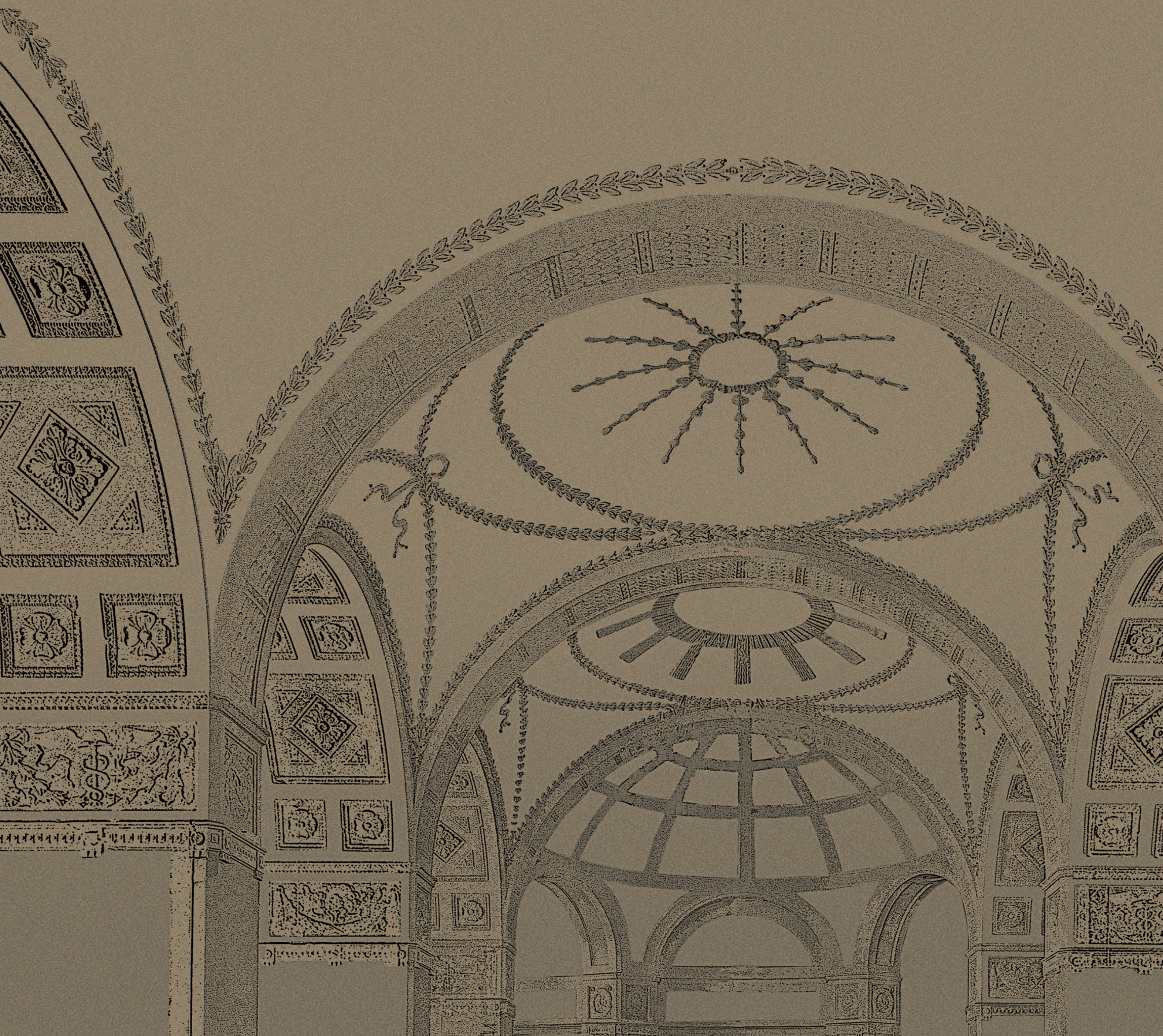
LATVIJAS BANKA

BANK OF LATVIA: ANNUAL REPORT 2009



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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 *the indicator is below 0.5 but over 0, or the result of the computation of the indicator is 0.*

Photos by Gunta Andersone, Ainars Meiers and Indriķis Stūrmanis.

The cut-off date is 19 April 2010.

CONTENTS

ABBREVIATIONS

BIS	Bank for International Settlements
CEBS	Committee of European Banking Supervisors
CIF	cost, insurance and freight at the importer's border
CPI	Consumer Price Index
CSB	Central Statistical Bureau of Latvia
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EFC	Economic and Financial Committee
EKS	Bank of Latvia's Electronic Clearing System
EMU	Economic and Monetary Union
ERM II	Exchange Rate Mechanism II
ESA 95	European System of Accounts 1995
ESCB	European System of Central Banks
EU	European Union
EU8	countries which joined the EU on 1 May 2004 (except Cyprus and Malta)
EU27	countries of the EU
Eurostat	Statistical Bureau of the European Union
FCMC	Financial and Capital Market Commission
FOB	free on board at the exporter's border
FRS	US Federal Reserve System
GDP	gross domestic product
IMF	International Monetary Fund
ISO	International Organization for Standardization
JSC	joint stock company
LCD	Latvian Central Depository
M0	monetary base
M1	narrow monetary aggregate
M2	intermediate monetary aggregate
M2X	broad money
M3	broad monetary aggregate
MFI	monetary financial institution
Ministry of Finance	Ministry of Finance of the Republic of Latvia
NACE	EU statistical Classification of Economic Activities *(Nomenclature statistique des activités économiques dans la Communauté européenne)*
OECD	Organisation for Economic Co-operation and Development
OMXR	NASDAQ OMX Riga index
Plc	public limited company
SAMS	Bank of Latvia's Interbank Automated Payment System
SDR	Special Drawing Rights
SEPA	Single Euro Payments Area
SJSC	state joint stock company
Treasury	Treasury of the Republic of Latvia
UK	United Kingdom
US	United States of America
VAT	value added tax
VNS	Bank of Latvia's Securities Settlement System

FOREWORD OF THE GOVERNOR

We are likely to remember 2009 as the year with a pronounced drop in GDP, an ever more rapidly rising unemployment and the associated uncertainty about the future prospects of the Latvian economy. At the same time, 2009 can also be considered a breaking point, especially after the budget amendments adopted by the Saeima of the Republic of Latvia in June 2009.

We have experienced sharp and interesting exchanges on the way of reform chosen by Latvia and on the possible alternatives. I am satisfied that the view that there was no alternative is gaining ground. Why not? Because for many years Latvia spent more than it could earn and increased its spending to a level that cannot be sustained in the long term.

At the beginning of 2009, it became clear that the drop in GDP would be substantial and the expected tax income, in the absence of adequate cuts in expenditure, threatened a budget deficit that would be impossible to finance. Moreover, the fiscal expansion of the growth years acted to step up the overheating of the economy, dealing a devastating blow to the competitiveness of the economy, which had to be regained to resume growth. The implication was that to the end of renewing fiscal sustainability and macroeconomic stability as well as quickening the pace of economic recovery, important structural reforms and fiscal consolidation were needed, gradually balancing the budgetary expenditure with revenue.

Although the course of action was clearly set and enjoyed the support of the social partners and many groups of the society, under the influence of the heavy burden of reform and possibly the atmosphere of preparation for the local elections, the implementation of the measures so indispensable for stabilising the economy stalled initially. The protracted negotiations with the international lenders about further implementation of the aid programme as well as the delays in development of the required reforms and adoption of important decisions gave rise to uncertainty and investors lost their confidence in a positive solution to the economic situation. Latvia was the focus of the world's media. The uncertainty caused wide speculations on the financial markets, interest rates grew rapidly, Latvia's reputation deteriorated, businesses lost their foreign partners, the international rating agencies downgraded Latvia's sovereign credit rating and the financing available to the economy dried up. That caused the economic downturn to deepen. The turning point, however, was reached with adopting amendments to the 2009 budget in June and the 2010 budget in December.

The combined effort of the Latvian government and parliament managed to stop the situation from deteriorating further and, in part, to dispel uncertainty. The Latvian reforms gained the trust of international investors, international rating agencies and financial markets. The interest rates dropped rapidly, thus easing both the government borrowing costs and the burden of credit payments on many borrowers. After the adoption of the 2010 budget by the Saeima of the Republic of Latvia, even the greatest sceptics lost their arguments. Latvia is writing a new page in the history of finance, becoming a model for other countries.

It is even more important to note that alongside fiscal consolidation a number of positive economic developments are observed. First, the competitiveness of Latvian businesses has started to recover and is improving; it had deteriorated as wage increases substantially outpaced productivity, thereby limiting the export capacity of businesses and their ability to compete on the international markets. Second, we are pleased that the Latvian goods exports expanded from the second to the fourth quarter of 2009 almost reaching the pre-crisis levels. Third, the Latvian current account deficit has turned into a surplus. That means that we are finally able to finance imports on our own, without increasing the national debt. Fourth, in these difficult times, Latvian businesses have managed to increase their export market shares on foreign markets, successfully competing with the manufacturers of other countries under the circumstances of a deep crisis.

The structural changes indispensable for sustainable development and growth are becoming clearly pronounced: in GDP, the share of those sectors capable of competing in export markets has been progressively on the rise, gradually compressing the share of building and retail trade sectors. In the fourth quarter of 2009, the share of exports in GDP was already 46% compared to 39% in the corresponding period of the previous year. The structural reforms will make the economy much more effective and competitive while reinforcing the foundation for future growth.

The measures that Latvia undertook to overcome the crisis and that met with distrust from many have already demonstrated their advantages. Yet we should not stop with what we have achieved. The 2011 budget and that it is drawn up with further structural reforms and fiscal consolidation will be no less important to reinforce the macroeconomic stability indispensable for sustainable development. That will put in place the preconditions for meeting the Maastricht criteria allowing Latvia to introduce the euro as early as 2014, thereby providing development opportunities for the economy at large, creating new jobs and increasing the budgetary revenue.

Ahead of the rapid deterioration in the economic activity, shrinking inflation and decelerating lending, the Bank of Latvia substantially reduced the minimum reserve requirements applied to banks already in 2008, gradually reducing the minimum reserve ratio to 3.00% and later leaving it unchanged. The lending facility rate also remained unchanged in 2009, whereas the refinancing rate was reduced in March and May from 6.00% to 4.00% overall and the deposit facility rate was decreased in January and March to 1.00% overall, to provide an additional incentive for the banks to invest their free liquidity in the economy.

The Bank of Latvia contributed to the stability of financial market infrastructure by providing interbank payment and electronic clearing opportunities, ensuring a wide range of modernised real-time gross settlement services via TARGET2-Latvija, implementing oversight of the payment and securities systems and supporting the Single Euro Payments Area (SEPA) initiative. The Bank of Latvia expanded the participation in the Credit Register and the scope of information required, and, in compliance with the requirements of the international institutions, prepared and disseminated the Latvian balance of payments statistics as well as the financial market and monetary statistics.

The Bank of Latvia ensured the cash currency circulation by checking the banknotes received from banks for wear and tear and authenticity as well as replacing the money notes taken out of circulation with a range of paper money and coins in accordance with demand. The year 2009 entered the history of Latvian money with five new silver collector coins. The hitherto greatest international achievement by Latvian coins dates from the beginning of 2010: the "Coin of Latvia" struck based on the concept and model authored by Teodors Zaļkalns in 1922 received the award "Best Gold Coin" and the overall "Coin of the Year" award in the prestigious Coin of the Year competition held by the US Krause Publications.

I would like to use this opportunity to thank the Bank of Latvia's employees for their selfless, successful and professional work in 2009 in helping to execute the Bank of Latvia's tasks.

Ilmārs Rimšēvičs
Governor of the Bank of Latvia
Riga, 14 April 2010

THE BANK OF LATVIA'S VISION AND MISSION

VISION

The Bank of Latvia is an independent entity that carries out its tasks in the public interest and with a high sense of professional responsibility. It is a full-fledged participant in the ESCB and cooperates with other EU institutions, developing stable and favourable environment for the economic growth of Latvia.

MISSION

The objective of the operation of the Bank of Latvia as the central bank is price stability promoting Latvia's long-term economic growth.

The Bank of Latvia is an active and responsible participant of the ESCB, promoting integration and stability of the financial systems of Latvia and other EU countries.

The Bank of Latvia raises the level of Latvian general public's perception of economic issues, promoting understanding and credibility.

The Bank of Latvia operates effectively in a professional manner ensuring high quality, risk management and business continuity.

The Bank of Latvia is a reliable cooperation partner.

NATIONAL ECONOMY DEVELOPMENTS AND MONETARY POLICY

GLOBAL ECONOMIC ENVIRONMENT

While in the initial months of 2009 the global economy continued to plunge into an ever deeper recession, the first signs of recovery started to surface in the middle of the year. Confidence indicators improved, financial market conditions became more benevolent, and the world trade resumed growth. From the third quarter onwards, the GDP growth returned to positive territory in a number of developed and developing countries. Industrial activity was the main driver behind the observed recovery. Despite the recent crisis being among the most severe in world history, concerted actions of many countries and government measures seeking to boost the demand provided a relatively immediate impetus to the renewal of global growth.

The most severe economic downturn ever observed in the history of the euro area ended in the third quarter of 2009, when the GDP growth was back to positive territory after a protracted five-quarter period of negative growth. A number of interacting factors were responsible for this, albeit relatively slow, economic recovery at the close of the year. First, it reflected overall global improvements: in line with a stronger demand for goods from the euro area, the latter's foreign trade performance improved and exports figured as the main driver of growth in the third and fourth quarters. Second, these improvements were supported by unprecedented and effective monetary and fiscal measures, undertaken by governments of many countries around the world since the end of 2008 to limit the adverse effects of the crisis. Although in the absence of such measures the economic downturn would have been even deeper, the fiscal balances and labour market conditions deteriorated in almost every euro area country and, consequently, affected also the private demand.

A year after the beginning of the global financial crisis, the EU8 countries also started to show the first signs of improving conditions amidst continuously falling GDP in the majority of them. Poland was the only EU8 country with a positive GDP growth in 2009. Poland's pre-crisis economic situation had been better than that of other countries in the region, and its economy, while being less open, excels in higher diversity. Other Central and Eastern European countries recorded decelerating rates of economic activity, with such deceleration being particularly steep in the Baltic States. In Estonia, as the government had been practicing austerity fiscal policy in previous years, the state budget balance did not deteriorate as sharply as in the neighbouring countries. The third quarter saw easing in the GDP decline in Estonia, as the pace of stock adjustments calmed down and domestic demand gained some momentum in the fourth quarter. Exports and imports of goods had been there on the rise already in the second and third quarters respectively. In Lithuania, with the manufacturing sector sending recovery signals, the pace of economic downturn moderated in the third and fourth quarters. Nevertheless, GDP contracted in all three Baltic States for the year overall.

Sweden's GDP recorded notable shrinkages well into the first half of the year due to weak domestic demand and contracting manufacturing and export volumes; in the second half of the year, however, when the country's major trade partners strengthened and the demand for goods from Sweden grew, business confidence increased and the volume of orders started to pick up. Private consumption followed suit from the mid-year, thus slowing down the pace of economic downturn. The Danish economy had recorded sharp contractions in the economic activity and GDP since as early as 2007; nonetheless, from the third quarter, GDP growth became positive also in Denmark.

Following the steep GDP drop in the first half of the year, the UK, similar to many other states, recorded a pickup in the second half of the year, which was primarily driven by such one-off factors as growing government expenditure and the return to standard (higher) VAT rate as of 1 January 2010, due to which private consumption rose notably prior to this date. Amidst strengthening global demand, the manufacturing industries did not report any substantial upswing.

Economic recession that had captured the US in the middle of 2008 ended in the third quarter of 2009 when the GDP growth renewed. Industrial production showed signs of recovery in the second half of the year, while private consumption remained relatively resilient. The economic stimulus package put in place by the US government played an important role. Nevertheless, due to still unfavourable labour market situation, the pace of recovery was slow. Retail trade and industry improved in the second half of the year, while the construction sector continued on a downward trend.

The implications of the world financial crisis were felt in Russia more strongly than in other countries, as the structural reforms needed to minimise the dependence of the economy on oil prices in the global market had been delayed. As a result, the GDP growth dropped sharply in the first half of the year. In the third quarter, however, the situation started to improve and translated into buoyant growth in the fourth quarter, mirroring export acceleration and a positive contribution from the changes in inventories. At the beginning of 2009, the Russian government launched a set of measures to enhance the access to financing and to reduce the administrative barriers for businesses.

Following a steep drop in the previous year, the global oil prices stabilised at the beginning of 2009, to surge again at the end of the first quarter on global financial market hopes for an optimistic economic outlook. Further on, overall oil prices continued progressively on an upward trend. Amidst changing market sentiments, this upward trend in oil prices was broken by downward, albeit short-lived, fluctuations from time to time. Overall, oil prices rose from 35 US dollars per barrel to 78 US dollars per barrel over a year (end of 2008 to end of 2009). The expectations of market participants about the anticipated future demand for oil figured as a key factor underlying the oil price dynamics. Market perceptions about shifts in the demand for oil were primarily underpinned by the forecasts of the International Energy Agency. They were revised down at the beginning of the year to capture a potential contraction in the demand for oil in 2009. Nevertheless, shifts in the International Energy Agency's forecast trends relative to global oil demand in 2009 and 2010 followed soon – already in the second half of the year. These forecasts were subject to upward revisions on several occasions due to more dynamic development of the Asian countries and first recovery signals coming from the developing economies. In the first half of the year, oil prices were supported by constraints on oil production by the OPEC countries. In 2009, production of oil by OPEC countries declined from 35.8 million to 33.6 million barrels per day. Meanwhile in non-OPEC countries, it grew slightly from 51.3 million to 51.5 million barrels per day. The prices of non-ferrous and precious metals were also up.

The moderate pace of oil price rises in 2009 did not exert a strong pressure on inflation and would likely rank as an inflationary risk aggravating factor only in the future. That is why, central banks across the world, when facing the downturn, were able to employ relatively radical economy-boosting monetary policy stimulus packages. The FRS and the Bank of Japan had lowered their base rates close to zero already in 2008, whereas the ECB and the Bank of England accomplished the process in the first half of 2009. Thus the base rates of world major central banks were at their lows, with a limited likelihood of further lowering. The base rates of the FRS, the ECB, the Bank of England, and the Bank of Japan were 0%–0.25%, 1.0%, 0.5%, and 0.1% respectively. Most central banks of other countries in the world, including those in non-euro area Member States of the European Union, also lowered their base rates on a regular basis to give momentum to the economy. Base rates of world major central banks were kept low also in the second half of the year, as the recovery was still fragile and exposed to different risks. Some other central banks, e.g. the Bank of Israel and the Central Bank of Norway, started to raise their base rates in the third quarter on account of concerns about growing inflationary pressures.

In addition to interest rates, all central banks across the world resorted to quantitative monetary instruments in 2009. In the first quarter, the statement of the US government on the allocation of additional funds for the purchase of government long-term securities for 300 billion US dollars, mortgage-backed securities of companies Fannie Mae and Freddie Mac for 1.25 trillion US dollars, and agency debt for 200 billion US dollars was of importance for the financial market. Also, the Bank of England announced in March an asset purchase programme, which from the initial 75 billion British pounds sterling rose to 200 billion British pounds sterling in the course of the year. Similar programmes were undertaken also by the Bank of Japan. Meanwhile, the ECB launched a facility providing for the purchase of euro denominated covered bonds in the amount of 60 billion euro at the beginning of the third quarter, with the total amount unchanged by the end of the year. Central banks attempted to make credit resources accessible to market participants in needed amounts. The FRS launched also several liquidity programmes for market participants to borrow funds under terms agreed upon in advance. The ECB instead resorted to extraordinary auctions (in addition to regular and supplementary ones), including longer-term refinancing operations. In order to give impetus to the euro area banks to resume mutual lending, the ECB held tender procedures with 1-year maturity in June, September, and December, enabling banks to borrow unlimited financing at a fixed 1% rate. Via these tender procedures the banks borrowed 442.2 billion euro, 75.2 billion euro, and 96.9 billion euro respectively. When the economic conditions improved, at the end of the year the ECB and FRS made announcements on scaling back such unconventional monetary policy measures. Facing a weaker-than-expected demand from market participants, the FRS introduced a 25 billion US dollar cut to the agency debt purchase programme. At the beginning of 2010, a decision not to extend several liquidity programmes was made. Meanwhile towards the end of the fourth quarter, the ECB announced that it would discontinue the 12-month and 6-month tender procedures and introduce changes to the interest rate calculation methodology for the December 1-year tender procedure.

Regarding global stock markets, the prices were generally determined by the market players' risk appetites and assessment of the global economic perspective. The downward dynamics of stock prices reached a conditioned breaking point in March when, with market participants becoming more optimistic, their risk appetites growing, and macroeconomic and business indicators sending ever stronger signals of recovery, an upward price trend set in. In 2009 overall, the US stock market index Standard & Poor's 500 increased by 23.5%, more liquid stock index DJIA grew by 18.8%, and NASDAQ Composite picked up 43.9%. The euro area stock market index Dow Jones EURO STOXX 50 was up 24.2%, while Japan's stock market index Nikkei 225 gained 19.0%. The increase in China's stock market index SSE A Share by 79.8% was particularly notable. Rising oil and metal prices and market participants' renewed risk appetites affected also the Russian stock market index RTS, which increased by 128.6% within the year.

The dynamics of yields on securities responded to the improving indicators of economic performance, market participants' intention to shift, in part, safe portfolios towards more risky ones, and numerous issues of general government securities. The market demand for government securities was strong, as, for instance, financial institutions with spare funds at their disposal willingly invested also in government securities. On the backdrop of interaction of various factors, the yields on government securities grew only somewhat in 2009. Towards year's end, the yield on US government 2-year bonds rose to 1.1% (0.8% at the end of 2008), whereas that on Germany's government 2-year bonds declined from 1.9% to 1.4%. The yield on the US government 10-year bonds increased from 2.1% to 3.8%, while that on Germany's government 10-year bonds went up from 3.0% to 3.4%.

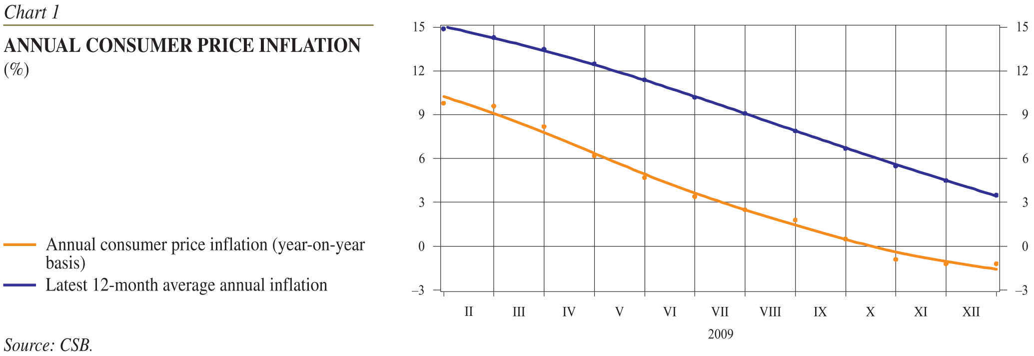
In the first quarter, the euro tended to depreciate against the US dollar, since market players assessed the euro area's outlook more critically. However in March, following the FRS announcement about the purchase of government long-term securities, the euro appreciation against the US dollar began. This trend, driven by market players' stronger risk appetites reflected by reduced positions in the US dollars and lower base rates of the FRS, persisted till December. When the news about the situation in Dubai and later also about the enormous budget deficit and public debt in Greece shook the market, the euro depreciated. In the course of the year overall, the exchange rate of the euro against the US dollar had slightly increased.

INFLATION

In 2009, primarily due to the demand-side factors, the annual consumer price inflation declined fast from 9.8% in January to –1.2% in December (see Chart 1); the average annual inflation was down to 3.5% (15.4% in 2008). It was on account of the weakening domestic and foreign demand, the latter as a financial crisis consequence, and relatively low prices of the global energy resources. With the economic activity becoming sluggish, the input costs (labour costs in particular) dropped notably as well. Consequently, these reduced input costs and the undertaken structural reforms enabled businesses to lower prices in order to attract as many customers as possible in the circumstances of falling demand. More pronounced price reductions were confined by the supply-side factors, changes in indirect taxes, and renewed surges in global oil prices.

Chart 1

ANNUAL CONSUMER PRICE INFLATION
(%)



Source: CSB.

The increased tax rates also held back prices from dropping at a faster rate. In order to push up the general government budgetary revenues, a higher (by 3 percentage points) VAT rate was introduced in January 2009. This increase affected prices of almost all goods and services, with the estimated 2.1 percentage point contribution to average annual inflation. In addition, effected were the amendments to the Law "On Excise Tax" providing for an increased excise tax on tobacco products and alcoholic beverages.

Capturing the steep drop in demand, the annual consumer price core inflation was down 8.3 percentage points (–2.0% in December) over the year, and the contribution of these changes to average annual inflation amounted to 2.1 percentage points. The contribution of non-administered service prices to the consumer price dynamics decreased most notably. At the beginning of the year, it was 2.1 percentage points of total inflation, but as non-administered service prices strongly responded to falling household incomes and dropped, this contribution became negative (–1.1 percentage points) at the close of the year. The impact of processed food prices on total inflation also weakened substantially. With food prices on a downward trend, their contribution shrank by 2.4 percentage points, to stand at –0.6 percentage point at the end of the year. The contribution of prices of other tradables to inflation had been negative since the beginning of the year; moreover, as a result of adverse effects of import prices and the shrinking demand, this contribution continued on a downward trend, to –1.2 percentage points at the close of the year.

In the wake of dropping global energy prices in 2008, the energy tariffs fell and substantially reduced the effects of administered prices on inflation: the latter slipped down in the course of the year from 5.1 percentage points in January to 0.3 percentage point at the end of the year. However, some administered prices continued to rise. As public funding contracted, it was primarily in the services sector, specifically health care and education, that administered prices continued on an upward trend.

Under the impact of both weak demand and stabilising global food prices, those of unprocessed food dropped 12.9% over the year, with a 0.2 percentage point contribution to average annual inflation.

Notwithstanding an end-of-the-year rise in fuel prices due to notably higher global oil prices, for 2009 overall, a 7.7% decline against 2008 was recorded, thus bringing down the average annual inflation rate by 0.3 percentage point.

Lower input costs and sluggish demand also pressed down the producer prices, which decreased at a faster pace than consumer prices and were on average 4.7% lower than in 2008; the producer prices of output for exports posted particularly sharp falls. All in all, manufacturing recorded the steepest price declines. When the purchase prices reflecting shifts in global prices went down, metal and food industries reported the most substantial price drops, 5.4% and 13.0% respectively. At the same time, the producer price level was pushed up by producer prices in the energy sector where they were 9.7% higher than in 2008.

In 2009 overall, construction costs decreased by 10.9%, primarily due to lower wages and salaries (by 21.8%) and building material prices (by 7.5%). Construction costs of industrial, agricultural and commercial buildings as well as hotels shrank most, while the decline in office building construction costs was the least pronounced. Despite some deceleration towards the end of 2009, the annual pace of cost reduction remained buoyant, implying a further cost decline in 2010 as well.

GROSS DOMESTIC PRODUCT

A primary trigger of contractions in real GDP in 2009 was weak and ever weaker domestic demand that persisted throughout the year and was also adversely affected by fiscal consolidation efforts. Meanwhile, real exports of goods and services were on a downward trend at the beginning of the year but rebounded in the second half of the year when the global economy started to recover and competitiveness to strengthen gradually. The quarterly growth in exports turned somewhat positive as early as the third quarter and became more pronounced towards the end of the year. Nevertheless, these overall positive shifts in exports did not generate sufficient momentum for the drop in domestic demand to abate as yet. Although they boosted production in export-oriented industries of the manufacturing sector, the negative effects of domestic demand on the dynamics of several other branches were not offset.

In the first three quarters of 2009, the annual pace of contraction in real GDP accelerated, with GDP falling by 17.8%, 18.4%, and 19.0% in each respective quarter; in the fourth quarter, by contrast, the downturn slowed somewhat (16.9%). As a result for the year as a whole, GDP dropped 18.0% at constant prices (see Table 1) and stood at 13 244.3 million lats at current prices.

Table 1

GDP AND GROSS VALUE ADDED (SECTORAL CONTRIBUTION)
(at constant prices; year-on-year basis)

	Decrease (%)	Contribution to gross value added decrease (in percentage points)
GDP	18.0	x
Gross value added	16.1	x
Goods-producing sector	19.5	5.0
Services sector	15.0	11.1

Source: CSB.

Of all the components of domestic demand, it was private investment that reacted most promptly to the economic downturn, with its contribution to the decline in total demand the largest. In 2009, the share of private investment in total investment dropped substantially, with government investment falling less buoyantly. Gross capital formation contracted by 37.7% in 2009 overall. Given an extremely sharp collapse in the construction of new buildings (against 2008, the number of issued building permits decreased more than twice), activities increased in the repair and renovation segment (including heat insulation of buildings). The activity in this segment was spurred by labour availability and declining construction costs, primarily resulting from lower wages and salaries.

In 2009, disposable income of households strongly contracted mainly due to cuts in wages and salaries, while the share of social benefits in it expanded, preventing an even more critical private consumption drop. Consequently, on the backdrop of persisting uncertainty about the future financing for the economy and households, the latter continued their pro-cyclical behaviour of previous years, with constraints on spending in excess of reductions in income. Overall, private consumption shrank by 22.4% and public consumption (on account of budget expenditure cuts) by 9.2% in 2009.

In line with the weakening domestic demand, imports of goods and services fell steeply by 34.2%. As exports contracted at a more moderate pace (by 13.9%), the contribution of net exports to real GDP changes was positive in 2009. Not only general sluggishness of domestic demand but also structural changes in it were among the factors underpinning the downturn in imports: the demand primarily shrank for luxury goods, capital goods, and durables produced outside Latvia. Despite the weakening of domestic demand over the year, the pace of decline in real imports moderated in the second half of the year on account of the demand for imported intermediate goods needed to produce output for exports.

The overall contraction in gross value added (owing to the weak domestic demand) was primarily driven by trade (contribution of 6.1 percentage points, decline of 28.7%), construction (2.8 percentage points and 33.6% respectively), and manufacturing (2.1 percentage points and 19.2% respectively). Transportation services decreased, and a 14.8% drop in the transport, storage and communication sector accounted for 2.1 percentage points of the fall in gross value added.

Trade lost much of its momentum in 2009. Lower household incomes and growing precautionary sentiments were the drivers behind the narrowing sales volumes. Towards the end of 2009, both total retail trade turnover and sales of motor vehicles had gone down to the level of the third quarter of 2004. The dynamics of the respective indicators, on the other hand, had varied greatly: the demand for motor vehicles during the economic upswing had outpaced the increment in total retail trade turnover, with accordingly as steep a moderation during the economic downturn.

Over the year, manufacturing output posted a 17.7% narrowing (at constant prices; according to working-day adjusted data). The sharpest annual fall refers to the first quarter, with its pace easing gradually in the subsequent quarters. The abating domestic demand adversely affected the growth in manufacturing over the year, whereas the revival of external demand in the second half of the year fostered the development of several industries. Production optimisation measures undertaken by businesses that improved competitiveness substantially had a positive overall impact as well. Effective marketing policies led to better performance indicators of some industries. The manufacture of wood and of products of wood and cork increased by 3.1% in 2009, whereas that of chemicals and chemical products as well as metals contracted somewhat (by 4.1% and 6.2% respectively). At the same time, substantial output contractions were recorded by the engineering and metalworking sectors where output of some industries shrank almost twofold, manufacture of clothing and textile articles, and other non-metallic mineral products. A 13.1% deceleration in the pace of food production contributed most to the fall in GDP.

The domestic demand was a driver behind an ever deteriorating situation in construction as well, where the annual rate of decline in construction output accelerated with every coming quarter (from 29.7% in the first quarter to 38.5% in the fourth quarter; a 35.3% decline in 2009). With the output narrowing more than twice, the fall was particularly severe for construction of residential buildings. Meanwhile, the sector of engineering structures recorded a lesser narrowing of construction output.

For the sector of transport, storage and communication, the year 2009 was less successful than the previous one. On the one hand, traffic by rail through Latvian ports expanded by 2.8%; on the other hand, domestic traffic and transit cargo by road contracted steeply (by 23.0% and 33.5% respectively), thus by 4.2% reducing total freight traffic by rail. The turnover at Latvian ports dropped 2.6%. It was primarily determined by a 6.8% smaller volume of freight handled at Ventspils port, with the volume of handled mineral fertilisers shrinking most. Oil products transport by pipelines continued on a downward trend as well.

The dynamics of investment in the economy was undermined by the weak demand, low utilisation of production capacity, and financial constraints. Non-financial investment in the economy amounted to mere 1 702.0 million lats, which was 34.2% below the 2008 level (at constant prices). In the breakdown by sector, the largest investment went to the government sector (403.2 million lats; an 8.5% reduction), manufacturing (506.3 million lats; a 30.6% reduction), transport and storage (187.8 million lats; a 27.9% reduction), and trade (135.6 million lats; a 53.1% reduction). Investment grew only for information and communication services (118.2 million lats; a 7.2% rise).

LABOUR MARKET

With some lag, labour market reflected the sharp economic downturn of 2008 and 2009. Demand in labour contracted faster than supply, and wage cuts were common. Unemployment rate hit its all-time high at the end of the year, standing 1.6 times higher than the previous peak registered at the end of 1999. Simultaneously, the weakening of competiveness observed in the course of several years was stopped: the gap between wages and labour productivity that had been widening during the past two and a half years narrowed down, and unit labour costs declined for the first time since 2001. A gradual recovery of competitive power will continue also in 2010 and is expected to serve as the cornerstone for a sustainable economic growth. Following a year-long break, labour productivity per hour worked (a leading GDP indicator) was on a rise again starting from the second quarter of 2009.

In 2009, compensation per employee declined by 13.0% (by 20.0% in the fourth quarter year-on-year). Labour productivity per person employed decreased only somewhat (labour productivity per hour worked increased to a lesser extent than weekly working hours contracted) and unit labour costs declined significantly both in nominal and real terms (by 8.1% and 11.5% respectively, the annual decrease rate standing at 19.7% and 18.8% respectively), thus restoring the competitiveness of the economy. In 2009, full-time equivalent average monthly gross wage was 461 lats (a 3.9% decline compared to 2008; in the fourth quarter, monthly gross wage recorded an annual decrease rate of 12.1%, and even as high as 23.7% in the public sector).

The level of registered unemployment rose to 16.0% at the end of 2009 (on an annual basis, more than a twofold increase). The rise of unemployment rate was particularly strong in the first quarter (1.2–1.3 percentage points per month). In summer, the registered unemployment increased at a slower rate, 0.2–0.3 percentage point per month, while towards the end of the year the growth accelerated to 0.9–1.0 percentage point per month. Since the beginning of the year, increases were recorded for both cyclical unemployment (due to the economic downturn in all sectors) and structural unemployment (with construction reporting the most pronounced boost in lay-offs). During the year the regional disparities in unemployment changed somewhat, with the unemployment rate growing at a slower pace in the largest cities than in regions. The rate of long-term (over 1 year) unemployment increased a little in the last months of the year, to stand at 13.5% in December.

According to the CSB labour survey, lay-offs primarily hit less educated individuals and those having little work experience, young people and males. E.g. in the fourth quarter when, on average, the rate of jobseekers was 19.7%, it was 42.8% among young males, 31.2% among individuals who had elementary or lower education, and 10.2% among individuals with higher education. The disparities between the unemployment rates in the breakdown by age, gender and education became more and more pronounced. The rate of economic inactivity stood at 35.0% in the fourth quarter, posting a 2.0 percentage points increase compared to a year ago. The number of people who have lost any hope of finding a job doubled over the year.

The number of job vacancies registered with the State Employment Agency fell more than twofold over the year. By the end of the year, the State Employment Agency had registered more than 100 jobseekers per vacancy (five times more than at the end of the previous year). According to the CSB job vacancy survey, the number of job vacancies decreased in all sectors and to a similar extent in the private and public sectors.

In 2009, the gap between the unemployment rate and labour income in Latvia versus the euro area widened, thus the issue of labour outflow once again moved to the foreground. The fact is double-confirmed by the CSB long-term migration statistics (in 2009, 7.3 thousand people left Latvia – a 21.4% year-on-year increase) and the number of new accounts in the UK and Ireland's social insurance schemes. The number of guest workers, on the contrary, decreased 2.5 times and was the same as in 2006 (only 1.2 thousand job invitations were approved in 2009).

FOREIGN TRADE AND THE BALANCE OF PAYMENTS

International trade activity deteriorated significantly worldwide in 2009, with the trade in cyclical goods (industrial goods and many consumer durables) experiencing a particular fall. The year in global trade was also marked by growing protectionism and measures to stimulate the consumption of domestically produced goods. Latvia's imports of goods contracted at a considerably steeper pace in comparison with exports (by 38.1% and 19.1% respectively) due to the differences in the degree of weakening of the demand on the domestic and foreign markets. That led to a rapid improvement of the trade balance as well as a surplus in the current transfers account.

The foreign trade turnover declined to 8.2 billion lats in 2009 (see Table 2).

Table 2

LATVIA'S FOREIGN TRADE
(exports in FOB prices; imports in CIF prices; in millions of lats)

	2009	2008
Exports	**3 582.6**	4 428.9
Imports	**4 655.9**	7 527.7
Balance	**–1 073.3**	–3 098.8

Source: CSB.

Against the background of the sluggish demand and financial turmoil, the share of capital goods in the structure of Latvia's imports shrank, thereby dampening investment and economic activity, particularly in construction and industry. Cyclical economic downturn resulted in a fall of transport vehicle imports by 62.9% over 2008, whereas imports of machinery and mechanical appliances, electrical equipment contracted by 46.8%, imports of stone, plaster and cement articles by 38.0% due to lower demand for building materials and imports of mineral products by 30.5% respectively.

