

# LATVIJAS BANKA: ANNUAL REPORT 2016



*In Charts, the dots indicate the actual data, and the lines reflect the smoothing approximation of the data. The smoothing approximation of the daily data is more distinguished than the curve of the actual data.*

*Details may not add because of rounding-off.*

- no transactions or no outstanding amounts in the period.*
- x no data available or no computation of indicators possible.*
- 0; 0.0 magnitude less than half of the unit employed.*

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## ABBREVIATIONS

ABSPP	asset-backed securities purchase programme
APP	asset purchase programme
BIS	Bank for International Settlements
CBPP3	third covered bond purchase programme
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
CSB	Central Statistical Bureau of Latvia
CSPP	corporate sector purchase programme
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EFC	Economic and Financial Committee
EKS	Electronic Clearing System of Latvijas Banka
ESA 2010	European System of Accounts 2010
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
EU	European Union
EURIBOR	Euro Interbank Offered Rate
Eurostat	Statistical Bureau of the EU
expanded APP	expanded asset purchase programme
FCMC	Financial and Capital Market Commission
FRS	US Federal Reserve System
GDP	gross domestic product
G20	19 major world economies and the EU
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
JSC	joint stock company
LCD	Latvian Central Depository
Ltd.	limited liability company
LTRO	longer-term refinancing operations
M1	narrow monetary aggregate
M2	intermediate monetary aggregate
M3	broad monetary aggregate
MFI	monetary financial institution
NCB	national central bank
OECD	Organisation for Economic Co-operation and Development
OFIs	other financial intermediaries and financial auxiliaries, insurance corporations and pension funds
OPEC	Organization of Petroleum Exporting Countries
O-SII	other systemically important institutions
OTC	over-the-counter trading
PIT	personal income tax
PSPP	public sector purchase programme
SDR	Special Drawing Rights
SEA	State Employment Agency
SEPA	Single Euro Payments Area
SSM	Single Supervisory Mechanism
TLTRO	targeted longer-term refinancing operations
UK	United Kingdom
US	United States of America
VAT	Value Added Tax
WTO	World Trade Organization

## FOREWORD OF THE GOVERNOR OF LATVIJAS BANKA



The year 2016 was a rather eventful period for the global economy, and the leading central banks continued to pursue an active monetary policy. In the euro area as well, balance was sought between the goals of sustainable development and solutions to topical problems by injecting additional financing into the economy.

Latvia's joining the euro area three years ago coincided with the time when the implementation of non-standard monetary policy measures began. That was a challenge not only to Latvia and Lithuania (the latter joined the euro area in 2015), the new members of the "euro club", but also to the old member states of the euro area.

Implementing the Public Sector Purchase Programme in 2015 and 2016, Latvijas Banka purchased securities of the Latvian government and euro area international organisations for a total of 4.4 billion euro; 1.1 billion of this amount went to the system of Latvian credit institutions. Although the monetary policy transmission mechanism is yet to function flawlessly and credit institutions are reluctant to grant loans, a part of this money entered the real economy and promoted lending growth.

The active monetary policy of the Eurosystem and global trends of oil and food prices support bringing the euro area inflation closer to the target level. Faster economic growth is also observed; however, both the euro area at large and Latvia in particular will have to face crucial challenges related to modernisation of the economy and establishing sustainable growth foundations.

There comes a moment in the development of any country when the hardships related to state-building have been overcome and it is time to assess the accomplishments to take important steps toward further development. It is never easy, for overcoming barriers always involves additional effort, perfecting the existing and acquiring new skills.

Latvia currently finds itself in just such a situation and, in the course of 2016, the phrases "reforms", "structural changes" and "competitiveness" became standard in the vocabulary of practically every politician, decision maker, economist, businessman and many ordinary people.

The fact that without reforms faster economic growth and higher living standards are not possible is understood not only in Latvia but also in the entire euro area. Global economic developments make us stay alert and do not let us forget the need to foster competitiveness and reinforce our future potential. Latvia's goal is a faster achievement of the average EU living standards, without falling into a middle-income trap. Unfortunately, the 2016

performance of the economy affirmed a dangerous trend – our excessive dependence on the availability of EU funding. The amount of EU financing shrank, and the economic growth immediately subsided accordingly.

Such a dependence is even more dangerous when we think about the future. In 2017, a faster absorption of the available EU funding is expected and, consequently, also larger inflows of investment into the economy and a more robust GDP growth. This may give rise to a misleading impression that the economy is growing fast even without painful, unpopular and in the pre-election-time risky reforms.

Latvijas Banka's economists have calculated the GDP growth, excluding the impact of EU funds. Without the EU funding, Latvia's GDP grows at the rate of about 2% per annum, and such a low rate creates the risk that we will not reach either the German or the EU average level in the foreseeable future and even increasingly lag behind our neighbours.

What is to be done to achieve faster and more sustainable growth? In 2016, Latvijas Banka helped the government find the answer to this question. It involves fostering the interest of investors and improving the potential of the working force by implementing vital reforms in education, healthcare and business environment. Recently, Latvijas Banka also drafted its "Tax Strategy 20/20", which contains proposals for introducing a competitive and growth-promoting tax system. We are pleased to have won the government's ear, and significant improvements in several areas are being planned. Latvijas Banka is ready to provide both practical and analytical support also in the future.

Looking back on the developments and accomplishments of Latvijas Banka in 2016, they are interconnected by the fact that we keep looking for ways to be ever more effective in discharging our important public functions, including the use of the latest modern technologies.

In 2016, Latvijas Banka actively continued to upgrade its interbank settlement system in preparation for the introduction of instant payments. Modernisation of the infrastructure of Latvijas Banka means that with the support of credit institutions the Latvian entrepreneurs and general public will be able to use interbank transfers executed within a few seconds, 24 hours a day, seven days a week already in 2017. The central bank will continue to pay particularly close attention to the introduction of modern technological solutions in Latvia's financial sector, including support for the development of the financial services and financial technology sector.

As of 1 July 2016, the national counterfeit centre has been operating at Latvijas Banka. The central bank's experts are responsible for examination of all suspicious banknotes received from collectors, population and the State Police. By executing this important function at Latvijas Banka, the expert examination process has become more efficient, suspected counterfeit submitters receive answers more promptly, government expenditure for the discharge of this function has been reduced, and the Police can now allot more resources for their basic duties. The central bank keeps working to speed up the cash examination process and make it more efficient.

An event deserves special highlighting, as it yet again proves that Latvia has a great potential. Our children excelled at the euro area level educational "Euro Run" game, in which school-age children's knowledge of money design and security was tested. Altogether, 11 242 euro-area children in the 9 to 12 age group took part. The Latvian children proved to be absolutely the best: of 10 players with the highest score, eight were from Latvia. In November, pupils of Jelgava Spīdola Gymnasium and their teacher Inta Jorņiņa, who participated in organising the Euro Run game, received an international award at the competition of education projects held by the non-profit organisation Child & Youth Finance International in Stockholm.

Latvijas Banka is ready for participation in the programme dedicated to the centennial of Latvia's statehood, providing for the research of important events in the financial history of the country and assessment of the contribution of outstanding people as well as creating several commemorative and collector coin series and individual coins dedicated to the foundation of the Latvian State. Latvijas Banka will conclude the celebration of country's centennial with its own 100-year anniversary on 1 November 2022.

I would like to thank the employees of Latvijas Banka as well as the experts involved in our projects for their work in 2016 and to wish them energy and vigour for the future. My best wishes for our mutual success!



Ilmārs Rimšēvičs  
Governor of Latvijas Banka  
Riga, 6 March 2017

# STATEMENT OF VISION, MISSION AND VALUES OF LATVIJAS BANKA

## VISION OF LATVIJAS BANKA

Latvijas Banka is a participant of the Eurosystem and a full-fledged member of the European System of Central Banks. It makes a significant contribution to stable and sustainable economic development of Latvia and the euro area. Latvijas Banka is an independent entity that carries out its tasks for public benefit and with a high sense of professional responsibility. Latvijas Banka is a reliable cooperation partner and the economic competence centre in Latvia.

## MISSION OF LATVIJAS BANKA

The primary operational objective of Latvijas Banka as the central bank and a participant of the Eurosystem is the maintenance of price stability to promote long-term economic growth. The principal tasks of Latvijas Banka are as follows:

- participate in the formulation and implementation of the euro area's monetary policy;
- manage financial investment;
- ensure currency circulation in Latvia and participate in shaping currency circulation in the euro area;
- participate in promoting smooth operation of payment systems in the Eurosystem;
- prepare and publish statistical information in compliance with the provisions of the EU legislation.

Latvijas Banka performs the tasks entrusted to it in a professional and continuous manner, ensuring high-quality work and efficiency.

Latvijas Banka contributes to the general public's knowledge of economics and is an active participant of the Eurosystem.

## VALUES

Our values reflect our attitude towards work, colleagues and society.

### Competence:

- we have in-depth knowledge and excellent skills;
- we learn from best practices of others and serve as a model to others;
- we are committed to finding quality and effective solutions.

### Credibility:

- we work for public benefit, and we are interested in public opinion;
- we act in a responsible and predictable manner;
- our operations and activities are transparent – we act openly and explain our action.

### Cooperation:

- we work as a team;
- we are responsive and open to new ideas;
- we listen to recommendations and maintain good long-term partnerships;
- we are result-oriented.



# ECONOMIC ENVIRONMENT



## GLOBAL ECONOMIC DEVELOPMENTS

The global economic growth remained moderate in 2016, with its pace slightly more subdued than in the previous year. This was mainly determined by the global trade losing some of its momentum and by still modest investment inflows. Concerns about the deceleration of global economic growth and the prolonged period of low oil and other commodity prices dominated in the first half of the year, while in its second half attention focused on political developments, specifically the UK referendum on EU membership in June and the US presidential election in November. These events underpinned the heightened uncertainty surrounding the future growth outlook and caused financial market volatility. Throughout the year, financing conditions remained favourable and economic growth was supported by accommodative monetary policy stances of the world leading central banks, with those of the EU countries and the Bank of Japan continuing their monetary easing policies and the US resuming its monetary policy normalisation.

### *Economic growth in advanced economies continued, yet at a slower rate than in 2015<sup>1</sup>*

The continuously low investment level, driven by high uncertainty surrounding global growth and geopolitical developments, weighed on the growth; central bank accommodative monetary policy, in turn, kept on supporting economic growth by providing access to cheap financial resources. Also, labour markets improved, unemployment rate went on decreasing, and wage growth accelerated.

The US continued to record relatively low growth figures, with GDP picking up 1.6% in 2016. Among the growth restricting factors was a period of low energy prices, which weakened the energy sector, an ongoing appreciation of the US dollar, which impaired exporters' competitiveness, and a relatively low investment level. Following somewhat weak performance in the first half of the year, the US saw the economic growth rate accelerate notably in the second half, primarily due to the strengthening labour market situation acting as a strong driver of private consumption. Consequently, at the year's end, the FRS resolved to raise the federal funds target rate by 25 basis points, noting that even after this increase it would stimulate the economy. With the growth continuing, market participants expect further interest rate increases also in the coming years.

Despite a notable heightening of uncertainty triggered by the outcome of the UK referendum, growth in the UK remained rather strong. In 2016, UK's GDP increased by 1.8% primarily because of strongly rising private consumption. Additionally, a sharp depreciation of the British pound sterling in the aftermath of the referendum turned out to be supportive to exporters. Nevertheless, the uncertainty about future economic relations with foreign partners that weighed on investment influx, on the one hand, and the drastic fall in the value of British pound sterling that pushed up inflation and limited customer purchasing power, on the other hand, are likely to worsen the near-term growth outlook. Hence, the Bank of England resolved to cut the base rate to a record-low level (0.25%) and expanded the UK quantitative easing programme.

In 2016 vis-à-vis 2015, Japan's advance marginally slowed down, with GDP posting a 1.0% pickup. It was basically due to continuing deceleration of the Chinese economy, Japan's important trade partner. Also, the strengthening in private consumption was rather subdued, as the wage growth was still weak despite a record low unemployment rate. As a result, the Bank of Japan announced new extraordinary monetary policy measures in the autumn of 2016 and, to boost lending, introduced quantitative and qualitative monetary easing with yield curve control.

<sup>1</sup> See p. 13 for information about euro area economic developments.

***The overall annual growth in developing countries, albeit still stronger than in advanced economies, was slower than in 2015***

A slowdown in economic growth of developing countries was triggered by weak demand and the resulting low-level prices of goods. In the second half of the year, the developing world recorded some growth rate acceleration, as economies of commodity exporting countries were gradually recovering from recession caused by a period of low energy prices. Yet geopolitical conflicts and heightened uncertainty in advanced economies remained a drag on its pace. A substantial negative effect came from the dynamics of China's economy, where the pace of GDP growth, though having picked up 6.7% in 2016 (6.9% in 2015), continued on a gradual year-on-year deceleration track. Growth was subdued by falling volumes of private sector investments and stagnating production output, while stronger private consumption and public investment somewhat supported development.

***In 2016 oil and gold prices increased overall***

Towards the close of 2016, so far persistently low inflation hiked, in developed countries particularly, due to the rising energy prices. After a two-year long period of decline, the oil price started to elevate in 2016. Displaying strong volatility over the year, the price of *Brent* crude oil gained 52.4%, rising to 56.82 US dollars per barrel at the end of 2016. When the year started, the price had been falling due to then still existing global overproduction; in addition, concerns about decelerating economy of China, a leading energy consumer, triggered some worsening in expectations of future oil demand. Early in the year, the price of *Brent* crude oil had dropped to 27.10 US dollars per barrel, i.e. the lowest level since 2003; over the year, the price gradually recovered. It stabilised in November, when OPEC members and Russia agreed to enforce a cut in production, thus alleviating concerns about potential oil overproduction in the near future.

The demand for gold was spurred by the political uncertainty rising globally, and the gold price decline observed in the previous years ended in 2016. Notably over the year, the gold price in US dollar terms increased by 8.5%.

***Global leading central bank policy divergence affected developments in government bond and money markets***

In the euro area, the UK and Japan, the government bond yields decreased year-on-year in 2016. In the US, government bond yields increased in response to the monetary policy normalisation by the FRS. In mid-2016, the euro area government bond yields reached their historic lows; moreover, those of the countries with a higher credit rating even moved to the negative territory.

In early 2016, worries about deceleration of economic growth rates in the world, particularly in developing countries, gave rise to uncertainty in the financial markets. The ruling negative risk perception boosted the demand for safer assets, driving down government bond yields in countries with higher credit ratings. The referendum in the UK and its outcome on the country's EU membership continued to aggravate uncertainty in financial markets and affect government bond yields. However, at the end of 2016, when the US election results imbued market participants with confidence in faster monetary policy normalisation, more benign business environment and growing fiscal spending, the government bond yields recovered. Expectations of a more dynamic growth of the US economy triggered higher inflation expectations, which found their reflection in escalating government bond yields. The government bond risk premia in euro area peripheral countries tended to grow basically due to the ongoing uncertainty and political risks. Over the year, yields on the German government 10-year bonds decreased by 42 basis points (down to 0.21%), their counterparts in the UK and Japan followed with contractions of 72 basis points (to 1.24%) and 22 basis points (to 0.04%) respectively. The US government 10-year bond yields, in turn, rose by 17 basis points (up to 2.44%).

The interest rate changes driven by monetary policy measures impacted exchange rates as well. Thus, for instance, in 2016, the euro weakened against the US dollar by 3.2% (from 1.0862 at the end of 2015 to 1.0517 at the end of 2016), reaching a high (1.1616) on 3 May and a low (1.0352) on 20 December. The appreciation of the US dollar was driven by relatively higher interest rates in the US, anticipations of interest rate hikes in the coming years, eventual US market protectionism, and expectations related to fiscal policy measures of the incoming US president's administration stimulating economic growth. The appreciation trend of the US dollar became particularly evident in the fourth quarter when the US president election results were announced and after the FRS decision to raise the base rate. The US dollar depreciated against the Japanese yen by 2.7% (from 120.22 at the end of 2015 to 116.96 at the end of 2016), recording a peak (121.69) on 29 January and a low (99.02) on 24 June. In 2016, the US dollar was remarkably unstable against the Japanese yen. In the first half of the year when global risks aggravated and due to the FRS's cautious stance relative to further interest rate hikes, the Japanese yen steeply appreciated. However, in the second half of the year, when market participants' optimism relative to the US economic growth increased, the US dollar sharply appreciated against the Japanese yen. Over the year, the British pound sterling depreciated against the US dollar by 16.3% (from 1.4736 at the end of 2015 to 1.2340 at the end of 2016), standing at a high (1.5018) on 24 June and at a low (1.1841) on 7 October. In the first half of 2016, the British pound sterling was broadly stable against the US dollar. Nevertheless, the UK referendum on country's EU membership introduced cardinal changes to the situation: eventual problems related to the country's exit from the EU and impressive uncertainty in the market triggered a sharp depreciation of the British pound sterling.

In 2016 overall, stock market indices in major advanced economies either increased or remained unchanged. Early in the year, stock markets across the globe recorded decreases, largely on account of concerns relative to the slowing growth rate of global economy and the prolonged period of low oil and other commodity prices. Up to June when the UK referendum on country's EU membership took place, stock markets had received positive support from the ECB Governing Council's stimulus package, which it announced at the March meeting, and oil price hikes. Due to the heightened uncertainty related to the UK's exit from the EU, stock prices declined. Market sentiments improved somewhat in the second half of the year again, while a more pronounced improvement followed the US presidential election. The response of Dow Jones US Banks Index to the outcome of the US presidential election was particularly favourable: in 2016, it picked up 21.4%. Broad US stock indices leaped to their record highs on several occasions in the second half of the year. In 2016, S&P 500 was up by 9.5%, and DJIA grew by 13.4%. As to the euro area, stock prices rose in the core countries, while the peripheral ones saw marginal stock price falls. The EURO STOXX 50 price index posted a 0.7% pickup over the year, whereas broader EURO STOXX 600 fell by 1.2%. The bank stock price index dropped most (by 8.0% over the year) in the euro area, because investors voiced concerns about bank profitability amidst the prolonged period of low interest rates and, additionally, still high level of non-performing loans of euro area peripheral country banks. Stock prices in the UK grew primarily due to the depreciating British pound sterling, this having a positive impact on profits of major global international stock companies. Hence, the UK's FTSE 100 globally was among the best indicators in local currency (14.4%), while the growth in 2016 was minor, if depreciation of British pound sterling is taken into account (by 16.3% against the US dollar and by 13.7% against the euro).

## THE EURO AREA ECONOMY AND EUROSISTEM'S MONETARY POLICY

### *Euro area economic growth continued*

The euro area economy has already been recovering since 2014 on account of the accommodative monetary policy measures implemented by the ECB and owing to the broadly neutral fiscal policy. Growth continued also in 2016, with GDP growth rate reaching 1.7% (2.0% in 2015). However, this rate remained slower than before the crisis, and the euro area economy still faced a number of challenges. Many one-off factors, whose impact is gradually decreasing, i.e. historically low commodity (including energy) prices in the global market and depreciation of the euro, continued to support euro area growth in 2016. At the same time, the level of uncertainty associated with a lot of non-euro area events, which can potentially have an adverse effect on the euro area economy in the future, augmented (the uncertainty in relation to the UK vote at the referendum on its membership of the EU and actions of the new US administration).

Private demand had already been contributing to the growth of the euro area economy since 2013, retaining the status of the euro area economic growth driver also in 2016 and edging up by 1.9% (a little higher than in the previous year). Its dynamics on a quarterly basis was rather volatile. A decline was observed in the second quarter following the steep rise in the first quarter, but the rate of increase in private demand accelerated again in the second half of the year. Private demand in the euro area was primarily facilitated by a steady rise in disposable income of households. It strengthened as the labour market situation improved on account of employment and nominal wage growth. Consumers' purchasing power benefited from a very low inflation rate across the euro area over the past three years, reflecting low energy prices in the global market. Thus, the population could channel a larger share of its income for spending. In 2016, government consumption increased faster than in the previous year, continuing to provide a significant support to the euro area economic growth. Dynamics of government expenditure by country varied quite considerably, mainly reflecting an upward path of government expenditure in relation to the necessity to integrate a significant influx of immigrants, e.g. in Germany, as well as the need to increase spending on national security, e.g. in France.

Since early 2015, the euro area investment growth rate was steeper than that of the domestic demand and twice as steep as the total GDP growth rate; however, it was slower than before the crisis. Investment expansion forms an integral part of any economic recovery. Therefore, it is crucial to maintain positive investment dynamics in the euro area. In 2016, the euro area saw investment in equipment and machinery edging up and investment in construction boosting even sharper. Investment dynamics still varies significantly in the breakdown by euro area country. A considerable increase in investment was observed in the large countries, i.e. Germany, France and Italy (France and Italy saw such an upward trend for the first time after the crisis mainly on account of investment growth in construction). Meanwhile, the investment growth rate in Spain and the Netherlands was slower than in the previous year both with regard to equipment and construction. Investment in a number of the so-called new EU countries decelerated due to the change of EU funding programming periods. Overall, faster growth rate of investment in the euro area were limited by the economic and political uncertainty as well as by the ongoing adjustment of corporate balance sheets in many countries, offsetting the positive impetus from the accommodative monetary policy implemented by the ECB which significantly improved financial conditions. In the second half of 2016, uncertainty increased in relation to the necessity to review the EU and UK economic ties following the UK vote on its withdrawal from the EU and with regard to the possible impact of the new US administration's policy on the global investment climate and trade.

Along with the deceleration of the global economic growth rate in comparison with

2015, the euro area export demand also weakened in 2016. The positive impact of the depreciation of the euro in 2015 which was still present also in 2016 could not offset the adverse effect of the decrease in external demand. Thus, the growth rate of exports across the euro area was much slower in 2016 than in 2015, i.e. 2.9% and 6.3% respectively. Meanwhile, trade within the euro area proceeded comparatively better than trade with non-euro area countries. The rate of imports growth in 2016 was also slower than in 2015, in the first half of the year in particular, with only a moderate increase in the second half of the year. Overall, net export contribution to the euro area GDP in 2016 was positive but small.

***Along with declining unemployment and rising employment rate, recovery of the euro area labour market continued***

At the end of 2016, the total euro area unemployment level had already decreased to 9.6%, which was the lowest level since 2011. However, this was insufficient to overcome the adverse effect of the euro area financial crisis on the labour market, and the euro area has not returned to the pre-crisis unemployment rate yet. At the same time, the significant disparities, which had developed among the euro area countries after the crisis, gradually decreased in the recent years as all EU countries saw a fall in unemployment. The drop in unemployment rate was faster, e.g. in Spain, Greece and Portugal, but in other countries where it was already considerably lower, i.e. in Austria and Germany, the process was slower. New job creation in the euro area countries was underpinned by the strengthening of the economic activity rate in the euro area, the positive impact of the short-term fiscal measures implemented in several countries, e.g. in Italy and France, as well as by the beneficial effects of the structural reforms and active labour market policy, e.g. in Spain.

***The inflation rate in the euro area as a whole remained very low***

Although the annual headline inflation was 0.2% in 2016, changes in inflation rate dynamics could be observed from a monthly perspective, primary reflecting the impact of the energy component on the headline inflation. HCPI across the euro area was still negative or close to zero in the first half of the year. However, at the end of the year, the annual rate of change in inflation returned to positive territory and surged in the last months of the year. Development of the energy component, which reflected the base effect of an increase in global oil prices, markedly affected euro area inflation at the end of the year. At the same time, core inflation in the euro area remained broadly unchanged in 2016 in comparison with the previous year (0.9%), continuing to point to a low inflation pressure from domestic factors observed in both development of the services inflation component and dynamics of non-energy industrial goods component. Taking account of the fact that the positive effect of the energy price rise on the total rate of inflation in the euro area will not last for long, as suggested by expectations of market participants with regard to future oil prices, the future inflation outlook in the euro area will depend to a large extent on development of core inflation. Inflation expectations in the euro area measured by the 5-year swap index fell to the lowest level of 0.8% in February 2016, but they gradually improved during the year and were already approaching 1.7% in December. This means that investors have started to review their expectations in relation to the future path of inflation, and they expect inflation to pick up gradually. The results of inflation expectations surveys also started to improve gradually at the year-end.

The accommodative monetary policy measures implemented by the Eurosystem coupled with the future forward guidance have had positive effects on both money market interest rates and borrowing costs of the private sector which continued to edge down in 2016. The dynamics of the loan portfolio of credit institutions also improved. However, inflation dynamics remained weaker than expected in early 2016, and indicators of inflation expectations based on financial market instruments were still low, signalling the necessity of further accommodative monetary policy stance of the Eurosystem to ensure a return of inflation to the ECB target levels over the medium term.

### *The Eurosystem's accommodative monetary policy stance continued*

In early 2016, economic and financial conditions deteriorated on account of the heightened uncertainty related to the global economic growth and due to wider geopolitical risks. Inflation in the euro area was lower than expected mainly owing to changes in oil prices; inflation expectations also remained low. To avoid the impact of indirect effects on price formation and ensure a return of inflation to the ECB target levels, the Governing Council of the ECB decided on 10 March 2016 to take additional accommodative monetary policy measures. The set of measures included cutting the key monetary policy interest rates, extending the expanded APP by increasing the purchase volume and supplementing the range of assets eligible for purchase, launching new TLTROs and other measures. This set of measures is based on the use of the synergy of various instruments and has been calibrated to further ease financial conditions, facilitate lending, thus strengthening the euro area economic recovery and accelerate a return of inflation to the ECB target levels below, but close to, 2% over the medium term.

It was decided to lower the interest rate on the main refinancing operations by 5 basis points to 0.00% and the interest rate on the marginal lending facility by 5 basis points to 0.25%. The interest rate on the deposit facility was decreased by 10 basis points to -0.40% (see Table 1).

Table 1

#### **KEY ECB INTEREST RATES** (%)

Types of key ECB interest rates	Until 15.03.2016	As of 16.03.2016
Deposit facility	-0.30	-0.40
Main refinancing operations	0.05	0.00
Marginal lending facility	0.30	0.25

Source: ECB.

The Governing Council of the ECB decided to increase the monthly purchases under the expanded APP from 60 billion euro to 80 billion euro starting from April and continue securities purchases until March 2017, or beyond, if necessary, and in any case until the Governing Council of the ECB sees a sustained adjustment in the path of inflation which is consistent with its aim over the medium term.

The expanded APP was supplemented with the CSPP. Its purpose is to further strengthen the impact of asset purchases carried out by the Eurosystem on financing conditions of the real economy. Investment-grade euro-denominated bonds issued by non-bank corporations established in the euro area were purchased under the CSPP. The Eurosystem purchased up to 70% of single issue securities both in the primary and secondary markets with a remaining maturity from 6 months to 30 years. Thus, the expanded APP consisted of the following programmes at the end of 2016:

- the third covered bond purchase programme (CBPP3);
- the asset-backed securities purchase programme (ABSPP);
- the public sector purchase programme (PSPP);
- the corporate sector purchase programme (CSPP).

In addition, a decision was taken to conduct four new TLTRO-II, each with a maturity of 4 years, starting in June 2016. The new TLTRO-II operations strengthen the ECB's accommodative monetary policy stance and foster the transmission of monetary policy, creating further incentives for lending to the real economy. Interest rates on the funds borrowed within the above operations will be allowed to be as low as the ECB interest rate on the deposit facility provided that credit institutions fulfil specific terms.

The Governing Council of the ECB reinforced the forward guidance, emphasising that the Governing Council of the ECB expects the key ECB interest rates to remain at

present or lower levels for an extended period of time, and well past the horizon of the asset purchases.

The set of measures adopted at the March meeting of the Governing Council of the ECB continues to ease private sector borrowing conditions, thereby reinforcing the euro area economic recovery and accelerating the return of inflation to the desired levels. The adopted set of measures contributed to an increase in excess liquidity in the Eurosystem, encouraging credit institutions to look for more profitable investment opportunities, including lending to the real economy. A negative rate on the deposit facility which is applied to excess of minimum reserve requirements of credit institutions' current accounts reinforces the effects of the expanded APP.

In the second half of 2016, the euro area economic growth continued, although uncertainty was present in the external environment. It was mainly possible due to the accommodative monetary policy implemented by the Eurosystem. Inflation edged up slightly mostly as a result of the increasing energy prices. Taking account of the prolonged subdued inflation and persisting significant risks to economic development, the Governing Council of the ECB did not obtain assurance that inflation could return to the desired levels in the near term.

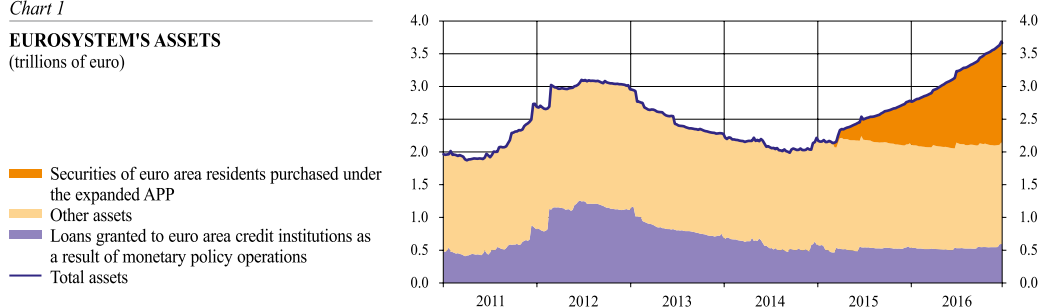
During its December meeting, the Governing Council of the ECB decided to extend the expected period of the expanded APP until the end of December 2017 or, if necessary, longer, but in any case, until the Governing Council of the ECB sees a sustained adjustment in the path of inflation consistent with its inflation target. At the same time, it was decided to continue purchases under the expanded APP at a monthly pace of 60 billion euro as of April 2017. To ensure a successful implementation of the expanded APP in the future as well, the Governing Council of the ECB decided to change certain parameters of the expanded APP from January 2017. Firstly, the maturity range of securities purchased within the PSPP was extended by reducing the minimum residual maturity of 2 years to 1 year. Second, purchases of securities with a yield to maturity below the interest rate on the ECB deposit facility will be carried out if it is necessary for the implementation of the expanded APP. At the same time, as decided before, the principal payments from maturing securities purchased under the expanded APP will still be reinvested.

In 2016, the euro area national central banks continued to offer market participants an opportunity to borrow securities purchased under the PSPP through repos to stimulate liquidity of euro area bonds and that of the repo market. In July 2016, individual central banks started to offer securities purchased under the CSPP as well. To avoid reduced repo market activity and improve asset borrowing opportunities, the Governing Council of the ECB decided that the euro area national central banks would offer a possibility to use also cash as collateral in these transactions as of December 2016.

In 2016, the total book value of the Eurosystem's assets grew by approximately 882 billion euro and reached 3.66 trillion euro at the end of the year, exceeding an all-time high seen in 2012 (see Chart 1). The increase in the asset book value is mainly attributed to the asset purchase programme implemented by the Eurosystem. The book value of the portfolio of assets purchased under the expanded APP stood at 1.53 trillion euro at the end of December 2016. The PSPP accounted for the major part of the amount, i.e. 82% or 1.25 trillion euro, CBPP3 – for 13% or 204 billion euro, CSPP – for 3% or 51 billion euro and ABSPP – for 1% or 23 billion euro. With purchases under the expanded APP going on, the excess liquidity continued the upward trend. The average excess liquidity picked up from 372 billion euro in 2015 to 892 billion euro in 2016, but at the end of the year it reached 1 194 billion euro.



Chart 1

**EUROSYSTEM'S ASSETS**  
(trillions of euro)

Source: ECB.

In 2016, the remaining two TLTRO-I and the first three TLTRO-II were conducted, with the outstanding amount of TLTROs reaching 545.2 billion euro at the end of 2016 and augmenting by 127.3 billion euro within the year.

The Eurosystem continued to use open market operations and standing facilities and established minimum reserve requirements. The Eurosystem pursued its efforts to conduct weekly main refinancing operations with a maturity of 7 days and monthly LTROs with a maturity of 3 months as open market operations. The regular open market operations were conducted as fixed rate tenders with full allotment.

The use of the main refinancing operations in 2016 continued to decrease and was on average 48.5 billion euro (92.0 billion euro in 2015). Fluctuations of the use of individual main refinancing operations went down in 2016. Demand for LTROs with a maturity of 3 months also declined. The deceleration in the use of the regular operations is attributed to their partial substitution by TLTROs and improvement of credit institutions' liquidity.

The Eurosystem also continued to offer liquidity in US dollars with a maturity of 7 days to credit institutions on a weekly basis. Along with the raising of the target range of federal funds rate in the US, credit institutions' demand for resources in US dollars augmented; however it was still negligible.

The minimum reserve ratio of the Eurosystem remained unchanged in 2016. It was 1% on short-term deposits and securities, including deposits with a maturity of up to 2 years, deposits with the period of notice of up to 2 years and securities issued with a maturity of up to 2 years. Meanwhile, the minimum reserve ratio on deposits and securities with an original maturity of over 2 years and repo transactions was 0%. Along with the lowering of the interest rate on the main refinancing operations in March, remuneration for funds held on reserve accounts to fulfil the minimum reserve requirements was reduced from 0.05% to 0.00%, while the rate on deposit facility, which was negative in 2016, was applied to the funds kept at the central bank and exceeding the minimum reserve requirements.

## LATVIA'S ECONOMIC DEVELOPMENT

### MONEY SUPPLY AND FINANCIAL CONDITIONS

Despite the growing political uncertainty and risk factors, the macroeconomic indicators of the major global economies improved in 2016 and positive near-term growth expectations strengthened. These favourable developments were largely underpinned also by the growth-supporting monetary policies implemented by the central banks in the previous years. Under the influence of the Eurosystem's monetary policy, the financial conditions in Latvia continued to improve in 2016. Exporting non-financial corporations benefited from depreciation of the euro, ample supply of cheap financing helped to reduce the lending rates applied to domestic non-financial corporations and households and encouraged borrowing from the securities market. These positive economic developments were also reflected in the stock market: following a rise observed for major European

stock market indices, Nasdaq Riga increased by 23.5% over 2016, whereas the Baltic share price index OMXBBGI appreciated by 21.6%. Interest rates of debt securities continued to decrease under the influence of the expanded APP.

***Stable, resilient and sustainable credit institutions ensured the effectiveness of the monetary policy***

The implementation of the ECB's accommodative monetary policy providing liquidity through both the expanded APP and TLTROs enabled the credit institutions to use the central bank money and strengthen their financial positions in order to improve the credit supply to non-financial corporations and households. Latvia's credit institutions benefited from this unique opportunity and managed to maintain the previously-achieved sound financial stability ratios and continued to recover in 2016. Overall, this helps to avoid a situation where the problems faced by credit institutions dampen the economic growth and reduce the effectiveness of the monetary policy.

Despite moderate economic growth observed in Latvia in 2016, credit institution assets<sup>1</sup> (see Chart 2 for the composition of assets) contracted by 7.6% as opposed to a 3.6% increase in 2015. This was mainly determined by a 26.3% decrease in non-resident deposits (see Chart 3 for the composition of credit institution liabilities) under the impact of the economic recession in Russia and tightening of the requirements in the area of providing services to foreign customers.

Chart 2

**COMPOSITION OF THE CREDIT INSTITUTION ASSETS (%)**

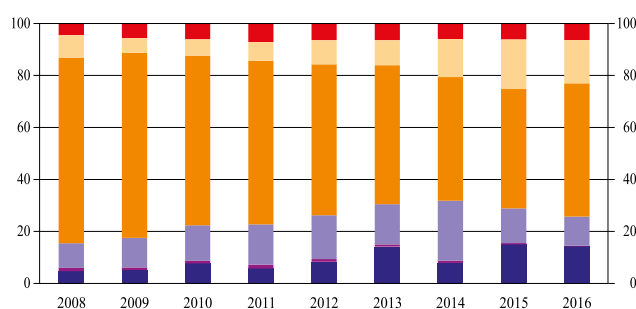
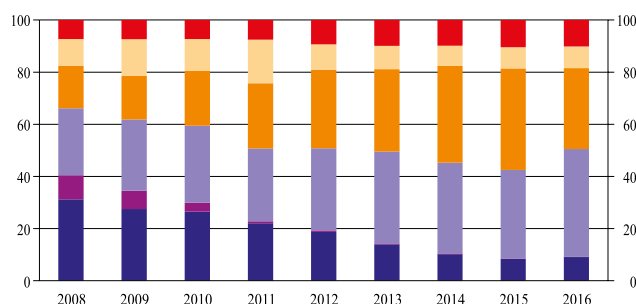
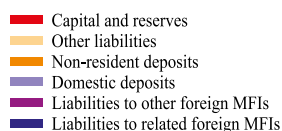


Chart 3

**COMPOSITION OF THE CREDIT INSTITUTION LIABILITIES (%)**



MFI financing from abroad shrank by another 1.5% (a 15.0% decrease in 2015), accounting for 9.2% of the aggregate liabilities of credit institutions at the end of the year (including 9.1% consisting of the financing from parent banks), whereas the significance of domestic financing increased.

The share of liquid assets in aggregate credit institution assets remained high (33.8% at the end of 2016), while the quality of the credit institution loan portfolio in the circumstances of an economic recovery improved further, with the share of loans past due over 90 days in the aggregate loan portfolio of credit institutions contracting from 6.0% at the end of 2015 to 4.4% at the end of 2016. Another sign of the stability of the credit institution system is also the persistently high total capital ratio of credit institutions amounting to

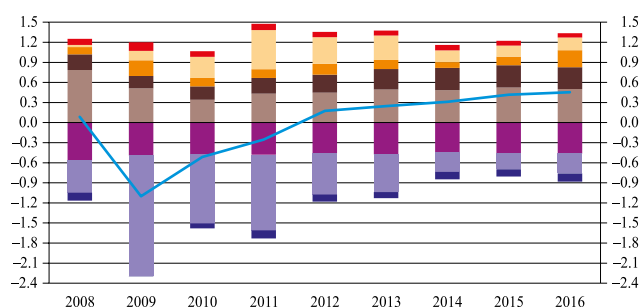
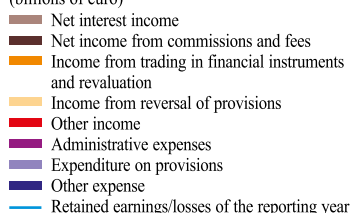
<sup>1</sup> At the end of 2016, 23 credit institutions, including seven branches of foreign credit institutions were registered in the Republic of Latvia. The credit institution's license of the JSC TRASTA KOMERC BANKA was cancelled in March 2016.

21.4% at the end of the year (the minimum requirement is 8%). Common Equity Tier I capital ratio stood at 18.1%. Over the year, 10 credit institutions increased their Common Equity Tier I capital by a total of 203.8 million euro.

Most Latvia's credit institutions operated with profit in 2016, overall earning 453.8 million euro in comparison with 415.9 million euro profit earned in the previous year (see Chart 4), although this was largely a result of a one-off transaction<sup>1</sup>. The effect of this transaction excluded, the profit would have totalled 335.0 million euro, representing a 19.5% decrease over 2015.

Chart 4

#### DYNAMICS OF CREDIT INSTITUTION INCOME AND EXPENSE AND PERFORMANCE RESULTS (billions of euro)



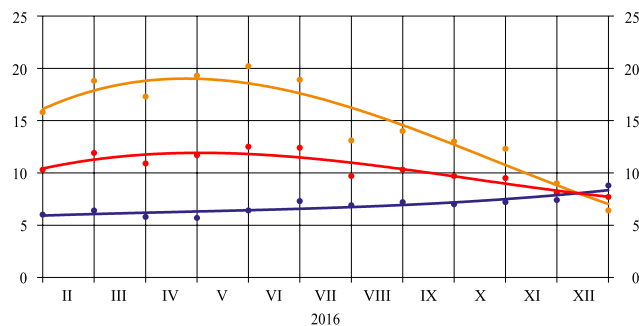
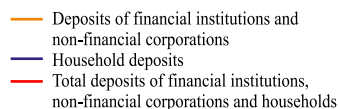
Net interest income, remaining the most sizeable component of the operating income, shrank by 3.9% year-on-year and still accounted for almost half of the operating income. Net commissions and fees, the second most important income component, decreased by 2.8% as opposed to an increase of 0.6% in 2015, nevertheless representing nearly one third of the operating income.

#### *Domestic deposits remained one of the most stable financing sources of credit institutions*

The moderate recovery of lending was still financed from domestic deposits overall growing faster than the Latvian economy. A shift in tendencies could also be observed in the course of the year, with the growth of deposits by non-financial corporations decelerating and that of household deposits slightly accelerating which could indirectly suggest a change of preference from increasing consumption to building up savings. Overall, the growth of domestic deposits was even throughout the year and, despite being slightly lower than in 2015, reached 7.7% in 2016, with deposits by non-financial corporations and household deposits increasing by 10.5% and 8.8% respectively (see Chart 5).

Chart 5

#### ANNUAL CHANGES IN DEPOSITS OF DOMESTIC FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS (%)



The interest rates on new fixed-term euro deposits from households and non-financial corporations remained broadly unchanged in 2016: in the case households, it was 0.6% both in 2015 and 2016, whereas in the case of non-financial corporations it was close to zero. Despite the prevailing negative money market interest rates, some Latvian credit institutions reported that they applied negative rates only to large fixed-term deposits of

<sup>1</sup> Sale of Visa Europe shares at the request of VISA Inc.

non-financial corporations. A part of households and non-financial corporations chose to earn a higher return on deposits by investing their free liquidity in longer-term deposits: consequently, the growth of deposits with an agreed maturity of up to 2 years also resumed at the end of 2016. At the same time, deposits redeemable at notice continued to expand, while the bulk of deposits was still concentrated in the most liquid segment, i.e. in overnight deposits.

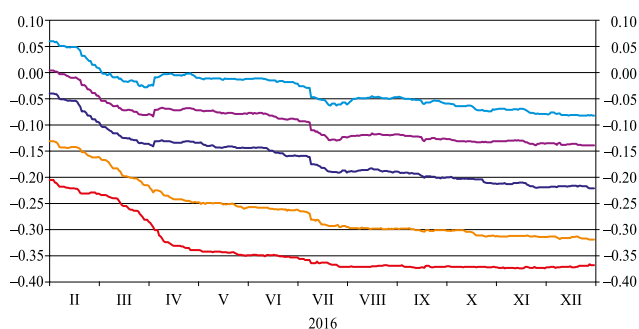
The money market was rather quiet, as there was no need for active borrowing on the interbank market. This was a result of the accommodative monetary policy providing ample liquidity to credit institutions and the ever-growing domestic deposits.

Euro money market rates hit new record-lows in 2016 (see Chart 6). For example, 3-month EURIBOR reached  $-0.32\%$  at the end of 2016, and Latvia's credit institutions became less active on both domestic as well as external money markets. The total interbank market turnover in all currencies decreased by 43.5% in 2016, with the average monthly turnover shrinking from 38 billion euro in 2015 to 21 billion euro in 2016. Domestic money market rates were close to  $-0.40\%$  at the end of 2016 for borrowing in euro, whereas the rates for business in US dollars increased from 0.26% in 2015 to 0.51% at the end of 2016 under the impact of the US monetary policy.

Chart 6

EURIBOR (%)

— 1 month  
— 3 months  
— 6 months  
— 9 months  
— 12 months



Source: Bloomberg.

#### **Lower interest rates spurred the activity on the debt securities market**

The declining interest rates at the primary auctions as well as on the secondary market encouraged the issuance of debt securities in both government and corporate sectors. Increasing the issuance of government debt securities on both domestic and external markets at the low interest rates also helped to reduce the government debt servicing costs. Overall 559.0 million euro-worth of Latvian government securities was supplied by the Treasury at auctions in 2016, representing a 36.3% increase in comparison with 2015. On the primary market, the yield rate of 3-year bonds decreased from 0.20% in October 2015 to  $-0.02\%$  in December 2016, whereas the yield of 5-year bonds declined from 0.86% to 0.09%. The Treasury also issued bonds on the external market on two occasions. The first 20-year government bonds worth 650 billion euro with the average yield of 1.514% and a 50 basis points spread over the average swap rate were issued in May. 10-year government bonds worth 650 billion euro with the average yield of 0.456% and a 19 basis points spread over the average swap rate were issued in September.

18 new issues of corporate debt securities were registered with the LCD, totalling 300.0 million euro. Partly substituting their deposit financing by issuance of debt securities, credit institutions remained major issuers, with their issues totalling 273.2 million euro.

The activity on the equity market was lower in 2016: the turnover of Nasdaq Riga Main List and Secondary List shares decreased 3.3 times (to 13.8 million euro) as a result of share buybacks by individual non-financial corporations.

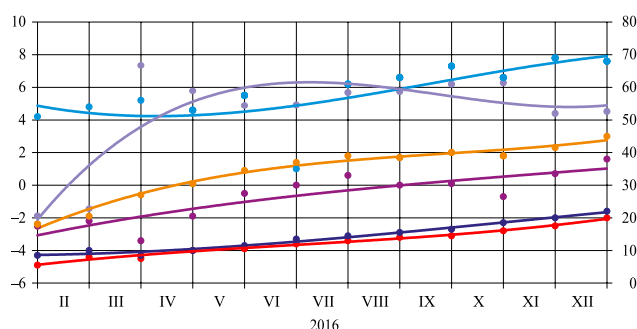
***The decrease of the borrowing costs for non-financial corporations and households was an important factor supporting the recovery of lending***

A new trend emerged in Latvia's economy in 2016: with credit institutions gradually resuming lending to the economy, the portfolio of loans granted to domestic non-financial corporations and households started to grow as of March and the annual growth rate of loans also returned to positive territory as of April (see Chart 7). Overall, the portfolio of loans to domestic financial institutions, non-financial corporations and households expanded by 3.0% in the course of the year. This was the first increase reported for the credit institutions' loan portfolio since 2008.

