurchase agreements are classified according to the issuer of the security. As a result, claims arising from Latvian government securities purchased under agreements to resell to domestic credit institutions in the amount of 30 545 thousand lats (18 700 thousand lats at the end of 2001) and the related accrued interest income in the amount of 80 thousand lats (20 thousand lats at the end of 2001) are reported as exposure to the Latvian Government.

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

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

	Amount (in thousands of lats)		Percentage	
	2002	2001	2002	2001
European Union	432 605	408 031	48.4	46.3
United States of America	197 990	214 349	22.1	24.3
Japan	26 106	44 640	2.9	5.1
Other countries	70 792	72 552	7.9	8.2
International institutions	167 120	141 917	18.7	16.1
<b>Total</b>	<b>894 613</b>	<b>881 489</b>	<b>100.0</b>	<b>100.0</b>

### 30. ASSETS BY CREDIT RATINGS ASSIGNED TO THE COUNTERPARTY

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

	Credit rating	Amount (in thousands of lats)		Percentage	
		2002	2001	2002	2001
<b>FOREIGN ASSETS</b>					
Gold	AAA	<b>11 293</b>	9 740	<b>1.1</b>	1.0
	AA+	<b>13 210</b>	17 475	<b>1.3</b>	1.8
	AA	<b>19 915</b>	11 530	<b>1.9</b>	1.2
	AA-	<b>6 607</b>	5 698	<b>0.6</b>	0.6
Special Drawing Rights	AAA	<b>41</b>	54	<b>0</b>	0
Foreign debt securities	AAA	<b>386 495</b>	362 163	<b>37.2</b>	37.0
	AA+	<b>52 680</b>	54 792	<b>5.1</b>	5.6
	AA	<b>42 109</b>	54 628	<b>4.0</b>	5.6
	AA-	<b>52 413</b>	93 560	<b>5.0</b>	9.5
	A+	<b>11 492</b>	37 200	<b>1.1</b>	3.8
	A	<b>20 965</b>	14 495	<b>2.0</b>	1.5
	A-	<b>16 889</b>	8 966	<b>1.6</b>	0.9
Deposits with foreign credit institutions and other foreign financial institutions	AAA	<b>71 449</b>	11 121	<b>7.0</b>	1.1
	AA+	<b>19 826</b>	7 628	<b>1.9</b>	0.8
	AA	<b>9 905</b>	14 599	<b>1.0</b>	1.5
	AA-	<b>25 479</b>	52 749	<b>2.4</b>	5.4
	A+	<b>12 106</b>	5 101	<b>1.2</b>	0.5
	A	<b>14 675</b>	15 240	<b>1.4</b>	1.6
	A-	<b>41</b>	-	<b>0</b>	-
Foreign currency in cash	AAA	<b>789</b>	557	<b>0.1</b>	0.1
International Monetary Fund	AAA	<b>101 144</b>	101 144	<b>9.7</b>	10.3
Shares in the BIS	AAA	<b>1 197</b>	1 043	<b>0.1</b>	0.1
Derivative financial instruments	AA+	<b>264</b>	270	<b>0</b>	0
	AA	<b>761</b>	1 009	<b>0.1</b>	0.1
	AA-	<b>1 517</b>	-	<b>0.1</b>	-
	A+	<b>647</b>	275	<b>0.1</b>	0
	A	<b>130</b>	-	<b>0</b>	-
Accrued interest income	Different	<b>216</b>	420	<b>0</b>	0
Other foreign assets	Different	<b>358</b>	32	<b>0</b>	0
<b>DOMESTIC ASSETS</b>					
Loans to credit institutions	Different	<b>30 690</b>	18 833	<b>2.9</b>	1.9
Transit credits	BBB+	<b>11 749</b>	-	<b>1.1</b>	-
	BBB	-	18 612	-	1.9
Government securities	A-	<b>64 382</b>	24 715	<b>6.2</b>	2.5
Other	Different	<b>39 500</b>	35 961	<b>3.8</b>	3.7
<b>TOTAL</b>		<b>1 040 934</b>	979 610	<b>100.0</b>	100.0