In the first half of the year, Latvia's exports decreased in all major commodity groups. With the global economic development stabilising gradually, Latvia's exports resumed growth in the nominal terms in the second half of the year. Initially, they grew mainly on account of the increasing real volume, yet in the fourth quarter also as a result of rising prices quarter-on-quarter. For the first time in 2009, positive annual growth of goods exports was registered in December, as in contrast to the situation at the turn of 2008 the month-on-month decrease of exports was mainly seasonal. Exports of wood and articles of wood, products of the chemical and allied industries and mineral products (including high levels of electricity exports at the end of the year) as well as particular agricultural and food product groups stabilised or expanded in the second half of the year. Exports of base metals and articles of base metals stabilised at the turn of the year, whereas that of optical instruments and apparatus grew significantly, reaching one of monthly and quarterly all-time highs in December and fourth quarter respectively.

As a result of cost optimisation measures implemented by private and public companies and institutions as well as the effect of the weakening consumption on price developments, the decline of prices and costs in Latvia was steeper than the average decline observed with the major trade partners. Therefore, the price and cost competitiveness improved, as reflected by the downward trends of the nominal and real effective exchange rate of the lats. Following significant deterioration in the fourth quarter of 2008, terms of trade also improved gradually in the course of the year. Positive real annual growth of exports was also registered in the fourth quarter of 2009, as the price reduction observed in the previous periods had mostly affected export goods.

Market share developments also pointed to improvement of competitiveness. Following a decline at the turn of 2008, gradual positive changes in Latvia's export shares *vis-à-vis* several major trade partners as well as the overall EU27 market were observed in 2009. That was affected by changes in the structure of goods trade during the period of the economic downturn. Overall, Latvia's export share in Lithuania's imports was about one fourth and that in Estonia's imports was one fifth larger year-on-year in 2009. Positive, albeit more moderate changes in market shares in 2009 as compared to the average level of 2008 were also observed on the markets of Poland, Finland, Russia, Germany and the Netherlands (an increase of 6%–12%).

A surplus of 1 250.0 million lats or 9.4% of GDP was registered in the current account of the balance of payments for the first time since 1994 (in 2008, the current account deficit reached 13.0% of GDP, whereas in two preceding years it was over 22% of GDP).

Foreign trade of goods and services was almost balanced in 2009: trade deficit amounted to merely 0.3% of GDP in comparison with 13.6% of GDP in 2008. Moreover, already starting from the second quarter the excess of exports over imports grew progressively, reaching 2.4% of GDP in the fourth quarter. The positive developments were a result of deceleration in the rapid fall of exports of goods at the beginning of 2009. Services exports experienced a more modest decline at the beginning of the year and continued to shrink at the end of the year on account of the expansion of the neighbouring countries in the area of freight transportation. The same as the imports of goods, services imports continued to decline rapidly year-on-year in 2009.

The main contributor to the current account surplus was the surplus in the income account (6.4% of GDP; a deficit of 1.6% of GDP in 2008) resulting from the losses incurred by direct investment companies. The surplus of the current transfers account also expanded from 2.2% of GDP in 2008 to 3.3% of GDP in 2009, with half of the change being attributable to income from the government selling the greenhouse gas emission units.

With the amount of the received EU funding designated for capital investment growing, the surplus of the capital account increased to 2.4% of GDP. Financial account ran a deficit of 12.6% of GDP, as the net foreign liabilities of Latvia's residents contracted as a result of transactions: short-term financing outflows from banks exceeded the government loans and the foreign assets of the private sector increased. With the financial and macroeconomic stability returning, the outflow of funds from banks decreased significantly both in Latvia and worldwide in the second half of the year and the fourth quarter in particular. Foreign direct investment in Latvia also grew and was mostly related to investment in the financial sector.

FISCAL POLICY

On a cash flow basis, the consolidated general government budget posted a deficit of 892.1 million lats or 6.7% of GDP in 2009. According to an accrual principle (ESA 95), used to evaluate compliance with the Maastricht criteria, the consolidated general government budget ran a deficit of 1 195.6 million lats or 9.0% of GDP.

In 2009, the deficit of the central government basic budget was 643.8 million lats, that of the local government consolidated budget stood at 213.0 million lats, and the central government social security budget recorded a deficit of 59.5 million lats. The revenue of derived public persons exceeded expenditure by 18.1 million lats.

With economic indicators deteriorating and tax revenue rapidly decreasing, amendments to the Law "On State Budget 2009" were adopted in the middle of 2009 with the aim of improving the consolidated general government budget balance by 500.0 million lats. The amendments prescribed that the untaxed minimum of the personal income was reduced from 90 lats to 35 lats, the excise tax on beer and other alcoholic beverages was raised, and the share of the state capital companies' profit paid out in dividends was increased. The expenditure for unemployment benefits, interest payments on the government debt, as well as for EU funds-related projects grew. At the same time, the net decrease in the expenditure resulted from a cut on wages and salaries in the public sector, the decrease in the expenditure on goods and services, lowered old-age and service pensions, and old-age pensions to pensioners who have a job (by 10% and 70% respectively), as well as a drop in the capital expenditure and expenditure on subsidies and grants (a large part of the expenditure cuts was recorded for the Ministry of Health of the Republic of Latvia). However, according to the ruling of the Constitutional Court of the Republic of Latvia passed on 21 December 2009, the reduction of old-age pensions constitutes a breach of the Constitution of the Republic of Latvia, and the withheld part of the old-age pensions will have to be reimbursed.

In the second half of 2009, several decisions to increase budgetary appropriations were made whereby the government granted additional funding to projects co-financed from the EU funds, health care and implementation of the social security network measures.

In 2009, the consolidated general government budget revenue amounted to 4 734.7 million lats or 35.7% of GDP. The consolidated general government budget revenue contracted by 988.3 million lats or 17.3% year-on-year, with a 1 222.2 million lats or 25.8% decrease in the tax revenue accounting for the revenue fall. As a result of shrinking domestic demand, the VAT revenue decreased by 318.7 million lats or 28.5%. With the corporate profits falling, the corporate income tax revenue shrank notably (by 305.9 million lats or 60.8%). Although the untaxed minimum of the personal income was reduced as of 1 July, and the respective share of the social security contributions transferred to the state-funded pension scheme was cut as of 1 May, the personal income tax revenue and social security contributions decreased by 299.7 million lats or 29.1% and 235.8 million lats or 16.8% respectively. The decline was mainly attributable to the rapidly decreasing wages and salaries and a fall in employment in the economy. Non-tax revenue increased by 128.0 million lats or 43.4% over the year on account of proceeds from sales of state-owned greenhouse gas emission units (91.4 million lats), and the increased share of the state capital companies' profit paid out in dividends. With increasing involvement in EU funds-related projects, the received foreign financial assistance exceeded the level of 2008 by 99.4 million lats.

In 2009, the consolidated general government budget expenditure amounted to 5 626.8 million lats or 42.5% of GDP. The consolidated general government budget expenditure decreased by 627.3 million lats or 10.0% year-on-year. Almost all budget expenditure items (except interest expenditure and subsidies and grants) contracted. The largest contribution to the decrease in the expenditure was on account of a drop in compensation to employees (338.3 million lats or 20.2%), capital expenditure (307.8 million lats or 41.7%) and expenditure on goods and services (247.0 million lats or 26.8%).

At the end of 2009, the general government debt totalled 4 265.1 million lats or 32.2% of GDP, representing a yearly increase of 1 537.4 million lats, on the cash flow basis. However, according to an accrual principle (ESA 95), used to evaluate compliance with the Maastricht criteria, the general government debt was 4 783.4 million lats or 36.1% of GDP. The foreign debt increased by 1 993.4 million lats on account of the international loan disbursements received from the EC, IMF and the World Bank to stabilise the Latvian economy and restore growth. The domestic borrowing dropped by 455.8 million lats, as short-term Treasury bills matured.

BANKING DEVELOPMENTS

At the end of 2009, 21 banks (including 19 private banks), eight branches of foreign banks (including two that began their operations in 2009), 34 credit unions (one began and two wound up their operations in 2009), eight electronic money institutions (two began and one wound up its operations in 2009) and two money market funds (one wound up its operations in 2009) were registered in the Republic of Latvia. The government's participating interest in the banking sector's paid-up share capital increased to 18.0% at the end of 2009, as the government injected capital into both banks where the state holds a stake.

Although the first signs of recovery were witnessed in the global economy in 2009, overall negative development tendencies prevailed in the Latvian economy despite some positive indications. As a result, on account of decreasing resident loans the bank assets shrank by 6.7% in the course of the year under the impact of the weak domestic economic activity, including that of the financial sector. Economic downturn also limited the opportunities for Latvian banks to draw liquidity from financial markets. The minor decrease in deposits observed in the first three quarters of 2009 reversed in the fourth quarter. As a result, resident deposits remained broadly stable in 2009, whereas non-resident deposits shrank by 4.2% in comparison with a 19.2% decrease in 2008.

Looking at the composition of the funding used by the banks, the contribution of borrowing from foreign MFIs decreased and amounted to 35.9% of the total liabilities at the end of year, including 27.5% from associated and affiliated credit institutions, in comparison with 41.9% at the end of 2008. This decrease was partly offset by the expansion of the subordinated and paid-up capital to 9.9% of the total liabilities at the end of 2009 as opposed to 5.2% at the end of 2008.

Against the background of a broad-based deceleration of activity in all major economic sectors, with loan delinquency on a rise the credit quality at banks continued to deteriorate in 2009. Loans past due over 90 days grew to 16.4% on the total banking sector credit portfolio. At the same time, the banks implemented active debt restructuring measures providing relief to troubled borrowers. Restructured loans amounted to 16.3% of the total credit portfolio at the end of 2009.

The losses of the banking sector totalled 773.4 million lats in 2009 as opposed to 60.0 million lats profit in 2008 and primarily resulted from a significant build-up (1 268.1 million lats) of provisions for loan impairment and liabilities. Although ROE was –41.6% and ROA amounted to –3.5% at the end of the year, the banking sector concluded the year 2009 with operating profit (the total of net interest income, income from dividends, net commissions and fees, gains/losses from trades of financial instruments and financial instrument revaluation result) of 663.6 million lats. The income of banks decreased year-on-year, while the expenditure grew merely as a result of the significant provisions made. Banks maintained high capital adequacy ratios, with considerable capital investment amounting to 929.7 million lats more than offsetting the losses.

MONEY SUPPLY

The principal monetary aggregates of the Latvian banking system and the Bank of Latvia are featured in Appendix 1. Initially, the behaviour of the monetary aggregates in 2009 mirrored the sharp downturn of the economic development with both domestic and external demand shrinking as well as the impact of the global financial crisis on the Latvian banking system and money market. Yet with the stabilisation of the economy and the financial markets and recovery of the external demand, money supply also resumed growth in November. Overall, M3 decreased by 2.8% as compared to 4.3% in the previous year (see Chart 2), amounting to 5 873.1 million lats at the end of 2009 (see Chart 3). The first half of the year was marked by deceleration of the economic growth and financial market tensions, and M3 shrank by 3.5%. In the second half of the year, however, M3 grew by 0.8% as a result of improved liquidity conditions and restored confidence in the financial sector. The annual rate of decline of M3 accelerated gradually until August reaching 13.2% and steeply decelerated in the last months of the year. The highest month-on-month increase of M3 amounting to 218.8 million lats or 3.9% was reported in December, when deposits with MFIs (excluding the Bank of Latvia) as well as currency in circulation grew significantly. The highest monthly drop of 112.3 million lats or 1.9% was recorded in March, when the demand for cash plummeted.

Chart 2

M3 AND LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS

(annual percentage changes)

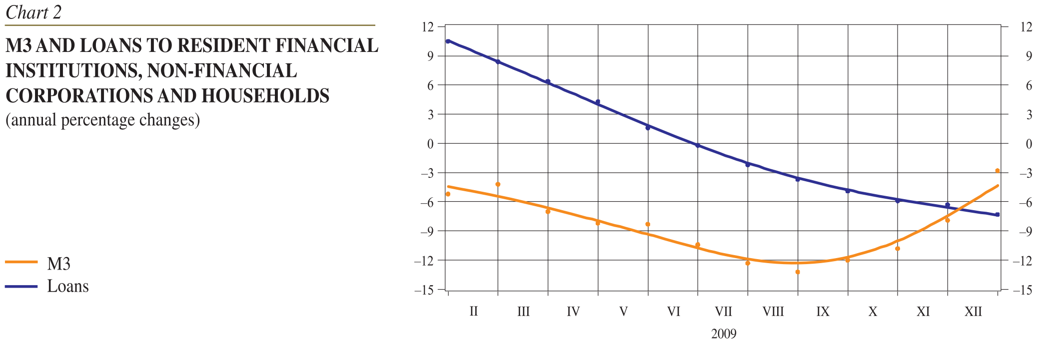
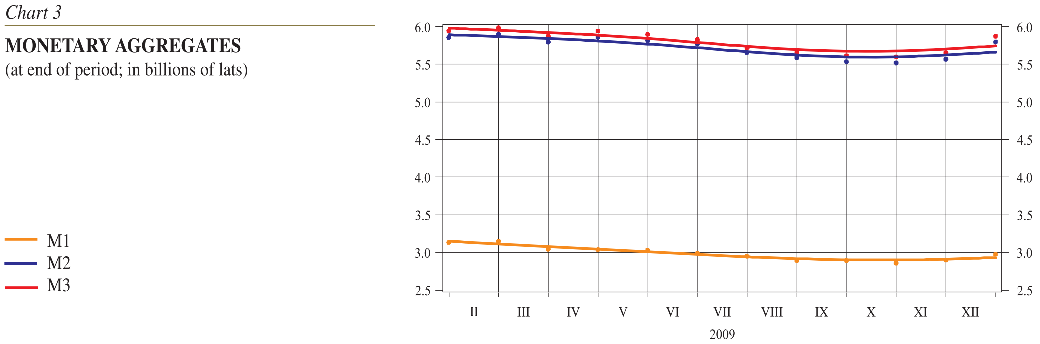


Chart 3

MONETARY AGGREGATES

(at end of period; in billions of lats)

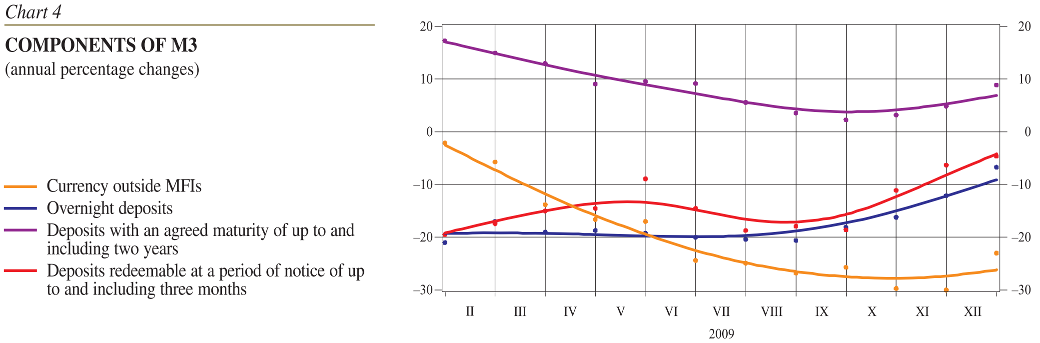


The expansion of the less liquid cash components had an upward effect on M3, primarily offsetting the contraction of the more liquid assets contained in M1 (see Chart 4). Against the background of decelerating inflation growth and rising rates on time deposits and savings deposits, growing opportunity costs of holding cash and wider use of cashless payments reducing the advantages of cash liquidity, M1 decreased by 10.9% in 2009 (by 15.0% in 2008), including overnight deposits with MFIs in all currencies contracted by 6.7% and currency in circulation (the lats banknotes and coins issued by the Bank of Latvia less vault cash of other MFIs) shrank by 23.0%. The cash component of M3 decreased to 11.4% at the end of 2009 (14.3% at the end of 2008), whereas the contribution of overnight deposits declined from 41.0% to 39.4% respectively.

Chart 4

COMPONENTS OF M3

(annual percentage changes)



M2 decreased by 2.8% in comparison with a 4.4% decline in 2008, with the stock of all currency deposits with an agreed maturity of up to and including two years held with MFIs which are significant in terms of the value growing by 8.9% and all currency deposits redeemable at a period of notice of up to and including three months contracting by 4.6%. Other components of M3 remained rather modest, with money market fund shares/units totalling 76.1 million lats at the end of the year and MFI debt securities with a maturity of up to and including two years amounting to 0.9 million lats, representing a 8.4% annual increase and a 4.9 times annual decrease respectively. So far, Latvian banks have concluded no repo agreements meeting the definition of M3.

As regards the counterparts of M3, MFI loans to resident financial institutions, non-financial corporations and households decreased by 7.3% and continued to be the main contributor to the contraction of the monetary aggregates. The money multiplier increased substantially and was 3.57 in December (2.86 in December 2008). Stabilisation of the macroeconomic risks contributed to deceleration of the velocity of money from 2.7 in 2008 to 2.3 in 2009.

Deposits of resident financial institutions, non-financial corporations and households held with MFIs increased by 87.7 million lats or 1.7% in 2009 in comparison with a decline of 3.9% in 2008. Deposits resumed growth in the last months of the year when the economy stabilised and confidence in the stability of the Latvian banking sector was restored in the wake of the global economy gradually recovering from the financial crisis.

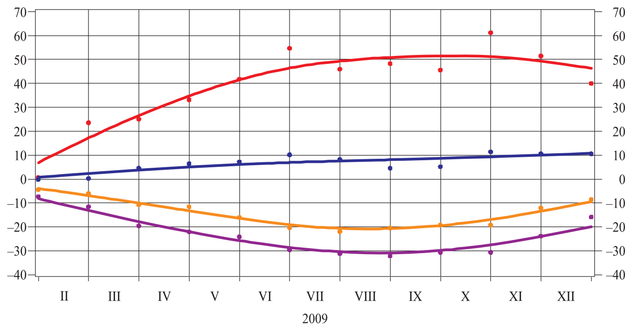
Despite higher remuneration on lats deposits and their significant growth towards the end of the year, financial market tensions observed in the first half of the year resulted in an annual decline of those deposits by 315.6 million lats or 12.1% in 2009. US dollar deposits also contracted at a similar rate, whereas euro deposits grew significantly by 433.9 million lats or 20.4% as a result of the important role played by the euro in Latvia's economy, its dominance in lending as well as several episodes of speculations and heightened concerns *vis-à-vis* the sustainability of the lats peg rate to the euro observed during the year (see Chart 5 for the developments in lats and euro deposits made by resident financial institutions, non-financial corporations and households). At the end of 2008, deposits in lats accounted for 49.3% of the deposits of resident non-MFIs, while at the end of 2009 the respective share contracted to 40.5%. Deposits made in the US dollar shrank from 5.0% to 4.4% respectively. The share of the euro in total deposits increased from 45.1% at the end of 2008 to 54.4% at the end of 2009.

Chart 5

DEPOSITS OF RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS WITH MFIs (EXCLUDING THE BANK OF LATVIA)

(annual percentage changes)

- Lats deposits of financial institutions and non-financial corporations
- Lats deposits of households
- Euro deposits of financial institutions and non-financial corporations
- Euro deposits of households



Gradually climbing interest rates on time deposits resulted in a decline of the share of overnight deposits in the composition of deposits from 45.6% at the end of 2008 to 42.8% at the end of 2009, with the share of time deposits expanding accordingly. The share of household deposits contracted slightly and amounted to 55.7% of all deposits in comparison with 58.1% at the end of 2008. The outstanding amount of those deposits also shrank by 2.4%, while the deposits made by financial institutions and non-financial corporations grew by 7.5%. Household deposits accounted for 60.3% of all time deposits and 49.6% of overnight deposits (67.9% and 46.4% at the end of 2008 respectively).

The decrease of the monetary aggregate M2X estimated based on the Bank of Latvia's methodology (1.9%; 3.9% in 2008) was slightly lower than the contraction of the aggregate money supply.

Monetary development trends were also affected by drying-up capital inflows, particularly in the banking sector, with the banks repaying syndicated loans and liquidity received from parent banks shrinking. At the same time, the funding received by the government from foreign donors and the reduction of the negative MFI (excluding the Bank of Latvia) net foreign assets by 48.9% to 3 021.6 million lats in 2009, with the Bank of Latvia's net foreign assets growing by 42.1% and reaching 3 313.1 millions lats, had an upward effect on the money stock. Thus the downward trend in the net foreign assets observed for several years reversed. With liabilities to non-resident banks (primarily parent banks) shrinking, the foreign liabilities of MFIs (excluding the Bank of Latvia) decreased by 2.0 billion lats or 15.1% in 2009 (a 0.4 billion lats increase in 2008), including a decline of liabilities to foreign MFIs by 1.9 billion lats or 20.8% (of which a decrease of 1.3 billion lats or 18.4% *vis-à-vis* associated and affiliated MFIs), whereas non-resident non-MFI deposits declined by 0.2 billion lats or 5.8%. Foreign assets of banks decreased by merely 71.0 million lats, with claims on foreign non-MFIs declining by 225.9 million lats (including a decrease of 166.6 million lats in outstanding credits) and claims on non-resident MFIs growing by 181.5 million lats. Thus the negative net foreign assets of MFIs (excluding the Bank of Latvia) were 1.9 billion lats lower at the end of 2009 year-on-year (in 2008, the negative net foreign assets of MFIs grew by 1.0 billion lats).

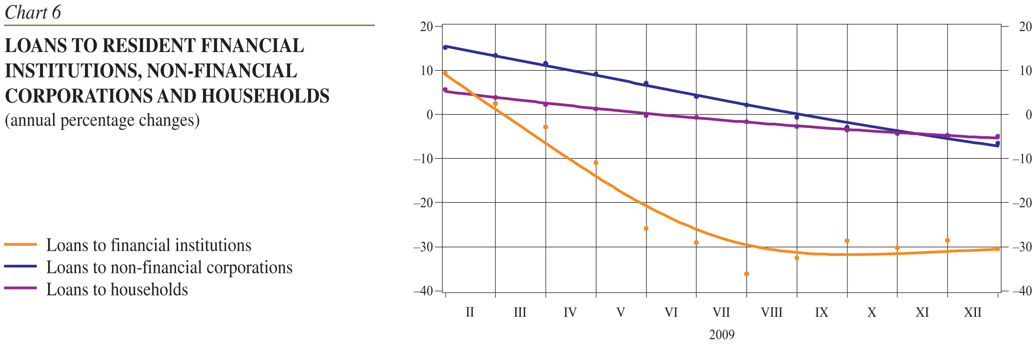
With the deteriorating domestic demand dampening the appetite for borrowing among households and businesses as well as the banks revaluating the prevailing market risks, a gradual month-on-month decline in loans continued in 2009. The annual growth rate of MFI loans to resident financial institutions, non-financial corporations and households also continued to decelerate and entered a negative territory in June, declining to already –7.3% by December. Overall, loans to resident financial institutions, non-financial corporations and households decreased by 1.1 billion lats in comparison with an increase of 1.5 billion lats or 11.7% in 2008, including a fall by 0.5 billion lats in the first half of the year and by 0.6 billion lats in the second half of the year. Exposure to domestic loans remained broadly unchanged in the aggregate balance sheet assets of MFIs (excluding the Bank of Latvia): 63.4% at the end of 2009 in comparison with 63.6% at the end of 2008.

The consolidated general government budget ran a deficit; nevertheless, the negative MFI net claims on the government grew by 1.1 billion lats in 2009 as a result of the external borrowing of the government.

The decrease in MFI loans was similar for both non-financial corporation and household sectors (an annual decline by 476.2 million lats and 314.2 million lats respectively), lending to financial institutions also contracted by 272.4 million lats. The rate of change in loans granted to resident financial institutions, non-financial corporations and households gradually moderated. The annual rate of change in lending to non-financial corporations declined from 16.9% in 2008 to –6.5% in 2009, whereas that of household loans fell from 6.9% to –4.9% respectively. Loans to financial institutions contracted even more significantly, with the annual rate of decline reaching –30.4% in December 2009 (see Chart 6 for the developments in loans granted to financial institutions, non-financial corporations and households).

Chart 6

LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS
(annual percentage changes)



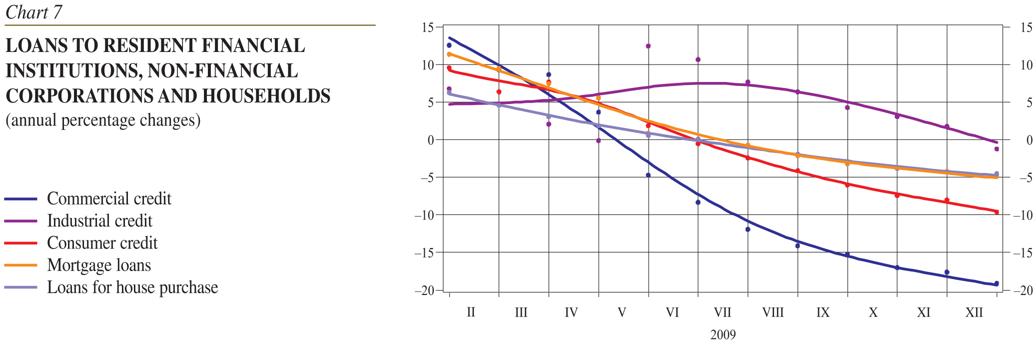
Corporate loans contracted mainly on account of commercial credit shrinking by 19.1%, while industrial credit decreased by merely 1.2%, and their respective shares in total loans were 16.2% and 13.6% at the end of the year in comparison with 18.6% and 12.8% at the end of 2008 respectively.

Household loans for house purchase were the main contributors to the dry-up of household lending (4.5%; see Chart 7 for developments concerning the main types of lending). At the end of December, loans for house purchase totalled 4.8 billion lats or 79.3% of all loans granted to households, representing a year-on-year decrease of 0.3 billion lats. Loans for purchasing consumer goods also contracted by 9.6%, while their share in all household loans decreased by 0.6 percentage point reaching 11.8%. The dampened lending for house purchase resulted also in deceleration of the annual growth of the overall mortgage loans by 4.7% in comparison with a 12.6% increase observed in 2008. The share of those loans amounted to 58.5% of all loans at the end of 2009 in comparison with 56.9% at the end of 2008.

Chart 7

LOANS TO RESIDENT FINANCIAL INSTITUTIONS, NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS

(annual percentage changes)



The dry-up of loans for house purchase had a significant impact on the real estate market developments, yet the plunge of the real estate prices that lasted over two years came to a halt in 2009: the average price of standard housing in apartment blocks in Riga reached the low in June, having fallen by 71.5% in comparison with the peak observed in April 2007 (data by *Latio Ltd*.). By the end of the year, however, the prices of standard housing in apartment blocks in Riga had already grown by 12.2%. Such price developments were primarily explained by the depletion of supply on the real estate market, as a large part of properties whose owners were ready to sell them at a price that low were sold, while the owners that were dissatisfied with the price removed their properties from the market to put them on offer again once the prices have grown. The price rise observed at the turn of the year was less notable for new housing; nevertheless, cheap offers were increasingly rarer in this segment as well.

Housing rent continued to decrease throughout the year, yet the rate of decline decelerated in the second half of the year. The fall of commercial real estate rent also decelerated.

Corporate loans expanded slightly in transport and storage as well as construction sectors, whereas the majority of other sectors experienced a decline, with the steepest one being registered in financial and insurance activities, trade and manufacturing. At the end of the 2009, the bulk of corporate loans was still concentrated in the sectors of real estate (32.6%), manufacturing (13.4%), trade (11.2%) and financial intermediation and insurance (10.7%).

Rapidly rising lats interest rates dampened the demand for lats loans; nevertheless, lending to financial institutions, non-financial corporations and households in euro and other foreign currencies also decreased. In 2009, loans granted to resident financial institutions, non-financial corporations and households in lats shrank by 630.8 million lats or 36.9%, whereas the euro loans by 361.0 million lats or 2.9%. Other foreign currency loans, of which 75% were the US dollar loans, contracted by 71.0 million lats or 15.4%. Thus the share of loans granted to resident non-MFIs in lats declined by 3.7 percentage points in the course of the year and amounted to 7.9% at the end of 2009, the share of euro loans grew by 4.0 percentage points to 89.2%, whereas the share of the US dollar loans decreased to 2.1%.

LENDING AND DEPOSIT RATES

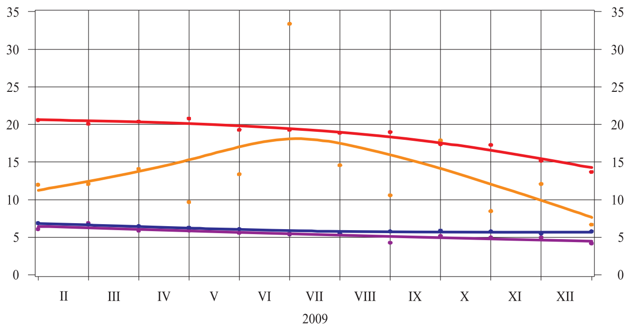
Interest rates on loans granted in lats to resident non-financial corporations and households and on lats deposits received from the respective segment were volatile in 2009. Volatility was a result of both sharp liquidity swings on the lats money market and the limited market for new lats loans. Nevertheless, the rates were overall higher in 2009 as compared to 2008. At the turn of the year, with the lats money market rates decreasing more rapidly and the share of loans with traditionally lower interest rates in new loans expanding, the interest rates on new loans granted in lats fell. The rates on euro loans and deposits followed a downward trend in 2009, as the euro money market index gradually declined to an all-time-low. The only exception was the volatile and comparatively high rates on consumer credit granted to households in euro. At the turn of the year, the banks became more willing to draw additional liquidity from resident households, and the legislative changes concerning the capital gains tax also had an upward effect on both euro and lats interest rates on household deposits. Overall, the rates on euro loans and deposits were lower in 2009 in comparison with 2008. The considerably lower level of euro lending rates further enhanced the role of the euro as a lending currency, whereas the high lats deposit rates prevented the lats deposits from losing their importance on the deposit market.

Bank margins on lats loans continued to be volatile in 2009. During the periods of rising lats money market indices, banks tended to set lower margins on their lending to non-financial corporations and households, whereas when the lats money market indices declined, the margins grew. As a result, the rates on the lats lending to non-financial corporations and households were less volatile in comparison with the lats money market rates. Overall, faster growth of the lats money market rates tended to have a stronger impact on the rates of new lats loans granted to non-financial corporations. Interest rates on euro loans remained broadly stable in 2009, as the banks had priced in the growing default risk of their customers and other banking risks already in the previous year, and access to financing experienced no significant improvement in 2009.

The weighted average rate on new lats loans granted to resident households declined from 17.5% in December 2008 to 13.7% in December 2009, whereas that on new lats loans granted to non-financial corporations declined from 13.4% in December 2008 to 6.7% in December 2009 (see Chart 8). The weighted average rate on new household loans granted in foreign currencies decreased by 1.7 percentage points to 5.8%, whereas

Chart 8

WEIGHTED AVERAGE INTEREST RATES ON NEW LOANS TO RESIDENT NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS
(%)

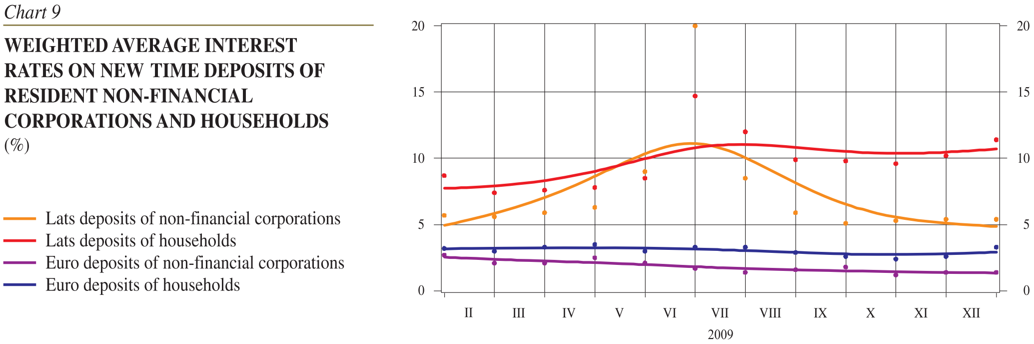


that on loans to non-financial corporations contracted by 2.5 percentage points to 4.2%. The share of floating rate loans with the initial rate fixation period of up to one year in new loans increased slightly from 84.8% in December 2008 to 88.4% in December 2009. The share of loans with the initial rate fixation period from one to five years, by contrast, contracted from 12.3% in December 2008 to 7.4% in December 2009. As the interest rates on lats loans granted to non-financial corporations and households remained higher than those on foreign currency loans, the share of the foreign currency loans in new loans continued to be significant.

Most new time deposits of resident non-financial corporations and households (about 98.8% on average) were with a maturity of up to one year. The weighted average rate on lats time deposits of resident households grew from 9.5% in December 2008 to 11.4% in December 2009, whereas that on lats time deposits of resident non-financial corporations declined from 9.8% to 5.4% respectively (see Chart 9). The weighted average rate on time deposits received from households in foreign currencies decreased by 0.4 percentage point to 3.1%, whereas that on the respective non-financial corporation deposits went down 1.8 percentage points to stand at 1.3%. As a result of the high lats deposit rates, the share of lats deposits received from non-financial corporations and households expanded.

Chart 9

WEIGHTED AVERAGE INTEREST RATES ON NEW TIME DEPOSITS OF RESIDENT NON-FINANCIAL CORPORATIONS AND HOUSEHOLDS
(%)



The differential between the rates on new loans and new deposits continued to narrow gradually. With the significance of deposits growing, the pass-through of the growing lats money market rates to the rates on deposits from households and non-financial corporations was stronger in comparison with the rates on lats loans, while the euro deposit rates reacted less to the decline in euro money market rates in comparison with the euro lending rates. The tendency was the same for the differential between the lending and deposit rates.

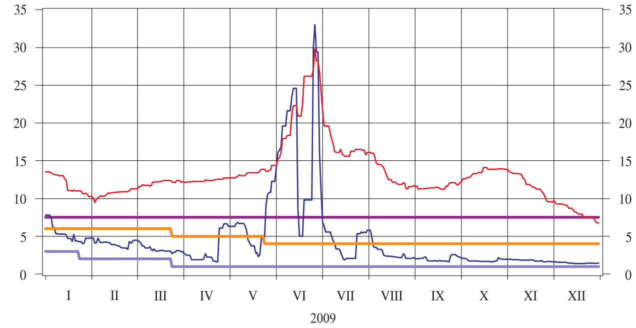
INTERBANK MARKET

The lats money market experienced the most severe turbulences in a period of more than 10 years. Although they did not stop the business on the lats money market, for a short period the quoted rates and transaction rates reached a level not observed since April 1996 (see Chart 10). RIGIBOR is calculated since the end of 1997. On 26 June 2009, RIGIBOR of all maturities reached an all-time-high: 33.00%, 29.80% and 24.40% for overnight, three-month and one-year maturities respectively. The overnight rate on certain transactions in lats even reached 125% in June, whereas that on transactions with a one-month maturity was 110%. Nevertheless, the weighted average rate on transactions between Latvian banks in lats was considerably lower in June: 21.55% for overnight transactions and an average of 22.30% for all maturities.

Interest rates soared primarily as a result of the heightened risk perception relating to concerns over Latvia's default in the event of failure to meet the international donors'

Chart 10

MONEY MARKET INTEREST RATES
(%)



[1] Where the lending facility has been used no more than 5 working days within the previous 30-day period.

demands and its potential consequences. Erratic interest rate movements enhanced the uncertainty regarding the optimum level of interest rates, further widening the differences across bank quotations as well as the spread between the deposit and lending rates offered by an individual bank. For instance, on 26 June the difference between various maturity lending rate quotations offered by various banks was 20.1–32.5 percentage points. The spread between deposit and lending rate quotations of individual banks was 2.0–25.0 percentage points.

As a result of the lats money market tensions, there was a heightened demand for lats on the foreign exchange market in June; therefore, the banks started to repurchase lats from the Bank of Latvia. Currency conversions resulted in a significant boost of the banks' lats liquidity, and shorter-term interest rates plunged. A gradual decline of longer-term rates also followed. Longer-term rates temporarily resumed growth in October; nevertheless, the adoption of the state budget 2010 caused a rapid return to the downward trend in the lats interest rates. Initially, the lats money market tensions and later significant excess liquidity on the lats money market reduced the need for interbank business on the money market, thereby compressing the lats money market turnover involving Latvian banks by 53.1% to 743.3 million lats per month, with a more moderate decline continuing also in the following months.

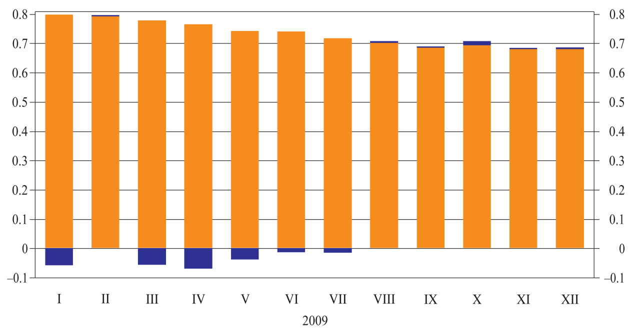
The average annual 3- and 6-month RIGIBOR was 13.17% and 14.45% respectively, representing a 5.19 percentage points and 5.55 percentage points increase over the previous year, whereas at the end of the year it declined to 6.80% and 8.81% respectively.

MONETARY BASE

The contraction of the bank liquidity resulted in shrinking of the minimum reserves held on the settlements accounts of the banks with the Bank of Latvia (see Chart 11). Thus deposits from credit institutions and other financial institutions held by the Bank of Latvia declined by 235.8 million lats or 21.6% in 2009 as opposed to an increase of 23.1% in 2008. With the demand for cash continuing to decrease, currency in circulation

Chart 11

BANK RESERVES WITH THE BANK OF LATVIA
(in billions of lats)



shrank by 229.9 million lats or 22.6% (by 3.0% in 2008). As a result, the monetary base M0 decreased by 22.1% in 2009 and totalled 1 645.8 million lats at the end of the year, whereas the cash component of the monetary base contracted to 47.9% in comparison with 48.2% at the end of 2008.