Chart 7

**ANNUAL CHANGES IN LOANS TO DOMESTIC FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS (%)**

- Loans to non-financial corporations
- Loans to households
- incl. for house purchase
- Total loans to financial institutions, non-financial corporations and households
- Consumer credit
- Loans to financial institutions (right-hand scale)

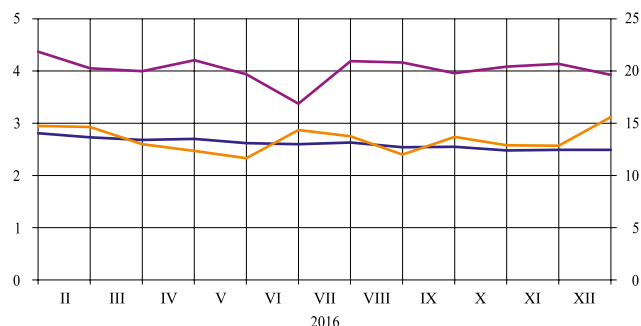


Initially, the rise was determined by the non-bank financial sector where loans increased particularly as a result of restructuring the financing of individual market participants in relation to gradual development of the leasing sector. Nevertheless, lending to non-financial corporations also rebounded soon afterwards, although the pace of recovery was still dampened by the disrupted access to the EU structural funds which was an obstacle for making further progress with construction projects. New loans to non-financial corporations (excluding renegotiated loans) also exceeded the previous year figure by 39.3% in 2016. The loan demand of non-financial corporations was supported by the decline of lending rates which continued also in 2016. Latvia's credit institutions competed for winning over large and highly-trustworthy customers whose creditworthiness could be rather easily checked; therefore, the steepest fall was reported for the interest rates on large loans to non-financial corporations. The interest rates on large loans to non-financial corporations were reduced on account of both lower financing costs of credit institutions as well as cutting the spreads (the difference between the lending rate and the euro money market rate). Overall, the interest rates on new euro loans to non-financial corporations decreased from 3.2% in 2015 to 2.7% in 2016. The interest rate on new small and medium-sized euro loans (up to 1 million euro) to non-financial corporations declined by 0.2 percentage point (4.2% in 2015), whereas that on large loans (over 1 million euro) went down by 0.5 percentage point (3.0% in 2015; see Chart 8 for the weighted average interest rates on new short-term euro loans to domestic non-financial corporations and households).

Chart 8

**WEIGHTED AVERAGE SHORT-TERM INTEREST RATES ON NEW LOANS TO DOMESTIC NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS (%)**

- Loans to non-financial corporations
- Household loans for house purchase
- Consumer credit to households (right-hand scale)



With the house purchase support programme for new families continuing and the activity on the real estate market growing, the household demand for loans also improved in 2016. New household loans for house purchase (excluding renegotiated loans) increased

by 38.0% in 2016, whereas consumer credit expanded by 29.3%. The interest rate on new household loans for house purchase in euro declined from 3.1% in 2015 to 3.0% in 2016. Most of the new household loans for house purchase were euro loans with a floating interest rate and initial rate fixation period of up to one year. For this particular type of loans, the fall of the interest rate was steeper: from 2.9% in 2015 to 2.6% in 2016. The agreed rate of new consumer credit to households in euro changed relatively little in 2016: from 18.8% in 2015 to 18.5% in 2016. The effective rate of the respective credit, however, decreased more considerably: from 26.0% in 2015 to 24.6% in 2016. New consumer credit to households in euro increased significantly, with households paying lower fees and commissions and other non-interest rate charges.

The quarterly bank lending survey conducted by Latvijas Banka in cooperation with the ECB suggests that the demand for loans has grown in 2016, while the lending standards applied by credit institutions have remained broadly unchanged. As regards lending to non-financial corporations, Latvia's credit institutions compensated the decline in the lending rates by raising the non-interest rate charges. At the same time, the growing competition forced credit institutions to ease the credit terms applied to non-financial corporations with regard to, for example, collateral, thereby improving their access to financing. The credit terms and conditions applied to household loans for house purchase by Latvia's credit institutions remained broadly unchanged, while the margins on consumer credit and other lending to households were slightly decreased.

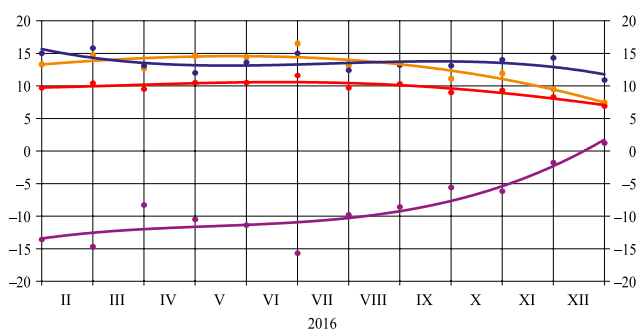
***Latvia's moderate economic growth and ample liquidity position of the credit institutions were reflected also by the monetary developments***

Overnight deposits (Latvia's contribution to the euro area M1) increased by 7.4% in 2016. The rise in Latvia's contribution to the euro area M2 was similar at 7.0%, with growth reported for both deposits redeemable at notice and deposits with an agreed maturity of up to 2 years (see Appendix 1). Latvia's contribution to other components of the euro area broad monetary aggregate M3 was insignificant. Overall, Latvia's contribution to the euro area M3 grew by 6.9% in 2016 (see Chart 9). Looking at the euro area as a whole, overnight deposits, M2 and M3 increased by 9.7%, 4.8% and 5.0% respectively in 2016.

Chart 9

**COMPONENTS OF LATVIA'S CONTRIBUTION TO EURO AREA MONEY SUPPLY**  
(year-on-year changes; %)

- Overnight deposits
- Deposits with an agreed maturity of up to two years
- Deposits redeemable at a period of notice of up to three months
- M3



At the end of 2016, Latvia's contribution to the euro area monetary base had decreased by 5.7% year-on-year (to 8.5 billion euro), despite the prevailing upward year-on-year trend observed in the course of the year. The monetary base mainly consisted of the proportionate share of Latvijas Banka in the total amount of banknotes issued by the Eurosystem (4.2 billion euro) and the credit institutions' current accounts, including the minimum reserve system (4.2 billion euro). Latvijas Banka's net foreign assets (non-euro area assets) expanded by 135.5 million euro or 4.1%, amounting to 3.5 billion euro at the end of 2016.

## EXTERNAL DEMAND AND COMPETITIVENESS

### *External demand improved somewhat; however, risks associated with the increasing protectionism and the policy of Russia persisted*

In 2016, the most significant challenges faced by Latvian exporters in the global economic environment were related to the outcome of the referendum on the UK's membership of the EU, the intensification of the global protectionism in relation to the policy of the newly-elected President of the US and the weak demand in several export markets, including Russia's weakened market and its implemented policy.

Although external demand<sup>1</sup> improved overall in 2016 in comparison with 2015, its growth was only moderate. The upward trend in external demand was reflected in a 2.6% increase in real volumes of Latvia's exports of goods and services. With their real imports expanding considerably, Estonia and Poland secured the largest positive contributions to growth in external demand, while the increase in Lithuania's imports was rather modest. Due to delayed absorption of the financing from the EU structural funds, investment decreased or stagnated in all three of the above trade partners of Latvia in 2016, representing a largely similar trend to that of Latvia. However, the imports of Estonia and Poland grew on account of private consumption and increasing export flows. Latvia's external demand was adversely affected by Russia where, as a result of a contraction of private consumption and investment, imports also declined further, albeit at a slower pace than in 2015. The outcome of the UK referendum had a less negative short-term impact on its economy than projected; however, the expansion of real imports in 2016 was almost half of that seen in the previous year.

Latvia's exports of goods grew somewhat in real terms in 2016; however, the increase in income from exports was constrained due to a fall in prices, largely driven by declining prices in the global commodity markets. The prices of several commodity groups exported from Latvia, e.g. agricultural and food products, wood and paper products, electronic products and electrical equipment, decreased over the year, and the prices of mineral products fell significantly. Several commodity groups with moderating exports, e.g. machinery and mechanical appliances, electrical equipment and mineral products, have a large share of re-exports. Thus, the income from exports of goods remained almost unchanged in comparison with 2015, posting a 0.2% decline.

Income from exports of services rose by 5.1% continuing on an upward trend at a pace similar to that of the previous year despite the factors hindering the development of transportation services, the largest group of services exported by Latvia (36%). This was a result of global developments (the low coal prices in the first half of the year) and the policy implemented by Russia (diverting cargoes to Russia's own ports).

In the breakdown by commodity group, transport vehicles accounted for the largest positive contribution to growth in the value of exports of goods in 2016; however, this development represents a single transaction – the implementation of a large project by a shipbuilding company. Overall, the income from exports of wood and products of wood remained on a solid upward path both in 2016 and in recent years justifying previous investment in this sector. Growth in exports of pharmaceutical products suggests that, following a two-year decline in exports, the manufacturers of medical products managed to redirect their exports to other markets and expand sales in the existing markets successfully. Despite the continuation of the embargo imposed by Russia, the food industry businesses adjusted gradually to the new market conditions, and, following a fall in 2015, growth resumed in 2016. Although a strong decline was observed in the construction sector, exports of building materials expanded. This is partly related to the

<sup>1</sup> External demand is measured by an index aggregating data (in weighted terms) on the real imports of Latvia's trade partners.

successful development of the construction market in Sweden. However, the favourable developments in a number of commodity groups could not offset the fall in the export value of the commodity groups with the largest share of re-exports – mineral products, machinery and electrical equipment, base metals and textile articles.

Growth in exports of services was primarily driven by telecommunication services, computer services and information services. An increase was also recorded in construction services, particularly in Sweden where Latvian companies provided services of constructions' design and installation. Exports of construction services also expanded in Norway, Germany and the UK. Meanwhile, exports of transportation services rendered to foreign customers accounted for the largest negative contribution as a result of a decline in all types of transportation services, with the exception of transportation by road. Income from foreign travellers visiting Latvia also decreased somewhat, probably due to the base effect: higher spending of foreign visitors was recorded in 2015 when a number of events related to the Latvian Presidency of the Council of the EU took place in Riga. Therefore, the level of income in 2016, which was close to that in 2015, is a positive development.

In the breakdown by country, in 2016 an increase in exports of goods to Germany, Sweden, Denmark and the UK accounted for the largest positive contribution, while a decline in exports of goods to Russia and other CIS countries had a negative impact. Exports to the Baltic States displayed different trends in 2016. Exports of goods to Lithuania decreased largely owing to a decline in re-exports of mineral products and electrical equipment. Meanwhile, exports of goods (transport vehicles and wood in particular) to Estonia expanded reflecting Estonia's positive contribution to the external demand index of Latvia. This development contrasts the stable increase in exports to Lithuania and contraction of exports to Estonia observed in the previous years. With the challenging situation in Russia persisting, exports of goods to this country decreased for the third consecutive year posting a decline in almost all categories of goods. Thus, the share of exports to Russia in the total exports of goods shrank to 7.6%. Despite the sharp depreciation of the British pound sterling following the publication of the referendum outcome in July 2016, income from exports of goods to the UK grew by 10.2% overall. The strongest increase was recorded in the second half of 2016, mainly owing to a rise in income from exports of wood and products of wood, the largest commodity group exported to the UK accounting for 67% of the total exports of goods to the UK.

According to the global economic outlook and Latvia's external demand forecast for 2017, growth is expected to be more pronounced than in 2016, albeit still moderate. Latvian businesses exporting goods may benefit from several new international agreements: the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada which could provisionally take effect already in the first half of 2017; the Trade Facilitation Agreement of the WTO which, following its ratification, will offer easier access to the WTO member state markets; and the expanded Information Technology Agreement reducing customs duties for 90% of information technology products. However, external environment developments are difficult to predict due to Russia's policy, a change in the policy course in the UK and the US, the forthcoming elections in several EU countries and the intensification of protectionism in global trade.

***The sustained profitability of businesses and the growing share of Latvia's export market indicated an improvement in competitiveness***

Competitiveness indicators suggested a more favourable position in 2016 compared to that in 2015. Although competitiveness of labour costs declined somewhat, the profitability remained high and the market shares in global and EU imports increased slightly. The EC business survey also suggests that the manufacturing businesses' assessment of their competitive position improved on average in 2016 as compared to 2015, particularly in respect of the markets outside the EU.



The ability of exporting businesses to improve their positions in the existing export markets and conquer new markets for their products was confirmed by a significant increase in Latvia's market share of exports of goods in the EU imports<sup>1</sup> and a slight pickup in the global imports<sup>2</sup> which, following a drop in 2015, resumed in the second half of 2016. The market share<sup>3</sup> of exports of services in the EU imports<sup>4</sup> also posted an increase, albeit a minor one. This suggests a positive development, given that the market share contracted in 2014 and 2015. The market share increased in difficult conditions as the cost-related competitive advantages of businesses shrank and investors refrained from significant investing in development owing to the geopolitical situation in Western Europe and the eastern neighbouring countries in recent years and a disrupted access to funding in the EU structural fund programming period. In order to maintain competitiveness, investing in development is particularly important from the perspective of innovations, also suggested by the assessment of the Global Competitiveness Index prepared by the World Economic Forum where Latvia was ranked lower in 2016 than in 2015.

Cost competitiveness declined somewhat in 2016. The real effective unit-labour-cost-deflated exchange rate of euro picked up somewhat; however, the profitability of agriculture and manufacturing, Latvia's major exporting sectors, remained at a relatively high level or even improved. A contraction in other costs, e.g. energy costs, changes in the variety of goods, successfully marketed niche products or an improvement in the product quality may have absorbed the increase in labour costs in this period. Manufacture of pharmaceutical products, computers and paper and paper products remained highly profitable. The high profitability of the manufacture of textiles and wood continued on an upward trend, and the profitability of the manufacture of motor vehicles, trailers and semi-trailers improved significantly. Persistently stronger increase in labour costs as compared to the competitor economies and a rise in energy prices, which started at the end of 2016, may reduce the competitiveness or exert a downward pressure on the profitability.

## DOMESTIC ECONOMIC ACTIVITY

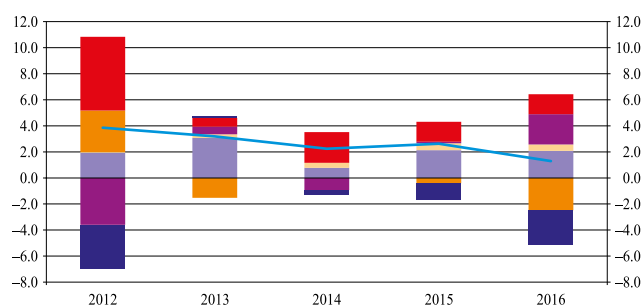
### *With the delays in the absorption of EU funds, investment activity declined; an increase in private consumption continued to support growth*

In 2016, the GDP growth rate was the lowest since the crisis. At constant prices, GDP grew by 1.3% according to seasonally and calendar adjusted data (see Chart 10) and by 2.0% in seasonally non-adjusted terms. However, the slowdown was mostly attributable to a short-term factor, i.e. the slow absorption of project financing from the EU funds programming period 2014–2020 due to a delayed drafting of legislative acts. Latvia's economic growth was also held back by global developments and persistently weak external demand. Meanwhile, a relatively more favourable situation in the labour market

Chart 10

**GDP COMPONENT CONTRIBUTION TO GDP ANNUAL GROWTH AND GDP ANNUAL GROWTH**  
(seasonally and calendar adjusted data; %)

Private consumption  
Public consumption  
Gross capital formation  
Inventory changes  
Exports of goods and services  
Imports of goods and services  
GDP



Source: CSB.

<sup>1</sup> According to Eurostat's preliminary data.

<sup>2</sup> According to the WTO preliminary data.

<sup>3</sup> According to the WTO preliminary data.

<sup>4</sup> Data on the market share in the global imports of services are available with considerable lag.

and a rise in disposable income ensured higher private consumption in 2016. Access to the EU structural funds improved and external demand started to recover at the end of the year paving the way for slightly faster growth in the coming years. However, the recovery of balanced and sustainable growth can be achieved by implementing structural reforms and ensuring a favourable business environment, thereby strengthening the productivity potential and facilitating more investment.

The delayed projects of the EU funds programming period led to extremely weak investment activity which was reflected in the shrinking government sector investment and held up the investment decisions of the private sector. At the same time, external uncertainties and the weak external demand also constrained private investment. Gross fixed capital formation declined in annual terms by almost 12%. While investment in civil engineering works and non-residential buildings saw the most significant reduction, investment in machinery and equipment also contracted notably. Capacity utilisation returned to its high pre-crisis level in most industries, except for the manufacture of food products and beverages where more complete capacity utilisation may have been hampered by the inaccessibility of the Russian market. This level of capacity utilisation may point to the need of investment to ensure further development. Corporate financial indicators suggest an increase in own funds. However, due to the postponement of investment decisions brought about by the weak external demand and the delayed financing from the EU funds, lending to businesses also picked up only gradually.

The shortage of investment hindered imports, and imports of capital and intermediate goods declined in 2016. Imports of goods and services expanded overall in real terms, supported by a sustained upward trend in private consumption and, consequently, also in imports of consumer goods.

Private consumption, albeit falling behind the growth rate of the previous year, remained the key driving force of growth. Consumption expanded as a result of increasing disposable income. Despite a deceleration, growth in real net wages reached 4.6%. The relatively stable consumption was mirrored by a pickup in retail trade turnover (in real terms), albeit slower than in 2015. The increase in consumption of goods in particular supported the overall private consumption growth, while the contribution of consumption of services was smaller in 2016. In some segments of consumption, e.g. trade of new motor vehicles, the increase was supported by a gradual recovery in leasing and lending.

Even though impact of the weak external demand and the consequences of Russia's policy, i.e. sanctions against certain groups of food products and Russia's policy with respect to ports, still persisted, the expansion in exports of goods and services was positive and reached 2.7% in real terms.

***GDP growth was limited by the challenges in the construction sector and facilitated by the development of manufacturing***

In the breakdown by sector, the delayed inflows from the EU funds affected mostly construction, since a large proportion of the financing from the EU structural funds is directly or indirectly related to this sector. Value added in construction declined by 17.1% according to seasonally and calendar adjusted data, mostly due to the subsectors of construction directly dependent on the availability of public funding. Consequently, the volume of construction of civil engineering works (roads, bridges, railway, as well as water supply and power supply systems) and non-residential buildings (educational establishments, museums, sports facilities, health care facilities, etc.) contracted more markedly. The decline in the volume of construction also had an indirect impact on the related economic sectors, i.e. mining, some subsectors of manufacturing (manufacture of building materials, metal products, rubber and plastics products and chemical products), the transportation sector (primarily domestic freight transportation by road) and, to a lesser extent, energy.

The performance of the transportation and storage sector was weak in 2016 due to both global developments and the policy implemented by Russia. Value added in the sector rose by 0.7% mostly as a result of a notable increase in transportation by road. Transportation abroad, i.e. transportation services provided by commercial companies registered in Latvia ensuring transportation between two destinations abroad in one or several countries, accounted for the largest contribution to the expansion in the volume of transportation by road. Meanwhile, the volume of rail freight and cargoes loaded and unloaded at ports continued on a downward path. This was a result of both the adverse global developments characterised by low coal prices in the first half of the year and Russia's policy directed towards more active use of Russia's own ports which have undergone large-scale investment over the previous years.

The negative contribution of construction was offset by the positive development of manufacturing, trade and individual services sectors, e.g. miscellaneous professional, scientific and technical activities, information and communication services, as well as accommodation and food service activities.

The performance of manufacturing should be viewed as very good in 2016 both historically and taking account of the complex external conditions. Value added in the sector grew by 5.4%. The sector expanded at a particularly fast pace towards the end of the year when external demand improved gradually and a positive annual growth rate was observed in most subsectors. Like in the previous years, the sector's growth was driven by an increase in the output in wood industry, which continued on an upward trend despite the policy changes in the UK, one of the main export markets. Manufacture of computer, electronic and optical products as well as that of machinery and equipment n.e.c. also posted favourable growth. In the second half of the year, growth in the food industry, affected by the Russian sanctions, also increasingly stabilised as a result of businesses penetrating into new markets.

Overall, the trade sector including wholesale and retail trade as well as trade and repair of motor vehicles and motorcycles made a substantial contribution to GDP growth, with value added in the sector increasing by 3.4%. This was primarily due to the high activity in wholesale trade at the end of 2015 providing momentum for the high annual growth rate in the first three quarters of 2016; however, during the year, the turnover no longer showed signs of increase in real terms. Therefore, the high level should be viewed as the result of a one-off factor. In 2016, trade of motor vehicles and motorcycles (similarly to retail trade) saw growth, albeit weaker than in the previous years. The retail trade growth momentum decelerated as a result of both a contraction in the trade volume of some commodity groups such as food products, beverages and tobacco products and a considerably smaller contribution from trade of fuel and household goods. Such trade dynamics could be partly caused by the saturation level reached in respect to the basic goods; however, the rise in income was also slightly lower than in 2015.

The professional and administrative services sectors also developed successfully on account of a strong increase in architectural and engineering activities, services to buildings and landscape activities, as well as advertising and market research activities. The expanding volume of various architectural and engineering activities points to more rapid construction growth in the future.

In 2016, GDP growth was supported by an increase in product tax (VAT, excise tax and customs duty) revenue which was more pronounced than the growth in the major economic sectors. The steeper rise in product tax revenue was related to a decline in the grey economy brought about by improved collectibility of taxes.

With external demand and the accessibility of the financing from the EU structural funds improving, in 2017 GDP growth is expected to reach 3.4% according to seasonally and calendar adjusted data and 3.0% in seasonally non-adjusted terms.

## LABOUR MARKET

### *Labour market was affected by decelerating domestic activity, institutional and demographic factors*

The labour market situation improved for employees, albeit not to the extent recorded in the previous year, because decelerating economic growth was a drag on the wage rise and unemployment decline. Minimum wage hikes supported elevation in overall wages and salaries to a lesser extent. Even though the number of persons employed stagnated due to contracting population, the employment rate elevated somewhat.

The unemployment rate kept on declining. It was on account of the structural component which remained high vis-à-vis the EU average. As regards the cyclical component, it remained close to zero. In the fourth quarter of 2016, job seekers accounted for 9.3% of the economically active population (0.5 percentage point decrease over the year). As the number of persons employed did not change much during the year, higher labour productivity was the driving factor of economic growth. Employment rate increased close to historical high, whereas the number of working age population contracted, in part due to labour migration. At the same time, changes in employment structure were in place: the number of persons employed notably increased in manufacturing and decreased in construction and trade. The participation rate surged to its historical high (68.2%), though partly due to the impact of age structure changes. By contrast, the latter changes are expected to affect the participation rate negatively in the near future.

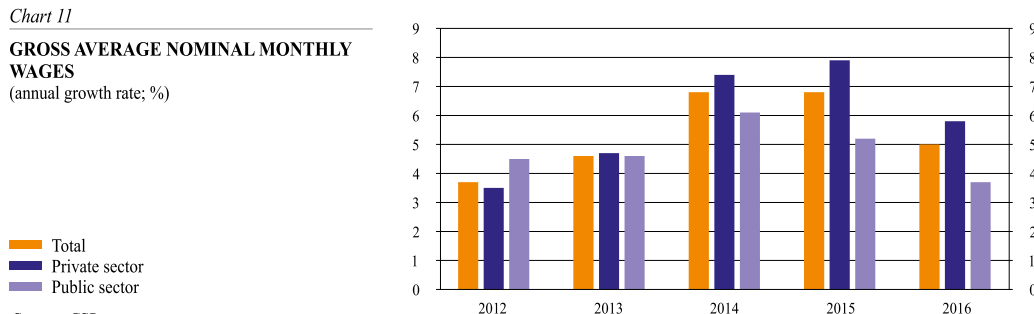
### *The pace of wage growth gradually decelerated*

Wages and salaries lost some growth momentum (5.0%), reflecting a slower rise in minimum wage and more subdued economic development (see Chart 11). Still, wages rose at a somewhat stronger pace than productivity, and unit labour costs thus continued on an upward trend. The labour income share in total value added still lagged behind the EU average. The share of businesses referring to labour shortages as an essential drag on their activity is steadily moderate, hence there are no grounds to anticipate steeply rising unit labour costs that would impair competitiveness of the economy.

Chart 11

#### GROSS AVERAGE NOMINAL MONTHLY WAGES

(annual growth rate; %)



Source: CSB.

Sharp unemployment disparities due to education remained in place: less educated population encountered problems in finding jobs, while better educated employees were paid higher wages. Also, regional disparities of unemployment and wages continued to be pronounced. In such circumstances, sharply elevating minimum wages (without supportive dynamics in productivity and average wages) are likely to impair labour market conditions for low-qualified workers or employees in low-average-wage regions, e.g. in Latgale, negatively affecting employment.

In the coming years, supported by a more dynamic economic development, unemployment is expected to decline gradually and hover close to natural rate. The number of persons employed is unlikely to change notably, as further population shrinkages are anticipated. In 2017, the wage and salary increase will be determined by a more dynamic wage elevation in certain public sector branches, as approved in the state budget. The projected

acceleration of the economic growth notwithstanding, wages in the private sector are likely to retain the present growth dynamics due to delayed spillover effects from the slower economic growth in 2016.

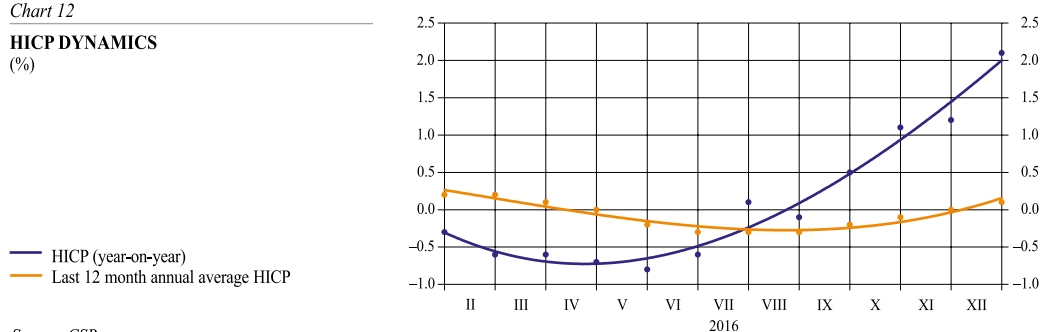
## INFLATION

### *Inflation was driven up primarily by rising global oil and food prices*

The average inflation (HICP) remained at a very low level, at 0.1%, in 2016. Nevertheless, over the year, the inflation dynamics showed remarkable shifts. Inflation remained in the negative territory in the first half of the year but steadily rebounded in the second half. In December, consumer prices had picked up 2.1% year-on-year (see Chart 12). These inflation moves were triggered primarily by global trends of such supply-side factors as oil and food price changes. Pressure on inflation from the demand-side factors remained moderate due to decelerating economic development.

Chart 12

#### HICP DYNAMICS (%)



Source: CSB.

January of 2016 posted the lowest global oil prices in the run of 12 last years, with a spillover effect on fuel prices in Latvia following almost two months later. The effects of the oil price drop were even more delayed relative to natural gas and heating prices, which reached a minimum level in the second half of 2016. Despite the modest oil price rises since spring, in 2016 the energy price was still somewhat lower on average than in the previous year due to these lagged effects, while full transmission of these rises to consumer prices is expected only in 2017.

Also, global food prices fell to their lowest levels in seven years in January of 2016. By the end of the year, however, only grain prices had retained the downward trend owing to the record-high harvest and ever growing accumulation of global inventories. As a result, the grain purchase price in Latvia was lower than in the previous year, and the price of bread was firm. The other product groups posted price rises. In line with global developments and due to stronger demand in the region, the purchase price of milk rose substantially in Latvia in the second half of the year. This trend, however, in 2016 was not fully transmitted to milk and particularly dairy product retail prices but is expected to surface mainly at the beginning of 2017. Prices of fresh fish, also in line with global developments, elevated notably at the close of 2016.

The demand-side pressure on inflation remained weak. Unemployment continued to linger close to its natural rate, the growth in wages and salaries decelerated, and the business assessment of labour shortages was still steadily moderate.

## BALANCE OF PAYMENTS AND EXTERNAL DEBT

### *Current account surplus was primarily driven by weak domestic investment activity and global oil price declines*

In 2016, income from Latvia's exports of goods and services exceeded the value of imports for the first time since 2000. Given the complex external environment, export

sustainability should be assessed positively; nevertheless, effects from the weak domestic investment activity and globally declining oil prices on the current account dynamics were more pronounced. In 2016, the current account posted a surplus of 369.5 million euro (1.5% of GDP; see Chart 13). Previously, Latvia's current account balance had been positive in 2009 and 2010, i.e. during the global crisis and the economic downturn in Latvia respectively.

Chart 13

**CURRENT ACCOUNT BALANCE**  
(% of GDP)


Factors dominating external environment in 2015 were in place also in 2016. The weak external demand weighed on the volume expansion of exports of goods, and, coupled with price declines in global product markets, adversely affected the growth of income from exports. At the same time, global product price declines (of oil in particular) triggered some reduction in import costs. The heightened global uncertainty in 2016 was accompanied also by a domestic factor: the absorption of the financing from the EU structural funds was delayed, resulting in markedly undermined investment activity, reducing the demand for imports. Despite income from exports of goods remaining at the previous year's level (-0.5% vis-à-vis 2015), with import falls dominating (-2.9%), the deficit of goods balance fell to the lowest level so far recorded (7.0% of GDP). Weak absorption of financing from the EU structural funds notwithstanding, the inflow into primary and secondary income accounts from the European Social Fund and the European financing for agriculture in 2016 were more voluminous (by 35.3%) than in 2015, positively impacting the current account.

Even though the contraction in exports of transport services in 2016 continued due to Russia's domestic-port-oriented policy and global coal prices, overall exports of services expanded at a pace similar with that in 2015 (by 5.1%). Income from telecommunication, computer and information services as well as an increase in construction services more than offset the diminishing transport services. Like in the previous years, the services account posted a surplus (7.5% of GDP). It was marginally boosted by the weakening import growth dynamics (to 4.0%), also determined by the shrinking transport services (particularly imports of air and rail transport services).

The gradually improving external demand supports a positive outlook for export income growth in Latvia in 2017. However, the ongoing upswing in global oil prices as well as more dynamic absorption of EU funding and anticipated domestic investment activity are likely to boost the demand for imports. Consequently, amidst accelerating economic growth rates, Latvia is most likely to run a current account deficit in the future.

***Largest cross-border financial flows reflected decision-making of both public and private sector***

Cross-border financial flows in 2016 were affected by the decisions of both private and public sectors. In 2016 overall, foreign assets in the financial account grew faster (by 2.0 billion euro) than did Latvia's liabilities (by 1.5 billion euro).

Speaking about the asset side, the largest cross-border financial flows of the private sector in 2016 were related to falling credit institutions' deposits with foreign banks and contracting portfolio investment abroad. Changes in credit institutions' deposits mirrored

standard interbank transactions, which depend on the decisions of credit institution groups relative to intra-group liquidity allocation. Changes were also related to non-resident deposit shrinkages at Latvian credit institutions (observed already since the beginning of the year due to tighter anti-money laundering requirements and sluggish economic development of Russia), which offset the outflows of deposits by cutting their foreign assets. In 2016 overall, non-resident deposits with credit institutions decreased by 3.2 billion euro and portfolio investment abroad by 1.3 billion euro. The value of foreign direct investment inflows in Latvia in 2016 amounted to 0.5% of GDP. Largest investments were from Luxembourg, Austria and Russia and went to wholesale and retail trade, also to repair of vehicles, information and communication services, as well as to transport and storage. Foreign direct investment in Latvia in 2016 was notably smaller than in 2015 (2.5% of GDP) as a result of a single transaction: in the first half of 2016, the "Swedbank" AS group optimised its capital structure, as a result of which foreign direct investment in Latvia contracted. In the second half of the year, foreign direct investment flows in Latvia were steady (around 3.0% of GDP).

Inflows determined by public sector decisions were related to Latvijas Banka's participation in the Eurosystem's expanded APP, inflows of financing from the EU funds and government bond issuances. Participating in the expanded APP under the Eurosystem's monetary policy and managing Latvia's foreign currency and gold reserves, over the year Latvijas Banka invested 2.7 billion euro in foreign assets. The inflow of 262.2 million euro were in the form of financing from the EU Structural Funds (smallest amount of the last 10 years), which was largely connected with the slow fund absorption pace in the new EU funds programming period. To attract funding for refinancing government's previously undertaken commitments, Latvia issued in international markets eurobonds with 20 and 10 year maturities in May and September respectively (each issuance worth 650 million euro).

Despite non-resident deposits in Latvia shrinking in 2016 and thus alleviating credit institutions' foreign liabilities, Latvia's gross foreign debt swelled. General government foreign debt experienced a temporary upswing. The Treasury engaged in timely attraction of funds from foreign markets to refinance loan repayments projected for 2017. Of transactions under TARGET2 system, the volume of euro outgoing external payments exceeded the volume of euro incoming payments, which translated into an increment in foreign liabilities. At the close of the year, Latvia's gross foreign debt stood at 37.0 billion euro or 149.2% of GDP. At the same time, foreign assets, of them Latvijas Banka's investments in foreign assets most notably, swelled; consequently, Latvia's foreign debt in net terms grew to a lesser extent than in gross terms and at end-2016 stood at 7.3 billion euro or 29.4% of GDP.

## FISCAL POLICY

***The government deficit decreased on account of both higher revenue from taxes and lower spending on investment and interest payments; more expansionary policy can be expected in the future***

The budgetary outcomes suggest that a contractionary fiscal policy was implemented in 2016, with the deficit-to-GDP ratio shrinking by more than 1 percentage point in structural terms. Nevertheless, such a development is rather to be considered an exception and a more expansionary fiscal policy is planned for the years to come<sup>1</sup>.

In 2016, the government budget posted a slight surplus<sup>2</sup> of 0.01% of GDP, as compared to a budget deficit of 1.3% of GDP in 2015. This was a result of an increase in aggregate

<sup>1</sup> Article 5 of the Law on Medium-Term Budget Framework for 2017, 2018 and 2019 [reviewed on 16 February 2017]. Available at: <https://likumi.lv/ta/id/287246-par-videja-termina-budzeta-ietvaru-2017-2018-un-2019-gadam>.

<sup>2</sup> According to ESA 2010 methodology.

revenue by 2.9% in comparison with 2015, including a 6.0% rise in tax revenue, with spending remaining almost unchanged, i.e. decreasing by 0.2%. Nevertheless, despite the improvement in the fiscal position achieved in 2016, due to the spending policy that the government expects to implement within the next three years, the deficit will approach 1% of GDP.

Although the overall spending remained broadly unchanged in 2016, this masked opposite and mutually offsetting trends in individual expenditure items. The rise in compensation of employees was offset by a significant decrease in general government (both central and local governments) investment due to the delays in starting the projects of the new EU structural funds 2014–2020 programming period. Lower government investment was one of the main factors limiting the economic growth in 2016. Nevertheless, with the absorption of the EU structural funds resuming, government investment can be expected to accelerate in 2017 and 2018 and increase the spending figures accordingly. Meanwhile, the Treasury managed to achieve a significant 127.0 million euro decline in interest payments through implementing several government debt refinancing measures at the historically lowest interest rates. This expenditure saving effect will persist also in the medium-term.

Tax revenue increased on account of rising income and robust private consumption in combination with improved tax collectibility as well as changes in tax legislation. The solid 416.9 million euro rise in tax revenue achieved in 2016 supported an increase in the ratio of tax revenue to GDP to almost 30%, which is the highest mark of the last 15 years. The overall growth rate of tax revenue was more moderate, as due to delays in the transition to the new EU structural funds programming period revenue from foreign financial assistance contracted. An increase in revenue was reported for all major types of taxes (PIT, corporate income tax, VAT, state compulsory social security contributions and excise tax) in 2016. Revenue from VAT made the largest contribution to the overall tax revenue growth, increasing by 6.1% or 115.3 million euro and considerably exceeding the growth rate of private consumption, which suggests an improvement in the collectibility of taxes. Revenue from VAT increased also due to changes in legislation: reverse VAT payment procedure for electronic equipment and a standard rate of 21% applied to housing management and maintenance fees as of April. With the corporate profits improving, the steepest growth at 9.6% was reported for the corporate income tax. Revenue from excise taxes also increased notably by 8.1% due to higher consumption and raising the rates on tobacco products, alcoholic beverages and fuel. Raising the minimum wage and salary from 360 euro to 370 euro and the growing average wage and salary in the economy resulted in higher revenue from taxes on labour (PIT and state compulsory social security contributions).

At the turn of 2016, the government adopted the law on 2017 budget and the medium-term budget framework for 2017–2019. Continuing with the priorities set for 2016, the medium-term budget policy will focus on external and domestic security, health and education sectors as well as on reducing the income inequality.

In preparation for the roll-over of debt in 2017, the Treasury drew liquidity from two eurobond issues in the total amount of 1.3 billion euro in May and September 2016. These two issues were the main drivers of the increase of the general government debt<sup>1</sup> from 36.5% of GDP at the end of 2015 to 40.1% of GDP at the end of 2016. It is noteworthy that the long-term bonds issued in May were with the so-far longest maturity (20 years), and both issues had the historically lowest long-term borrowing rate. Favourable borrowing conditions were achieved on account of both the pursued fiscal discipline strengthening the investors confidence in Latvia as well as the advantages provided by participation in the euro area, including the record-low interest rates and non-standard monetary policy

<sup>1</sup> According to ESA 2010 methodology.



measures. It is important for the government to continue with the implementation of a sound fiscal policy in the environment of low government debt service costs and to carry out the structural reforms required for sustainable development.

When reviewing the budget in December, the Fiscal Discipline Council<sup>1</sup> also confirmed that no structural balance adjustment is required, at the same time recommending to implement a conservative fiscal policy and limit the growth of spending.

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<sup>1</sup> Fiscal Discipline Council. Opinion on compliance with Article 11 of the Fiscal Discipline Law [reviewed on 13 February 2017]. Available at: [http://fdp.gov.lv/files/uploaded/FDP\\_1\\_08\\_1449\\_20161209\\_FDL\\_11pant.pdf](http://fdp.gov.lv/files/uploaded/FDP_1_08_1449_20161209_FDL_11pant.pdf).

**OPERATIONS AND ACTIVITIES OF LATVIJAS BANKA**



## LEGAL FRAMEWORK AND FUNCTIONS. LATVIJAS BANKA IN THE EUROSISTEM AND INSTITUTIONS OF THE EUROPEAN UNION

Latvijas Banka is the central bank of the Republic of Latvia and a member of the Eurosystem and the ESCB.

In its activities, Latvijas Banka complies with the Republic of Latvia and EU legislation, as well as ECB legal acts in accordance with the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks and the European Central Bank (hereinafter, the Statute of the ESCB and ECB).

The primary objective of Latvijas Banka, as stipulated by the Law on Latvijas Banka, is to maintain price stability. Latvijas Banka has the following basic tasks:

- participate in defining and implementing the Eurosystem's monetary policy;
- manage the foreign reserves and other financial investments;
- ensure currency circulation in Latvia and participate in ensuring the currency circulation in the euro area;
- participate in promoting smooth functioning of payment systems;
- compile and publish statistical information in order to ensure the performance of the tasks of Latvijas Banka;
- cooperate with the ECB, the central banks of other EU Member States and other countries, as well as other financial institutions;
- act as the financial agent of Latvia's government and provide financial services to other market participants;
- act as an advisor to the Saeima and the Cabinet of Ministers of the Republic of Latvia on monetary policy issues and other issues related to the performance of the tasks of Latvijas Banka;
- maintain the Credit Register;
- issue licences to legal persons listed in the Register of Enterprises of the Republic of Latvia, except credit institutions, for the purchase and sale of cash currency as a commercial activity.

On 1 July 2016, Latvijas Banka started to fulfil the functions of the National Analysis Centre and the Coin National Analysis Centre, thus ensuring effective counterfeit analysis and speeding up the process of counterfeit registration and systematisation notably.

Latvijas Banka is not subject to decisions and instructions by the government or other institutions. Latvijas Banka is independent in making and implementing decisions. Latvijas Banka is supervised by the Saeima of the Republic of Latvia.

In 2016, the Governor of Latvijas Banka participated in the work of the Governing Council and the General Council of the ECB, namely, in the formulation of the Eurosystem's monetary policy and decision-making related to the tasks of the Eurosystem and the ESCB.

The Deputy Governor of Latvijas Banka, in cooperation with the FCMC, participated in the work of the Supervisory Board of the ECB, ensuring the fulfilment of the ECB tasks relating to the supervision of credit institutions and preparing the respective draft decisions to be submitted to the Governing Council of the ECB according to the non-objection procedure.

Representatives of Latvijas Banka participated in the Eurosystem/ESCB committees (see Appendix 4) and working groups, dealing with issues related to monetary policy, market operations, financial stability, payment systems, euro banknotes, statistics, international relations, communication, accounting etc.

Experts of Latvijas Banka also participated in committees and working groups of the

Council of the EU and the EC. Sitting on the EFC and its subcommittees, representatives of Latvijas Banka regularly participated in the preparation of decisions concerning the economic development and financial stability of the EU and the development of the EU economic policy strategy, inter alia, concerning the instruments for ensuring sustainable growth and investment in the EU economy, as well as in the formulation of policies of international financial institutions.

Representatives of Latvijas Banka participated in the EC and Eurostat working groups addressing issues related to euro coins, payment systems, economic forecasting and statistics.

In 2016, the Governor of Latvijas Banka participated in the work of the ESRB making decisions on recommendations and warnings towards preventing the systemic risks of the EU financial system as well as other issues related to the macro-prudential policy. Representatives of Latvijas Banka engaged in the work of the Advisory Technical Committee of the ESRB and its working groups.

With the FCMC's consent, a representative of Latvijas Banka also participated in the work of the Board of Supervisors of the EBA whose general objective is to maintain financial stability and to safeguard the integrity, efficiency and orderly functioning of the banking sector.

## MONETARY POLICY IMPLEMENTATION IN LATVIA

The Eurosystem has been implementing the expanded APP for the second consecutive year, thus amassing experience in large-scale asset purchases. This has led to first estimates about the effects of the Eurosystem's accommodative monetary policy on economy. The accommodative monetary policy has facilitated a decline in money market interest rates, triggered an upswing in the demand for loans, resulted in lower interest rates on household and corporate loans, and reduced yields on private and public sector bonds. Implementing the Eurosystem's monetary policy, Latvijas Banka participated in the PSPP by purchasing bonds of the Latvian government and securities issued by international organisations and multilateral development banks. The Latvian credit institutions, on the other hand, made little use of the possibilities offered by the Eurosystem's monetary policy instruments and held ample free resources with the central bank.

Over the year, the outstanding value of securities held by Latvijas Banka for monetary policy purposes rose from 1.8 billion euro to 4.4 billion euro, with the average monthly purchase value under the PSPP of 212 million euro (180 million euro in 2015). At the end of 2016, the Eurosystem's holding of the Latvian government securities amounted to 1.3 billion euro<sup>1</sup>. Latvijas Banka's purchases under the PSPP expanded as the Eurosystem pushed up the monthly securities purchase volume under this programme from April 2016.

In an accommodative monetary policy environment, excess liquidity of Latvia's credit institutions rose from 3.5 billion euro on average in December 2015 to 4.1 billion euro on average in December 2016. With the minimum reserve requirement for credit institutions reaching 229 million euro at the end of 2016, the ratio of balance on credit institutions' current accounts to the minimum reserve requirement was 18, i.e. the highest in the euro area (5 in the euro area on average, 17 in Estonia, and 13 in Lithuania), implying a significant excess of liquidity. Nevertheless, the Latvian credit institutions recorded a notably weaker rise in liquidity vis-à-vis the increase in Latvijas Banka's holding of securities for monetary policy purposes, because most of Latvijas Banka's securities came from non-resident credit institutions.

Amidst ample liquidity, credit institutions in Latvia showed little interest in Eurosystem's

<sup>1</sup> <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html>.

reverse market operations. Main refinancing operations, the marginal lending facility and deposit facility were not used. The average outstanding amount of LTROs in 2016 was 245.3 million euro (175.0 million euro in 2015), of which TLTROs accounted for average outstanding amount of 243.5 million euro and LTROs with a 3-month maturity of 1.8 million euro. In comparison with 2015, the interest about TLTROs increased as the Eurosystem offered more attractive conditions to banks: if credit institutions boost their lending to the economy, the interest rate on TLTROs can be as low as the interest rate on the ECB's deposit facility, which was negative, at  $-0.4\%$ , in 2016.

## ECONOMIC RESEARCH, ANALYSIS AND FORECASTING

Economic research and economic analysis are important functions of Latvijas Banka's operation; the objective is to provide sound explanation for current and projected future economic processes as well as for alternative economic growth scenarios in a changing economic policy environment by employing scientific methods. This enhances the adoption of quality economic policy decisions at the level of both Latvia and the euro area.