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

	Credit rating	Amount (in thousands of lats)		Percentage	
		2002	2001	2002	2001
Foreign assets	AAA	<b>572 408</b>	485 822	<b>63.9</b>	55.1
	AA	<b>244 686</b>	313 938	<b>27.4</b>	35.6
	A	<b>76 945</b>	81 277	<b>8.6</b>	9.2
	Different	<b>574</b>	452	<b>0.1</b>	0.1
Total		<b>894 613</b>	881 489	<b>100.0</b>	100.0

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

## REPORT OF THE AUDIT COMMISSION TO THE BANK OF LATVIA'S BOARD OF GOVERNORS

We have audited the balance sheet of the Bank of Latvia as at 31 December 2002, and the related statements of profit and loss, recognised gains and losses, and cash flows for the year then ended and the accompanying notes (hereinafter, the financial statements). These financial statements, which are set out on pages 46 to 73, are the responsibility of the Bank of Latvia's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank of Latvia as at 31 December 2002, and the results of its operations and its cash flows for the year then ended in conformity with the accounting principles adopted by the Bank of Latvia and the Law "On the Bank of Latvia".

ERNST & YOUNG

THE STATE AUDIT OFFICE  
OF THE REPUBLIC OF LATVIA

Riga  
27 February 2003

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

On March 27, 2003, the Bank of Latvia's Board of Governors passed Resolution No. 101/1 "On the Bank of Latvia's Annual Report for 2002".

Having reviewed the results of the audit of the Bank of Latvia's economic activity in 2002, the Bank of Latvia's Board of Governors resolves:

1 To approve the Bank of Latvia's annual report for 2002, including the balance sheet, profit and loss statement, statement of recognised gains and losses and cash flow statement.

2 To appropriate the Bank of Latvia's profit for 2002 in the following way.

2.1 5 341 thousand lats to be transferred to the state revenue.

2.2 9 093 thousand lats to be transferred to the Bank's reserve capital.