Shrinking of the monetary base was affected by the contracting net domestic assets of the Bank of Latvia (the negative net domestic assets grew by 1.4 billion lats), with domestic loans decreasing. Of the domestic loans, both loans granted to banks and net credit to the government contracted sharply by 498.9 million lats (see Table 3 for the monthly average amounts outstanding) and 653.8 million lats respectively, with government deposits with the Bank of Latvia growing on account of the received foreign assistance funding accordingly.

Table 3

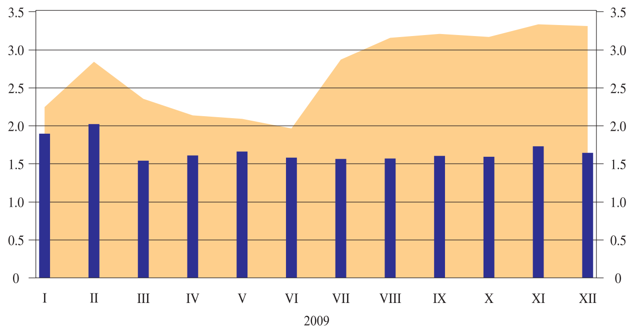
THE BANK OF LATVIA'S LOANS TO MFIs
(average balances; in millions of lats)

	2009	2008
January	**600.6**	7.7
February	**594.0**	10.1
March	**393.8**	0
April	**256.8**	0
May	**274.8**	0
June	**327.7**	0
July	**245.8**	0
August	**236.1**	0
September	**228.6**	0.5
October	**225.1**	132.9
November	**158.8**	379.2
December	**142.3**	503.6

The Bank of Latvia's net foreign assets grew by 980.8 million lats primarily as a result of the foreign currency deposits made by the government. At the end of 2009, the Bank of Latvia's reserve assets covered the goods imports of 8.5 months (of 3.7 months at the end of 2008), whereas the backing of the national currency with the Bank's net foreign assets was 201.3% (see Chart 12; 110.5% at the end of 2008).

Chart 12

BACKING OF THE NATIONAL CURRENCY
(in billions of lats)



THE FOREIGN EXCHANGE MARKET AND LATVIA'S EXTERNAL DEBT

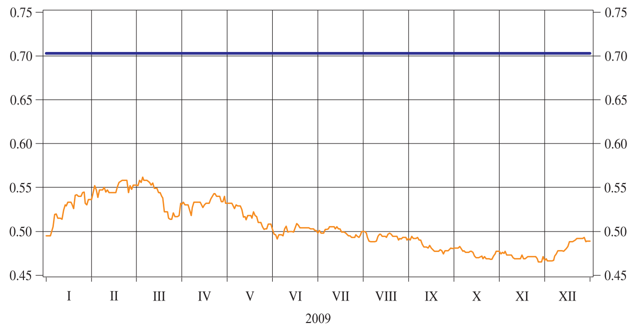
In 2009, the global foreign exchange market saw the US dollar depreciate against the euro and the British pound sterling and appreciate somewhat against the Japanese yen. In the first three months of 2009, the global economic and financial crisis had a substantial impact on the foreign exchange market. During that period the US dollar appreciated against other major world currencies on account of capital flows to the US as the US were considered a safer haven during crisis and also a place where the recovery would sooner materialise. The large share of the banking sector in the UK national economy along with the adjustment of the overvalued housing market were the factors causing further depreciation of the British pound sterling against the US dollar as well as the euro. Euro area investors were concerned about the strong links of the financial sectors of several euro area countries with individual East European economies. In Japan, with exports playing an essential role in its national economy, GDP shrank by 8.6% in the first quarter. Nevertheless, beginning with the second quarter the global stock markets started to recover, suggesting that the economy was likely to bottom out. The macroeconomic data raised hope for a rapid recovery of the global economy. With the overall optimism growing, capital outflow from the US was observed. A discussion on the US dollar loosing the status of the reserve and settlement currency was resumed, further contributing to the depreciation of the US dollar against other major world currencies. Challenges in the US financial sector and the persistently fragile economic situation underlay the implementation of the FRS unprecedented expansionary monetary policy, and the record low federal funds rate (close to zero) was retained in 2009. In view of the aggravating economic environment and the threat of imminent inflation easing, the ECB also reduced its key interest rate (to 1.00%) in 2009. The Bank of England cut its bank rate from 2.00% to 0.50% over the year while the policy rate set by the Bank of Japan remained close to zero (0.1%).

In 2009, the euro appreciated against the US dollar by 2.5% (from 1.3971 at the end of 2008 to 1.4321 at the end of 2009), reaching its high (1.5144) on 25 November and low (1.2457) on 4 March. Year 2009 was extremely difficult for the US economy. Although the economic growth indicators increased in the second half of the year, unemployment continued to expand. The major US banks managed to overcome the financial crisis with the help of the government support; unfortunately many smaller banks failed. The financial system incurred huge losses. At the beginning of 2009, the key US stock market indices continued to decline before reporting a recovery trend in the second half of the year. To support the national economy and financial markets, the FRS purchased mortgage-backed securities and other financial instruments from market participants. Oil prices, after having seen a drop below 40 US dollars per barrel in early 2009, started to grow again as investor sentiment improved. The global economic downslide and weaker demand for energy, however, prevented the oil price from reaching the high observed in 2008. The drop in energy prices and consumption resulted in deflation observed in the euro area in mid 2009; in May the ECB reduced its key interest rate. The US dollar appreciated *vis-à-vis* the Japanese yen (from 90.64 at the end of 2008 to 93.02 at the end of 2009, rising by 2.6%), reaching its high (101.44) on 6 April and low (84.83) on 27 November. At the beginning of 2009, the Japanese economy saw a steep fall, yet stabilising in the second half of the year and inspiring hopes that the Japanese exports would pick up again, therefore the Japanese yen appreciated strongly in the second half of the year. In 2009, the British pound sterling appreciated against the US dollar by 10.8% (from 1.4593 at the end of 2008 to 1.6170 at the end of 2009), reaching its high (1.7043) on 5 August and low (1.3503) on 23 January.

On the Latvian foreign exchange market, the US dollar depreciated against the lats from 0.5064 at the end of 2008 to 0.4952 at the end of 2009, recording a 2.2% decrease. The US dollar reached its high (0.5688) on 4 March and a low (0.4675) on 3 December. Over the year, the exchange rate of the euro against the lats fluctuated within the limits of the currency intervention band set by the Bank of Latvia. For the most part of the year, the euro exchange rate was close to the upper limit of the intervention band set by the Bank of Latvia (0.7098); the lowest euro exchange rate was recorded in June and July when it was close to the lower limit of the intervention band set by the Bank of Latvia (0.6958; for the exchange rate developments of the major currencies set by the Bank of Latvia, see Chart 13 and Appendix 5).

Chart 13

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



In 2009, Latvia's external debt decreased by 0.4 billion lats, standing at 20.5 billion lats (154.7% of GDP) at the end of the year. Net external debt shrank by 1.7 billion lats, reaching 7.5 billion lats (56.5% of GDP) at the end of the year.

The composition of the external debt by sector changed notably. The government liabilities to non-residents and debt-related direct investment grew by 1.9 billion lats and 0.3 billion lats respectively. The liabilities of the Bank of Latvia, the banking sector and other sectors posted a respective drop of 0.3 billion lats, 2.2 billion lats and 0.1 billion lats. Thus the share of the government and central bank liabilities in the composition of the external debt increased to 16.4% (8.4% at the end of 2008) and that of debt-related direct investment expanded to 10.6% (9.2% at the end of 2008) while the share of liabilities of banks and other sectors narrowed to 53.1% (62.3% at the end of 2008) and 19.9% (20.1% at the end of 2008) respectively.

As to the breakdown of the external debt by instrument, an increase in the share of debt-related direct investment and loans along with a decline in that of other debt instruments was observed in 2009. At the end of 2009, debt-related direct investment, loans, debt securities, currency and deposits, and trade credit amounted to 10.6% (9.2% at the end of 2008), 70.5% (67.8% at the end of 2008), 3.7% (3.6% at the end of 2008), 10.6% (14.4% at the end of 2008) and 3.5% (3.9% at the end of 2008) of external debt respectively.

In 2009, the long-term debt grew by 1.5 billion lats (to 15.5 billion lats or 75.4% of the external debt) whereas the short-term debt contracted by 2.0 billion lats (to 5.0 billion lats or 24.6% of the external debt).

At the end of 2009, the banks' external debt amounted to 10.9 billion lats (13.0 billion lats at the end of 2008). As to the maturity profile, the share of the received long-term financing expanded to 64.4% (from 58.9% at the end of 2008). Loans from parent banks contracted to 5.9 billion lats (7.2 billion lats at the end of 2008), and their share in the breakdown by creditor shrank to 54.1% (55.4% at the end of 2008). Currency and deposits decreased by 0.7 billion lats, with their share in the bank external debt narrowing to 19.4% (21.2% at the end of 2008). At the end of 2009, the banks' net external debt fell to 6.2 billion lats (8.3 billion lats at the end of 2008).

The external debt of other sectors contracted by 3.1%, standing at 4.1 billion lats at the end of 2009 (including long-term liabilities in the amount of 3.0 billion lats): the share of loans expanded to 79.2% (77.1% at the end of 2008) while that of trade credit narrowed to 17.6% (from 19.3% at the end of 2008). Debt-related direct investment (debt liabilities of other sectors and banks to direct investors and direct investment enterprises) grew by 13.4%, reaching 2.2 billion lats at the end of 2009.

According to the Treasury's official report, the central government external debt increased by 2.0 billion lats over 2009, standing at 3.3 billion lats (24.6% of GDP) at the end of the year. In 2009, within the framework of Latvia's Economic Stabilisation and

Growth Revival Programme Latvia was granted a loan by the IMF (178.4 million XDR), EC (2.2 billion euro) and World Bank (200 million euro). 63.5 million lats (including 15.9 million lats for repayment of the principal amounts of loans) equalling 1.1% of annual exports of goods and services, were used to service foreign debt. In 2009, the central government external debt composition by currency changed: the share of euro-denominated liabilities increased to 82.0% (from 65.6% at the end of 2008) whereas that of SDR- and US dollar-denominated liabilities contracted to 17.3% and 0.7% respectively (from 32.5% and 1.9% at the end of 2008 accordingly).

SECURITIES MARKET

Over 2009, activity on the government securities market increased notably, particularly so at the end of the year. Stabilisation of the financial system, the fiscal consolidation measures agreed with the international lenders as well as a decline in inflation had a positive effect on the securities market in Latvia. However, concern regarding Latvia's long-term macroeconomic outlook persisted, and interest rates on bank time deposits remained high: interest rates on deposits in lats with maturity of over one year exceeded 10% in 2009.

At auctions of government securities in 2009, the Treasury offered lats-denominated debt securities in the amount of 1 917.4 million lats. The bid amount was 1 888.4 million lats and the amount sold stood at 1 166.7 million lats. The supply and the amount sold posted 40.2% and 68.6% increases respectively in comparison with 2008. In 2009, only Treasury bills were offered in the primary market auctions of government securities as market participants treated Treasury bonds with caution. The main goal of the Treasury was to revive the government securities market in order to enable offering also longer-term securities at a later stage.

In the primary market, yields on government securities posted a downward trend. The weighted average yield on 3-month Treasury bills went down from 11.00% at the last auction in December 2008 to 5.82% a year later. The yields on 6- and 12-month Treasury bills shrank at a more moderate rate: from 11.00% to 9.27% and from 11.00% to 10.25% respectively. At the end of the year, yields on longer-term securities remained relatively high: after the sharp pick-up observed before they were traditionally slower to react to improvement in macroeconomic developments.

The outstanding amount of government securities issued in lats dropped 21.3% (to 823.2 million lats) as the securities issues of late 2008 matured and were redeemed. As to the breakdown of government securities by holder in 2009, government securities holdings of Latvian banks shrank from 77.2% to 53.4%, while the share of resident customers expanded from 21.0% to 43.8% and that of non-resident customers widened from 1.7% to 2.8%.

The stock of publicly traded corporate debt securities registered with the LCD in 2009 (in all currencies) grew from 156.1 million lats to 157.3 million lats, including an increase in the stock of publicly traded corporate debt securities denominated in lats and registered with the LCD (from 30.6 million lats to 52.9 million lats), the pick-up resulting from short-term (with maturity of up to one year) securities issues by foreign issuers. One lats-denominated securities issue – SJSC *Latvijas Hipotēku un zemes banka* 6-year mortgage bonds in the amount of 3 million lats – matured, and three new issues of debt securities denominated in lats were launched, including a 6-month debt securities issue in the amount of 12.3 million lats by *DnB NORD Bankas AB* (Lithuania) and two issues of 6-month debt securities in the total amount of 13.0 million lats issued by *Nordea Bank AB* (Sweden). As regards securities denominated in foreign currencies, nine issues matured and four new issues were launched.

In the debt securities secondary market, the bid yield on the Latvian government Treasury bonds maturing in July 2019 on NASDAQ OMX Riga picked up from 11.0% to 14.00% in 2009. Normally these quotations were made at the end of the month as longer-term securities had low liquidity in the secondary market. At the end of 2009, the bid rate of the government securities with the time to maturity less than one month was 4.00%, down from 10.10% at the end of 2008. Unlike bonds, the bid yield on short-term Treasury bills was closer to the yields of real transactions. The bid yield on mortgage bonds of the SJSC *Latvijas Hipotēku un zemes banka*, maturing in August 2013, moved up from 9.75% to 13.00%.

At the end of 2008, the bid yield on Latvian government eurobonds (maturing in 2018) was 9.86%. At the end of February 2009, it reached 12% before starting to decrease in early April, and stood at 8.15% at the end of the year. The spread between the bid yields on the above eurobonds and German government bonds of the respective maturity shrank from 694 basis points to 497 basis points. With the impact of the global financial market crisis easing, bid yields of the German government long-term bonds moved up while those of the emerging economies fell.

In 2009, the turnover of debt securities on NASDAQ OMX Riga was 16.8 million lats (a 37.5% decrease year-on-year). Government securities recorded the highest turnover (14.9 million lats) in 2009, with that of the SJSC *Latvijas Hipotēku un zemes banka* mortgage bonds recording the second highest turnover amounting to 1.3 million lats. The activity of the Treasury issuing new securities facilitated the turnover of government securities; however, the uncertainty regarding the development of the Latvian economy had a dampening effect on the turnover.

The NASDAQ OMX Riga stock turnover stood at 9.8 million lats in 2009 (2.0 times lower than in 2008). The largest stock turnover was recorded for the shares of the JSC *Grindeks* (3.0 million lats); the turnover of the JSC *Latvijas kuģniecība* and JSC *Olainfarm* shares was slightly smaller, standing at 1.9 million lats and 1.3 million lats respectively.

In 2009, corporate profit, return, and turnover continued on the downward trend. Despite the fact that companies were successful in reducing their costs, the weak demand was detrimental to the growth. Nevertheless, several indicators pointed to stabilisation of the economy at the end of the year. In view of the fact that a tax on capital gains was introduced as of 2010, at the end of 2009 several companies announced payment of a relatively large amount of dividends still in 2009, thus the turnover of their shares on the stock exchange increased.

The NASDAQ OMX Riga index OMXR rose by 2.8% in 2009. By the end of March, it had followed a downward trend before reversing and reaching its maximum on 23 September (+39.0% in comparison with the end of the previous year) and then falling back again. The rapid price rise on the stock market resulted from the resumed interest of foreign investors in the stocks of Latvian corporations. The world stock market indices began to move up in early March, therefore foreign investors were seeking markets where the increase had not started yet. When the foreign investors had purchased the desired amount of shares and their interest subsided, the demand on the stock market grew weaker and prices fell again.

At the end of 2009, shares of 35 corporations were listed on NASDAQ OMX Riga: five corporations were listed on the Baltic Main List and 30 corporations were included on the Baltic Secondary List.

CENTRAL BANK OPERATIONS AND ACTIVITIES

THE BANK OF LATVIA IN THE EUROPEAN SYSTEM OF CENTRAL BANKS AND INSTITUTIONS OF THE EUROPEAN UNION

Like the national central banks of other EU countries, the Bank of Latvia continued to operate within the ESCB. In its activities, the Bank of Latvia complies with the ECB legal acts in compliance with the Treaty on the Functioning of the European Union and the Statute of the ESCB and ECB. The primary goal of the Bank of Latvia is to maintain price stability in Latvia. Pursuant to the Law "On the Bank of Latvia", its main tasks are as follows:
– establishment and implementation of monetary policy;
– management of foreign currency and gold reserves;
– issue of the national currency, both banknotes and coins;
– organisation and management of the interbank payment system and promotion of a smooth functioning of the payment system in Latvia;
– compiling and publishing financial statistics and Latvia's balance of payments;
– representation of Latvia in foreign central banks and international financial institutions;
– acting as a financial agent for the Latvian government.

The Bank of Latvia also ensures the operation of the Credit Register. The Bank grants the legal persons registered with the Republic of Latvia Enterprise Register (except credit institutions) licences for purchasing and selling foreign currency in the form of business activities and controls compliance with the procedure for purchasing and selling foreign currency established by it.

The Governor of the Bank of Latvia participated in the ECB General Council meetings. In compliance with the Statute of the ESCB and ECB, the ECB General Council discussed on its meetings reports on macroeconomic, monetary and financial developments in the EU Member States, reports on functioning of ERM II as well as addressed other issues concerning the national central banks of all EU Member States.

The Bank of Latvia's representatives continued to participate in 12 ESCB committees and the Human Resources Conference (see Appendix 8), as well as more than 30 working groups, dealing with issues related to monetary policy, banking supervision, euro banknotes, statistics, accounting, market operations, payment systems, international relations and other issues.

The Bank of Latvia's experts also participated in several committees and working groups of the Council of the EU and the EC. Sitting on the EFC and its subcommittees, the representatives of the Bank of Latvia regularly participated in the decision-making concerning the economic and financial development of the EU, discussed the preparation of countries for the introduction of the euro, relations with third countries and policies of international financial institutions as well as took part in drafting proposals addressing the economic policy strategy and instruments. The Bank of Latvia's representatives continued their participation in the EC and Eurostat working groups addressing issues related to euro coins, payment systems, economic forecasting and statistics.

In compliance with the provisions of the Statute of the ESCB and ECB, the Bank of Latvia ensured translation of the ECB Annual Report 2008 and quarterly versions of the ECB's Monthly Bulletin (published on the Internet).

STRATEGIC PLANNING

In 2009, the Bank of Latvia fulfilled its main tasks and planned the activities seeking to reach the objectives stated in its strategic guidelines.

The Bank of Latvia's strategic guidelines cover the period up to 2011. The Bank of

Latvia's priority goals and goals of diverse bank's functions are stated in these guidelines. The Bank's priorities are as follows:
– price stability and promotion of stability of the financial system. The Bank of Latvia promotes in-depth studies of the economic environment to use the resulting information in its monetary policy decisions;
– preparation for a full-fledged membership of Latvia in the EMU. In cooperation with the government and other institutions, the Bank of Latvia facilitates the implementation of the Maastricht criteria as well as ensures the financial sector settlement infrastructure, the cash changeover, the necessary amendments to the laws and regulations and full-fledged participation in the ESCB;
– promotion of public awareness of the Bank of Latvia's operation, and the decisions it has taken as well as Latvia's economic development. It is essential for the Bank of Latvia to provide transparent and detailed information on the Bank of Latvia's actions and reasons behind them;
– enhancement of the Bank of Latvia's management processes. The Bank of Latvia proceeds with the improvement of management processes, taking into account the best practices of corporate management;
– improvement of the Bank of Latvia's operational efficiency. The Bank of Latvia balances the timing, quality and costs depending on priority set in each task;
– development of the Bank of Latvia as a learning organisation. It is important for the Bank of Latvia that its employees possess a positive attitude towards work, persist in improving their skills to attain the necessary results, collaborate and share their know-how with colleagues;
– increased staff motivation. The Bank of Latvia wishes to attract, engage and retain highly proficient and creative personnel.

In 2009, many measures were implemented to facilitate the achievement of goals: for a more detailed description see below.

FOREIGN EXCHANGE POLICY AND FOREIGN RESERVES

Latvia continued to participate in the ERM II to become a full-fledged member of the EMU and introduce the euro. The Maastricht criteria specify that for at least two years prior to the euro changeover the lats is to be pegged to the euro, with the fluctuation of the lats exchange rate against the euro not exceeding ±15% against the central parity rate of the lats *vis-à-vis* the euro. The Bank of Latvia has unilaterally ensured the lats exchange rate fluctuations against the euro within ±1% of the central parity rate. In 2009, the euro exchange rate against the lats fluctuated within the limits of the currency intervention band set by the Bank of Latvia (EUR 1 = LVL 0.6958/0.7098), remaining close to the upper limit of the intervention band for the most part of the year.

The Bank of Latvia's foreign reserves, which include gold, convertible foreign currencies and SDR, amounted to 3 376.6 million lats at the end of 2009 (2 597.9 million lats at the end of 2008). The notable growth in the foreign reserves resulted from income from investing foreign reserves in foreign financial markets in accordance with the guidelines adopted by the Council of the Bank of Latvia and as a result of inflows of funding received under international loan agreements into the Treasury accounts.

The Bank of Latvia manages its foreign reserves in compliance with the guidelines adopted by the Council of the Bank of Latvia. The base currency of the benchmark portfolio is the euro, and the benchmark assets are composed of 50% of euro-denominated assets, 40% of US dollar-denominated assets and 10% of Japanese yen-denominated assets. The Bank of Latvia invests its foreign reserves in safe and liquid financial instruments, primarily in debt securities issued by governments and government agencies of the euro area countries and the US and international organisations, as well as in highly rated bank and corporate debt securities, asset-backed securities and callable bonds. Interest rate futures are used to manage the duration of the reserves. For the purpose of implementing yield curve strategies on the interest rate market, interest rate swaps are used, whereas foreign exchange futures and forwards are applied to ensure the optimal currency composition of the foreign reserves.

The Bank of Latvia stored its gold reserves with the Bank of England. Foreign exchange futures and forwards, and interest rate swaps were also used in the management of the gold reserves.

The Bank of Latvia used the services of four external reserve managers. They managed a minor portion of the foreign reserves pursuant to the guidelines adopted by the Council of the Bank of Latvia.

In foreign reserve management much attention is paid to risk management and control. Foreign reserve portfolio compliance with the guidelines is checked on a daily basis and the risk allocation by various investment decisions is managed.

MONETARY POLICY INSTRUMENTS

In view of the economic downslide, the Bank of Latvia continued to pursue accommodative monetary policy in 2009. In contrast to the previous year when inflation reached a high since 1996, it moderated considerably in 2009.

In response to the marked slowdown in economic activity, easing inflation and sluggish lending, the Bank of Latvia lowered the refinancing rate twice in 2009: from 6.00% to 5.00% as of 24 March and from 5.00% to 4.00% as of 24 May. The Bank of Latvia also reduced the overnight deposit facility rate on two occasions: from 3.00% to 2.00% as of 24 January and from 2.00% to 1.00% as of 24 March. The overnight deposit facility rate was lowered with a view to provide additional incentive for banks to channel into the economy the ample funds they had accumulated with the Bank of Latvia in the form of excess reserves. However, the recourse to the overnight deposit facility suggested that the change in the rate had had minor effect on the banks' behaviour: given the high degree of uncertainty with respect to the future development of the government policy and the national economy, banks still tended to prefer safety.

The marginal lending facility rate was left unchanged (7.50% in case the respective bank had resorted to the lending facility no more than 5 working days within the previous 30 day period; 15% in case the bank had resorted to the lending facility 6–10 working days within the previous 30 day period; 30% in case the bank had resorted to the lending facility for more than 10 working days within the previous 30 day period).

In 2009, the crucial role of fiscal policy in the recovery of the economy explicitly manifested itself: a reduction in the budget deficit could trigger the required change in the sentiment in order that the economic growth could resume. Without an appropriate fiscal policy the implementation of the Bank of Latvia's monetary policy might be exposed to risk. In the last few months of 2009, it could be seen well enough how important the process of improving the state financial issues was for stabilising the national economy. After the budget for 2010 (in compliance with the government commitment framework agreed with international lenders) was approved, uncertainty in financial markets notably eased: interbank market interest rates contracted, with the drop of interest rates on loans granted to residents also reflecting the latter.

With the economic activity moderating, the impact of the autonomous liquidity factors eased. The average end-of-day balance of the currency in circulation was 830.9 million lats in 2009 (an 18.5% year-on-year fall), directly reflecting the GDP dynamics, and the retail trade turnover shrank at a more rapid rate than the currency in circulation. The average minimum reserve requirements for banks stood at 727.1 million lats (44.0% lower year-on-year). The decrease largely resulted from the reductions of the reserve ratio at the end of 2008 (in October, November and December), as well as a decrease in bank liabilities. Reserve requirements shrank from 796.4 million lats at the beginning of 2009 to 673.7 million lats at the end of 2009 on account of a drop in bank liabilities as the reserve ratio had remained unchanged over the year. The reserve base and the reserve requirements contracted by 13.1% and 15.4% respectively (including a fall of 20.6% in the minimum reserve requirement for liabilities with an agreed maturity of up to two years and a 1.9% decrease in that for liabilities with an agreed maturity of over two years).

In contrast to the previous year, the average amount of the government lats deposit with the Bank of Latvia decreased by 36.3% (to 109.8 million lats). Although the government had the funds of the foreign financial assistance granted as loans in euro at its disposal, the government was cautious with converting euro into lats.

In the first half of the year, 511.1 million lats were sold for euro to the Bank of Latvia (by settlement day), these transactions being reversed to a large extent in the second half of the year, and in 2009 the net amount of lats sold to the Bank of Latvia for euro was 55.8 million lats. In early 2009, uncertainty about the economic situation was observed, and economic agents were concerned about the sustainability of the lats exchange rate, hence banks were selling lats for euro to the Bank of Latvia; later, however, banks had to buy lats from the Bank of Latvia as the amount of lats had dropped below the level required to comply with the reserve requirements. The Treasury became an important player on the foreign exchange market, particularly at the end of the year when budgetary expenditure grew higher due to seasonal factors: then the Treasury converted euro into lats at the Bank of Latvia.

In 2009, the amount allotted in the Bank of Latvia's main refinancing operations was 1.25 billion lats (the same as in the previous year). The banks' bids amounted to 744.4 million lats (a 23.7% decrease), and the allotted amount stood at 335.9 million lats (a 7.7% drop). The average amount at the main refinancing operations contracted to 6.7 million lats (7.1 million lats in 2008), with the weighted average interest rate standing at 7.70% (35 basis points higher year-on-year).

In 2009, the volume of currency swaps offered by the Bank of Latvia was 2.5 billion lats (the same as in the previous year). The demand in the foreign exchange swap auctions was 2 044.6 million lats (39.8% up year-on-year), and the concluded foreign exchange swaps stood at 1 101.1 million lats (68.1% up). The average amount of currency swaps was 22.2 million lats (an 80.5% surge year-on-year), with the weighted average interest rate of 10.26% (256 basis points higher in comparison with the previous year).

Auctions of the main refinancing operations and currency swaps in 2009 were conducted every working day, with the allotment amount of 5 million lats and 10 million lats respectively. The minimum bid rates in these auctions were linked to the refinancing rate. In the second half of the year, with the liquidity surplus increasing, the demand gradually moderated. The demand for currency swaps was stronger due to the availability of collateral.

As a result of excess liquidity, banks pursued prudent lending policy; hence the overnight deposit facility was an essential monetary policy instrument. In 2009, net recourse to the overnight deposit facility reached 172.8 million lats, an 82.3% increase year-on-year. The weighted average deposit facility rate stood at 1.52%, 144 basis points lower than in the previous year. The deposit facility was actively used at the beginning and end of the year and less so in the middle of it.

The average recourse to the marginal lending facility reached 6.3 million lats in 2009 (45.8 million lats in 2008), with the weighted average interest rate standing at 8.47% (97 basis points up year-on-year).

The Bank of Latvia continued to calculate RIGIBID (deposit rates on the interbank market) and RIGIBOR (lending rates on the interbank market) in accordance with the Bank of Latvia's "Regulation for the Calculation of RIGIBID and RIGIBOR", including those banks in quotation list that were active on the interbank market and able to conduct market operations at the quoted money market rates on transactions in lats: at the end of 2009, the JSC Swedbank, JSC *Latvijas Krājbanka*, JSC *SEB banka*, JSC UniCredit Bank, Latvian Branch of *Nordea Bank Finland Plc*, JSC *DnB NORD Banka* and SJSC *Latvijas Hipotēku un zemes banka*.

ECONOMIC RESEARCH, ANALYSIS AND FORECASTING

A modern central bank can effectively implement monetary policy building on an in-depth analysis of development trends in macroeconomic indicators and the related interactions, such analysis performed using statistical, mathematical and econometric methods. Economic research and analysis are vital for contributing quantitative and scientifically sound accounts of economic processes, developing econometric forecasting models for macroeconomic indicators, and estimating alternative scenarios.

In 2009, the Bank of Latvia began to publish *Discussion Papers*, a new series of publications. This series contains analysis carried out at the Bank of Latvia and conclusions thereof. Materials are published to bring issues vital for Latvia's economic development up for public discussion. Some of them are used during expert discussions organised by the Bank of Latvia. In contrast to the traditional *Working Papers* series whose target audience is comprised of scholars, researchers, and specialists of central banks and other institutions of various countries, the focus of *Discussion Papers* series is on public at large in Latvia and beyond.

The Bank of Latvia also started to issue a new regular publication *Macroeconomic Developments Report* in 2009. It is a quarterly appearing since the third quarter of 2009 and replacing *Monetārais Apskats. Monetary Review* published since 1994. Developments in the external sector and exports, financial markets, domestic demand and supply, costs and prices, and balance of payments are in the focus of this publication. Economic perspectives and inflation forecasts developed by the Bank of Latvia are also included.

Four working papers and one discussion paper were published on the Bank of Latvia website in 2009 (see Appendix 9); one article written by the Bank of Latvia staff members was published in an international peer-reviewed journal; four experts' roundtables and one conference were held. The issues tackled focused on crucial economic problems of Latvia: returning to economic stability and growth, importance of the euro and economic aspects of the lats stability amidst a financial crisis, deflation and its implications, interest rate modelling and advantages of a fixed exchange rate, and the dynamics of total factor productivity, natural rate of unemployment and capacity utilisation.

According to the outcomes of the analysis conducted by the Bank of Latvia, fiscal consolidation or reduction of the budget deficit shall be accomplished in 2012 at the latest in order to comply with the Maastricht fiscal convergence criteria. Cuts shall refer to excessive budget expenditure, also via the on-going structural reforms in education, health care and public administration. In order to ensure a tight fiscal policy for some time to come when the adverse effects of population aging become apparent, legislative provisions restricting fiscal policy, e.g. setting an objective for the general government budgetary surplus, restricting budget expenditure, and minimising employers' capacity to raise wages and salaries in the public sector in the future, should be introduced in Latvia (see the Bank of Latvia website for the materials of the Bank of Latvia annual conference of 1 October 2009 *Return to Sustainable Economic Growth and Stability in Latvia*).

In the context of Latvia preparing for full-fledged participation in the EMU, the Bank of Latvia developed a convergence model of interest rate term structure within an arbitrage free pricing framework. The developed model is of a universal nature: it can be applied to a country planning to join the euro area as well as to a country planning to join any currency area. This Bank of Latvia research and the model developed and tested within it will become particularly topical when Latvia complies with all Maastricht convergence criteria and makes a formal announcement of the national euro changeover date.

Acknowledging that inflation and its dynamics are among the most important indicators for major economic agents such as producers, consumers, investors, and monetary and fiscal policy makers, the Bank of Latvia has explored and assessed a short-term relationship between capacity utilisation rate and inflation. Capacity utilisation rate that does not exert any upward pressure on inflation was described; likewise, it was explored whether Latvia's production capacity utilisation rate figured as a factor triggering an upsurge in inflation after the EU accession. The research was published in the international peer-reviewed *Baltic Journal of Economics*.

Productivity and its dynamics are ranked among major factors underpinning sustainable economic growth over a longer horizon; consequently, a timely assessment of productivity dynamics is an important task. The Bank of Latvia has estimated total factor productivity growth for six major sectors of Latvia's economy. The estimates are based on qualitative changes in productivity factors and the use of a mechanism to capture labour and capital utilisation intensity. An important feature of this research is an advanced measurement of production factor values representing qualitative and structural changes in production factors.

By developing and estimating a model of general equilibrium, the Bank of Latvia proved that under a fixed exchange rate regime (in Latvia and other countries with a similar economy) inflation rate is less volatile than under a system of inflation targeting. The model outcomes support the fixed exchange rate option as appropriate from the point of view of maintaining price stability.

If compared with the other EU countries, gross savings in Latvia are at an average level, while investment ranks among the highest. This is a positive indication supporting a growth-oriented, far-reaching policy; nonetheless, both detailed analysis in the breakdown by economic sector and industry and the investment structure reveal different trends. In Latvia, the national savings are basically sufficient to cover the renewal of fixed assets, while the economic growth depends primarily on borrowed financing. The analysis conducted by the Bank of Latvia discloses the absence of sustainable development policies for practically all institutional sectors. The Bank of Latvia published information about the cross-section model used to study the savings behaviour of Latvian households.

CASH MANAGEMENT

At the end of 2009, currency in circulation diminished by 22.6% year-on-year (from 1 018.1 million lats to 788.2 million lats). Over five years, the currency in circulation has grown 1.1 times.

Banknotes and coins received from banks were checked for authenticity and suitability

BANK OF LATVIA'S BANKNOTES AND COINS PRINTED AND STRUCK IN 2009

5 LATS

Size: 130 x 65 mm
Colour: green
Printed by
Giesecke & Devrient GmbH
(Germany)
Artists:
Imants Žodžiks,
Valdis Ošiņš

Obverse
An oak-tree and a stylised oak-leaf (a see-through register) are superimposed on a motif of ornamental suns, with two inscriptions of the nominal value 5 in relief imprinted above. Across the top of the banknote, there is the two-coloured inscription LATVIJAS BANKAS NAUDAS ZĪME (money note of the Bank of Latvia), with the serial number of the banknote inscribed in red underneath. Across the bottom of the banknote, there are the inscriptions PIECI LATI (five lats) in two-coloured print, LATVIJAS BANKA (Bank of Latvia), the facsimile signature of the Governor of the Bank of Latvia, and the serial number of the banknote in black print. On the right side of the banknote, there is a vertical ornamental band composed of the motif of Lielvārde belt, topped with the numeral 5. The nominal value is visible on the ornamental band when the banknote is viewed at an angle against the light. In the left upper part of the banknote, there is a green dot (Braille) in relief on a white background that is watermarked. Beneath the watermark, there is a horizontal band of fine green lines, on which the numeral 5 and inscriptions LATVIJAS BANKA (Bank of Latvia) in microlettering in a blend of colours are superimposed. The numeral is printed in special paint creating a colour-changing optical effect depending on the angle of viewing. On the left from the numeral 5, there is a vertical band with the numeral 5 in relief repeated four times in different shades of colour depending on the angle of viewing.

Reverse
A design of an ornamental sun cut in wood is superimposed on a distaff motif. A vertical metallic holographic band with the inscriptions of the nominal value is worked into the paper on the left of the ornamental sun; a stylised oak-leaf is on the right. Across the top of the banknote, there is the inscription PIECI LATI (five lats) and the numeral 5. The numeral 5 and two-coloured inscription LATVIJAS BANKAS NAUDAS ZĪME (money note of the Bank of Latvia) are at the bottom of the banknote. On the left of the distaff motif, there is a vertical band of numerals 5 with diagonal stripes that blend into one another. Along the edge of the band on a white background, there is a vertical inscription © LATVIJAS BANKA 1992 (© Bank of Latvia 1992). A design of the large coat of arms of the Republic of Latvia, with the year 2009 inscribed underneath, is depicted on a white background in the lower right corner of the banknote. Above the coat of arms, the paper is watermarked (a profile of a Latvian folk-maid).

2 SANTIMS

Weight: 1.90 g; diameter: 17.00 mm
Metal: copper-clad steel
Struck by *Staatliche Münzen Baden-Württemberg* (Germany)
Artists: Gunārs Lūsis (graphic design),
Jānis Strupulis (plaster model)

Obverse
The small coat of arms of the Republic of Latvia, encircled by the inscription LATVIJAS REPUBLIKA (Republic of Latvia) and the year, is placed in the centre.
Reverse
The numeral 2 is centred on the coin, with the inscription SANTĪMI arranged in a semicircle beneath it. Two diamond-shaped suns are located on either side of the numeral. At the top of the coin, five arcs (representing the work cycle) join the two diamond-shaped suns.
Edge: plain.

20 LATS

Size: 130 x 65 mm
Colour: brown
Printed by
Giesecke & Devrient GmbH
(Germany)
Artists:
Imants Žodžiks,
Valdis Ošiņš

Obverse
An ancient Latvian homestead and a stylised oak-leaf (a see-through register) are superimposed on an ornamental background, with two inscriptions of the nominal value Ls 20 embedded above. Across the top of the banknote, there is the two-coloured inscription LATVIJAS BANKAS NAUDAS ZĪME (money note of the Bank of Latvia), with the serial number of the banknote inscribed in red underneath. Across the bottom of the banknote, there are the inscriptions DIVDESMIT LATU (twenty lats), LATVIJAS BANKA (Bank of Latvia), the facsimile signature of the Governor of the Bank of Latvia, and the serial number of the banknote in black print. On the right side of the banknote, there is a vertical ornamental band composed of the motif of Lielvārde belt, topped with the numeral 20. In the left upper part of the banknote, there are two brown dots (Braille) in relief arranged horizontally on a white background that is watermarked. Beneath the watermark, there is a horizontal band of fine brown lines, on which the numeral 20 and inscriptions LATVIJAS BANKA (Bank of Latvia) in microlettering in a blend of colours are superimposed. The numeral is printed in special paint creating a colour-changing optical effect depending on the angle of viewing. On the left of the numeral 20, there is a vertical band with the numeral 20 in relief repeated four times in different shades of colour depending on the angle of viewing.