Twice a year, in June and December, the Eurosystem publishes the macroeconomic projections developed by its staff, including experts of Latvijas Banka. The forecasting process at Latvijas Banka is adapted for successful participation in forecasting procedures of the Eurosystem both by developing macroeconomic forecasts for the Latvian economy and taking part in the discussions of forecasting outcomes of other euro area countries in the Eurosystem/ESCB Monetary Policy Committee and its Working Group on Forecasting.

Daily analytical work is no less important than forecasting, and in cooperation with other central banks of euro area countries it is conducted within the Eurosystem/ESCB Monetary Policy Committee and its three Working Groups on Econometric Modelling, on Forecasting, and on Public Finance, wherein substantiated discussions form the basis for the Eurosystem's monetary policy decisions by the ECB's Governing Council. In addition, work is going on in fora organised by these groups, in which the employees of Latvijas Banka are active participants. The Task Force, i.e. a group of experts, on Low Inflation analysed causes and effects of low inflation, focusing on the Phillip's curve relationship between economic activity and inflation as well as on the role of inflation expectations in inflation dynamics. The Task Force on Forecasting Residential Property Prices managed to improve and upgrade instruments used in the respective forecasting. To develop recommendations for economic policy solutions, the Task Force on Low Investment analysed factors determining slow investment growth by employing several alternative econometric models. Representatives of Latvijas Banka participated in the work of the Task Force on Links between Real and Financial Cycles, researching the relationship between financial (credit) and real (GDP) cycles.

To promote cooperation with researchers of other countries, employees of Latvijas Banka continued to participate in the ECB Networks of Competitiveness Research (*CompNet*), Wage Dynamic, and Household Finance and Consumption. Experts of Latvijas Banka also take part in the work of regular meetings of the EC and OECD working groups on forecasting.

External reviewers from NCBs or academia of other countries are involved in assessing working papers to ensure their high quality. In 2016, Latvijas Banka proceeded with research activities in three priority directions: 1) monetary policy transmission, 2) fiscal policy and public debt sustainability, and 3) long-term growth and competitiveness. Latvijas Banka published five working papers on its website in 2016.

The authors of Working Paper No. 1/2016 developed an econometric model using Latvia's national supply and use tables. The focus is on the fiscal block, incorporating five types

of government expenditure and five revenue sources, including such four major taxes as PIT, state compulsory social security contributions, VAT and the excise tax. The model leads to drawing in-depth and detailed conclusions about effects of several fiscal measures on Latvia's economy, both in its aggregate and by sector. The findings of this working paper have been presented at the seminar of the Eurosystem/ESCB Monetary Policy Committee's Working Group on Public Finance.

Working Paper No. 2/2016 proposes a zero lower band and shadow rate term structure of an interest rates model with both unobservable factors and factors of non-standard monetary policy measures. The non-standard factors include the Eurosystem's holdings of expanded APPs and LTROs as well as their weighted average maturities. The findings of the research show that, at the end of September 2015, the rate of 5-year overnight indexed swaps was about 60 basis points lower than it would have been in the absence of non-standard monetary policy measures. These findings are useful in explaining the efficiency of euro area monetary policy. The research was presented at a conference, organised by Banca d'Italia, and the 10th International Conference on Computational and Financial Econometrics in Spain.

Working Paper No. 3/2016 deals with the relationship between inflation and economic activity in Latvia, with a focus on its variation over time. The findings suggest that the Phillips curve has recently flattened as Latvia's economy entered a period of very low inflation. It implies that unconventional monetary policy instruments may be of limited effectiveness to control inflation in Latvia. Hence, structural reforms aimed at increasing competition and reducing price stickiness are necessary.

Working Paper No. 4/2016 discusses the importance of price and cost competitiveness for intra-euro area and extra-euro area trade. The findings show that price competitiveness is a more important driver of trade flows outside the euro area than within it, especially relative to exports that tend to be more sensitive than imports to a change in relative prices. This implies that for adjusting competitiveness disequilibria in countries with a current account deficit, structural reforms, including reforms in the domestic product and labour markets and reforms boosting non-price competitiveness, should be implemented side by side with price and cost adjustments. This paper has been prepared in cooperation with the ECB's specialists and was also published in the ECB working paper series.

Studying eventual negative side effects of the current monetary policy, Working Paper No. 5/2016 suggests that amidst falling interest rates countries tend to pursue more expansionary fiscal policies, leading to deteriorating fiscal balances. The findings therein overall suggest that the use of non-standard policy instruments bringing about a sharp interest rate decrease may negatively affect the implementation of fiscal policy and structural reforms.

Latvijas Banka encourages the publishing of its employees' research in international refereed journals. In 2016, there were four such working papers, first published within the working paper series of Latvijas Banka. Thus, the *Journal of International Money and Finance (Elsevier)* published an article (Latvijas Banka's Working Paper No. 5/2014) about the international transmission of euro area and US negative credit supply shocks. Working Paper No. 1/2014 formed the basis for a publication in the journal *Studies in Nonlinear Dynamics and Econometrics (De Gruyter)*, presenting an approach based on a perturbation technique to construct global solutions to dynamic stochastic general equilibrium models.

Latvijas Banka disseminates the research findings to public at large via articles and blogs (e.g. [macroeconomics.lv](http://macroeconomics.lv), [delfi.lv](http://delfi.lv), [voxeu.org](http://voxeu.org)).

## INVESTMENT MANAGEMENT

Foreign reserves of gold and foreign currencies as well as other financial investments of Latvijas Banka amounted to 5.8 billion euro at the end of 2016 (5.2 billion euro at the end of 2015).

Latvijas Banka manages its investments in compliance with the guidelines adopted by the Council of Latvijas Banka. Most financial assets at Latvijas Banka were managed relative to the weighted index of 1–10 year US, euro area, Canada and the UK government securities. The benchmark currency is the euro, and the benchmark assets were composed of 55% US dollar-denominated, 21% euro-denominated, 14% British pound sterling-denominated, and 10% Canadian dollar-denominated assets. In 2016, Japanese yen-denominated assets were withdrawn from the benchmark assets. Also, the portfolio of 1–3 year fixed income securities and the portfolio of 1–10 year fixed income securities were merged, a new portfolio of government 10 year fixed income securities was formed early in the year, and a long-term securities portfolio was added in the mid-year. Latvijas Banka invests its financial assets in safe and liquid financial instruments, basically in debt securities issued by governments of EU countries and the US, their agencies and international organisations, as well as in highly rated bank and corporate debt securities, asset-backed debt securities and callable bonds. Interest rate futures are used to regulate the duration of reserves. Interest rate swaps are used to implement yield curve strategies on the interest rate market, whereas currency futures and forward exchange rate contracts ensure the optimal currency composition of financial assets.

In investment management, given the composition of the benchmark portfolio, the focus was on interest rates of 2, 5 and 10 year government bonds, which during 2016 decreased in Germany and the UK but rose in the US and Canada (see Table 2). With historically very low interest rates persisting, it is complicated for a national central bank as conservative investor with modest risk appetite to generate positive yields.

Table 2

### GOVERNMENT BOND INTEREST RATES (end of year; %)

Government bond maturity	Germany		UK		US		Canada	
	2016	2015	2016	2015	2016	2015	2016	2015
2 years	-0.77	-0.35	0.08	0.65	1.19	1.05	0.75	0.48
5 years	-0.53	-0.05	0.49	1.35	1.93	1.76	1.11	0.73
10 years	0.21	0.63	1.24	1.96	2.44	2.27	1.72	1.39

The gold reserves of Latvijas Banka are stored in the Bank of England. To hedge the risk related to market value fluctuations of the gold reserve, Latvijas Banka used currency futures and foreign exchange forward contracts as well as foreign exchange swaps.

In 2016, Latvijas Banka concluded asset management agreements with three new external managers, thus currently using the services of seven external asset managers. They manage a portion of Latvijas Banka's financial assets in compliance with the guidelines issued by the Council of Latvijas Banka. In the fourth quarter of 2016, the share of financial assets other than investments in government securities managed by external managers was increased to further diversify financial assets and boost income in proportion to the undertaken risk.

In investment management, much attention is paid to risk management and control. The compliance of financial asset and gold portfolios with the guidelines is monitored and the risk allocation in accordance with various investment decisions is controlled on a daily basis.

Latvijas Banka manages its share of foreign reserve assets denominated in Japanese yen and transferred to the ECB together with the *Oesterreichische Nationalbank*.

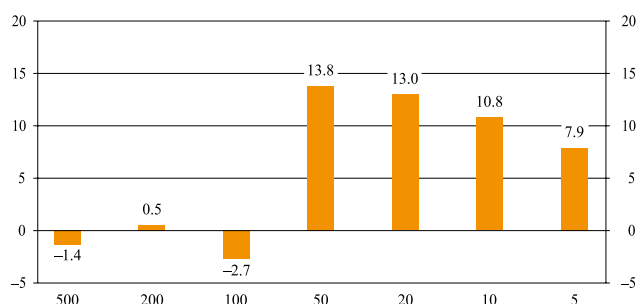
## CURRENCY IN CIRCULATION

At the end of 2016, the value of euro banknotes and coins issued into circulation by Latvijas Banka was 308.1 million euro, of which banknotes accounted for 247.4 million euro or 80.3%, and coins for 60.7 million euro or 19.7%.

As to the quantity of banknotes, Latvijas Banka's currency issuance during 2016 grew by 7.9%, amounting to 41.9 million euro banknotes at the end of the year. Of euro banknotes issued by Latvijas Banka by the end of 2016, 50 euro and 20 euro banknotes predominated (13.8 million and 13.0 million respectively; see Chart 14).

Chart 14

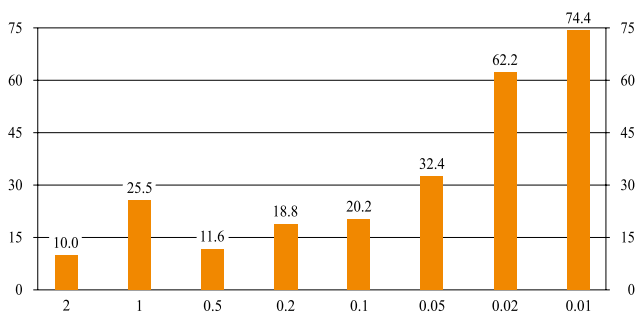
### EURO BANKNOTES ISSUED BY LATVIJAS BANKA IN NET TERMS (at the end of 2016; face value; number in millions)



Whereas the quantity of coins issued by Latvijas Banka in 2016 increased by 19.5%, amounting to 255.1 million euro coins by the end of December. At the end of 2016, 1 cent and 2 cent coins made up the largest part of Latvijas Banka's euro coins in circulation (74.4 million and 62.2 million coins respectively; see Chart 15).

Chart 15

### EURO COINS ISSUED BY LATVIJAS BANKA IN NET TERMS (at the end of 2016; face value; number in millions)



Cash received from credit institutions was checked for fitness and authenticity by automated cash processing systems of Latvijas Banka, and 138.8 million banknotes were processed in 2016. 20.5% or 28.5 million of the processed banknotes were sorted as unfit for circulation and destroyed (16.6% and 23.3 million respectively in 2015).

In 2016, Latvijas Banka continued to register merchants, engaged in handling and recirculating of euro banknotes and coins, and to monitor their operation. A merchant is entitled to handle and recirculate euro banknotes and coins in the Republic of Latvia upon registering with Latvijas Banka as a cash handling institution. At the end of 2016, 70 cash handling institutions were registered in Latvia. Latvijas Banka conducted inspections of cash handlers and assessed the compliance of their operation with the requirements of legislative acts regulating cash handling.

On 1 July 2016, Latvijas Banka took over the functions of the National Analysis Centre and the Coin National Analysis Centre to ensure identification of suspected counterfeit banknotes and coins detected in the territory of Latvia. The total nominal value of counterfeits detected in 2016 (69.9 thousand euro) accounted for 0.02% of the cash volume issued by Latvijas Banka into circulation (115.9 thousand euro and 0.02% respectively in 2015). In 2016, 1 277 counterfeit euro banknotes and 300 counterfeit euro coins were detected.



The take-over of the functions from the two centres above substantially (more than 2 times) cut the currency inspection time vis-à-vis the previously required time for the counterfeit to be detected and delivered to the National Analysis Centre and the Coin National Analysis Centre. The competent institution's opinion on the counterfeit detected now reaches the State Police for decision taking on criminal proceedings in less than two weeks from the moment of its submission for inspection.

The exchange of lats banknotes and coins to euro banknotes and coins (worth 3.9 million lats) continued throughout 2016; of the exchanged amount, 3.3 million lats were in banknotes and 0.6 million lats in coins. By the end of 2016, banknotes and coins worth 46.8 million lats and 44.5 million lats respectively had not been yet exchanged. 5 lats and 20 lats banknotes (1.8 million and 0.9 million respectively) and 1 santim and 2 santim coins (150.6 million and 90.5 million respectively) were among the least exchanged.

## 2 EURO COMMEMORATIVE COINS



### THE LATVIAN BROWN

Struck in 2016 by *UAB Lietuvos monetų kalykla* (Lithuania)  
The national side artists: Gunārs Lūsis (graphic design) and Jānis Strupulis (plaster model)  
The national side features a cow.



### VIDZEME

Struck in 2016 by *UAB Lietuvos monetų kalykla* (Lithuania)  
The national side artists: Laimonis Šēnbergs (graphic design) and Jānis Strupulis (plaster model)  
The national side features the coat of arms of Vidzeme.

Weight: 8.50 g; diameter: 25.75 mm; thickness: 2.20 mm  
Shape: round; colour: outer part – silver, inner part – gold  
Composition: outer part – copper-nickel (Cu, Ni), inner part – three layers: nickel brass, nickel, nickel brass (Ni, Cu, Zn; Ni; Ni, Cu, Zn)  
The edge of the coin bears the inscription \* DIEVS \* SVĒTĪ \* LATVIJU (God, Bless Latvia).  
The common side artist Luc Luycx

## 5 EURO COLLECTOR COINS

### FAIRY TALE COIN II. HEDGEHOG'S COAT

Weight: 28.28 g, shape: oval;  
length: 42.00 mm; width: 35.00 mm  
Metal: silver of .925 fineness;  
quality: proof  
Struck in 2016 by *UAB Lietuvos monetų kalykla* (Lithuania)  
Artists: Gundega Muzikante (graphic design) and Ligita Franckeviča (plaster model)



### "BALTARS". PORCELAIN

Weight: 18.00 g; diameter: 38.61 mm;  
shaped with slight incurvature  
Metal: silver of .925 fineness; quality:  
proof; colour-printed reverse  
Struck in 2016 by *UAB Lietuvos monetų kalykla* (Lithuania)  
Artist: Francēska Kirke (graphic design)

### NATIONAL ENTREPRENEUR

Weight: 30.30 g; decagon side length: 12.00 mm  
 Metal: silver of .925 fineness; quality: proof  
 Struck in 2016 by *UAB Lietuvos monetų kalykla* (Lithuania)  
 Artists: Paulis Liepa (graphic design) and Ivars Drulle (plaster model)



### GOLD BROOCHES. THE DISC FIBULA

Weight: 3.10 g; shape: irregular circle; diameter: 18.00 mm  
 Metal: 999.9° gold; quality: proof  
 Struck in 2016 by *Münze Österreich Aktiengesellschaft* (Austria)  
 Artists: Ingūna Elere (graphic design) and Solvita Rulle (plaster model)

### JANIS ROZENTĀLS

Weight: 62.00 g; shape: rectangle; measurements: 80.00 mm × 38.00 mm  
 Metal: silver of .925 fineness  
 Quality: proof; colour-printed reverse  
 Struck in 2016 by *Koninklijke Nederlandse Munt* (The Netherlands)  
 Artists: Sandra Krastiņa (graphic design) and Jānis Strupulis (plaster model)



### CHRISTMAS BATTLES

Weight: 28.00 g; shape: regular hexagon; length of longer diagonal: 38.61 mm  
 Metal: silver of .925 fineness; quality: proof  
 Struck in 2016 by *UAB Lietuvos monetų kalykla* (Lithuania)  
 Artists: Kristaps Ģelzis (graphic design) and Līgita Franckeviča (plaster model)



### THE EARTH

Weight (silver): 14.00 g; weight (total): 20.00 g  
 Diameter: 40.00 mm (width of outer ring – 4.00 mm; width of perlucor ring – 12.00 mm; diameter of Earth's image – 8.00 mm)  
 Materials: silver of .925 fineness and perlucor; silver quality: proof  
 Struck in 2016 by *UAB Lietuvos monetų kalykla* (Lithuania)  
 Artist: Mārcis Kalniņš (graphic design)

In 2016, Latvijas Banka continued to issue collector and commemorative coins of high artistic quality celebrating various significant events of Latvian history and culture. "Fairy Tale Coin II. Hedgehog's Coat" (issued 19 April 2016) was dedicated to a popular fairy tale. The coin ""Baltars". Porcelain", with its issuance marked at the Museum of Decorative Art and Design, was minted in the form of a flat plate to honour "Baltars", the workshop and pride of Latvia's national culture where fine china was artistically painted (issued 9 August 2016). The coin "National Entrepreneur" was created in cooperation with the Latvian Chamber of Commerce and Industry (issued 13 September 2016). The coin "Gold Brooches. The Disc Fibula" was the first in the euro gold collector coin series dedicated to Latvian brooches and honouring Latvia's centenary (issued 10 November 2016). The presentation event of silver coin "The Princess and the Monkey" (issued 23 November 2016), featuring one of the most famous paintings by Janis Rozentāls and a dedication to his 150th anniversary, was held at the Latvian National Museum of Art in front of the original painting. The prolific year in coin art was concluded by the "Christmas Battles" coin (issued 6 December 2016), honouring 100 years of the Christmas Battles, and the innovative coin "The Earth" (issued 22 December 2016).

In 2016, Latvijas Banka put two 2 euro commemorative coins into circulation. They are "The Latvian Brown" (in circulation as of 19 July 2016) and "Vidzeme" (in circulation as of 15 November 2016), the latter coin being first within the four-coin series featuring the coats of arms of Latvia's cultural and historical regions and a contribution to the country's centenary.

Collector coins of Latvijas Banka received recognition in 2016 at the international Coin Constellation Contest organised by *Watermark*, Russian Numismatic Publishing House. The coin "Valse Mélancolique" was the winner in the nomination "Successful Artistic Solution", the first place in the nomination "Unique Concept" went to the coin "Rainis and Aspazija", while the coin "500 Years of Livonian Ferding" was awarded the second place in the nomination "Coin Classic".

In March 2016, Latvijas Banka conducted the traditional public survey "Latvia's Coin of the Year 2015". It is the most important event dedicated to coin art in Latvia, which places emphasis on contributions artists make to coin art and shows what themes and artistic presentations are favoured by the public. The survey, overall involving 12.6 thousand participants, named the "Fairy Tale Coin I. Five Cats" as the winner of "Latvia's Coin of the Year 2015" award, with one third of the votes going for it.

## PAYMENT AND SETTLEMENT SYSTEMS

### TARGET2-LATVIJA OPERATION

TARGET2, operated by the Eurosystem, was one of the world's largest payment systems in 2016. It provides real-time gross settlement in euro to support the implementation of the Eurosystem's monetary policy operations and interbank market transactions, the enforcement of customers' urgent payments and execution of interbank settlement with regard to other payments, securities settlement and financial instrument clearing systems. Latvijas Banka continued to operate TARGET2-Latvija, the component system of TARGET2 in Latvia. TARGET2 and the TARGET2-Securities platform developed by the Eurosystem for the purpose of harmonising the European securities market were the key components of the Eurosystem's market infrastructure.

In 2016, Latvijas Banka together with other members of the Eurosystem continued the implementation of several TARGET2 development projects, including those of the component system TARGET2-Latvija operated by Latvijas Banka. A long-term development strategy of the Eurosystem's market infrastructures (Vision 2020) was developed to modernise the Eurosystem's market infrastructure in line with development

of financial technologies and to promote smooth functioning of payment systems. The assessment of the integration of TARGET2 with TARGET2-Securities was commenced to carry out technical and functional upgrading of TARGET2, enhance information and cyber security, use the leading-edge technologies employed in the TARGET2-Securities platform as well as optimise operational costs of TARGET2 and TARGET2-Securities. The analysis of the benefits arising from this integration will help to verify whether it is possible and necessary to provide new payment and securities settlement services in the real-time gross settlement area. In response to market initiatives with regard to the introduction of instant payments in euro in the future and to avoid fragmentation of the instant payment market, Latvijas Banka and other participants of the Eurosystem started to explore the ways TARGET2 could support instant payment settlement in a continuous manner and on a daily basis (the so-called 24/7/365 regime). The Eurosystem will finish the assessment of these possibilities in 2017 to take a decision on the introduction of the new services into TARGET2, including the component system TARGET2-Latvija operated by Latvijas Banka.

In 2016, Latvijas Banka carried out the necessary preparatory work and tests to provide smooth cash settlement to participants of Latvia's securities market via TARGET2-Latvija. They will commence securities settlement in the TARGET2-Securities platform on 18 September 2017. The Eurosystem's TARGET2-Securities project, which also includes Latvijas Banka, is an international and unique securities settlement development project encompassing transaction settlement of the central securities depositories of the 19 euro area countries, Denmark, Hungary, Romania and Switzerland into a single TARGET2-Securities platform. 12 central depositories together with participants of the securities market of the respective country had started operation in the TARGET2-Securities platform by the end of 2016.

The availability of TARGET2-Latvija accounted for 100% in 2016. The daily average volume of the customer payments processed via TARGET2-Latvija stood at 1.3 thousand and their value was 98.6 million euro, while the volume of interbank payments was 0.3 thousand and their value – 816.0 million euro.

In 2016, 429.2 thousand payments in the amount of 235.1 billion euro were processed in TARGET2-Latvija (see Table 3). The total volume of payments increased by 19.5%, but the total value decreased by 11.2% year-on-year. The decline in volume had been going on since mid-2015 when several Nordic group credit institutions changed their liquidity management methods by reducing the frequency of liquidity transfers through keeping funds in the TARGET2-Latvija component system without transferring them to TARGET2 component systems of other countries. The monthly volume of the payments processed in TARGET2-Latvija was more volatile than their value (see Chart 16).

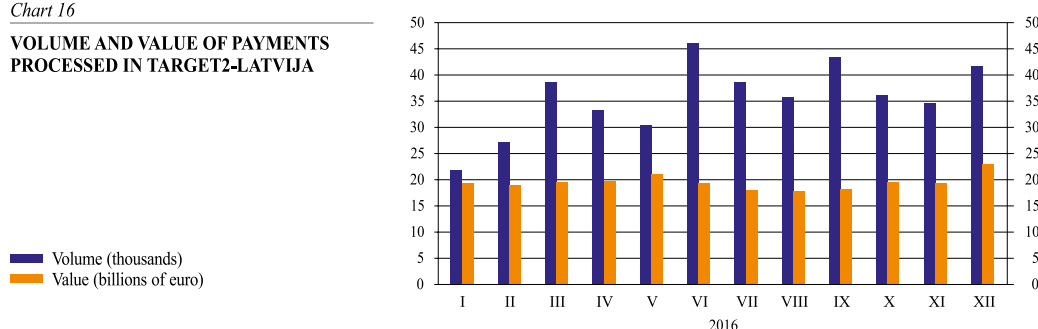
Table 3

**PAYMENTS PROCESSED IN  
TARGET2-LATVIJA**

	Volume (thousands)			Value (billions of euro)		
	Interbank payments	Customer payments		Interbank payments	Customer payments	
<b>2016</b>	<b>89.8</b>	<b>339.4</b>	<b>429.2</b>	<b>209.7</b>	<b>25.4</b>	<b>235.1</b>
2015	68.3	290.8	359.1	243.6	21.1	264.7
2014	75.1	281.2	356.3	326.9	16.1	343.0
2013	38.3	311.5	349.8	116.4	15.6	132.0
2012	35.7	292.4	328.1	173.1	12.9	186.0

At the end of 2016, 21 credit institutions, the Treasury and Latvijas Banka were the participants of TARGET2-Latvija. TARGET2-Latvija also ensured final settlement in euro for the EKS, the securities settlement system operated by the LCD and the payment card processing system of First Data Latvia Ltd.

Chart 16

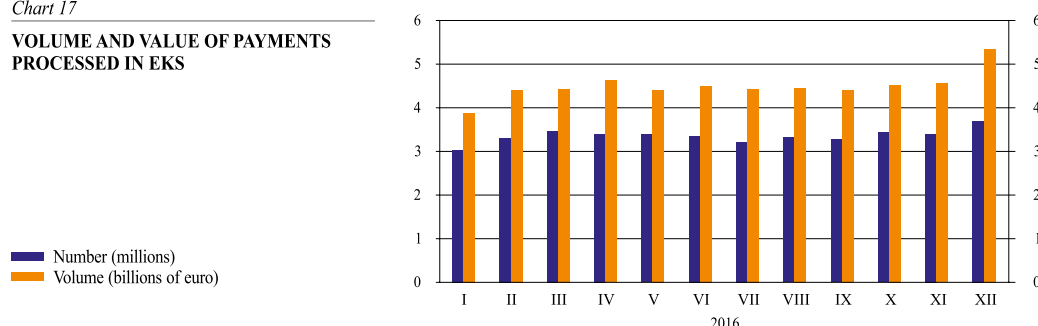
**VOLUME AND VALUE OF PAYMENTS PROCESSED IN TARGET2-LATVIJA**

**OPERATION OF THE EKS, A SYSTEM MAINTAINED BY LATVIJAS BANKA, AND PAYMENT SERVICES**

The EKS, maintained by Latvijas Banka, continued to ensure modern and efficient customer payments in euro within SEPA for Latvia's credit institutions and the Treasury. The EKS carried out fully automated processing of SEPA credit transfers in the EKS clearing service, providing settlement seven times a day within TARGET2-Latvija in participants' settlement accounts opened with Latvijas Banka.

To develop and improve the EKS and support development of innovative instruments in the country, Latvijas Banka, in collaboration with Latvia's credit institutions, successfully continued the establishment of the instant payment service in the EKS in 2016. This service will enable the execution of payments submitted by credit institutions' customers within several seconds, and it will be available in the 24/7/365 regime. The service is geared towards the enforcement of retail payments of individuals and enterprises. Latvijas Banka intends to implement this innovative financial services project in August 2017. In order to ensure access of Latvia's population to instant payments, Latvijas Banka will connect the EKS instant payment service with other European instant payment systems, thus making it possible to execute instant payments among all Latvia's credit institutions irrespective of their participation in the EKS as well as make such payments within SEPA.

In 2016, the daily average of customer payments processed in the EKS, which has been designed for processing a large volume of retail payments submitted by customers, accounted for 156.9 thousand amounting to 210.1 million euro. The availability of the EKS stood at 99.78%. The EKS processed 40.3 million payments totalling 54.0 billion euro, leading to a year-on-year increase of 6.0% and 3.0% respectively. The trend observed in 2015 continued, i.e. December saw the highest volume and value of payments processed in the EKS but January – the lowest (see Chart 17).

Chart 17

**VOLUME AND VALUE OF PAYMENTS PROCESSED IN EKS**


At the end of 2016, the EKS comprised the following direct participants: 15 credit institutions, the Treasury and Latvijas Banka, as well as two indirect participants.

Latvijas Banka ensured the execution of SEPA credit transfers also to its customers, including credit unions, via indirect participation in the EKS, thus providing an opportunity to make and receive payments in euro across SEPA. For other customers,

which had not migrated to the SEPA Credit Transfer Scheme, Latvijas Banka ensured access to SEPA by submitting credit transfers on their behalf. In 2016, Latvijas Banka provided payment services in euro to the FCMC and other Latvian, foreign and international financial institutions, processing payments in the amount of 1.3 billion euro (2.1 billion euro in 2015).

#### OVERSIGHT OF PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

In 2016, Latvijas Banka participated in the joint Eurosystem oversight of payments and securities settlements organised by the Eurosystem, thus enhancing development of efficient and secure payment systems in the EU (particularly in Latvia). Along with the rapid development of digital financial technologies or the so-called FinTech, Latvijas Banka engaged in several projects dealing with innovative payment oversight. One of the most significant activities with regard to Latvia's payment systems was the oversight of the establishment of Latvijas Banka's innovative instant payment service in the EKS by providing recommendations on the necessary financial risk mitigation measures and compliance of the planned service with the best practice of operation of such services. To promote development of innovative settlement in Latvia, wider availability of payment services to Latvia's population and entrepreneurs as well as competitiveness of Latvia's financial technologies sector in the field of payments, Latvijas Banka conducted further investigation in 2016 and drew up a proposal in relation to the execution of SEPA credit transfers of customers of payment institutions and e-money institutions licensed in the EEA via Latvijas Banka's payment infrastructure<sup>1</sup>. 2016 saw a steep rise in popularity of the distributed ledger technology, which has the potential for boosting efficiency of processes and reducing the costs related to record keeping of data and transactions of the financial sector.

In order to verify EKS security, its smooth operation and conformity with international standards regarding the reduction of legal and operational risks, Latvijas Banka carried out an oversight assessment of the EKS and its connection to STEP2, a system operated by EBA Clearing, in relation to their compliance with the Principles for Financial Market Infrastructures (hereinafter, the PFMI). Latvijas Banka completed the EKS oversight assessment within the framework of the Eurosystem's oversight assessment (in compliance with the PFMI) of all retail payment systems operating in the euro area. Peer review of all assessments carried out within the framework of the comprehensive assessment has been planned for 2017. It is aimed at ensuring an equal approach to an oversight assessment of retail payment systems operating in the euro area. According to the ECB payment systems, oversight methodology the compliance with the respective PFMI and oversight expectations for links are divided into four levels: compliant, broadly compliant, partly compliant and not compliant. Latvijas Banka's oversight assessment of the EKS and the link of the EKS to STEP2, a system operated by EBA Clearing, revealed that the EKS and link were fully in line with all applicable PFMI and oversight expectations for links.

In the area of oversight of securities settlement systems, Latvijas Banka, in cooperation with Eesti Pank and Lietuvos bankas, monitored a project of merging the central securities depositories of the Baltic States to facilitate project development in compliance with international principles, the best practice of operation of securities settlement systems and with Latvian and EU legislation as well as to ensure successful joining of Latvia's securities market to the TARGET2-Securities platform. It has been planned that the project of merging the central securities depositories of the Baltic States will lead to the establishment of one central depository in Latvia in 2017. The LCD will take over liabilities of Estonian and Lithuanian central securities depositories, and its new name will be Nasdaq CSD SE. Nasdaq CSD SE will maintain three securities settlement

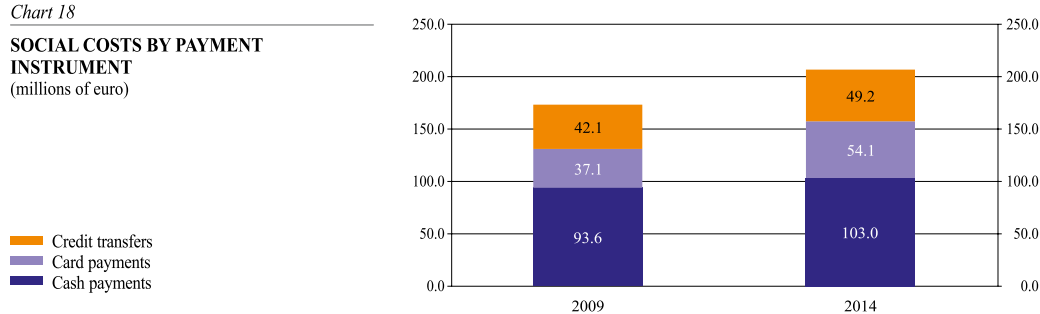
<sup>1</sup> The Council of Latvijas Banka approved the respective amendments to the "Regulation for Servicing of Customer Accounts of Latvijas Banka" on 16 January 2017.

systems pursuant to legislation of Latvia, Lithuania and Estonia respectively, and they will operate in a single settlement platform. Nasdaq CSD SE plans to launch its operation by joining the Eurosystem's TARGET2-Securities platform in September 2017 after obtaining a licence of a central securities depository. Latvijas Banka coordinated a joint oversight assessment of Nasdaq CSD SE securities settlement systems by the central banks of the Baltic States regarding compliance of these systems with the PFMI as well as participated in cooperation of supervisory and oversight authorities of the Baltic States organised by the FCMC. This collaboration is necessary to prepare for licensing and supervision of Nasdaq CSD SE therefore Latvijas Banka voiced its opinion about cooperation procedures and oversight issues concerning securities settlement systems.

In 2016, Latvijas Banka assessed the costs incurred by traders, service providers and financial institutions in 2014 (the first year following the introduction of the euro) to enable the public, i.e. natural and legal persons, to make payments when paying for goods and services in Latvia (hereinafter, the social costs). Such an assessment for 2009 was carried out in 2011. The assessment results suggest that the total social costs of payments made in Latvia in 2014 constituted 206.3 million euro or 0.86% of GDP (172.9 million euro or 0.93% of GDP in 2009). They had increased by 33.4 million euro or 19.3% in comparison with 2009. In 2014, the highest social costs were those of cash payments (103.0 million euro; see Chart 18) although their share in the total social costs decreased to 49.9% (54.2% in 2009).

Chart 18

#### SOCIAL COSTS BY PAYMENT INSTRUMENT (millions of euro)



The total social costs of financial institutions, i.e. credit institutions, Latvijas Banka and interbank payment infrastructure operators stood at 111.0 million euro in 2014, but those of traders and service providers amounted to 95.3 million euro.

According to this assessment, each inhabitant of Latvia made on average 455 payments in 2014 which is 14.3% or 57 payments more than in 2009. The social costs of one cash payment were the lowest, but those of one credit transfer – the highest (16.4 cents and 48.9 cents respectively; see Table 4). It was only the social costs of one cash payment that had increased compared to 2009. Meanwhile, the social costs of one credit transfer edged down more significantly (by 24.6% or 15.9 cents).

Table 4

#### UNIT SOCIAL COSTS

Type of payment	In 2014 (cents)	In 2009 (cents)	Changes	
			cents	%
Cash payment	16.4	12.7	3.7	29.1
Card payment	31.5	47.4	-8.0	20.2
Credit transfer	48.9	56.9	-15.9	24.6

Latvijas Banka compiled data on the payment instruments used by customers (see Table 5). In 2016, a total of 399.3 million non-cash payments in the amount of 289.6 billion euro were made in Latvia. In comparison with 2015, the number of non-cash payments recorded an increase of 10.2% primarily on account of card payments, which were the most frequently used non-cash settlement. Overall, 242.8 million card payments totalling 4.6 billion euro were made in 2016. The volume and value of card

Table 5

**NON-CASH PAYMENT INSTRUMENTS  
USED IN LATVIA**

	Volume (millions)				Value (billions of euro)			
	Customer credit transfers	Card payments	Direct debit, cheques, e-money payments and other payment instruments		Customer credit transfers	Card payments	Direct debit, cheques, e-money payments and other payment instruments	
<b>2016</b>	<b>156.0</b>	<b>242.8</b>	<b>0.5</b>	<b>399.3</b>	<b>284.8</b>	<b>4.6</b>	<b>0.2</b>	<b>289.6</b>
2015	145.9	215.2	0.1	361.2	361.9	4.2	0.0	366.1
2014	138.3	191.0	5.0	334.3	437.9	3.8	0.3	442.0
2013	139.7	151.6	6.4	297.7	575.7	3.2	0.3	579.2
2012	130.3	128.0	5.7	264.0	488.9	2.7	0.3	491.9

payments picked up by 12.8% and 8.6% respectively in comparison with 2015. Another widely used non-cash payment instrument was customers' credit transfers whose volume reached 156.0 million (annual growth of 6.0%), but their value stood at 284.8 billion euro (a decrease of 21.2%) in 2016. Other payment instruments, i.e. cheques, e-money payments and other payment instruments, were relatively seldom used.

In 2016, Latvijas Banka took part in ECB consultations and discussions by participating in the creation of a secure and harmonised payment market in Europe and by defending interests of Latvia's payment market. Latvijas Banka, in collaboration with the FCMC, continued to take an active part in the European Forum on the Security of Retail Payments established by the ECB. In the framework of the Forum, Latvijas Banka, in cooperation with the EBA, developed guidelines and technical standards on secure communication of market participants and strong user authentication stipulated by the revised Payments Services Directive<sup>1</sup>. Such technical standards are necessary to improve customer protection, enhance innovation and strengthen payment services security.

**FINANCIAL STABILITY**

In 2016, Latvijas Banka, in cooperation with the FCMC, provided analytical input to the development of the O-SII capital buffer requirements method and setting the level of capital buffer requirements. In October 2016, the FCMC took a decision to set the O-SII capital reserve requirements for six Latvian credit institutions.

Considering Latvijas Banka's expertise in the assessment of the economic development cycles, ESRB recommendations and best international practices, Latvijas Banka conducted an economic analysis fostering decision-taking regarding the countercyclical capital buffers for credit institutions. Latvijas Banka submitted the results of the above analysis to the FCMC – the authority responsible for setting the countercyclical capital buffer in Latvia.

Latvijas Banka continued to be active in providing advice to the Latvian government with regard to drafting the financial sector development plan, various legislative initiatives, regulations of the Cabinet of Ministers and other legal acts. Latvijas Banka delivered its opinion on draft EU legislation and draft amendments to it.

To improve the stress test methodology, a micro simulation model was created for stress-testing household financial sensitivity by employing the data obtained from the first household finance and consumption survey<sup>2</sup> conducted in Latvia. The methodology of vulnerability stress tests was also enhanced through the transition from credit institutions'

<sup>1</sup> Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No. 1093/2010, and repealing Directive 2007/64/EC.

<sup>2</sup> A joint project of the euro area countries coordinated by the ECB.



individual level reports to the consolidated reports. Thus, complete information on loans and debt securities of credit institutions' subsidiaries is taken into account in the consolidated stress test.

Latvijas Banka engaged in the work of the ECB Macroeprudential Forum and ECB Supervisory Board. Latvijas Banka, through its engagement in the implementation of the ECB macroprudential policy and in close cooperation with the FCMC, provided contribution to the assessment of systemic risks to financial stability in the euro area, the development of financial stability analysis tools and evaluation of macroprudential policy instruments by participating in the work of the Eurosystem/ESCB Financial Stability Committee and the relevant groups, i.e. the Macroeprudential Policy Group and Macroeprudential Analysis Group. At expert level, Latvijas Banka took an active part in the work of the subgroup of the ECB Macroeprudential Policy Group. This subgroup used micro level data to assess the impact of borrower-oriented macroprudential instruments on lending and the real estate market.

In parallel with the above euro area working groups, Latvijas Banka engaged in the work of the ESRB Advisory Technical Committee and its working groups (the Analysis Working Group and Instrument Working Group) and contributed to drafting ESRB policy and analysis documents and defining opinion.

In 2016, cooperation among the Nordic and Baltic countries in the field of financial stability continued and was enforced. Management level information exchange on financial stability issues between national central banks and national supervisory institutions continued in the framework of the Nordic-Baltic Macroeprudential Forum. Information exchange on financial stability and systemic risk issues was activated within the Nordic-Baltic Stability Group in a broader format by involving representatives of the ministries of finance of the above countries. A Memorandum of Understanding of the Nordic-Baltic national central banks on operation of cross-border banking groups in the Nordic-Baltic region was developed. Within the Nordic-Baltic Macroeprudential Forum, subgroups also continued to study the analytical issues of setting a countercyclical capital buffer rate and develop legal and practical aspects of the reciprocity of regulatory requirements.

## OPERATION OF THE CREDIT REGISTER

Latvijas Banka maintains the Credit Register which accumulates data on credit liabilities of and guarantees provided by natural and legal persons by collecting and storing in the Credit Register data on its participants' (credit institutions, credit institutions' subsidiaries (leasing companies), other companies having close links with credit institutions, credit unions, insurers and JSC *Attīstības finanšu institūcija Altum*) borrowers and borrowers' guarantors, their credits and delayed payments. When using the Credit Register data, its participants have an opportunity to assess the creditworthiness of the person which applies for credit or wants to provide a guarantee for other person's liabilities. Thus, the use of the Credit Register data enhances honest and responsible lending and borrowing, thereby strengthening Latvia's financial stability.

At the same time, the Credit Register provides information necessary for the fulfilment of Latvijas Banka's and FCMC's tasks, contributes to the execution of the ESCB's tasks as well as presents additional opportunities for public institutions to receive data for the purpose of the analysis to be carried out within the framework of the tasks stipulated by laws and regulations.

Latvijas Banka makes it possible for any person to receive Credit Register data pertaining to him/her/it free of charge. In 2016, 4.8 thousand persons (4.5 thousand persons in 2015) used this opportunity by arriving at Latvijas Banka in person. Meanwhile, a

natural person can immediately receive the Credit Register data pertaining to him/her electronically on the website <https://manidati.kreg.lv>. Over the year, natural persons requested information about themselves electronically 949 times (911 times in 2015). The Credit Register participants submitted 12.4 million requests (12.8 million requests in 2015) to the Credit Register for the purpose of the assessment of the creditworthiness of their current or potential borrowers and borrowers' guarantors.

In 2016, Latvijas Banka continued to take care of the quality of the data contained in the Credit Register and the rationale behind the requests by checking activities undertaken by Credit Register participants. At the same time, Latvijas Banka enhanced the Credit Register's functionality by adding the possibility for the Credit Register participants to reflect more accurately the cases of actual termination of the borrower's individual obligations.

In 2016, Latvijas Banka commenced a comprehensive improvement of the Credit Register to implement the requirements of Regulation (EU) No. 2016/867 of the European Central Bank of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13) and to integrate the functionality of the FCMC internal assessment system of the structure of credit institutions' loan portfolios (hereinafter, the KREDIS system) as well as to expand the range of the Credit Register participants to include the Treasury. In implementing the requirements of the Regulation, the national central banks of the euro area will include detailed data on credits granted to legal persons by credit institutions in the Analytical Credit Datasets. The Eurosystem, ESCB and ESRB need such detailed information for successful execution of their tasks. Meanwhile, the expansion of the Credit Register by supplementing it with information necessary for the execution of FCMC tasks will provide an opportunity to cease the use of the KREDIS system in the future by reducing the information provision burden for Credit Register participants, i.e. credit institutions, and by ensuring the resource optimisation provided by the use of a single information system. The implementation of this project will also additionally contribute to the execution of FCMC and Latvijas Banka's tasks.

At the end of 2016, the Credit Register comprised 105 participants which authorised 788 users to work with the Credit Register (104 participants and 775 users respectively in 2015). The Credit Register contained data on 4.2 million obligations, of which 1.2 million obligations were outstanding ones, pertaining to 1.1 million persons (at the end of 2015, on 3.9 million obligations pertaining to 1.1 million persons). The total outstanding obligations of the Credit Register participants amounted to 20.0 billion euro (20.2 billion euro at the end of 2015).

## STATISTICS

Latvijas Banka collects and compiles financial and monetary statistics and balance of payments statistics as well as prepares quarterly financial account statistics and government finance statistics. Following the ECB's request, Latvijas Banka has also been involved in addressing the methodology-related issues of some fields of economic statistics and compiling specific aggregates.

Latvijas Banka employs statistical data to perform financial and macroeconomic analyses as well as raise public awareness of the developments in the financial sector and the economy. The ECB uses statistical data produced by Latvijas Banka to compile the Eurosystem's monetary statistics and the relevant statistics of the euro area as well as to discharge its other tasks.

Latvijas Banka continued to provide the regular statistical data to the ECB, BIS, Eurostat, OECD, the World Bank and IMF and statistical information to other domestic and foreign data users. To furnish timely information to a wide range of data users, Latvijas

Banka disseminated financial and monetary statistics, balance of payments statistics and quarterly financial account statistics of Latvia via its regular publications and the website and compiled data for publishing in the ECB publications and Statistical Data Warehouse as well as in the IMF publications and website, and within the framework of the IMF Special Data Dissemination Standard. Latvijas Banka complemented the range of financial soundness indicators with new indicators for transmission to the IMF as well as participated in the IMF's Financial Access Survey, reporting data on the access to and scope of the services provided to households by Latvia's financial institutions. Latvijas Banka also took part in the campaign organised by the ECB to familiarise users with the contents and features of the ESCB statistics site "Our Statistics" as well as participated in producing information on the current account of the euro area balance of payments published in the section "Insights into Euro Area Statistics" of this site.

In 2016, Latvijas Banka made public the statistical programme of the current year and the medium-term statistical work programme for the period until 2020 for the first time. Latvijas Banka's annual statistical programme aims to provide information on the key tasks of Latvijas Banka in the area of statistics, types of statistics collected and published by the central bank, the legal framework, frequency and deadlines for compilation of these statistics, reporting agents and main users of the respective statistical data as well as on data publication deadlines. The objective of the medium-term statistical programme of Latvijas Banka is to ensure transparent information on statistical activities planned by Latvijas Banka in the longer term. It includes the most important planned tasks, their brief description, the planned deadlines, expected results and impact on reporting agents.

#### FINANCIAL AND MONETARY STATISTICS

In 2016, the compilation of statistical data in accordance with the requirements of the ECB and other data users was successfully ensured in the field of financial and monetary statistics. In addition, selected methodological issues were examined as well as statistical data analysis and control tools were improved for the purpose of data quality assurance. At the same time, Latvijas Banka ensured the implementation of the requirements laid down in Regulation (EU) No. 1374/2014 of the European Central Bank of 28 November 2014 on statistical reporting requirements for insurance corporations (ECB/2014/50) and in the Guideline of the European Central Bank of 4 April 2014 on monetary and financial statistics (2014/810/EU) by using the host country approach that envisages data collection and compilation about resident insurance corporations. Thus, the new task included in the Statistical Programme of Latvijas Banka for 2016 was fulfilled. In order to implement the new requirements laid down in the above Guideline in relation to drawing up lists of financial institutions for the needs of the ECB Register of Institutions and Affiliates Database (RIAD), Latvijas Banka started to compile and send on a regular basis to the ECB the basic information on insurance corporations necessary also for the RIAD.