ILMĀRS RIMŠĒVIČS  
GOVERNOR  
BANK OF LATVIA





## APPENDICES



## Appendix 1

## MONETARY INDICATORS IN 2002

(at end of month; in millions of lats)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
<b>BANK OF LATVIA</b>												
Monetary base M0	637.1	632.0	637.1	622.3	629.9	666.4	664.6	682.4	657.8	665.5	713.2	<b>755.1</b>
Currency in circulation	525.4	527.0	532.8	524.5	529.2	546.1	551.6	562.5	569.0	576.2	585.8	<b>622.6</b>
Deposits with the Bank of Latvia	111.7	105.0	104.4	97.8	100.8	120.2	113.0	119.9	88.8	89.3	127.4	<b>132.5</b>
Currency vs monetary base (%)	82.5	83.4	83.6	84.3	84.0	81.9	83.0	82.4	86.5	86.6	82.1	<b>82.5</b>
Net foreign assets	750.9	753.4	749.2	748.8	735.7	725.1	718.7	763.9	780.3	733.3	712.8	<b>777.8</b>
Net domestic assets	-113.8	-121.3	-112.1	-126.5	-105.7	-58.8	-54.2	-81.6	-122.5	-67.8	0.4	<b>-22.7</b>
Credits	-35.8	-38.6	-28.5	-35.1	-25.0	-3.8	3.9	-21.6	-55.6	-4.8	62.7	<b>44.7</b>
To banks	11.8	6.1	14.6	4.0	7.3	22.7	29.3	27.7	40.1	29.2	35.7	<b>30.7</b>
To the Government (net)	-47.5	-44.8	-43.1	-39.2	-32.2	-26.4	-25.4	-49.4	-95.7	-34.1	27.1	<b>14.1</b>
Other items (net)	-78.0	-82.7	-83.5	-91.3	-80.8	-55.0	-58.1	-60.0	-66.9	-63.0	-62.3	<b>-67.5</b>
<b>BANKING SYSTEM</b>												
Broad money M2X	1 548.3	1 580.5	1 645.7	1 658.4	1 653.0	1 711.6	1 709.0	1 728.1	1 736.2	1 771.4	1 795.1	<b>1 864.9</b>
Currency outside banks	465.2	466.4	471.8	464.1	470.0	482.8	489.5	499.5	501.6	510.2	521.2	<b>543.1</b>
Deposits of domestic enterprises and private persons	1 083.1	1 114.1	1 173.9	1 194.4	1 183.0	1 228.8	1 219.5	1 228.6	1 234.6	1 261.2	1 273.9	<b>1 321.8</b>
In foreign currencies	490.0	505.2	544.8	542.0	536.2	554.0	545.5	557.3	548.4	550.4	555.2	<b>540.3</b>
Domestic money supply M2D <sup>1</sup>	1 058.4	1 075.3	1 101.0	1 116.4	1 116.9	1 157.6	1 163.5	1 170.8	1 187.8	1 221.0	1 239.9	<b>1 324.6</b>
Net foreign assets	492.9	499.8	494.1	496.3	453.1	514.1	466.7	489.8	454.1	404.1	387.6	<b>352.1</b>
Net domestic assets	1 055.4	1 080.7	1 151.7	1 162.1	1 200.0	1 197.5	1 242.4	1 238.3	1 282.1	1 367.3	1 407.5	<b>1 512.8</b>
Loans of domestic enterprises and private persons	1 367.0	1 393.2	1 434.1	1 455.2	1 480.8	1 514.4	1 559.1	1 595.0	1 664.2	1 734.3	1 794.5	<b>1 849.5</b>
Bank of Latvia refinancing rate (at end of month; %)	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.0	3.0	3.0	<b>3.0</b>
Weighted average interest rates on transactions in lats (%)												
Interbank loans	3.9	3.4	3.3	3.1	2.9	2.8	2.9	3.1	2.7	3.0	2.6	<b>2.7</b>
Long-term loans to enterprises and private persons	10.1	10.7	9.6	9.3	8.9	8.5	8.4	8.5	8.1	7.4	7.8	<b>7.4</b>
Time deposits of enterprises and private persons	4.5	3.9	3.7	3.6	3.1	3.2	3.0	3.2	2.8	3.1	2.9	<b>3.3</b>
LVL vs USD (at end of month)	0.644	0.644	0.641	0.630	0.620	0.605	0.604	0.604	0.606	0.606	0.605	<b>0.594</b>
LVL vs EUR (at end of month)	0.557	0.557	0.561	0.568	0.581	0.596	0.593	0.593	0.593	0.595	0.599	<b>0.610</b>