Reverse
It depicts a motif of traditional Latvian ornaments. A vertical metallic holographic band with the inscriptions of the nominal value is worked into the paper on the left of the ornamental sun; a stylised oak-leaf is on the right. Across the top of the banknote, there is a two-coloured inscription DIVDESMIT LATU (twenty lats) and the numeral 20. The numeral 20 and two-coloured inscription LATVIJAS BANKAS NAUDAS ZĪME (money note of the Bank of Latvia) are at the bottom of the banknote. On the left of the ornamental motif, there is a vertical band of numerals 20 with diagonal stripes that blend into one another. Along the edge of the band on a white background, there is a vertical inscription © LATVIJAS BANKA 1992 (© Bank of Latvia 1992). A design of the large coat of arms of the Republic of Latvia, with the year 2009 inscribed underneath, is depicted on a white background in the lower right corner of the banknote. Above the coat of arms, the paper is watermarked (a profile of a Latvian folk-maid).

5 SANTIMS

Weight: 2.50 g; diameter: 18.50 mm
Metal: alloy of copper, nickel and zinc
Struck by
Staatliche Münzen Baden-Württemberg (Germany)
Artists: Gunārs Lūsis (graphic design),
Jānis Strupulis (plaster model)

Obverse
The small coat of arms of the Republic of Latvia, encircled by the inscription LATVIJAS REPUBLIKA (Republic of Latvia) and the year, is placed in the centre.
Reverse
The numeral 5 is centred on the coin, with the inscription SANTĪMI arranged in a semicircle beneath it. Two diamond-shaped suns are located on either side of the numeral. At the top of the coin, five arcs (representing the work cycle) join the two diamond-shaped suns.
Edge: plain.

500 LATS

Size: 130 x 65 mm
Colour: golden brown
Printed by
Giesecke & Devrient GmbH
(Germany)
Artists:
Imants Žodžiks,
Valdis Ošiņš

Obverse

A profile of a Latvian folk-maid and a stylised oak-leaf (a see-through register) are superimposed on a motif of ornaments of a bronze head-dress. On the left of the portrait, there is a vertical translucent band, which covers the see-through register, and transparent window above it featuring three stars in a semicircle on a light background and the letterings "Ls" in four displaced lines on a dark background. Across the top of the banknote, there is the inscription LATVIJAS BANKAS NAUDAS ZĪME (money note of the Bank of Latvia). Across the bottom of the banknote, there are the inscriptions PIECSIMT LATU (five hundred lats) in the colour-changing optical effect print, LATVIJAS BANKA (Bank of Latvia), the facsimile signature of the Governor of the Bank of Latvia, and the serial number of the banknote in black print. On the right side of the banknote, there is a vertical ornamental band composed of the motif of Lielvārde belt, topped with the numeral 500. When the banknote is tilted to the light, the nominal value is visible on the ornamental band. In the left upper part of the banknote, there are three golden-brown dots (Braille) in relief arranged vertically on a white background, the serial number in red print to the left of them, and a watermark. Beneath the watermark, there is a horizontal band with the numerals 500 in greyish brown print and a numeral 500 in a larger and darker greyish brown print, which changes the colour when the banknote is tilted and acquires a different shade under the impact of heat.

Reverse

It depicts a motif of ornaments of a bronze head-dress. It is crossed by a vertical metallic holographic band with the inscription of the nominal value worked into the paper; a stylised oak-leaf is on the right. Across the top of the banknote, there is a two-coloured inscription PIECSIMT LATU (five hundred lats) and the numeral 500. The numeral 500 and two-coloured inscription LATVIJAS BANKAS NAUDAS ZĪME (money note of the Bank of Latvia) are at the bottom of the banknote. A vertical band of numerals 500 with diagonal stripes that blend into one another is on the left of the ornamental motif. Along the edge of the band on a white background, there is a vertical inscription © LATVIJAS BANKA 1992 (© Bank of Latvia 1992). A design of the large coat of arms of the Republic of Latvia, with the year 2008 inscribed underneath, is depicted on a white background in the lower right corner of the banknote. Above the coat of arms, the paper is watermarked (a profile of a Latvian folk-maid).

The transparent window on a light and dark background on the obverse (on the left) and reverse (on the right) of the banknote.

20 SANTIMS

Weight: 4.00 g; diameter: 21.50 mm
Metal: alloy of copper, nickel and zinc
Struck by *Staatliche Münzen Baden-Württemberg* (Germany)
Artists: Gunārs Lūsis (graphic design), Jānis Strupulis (plaster model)

Obverse
The small coat of arms of the Republic of Latvia, encircled by the inscription LATVIJAS REPUBLIKA (Republic of Latvia) and the year, is placed in the centre.
Reverse
The numeral 20 is centred on the coin. The inscription SANTĪMU, arranged in a semicircle, is beneath the numeral. Two diamond-shaped suns are located on either side of the numeral. At the top of the coin, five arcs (representing the work cycle) join the two diamond-shaped suns.
Edge: plain.

50 SANTIMS

Weight: 3.50 g; diameter: 18.80 mm
Metal: alloy of copper and nickel
Struck by *Staatliche Münzen Baden-Württemberg* (Germany)
Artists: Gunārs Lūsis (graphic design), Jānis Strupulis (plaster model)

Obverse
The small coat of arms of the Republic of Latvia, encircled by the inscription LATVIJAS REPUBLIKA (Republic of Latvia) and the year, is placed in the centre.
Reverse
A pine tree seedling, the symbol of bountiful Latvian timber resources, is depicted in the upper part of the coin. A horizontal line separates it from the numeral 50, under which the inscription SANTĪMU is placed in a semicircle.
Edge: vertically reeded.

2 LATS

Weight: 9.50 g (weight of the central circle – 4.50 g, weight of the outer ring – 5.00 g);
diameter: 26.30 mm (diameter of the central circle – 18.21 mm)
Metal of the central circle: alloy of copper, nickel and zinc; metal of the outer ring: alloy of copper and nickel
Struck by British Royal Mint (the UK)
Artists: Gunārs Lūsis (graphic design), Jānis Strupulis (plaster model)

Obverse
The large coat of arms of the Republic of Latvia is placed in the central circle. The inscription LATVIJAS REPUBLIKA (Republic of Latvia) is arranged in a semicircle in the upper part of the outer ring. In the lower part of the ring, there is the year 2009 separated by dots.
Reverse
A cow with the numeral 2 underneath is featured in the upper part of the central circle. The inscription LATI is in the lower part of the outer ring. The background motif (clouds and grass) is the element linking the central circle with the outer ring.
Edge: vertically reeded, with two inscriptions LATVIJAS BANKA (Bank of Latvia) separated by dots.

SPECIAL CIRCULATION COINS OF LIMITED MINTAGE

NAMEJS RING

Face value: 1 lats
Weight: 4.80 g; diameter: 21.75 mm
Metal: alloy of copper and nickel
Struck by *Staatliche Münze Berlin* (Germany)
Artists: Ilze Lībiete (graphic design), Baiba Šime (plaster model)

CHRISTMAS TREE

Face value: 1 lats
Weight: 4.80 g; diameter: 21.75 mm
Metal: alloy of copper and nickel
Struck by *Staatliche Münze Berlin* (Germany)
Artists: Arvīds Priedīte (graphic design),
Ligita Franckeviča (plaster model)

COLLECTOR COINS

THE PIGLET

Face value: 1 lats
Weight: 20.00 g; diameter: 34.00 mm
Metal: silver of .925 fineness; quality: proof
Struck by *Rahapaja Oy* (Finland)
The reverse of the coin was designed using the drawing by Emīlija Adumāne, participant at the children's contest of drawings *My Dream Coin*, and modelled by Ligita Franckeviča.

UNIVERSITY OF LATVIA

Face value: 1 lats
Weight: 31.47 g; diameter: 38.61 mm
Metal: silver of .925 fineness; quality: proof
Struck by *Koninklijke Nederlandse Munt*
(the Netherlands)
Artists: Guntars Sietiņš (graphic design),
Jānis Strupulis (plaster model)

TIMES OF THE SURVEYORS

Face value: 1 lats
Weight: 31.47 g; diameter: 38.61 mm
Metal: silver of .925 fineness; quality: proof
Struck by *Koninklijke Nederlandse Munt*
(the Netherlands)
Artists: Laimonis Šēnbergs (graphic design),
Ligita Franckeviča (plaster model)

COIN OF WATER

Face value: 1 lats
Weight: 26.00 g; area measurement:
32.00 x 32.00 mm; shape: square
Metal: silver of .925 fineness;
quality: proof
Struck by *Rahapaja Oy* (Finland)
Artists:
Ilmārs Blumbergs (graphic design),
Jānis Strupulis (plaster model)

THE EU COLLECTOR COIN PROGRAMME *EUROPEAN HERITAGE*

CHRISTMAS TREE

Face value: 1 lats
Weight: 22.00 g; diameter: 35.00 mm
Metal: silver of .925 fineness; quality: proof
Struck by *Koninklijke Nederlandse Munt*
(the Netherlands)
Artists: Edgars Folks (graphic design),
Jānis Strupulis (plaster model)

for circulation by using automated cash processing systems. In 2009, the amount of processed cash (3 931.5 million lats) exceeded that of currency in circulation 5.0 times (3.9 times in 2008). Of the amount of cash processed, 620.3 million lats or 15.8% was withdrawn from circulation (656.0 million lats or 16.4% in 2008).

The total nominal value of counterfeits detected in 2009 (15.1 thousand lats) accounted for only 0.002% of the currency in circulation.

The Bank of Latvia released a new issue of 2-, 5-, 20- and 50-santims and 2-lats circulation coins and 5-, 20-lats banknotes, as well as a 500-lats banknote with improved security features in 2009.

New special 1-lats coins *Namejs Ring* (in circulation as of 8 June 2009) and *Christmas Tree* (in circulation as of 26 November 2009) replenished the stock of circulation coins.

In 2009, the Bank of Latvia issued a 1-lats silver coin (in circulation as of 25 March 2009), its reverse featuring a piglet – a drawing by Emīlija Adumāne, a six-year old girl from Riga who won the children's contest of drawings *My Dream Coin* organised in the previous year. The 1-lats silver coin *Times of the Surveyors* (in circulation as of 21 September 2009) commemorated the 130th anniversary of the first Latvian full-length realistic novel by brothers Kaudzītes, whereas the 1-lats silver coin *University of Latvia* (in circulation as of 24 August 2009) was dedicated to the 90th anniversary of the foundation of Latvia's most prominent higher educational establishment. The 1-lats silver *Coin of Water* (in circulation as of 16 November 2009) designed by Ilmārs Blumbergs reflects the idea of collaboration between the human mind and water and man's interference in the harmony of nature. The 1-lats silver coin *Christmas Tree* (in circulation as of 26 November 2009) was issued within the framework of the international coin programme *European Heritage* thus honouring 500 years since a Christmas tree decorated by the Brotherhood of Blackheads in Riga was first mentioned in writings.

STATISTICS

In 2009, a number of the Bank of Latvia regulations in the area of financial market and monetary statistics were drafted and approved.

The Bank of Latvia's Regulation No 40 "Regulation for Compiling the Monthly Financial Position Report of Monetary Financial Institutions" of 16 July 2009 (in effect as of 1 May 2010) was adopted upon transposing the requirements of the Regulation (EC) No 25/2009 (recast; ECB/2008/32) concerning the balance sheet of the monetary financial institutions sector. At the same time, particular attention was focussed on optimising the reporting burden on the reporting agents. In the future, credit unions will compile and submit the respective reports on a quarterly basis and electronic money institutions – semi-annually. MFIs will no longer have to submit information on the types of loans and debt securities which the Bank of Latvia can access from the Credit Register database and data on securities reports collected by the Bank of Latvia. In the reports, new categories of loans granted by MFIs and groups of borrowers are reported separately, breakdown by currency has been amended as well as other amendments made thereof. These changes will not cause breaks in time series of the MFI balance sheet statistical data published by the Bank of Latvia, albeit supplement the above time series with new data submitted by MFIs. The Bank of Latvia regulations stipulating the submission of MFI statistical reports have been amended respectively.

The Bank of Latvia's Regulation No 42 "Regulation for Compiling Interest Rate Reports of Monetary Financial Institutions" of 10 September 2009 (to take effect on 1 June 2010) was adopted upon transposing the latest amendments of Regulation (EC) No 63/2002 (ECB/2001/18) concerning statistics on interest rates applied by monetary financial institutions to deposits and loans *vis-à-vis* households and non-financial corporations. In addition to the above amendments, the reporting burden on credit unions has also been reduced. Henceforth, the above report will only be submitted by the largest credit unions on a quarterly rather than monthly basis.

The Bank of Latvia's Regulation No 41 "Regulation for Compiling Reports on Foreign Currency Purchases and Sales" of 16 July 2009 (in effect as of 1 January 2010) stipulated the recording of transactions by transaction date rather than the settlement date as well as expanded the range of data provided on cash and cashless transactions both in lats and other currencies. Foreign exchange market accounts for an active financial market share, hence the report data will provide for a more comprehensive market analysis.

The Bank of Latvia's Regulation No 47 "Regulation for Compiling the 'Report and Projections on Long-Term Foreign Debt of Monetary Financial Institutions' " of 5 November 2009 (to take effect on 1 June 2010) provides for information consistent with the requirements of the IMF and the EU and necessary for analysing the external debt, balance of payments and national macroeconomic indicators, and for making projections.

The implementation of the ECB's requirements for compiling investment fund statistics was also continued, and the publishing of monthly list of investment funds on the Bank of Latvia's website and transmission of data required for maintaining the list of the EU Member State investment funds to the ECB was commenced.

An in-depth study of several areas, such as the credit lines granted by MFIs and data availability, potential operational issues of payment institutions as well as the scope of capital companies operating in the area of venture capital, was conducted in relation to the EU requirements for compilation of statistics.

The Bank of Latvia continued to cooperate with the IMF in the field of financial stability statistics and commenced compiling, on a regular basis, the financial stability indicators and balance sheet and profit and loss statement of MFIs (excluding money market funds), and transmitted the above data to the IMF as well as published them on the Bank of Latvia website.

The methodological work continued in the area of preparing Latvia's balance of payments statistics, with the main focus on reducing the reporting agents' burden.

The Bank of Latvia's Regulation No 43 "Regulation for Compiling Reports on Securities" of 10 September 2009 (in effect as of 1 April 2010) will also provide for compiling data on a security-by-security basis regarding the securities without the International Securities Identification Number (ISIN). Thus a more accurate compilation of data on direct investment of credit institutions needed for complying with the requirements of the ECB, Eurostat and IMF will be ensured.

The Bank of Latvia's Regulation No 48 "Regulation for Compiling the 'Report on External Payments of Non-banks' " of 5 November 2009 (in effect as of 1 January 2010) stipulated a new threshold of external payments (5 000 lats; previously – 1 000 lats). Hence no data are to be submitted to the Bank of Latvia where the above threshold is not exceeded, and as a result data processing has been optimised at the Bank of Latvia and the reporting agents' burden reduced.

In 2009, electronic transmission of data on non-financial corporations was updated, and as a result of telephone surveys about 60% of non-financial corporations submitted data for compiling the balance of payments statistics electronically. Thus data processing has been optimised at the Bank of Latvia and shorter time frame for compiling quarterly balance of payments statistics facilitated.

Knowledge and experience gained from the activities organised by the Seasonal Adjustment Steering Group led to the implementation of methods for estimating the travellers' spending that is needed for compiling the balance of payments. The above methods are based on the development and analysis of time series models.

As regards official statistics, successful transition to a new sample design of the survey on foreign investment of non-financial corporations, one of the main sources of the balance of payments data, has been implemented in relation to the planned transition to the updated version of the EU statistical Classification of Economic Activities (NACE Rev. 2).

In the area of the government finance statistics, the Bank of Latvia's experts continued participation in cross-institutional working groups dealing with the issues related to the preparation of notification on the budget deficit and debt and updating the methodology, provision of information on the amount and spending of the EU funds, accounting for public and private partnership projects, and the compilation of Latvian government finance statistics on a regular basis for transmission to the ECB. In 2009, transition to the data compilation in accordance with the ECB Guideline of 31 July 2009 on government finance statistics (recast; ECB/2009/20) stipulating full recording of the government deficit and the respective revenue and expenditure ratios in compliance with the principles of the ESA 95 was implemented. Pursuant to the requirements of the ECB and Eurostat, the Bank of Latvia's experts compiled, on a regular basis, data on the measures taken by the Latvian government to prevent financial crisis in 2008 and 2009, and their impact on the budget deficit and debt.

The Bank of Latvia continued the regular transmission of statistical data to the ECB, BIS and IMF and transmitted statistical information to other domestic and foreign data users. To furnish timely information to a wide range of data users, the Bank of Latvia disseminated financial and monetary statistics and balance of payments statistics of Latvia via its regular publications and the Bank's website and compiled data for publishing in the ECB publications and the ECB Statistical Data Warehouse (on the ECB website) as well as the IMF publications and within the IMF Special Data Dissemination Standard. To accelerate and simplify the data exchange between the Bank of Latvia and the CSB, an online data exchange solution was provided between the two institutions.

PAYMENT AND SETTLEMENT SYSTEMS

The Bank of Latvia continued to ensure the operation of three payment systems (the SAMS – real-time gross settlement system for interbank and urgent payments, the EKS – clearing and settlement of net positions of batch retail payments, and in conjunction with other participants of the ESCB – TARGET2, whose component system is TARGET2-Latvija).

The new legal framework for the SAMS and EKS became effective on 1 January 2009, harmonising the regulation of all three payment systems maintained by the Bank of Latvia and expanding the scope of potential participants.

At the end of 2009, 21 banks, three branches of foreign banks and the Bank of Latvia were the participants in the SAMS. In 2009, 83.8% of all interbank payments initiated in Latvia in lats were made via the SAMS and their share of value was 88.2% (87.3% and 88.8% in 2008 respectively). The total volume of payments processed in the SAMS decreased by 19.4% year-on-year, to 200.2 thousand, while their total value diminished by 7.9%, to 167.5 billion lats. Both interbank and customer payments were processed in the SAMS and their share of volume amounted to 44.4% and 55.6% respectively, while that of value was 93.2% and 6.8% respectively. In 2009, the average value per payment executed via the SAMS stood at 836.5 thousand lats (732.2 thousand lats in 2008). The volume concentration ratio of the payments made by the five largest banks in the SAMS was 72.3%, while the payment value concentration ratio amounted to 85.1%, primarily on account of the share of payments made by the Bank of Latvia (70.3% and 82.8% in 2008 respectively). The SAMS ensured 99.79% availability of the system to its participants in 2009 (99.97% in 2008).

At the end of 2009, 21 banks, three branches of foreign banks and the Bank of Latvia participated in the EKS lats settlement. In 2009, of all customer credit transfers executed among banks in Latvia in lats, 75.1% and 72.8% were handled by the EKS in terms of volume and value (75.2% and 71.0% in 2008 respectively). The total volume of payments processed in the EKS in lats declined by 4.3% (to 31.8 million) and their total value dropped by 22.1% (to 10.2 billion lats). The payments executed in the EKS were processed in two clearing cycles. Of the entire payments effected via the EKS in lats, 67.9% and 57.2% were handled in the first clearing cycle in terms of volume and value. In 2009, the average value of a single payment made in the EKS in lats decreased by 18.6% (to 320 lats). The volume concentration ratio of the payments made by the five largest banks in the EKS was 79.6%, while the payment value concentration ratio stood at 79.1% (78.1% and 77.4% in 2008 respectively).

At the end of 2009, 20 banks, two branches of foreign banks, the Treasury and the Bank of Latvia participated in the EKS euro settlement. In 2009, the EKS processed 6.9% of all customer credit transfers in euro (their share of value – 1.7%). The total volume of payments processed in the EKS in euro increased by 12.8% (to 252.5 thousand) while their total value dropped by 11.7% (to 1.3 billion lats). The payments made in the EKS in euro were processed in two clearing cycles. Of all payments executed via the EKS in euro, 63.6% and 59.3% were processed in the first clearing cycle in terms of volume and value respectively. In 2009, the average value per payment made via the EKS in euro declined by 21.7% (to 5 243 euro). The volume concentration ratio of the payments made by the five largest banks in the EKS in euro was 71.3% and the payment value concentration ratio amounted to 68.2% (76.8% and 73.3% in 2008 respectively).

The Bank of Latvia together with other central banks of the ESCB contributed to the development of TARGET2 and implementation of the system's new version. As of 23 November 2009, TARGET2-Latvija has ensured payment processing in line with the functionality of the new release. Meanwhile, legislation governing the operation of TARGET2-Latvija was amended.

At the end of 2009, 20 banks, two branches of foreign banks, the Treasury and the Bank of Latvia were direct participants in TARGET2-Latvija. In 2009, the total volume of payments processed in TARGET2-Latvija increased by 13.4% (to 169.9 thousand) and their total value rose 2.9 times (to 200.5 billion euro). TARGET2-Latvija processed both interbank and customer payments and their share of volume amounted to 25.6% and 74.4% respectively, while that of value was 97.1% and 2.9% respectively. The average value per payment executed via TARGET2-Latvija increased 2.5 times in 2009, reaching 1.2 million euro. The volume concentration ratio of the payments effected by the five largest banks in TARGET2-Latvija was 60.4% and the payment value concentration ratio stood at 92.1%.

PAYMENT SYSTEM OVERSIGHT

The Bank of Latvia continued to oversee the payment system of Latvia. A day-to-day oversight of the systemically important payment systems (the SAMS and the EKS) continued in compliance with "The Bank of Latvia's Payment System Policy", and the Bank of Latvia primarily analysed the SAMS and EKS business continuity and statistical data.

Pursuant to the risk-based assessment methodology developed by the ECB, in 2009 the Bank of Latvia commenced, within the oversight framework, an assessment of payment systems operating in Latvia. According to the above methodology, three steps have to be taken to perform the assessment. As a first step, payment systems are mutually comparable by assessing their significance and status of oversight with the aim of setting an oversight priority. To set an oversight priority with respect to a particular component of a payment system and its exposures, each payment system has to be assessed against the risk categories as a second step, taking into account the probability of a specific risk and its impact and the implemented risk mitigation measures. The third step in this process is the summarising of the above assessment and planning subsequent oversight of each payment system on its basis.

The first assignment of the assessment was performed by the Bank of Latvia in 2009, and the significance of a payment system was estimated by taking into account the system's visibility, turnover, critical number of participants, interoperability and potential impact on other systems' capability to effect settlements, its use in monetary policy operations and influence on the economy. The status of the oversight was determined, depending on the time period that had elapsed since the performance of the system's last oversight as well as following the required improvements and the type of an oversight assessment.

An oversight priority set for the payment systems within the Bank of Latvia's policy was supported by the risk-based assessment. The main attention regarding the oversight has to be focussed on the SAMS, including the performance of its day-to-day oversight. In the coming periods, an oversight of JSC *Itella Information*, an interbank direct debit payment system, has to be primarily conducted within the retail payment systems area.

From the payment system oversight perspective, the Bank of Latvia was consulted in 2009 by the Ministry of Finance on drafting the Law "On Payment Services" with the aim of incorporating into the Republic of Latvia laws the legislative provisions arising from Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.

Eighteen electronic money institutions that may commence their operation in line with the requirements of the Law "On Credit Institutions" without being granted a licence, had notified the Bank of Latvia by the end of 2009 on launching their operation. Five electronic money institutions commenced their operation and one electronic money institution suspended operation.

The Bank of Latvia compiled data on the payment instruments used. Customer credit transfers (114.3 million payments or 52.6%) and payments by payment cards (97.8 million payments or 45.0%) accounted for the majority of all payment instruments used in Latvia in 2009. The value of such payments amounted to 242.7 billion lats and 1.4 billion lats respectively. Other payment instruments (direct debit, cheques, e-money) were relatively seldom used.

The Bank of Latvia engaged in further activities of SEPA Project in 2009 by steering the National SEPA Working Group and participating in the SEPA Working Group of the Payment Committee established by the Association of Latvian Commercial Banks, and launching the SEPA Project at the Bank of Latvia.

The draft Version 1.0 of Latvia's National SEPA Plan developed by the National SEPA Working Group was approved by the Money and Payment Systems Working Group of the Republic of Latvia Euro Project at the meeting held on 14 December. Latvia's National SEPA Plan describes the roles of stakeholders in the SEPA Project and tasks to be performed as well as presents a timeframe for launching the SEPA payments on Latvia's payment market. In 2009, the National SEPA Working Group developed and launched the national SEPA Latvija website – currently the main source of information on the SEPA Project in Latvia.

The Board of the Bank of Latvia approved the Bank of Latvia's SEPA Plan on 23 July. The above Plan is aimed at describing the use of SEPA core products at the Bank of Latvia, thereby also offering SEPA credit transfers to the Bank of Latvia customers. According to the Plan, the Bank of Latvia conducted a self-assessment of its operations as the user and provider of those SEPA products which have to be provided as of 12 November 2010. The self-assessment confirms the Bank of Latvia's compliance with the SEPA requirements.

On 3 August, the Bank of Latvia sent the European Payments Council an application letter regarding an intention to develop the EKS into a clearing and settlement infrastructure compliant with the SEPA Credit Transfer Scheme. In mid 2009, the Bank of Latvia conducted a self-assessment of the EKS for the SEPA compliance in accordance with the ECB Terms of Reference for SEPA compliant infrastructures. To be transformed into a SEPA scheme compliant system, the EKS is currently under development and its self-assessment has been conducted, taking into account the EKS functionality which has to be ensured as of 12 November 2010. The self-assessment confirms compliance of the EKS with the SEPA requirements.

OVERSIGHT OF SECURITIES SETTLEMENT SYSTEMS

The Bank of Latvia continued to ensure smooth operation of the VNS in 2009. Outstanding securities recorded in the VNS amounted to 500.1 million lats at the end of 2009, of which, the Treasury bills were in the amount of 179.9 million lats, Treasury bonds stood at 308.5 million lats and private sector debt securities were 11.7 million lats.

Within the framework of the oversight of securities settlement systems, the Bank of Latvia took part in the Latvian National User Group of the Eurosystem's TARGET2-Securities Project and submitted proposals for drafting high level plan TARGET2-Securities Implementation in Latvia. The above plan has been developed in line with the provisions of TARGET2-Securities Memorandum of Understanding concluded between the Eurosystem and Central Depositories of Europe. The LCD signed the above Memorandum on 25 September.

The Bank of Latvia continued to participate in the working group of the ESCB and the Committee of European Securities Regulators (CESR) and contributed to drafting "Recommendations for the Securities Settlement Systems and central counterparties in the European Union". The final version of the above Recommendations was published on the ECB's website on 23 June. The Recommendations are binding on the overseers of securities settlement systems of central banks and securities market regulators of the EU Member States, who will apply them to the oversight of the EU securities settlement systems and central counterparties and assessment of the respective operations. The Bank of Latvia will apply the above Recommendations to the oversight of securities settlement systems.

FINANCIAL STABILITY

The Bank of Latvia continued to assess the financial system stability and its vulnerability, with a particular focus on the system risk analysis. In view of a predominant role of credit risk in the bank operational risk structure, considerable attention was paid to econometric modelling of credit risk allowing for a quantified description of impact exerted by various macroeconomic factors on the quality of bank loan portfolio. The results of modelling are used for projecting indicators describing the quality of a loan portfolio and macroeconomic stress testing. Markov's chain model was also developed to improve a short-term forecasting of credit risk. Aware of the particular importance of lending to the Latvian economic development, the Bank of Latvia continued to compile and began to publish on its website the results of bank lending survey, facilitating cooperation with the FCMC in the preliminary data exchange and stress testing at the same time.

Foreign funding and its sustainability for Latvia's financial sector during the economic downturn and also in the coming years is significant for assessing the potential of ensuring Latvia's financial stability and mitigating the threat of systemic risk. In September 2009, four major Scandinavian banks *(Bank DnB NORD A/S, Nordea Bank Finland Plc, Swedbank AB, Skandinaviska Enskilda Banken AB)* whose branches and subsidiaries operate in Latvia, undertook to ensure their liquidity and capital adequacy ratios in line with the effective regulatory requirements.

The Bank of Latvia, together with the FCMC and the Ministry of Finance, participated in drafting legislation governing the financial sector, and provided an assessment thereof. On the EU scale, the representatives of the Bank of Latvia took part in the EFC, the CEBS and the ESCB Banking Supervision Committee as well as working groups established by the above committees. The above institutions, dealing with financial stability issues, commenced assessment of inter-sectoral and cross-border risks and organised EU-wide stress tests. They also analysed impact of regulatory and supervisory measures of the new credit institutions and assessed potential pro-cyclical effects.

The global financial crisis necessitated the strengthening of macro-prudential monitoring and deeper and more comprehensive supervision of systemic risk, in particular regarding the inter-sectoral and cross-border links of financial systems. In 2009, seeking solution within the EU, the EC presented a set of draft legislation for introducing new institutional supervisory system in the EU. The above system will be based on two pillars (the European Systemic Risk Board and the European System of Financial Supervisors) ensuring a link between the macro-prudential monitoring and micro-prudential monitoring.

OPERATION OF THE CREDIT REGISTER

At the end of 2009, the Credit Register comprised 110 participants who authorised 750 users to work with the Credit Register.

As of 1 April 2009, the list of the Credit Register participants was expanded in accordance with the Bank of Latvia's Regulation No. 32 "Regulation for the Credit Register" of 12 March 2009, stipulating that the Credit Register participants were not only bank subsidiaries providing financial services associated with credit risks, but also all companies having close links with the bank and providing financial services associated with credit risks. The amount of data to be submitted to the Credit Register was expanded in the first half of 2009. Collection of data on the persons' individual liability periods was commenced; provisions for submitting data on the type of borrower's liabilities and collateral, and the amount of losses were supplemented and updated.

The Credit Register contained data on 921 thousand borrowers and 2.44 million liabilities, and the total loan portfolio of the Credit Register participants reached 16.46 billion lats at the end of 2009.

The Credit Register data were accessible to the participants of the Credit Register, the FCMC and the Bank of Latvia, borrowers and borrower guarantors (natural and legal persons regarding their liabilities).

The Credit Register participants submitted 3.23 million requests about persons in 2009, of which 3.11 million were requests about natural persons and 0.12 million requests about legal persons.

In 2009, 2 794 requests were submitted to the Bank of Latvia by natural and legal persons regarding the provision of data on their liabilities existing in the Credit Register. Reports on individual liabilities were provided at the Riga, Liepāja, Daugavpils and Rēzekne Branches of the Bank of Latvia.

INFORMATION TECHNOLOGIES

The enhancement of the Bank of Latvia's electronic document management system eDPS continued in 2009, expanding the functionality of electronic circulation of general correspondence and official documents, thus notably improving and accelerating the document flow. Electronic coordination of agreements was introduced, and the flow of procurement-related documentation was enhanced.

The server consolidation project launched in late 2008 has been successfully completed; thus, thanks to virtualisation technologies, the number of servers has been considerably cut down. Now the server capacity is utilised in a more efficient manner and the server infrastructure maintenance costs decreased, including those of software licences and power consumption.

Green computing project was implemented in 2009, allowing significant computer energy saving and moving on to a more environment-friendly and economical printing option. The number of computers was significantly reduced by avoiding, as far as possible, the use of a desktop and a portable computer by one and the same user. This allowed cutting on computer maintenance and licence costs.

The upgrading of computer network connections in the Bank of Latvia regional branches has been finalised. Now high-speed redundant connections are provided by two independent suppliers and, taken together, at a lower cost.

In 2009, the local backbone switches were upgraded, allowing high-speed redundant connections for servers and inter-site connections. Thus the operating speed and business continuity of critical and top-importance information systems has been improved.

A pilot project of single telecommunications solution has been implemented ensuring additional functionality, including a faster and more comprehensive communication and information flow that is indispensable for performing job obligations at the best quality in the present dynamic environment. At the same time, the local PBX has been modernised and become part of the single telecommunications solution, allowing reducing its maintenance costs. The project will be implemented step by step in the next two- or three-year period.

In 2009, the Bank of Latvia took part in the current round of a survey conducted by the Information Security Forum every two years to assess the compliance and security of the information systems environment of the Forum's members, and received a high appraisal.

INFORMATION TO THE PUBLIC

Economic experts and other interested parties may access the Bank of Latvia's macroeconomic analysis results both via mass media and directly on the Bank of Latvia website and in publications. Statistics on Latvia's balance of payments, external debt, banking sector, monetary operations, securities transactions and payment systems are posted on the Bank of Latvia website. The central bank, on a regular basis, issues publications providing comprehensive information on developments in the financial sector and the national economy. The Bank of Latvia Annual Report for 2008 discloses information on the central bank operations and financial results. Latvia's economic development was analysed in the context of global economic development. The Bank of Latvia's quarterly publications *Monetārais Apskats*. *Monetary Review* (starting with the third quarter of 2009, replaced by *Macroeconomic Developments Report*), *Latvijas Maksājumu Bilance*. *Latvia's Balance of Payments*, monthly publications *Monetary Bulletin* and *Latvia's Balance of Payments (Key Items)* as well as *Financial Stability Report* play an important role in information dissemination. To enable the central bank to take well-considered and responsible monetary policy decisions, the Bank of Latvia experts carried out in-depth research and initiated public debate on key topics (see Chapter "Economic Research, Analysis and Forecasting" and Appendix 9).

The Bank of Latvia macroeconomic research and financial market analysis that is necessary for understanding the situation and decision taking was made available to the public. Following each Bank of Latvia's Council meeting, the Governor of the Bank of Latvia briefed the representatives of mass media on recent macroeconomic developments. The Bank of Latvia economists commented on topical issues and developments in the national economy, and also released monetary and macroeconomic indicators. The Bank of Latvia experts published their working papers in scientific journals in economics, including the analytical periodical *Baltic Journal of Economics*.

The Bank of Latvia organised its annual conference on economic development entitled *Return to Sustainable Economic Growth and Stability in Latvia*, its objective being facilitating an understanding among experts in relevant sectors, and encouraging discussion on the analysis of economic development and growth. The discussions were on the topic of political and economic prerequisites for overcoming the financial crisis that has been aggravated by exaggerated real estate prices and consumer price hikes.

Experts' roundtables involving financial market participants, entrepreneurs and economists analysed and discussed the most important issues and opportunities of the national economy against the backdrop of the ongoing global financial crisis and recession. Experts' roundtable The *Role of the Euro in Global Financial Crisis* debated on the advantages of the single currency in a financial crisis. Experts' roundtable *Economic Aspects of the Lats Stability in the Context of Crisis* discoursed on the impact of foreign exchange policy on the national economy and individual social groups and looked at experience elsewhere in the world and proposed ways for building competitive power. Experts' roundtable *The Trust Factor in Financial Markets and Economy* analysed the effects of loss of confidence – both globally and domestically – on the financial sector and economy, and developed recommendations for recovering trust. Experts' roundtable *Deflation as a Factor for Restoring Competitiveness and Precondition for Future Growth* dealt with deflationary developments and made forecasts about price developments and Latvia's chance to restore its competitiveness.

Foreign exchange policy was among the topics discussed by Latvian and global economists in the context of competitive power and financial soundness of Latvian businesses. On the one hand, this discussion and reservations as to Latvia's ability to implement fiscal policy caused mistrust in the lats, as well as tensions and extra volatility in foreign exchange and financial markets. On the other hand, this discussion was necessary in order to prove to Latvia and the rest of the world that the policy pursued by the Bank of Latvia is reasonable and appropriate for Latvia's economic model, and this is true also for a crisis situation. The Bank of Latvia confirmed the persistence of its policy stance and provided an analysis and explanations to all stakeholders: economic policy decision makers, financial market participants in Latvia and abroad, academics, business people and the public. The Bank of Latvia's top management has offered elaborate comments on the situation to the factions and relevant commissions of the Saeima of the Republic of Latvia. The Bank of Latvia has been explaining the advantages of a fixed exchange rate to a small and open economy at various forums, including experts' roundtable. The central bank also pointed to short-lividness of the positive effects of devaluation, recommended by some economic experts, on exports as opposed to its adverse impact on household and public expenditure and the size of debt, consumer prices and financial stability. Governor of the Bank of Latvia met with financial market participants, investors and journalists in the countries that have an important role in the Latvian economy (Sweden, Finland, Germany), making explicit Latvia's economic situation, monetary and other economic policy decisions. According to public opinion polls, majority of the Latvian population are in favour of a stable foreign exchange policy.

The introduction of the euro has an important role in restoring macroeconomic stability and economic growth. This is why it is necessary to explain the procedure of the euro changeover to users and introduce them to the design of euro banknotes and coins and non-cash settlement. The Bank of Latvia described the significance of the euro changeover to the national economy and pointed to the need to attain, as soon as possible, compliance with the Maastricht criteria. All information was made available on the Bank of Latvia website, in mass media and at public discourse forums. Setting a target date for the euro changeover was recognised as an indispensable step both by business organisations and the government, and in early 2010 the Cabinet of Ministers of the Republic of Latvia in Latvia's National Euro Changeover Plan named the euro changeover date, 1 January 2014.

To raise public awareness of the economic benefits from changing over to the euro and of the EMU structure, and also to promote the design elements of the single currency, in spring 2009 the Bank of Latvia, in cooperation with the magazine "Mājas Viesis", organised a quiz "10 Years of the Euro". The Bank of Latvia also participated in an information campaign "The European Union Garden Party" that took place on 1 May 2009 and was organised by the Ministry of Foreign Affairs of the Republic of Latvia and other organisations. The Bank of Latvia answered the questions within its competence on the Ministry of Finance-owned euro changeover site eiro.lv.