In 2016, Latvijas Banka together with other national central banks of the EU countries and the ECB examined several methodological issues with regard to further harmonisation of MFI balance sheet data at the euro area level. Explanations in relation to recording of credit institutions' own shares, reverse repos, securities lending transactions, capital and its components as well as irrevocable payment liabilities in the monthly financial position report in Latvia were produced. Latvijas Banka provided information for the purposes of an ECB study on the revision policy and practice as well as quality controls used by the EU Member States in the field of MFI interest rate statistics. The results obtained will be employed by the ECB to amend the Guideline of the European Central Bank of 4 April 2014 on monetary and financial statistics (2014/810/EU) and the Manual on Interest Rate Statistics as well as to establish a requirement to start the provision of individual data in 2017.

In 2016, Latvijas Banka's experts started participating in several ESCB expert working

groups aimed at making proposals designed to enhance the quality of interest rate statistics, improve the RIAD and establish the European Reporting Framework.

#### BALANCE OF PAYMENTS STATISTICS

Additional data sources were introduced in the compilation of the balance of payments statistics in 2016. The use of Land Register data was commenced to reflect information on the real estate purchased by non-residents in Latvia more accurately.

The range of data published in Latvijas Banka's internet statistical database INTS was expanded. In addition to the previous directional principle, i.e. direct investment in Latvia and direct investment abroad, direct investment data were reflected in the balance of payments and international investment position according to the principle of assets and liabilities. Following this principle, all claims of a Latvian enterprise against direct investors, direct investment enterprises or fellow enterprises are recorded as assets, while liabilities of a Latvian enterprise to direct investors, direct investment enterprises or fellow enterprises are recorded as liabilities. In 2016, publication of data on international trade in services by country was also commenced.

#### GENERAL ECONOMIC AND GOVERNMENT FINANCE STATISTICS

In the fourth quarter of 2016, the revision of annual quarterly financial account statistics was carried out in compliance with the revision policy harmonised at the EU level. Data for the period from the fourth quarter of 2014 to the second quarter of 2016 were revised and published.

In accordance with the Statistical Programme of Latvijas Banka for 2016, Latvijas Banka's internet statistical database INTS was expanded by adding data on quarterly financial account statistics. User-friendly standard tables of quarterly financial accounts in the breakdown by financial instrument and sector of quarterly financial accounts as well as by financial instrument sector and counterparty sector have been produced.

Latvijas Banka organised its first household finance and consumption survey in line with the ECB requirements, using the single methodology. In compliance with the Statistical Programme of Latvijas Banka for 2016, the obtained survey data on households' real assets and their financing, credit constraints, other liabilities, private business, financial assets, employment, pensions, income, transfers and consumption were processed and compiled. The survey results were not published in 2016 as checking and analysing the obtained information at the euro area level was more time-consuming than planned.

#### PROVIDING FINANCIAL SERVICES TO THE GOVERNMENT

In order to facilitate efficient and safe budgetary payments, Latvijas Banka ensures the management of the Treasury's current accounts opened with Latvijas Banka. The Treasury uses payment services provided by Latvijas Banka for effecting settlement and also participates in the payment systems of Latvijas Banka in the capacity of a direct participant. In 2016, the Treasury had settlement accounts in euro and foreign currencies with Latvijas Banka. Over the year, Latvijas Banka settled 0.9 thousand payments of the Treasury in euro and foreign currencies totalling 6.0 billion euro.

#### ADVISORY SERVICES TO THE GOVERNMENT AND OTHER INSTITUTIONS

One of the tasks of Latvijas Banka is to advise the Saeima and the Cabinet of Ministers of the Republic of Latvia on monetary policy and other issues related to the performance of the tasks of Latvijas Banka.

In 2016, the Governor of Latvijas Banka, other officials of Latvijas Banka and its employees held regular meetings with the representatives of the Saeima and the government of the Republic of Latvia, including participation in the meetings of the committees of the Saeima and the Cabinet of Ministers, and in the work of several committees established by the government, providing an opinion on the financial and economic development issues as well as recommendations on structural reforms, inter alia, in the sectors of health care and education.

Employees of Latvijas Banka contributed to the promotion of Latvia's economic development by participating in different working groups and professional organisations, sharing experience and providing advice to them, including in the process of drafting legal acts and their amendments regulating the financial sector, financial services, anti-money laundering and combating the financing of terrorism and other areas.

Experts of Latvijas Banka provided support for the government enabling Latvia to take an active part in the EU and the OECD, as well as ensured the provision of information to and its exchange with the international rating agencies.

Employees of Latvijas Banka participated in the work of the Supervisory Committees and sub-committees of the EU structural funds and the Cohesion Fund; they provided advice on the drafting of the planning documents of the EU budget programming period 2014–2020 and were involved in the assessment supervision with regard to the use of financing from the EU structural funds and the assessment of project applications in selected fields.

Representatives of Latvijas Banka participated in the Fiscal Discipline Council of the Republic of Latvia and its working groups, providing advice on the assessment of the output gap, fiscal risks and the fiscal security reserve for the purpose of drawing up the Fiscal Discipline Compliance Report on the draft state budget for 2017 and draft budget frameworks for 2018 and 2019. With regard to the government expenditure, experts of Latvijas Banka engaged in the work of several working groups providing recommendations on more effective use of state budgetary funds.

Employees of Latvijas Banka in their capacity as experts continued to participate in preparing the notification data of general government budget deficit and debt for 2015 and dealing with the methodological issues related to accounting of the European System of National and Regional Accounts.

Experts of Latvijas Banka provided their recommendations and assessment as part of the process of drawing up the Tax Policy Guidelines for 2018–2021 and the Financial Sector Development Plan for 2017–2019.

Representatives of Latvijas Banka were engaged in the evaluation of the enterprises participating in a competition "Trademark of the Year" organised by the Patent Office of the Republic of Latvia and the Latvian Chamber of Commerce and Industry and a competition "Export and Innovation Award" organised by the Investment and Development Agency of Latvia in cooperation with the Ministry of Economics of the Republic of Latvia.

## **INFORMATION AND EDUCATIONAL FACILITIES PROVIDED TO THE PUBLIC**

### **IMPORTANT ASPECTS OF COMMUNICATION**

Information and education of public is an important activity of Latvijas Banka to enable the public to assess comprehensively the macroeconomic development and the impact monetary and other policies supporting advance in various areas exert on economic growth, competitiveness, business activities and public wellbeing.

In 2016, Latvijas Banka continued to inform the public about Eurosystem's significant monetary policy decisions and Latvijas Banka's participation in their implementation. Based on economic expert analysis, Latvijas Banka actively voiced its stance on the economic development in Latvia and euro area. At regular press conferences, the Governor of Latvijas Banka provided information about the economic growth and challenges in both the euro area and Latvia, necessary reforms, fiscal discipline, and decisions taken by the ECB's Governing Council (see Appendix 7).

In 2016, Latvijas Banka focused on several issues crucial for Latvia's population and economic development. The structural reform process has become increasingly pressing both in Latvia and the euro area. To strengthen competitiveness of the economy, changes in education and health as well as improvements in the legal and business environment are particularly important. In these areas, Latvijas Banka presented its mandatory health insurance concept, explaining it to the sector and public at large, came forth with recommendations for improving various segments of education, and defined the role of reasonable fiscal policy and stable tax policy.

Studies confirm that the inhabitants of Latvia have approved of the euro bank notes as being secure, settlement-friendly and quality means of payment. Moreover, Latvia keeps ranking among the euro area leaders in terms of awareness of the design and security features of the euro cash. To further promote this awareness, Latvijas Banka carried out an extensive information campaign devoted to the second (Europa series) issue of 50 euro banknotes to be put into circulation in the euro area in April 2017, and the take-over of functions of the national counterfeit centre as of 1 July 2016. The bank also provided an insight into its cash handling activities and duties of currency security experts. Information has been disseminated among the public on steps to be taken if a bank note is damaged or suspected counterfeit.

People in Latvia have been informed about the on-going preparations to launch infrastructure for instant or immediate payments, which will enable customers to make instant payments 24/7/365 in 2017.

In the autumn of 2016, Latvijas Banka presented to the public and its cooperation partners a programme the bank is going to implement within the celebrations of Latvia's centenary. The presentation of the collector coin "Gold Brooches. The Disc Fibula" introduced Latvijas Banka's participation in this 100th anniversary celebration programme. A competition of children's drawings "My Latvia" to select a design for a collector coin to be issued in 2018 was announced in 2016.

## PUBLICATIONS

Latvijas Banka continued to prepare a wide range of regular publications. Incorporating the data provided by Latvijas Banka, the CSB, the Ministry of Finance of the Republic of Latvia, the FCMC and other institutions, the Macroeconomic Developments Report, issued in June and December, discussed the issues of external sector, financial market, domestic demand and supply, costs and prices, and balance of payments, as well as presented GDP and inflation forecasts. The balance of payments statistics compiled by Latvijas Banka are published in *Latvijas Maksājumu Bilance*. Latvia's Balance of Payments (2015), while the publication Financial Stability Report assessed major stability risks. In 2016, five working papers by Latvijas Banka's specialists were published on the websites of Latvijas Banka (see Appendix 6).

In compliance with the requirements of the Statute of the ESCB and the ECB, Latvijas Banka ensured the Latvian translation of the ECB's Annual Report 2015, the Summary of the ECB's Convergence Report of June 2016, and the ECB's Economic Bulletin issues which were published after the monetary policy meetings of the Governing Council of the ECB in March, June, September and December (published on the Internet).

Economists of Latvijas Banka published their working papers on the websites of Latvijas Banka and respectable international peer-reviewed journals (*Baltic Journal of Economics*, *Journal of International Money and Finance*, ECB Working Paper Series, ECB Occasional Paper Series, *VoxEU* and other).

Throughout the year overall, more than 14 000 publications on issues concerning the activities of Latvijas Banka and the macroeconomic and financial analysis appeared in different mass media in Latvia, more than 650 journalists' questions were answered, and over 130 interviews with Latvijas Banka's management, economists and other specialists were published.

#### LATVIJAS BANKA WEBSITES

To disseminate information about the operation of the Eurosystem and goals and instruments of monetary policy to public at large, Latvijas Banka publishes, on a regular basis, its expert commentaries on the decisions taken by the ECB's Governing Council and the development of financial markets and economy in the euro area on its website [www.bank.lv](http://www.bank.lv). Information about the use and performance of monetary policy instruments has been published.

A survey conducted by SIA TNS Latvia in 2016 shows that it is Latvijas Banka's opinion about economic processes and forecasts for Latvia and the euro area that the country's economic experts, analysts and academia largely rely on. Latvijas Banka shares most important macroeconomic data, their analysis and research, as well as commentaries of its economists on developments in the Latvian and global economy via its Internet communication channel [www.macroeconomics.lv](http://www.macroeconomics.lv). In comparison with 2015, the number of visitors of this website has increased by 8%. Among the most popular topics are economic growth forecasts provided by Latvijas Banka, materials of its annual scientific conference, various economic sector reviews, and economic updates.

The content of Latvijas Banka's economic literacy website "Money School" was regularly updated and enriched with short films, exercises, tests, presentations to be used during lessons, methodological recommendations and other similar materials to assist the teachers of social sciences and economics.

#### ANNUAL CONFERENCE AND EXPERT ROUNDTABLE DISCUSSIONS

On 28 September 2016, Latvijas Banka hosted its annual conference on economy, which, as a follow-up of the discussion about the need to implement structural reforms which started two years ago, dealt with structural reforms in the health and education sectors. At the conference "Reforms – Key to Competitiveness and Growth", economists of Latvijas Banka, sector experts and policy decision makers sought for solutions by which to improve the quality in health care and education and optimise the allocation of resources therein to create thereby a perspective for growth, investments and competitiveness. The conference was attended by policy makers, managers and specialists of leading health and educational institutions, and media representatives. It was also webcast, and more than 1 000 viewers followed this discussion.

To enhance the adoption of macroeconomic development-oriented decisions in the country and to encourage professional discussion on issues relevant for the Latvian economy as well as to share expertise regarding the latest developments in the euro area and globally, Latvijas Banka organised the traditional expert roundtable discussion. In 2016, the discussion focused on how to render Latvia's tax system stable and competitive, what are the ways of economic-growth-friendly distribution of the tax burden, and on additional opportunities for boosting budget revenue. Expert discussions were also devoted to the global economy's shifting centre of gravity and the outlook for Latvia's growth relative to the country's operation in the markets of China and the US. Representatives of credit

institutions and businesses discussed the effects of low interest rate environment and the impact of low interest rates on lending in Latvia. Latvijas Banka's online discussions and materials thereof are available on [www.makroekonomika.lv](http://www.makroekonomika.lv).

#### IMPROVEMENT OF ECONOMIC LITERACY

One of Latvijas Banka's activities is related to providing comprehensive information to public at large to improve their economic literacy via a long-term economic education programme for audiences of different population groups.

In 2016, leading economists of Latvijas Banka continued to deliver guest lectures to students of Latvia's universities on the euro area economy and monetary policy, instruments of economic governance, fiscal discipline and crisis management, payment instruments and payment systems in the world and in Latvia, living standards in Latvia, etc.

A competition of Student Scientific Research Papers was organised by Latvijas Banka already for the 14th time with a view to identify macroeconomic problems in Latvia and the euro area and analyse them by involving most talented would-be economists in this work. Overall, 13 papers by 20 contestants were submitted, with the authors of research coming from three Latvian higher educational establishments.

In 2016, Latvijas Banka continued its collaboration commenced in the previous year with the National Centre for Education and the Jelgava Spīdola Gymnasium by delivering in various cities of Latvia 42 educational lectures on security features of euro banknotes and coins for 3rd to 6th graders and at the same time encouraging students to take part in the competition "Euro Run", a game organised by Latvijas Banka in partnership with the ECB; likewise, eight seminars for primary school and social sciences teachers were held. The methodology of educational classes, developed jointly with the students of Jelgava Spīdola Gymnasium, and the educational campaign carried out in Latvia earned high international esteem: the project won the main prize in the nomination "Outstanding Youth Economic Citizenship Award" at the educational project competition initiated by the international non-profit organisation Child & Youth Finance International (CYFI).

The students from Latvian schools who participated in the on-line "Euro Run" game for the first time were very active and demonstrated excellent knowledge. 23% of all euro area participants registered for the competition represented Latvia; of 100 contenders with the highest score 47 came from Latvia; of 10 contestants with the highest score 8 young people were from Latvia.

In the summer of 2016, a regular seminar "Topical Economic Issues" was organised at Latvijas Banka, enabling the teachers of economics and commercial sciences to improve their understanding of macroeconomic issues.

To pursue the aims and to fulfil the tasks set down in the financial literacy strategy for Latvian population aimed at improving their macroeconomic literacy, Latvijas Banka took part in the projects initiated by its cooperation partners in 2016, the Financial Education Week, Security Days, and summer school "Alfa" for talented Latvian youth among them. In partnership with Junior Achievement – Young Enterprise Latvija, the central bank organised the final of the competition "My Dictionary" for primary school students for the fourth consecutive year, thus enhancing their discourse skills on economic issues when communicating with the public of different generations.

Latvijas Banka is carrying out a gradual redesigning of the interactive centre for financial education and information "Money World". The expansion of the content and showcases layout and the introduction of a new guided tour service solution will enable the centre to increase the number of visitors and make the centre more accessible. Redesigning of



the exposition content is implemented by Latvijas Banka's specialists who are advised by experts of financial, education and other sectors, while the interactive part is created by companies specialising in exposition and multimedia and attracted to the project via public procurement procedure.

## **COOPERATION WITH INTERNATIONAL ORGANISATIONS AND FOREIGN CENTRAL BANKS**

Latvijas Banka is the representative of the Republic of Latvia in foreign central banks and international financial institutions. Latvijas Banka may participate in operations of other international financial and credit organisations consistent with its objectives and tasks.

In 2016, Latvijas Banka continued to represent Latvia's interests at meetings of the IMF Board of Governors and in the coordination of operational issues. Priorities of the IMF policy were mainly related to the developments in the global economy and the global financial system. To ensure stronger growth, the IMF urged to follow a balanced three-pillar policy path – growth-friendly fiscal policy, structural reforms and accommodative monetary policy. At the same time, it is necessary to increasingly focus on the development of globalisation and technologies and to promote the positive benefits to the public. The IMF analysed developments in the international monetary system and the possible need to strengthen the global financial safety net as well as reviewed the adequacy of the IMF resources. The improvement of the 15th review of quotas and the review of the quota formula calculating the quota share are still underway.

Latvia's interests in the IMF were represented in the Nordic-Baltic Constituency that includes Denmark, Estonia, Iceland, Latvia, Lithuania, Norway, Finland and Sweden. One Executive Director represented this constituency on the IMF Executive Board, with a total of 3.3% votes.

Representatives of Latvijas Banka continued to participate in the work of the Nordic-Baltic Monetary and Financial Committee established for setting strategic directions and laying down guidelines and developing a joint opinion on operational issues of the IMF.

In 2016, cooperation with the IMF, based on consultations under Article IV of the IMF Articles of Agreement, continued.

In 2016, Latvijas Banka continued its membership in the BIS.

In 2016, cooperation among the Nordic and Baltic countries continued in the field of financial stability, inter alia, a meeting of the Working Group on Reciprocal Recognition of the Regulatory Requirements of the Nordic-Baltic Macro-prudential Forum was held in Riga in January, but a seminar for experts of the national central banks of these countries on financial stability issues was organised in September.

Cooperation among the national central banks of the Baltic States continued. A seminar for researchers of these national central banks was held in March, but a seminar for experts on communication and risk management issues – in May.

Several external meetings of the Eurosystem/ESCB Committees and their Working Groups as well as other events were organised in Riga in 2016. In April, Latvijas Banka, jointly with the ECB, organised the closing event of the game for students "Euro Run" aimed at promoting financial literacy. In June, Latvijas Banka held a meeting and seminar of the Working Group on Public Finance of the Eurosystem/ESCB Monetary Policy Committee on topical public finance management issues, in September, a meeting of the Eurosystem/ESCB Committee on Controlling was organised, but in October – a meeting of the Economics Statistics Working Group of the Eurosystem/ESCB Statistics

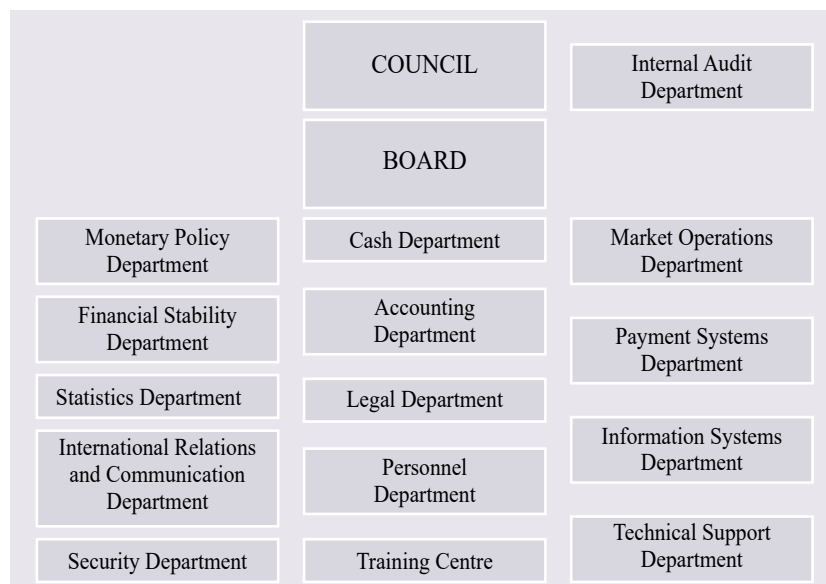
Committee. In 2016, Latvijas Banka held several ESCB and SSM training workshops for improving different professional skills.

In 2016, cooperation with the National Bank of Belarus continued as part of experience exchange visits. Employees of Latvijas Banka also advised experts of the National Bank of Tajikistan on accounting and financial issues as well as presented the exhibition design principles practiced by an educational visitors centre and shared its operational planning expertise with the experts of the Central Bank of the Russian Federation.

In 2016, international financial organisations and foreign central banks extended support to Latvijas Banka, providing opportunities to participate in the workshops and courses hosted by these institutions. Employees of Latvijas Banka participated in courses, seminars and conferences organised by the ECB, EC, IMF, Joint Vienna Institute, Study Center Gerzensee, Federal Reserve Bank of New York, as well as by the central banks of the UK, France, Italy, Lithuania, the Netherlands, Portugal, and Turkey.

MANAGEMENT AND ORGANISATION OF LATVIJAS BANKA





THE COUNCIL OF LATVIJAS BANKA

The Council of Latvijas Banka takes decisions on behalf of Latvijas Banka. The term of office of the Governor, Deputy Governor and Members of the Council of Latvijas Banka is six years. At the end of 2016, the composition of the Council of Latvijas Banka was as follows:

- Governor **Ilmārs Rimšēvičs;**
- Deputy Governor **Zoja Razmusa;**
- Members of the Council<sup>1</sup>: **Edvards Kušners,**  
**Vita Pilsuma,**  
**Arvils Sautiņš,**  
**Aivars Skopiņš.**

Meetings of the Council of Latvijas Banka are held as appropriate, but at least once a quarter. The Council of Latvijas Banka held 11 meetings in 2016. When performing the tasks stipulated in the Law on Latvijas Banka, the Council of Latvijas Banka adopted 106 legal acts overall in 2016 regarding the use of monetary policy instruments, investment management, provision of currency in circulation, the operation and oversight of the payment and securities settlement systems, operation of the Credit Register, licensing and supervising of the purchase and sales of foreign currency and other issues pertaining to the operation, management and organisation of Latvijas Banka.

THE BOARD OF LATVIJAS BANKA

To carry out and manage day-to-day activities of Latvijas Banka, the Council of Latvijas Banka has established the Board of Latvijas Banka that performs activities on a continuous basis. At the end of 2016, its composition was as follows:

- Chairman of the Board **Māris Kālis;**
- Deputy Chairperson of the Board **Ilze Posuma;**
- Members of the Board: **Jānis Blūms,**  
**Jānis Caune,**  
**Harijs Ozols,**  
**Raivo Vanags.**

<sup>1</sup> Two positions of the member of the Council of Latvijas Banka were vacant at the end of 2016. Pursuant to the Amendments to the Law on Latvijas Banka (in effect as of 19 January 2017), the Council of Latvijas Banka comprises the Governor, the Deputy Governor and four Members of the Council.

The Board of Latvijas Banka conducted daily activities of Latvijas Banka in compliance with the requirements of the Law on Latvijas Banka and other legal acts, as well as by implementing decisions of the Council of Latvijas Banka.

#### EMPLOYEES OF LATVIJAS BANKA

At the end of 2016, the number of Latvijas Banka employees was 539, of which 22 had fixed-term employment contract (compared with 540 and 22 employees at the end of 2015, respectively). At the end of 2016, the staff of Latvijas Banka was 57% male and 43% female. Structural improvements continued at Latvijas Banka in 2016. To provide for more efficient synergies between the international and EU economic and financial processes and the ECB's engagement in them, the functions of the Governor's Office were delegated to the International Relations and Communication Department in March 2016, while ensuring more rational coordination of the EU and Eurosystem related issues.

The Counsellor of Latvijas Banka worked at the Permanent Representation of Latvia to the EU in 2016.

#### COMMISSIONS, COMMITTEES AND WORKING GROUPS OF LATVIJAS BANKA

In order to ensure quality performance of tasks of Latvijas Banka, several committees, commissions and working groups approved by the Council of Latvijas Banka, the Governor of Latvijas Banka or the Board of Latvijas Banka continued their work in 2016.

Along with the takeover of the functions of the National Analysis Centre and the Coin National Analysis Centre, the Commission for Management of Banknotes and Coins of Latvijas Banka replacing the Commission for Examination of Banknotes and Coins and for Controlling Cash Processing of Latvijas Banka and deciding on the replacement of damaged euro and lats banknotes and coins in circulation, exercising control of the identification, accounting, storage and destruction of banknotes and coins having signs of counterfeiting and counterfeits, registering cash processing institutions and cancelling their registration as well as controlling the operation of cash processing institutions started operation on 1 July 2016.

To ensure fulfilment of the requirements specified for purchasing and selling foreign currency as a financial service, the Licensing Committee of Latvijas Banka issued, re-registered and rewrote licences for purchasing and selling foreign currency to capital companies as a commercial activity and controlled operation of the licensed capital companies.

The Operational Risk Management Committee of Latvijas Banka monitored the operational risk management at Latvijas Banka. A wide range of issues related to security were addressed by the Security Oversight Commission of Latvijas Banka. At the same time, the Information Systems Management Committee of Latvijas Banka monitored and coordinated issues related to the operation and development of Latvijas Banka's information systems, as well as personal data processing.

The Ethics Committee of Latvijas Banka monitored the implementation of the "Code of Conduct of Latvijas Banka".

The Budget Commission of Latvijas Banka, whose aim is to facilitate proper utilisation of financial resources of Latvijas Banka, contributed to the operational management of Latvijas Banka. The Standing Commission for Procurement of Latvijas Banka achieved this objective in the area of procurements organised by Latvijas Banka. The Investment Committee of Latvijas Banka developed and defined a strategy for and made tactical decisions in managing financial assets and gold.

The Audit Committee of Latvijas Banka authorised by the Council of Latvijas Banka carried out the oversight of the internal audit function, activities of the external auditors of Latvijas Banka and preparation of financial statements, as well as enhanced the functioning of the internal control system of Latvijas Banka.

## COMMISSIONS AND COMMITTEES OF LATVIJAS BANKA AT THE END OF 2016

The Audit Committee of Latvijas Banka	The Ethics Committee of Latvijas Banka
The Budget Commission of Latvijas Banka	The Information Systems Management Committee of Latvijas Banka
The Coin Design Commission of Latvijas Banka	The Investment Committee of Latvijas Banka
The Commission for Management of Banknotes and Coins of Latvijas Banka	The Licensing Committee of Latvijas Banka
The Commission for Evaluation of Gifts and Disposal and Write-off of Movable Assets of Latvijas Banka	The Operational Risk Management Committee of Latvijas Banka
The Commission for Optimisation of Work Premises of Latvijas Banka	The Security Oversight Commission of Latvijas Banka
The Document and Archives Management Expert Commission of Latvijas Banka	The Standing Commission for Procurement of Latvijas Banka

## MANAGEMENT PRINCIPLES AND DEVELOPMENT

Management of Latvijas Banka ensures quality performance of the tasks stipulated in the Law on Latvijas Banka and other legal acts. The management model of Latvijas Banka provides an opportunity to measure the results achieved vis-à-vis customers, employees and general public as well as enables detection of gaps in the areas of strategies, resources, staff and processes management and leadership.

"Statement of Vision, Mission and Values of Latvijas Banka" and the strategic goals of Latvijas Banka form the basis for the operation and development planning. Every year, the progress towards achieving the set objectives is measured. At the same time, the execution of functions and processes is monitored daily and implementation of work plans is reviewed on a regular basis. Customer surveys are conducted biannually asking customers to assess the quality of Latvijas Banka's services, the level of their accessibility and convenience, and cooperation with the staff.

The customer survey of 2016 shows that the rating of the performance of the core functions is high (4.73 points out of 5), while the annual staff survey of 2016 assigns a high score for the quality of implementation of support functions (4.65 points out of 5).

## RESOURCE MANAGEMENT

### HUMAN RESOURCES

In 2016, Latvijas Banka continued to pursue its key principles of human resources policy by hiring qualified and professional employees as a result of an effective staff recruitment process and establishing long-term employment relationships, creating a motivating working environment and enhancing professional development opportunities.

Like in previous years, Latvijas Banka used staff rotation and promotion to foster personnel development and career. Within a short-term ESCB secondment programme three staff members went to the ECB to complement their work experience at the Directorate General Macro-prudential Supervision II, the Directorate General Communications and Directorate General Economics, but one employee continued her work at the Directorate Banknotes of the ECB. The employee of Latvijas Banka appointed

as the Adviser to the Executive Director of the Nordic-Baltic Constituency of the IMF in 2015 continued her work.

Staff of Latvijas Banka continued to broaden their professional expertise in the fields of monetary policy, financial stability, macroeconomics, econometrics, financial market, financial institution supervision, statistics, financial accounting, internal audit, personnel management, law, risk management, securities operations, cash processing supervision and information technologies. Several employees of Latvijas Banka developed further their professional knowledge by participating in international professional certification programmes.

Latvijas Banka's staff training costs amounted to 1.4% of the total expenses on remuneration (1.7% in 2015).

## FINANCIAL RESOURCES

The financial management system of Latvijas Banka has been developed in a way that it ensures support to decision making, financial risk management and efficient use of financial resources.

Latvijas Banka primarily finances its operation from the income generated from managing financial assets. Latvijas Banka does not receive financing from the state budget. Instead, it transfers 65% of the profit made during the reporting year to the state budget. In 2016, Latvijas Banka recorded profits of 11.8 million euro, of which 7.7 million euro are to be transferred to the state budget. Latvijas Banka has contributed to the state budget a total of 142.8 million euro from its profit earned between 2011 and 2015.

Major financial transactions of Latvijas Banka are related to the management of financial assets and implementation of monetary policy. Financial assets are managed in compliance with the basic principles set out in the "Guidelines for Managing Financial Assets and Gold of Latvijas Banka" adopted by the Council of Latvijas Banka. They include preserving the value of investments, ensuring their liquidity and earning income within the framework of acceptable risk standards without contradicting the monetary policy implemented by the Eurosystem. Meanwhile, operations related to the implementation of monetary policy are performed by Latvijas Banka in line with the "Procedure for Participation in the Eurosystem Monetary Policy Operations Organised by Latvijas Banka" adopted by the Council of Latvijas Banka.

In order to ensure comprehensive and transparent information about financial transactions, financial risks and their management, as well as about performance results of Latvijas Banka, it prepares and publishes annual financial statements. They are drafted in accordance with the mandatory requirements of the ECB legal framework for accounting and financial reporting binding on the ESCB and in line with the "Financial Accounting Policy of Latvijas Banka", adopted by the Council of Latvijas Banka, by organising accounting in compliance with the "Financial Accounting Regulation of Latvijas Banka", adopted by the Board of Latvijas Banka, and other regulations of Latvijas Banka pursuant to the Law on Latvijas Banka and requirements of other laws and regulations of the Republic of Latvia binding on Latvijas Banka.

Latvijas Banka publishes a monthly closing balance sheet and Notes to it, as well as other financial information available also on the website of Latvijas Banka. Latvijas Banka's integrated information system ensures a standardised, automated, safe and efficient execution of financial transactions of Latvijas Banka, their uniform accounting and drawing up of financial statements. Within the framework of the internal financial control system, the management of Latvijas Banka regularly assesses changes in assets and liabilities, as well as in income and expenses of Latvijas Banka, paying particular attention both to the results of investment management and compliance of operating costs and long-term investments with the approved budget of Latvijas Banka. The Council of

Latvijas Banka approves the annual budget of Latvijas Banka; the management of the budget is carried out according to the "Regulation for Managing the Budget of Latvijas Banka" adopted by the Council of Latvijas Banka and aimed at ensuring efficient use of Latvijas Banka's financial resources. The Regulation provides for the procedure of drafting, approving and monitoring the execution of Latvijas Banka's budget. Within the budget management framework, Latvijas Banka assesses the effectiveness, costs and human resources of each project on a continuous basis in order to ensure efficient use of funds. To assure the independence of internal audit, the Council of Latvijas Banka also approves an expenditure plan for the Internal Audit Department.

The Budget Commission, set up by the Council of Latvijas Banka, evaluates the draft budget prepared by the Board of Latvijas Banka and oversees the budget execution. The Board of Latvijas Banka, together with the heads of the relevant structural units of Latvijas Banka, draws up the draft budget and submits it to the Budget Commission and the Council of Latvijas Banka, as well as controls the budget execution and report on it on a regular basis.

## INFRASTRUCTURE RESOURCES

### **Engineering and technical infrastructure resources**

Latvijas Banka provides and maintains infrastructure necessary for its operation. Construction works necessary for the maintenance of buildings were carried out in the buildings of Latvijas Banka in Riga and the building of the Training Centre.

Renovation of the roof and its covering constructions of Latvijas Banka's building at K. Valdemāra iela 2A, Riga, started in 2015 was completed in 2016 in order to enhance the protection of the national architectural heritage against the adverse environmental impact and support its safety and energy efficiency.

### **Resources of information technologies**

In 2016, all websites of Latvijas Banka were deployed increasingly using cloud computing services allowing better availability and flexible resource management, thus enabling quality performance of those websites also during high workloads. The use of the possibilities of cloud computing services in the testing of information systems and other areas was also launched.

The infrastructure of the wireless computer network was modernised, thus enabling higher quality, availability and security as well as flexibility in mutual separation of different types of use.

The workstation software platform was modernised by switching to the newest operating system and the office software providing users with wider and more convenient possibilities for use including the possibilities offered by cloud computing services to draft documents simultaneously and higher quality management possibilities and security solutions.

Security solutions and procedures were improved to mitigate risks associated with the most topical technological and other threats.

### **More efficient use of environmental resources**

Latvijas Banka is an environmentally friendly institution striving to ensure more efficient use of environmental resources.

Over time, several measures have been taken to reduce the usage of paper and, consequently, also resources required for its production. The document circulation has also been fully provided in electronic format, thus substantially reducing the need for document printing. Meanwhile, waste paper is recycled.



Raw material (toner, ink and paper) efficient printing mode of printers is used to ensure lower consumption of raw materials and required paper (by applying duplexing). The employees are encouraged to choose a more efficient printing mode by assessing the necessity of printing (colour material printing in particular). Using an enhanced security printout management system has limited the possibility of preparing a print-out by mistake.

As regards energy efficiency, Latvijas Banka also takes into account energy consumption of new equipment when implementing projects related to technical modernisation of equipment. Energy efficiency ratio is considered if upgrading hardware and other technical equipment.

Successful continuation of server and data array virtualisation and consolidation of their resources still leads to lower electricity consumption and heat generated by these recourses. Consequently, fewer resources are needed for their cooling.

## RISK MANAGEMENT

Latvijas Banka manages strategic, financial and operational risks. Latvijas Banka's risk management goals and basic principles are set in "The Risk Management Policy of Latvijas Banka", "The Business Continuity Management Policy of Latvijas Banka", "The Information and Information Systems Security Policy of Latvijas Banka", and "The Physical Security Policy of Latvijas Banka" adopted by the Council of Latvijas Banka. A comprehensive and uniform supervision of the implementation of these policies is carried out by the Security Oversight Commission of Latvijas Banka.

Financial risks including market risk (price, interest rate and currency risks), credit and liquidity risks of Latvijas Banka are managed to mitigate a potential negative impact on Latvijas Banka's finances as a result of adverse changes in financial market factors, a counterparty default or in relation to limited possibilities to dispose investment in a short time and at a competitive market price.

Financial risks related to Latvijas Banka's investment are managed in accordance with "The Procedure for Managing Financial Assets and Gold of Latvijas Banka" adopted by the Council of Latvijas Banka. Investment is managed by grouping it into different investment portfolios. The compliance with the parameters set for each type of investment portfolio and characterising the acceptable level of financial risks of the relevant investment portfolio and the return target is controlled by the Risk Management Division of the Market Operations Department. For the purpose of managing investment, including the related financial risks, the Investment Committee of Latvijas Banka develops an investment management strategy, approves investment tactics and sets detailed limits for financial risks, as well as oversees the operation of external investment managers. The Investment Committee of Latvijas Banka reviews the investment strategy once a quarter, but receives and reviews, on a weekly basis, reports on and forecasts for developments in financial markets prepared by financial investment portfolio managers, reports by financial risk managers, as well as approves investment management tactics for the forthcoming week. The Market Operations Department informs the Council and the Board of Latvijas Banka about the investment management results on a regular basis.

Operational risks of Latvijas Banka are managed to mitigate a potential negative impact on Latvijas Banka's operation, reputation or finances resulting from inadequate or erroneous execution of processes, actions, unavailability or inactions on the part of an employee, inadequate operation or unavailability of the infrastructure of information systems or the information systems of Latvijas Banka or the infrastructure of Latvijas Banka, or external events.

Latvijas Banka's operational risks are managed through processes and projects by identifying and assessing risks and, depending on the level of risk, opting for the most appropriate risk mitigation measures. The management of operational risks is organised by the Operational Risk Manager of Latvijas Banka and conducted, on a daily basis, by the structural units of Latvijas Banka, project managers and other employees of Latvijas Banka responsible for the execution of Latvijas Banka's processes. Operational risk management is supervised by the Operational Risk Management Committee of Latvijas Banka, appointed by the Board of Latvijas Banka, which ensures coordination of the measures to be carried out under the operational risk management process and provides support to the Board of Latvijas Banka in the area of risk management.

The business continuity management of Latvijas Banka is aimed at ensuring continuity of the processes critical to the performance of the core functions of Latvijas Banka or to the achievement of its objectives or, in case a critical process is interrupted, its re-establishment at an appropriate level and in an acceptable timeframe, as well as an efficient incident and crisis management.

Given the potential threats, preventive measures are taken to reduce the likelihood of discontinuity of the critical processes and the plans and organisational procedures for cases in which the implementation of the critical processes is jeopardised are prepared.

Security of information systems of Latvijas Banka is managed to prevent a potential negative impact on availability, security and integrity of the infrastructure and information systems of Latvijas Banka.

The information systems of Latvijas Banka are classified on the basis of their importance for the fulfilment of Latvijas Banka's tasks and in compliance with the confidentiality, integrity and availability requirements regarding the data to be processed, with the physical and logical protection commensurate with each level of classification being established.

The physical security risk including the risks associated with fire safety and civil protection of Latvijas Banka are managed to mitigate a potential negative impact on the physical security of persons present on the immovable property of Latvijas Banka, Latvijas Banka's premises and transportation of the cash and other valuables of Latvijas Banka.

Staff members were trained in the areas of information and information system security as well as operational risk management, including business continuity management.

## **INTERNAL AND EXTERNAL AUDIT**

By applying a systemic and planned approach, the internal audit provides the management of Latvijas Banka with an objective and independent evaluation of the effectiveness of Latvijas Banka's governance, risk management, control system and processes and advises on improvements in Latvijas Banka's operation. The internal audit at Latvijas Banka is conducted by the Internal Audit Department, while the Audit Committee of Latvijas Banka oversees the internal audit and supports its development. The internal audit is organised and conducted in accordance with "The Internal Audit Policy of Latvijas Banka" adopted by the Council of Latvijas Banka and the Regulation of the Internal Audit Department. It is carried out in line with the "International Standards for the Professional Practice of Internal Auditing" and the "Code of Ethics" of the Institute of Internal Auditors.

The compliance of internal audit activities with the "International Standards for the Professional Practice of Internal Auditing" and the "Code of Ethics" of the Institute of Internal Auditors has been attested by the external assessment of internal audit quality made by SIA "PricewaterhouseCoopers" in 2015.

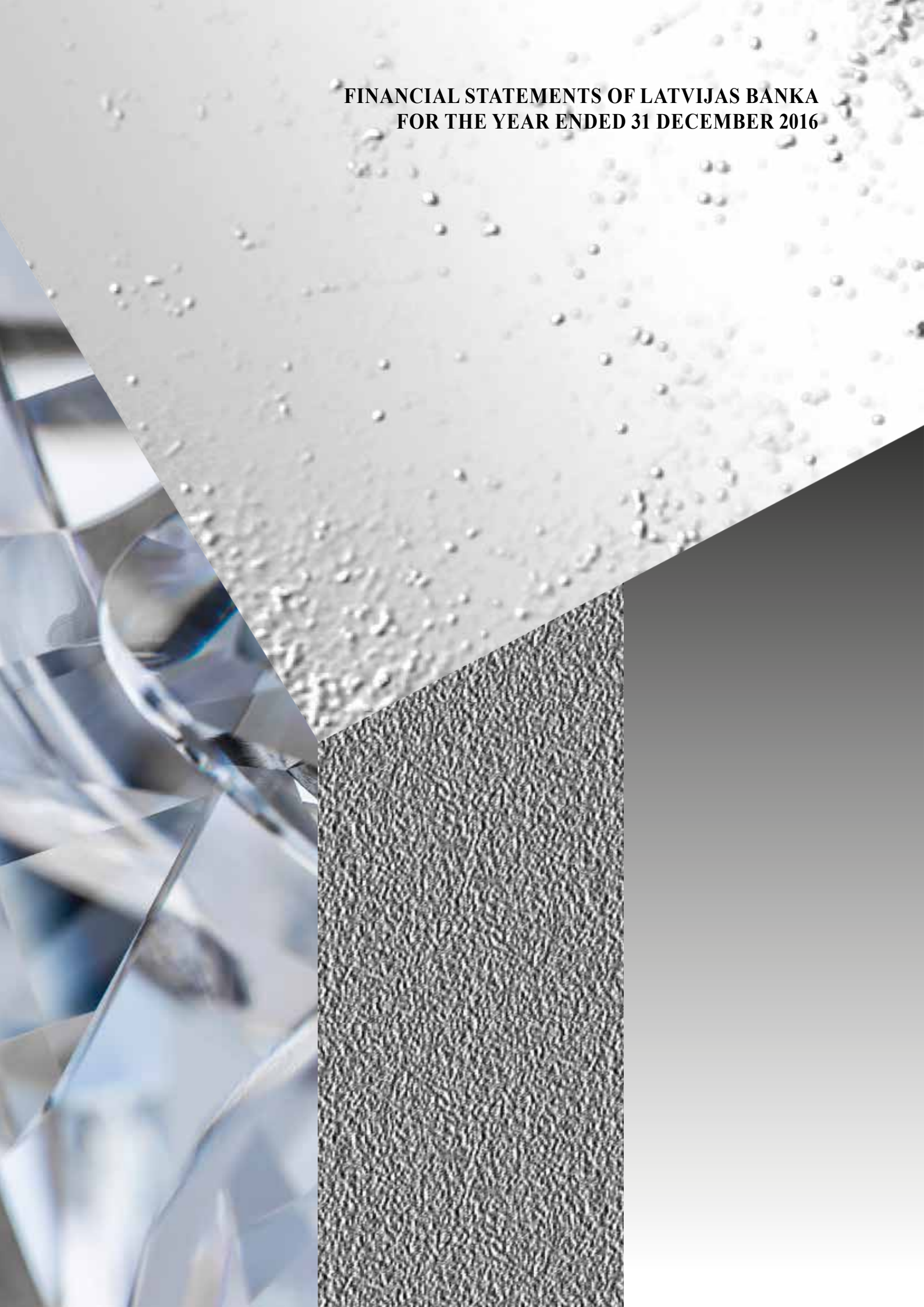
The internal audit covers all business areas of Latvijas Banka. Internal audits are planned and conducted using a risk based approach. The Head of the Internal Audit Department reports the outcome of each internal audit to the Governor and the Audit Committee of Latvijas Banka. The Audit Committee of Latvijas Banka jointly with the Head of the Internal Audit Department reviews the internal audit findings, recommendations and their implementation on a quarterly basis. The results of internal audit activities are reported to the Council of Latvijas Banka on an annual basis.

The Internal Audit Department also carries out internal audits based on the audit plan agreed by the Eurosystem/ESCB Internal Auditors Committee. These internal audits are carried out in accordance with the Audit Charter for the Eurosystem/ESCB and the Single Supervisory Mechanism. In 2016, five such internal audits were performed.

The staff of the Internal Audit Department are also engaged in the fulfilment of other Eurosystem/ESCB internal audit tasks, and in 2016 the Head of the Internal Audit Department chaired the audit group which carried out the internal audit of the TARGET2-Securities financial statements for 2015. In addition, to support mobility of auditors and development of their knowledge base, short-term exchanges of internal auditors with Lietuvos bankas and Banca d'Italia were arranged.

Pursuant to the Law on Latvijas Banka, Latvijas Banka's financial statements are audited by independent external auditors recommended by the Governing Council of the ECB and approved by the Council of the EU. KPMG Baltics SIA, a commercial company of certified auditors, has been approved as the auditors of Latvijas Banka's financial statements for 2015–2019.

**FINANCIAL STATEMENTS OF LATVIJAS BANKA  
FOR THE YEAR ENDED 31 DECEMBER 2016**



## BALANCE SHEET

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

	Note <sup>1</sup>	2016	2015
<b>ASSETS</b>			
Gold and gold receivables	6	<b>234 305</b>	207 670
Claims on non-euro area residents denominated in foreign currency	7	<b>3 092 076</b>	2 949 979
Receivables from the International Monetary Fund		153 992	153 780
Balances with banks and security investments, external loans and other external assets		2 938 084	2 796 199
Claims on euro area residents denominated in foreign currency	8	<b>358 839</b>	541 073
Claims on non-euro area residents denominated in euro	9	<b>144 564</b>	169 490
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10	<b>257 160</b>	263 730
Longer-term refinancing operations		257 160	263 730
Other claims on euro area credit institutions denominated in euro	11	<b>9 071</b>	2 491
Securities of euro area residents denominated in euro	12	<b>6 319 754</b>	3 015 433
Securities held for monetary policy purposes		4 357 306	1 808 374
Other securities		1 962 448	1 207 059
Intra-Eurosystem claims	13	<b>4 195 918</b>	3 802 596
Participating interest in the European Central Bank		115 082	115 082
Claims equivalent to the transfer of foreign reserves		163 480	163 480
Other claims within the Eurosystem		3 917 356	3 524 034
Other assets	14	<b>160 618</b>	166 225
<b>TOTAL ASSETS</b>		<b>14 772 305</b>	11 118 687

<sup>1</sup> The accompanying Notes set out on pages 73 to 116 are an integral part of these financial statements.