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

## THE BANK OF LATVIA'S MONTH-END BALANCE SHEETS FOR 2002

(in thousands of lats)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
<b>FOREIGN ASSETS</b>	883 190	873 118	875 005	867 560	857 292	848 989	835 278	877 778	896 676	848 043	826 833	<b>894 613</b>
Gold	45 378	47 738	47 325	48 767	50 117	48 168	45 644	46 708	48 330	47 733	47 611	<b>51 025</b>
Special Drawing Rights	209	99	99	122	29	29	184	124	124	124	46	<b>41</b>
Convertible foreign currencies	733 452	721 899	724 126	712 314	702 508	692 740	681 957	726 666	744 583	695 827	674 388	<b>737 313</b>
International Monetary Fund	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	101 144	<b>101 144</b>
Shares in the BIS	1 065	1 120	1 110	1 144	1 176	1 130	1 071	1 096	1 134	1 120	1 117	<b>1 197</b>
Other foreign assets	1 942	1 118	1 201	4 069	2 318	5 778	5 278	2 040	1 361	2 095	2 527	<b>3 893</b>
<b>DOMESTIC ASSETS</b>	100 656	115 418	132 853	122 581	125 643	141 164	144 108	142 664	154 499	144 576	151 950	<b>146 321</b>
Loans to credit institutions	11 782	6 132	14 583	4 012	7 292	22 676	29 327	27 743	40 065	29 243	35 671	<b>30 690</b>
Transit credits	17 249	17 249	17 168	16 867	16 599	15 072	13 497	13 497	13 542	13 542	13 513	<b>11 749</b>
Government securities	35 753	55 947	65 134	65 372	65 374	66 269	63 629	63 891	63 361	63 982	64 259	<b>64 382</b>
Fixed assets	32 703	32 584	32 583	32 474	32 332	32 232	32 267	32 095	32 086	32 447	32 618	<b>32 798</b>
Other domestic assets	3 169	3 506	3 385	3 856	4 046	4 915	5 388	5 438	5 445	5 362	5 889	<b>6 702</b>
<b>TOTAL ASSETS</b>	983 846	988 536	1 007 858	990 141	982 935	990 153	979 386	1 020 442	1 051 175	992 619	978 783	<b>1 040 934</b>
<b>FOREIGN LIABILITIES</b>	132 270	119 760	125 798	118 770	121 630	123 866	116 535	113 835	116 394	114 791	113 992	<b>116 778</b>
Convertible currencies	12 188	–	6 680	–	–	2 543	–	–	–	–	–	<b>–</b>
International Monetary Fund	114 488	114 488	114 488	114 488	114 962	113 437	111 913	111 913	111 913	111 913	111 913	<b>110 388</b>
Foreign bank deposits in lats	459	454	464	457	635	640	636	637	614	587	612	<b>679</b>
Non-convertible currencies	41	41	40	40	39	38	38	37	37	37	37	<b>37</b>
Other foreign liabilities	5 094	4 777	4 126	3 785	5 994	7 208	3 948	1 248	3 830	2 254	1 430	<b>5 674</b>
<b>LATS IN CIRCULATION</b>	525 420	526 980	532 753	524 523	529 157	546 124	551 584	562 512	568 985	576 216	585 828	<b>622 632</b>
<b>DOMESTIC LIABILITIES</b>	249 832	265 616	276 081	271 921	257 202	242 196	232 141	262 664	282 193	219 686	198 336	<b>209 676</b>
Balances due to credit institutions	120 309	117 744	129 792	134 472	127 331	121 087	114 076	119 473	88 557	88 048	126 342	<b>134 223</b>
Balances due to the Government	100 548	117 949	125 434	121 390	114 217	107 776	102 521	126 738	172 571	111 601	50 712	<b>62 079</b>
Balances due to other financial institutions	8 188	8 070	7 976	3 959	4 540	3 263	4 405	3 365	3 214	4 114	3 937	<b>3 012</b>
Other domestic liabilities	20 787	21 853	12 879	12 100	11 114	10 070	11 139	13 088	17 851	15 923	17 345	<b>10 362</b>
<b>CAPITAL AND RESERVES</b>	76 324	76 180	73 226	74 927	74 946	77 967	79 126	81 431	83 603	81 926	80 627	<b>91 848</b>
Nominal capital	10 100	10 100	10 100	10 100	10 100	10 100	25 000	25 000	25 000	25 000	25 000	<b>25 000</b>
Reserve capital	5 512	5 512	5 512	5 512	5 512	5 512	28 835	28 835	28 835	28 835	28 835	<b>37 928</b>
Other reserves	38 224	38 224	38 224	38 223	38 223	38 223	–	–	–	–	–	<b>–</b>
Valuation account	21 963	21 819	18 865	20 561	20 580	23 601	24 760	27 065	29 237	27 560	26 261	<b>28 389</b>
European Union grant	525	525	525	531	531	531	531	531	531	531	531	<b>531</b>
<b>TOTAL LIABILITIES, CAPITAL AND RESERVES</b>	983 846	988 536	1 007 858	990 141	982 935	990 153	979 386	1 020 442	1 051 175	992 619	978 783	<b>1 040 934</b>