Public opinion and sentiment are important factors for overcoming the economic crisis and achieving future growth, and they largely depend on the understanding of macroeconomic developments and decisions. This is why communicating the macroeconomic and financial developments to the general public and to specific target groups is a key communication area for the Bank of Latvia. In cooperation with the Bank of Latvia and using its staff expertise and explanations, the national TV channel in the framework of educational package produced a series of analytical TV shows *Naudas zīmes*; the Bank also contributed to the preparation of *Lata spogulī*, a sequence of radio broadcasts on financial topics addressing a vast audience. The Bank of Latvia staff delivered lectures on economic developments to the students of Rēzekne and Daugavpils higher educational institutions. The bulletin *Averss un Reverss* witnessed four issues in 2009; thereafter, at the end of the year, it was replaced with articles by the Bank of Latvia experts posted on the Bank of Latvia's website under the commentary section, thus delivering information to the users more promptly.

The Bank of Latvia educational facility Visitors Centre "Money World" contributed to improving public awareness concerning macroeconomic and monetary policy-making. In 2009, the number of visitors reached beyond 6 500 and included secondary school seniors, students and other interested individuals who were introduced to the basics of economics via a diverse and interactive exposition and had their questions on topical economic issues answered by visitor attendants.

In order to encourage the students from Latvian higher educational institutions to address the macroeconomic issues of the day, the Bank of Latvia organises a competition for students' research papers. In 2009, 22 students entered the contest and five were awarded, their research topics dealing with the impact of investment on productivity, fiscal consolidation, the convergence of interbank market, the effect of industrial clusters on exports, the use of the EU structural funds.

The Bank of Latvia furnishes the general public and industry professionals with information on cash and non-cash money. The users of cash – population and bank tellers and cashiers at retail shops in particular – should be well-informed on banknote security features in order to avoid counterfeit money. At the beginning of 2009, the Bank of Latvia disseminated information about the extra security features for the new 500-lats banknote, simultaneously reminding on the key security features of the other denomination banknotes. An updated and more user-friendly overview of the banknote security features has been made available on the Bank of Latvia website.

The Bank of Latvia is among the authorities responsible for the SEPA project implementation in Latvia, and a Bank's representative heads the National SEPA Working Group. Thus the Bank of Latvia is coordinating the SEPA project communication; the SEPA website was launched in 2009.

The Bank of Latvia organised the traditional public survey on the most popular collector coin design in 2008. The survey was supported by *100 g kultūras*, a sequence of TV shows on the national TV channel, and the public library network. The *Lucky Coin* (artists Arvīds Priedīte and Jānis Strupulis) won the title of *Latvia's Coin of the Year 2008* with 51.6% votes.

ORGANISATIONAL DEVELOPMENT

The composition of the Council of the Bank of Latvia, as at the end of 2009, was as follows:

– Governor	**Ilmārs Rimšēvičs**;
– Deputy Governor	**Andris Ruselis**;
– Members of the Council:	**Harijs Bušs**, **Leonīds Gricenko**, **Vita Pilsuma**, **Arvils Sautiņš**, **Aivars Skopiņš**, **Valentīna Zeile**.

The Board of the Bank of Latvia, as at the end of 2009, was as follows:

– Chairman of the Board	**Māris Kālis**;
– Deputy Chairman of the Board	**Reinis Jakovļevs**;

– Members of the Board: **Andris Ņikitins**,
Harijs Ozols,
Ilze Posuma,
Raivo Vanags.

At the end of 2009, the number of the Bank of Latvia's employees was 618, of which 17 were employees with a fixed term job contract (644 and 18 employees at the end of 2008 respectively); the Bank's staff was 57% male and 43% female.

To ensure exchange of information between the Bank of Latvia and the EU institutions, Counsellor of the Bank of Latvia at the Permanent Representation of Latvia to the EU continued his work in 2009.

Structural improvements continued at the Bank of Latvia in 2009. To optimise staff resources and improve the efficiency of processes, the Internal Audit Department and Cashier's and Money Operations Department underwent structural changes. The Operational Audit Division and Information System Audit Division, as well as Money Operations Division were closed.

To ensure the management of information security in accordance with the principles of best practice, a position of the Information Security Manager of the Bank of Latvia was opened.

In 2009, changes were introduced in operational organisation of the Bank of Latvia structural units providing support functions. The staff number has been reduced in the Communications Department, Technical Department, Security Department and Training and Recreation Centre.

PERSONNEL DEVELOPMENT

In 2009, the Bank of Latvia, while pursuing its key principles of personnel policy, hired well-qualified and professional staff members and established a long-term working relationship by offering a motivating work environment, possibilities for professional development, and, in return, expecting the employee to demonstrate a high quality performance, reach the set out goals, display initiative, creative approach and loyalty.

Similar to the previous years, for the purposes of personnel development the Bank of Latvia uses internal and external rotation and personnel training. Internal rotation allows the employees to enhance their professional knowledge, develop skills and build their careers within the Bank of Latvia. As a result of internal recruitment, in 2009 13 employees were promoted and 15 were appointed replacements for colleagues in longer-term absence. Three Bank of Latvia staff members were on short-term secondment with the ECB and complemented their knowledge in the area of financial stability, economics and terminology. One Bank of Latvia staff member had hands-on experience in a position with the IMF.

Sharing the responsibility about training and development between the employees and the Bank of Latvia is an important element of human resources policy. On the one hand, the Bank of Latvia provides resources and training programme. On the other hand, employees are expected to make every effort towards learning and development, and ensure that their expertise is on top level at all times. The Bank of Latvia staff training costs amounted to 1.9% of the total expenses on wages, salaries and other personnel costs (2.2% in 2008).

To continue with improving the Bank of Latvia staff academic and professional knowledge, the human resources development strategy focused mainly on enhancing and consolidating management skills, and continued with the long-term training programme for managers that was launched in 2007. The key topics of the training programme for managers were: increasing management effectiveness, enhancement of communication skills and development and motivation of subordinates. In 2009, the programme enrolled 16 managers with human resource management experience of over five years. An event "The Best Practice Day" was organised with an objective to strengthen the knowledge built during the training course and to discuss topical human resources management issues. The managers who had completed the training course in the previous years were invited to participate.

In order to identify the individual development needs for managers and employees, in 2009, as part of the Talent Management Project, competence interviews were conducted with all heads of structural units and employees from structural units performing core functions, whereas a 180-degree evaluation was done for employees from structural units with support functions.

"The Bank of Latvia Guidelines for Developing Competencies", a manual prepared by the Personnel Department for planning and implementing social competencies development, has been made available to all Bank of Latvia employees. It is envisaged that social competencies can be enhanced in a number of ways: by using the relevant training programmes, coaching and other practical methods, and emphasising managers' responsibility for developing employees' competencies. In late 2009, seminars were held on enhancing the competencies in the area of communication and information sharing as well as information compiling and analysis.

Seminars led by the Bank of Latvia staff are conducted with the aim to increase awareness about the functions performed by the Bank of Latvia. In 2009, the Monetary Policy Department, Market Operations Department, Payment Systems Department, Communications Department (Library) seminars were held, as well as a seminar on the collector coins issued by the Bank of Latvia. At the end of 2009, two special seminars were organised: by the Bank of Latvia monetary policy experts on topical macroeconomic issues and by public relations specialists on public relations matters.

The Bank of Latvia continued to use the premises of its Training and Recreation Centre as the venue for staff training in view of its high quality technical support. The Bank of Latvia hosted the second part of the ESCB seminar "Heading for Leadership" (the first part was run in Romania). The audience was the heads of structural units of the ECB and seven central banks of the EU Member States.

For the purpose of further enhancement of the management system and in order to be ready for the self-assessment of the Bank of Latvia management process, eight Bank of Latvia's managers acquired organisational self-assessment skills in accordance with Common Assessment Framework (CAF).

RISK AND QUALITY MANAGEMENT

In 2009, as part of risk management process and as a replacement for "The Security Policy of the Bank of Latvia", the Bank of Latvia's Council adopted "The Bank of Latvia Risk Management Policy", "The Bank of Latvia Business Continuity Policy", "The Bank of Latvia Information and Information Systems Security Policy" and "The Bank of Latvia Physical Security Policy". The Bank of Latvia's Security Supervision Commission carried out a comprehensive and uniform oversight of the policies.

The Bank of Latvia's financial risks are managed in line with the "Guidelines for Managing the Bank of Latvia's Foreign Reserves", which are reviewed by the Bank of Latvia's Council at least once a year and amended if necessary.

The risk analysis related to critical and top-importance Bank of Latvia's information systems was carried on according to the information systems risk management methodology approved in 2008. Risk analysis is also performed as part of any information system development or upgrading project.

The management of the Bank of Latvia's operational risks was coordinated by the Head of Risk Management of the Bank of Latvia, who, at least once a year, evaluates and summarises risk assessments of the Bank's organisational units with regard to all essential operations. Operational risk management was supervised by the Bank of Latvia's Operational Risk Management Committee appointed by the Board of the Bank of Latvia.

The Bank of Latvia's business continuity arrangements focused on fine-tuning the business continuity management system, considering the Bank of Latvia's needs and previous experience in business continuity management, the best practice, the ECB recommendations, as well as the implementation of uniform routines for incident registration and management.

In April 2009, the Board of the Bank of Latvia reviewed and approved the Bank's risk statement as well as reported to the Bank of Latvia's Council on the situation in the area of risk management. Personnel training was conducted in the field of information and information system security, business continuity and operational risk management.

A high-quality management system is needed in order to support the execution of tasks in the best quality. In 2009, the Bank of Latvia carried out a self-assessment of the management processes in compliance with CAF developed by the European Institute of Public Administration.

During the assessment, areas calling for improvement were identified and measures towards the enhancement of the management system were drafted. In the long-term, the application of CAF will allow exploring and evaluating the management system development trends and continuously improve the management processes.

INTERNAL AND EXTERNAL AUDIT

Through an unbiased examination of the Bank's functions and processes the internal audit provides the Bank of Latvia's management with an independent evaluation of the effectiveness of risk management, control systems and processes and gives recommendations for improvements. The internal audit of the Bank of Latvia is conducted by the Internal Audit Department. The Audit Committee of the Bank of Latvia supervises and facilitates improvements to internal audit.

The internal audit is organised and performed according to the "Internal Audit Policy of the Bank of Latvia" approved by the Bank of Latvia's Council. The internal audit is conducted according to the Institute of Internal Auditors' "International Standards for the Professional Practice of Internal Auditing" and "Code of Ethics", as well as the standards established by CobiT (Control Objectives for Information and Related Technology) and ISACA (Information System Audit and Control Association).

The internal audit addresses all operational areas of the Bank of Latvia. Internal audit engagements are planned and performed on the basis of risk assessment. The results of each internal audit engagement are reported to the Bank of Latvia's Governor and the Audit Committee. On a quarterly basis, the Bank of Latvia's Audit Committee and Head of Internal Audit Department review the internal audit findings, recommendations and their implementation. The results of internal audit are reported to the Bank of Latvia's Council once per year.

In 2008, an external assessment of the internal audit quality assurance programme recognised that the internal audit practice of the Bank of Latvia is partly compliant with the "International Standards for the Professional Practice of Internal Auditing" and fully compliant with the "Code of Ethics"; it is also compliant with the requirements of the ESCB Internal Auditors Committee Manual. Proceeding from these findings, an action plan has been prepared towards enhancement of the internal audit activities, and all measures of the plan have been implemented by the end of 2009.

The Internal Audit Department participated in the work of the Internal Auditors Committee (IAC) of the ESCB and conducted internal audits of the Bank of Latvia according to the annual plan.

In compliance with the Law "On the Bank of Latvia", the Bank of Latvia's business activities and financial statements for the reporting year are audited by an Audit Commission whose composition is approved by the State Audit Office of the Republic of Latvia.

ACCOUNTING AND BUDGET MANAGEMENT

The Bank of Latvia's accounting system has been established and managed in line with the "Financial Accounting Policy of the Bank of Latvia" approved by the Bank of Latvia's Council, "Bank of Latvia Financial Accounting Regulation" approved by the Board of the Bank of Latvia and other regulations of the Bank, in compliance with the Law "On the Bank of Latvia" and other laws and regulations binding on the Bank of Latvia. "Financial Accounting Policy of the Bank of Latvia" stipulates that events and financial transactions of the Bank of Latvia relating to the implementation of monetary policy and management of foreign reserves are accounted for in accordance with the principal accounting policies established by the ECB Guideline of 10 November 2006 on the legal framework for accounting and financial reporting in the ESCB (ECB/2006/16), at the same time taking into consideration that the Bank of Latvia is not yet a participant of the Eurosystem. In 2009, the Bank of Latvia's Council complemented the "Financial Accounting Policy of the Bank of Latvia" with requirements for Notes to annual financial statements.

The Bank of Latvia publishes a monthly balance sheet, annual financial statements and other financial information. This information is also available on the Bank of Latvia's website. The Bank's integrated information system ensures a standardised, automated, safe and efficient execution of the Bank of Latvia's financial transactions and uniform accounting for and financial reporting on them. The top management of the Bank of Latvia and specialists receive updated information about the Bank of Latvia's financial position, performance results and budget implementation on a daily basis. Within the framework of the internal financial control system, the Bank of Latvia's top management assesses, on a regular basis, changes in the Bank of Latvia's assets and liabilities as well as income and expenses, paying particular attention both to the results from managing foreign currency and gold reserves as well as to the consistency of operating costs and long-term investment with the Bank's approved budget.

The Council of the Bank of Latvia approves the Bank of Latvia's budget; the management of the budget is carried out in compliance with the "Regulation for Managing the Bank of Latvia's Budget" approved by the Council of the Bank of Latvia and aimed at ensuring spending efficiency. The Regulation provides for the procedure of drafting, approving and monitoring the execution of the Bank's budget. To support the independence of internal audit, the Bank of Latvia's Council approves a separate expenditure plan for the Internal Audit Department.

For the purposes of budget evaluation, the Bank of Latvia's Council has set up a Budget Commission, comprising six members of the Bank of Latvia's Council. The main tasks of the Bank of Latvia's Budget Commission are evaluation of the draft budget prepared by the Board of the Bank of Latvia and oversight of the budget execution. The key budget management tasks of the Bank of Latvia's Board are to prepare the draft budget in collaboration with the heads of relevant organisational units, and to submit it to the Bank of Latvia's Budget Commission and the Council as well as to report on budget execution on a regular basis.

COOPERATION WITH INTERNATIONAL ORGANISATIONS

The Bank of Latvia continued to represent Latvia's interests at the meetings of the IMF Board of Governors as well as participated in the coordination of routine issues.

Latvia's interests in the IMF were represented in the Nordic-Baltic Constituency that includes Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden. One Executive Director represented this constituency on the IMF Executive Board, with a total of 3.44% votes.

Representatives of the Bank of Latvia continued to participate in the work of the Nordic-Baltic Monetary and Financial Committee established for developing strategies and guidelines and preparing a joint opinion on operational issues of the IMF.

Cooperation with the IMF continued in 2009 under a 1.52 billion XDR Stand-By Arrangement towards the implementation of Latvia's economic stabilisation and recovery plan.

In 2009, Latvia continued its activities as a member of the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation and the EBRD. The Bank of Latvia continued its membership in the BIS.

COOPERATION WITH FOREIGN CENTRAL BANKS AND TECHNICAL ASSISTANCE

In 2009, the Bank of Latvia continued its cooperation with the central banks of other countries, sharing expertise and information.

In the first half of the year, a staff member of the Statistics Department, as part of the ECB and national central bank technical assistance programme, drafted a report on compiling balance of payments statistics in the National Bank of Serbia. Recommendations were developed for improving data preparation in order to attain compliance with the EU and ECB requirements for balance of payments statistics.

In October, the Bank of Latvia Visitors Centre "Money World" staff consulted experts from the National Bank of Georgia on establishing, structuring and running a visitors centre.

In November, staff members of the Market Operations Department shared their expertise with the *Magyar Nemzeti Bank* specialists on foreign reserves management and risk management issues.

The Bank of Latvia organised several international meetings. Nordic-Baltic Monetary and Financial Committee Group of Alternates meeting and Nordic-Baltic Monetary and Financial Committee meeting were held in Jūrmala, in April and September respectively. During the meetings, representatives of Nordic and Baltic central banks and ministries of finance discussed topical IMF issues and also the cooperation with other international financial institutions and other entities.

International financial institutions and foreign central banks extended support to the Bank of Latvia, providing opportunities to participate in the workshops and courses hosted by these institutions as well as to receive consultations on the issues related to the central bank operations.

The Bank of Latvia's employees participated in courses held by the ECB, the IMF Institute, the Joint Vienna Institute and the World Bank, and also in seminars organised by the central banks of Austria, the Czech Republic, France, Italy, Lithuania, the Netherlands, Poland, Switzerland and the UK, and the Federal Reserve Bank of New York. The Bank of Latvia staff members paid exchange-of-experience visits to the central banks of Belgium, Denmark, Poland and Slovakia, and obtained consultations on central banking matters.

FINANCIAL STATEMENTS OF THE BANK OF LATVIA FOR THE YEAR ENDED 31 DECEMBER 2009

BALANCE SHEET

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

ASSETS	Notes[1]	**2009**	2008
FOREIGN ASSETS		**3 384 585**	2 734 395
Gold	5	134 365	108 998
Special Drawing Rights	6	91 237	187
Convertible foreign currencies	7	3 150 992	2 488 693
Participating interest in the European Central Bank	8	750	743
Participating interest in the Bank for International Settlements	9	1 763	1 763
Other foreign assets	10	5 478	134 011
DOMESTIC ASSETS		**175 719**	679 200
Loans to credit institutions	11	140 449	639 263
Fixed assets	12, 13	33 232	34 626
Other domestic assets	14, 15	2 038	5 311
TOTAL ASSETS		**3 560 304**	3 413 595

[1] The accompanying notes set out on pages 74 to 110 are an integral part of these financial statements.

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

LIABILITIES, CAPITAL AND RESERVES	Notes	**2009**	2008
FOREIGN LIABILITIES		**71 469**	402 145
Convertible foreign currencies	16	19 006	131 252
International Monetary Fund	6	256	256
Other international institution deposits in lats	17	32 502	6 503
Foreign bank deposits in lats	18	499	247 001
Other foreign liabilities	19	19 206	17 133
LATS IN CIRCULATION	20	**788 155**	1 018 092
DOMESTIC LIABILITIES		**2 412 922**	1 751 384
Balances due to credit institutions	21	1 115 677	1 094 295
Balances due to the government	22	1 291 942	638 056
Balances due to other financial institutions		1 948	1 705
Other domestic liabilities	23, 24	3 355	17 328
CAPITAL AND RESERVES		**287 758**	241 974
Nominal capital	25	25 000	25 000
Reserve capital	25	114 236	95 533
Valuation account	25	74 129	68 004
Profit of the reporting year	25	74 393	53 437
TOTAL LIABILITIES, CAPITAL AND RESERVES		**3 560 304**	3 413 595
OFF-BALANCE SHEET ACCOUNTS	37		

The financial statements, which are set out on pages 68 to 110 were authorised by the Board of the Bank of Latvia on 16 March 2010.

BOARD OF THE BANK OF LATVIA

M. Kālis

R. Jakovļevs

A. Ņikitins

H. Ozols

I. Posuma

R. Vanags

PROFIT AND LOSS STATEMENT

(in thousands of lats)

	Notes	**2009**	2008
INTEREST INCOME			
Foreign operations	26	**59 245**	143 646
Interest on securities		51 702	96 553
Interest on deposits with foreign credit institutions and other foreign financial institutions		3 305	11 613
Interest on derivative financial instruments		4 238	35 480
Domestic operations	26	**26 925**	7 264
Interest on loans to credit institutions		24 696	6 723
Interest on derivative financial instruments		2 229	541
INTEREST EXPENSE			
Foreign operations	26	**1 662**	11 923
Interest on deposits		93	237
Interest on derivative financial instruments		1 569	11 686
Domestic operations	26	**18 515**	54 461
Interest on deposits of credit institutions		11 895	39 996
Interest on government deposits		6 592	14 366
Interest on deposits of other financial institutions		28	99
NET INTEREST INCOME	26	**65 993**	84 526

(cont.) (in thousands of lats)

	Notes	2009	2008
REALISED GAINS/LOSSES (–) FROM FINANCIAL OPERATIONS	27	**36 959**	34 886
Foreign operations		**22 521**	23 488
Securities		28 069	3 151
Derivative financial instruments		–5 548	20 337
Foreign currency exchange transactions		**14 438**	11 398
WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS	28	**5 474**	38 087
Foreign operations		**5 462**	37 349
Securities		5 462	30 941
Derivative financial instruments		–	6 408
Foreign currency position		**12**	738
INCOME FROM PARTICIPATING INTEREST	29	**221**	206
OTHER OPERATING INCOME	30	**4 683**	3 433
BANKNOTE PRODUCTION AND COINAGE COSTS	31	**4 695**	4 046
OTHER OPERATING EXPENSES		**23 294**	27 481
Remuneration	32	12 643	15 326
Social security costs	32	2 886	3 063
Depreciation and amortisation charges	12, 15	3 373	3 729
Maintenance and operation of information systems		1 510	1 574
Other operating expenses	33	2 882	3 789
PROFIT OF THE REPORTING YEAR		**74 393**	53 437

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

(in thousands of lats)

	Notes	**2009**	2008
REVALUATION	25	**27 907**	–833
Foreign currency and gold		18 812	733
Interest rate swap contracts		–	–3 145
Securities		9 095	1 579
REALISATION OF ACCUMULATED REVALUATION RESULT	25	**–27 256**	–3 763
Foreign currency and gold		–1 238	–831
Interest rate swap contracts		–3 263	364
Securities		–22 755	–3 296
WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS	25, 28	**5 474**	38 087
PROFIT OF THE REPORTING YEAR		**74 393**	53 437
TOTAL		**80 518**	86 928

CASH FLOW STATEMENT

(in thousands of lats)

	Notes	**2009**	2008
CASH FLOW FROM OPERATING ACTIVITIES			
Profit of the reporting year		**74 393**	53 437
Non-cash transaction adjustments	34 (1)	**8 850**	41 823
Net movements in balance sheet positions	34 (1)	**209 535**	372 221
Net cash and cash equivalents inflow from operating activities		**292 778**	467 481
CASH FLOW FROM INVESTING ACTIVITIES			
Increase of participating interest in the European Central Bank	8	**–7**	–
Dividends on shares of the Bank for International Settlements	29	**221**	206
Acquisition of fixed assets	12	**–1 692**	–5 291
Acquisition of intangible assets	15	**–50**	–55
Net cash and cash equivalents outflow from investing activities		**–1 528**	–5 140
CASH FLOW FROM FINANCING ACTIVITIES			
Profit appropriated to the state budget	25	**–34 734**	–15 439
Net cash and cash equivalents outflow from financing activities		**–34 734**	–15 439
NET CASH AND CASH EQUIVALENTS INFLOW		**256 516**	446 902
Cash and cash equivalents at the beginning of the year	34 (2)	**687 709**	240 807
Cash and cash equivalents at the end of the year	34 (2)	**944 225**	87 709

NOTES TO THE FINANCIAL STATEMENTS

1. PRINCIPAL ACTIVITIES

The Bank of Latvia is the central bank of Latvia. It was established on 31 July 1990 and operates under the Law of the Republic of Latvia "On the Bank of Latvia".

The primary goal of the Bank of Latvia is to maintain price stability in Latvia. Pursuant to the Law "On the Bank of Latvia", its primary tasks are as follows:
– establishment and implementation of monetary policy;
– management of foreign currency and gold reserves;
– issue of the national currency, both banknotes and coins;
– organisation and management of the interbank payment system and promotion of a smooth functioning of the payment system in Latvia;
– compiling and publishing financial statistics and Latvia's balance of payments;
– representation of Latvia in foreign central banks and international financial institutions;
– acting as a financial agent for the Latvian government.

The Bank of Latvia ensures the operation of the Credit Register as of 1 January 2008. The Bank of Latvia also issues licences to legal persons listed in the Republic of Latvia Register of Enterprises, except credit institutions, for the purchase and sale of foreign currency as a commercial activity, and controls compliance with the procedure it has established for effecting foreign currency purchase and sales transactions.

In the execution of its tasks and control in accordance with the Law "On the Bank of Latvia" and the Law "On Credit Institutions", the Bank of Latvia neither seeks nor takes instructions from the government or any other institution. The Bank of Latvia is independent in setting and implementing policy under its legal mandate. The Bank of Latvia is supervised by the Parliament (Saeima) of the Republic of Latvia.

The Bank of Latvia does not engage in any commercial activity, and its operation related to the execution of its tasks is mainly financed from income received from foreign currency and gold reserves (hereinafter, foreign reserves) management.

The Head Office of the Bank of Latvia is situated in Riga, K. Valdemāra Street 2A. The Bank of Latvia manages the storage, processing and circulation of cash through its Riga Branch and the regional branches in Daugavpils, Liepāja and Rēzekne.

2. RISK MANAGEMENT

The main risks associated with the Bank of Latvia's activities are financial and operational risks. Therefore, the Board of the Bank of Latvia has established a risk management framework under the principles and guidelines set forth by the Council of the Bank of Latvia, which is continuously improved in line with the developments in financial markets and the Bank of Latvia's operations. Management of the Bank of Latvia's financial and operational risk is reviewed by the Internal Audit Department and is monitored by the Security Supervision Commission and Audit Committee of the Bank of Latvia, each of which is comprised of members of the Council of the Bank of Latvia.

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

The Bank of Latvia manages financial risks related to foreign currency and gold reserves in accordance with the "Guidelines for Managing the Bank of Latvia's Foreign Reserves" (hereinafter, the Guidelines), as approved by the Council of the Bank of Latvia.

Managing of foreign reserves is conducted in compliance with the basic principles set out in the Guidelines, including preserving the value of foreign reserves, ensuring their liquidity and earning income within the framework of acceptable risk without contradicting to the Bank of Latvia's monetary policy objectives.

Foreign reserves are managed by classifying them into different investment portfolios. Portfolios of borrowed funds include foreign reserves which correspond to the Bank of Latvia's liabilities in foreign currencies to other institutions. Separate investment portfolios exist for gold reserves, foreign currency reserves managed by the Bank of Latvia, and foreign currency reserves managed by external foreign reserves managers.

Parameters for a benchmark portfolio reflecting the acceptable level of financial risks, return target as well as the target structure of investments are set out for each portfolio type in the Guidelines. For foreign reserves portfolios (except for the gold reserves portfolio, portfolios of borrowed funds, and asset-backed security portfolios) the benchmark portfolio is pledged to the weighted 1–3 year government securities index of the euro area countries, US and Japan and denominated in euro, eliminating the currency risk. On a business day basis, the Risk Management Division of the Market Operations Department monitors the compliance of foreign reserves with the requirements set out in the Guidelines.

For the purpose of financial risk management, the Investment Committee of the Bank of Latvia that develops the investment management strategy approves tactical decisions and sets detailed limits for financial risks. The Investment Committee of the Bank of Latvia reviews the investment strategy once a quarter, and on a weekly basis receives and reviews reports and forecasts for developments in financial markets, which are prepared by foreign reserves investment portfolio managers, and approves the investment management tactical decisions for the forthcoming week. Once every two months the Market Operations Department informs the Council and the Board of the Bank of Latvia about the results of management of foreign reserves.

MARKET RISK

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

The Bank of Latvia 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 foreign reserve management. The Bank of Latvia manages the interest rate risk by using a modified duration limit set individually for each investment portfolio.

Bank of Latvia's exposure to currency risk is determined by the structure of its foreign currency and gold reserves, which cannot be formed in compliance with the Bank of Latvia's liability parameters. The Bank of Latvia monitors the currency risk by determining open currency position limits. In accordance with the exchange rate policy of the Bank of Latvia for foreign reserves portfolios, except for portfolios of borrowed funds, the benchmark portfolio currency is the euro. For portfolios of borrowed funds, the benchmark currency structure is formed in compliance with the parameters of respective liabilities. Deviations from the benchmark currency structure give rise to the open currency position. Pursuant to the Guidelines, substantial deviation from the benchmark position is not permissible. In order to achieve the compliance of open foreign currency positions with the limits, the Bank of Latvia hedges the risk of fluctuations in gold reserves market value and foreign exchange rates by concluding forward exchange rate and currency future contracts.

Every business day, the Risk Management Division of the Market Operations Department monitors the compliance of the modified duration limits and open currency positions with the Guidelines and the related resolutions passed by the Investment Committee of the Bank of Latvia.

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

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

Exposure of the Bank of Latvia to market risk (as at the end of 2009 and 2008) is provided in Notes 39 and 40.

CREDIT RISK

Credit risk is exposure to losses resulting from counterparty default. The Bank of Latvia's exposure to credit risk results mainly from investments in foreign financial instruments, including short-term cash and gold deposits, and short-term lending to domestic credit institutions.

The Bank of Latvia manages exposure to credit risk related to investments made in foreign financial instruments, including short-term cash and gold deposits, by establishing limits on investments of different credit quality in the Guidelines. Credit quality is evaluated on the basis of ratings assigned by the international rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's. The Bank of Latvia is allowed to invest in securities of the OECD countries, whose long-term credit rating in foreign currencies is at least A–/A–/A3. Limits are set also on the maximum investment in financial instruments of the same class and counterparty, as well as in financial instruments of one issuer. In order to monitor the Bank's exposure to credit risk associated with its foreign operations, the Risk Management Division of the Market Operations Department is involved in monitoring of the Bank of Latvia's compliance with the Guidelines on a business day basis.

Short-term loans granted to domestic credit institutions are secured by collateral of Latvian government securities (hereinafter, government securities) and such private sector debt securities, according to the requirements established by the Council of the Bank of Latvia. The Market Operations Department reviews the compliance of ratings assigned to issuers of securities with the requirements of the Council of the Bank of Latvia and monitors the adequacy of collateral on a regular basis. Exposure of the Bank of Latvia to credit risk (as at the end of 2009 and 2008) is provided in Notes 42 to 44.

LIQUIDITY RISK

Liquidity risk is associated with a failure to meet liabilities timely. Bank of Latvia's exposure to liquidity risk arises mainly from the need to ensure foreign currency for conducting interventions and repaying deposits of the Latvian government and other institutions. The Bank of Latvia manages liquidity risk by investing foreign exchange reserves in liquid debt securities and other financial instruments issued by international institutions, foreign governments and the corporate sector, while investing its gold reserves in short-term deposits with foreign financial institutions. Investments are made so as to ensure timely meeting of the Bank of Latvia's liabilities. The structure of the Bank of Latvia's cash and its equivalents is provided in Note 34. The liquidity profile of the Bank of Latvia's assets and liabilities as at the end of 2009 and 2008 is provided in Note 41.

The Bank of Latvia 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.

OPERATIONAL RISKS

Operational risk is exposure to financial and non-financial losses resulting from an unexpected interruption of operation, unauthorised use of information or threats to the employees of the Bank of Latvia, its information, information systems and technical resources, or material values.

The basic principles of the Bank of Latvia's operational risk management are determined by the Council of the Bank of Latvia. The Bank of Latvia's operational risk management is implemented by the Board of the Bank of Latvia. In addition, the Board of the Bank of Latvia has established the Committee for Managing the Bank of Latvia's Operational Risks which coordinates, on a daily basis, the activities under the operational risk management process and provides support to the Board of the Bank of Latvia on operational risk management issues. The Committee is presided by a member of the Board of the Bank of Latvia and includes the Risk Management Officer, Operational Continuity Officer, Information Security Officer, Information Systems Security Officer, Data Privacy Officer, and the Head of Security Department.

In 2009, the Bank of Latvia amended "The Regulation for Managing Operational Risks of the Bank of Latvia", which covers identification, analysis and assessment of risks as well as planning, implementation, supervision, revision, and informing of risk mitigation activities. Risk management is conducted by the Bank of Latvia employees who are responsible for Bank of Latvia processes, department heads who are involved in the processes, project managers and other employees of the Bank of Latvia.

In order to minimise operational risks with respect to information systems, the Bank of Latvia has established the Committee for Managing Information Systems of the Bank of Latvia which assesses the information system governance on a regular basis. In order to ensure confidentiality of information, authorised access and integrity, information systems are classified under the internal control system. The Bank of Latvia has appointed the owners of information who are responsible for risk analysis, protection and determination of access rights and application procedures of relevant information systems. The Bank of Latvia conducts, on a regular basis, the analysis of information system security risks and improves security measures and tools.

In 2009, the Bank of Latvia amended "The Procedure for Managing the Continuity of the Bank of Latvia's Operation", which sets out the procedure for organising the operational continuity management at the Bank of Latvia, delegation of responsibilities in the area of operational continuity management and critical processes. "The Procedure for Managing Incidents and Emergency Situations at the Bank of Latvia" sets out the procedures for managing and reporting incidents and emergency situations and informing the employees of the Bank of Latvia in the event of an incident or emergency situation. In order to provide for a uniform reporting of incidents and emergency situations and to improve the collection and analysis of relevant information, the Bank of Latvia established a single register of incidents and emergency situations in 2009.

The Bank of Latvia conducts, on a regular basis, educational sessions for employees on information and information systems security, risk management and management of operational continuity.

Under the total operational risk minimisation system, the Bank of Latvia is insured against certain types of operational risks.

3. PRINCIPAL ACCOUNTING POLICIES

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

BASIS OF PRESENTATION

These financial statements have been prepared in accordance with the "Financial Accounting Policy of the Bank of Latvia" approved by the Bank of Latvia's Council, and the Law "On the Bank of Latvia".

The "Financial Accounting Policy of the Bank of Latvia" requires that events and financial transactions of the Bank of Latvia relating to the implementation of monetary policy and management of foreign reserves are accounted for in accordance with the principal accounting policies established by the ECB Guideline of 10 November 2006 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2006/16).

BASIS OF MEASUREMENT

These financial statements have been prepared in accordance with the historical cost basis of accounting except gold, debt securities and interest rate derivatives and currency futures contracts, which are accounted for at fair value. Forward exchange rate contracts and currency swap arrangements are valued according to the principles described in Note 3 under "Financial derivatives". The reconciliation of the book value and fair value of these instruments is provided in Note 37.

USE OF ESTIMATES

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 of the reporting period and each particular future period to which it refers.

FOREIGN CURRENCY TRANSLATION

Transactions denominated in foreign currencies are recorded in lats at the exchange rates quoted by the Bank of Latvia for the day of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into lats at the exchange rates set by the Bank of Latvia at the end of the reporting period. Non-monetary assets and liabilities, measured at cost or amortised cost, are translated into lats at the exchange rate for the respective foreign currency set by the Bank of Latvia on the day of the transaction. Taking into account the lats peg to the euro, the Bank of Latvia sets the exchange rates for other currencies on the basis of the exchange rate of euro against the US dollar and the exchange rates of the US dollar against other currencies as quoted in the information system Reuters.

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 currency positions are credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on financial instruments".

The principal exchange rates of foreign currencies and gold set by the Bank of Latvia and used in the preparation of the balance sheet for the year ended 31 December 2009 and the year ended 31 December 2008 are as follows:

(at the end of the year)

	2009	2008	Changes (%)
Euro (EUR)	**0.702804**	0.702804	0
US dollar (USD)	**0.489**	0.495	–1.2
Japanese yen (JPY)	**0.00533**	0.00547	–2.6
Gold (XAU)	**540.256**	438.259	23.27
Special Drawing Rights (XDR)	**0.766**	0.764	0.3

RECOGNITION AND DERECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

Financial assets and financial liabilities are recognised in the balance sheet when the Bank of Latvia becomes a contractual party in the respective financial transaction. A regular way purchase or sale of financial assets is recognised and derecognised on the settlement day.

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

FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

Fair value of financial instruments is determined by the Bank of Latvia using quoted prices in active market, 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. Note 7 discloses the determination of fair value of investments in securities.

Fair value of the Bank of Latvia's financial assets and financial liabilities does not differ materially from the reported book value of the respective assets and liabilities, if not specified otherwise in particular notes to the financial statements.

OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

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

GOLD

Gold reserves are recorded at market value in the balance sheet.

Any gain or loss arising from the revaluation of gold reserves is credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on financial instruments".

SECURITIES

Securities are stated at fair value in the balance sheet.

Interest on securities, including premium and discount, is recognised in the profit and loss statement as interest income. Gain or loss arising from transactions in securities and revaluation are credited or charged to the profit and loss statement or the balance sheet caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on financial instruments".

REVERSE REPURCHASE AGREEMENTS

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

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

REPURCHASE AGREEMENTS

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

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

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

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

PARTICIPATING INTEREST

Participating interest includes long-term investments of the Bank of Latvia in equity instruments. The Bank of Latvia 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 which do not have a quoted price in an active market and whose fair value cannot be reliably measured are reported in the balance sheet at cost. An increase or decrease in participating interest due to acquisition or sale of new equity instruments is recognised considering the historical cost basis.

DERIVATIVE FINANCIAL INSTRUMENTS

The Bank of Latvia 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 transaction day at the spot rate of the transaction and are recorded in the balance sheet in lats at the exchange rate of the respective currency set by the Bank of Latvia 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, are recognised in the profit and loss statement as interest income or interest expense. 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 upon 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 caption "Valuation account" in accordance with the principles referred to in Note 3 under "Recognition of profit or loss on financial instruments".

ACCRUED INTEREST INCOME AND EXPENSE

Accrued interest income on securities is included in the carrying amount of the respective interest bearing securities. Accrued interest income and expense on other financial instruments are reported under relevant balance sheet captions of other assets or other liabilities.

FIXED ASSETS

Fixed assets are tangible long-term investments with the useful life over one year. These assets are used in the provision of services as well as in the maintenance of other fixed assets and to ensure the Bank of Latvia's operation.

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.

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

(%)

	2009	2008
Buildings		
– structures	**1**	1
– outer finishing	**5**	5
– interior decorations	**5–20**	5–20
– engineering communications	**5**	5
– other components	**10–14**	10–20
Improvement of territory	**10**	10
Transport vehicles	**10**	10
Office furniture	**10**	10
Computer equipment	**20–33**	20–33
Other office equipment	**20**	20
Cash processing equipment	**10–20**	10–20
Tools	**50**	50
Other fixed assets	**7–20**	7–20

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

Pursuant to the Law "On Disposal of the State and Local Government Property", the Bank of Latvia disposes of fixed assets to the state and local government institutions without charge. Loss on disposal of fixed assets is determined on the basis of the carrying amount of the fixed assets as at the time of disposal and is reported under the profit and loss statement caption "Other operating expenses".