<i>(cont.)</i>	(at the end of the year; in thousands of euro)		
	Note	<b>2016</b>	2015
<b>LIABILITIES</b>			
Banknotes in circulation	15	<b>4 150 106</b>	3 992 436
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	16	<b>4 191 147</b>	4 784 410
Current accounts (covering the minimum reserve system)		4 191 147	4 784 410
Other liabilities to euro area credit institutions denominated in euro	17	<b>720</b>	8 830
Liabilities to other euro area residents denominated in euro	18	<b>212 239</b>	145 894
General government		46 710	38 055
Other liabilities		165 529	107 839
Liabilities to non-euro area residents denominated in euro	19	<b>17 888</b>	9 099
Liabilities to euro area residents denominated in foreign currency	20	<b>159 844</b>	155 228
Liabilities to non-euro area residents denominated in foreign currency	21	–	478
Intra-Eurosystem liabilities	13	<b>5 292 395</b>	1 312 104
Liabilities related to TARGET2 and correspondent accounts (net)		5 292 395	1 312 104
Other liabilities	22	<b>294 614</b>	258 853
Capital and reserves	23	<b>453 352</b>	451 355
<b>TOTAL LIABILITIES</b>		<b>14 772 305</b>	11 118 687

## PROFIT AND LOSS STATEMENT

		(in thousands of euro)	
	Note	2016	2015
Net interest income	33	<b>56 801</b>	44 953
Interest income		102 982	64 696
Interest expense		-46 181	-19 743
Net result of financial operations, recognition of revaluation result in profit and loss statement and financial risk provisions		<b>-100 590</b>	-11 717
Realised gains arising from financial operations	34	38 539	37 216
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	-52 729	-13 633
Provisions for market risk and credit risk	36	-86 400	-35 300
Net expense from fees and commissions		<b>-2 200</b>	-1 388
Fees and commissions income		396	422
Fees and commissions expense		-2 596	-1 810
Income from participating interest	37	<b>5 242</b>	4 157
Net result of pooling of monetary income	38	<b>10 834</b>	25 675
Other operating income	39	<b>81 051</b>	1 762
<b>NET INCOME</b>		<b>51 138</b>	63 442
Remuneration	40	<b>-17 184</b>	-16 932
Social security costs and solidarity tax	40	<b>-3 852</b>	-3 518
Banknote and coin acquisition costs	41	<b>-7 283</b>	-1 955
Depreciation of fixed assets and amortisation of intangible assets	14	<b>-3 755</b>	-3 722
Other operating expenses	42	<b>-7 291</b>	-7 278
<b>PROFIT OF THE REPORTING YEAR</b>		<b>11 773</b>	30 037

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

		(in thousands of euro)	
	Note	2016	2015
Profit of the reporting year		<b>11 773</b>	30 037
Revaluation	23	<b>-16 416</b>	-13 537
Realisation of the accumulated revaluation result	23	<b>-26 565</b>	-33 773
Recognition of revaluation result on financial assets and positions in profit and loss statement	23, 35	<b>52 729</b>	13 633
Total changes in the valuation account	23	<b>9 748</b>	-33 677
<b>TOTAL</b>		<b>21 521</b>	-3 640

The financial statements, which are set out on pages 69 to 116, were authorised by the Board of Latvijas Banka on 10 March 2017.

### BOARD OF LATVIJAS BANKA

M. Kālis

I. Posuma

J. Blūms

J. Caune

H. Ozols

R. Vanags



## 1. PRINCIPAL ACTIVITIES

Latvijas Banka is the central bank of the Republic of Latvia and a member of the ESCB and the Eurosystem. It was established on 19 September 1922 (re-established in 1990). In its activities, Latvijas Banka complies with the Republic of Latvia and EU legislation as well as ECB legal acts in compliance with the Treaty on the Functioning of the European Union and the Statute of the ESCB and of the ECB.

Pursuant to the Law on Latvijas Banka, the primary goal of Latvijas Banka is to maintain price stability. Latvijas Banka has the following primary tasks:

- participate in the formulation and implementation of the Eurosystem's monetary policy;
- manage the foreign reserves and other financial investments;
- ensure cash currency circulation in Latvia and participate in providing the cash currency circulation in the euro area;
- promote smooth functioning of payment systems;
- compile and publish statistical information in order to ensure the performance of the tasks of Latvijas Banka;
- cooperate with the ECB, the central banks of other EU Member States and other countries, as well as other financial institutions;
- operate as the financial agent of Latvia's government and provide financial services to other market participants;
- act as an advisor to the Saeima (Parliament) and Cabinet of Ministers of the Republic of Latvia on monetary policy issues and other issues related to the implementation of the tasks of Latvijas Banka;
- maintain the Credit Register;
- issue licences to legal persons listed in the Register of Enterprises of the Republic of Latvia, except credit institutions, for the purchase and sale of foreign currency as a commercial activity.

On 1 July 2016, Latvijas Banka started to implement the function of the National Analysis Centre and the Coin National Analysis Centre, thus ensuring efficient analysis of currency counterfeits and considerably speeding up their registration and systematisation.

Latvijas Banka neither seeks nor takes instructions from the government of Latvia and other EU Member States, EU institutions and other national, foreign or international institutions and their entities. Latvijas Banka is independent in setting and implementing policy under its legal mandate. Latvijas Banka is supervised by the Saeima of the Republic of Latvia.

Latvijas Banka's operation related to the execution of its tasks is mainly financed from income received from its investment management.

The Head Office of Latvijas Banka is situated at K. Valdemāra iela 2A, Riga. Latvijas Banka manages the storage, processing and circulation of cash through its branches in Riga and Liepāja.

## 2. PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies adopted by Latvijas Banka in the preparation of these financial statements is set out below.

### 2.1 CHANGE IN ACCOUNTING POLICIES

The Council of Latvijas Banka introduced amendments to the "Financial Accounting Policy of Latvijas Banka" providing that those lats banknotes and coins issued by Latvijas Banka that have not been yet exchanged for the euro banknotes and coins are reported in the balance sheet considering the exchange probability of lats banknotes and coins. As a result of amendments to the accounting policies, liabilities for the issued lats banknotes

and coins have been reduced by 78.1 million euro, recognising respective income (see Notes 22.1 and 39). The change in accounting policies has been applied prospectively.

## 2.2 BASIS OF PREPARATION

These financial statements have been prepared in accordance with the Guideline of the ECB of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (recast) (ECB/2016/34), Financial Accounting Policy of Latvijas Banka approved by Latvijas Banka's Council, and the requirements of the Law on Latvijas Banka governing financial reporting.

## 2.3 BASIS OF MEASUREMENT

These financial statements have been prepared in accordance with the historical cost basis of accounting. Gold, debt securities (except held-to-maturity debt securities and securities held for monetary policy purposes that are measured at amortised cost), participating interest (except the participating interest in the ECB), currency future contracts and interest rate derivatives are accounted for at fair value. Forward exchange rate contracts and currency swap arrangements are valued according to the principles described in Note 2.16. The comparison of the book value and fair value of these instruments is provided in Note 5.

## 2.4 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair value is the price at which a financial asset could be sold or financial liability could be transferred in an orderly transaction between market participants at the measurement date.

Fair value of financial instruments is determined by Latvijas Banka using quoted prices in active markets, other financial market information sources or discounted cash flows. The discounted cash flows are modelled using quoted market prices of financial instruments and money market interest rates. The breakdown of assets measured at fair value as well as of financial instruments that have not been measured at their fair value but whose estimated fair value is different from their book value, taking into account the hierarchy of fair value determination, is provided in Note 5.

## 2.5 FOREIGN CURRENCY AND GOLD TRANSLATION

For foreign currency translation Latvijas Banka applies foreign exchange rates published by the ECB. The price of gold is set on the basis of the quoted gold market price in US dollars and the exchange rate of the US dollar against the euro published by the ECB. The exchange rate of the SDR is set on the basis of the weights of the SDR basket of currencies published by the IMF and the exchange rates of the respective currencies published by the ECB.

Transactions denominated in foreign currencies are recorded in euro at the respective exchange rates on the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into euro at the exchange rates at the end of the reporting period. Non-monetary assets and liabilities, measured at cost or amortised cost, are translated into euro at the exchange rate for the respective foreign currency on the day of the transaction.

Transactions in foreign currencies are included in the calculation of net foreign currency position of the respective currency. The transactions in foreign currencies reducing the respective currency position result in realised gains or losses. Any gain or loss arising from revaluation of transactions in foreign currencies and foreign currency positions are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency revaluation reserve ("Valuation account") in accordance with the principles referred to in Note 2.24. The principles referred to herein and in Note 2.24 for valuation and recording of transactions denominated in foreign currencies are also applied to gold.

The exchange rates of major foreign currencies (currency units per euro) and gold price (euro per troy ounce) in euro used in the preparation of the balance sheet for the year ended 31 December 2016 and the year ended 31 December 2015 are as follows:

	(at the end of the year)		
	2016	2015	Changes (%)
US dollar (USD)	<b>1.0541</b>	1.0887	-3.2
Japanese yen (JPY)	<b>123.40</b>	131.07	-5.9
Canadian dollar (CAD)	<b>1.4188</b>	1.5116	-6.1
British pound sterling (GBP)	<b>0.85618</b>	0.73395	16.7
Gold (XAU)	<b>1098.046</b>	973.225	12.8

## 2.6 RECOGNITION AND DERECOGNITION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Financial assets and financial liabilities are recognised in the balance sheet when Latvijas Banka becomes a contractual party in the respective financial transaction.

A financial asset is derecognised when the contractual rights to cash flows arising from the respective financial asset expire or are transferred, thereby risks and rewards related to the particular asset are transferred, and Latvijas Banka does not retain control over the asset. Financial liabilities are derecognised when the respective obligations are settled.

A regular way purchase or sale of financial assets is recognised and derecognised on the settlement day.

## 2.7 OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Financial assets and financial liabilities are offset and the net amount in the financial statements is reported only in cases when there is a legally enforceable right to set off the recognised amounts, and there is an intention to dispose of the respective assets and settle the liability simultaneously.

## 2.8 USE OF ESTIMATES AND ASSUMPTIONS

Estimates and assumptions have been made in the preparation of the financial statements that affect the amounts of certain assets, liabilities and contingent liabilities reported in the financial statements. Future events may affect the above-mentioned estimates and assumptions. The effect of a change in such estimates and assumptions is reported in the financial statements for the reporting year and each year in the future to which it refers.

The major estimates and assumptions in the preparation of the financial statements have been made with respect to the following: impairment of assets (see Note 2.20), the method for establishing the fair value of the BIS shares (see Note 14.2), the exchange probability of those lats banknotes and coins that have not been yet exchanged for the euro banknotes and coins (see Note 2.21), the useful life of fixed assets and intangible assets (see Notes 2.18 and 2.19), the repurchasing probability of collector coins (see Note 2.22), provisions for market risk and credit risk (see Notes 2.23 and 36), the breakdown of fair value determination (see Note 5), and the method of recognising a part of the initial valuation account balance in profit and loss statement (see Note 23).

## 2.9 GOLD AND GOLD RECEIVABLES

Gold is stated at market value in the balance sheet in accordance with the principles described in Note 2.5.

Any gain or loss arising from transactions in gold and revaluation of gold reserves is credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the foreign currency revaluation reserve in accordance with the principles described in Note 2.24.

## 2.10 DEBT SECURITIES

Debt securities are stated at fair value in the balance sheet, except those held to maturity and securities held for monetary policy purposes, measured at amortised cost. Securities held to maturity are securities with fixed or determinable payments and fixed maturity which Latvijas Banka intends to hold to maturity.

Interest on securities, including premium and discount, is recognised in the profit and loss statement as interest income (see Note 2.25).

Gain or loss arising from transactions in debt securities and revaluation of the debt securities stated at fair value are credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the securities revaluation reserve in accordance with the principles referred to in Note 2.24.

## 2.11 REVERSE REPURCHASE AGREEMENTS

Reverse repurchase agreements are accounted for as financing transactions. Securities purchased under reverse repurchase agreements are not reported on Latvijas Banka's balance sheet. The related funding provided to the counterparty is reported on Latvijas Banka's balance sheet at nominal value as claims on the seller of the securities.

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

## 2.12 REPURCHASE AGREEMENTS

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

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

## 2.13 SECURITIES LENDING

Securities lent under automated security lending programme agreements are reported on Latvijas Banka's balance sheet along with other securities that are not involved in these transactions. Only cash collateral placed on the account of Latvijas Banka is recognised in the balance sheet.

Income from securities lending transactions is recognised as interest income in the profit and loss statement.

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

Loans to credit institutions, deposits and similar financial claims and financial liabilities are recorded at nominal value in the balance sheet.

## 2.15 PARTICIPATING INTEREST

Participating interest includes long-term investments of Latvijas Banka in equity instruments. Latvijas Banka has no control or significant influence in any institution, therefore participating interest is not accounted for as an investment in a subsidiary or an associate. Equity instruments are reported at fair value in the balance sheet, except participating interest in the ECB, which is reported at cost in the balance sheet in accordance with the ECB's legal framework for accounting and financial reporting.

The change in fair value of participating interest is reported under the balance sheet item "Capital and reserves" as the revaluation reserve for equity instruments.

## 2.16 DERIVATIVE FINANCIAL INSTRUMENTS

Latvijas Banka enters into commitments involving forward exchange rate contracts, currency and interest rate swap arrangements, and interest rate and currency future contracts, which are reported in off-balance sheet accounts at their contract or notional amount. Forward exchange rate contracts and currency swap arrangements are included in the net position of the respective currency on the transaction day at the spot rate of the transaction and are recorded in the balance sheet in euro at the exchange rate of the respective currency at the end of the reporting period. Other derivative financial instruments are reported in the balance sheet at fair value.

Interest on derivative financial instruments, including the spot and forward interest rate spread of forward exchange rate contracts and currency swap arrangements, is recognised in the profit and loss statement as interest income or interest expense over the term of the agreement. Any gain or loss arising from a change in fair value of interest rate and currency future contracts is included in the profit and loss statement taking into account settlement. Any gain or loss arising from a change in fair value of other derivative financial instruments is credited or charged to the profit and loss statement or the balance sheet item "Capital and reserves" as the revaluation reserve in accordance with the principles referred to in Note 2.24.

## 2.17 ACCRUED INTEREST INCOME AND EXPENSE

Accrued interest income and expense are reported under balance sheet items of other assets or other liabilities.

## 2.18 FIXED ASSETS

Fixed assets are tangible long-term investments with the useful life of over one year. Capitalisation limit of fixed assets is 150 euro, except the costs related to real estate improvements and replacement of fixed asset parts for which the Board of Latvijas Banka has set a higher capitalisation limit depending on their significance. Fixed assets are used in the provision of services as well as in the maintenance of other fixed assets and to ensure operation of Latvijas Banka.

Fixed assets are recorded at cost less accumulated depreciation and impairment, if any.

Depreciation is recognised 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. Buildings and structures are accounted by separate components, with individual useful life set for each such component.

In 2016, the useful lives set for fixed assets were not changed. In 2016 and 2015, the useful lives set for fixed assets were as follows:

	(years)	
	2016	2015
Buildings and their components, improvements to the territory, incl.	5–100	5–100
structures	100	100
finishing, equipment and engineering communications	5–20	5–20
Transport vehicles	10–15	10–15
Office equipment and tools	5–25	5–25
Cash processing, verifying and storage equipment	5–15	5–15
Computer and telecommunication equipment	2–5	2–7
Other fixed assets	5–15	5–15

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

## 2.19 INTANGIBLE ASSETS

Intangible assets are long-term investments without physical substance with a useful life of over one year. Capitalisation limit of intangible assets is 150 euro. Intangible assets include software application rights and other rights.

Intangible assets are reported in the balance sheet at cost less accumulated amortisation and impairment, if any.

Acquisition costs of intangible assets are amortised over the useful life of the respective assets using the straight-line method; however, this period may not exceed 10 years.

Costs related to software development by Latvijas Banka are recognised in the profit and loss statement when incurred.

## 2.20 IMPAIRMENT OF ASSETS

An asset is impaired when its carrying amount exceeds its recoverable amount. Upon detecting any indications of impairment of an asset, the recoverable amount of the respective asset is estimated. If the recoverable amount is less than the carrying amount of the respective asset, adequate impairment allowances for the respective asset are made. Such impairment allowances are recognised in the profit and loss statement with a respective reduction in the asset's carrying amount.

The ECB carries out impairment assessment of securities held for monetary policy purposes, identifying any potential changes in future cash flows and any other factors encumbering the fulfilment of the liabilities by the securities issuer. Assets are impaired when the carrying amount of securities held for monetary policy purposes exceed their recoverable amount. The latter in its turn is defined as the present value of a future cash flow estimate. The ECB Governing Council approves the results of the asset impairment assessment carried out by the ECB.

## 2.21 CURRENCY IN CIRCULATION

In view of the fact that euro banknotes are issued by all euro area NCBs and the ECB, they report a certain share of the total amount of euro banknotes issued by the Eurosystem on their balance sheets. The share allocated to the ECB is 8% of the total amount of euro banknotes issued by the Eurosystem; the remaining 92% are allocated to the NCBs in proportion to their share in the ECB's capital and reported under the balance sheet item "Banknotes in circulation". Of the total amount of euro banknotes issued by the Eurosystem, the share allocated to Latvijas Banka is larger than the actual net amount of euro banknotes it has issued (see Note 15); consequently, claims on the ECB for the allocation of banknotes are reported under the balance sheet item "Intra-Eurosystem claims".

Pursuant to the Law on the Procedure for Introducing the Euro, the period for exchanging the lats cash to the euro at Latvijas Banka is unlimited.

The lats banknotes and coins issued by Latvijas Banka which have not been yet exchanged for the euro banknotes and coins are disclosed in the balance sheet considering the exchange probability of such lats banknotes and coins within 20 years from the euro changeover.

Euro coins and the lats banknotes and coins in circulation issued by Latvijas Banka that have been recognised as liabilities by Latvijas Banka, except collector coins, are reported under the balance sheet item "Other liabilities" at nominal value.

## 2.22 COLLECTOR COINS

Collector coins sold are not included in the balance sheet liabilities, as the repurchasing probability of those coins is low or the value of precious metals of which the coins are made exceeds the nominal value. Proceeds from sales of collector coins are recognised in

the profit and loss statement when incurred. The accounting principles established with respect to collector coins are applied to the lats gold circulation coins and collector coins.

### 2.23 PROVISIONS

Provisions are recognised in the financial statements when Latvijas Banka has incurred a present legal or constructive obligation arising from a past event or transaction and a reliable estimate can be made of the obligation and it can be expected to result in a cash outflow from Latvijas Banka.

In addition, on the basis of reasonable risk estimates, Latvijas Banka's Council decides on making provisions for market risk (price, interest rate and currency risks) and credit risk associated with Latvijas Banka's investment management and other financial transactions (see also Note 36).

### 2.24 RECOGNITION OF GAINS OR LOSSES ON FINANCIAL INSTRUMENTS, FOREIGN CURRENCY AND GOLD POSITION

Gains or losses on financial instruments, foreign currency and gold position are recognised in accordance with the following principles provided by the ECB's legal framework for accounting and financial reporting:

- (a) realised gains and losses shall be recognised in the profit and loss statement;
- (b) unrealised gains shall be recognised in the balance sheet item "Capital and reserves" as the revaluation reserve;
- (c) unrealised losses recognised in the balance sheet item "Capital and reserves" as the revaluation reserve at the end of the reporting year shall be transferred to the profit and loss statement if they exceed the previous revaluation gain on the respective financial instrument, foreign currency or gold position;
- (d) unrealised losses recognised in the profit and loss statement at the end of the reporting year shall not be reversed and offset by unrealised gains of the respective financial instrument, foreign currency or gold position in the subsequent years;
- (e) there shall be no netting of unrealised losses in a financial instrument, foreign currency or gold position against unrealised gains in other financial instrument, foreign currency or gold position.

The average cost method shall be used to calculate realised and unrealised gains and losses of financial instrument, foreign currency and gold position. The average cost of financial instrument, foreign currency or gold position shall be increased or reduced by unrealised losses that are recognised in the profit and loss statement at year-end.

### 2.25 INTEREST INCOME AND EXPENSE

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

Interest income includes interest on securities, securities lending, deposits placed, loans granted, forward exchange rate contracts, currency and interest rate swap arrangements, intra-Eurosystem claims, as well as negative interest on deposits received. Interest on securities also includes premium and discount, which is amortised over the remaining life of the respective securities using the straight-line method.

Interest expense includes interest on deposits received from the Latvian government, credit institutions and other financial institutions, as well as interest on forward exchange rate contracts and currency and interest rate swap arrangements, intra-Eurosystem liabilities, as well as negative interest on deposits placed.

In the profit and loss statement received negative interest is reported as interest income; paid negative interest is reported as interest expense. Accrued negative interest on balance sheet liabilities is reported under the balance sheet item "Other assets"; accrued negative interest on balance sheet assets is reported under the balance sheet item "Other liabilities".

## 2.26 REALISED GAINS OR LOSSES FROM FINANCIAL OPERATIONS

Realised gains or losses from financial operations are recognised in the profit and loss statement at the time of disposal of financial instrument or at the time of settlement.

Realised gains or losses from financial operations include realised gains or losses of derivative financial instruments, disposal of debt securities, and foreign exchange transactions.

## 2.27 INCOME FROM PARTICIPATING INTEREST

The change in fair value of participating interest is reported under the balance sheet item "Capital and reserves" as the revaluation reserve for equity instruments.

Dividends on participating interest are recognised in the profit and loss statement when the right to receive payment is established.

Pursuant to the decision of the Governing Council of the ECB, the income gained by the ECB on the claims for the allocation of banknotes within the Eurosystem, and from the Securities Markets Programme, the asset-backed securities purchase programme, the third covered bond purchase programme, as well as from the PSPP shall be distributed as interim profit for the reporting year in which it accrues. The Governing Council of the ECB decides on the interim profit distribution in January of the following year; however, it may resolve not to do so in cases when the ECB's net profit for the reporting year is less than its income included in the ECB's interim profit distribution, as well as in the event the Governing Council decides to establish provisions for foreign exchange rate, interest rate, credit and gold price risks. In addition, the Governing Council of the ECB may resolve to make deductions from the interim profit distribution result in respect of expenses incurred by the ECB in connection with the issue and handling of euro banknotes; the deductions may not exceed income on the claims for the allocation of banknotes within the Eurosystem.

Moreover, after the approval of the ECB's Annual Accounts, the Governing Council distributes the remainder of the ECB's annual profit of the reporting year to euro area NCBs in proportion to their shares in the ECB's capital (see Note 13.1).

Income from participating interest in the ECB is reported under the profit and loss statement item "Income from participating interest".

## 2.28 NET RESULT OF POOLING OF MONETARY INCOME

Pursuant to the Statute of the ESCB and of the ECB, euro area NCBs gain income from the implementation of the single monetary policy of the Eurosystem. Total monetary income of the Eurosystem equals the income on assets arising from the issue of euro banknotes and receiving deposits from credit institutions. The income is allocated to euro area NCBs in proportion to their shares in the capital of the ECB. For the first six years following the joining of the Eurosystem an NCB's monetary income is adjusted in compliance with a definite coefficient to avoid significant euro area NCB income fluctuations (see also Note 33).

The net monetary income pooled by Latvijas Banka includes the income derived from earmarkable assets of Latvijas Banka, reduced by expenses for the monetary liabilities of Latvijas Banka. The earmarkable assets of Latvijas Banka for the allocation of monetary income include gold, assets acquired as a result of monetary policy operations, intra-Eurosystem claims as well as other assets in the amount necessary to fully cover the monetary liabilities. Monetary liabilities of Latvijas Banka include banknotes in circulation, deposits of credit institutions resulting from monetary policy operations and intra-Eurosystem liabilities.



Latvijas Banka's monetary income received comprises Latvijas Banka's share in the Eurosystem's total monetary income set on the basis of Latvijas Banka's share in the ECB's capital.

#### 2.29 BANKNOTE AND COIN ACQUISITION COSTS

Banknote and coin acquisition costs are charged to the profit and loss statement at the time of banknote and coin acquisition.

#### 2.30 OTHER EXPENSE AND INCOME

Bank's other operating expense and income are recognised in the profit and loss statement on an accrual basis. The amount of accrued expense and income for the reporting period is calculated in accordance with the volume of services received or rendered in the reporting period. Lease payments are recognised in the profit and loss statement proportionally over the term of the respective agreement.

### 3. SUMMARY OF THE FINANCIAL POSITION AND FINANCIAL PERFORMANCE OF LATVIJAS BANKA

#### 3.1 FINANCIAL POSITION

In 2016, Latvijas Banka's assets grew by 3 653.6 million euro, mostly on account of securities purchases for monetary policy and investment purposes.

In 2016, following the decision of the Governing Council of the ECB of 22 January 2015 on an expanded asset purchase programme (APP) and the decision of the Governing Council of the ECB of 10 March 2016 on supplementing the PSPP, Latvijas Banka made purchases of securities issued by the Latvian government and international institutions; mostly as a result of the above purchases, the balance of the balance sheet item "Securities held for monetary policy purposes" increased by 2 548.9 million euro. Euro area NCBs purchased PSPP securities in proportion to their shares in the ECB's capital.

An increase in the assets under the balance sheet items "Claims on non-euro area residents denominated in foreign currency", "Balances with credit institutions and security investments, external loans and other external assets", and "Other securities" basically resulted from investment activities in line with the liquidity management principles set by the ECB's Governing Council (see also Note 4).

In 2016, the amount of loans granted to credit institutions by Latvijas Banka as a result of monetary policy operations (mostly targeted longer-term refinancing operations) decreased by 6.6 million euro.

Other claims related to other operational requirements within the Eurosystem grew by 393.3 million euro, mostly on account of a rise in claims on banknote allocation in the Eurosystem (see also Note 13.4).

In 2016, banknotes in circulation increased by 157.7 million euro, in line with the pickup in the overall amount of banknotes in circulation of the euro area NCBs.

At the end of 2016, credit institution deposits, reported under the balance sheet item "Liabilities to euro area credit institutions related to monetary policy operations denominated in euro", decreased by 593.3 million euro.

As a result of cross-border payments, liabilities to the ECB for the settlement result in TARGET2, reported under the balance sheet item "Intra-Eurosystem liabilities", increased to 5 292.4 million euro (1 312.1 million euro at the end of 2015). The above increase mostly resulted from Latvijas Banka's payments related to purchases of securities issued by the Latvian government and international institutions, an increase in investment portfolios, as well as a decrease in credit institution deposits.

Capital and reserves of Latvijas Banka increased by 2.0 million euro on account of net changes in valuation of financial instruments (9.7 million euro) and profits earned in 2016 (11.8 million euro), while the share of profits earned in 2015 and remitted to the state budget revenue in the amount of 19.5 million euro had a decreasing effect.

### 3.2 FINANCIAL PERFORMANCE

In 2016, Latvijas Banka's profit amounted to 11.8 million euro (30.0 million euro in 2015). Net interest income in 2016 grew by 11.8 million euro as compared to 2015.

A 38.3 million euro increase in interest income resulted from a 16.1 million euro rise in interest income on investment on account of higher investment amounts and an expanding share of higher yield financial instruments in the total amount of investment. Interest income on monetary operations grew by 22.4 million euro, basically as a result of PSPP securities purchases in 2016 and an increase in negative interest received on credit institution demand deposits.

An 26.4 million euro increase in interest expense was mostly a result of a rise in interest expense on investment in relation to the transactions carried out by Latvijas Banka for the purpose of hedging currency risk.

The realised gains from financial operations were significantly affected by partial disposal of the long-term fixed income securities portfolio in 2016 (see also Note 4) as a result of which the gains from the disposal of debt securities grew by 36.7 million euro.

The recognition of the revaluation result on financial assets and positions in profit and loss statement amounted to 52.7 million euro and it was affected by the increase in the negative result on revaluation of debt securities on account of a rise in yields at the end of 2016.

The provisions established by the Council of Latvijas Banka for market risk and credit risk in 2016 were 51.1 million euro higher than in 2015, mainly as a result of an increase in the amount of investment as well as changes in the investment structure during 2016.

Pursuant to the Statute of the ESCB and of the ECB, the income generated by euro area NCBs through the implementation of the single monetary policy of the Eurosystem is allocated to euro area NCBs in proportion to their shares in the ECB's capital. In 2016, Latvijas Banka's net result of pooling of monetary income was 10.8 million euro (25.7 million euro in 2015).

Other operating income increased primarily on account of a revaluation of liabilities for the issued lats banknotes and coins.

Total recognised financial result, including changes in the "Valuation account" balance, increased by 25.2 million euro, primarily on account of a larger negative result (39.1 million euro) on revaluation of financial instruments recognised in the profit and loss statement, a 9.0 million increase in the result on revaluation of securities and an 18.2 million euro decrease in the profits of the reporting year as compared to 2015.

Latvijas Banka's future financial performance will be mostly affected by the monetary policy pursued by the Eurosystem and by interest rate developments in the financial markets of the euro area and US since Latvijas Banka is exposed to interest rate risk.

### 4. FINANCIAL INVESTMENT POLICY

Investments are managed in compliance with the basic principles set out in the Procedure adopted by the Council of Latvijas Banka, inter alia preserving the value of investments, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting the monetary policy implemented by the Eurosystem.

Investments include assets reported under the balance sheet items "Gold and gold receivables", "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency", "Claims on non-euro area residents denominated in euro", "Other claims on euro area credit institutions denominated in euro" and "Other securities", as well as derivative financial instruments and spot exchange rate contracts whose book value is reported under relevant balance sheet items of other assets or other liabilities.

Investments are managed by classifying them into different investment portfolios by investment strategy and source of funding. Portfolios of borrowed funds include investments which correspond to Latvijas Banka's liabilities in foreign currencies to government or government deposits. Investments that are not included in the portfolios of borrowed funds (net investments) are included in the portfolios of 1–10 year fixed income securities, 10 year government fixed income securities, mortgage-backed securities, Latvian government securities and other portfolios. A part of investments included in the 1–10 year fixed income securities portfolios and mortgage-backed securities portfolios are managed by external investment managers.

The parameters for a benchmark reflecting the acceptable level of financial risks and return target are set out for the 1–10 year fixed income securities portfolios, 10 year government fixed income securities and mortgage-backed securities portfolios, and portfolios of borrowed funds.

The breakdown of investments by type of investment portfolio at the end of 2016 and 2015 was as follows:

	Portfolio value (in thousands of euro)		Proportion (%)	
	2016	2015	2016	2015
1–3 year fixed income securities portfolios	–	3 561 588	–	68.5
1–10 year fixed income securities portfolios	<b>3 043 063</b>	–	<b>52.5</b>	–
10 year government fixed income securities portfolio	<b>1 156 619</b>	–	<b>19.9</b>	–
Mortgage-backed securities portfolios	<b>1 156 594</b>	536 233	<b>19.9</b>	10.3
1–10 year government fixed income securities portfolio	–	371 829	–	7.2
Long-term fixed income securities portfolio	–	299 195	–	5.8
Gold portfolio	<b>234 505</b>	222 411	<b>4.0</b>	4.3
Portfolios of borrowed funds	<b>159 844</b>	155 228	<b>2.8</b>	3.0
Latvian government securities portfolio	<b>49 606</b>	49 323	<b>0.9</b>	0.9
<b>Total</b>	<b>5 800 231</b>	<b>5 195 807</b>	<b>100.0</b>	<b>100.0</b>

The 1–10 year fixed income securities portfolio benchmark at the end of 2016 was the weighted 1–10 year government securities index of the UK, the US, euro area countries and Canada. 1–10 year fixed income securities portfolios were created in 2016 by combining 1–3 year fixed income securities portfolios whose benchmark was the weighted 1–3 year government securities index of the UK, the US, euro area countries, Japan and Canada with 1–10 year government fixed income securities portfolio whose benchmark was the weighted 1–10 year government securities index of UK, the US, euro area countries, Japan and Canada.

The mortgage-backed securities portfolio benchmark was the US mortgage-backed securities index.

At the beginning of 2016, Latvijas Banka created a 10 year government fixed income securities portfolio comprising euro denominated government securities. In 2016, the long-term fixed income securities portfolio was added to the 10 year government fixed income securities portfolio.

The benchmark for borrowed fund portfolios is formed in compliance with the parameters of respective liabilities.

Latvian government securities portfolio comprises euro denominated Latvian government bonds with term to maturity of 5–10 years at the time of acquisition.

Latvijas Banka's investment benchmark currency is the euro, except for portfolios of borrowed funds, thus limiting the currency risk. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the currency of respective liabilities.

Following the liquidity management principles set by the ECB's Governing Council, the value of the investment portfolios has increased by 604.4 million euro as compared to the end of 2015 (increased by 756.4 million euro in 2015 as compared to the end of 2014).

The description of the main methods used in financial risk management is provided in Note 25.1.

## BALANCE SHEET NOTES

### 5. FAIR VALUE MEASUREMENT

Fair value of Latvijas Banka's assets is determined using the following hierarchy (see also Note 2.4):

- quoted market price. Fair value is determined using quoted prices for identical financial instruments in active markets;
- observable data. Fair value is determined using quoted prices for similar financial instruments in active markets, quoted prices for similar or identical financial instruments in inactive markets or using models where all significant inputs are observable;
- non-observable data. Fair value is determined using a model where significant inputs are non-observable.

At the end of 2016 and 2015, Latvijas Banka's assets carried at fair value were generally valued on the basis of a quoted market price.

At the end of 2016 and 2015, participating interest in the BIS was assessed using non-observable data. The assessment was conducted using the 70% net asset value method (see also Note 14.2).

At the end of 2016 and 2015, the breakdown of financial instruments and gold carried at fair value and of the financial instruments whose fair value is different from their book value, according to the fair value hierarchy was as follows:

	Book value	Fair value			Total fair value	Difference between book value and fair value
		Quoted market price	Observable data	Non-observable data		
(in thousands of euro)						
<b>As at 31 December 2016</b>						
Gold	234 305	234 305	–	–	234 305	–
Securities in investment portfolios	5 268 697	4 743 742	524 955	–	5 268 697	–
Forward exchange rate contracts	–13 237	–	–19 110	–	–19 110	–5 873
Interest rate swaps	–1	–	–1	–	–1	–
Securities held for monetary policy purposes	4 401 629	4 423 185	–	–	4 423 185	21 556
Participating interest in the Bank for International Settlements	32 235	–	–	32 235	32 235	–
<b>Total</b>	<b>9 923 628</b>	<b>9 401 232</b>	<b>505 844</b>	<b>32 235</b>	<b>9 939 311</b>	<b>15 683</b>
<b>As at 31 December 2015</b>						
Gold	207 670	207 670	–	–	207 670	–
Securities in investment portfolios	4 203 867	3 736 100	484 277	–	4 220 377	16 510
Forward exchange rate contracts	33 428	–	30 690	–	30 690	–2 738
Interest rate swaps	137	–	137	–	137	–
Securities held for monetary policy purposes	1 808 374	1 798 721	–	–	1 798 721	–9 653
Participating interest in the Bank for International Settlements	30 699	–	–	30 699	30 699	–
<b>Total</b>	<b>6 284 175</b>	<b>5 742 491</b>	<b>515 104</b>	<b>30 699</b>	<b>6 288 294</b>	<b>4 119</b>

The debt securities, including accrued interest income on the above securities are reported under the balance sheet items "Claims on non-euro area residents denominated in foreign currency", "Claims on euro area residents denominated in foreign currency", "Claims on non-euro area residents denominated in euro", "Securities of euro area residents denominated in euro", "Other assets" and "Other liabilities".

The book value of forward exchange rate contracts is reported under the balance sheet items "Other assets" or "Other liabilities", while the present Note discloses the total net book value.

The average market prices on the last trading day of the reporting year are obtained from the electronic information systems Bloomberg and Interactive Data (quoted market price if the market of the respective financial instrument is active; observable data if the market is inactive). Where the above quoted price for a financial instrument is absent in the electronic information systems and the market for the financial instrument is inactive, the price provided by a market participant or the discounted cash flow is used for evaluating the financial instrument (observable data).

## 6. GOLD AND GOLD RECEIVABLES

	Troy ounces	In thousands of euro
As at 31 December 2014	213 384	210 774
During 2015		
Decrease in gold market value	x	-3 104
As at 31 December 2015	213 384	207 670
<b>During 2016</b>		
Increase in gold market value	x	26 635
<b>As at 31 December 2016</b>	<b>213 384</b>	<b>234 305</b>

Latvijas Banka hedges the risk related to gold price fluctuations by entering into forward exchange rate contracts, currency swap arrangements, and currency future contracts (see Notes 3.2 and 26). Revaluation of gold, forward exchange rate contracts, and currency swap arrangements is recognised under the balance sheet item "Capital and reserves" as the revaluation reserve, whereas revaluation of currency future contracts, taking into account that they are settled, is recognised under the profit and loss statement item "Realised gains arising from financial operations".

At the end of 2016 and 2015, Latvijas Banka had no gold receivables.

## 7. CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

### 7.1 RECEIVABLES FROM THE INTERNATIONAL MONETARY FUND

Pursuant to the Law on the Republic of Latvia Joining the International Monetary Fund, Latvijas Banka serves as a depository for the IMF and services the IMF accounts in the member state currency without compensation. The IMF holdings in euro comprise promissory notes issued by the Latvian government, Account No. 1 used for financial transactions with the IMF, and Account No. 2 used for the IMF administrative expenditure and receipts.

Latvia's claims on the IMF include SDR and Latvia's quota in the IMF. SDR is an international reserve asset created by the IMF and used in transactions between the IMF and its members. The quota in the IMF reflects the subscription in the IMF of respective members. Latvia's quota in the IMF is secured by the Latvian government promissory note issued to the IMF and denominated in SDR. In 2016, IMF member quotas were increased and realigned to better reflect the change in the relative weights of IMF member countries in the global economy. Consequently, Latvia's quota in the IMF increased by 190 200 thousand SDR, with a respective overall increase in the value of the promissory note issued by the government of Latvia and the balance on Account No. 1.

Latvia's liabilities to the IMF are made up of the IMF holdings in euro and IMF allocations. At the end of 2016, the receivables from the IMF in SDR as recorded on Latvijas Banka's balance sheet were equivalent to 153 992 thousand euro (153 780 thousand euro at the end of 2015), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 1 081 thousand euro (474 thousand euro at the end of 2015) held on its Accounts No. 1 and No. 2 (see also Note 19).

At the end of 2016 and 2015, Latvia's net receivables from the IMF were as follows:

	(in thousands of euro)		(in thousands of SDR)	
	2016	2015	2016	2015
Latvia's quota in the International Monetary Fund	<b>423 550</b>	180 864	<b>332 300</b>	142 100
International Monetary Fund holdings in euro	<b>-423 501</b>	-180 816	<b>-332 262</b>	-142 062
Promissory note of the Latvian government	-422 420	-180 342	-331 414	-141 690
Account No. 1	-1 059	-452	-831	-355
Account No. 2	-22	-22	-17	-17
Reserve position in the International Monetary Fund	<b>71</b>	70	<b>55</b>	55
SDR	<b>153 992</b>	153 780	<b>120 817</b>	120 821
General allocation	<b>-119 810</b>	-119 640	<b>-93 998</b>	-93 998
Special allocation	<b>-34 190</b>	-34 141	<b>-26 824</b>	-26 824
Latvia's net receivables from the International Monetary Fund	<b>63</b>	69	<b>50</b>	54

The reserve position in the IMF is the difference between Latvia's quota in the IMF and the IMF holdings in euro, excluding the balance on Account No. 2.

## 7.2 BALANCES WITH CREDIT INSTITUTIONS AND SECURITY INVESTMENTS, EXTERNAL LOANS AND OTHER EXTERNAL ASSETS

	(in thousands of euro)	
	2016	2015
Debt securities	<b>2 798 318</b>	2 589 637
Reverse repurchase agreements	<b>78 550</b>	37 108
Demand deposits	<b>61 190</b>	169 439
Foreign currency in cash	<b>26</b>	15
Total	<b>2 938 084</b>	2 796 199

## 8. CLAIMS ON EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

	(in thousands of euro)	
	2016	2015
Debt securities	<b>356 993</b>	538 707
Demand deposits	<b>1 846</b>	2 366
Total	<b>358 839</b>	541 073

## 9. CLAIMS ON NON-EURO AREA RESIDENTS DENOMINATED IN EURO

	(in thousands of euro)	
	2016	2015
Debt securities	<b>133 942</b>	164 168
Demand deposits	<b>10 622</b>	5 322
Total	<b>144 564</b>	169 490

## 10. LENDING TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO

At the end of 2016, the total amount of Eurosystem loans in monetary policy operations reached 595 874 million euro (558 989 million euro at the end of 2015), including

257.2 million euro (263.7 million euro at the end of 2015) of loans granted by Latvijas Banka. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are allocated among euro area NCBs in proportion to their share in the ECB's capital (see Note 2.28). Losses from Eurosystem lending related to monetary policy operations might only be incurred where the counterparty defaults on its obligations and the funds recovered as a result of the realisation of the collateral provided by the counterparty are not sufficient (see also Note 25.1.2).

#### 10.1 MAIN REFINANCING OPERATIONS

Main refinancing operations are open market operations executed through liquidity providing reverse transactions, conducted through weekly standard tenders with a maturity of one week. These operations play a key role in steering interest rates, managing market liquidity and signalling the monetary policy stance. At the end of 2016 and 2015, Latvijas Banka had granted no loans in main refinancing operations.

#### 10.2 LONGER-TERM REFINANCING OPERATIONS

Longer-term refinancing operations are open market operations with a maturity of over 1 week, executed through reverse transactions with the aim to provide credit institutions with additional longer-term refinancing. At the end of 2016, the balance of longer-term refinancing operations conducted by Latvijas Banka stood at 12 500 thousand euro (10 000 at the end of 2015). Following the decision of the Governing Council of the ECB, targeted longer-term refinancing operations were launched in 2014. These liquidity providing reverse operations are conducted by way of a fixed-rate tender procedure aiming to promote lending to households and non-financial corporations by credit institutions in euro area countries. At the end of 2016, the balance of the targeted longer-term refinancing operations conducted by Latvijas Banka stood at 244 660 thousand euro; these operations will mature on 24 June 2020 and 30 September 2020 (at the end of 2015 the balance was 253 730 thousand euro).

### 11. OTHER CLAIMS ON EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO

Other claims on euro area credit institutions denominated in euro mostly include Latvijas Banka's pledged assets for providing collateral for transactions in financial derivatives. At the end of 2016, the book value and market value of the pledged assets amounted to 8 780 thousand euro (0 at the end of 2015). Latvijas Banka's demand deposits in euro with euro area credit institutions are also reported under this item (291 thousand euro at the end of 2016; 2 491 thousand euro at the end of 2015).

### 12. SECURITIES OF EURO AREA RESIDENTS DENOMINATED IN EURO

In 2016 Latvijas Banka purchased securities issued by the Latvian government and international institutions under the PSPP; as a result, the balance sheet item "Securities held for monetary policy purposes" grew by 2 548.9 million euro.

At the end of 2016, the amount of securities held by the Eurosystem for monetary policy purposes totalled 1 654 026 million euro (803 135 million euro at the end of 2015). Of them, Latvijas Banka held 4 357 306 thousand euro (1 808 374 thousand euro at the end of 2015). Pursuant to the Statute of the ESCB and of the ECB, any income and losses, if any materialise, are allocated among euro area NCBs in proportion to their share in the ECB's capital, except any risks associated with the purchases of government securities carried out by Latvijas Banka and other euro area NCBs under the PSPP. Of the total amount of securities held by the Eurosystem for monetary policy purposes, at the end of 2016 the amount of government securities purchased by the euro area NCBs under the PSPP totalled 1 002 725 million euro (392 018 million euro at the end of 2015); of them,



Latvijas Banka held securities in the amount of 706 919 thousand euro (472 158 thousand euro at the end of 2015).

The ECB's Governing Council made a decision to increase the monthly amount of security purchases under the expanded APP from 60 000 million euro to 80 000 million euro from April 2016, and after March 2017 to continue monthly purchases of securities in the amount of 60 000 million euro up to December 2017 or beyond, if necessary.

Securities held for monetary policy purposes and securities held to maturity are measured at amortised cost. The comparison of the book value and fair value of the above securities is represented in Note 5. Other securities are accounted for at fair value.