## Appendix 3

## THE BANK OF LATVIA'S YEAR-END BALANCE SHEETS FOR THE YEARS 1998–2002

(in thousands of lats)

	1998	1999	2000	2001	2002
<b>FOREIGN ASSETS</b>	576 205	656 304	669 551	881 489	<b>894 613</b>
Gold	40 651	42 215	41 917	44 443	<b>51 025</b>
Special Drawing Rights	165	1 788	3	54	<b>41</b>
Convertible foreign currencies	455 729	506 582	521 512	732 799	<b>737 313</b>
International Monetary Fund	72 929	101 144	101 144	101 144	<b>101 144</b>
Shares in the BIS	951	988	983	1 043	<b>1 197</b>
Non-convertible currencies	346	276	–	–	<b>–</b>
Other foreign assets	5 434 <sup>1</sup>	3 311	3 992	2 006	<b>3 893</b>
<b>DOMESTIC ASSETS</b>	166 112	165 181	143 859	98 121	<b>146 321</b>
Loans to credit institutions	52 040	63 322	42 530	18 833	<b>30 690</b>
Transit credits	54 344	50 110	23 835	18 612	<b>11 749</b>
Government securities	49 416	30 387 <sup>2,3</sup>	51 725 <sup>2,3</sup>	24 715	<b>64 382</b>
Investment in associate	–	4 726	–	–	<b>–</b>
Fixed assets	9 243	15 117	22 657	32 819	<b>32 798</b>
Other domestic assets	1 069 <sup>1</sup>	1 519 <sup>3,4</sup>	3 112 <sup>3</sup>	3 142	<b>6 702</b>
<b>TOTAL ASSETS</b>	<b>742 317</b>	<b>821 485</b>	<b>813 410</b>	<b>979 610</b>	<b>1 040 934</b>
<b>FOREIGN LIABILITIES</b>	110 784	134 653	129 053	122 306	<b>116 778</b>
International Monetary Fund	109 418	128 699	122 014	116 012	<b>110 388</b>
Foreign bank deposits in lats	250	321	158	454	<b>679</b>
Non-convertible currencies	53	42	42	41	<b>37</b>
Other foreign liabilities	1 063 <sup>1</sup>	5 591	6 839	5 799	<b>5 674</b>
<b>LATS IN CIRCULATION</b>	<b>374 448</b>	<b>426 101</b>	<b>482 314</b>	<b>556 003</b>	<b>622 632</b>
<b>DOMESTIC LIABILITIES</b>	202 601	214 333	140 723	226 374	<b>209 676</b>
Balances due to credit institutions	95 669	95 765	80 453	82 433	<b>134 223</b>
Balances due to the Government	101 639	110 278	45 926	119 587	<b>62 079</b>
Balances due to other financial institutions	1 336	4 341	3 950	3 441	<b>3 012</b>
Other domestic liabilities	3 957 <sup>1</sup>	3 949	10 394	20 913	<b>10 362</b>
<b>CAPITAL AND RESERVES</b>	54 484	46 398	61 320	74 927	<b>91 848</b>
Nominal capital	4 750	4 750	4 750	10 100	<b>25 000</b>
Reserve capital	2 181	2 181	3 297	5 512	<b>37 928</b>
Other reserves	25 243	25 243	32 497	38 224	<b>–</b>
Valuation account	21 864	13 709 <sup>5</sup>	20 254 <sup>5</sup>	20 567	<b>28 389</b>
European Union grant	446	515	522	524	<b>531</b>
<b>TOTAL LIABILITIES, CAPITAL AND RESERVES</b>	<b>742 317</b>	<b>821 485</b>	<b>813 410</b>	<b>979 610</b>	<b>1 040 934</b>

<sup>1</sup> Forward contracts and currency swap arrangements are reported at their fair value, applying the current accounting policy for derivative financial instruments retrospectively.