INTANGIBLE ASSETS

Intangible assets are long-term investments without physical substance with a useful life of over one year. 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 relevant assets using the straight-line method; however, this period may not exceed 10 years.

Costs related to software development by the Bank of Latvia are recognised in the profit and loss statement when incurred.

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 allowances for the relevant asset are made. Such allowances are recognised in the profit and loss statement with a respective reduction in the asset's carrying amount.

LATS IN CIRCULATION

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

GOLD CIRCULATION COINS

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

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

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 repurchase value. Proceeds from sales of collector coins are recognised in the profit and loss statement when incurred.

PROVISIONS

Provisions are recognised in the financial statements when the Bank of Latvia 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 the Bank of Latvia.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents recorded in the cash flow statement include convertible foreign currency in cash, demand deposits and deposits with an original maturity up to 5 business days made with foreign credit institutions, and other foreign financial institutions.

RECOGNITION OF GAINS OR LOSSES ON FINANCIAL INSTRUMENTS

Gains or losses on financial instruments are recognised in accordance with the following principles, established by the ECB Guideline of 10 November 2006 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2006/16):
(a) realised gains and losses shall be recorded in the profit and loss statement;
(b) unrealised gains shall be recognised in the balance sheet caption "Valuation account";
(c) unrealised losses recognised in the balance sheet caption "Valuation account" at

the end of the reporting year shall be transferred to the profit and loss statement if they exceed previous revaluation gain on the respective financial instrument, foreign currency or gold holding;
(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 holding in the subsequent years;
(e) there shall be no netting of unrealised losses in a financial instrument, foreign currency or gold holding against unrealised gains in other financial instrument, foreign currency or gold holding.

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

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 acquired securities, deposits, loans granted, forward exchange rate contracts, and currency and interest rate swap arrangements. Interest on acquired 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, domestic credit institutions and other financial institutions, as well as forward exchange rate contracts, and currency and interest rate swap arrangements.

REALISED GAINS OR LOSSES FROM FINANCIAL OPERATIONS
Realised gains or losses from investment in financial instruments are recognised in the profit and loss statement at the time of disposal of financial instrument or at the moment of settlement.

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

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

BANKNOTE PRODUCTION AND COINAGE COSTS
Banknote production and coinage costs, except gold circulation coin production costs, are charged to the profit and loss statement at the moment of acquisition.

OTHER EXPENSE AND INCOME
Bank's other operating expense and income is 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.

4. SUMMARY OF THE BANK OF LATVIA'S FINANCIAL POSITION AND FINANCIAL PERFORMANCE

FINANCIAL POSITION
In 2009, the Bank of Latvia assets grew by 146.7 million lats, on account of an increase in foreign assets.

Convertible foreign currencies posted a 662.3 million lats increase, mainly due to the loan to the Latvian government granted by the EC, IMF and other international lenders, which has been deposited on the Treasury accounts with the Bank of Latvia. A decreasing effect resulted from repaying funds to foreign financial institutions for the funding received under foreign exchange swaps and securities repurchase agreements in 2008 which also caused a 330.7 million lats decrease in liabilities reported under the Bank of Latvia balance sheet captions "Convertible foreign currencies" and "Foreign bank deposits in lats". In order to ensure stability of the exchange rate of the lats against the euro, in the first half of 2009, the Bank of Latvia sold part of its foreign currency reserves as a result of interventions in the foreign exchange market; in the second half of 2009, however, opposite interventions were made as the Bank of Latvia purchased euro mostly from the Treasury of the Republic of Latvia (in 2009, foreign currency sales amounted to 690.9 million lats). As a result of interventions in the foreign exchange market, the Bank of Latvia sold euro in exchange for lats in the net amount of 55.8 million lats in the reporting year.

The increase in foreign assets was also affected by the allocation of SDRs received from the IMF in the amount of 72.3 million lats, allocated to all IMF members, including Latvia, to provide liquidity to the global economy. IMF members were also assigned an additional allocation of SDRs (Latvia's share amounted to 20.5 million lats) with the aim of balancing the uneven distribution of SDRs as more than one fifth of member countries had not received any SDR allocations since they joined the IMF after 1981. Latvia received such allocation for the first time.

A fall of 128.5 million lats in other foreign assets was mostly on account of changes in the volume and valuation of non-traded financial derivative contracts concluded with foreign financial institutions.

With the situation in the Latvian financial system stabilising and due to excess liquidity of the lats, credit institutions' demand for the liquidity offered by the Bank of Latvia gradually moderated in 2009, and the caption "Loans to credit institutions" on the asset side of the balance sheet recorded a 498.8 million lats decrease.

With the demand for cash contracting, the amount of currency in circulation shrank in 2009. As a result, a decrease of 229.9 million lats was reported on the Bank of Latvia balance sheet caption "Lats in circulation".

The Bank of Latvia's capital and reserves increased by 45.8 million lats on account of profit earned in 2009 and change in valuation of financial instruments. The transfer of profit to the state budget in the amount of 34.7 million lats had a decreasing effect.

FINANCIAL PERFORMANCE

In 2009, the Bank of Latvia earned 74.4 million lats in profit. Although net interest income in 2009 decreased by 18.5 million lats year-on-year, the drop was offset by positive changes in other profit and loss statement items. With interest rates in the euro area and Japan falling, the market value of securities held by the Bank of Latvia increased. Hence, the Bank of Latvia's realised gains from securities disposal grew and write-downs on financial assets and positions decreased by 32.6 million lats in comparison with 2008. The investment decisions also had a positive impact on income, resulting in a considerably higher return on foreign reserves in comparison with that on the benchmark portfolio.

The fall in net interest income was mostly a consequence of a decrease in foreign reserves of the Bank of Latvia at the end of 2008 and in the first half of 2009, due to the sales of foreign currency by the Bank of Latvia as a result of interventions in the foreign exchange market, as well as the low levels of interest rates in the US and the euro area.

The narrowing spread between the euro and US dollar short-term interest rates also resulted in lower net interest income on financial derivatives, used by the Bank of Latvia mostly for hedging currency risk exposure.

In 2009, the Bank of Latvia's lending to credit institutions gradually moderated; nevertheless, the average outstanding balance of loans considerably exceeded those granted in 2008 and resulted in a 18.0 million lats rise in interest income.

As a result of lowering deposit interest rates and a decrease in the amount of the credit institution minimum reserve requirements held with the Bank of Latvia, the interest expense on credit institution deposits, including remuneration for holding the minimum reserves, fell by 28.1 million lats. Lower lats interest rates and smaller amount of funds in lats deposited by the Latvian government also accounted for a 7.8 million lats drop in interest expense on the government deposits.

In the first half of 2009, following a decrease in the foreign currency reserves as a result of interventions, the Bank of Latvia disposed of a part of securities it had purchased, realising the securities revaluation result of 22.8 million lats, accumulated on the valuation account earlier. The realised gains/losses from financial operations were negatively affected by the negative result on currency future contracts concluded for the purpose of hedging currency risk exposure, as the positive result on revaluation of the hedged balance sheet items has been reported in the balance sheet caption "Valuation account".

With the Bank of Latvia cutting its administrative expense in 2009, including remuneration of employees, the Bank of Latvia's other operating expense decreased by 4.2 million lats year-on-year. In 2010, following changes in the market, the Bank of Latvia implements further decrease in the remuneration expenses.

The uncertainty of the Bank of Latvia's financial performance in 2010 is mostly related to interest rate developments in the US and euro area financial markets since the Bank of Latvia is exposed to the interest rate risk. In view of the historically low levels of interest rates, a further interest rate fall is potentially negligible in comparison with a potential rise; thus, the expected pickup in interest rates in the foreign financial market may negatively affect the income on the fixed income securities.

5. GOLD

Movements in gold reserves in 2009 and 2008 were as follows:

	Troy ounces	In thousands of lats
As at 31 December 2007	248 701	99 130
During 2008		
Increase in gold market value	x	9 866
Net change resulting from gold depositing and deposit withdrawal	6	2
As at 31 December 2008	248 707	108 998
During 2009		
Increase in gold market value	x	25 367
As at 31 December 2009	**248 707**	**134 365**

The Bank of Latvia hedges the risk related to fluctuations in gold reserves market value by entering into forward exchange rate and currency future contracts (see also

Note 39). Revaluation of gold reserves and forward exchange rate contracts is recognised in the balance sheet caption "Valuation account", whereas revaluation of currency future contracts is recognised in the profit and loss statement caption "Realised gains/losses from financial operations".

6. INTERNATIONAL MONETARY FUND

Pursuant to the Law "On the Republic of Latvia Joining the International Monetary Fund" the Bank of Latvia serves as a depository for the IMF and services the IMF accounts in the member state currency without compensation. The IMF holdings in lats 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 is recorded as an asset denominated in SDR. Latvia's quota in the IMF is 126 800 thousand XDR.

Latvia's liabilities to the IMF are made up of the IMF holdings in lats and IMF allocations. On 28 August 2009, the IMF made general allocations to all IMF members in the amount of 74.13% in proportion to their existing quotas in the IMF, including 93 998 thousand XDR for Latvia, to boost liquidity of the global economy. A special allocation of 26 824 thousand XDR was made on 9 September 2009. The special allocation aims at making SDR allocations more equitable and correcting the fact that more than one fifth of all members that joined the IMF after 1981 had never received an SDR allocation. Latvia received such allocation for the first time.

At the end of 2009, the claims on the IMF in SDR as recorded on the Bank of Latvia's balance sheet were equivalent to 91 237 thousand lats (at the end of 2008 – 187 thousand lats), whereas the liabilities to the IMF are made up of funds at the disposal of the IMF in the amount of 256 thousand lats (at the end of 2008 – 256 thousand lats) held on its Accounts No. 1 and No. 2.

At the end of 2009 and 2008, Latvia's net claims and liabilities to the IMF were as follows:

	(in thousands of lats)		(in thousands of XDR)	
	2009	2008	**2009**	2008
Latvia's quota in the IMF	**97 129**	96 875	**126 800**	126 800
IMF holdings in lats	**–643 865**	–505 850	**–840 554**	–662 106
Promissory notes of the Latvian government	–643 609	–505 594	–840 220	–661 772
Account No. 1	–243	–242	–317	–317
Account No. 2	–13	–14	–17	–17
Stand-By Arrangement for Latvia	**546 765**	409 003	**713 792**	535 344
Reserve position in IMF	**42**	42	**55**	55
SDR	**91 237**	187	**119 108**	245
General allocation	**–72 002**	–	**–93 998**	–
Special allocation	**–20 547**	–	**–26 824**	–
Latvia's net claims/liabilities (–) to the IMF	**–1 270**	229	**–1 659**	300

The reserve position in the IMF is the difference between the total Latvian quota in the IMF and the IMF holdings in lats, excluding the balance on Account No. 2 and adding the amount of the IMF loan.

Claims on and liabilities to the IMF are expressed in lats at the SDR exchange rate set by the Bank of Latvia at the end of the year.

7. CONVERTIBLE FOREIGN CURRENCIES

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

The carrying amount of interest bearing debt securities includes accrued interest income (16 947 thousand lats at the end of 2009 and 28 568 thousand lats at the end of 2008).

At the end of 2009 and 2008, the balance sheet asset caption "Convertible foreign currencies" was comprised of the following assets:

(in thousands of lats)

	2009	2008
Debt securities of foreign governments, financial institutions and non-financial corporations	**2 012 260**	1 800 987
Demand deposits with foreign central banks, credit institutions and international institutions	**805 403**	661 741
Time deposits with foreign credit institutions and other foreign financial institutions	**313 986**	19 679
Foreign currency in cash	**19 343**	6 286
Total	**3 150 992**	2 488 693

The breakdown of fair value of Bank of Latvia's investments in debt securities of foreign governments, financial institutions and non-financial corporations is determined using the following hierarchy:
– quoted price. The price in this group of securities is determined using quoted prices for identical instruments in active markets;
– observable data. The price in this group of securities is determined using quoted prices for similar instruments in active markets, quoted prices for similar or identical instruments in inactive markets or using models where all significant inputs are observable;
– non-observable data. The price in this group of securities is determined using models where significant inputs are not observable.

At the end of 2009 and 2008, Bank of Latvia's investments in debt securities were generally valued on the basis of quoted prices for identical instruments in active markets. With financial market liquidity improving, the proportion of securities classified in this fair value assessment group increased in 2009. At the end of 2009 and 2008, the breakdown of Bank of Latvia's investments in debt securities of foreign governments, financial institutions and non-financial corporations according to the fair value hierarchy was as follows:

(in thousands of lats)

	2009	2008
Quoted price	**1 796 323**	1 414 545
Observable data	**215 937**	311 773
Non-observable data	–	74 669
Total	**2 012 260**	1 800 987

The average market prices on the last trading day of the reporting year are obtained from the electronic information systems Bloomberg and Interactive Data. Where the above price for a financial instrument is inaccessible or absent in the electronic information systems, the latest available market price or the price determined by applying the discounted cash flow approach is used for evaluating the financial instrument. Where the fair value of securities is based on the information provided by market participants, the securities are included in the assessment group of non-observable data.

8. PARTICIPATING INTEREST IN THE EUROPEAN CENTRAL BANK

With Latvia's accession to the EU, the Bank of Latvia became a subscriber of the capital of the ECB. In accordance with the Statute of the ESCB and the ECB, the share of the Bank of Latvia in the ECB's capital was calculated on the basis of the EU states' population and GDP data and is adjusted every five years or at shorter intervals depending on changes in the number of the EU Member States.

Until 1 January 2009, the share of the Bank of Latvia in the ECB's capital was 0.2813%, which corresponds to 16 205 thousand euro (11 389 thousand lats). On 1 January 2009, the ECB capital shares held by the national central banks were adjusted in compliance with the Statute of the ESCB and the ECB; as a result, the share of the Bank of Latvia in the ECB's capital increased to 0.2837%, which corresponds to 16 343 thousand euro (11 486 thousand lats). As Latvia does not participate in the euro area, pursuant to the transitional provisions of the Statute of the ESCB and the ECB, the Bank of Latvia has paid up a minimum 7% contribution of its total subscribed capital in the ECB amounting to 1 144 thousand euro or 750 thousand lats (743 thousand lats at the end of 2008; see also Note 38).

Participating interest in the ECB's capital has been reported at cost in the balance sheet of the Bank of Latvia. ECB's capital shares are not traded in the public securities market, and the share of the Bank of Latvia in the ECB's capital can be increased or decreased only in the cases referred to in this Note.

9. PARTICIPATING INTEREST IN THE BANK FOR INTERNATIONAL SETTLEMENTS

At the end of 2009 and 2008, the Bank of Latvia owned 1 070 shares in the BIS, which correspond to approximately 0.20% of the total subscribed and paid-up BIS capital.

The nominal value of the Bank of Latvia's shareholding in the BIS is 5 350 thousand XDR (the nominal value per share is 5 thousand XDR), paid up in the amount of 25% or 1 338 thousand XDR (see also Note 38). The deemed cost of this holding as at 31 December 2009 and 31 December 2008 is reported in the Bank of Latvia's balance sheet in the amount of 1 763 thousand lats (see also Note 29).

BIS shares are not traded in the public securities market. Pursuant to the Statutes of the BIS, only central banks can be shareholders in the BIS. The fair value of BIS shares, defined as 70% of the Bank of Latvia's share in the BIS net assets[1], differs from their book value and was 14 409 thousand lats at the end of 2009 (13 729 thousand lats at the end of 2008).

[1] The BIS applies this valuation method for calculating the price of its shares; the International Court at the Hague has recognised it as appropriate for the valuation of shares when repurchasing them from former private shareholders of the BIS.

10. OTHER FOREIGN ASSETS

At the end of 2009 and 2008, other foreign assets consisted of the following items:

(in thousands of lats)

	2009	2008
Non-traded financial derivative contracts with foreign financial institutions	**5 056**	133 551
Prepaid expense	**326**	392
Interest accrued on deposits	**17**	27
Other	**79**	41
Total	**5 478**	134 011

11. LOANS TO CREDIT INSTITUTIONS

At the end of 2009, loans to domestic credit institutions included short-term loans in the amount of 140 449 thousand lats (639 263 thousand lats at the end of 2008). With the tensions in the financial system moderating in 2009, credit institutions' liquidity increased; hence the amount of short-term loans granted by the Bank of Latvia decreased considerably at the end of 2009.

Loans granted to domestic credit institutions are secured by collateral of Latvian government securities and private sector debt securities with the fair value of 211 501 thousand lats at the end of 2009 (678 027 thousand lats at the end of 2008; see also the section "Credit risk" in Note 2).

12. FIXED ASSETS

The following changes in fixed assets took place in 2009 and 2008:

(in thousands of lats)

	Buildings improvement of territory, and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
As at 31 December 2007						
Cost	32 216	6 849	5 441	1 032	4 785	50 323
Accumulated depreciation	–5 568	–4 856	–2 616	–675	–3 962	–17 677
Net book value	26 648	1 993	2 825	357	823	32 646
During 2008						
Additions	3 833	361	254	279	564	5 291
Change in classification	2	–9	9	–1	–1	–
Disposals and write-offs	–	–405	–1 061	–23	–234	–1 723
Net change in cost	3 835	–53	–798	255	329	3 568
Depreciation charge	–1 945	–587	–379	–71	–322	–3 304
Change in classification	–1	2	–2	1	–	–
Accumulated depreciation on disposals and write-offs	–	400	1 061	23	232	1 716
Net change in accumulated depreciation	–1 946	–185	680	–47	–90	–1 588
As at 31 December 2008						
Cost	36 051	6 796	4 643	1 287	5 114	53 891
Accumulated depreciation	–7 514	–5 041	–1 936	–722	–4 052	–19 265
Net book value	28 537	1 755	2 707	565	1 062	34 626

(cont.) (in thousands of lats)

	Buildings improvement of territory, and land	Furniture and office equipment	Cash processing equipment	Transport vehicles	Other fixed assets	Total
During 2009						
Additions	1 107	241	15	128	201	1 692
Change in classification	–	9	–	–	–9	–
Disposals and write-offs	–1	–701	–29	–130	–123	–984
Net change in cost	1 106	–451	–14	–2	69	708
Depreciation charge	–1 806	–545	–387	–96	–249	–3 083
Change in classification	–	–12	–	–	12	–
Accumulated depreciation on disposals and write-offs	1	698	29	130	123	981
Net change in accumulated depreciation	–1 805	141	–358	34	–114	–2 102
As at 31 December 2009						
Cost	37 157	6 345	4 629	1 285	5 183	54 599
Accumulated depreciation	–9 319	–4 900	–2 294	–688	–4 166	–21 367
Net book value	**27 838**	**1 445**	**2 335**	**597**	**1 017**	**33 232**

At the end of 2009, the total cadastral value of land under the ownership and possession of the Bank of Latvia was 3 168 thousand lats (3 171 thousand lats at the end of 2008). Land is reported in the balance sheet of the Bank of Latvia at cost (1 669 thousand lats at the end of 2009 and 264 thousand lats at the end of 2008). Changes in the historical cost of land in 2009 are related to a change in the classification of the real estate components.

13. LEASING

The Bank of Latvia's assets subject to leases are buildings, land, and equipment. In the balance sheet they are reported as fixed assets. All lease agreements where the Bank of Latvia acts as a lessor are operating leases. Lease payments, except those that are directly transferred to the state budget, are recognised in the profit and loss statement proportionally over the term of the respective agreement. The depreciation of the leased assets is calculated on the basis of the depreciation policy described in Note 3 under "Fixed assets" and reported in the profit and loss statement as depreciation charges.

Carrying amount of leased assets at the end of 2009 and 2008 was as follows:

(in thousands of lats)

As at 31 December 2008	
Cost	2 504
Accumulated depreciation	–416
Net book value	2 088
As at 31 December 2009	
Cost	1 086
Accumulated depreciation	–381
Net book value	**705**

14. OTHER DOMESTIC ASSETS

At the end of 2009 and 2008, other domestic assets consisted of the following items:

(in thousands of lats)

	2009	2008
Accrued interest on loans to credit institutions	**763**	2 714
Intangible assets	**761**	1 001
Non-traded financial derivative and spot exchange rate contracts with domestic institutions	**147**	211
Tax claims	**–**	209
Prepaid expense	**160**	183
Other	**207**	993
Total	**2 038**	5 311

15. INTANGIBLE ASSETS

The following changes in intangible assets took place in 2009 and 2008:

(in thousands of lats)

As at 31 December 2007	
Cost	3 750
Accumulated amortisation	–2 379
Net book value	1 371
During 2008	
Additions	55
Derecognised assets	–85
Net change in cost	–30
Amortisation charge	–425
Accumulated amortisation on disposals	85
Net change in accumulated amortisation	–340
As at 31 December 2008	
Cost	3 720
Accumulated amortisation	–2 719
Net book value	1 001
During 2009	
Additions	50
Derecognised assets	–1
Net change in cost	49
Amortisation charge	–290
Accumulated amortisation on derecognised assets	1
Net change in accumulated amortisation	–289
As at 31 December 2009	
Cost	3 769
Accumulated amortisation	–3 008
Net book value	**761**

16. CONVERTIBLE FOREIGN CURRENCIES

Convertible foreign currency liabilities consist of funds on the EC account for settlements in euro. The EC account is used by the EC for the distribution of EU budgetary funds (see also Note 17).

At the end of 2009 and 2008, convertible foreign currency liabilities consisted of the following items:

(in thousands of lats)

	2009	2008
Repurchase agreements	–	123 953
EC demand deposits	**19 006**	6 230
Other liabilities	–	1 069
Total	**19 006**	131 252

17. OTHER INTERNATIONAL INSTITUTION DEPOSITS IN LATS

Deposits of other international institutions in lats consist of funds on the EC account for settlements in lats, which is used for effecting Latvian government payments to the EU budget (see also Note 16) and liabilities to other international institutions.

At the end of 2009 and 2008, the breakdown of deposits of other international institutions in lats was as follows:

(in thousands of lats)

	2009	2008
EC demand deposits	**32 252**	6 273
Other deposits	**250**	230
Total	**32 502**	6 503

18. FOREIGN BANK DEPOSITS IN LATS

Decrease in foreign bank deposits in lats resulted from repaying short term deposits of *Sveriges Riksbank* and *Danmarks Nationalbank* resulting from the exchange of the lats to the euro under foreign currency swaps in 2008.

19. OTHER FOREIGN LIABILITIES

At the end of 2009 and 2008, other foreign liabilities consisted of the following items:

(in thousands of lats)

	2009	2008
Non-traded financial derivative contracts and spot exchange rate contracts with foreign financial institutions	**18 826**	16 292
Accrued expense	**332**	304
Other	**48**	537
Total	**19 206**	17 133

20. LATS IN CIRCULATION

At the end of 2009 and 2008, the following units of lats (LVL) and santims (s) were in circulation:

Nominal	Amount (in thousands of lats)		Number (in thousands of units)		Percentage (%)	
	2009	2008	**2009**	2008	**2009**	2008
Banknotes						
LVL 500	**62 842**	110 872	**126**	222	**8.0**	10.9
LVL 100	**94 337**	145 212	**943**	1 452	**12.0**	14.3
LVL 50	**61 163**	73 889	**1 223**	1 478	**7.8**	7.3
LVL 20	**388 305**	485 292	**19 415**	24 265	**49.3**	47.7
LVL 10	**63 321**	73 773	**6 332**	7 377	**8.0**	7.2
LVL 5	**61 313**	70 781	**12 263**	14 156	**7.7**	6.9
Total banknotes	**731 281**	959 819	**x**	x	**92.8**	94.3
Coins						
LVL 100	**405**	405	**4**	4	**0.1**	0
LVL 10	**145**	145	**15**	15	**0**	0
LVL 2	**7 985**	8 673	**3 993**	4 337	**1.0**	0.9
LVL 1	**27 936**	28 345	**27 937**	28 345	**3.5**	2.8
50 s	**7 677**	7 744	**15 353**	15 489	**1.0**	0.8
20 s	**4 287**	4 376	**21 435**	21 881	**0.5**	0.4
10 s	**2 638**	2 723	**26 375**	27 224	**0.3**	0.3
5 s	**2 018**	2 082	**40 352**	41 638	**0.3**	0.2
2 s	**2 163**	2 166	**108 159**	108 294	**0.3**	0.2
1 s	**1 620**	1 614	**161 959**	161 425	**0.2**	0.1
Total coins	**56 874**	58 273	**x**	x	**7.2**	5.7
Total lats in circulation	**788 155**	1 018 092	**x**	x	**100.0**	100.0

At the end of 2009 and 2008, the total nominal value of gold circulation coins (fineness .999) issued, with the denomination of LVL 100, was 1 988 thousand lats. The respective coins in circulation are not included in the balance sheet caption "Lats in circulation", since their nominal value is directly supported by their content of gold.

As at the end of 2009, collector coins with the total nominal value of 1 480 thousand lats had been issued (1 449 thousand lats at the end of 2008). These coins are not included in the balance sheet caption "Lats in circulation".

21. BALANCES DUE TO CREDIT INSTITUTIONS

Balances due to credit institutions include balances on the settlement accounts of domestic credit institutions opened with the Bank of Latvia, as well as overnight deposits (deposit facility) received from the above financial institutions. The respective credit institutions place their funds with the Bank of Latvia in order to comply with its minimum reserve requirement, as well as to effect interbank and customer payments, the Bank of Latvia's monetary policy operations and other settlements.

At the end of 2009 and 2008, balances due to domestic credit institutions consisted of the following items:

(in thousands of lats)

	2009	2008
Current account balances in lats	**835 761**	1 069 279
Deposit facility	**260 020**	2 590
Current account balances in euro	**19 896**	22 426
Total	**1 115 677**	1 094 295

22. BALANCES DUE TO THE GOVERNMENT

Latvian government deposits consist of the Treasury of the Republic of Latvia demand deposits and time deposits in lats and foreign currencies received by the Bank of Latvia acting as the financial agent of the Latvian government. In 2009, a rise in the Latvian government deposits in foreign currency is mostly a result of inflows of funds received under the international loan agreements.

At the end of 2009 and 2008, the breakdown of Latvian government deposits was as follows:

(in thousands of lats)

	2009	2008
Time deposits in foreign currencies	**1 063 849**	–
Demand deposits in foreign currencies	**197 870**	467 188
Demand deposits in lats	**30 223**	–
Time deposits in lats	**–**	170 868
Total	**1 291 942**	638 056

23. OTHER DOMESTIC LIABILITIES

At the end of 2009 and 2008, other domestic liabilities consisted of the following items:

(in thousands of lats)

	2009	2008
Accrued expense and similar liabilities	**1 689**	3 148
Accrued interest expense	**252**	600
Tax liabilities	**18**	–
Money in transit	**–**	11 192
Non-traded currency swap arrangements with domestic credit institutions	**–**	403
Other	**1 396**	1 985
Total	**3 355**	17 328

24. TAX

In 2009 and 2008, the Bank of Latvia calculated and paid the following taxes:

(in thousands of lats)

	Personal income tax	Compulsory social security contributions (by employer)	Compulsory social security contributions (by employee)	Tax on real estate	Value added tax	Other taxes and duties	Total
Liabilities as at 31 December 2007	0	6	2	0	162	0	170
During 2008							
Calculated	3 015	3 063	1 065	88	309	1	7 541
Decrease in deferred liabilities	–	–230	–	–	–	–	–230
Recalculation of liabilities	–	–	–	–	–362	–	–362
Paid	–3 015	–2 839	–1 067	–88	–318	–1	–7 328
Claims as at 31 December 2008	0	0	0	0	–209	0	–209
During 2009							
Calculated	2 477	2 886	1 142	93	247	1	6 846
Increase in deferred liabilities	0	146	0	0	0	0	146
Paid	–2 477	–3 032	–1 142	–93	–20	–1	–6 765
Liabilities as at 31 December 2009	**0**	**0**	**0**	**0**	**18**	**0**	**18**

In addition to the tax payments indicated herein, the Bank of Latvia transfers 65% of the profit for the reporting year (30% in 2008), including the payment for the usage of state capital (34 734 thousand lats in 2009; 15 439 thousand lats in 2008; see also Notes 25 and 35) to the state budget. The Bank of Latvia is not subject to corporate income tax.

25. CAPITAL AND RESERVES

In 2009 and 2008, changes in the Bank of Latvia's capital and reserves were as follows:

(in thousands of lats)

	Nominal capital	Reserve capital	Valuation account	Profit of the reporting year	Capital and reserves
As at 31 December 2007	25 000	59 508	34 513	51 464	170 485
During 2008					
Revaluation, realisation, and write-downs	x	x	33 491	x	33 491
Profit appropriated to the state budget	x	x	x	–15 439	–15 439
Profit transferred to the reserve capital	x	36 025	x	–36 025	–
Profit of the reporting year	x	x	x	53 437	53 437
As at 31 December 2008	25 000	95 533	68 004	53 437	241 974
During 2009					
Revaluation, realisation, and write-downs	x	x	6 125	x	6 125
Profit appropriated to the state budget	x	x	x	–34 734	–34 734
Profit transferred to the reserve capital	x	18 703	x	–18 703	–
Profit of the reporting year	x	x	x	74 393	74 393
As at 31 December 2009	**25 000**	**114 236**	**74 129**	**74 393**	**287 758**

The capital of the Bank of Latvia is comprised of the nominal capital, reserve capital and the balance sheet item "Valuation account", as well as the undistributed profit. The Bank of Latvia does not take decisions affecting the formation of the nominal capital, reserve capital, and the profit distribution as they are provided for by the Law "On the Bank of Latvia". The balance sheet item "Valuation account" comprises the positive result on revaluation of the financial instruments. The accounting policies described in Note 3 stipulate 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 "Valuation account", thus facilitating the preservation of the capital under the impact of financial instrument price, interest rate and exchange rate fluctuations.

No external capital adequacy requirements have been stipulated for the Bank of Latvia capital; nevertheless, is should be adequate to promote credibility of the monetary policy implemented by the Bank of Latvia, and to ensure implementation of its operations and financial independence when performing the tasks set forth by the Law "On the Bank of Latvia". The Bank of Latvia does not hedge interest rate risk related to domestic financial assets where a conflict with the policy objectives pursued by it could arise. The implementation of the monetary policy as well as exposure to other financial and operational risks may adversely affect the Bank of Latvia income or cause losses to be covered from the capital of the Bank of Latvia.

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

The Law "On the Bank of Latvia" establishes that a part of the Bank of Latvia's 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 (15% in 2008) shall be transferred to the state budget. At the end of 2009 and 2008, the corporate income tax rate applicable to residents of Latvia was 15%. Therefore, 65% of the Bank of Latvia's profit of the reporting year shall be transferred to the state budget within 15 days following the approval of the annual report of 2009 by the Council of the Bank of Latvia. In 2010, the Bank of Latvia will transfer 48 355 thousand lats from its profit earned in 2009 to the state budget.

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

In 2009 and 2008, changes in the balance sheet caption "Valuation account" were as follows:

(in thousands of lats)

	2009	Write-downs	Revalua-tion	Reali-sation	2008	Write-downs	Revalua-tion	Reali-sation	2007
Initial valuation account	**24 283**	x	x	216	24 067	x	x	3 352	20 715
Deferred result on revaluation of foreign currencies and gold	24 018	x	x	–	24 018	x	x	–	24 018
Deferred result on revaluation of non-traded interest rate swap arrangements	–	x	x	–	–	x	x	545	–545
Deferred result on revaluation of securities	265	x	x	216	49	x	x	2 807	–2 758
Result on revaluation of foreign currencies and gold	**21 477**	12	18 812	–1 238	3 891	738	733	–831	3 251
Result on revaluation of non-traded interest rate swap arrangements	**–**	–	–	–3 263	3 263	6 408	–3 145	–181	181
Result on revaluation of securities	**28 369**	5 462	9 095	–22 971	36 783	30 941	1 579	–6 103	10 366
Total	**74 129**	5 474	27 907	–27 256	68 004	38 087	–833	–3 763	34 513

The initial valuation account was established by transferring thereto the result on revaluation prior to the change in the accounting policies on 1 January 2007. The change in the balance of the initial valuation account in 2009 is related to the recognition of the profit or loss or result on revaluation from disposal of the financial instruments of the Bank of Latvia in the reporting year in the amount of 216 thousand lats (3 352 thousand lats in 2008) outstanding at the end of 2006. At the end of 2009, balances of other items comprise the positive result on revaluation of the respective financial instruments, calculated from the beginning of 2007 (the negative result on revaluation at the end of year has been recognised in the caption "Write-downs on financial assets and positions" of the profit and loss statement; see also Note 3).

26. NET INTEREST INCOME

In 2009, the Bank of Latvia's net interest income amounted to 65 993 thousand lats (84 526 thousand lats in 2008). The income was mainly derived from investing foreign currency reserves and from loans to credit institutions. The fall in net interest income was mostly on account of a decrease in foreign currencies at the end of 2008 and in the first half of 2009 as the Bank of Latvia sold euro as a result of interventions in the foreign exchange market, with the low levels of interest rates in the US and the euro area also contributing to it.

Interest income from foreign operations shrank by 84 401 thousand lats in comparison with 2008, and interest expense contracted by 10 261 thousand lats year-on-year.

In 2009, interest income from domestic operations increased by 19 661 thousand lats due to a higher average outstanding balance of loans granted to domestic credit institutions in comparison with 2008.

Interest expense on domestic operations (18 515 thousand lats; 54 461 thousand lats in 2008) was largely comprised of interest on deposits of domestic credit institutions and the Latvian government. Interest expense on credit institution deposits decreased by 28 101 thousand lats as a result of lowering the deposit facility rate and a decrease in the amount of the credit institution minimum reserve requirements held with the Bank of Latvia. The Bank of Latvia received a smaller amount of Latvian government funds as deposits than in 2008; moreover, interest paid on these deposits also fell, therefore interest expense on government deposits decreased by 7 774 thousand lats in 2009.

27. REALISED GAINS/LOSSES FROM FINANCIAL OPERATIONS

Realised gains/losses from financial operations comprises the realised gains and losses on exchange rate contracts, gains and losses from the disposal of securities as well as realised gains and losses on financial derivatives.

The increase in profit on foreign exchange rate contracts mostly resulted from the interventions conducted in the foreign exchange market, selling foreign currency in the amount of 690 946 thousand lats. Realised gains/losses from financial operations were positively affected by the interest rate fall in the euro area and Japan as it increased profits gained from securities disposal. Disposing of a part of securities it had purchased, the Bank of Latvia also realised the positive securities revaluation result of 22.8 million lats, accumulated on the valuation account in previous reporting years. The realised gains/losses from financial operations were negatively affected by negative result on currency future contracts that had been concluded for the purpose of hedging currency risk exposure, as the positive revaluation result of the hedged balance sheet items has been reported in the balance sheet caption "Valuation account".

28. WRITE-DOWNS ON FINANCIAL ASSETS AND POSITIONS

The revaluation result of several securities and foreign currency positions at the end of 2009 was negative, and it has been recognised as write-downs on financial assets and positions in the profit and loss statement while the positive result on the revaluation of securities and foreign currency positions has been reported in the balance sheet caption "Valuation account" (see also Note 25).

29. INCOME FROM PARTICIPATING INTEREST

Income from participating interest in the amount of 211 thousand lats (206 thousand lats in 2008) comprises the dividends received from the participating interest in the BIS (see also Note 9).

30. OTHER OPERATING INCOME

Other operating income in 2009 and 2008 was as follows:

(in thousands of lats)

	2009	2008
Income from sale of collector coins	**525**	1 113
Income from payment and securities settlement services	**301**	317
Other	**3 857**	2 003
Total	**4 683**	3 433

31. BANKNOTE PRODUCTION AND COINAGE COSTS

The breakdown of banknote production and coinage costs in 2009 and 2008 was as follows:

(in thousands of lats)

	2009	2008
Banknote production	**3 322**	1 612
Coinage of circulation coins	**842**	1 612
Coinage of collector coins	**531**	822
Total	**4 695**	4 046

32. REMUNERATION AND SOCIAL SECURITY COSTS

Remuneration and social security costs in 2009 and 2008 were as follows:

(in thousands of lats)

	2009	2008
Remuneration		
Remuneration of members of the Council and the Board	**1 106**	1 470
Remuneration of other personnel	**11 537**	13 856
Total remuneration	**12 643**	15 326
Social security costs	**2 886**	3 063
Total remuneration and social security costs	**15 529**	18 389

Remuneration of those members of the Bank of Latvia's Board who are also Heads of Departments of the Bank of Latvia includes remuneration for performance of operational duties.

The number of employees in 2009 and 2008 was as follows:

	2009	2008
Number of employees at the end of the year		
Members of the Council and the Board	**14**	14
Other personnel	**604**	630
Total at the end of the year	**618**	644
Average number of employees per period	**634**	649

33. OTHER OPERATING EXPENSES

Other operating expenses in 2009 and 2008 were as follows:

(in thousands of lats)

	2009	2008
Municipal services	**565**	534
Maintenance of buildings, territory and equipment	**415**	475
Risk insurance	**291**	250
Personnel training	**240**	331
Business travel	**235**	288
Telecommunications services and system maintenance	**228**	265
Information and public relations	**222**	251
Acquisition of low value office supplies	**197**	215
Transport provision	**147**	172
Tax on real estate	**91**	86
Audit, advisory and legal services	**26**	47
Other	**225**	875
Total	**2 882**	3 789

The audit, advisory and legal services expenses also comprise the remuneration in the amount of 22 thousand lats paid to paid to Deloitte Audits Latvia SIA for the audit of 2009 financial statements (remuneration of 28 thousand lats to KPMG Baltics SIA for the audit of 2008 financial statements – in 2008).