	(in thousands of euro)	
	2016	2015
		Book value
Securities held for monetary policy purposes	<b>4 357 306</b>	1 808 374
Latvian government securities	706 919	472 158
Securities issued by international institutions	3 650 387	1 336 216
Other securities	<b>1 962 448</b>	1 207 059
Securities not held to maturity	1 962 448	909 992
Securities held to maturity	–	297 067
<b>Total</b>	<b>6 319 754</b>	3 015 433

### 13. INTRA-EUROSISTEM CLAIMS/LIABILITIES (–)

	Note	(in thousands of euro)	
		2016	2015
Participating interest in the European Central Bank	13.1	<b>115 082</b>	115 082
Claims in respect of foreign reserves transferred to the European Central Bank	13.2	<b>163 480</b>	163 480
Claims for the allocation of banknotes in the Eurosystem	13.4	<b>3 902 650</b>	3 495 103
Claims related to other operational requirements within the Eurosystem	13.5	<b>14 706</b>	28 931
<b>Total intra-Eurosystem claims</b>		<b>4 195 918</b>	3 802 596
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	13.3	<b>–5 292 395</b>	–1 312 104
<b>Total intra-Eurosystem liabilities</b>		<b>–5 292 395</b>	–1 312 104
<b>Intra-Eurosystem claims/liabilities (net)</b>		<b>–1 096 477</b>	2 490 492

#### 13.1 PARTICIPATING INTEREST IN THE EUROPEAN CENTRAL BANK

With Latvia's accession to the EU, Latvijas Banka became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and of the ECB, Latvijas Banka's ECB capital key is calculated on the basis of Latvia's population and gross domestic product data. The NCB capital keys are adjusted every five years or at shorter intervals depending on changes in the number of the EU Member States. Since 1 January 2015 Latvijas Banka's ECB capital key is 0.2821%, equivalent to 30 537 thousand euro.

The Statute of the ESCB and of the ECB stipulates that a euro area NCB shall pay up its subscribed share in the ECB's capital in full, as well as in the ECB's reserve capital, provisions equivalent to reserves and the valuation account for financial instruments, in proportion to its share in the ECB's capital. As of 1 January 2015, participating interest in the ECB consists of the paid up shares in the amount of 30 537 thousand euro in the ECB's capital, transfers to the financial instrument revaluation account amounting to 42 752 thousand euro and the difference between the market value of the foreign reserves

transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro (see also Note 13.2).

ECB's capital shares are not traded in the public securities market, and Latvijas Banka's participating interest in the ECB can be increased or decreased only in the cases referred to in this Note.

	2016	2015
Total amount of the European Central Bank's subscribed capital (in thousands of euro)	<b>10 825 007</b>	10 825 007
The subscribed and paid-up share of Latvijas Banka in the European Central Bank's capital (in thousands of euro)	<b>30 537</b>	30 537
The percentage share of Latvijas Banka in the European Central Bank's capital (%)	<b>0.2821</b>	0.2821

At the end of 2016 and 2015, the percentage shares of NCBs in the ECB's capital (capital key) were as follows:

	2016		2015	
	(%)			
	2016	2015	2016	2015
Nationale Bank van België/Banque Nationale de Belgique	<b>2.4778</b>	2.4778		
Deutsche Bundesbank	<b>17.9973</b>	17.9973		
Eesti Pank	<b>0.1928</b>	0.1928		
Banc Ceannais na hÉireann/Central Bank of Ireland	<b>1.1607</b>	1.1607		
Bank of Greece	<b>2.0332</b>	2.0332		
Banco de España	<b>8.8409</b>	8.8409		
Banque de France	<b>14.1792</b>	14.1792		
Banca d'Italia	<b>12.3108</b>	12.3108		
Central Bank of Cyprus	<b>0.1513</b>	0.1513		
Latvijas Banka	<b>0.2821</b>	0.2821		
Lietuvos bankas	<b>0.4132</b>	0.4132		
Banque centrale du Luxembourg	<b>0.2030</b>	0.2030		
Bank Ċentrali ta' Malta/Central Bank of Malta	<b>0.0648</b>	0.0648		
De Nederlandsche Bank	<b>4.0035</b>	4.0035		
Oesterreichische Nationalbank	<b>1.9631</b>	1.9631		
Banco de Portugal	<b>1.7434</b>	1.7434		
Banka Slovenije	<b>0.3455</b>	0.3455		
Národná banka Slovenska	<b>0.7725</b>	0.7725		
Suomen Pankki – Finlands Bank	<b>1.2564</b>	1.2564		
Subtotal for euro area NCBs	<b>70.3915</b>	70.3915		
Българска народна банка (Bulgarian National Bank)	<b>0.8590</b>	0.8590		
Česká národní banka	<b>1.6075</b>	1.6075		
Danmarks Nationalbank	<b>1.4873</b>	1.4873		
Hrvatska narodna banka	<b>0.6023</b>	0.6023		
Magyar Nemzeti Bank	<b>1.3798</b>	1.3798		
Narodowy Bank Polski	<b>5.1230</b>	5.1230		
Banca Națională a României	<b>2.6024</b>	2.6024		
Sveriges Riksbank	<b>2.2729</b>	2.2729		
Bank of England	<b>13.6743</b>	13.6743		
Subtotal for non-euro area NCBs	<b>29.6085</b>	29.6085		
Total	<b>100.0000</b>	100.0000		

In 2016, the subscribed and paid-up capital of the ECB remained unchanged.

The subscribed and paid-up NCB shares in the ECB's capital at the end of 2016 and 2015 were as follows:

	(in thousands of euro)			
	Subscribed capital		Paid-up capital	
	2016	2015	2016	2015
Nationale Bank van België/ Banque Nationale de Belgique	<b>268 222</b>	268 222	<b>268 222</b>	268 222
Deutsche Bundesbank	<b>1 948 209</b>	1 948 209	<b>1 948 209</b>	1 948 209
Eesti Pank	<b>20 871</b>	20 871	<b>20 871</b>	20 871
Banc Ceannais na hÉireann/Central Bank of Ireland	<b>125 646</b>	125 646	<b>125 646</b>	125 646
Bank of Greece	<b>220 094</b>	220 094	<b>220 094</b>	220 094
Banco de España	<b>957 028</b>	957 028	<b>957 028</b>	957 028
Banque de France	<b>1 534 899</b>	1 534 899	<b>1 534 899</b>	1 534 899
Banca d'Italia	<b>1 332 645</b>	1 332 645	<b>1 332 645</b>	1 332 645
Central Bank of Cyprus	<b>16 378</b>	16 378	<b>16 378</b>	16 378
Latvijas Banka	<b>30 537</b>	30 537	<b>30 537</b>	30 537
Lietuvos bankas	<b>44 729</b>	44 729	<b>44 729</b>	44 729
Banque centrale du Luxembourg	<b>21 975</b>	21 975	<b>21 975</b>	21 975
Bank Ċentrali ta' Malta/Central Bank of Malta	<b>7 015</b>	7 015	<b>7 015</b>	7 015
De Nederlandsche Bank	<b>433 379</b>	433 379	<b>433 379</b>	433 379
Oesterreichische Nationalbank	<b>212 506</b>	212 506	<b>212 506</b>	212 506
Banco de Portugal	<b>188 723</b>	188 723	<b>188 723</b>	188 723
Banka Slovenije	<b>37 400</b>	37 400	<b>37 400</b>	37 400
Národná banka Slovenska	<b>83 623</b>	83 623	<b>83 623</b>	83 623
Suomen Pankki – Finlands Bank	<b>136 005</b>	136 005	<b>136 005</b>	136 005
Subtotal for euro area NCBs	<b>7 619 885</b>	7 619 885	<b>7 619 885</b>	7 619 885
Българска народна банка (Bulgarian National Bank)	<b>92 987</b>	92 987	<b>3 487</b>	3 487
Česká národní banka	<b>174 012</b>	174 012	<b>6 525</b>	6 525
Danmarks Nationalbank	<b>161 000</b>	161 000	<b>6 038</b>	6 038
Hrvatska narodna banka	<b>65 199</b>	65 199	<b>2 445</b>	2 445
Magyar Nemzeti Bank	<b>149 363</b>	149 363	<b>5 601</b>	5 601
Narodowy Bank Polski	<b>554 565</b>	554 565	<b>20 796</b>	20 796
Banca Națională a României	<b>281 710</b>	281 710	<b>10 564</b>	10 564
Sveriges Riksbank	<b>246 042</b>	246 042	<b>9 227</b>	9 227
Bank of England	<b>1 480 244</b>	1 480 244	<b>55 509</b>	55 509
Subtotal for non-euro area NCBs	<b>3 205 122</b>	3 205 122	<b>120 192</b>	120 192
Total <sup>1</sup>	<b>10 825 007</b>	10 825 007	<b>7 740 077</b>	7 740 077

### 13.2 CLAIMS EQUIVALENT TO THE TRANSFER OF FOREIGN RESERVES TO THE EUROPEAN CENTRAL BANK

Pursuant to the Statute of the ESCB and of the ECB, euro area NCBs shall transfer a definite amount of their foreign reserves to the ECB. The amount of foreign reserves to be transferred shall be fixed in proportion to the percentage share of each euro area NCB in the ECB's capital. For the foreign reserves transferred to the ECB Latvijas Banka received a euro-denominated claim on the ECB in the amount of 163 480 thousand euro, i.e. in proportion to the value of the respective claims of other euro area NCBs. The

<sup>1</sup> The total amount and the sum of the components may differ due to rounding.

difference between the market value of the foreign reserves transferred to the ECB and the value of the corresponding euro-denominated claim in the amount of 41 793 thousand euro is reported as participating interest in the ECB (see also Note 13.1). For the foreign reserves transferred to the ECB Latvijas Banka receives interest income calculated at the interest rate on the main refinancing operations set by the ECB (see also Note 33).

### 13.3 CLAIMS/LIABILITIES RELATED TO TARGET2 AND NATIONAL CENTRAL BANK CORRESPONDENT ACCOUNTS (NET)

TARGET2 system is a real-time gross settlement system for large value payments in euro. Claims and liabilities related to TARGET2 settlements originate as a result of cross-border payments settled in the central bank money. The above settlements result in bilateral claims and liabilities in the TARGET2 accounts held by NCBs. The net positions for the bilateral balances are attributed to the ECB and calculated on a daily basis, leaving each NCB with a single net position vis-à-vis the ECB. This is reported on the NCB's balance sheet as net claims or liabilities related to TARGET2 settlements.

In 2016, liabilities related to TARGET2 and national central bank correspondent accounts (net) increased as a result of the cross-border payments effected by credit institutions and Latvijas Banka. The above increase mostly resulted from Latvijas Banka's payments related to purchases of securities issued by the Latvian government and international institutions, an increase in investment portfolios, as well as a decrease in credit institution deposits.

Interest is paid on the above claims and liabilities as per the rate on the main refinancing operations set by the ECB.

### 13.4 CLAIMS FOR THE ALLOCATION OF BANKNOTES IN THE EUROSYSYSTEM

In view of the fact that euro banknotes are issued by all euro area NCBs and the ECB, they report a definite share of the total amount of euro banknotes issued by the Eurosystem on their balance sheets. Of the total amount of euro banknotes issued, the share allocated to Latvijas Banka is larger than the net amount of euro banknotes it has actually issued (see Note 15); in view of the above, the adjustment related to banknotes in circulation results in corresponding claims on the ECB for the allocation of banknotes, reported under the balance sheet item "Claims related to other operational requirements within the Eurosystem" (see Note 13).

### 13.5 CLAIMS RELATED TO OTHER OPERATIONAL REQUIREMENTS WITHIN THE EUROSYSYSTEM

Claims related to other operational requirements within the Eurosystem comprise claims on the ECB associated with the net result of pooling of monetary income and the ECB's interim profit distribution.

Monetary income to be received by Latvijas Banka in 2016 was higher than its monetary income to be pooled. It resulted in a claim on the ECB associated with the net result of pooling of monetary income, standing at 10 834 thousand euro at the end of 2016 (see also Notes 2.28 and 38).

Claims for the ECB's interim profit distribution in the amount of 3 872 thousand euro are set as per Latvijas Banka's percentage share in the ECB's capital (see also Notes 2.27 and 37).

**14. OTHER ASSETS**

(in thousands of euro)

	Note	2016	2015
Accrued income on debt securities		<b>63 744</b>	44 421
Fixed assets	14.1	<b>37 611</b>	38 844
Participating interest in the Bank for International Settlements	14.2	<b>32 235</b>	30 699
OTC financial derivative contracts and spot exchange rate contracts	24	<b>21 961</b>	47 561
Intangible assets	14.3	<b>1 973</b>	1 908
Prepaid expenses		<b>1 024</b>	1 056
Other accrued income		<b>886</b>	1 161
Other		<b>1 184</b>	575
<b>Total</b>		<b>160 618</b>	166 225

**14.1 FIXED ASSETS**

(in thousands of euro)

	Buildings, improvement of territory, and land	Furniture and office equipment	Computer and telecom- munication equipment	Cash processing and storage equipment	Transport vehicles	Other fixed assets	Total
<b>As at 31 December 2014</b>							
Cost	57 257	4 997	5 023	7 443	1 641	7 857	84 218
Accumulated depreciation	-23 805	-3 909	-3 437	-4 970	-1 181	-6 660	-43 962
Net book value	33 452	1 088	1 586	2 473	460	1 197	40 256
<b>During 2015</b>							
Additions	739	65	591	192	143	404	2 134
Disposals and write-offs	-39	-101	-343	-715	-26	-445	-1 669
Net change in cost	700	-36	248	-523	117	-41	465
Depreciation charge	-2 053	-129	-504	-423	-71	-288	-3 468
Accumulated depreciation on disposals and write-offs	22	98	340	662	25	444	1 591
Net change in accumulated depreciation	-2 031	-31	-164	239	-46	156	-1 877
<b>As at 31 December 2015</b>							
Cost	57 957	4 961	5 271	6 920	1 758	7 816	84 683
Accumulated depreciation	-25 836	-3 940	-3 601	-4 731	-1 227	-6 504	-45 839
Net book value	32 121	1 021	1 670	2 189	531	1 312	38 844
<b>During 2016</b>							
Additions	1 349	93	536	127	47	155	2 307
Disposals and write-offs	-	-293	-380	-14	-78	-48	-813
Net change in cost	1 349	-200	156	113	-31	107	1 494
Depreciation charge	-1 846	-132	-758	-408	-82	-300	-3 526
Accumulated depreciation on disposals and write-offs	-	280	380	14	78	47	799
Net change in accumulated depreciation	-1 846	148	-378	-394	-4	-253	-2 727
<b>As at 31 December 2016</b>							
Cost	59 306	4 761	5 427	7 033	1 727	7 923	86 177
Accumulated depreciation	-27 682	-3 792	-3 979	-5 125	-1 231	-6 757	-48 566
<b>Net book value</b>	<b>31 624</b>	<b>969</b>	<b>1 448</b>	<b>1 908</b>	<b>496</b>	<b>1 166</b>	<b>37 611</b>

At the end of 2016, Latvijas Banka's contractual commitments related to acquisition of fixed assets were 2 222 thousand euro (767 thousand euro at the end of 2015).

#### 14.2 PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2016 and 2015, Latvijas Banka owned 1 070 shares in the BIS, which corresponded to 0.19% of the total subscribed and paid-up BIS capital.

The total nominal value of Latvijas Banka's shareholding in the BIS is 5 350 thousand SDR (the nominal value per share is 5 thousand SDR), paid up in the amount of 1 338 thousand SDR or 25% (see also Note 46). At the end of 2016 and 2015, the BIS shareholding is reported in Latvijas Banka's balance sheet at fair value. The shares in the BIS are not traded in the public securities market. In the opinion of Latvijas Banka's management, the most appropriate method for establishing the fair value of the BIS shares is the use of 70% of the BIS net asset value based on the latest published financial statements of the BIS. The BIS applied this valuation method for calculating the issue price of its shares; the International Court at The Hague has also recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. At the end of 2016, the estimated fair value of BIS shares was 32 235 thousand euro (30 699 thousand euro at the end of 2015).

#### 14.3 INTANGIBLE ASSETS

(in thousands of euro)

As at 31 December 2014	
Cost	7 613
Accumulated amortisation	-5 798
Net book value	1 815
During 2015	
Additions	347
Derecognised intangible assets	-1 452
Net change in cost	-1 105
Amortisation charge	-254
Accumulated amortisation on derecognised intangible assets	1 452
Net change in accumulated amortisation	1 198
As at 31 December 2015	
Cost	6 508
Accumulated amortisation	-4 600
Net book value	1 908
<b>During 2016</b>	
Additions	298
Derecognised intangible assets	-189
Net change in cost	109
Amortisation charge	-229
Accumulated amortisation on derecognised intangible assets	185
Net change in accumulated amortisation	-44
<b>As at 31 December 2016</b>	
Cost	6 617
Accumulated amortisation	-4 644
<b>Net book value</b>	<b>1 973</b>

**15. BANKNOTES IN CIRCULATION**

	(in thousands of euro)	
	2016	2015
Euro banknotes	<b>4 150 106</b>	3 992 436
Euro banknotes issued by Latvijas Banka	247 456	497 333
Adjustment for banknote allocation in the Eurosystem	3 902 650	3 495 103
<b>Total</b>	<b>4 150 106</b>	3 992 436

The euro coins issued by Latvijas Banka are reported under the balance sheet item "Other liabilities" (see also Note 22).

**16. LIABILITIES TO EURO AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS DENOMINATED IN EURO****16.1 CURRENT ACCOUNTS (COVERING THE MINIMUM RESERVE SYSTEM)**

Current accounts contain the credit balances on the transaction accounts of credit institutions that are required to hold minimum reserves. Minimum reserve balances have been remunerated at the latest available interest rate used by the Eurosystem in its tenders for main refinancing operations. Since June 2014, the lower rate of either zero per cent or the ECB's deposit facility rate has been applied to the reserves held in excess of the required minimum reserves. At the end of 2016, balance on the current accounts placed with Latvijas Banka was 4 191 147 thousand euro (4 784 410 thousand euro at the end of 2015), including the minimum reserves in the amount of 228.9 million euro (230.6 million euro at the end of 2015).

**16.2 DEPOSIT FACILITY**

Deposit facility is a standing facility of the Eurosystem used by credit institutions to place their overnight deposits at a pre-specified rate. No such deposits were placed with Latvijas Banka at the end of 2016 and 2015.

**17. OTHER LIABILITIES TO EURO AREA CREDIT INSTITUTIONS DENOMINATED IN EURO**

Other liabilities to euro area credit institutions denominated in euro resulted from funds received as collateral for forward exchange rate contracts accounting for 720 thousand euro at the end of 2016 (8 830 thousand euro at the end of 2015).

**18. LIABILITIES TO OTHER EURO AREA RESIDENTS DENOMINATED IN EURO**

Liabilities to other euro area residents denominated in euro comprise demand deposits by the Latvian government and other financial institutions. Government deposits comprise the Treasury demand deposits received by Latvijas Banka acting as the financial agent of the Latvian government (see also Note 43).

Deposits of other financial institutions mostly include the funds of the FCMC and the Deposit Guarantee Fund and Fund for the Protection of the Insured, both managed by the FCMC, in the amount of 137 125 thousand euro (106 952 thousand euro at the end of 2015).

## 19. LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN EURO

	(in thousands of euro)	
	2016	2015
European Commission	14 547	202
Other financial institutions	2 260	8 423
International Monetary Fund	1 081	474
Total	17 888	9 099

## 20. LIABILITIES TO EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

Liabilities to euro area residents denominated in foreign currency comprise demand deposits of the Latvian government in foreign currency standing at 159 844 thousand euro at the end of 2016 (155 228 thousand euro at the end of 2015; see also Note 43).

## 21. LIABILITIES TO NON-EURO AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY

At the end of 2016, Latvijas Banka had no liabilities to non-euro area residents denominated in foreign currency (478 thousand euro at the end of 2015).

## 22. OTHER LIABILITIES

		(in thousands of euro)	
	Note	2016	2015
Provisions for market risk and credit risk	36	136 500	50 100
Euro coins in circulation	22.1	60 728	52 484
Lats banknotes in circulation	22.1	45 226	71 261
OTC financial derivative contracts and spot exchange rate contracts	24	37 624	14 144
Lats coins in circulation	22.1	6 580	64 265
Accrued expense and similar liabilities		6 278	5 170
Tax liabilities	22.2	159	197
Other		1 519	1 232
Total		294 614	258 853

### 22.1 BANKNOTES AND COINS IN CIRCULATION

Apart from the lats and euro circulation coins issued by Latvijas Banka and reported on the liabilities side of the balance sheet, euro collector coins, lats collector coins and precious metal circulation coins were also in circulation with the total nominal value of 5 953 thousand euro at the end of 2016 (5 787 thousand euro at the end of 2015). The above coins in circulation have not been reported under the balance sheet item "Other liabilities" (see also Notes 2.22 and 46).

Lats banknotes and coins, whose exchange probability is low, in the amount of 78 100 thousand euro (lats banknotes in the amount of 21 325 thousand euro and lats coins in the amount of 56 775 thousand euro) have not been reported under the balance sheet liabilities (see also Notes 2.1 and 46).



## 22.2 TAX LIABILITIES

At the end of 2016 and 2015, tax liabilities of Latvijas Banka were as follows:

	(in thousands of euro)						
	Personal income tax	State compulsory social security contributions and ST (by employer)	State compulsory social security contributions and ST (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2014	–	–	–	–	175	–	175
During 2015							
Calculated	2 969	3 518	1 462	150	840	2	8 941
Increase in deferred liabilities	–	–239	–	–	–	–	–239
Paid	–2 969	–3 273	–1 460	–150	–826	–2	–8 680
Liabilities as at 31 December 2015	–	6	2	–	189	–	197
<b>During 2016</b>							
Calculated	3 085	3 852	1 689	160	1 155	2	9 943
Decrease in deferred liabilities	–	–64	–	–	–	–	–64
Paid	–3 085	–3 794	–1 691	–160	–1 185	–2	–9 917
<b>Liabilities as at 31 December 2016</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>159</b>	<b>–</b>	<b>159</b>

In addition to the tax payments indicated herein, Latvijas Banka transfers to the state budget 65% of the profit for the reporting year (19 524 thousand euro in 2016; 23 894 thousand euro in 2015; see also Notes 23 and 43). The transfer includes the payment for the usage of state capital. Latvijas Banka is not subject to corporate income tax.

## 23. CAPITAL AND RESERVES

	(in thousands of euro)				
	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
As at 31 December 2014	100 000	200 504	141 625	36 760	478 889
During 2015					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	–33 677	x	–33 677
Profit appropriated to the state budget	x	x	x	–23 894	–23 894
Profit transferred to the reserve capital	x	12 866	x	–12 866	–
Profit of the reporting year	x	x	x	30 037	30 037
As at 31 December 2015	100 000	213 370	107 948	30 037	451 355
<b>During 2016</b>					
Net result of revaluation, realisation, and revaluation result recognition in profit and loss statement	x	x	9 748	x	9 748
Profit appropriated to the state budget	x	x	x	–19 524	–19 524
Profit transferred to the reserve capital	x	10 513	x	–10 513	–
Profit of the reporting year	x	x	x	11 773	11 773
<b>As at 31 December 2016</b>	<b>100 000</b>	<b>223 883</b>	<b>117 696</b>	<b>11 773</b>	<b>453 352</b>

The capital and reserves of Latvijas Banka is comprised of the nominal capital, reserve capital and the valuation account, as well as the undistributed profit of the reporting year.

The legal framework does not provide for any capital adequacy requirements for Latvijas Banka; nevertheless, the amount of its capital should be adequate to promote credibility of the monetary policy implemented by Latvijas Banka, and to ensure implementation of its operations and financial independence when performing the tasks set forth by the Statute of the ESCB and of the ECB and the Law on Latvijas Banka. The implementation of the monetary policy as well as exposure to other financial and operational risks may adversely affect Latvijas Banka's income or result in losses to be covered from the capital and reserves of Latvijas Banka.

The nominal capital of Latvijas Banka is comprised of the state-allotted resources, transfers from the reserve capital and Latvijas Banka's profit allocations.

The Law on Latvijas Banka establishes that a part of Latvijas Banka's profit of the reporting year, calculated by applying the same percentage as the tax rate set for resident corporate entities of Latvia by the Law on Corporate Income Tax, together with a payment in the amount of 50% of the profit of the reporting year for the usage of state capital shall be transferred to the state budget, as well as that the Council of Latvijas Banka, upon approving the annual report, may make a decision on reducing the percentage share of the payment for the usage of state capital where it is necessary for increasing the reserve capital of Latvijas Banka in relation to the financial risks Latvijas Banka is exposed to when executing its tasks. At the end of 2016 and 2015, the corporate income tax rate applicable to residents of Latvia was 15%. Therefore, unless the Council of Latvijas Banka decides otherwise, 65% of Latvijas Banka's profit of the reporting year or 7 653 thousand euro shall be transferred to the state budget within 15 days following the approval of the Annual Report of 2016 by the Council of Latvijas Banka.

Latvijas Banka's profit remaining after making the above deductions shall be transferred to the reserve capital as prescribed by the Law on Latvijas Banka. The reserve capital shall be formed to cover potential losses.

The valuation account comprises the positive result on revaluation of the financial instruments and gold. The accounting policy, harmonised with the principal accounting policies established by the ECB's legal framework for accounting and financial reporting and described in Note 2 stipulates that the realised gains are recognised in the profit and loss statement only after the disposal of a financial instrument or settlement while unrealised gains are recorded under the balance sheet item "Capital and reserves" as the revaluation reserve, thus facilitating the preservation of the capital under the impact of financial instrument price, interest rate and exchange rate fluctuations.

In 2016 and 2015, changes in the valuation account were as follows:

(in thousands of euro)

	2016	Recognition in profit and loss statement	Revaluation	Realisation	2015
Initial valuation account	16 916	x	x	-11 036	27 952
Revaluation reserve for equity instruments	29 726	-	1 536	-	28 190
Result on revaluation of foreign currencies and gold	35 449	72	10 343	-26	25 060
Result on revaluation of interest rate swap arrangements	-	-	-	-185	185
Result on revaluation of securities	35 605	52 657	-28 295	-15 318	26 561
Total	117 696	52 729	-16 416	-26 565	107 948

	2015	Recognition in profit and loss statement	Revaluation	Realisation	2014
Initial valuation account	27 952	x	x	-13 543	41 495
Revaluation reserve for equity instruments	28 190	-	2 523	-	25 667
Result on revaluation of foreign currencies and gold	25 060	214	-1 438	-2 225	28 509
Result on revaluation of interest rate swap arrangements	185	48	137	-	-
Result on revaluation of securities	26 561	13 371	-14 759	-18 005	45 954
Total	107 948	13 633	-13 537	-33 773	141 625

In accordance with the ECB's legal framework for accounting and financial reporting, on 1 January 2015 Latvijas Banka reclassified the accumulated result on revaluation of foreign currencies to the initial valuation account. The initial valuation account also comprises the accumulated result on revaluation of financial instruments and gold prior to the change in the accounting policy on 1 January 2007.

The balance on the initial valuation account is recognised in the profit and loss statement to compensate lower remuneration for claims related to the banknote allocation within the Eurosystem as per the coefficients applied in accordance with the decisions of the Governing Council of the ECB for the calculation of the remuneration adjustment for claims related to the banknote allocation within the Eurosystem in the first six years after an NCB joins the Eurosystem (see Note 33). The amount to be recognised in the profit and loss statement for the respective year is calculated by multiplying the balance on the initial valuation account as at 1 January 2016 with the share of the coefficient for calculating the compensation amount for the respective year in the total coefficients (indicated in Note 33) during the transition period when the adjustment amounts for the claims on banknote allocation in the Eurosystem are calculated.

The revaluation reserve for equity instruments has been established to account for the result on revaluation of the BIS shares. The result on revaluation of the BIS shares is not recognised in the profit and loss statement.

#### 24. DERIVATIVE FINANCIAL INSTRUMENTS AND SPOT EXCHANGE RATE CONTRACTS

Latvijas Banka enters into forward and spot exchange rate contracts, currency and interest rate swap arrangements, forward transactions in securities, and interest rate and currency future contracts in order to manage interest rate and currency risks associated with Latvijas Banka's investments. At the end of 2016 and 2015, the contract or notional amounts and book value of the above transactions were as follows:

	Contract or notional amount		Book value			
			Assets		Liabilities	
	2016	2015	2016	2015	2016	2015
OTC financial derivative and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	4 864 061	4 384 675	19 451	46 517	33 068	13 217
Spot exchange rate contracts	399 382	359 907	396	560	16	432
Forward transactions in securities	1 453 643	723 093	2 114	299	4 539	447
Interest rate swap arrangements	17 380	16 385	–	185	1	48
Total	x	x	21 961	47 561	37 624	14 144
Traded financial derivative contracts						
Interest rate future contracts	1 102 247	573 263	x	x	x	x
Currency future contracts	189 710	179 512	x	x	x	x

The book value of the OTC financial derivative contracts and spot exchange rate contracts is reported under the balance sheet items "Other assets" or "Other liabilities" (see also Notes 14 and 22). Since settlement has been made for the change in the fair value of future contracts, the change is reported as demand deposits under the respective balance sheet asset item.

## MAJOR RISKS AND PRINCIPLES FOR THEIR MANAGEMENT

### 25. RISK MANAGEMENT

Financial and operational risks are the main risks associated with the activities of Latvijas Banka. Management of Latvijas Banka's risks is organised and implemented according to the Risk Management Policy of Latvijas Banka approved by the Council of Latvijas Banka. Therefore, the Board of Latvijas Banka has established a risk management framework under the basic principles set forth by the Council of Latvijas Banka, which is improved in line with the developments in financial markets and operations of Latvijas Banka as well as changes in external environment. Management of Latvijas Banka's financial and operational risks is reviewed by the Internal Audit Department and is monitored by the Budget Commission of Latvijas Banka, Security Supervision Commission, and Audit Committee, each of which is comprised of Members of the Council of Latvijas Banka.

#### 25.1 FINANCIAL RISKS

Market risk (price, interest rate and currency risks), credit and liquidity risks are the most significant financial risks Latvijas Banka is exposed to in its daily activities.

Latvijas Banka manages financial risks related to its investments in line with the Procedure, adopted by the Council of Latvijas Banka; the basic principles of its investment policy are described in Note 4. Investments are managed by classifying them into different investment portfolios. Parameters for a benchmark reflecting the acceptable level of financial risks and return target are set out for each financial instrument portfolio. The Risk Management Division of the Market Operations Department monitors the investment compliance with the established requirements.

For the purpose of investment management, including management of the related financial risks, the Investment Committee of Latvijas Banka develops an investment management strategy, approves tactical decisions and sets detailed limits for financial risks, as well as

oversees the operation of the external managers. The Investment Committee of Latvijas Banka reviews the investment strategy once a quarter, and on a weekly basis receives and reviews reports on and forecasts for developments in financial markets, prepared by financial investment portfolio managers, reports by financial risk managers, and approves the investment management tactical decisions for the forthcoming week. The Market Operations Department informs the Council and the Board of Latvijas Banka about the results of investment management on a regular basis.

Latvijas Banka purchases assets under the PSPP in accordance with the decisions of the ECB's Governing Council. Latvijas Banka makes the purchases and manages financial risks in line with the guidelines of the ECB's Governing Council and the procedure adopted by the Board of Latvijas Banka. Financial risks arising as a result of implementing monetary policy are shared among the euro area NCBs in proportion to their shares in the ECB's capital, except risks associated with the purchases of Latvian government securities carried out by Latvijas Banka under the PSPP.

#### 25.1.1 MARKET RISK

Market risk is exposure to losses due to adverse changes in financial markets (for example, movements in interest rates or exchange rates).

Latvijas Banka is exposed to interest rate risk primarily due to investing in foreign debt securities and interest rate derivatives that are subject to interest rate fluctuations and used within the course of investment management. Latvijas Banka manages interest rate risk by using a modified duration limit set individually for each investment portfolio.

Latvijas Banka's exposure to currency risk is determined by its investment structure. Latvijas Banka manages currency risk by establishing that the benchmark currency is the euro, thus hedging the currency risk, and using tracking error limits in relation to the respective benchmark. Tracking error is calculated as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark. The aggregate market and credit risk of 1–10 year fixed income securities portfolios, and mortgage-backed securities portfolios (see Note 4) is managed by determining the tracking error limit. Tracking error in 2016 and 2015 is disclosed in Note 28.

For investment portfolios, except for portfolios of borrowed funds, the benchmark currency is the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the respective currency. Deviations from the benchmark currency structure give rise to the open currency position. In order to achieve the compliance of open foreign currency positions with the limits, Latvijas Banka hedges the currency risk by using forward exchange rate contracts, currency swap arrangements, and currency future contracts.

The Risk Management Division of the Market Operations Department monitors the compliance of the modified duration, tracking error, and open currency positions with the Procedure adopted by the Council of Latvijas Banka and the related resolutions passed by the Investment Committee of Latvijas Banka.

Latvijas Banka's exposure to market risk (as at the end of 2016 and 2015) is disclosed in Notes 26–28.

#### 25.1.2 CREDIT RISK

Credit risk is exposure to losses resulting from counterparty default. Latvijas Banka's exposure to credit risk results mainly from investments in foreign financial instruments, and as a result of monetary policy operations. Pursuant to the Statute of the ESCB and of the ECB, risks associated with the implementation of monetary policy (if any materialise) are shared among euro area NCBs in proportion to their share in the ECB's capital,

except risks associated with the purchases of Latvian government securities carried out by Latvijas Banka under the PSPP.

Latvijas Banka manages exposure to credit risk related to investments made in foreign financial instruments by establishing limits on investments of different credit quality. Credit quality is evaluated on the basis of ratings assigned by the international credit rating agencies Fitch Ratings, Moody's Investors Service, Standard & Poor's, and DBRS. Latvijas Banka is allowed to invest in financial instruments of certain credit quality of the OECD countries, as well as in Latvian government securities. Limits are also set on the maximum investment in financial instruments of the same class and counterparty, as well as in financial instruments of one issuer. Forward transactions in mortgage-backed securities are partly secured with short-term financial instruments. To hedge the credit risk associated with OTC derivative counterparties, Latvijas Banka and the respective counterparties enter into Master Agreements of International Swaps and Derivatives Association, Inc. (ISDA Master Agreement) with Credit Support Annex, and the external managers of mortgage-backed securities portfolios enter with their counterparties into Treasury Market Practices Group (TMPG) Master Securities Forward Transaction Agreements. In order to monitor Latvijas Banka's credit risk exposure associated with its investments, the Risk Management Division of the Market Operations Department monitors compliance with the Procedure, adopted by the Council of Latvijas Banka.

In 2016 and 2015, loans granted to credit institutions in monetary policy operations were secured by securities collateral in compliance with the ECB requirements. The Market Operations Department monitors the adequacy of collateral of the respective loans and its eligibility and compliance with the ECB's requirements on a regular basis, as well as maintains a list of securities issued and held in the Republic of Latvia and eligible for monetary policy operations.

Latvijas Banka's exposure to market risk (as at the end of 2016 and 2015) is disclosed in Notes 30–32.

### 25.1.3 LIQUIDITY RISK

Liquidity risk is associated with a failure to dispose investment in a short time and at a competitive market price. Along with Latvia's participation in the euro area, the need for liquidity as well as the risk associated with a failure to meet liabilities in a timely manner has moderated. Following its investment strategy, Latvijas Banka manages liquidity risk by investing a certain amount of its investments in liquid debt securities issued by international institutions, foreign governments and the corporate sector, short-term deposits with foreign financial institutions and other financial instruments. The liquidity structure of Latvijas Banka's assets and liabilities as at the end of 2016 and 2015 is disclosed in Note 29.

Liquidity risk can be limited by investment diversification. Latvijas Banka manages liquidity risk also by setting limits on the maximum investment in financial instruments of the same class and in financial instruments of the same issuer.

### 25.2 OPERATIONAL RISKS

Operational risks are related to a potential negative impact on Latvijas Banka's operation, reputation or finances resulting from inadequate or erroneous execution of processes, actions on the part of an official or employee of Latvijas Banka, inadequate operation or unavailability of the infrastructure of information systems or an information system or the infrastructure, or external events.

Latvijas Banka's operational risk management is implemented by the Board of Latvijas Banka according to the basic principles defined by the Council of Latvijas Banka. The Board of Latvijas Banka has established the Operational Risk Management Committee of

Latvijas Banka to coordinate, on a day-to-day basis, the activities under the operational risk management process and to provide support to the Board of Latvijas Banka on operational risk management issues. The Committee is chaired by a Member of the Board of Latvijas Banka and is composed of the Operational Risk Manager, Information Risk Manager, the Head of the Technical Support Department, and the Head of the Security Department.

The security management of the information and information systems of Latvijas Banka is organised and implemented in accordance with the Information and Information Systems Security Policy of Latvijas Banka approved by Latvijas Banka's Council. In order to ensure confidentiality, access to and integrity of information, information at Latvijas Banka is classified on the basis of its level of confidentiality and accessibility and is protected against its unauthorised processing, use or disclosure. The information systems of Latvijas Banka are classified into levels depending on their impact on the implementation of processes and the confidentiality, integrity and availability requirements regarding the processed information. The owners of Latvijas Banka's information systems in cooperation with the Information Systems Department have established rules for the usage and access rights of the information system, as well as ensure the implementation of risk analysis of the respective information system. The Head of Information Systems Department ensures that the functionality and performance of Latvijas Banka's information system infrastructure complies with the requirements set for the information systems, as well as the infrastructure's safe and continuous operation. Latvijas Banka conducts, on a regular basis, security risk analysis of information systems and electronically stored information and improves security measures and tools.

The management of Latvijas Banka's business continuity is organised and conducted in accordance with the Business Continuity Management Policy of Latvijas Banka, approved by the Council of Latvijas Banka, abiding by the internationally recognised standards and taking into account the ECB recommendations regarding business continuity management.

Latvijas Banka conducts, on a regular basis, educational sessions for employees on information and information systems security, operational risk management and management of business continuity.

An environment protected against physical hazards is organised and ensured on the premises of Latvijas Banka and during transportation of cash and other valuables in accordance with the Physical Security Policy of Latvijas Banka, adopted by the Council of Latvijas Banka, and other legislative acts of Latvijas Banka regulating the physical security management procedure for Latvijas Banka. Fire training is organised for the staff of Latvijas Banka, and training for the employees of the Security Department to maintain and improve their qualification is organised on a regular basis.

In order to limit the implications of operational risks, Latvijas Banka is insured against a possible impact of certain types of operational risks.

In 2016, operational risks, inter alia risks related to ensuring Latvijas Banka's business continuity, information and information systems, as well as physical security were appropriately managed and did not substantially hamper Latvijas Banka's operation.

## 26. CURRENCY STRUCTURE

(in thousands of euro)

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	EUR	USD	GBP	CAD	JPY	Gold	Other	Total
<b>As at 31 December 2016</b>								
Total assets	11 123 287	2 934 068	277 936	162 661	16 114	234 305	23 934	14 772 305
Total liabilities	14 653 109	78 069	12 299	141	11 794	–	16 893	14 772 305
Net position on balance sheet	–3 529 822	2 855 999	265 637	162 520	4 320	234 305	7 041	0
Net position on financial instruments' off-balance sheet accounts	3 506 985	–2 842 977	–265 516	–165 874	–6 563	–234 323	–7 395	–15 663
<b>Net position on balance sheet and off-balance sheet accounts</b>	<b>–22 837</b>	<b>13 022</b>	<b>121</b>	<b>–3 354</b>	<b>–2 243</b>	<b>–18</b>	<b>–354</b>	<b>–15 663</b>
<b>Net position on balance sheet and off-balance sheet accounts to total assets (%)</b>	<b>–0.2</b>	<b>0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>–0.1</b>
<b>As at 31 December 2015</b>								
Total assets	7 460 510	2 371 111	447 962	195 462	429 391	207 670	6 581	11 118 687
Total liabilities	11 011 323	77 367	18 517	177	11 264	–	39	11 118 687
Net position on balance sheet	–3 550 813	2 293 744	429 445	195 285	418 127	207 670	6 542	0
Net position on financial instruments' off-balance sheet accounts	3 588 618	–2 296 007	–429 807	–193 680	–417 171	–207 686	–10 850	33 417
Net position on balance sheet and off-balance sheet accounts	37 805	–2 263	–362	1 605	956	–16	–4 308	33 417
Net position on balance sheet and off-balance sheet accounts to total assets (%)	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.3

## 27. REPRICING MATURITY

The table below reflects the sensitivity of Latvijas Banka's assets, liabilities and off-balance sheet accounts to a change in interest rates. Items reported in this table are stated at carrying amounts, except for interest rate and currency future contracts and forward transactions in securities that are stated at notional amounts and included in off-balance sheet accounts. A nearest contractual interest repricing or residual maturity date to 31 December of the reporting year is used for categorising the items sensitive to a change in interest rates reported in this table.

(in thousands of euro)

	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non-interest bearing items	Total
<b>As at 31 December 2016</b>							
Gold and gold receivables	–	–	–	–	–	234 305	234 305
Claims on non-euro area residents denominated in foreign currency	131 505	116 403	88 249	584 899	1 934 402	236 618	3 092 076
Claims on euro area residents denominated in foreign currency	30 486	3 349	123 019	–	200 139	1 846	358 839
Claims on non-euro area residents denominated in euro	26 570	1 412	26 276	–	79 684	10 622	144 564
Lending to euro area credit institutions related to monetary policy operations denominated in euro	12 500	–	–	244 660	–	–	257 160



<i>(cont.)</i>	(in thousands of euro)						
	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non-interest bearing items	Total
Other claims on euro area credit institutions denominated in euro	–	–	–	–	–	9 071	9 071
Securities of euro area residents denominated in euro	–	–	249 983	128 884	5 940 887	–	6 319 754
Intra-Eurosystem claims	–	–	–	–	–	4 195 918	4 195 918
Other assets	10	18	165	828	51 160	108 437	160 618
<b>Total assets</b>	<b>201 071</b>	<b>121 182</b>	<b>487 692</b>	<b>959 271</b>	<b>8 206 272</b>	<b>4 796 817</b>	<b>14 772 305</b>
Banknotes in circulation	–	–	–	–	–	4 150 106	4 150 106
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 191 147	–	–	–	–	–	4 191 147
Other liabilities to euro area credit institutions denominated in euro	720	–	–	–	–	–	720
Liabilities to other euro area residents denominated in euro	209 835	–	–	–	–	2 404	212 239
Liabilities to non-euro area residents denominated in euro	16 767	–	–	–	–	1 121	17 888
Liabilities to euro area residents denominated in foreign currency	159 844	–	–	–	–	–	159 844
Intra-Eurosystem liabilities	5 292 395	–	–	–	–	–	5 292 395
Other liabilities	–	–	–	–	–	294 614	294 614
Capital and reserves	–	–	–	–	–	453 352	453 352
<b>Total liabilities</b>	<b>9 870 708</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>4 901 597</b>	<b>14 772 305</b>
Net position on balance sheet	–9 669 637	121 182	487 692	959 271	8 206 272	–104 780	–
Assets on financial instruments' off-balance sheet accounts	6 217 398	99 611	170 382	211 626	1 296 391	–	7 995 408
Liabilities on financial instruments' off-balance sheet accounts	7 234 395	167 502	122 770	19 494	466 910	–	8 011 071
<b>Net position on balance sheet and off-balance sheet accounts</b>	<b>10 686 634</b>	<b>53 291</b>	<b>535 304</b>	<b>1 151 403</b>	<b>9 035 753</b>	<b>–104 780</b>	<b>–15 663</b>
As at 31 December 2015							
Gold and gold receivables	–	–	–	–	–	207 670	207 670
Claims on non-euro area residents denominated in foreign currency	279 286	111 938	693 441	870 040	830 657	164 617	2 949 979
Claims on euro area residents denominated in foreign currency	3 951	–	231 896	286 161	18 805	260	541 073
Claims on non-euro area residents denominated in euro	5 313	25 997	84 825	31 314	22 032	9	169 490
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10 000	–	63 210	190 520	–	–	263 730
Other claims on euro area credit institutions denominated in euro	52	–	–	–	–	2 439	2 491
Securities of euro area residents denominated in euro	32 329	30 502	264 782	514 324	2 173 496	–	3 015 433
Intra-Eurosystem claims	3 687 513	–	–	–	–	115 083	3 802 596
Other assets	907	1 116	8 587	8 521	25 475	121 619	166 225
<b>Total assets</b>	<b>4 019 351</b>	<b>169 553</b>	<b>1 346 741</b>	<b>1 900 880</b>	<b>3 070 465</b>	<b>611 697</b>	<b>11 118 687</b>

<i>(cont.)</i>	(in thousands of euro)						
	Up to 3 months	3–12 months	1–3 years	3–5 years	Over 5 years	Non-interest bearing items	Total
Banknotes in circulation	–	–	–	–	–	3 992 436	3 992 436
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 784 410	–	–	–	–	–	4 784 410
Other liabilities to euro area credit institutions denominated in euro	8 830	–	–	–	–	–	8 830
Liabilities to other euro area residents denominated in euro	145 008	–	–	–	–	886	145 894
Liabilities to non-euro area residents denominated in euro	8 584	–	–	–	–	515	9 099
Liabilities to euro area residents denominated in foreign currency	155 228	–	–	–	–	–	155 228
Liabilities to non-euro area residents denominated in foreign currency	478	–	–	–	–	–	478
Intra-Eurosystem liabilities	1 312 104	–	–	–	–	–	1 312 104
Other liabilities	–	–	–	–	–	258 853	258 853
Capital and reserves	–	–	–	–	–	451 355	451 355
<b>Total liabilities</b>	<b>6 414 642</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>4 704 045</b>	<b>11 118 687</b>
Net position on balance sheet	–2 395 291	169 553	1 346 741	1 900 880	3 070 465	–4 092 348	–
Assets on financial instruments' off-balance sheet accounts	5 369 658	83 793	239 720	10 839	511 666	–	6 215 676
Liabilities on financial instruments' off-balance sheet accounts	5 733 023	–	6 797	138 330	304 109	–	6 182 259
Net position on balance sheet and off-balance sheet accounts	–2 758 656	253 346	1 579 664	1 773 389	3 278 022	–4 092 348	33 417

## 28. TRACKING ERROR

The exposure to aggregate market risk and credit risk of investments, included in 1–3 year fixed income securities and 1–10 year government fixed income securities portfolios and mortgage-backed securities portfolios is characterised by the tracking error, which is measured as the expected annualised standard deviation of the difference in return between the investment portfolio and the respective benchmark (see also Note 25.1). At the end of 2016, the actual (ex-post) tracking error of the 1–10 year fixed income securities portfolios was 25 basis points. At the end of 2015, the actual (ex-post) tracking errors of the 1–3 year fixed income securities portfolios and the 1–10 year government fixed income securities portfolio were 25 basis points and 37 basis points respectively (for changes in investment portfolios, see also Note 4). At the end of 2016 and 2015, the actual (ex-post) tracking errors of the mortgage-backed securities portfolios were 79 basis points and 76 basis points respectively.