<sup>2</sup> Latvian government securities, which in the financial statements for 1999 and 2000 were reported at amortized acquisition cost, are stated at their fair value, applying the current Latvian government securities valuation policy retrospectively.

<sup>3</sup> Restated to include accrued interest income on Latvian government bonds, which was reported under the caption "Other domestic assets" in the financial statements for 1999 and 2000.

<sup>4</sup> Restated to include intangible assets, which were reported under "Fixed assets" in the financial statements for 1999.

<sup>5</sup> Restated to include the revaluation result arising after retrospectively revaluing Latvian government securities in accordance with the current Latvian government securities valuation policy.

## Appendix 4

**THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENTS  
FOR THE YEARS 1998–2002**

(in thousands of lats)

	1998	1999	2000	2001	2002
<b>INTEREST INCOME</b>					
Foreign operations <sup>1</sup>	25 473	21 771	28 075	35 985	<b>30 762</b>
Domestic operations	5 588	6 096	5 496	6 340	<b>5 550</b>
<b>INTEREST EXPENSE</b>					
Foreign operations <sup>1</sup>	363	33	55	44	<b>127</b>
Domestic operations	5 113	4 870	3 754	2 797	<b>3 688</b>
<b>NET INTEREST INCOME</b>	<b>25 585</b>	<b>22 964</b>	<b>29 762</b>	<b>39 484</b>	<b>32 497</b>
<b>SPECIFIC PROVISIONS</b>	<b>3 000</b>	<b>10 748</b>	<b>290</b>	<b>–</b>	<b>–</b>
LOSS ON DISPOSAL OF INVESTMENT IN ASSOCIATE	–	–	2 030	–	–
OTHER OPERATING INCOME	482	3 884	527	520	<b>605</b>
OTHER OPERATING EXPENSE	15 332	16 100	16 809	17 850	<b>18 668</b>
<b>PROFIT BEFORE APPROPRIATION</b>	<b>7 735</b>	<b>–</b>	<b>11 160</b>	<b>22 154</b>	<b>14 434</b>

## Appendix 5

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

(LVL vs foreign currency)

2002	EUR			GBP			100 JPY			USD		
	Maximum	Average	Minimum	Maximum	Average	Minimum	Maximum	Average	Minimum	Maximum	Average	Minimum
I	0.5720	0.5647	0.5554	0.9240	0.9160	0.9090	0.4850	0.4812	0.4760	0.6450	0.6378	0.6330
II	0.5617	0.5589	0.5546	0.9180	0.9141	0.9090	0.4850	0.4812	0.4770	0.6460	0.6424	0.6400
III	0.5640	0.5603	0.5568	0.9140	0.9099	0.9040	0.4990	0.4879	0.4800	0.6440	0.6395	0.6360
IV	0.5680	0.5631	0.5600	0.9200	0.9176	0.9140	0.4930	0.4860	0.4790	0.6410	0.6368	0.6300
V	0.5810	0.5735	0.5690	0.9210	0.9146	0.9070	0.5010	0.4947	0.4890	0.6310	0.6265	0.6200
VI	0.5970	0.5862	0.5790	0.9240	0.9112	0.9040	0.5040	0.4979	0.4930	0.6220	0.6166	0.6050
VII	0.6040	0.5967	0.5920	0.9450	0.9337	0.9220	0.5150	0.5090	0.5030	0.6070	0.6007	0.5940
VIII	0.5950	0.5920	0.5890	0.9480	0.9317	0.9240	0.5140	0.5081	0.5030	0.6090	0.6050	0.6020
IX	0.5970	0.5932	0.5890	0.9460	0.9405	0.9330	0.5110	0.5021	0.4920	0.6100	0.6049	0.5990
X	0.5980	0.5954	0.5930	0.9500	0.9454	0.9400	0.4990	0.4901	0.4870	0.6100	0.6067	0.6040
XI	0.6040	0.6014	0.5970	0.9500	0.9445	0.9350	0.4990	0.4945	0.4890	0.6050	0.6010	0.5970
XII	0.6110	0.6065	0.6000	0.9520	0.9463	0.9360	0.4940	0.4888	0.4820	0.6040	0.5989	0.5940