34. CASH FLOW STATEMENT

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

(in thousands of lats)

	2009	2008
Profit before appropriation	**74 393**	53 437
Non-cash transaction adjustments		
Depreciation of fixed assets and amortisation of intangible assets	3 373	3 729
Losses on disposal of fixed assets	3	7
Write-downs on financial assets and positions	5 474	38 087
Net non-cash transaction adjustments	**8 850**	41 823
Change in balance sheet items		
Net increase in gold	–	–2
Net increase in Special Drawing Rights	–91 050	–103
Net increase (–)/decrease in foreign debt securities and other foreign investments	–300 030	511 732
Net increase (–)/decrease in loans to domestic credit institutions	498 814	–632 413
Net increase (–)/decrease in other assets	3 007	–3 376
Net increase/decrease (–) in foreign convertible currency liabilities	–112 246	125 922
Net increase/decrease (–) in foreign bank and other international institution deposits in lats	–220 503	247 420
Net decrease in lats in circulation	–229 937	–31 381
Net increase/decrease (–) in deposits of domestic credit institutions	21 382	–322 507
Net increase in Latvian government deposits	653 886	466 815
Net increase/decrease (–) in deposits of other financial institutions	243	–3 171
Net increase/decrease (–) in other liabilities	–14 031	13 285
Net change in balance sheet items	**209 535**	372 221
Net cash and cash equivalents inflow arising from operating activities	**292 778**	467 481

(2) Analysis of balances and movements in cash and cash equivalents

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

	2009	Change	2008	Change	2007
Convertible foreign currencies in cash	**19 343**	13 057	6 286	3 821	2 465
Demand deposits with foreign credit institutions and other foreign financial institutions	**805 403**	143 662	661 741	438 211	223 530
Time deposits with foreign credit institutions and other foreign financial institutions with original maturity up to 5 business days	**119 479**	99 797	19 682	4 870	14 812
Total cash and cash equivalents	**944 225**	256 516	687 709	446 902	240 807

35. TRANSACTIONS WITH THE LATVIAN GOVERNMENT

The Bank of Latvia is wholly owned by the Republic of Latvia and carries out transactions with the Treasury of the Republic of Latvia, acting as the financial agent of the Latvian government. Performing this function, the Bank of Latvia services the Treasury's accounts in lats and foreign currency, as well as conducts foreign exchange transactions. The Bank of Latvia conducts government securities transactions in the secondary securities market in order to implement monetary policy. In the above transactions, the Bank of Latvia is not subject to the decisions and orders of the government or its institutions, and is independent in making its own decisions.

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

At the end of 2009 and 2008, the breakdown of the Bank of Latvia claims on and liabilities to the Latvian government and the respective interest rates were as follows:

	Amount (in thousands of lats)		Interest rate (%)	
	2009	2008	**2009**	2008
Liabilities/claims (–)				
Time deposits in foreign currencies	**1 063 849**	–	**0.17–0.38**	–
Demand deposits in foreign currencies	**197 870**	467 188	**0.00–0.05**	0.01–2.10
Demand deposits in lats	**30 223**	–	**1.18**	–
Time deposits in lats	**–**	170 868	**–**	5.53
Spot exchange rate contracts	**–105**	–	**x**	x
Tax liabilities/claims (–)	**18**	–209	**x**	x
Accrued interest expense	**4**	52	**x**	x
Total net liabilities	**1 291 859**	637 899	**x**	x

In 2009 and 2008, the breakdown of the Bank of Latvia's income and expense related to the Latvian government, as well as the Bank of Latvia's profit appropriated to the state budget was as follows (see also Note 26):

(in thousands of lats)

	2009	2008
Expense and the Bank of Latvia's profit appropriated to the state budget		
Interest on government deposits	**6 592**	14 366
Taxes	**6 846**	7 541
Profit appropriated to the state budget	**34 734**	15 439
Total expense and the Bank of Latvia's profit appropriated to the state budget	**48 172**	37 346

36. PLEDGED ASSETS

Securities and other financial instruments with the market value of 14 905 thousand lats, as at the end of 2009 (180 840 thousand lats at the end of 2008), have been sold in repurchase agreements (repos) or pledged to provide collateral for interest rate future contract and other transactions. These financial instruments are included in the balance sheet asset caption "Convertible foreign currencies".

37. OFF-BALANCE SHEET ACCOUNTS

The Bank of Latvia enters into forward and spot exchange rate contracts, interest rate swap arrangements and interest rate and currency future contracts in order to manage interest rate and currency risk associated with the Bank of Latvia's foreign reserves. As part of its monetary policy, the Bank of Latvia also engages in currency swap arrangements. The Bank of Latvia enters into forward and spot exchange rate contracts with the Treasury of the Republic of Latvia in order to manage the currency risk associated with Latvian government funds.

At the end of 2009 and 2008, the Bank of Latvia's off-balance sheet account profile was as follows:

(in thousands of lats)

	Contract or notional amount		Book value			
			Assets		Liabilities	
	2009	2008	**2009**	2008	**2009**	2008
Non-traded financial derivative and spot exchange rate contracts with foreign financial institutions						
Forward exchange rate contracts and currency swap arrangements	**1 365 021**	1 421 228	**4 676**	127 451	**18 216**	6 227
Spot exchange rate contracts	**68 664**	46 736	**–**	–	**137**	914
Gold interest rate swap arrangements	**–**	28 049	**–**	27	**–**	72
Other interest rate swap arrangements	**–**	248 292	**–**	5 648	**–**	8 437
Total	**x**	x	**4 676**	133 126	**18 353**	15 650
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	**1 307 220**	1 329 814	**–668**	6 276	**1 971**	–2 909
Currency future contracts	**210 230**	–	**–1 241**	–	**6 745**	–
Total	**x**	x	**–1 909**	6 276	**8 716**	–2 909
Non-traded financial derivative and spot exchange rate contracts with domestic institutions						
Currency swap arrangements	**–**	60 403	**–**	211	**–**	403
Spot exchange rate contracts	**14 654**	–	**147**	–	**–**	–
Total	**x**	x	**147**	211	**–**	403
Other transactions						
Agreements concluded on a regular way placement and receipt of time deposits	**520 045**	9 839	**x**	x	**x**	x
Forward transactions in securities	**123 547**	203 461	**380**	655	**467**	464
Contracted commitments related to acquisition of fixed assets	**79**	136	**x**	x	**x**	x

As at the end of 2009 and 2008, the book value and the fair value of non-traded contracts concluded by the Bank of Latvia were not materially different. At the end of 2009 and 2008, the comparison of the book value of the off-balance sheet instruments and their net fair value was as follows:

(in thousands of lats)

	Net fair value		Net book value		Difference	
	2009	2008	**2009**	2008	**2009**	2008
Non-traded financial derivative contracts with foreign financial institutions and spot exchange rate contracts						
Forward exchange rate contracts and currency swap arrangements	**–13 552**	120 240	**–13 540**	121 224	**–12**	–984
Spot exchange rate contracts	**–137**	–914	**–137**	–914	**0**	0
Gold interest rate swap arrangements	**–**	–45	**–**	–45	**–**	0
Other interest rate swap arrangements	**–**	–2 789	**–**	–2 789	**–**	0
Total	**–13 689**	116 492	**–13 677**	117 476	**–12**	–984
Traded financial derivative contracts with foreign financial institutions						
Interest rate future contracts	**1 303**	3 367	**1 303**	3 367	**0**	0
Currency futures contracts	**5 504**	–	**5 504**	–	**0**	–
Total	**6 807**	3 367	**6 807**	3 367	**0**	0
Non-traded financial derivative contracts with domestic credit institutions						
Currency swap arrangements	**–**	–173	**–**	–192	**–**	19
Spot exchange rate contracts	**147**	–	**147**	–	**0**	–
Total	**147**	–173	**147**	–192	**0**	19

38. CONTINGENT LIABILITIES AND COMMITMENTS

In 2005, the liquidator of the bankrupt JSC *Banka Baltija* filed a claim against the Bank of Latvia on behalf of the creditors of JSC *Banka Baltija* in the Riga Regional Court for the recovery of losses the amount of which was increased to 238.3 million lats in February 2010 (the amount of claim was 185.6 million lats at the end of 2009). The claimant alleges that the Bank of Latvia, as the institution in charge of banking supervision at that time, is responsible for losses arising from the bankruptcy of JSC *Banka Baltija* in 1995. The Bank of Latvia is confident that the claim is without merits; therefore no provision is recognised in the financial statements. The final ruling on the case is expected no earlier than in 2010.

The Bank of Latvia has not paid up 93% of the Bank of Latvia's share in the ECB subscribed capital, which is payable following the decision of the General Council of the ECB. At the end of 2009, the Bank of Latvia's unpaid share in the ECB subscribed capital was 15 199 thousand euro (10 682 thousand lats; at the end of 2008 – 15 070 thousand euro or 10 592 thousand lats).

The Bank of Latvia's uncalled portion of the BIS shares is 75% of their nominal value. These shares are callable following the decision of the BIS Board. At the end of 2009, the uncalled portion of the BIS share holding was 4 013 thousand XDR (3 074 thousand lats; at the end of 2008 – 4 013 thousand XDR or 3 066 thousand lats).

At the end of 2009, the Bank of Latvia had issued collector coins in the nominal value of 1 480 thousand lats (1 449 thousand lats at the end of 2008) and gold circulation coins with a nominal value of 1 988 thousand lats (1 988 thousand lats at the end of 2008). These coins may be represented to the Bank of Latvia in exchange for lats at a nominal value. In the opinion of management, the probability that the Bank of Latvia will be required to repurchase these coins from their holders is considered low and no provisions have been made.

39. CURRENCY PROFILE

At the end of 2009 and 2008, the currency profile of the Bank of Latvia's assets, liabilities and off-balance sheet accounts was as follows:

(in thousands of lats)

	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
As at 31 December 2009								
Foreign assets								
Gold	–	–	–	–	–	134 365	–	134 365
Special Drawing Rights	–	91 237	–	–	–	–	–	91 237
Convertible foreign currencies	–	–	930 978	2 056 297	160 841	–	2 876	3 150 992
Participating interest in the European Central Bank	–	–	–	750[1]	–	–	–	750
Participating interest in the Bank for International Settlements	–	1 763[1]	–	–	–	–	–	1 763
Other foreign assets	4 699	–	625	97	22	–	35	5 478
Domestic assets								
Loans to credit institutions	140 449	–	–	–	–	–	–	140 449
Fixed assets	33 232	–	–	–	–	–	–	33 232
Other domestic assets	2 007	–	–	31	–	–	–	2 038
TOTAL ASSETS	**180 387**	**93 000**	**931 603**	**2 057 175**	**160 863**	**134 365**	**2 911**	**3 560 304**
Foreign liabilities								
Convertible foreign currencies	–	–	–	19 006	–	–	–	19 006
International Monetary Fund	256[2]	–	–	–	–	–	–	256
Other international institution deposits in lats	32 502	–	–	–	–	–	–	32 502
Foreign bank deposits in lats	499	–	–	–	–	–	–	499
Other foreign liabilities	18 342	–	637	100	–	–	127	19 206
Lats in circulation	788 155	–	–	–	–	–	–	788 155
Domestic liabilities								
Balances due to credit institutions	1 095 781	–	–	19 896	–	–	–	1 115 677
Balances due to the government	30 223	91 237	91 955	1 078 270	71	–	186	1 291 942
Balances due to other financial institutions	1 948	–	–	–	–	–	–	1 948
Other domestic liabilities	2 202	–	264	889	–	–	–	3 355
TOTAL LIABILITIES	**1 969 908**	**91 237**	**92 856**	**1 118 161**	**71**	**–**	**313**	**3 272 546**

[1] The respective assets are recorded in the balance sheet at cost and the Bank of Latvia is not exposed to currency risk related to these assets.
[2] The Bank of Latvia is exposed to the SDR currency risk related to IMF holdings in lats based on changes in the underlying SDR balances determined in accordance with the exchange rate set by the IMF.

(cont.) (in thousands of lats)

	LVL	XDR	USD	EUR	JPY	Gold	Other	Total
Net position on balance sheet	–1 789 521	1 763	838 747	939 014	160 792	134 365	2 598	287 758
Net position on financial instruments' off-balance sheet accounts	–6 178	–	–839 079	1 126 027	–160 143	–134 524	–170	–14 067
Net position on balance sheet and off-balance sheet accounts	–1 795 699	1 763	–332	2 065 041	649	–159	2 428	273 691
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	–256[1]	–332	2 064 291	649	–159	2 428	2 066 621
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	–0.01	–0.02	99.89	0.03	–0.01	0.12	100.00
Benchmark currency structure (%)	x	0	0	100.00	0	0	0	100.00
As at 31 December 2008								
TOTAL ASSETS	604 983	1 950	786 183	1 746 699	160 525	109 026	4 229	3 413 595
TOTAL LIABILITIES	2 545 261	187	10 962	615 125	9	41	36	3 171 621
Net position on balance sheet	–1 940 278	1 763	775 221	1 131 574	160 516	108 985	4 193	241 974
Net position on financial instruments' off-balance sheet accounts	266 672	–	–776 975	900 383	–158 494	–111 872	–2 430	117 284
Net position on balance sheet and off-balance sheet accounts	–1 673 606	1 763	–1 754	2 031 957	2 022	–2 887	1 763	359 258
Net position on balance sheet and off-balance sheet accounts exposed to currency risk	x	–256	–1 754	2 031 214	2 022	–2 887	1 763	2 030 102
Foreign currency profile of the net position on balance sheet and off-balance sheet accounts exposed to currency risk (%)	x	–0.01	–0.09	100.05	0.10	–0.14	0.09	100.00
Benchmark currency structure (%)	x	0	0	100.00	0	0	0	100.00

40. REPRICING MATURITY AND TRACKING ERROR

The table below reflects the sensitivity of the Bank of Latvia'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 items reported in this table.

[1] Net XDR position on balance sheet and off-balance sheet accounts exposed to currency risk comprises liabilities to the IMF (256 thousand lats) and does not include participating interest in the BIS (1 763 thousand lats).

(in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years		
As at 31 December 2009							
Foreign assets							
Gold	–	–	–	–	–	134 365	134 365
Special Drawing Rights	91 237	–	–	–	–	–	91 237
Convertible foreign currencies	1 820 244	55 039	98 054	677 366	477 515	22 774	3 150 992
Participating interest in the European Central Bank	–	–	–	–	–	750	750
Participating interest in the Bank for International Settlements	–	–	–	–	–	1 763	1 763
Other foreign assets	17	–	–	–	–	5 461	5 478
Domestic assets							
Loans to credit institutions	140 449	–	–	–	–	–	140 449
Fixed assets	–	–	–	–	–	33 232	33 232
Other domestic assets	763	–	–	–	–	1 275	2 038
TOTAL ASSETS	**2 052 710**	**55 039**	**98 054**	**677 366**	**477 515**	**199 620**	**3 560 304**
Foreign liabilities							
Convertible foreign currencies	–	–	–	–	–	19 006	19 006
International Monetary Fund	–	–	–	–	–	256	256
Other international institution deposits in lats	–	–	–	–	–	32 502	32 502
Foreign bank deposits in lats	–	–	–	–	–	499	499
Other foreign liabilities	–	–	–	–	–	19 206	19 206
Lats in circulation	–	–	–	–	–	788 155	788 155
Domestic liabilities							
Balances due to credit institutions	1 092 267	–	–	–	–	23 410	1 115 677
Balances due to the government	1 291 661	–	–	–	–	281	1 291 942
Balances due to other financial institutions	1 225	–	–	–	–	723	1 948
Other domestic liabilities	252	–	–	–	–	3 103	3 355
TOTAL LIABILITIES	**2 385 405**	**–**	**–**	**–**	**–**	**887 141**	**3 272 546**

(cont.) (in thousands of lats)

	Interest bearing					Non-interest bearing	Total
	Up to 3 months	3–6 months	6–12 months	1–3 years	Over 3 years		
Net position on balance sheet	–332 695	55 039	98 054	677 366	477 515	x	x
Assets on financial instruments' off-balance sheet accounts	1 991 053	54 933	72 372	840 742	116 861	x	x
Liabilities on financial instruments' off-balance sheet accounts	2 503 204	175 715	58 845	178 583	173 144	x	x
Net position on balance sheet and off-balance sheet accounts	–844 846	–65 743	111 581	1 339 525	421 232	x	x
As at 31 December 2008							
TOTAL ASSETS	1 546 308	81 187	122 809	864 863	508 813	289 615	3 413 595
TOTAL LIABILITIES	1 837 809	–	–	–	–	1 333 812	3 171 621
Net position on balance sheet	–291 501	81 187	122 809	864 863	508 813	x	x
Assets on financial instruments' off-balance sheet accounts	1 868 363	2 559	–	1 383 681	5 174	x	x
Liabilities on financial instruments' off-balance sheet accounts	2 941 077	–	11 069	4 094	186 253	x	x
Net position on balance sheet and off-balance sheet accounts	–1 364 215	83 746	111 740	2 244 450	327 734	x	x

The exposure of foreign reserves portfolios to credit risk and aggregated market risk (except for the gold reserves portfolio, portfolios of borrowed funds, and asset-backed security portfolios) is characterised by the tracking error, which is measured as the annualised standard deviation of the difference in return between the investment portfolio and a respective benchmark portfolio. For foreign reserves portfolios (except for the gold reserves portfolio, portfolios of borrowed funds, and asset-backed security portfolios) the benchmark portfolio is pledged to the weighted 1–3 year government securities index of the euro area countries, US and Japan in euro, eliminating the currency risk.

In 2009 and 2008, the actual *(ex-post)* tracking error of the foreign currency reserves portfolio managed by the Bank of Latvia was 55 basis points and 102 basis points respectively, whereas the tracking error of the foreign currency reserves portfolio managed by external asset managers was 62 basis points and 177 basis points respectively. The expected *(ex-ante)* tracking error lay within the following basis point intervals during the year:

Tracking error (in basis points)	Number of business days	
	2009	2008
10–39	–	67
40–69	**181**	149
70–99	**66**	31
100–129	**1**	–
Total	**248**	247

41. LIQUIDITY PROFILE

At the end of 2009 and 2008, the liquidity profile of the Bank of Latvia's assets and liabilities was as follows:

(in thousands of lats)

	2009			2008		
	Up to 3 months	No fixed maturity	**Total**	Up to 3 months	No fixed maturity	Total
Assets						
Foreign assets	3 381 667	2 918	**3 384 585**	2 731 466	2 929	2 734 395
Domestic assets	141 511	34 208	**175 719**	643 135	36 065	679 200
TOTAL ASSETS	3 523 178	37 126	**3 560 304**	3 374 601	38 994	3 413 595
Liabilities						
Foreign liabilities	71 437	32	**71 469**	402 112	33	402 145
Lats in circulation	–	788 155	**788 155**	–	1 018 092	1 018 092
Domestic liabilities	2 412 922	–	**2 412 922**	1 750 741	643	1 751 384
TOTAL LIABILITIES	2 484 359	788 187	**3 272 546**	2 152 853	1 018 768	3 171 621
Net position on balance sheet	1 038 819	–751 061	**x**	1 221 748	–979 774	x

42. SECTORAL PROFILE OF ASSETS

The sectoral profile of the Bank of Latvia's assets at the end of 2009 and 2008 was as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2009	2008	**2009**	2008
Claims				
Foreign central governments and other governmental institutions	**1 327 922**	1 148 514	**37.3**	33.6
Foreign local governments	**86 146**	79 057	**2.4**	2.3
Foreign central banks and credit institutions	**1 480 509**	1 149 663	**41.6**	33.7
Other foreign financial institutions	**376 264**	365 159	**10.6**	10.7
Foreign non-financial corporations	**12 427**	9 967	**0.3**	0.3
International institutions	**141 194**	42 674	**4.0**	1.3
Latvian central government	**101 110**	589 843	**2.8**	17.3
Domestic credit institutions	**47**	836	**0**	0
Unclassified assets	**34 685**	27 882	**1.0**	0.8
Total	**3 560 304**	3 413 595	**100.0**	100.0

For the purposes of credit risk analysis, loans issued to domestic credit institutions and secured by pledged securities are classified herein according to the issuer of the security.

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

At the end of 2009 and 2008, the Bank of Latvia's foreign assets broken down by their location or the counterparty's domicile were as follows:

	Amount (in thousands of lats)		Percentage (%)	
	2009	2008	**2009**	2008
Euro area	**2 003 361**	1 415 730	**59.2**	51.8
Other EU countries	**324 963**	378 361	**9.6**	13.8
US	**588 869**	579 994	**17.4**	21.2
Japan	**160 300**	175 362	**4.7**	6.4
Other countries	**165 898**	142 274	**4.9**	5.2
International institutions	**141 194**	42 674	**4.2**	1.6
Total	**3 384 585**	2 734 395	**100.0**	100.0

44. ASSETS BY CREDIT RATINGS ASSIGNED TO THE COUNTERPARTY

At the end of 2009 and 2008, the Bank of Latvia's assets broken down by categories of credit ratings assigned to the counterparty were as follows:

	Credit rating	Amount (in thousands of lats)		Percentage (%)	
		2009	2008	**2009**	2008
FOREIGN ASSETS					
Gold	AAA	**134 365**	108 998	**3.8**	3.2
Special Drawing Rights	AAA	**91 237**	187	**2.6**	0
Foreign debt securities	AAA	**1 597 094**	1 310 234	**44.9**	38.4
	AA+	**97 909**	123 443	**2.8**	3.6
	AA	**37 236**	19 019	**1.0**	0.6
	AA–	**183 745**	199 854	**5.2**	5.9
	A+	**65 680**	64 241	**1.8**	1.9
	A	**3 565**	62 777	**0.1**	1.8
	A–	**2 389**	1 366	**0.1**	0
	BBB+	**23 966**	–	**0.7**	–
	BBB	**445**	12 766	**0**	0.4
	BBB–	**231**	–	**0**	–
	BB	**–**	7 287	**–**	0.2
Deposits with foreign financial institutions	AAA	**758 524**	589 371	**21.3**	17.3
	AA+	**487**	1 353	**0**	0
	AA	**93 001**	14 122	**2.6**	0.4
	AA–	**15 805**	46 945	**0.4**	1.4
	A+	**177 692**	–	**5.0**	–
	A	**56 310**	29 629	**1.6**	0.9
	A–	**17 570**	–	**0.52**	–

(cont.)

	Credit rating	Amount (in thousands of lats)		Percentage (%)	
		2009	2008	**2009**	2008
Foreign currency in cash	AAA	**19 343**	6 286	**0.5**	0.2
Participating interest in the European Central Bank	AAA	**750**	743	**0**	0
Participating interest in the Bank for International Settlements	AAA	**1 763**	1 763	**0.1**	0.1
Derivative financial instruments	AAA	**1 084**	11 139	**0**	0.3
	AA	**316**	9 395	**0**	0.3
	AA–	**19**	57 112	**0**	1.6
	A+	**1 567**	31 698	**0.1**	0.9
	A	**1 521**	20 732	**0**	0.6
	A–	**549**	3 475	**0**	0.1
Accrued interest income	Different	**17**	27	**0**	0
Other foreign assets	Different	**405**	433	**0**	0
DOMESTIC ASSETS					
Loans to credit institutions	Different	**140 449**	639 263	**3.9**	18.7
Other	Different	**35 270**	39 937	**1.0**	1.2
TOTAL		**3 560 304**	3 413 595	**100.0**	100.0

At the end of 2009 and 2008, the Bank of Latvia's foreign assets broken down by major categories of credit ratings assigned to the counterparty were as follows:

	Credit rating category	Amount (in thousands of lats)		Percentage (%)	
		2009	2008	**2009**	2008
Foreign assets	AAA	**2 604 160**	2 028 722	**76.9**	74.2
	AA	**428 518**	471 242	**12.7**	17.2
	A	**326 843**	213 918	**9.7**	7.8
	BBB	**24 642**	12 766	**0.7**	0.5
	BB	–	7 287	–	0.3
	Different	**422**	460	**0**	0
Total		**3 384 585**	2 734 395	**100.0**	100.0

Based on Standard & Poor's credit ratings or other equivalent credit ratings assigned by other international credit rating agency to the counterparty, the above tables show the breakdown of the Bank of Latvia's assets as at the end of the 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. Ratings below "AAA" are modified by marks "+" or "–" to show the relative standing within the major categories of an international agency's ratings.

INDEPENDENT AUDITORS' REPORT TO THE COUNCIL OF THE BANK OF LATVIA

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Bank of Latvia ("the Bank"), which comprise the balance sheet as at 31 December 2009, and the related statements of profit and loss, total recognised gains and losses and cash flow for the year then ended, and a summary of principal accounting policies and other explanatory notes to the financial statements, as set out on pages 68 to 110.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with the "Financial Accounting Policy of the Bank of Latvia" approved by the Bank of Latvia's Council, and the law "On the Bank of Latvia". This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the financial statements of the Bank give a true and fair view of the financial position of the Bank as at 31 December 2009, and of its financial performance and its cash flows for the year then ended in accordance with the "Financial Accounting Policy of the Bank of Latvia" approved by the Bank of Latvia's Council, and the law "On the Bank of Latvia".

Deloitte Audits Latvia SIA
Licence No. 43

Inguna Staša
Board Member
Riga, Latvia
16 March 2010

The State Audit Office
of the Republic of Latvia

Inguna Sudraba
Auditor General
Riga, Latvia
31 March 2010

APPENDICES

Appendix 1

MONETARY INDICATORS IN 2009

(at end of period; in millions of lats)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	**XII**
BANK OF LATVIA												
M0	1 895.9	2 025.4	1 545.3	1 612.2	1 660.9	1 584.8	1 566.8	1 573.3	1 604.3	1 593.8	1 729.2	**1 645.8**
Currency in circulation	949.7	922.2	833.4	846.6	825.1	758.5	767.1	756.7	748.7	745.6	739.5	**788.2**
Demand deposits with the Bank of Latvia	946.2	1 103.2	711.9	765.5	835.8	826.3	799.8	816.6	855.6	848.3	989.7	**857.6**
Currency vs monetary base (%)	50.1	45.5	53.9	52.5	49.7	47.9	49.0	48.1	46.7	46.8	42.8	**47.9**
Net foreign assets	2 246.8	2 845.8	2 355.0	2 136.3	2 090.8	1 967.3	2 873.9	3 158.4	3 209.3	3 169.8	3 338.0	**3 313.1**
Net domestic assets	–351.0	–820.4	–809.7	–524.1	–429.9	–382.5	–1 307.1	–1 585.2	–1 605.0	–1 575.9	–1 608.8	**–1 667.4**
Credit	–118.6	–576.2	–281.3	–221.2	–178.1	–138.2	–1 053.3	–1 323.5	–1 338.8	–1 313.0	–1 350.8	**–1 151.5**
To MFIs	595.3	592.8	254.3	275.0	362.2	258.9	255.0	235.0	225.0	226.1	145.2	**140.4**
To central government (net)	–713.9	–1 169.0	–535.6	–496.2	–540.3	–397.0	–1 308.3	–1 558.5	–1 563.8	–1 539.2	–1 496.0	**–1 291.9**
Other assets (net)	–232.4	–244.2	–528.4	–302.9	–251.9	–244.3	–253.7	–261.7	–266.3	–262.9	–258.0	**–515.9**
MFI												
M1	3 138.0	3 150.4	3 046.2	3 041.3	3 033.0	2 993.5	2 953.0	2 895.2	2 896.5	2 862.1	2 902.6	**2 979.3**
M2	5 856.8	5 898.3	5 795.3	5 858.9	5 811.8	5 768.6	5 655.3	5 587.4	5 534.7	5 518.4	5 567.9	**5 796.2**
M3	5 942.1	5 985.0	5 872.7	5 940.1	5 895.9	5 829.2	5 717.7	5 654.7	5 614.4	5 598.4	5 654.3	**5 873.1**
M2X	5 809.9	5 855.0	5 738.6	5 823.5	5 770.6	5 737.9	5 631.6	5 572.3	5 523.4	5 517.0	5 567.0	**5 820.3**
Currency outside MFIs	832.2	803.9	726.6	725.6	718.7	661.0	664.9	658.3	651.5	641.8	639.6	**667.3**
Deposits of resident financial institutions, non-financial corporations and households	4 977.8	5 051.1	5 012.0	5 097.9	5 051.9	5 076.9	4 966.7	4 914.1	4 871.8	4 875.2	4 927.5	**5 153.0**
In foreign currencies	2 461.3	2 578.6	2 671.9	2 727.3	2 819.8	2 933.2	2 871.5	2 838.3	2 803.4	2 823.6	2 803.2	**2 866.8**
Net foreign assets	–5 871.3	–5 071.2	–5 139.9	–5 062.6	–4 976.7	–4 946.9	–3 976.0	–3 683.8	–3 571.1	–3 525.3	–3 333.2	**–3 021.6**
Net domestic assets	11 681.2	10 926.1	10 878.5	10 886.1	10 747.3	10 684.9	9 607.6	9 256.1	9 094.5	9 042.3	8 900.2	**8 841.9**
Loans to resident financial institutions, non-financial corporations and households	14 552.2	14 491.9	14 368.3	14 252.4	14 140.2	14 076.1	13 976.5	13 921.5	13 880.8	13 796.7	13 718.8	**13 514.9**
INTEREST RATES												
Bank of Latvia refinancing rate (at end of period; %)	6.0	6.0	5.0	5.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	**4.0**
Weighted average interest rates on transactions in lats (%)												
Interbank loans	3.6	3.3	2.4	3.0	4.9	22.3	2.8	2.2	1.6	1.3	1.4	**1.4**
Loans to non-financial corporations and households with a floating interest rate and an initial rate fixation of up to 1 year (new business)	17.0	16.7	18.1	16.0	18.7	31.1	15.9	17.4	15.0	9.0	12.0	**7.9**
Time deposits of non-financial corporations and households (new business)	6.7	6.0	6.2	6.6	8.9	18.5	9.6	6.7	6.3	6.5	6.7	**7.9**

Appendix 2

THE BANK OF LATVIA'S MONTH-END BALANCE SHEETS FOR 2009

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

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	**XII**
FOREIGN ASSETS	2 566 018	3 131 953	2 379 158	2 148 983	2 115 398	1 984 405	2 885 969	3 169 676	3 227 795	3 186 316	3 382 077	**3 384 585**
Gold	117 820	130 297	122 332	118 222	119 855	116 771	115 652	115 633	118 539	122 540	137 263	**134 365**
SDR	1 415	376	366	364	324	322	322	72 647	92 128	91 885	91 740	**91 237**
Convertible foreign currencies	2 397 736	2 941 651	2 223 034	2 022 047	1 966 699	1 858 333	2 760 678	2 970 716	3 006 145	2 964 509	3 147 582	**3 150 992**
Participating interest in the ECB	750	750	750	750	750	750	750	750	750	750	750	**750**
Participating interest in the BIS	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	1 763	**1 763**
Other foreign assets	46 534	57 116	30 913	5 837	26 007	6 466	6 804	8 167	8 470	4 869	2 979	**5 478**
DOMESTIC ASSETS	634 770	631 012	292 229	312 589	401 798	295 460	292 817	274 594	261 055	263 613	182 378	**175 719**
Loans to credit institutions	595 313	592 813	254 300	275 000	362 190	258 873	254 983	234 983	224 977	226 137	145 197	**140 449**
Fixed assets	34 348	34 168	33 959	33 713	33 465	33 250	33 136	33 263	33 320	33 213	33 065	**33 232**
Other domestic assets	5 109	4 031	3 970	3 876	6 143	3 337	4 698	6 348	2 758	4 263	4 116	**2 038**
TOTAL ASSETS	3 200 788	3 762 965	2 671 387	2 461 572	2 517 196	2 279 865	3 178 786	3 444 270	3 488 850	3 449 929	3 564 455	**3 560 304**
FOREIGN LIABILITIES	319 183	286 112	24 111	12 717	24 584	17 133	12 070	11 228	18 472	16 552	44 088	**71 469**
Convertible foreign currencies	36 047	14 444	3 448	2 260	6 955	5 308	4 321	5 303	3 958	860	19 446	**19 006**
IMF	271	273	266	265	261	260	260	255	254	253	254	**256**
Other international institution deposits in lats	6 297	894	4 206	3 945	12 578	7 209	2 403	3 874	7 426	8 206	14 786	**32 502**
Foreign bank deposits in lats	245 155	246 332	123	329	291	52	130	93	27	181	173	**499**
Other foreign liabilities	31 413	24 169	16 068	5 918	4 499	4 304	4 956	1 703	6 807	7 052	9 429	**19 206**
LATS IN CIRCULATION	949 717	922 193	833 371	846 635	825 070	758 527	767 095	756 655	748 657	745 582	739 458	**788 155**
DOMESTIC LIABILITIES	1 674 126	2 290 504	1 540 496	1 340 517	1 401 368	1 228 806	2 115 937	2 385 910	2 425 109	2 391 382	2 492 516	**2 412 922**
Balances due to credit institutions	946 345	1 104 354	980 644	819 271	835 795	825 455	795 450	816 197	855 539	846 518	987 897	**1 115 677**
Balances due to the government	713 880	1 169 040	535 630	496 214	540 258	397 048	1 308 299	1 558 454	1 563 772	1 539 174	1 496 020	**1 291 942**
Balances due to other financial institutions	5 673	1 266	2 832	1 800	1 492	1 142	5 741	1 800	1 461	2 080	2 110	**1 948**
Other domestic liabilities	8 228	15 844	21 390	23 232	23 823	5 161	6 447	9 459	4 337	3 610	6 489	**3 355**
CAPITAL AND RESERVES	257 762	264 156	273 409	261 703	266 174	275 399	283 684	290 477	296 612	296 413	288 393	**287 758**
TOTAL LIABILITIES, CAPITAL AND RESERVES	3 200 788	3 762 965	2 671 387	2 461 572	2 517 196	2 279 865	3 178 786	3 444 270	3 488 850	3 449 929	3 564 455	**3 560 304**

Appendix 3

THE BANK OF LATVIA'S YEAR-END BALANCE SHEETS FOR THE YEARS 2005–2009

(at end of year; in thousands of lats)

	2005	2006	2007	2008	**2009**
FOREIGN ASSETS	1 405 794	2 451 207	2 806 790	2 734 395	**3 384 585**
Gold	76 170	83 668	99 130	108 998	**134 365**
SDR	85	85	83	187	**91 237**
Convertible foreign currencies	1 323 520	2 333 279	2 687 707	2 488 693	**3 150 992**
Participating interest in the ECB	760	760	743	743	**750**
Participating interest in the BIS	1 763	1 763	1 763	1 763	**1 763**
Other foreign assets	3 496	31 652	17 364	134 011	**5 478**
DOMESTIC ASSETS	159 530	34 913	41 211	679 200	**175 719**
Loans to credit institutions	23 300	–	6 850	639 263	**140 449**
Government securities	98 817	–	–	–	**–**
Fixed assets	34 878	32 763	32 646	34 626	**33 232**
Other domestic assets[1]	2 535	2 150	1 715	5 311	**2 038**
TOTAL ASSETS	1 565 324	2 486 120	2 848 001	3 413 595	**3 560 304**
FOREIGN LIABILITIES	15 606	36 881	30 825	402 145	**71 469**
Convertible foreign currencies	3 295	21 158	5 330	131 252	**19 006**
IMF[1]	285	269	254	256	**256**
Other international institution deposits in lats	1 105	1 348	6 049	6 503	**32 502**
Foreign bank deposits in lats	486	448	35	247 001	**499**
Other foreign liabilities[2]	10 435	13 658	19 157	17 133	**19 206**
LATS IN CIRCULATION	877 274	1 073 851	1 049 473	1 018 092	**788 155**
DOMESTIC LIABILITIES	575 762	1 271 929	1 597 218	1 751 384	**2 412 922**
Balances due to credit institutions	502 669	1 212 263	1 416 802	1 094 295	**1 115 677**
Balances due to the government	68 389	49 818	171 241	638 056	**1 291 942**
Balances due to other finantial instruments	2 004	6 308	4 876	1 705	**1 948**
Other domestic liabilities[3]	2 700	3 540	4 299	17 328	**3 355**
CAPITAL AND RESERVES	96 682	103 459	170 485	241 974	**287 758**
Nominal capital	25 000	25 000	25 000	25 000	**25 000**
Reserve capital[3]	48 090	54 898	59 508	95 533	**114 236**
Valuation account	13 333	16 442	34 513	68 004	**74 129**
Undistributed profit[3]	9 726	6 586	51 464	53 437	**74 393**
EU grant	533	533	–	–	**–**
TOTAL LIABILITIES, CAPITAL AND RESERVES	1 565 324	2 486 120	2 848 001	3 413 595	**3 560 304**

[1] In the financial statements for 2005–2007, Latvia's quota in the IMF, secured by a promissory note issued by the government of Latvia, is reported in the asset and liability item "The International Monetary Fund" respectively. In 2008, the Bank of Latvia changed the reporting of assets and liabilities related to the IMF on its balance sheet. Latvia's quota in the IMF, secured by a promissory note issued by the government of Latvia, has been excluded from the foreign assets and liabilities respectively and reported in the financial statements of the government of Latvia.
[2] Liabilities in non-convertible currencies that were reported under the caption "Non-convertible currencies" in the financial statements for the year 2005 are also included.
[3] In the financial statements for year 2005, profit was divided across several captions: profit appropriated to the state budget was reported under the caption "Other domestic liabilities", and increase in reserve capital was reported under the caption "Reserve capital".