The expected (ex-ante) tracking error lay within the following basis point intervals during the year:

	Book value (at the end of the year; in thousands of euro)	Expected tracking error (number of business days)		
		10–39	40–69	70–99
<b>During 2016</b>				
1–10 year fixed income securities portfolios	3 043 063	86	–	–
1–3 year fixed income securities portfolios	–	167	–	–
Mortgage-backed securities portfolios	1 156 594	3	207	43
1–10 year government fixed income securities portfolio	–	167	–	–
<b>During 2015</b>				
1–3 year fixed income securities portfolios	3 561 588	250	–	–
Mortgage-backed securities portfolios	536 233	60	165	25
1–10 year government fixed income securities portfolio	371 829	63	–	–

## 29. LIQUIDITY STRUCTURE

In the liquidity structure, asset items are reported on the basis of Latvijas Banka's capability to convert them into cash. Liabilities items are reported by their expected settlement date.

	(in thousands of euro)			
	Up to 3 months	Over 3 months	No fixed maturity	Total
<b>As at 31 December 2016</b>				
<b>Assets</b>				
Gold and gold receivables	234 305	–	–	<b>234 305</b>
Claims on non-euro area residents denominated in foreign currency	3 092 076	–	–	<b>3 092 076</b>
Claims on euro area residents denominated in foreign currency	358 839	–	–	<b>358 839</b>
Claims on non-euro area residents denominated in euro	144 564	–	–	<b>144 564</b>
Lending to euro area credit institutions related to monetary policy operations denominated in euro	12 500	244 660	–	<b>257 160</b>
Other claims on euro area credit institutions denominated in euro	9 071	–	–	<b>9 071</b>
Securities of euro area residents denominated in euro	6 319 754	–	–	<b>6 319 754</b>
Intra-Eurosystem claims	14 706	–	4 181 212	<b>4 195 918</b>
Other assets	86 591	–	74 027	<b>160 618</b>
<b>Total assets</b>	<b>10 272 406</b>	<b>244 660</b>	<b>4 255 239</b>	<b>14 772 305</b>
<b>Liabilities</b>				
Banknotes in circulation	–	–	4 150 106	<b>4 150 106</b>
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 191 147	–	–	<b>4 191 147</b>
Other liabilities to euro area credit institutions denominated in euro	720	–	–	<b>720</b>
Liabilities to other euro area residents denominated in euro	212 239	–	–	<b>212 239</b>
Liabilities to non-euro area residents denominated in euro	17 888	–	–	<b>17 888</b>
Liabilities to euro area residents denominated in foreign currency	159 844	–	–	<b>159 844</b>
Intra-Eurosystem liabilities	5 292 395	–	–	<b>5 292 395</b>
Other liabilities	182 050	–	112 564	<b>294 614</b>
<b>Total liabilities</b>	<b>10 056 283</b>	<b>–</b>	<b>4 262 670</b>	<b>14 318 953</b>
<b>Net position on balance sheet</b>	<b>216 123</b>	<b>244 660</b>	<b>–7 431</b>	<b>x</b>

<i>(cont.)</i>	(in thousands of euro)			
	Up to 3 months	Over 3 months	No fixed maturity	Total
As at 31 December 2015				
Assets				
Gold and gold receivables	207 670	–	–	207 670
Claims on non-euro area residents denominated in foreign currency	2 949 979	–	–	2 949 979
Claims on euro area residents denominated in foreign currency	541 073	–	–	541 073
Claims on non-euro area residents denominated in euro	169 490	–	–	169 490
Lending to euro area credit institutions related to monetary policy operations denominated in euro	10 000	253 730	–	263 730
Other claims on euro area credit institutions denominated in euro	2 491	–	–	2 491
Securities of euro area residents denominated in euro	3 015 433	–	–	3 015 433
Intra-Eurosystem claims	28 931	–	3 773 665	3 802 596
Other assets	93 143	–	73 082	166 225
<b>Total assets</b>	<b>7 018 210</b>	<b>253 730</b>	<b>3 846 747</b>	<b>11 118 687</b>
Liabilities				
Banknotes in circulation	–	–	3 992 436	3 992 436
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	4 784 410	–	–	4 784 410
Other liabilities to euro area credit institutions denominated in euro	8 830	–	–	8 830
Liabilities to other euro area residents denominated in euro	145 894	–	–	145 894
Liabilities to non-euro area residents denominated in euro	9 099	–	–	9 099
Liabilities to euro area residents denominated in foreign currency	155 228	–	–	155 228
Liabilities to non-euro area residents denominated in foreign currency	478	–	–	478
Intra-Eurosystem liabilities	1 312 104	–	–	1 312 104
Other liabilities	70 819	–	188 034	258 853
<b>Total liabilities</b>	<b>6 486 862</b>	<b>–</b>	<b>4 180 470</b>	<b>10 667 332</b>
<b>Net position on balance sheet</b>	<b>531 348</b>	<b>253 730</b>	<b>–333 723</b>	<b>x</b>

### 30. SECTORAL STRUCTURE OF ASSETS

	Amount (in thousands of euro)		Proportion (%)	
	2016	2015	2016	2015
European Central Bank	<b>4 195 932</b>	3 802 877	<b>28.4</b>	34.2
Central governments and other governmental institutions	<b>3 830 747</b>	2 863 088	<b>25.9</b>	25.8
Other financial institutions	<b>3 014 455</b>	2 759 574	<b>20.4</b>	24.7
International institutions	<b>2 492 350</b>	260 690	<b>16.9</b>	2.3
Central banks and credit institutions	<b>1 077 208</b>	1 296 377	<b>7.3</b>	11.7
Local governments	<b>84 388</b>	85 998	<b>0.6</b>	0.8
Non-financial corporations	<b>37 419</b>	8 840	<b>0.3</b>	0.1
Unclassified assets	<b>39 806</b>	41 243	<b>0.2</b>	0.4
<b>Total</b>	<b>14 772 305</b>	11 118 687	<b>100.0</b>	100.0

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

	Amount (in thousands of euro)		Proportion (%)	
	2016	2015	2016	2015
European Central Bank	4 195 932	3 802 877	28.4	34.2
Euro area countries	4 843 351	3 859 903	32.8	34.7
International institutions	2 492 350	260 690	16.9	2.3
US	1 788 884	1 137 245	12.1	10.2
UK	618 873	731 428	4.2	6.6
Canada	310 337	285 628	2.1	2.6
Other European Union countries	188 658	182 897	1.3	1.6
Japan	65 581	487 442	0.4	4.4
Other countries	268 339	370 577	1.8	3.4
<b>Total</b>	<b>14 772 305</b>	<b>11 118 687</b>	<b>100.0</b>	<b>100.0</b>

### 32. ASSETS BY CREDIT RATING ASSIGNED TO THE COUNTERPARTY

	Amount (in thousands of euro)		Proportion (%)	
	2016	2015	2016	2015
European Central Bank	4 195 932	3 802 877	28.4	34.2
AAA	4 090 375	2 007 854	27.7	18.1
AA	4 455 291	3 664 525	30.2	32.9
A	1 201 468	1 317 148	8.1	11.8
BBB	529 726	18 938	3.6	0.2
Assets not exposed to credit risk and assets without counterparty credit rating	299 513	307 345	2.0	2.8
<b>Total</b>	<b>14 772 305</b>	<b>11 118 687</b>	<b>100.0</b>	<b>100.0</b>

Based on Standard & Poor's credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above table show the breakdown of Latvijas Banka's assets as at the end of the reporting period. 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 in the long term. "BBB" is a medium grade considered to be the lowest level of investment-grade rating.

## PROFIT AND LOSS STATEMENT NOTES

### 33. NET INTEREST INCOME

	(in thousands of euro)	
	2016	2015
Interest income	<b>102 982</b>	64 696
Interest on investments	71 342	55 237
Interest on customer deposits	531	164
Interest on monetary policy operations	30 879	8 468
Interest on intra-Eurosystem claims	230	827
Interest expense	<b>-46 181</b>	-19 743
Interest on investments	-45 102	-18 340
Interest on monetary policy operations	-776	-113
Interest on intra-Eurosystem liabilities	-303	-1 290
Net interest income	<b>56 801</b>	44 953

Net interest income was mainly derived from debt securities. In 2016, net interest income increased by 11 848 thousand euro in comparison with 2015. The increase in the amount of securities and investment in higher-yield securities had a positive effect, while a rise in the costs for hedging currency risks resulting from the widening of the spread between the interest rates of the euro and other investment currencies of Latvijas Banka had a negative impact.

Interest income from and interest expense on the intra-Eurosystem claims and liabilities are remunerated by applying the ECB's interest rate on the main refinancing operations and include income from foreign reserves transferred to the ECB and claims on allocation of banknotes in the Eurosystem, as well as expense on liabilities related to TARGET2 settlements.

According to the ECB Governing Council's decision on the allocation of monetary income for first six years following the euro changeover the remunerable part of the claims on banknote allocation in the Eurosystem is reduced in compliance with a definite coefficient to avoid significant NCB income fluctuations. The adjustment of the reduction of the remunerable part of Latvijas Banka's claims on banknote allocation in the Eurosystem in the course of the six years is as follows:

Reporting year	Coefficient (%)
2014	100.00000
2015	86.06735
2016	70.13472
2017	53.34835
2018	35.98237
2019	18.17225

In 2016, interest income on monetary policy operations increased on account of a lower negative deposit facility rate, higher average daily balance of credit institutions' demand deposits (see Note 16) and the implementation of the PSPP.

The application of the interest on deposits is stipulated in the Guideline of the ECB of 20 February 2014 on domestic asset and liability management operations by the national central banks (ECB/2014/9) (2014/304/EU).

### 34. REALISED GAINS/LOSSES ARISING FROM FINANCIAL OPERATIONS

	(in thousands of euro)	
	2016	2015
Debt securities	63 540	23 119
Derivative financial instruments	-37 440	-1 524
Foreign exchange transactions	12 439	15 621
Total	38 539	37 216

Gains from the disposal of debt securities increased by 40 421 thousand euro in comparison with 2015, mainly as a result of a fall in the yields, euro area long-term yields in particular, in the first half of 2016, as well as the partial disposal of the long-term fixed income securities portfolio.

The realised result from financial operations was negatively affected by the result on derivative financial instruments posting a decrease of 35 916 thousand euro in comparison with 2015, mostly on account of the result of interest rate future contracts as well as the result of currency future contracts concluded for the purpose of hedging currency risks. In view of Latvijas Banka hedging the risks related to gold price and foreign exchange fluctuations, the negative result of the currency future contracts concluded for the purpose of hedging currency and gold price risk exposure is offset in equal value by the positive revaluation result of the hedged balance sheet items reported under the balance sheet item "Capital and reserves" as the revaluation result of foreign currency and gold, and the realised result on foreign exchange transactions recognised in the profit and loss statement.

In 2015 and 2016, the realised gains on foreign exchange transactions mostly resulted from the recognition of a part of the initial valuation account balance in profit and loss statement (see also Note 23).

### 35. RECOGNITION OF REVALUATION RESULT ON FINANCIAL ASSETS AND POSITIONS IN PROFIT AND LOSS STATEMENT

	(in thousands of euro)	
	2016	2015
Debt securities	-52 657	-13 371
Foreign currency positions	-72	-214
Interest rate swap arrangements	-	-48
Total	-52 729	-13 633

The revaluation result of several debt securities, foreign currency positions, and interest rate swap arrangements at the end of 2016 and 2015 was negative, and it has been recognised in the profit and loss statement while the positive result on the revaluation of debt securities, foreign currency positions, and interest rate swap arrangements has been reported under the balance sheet item "Capital and reserves" as the revaluation result of securities, foreign currency, and interest rate swap arrangements (see also Note 23).

The increase in negative result on revaluation of debt securities is related to a rise in yields at the end of 2016.

### 36. PROVISIONS FOR MARKET RISK AND CREDIT RISK

Financial risks of Latvijas Banka relate primarily to its investments in financial instruments, as well as the implementation of the single monetary policy operations associated with Latvijas Banka's participation in the Eurosystem and sharing of the related risks and financial results. Latvijas Banka's assets are mostly exposed to market

risk (interest rate and currency risks) and credit risk (credit rating downgrade and default risks). Latvijas Banka carries out assessment of its financial risks and financial buffers in compliance with the ECB's common methodology for Eurosystem financial risk assessment. According to the methodology for Eurosystem financial risk assessment, the Expected Shortfall measure with confidence level of 99% (ES99%) for a risk horizon of one year is used. ES99% describes the losses determined by the average value of 1% of the most unfavourable simulated profitability scenarios. The above methodology takes account of various market risk and credit risk factors as well as uses historical data and assumptions of the Eurosystem/ESCB's Risk Management Committee. ES99% includes assumptions concerning development of adverse financial market factors, e.g. euro appreciation, interest rate rise, widening of the interest rate spreads, credit rating downgrades. Considering the limitations applied in calculating ES99% and the conservative approach to risk estimates, as well as changes in the investment portfolios of Latvijas Banka, the targeted amount of provisions is 250 000 thousand euro, which is smaller than the estimated ES99%. Review of the targeted amount of provisions takes place on an annual basis; the level of financial risks, the available financial reserves and long-term prospects of the financial market development are taken account of when setting it.

Based on the above risk estimates, in 2016 the Council of Latvijas Banka decided to establish additional provisions in the amount of 86 400 thousand euro (35 300 thousand euro in 2015) for market risk and credit risk with regard to investment management transactions of Latvijas Banka. At the end of 2016, the above provisions totalled 136 500 thousand euro. Provisions were raised on account of the overall level of financial risks that increased in 2016 due to higher levels of aggregate investment by Latvijas Banka (see also Note 4) and an increase in the amount of financial instruments with longer modified duration. Moreover, based on the assessment of the overall level of financial risks, as well as the projected amount of income available for accumulating the provisions, in addition to the amount of 56 800 thousand euro, calculated in accordance with the current policy of accumulating provisions in 2016, the provisions have been raised by 29 600 thousand euro, channelling for the above purpose the income related to the partial disposal of the long-term fixed income securities portfolio and merging it with the 10 year fixed income government securities portfolio.

It has been planned to continue accumulating provisions for market risk and credit risk for a longer time period, reaching the targeted amount in the next few years. Provisions for the market risk and credit risk may be reduced when financial risks materialise provided they are not offset against the accumulated revaluation result and other income, as well as when financial risks moderate.

### 37. INCOME FROM PARTICIPATING INTEREST

Income from participating interest comprises dividends received from the participating interest in the BIS in the amount of 289 thousand euro (305 thousand euro in 2015; see also Note 14.2) and income from the ECB's interim profit distribution for the reporting year and the remainder of the ECB's annual profit of the previous year in the amount of 4 953 thousand euro (3 852 thousand euro in 2015, see also Note 2.27).

### 38. NET RESULT OF POOLING OF MONETARY INCOME

	(in thousands of euro)	
	2016	2015
Monetary income pooled	-28 871	-10 269
Monetary income received	39 705	35 944
Net result of pooling of monetary income	10 834	25 675



The monetary income received grew on account of an increase in the amount of securities purchased under the PSPP. The increase in monetary income pooled was compensated by a respective increase in interest on monetary policy operations.

### 39. OTHER OPERATING INCOME

	(in thousands of euro)	
	2016	2015
Revaluation of liabilities for the issued lats banknotes and coins	78 100	–
Income from sale of collector coins	1 686	1 333
Other	1 265	429
<b>Total</b>	<b>81 051</b>	<b>1 762</b>

As a result of revaluation of liabilities for the issued lats banknotes and coins, income increased as the lats banknotes and coins, whose exchange probability is low, are not reported on the balance sheet pursuant to the "Financial Accounting Policy of Latvijas Banka" as amended by the Council of Latvijas Banka in 2016 (see also Note 2.1).

### 40. REMUNERATION, SOCIAL SECURITY COSTS, AND SOLIDARITY TAX

	(in thousands of euro)	
	2016	2015
Remuneration		
Remuneration of Members of the Council and the Board	–1 581	–1 556
Remuneration of other personnel	–15 603	–15 376
<b>Total remuneration</b>	<b>–17 184</b>	<b>–16 932</b>
Social security costs and solidarity tax	–3 852	–3 518
<b>Total remuneration, social security costs, and solidarity tax</b>	<b>–21 036</b>	<b>–20 450</b>

Remuneration of those Members of the Board of Latvijas Banka who are also Heads of Departments of Latvijas Banka includes remuneration for performance of these duties.

At the end of 2016, the number of employees was 539 (540 at the end of 2015), representing 517 full-time equivalents in 2016 (525 in 2015).

### 41. BANKNOTE AND COIN ACQUISITION COSTS

	(in thousands of euro)	
	2016	2015
Acquisition of banknotes	–5 741	–
Acquisition of circulation coins	–1 276	–752
Acquisition of collector coins	–266	–1 203
<b>Total</b>	<b>–7 283</b>	<b>–1 955</b>

In 2016, Latvijas Banka paid for the euro banknotes acquired for the purposes of exchanging lats for euro and for replenishing the banknote stocks of the Eurosystem.

**42. OTHER OPERATING EXPENSES**

	(in thousands of euro)	
	2016	2015
Maintenance and operation of information systems	-3 577	-3 341
Municipal services	-809	-832
Business travel	-576	-622
Maintenance of buildings, territory and equipment	-520	-581
Information and public relations	-267	-235
Telecommunication services and system maintenance	-254	-263
Personnel training	-233	-280
Risk insurance	-221	-252
Acquisition of low value office supplies	-163	-181
Tax on real estate	-160	-149
Transport provision	-71	-79
Event services	-69	-101
Disposal of material values	-18	-20
Other	-353	-342
<b>Total</b>	<b>-7 291</b>	<b>-7 278</b>

Other expenses also comprise the remuneration in the amount of 29 thousand euro paid to KPMG Baltics SIA for the audit of 2016 financial statements of Latvijas Banka (29 thousand euro in 2015).

**OTHER NOTES****43. TRANSACTIONS WITH THE LATVIAN GOVERNMENT**

Latvijas Banka, whose capital is wholly owned by the Republic of Latvia, carries out transactions with the Treasury, acting as the financial agent of the Latvian government. Performing this function, Latvijas Banka services the Treasury's accounts in euro and foreign currencies. Latvijas Banka is independent in making its own decisions on entering into the above transactions. The Treasury demand deposits are recorded under the balance sheet items "Liabilities to other euro area residents denominated in euro" and "Liabilities to euro area residents denominated in foreign currency".

The interest rates and foreign exchange rates used in the transactions with the Latvian government are market-based according to the ECB's decisions. No commission fees are applied to transactions with the Latvian government.

Pursuant to Guideline of the ECB of 20 February 2014 on domestic asset and liability management operations by the national central banks (ECB/2014/9) (2014/304/EU), Latvijas Banka applies the euro overnight index average (EONIA) rate (it was negative at the end of both 2016 and 2015 (-0.329% and -0.127% respectively) to the amount of the Treasury's deposits in euro up to 200 million euro. As regards the total outstanding amount of the Treasury's settlement accounts in euro and foreign currencies exceeding 200 million euro, Latvijas Banka applies the deposit facility rate set by the ECB (it was negative at the end of both 2016 and 2015 (-0.40% and -0.30% respectively).

At the end of 2016 and 2015, the breakdown of Latvijas Banka's claims and liabilities to the Latvian government were as follows:

	(in thousands of euro)	
	2016	2015
Claims		
Securities held for monetary policy purposes	<b>706 919</b>	472 158
Other securities	<b>48 754</b>	48 468
Accrued interest on debt securities	<b>12 145</b>	10 929
Total claims	<b>767 818</b>	531 555
Liabilities		
Demand deposits in euro	<b>46 710</b>	38 055
Demand deposits in foreign currencies	<b>159 844</b>	155 228
Tax liabilities	<b>159</b>	197
Total liabilities	<b>206 713</b>	193 480

In 2016 and 2015, the breakdown of Latvijas Banka's income and expense related to the Latvian government, as well as Latvijas Banka's profit of the previous reporting year appropriated to the state budget was as follows (see also Notes 22.2 and 23):

	(in thousands of euro)	
	2016	2015
Income (-)/expense and Latvijas Banka's profit appropriated to the state budget		
Interest on debt securities	<b>-2 272</b>	-1 154
Negative interest on government deposits	<b>-85</b>	-57
Recognition of revaluation result on debt securities in profit and loss statement	<b>1 188</b>	412
Taxes	<b>9 943</b>	8 941
Profit appropriated to the state budget	<b>19 524</b>	23 894
Total net expense and Latvijas Banka's profit appropriated to the state budget	<b>28 298</b>	32 036

#### 44. PLEDGED ASSETS

Securities and other financial instruments purchased by Latvijas Banka with the market value of 33 038 thousand euro, as at the end of 2016 (5 778 thousand euro at the end of 2015), have been pledged to provide collateral for forward exchange rate contracts and interest rate and currency future contracts.

#### 45. SECURITIES LENDING

On behalf of Latvijas Banka its agents conclude securities lending transactions, as part of an automated security lending programme, where securities held by Latvijas Banka are lent against cash or other securities collateral. Securities lending transactions provide additional income without any material impact on investment liquidity as the securities lent are readily available to Latvijas Banka. The above agents administer the securities lending transactions and monitor the eligibility of the securities lending transactions and related collateral. The fair value of collateral provided in securities lending transactions is higher than that of the securities lent.

To improve securities market liquidity, Latvijas Banka, simultaneously with other euro area NCBs, lends securities purchased under the PSPP; Latvijas Banka conducts the above lending under the automated security lending programme.

At the end of 2016, the fair value of the securities lent, determined using quoted prices in an active market, was 118 129 thousand euro (53 692 thousand euro at the end of 2015); inter alia, the fair value of securities purchased and lent under the PSPP stood at 11 101 thousand euro at the end of 2016 (7 050 thousand euro at the end of 2015).

Foreign currency cash or securities received in the agent account of Latvijas Banka's automated security lending programme as collateral for securities lending transactions is not recognised in Latvijas Banka's balance sheet (see also Note 2.13).

#### 46. CONTINGENT LIABILITIES AND COMMITMENTS

The uncalled portion of the BIS shares held by Latvijas Banka is 75% of their nominal value; these shares are callable following a respective decision of the BIS Board. At the end of 2016, the uncalled portion of the BIS shareholding was 4 013 thousand SDR (5 115 thousand euro; 4 013 thousand SDR (5 108 thousand euro) at the end of 2015; see also Note 14.2).

At the end of 2016, Latvijas Banka had issued euro collector coins, lats collector coins and precious metal circulation coins in the nominal value of 6 529 thousand euro (5 787 thousand euro at the end of 2015). These coins may be represented to Latvijas Banka at a nominal value. In the opinion of management of Latvijas Banka, the probability that Latvijas Banka will be required to repurchase these coins from their holders is considered low and no provisions have been made.

At the end of 2016, Latvijas Banka had issued lats banknotes and coins with the face value of 129 906 thousand euro (135 526 thousand euro at the end of 2015), reported on the balance sheet in the amount of 51 806 thousand euro (135 526 thousand euro at the end of 2015). Pursuant to the Law on the Procedure for Introducing the Euro, the period for exchanging the lats cash to the euro at Latvijas Banka is unlimited. In the opinion of the management of Latvijas Banka, the probability that Latvijas Banka would be required to exchange lats banknotes and coins in the amount of 78 100 thousand euro at face value, is low.

In 2015, the Eurosystem's TARGET2-Securities platform was launched enabling the central securities depositories and NCBs to provide cross-border securities settlement services. Latvijas Banka is carrying out preparations for migration of securities market participants in Latvia to TARGET2-Securities platform in 2017 and shares its costs together with other NCBs. Latvijas Banka plans to contribute approximately 1.3 million euro in 2017–2020. TARGET2-Securities platform is expected to operate on a full cost-recovery basis and income from commission fees in the medium term will cover its costs.

# INDEPENDENT AUDITORS' REPORT

## TO THE COUNCIL OF LATVIJAS BANKA

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### *Our Opinion on the Financial Statements*

We have audited the accompanying financial statements of Latvijas Banka ("the Bank") set out on pages 69 to 116, which comprise:

- the balance sheet as at 31 December 2016,
- the profit and loss statement for the year then ended,
- the statement of total recognised gains and losses for the year then ended,
- the notes to the financial statements, which include a summary of principal accounting policies and other explanatory notes.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Latvijas Banka as at 31 December 2016, and of its financial performance for the year then ended in accordance with the Guideline (EU) 2016/2249 of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the requirements of the Law on Latvijas Banka governing financial reporting.

### *Basis for Opinion*

In accordance with the Law on Audit Services of the Republic of Latvia we conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditors' Responsibility for the Audit of the Financial Statements section of our report.

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and independence requirements included in the Law on Audit Services of the Republic of Latvia that are relevant to our audit of the financial statements. We have also fulfilled our other professional ethics responsibilities and objectivity requirements in accordance with the IESBA Code and the Law on Audit Services of the Republic of Latvia.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Responsibilities of Board and Those Charged with Governance for the Financial Statements*

The Board of the Bank is responsible for the preparation of the financial statements that give a true and fair view in accordance with the Guideline (EU) 2016/2249 of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34), "Financial Accounting Policy of Latvijas Banka" approved by the Council of the Bank, and the requirements of the Law on Latvijas Banka governing financial reporting. The Board of the Bank is also responsible for such internal control as the Board of the Bank determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Based on the Law on Latvijas Banka, the Board of the Bank is responsible for the preparation of the financial statements using the going concern basis of accounting.

Those charged with the Bank's governance are responsible for overseeing the Bank's financial reporting process.

### *Auditors' Responsibility for the Audit of the Financial Statements*

Our audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves a fair presentation.

We communicate with those charged with the Bank's governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG Baltics SIA  
Licence No. 55

Armine Movsisjana  
Chairperson of the Board  
Latvian Certified Auditor  
Certificate No. 178  
Riga, Latvia

10 March 2017



## MONETARY INDICATORS IN 2016

(at the end of the period; millions of euro)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
<b>LATVIJAS BANKA</b>												
Latvia's contribution to the euro area monetary base	8 079.6	8 249.6	7 678.8	7 924.0	7 868.6	7 251.1	7 887.5	7 810.6	8 122.5	8 446.7	8 507.6	<b>8 453.7</b>
Currency in circulation	4 103.3	4 104.6	4 132.8	4 142.2	4 156.3	4 191.1	4 231.2	4 217.5	4 229.7	4 250.2	4 256.3	<b>4 262.6</b>
Current accounts (covering the minimum reserve system)	3 976.3	4 145.0	3 546.0	3 781.8	3 712.2	3 060.0	3 656.3	3 593.1	3 892.8	4 196.6	4 251.3	<b>4 191.1</b>
Deposit facility and other liabilities related to monetary policy operations	0	0	0	0	0	0	0	0	0	0	0	<b>0</b>
Foreign assets outside the euro area	3 451.3	3 494.5	3 246.5	3 294.3	3 350.0	3 344.4	3 123.9	3 119.8	3 475.1	3 496.3	3 540.3	<b>3 470.9</b>
Foreign liabilities outside the euro area	1.8	3.8	9.8	4.6	1.1	9.7	1.4	3.3	3.9	3.8	1.1	<b>17.9</b>
Credit	4 155.3	4 776.4	5 062.1	5 337.6	5 615.3	5 882.6	6 144.3	6 308.0	6 388.7	6 647.3	6 839.0	<b>6 944.3</b>
To MFIs in the euro area	739.3	741.3	629.4	663.8	687.8	679.0	694.7	690.8	528.2	572.6	607.0	<b>548.0</b>
To the general government sector in the euro area	1 312.1	1 724.7	1 973.3	1 981.2	2 015.0	2 063.7	2 092.8	2 124.2	2 270.1	2 289.9	2 254.1	<b>2 270.5</b>
To other euro area residents	2 103.8	2 310.3	2 459.4	2 692.6	2 912.4	3 139.8	3 356.7	3 493.0	3 590.4	3 784.8	3 977.9	<b>4 125.8</b>
<b>MFI</b>												
Overnight deposits (Latvia's contribution to M1 of the euro area)	9 343.8	9 614.6	9 497.2	9 694.1	9 745.7	9 890.7	9 793.4	9 889.8	9 879.1	9 907.6	10 038.5	<b>10 158.5</b>
Deposits with an agreed maturity of up to 2 years	1 228.0	1 238.3	1 320.9	1 304.1	1 229.2	1 219.6	1 233.7	1 231.7	1 237.9	1 245.8	1 303.4	<b>1 285.2</b>
Deposits redeemable at notice of up to 3 months	801.9	826.4	790.1	801.5	802.8	809.2	813.7	820.3	830.1	842.0	855.7	<b>864.1</b>
Latvia's contribution to M2 of the euro area	11 373.7	11 679.3	11 608.2	11 799.7	11 777.7	11 919.5	11 840.8	11 941.8	11 947.1	11 995.4	12 197.6	<b>12 307.8</b>
Money market fund shares and units	0	0	0	0	0	0	0	0	0	0	0	<b>0</b>
Debt securities with a maturity of up to 2 years	53.6	44.4	28.8	14.7	18.8	12.5	22.9	31.5	42.0	35.4	36.6	<b>67.8</b>
Latvia's contribution to M3 of the euro area	11 427.3	11 723.7	11 637.0	11 814.4	11 796.5	11 932.0	11 863.7	11 973.3	11 989.1	12 030.8	12 234.2	<b>12 375.6</b>
Net foreign assets outside the euro area	-1 549.9	-1 253.2	-1 228.7	-1 358.2	-1 289.4	-1 172.1	-1 704.7	-1 454.4	-1 134.0	-1 125.5	-1 195.2	<b>-895.3</b>
Credit to euro area financial institutions, non-financial corporations and households	13 631.5	13 678.7	13 780.5	13 898.2	14 054.8	14 145.8	14 170.1	14 200.8	14 202.0	14 185.1	14 248.1	<b>14 262.8</b>
Loans to resident financial institutions, non-financial corporations and households	12 273.1	12 264.8	12 399.8	12 460.1	12 611.2	12 630.0	12 652.7	12 683.5	12 704.5	12 690.7	12 740.6	<b>12 709.9</b>
Deposits by resident financial institutions, non-financial corporations and households	10 230.2	10 509.4	10 469.2	10 602.1	10 634.5	10 716.8	10 604.4	10 701.8	10 713.4	10 736.7	10 800.5	<b>11 126.0</b>
<b>INTEREST RATES</b>												
Interest rate on the main refinancing operations (at end of period; %)	0.05	0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	<b>0.00</b>
Weighted average interest rates on transactions in euro (%)												
Interbank loans	-0.27	-0.28	-0.38	-0.36	-0.38	-0.38	-0.38	-0.38	-0.38	-0.06	-0.42	<b>-0.40</b>
Loans to non-financial corporations and households with a floating interest rate and an initial rate fixation of up to 1 year (new business)	3.2	3.2	2.7	2.6	2.5	3.0	2.9	2.5	2.9	2.7	2.7	<b>3.2</b>
Time deposits by non-financial corporations and households (new business)	0.3	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.2	0.1	<b>0.3</b>



## MONTH-END BALANCE SHEETS OF LATVIJAS BANKA FOR 2016

(at the end of the month; thousands of euro)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
<b>ASSETS</b>	<b>11 516 732</b>	<b>12 202 426</b>	<b>12 364 331</b>	<b>12 662 332</b>	<b>13 011 146</b>	<b>13 333 672</b>	<b>13 409 534</b>	<b>13 611 915</b>	<b>14 070 055</b>	<b>14 388 661</b>	<b>14 644 564</b>	<b>14 772 305</b>
Gold and gold receivables	218 142	240 537	231 330	238 627	231 950	253 361	256 218	251 805	253 055	248 044	237 802	<b>234 305</b>
Claims on non-euro area residents denominated in foreign currency	3 068 131	3 076 089	2 853 749	2 890 329	2 936 946	2 903 426	2 690 398	2 705 021	2 471 602	3 101 154	3 150 165	<b>3 092 076</b>
Receivables from the IMF	152 741	153 285	149 527	150 180	151 999	151 975	151 479	151 262	151 057	151 600	153 751	<b>153 992</b>
Balances with credit institutions and security investments, external loans and other external assets	2 915 390	2 922 804	2 704 222	2 740 149	2 784 947	2 751 451	2 538 919	2 553 759	2 320 545	2 949 554	2 996 414	<b>2 938 084</b>
Claims on euro area residents denominated in foreign currency	567 032	634 784	499 164	523 849	544 432	551 213	577 589	577 492	364 690	400 661	407 875	<b>358 839</b>
Claims on non-euro area residents denominated in euro	165 022	177 852	161 401	165 389	181 075	187 662	177 257	162 955	750 464	147 055	152 355	<b>144 564</b>
Lending to euro area credit institutions related to monetary policy operations denominated in euro	253 730	244 990	244 990	244 990	244 990	234 280	234 280	234 280	244 660	244 660	244 660	<b>257 160</b>
Main refinancing operations	–	–	–	–	–	–	–	–	–	–	–	–
Longer-term refinancing operations	253 730	244 990	244 990	244 990	244 990	234 280	234 280	234 280	244 660	244 660	244 660	<b>257 160</b>
Fine-tuning reverse operations	–	–	–	–	–	–	–	–	–	–	–	–
Structural reverse operations	–	–	–	–	–	–	–	–	–	–	–	–
Marginal lending facility	–	–	–	–	–	–	–	–	–	–	–	–
Credits related to margin calls	–	–	–	–	–	–	–	–	–	–	–	–
Other claims on euro area credit institutions denominated in euro	1 188	8 937	52	6 555	14 080	11 814	9 380	1 566	525	11 597	22 246	<b>9 071</b>
Securities of euro area residents denominated in euro	3 333 339	3 887 662	4 317 848	4 562 188	4 811 752	5 085 289	5 323 006	5 494 634	5 778 837	5 990 401	6 164 174	<b>6 319 754</b>
Securities held for monetary policy purposes	2 000 353	2 194 004	2 375 699	2 641 170	2 891 727	3 130 512	3 341 851	3 523 643	3 732 896	3 989 942	4 202 936	<b>4 357 306</b>
Other securities	1 332 986	1 693 658	1 942 149	1 921 018	1 920 025	1 954 777	1 981 155	1 970 991	2 045 941	2 000 459	1 961 238	<b>1 962 448</b>
Intra-Eurosystem claims	3 765 925	3 793 464	3 844 649	3 892 325	3 916 150	3 955 145	3 996 856	4 039 367	4 061 038	4 107 270	4 119 788	<b>4 195 918</b>
Participating interest in the ECB	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	115 082	<b>115 082</b>
Claims equivalent to the transfer of foreign reserves to the ECB	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	163 480	<b>163 480</b>
Claims related to TARGET2 and national central bank correspondent accounts (net)	–	–	–	–	–	–	–	–	–	–	–	–
Claims related to other operational requirements within the Eurosystem	3 487 363	3 514 902	3 566 087	3 613 763	3 637 588	3 676 583	3 718 294	3 760 805	3 782 476	3 828 708	3 841 226	<b>3 917 356</b>
Items in course of settlement	–	–	–	–	–	–	–	–	–	–	–	–
Other assets	144 223	138 111	211 148	138 080	129 771	151 482	144 550	144 795	145 184	137 819	145 499	<b>160 618</b>

Appendix 2 (cont.)

(at the end of the month; thousands of euro)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
<b>LIABILITIES</b>	<b>11 516 732</b>	<b>12 202 426</b>	<b>12 364 331</b>	<b>12 662 332</b>	<b>13 011 146</b>	<b>13 333 672</b>	<b>13 409 534</b>	<b>13 611 915</b>	<b>14 070 055</b>	<b>14 388 661</b>	<b>14 644 564</b>	<b>14 772 305</b>
Banknotes in circulation	3 915 722	3 917 863	3 946 528	3 956 179	3 969 946	4 003 951	4 042 349	4 028 335	4 039 700	4 059 989	4 064 680	<b>4 150 106</b>
Liabilities to euro area credit institutions related to monetary policy operations denominated in euro	3 976 286	4 144 983	3 545 990	3 781 850	3 712 241	3 060 039	3 656 339	3 593 114	3 892 787	4 196 573	4 251 285	<b>4 191 147</b>
Current accounts (covering the minimum reserve system)	3 976 286	4 144 983	3 545 990	3 781 850	3 712 241	3 060 039	3 656 339	3 593 114	3 892 787	4 196 573	4 251 285	<b>4 191 147</b>
Deposit facility	–	–	–	–	–	–	–	–	–	–	–	–
Fixed-term deposits	–	–	–	–	–	–	–	–	–	–	–	–
Fine-tuning reverse operations	–	–	–	–	–	–	–	–	–	–	–	–
Deposits related to margin calls	–	–	–	–	–	–	–	–	–	–	–	–
Other liabilities to euro area credit institutions denominated in euro	1 470	1 160	7 020	–	–	12 330	–	370	1 140	–	–	<b>720</b>
Liabilities to other euro area residents denominated in euro	137 556	129 097	107 495	115 300	162 014	182 352	179 092	175 000	171 925	176 811	178 733	<b>212 239</b>
General government	23 490	11 065	10 122	12 836	60 323	68 398	9 706	6 319	10 315	9 756	12 469	<b>46 710</b>
Other liabilities	114 066	118 032	97 373	102 464	101 691	113 954	169 386	168 681	161 610	167 055	166 264	<b>165 529</b>
Liabilities to non-euro area residents denominated in euro	1 801	3 842	8 881	4 568	1 120	7 230	1 385	1 974	3 725	3 845	1 130	<b>17 888</b>
Liabilities to euro area residents denominated in foreign currency	155 342	158 102	152 494	150 979	155 057	152 278	152 340	151 371	154 128	158 185	165 122	<b>159 844</b>
Liabilities to non-euro area residents denominated in foreign currency	–	–	940	–	–	2 513	–	1 330	152	–	–	–
Intra-Eurosystem liabilities	2 599 988	3 032 063	3 827 065	3 880 784	4 196 998	5 067 186	4 540 467	4 803 648	4 947 772	4 945 716	5 154 243	<b>5 292 395</b>
Liabilities related to TARGET2 and national central bank correspondent accounts (net)	2 599 988	3 032 063	3 827 065	3 880 784	4 196 998	5 067 186	4 540 467	4 803 648	4 947 772	4 945 716	5 154 243	<b>5 292 395</b>
Liabilities related to other operational requirements within the Eurosystem	–	–	–	–	–	–	–	–	–	–	–	–
Items in course of settlement	–	–	–	–	–	–	–	–	–	–	–	–
Other liabilities	255 585	310 515	250 843	279 395	309 472	288 819	252 508	267 054	259 161	311 833	364 469	<b>294 614</b>
Capital and reserves	472 982	504 801	517 075	493 277	504 298	556 974	585 054	589 719	599 565	535 709	464 902	<b>453 352</b>

*Appendix 3***ORGANISATIONAL UNITS OF LATVIJAS BANKA AT THE END OF 2016****1. ACCOUNTING DEPARTMENT**

(Head of Department, Chief Accountant of Latvijas Banka – Jānis Caune; Deputy Head of Department, Deputy Chief Accountant of Latvijas Banka – Iveta Medne)

1.1 Financial Statements and Accounting Policy Division (Head of Division – Gatis Gersons)

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

**2. CASH DEPARTMENT**

(Head of Department – Jānis Blūms; Deputy Head of Department – Vilnis Kepe)

2.1 Cash Operations Division (Head of Division<sup>1</sup> – Ģirts Jansons)

2.2 Coin Division (Head of Division – Ieva Bela)

2.3 Cash Technology Division (Head of Division – Aleksandrs Antiņš)

2.4 Riga Branch (Branch Manager – Jānis Strēlnieks)

2.5 Liepāja Branch (Branch Manager – Gundars Lazdāns)

**3. FINANCIAL STABILITY DEPARTMENT**

(Head of Department – Elmārs Zakulis; Deputy Head of Department – Andris Ņikitins)

3.1 Financial Stability Division (Head of Division – Armands Pogulis)

**4. INFORMATION SYSTEMS DEPARTMENT**

(Head of Department – Harijs Ozols; Deputy Head of Department – Krišs Rauhvarģers)

4.1 System Design and Programming Division (Head of Division – Ilģvars Apinis)

4.2 Computer Network and Server Systems Division (Head of Division – Uldis Kristapsons)

4.3 Bank Information System Maintenance and Development Division (Head of Division – Lģgita Komule)

4.4 Information Systems Security Division (Head of Division – Ilona Etmāne)

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

4.6 Systems Maintenance Division (Head of Division – Valērijs Kondratģevs)

**5. INTERNAL AUDIT DEPARTMENT**

(Head of Department – Leo Aģmanis; Deputy Heads of Department – Jānis Straģinskis, Juris Ziedģņģš)

**6. INTERNATIONAL RELATIONS AND COMMUNICATION DEPARTMENT**

(Head of Department – Juris Kravalis)

6.1 Document Management and Library Division (Head of Division – Ineta Strāde)

6.2 Publications Division (Head of Division, Deputy Head of Department – Aina Raņģe)

6.3 Public Relations Division (Head of Division, Deputy Head of Department – Kristaps Otersons)

6.4 International Relations and Protocol Division (Head of Division, Deputy Head of Department, Head of Governor's Office – Aleksandra Bambale)

**7. LEGAL DEPARTMENT**

(Head of Department – Ilze Posuma; Deputy Heads of Department – Maiģa Āboliņa, Iveta Krastiņa)

**8. MARKET OPERATIONS DEPARTMENT**

(Head of Department – Raivo Vanags; Deputy Head of Department – Daira Brunere)

8.1 Trading and Investment Division (Head of Division, Deputy Head of Department – Vadims Zaicevs)

8.2 Risk Management Division (Head of Division – Zane Volkopa)

<sup>1</sup> As of 1 February 2017 – Head of Division, Deputy Head of Department.

*Appendix 3 (cont.)*

9. MONETARY POLICY DEPARTMENT

(Head of Department – Uldis Rutkaste; Deputy Head of Department – Mārtiņš Bitāns)

9.1 Macroeconomic Analysis Division (Head of Division – Santa Bērziņa)

9.2 Financial Market Analysis Division (Head of Division – Gunārs Bērziņš)

9.3 Monetary Research and Forecasting Division (Head of Division –  
Gundars Dāvidsons)

10. PAYMENT SYSTEMS DEPARTMENT

(Head of Department – Egons Gailītis; Deputy Heads of Department – Irēna Krūmane,  
Anda Zalmane)

10.1 Payment Systems Policy Division (Head of Division – Deniss Filipovs)

10.2 Payment Systems Operations Division (Head of Division – Natālija Popova)

10.3 Payment and Settlement Division (Head of Division – Una Ruka)

10.4 Credit Register Division (Head of Division – Laura Ausekle)

11. PERSONNEL DEPARTMENT

(Head of Department – Liene Glāzniece; Deputy Heads of Department –  
Helmūts Ancāns, Vineta Veikmane)

12. SECURITY DEPARTMENT

(Head of Department – Romualds Namnieks; Deputy Heads of Department –  
Imants Kravals, Sandis Mackēvičs)

12.1 Analytical Unit (Head of Unit – Māris Dzelme)

12.2 Armament Unit (Head of Unit – Juris Kušķis)

12.3 Central Division (Head of Division – Ivars Geriņš)

12.4 Riga Division (Head of Division – Igo Peičs)

12.5 Liepāja Division (Head of Division – Gints Liepiņš)

13. STATISTICS DEPARTMENT

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

13.1 Financial Market and Monetary Statistics Division (Head of Division –  
Zigrīda Aušta)

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

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

14. TECHNICAL SUPPORT DEPARTMENT

(Head of Department – Reinis Jakovļevs)

14.1 General Service Division (Head of Division – Einārs Čiņš)

14.2 Building Systems Division (Head of Division, Deputy Head of Department –  
Jānis Kreicbergs)

14.3 Security Systems Division (Head of Division – Viesturs Balodis)

15. TRAINING CENTRE

(Head of Centre – Gundega Vizule)

## **PARTICIPATION OF LATVIJAS BANKA IN THE EUROSISTEM AND THE EUROPEAN SYSTEM OF CENTRAL BANKS**

### **Governing Council of the ECB**

Ilmārs Rimšēvičs, Governor of Latvijas Banka

### **General Council of the ECB**

Ilmārs Rimšēvičs, Governor of Latvijas Banka

### **Supervisory Board of the ECB**

Zoja Razmusa, Deputy Governor of Latvijas Banka (banking supervisory institution is represented by Pēters Putniņš, Chairman of the FCMC)

### **Accounting and Monetary Income Committee (AMICO)**

Jānis Caune, Member of the Board of Latvijas Banka, Chief Accountant of Latvijas Banka, Head of Accounting Department

Gatis Gersons, Head of Financial Statements and Accounting Policy Division, Accounting Department

### **Banknote Committee (BANCO)**

Jānis Blūms, Member of the Board of Latvijas Banka, Head of Cash Department

Ģirts Jansons, Head of Cash Operations Division, Cash Department<sup>1</sup>

### **Budget Committee (BUCOM)**

Jānis Caune, Member of the Board of Latvijas Banka, Chief Accountant of Latvijas Banka, Head of Accounting Department

Iveta Medne, Deputy Chief Accountant of Latvijas Banka, Deputy Head of Accounting Department

### **Committee on Controlling (COMCO)**

Iveta Medne, Deputy Chief Accountant of Latvijas Banka, Deputy Head of Accounting Department

Gatis Gersons, Head of Financial Statements and Accounting Policy Division, Accounting Department

### **Financial Stability Committee (FSC)**

Elmārs Zakulis, Head of Financial Stability Department

### **Eurosystem/ESCB Communications Committee (ECCO)**

Kristaps Otersons, Deputy Head of International Relations and Communication Department, Head of Public Relations Division

Varis Vagoņiņš-Vagulis, Chief Communication Project Manager of Public Relations Division, International Relations and Communication Department

### **Human Resources Conference (HRC)**

Liene Glāzniece, Head of Personnel Department

Vineta Veikmane, Deputy Head of Personnel Department

### **Information Technology Committee (ITC)**

Harijs Ozols, Member of the Board of Latvijas Banka, Head of Information Systems Department

Krišs Rauhvarģers, Deputy Head of Information Systems Department

### **Internal Auditors Committee (IAC)**

Leo Ašmanis, Head of Internal Audit Department

Juris Ziediņš, Deputy Head of Internal Audit Department

<sup>1</sup> As of 1 February 2017 – Deputy Head of Cash Department, Head of Cash Operations Division.