<sup>1</sup> The amounts reported under the interest income caption "Foreign operations" for the period from 1998 until 2000 have been reduced by including expense on transactions with foreign debt securities, which were reported under the interest expense caption "Foreign operations" in the financial statements for 1998–2000.

*Appendix 6***THE BANK OF LATVIA'S ORGANISATIONAL UNITS AT THE END OF 2002****1 ACCOUNTING DEPARTMENT**

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

1.1 Central Accounting Division (Head of Division – Jānis Caune)

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

**2 CASHIER'S AND MONEY OPERATIONS DEPARTMENT**

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

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

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

2.3 Coin Division (Head of Division – Maruta Brūkle)

**3 COMMUNICATIONS DEPARTMENT**

(Head of Department – Aina Raņķe)

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

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

3.3 Archive (Manager of Archive – Baiba Blese)

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

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

**4 CONSTRUCTION DEPARTMENT**

(Head of Department – Juris Kozlovskis)

**5 FOREIGN EXCHANGE DEPARTMENT**

(Head of Department – Roberts L. Grava)

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

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

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

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

5.5 Risk Control Division (Head of Division – Daira Brunere)

**6 FOREIGN RELATIONS DEPARTMENT**

(Head of Department – Juris Kravalis; Deputy Head of Department<sup>1</sup>)

**7 GENERAL SERVICE DEPARTMENT**

(Head of Department – Einārs Cišs)

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

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

7.3 Transport Division (Head of Division – Imants Vācietis)

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

**8 GOVERNOR'S OFFICE**

(Head of Office – Guntis Valujevs)

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<sup>1</sup> Vacancy. As of January 1, 2003, Ms. Aleksandra Bambale.



*Appendix 6*  
*(cont.)*

9 INFORMATION SYSTEMS DEPARTMENT

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

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

9.2 System Maintenance Division (Head of Division – Edvīns Mauriņš)

9.3 Computer Network and Server Systems Division (Head of Division – Egons Bušs)

9.4 System Security and Quality Assurance Division (Head of Division – Ilona Etmāne)

10 INTERNAL AUDITING DEPARTMENT<sup>1</sup>

(Head of Department – Modris Briedis)

10.1 Bank Audit Division<sup>2</sup> (Head of Division, Deputy Head of Department – Anita Hāznere)

10.2 Information Systems Audit Division (Head of Division – Juris Ziediņš)

11 LEGAL DEPARTMENT

(Head of Department – Pēteris Putniņš; Deputy Head of Department – Bruno Mačs)

12 MONETARY POLICY DEPARTMENT

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

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

12.2 Open Market Operations Division (Head of Division – Anda Kalniņa)

12.3 Financial Market Analysis Division (Head of Division – Jeļena Zubkova)

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

13 PAYMENT SYSTEMS DEPARTMENT

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

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

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

13.3 Account Service and Maintenance Division (Head of Division – Natālija Popova)

14 PERSONNEL DEPARTMENT

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

15 PUBLIC RELATIONS DEPARTMENT

(Head of Department, Press Secretary – Edžus Vējiņš; Deputy Head of Department – Kristaps Otersons)

16 SECURITY DEPARTMENT

(Head of Department – Aldis Liekniņš)

16.1 Headquarters (Head of Division, Deputy Head of Department – Igors Fleitmanis)

16.1.1 Analysis Unit (Head of Unit – Juris Jansons)

16.1.2 Security Guards Unit (Head of Unit – Eduards Bukovskis)

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<sup>1</sup> As of January 1, 2003, Internal Audit Department.