Appendix 4

THE BANK OF LATVIA'S PROFIT AND LOSS STATEMENTS FOR THE YEARS 2005–2009

(in thousands of lats)

	2005	2006	2007[1]	2008	**2009**
INTEREST AND SIMILAR INCOME					
Foreign operations	33 473	51 057	125 829	143 646	**59 245**
Domestic operations	5 080	–3 167	3 278	7 264	**26 925**
INTEREST EXPENSE					
Foreign operations	9	8	24 255	11 923	**1 662**
Domestic operations	10 018	20 188	36 122	54 461	**18 516**
NET INTEREST AND SIMILAR INCOME	28 526	27 694	68 730	84 526	**65 993**
REALISED GAINS OR LOSSES FROM FINANCIAL OPERATIONS[2]	–	–	14 310[3]	34 886	**36 959**
INCOME FROM PARTICIPATING INTEREST[4]	200	211	216	206	**221**
IMPAIRMENT OF FINANCIAL ASSETS AND POSITION VALUE	–	–	5 862	38 087	**5 474**
OTHER OPERATING INCOME	577	712	1 195	3 433	**4 683**
BANKNOTE PRODUCTION AND COINAGE COSTS[5]	296	1 071	3 772	4 046	**4 695**
OTHER OPERATING EXPENSE	19 281	20 960	23 353	27 481	**23 294**
PROFIT OF THE REPORTING YEAR	9 726	6 586	51 464	53 437	**74 393**

[1] Data of 2007–2009 have been prepared in line with the accounting principles applied as of 1 January 2007 (for the description of changes in the accounting policies see Note 3 to the Bank of Latvia's financial statements for 2007).
[2] In the financial statements for 2005–2007, realised gains or losses from financial operations are reported under the profit and loss statement caption "Interest and similar income".
[3] Realised profit on exchange rate contracts that was reported separately in the financial statements for 2007 is also included.
[4] In the financial statements for 2005–2007, income from participating interest is reported under the profit and loss statement caption "Interest and similar income".
[5] In the financial statements for 2005–2007, banknote production and coinage costs are reported under the profit and loss statement caption "Other operating expense".

Appendix 5

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

(LVL vs foreign currency)

2009	GBP				100 JPY				USD			
	Maximum	Average	Minimum	At end of period	Maximum	Average	Minimum	At end of period	Maximum	Average	Minimum	At end of period
I	0.7910	0.7597	0.7230	0.7580	0.6140	0.5803	0.5470	0.5960	0.5450	0.5241	0.4950	0.5360
II	0.8110	0.7893	0.7580	0.7860	0.6160	0.5979	0.5650	0.5660	0.5580	0.5488	0.5360	0.5530
III	0.7940	0.7659	0.7420	0.7560	0.5730	0.5530	0.5240	0.5480	0.5620	0.5394	0.5140	0.5320
IV	0.7980	0.7823	0.7580	0.7830	0.5620	0.5395	0.5140	0.5500	0.5430	0.5331	0.5180	0.5320
V	0.8100	0.7939	0.7810	0.8100	0.5500	0.5373	0.5240	0.5280	0.5320	0.5182	0.5020	0.5080
VI	0.8320	0.8187	0.7970	0.8260	0.5270	0.5191	0.5090	0.5260	0.5090	0.5012	0.4910	0.5010
VII	0.8280	0.8169	0.8120	0.8200	0.5460	0.5283	0.5150	0.5260	0.5050	0.4991	0.4930	0.5000
VIII	0.8290	0.8166	0.7970	0.7970	0.5270	0.5199	0.5090	0.5230	0.5000	0.4934	0.4880	0.4900
IX	0.8050	0.7902	0.7630	0.7650	0.5380	0.5276	0.5210	0.5340	0.4940	0.4831	0.4740	0.4800
X	0.7820	0.7670	0.7510	0.7820	0.5400	0.5268	0.5090	0.5280	0.4830	0.4745	0.4680	0.4770
XI	0.7910	0.7820	0.7730	0.7730	0.5470	0.5273	0.5210	0.5470	0.4770	0.4709	0.4650	0.4710
XII	0.7930	0.7822	0.7690	0.7830	0.5450	0.5374	0.5240	0.5330	0.4930	0.4808	0.4660	0.4890

Appendix 6

THE BANK OF LATVIA'S ORGANISATIONAL UNITS AT THE END OF 2009

1. ACCOUNTING DEPARTMENT
(Head of Department, Chief Accountant – Jānis Caune; Deputy Chief Accountant – Iveta Čavare)
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. CASHIER'S AND MONEY OPERATIONS DEPARTMENT
(Acting Head of Department – Jānis Blūms; Deputy Heads of Department – Veneranda Kausa, Vilnis Kepe)
2.1 Cash Operations Division (Head of Division – Oskars Zaltans)
2.2 Coin Division (Head of Division – Maruta Brūkle)
2.3 Money Expertise and Equipment Maintenance Division (Head of Division – Andris Tauriņš)

3. COMMUNICATIONS DEPARTMENT
(Head of Department – Aina Raņķe)
3.1 Publications Division (Head of Division, Deputy Head of Department – Aija Grīnfelde)
3.2 Library (Manager of Library – Anita Zariņa)
3.3 Archive (Manager of Archive – Baiba Blese)
3.4 Clerical Office (Head of Clerical Office, Deputy Head of Department – Svetlana Petrovska)
3.5 Protocol Division (Head of Division – Gundega Vizule)

4. GOVERNOR'S OFFICE
(Head of Office – Guntis Valujevs)

5. INFORMATION SYSTEMS DEPARTMENT
(Head of Department – Harijs Ozols; Deputy Head of Department – Ivo Odītis)
5.1 System Design and Programming Division (Head of Division – Ilgvars Apinis)
5.2 Computer Network and Server Systems Division (Head of Division – Uldis Kristapsons)
5.3 Bank Information System Maintenance and Development Division (Head of Division – Valdis Spūlis)
5.4 Information Systems Security Division (Head of Division – Ilona Etmane)
5.5 Information Systems Quality Assurance Division (Head of Division – Askolds Kālis)
5.6 Systems Maintenance Division (Head of Division – Edvīns Mauriņš)

6. INTERNAL AUDIT DEPARTMENT
(Head of Department – Leo Ašmanis; Deputy Heads of Department – Anita Hāznere, Juris Ziediņš)

7. INTERNATIONAL DEPARTMENT
(Head of Department – Juris Kravalis; Deputy Head of Department – Aleksandra Bambale)

8. LEGAL DEPARTMENT
(Head of Department – Ilze Posuma; Deputy Heads of Department – Iveta Krastiņa, Edvards Kušners)

Appendix 6
(cont.)

9. MARKET OPERATIONS DEPARTMENT
(Head of Department – Raivo Vanags)
9.1 Trading and Investment Division (Head of Division – Vadims Zaicevs)
9.2 Risk Management Division (Head of Division, Deputy Head of Department – Daira Brunere)
9.3 Payments Division (Head of Division – Una Ruka)

10. MONETARY POLICY DEPARTMENT
(Head of Department – Kārlis Bauze; Deputy Heads of Department – Zoja Razmusa, Uldis Rutkaste)
10.1 Macroeconomic Analysis Division (Head of Division – Santa Bērziņa)
10.2 Financial Market Analysis Division (Head of Division – Elmārs Zakulis)
10.3 Monetary Research and Forecasting Division (Head of Division – Konstantīns Beņkovskis)
10.4 Financial Stability Division (Head of Division – Jeļena Zubkova)

11. PAYMENT SYSTEMS DEPARTMENT
(Head of Department – Egons Gailītis)
11.1 Payment Systems Policy Division (Head of Division – Anda Zalmane)
11.2 Payment Systems Operations Division (Head of Division, Acting Deputy Head of Department – Natālija Popova)
11.3 Account Service and Maintenance Division (Head of Division – Andra Gailīte)
11.4 Register of Debtors Division (Head of Division – Laura Ausekle)

12. PERSONNEL DEPARTMENT
(Head of Department – Inta Lovnika; Deputy Head of Department – Vineta Veikmane)

13. PUBLIC RELATIONS DEPARTMENT
(Head of Department, Press Secretary – Mārtiņš Grāvītis; Deputy Head of Department – Kristaps Otersons)
13.1 Visitors Centre (Head of Centre – Jānis Motivāns)

14. SECURITY DEPARTMENT
(Head of Department – Romualds Namnieks; Deputy Heads of Department – Imants Kravals, Sandis Mackēvičs)
14.1 Analytical Unit (Head of Unit – Māris Dzelme)
14.2 Armament Unit (Head of Unit – Juris Kušķis)
14.3 Central Division (Head of Division – Guntars Ezeriņš)
14.4 Riga Division (Head of Division – Normunds Puzulis)
14.5 Daugavpils Division (Head of Division – Ilmārs Suhockis)
14.6 Liepāja Division (Head of Division – Gints Liepiņš)
14.7 Rēzekne Division (Head of Division – Andrejs Gugāns)

15. STATISTICS DEPARTMENT
(Head of Department – Agris Caune; Deputy Head of Department – Ilmārs Skarbnieks)
15.1 Financial Market and Monetary Statistics Division (Head of Division – Zigrīda Aušta)
15.2 Balance-of-Payments Statistics Division (Head of Division – Daiga Gaigala-Ližbovska)
15.3 General Economic and Financial Statistics Division (Head of Division – Iveta Salmiņa)

Appendix 6
(cont.)

16. TECHNICAL SUPPORT DEPARTMENT
(Head of Department – Andris Ņikitins)
16.1 General Service Division (Head of Division – Einārs Cišs)
16.2 Building Systems Division (Head of Division, Deputy Head of Department – Jānis Kreicbergs)
16.3 Security Systems Division (Head of Division – Viesturs Balodis)

17. RIGA BRANCH
(Branch Manager – Jānis Strēlnieks; Deputy Branch Manager – Gunārs Vīksne)

18. DAUGAVPILS BRANCH
(Branch Manager – Ināra Brauna; Deputy Branch Manager – Bernarda Kezika)

19. LIEPĀJA BRANCH
(Branch Manager – Gundars Lazdāns; Deputy Branch Manager – Ieva Ratniece)

20. RĒZEKNE BRANCH
(Branch Manager – Anna Matisāne; Deputy Branch Manager – Gintauts Senkans)

21. TRAINING AND RECREATION CENTRE
(Head of Centre – Zaiga Blūma; Deputy Head of Centre – Dace Miķilpa)

Appendix 7

THE BANK OF LATVIA'S STRUCTURE AT THE END OF 2009

Governor's Office	COUNCIL	Internal Audit Department
	BOARD	
Monetary Policy Department	Cashier's and Money Operations Department	Market Operations Department
Statistics Department	Riga Branch	Payment Systems Department
International Department	Daugavpils Branch	Accounting Department
Public Relations Department	Liepāja Branch	Information Systems Department
Communications Department	Rēzekne Branch	Legal Department
Technical Support Department	Security Department	Personnel Department
	Training and Recreation Centre	

Appendix 8

REPRESENTATION OF THE BANK OF LATVIA IN INTERNATIONAL ORGANISATIONS

EUROPEAN UNION

EFC
Kārlis Bauze, Head of Monetary Policy Department
Juris Kravalis, Head of International Department (Alternate)

EFC's Euro Coin Sub-Committee (ECSC)
Maruta Brūkle, Head of Coin Division, Cashier's and Money Operations Department

EFC's Sub-Committee on IMF and Related Issues (SCIMF)
Juris Kravalis, Head of International Department

Committee of European Banking Supervisors (CEBS)
Vita Pilsuma, Member of the Bank of Latvia's Council (Banking Supervisory Institution is represented by Jānis Placis, Member of the Council of the FCMC)

Committee on Monetary, Financial and Balance of Payments Statistics (CMFB)
Agris Caune, Head of Statistics Department
Ilmārs Skarbnieks, Deputy Head of Statistics Department

Eurostat Balance of Payments Committee
Daiga Gaigala-Ližbovska, Head of Balance-of-Payments Statistics Division, Statistics Department
Valters Zīle, Deputy Head of Balance-of-Payments Statistics Division, Statistics Department

Public Administration Network (PAN II)
Vilnis Kepe, Deputy Head of Cashier's and Money Operations Department

Permanent Representation of Latvia to the EU
Aldis Austers, Counsellor of the Bank of Latvia at the Permanent Representation of Latvia to the EU

EUROPEAN SYSTEM OF CENTRAL BANKS

General Council of the ECB
Ilmārs Rimšēvičs, Governor of the Bank of Latvia

Accounting and Monetary Income Committee (AMICO)
Jānis Caune, Chief Accountant of the Bank of Latvia
Gatis Gersons, Head of Financial Statements and Accounting Policy Division, Accounting Department

Banking Supervision Committee (BSC)
Zoja Razmusa, Deputy Head of Monetary Policy Department (Banking Supervisory Institution is represented by Ludmila Vojevoda, Member of the Council of the FCMC)

Banknote Committee (BANCO)
Jānis Blūms, Acting Head of Cashier's and Money Operations Department
Veneranda Kausa, Deputy Head of Cashier's and Money Operations Department

Eurosystem/ESCB Communications Committee (ECCO)
Mārtiņš Grāvītis, Head of Public Relations Department
Aina Raņķe, Head of Communications Department

Appendix 8
(cont.)

Human Resources Conference (HRC)
Inta Lovnika, Head of Personnel Department

Information Technology Committee (ITC)
Harijs Ozols, Member of the Bank of Latvia's Board, Head of Information Systems Department
Ivo Odītis, Deputy Head of Information Systems Department

Internal Auditors Committee (IAC)
Leo Ašmanis, Head of Internal Audit Department
Anita Hāznere, Deputy Head of Internal Audit Department

International Relations Committee (IRC)
Andris Ruselis, Deputy Governor of the Bank of Latvia
Juris Kravalis, Head of International Department

Legal Committee (LEGCO)
Ilze Posuma, Member of the Bank of Latvia's Board, Head of Legal Department
Iveta Krastiņa, Deputy Head of Legal Department

Market Operations Committee (MOC)
Raivo Vanags, Member of the Bank of Latvia's Board, Head of Market Operations Department
Harijs Zuļģis, Chief Expert of Market Operations Analysis, Market Operations Department

Monetary Policy Committee (MPC)
Kārlis Bauze, Head of Monetary Policy Department
Uldis Rutkaste, Deputy Head of Monetary Policy Department

Payment and Settlement Systems Committee (PSSC)
Egons Gailītis, Head of Payment Systems Department
Anda Kalniņa, Chief Economist of Financial Stability Division, Monetary Policy Department[1]

Statistics Committee (STC)
Agris Caune, Head of Statistics Department
Ilmārs Skarbnieks, Deputy Head of Statistics Department

INTERNATIONAL MONETARY FUND
Board of Governors
Ilmārs Rimšēvičs, Governor of the Bank of Latvia

Nordic-Baltic Monetary and Financial Committee (NBMFC)
Andris Ruselis, Deputy Governor of the Bank of Latvia

Nordic-Baltic Monetary and Financial Committee, Group of Alternates (NBMFC Alternates)
Juris Kravalis, Head of International Department

Nordic-Baltic IMF Office in Washington
Gundars Dāvidsons, Advisor to the Executive Director of the Nordic-Baltic Constituency of the IMF, Latvia's representative in IMF

[1] As of 22 March 2010, Ms. Natālija Popova, Acting Deputy Head of Payment Systems Department, Head of Payment Systems Operations Division.

Appendix 9

THE BANK OF LATVIA'S 2009 PUBLICATIONS

This list contains publications prepared and issued by the Bank of Latvia in 2009. These publications are available on the Bank of Latvia's website (www.bank.lv). Those prepared in print are available free of charge both at the Bank of Latvia and by mail (unless indicated otherwise and a sufficient number of copies are available) sending a request to the address indicated on the last page of this publication or by e-mailing to: info@bank.lv.

REGULAR PUBLICATIONS

Bank of Latvia: Annual Report 2008
Monetārais Apskats. Monetary Review (3, 4/2008 and 1, 2/2009)
Macroeconomic Developments Report (3/2009)
Monetary Bulletin (11, 12/2008 and 1–10/2009)
Financial Stability Report (2008)
Latvijas Maksājumu Bilance. Latvia's Balance of Payments (3, 4/2008 and 1, 2/2009)
Latvia's Balance of Payments (Key Items) (11, 12/2008)

WORKING PAPERS

1. *Ajevskis V*., *Vītola K*. Convergence Model of the Term Structure of Interest Rates
2. *Meļihovs A*., *Zasova A*. The Assessment of Natural Rate of Unemployment and Capacity Utilisation in Latvia
3. *Fadejeva L*., *Meļihovs A*. Measuring Total Factor Productivity and Variable Factor Utilisation: Sector Approach, The Case of Latvia
4. *Ajevskis V*., *Vītola K*. Advantages of Fixed Exchange Rate Regime from a General Equilibrium Perspective

DISCUSSION PAPER

1. *Bičevska A*., *Meļihovs A*., *Kalnbērziņa K*. Savings in Latvia

Appendix 10

2009 HIGHLIGHTS OF REGULATORY DOCUMENTS ADOPTED IN PURSUIT OF THE BANK OF LATVIA'S MAIN TASKS

Regulatory document	No	Date of adoption (effective date)	Title of the regulatory document adopted by the Bank of Latvia's Council
Regulation	24	08.01.2009 (08.01.2009)	"Amendments to the Bank of Latvia Regulation No 5 of 17 May 2007 'Regulation for the Use of the Bank of Latvia's Monetary Policy Instruments' "
Regulation	25	15.01.2009 (24.01.2009)	"Interest Rates on Transactions". The overnight deposit facility rate was reduced by 1.0 percentage point (to 2.00% per annum), and the refinancing rate (6.00% per annum) and the Bank of Latvia's marginal lending facility rate were left unchanged (7.50% per annum in case a bank has resorted to the lending facility no more than 5 working days within the previous 30 day period; 15% per annum in case a bank has resorted to the lending facility 6–10 working days within the previous 30 day period; 30% per annum in case a bank has resorted to the lending facility for more than 10 working days within the previous 30 day period).
Regulation	26	15.01.2009 (24.01.2009)	"Regulation for Calculating and Fulfilling the Minimum Reserve Requirements for Banks"
Regulation	27	15.01.2009 (01.02.2009)	"Regulation for the Credit Register"
Regulation	28	15.01.2009 (01.02.2009)	"Technical Regulation for the Credit Register"
Regulation	29	15.01.2009 (01.02.2009)	"The Amount of and the Payment Procedure for the Fees to Be Paid for the Use of the Credit Register by Its Participants"
Regulation	30	15.01.2009 (21.01.2009)	"Regulation for Reproducing the Lats Banknotes and Coins"
Regulation	31	12.03.2009 (24.03.2009)	"Interest Rates on Transactions". The refinancing rate and the overnight deposit facility rate were reduced by 1.0 percentage point (to 5.00% and 1.00% per annum respectively) and the Bank of Latvia's marginal lending facility rate was left unchanged.
Regulation	32	12.03.2009 (01.04.2009)	"Regulation for the Credit Register"
Regulation	33	12.03.2009 (01.04.2009)	"Technical Regulation for the Credit Register"
Regulation	34	12.03.2009 (01.04.2009)	"The Amount of and the Payment Procedure for the Fees to Be Paid for the Use of the Credit Register by Its Participants"
Regulation	166/1	20.04.2009 (21.04.2009)	"Regulation on Participation in the Securities Settlement System of the Bank of Latvia"
Regulation	35	13.05.2009 (24.05.2009)	"Interest Rates on Transactions". The refinancing rate was reduced by 1.0 percentage point (to 4.00% per annum) and the Bank of Latvia's marginal lending facility rate and the overnight deposit facility rate were left unchanged.
Regulation	36	13.05.2009 (01.06.2009)	"Regulation for Purchasing and Selling Cash Foreign Currencies"

Appendix 10
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Regulatory document	No	Date of adoption (effective date)	Title of the regulatory document adopted by the Bank of Latvia's Council
Recom-mendation	37	13.05.2009 (01.06.2009)	"Recommendations to Capital Companies that Have Received a Licence Issued by the Bank of Latvia for Purchasing and Selling Cash Foreign Currencies for Developing an Internal Control System for the Prevention of Laundering the Proceeds from Criminal Activity (Money Laundering) and of Terrorist Financing"
Regulation	38	13.05.2009 (08.06.2009)	"Description of Lats Banknotes and Coins"
Regulation	39	16.07.2009 (24.10.2009)	"Amendments to the Bank of Latvia Regulation No 26 of 15 January 2009 'Regulation for Calculating and Fulfilling the Minimum Reserve Requirements for Banks' "
Regulation	40	16.07.2009 (01.05.2010)	"Regulation for Compiling the Monthly Financial Position Report of Monetary Financial Institutions"
Regulation	41	16.07.2009 (01.01.2010)	"Regulation for Compiling Reports on Foreign Currency Purchases and Sales"
Regulation	42	10.09.2009 (01.06.2010)	"Regulation for Compiling Interest Rate Reports of Monetary Financial Institutions"
Regulation	43	10.09.2009 (01.04.2010)	"Regulation for Compiling Reports on Securities"
Regulation	171/5	10.09.2009 (01.10.2009)	"Amendments to the Bank of Latvia's Council Regulation No 166/1 of 20 April 2009 'Regulation on Participation in the Securities Settlement System of the Bank of Latvia' "
Regulation	44	05.11.2009 (01.05.2010)	"Regulation for Compiling the 'Report on Adjustments in Respect of Write-Offs/Write-Downs of Loans and Price Revaluations of Securities' "
Regulation	45	05.11.2009 (01.06.2010)	"Regulation for Compiling the 'Report on Net Open Foreign Exchange Position' "
Regulation	46	05.11.2009 (01.06.2010)	"Regulation for Compiling the 'Report on Money Market Transactions' "
Regulation	47	05.11.2009 (01.06.2010)	"Regulation for Compiling the 'Report and Projections on Long-Term Foreign Debt of Monetary Financial Institutions' "
Regulation	48	05.11.2009 (01.01.2010)	"Regulation for Compiling the 'Report on External Payments of Non-banks' "
Regulation	49	05.11.2009 (04.01.2010)	"Amendments to the Bank of Latvia Regulation No 5 of 17 May 2007 'Regulation for the Use of the Bank of Latvia's Monetary Policy Instruments' "
Regulation	50	05.11.2009 (26.11.2009 (Paragraph 1.1); 21.12.2009 (Paragraph 1.2))	"Amendments to the Bank of Latvia Regulation No 38 of 13 May 2009 'Description of Lats Banknotes and Coins' "

Appendix 11

GLOSSARY

Automatic loan: a collateralised loan granted to a bank registered in the Republic of Latvia under marginal lending facility of the Bank of Latvia until the next business day to cover the bank's overdraft.

Balance of payments: a statistical report that reflects Latvia's economic transactions with other countries within a specific period. This report includes the transactions related to goods, services, income and transfers, and such net transactions that result in financial claims ("Assets") or financial obligations ("Liabilities") to the rest of the world.

Bank for International Settlements (BIS): an international financial organisation, founded in May 1930, to facilitate international monetary and financial cooperation. The BIS acts as a bank for central banks.

Central government: public institutions, 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. The list of the institutional units of the Latvian central government is prepared in accordance with the requirements of the European System of Accounts 1995 (ESA 95) 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 multilateral net position of each bank by netting all payment documents submitted by the bank, i.e. establishing net cash liabilities to or claims on other banks.

Concentration ratio: market share of the five largest senders of payment messages in each payment system in terms of the total volume and value of transactions. The five largest senders in terms of the volume of payment transactions may be different from the five largest senders in terms of the value of payment transactions. The concentration ratio of the Bank of Latvia's payment systems includes also the Bank of Latvia's transactions.

Credit institution: a corporation 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, or electronic money institutions issuing means of payment in the form of electronic money. The credit institutions of Latvia (banks and electronic money institutions) have been included on the "List of Monetary Financial Institutions of the Republic of Latvia" (see Statistical Reporting Forms under Legal section on the Bank of Latvia's website at www.bank.lv).

Credit risk: the risk to incur losses as a result of a counterparty default.

Debt securities: securities representing an obligation and a promise on the part of the issuer (i.e. the borrower) to make one or more payment(s) to the holder (the lender) of the securities at a specified future date or dates (e.g. bonds, notes, money market instruments). Such securities usually carry a specific rate of interest (the coupon) or are sold at a discount to the amount that will be repaid at maturity. Debt securities issued with an original maturity of more than one year are classified as long-term debt securities.

Demand loan: a collateralised loan granted to a bank registered in the Republic of Latvia at its request under marginal lending facility of the Bank of Latvia until the next business day.

Appendix 11
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Deposits redeemable at notice: cash assets 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 with an agreed maturity: cash assets deposited with an MFI that cannot be withdrawn prior to maturity or can be withdrawn only subject to payment of a small penalty. This category also encompasses some non-marketable debt instruments, such as non-marketable (retail) certificates of deposit.

Direct investment: investment (net transactions and outstanding amounts) made by a foreign investor in order to obtain a lasting interest (ownership of at least 10% of the ordinary shares or voting power) in a Latvian company ("Direct investment in Latvia") or by a Latvian investor in a foreign company ("Direct investment abroad"). The components of direct investment are equity capital, reinvested earnings and other capital.

Economic and Financial Committee (EFC): a committee for economic and financial issues established by the EU Council, comprising representatives of the governments and central banks of the EU Member States as well as representatives of the EC and ECB.

Economic and Monetary Union (EMU): the Treaty on the Functioning of the European Union describes the process of achieving the EMU in the EU in three stages. Stage One of the EMU started on 1 July 1990 and ended on 31 December 1993. It was mainly characterised by the dismantling of all barriers to the free movement of capital within the EU. Stage Two of the EMU began on 1 January 1994. It provided for the establishment of the European Monetary Institute, prohibition of financing of the public sector by the central banks, prohibition of privileged access to financial institutions by the public sector and avoidance of excessive government budget deficits. Stage Three started on 1 January 1999 with the transfer of monetary competence to the ECB and the introduction of the euro. The euro cash changeover on 1 January 2002 completed the process setting up the EMU.

Electronic clearing system (EKS): the Bank of Latvia's net settlement system, which is used to process bulk retail payments and ensure the settlement of net positions.

Equities: securities representing ownership of a stake in a commercial company. They comprise listed and unlisted equities (e.g. quoted shares, unquoted shares and other forms of equity) and usually produce income in the form of dividends.

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 2009, the euro area comprised Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

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 ECB in cooperation with the central banks of the EU Member States. The ECB is governed by the Governing Council and the Executive Board, and, until all EU Member States adopt the euro, by a third decision-making body, the General Council.

Appendix 11
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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 Member States 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.

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.

Exchange rate mechanism II (ERM II): the exchange rate arrangement that ensures the framework for exchange rate policy cooperation between the euro area countries and the EU Member States not participating in Stage Three of EMU. As at the end of 2009, Denmark, Estonia, Latvia and Lithuania were members of the ERM II.

Financial auxiliaries: financial institutions that are primarily engaged in auxiliary financial activities, i.e. activities that are closely related to financial intermediation but are not financial intermediation themselves, e.g. investment brokers who do not engage in financial intermediation services on their own behalf, corporations that provide infrastructure for financial markets, institutions that supervise MFIs, financial corporations and the financial market. FCMC and NASDAQ OMX Riga are regarded as financial auxiliaries.

Financial institutions other than monetary financial institutions (MFIs): OFIs, financial auxiliaries, insurance corporations and pension funds.

Fixed rate instrument: a financial instrument for which the coupon is fixed throughout the life of the instrument.

Floating rate instrument: a financial instrument for which the coupon is periodically reset relative to a reference index to reflect changes in short-term or medium-term market interest rates. Floating rate instruments may have a coupon determined either on the basis of the reference index at a certain date before the start of the coupon accrual period or during the coupon accrual period.

Foreign exchange swap: a simultaneous spot purchase/sale and forward sale/purchase of one currency against another. Within the framework of market operations, the Bank of Latvia purchases foreign currency from banks registered in the Republic of Latvia for lats, simultaneously concluding a forward foreign currency sales deal, or sells foreign currency to banks registered in the Republic of Latvia, simultaneously concluding a forward foreign currency purchase deal. The foreign currency used in foreign exchange swap auctions by the Bank of Latvia is euro only. In foreign exchange swaps, the minimum lats bid rate used in foreign currency purchase/resale transactions with banks equals the refinancing rate of the Bank of Latvia, and the maximum lats bid rate used in foreign currency sales/repurchase deals equals the refinancing rate of the Bank of Latvia. The Bank of Latvia sets the total allotment amount for each auction.

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 all central banks of the EU Member States.

General government: public institutions 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. General government in the Republic of Latvia includes central government and local government. The list of the institutional units of the Latvian central government is prepared in accordance with the requirements of the European System of Accounts 1995 (ESA 95) by the CSB.

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.

Households: natural persons or groups of natural persons as consumers and producers of goods and non-financial services exclusively for their own final consumption. Sole proprietors are also regarded as households in Latvia provided that they have not registered their activity with the Commercial Register of the Enterprise Register of the Republic of Latvia. When aggregating data, the household sector usually includes also the data of non-profit institutions serving households.

Interbank automated payment system (SAMS): the Bank of Latvia's real time gross settlement system used for settlements concerning the Bank of Latvia's monetary policy operations, large-value interbank transfers and other payments in lats.

International investment position: a statistical report reflecting the value and composition of Latvia's outstanding financial claims on ("Assets") and financial liabilities to ("Liabilities") other countries.

International Monetary Fund (IMF): an international organisation, founded in July 1944, to facilitate international monetary cooperation, exchange rate stability, national economic growth and employment growth, and provide short-term financial assistance to IMF Member States for balancing the payment flow.

Liquidity risk: the risk that an obligation will not be settled when due and it will be impossible to dispose of assets close to their fair value.

Local government: public institutions, whose competence covers only a local economic territory. In Latvia, the local government level is comprised of the local authorities. The list of the institutional units of the Latvian local governments is prepared in accordance with the requirements of the European System of Accounts 1995 (ESA 95) by the CSB.

Longer-term refinancing operations: market operations of the Bank of Latvia organised in the form of auctions of reverse transactions, whereby banks registered in the Republic of Latvia are granted collateralised loans. The minimum bid rate at the auction equals the Bank of Latvia's refinancing rate. The Bank of Latvia sets the total allotment amount for each auction. The maturity of the loan is 91 days.

M0: monetary base calculated on the basis of the Bank of Latvia's methodology and comprising the lats banknotes and coins issued by the Bank of Latvia and demand deposits of resident MFIs and financial institutions (overnight deposits) with the Bank of Latvia.

M1: narrow monetary aggregate calculated on the basis of the ECB methodology and comprising the lats banknotes and coins issued by the Bank of Latvia (less vault cash of MFIs) and overnight deposits in lats and foreign currencies held with MFIs by resident financial institutions, non-financial corporations, households and non-profit institutions serving households and local governments.

M2: intermediate monetary aggregate calculated on the basis of the ECB methodology and comprising M1 and deposits redeemable at a period of notice of up to and including three months (i.e. short-term savings deposits) and deposits with an agreed maturity of up to and including two years (i.e. short-term time deposits) in lats and foreign currencies held with MFIs by resident financial institutions, non-financial corporations, households and non-profit institutions serving households and local governments.

M2X: broad money; this monetary aggregate is calculated on the basis of the Bank of Latvia's methodology and comprises the lats banknotes and coins issued by the Bank of Latvia (less vault cash of MFIs) and overnight deposits and time deposits in lats and foreign currencies (including deposits redeemable at notice and repurchase agreements) held with MFIs by resident financial institutions, non-financial corporations, households and non-profit institutions serving households. M2X incorporates deposits made by local governments as a net item on the demand side.

M3: broad monetary aggregate calculated on the basis of the ECB methodology and comprising M2, repurchase agreements, debt securities with a maturity of up to and including two years issued by MFIs, and money market fund shares and units.

Main refinancing operations: market operations of the Bank of Latvia organised in the form of auctions of reverse transactions, whereby banks registered in the Republic of Latvia are granted collateralised loans. The minimum bid rate at the auction equals the Bank of Latvia's refinancing rate. The Bank of Latvia sets the total allotment amount for each auction. The maturity of the loan is 7 days.

Marginal lending facility: a standing facility enabling banks registered in the Republic of Latvia to receive collateralised overnight loans either automatically or on demand.

Market operations: financial market operations initiated by the central bank. The Bank of Latvia's market operations fall into four categories used by the Eurosystem: main refinancing operations, longer-term refinancing operations, structural operations and fine-tuning operations. The main instruments of the Bank of Latvia's market operations are reverse transactions. Outright transactions are available for the conduct of structural operations, whereas outright transactions, foreign exchange swaps and time deposits are available for the conduct of fine-tuning operations.

Market risk: the risk to incur losses as a result of adverse changes in financial market factors (e.g. interest rates or exchange rates).

Monetary financial institutions (MFIs): institutions forming the money-issuing sector. The Bank of Latvia maintains the "List of Monetary Financial Institutions of the Republic of Latvia" (see Statistical Reporting Forms under Legal section on the Bank of Latvia's website at www.bank.lv) which comprised the Bank of Latvia, 37 credit institutions, two money market funds and 34 other MFIs (credit unions) as at the end of 2009. The ECB publishes the "List of MFIs of the EU Member States" regularly on its website (see Links on the Bank of Latvia's website at www.bank.lv).

Non-financial corporation: an economic entity producing goods or providing non-financial services with the aim of gaining profit or other yield. In Latvia, a sole proprietorship registered with the Commercial Register of the Enterprise Register of the Republic of Latvia is also regarded as a non-financial corporation.

Non-profit institutions serving households: non-profit institutions that provide goods and services to natural persons or groups of natural persons and that derive resources mainly from voluntary contributions in cash or kind, from payments made by general governments and from property income. Such institutions are, for instance, trade unions, professional or educational associations, consumer associations, political parties,

Appendix 11
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churches, religious communities as well as culture, recreation and sports clubs, charity, support and aid organisations.

Operational risk: the risk of incurring financial and non-financial losses as a result of an unexpected disruption of operations, unsanctioned use of information, non-compliance with security requirements and other internal or external circumstances relating to gaps in the internal control system.

Original maturity: in accordance with the terms and conditions agreed at the beginning of a financial operation, time from the issue date of a debt instrument to its maturity date or from the lending date to the maturity date or from the start date to the final date of any other financial operation.

Other financial intermediaries (OFIs): financial institutions other than insurance corporations and pension funds primarily engaged in financial intermediation by incurring liabilities in forms other than currency, non-MFI deposits and close substitutes for deposits or insurance technical reserves. OFIs are corporations engaged in lending (e.g. financial leasing companies, factoring companies, export/import financing companies), investment funds, investment brokerage companies, financial vehicle corporations, financial holding corporations, venture capital corporations as well as other financial institutions provided that their activity complies with the given definition.

Outright purchase and sales of securities: transactions as a result of outright purchase and sales auctions of securities organised by the Bank of Latvia. At auctions, the Bank of Latvia offers banks registered in the Republic of Latvia to purchase or sell lats-denominated debt securities. The maximum purchase price in outright purchases of securities and minimum sales price in outright sales of securities respectively is set according to the market price of the relevant securities. The Bank of Latvia defines the amount of securities to be bought or sold at each auction.

Outright transactions: transactions concluded between the Bank of Latvia and banks registered in the Republic of Latvia as a result of organised outright purchase or sales auctions of securities or purchase or sales of non-cash foreign currency.

Overnight deposit facility: a standing facility enabling banks registered in the Republic of Latvia to make overnight deposits with the Bank of Latvia on their own initiative.

Portfolio investment: investment (net transactions and positions) made by residents of Latvia in securities issued by residents of other countries ("Assets") and by residents of other countries in securities issued by residents of Latvia ("Liabilities"). Portfolio investment includes equity securities (providing for ownership of up to 10% of the ordinary shares or voting power) and debt securities, excluding securities recorded in foreign direct investment or reserve assets.

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 base: liabilities of banks registered in the Republic of Latvia subject to the minimum reserve requirements.

Reserve holdings: money holdings of banks registered in the Republic of Latvia with the Bank of Latvia serving to fulfil reserve requirements.

Reserve ratio: percentage share of the reserve base or minimum reserve ratio defined by the Bank of Latvia. The central bank may also define a ratio for each category of

Appendix 11
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balance sheet items included in the reserve base. The ratios are used to calculate reserve requirements.

Reserve requirement: requirement for banks registered in the Republic of Latvia to hold an amount of reserves compliant with the reserve ratio with the Bank of Latvia.

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 Bank of Latvia grants collateralised loans to banks registered in the Republic of Latvia.

RIGIBID (Riga Interbank Bid Rate): the index of Latvian interbank interest rates on deposits reflecting the lats money market interest rates set by banks included on the quotation list at which these banks are willing to borrow cash assets in lats from other banks. The Bank of Latvia calculates this index for transactions with an overnight maturity, a maturity of 1 day (starting with the next business day), 1 week, 1 month, 3 months, 6 months and 12 months.

RIGIBOR (Riga Interbank Offered Rate): the index of Latvian interbank lending interest rates reflecting the lats money market interest rates set by banks included on the quotation list at which these banks are willing to lend cash assets in lats to other banks. The Bank of Latvia calculates this index for transactions with an overnight maturity, a maturity of 1 day (starting with the next business day), 1 week, 1 month, 3 months, 6 months and 12 months.

SEPA (Single Euro Payment Area): area in which consumers, companies and other economic agents will be able to make and receive payments in euro both across countries and within the borders of each country regardless of their location in accordance with one and the same main provisions, rights and obligations. As at the end of 2009, SEPA encompassed all EU Member States, Iceland, Liechtenstein, Monaco, Norway and Switzerland.

Standing facility: a central bank facility available to counterparties on demand. The Bank of Latvia offers two standing overnight facilities to banks registered in the Republic of Latvia: marginal lending facility and overnight deposit facility.

TARGET (Trans-European Automated Real-time Gross settlement Express Transfer system): the real-time gross settlement system for the euro used for settlements concerning the central banks' monetary policy operations, large-value interbank transfers and other payments in euro.

TARGET2: a new generation of the TARGET system in which the current decentralised technical structure has been replaced by a single shared platform offering a harmonised service with a uniform pricing scheme.

TARGET2-Latvija: a component system of TARGET2 in Latvia. Its operation is ensured by the Bank of Latvia in conjunction with other central banks of the ECBS.

Time deposits with the Bank of Latvia: fixed rate lats deposits of a specified maturity made by banks registered in the Republic of Latvia with the Bank of Latvia as a result of time deposit auctions organised by the Bank of Latvia. The maximum deposit rate equals the Bank of Latvia's refinancing rate. The Bank of Latvia sets the total allotment amount for each auction.

Bank of Latvia: Annual Report 2009

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