*Appendix 4 (cont.)*

**International Relations Committee (IRC)**

Juris Kravalis, Head of International Relations and Communication Department  
Andris Strazds, Adviser to International Relations and Communication Department

**Legal Committee (LEGCO)**

Ilze Posuma, Deputy Chairperson of the Board of Latvijas Banka, Head of Legal Department  
Iveta Krastiņa, Deputy Head of Legal Department

**Market Infrastructure and Payments Committee (MIPC)**

Egons Gailītis, Head of Payment Systems Department  
Anda Zalmane, Deputy Head of Payment Systems Department

**Market Operations Committee (MOC)**

Raivo Vanags, Member of the Board of Latvijas Banka, Head of Market Operations Department  
Harijs Zuļģis, Chief Analyst of Financial Market Operations, Market Operations Department

**Monetary Policy Committee (MPC)**

Mārtiņš Bitāns, Deputy Head of Monetary Policy Department  
Gundars Dāvidsons, Head of Monetary Research and Forecasting Division, Monetary Policy Department

**Organisational Development Committee (ODC)**

Jānis Caune, Member of the Board of Latvijas Banka, Chief Accountant of Latvijas Banka, Head of Accounting Department  
Igoris Fleitmanis, Business Risk Manager of Latvijas Banka

**Risk Management Committee (RMC)**

Daira Brunere, Deputy Head of Market Operations Department  
Zane Volkopa, Head of Risk Management Division, Market Operations Department

**Statistics Committee (STC)**

Agris Caune, Head of Statistics Department  
Ilmārs Skarbnieks, Deputy Head of Statistics Department

## **REPRESENTATION OF LATVIJAS BANKA IN INTERNATIONAL ORGANISATIONS**

### **EUROPEAN UNION**

#### **ESRB**

Ilmārs Rimšēvičs, Governor of Latvijas Banka (the national banking supervisory institution is represented by Pēters Putniņš, Chairman of the FCMC)

#### **Advisory Technical Committee of the ESRB**

Elmārs Zakulis, Head of Financial Stability Department (the national banking supervisory institution is represented by Ludmila Vojevoda, Member of the Council of the FCMC)

#### **Economic and Financial Committee for the Council of the EU (EFC)**

Juris Kravalis, Head of International Relations and Communication Department  
Inese Allika, Chief Economist of International Relations and Protocol Division, International Relations and Communication Department (Alternate)

#### **EFC's Euro Coin Sub-Committee (ECSC)**

Ģirts Jansons, Head of Cash Operations Division, Cash Department<sup>1</sup>

#### **EFC's Sub-Committee on IMF and Related Issues (SCIMF)**

Ieva Skrīvere, Chief Economist of International Relations and Protocol Division, International Relations and Communication Department

#### **Board of Supervisors of the EBA**

Vita Pilsuma, Member of the Council of Latvijas Banka (the national banking supervisory institution is represented by Pēters Putniņš, Chairman of the FCMC)

#### **Permanent Representation of Latvia to the EU**

Antra Trenko, Counsellor of Latvijas Banka at the Permanent Representation of Latvia to the EU

#### **Committee on Monetary, Financial and Balance of Payments Statistics (CMFB)**

Agris Caune, Head of Statistics Department  
Ilmārs Skarbnieks, Deputy Head of Statistics Department

#### **EC Public Administration Network (PAN II)**

Antra Trenko, Counsellor of Latvijas Banka at the Permanent Representation of Latvia to the EU

### **INTERNATIONAL MONETARY FUND**

#### **Board of Governors**

Ilmārs Rimšēvičs, Governor of Latvijas Banka

#### **Nordic-Baltic Monetary and Financial Committee (NBMFC)**

Zoja Razmusa, Deputy Governor of Latvijas Banka

#### **Nordic-Baltic Monetary and Financial Committee, Group of Alternates (NBMFC Alternates)**

Juris Kravalis, Head of International Relations and Communication Department

#### **Nordic-Baltic IMF Office in Washington**

Agnija Jēkabsons, Advisor to the Executive Director of the Nordic-Baltic Constituency of the IMF, Latvia's representative in IMF

<sup>1</sup> As of 1 February 2017 – Deputy Head of Cash Department, Head of Cash Operations Division.

## LATVIJAS BANKA PUBLICATIONS AND MAJOR PUBLICATIONS BY THE EXPERTS OF LATVIJAS BANKA IN 2016

The following Latvijas Banka publications are available on Latvijas Banka website ([www.bank.lv](http://www.bank.lv)).

### REGULAR PUBLICATIONS AND SERIAL PUBLICATIONS

Financial Stability Report. 2016

Latvijas Banka: Annual Report 2015

*Latvijas Maksājumu Bilance*. Latvia's Balance of Payments. 2015

Macroeconomic Developments Report (June and December; No. 23 and No. 24, 2016)

### WORKING PAPERS

BENĶOVSKIS, Konstantīns, GOLUZINS, Eduards, TKAČEVŠ, Oļegs (2016). *CGE Model with Fiscal Sector for Latvia*. Latvijas Banka Working Paper, No. 1. 62 p.

AJEVSKIS, Viktors (2016). *A Term Structure of Interest Rates Model with Zero Lower Bound and the European Central Bank's Non-Standard Monetary Policy Measures*. Latvijas Banka Working Paper, No. 2. 18 p.

BESSONOVŠ, Andrejs, TKAČEVŠ, Oļegs (2016). *Relationship between Inflation and Economic Activity and Its Variation over Time in Latvia*. Latvijas Banka Working Paper, No. 3. 38 p.

BOBEICA, Elena, CHRISTODOULOPOULOU, Styliani, TKAČEVŠ, Oļegs (2016). *The Role of Price and Cost Competitiveness for Intra- and Extra-Euro Area Trade of Euro Area Countries*. Latvijas Banka Working Paper, No. 4. 43 p.

TKAČEVŠ, Oļegs, VILERTS, Kārlis (2016). *The Impact of Sovereign Bond Yields on Fiscal Discipline*. Latvijas Banka Working Paper, No. 5. 28 p.

### PUBLICATIONS

BENĶOVSKIS, Konstantīns, BĒRZIŅA, Santa, ZORGENFREIJA, Līva (2016). Evaluation of Latvia's Re-exports Using Firm-level Trade Data. *Baltic Journal of Economics*, vol. 16, No. 1, March 2016, pp. 1–20.

BENĶOVSKIS, Konstantīns, WÖRZ, Julia (2016). Non-Price Components of Market Share Gains: Evidence for EU Countries. *In: Boosting European Competitiveness. The Role of CESEE Countries*. Edited by M. Belka, E. Nowotny, P. Samecki and D. Ritzberger-Grünwald. Chapter 6, October 2016, pp. 58–72.

BOBEICA, Elena, CHRISTODOULOPOULOU, Styliani, TKAČEVŠ, Oļegs (2016). *The Role of Price and Cost Competitiveness for Intra- and Extra-Euro Area Trade of Euro Area Countries*. ECB Working Paper Series, No. 1941, July 2016. 63 p.

FADEJEVA, Ludmila, OPMANE, Ieva (2016). Internal Labour Market Mobility in 2005–2014 in Latvia: the Micro Data Approach. *Baltic Journal of Economics*, vol. 16, No. 2, June 2016, pp. 152–174.

FADEJEVA, Ludmila, FELDKIRCHER, Martin, REININGER, Thomas (2017). International Spillovers from Euro Area and US Credit and Demand Shocks: A Focus on Emerging Europe. *Journal of International Money and Finance*, vol. 70, February 2017, pp. 1–25.

LAFORCADE, Pierre, GERALI, Andrea, BRŪHA, Jan, BURSĪAN, Dirk, BUSS, Ginters, CORBO, Vesna, HAAVIO, Markus, HĀKANSON, Christina, HLEDIK, Tibor, KETAY, Gábor, KULIKOV, Dmitry, LOZEJ, Matija, MICALLEF, Brian, PAPAGEORGIOU, Dimitris, VANHALA, Juuso, ZELEZNIK, Marin (2016). *Labour Market Modelling in the Light of the Financial Crisis*. ECB Occasional Paper Series, No. 175, August 2016. 69 p.



**HIGHLIGHTS OF EUROSISTEM MONETARY POLICY AND OTHER IMPORTANT TASKS IN 2016**

On 21 January, the Governing Council of the ECB decided that the key interest rates used in Eurosystem monetary operations (hereinafter, the key ECB interest rates) would remain unchanged.

On 5 February, the Governing Council of the ECB approved the publication of an extended questions and answers document on the Agreement on Net Financial Assets ("What is ANFA?"; on 3 February, the governors of the national central banks (NCBs) of the euro area, signatories to the Agreement, approved the publication of it in full).

On 5 February, the Governing Council of the ECB approved amendments to the Eurosystem oversight policy framework for retail payment systems.

On 3 March, the Governing Council of the ECB decided to establish transparency requirements for non-marketable debt instruments backed by eligible public-sector credit claims seeking eligibility as collateral for regular Eurosystem credit operations.

On 10 March, the Governing Council of the ECB took the following decisions:

- 1) to decrease the interest rate on the main refinancing operations of the Eurosystem by 5 basis points to 0.00%, starting from the operation to be settled on 16 March 2016;
- 2) to decrease the interest rate on the marginal lending facility by 5 basis points to 0.25%, with effect from 16 March 2016;
- 3) to decrease the interest rate on the deposit facility by 10 basis points to -0.40%, with effect from 16 March 2016;
- 4) to expand the monthly purchases under the asset purchase programme to 80 billion euro starting in April;
- 5) to include investment grade euro-denominated bonds issued by non-bank corporations established in the euro area in the list of assets that are eligible for regular purchases (to launch CSPP as an additional component of the APP);
- 6) to launch a new series of four targeted longer-term refinancing operations (TLTRO II), each with a maturity of four years, starting in June. Borrowing conditions in these operations can be as low as the interest rate on the deposit facility.

On 11 March, the Governing Council of the ECB approved a Eurosystem response to the EC's Green Paper on retail financial services (Commission's Green Paper on retail financial services: better products, more choice, and greater opportunities for consumers and business).

On 16 March, in accordance with the Treaty on the Functioning of the European Union, which assigns the ECB the task of monitoring the compliance of EU central banks with the prohibitions referred to in Articles 123 and 124 thereof and the related Regulations, the Governing Council of the ECB approved the report covering the year 2015 (see Section "Compliance with the prohibition of monetary financing and privileged access" of ECB Annual Report 2015).

On 16 March, the Governing Council of the ECB adopted Guideline (EU) 2016/579 amending Guideline ECB/2012/27 on a Trans-European Automated Real-time Gross Settlement Express Transfer system (TARGET2) (ECB/2016/6).

On 18 March, the Governing Council of the ECB took note of the 21st T2S progress report and approved the revised migration plan included in the report. The Governing Council of the ECB also approved a revised version of the T2S user requirements.

On 30 March, the Governing Council of the ECB approved the assessment contained in the 2015 Quality Report on the euro area balance of payments and international

*Appendix 7 (cont.)*

investment position statistics, as well as the 2015 Quality Report on the euro area quarterly financial accounts.

On 6 April, the Governing Council of the ECB noted that the tenth edition of the ECB's report on "Financial integration in Europe" would be published on 25 April 2016 on the occasion of the joint conference of the ECB and the European Commission on financial market integration and stability in Europe.

On 14 April, the Governing Council of the ECB took note of the 2015 annual progress report on the preparatory measures for the long-term framework for the collection of granular credit data, prepared in accordance with Article 3(2) of Decision ECB/2014/6 on the organisation of preparatory measures for the collection of granular credit data by the European System of Central Banks (ESCB).

On 18 April, the Governing Council of the ECB adopted Decision (EU) 2016/702 amending Decision (EU) 2015/774 on a secondary markets public sector asset purchase programme (ECB/2016/8).

On 21 April, the Governing Council of the ECB decided that the key ECB interest rates would remain unchanged.

On 21 April, the Governing Council decided on a number of operational features of the corporate sector purchase programme and decided to expand the monthly purchases under the asset purchase programme to 80 billion euro.

On 28 April, the Governing Council of the ECB adopted Decision (EU) 2016/810 on a second series of targeted longer-term refinancing operations (TLTROs) (ECB/2016/10) and Decision (EU) 2016/881 amending Decision ECB/2014/34 on measures relating to targeted longer-term refinancing operations (ECB/2016/11). Decision ECB/2016/10 establishes the legal framework for the second series of TLTROs, which the Governing Council of the ECB decided to launch on 10 March 2016.

On 4 May, the Governing Council of the ECB decided to discontinue production of 500 euro banknote and not to include it in the Europa series. The Governing Council of the ECB also decided that the issuance of the 500 euro banknotes would be stopped around the end of 2018, when the 100 euro and 200 euro banknotes of the Europa series are planned to be introduced. The Governing Council of the ECB confirmed, that the 500 euro banknote would remain legal tender and could therefore continue to be used as a means of payment and store of value.

On 11 May, the Governing Council of the ECB took note of the TARGET Annual Report 2015.

On 12 May, the Governing Council of the ECB authorised the publication of the 15th annual review of "The international role of the euro. Interim Report, June 2016".

On 18 May, the Governing Council of the ECB authorised the publication of the "Financial Stability Review. May 2016".

On 18 May, the Governing Council of the ECB adopted Regulation (EU) 2016/867 on the collection of granular credit and credit risk data (ECB/2016/13) and Decision (EU) 2016/868 amending Decision ECB/2014/6 on the organisation of preparatory measures for the collection of granular credit data by the European System of Central Banks (ECB/2016/14). The Governing Council of the ECB also approved the publication of a document reflecting feedback received on an earlier draft of the Regulation (Feedback statement: Responses to the observations on the draft European Central Bank Regulation on the collection of granular credit and credit risk data. May 2016).

*Appendix 7 (cont.)*

On 26 May, the Governing Council of the ECB adopted Guideline (EU) 2016/1061 amending Guideline ECB/2008/8 on data collection regarding the euro and the operation of the Currency Information System 2 (ECB/2016/15).

On 1 June, the Governing Council of the ECB adopted Decision (EU) 2016/948 on the implementation of the corporate sector purchase programme (ECB/2016/16).

On 2 June, the Governing Council of the ECB decided that the key ECB interest rates would remain unchanged.

On 2 June, the Governing Council of the ECB decided that the Eurosystem would start purchases under the CSPP on 8 June and launch the first operation in the new series of TLTROs on 22 June.

On 9 June, the Governing Council of the ECB approved the harmonisation of the remuneration of the guarantee funds of systemically important payment systems (SIPS) held with the Eurosystem at the interest rate applied on the deposit facility. The Governing Council of the ECB approved the application of the interest rate in effect for the deposit facility to all guarantee funds of financial market infrastructures held with the Eurosystem.

On 24 June, the Governing Council of the ECB took note of the financial market developments following the outcome of the referendum on the UK membership of the EU held on 23 June.

On 24 June, the Governing Council of the ECB approved the publication of the disclosure report of the ECB self-assessment of TARGET2 against the Disclosure Framework of the Committee on Payment and Settlement Systems and International Organization of Securities Commissions, as required by Regulation ECB/2014/28 on oversight requirements for systemically important payment systems.

On 14 July, the Governing Council of the ECB approved the disclosure of three additional sets of data aimed at increasing transparency with regard to non-monetary policy portfolios held by Eurosystem central banks. The Eurosystem will publish, on a harmonised basis, a disaggregated Eurosystem statistical balance sheet, a disaggregated financial statement of the Eurosystem and the average annual net financial assets of the ECB and the euro area NCBs.

On 15 July, the Governing Council of the ECB approved a revised Eurosystem oversight policy framework document which describes the role of the Eurosystem in the field of oversight of payment, clearing and settlement systems and payment instruments.

On 21 July, the Governing Council of the ECB decided that the key ECB interest rates would remain unchanged, expecting the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases.

On 21 July, the Governing Council of the ECB confirmed that the monthly asset purchases of 80 billion euro are intended to run until the end of March 2017, or beyond, if necessary, and in any case until it sees a sustained adjustment in the path of inflation consistent with its inflation aim.

On 21 July, the Governing Council of the ECB decided, after a review of newly available statistical evidence, to lower, from 30% to 15%, the standardised deduction from the reserve base to be applied to liabilities with a maturity of up to two years within the debt securities category, as further specified in Regulation (EC) No 1745/2003 on the application of minimum reserves (the decision shall take effect as of the maintenance period starting on 14 December 2016).

*Appendix 7 (cont.)*

On 28 July, the Governing Council of the ECB took note of the positive experience with the Generation Euro Students' Award competition, which was launched in 2010 for a five-year trial period as a joint Eurosystem competition for secondary school students. The Governing Council of the ECB has decided to continue this competition.

On 28 July, the Governing Council of the ECB approved the publication of a report on the TITUS crisis communication exercise.

On 2 August, the Governing Council of the ECB adopted Regulation (EU) 2016/1384 amending Regulation (EU) No 1011/2012 (ECB/2012/24) concerning statistics on holdings of securities (ECB/2016/22), Guideline (EU) 2016/1386 amending Guideline ECB/2013/7 concerning statistics on holdings of securities (ECB/2016/23) and Recommendation ECB/2016/24 on the data quality management framework for statistics on holdings of securities.

On 18 August, the Governing Council of the ECB approved new links as eligible for use in Eurosystem credit operations in view of the third T2S migration wave (the list is available on the ECB's website).

On 7 September, the Governing Council of the ECB approved the Eurosystem contribution to the EC's DG FISMA consultation paper on further considerations for the implementation of the net stable funding ratio in the EU.

On 8 September, the Governing Council of the ECB decided that the key ECB interest rates would remain unchanged, expecting the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases.

On 8 September, the Governing Council of the ECB confirmed that the monthly asset purchases of 80 billion euro are intended to run until the end of March 2017, or beyond, if necessary, and in any case until it sees a sustained adjustment in the path of inflation consistent with its inflation aim.

On 9 September, the Governing Council of the ECB adopted Regulation (EU) 2016/1705 amending Regulation (EC) No 1745/2003 (ECB/2003/9) on the application of minimum reserves (ECB/2016/26).

On 9 September, the Governing Council of the ECB approved the indicative calendars for the Eurosystem's regular tender operations and reserve maintenance periods for 2017 and 2018.

On 9 September, the Governing Council of the ECB approved the publication of a report on TARGET2 explaining the methodology underlying the stress-testing framework and analysing the results obtained from the stress testing of liquidity risk in this system.

On 21 September, the Governing Council of the ECB adopted Decision (EU) 2016/1734 amending Decision ECB/2013/54 on the accreditation procedures for manufacturers of euro secure items and euro items (ECB/2016/25).

On 23 September, the Governing Council of the ECB approved the introduction of a billing threshold and a minimum billing amount, both set at 150 euro, for TARGET2-Securities (T2S) services.

On 28 September, the Governing Council of the ECB adopted Opinion CON/2016/47 on amendments to the Law on Latvijas Banka reducing the number of members of the Council of Latvijas Banka.

On 4 October, the Governing Council of the ECB decided on changes to the collateral

*Appendix 7 (cont.)*

eligibility criteria and risk control measures applicable to senior unsecured debt instruments issued by credit institutions or investment firms or their closely linked entities.

On 4 October, the Governing Council of the ECB approved principles increasing transparency in developing ECB regulations on European statistics and taking into account the transparency practices of the European Parliament, the Council of the EU and the EC.

On 14 October, the Governing Council of the ECB approved the publication of the ECB Report on financial structures 2016.

On 14 October, the Governing Council of the ECB reviewed the list of acceptable non-regulated markets for assets eligible as collateral for Eurosystem monetary policy operations; the list of issuers classified as multilateral development banks and international organisations; and the list of issuers classified as agencies in haircut category II.

On 20 October, the Governing Council of the ECB decided that the interest rate on the main refinancing operations will remain unchanged. The Governing Council of the ECB continues to expect the key ECB interest rates to remain at present or lower levels for an extended period of time, and well past the horizon of the net asset purchases.

On 20 October, the Governing Council of the ECB confirmed that the monthly asset purchases of 80 billion euro are intended to run until the end of March 2017, or beyond, if necessary, and in any case until it sees a sustained adjustment in the path of inflation consistent with its inflation aim.

On 31 October, the Governing Council of the ECB adopted Decision (EU) 2016/1974 amending Decision (EU) 2016/810 (ECB/2016/10) on a second series of targeted longer-term refinancing operations (ECB/2016/30).

On 2 November, the Governing Council of the ECB adopted Guideline (EU) 2016/2298 amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework (ECB/2016/31); Guideline (EU) 2016/2299 amending Guideline (EU) 2016/65 on the valuation haircuts applied in the implementation of the Eurosystem monetary policy framework (ECB/2016/32), as well as Guideline (EU) 2016/2300 amending Guideline ECB/2014/31 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2016/33).

On 2 November, the Governing Council of the ECB approved a Memorandum of Understanding between Eurostat and the ECB/Directorate General Statistics on the quality assurance of statistics underlying the Macroeconomic Imbalances Procedure.

On 3 November, the Governing Council of the ECB adopted Guideline (EU) 2016/2249 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34) (recast).

On 3 November, the Governing Council of the ECB adopted Decision (EU) 2016/2248 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (ECB/2016/36) (recast).

On 16 November, the Governing Council of the ECB authorised the publication of the "Financial Stability Review – November 2016".

On 30 November, the Governing Council of the ECB adopted Decision (EU) 2016/2164 on the approval of the volume of coin issuance in 2017 (ECB/2016/43).

On 8 December, the Governing Council of the ECB decided that the key ECB interest rates would remain unchanged, expecting the key ECB interest rates to remain at present

*Appendix 7 (cont.)*

or lower levels for an extended period of time, and well past the horizon of the net asset purchases.

On 8 December, the Governing Council of the ECB decided to continue its purchases under the asset purchase programme (APP) at the current monthly pace of 80 billion euro until the end of March 2017. From April 2017, the net asset purchases are intended to continue at a monthly pace of 60 billion euro until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council of the ECB sees a sustained adjustment in the path of inflation consistent with its inflation aim. The Governing Council of the ECB also decided to change some of the parameters of the APP. The Governing Council of the ECB decided to accept cash as collateral for securities lending facilities under the public sector purchase programme.

On 9 December, the Governing Council of the ECB took note of the 2015 Confidentiality Report that assesses the protection of confidentiality of individual statistical information collected by the ECB assisted by the NCB's, pursuant to Council Regulation (EC) 951/2009 amending Council Regulation (EC) 2533/98.

On 12 December, the Governing Council of the ECB approved the updated CCBM Manual of procedures and the updated CCBM Procedures for Eurosystem counterparties. It also endorsed the updates of the related internal Eurosystem/ESCB agreements. Furthermore, the Governing Council of the ECB approved the publication of the CCBM Procedures for Eurosystem counterparties and its technical annex on CCBM information for counterparties – Summary of legal instruments used in the euro area, on the ECB's website.

On 14 December, the Governing Council of the ECB decided that ABSPP will be fully implemented by the Eurosystem national central banks, instead of relying on the support of external asset managers, from 1 April 2017.

On 14 December, the Governing Council of the ECB approved its statement on macroprudential policies.

On 16 December, the Governing Council of the ECB authorised the launch of a public consultation on a draft ECB Regulation amending Regulation (EU) No 795/2014 on oversight requirements for systemically important payment systems (SIPS Regulation) and a draft Decision on the methodology for calculating sanctions for infringements of the SIPS Regulation.

On 16 December, the Governing Council of the ECB adopted Guideline (EU) 2017/148 amending Guideline ECB/2014/15 on monetary and financial statistics (ECB/2016/45).

On 21 December, the Governing Council of the ECB approved amendments to the list of agencies located in the euro area issuing securities that are eligible for the PSPP.

**2016 HIGHLIGHTS OF REGULATORY DOCUMENTS ADOPTED IN  
PURSUIT OF THE MAIN TASKS OF LATVIJAS BANKA**

<b>Regulatory document</b>	<b>No.</b>	<b>Date of adoption (effective date)</b>	<b>Title of the regulatory document adopted by the Council of Latvijas Banka</b>
Procedure	241/3	19.01.2016 (01.04.2016)	"Amendment to Procedure No. 183/3 'Participation Procedure in the Electronic Clearing System of Latvijas Banka' of the Council of Latvijas Banka of 9 September 2010"
Procedure	241/5	19.01.2016 (25.01.2016)	"Amendments to Procedure No. 217/1 'Participation Procedure in the Eurosystem Monetary Policy Operations Organised by Latvijas Banka' of the Council of Latvijas Banka of 12 December 2013"
Procedure	243/5	14.03.2016 (15.03.2016)	"Amendments to Procedure No. 216/7 'Participation Procedure in the VNS System of Latvijas Banka' of the Council of Latvijas Banka of 11 November 2013"
Regulation	144	14.03.2016 (15.03.2016)	"Amendments to Regulation No. 141 'Requirements for the Prevention of Laundering the Proceeds Derived from Criminal Activity and of Terrorist Financing upon Purchasing and Selling Cash Foreign Currencies' of Latvijas Banka of 15 September 2014"
Procedure	244/1	11.04.2016 (15.04.2016)	"Amendments to Procedure No. 186/4 'Participation Procedure in TARGET2-Latvija' of the Council of Latvijas Banka of 4 November 2010"
Regulation	145	12.05.2016 (01.07.2016)	"Amendments to Regulation No. 93 'Regulation for the Credit Register' of Latvijas Banka of 13 September 2012"
Regulation	146	12.05.2016 (01.07.2016)	"Amendments to Regulation No. 130 'Regulation for Electronic Information Exchange with Latvijas Banka' of Latvijas Banka of 12 December 2013"
Procedure	246/5	12.05.2016 (01.07.2016)	"Amendments to Procedure No. 232/5 'Participation Procedure in Cash Transactions at Latvijas Banka' of the Council of Latvijas Banka of 27 April 2015"
Regulation	147	12.05.2016 (01.07.2016)	"Amendments to Regulation No. 124 'Regulation for the Processing and Reissue of Euro Banknotes and Coins' of Latvijas Banka of 16 September 2013"
Regulation	148	12.05.2016 (01.06.2016)	"Amendments to Regulation No. 36 'Regulation for Purchasing and Selling Cash Foreign Currencies' of Latvijas Banka of 13 May 2009"
Procedure	247/4	12.07.2016 (13.07.2016)	"Amendment to Procedure No. 216/7 'Participation Procedure in the VNS System of Latvijas Banka' of the Council of Latvijas Banka of 11 November 2013"
Procedure	251/1	20.12.2016 (01.01.2017)	"Amendments to Procedure No. 217/1 'Participation Procedure in the Eurosystem Monetary Policy Operations Organised by Latvijas Banka' of the Council of Latvijas Banka of 12 December 2013"

**GLOSSARY**

**Asset-backed securities purchase programme (ABSPP):** a programme under which the Eurosystem purchases eligible asset-backed securities.

**Balance of payments:** a statistical statement summarising transactions between Latvia's residents and the residents of the rest of the world. It incorporates the current account, the capital account and the financial account.

**Bank for International Settlements (BIS):** an international financial organisation operating to facilitate international monetary and financial cooperation. The BIS acts as a bank for central banks.

**Banking union:** an EU-level framework for banking supervision and resolution operating based on a single rulebook applicable in the entire EU. Euro area countries and those EU countries outside the euro area opting to participate in the banking union are members of the banking union.

**Banknote Ethics Initiative (BnEI):** an initiative launched at the Currency Conference in May 2013 to provide ethical business practice, with a focus on the prevention of corruption and on compliance with anti-trust law within the banknote industry. ECB, Latvijas Banka and other euro area central banks are included in the list of organisations supporting the objectives of the initiative (the list is published on the website of the Banknote Ethics Initiative).

**Capital account:** a balance sheet component reflecting gross acquisitions/disposals of non-produced non-financial assets and capital transfers between Latvia's residents and the residents of the rest of the world.

**Central government:** public institutional units, including ministries, embassies, representative offices, agencies, councils, educational, healthcare, law enforcement, cultural and other public institutions whose competence covers the whole economic territory of the country, except for the administration of social security funds. The list of the institutional units of the Latvian central government is prepared by the CSB.

**Clearing:** the process of transmitting, processing and reconciling payment documents or securities transfer orders prior to settlement, resulting in establishment of the net position of each settlement participant by netting all payment documents submitted by the settlement participants, i.e. establishing net cash liabilities to or claims on other settlement participants.

**Collateral:** assets that are pledged or otherwise transferred to secure repayment of a loan, as well as those sold under repurchase agreements. The collateral used in the Eurosystem's reverse transactions should meet certain eligibility criteria.

**Corporate sector purchase programme (CSPP):** a programme within the framework of which the Eurosystem purchases euro-denominated investment grade bonds issued by corporations established in the euro in the secondary market.

**Council of the EU (EU Council):** the institution representing the governments of EU countries. The ministers of EU countries meet in the EU Council to adopt legislative acts and coordinate policies. The EU Council is an essential EU decision-maker. It is a single legal entity, but it meets in 10 different configurations, depending on the subject being discussed. The most significant tasks of the EU Council include negotiating and adopting legislative acts, developing common foreign and security policy of the EU, signing international agreements on behalf of the EU as well as adopting the EU budget together with the European Parliament.



*Appendix 9 (cont.)*

**Covered bond purchase programme (CBPP):** a programme under which the Eurosystem purchases eligible covered bonds.

**Credit institutions:** capital companies whose business is to receive deposits or other repayable funds from the public and to grant credits on its own account and provide other financial services.

**Current account:** a balance sheet component reflecting flows in goods, services, primary income and secondary income between Latvia's residents and the residents of the rest of the world.

**Debt security:** a security representing an obligation on the part of the issuer to make one or more payment(s) to the holder of the security at a specified future date or dates. Such security usually carries a specific rate of interest (the coupon) or is sold at a discount/premium to the amount that will be repaid at maturity.

**Deposit facility:** a standing facility of the Eurosystem which credit institutions registered in the Republic of Latvia and branches, registered in Latvia, of credit institutions registered in other countries may use to make overnight deposits with Latvijas Banka at a pre-specified interest rate.

**Deposits redeemable at notice:** funds deposited with an MFI without any specified maturity, with the possibility of withdrawing on demand either subject to notifying the MFI within an agreed period of notice or subject to payment of a substantial penalty.

**Deposits:** funds placed on the accounts of MFIs for a specified or unspecified period of time, with or without earning interest.

**Direct investment:** investment by an investor (direct investor) made directly or indirectly (through subsidiaries or associated companies) to acquire a lasting interest (corresponding to at least 10% ownership of ordinary shares or voting rights) in an enterprise (direct investment enterprise). The components of direct investment are equity and debt instruments.

**EBA Clearing (*EBA Clearing S.A.S. à capital variable*):** a capital company established by the major European and international banks, which provides pan-European payment infrastructure solutions, offering clearing and settlement services for both high-value and low-value euro payments to a wide community of banks in the EU.

**Economic and Financial Committee (EFC):** a counselling body set up to promote economic and financial policy coordination among the EU countries. In its fields of competence, the EFC provides opinions at the request of the EU Council or the EC, as well as ensures a dialogue between the Council and the ECB and provides assistance related to the preparatory work for the Council. The EFC is composed of representatives of the governments (usually Ministries of Finance) and central banks of the EU Member States as well as representatives of the EC and ECB.

**Electronic Clearing System of Latvijas Banka (EKS):** net settlement system of Latvijas Banka ensuring the processing of retail payment orders and the settlement of net positions.

**EONIA (euro overnight index average):** a measure of the effective interest rate prevailing in the euro interbank overnight market. It is calculated as a weighted average of the interest rates on unsecured overnight loans denominated in euro, as reported by a panel of contributing banks.

**Equities:** securities representing ownership of a stake in a commercial company. They comprise shares traded on stock exchanges (quoted shares), unquoted shares and other forms of equity. Equities usually produce income in the form of dividends.

*Appendix 9 (cont.)*

**EURIBOR (euro interbank offered rate):** the rate at which euro interbank term deposits are being offered within the euro area by one credit institution which is an active euro money market participant to another credit institution of such type in the euro area at 11.00 a.m. CET.

**Euro area:** EU countries which have adopted the euro as their single currency in accordance with the Treaty on the Functioning of the European Union and in which a single monetary policy is conducted under the responsibility of the Governing Council of the ECB. As at the end of 2016, the euro area comprised Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

**European Banking Authority (EBA):** an EU body with legal personality which forms part of the European System of Financial Supervisors and works to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objective is to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector.

**European Central Bank (ECB):** the central institution of the ESCB and the Eurosystem having a legal personality under the EU law. The ECB implements the tasks conferred upon the Eurosystem and the ESCB pursuant to the Statute of the ESCB and the ECB in cooperation with the national central banks of the EU Member States.

**European Council:** an EU institution defining the EU's overall political direction and priorities. It is comprised of the heads of state or government of the EU Member States, the President of the European Council and the President of the EC.

**European System of Central Banks (ESCB):** includes the ECB and the national central banks of the EU Member States. The national central banks of those EU countries that have not yet adopted the euro implement an independent monetary policy according to their national law and are thus not involved in the conduct of the monetary policy of the Eurosystem.

**European Systemic Risk Board (ESRB):** an independent EU body which is a part of the European System of Financial Supervision and is responsible for the macro-prudential oversight of the financial system within the EU in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU that arise from developments within the financial system, taking into account macroeconomic developments, so as to avoid periods of widespread financial distress. It contributes to the smooth functioning of the internal market and thereby ensures a sustainable contribution of the financial sector to economic growth.

**Eurosystem:** comprises the ECB and the national central banks of the euro area countries. The decision-making bodies of the Eurosystem are the Governing Council and the Executive Board of the ECB.

**Expanded asset purchase programme (APP):** includes all public and private sector asset purchase programmes that the Eurosystem implements to address the risks of a too prolonged period of low inflation. APP includes CBPP3, ABSPP, PSPP and CSPP.

**Financial account:** a balance sheet component reflecting financial assets and financial liabilities (direct investment, portfolio investment, financial derivatives, other investment and reserve assets) between Latvia's residents and the residents of the rest of the world.

**Financial stability:** the condition in which the financial system (financial intermediaries, markets and market infrastructures) is capable of withstanding shocks, without significant disruptions in the financial intermediation process and the supply of general financial services.

*Appendix 9 (cont.)*

**Fine-tuning operation:** an open market operation executed by the Eurosystem in order to deal with unexpected liquidity fluctuations in the market. The frequency and maturity of these operations are not standardised.

**Fixed rate instrument:** a financial instrument for which the coupon is fixed throughout the life of the instrument.

**General Council of the ECB:** one of the decision-making bodies of the ECB, comprising the President and the Vice-President of the ECB and the Governors of the central banks of all EU countries.

**General government:** public institutional units, engaged in production of non-market goods or provision of services intended for individual or collective consumption, or public institutions engaged in redistribution of national income or wealth, primarily financed from the contributions (taxes and duties) imposed on economic agents. General government in the Republic of Latvia includes central government, social security funds and local government. The list of the institutional units of the Latvian central government is prepared by the CSB.

**Governing Council of the ECB:** the main decision-making body of the ECB. It consists of members of the Executive Board of the ECB and the governors of the national central banks of the euro area.

**Gross settlement system:** a transfer system in which the settlement concerning each cash or securities transfer order occurs on an instruction-by-instruction basis in the order of receipt.

**Household:** a natural person or group of natural persons in the capacity of a consumer and producer of goods and a provider of non-financial services for exclusively own final use; a sole proprietor engaged in its professional practice or working at its farm (fishery) with the aim of gaining income or benefits, without employing any other person and without registering its activity with the Commercial Register of the Enterprise Register of the Republic of Latvia.

**International investment position:** a statistical statement reflecting the value and composition of financial claims (assets) on and financial obligations (liabilities) between Latvia's residents and the residents of the rest of the world, on a specific date, as well as changes in the residual values in the respective time period.

**International Monetary Fund (IMF):** an international organisation operating to facilitate international monetary cooperation, exchange rate stability, national economic growth and employment growth, and provide short-term financial assistance to IMF member countries for balancing the payment flow.

**Key ECB interest rates:** the interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility, set by the Governing Council of the ECB.

**Local government:** institutional units of the local public administration, whose competence covers only a local economic territory. The list of the institutional units of the Latvian central government is prepared by the CSB.

**Longer-term refinancing operation (LTRO):** an open market operation with a maturity longer than that of the main refinancing operation. Regular LTROs have a maturity of three months and are carried out through monthly standard tenders in the form of reverse transactions. The Eurosystem may also conduct non-standard LTROs with a maturity longer than three months (up to 48 months), aiming to provide additional longer-term liquidity and support the monetary policy objectives.

*Appendix 9 (cont.)*

**M1:** a narrow monetary aggregate comprising currency in circulation and overnight deposits held with MFIs by euro area residents.

**M2:** an intermediate monetary aggregate comprising M1 and deposits held with MFIs by euro area residents and redeemable at a period of notice of up to and including 3 months (i.e. short-term savings deposits) and those with an agreed maturity of up to and including 2 years (i.e. short-term time deposits).

**M3:** a broad monetary aggregate comprising M2 and marketable instruments, in particular repurchase agreements, money market fund shares/units, and debt securities with a maturity of up to and including two years issued by MFIs.

**Main refinancing operation:** a regular open market operation executed by the Eurosystem in the form of reverse transactions. Such operations are carried out through a weekly standard tender and normally have a maturity of one week.

**Marginal lending facility:** a standing facility, offered by the Eurosystem, which credit institutions registered in the Republic of Latvia and branches, registered in Latvia, of credit institutions registered in other countries may use to receive overnight credit from Latvijas Banka at a pre-specified interest rate against eligible assets.

**Market risk:** the risk related to fluctuations of the fair value or cash flow of financial instruments on account of movements in market prices. Market risk reflects the interest rate risk, currency risk and price risk.

**Monetary base (base money):** currency (banknotes and coins) in circulation, the minimum reserves credit institutions are required to hold with the Eurosystem as well as any excess reserves they may hold under the Eurosystem's deposit facility or as other liabilities related to the monetary policy operations.

**Monetary financial institution (MFI):** a central bank, credit institution, credit union, money market fund and other financial institution whose business is to receive deposits or close substitutes for deposits from customers other than MFIs and, on their own account, to grant credits and invest in securities, as well as an electronic money institution whose core business is to issue electronic money. Latvijas Banka sets up, maintains and regularly updates the List of Monetary Financial Institutions of the Republic of Latvia (see section Statistics on Latvijas Banka's website [www.bank.lv](http://www.bank.lv)). The list is also available on the ECB website where the ECB publishes the list of MFIs of the EU Member States on a regular basis. As at the end of 2016, there were 60 MFIs in Latvia.

**Monetary income:** income accruing to the national central banks of the euro area in the process of the Eurosystem's monetary policy implementation, derived from assets earmarked in accordance with guidelines established by the Governing Council and held against banknotes in circulation and credit institutions' deposits with central banks of the euro area.

**Non-financial corporation:** an economic entity producing goods or providing non-financial services, including an individual merchant registered with the Commercial Register of the Enterprise Register of the Republic of Latvia.

**Open market operation:** an operation executed in the financial market on the initiative of a central bank. With regard to their aims, regularity and procedures, Eurosystem's open market operations can be divided into four categories: main refinancing operations, longer-term refinancing operations, fine-tuning operations and structural operations.

**Organisation for Economic Co-operation and Development (OECD):** an intergovernmental organisation, a forum providing a platform for seeking answers to common

*Appendix 9 (cont.)*

problems, identifying good practices and coordinate domestic and stimulating policies that improve the economic and social well-being of persons.

**Outright transactions:** open market operations where the Eurosystem purchases or sells eligible assets outright in the market. Outright transactions are executed only for structural purposes.

**Price stability:** the maintenance of price stability is the primary objective of the Eurosystem. The Governing Council of the ECB has defined price stability as a year-on-year increase in the HICP for the euro area that is below 2%. The Governing Council has also stated that, in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2%.

**Public sector purchase programme (PSPP):** a programme within the framework of which the Eurosystem purchases bonds issued by the euro area central and local governments, agencies, international organisations and multilateral development banks in the secondary market.

**Real-Time Gross Settlement (RTGS) system:** a settlement system in which processing of cash or securities transfer orders and settlement takes place on an individual basis and in a consecutive order (without netting) in real time.

**Reserve requirement:** a requirement for credit institutions and credit unions to hold their minimum reserves with the national central bank over the reserve maintenance period. Compliance with the requirement is determined on the basis of the average end-of-day balance on the reserve account over the reserve maintenance period.

**Residual maturity:** time remaining until the maturity date of a debt instrument or a loan or time remaining until the final date of any other financial operation.

**Reverse transaction:** a transaction whereby the Eurosystem buys or sells assets under a repurchase agreement or conducts credit operations against collateral.

**Securities settlement system:** an agreement between at least three participants, apart from the operator of the system, on the execution of securities' transfer orders between those participants in accordance with uniform regulations and standardised procedures.

**Single Euro Payments Area (SEPA):** a project proposed by the European banks and supported by the Eurosystem and the EC to harmonise the way retail payments in euro are made, making payments in euro across European countries as fast, secure and effective as domestic payments. SEPA enables consumers, businesses and other economic agents to make both domestic and cross-border payments in euro on the same main terms and conditions, with the same rights and obligations, regardless of their location. As at the end of 2016, SEPA encompassed all EU Member States, Iceland, Liechtenstein, Monaco, Norway, San Marino and Switzerland.

**Single Supervisory Mechanism (SSM):** an EU-level framework for a prudential supervision of credit institutions in the euro area countries and in those EU countries outside the euro area opting to participate in the mechanism. The SSM is one of the central pillars of the banking union, comprising the ECB as the final responsible supervisory authority and the relevant national competent authorities of the EU countries.

**STEP2:** a payment system maintained by the EBA Clearing for the processing of retail payments in euro. STEP2 is a Pan-European Automated Clearing House (PE-ACH) system that fully complies with the requirements for SEPA clearing and settlement infrastructures set out by the European Payments Council, and is the sole system providing reachability of all EU credit institutions within SEPA.

*Appendix 9 (cont.)*

**Structural operations:** open market operations executed by the Eurosystem on a regular or non-regular basis whenever the ECB wishes to adjust the structural liquidity position of the Eurosystem vis-à-vis the financial sector.

**Systemic risk:** the risk that the inability of one participant to meet its obligations in a system will cause other participants to be unable to meet their obligations when they become due, potentially with spillover effects threatening the stability of or confidence in the financial system. That inability to meet obligations can be caused by operational or financial problems.

**TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer system):** the Eurosystem's real-time gross settlement system for the euro. The first generation TARGET system was replaced by TARGET2 in May 2008.

**TARGET2:** the second-generation TARGET system. It settles payments in euro in central bank money and functions on the basis of a single IT platform, to which all payment orders are submitted for processing.

**TARGET2-Latvija:** a component system of TARGET2 in Latvia. Its operation is ensured by Latvijas Banka in conjunction with the national central banks of the ESCB participating in TARGET2.

**TARGET2-Securities (T2S):** the Eurosystem's single technical platform enabling central securities depositories and national central banks to provide borderless and neutral core securities settlement services in the central bank money in Europe.

**Targeted longer-term refinancing operations (TLTROs):** reverse operations of the Eurosystem providing longer-term liquidity to credit institutions on attractive terms, so that they can continue easing the terms and conditions of lending to the private sector and to encourage their lending to the real economy.