<sup>2</sup> As of January 1, 2003, Operational Audit Division.

*Appendix 6*  
(cont.)

- 16.1.3 Armament Unit (Head of Unit – Juris Kušķis)
- 16.1.4 Technical Support Unit (Head of Unit – Vilnis Gābers)
- 16.2 Rīga Division (Head of Division, Deputy Head of Department – Andis Bērziņš)
- 16.2.1 Security Guards Unit (Head of Unit – Uldis Mackevičs)
- 16.2.2 Cash Transit and Transport Unit (Head of Unit – Jānis Osis)
- 16.3 Daugavpils Division (Head of Division – Ilmārs Suhockis)
- 16.4 Liepāja Division (Head of Division – Gints Liepiņš)
- 16.5 Rēzekne Division (Head of Division – Andrejs Gugāns)
- 16.6 Valmiera Division (Head of Division – Aldis Zemmers)

17 STATISTICS DEPARTMENT

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

- 17.1 Banking and Monetary Statistics Division (Head of Division – Zigrīda Aušta)
- 17.2 Balance-of-Payments Statistics Division (Head of Division – Daiga Gaigala-Ližbovska)
- 17.3 Statistics Analysis Division<sup>1</sup> (Head of Division – Iveta Salmiņa)

18 RIGA BRANCH<sup>2</sup>

(Branch Manager – Jānis Strēlnieks)

19 DAUGAVPILS BRANCH<sup>2</sup>

(Branch Manager – Jolanda Mateša)

20 LIEPĀJA BRANCH<sup>2</sup>

(Branch Manager – Gundars Lazdāns)

21 RĒZEKNE BRANCH<sup>2</sup>

(Branch Manager – Leonīds Gricenko)

22 VALMIERA BRANCH<sup>2</sup>

(Branch Manager – Sarmīte Kleimane)

23 TRAINING AND RECREATION CENTRE

(Director – Zaiga Blūma)

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<sup>1</sup> As of March 1, 2003, General Economic and Financial Statistics Division.

<sup>2</sup> The position of Deputy Branch Manager was introduced as of January 1, 2003. Gunārs Viksne is the Deputy Branch Manager at the Rīga Branch, Bernarda Kezika at the Daugavpils Branch, Ieva Ratniece at the Liepāja Branch, Anna Matisāne at the Rēzekne Branch, Anna Grigorjeva at the Valmiera Branch.

Governor's Office Guntis Valujevs	BOARD OF GOVERNORS Governor Ilmārs Rimšēvičs Deputy Governor Andris Ruselis	Internal Auditing Department <sup>1</sup> Modris Briedis
	EXECUTIVE BOARD Chairperson of the Executive Board Māra Raubiško Deputy Chairmen of the Executive Board Reinis Jakovļevs Helmūts Ancāns	
Information Systems Department Harijs Ozols	Monetary Policy Department Helmūts Ancāns	Public Relations Department Edžus Vējiņš Press Secretary
Payment Systems Department Egons Gailītis	Foreign Exchange Department Roberts L. Grava	Legal Department Pēteris Putniņš
Statistics Department Agris Caune	Accounting Department Māris Kālis	Foreign Relations Department Juris Kravalis
Communications Department Aina Raņķe	Construction Department Juris Kozlovskis	Security Department Aldis Liekniņš
General Service Department Einārs Cišs	Cashier's and Money Operations Department Veneranda Kausa	Personnel Department Inta Lovnika
Training and Recreation Centre Zaiga Blūma	Riga Branch Jānis Strēlnieks	Liepāja Branch Gundars Lazdāns
Daugavpils Branch Jolanda Mateša	Rēzekne Branch Leonīds Gricenko	Valmiera Branch Sarmīte Kleimane

<sup>1</sup> As of January 1, 2003, Internal Audit Department.

**Bank of Latvia: Annual Report 2002**

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